# BDC: Banking on Canadian Entrepreneurs

2004 ANNUAL REPORT

Canada

# Our Mission

To help create and develop Canadian small and medium-sized businesses through timely and relevant financial and consulting services.

# Our Vision

To make a unique and significant contribution to the success of dynamic and innovative entrepreneurship for the benefit of all Canadians.

# Our Key Services

Financial services (term financing); subordinate financing; venture capital; consulting services and BDC Connex® (financial products online).

# 1

# BDC: Banking on Canadian Entrepreneurs

A solemn commitment that spans 60 years. Over time, BDC has gone the extra mile to fulfill its mission of supporting entrepreneurship in Canada. We designed customized financing solutions to meet our clients' needs. We took more risks. We became more innovative. Why? Because we have faith in entrepreneurs. They are truly making a difference in the Canadian economy. And we know that by banking on their ideas, on their projects and on their dreams, we are encouraging their businesses to grow, which is an important way of helping to build Canada's future.

2004

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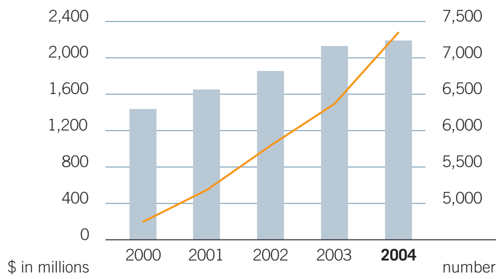
## Total Financing Authorized

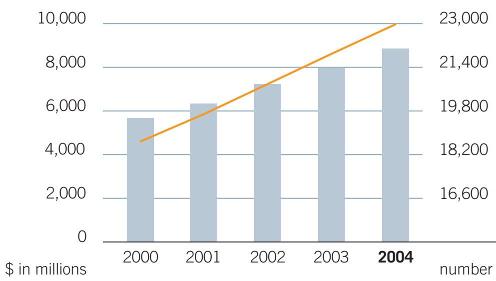
for the years ended March 31




| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Amount | 1,428 | 1,647 | 1,845 | 2,125 | **2,192** |
| Number | 4,749 | 5,173 | 5,806 | 6,387 | **7,338** |

## Total Financing Committed

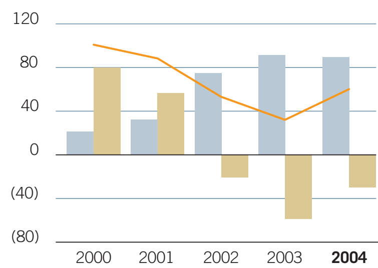
as at March 31




| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Amount | 5,641 | 6,353 | 7,201 | 8,026 | **8,845** |
| Number of clients | 18,667 | 19,664 | 20,780 | 21,897 | **22,966** |

## Net Income

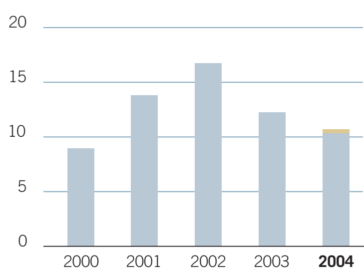
for the years ended March 31 ($ in millions)




| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Loans & Consulting | 21.1 | 32.1 | 74.7 | 91.4 | **89.4** |
| Venture Capital | 80.0 | 56.2 | (21.0) | (59.5) | **(30.3)** |
| Total net income | 101.1 | 88.3 | 53.7 | 31.9 | **59.1** |

## Dividends

for the years ended March 31 ($ in millions)




| | 2000 | 2001 | 2002 | | **2004*** |
|---|---|---|---|---|---|
| Dividends on preferred shares | 8.9 | 13.8 | 16.7 | 12.2 | **10.3** |
| Dividends on common shares | – | – | – | – | **0.4** |
| **Total dividends** | 8.9 | 13.8 | 16.7 | 12.2 | **10.7** |

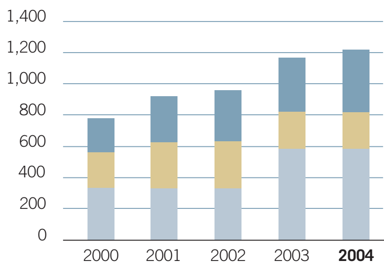
* In addition, based on BDC's fiscal 2004 performance, common dividends of $3.3 million were declared after March 31, 2004 and will be paid and recorded in fiscal 2005.

# highlights



## Total Shareholder's Equity

as at March 31 ($ in millions)

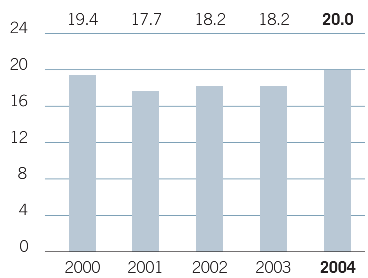


| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Common shares* | 331.2 | 331.2 | 331.2 | 586.2 | **586.2** |
| Preferred shares | 230.0 | 295.0 | 295.0 | 230.0 | **230.0** |
| Retained earnings | 222.6 | 297.1 | 334.1 | 353.8 | **402.3** |
| **Total shareholder's equity** | 783.8 | 923.3 | 960.3 | 1,170.0 | **1,218.5** |

* Includes $27.8 million of contributed surplus.

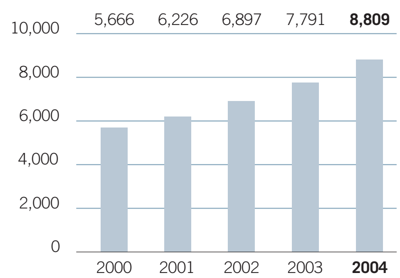
## Consulting Revenue

for the years ended March 31 ($ in millions)



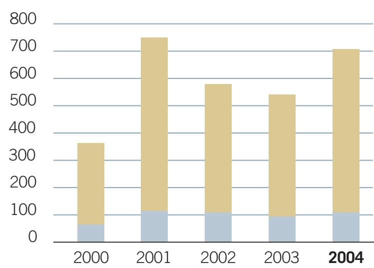

## Total Assets

as at March 31 ($ in millions)




## Total Value of Venture Capital Projects Financed

for the years ended March 31 ($ in millions)



| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| BDC Venture Capital authorized | 63 | 114 | 106 | 93 | **109** |
| Other sources of investment (estimated) | 301 | 636 | 472 | 446 | **598** |
| **Total** | 364 | 750 | 578 | 539 | **707** |

# Chairman's Message



The Business Development Bank of Canada is 60 years old. Proclaimed by an Act of Parliament in 1944, the institution evolved to establish itself as the undisputed leader in one area: serving the needs of Canada's small and medium-sized businesses by acting as a complementary lender in the financial services market. Throughout the Bank's history, BDC employees have invested their time and effort to constantly put the interests of entrepreneurs at the top of their agenda. Their unparalleled work ethic has contributed to making BDC an innovative and very successful organization.

In 2004, as a result of the departure of the former head of BDC, the Board authorized the appointment of an acting president and CEO, a decision that ensured continuity of leadership for BDC. Although these were trying times for BDC, our employees worked together as a team to help BDC record another year of good financial performance.

The Bank's results for the last fiscal year are indeed satisfactory. BDC repeated its fiscal 2003 feat by achieving more than $2 billion in authorizations. BDC also recorded a profit of $59 million and declared dividends of $10.7 million to the Government of Canada. BDC continued to fulfill its mission of filling gaps in the market.

A few examples are worth mentioning. BDC's new financing solutions successfully met the requirements of small and medium-sized businesses, and these solutions have shown a remarkable growth in numbers and in dollars in fiscal 2004. BDC also reinforced its position in the Canadian quasi-equity market by reasserting its role in subordinate financing transactions of $5,000,000 or less. In addition, BDC significantly increased its share of the Canadian venture capital market in fiscal 2004. Ever since the creation of BDC Venture Capital in 1983, BDC has increasingly played a major role in this industry. Focused on supporting carefully selected venture capital clients in the early stages of their business, BDC invests its resources in promising industry sectors, including information technology, telecommunications and biotechnology.

BDC's continued success may be explained by the fact that it is fulfilling its public policy mandate very well. Determined to encourage the creation and development of small and medium-sized businesses, BDC acts in accordance with its mandate by taking more risk and by offering innovative and customized business solutions. Above all, the client stands at the centre of BDC's initiatives.

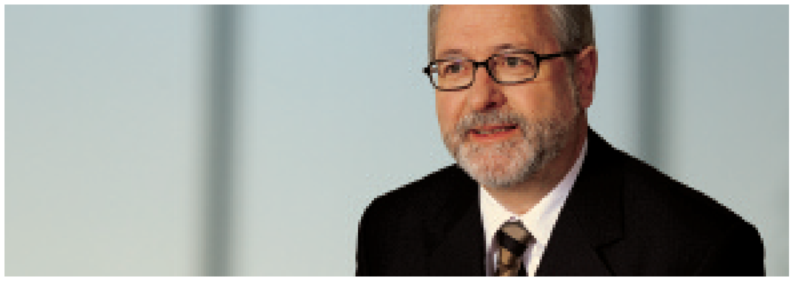
In addition, the Bank's decentralized decision-making process is clearly paying off. Employees conduct transactions at the regional level, closer to the clients. In its decision making, as well as in its business solutions, BDC demonstrates its client-driven approach.

In today's business world, the issue of corporate governance has taken on renewed meaning. It has become vitally important to Canadian Crown corporations, which all have boards as part of their operating structure. A well-run board with highly skilled members can even be a formidable strategic asset for an organization. BDC's Board of Directors actively supports initiatives designed to be implemented within the Bank's management structure of ethical business practices, corporate fairness, transparency and accountability. Most importantly, these sound corporate governance principles or standards are shared at all levels of BDC.

I wish to take this opportunity to thank Board members, past and present, for their contribution.

As Chairman of the Board, I'm proud to belong to such an organization. The Board, the Senior Management Team and all our employees have the interests of BDC at heart, an indisputable fact that has resulted in another successful year. I'm particularly pleased with our employees, whose professionalism and dedication are just two of the qualities that make our institution what it is and what it shall remain.

Cedric E. Ritchie
Chairman of the Board





# President's Message

In 2004, BDC celebrates its 60th anniversary. Since its inception in 1944, BDC has had one sole objective: to help create and develop Canada's small and medium-sized businesses. Over the last six decades, generations of employees have devoted their time and effort to fulfilling BDC's mandate. All employees respect and abide by BDC's principal core values which are crucial to our institution: ethics, client focus and teamwork. Our commitment to ourselves and to our clients may be summed up in a few words: true to our values, faithful to our clients.

## Our clients, first and foremost

By listening closely to our clients and by running surveys and similar initiatives, we have been able, over time, to develop a comprehensive knowledge of their needs. The satisfaction level of BDC clients reached 91 percent in 2004. Over the last couple of years, BDC has decentralized its decision-making process to be closer to its clients. More than 95 percent of our loans are now authorized at the regional level. More recently, BDC has emphasized the strong interaction between financial services and consulting services.

As a result of these operational strategies, which have affected our processes and organizational structures, our employees can now spend more time with clients while offering them the right financial or consulting solutions at the right time. In addition, these operational changes enhanced teamwork and ethics among BDC employees, two of our fundamental core values.

In fiscal 2004, the Canadian economy had to face SARS, Hurricane Juan, mad cow disease and forest fires. We helped our clients cope with the consequences of these events on their businesses by offering to postpone their capital payments for four months without penalty, and by giving them the chance to benefit from a working capital loan of up to $50,000. Over 6,000 postponements were granted to some 4,600 customers.

## Committed to innovation

Innovation has always been part of BDC's mandate. Being a complementary institution, we need to look at market gaps when supporting small and medium-sized businesses. In fiscal 2004, three of BDC's financial solutions – designed to support start-ups with loans of less than $100,000, to offer working capital loans to stimulate growth and to offer equipment financing for modernization purposes – showed a more than 40-percent increase in authorizations from the previous year. BDC created all three of these financial solutions over the last three years.

Partnering with other institutions in the public and private sectors is another way of fulfilling our mission and improving financial and management solutions for Canadian small and medium-sized businesses. Over the years, we have had the opportunity to partner with many institutions and we are thankful for their support.

In fiscal 2004, we concluded a strategic alliance with Caisse de dépôt et placement du Québec. The two partners will invest up to $300 million, which BDC will manage, designed to help businesses across the country achieve their growth objectives.

We have also intensified our partnership with Community Futures Development Corporations to offer more financial solutions to smaller businesses, mainly in rural areas.

## Initiatives on behalf of women entrepreneurs

Reiterating its support for women entrepreneurs in fiscal 2004, BDC created a new $25-million fund to improve access to financing for businesses owned by women. Acknowledging the fact that Canadian businesses owned by women are growing at twice the national average, BDC has significantly increased its lending commitment to women entrepreneurs over the years and supported initiatives such as the Women Presidents' Organization.

### Some good news for venture capital

BDC Venture Capital did better financially in fiscal 2004 and maintained its level of activity in a declining market. Recognizing BDC's role in the Canadian venture capital industry, particularly its support of early-stage knowledge-based businesses, the Minister of Finance announced in his 2004 Budget Speech that the federal government would provide BDC with an additional $250 million to support venture capital activities throughout Canada. BDC will use these funds to make pre-seed and seed capital investments, as well as to continue to create specialized venture capital funds, and to directly support start-up and early-stage businesses in their efforts to commercialize enabling technologies.

### An active year for BDC's consulting services

BDC Consulting also had a very good year, achieving revenues of $20 million. Responsive to client needs, BDC Consulting continued to offer services based on quality business practices. The demand for growth solutions – strategic planning, operations management, and sales and marketing strategies – was significant in 2004, showing that operational efficiency is a growing concern for small and medium-sized businesses in a competitive environment.

BDC has implemented a new operational strategy to strengthen the interrelationship of financial services and consulting services, allowing our consulting managers to spend more time with clients. To better meet the needs of smaller businesses for consulting and mentoring services, we introduced the Market Impact Strategy in 10 of our Entrepreneurship Centers across Canada. In addition, BDC introduced two new management support solutions at the end of fiscal 2004: an operational effectiveness diagnostic tool and a human resources management consulting solution.

### A few revealing figures for fiscal 2004

For the second consecutive year, BDC exceeded $2 billion in net authorizations. BDC's subordinate financing activities almost doubled compared to the previous year. In fiscal 2004, BDC recorded a total net income of $59 million, which represents a growth of 85 percent compared to last year. We also declared dividends of $10.7 million to our shareholder. BDC's productivity ratio of 49 percent was excellent, notwithstanding an $11 million increase in pension costs for Loans operations.

Because about 60 percent of BDC's portfolio is made up of loans of less than $250,000, and because it has introduced higher-risk financial solutions, BDC must manage credit risk carefully. We also need to provide adequate allowance for credit losses. In fiscal 2004, we increased our allowance to $488 million, representing 6.5 percent of the portfolio.

### Dedicated people, satisfied customers

Every year, BDC surveys its employees to ensure that it makes proper adjustments to provide a productive working environment.

Even though the environment for small and medium-sized businesses has changed significantly in the last 60 years, our long-standing commitment to clients has remained unaltered. Throughout the years, we have changed our ways to meet clients' needs. We have listened to our clients. We have evolved with them. Our clients know they can rely on us to offer them the best service.

With the creative contribution, professionalism and unrelenting commitment of all BDC employees to our mission, we will continue to build on a tradition of excellence that already spans six decades.

André Bourdeau
Acting President and Chief Executive Officer and
Executive Vice President, Financial Services and BDC Consulting Group

# Corporate Governance

BDC's Board of Directors and its management are committed to maintaining effective governance and strive each year to continuously improve the structure and processes that support corporate governance.

The governance policies are designed to help the Board of Directors supervise Management and approve the direction in which Management proposes to take BDC, while keeping in mind BDC's public policy goals, as well as its culture of sound and ethical business principles.

The Board of Directors derives its strength from the background, diversity, qualities, skills and experience of its members. It is composed of 15 members: the Chairperson, the President and CEO, and 13 other directors.

The Board of Directors has the following responsibilities:

- adopting strategic planning;
- ensuring the integrity of internal controls and management information systems;
- identifying BDC's principal business risks and ensuring the implementation of appropriate systems to manage these risks;
- conducting succession planning;
- monitoring the effectiveness of BDC's corporate governance practices and approving any modification.

The Board of Directors ensures open disclosure of financial information by approving the Annual Report on BDC's operations.

The Board of Directors has timely access to the information it needs to carry out its duties. Directors receive a comprehensive package of information before each board and committee meeting and attend an annual strategic planning session. After each committee meeting, the full Board receives a report on the committee's work.

The Board of Directors met 12 times in fiscal 2004. These meetings were held in five different locations across Canada. The Board of Directors also held its annual strategic planning session to review the Bank's strategic priorities and key factors in its economic environment, and to initiate an open and dynamic discussion with senior management on the projected Corporate Plan.

The Board of Directors continued to promote open communications with Management, enabling senior management to participate in board meetings. The Board also continued to hold in-camera sessions at the conclusion of each meeting, to foster open and frank discussions outside the presence of Management.

In a move toward better recognizing its real role, the Board of Directors approved the name change of the Executive Committee to the Credit/Investment Committee, as its terms of reference were recently modified to approving credits and investments.

Once they are appointed, directors attend an information session and meet all the members of senior management to receive the information about BDC's operations they need to properly carry out their responsibilities. In addition, directors can contact members of senior management at any time to obtain the additional information they need to fulfill their mandate. They are invited to participate in activities and professional development workshops on corporate governance or other topics related to their responsibilities.

The Board of Directors delegates part of its work to six committees. The Board ensures that these six committees are composed exclusively of independent directors, with the exception of the Credit/Investment Committee (formerly the Executive Committee), which includes the President and CEO, and the Pension Fund Committee and the Trustees of the Pension Fund, which includes the President and CEO, two BDC officers and one pensioner. These committees review and supervise various matters that the Board refers to them, and make recommendations they deem appropriate. All the committees report regularly to the Board of Directors on their activities and submit their recommendations and resolutions to the Board for approval. A brief description of their main responsibilities and achievements for fiscal 2004 follows.

## Governance Committee

During fiscal 2004, the Governance Committee met three times. The Governance Committee administers BDC's system of governance. It reviews governance best practices on a continuing basis and recommends appropriate changes to enhance the effectiveness of the governance system. As part of this review, it assesses the methods and processes the Board uses to fulfill its duties, including the following: the communication process shared by the Board and Management, the number and content of meetings, material provided to directors and resources available to directors. The Committee also determines the structure, mandate and membership of the Board's committees. A Policy on Disclosure of Wrongdoing was approved at the May 2004 board meeting.

During fiscal 2004, members had the opportunity to attend seminars on venture capital practices, to get information on such topics as the drivers behind investment decisions and the due diligence process.

Chairperson: Cedric E. Ritchie
Members: Cynthia Desmeules-Bertolin, Léandre Cormier, Jennifer Corson, Louis J. Duhamel, James A. Durrell, Barbara Stymiest, FCA, Jean-Claude Villiard

## Audit Committee

In fiscal 2004, the Audit Committee met five times. A primary focus was overseeing the special examination that will be completed next fiscal year. Every five years, BDC is subject to a special examination performed by BDC's auditors, as required by the *Financial Administration Act*. The Committee reviewed the examiners' plan and has received periodic status reports. The Committee also oversees financial reporting and internal control systems, and the employee code of conduct. Its members help the Board safeguard BDC's assets and manage its resources. It reviews the quarterly financial results and oversees the external auditors' involvement in the annual financial audit. It also reviews the Financial Statements and Management's Discussion and Analysis (MD&A) in the Annual Report prior to Board approval. The Committee received the annual plan and quarterly reports from the internal audit and inspection team. It continued its practice of meeting the external and internal auditors in private sessions and evaluated the independence of external auditors.

Chairperson: Terry B. Grieve, CA
Members: N. Murray Edwards, Gordon J. Feeney, Roslyn Kunin, Oryssia Lennie, Barbara Stymiest, FCA

## Human Resources Committee

The responsibilities of the Human Resources Committee include authorizing the Compensation Policy and ensuring a succession plan for senior management positions.

The Human Resources Committee supports BDC's HR strategy, which is based on fostering a culture of engagement, learning and growth. The strong correlation between employee engagement, client satisfaction and business performance validates the belief that the calibre of our employees is fundamental to our ability to deliver a level of service our clients expect from BDC.

The Human Resources Committee also supports BDC's commitment to the development of its leadership cadre to ensure organizational success in the future.

During fiscal 2004, the Committee held six meetings, during which several key HR initiatives were reviewed and approved. These included a review of BDC's Total Rewards policies and programs, the implementation of the BDC pension Web site, the second President's Leadership Forum, and the development and implementation of the Diversity Action Plan. In addition, the HR Committee reviewed and approved BDC's compensation programs and payments, and the corporate succession plan.

Chairperson: Gordon J. Feeney
Members: Leo E. Cholakis, Léandre Cormier, Jennifer Corson, Louis J. Duhamel, Oryssia Lennie

## Pension Fund Committee and the Trustees of the Pension Fund

The Pension Fund Committee and the Trustees of the Pension Fund monitor the activities of the pension fund, ensure that it is administered and financed in accordance with applicable legislation, and verify that any changes to the fund reflect the Committee's terms of reference.

The Committee met four times during fiscal 2004 to review the performance of the fund's investment managers, the Financial Statements and the actuarial assumptions of the pension plan. Changes were made to the management structure to enhance the fund's financial performance and stability.

Due to improved domestic and international stock markets, the fund reported a positive return on its assets for the year ended December 31, 2003.

Chairperson: Leo E. Cholakis
Members: Clément Albert, Cynthia Desmeules-Bertolin, Léandre Cormier, Mary Karamanos, Roslyn Kunin, Yves Milette, Cedric E. Ritchie, André Bourdeau



## Credit/Investment Committee (formerly the Executive Committee)

The Credit/Investment Committee met 24 times in fiscal 2004. It approved loans and venture capital investments that exceeded Management's delegated authority.

Chairperson: Cedric E. Ritchie
Members: James A. Durrell, Gordon J. Feeney, Terry B. Grieve, CA, Roslyn Kunin, Jean-Claude Villiard, André Bourdeau

## Special Committee

In the aftermath of the François Beaudoin judgment, the Board of Directors approved the creation of an interim Special Committee to deal with specific matters arising from that judgment.

Chairperson: Cedric E. Ritchie
Members: Leo E. Cholakis, N. Murray Edwards, Gordon J. Feeney, Terry B. Grieve, CA

# 10 Board of Directors

Cedric E. Ritchie | Roslyn Kunin | André Bourdeau | Jennifer Corson | Jean-Claude Villiard | Oryssia Lennie | Louis J. Duhamel

**Cedric E. Ritchie,** O.C.
Chairman of the Board, Business Development Bank of Canada
Toronto, Ontario

Cedric E. Ritchie, O.C., has been Chairperson of the Business Development Bank of Canada since January 2001. Mr. Ritchie was Chairman and CEO of The Bank of Nova Scotia from 1974 until his retirement in 1995. He sits on the boards of several organizations including Canada Post Corporation, Mercedes-Benz Canada and Twin Mining Corporation. Mr. Ritchie is a Fellow of the Institute of Canadian Bankers and Officer of the Order of Canada. He was inducted into the Canadian Business Hall of Fame in 2000.

**Roslyn Kunin,** Ph.D., C.M., O.C.
President, Roslyn Kunin & Associates Inc.
Vancouver, British Columbia

Dr. Roslyn Kunin joined the BDC Board of Directors on May 25, 1999. She is President of Roslyn Kunin & Associates Inc., an economic consulting firm. Previously, she was a regional economist with Employment and Immigration Canada and held several academic positions. Dr. Kunin is past Chair of the Vancouver Stock Exchange and former Executive Director of The Laurier Institution. Dr. Kunin is a Member of the Order of Canada.

**André Bourdeau**
Acting President and Chief Executive Officer and Executive Vice President, Financial Services and BDC Consulting Group
Montréal, Quebec

André Bourdeau has been with BDC since 1973 in positions of increasing responsibility. Among his previous positions, he was responsible for heading up Quebec Operations, was Senior Vice President, Operations for the national network, had responsibility for Management Services in Quebec and was Executive Assistant to the President. Mr. Bourdeau holds a Master's Degree in Business Sciences, Finance, from the Université de Sherbrooke.

**Jennifer Corson**
President, Renovators Resource Inc.
Halifax, Nova Scotia

Jennifer Corson, a Director of BDC since October 27, 1998, is President of Renovators Resource Inc., a principal of Solterre Design, and Vice President of Pick & Shovel Productions Limited. She is a published author, small business entrepreneur and green building specialist. She was also the winner of the BDC Young Entrepreneur Award for Nova Scotia in 1996.

**Jean-Claude Villiard**
Deputy Minister, Industry Canada
Ottawa, Ontario

Jean-Claude Villiard, who joined the BDC Board of Directors on June 18, 2003, is Deputy Minister, Industry Canada. Previously, he was President and Chief Executive Officer of Canada Mortgage and Housing Corporation. He was also Director of the World Bank's Infrastructure Development Group – Middle East and North Africa and held several senior management positions, including President of SNC Lavalin Capital Inc. Earlier, Mr. Villiard was Deputy Minister of International Affairs and Associate Deputy Minister of Energy and Resources with the Quebec Government.

**Oryssia Lennie**
Deputy Minister, Western Economic Diversification Canada
Edmonton, Alberta

Oryssia Lennie, a BDC Board member since October 27, 1998, is Deputy Minister of Western Economic Diversification Canada, which, as a federal department based in western Canada, provides a variety of services to small and medium-sized businesses. Previously, she held various positions within the Government of Alberta, including Deputy Minister of Federal and Intergovernmental Affairs.

**Louis J. Duhamel**
Partner, Taktik
(Division of Secor Conseil Inc.)
Montréal, Quebec

Louis J. Duhamel, who became a BDC Director on April 30, 2003, has held various positions with Secor Conseil Inc., one of Canada's leading management consulting groups. He is currently a partner in Secor's SME division, Taktik, which he co-founded. Mr. Duhamel also teaches at the Institut du commerce électronique.

Our sincere appreciation is extended to V. Peter Harder for the role he played in the development of BDC. His term expired in May 2003.


Léandre Cormier Cynthia Desmeules-Bertolin Leo E. Cholakis James A. Durrell Barbara Stymiest Terry B. Grieve Gordon J. Feeney

| | |
|---|---|
| **Léandre Cormier**<br>President and Owner<br>West-Wood Industries Ltd.<br>Scoudouc, New Brunswick | Léandre Cormier became a Director of BDC on August 15, 2002. He is President and owner of West-Wood Industries Ltd. of Scoudouc, New Brunswick which produces high-end custom windows and doors and other value-added wood products for Canadian and U.S. markets. From 1987 to 2000, Mr. Cormier was the president and owner of Georgetown Timber Ltd., of Georgetown, P.E.I. |
| **Cynthia Desmeules-Bertolin**<br>Senior Advisor, Métis Nation of Alberta<br>Edmonton, Alberta | Cynthia Desmeules-Bertolin, who joined the BDC Board on March 12, 2002, is the legal advisor to the Métis Nation of Alberta on the Aboriginal Rights agenda. Ms. Desmeules-Bertolin is a National Jurist for the PAR (Progressive Aboriginal Relations) Program at the Canadian Council for Aboriginal Business. She has served as a Vice-Chair of the National Aboriginal Economic Development Board federally and as a Director for Apeetogosan Métis Development Inc. |
| **Leo E. Cholakis,** LL.B.<br>Managing Director, Kensington Building Ltd.<br>Winnipeg, Manitoba | Leo E. Cholakis became a member of BDC Board of Directors on May 25, 1999. A commercial lawyer, Mr. Cholakis is Managing Director of Kensington Building Limited and President of Fairmont Real Estate Limited in Winnipeg. Previously, he served as a Director of the Bank of Canada. |
| **James A. Durrell**<br>President, Capital Dodge Chrysler Jeep Ltd.<br>Ottawa, Ontario | James A. Durrell joined the BDC Board of Directors on May 25, 1999. He is President of Capital Dodge Chrysler Jeep Ltd. in Ottawa. He has held many business and public service positions, including two years as President of the Ottawa Senators and six years as Mayor of Ottawa. |
| **Barbara Stymiest,** FCA<br>Chief Executive Officer, TSX Group<br>Toronto, Ontario | Barbara Stymiest, a Director of BDC since August 15, 2002, is Chief Executive Officer of TSX Group where she oversees operations and leads the strategic development of both the senior and junior capital markets. Ms. Stymiest is a member of the TSX Board and a Director of the Canadian Depository for Securities, Market Regulation Services Inc., the Canadian Capital Markets Association, and the World Federation of Exchanges. She is also a member of the CICA Accounting Standards Oversight Council, Toronto Rehab Foundation and the Campaign Cabinet of the United Way of Greater Toronto. |
| **Terry B. Grieve,** CA<br>Principal, Ventures West Management Inc.<br>Saskatoon, Saskatchewan | Terry B. Grieve, who joined the BDC Board on April 30, 1996, is a native of Saskatchewan and a principal of Ventures West Management Inc., a private, professional venture capital management firm. He is also Executive Vice President of the Saskfund group of companies. |
| **Gordon J. Feeney**<br>Company Director<br>Toronto, Ontario | Gordon J. Feeney, who became a BDC Director on March 12, 2002, a former Deputy Chairman of RBC Financial Group, retired in 2001 following a distinguished career in the financial industry. Mr. Feeney is currently Chairman of several companies, including Finance Corporation of Bahamas, Moneris Solutions Corporation, RBC Mutual Funds Inc. and Canadian Management Center. He also serves on the Boards of Directors for American Management Association, Rideau Inc., Davis + Henderson G.P. Inc. and International Survey Research Group. In addition, he is the Honorary Consul for The Commonwealth of the Bahamas and serves on several community boards. |
| Absent<br>**N. Murray Edwards**<br>President, Edco Financial Holdings Ltd.<br>Calgary, Alberta | N. Murray Edwards, a Director of BDC since March 31, 1998, is President of Edco Financial Holdings Ltd., a Calgary-based merchant banking corporation. He has extensive experience in the financial industry, as a lawyer and as director of numerous public and private companies. |


André Bourdeau Edmée Métivier Guy G. Beaudry Michel Ré Michel Bourret Jacques Lemoine

**André Bourdeau**
Acting President and Chief Executive Officer and Executive Vice President, Financial Services and BDC Consulting Group

André Bourdeau has been with BDC since 1973 in positions of increasing responsibility. Among his previous positions, he was responsible for heading up Quebec Operations, was Senior Vice President, Operations for the national network, had responsibility for Management Services in Quebec and was Executive Assistant to the President. Mr. Bourdeau holds a Master's Degree in Business Sciences, Finance, from the Université de Sherbrooke.

**Edmée Métivier**
Executive Vice President, Integrated Risk and Technology Management

Edmée Métivier joined BDC in 2000. She is responsible for Systems and Technology, Credit Risk Management, Treasury, Integrated Risk and Portfolio Management and Aboriginal Banking Services. She came to BDC following a 20-year career with RBC Financial Group. Ms. Métivier is a member of the Advisory Board of McGill Institute of Marketing (MIM), McGill University and is a Board member of Shad International, the Montréal Women's Y Foundation and Precarn Incorporated. She holds a M.A. in Practicing Management from University of Lancaster, England.

**Guy G. Beaudry**
Senior Vice President, Corporate Affairs and Chief Planning Officer

Guy G. Beaudry joined BDC in October 2001. He is responsible for Corporate Planning and Research, Marketing and E-business, Internal Audit and Inspection, Public Affairs, Shareholder Relations and Advertising, Legal Affairs and Corporate Secretariat. Previously, he was Chairman and Chief Executive Officer of Wavepath, a Silicon Valley wireless telecom business unit of Groupe Vidéotron and, earlier, Senior Vice-President, Corporate Affairs, of Groupe Vidéotron. Mr. Beaudry, a Law graduate of the Université de Montréal, is a past Chairman of the Board of the Canadian Cable Television Association and an alumnus of Canada's Top 40 Under 40.

**Michel Ré**
Executive Vice President, Investments

Michel Ré is responsible for subordinate financing and venture capital activities. He has more than 25 years of experience at BDC, where he has held a wide variety of positions in financing and consulting services, gaining an in-depth knowledge of the needs of entrepreneurs in many sectors of the economy. Mr. Ré holds a Bachelor of Administration degree from the Université du Québec à Montréal. He is a governor of the Quebec Venture Capital Association, Board member of Sommet Capital 2000 and was a member of the board of the Canadian Venture Capital Association.

**Michel Bourret**
Senior Vice President, Operations Quebec and Atlantic Region

Michel Bourret has been with BDC since 1969, during which time he has held various positions of increasing responsibility in the credit field. Prior to taking on his current position, he was Vice President, Credit Risk Management at Head Office. Mr. Bourret also worked at CIBC for several years and served as a member of the board of directors of the Fondation de l'Hôpital Charles-Lemoyne. He holds a Bachelor of Arts degree and a commerce degree from the École des Hautes Études Commerciales.

**Jacques Lemoine**
Senior Vice President
Operations
Ontario Region

Jacques Lemoine has been with BDC since 1974. Previously, he was Senior Vice President, Credit Risk Management, responsible for BDC's lending and for managing its portfolio in Canada. Before joining BDC, he held a number of positions in a chartered bank. Mr. Lemoine is involved in economic development associations, and community organizations such as Rotary, Chambers of Commerce, Junior Achievement. He is a past President of the Montréal Chapter of the Risk Management Association, an international association of lending and credit risk management professionals.



Alan B. Marquis Mary Karamanos Clément Albert Richard Morris Daniel Martel Charlotte Robb

**Alan B. Marquis**
Senior Vice President
Finance and Chief Financial Officer

Alan B. Marquis joined BDC in 1995. His responsibilities include Financial Reporting and Control, Financial Planning, Loan Accounting, Middle and Back Office Operations and Real Estate Facilities Management. Before joining BDC, Mr. Marquis was Executive Vice-President of Cast North America Inc., responsible for Finance, Container Operations and Logistics. Previously, he was Chief Financial Officer at Canadair Ltd. Mr. Marquis holds a Bachelor of Commerce degree from the University of Edinburgh, Scotland and is a member of the Institute of Chartered Accountants of Scotland.

**Mary Karamanos**
Senior Vice President
Human Resources

Mary Karamanos, who joined BDC in October 2002, is responsible for the development and implementation of BDC's human resources strategy. She has over 20 years' experience in strategic human resources and has held senior positions at Corby Distilleries in Canada and Allied Domecq, Spirits and Wine, U.S.A. She holds a B.A. in Industrial Relations from McGill University and a CCP designation (Certified Compensation Professional) from World at Work. She is active in the community and supports a number of children's charities.

**Clément Albert**
Vice President and Treasurer

Clément Albert joined BDC in 1981 and is responsible for the funding, investment and hedging operations of BDC, as well as administration of the Treasury Department. Mr. Albert is a trustee of the Pension Fund Committee. He is also responsible for the Business Continuity Planning of Head Office and the branches. Previously, he was Director, Capital Markets. Mr. Albert also has experience at the Bank of Montreal and the National Bank of Canada. He holds a Bachelor of Arts (Finance Major) from the École des Hautes Études Commerciales de Montréal.

**Richard Morris**
Vice President, Audit and Inspection

Richard Morris has been with BDC since 1979. Starting in Audit, he worked extensively in the Controller's Department, becoming the Corporate Controller, a position he held for six years. He then moved to Audit and Inspection as the Chief Auditor and has recently worked on risk management and ethics for BDC. Mr. Morris obtained his CA in London, England, and a B.A. Honours in Business Studies (Finance) at the City of London Polytechnic. He is currently a member of the board of governors of Scouts Canada.

**Daniel Martel**
Senior Vice President
Credit Risk Management

Daniel Martel has been with BDC since 1981 in positions of increasing responsibility. He has held the positions of Account Manager, Branch Manager, Assistant Vice President for Eastern Ontario and Vice President and Area Manager for Western Quebec. For the last three years, he was Vice President, Operations Support – Strategic Initiatives, responsible for the redesign of business processes and redefining BDC's organizational structure. He holds a Bachelor of Finance Honours degree with a major in Accounting and sits on the Board of the Jeunes Entreprises du Québec.

**Charlotte Robb**
Senior Vice President, Operations
Prairies and Western Region

Charlotte Robb joined the Business Development Bank of Canada in her current position in September 2002. Based in Edmonton, Ms. Robb came to BDC after a 28-year career with CIBC, where she was Vice President and Regional Manager, Commercial Banking, Alberta and Northwest Territories. Ms. Robb serves on the board of NAV Canada and the C.D. Howe Institute. She is strongly involved in her community, receiving awards for excellence in 1994, 1996 and 1997.

## 14 Public Policy

### Dedicated to Canadian entrepreneurs for six decades

The Business Development Bank of Canada (BDC) was created in 1944 under the name Industrial Development Bank (IDB). In 1975, the Federal Business Development Bank succeeded IDB. Twenty years later, its name was changed to BDC along with a new mandate as a commercial Crown corporation. Throughout the years, BDC may have operated under different names, but its mission has remained the same: to support Canadian entrepreneurs with timely and customized business solutions.

BDC's mandate is stipulated in the 1995 *Business Development Bank of Canada Act* and was renewed for 10 years in 2002 by the Parliament of Canada, which confirmed BDC's public policy role to act as a complementary institution to fill gaps in the Canadian financial services market.

To fulfill its mandate, BDC has put its key corporate values – ethics, clients and teamwork – to work to serve the best interests of entrepreneurs. Over time, it has refined its client-oriented approach, by conducting surveys related to client (potential and current) expectations and perceptions on specific issues. As a result, BDC has developed comprehensive knowledge of what clients want, enabling it to provide them with business solutions that meet their needs.

### A client-driven corporate structure

BDC's client-oriented approach is defined by the various business solutions it offers. It is also reflected in the way BDC is structured. For the last three years, BDC's clients have enjoyed the benefits of more decentralized decision-making at the regional level. Decisions are ultimately more responsive to client needs, quicker to implement and even more personalized.

### With our clients in different circumstances

In fiscal 2004, the Canadian economy was hit by a rare combination of natural disasters, disease and economic slowdown. Determined to assist clients impacted by SARS, fires in Western Canada and Hurricane Juan in the Maritimes, BDC acted swiftly. It allowed clients to postpone their capital payments for a four-month period without penalty. It also offered clients a working capital loan of up to $50,000. These initiatives were designed to help clients overcome temporary difficulties, but they also show how BDC fulfills its mandate to support Canadian entrepreneurs in good times and bad.

### Client-focus breeds excellent results

BDC's client-centric approach is clearly paying off. In fiscal 2004, our dedicated team of 1,400 employees, working in more than 80 branches across the country, served the requirements of some 23,000 clients. Significantly, our client satisfaction rate reached 91 percent. This proves that BDC's know-how, which is translated into client-focused business solutions, reflects client needs. Apart from this tangible recognition of its work, BDC achieved a good overall performance in 2004, which reinforced the relevancy of its public policy mandate.

For the second year in a row, BDC's net authorizations exceeded $2 billion. This significant milestone reflects activity across Canada. BDC's financing solutions such as subordinate financing, Co-Vision Loans, Productivity Plus Loans, as well as Innovation Loans have led the way. In fiscal 2004, BDC recorded an overall profit of $59 million and declared dividends of $10.7 million to its sole shareholder, the Government of Canada.

### Venture capital in recovery

There is renewed confidence in the economy that should stabilize activities in the Canadian venture capital industry. BDC Venture Capital notes that client businesses are faring better and its portfolio is showing a positive return for 2004.

The overall decline in industry activities resulted in increasing BDC's share of the market. By continuing to invest despite a 41-percent decrease in disbursements, BDC now accounts for 6 percent of total disbursements and some 9 percent of all venture capital transactions in Canada, according to data released by Macdonald & Associates.

Acknowledging BDC's long-standing experience and wide expertise in venture capital across Canada, the federal Minister of Finance announced in his 2004 Budget Speech that the Government of Canada had earmarked $250 million to increase BDC's venture capital activities. This amount will be allocated to support start-up knowledge-based businesses, namely in their commercialization efforts.

### BDC and Caisse de dépôt et placement du Québec: A natural fit

In fiscal 2004, BDC concluded an important strategic alliance with Caisse de dépôt et placement du Québec. The two partners will invest up to $300 million to help developing businesses across Canada achieve their growth objectives and have agreed that BDC will manage this joint venture. In signing this agreement, the Caisse acknowledged BDC's expertise in this market and the value of its Canada-wide network.

### BDC Consulting: Value-added advice for entrepreneurs

Due to its partnership with a network of private sector consultants, BDC is the only financial institution in Canada that offers nation-wide consulting services, an asset that enables it to provide clients with value-added expertise. In fiscal 2004, BDC Consulting revenues from activities reached $20 million. Demand for growth solutions – strategic planning, operations management and sales and marketing strategies – significantly increased in 2004, demonstrating that profitability and productivity issues are vitally important to entrepreneurs.

### Women entrepreneurs: A force to be reckoned with

For many years, BDC has chosen to partner with firms led by women, thereby acknowledging an undisputed fact: businesses owned by women constitute one of the fastest-growing segments of the Canadian economy. They now represent almost a quarter of BDC's lending customers. Determined to reinforce its commitment to women entrepreneurs, BDC created a new $25 million quasi-equity fund in fiscal 2004 designed to increase the availability of financing for these businesses.

Apart from ensuring financial support to women entrepreneurs, BDC also sponsored important initiatives in the past year, such as the Women Presidents' Organization (WPO) Conference luncheon in San Francisco in February 2004. BDC was the proud sponsor of the first Canadian chapter of the WPO, in recognition of what this organization does for the advancement of women in business. BDC currently supports two WPO chapters in Toronto. It expects to sponsor one more in the near future; other chapters could also be added in Montréal and Calgary. BDC will continue to work with its business partners, including the Réseau des SADC du Québec, to further promote women entrepreneurship in Canada.

### Supporting Aboriginal economic development

Recognizing the growing importance of the Aboriginal market in Canada, BDC established an Aboriginal Banking Unit in 1996 to play a leadership role and increase its visibility in this market. Beyond the lending activities designed for Aboriginal businesses, BDC put forward several initiatives in fiscal 2004. For the fourth consecutive year, it organized the E-Spirit Aboriginal Youth Business Plan Competition. This Internet-based initiative has enabled several hundred Aboriginal students across Canada, from grades 10 to 12, to complete a business plan using online modules.

BDC also created an Aboriginal Business Development Fund that combines financing with management training and ongoing mentorship. Through this program, BDC has allocated $1 million to four pilot projects in various regions of Canada. The partnering Aboriginal community-based organization manages all loans, training and mentorship related to this program. BDC Consulting also offers customized business solutions to Aboriginal businesses and organizations, including strategic planning, growth strategies and ISO certification. With its timely and well-targeted initiatives, BDC is helping Aboriginal entrepreneurs increase their access to financing and improve their management skills.

### Small Business Week®: Celebrating Canadian entrepreneurship for a quarter of a century

In addition to the 60th anniversary of the founding of BDC, 2004 marks the 25th anniversary of Small Business Week®. For a quarter of a century, BDC has paid tribute to the accomplishments of Canadian entrepreneurs. Over the years, Small Business Week® has become the annual event par excellence for the country's entrepreneurs. During Small Business Week®, 13 Young Entrepreneur Awards are presented yearly to talented young entrepreneurs who have distinguished themselves with their innovative spirit and business acumen. The last awards presentation was held in Halifax on October 20, 2003.

Winners of the 2003 Young Entrepreneur Awards were also invited to the second edition of BDC Forum, a one-day training and sharing session during which they had the opportunity to meet BDC senior executives, academics and business leaders who have made their mark in a specific business sector. The participating young entrepreneurs also benefited from information sessions organized by BDC Consulting that provided them with guidance for managing their businesses.

### Useful Web site resources at your fingertips

Guidance and other relevant information are also available on BDC's Web site. With a few mouse clicks, Canadian entrepreneurs have access to a full spectrum of services that includes advice on starting a business, financing exports and many other business topics. In addition, Web users can consult BDC's *Profit$* newspaper online and benefit from *eProfit$*, BDC's monthly electronic newsletter.

In November 2003, BDC launched its new BDC Connex Web site for clients. The site offers secure access to account information, such as debit notices, past payments and interest rates. It also includes many free features, such as a benchmarking tool that allows clients to compare their receivables, payables and inventory turnover with benchmarks in their industry sector. Furthermore, clients can consult more than 100 free articles offering information and timely advice that could help them better manage their companies.

### Shared core values

During its 60 years of existence, BDC has developed a wealth of expertise to address the needs of entrepreneurs. In light of the productivity and innovation challenges Canada is currently facing, BDC can be a solid partner for entrepreneurs by offering them what it knows best: comprehensive and customized business solutions provided by seasoned professionals who understand their needs and respond with quality service.

The key to BDC's success may be summed up in one word: people. Throughout the years, BDC has relied on the continuous commitment of competent, dedicated and ethical professionals to carry out its mission. The experience and expertise of our people represent tremendous assets for BDC and strongly contribute to its success.

At BDC, employees do matter. BDC rewards productive employees for the quality and consistency of their work. Employee surveys, special training sessions and one-on-one meetings are means by which BDC can better understand its employees and contribute to their work efficiency.

For BDC, having the right people who share the core corporate values of ethical leadership, customer focus and teamwork is essential. These values are shared, endorsed and understood by all. They represent the foundation on which we do business and fulfill our public policy mandate. BDC's corporate values are, in fact, a strong business statement that assures clients they will always benefit from the quality of service they have rightly come to expect. It is a solemn guarantee built on 60 years of rock-solid experience.

# Economic Background

After two years of turbulent global economic activity, 2003 was a turnaround year, particularly for the United States which began to show signs of a much anticipated economic rebound during the second half of the year. In Canada, economic growth was challenged by a long list of negative shocks in 2003 that affected many regions of the country: severe acute respiratory syndrome (SARS), the softwood lumber dispute, forest fires in British Columbia, the Ontario power blackout, Hurricane Juan in Atlantic Canada and the mad cow disease scare in the West. While these unusual occurrences had a negative effect on quarterly distribution of economic growth in 2003, the economy fared moderately well, with growth of 1.7 percent, roughly half the pace of 3.3 percent of 2002. Overall, the 2003 expansion positioned Canada in the mid-range of G7 economic growth.

Sound macroeconomic and structural policies were fundamental to achieving sustainable economic growth. While the federal government managed to avoid a deficit, all levels of government sought new ways to control spending. One of the major economic developments of the year was the significant recovery of the Canadian dollar against the U.S. dollar.

The dollar's appreciation brought mixed results. The stronger dollar dampened export growth for 2003 as a whole, despite the burgeoning economy of the United States, Canada's largest trading partner. Yet, businesses began to respond and take advantage of the higher dollar by increasing their investment in machinery and equipment and advanced technologies to improve their competitiveness. A 15-percent increase in corporate operating profits in 2003 positioned businesses for more productivity-enhancing investments for this year.

Industrial capacity utilization recorded its biggest jump in almost a decade in the fourth quarter of 2003. Industries operated at 82.9 percent compared with 81.3 percent in the third quarter. This was the largest quarterly gain since the second quarter of 1994. The fourth-quarter increase in overall capacity use was largely due to the manufacturing sector, which posted the strongest growth in its rate in more than nine years. Still, at these levels, Canada has the ability to respond to a sharp increase in demand for its goods and services.

Lower export levels negatively impacted employment growth, particularly in manufacturing. Over 2003, 271,000 new jobs (growth rate: 1.7%) were added to the economy, down from the 3.7% (560,000 jobs) growth rate observed in 2002. The slowdown in employment growth in 2003 is attributable to job losses in the manufacturing sector, reflecting a vulnerability of the Canadian economy. While weakened employment growth negatively impacted some consumer spending, historically low interest rates continued to fuel residential investment growth. More recently, there were indications of improved consumer confidence particularly with respect to their near-term financial prospects.

Entrepreneurship continues to be the engine of the Canadian economy: entrepreneurs represent close to half of private sector GDP and employ over 60 percent of the workforce in the private sector. Large in number but small in size, they continue to fall behind larger Canadian companies and their U.S. counterparts in innovation adoption, a key component of productivity. Many have difficulty in making the quantum leap from small to medium-sized, their growth often hampered by their inability to compete on a national or international scale.

The current strength of the Canadian dollar and positive global economic growth present unique opportunities for Canadian businesses to improve their productivity. In an ever-changing environment, businesses must constantly reinvent themselves by developing new products and adopting more efficient processes to be successful competitors in the global arena.

In this context, there has never been a more critical time for BDC's complementary role – that is, its role in supporting and contributing to the success of Canadian entrepreneurs. Tapping the full potential of innovative entrepreneurs requires that they have access to the right tools to succeed: value-added debt and equity financing and consulting services. As a provider of these business solutions to Canadian entrepreneurs, BDC aims to encourage increased investment of Canadian businesses so that they can address the innovation challenge and be mobilized into innovative action.

# Environmental Message

## Our environmental commitment

For BDC, sound environmental management is more than good business practice, it also helps build a sustainable future for generations to come.

Environmental issues have never been more important than in today's world. A growing number of governments is choosing to ratify international treaties and adopt environmental legislation. Businesses are increasingly required to implement environmental standards and practices. BDC is part of this global trend.

Each and every one of BDC's financing decisions is subject to an environmental review. In the early 1990s, BDC developed its own Environment Risk Policy to ensure that all credit decisions would include environmental assessment of potential business ventures. At BDC, we believe that good strategic environmental management brings many advantages, including improved efficiency, better compliance with environmental laws, increased customer loyalty and a positive image of environmental responsibility.

## The terms of our commitment

- Our clients must abide by environmental legislation.
- Our clients must provide details on all environmental concerns related to each property and business activity.
- Our managers review all site reports specific to a business.
- Our managers inspect the sites in person and are on the lookout for potential environmental risks.
- Our clients can be asked to provide environmental assessments on properties to confirm compliance with environmental legislation.
- BDC will not extend financing if there is an environmental issue that is not or cannot be resolved by the client.

# Atlantic Provinces

Eastern Canada's innovative life sciences cluster, fuelled by the rapid convergence of biotechnology and information technology, is poised to provide tremendous opportunities in the years to come in the bio-industries, wood science and marine science sectors. In 2003, increased production limits at Newfoundland's Hibernia and Terra Nova projects and continued capital spending in Nova Scotia's energy sector created the momentum for economic growth in Atlantic Canada, including construction related to energy projects. BDC will continue to be there for businesses in the Atlantic provinces as they explore opportunities in new and exciting fields.

| Management | Branches | |
|---|---|---|
| **Ross Miller**<br>Vice President and Area Manager<br>Newfoundland and Labrador | Corner Brook<br>Grand Falls | St. John's* |
| **Craig Levangie**<br>Vice President and Area Manager<br>Nova Scotia | Halifax*<br>Sydney | Truro<br>Yarmouth |
| **Claude Paré**<br>Vice President and Area Manager<br>New Brunswick and Prince Edward Island | Bathurst (N.B.)<br>Charlottetown (P.E.I.)<br>Edmundston (N.B.) | Fredericton (N.B.)<br>Moncton* (N.B.)<br>Saint John (N.B.) |

* Location of Entrepreneurship Centers



## Lending Authorized Classification by Province

| for the years ended March 31 | Number | 2004 Net amount ($000) | Number | 2003 Net amount ($000) |
|---|---|---|---|---|
| Newfoundland and Labrador | **358** | **$ 85,979** | 322 | $ 89,122 |
| Prince Edward Island | **36** | **10,922** | 20 | 5,455 |
| Nova Scotia | **164** | **30,500** | 185 | 57,692 |
| New Brunswick | **261** | **62,543** | 256 | 67,278 |
| Total | **819** | **$ 189,944** | 783 | $ 219,547 |

## Commitment to Lending Clients Classification by Province

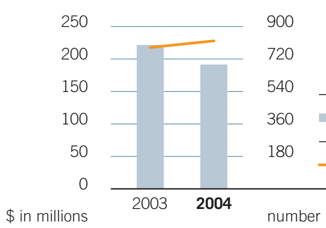
| as at March 31 | Number of clients | 2004 Amount ($000) | Number of clients | 2003 Amount ($000) |
|---|---|---|---|---|
| Newfoundland and Labrador | **1,147** | **$ 332,879** | 1,028 | $ 290,692 |
| Prince Edward Island | **137** | **50,441** | 142 | 44,815 |
| Nova Scotia | **648** | **177,313** | 660 | 174,014 |
| New Brunswick | **932** | **296,966** | 929 | 285,063 |
| Total | **2,864** | **$ 857,599** | 2,759 | $ 794,584 |

## Consulting

| for the years ended March 31 | 2004 | 2003 |
|---|---|---|
| Revenue ($000) | **$ 1,369** | $ 1,336 |
| Percentage of repeat business served | **36%** | 30% |

## Lending Authorized

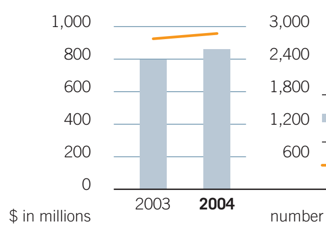
for the years ended March 31




| | 2003 | 2004 |
|---|---|---|
| Amount | 220 | **190** |
| Number | 783 | **819** |

## Commitment to Lending Clients

as at March 31




| | 2003 | 2004 |
|---|---|---|
| Amount | 795 | **858** |
| Number of clients | 2,759 | **2,864** |

# Quebec

Quebec leads the way in genomics which is not only an engine of economic growth, but the very heart of the biotechnology evolution that is uncovering new knowledge about the functioning of living organisms and the causes of disease. BDC proudly supports this innovative sector where intellectual capital is the most important commodity.

| Management | Branches | |
|---|---|---|
| **Thierry Limoges**<br>Vice President and Area Manager<br>Eastern Quebec | Chaudière-Appalaches<br>Chicoutimi | Québec City*<br>Rimouski |
| **France de Gaspé Beaubien**<br>Vice President and Area Manager<br>Southern Quebec | Drummondville | Longueuil* |
| **Alain Gilbert**<br>Vice President and Area Manager<br>Northern Quebec | Laval*<br>Lower Laurentians/Lanaudière | Rouyn-Noranda |
| **Michel Crête**<br>Vice President and Area Manager<br>Montréal | De Maisonneuve<br>Place Ville Marie* | Saint-Léonard |
| **Jean-Robert Lacasse**<br>Vice President and Area Manager<br>Western Quebec | Pointe-Claire | Saint-Laurent* |
| **France Bergeron**<br>Vice President and Area Manager<br>Regional Quebec | Hull<br>Saint-Jérôme<br>Sherbrooke | Trois-Rivières |

* Location of Entrepreneurship Centers



### Lending Authorized

| for the years ended March 31 | **Number** | **2004 Net amount ($000)** | Number | 2003 Net amount ($000) |
|---|---|---|---|---|
| Quebec | **2,776** | **$ 873,830** | 2,115 | $ 728,032 |

### Commitment to Lending Clients

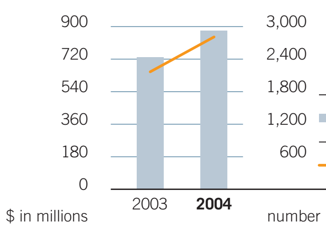
| as at March 31 | **Number of clients** | **2004 Amount ($000)** | Number of clients | 2003 Amount ($000) |
|---|---|---|---|---|
| Quebec | **7,882** | **$ 3,310,462** | 7,347 | $ 2,955,762 |

### Consulting

| for the years ended March 31 | **2004** | 2003 |
|---|---|---|
| Revenue ($000) | **$ 9,190** | $ 8,666 |
| Percentage of repeat business served | **59%** | 49% |

### Lending Authorized

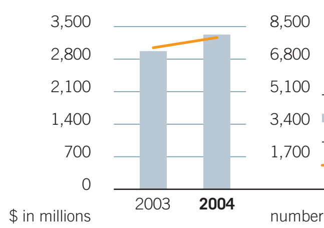
for the years ended March 31




| | 2003 | **2004** |
|---|---|---|
| Amount | 728 | **874** |
| Number | 2,115 | **2,776** |

### Commitment to Lending Clients

as at March 31




| | 2003 | **2004** |
|---|---|---|
| Amount | 2,956 | **3,310** |
| Number of clients | 7,347 | **7,882** |

# Ontario

Ontario's burgeoning services sector, which encompasses everything from real estate, communications and utilities to consumer and education services, today represents over three quarters of employment in the province. This dynamic sector has seen a 20 percent increase in the last 10 years, and is generating high-skilled jobs at a steady rate.

In addition, as the number of families in which both parents work continues to increase, businesses that provide support services ranging from gardening to personal grooming are growing right along with them, often assisted by BDC.

| Management | Branches | |
|---|---|---|
| **Peter Lawler**<br>Vice President and Area Manager<br>Eastern and Northern Ontario | Kingston | Ottawa* |
| **Chuck Smith**<br>Vice President and District Manager<br>Northern Ontario | North Bay<br>Sault Ste. Marie<br>Sudbury | Thunder Bay<br>Timmins |
| **Howard Shears**<br>Vice President and Area Manager<br>Southern Ontario | London*<br>Stratford | Windsor |
| **Michel Leduc**<br>Vice President and Area Manager<br>Toronto | Barrie<br>North York | Toronto*<br>Toronto North |
| **Brendan Cunneen**<br>Vice President and Area Manager<br>Toronto East | Durham<br>Markham | Peterborough<br>Scarborough* |
| **Pat Ghany**<br>Vice President and Area Manager<br>Mississauga | Brampton | Mississauga* |
| **Kevin Dane**<br>Vice President and Area Manager<br>Halton-Niagara | Halton*<br>Hamilton | Kitchener<br>St. Catharines |

* Location of Entrepreneurship Centers



## Lending Authorized

| for the years ended March 31 | 2004 Number | 2004 Net amount ($000) | 2003 Number | 2003 Net amount ($000) |
|---|---|---|---|---|
| Ontario | **2,139** | **$ 681,374** | 2,017 | $ 741,143 |

## Commitment to Lending Clients

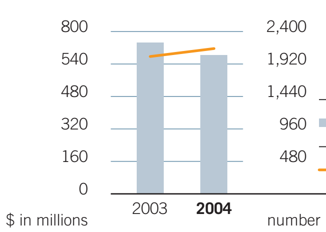
| as at March 31 | 2004 Number of clients | 2004 Amount ($000) | 2003 Number of clients | 2003 Amount ($000) |
|---|---|---|---|---|
| Ontario | **7,126** | **$ 2,738,675** | 6,795 | $ 2,478,651 |

## Consulting

| for the years ended March 31 | 2004 | 2003 |
|---|---|---|
| Revenue ($000) | **$ 6,052** | $ 5,250 |
| Percentage of repeat business served | **49%** | 44% |

## Lending Authorized

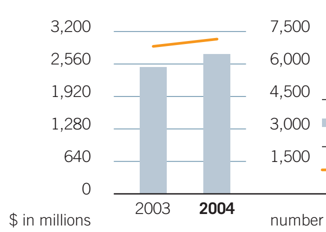
for the years ended March 31




| | 2003 | 2004 |
|---|---|---|
| Amount | 741 | **681** |
| Number | 2,017 | **2,139** |

## Commitment to Lending Clients

as at March 31




| | 2003 | 2004 |
|---|---|---|
| Amount | 2,479 | **2,739** |
| Number of clients | 6,795 | **7,126** |

# Prairies, Northwest Territories and Nunavut

An encouraging rebound in crop output due to improved agricultural conditions drove growth in the Prairies' agriculture sector last year. Soaring energy prices, as well as the impetus for investment in the mineral fuels and gas and oil sector, accounted for growth in the energy sector. Manitoba also saw brisk growth in the shipment of transportation equipment, while in the North, diamond mining is continuing to fuel the economy. BDC's tailor-made solutions are the perfect match for entrepreneurs operating in these diverse sectors.

| Management | Branches | |
|---|---|---|
| **Wellington Holbrook**<br>Vice President and Area Manager<br>Manitoba and Saskatchewan | Brandon (Man.)<br>Kenora (Ont.)<br>Regina (Sask.) | Saskatoon (Sask.)<br>Winnipeg* (Man.) |
| **Edward Straw**<br>Vice President and Area Manager<br>Southern Alberta | Calgary* (Alta.)<br>Calgary North (Alta.)<br>Calgary South (Alta.) | Cranbrook (B.C.)<br>Lethbridge (Alta.) |
| **Steve Zink**<br>Vice President and Area Manager<br>Northern Alberta and Northwest Territories | Edmonton* (Alta.)<br>Edmonton South (Alta.)<br>Fort St. John (B.C.) | Grande Prairie (Alta.)<br>Red Deer (Alta.)<br>Yellowknife (N.W.T.) |

* Location of Entrepreneurship Centers



## Lending Authorized Classification by Province and Territory

| for the years ended March 31 | 2004 Number | 2004 Net amount ($000) | 2003 Number | 2003 Net amount ($000) |
|---|---|---|---|---|
| Manitoba | **197** | **$ 40,320** | 132 | $ 29,374 |
| Saskatchewan | **89** | **19,039** | 138 | 25,141 |
| Alberta | **541** | **123,653** | 496 | 124,326 |
| Northwest & Nunavut Territories | **15** | **6,222** | 22 | 8,115 |
| Total | **842** | **$ 189,234** | 788 | $ 186,956 |

## Commitment to Lending Clients Classification by Province and Territory

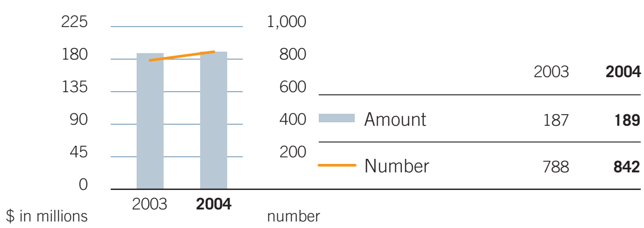
| as at March 31 | 2004 Number of clients | 2004 Amount ($000) | 2003 Number of clients | 2003 Amount ($000) |
|---|---|---|---|---|
| Manitoba | **504** | **$ 131,671** | 448 | $ 110,132 |
| Saskatchewan | **452** | **111,045** | 522 | 118,424 |
| Alberta | **1,502** | **487,838** | 1,385 | 452,972 |
| Northwest & Nunavut Territories | **67** | **33,938** | 72 | 31,284 |
| Total | **2,525** | **$ 764,492** | 2,427 | $ 712,812 |

## Consulting

| for the years ended March 31 | 2004 | 2003 |
|---|---|---|
| Revenue ($000) | **$ 1,911** | $ 1,762 |
| Percentage of repeat business served | **45%** | 47% |

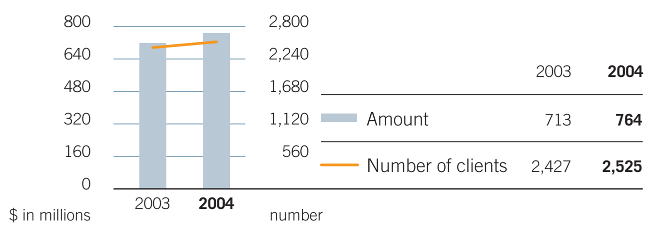
## Lending Authorized

for the years ended March 31




## Commitment to Lending Clients

as at March 31



# British Columbia and Yukon

The bright spots in the British Columbia economy in 2003 were stellar growth in natural gas exports, spurred by an energy boom in the Northeastern part of the province, and the red-hot housing market which gave rise to robust housing construction. In the Yukon, the agriculture sector is proving to be surprisingly vigorous and hardy, exhibiting healthy growth in recent years. Recognizing the potential of this area's enterprising entrepreneurs, BDC provides support for their growth and expansion.

| Management | Branches | |
|---|---|---|
| **Scot Speiser**<br>Vice President and Area Manager<br>B.C. North and Interior | Kamloops (B.C.)<br>Kelowna* (B.C.)<br>Prince George (B.C.) | Terrace (B.C.)<br>Whitehorse (Y.T.) |
| **Shirley Bennie**<br>Vice President and Area Manager<br>Vancouver | Campbell River<br>Langley<br>Nanaimo<br>North Vancouver | Surrey*<br>Vancouver*<br>Victoria |

* Location of Entrepreneurship Centers



## Lending Authorized Classification by Province and Territory

| for the years ended March 31 | Number | 2004 Net amount ($000) | Number | 2003 Net amount ($000) |
|---|---|---|---|---|
| British Columbia | **675** | **$ 144,802** | 610 | $ 153,549 |
| Yukon | **17** | **3,463** | 13 | 2,680 |
| Total | **692** | **$ 148,265** | 623 | $ 156,229 |

## Commitment to Lending Clients Classification by Province and Territory

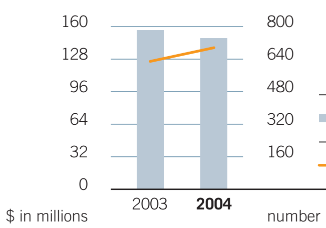
| as at March 31 | Number of clients | 2004 Amount ($000) | Number of clients | 2003 Amount ($000) |
|---|---|---|---|---|
| British Columbia | **2,310** | **$ 660,998** | 2,312 | $ 632,834 |
| Yukon | **89** | **21,796** | 93 | 21,321 |
| Total | **2,399** | **$ 682,794** | 2,405 | $ 654,155 |

## Consulting

| for the years ended March 31 | 2004 | 2003 |
|---|---|---|
| Revenue ($000) | **$ 1,484** | $ 1,207 |
| Percentage of repeat business served | **31%** | 47% |

## Lending Authorized

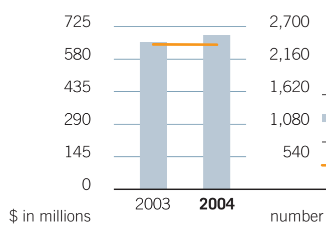
for the years ended March 31




| | 2003 | 2004 |
|---|---|---|
| Amount | 156 | **148** |
| Number | 623 | **692** |

## Commitment to Lending Clients

as at March 31




| | 2003 | 2004 |
|---|---|---|
| Amount | 654 | **683** |
| Number of clients | 2,405 | **2,399** |

# Management's Discussion and Analysis

The Management's Discussion and Analysis (MD&A) provides Management's perspective on BDC's performance in fiscal 2004, risk management activities and outlook for 2005.

**Objectives, Measures and Targets** (pages 31 and 32) summarizes the corporate objectives established in the annual Corporate Plan and the key performance indicators used to measure performance and results for fiscal 2004 and objectives for 2005. These measures are reviewed in more detail in subsequent sections of this MD&A, as shown below.

**Clients** (pages 33-37) discusses the market needs that BDC serves, the diversity of its clientele and the ways BDC helps Canadian entrepreneurs by providing fast and flexible service. Successful performance is assessed by growth and client satisfaction.

**Employee Commitment** (page 38) provides an overview of BDC's greatest asset – its employees. It shows how BDC fosters a culture of employee engagement and customer service that in turn makes BDC a more efficient and cost-effective institution. The employee commitment rating is the principal performance measure.

**Financial Statements Discussion** (pages 39-45) provides an in-depth analysis of the balance sheet and the results presented in the statement of income (pages 53 and 54) with reference to the five other performance measures.

**Productivity**
**Portfolio growth**
**Consulting revenue**
**Return on common equity**
**Venture Capital internal rate of return**

This discussion includes the contribution of each of the three business areas – Loans, Consulting and Venture Capital (VC) – and explains significant accounting policies and their effects on BDC's results.

**Integrated Risk Management** (pages 46-50) summarizes BDC's risk management activities and discusses BDC's approach to managing credit, market, liquidity and operational risks.

**Caution Regarding Forward-Looking Statements** The MD&A that follows this page includes forward-looking statements and assumptions, based on Management's best estimates. Risks and uncertainties may cause actual results to differ materially from these estimates. Some of the factors that could cause such differences include general economic and market conditions, such as interest rates and currency values and the performance of venture capital investments.

**How BDC Reports** BDC is governed by the *Business Development Bank of Canada Act* of 1995, and, as a Crown corporation, by Part X of the *Financial Administration Act*.

BDC prepares its financial statements, which are presented on pages 51 to 71 of this report in accordance with Canadian generally accepted accounting principles (GAAP).

To finance its activities, BDC issues debt instruments secured by the Government of Canada. From time to time, it receives equity infusions from the federal government, its sole shareholder. BDC does not require nor receive operating appropriations of Government funds.

## OBJECTIVES, MEASURES AND TARGETS

### Mandate

BDC's mandate is to support Canadian entrepreneurship by providing financial (loans, venture capital and subordinate financing) and consulting services.

### Corporate Objectives

**Clients** – To create a unique and valued relationship with Canadian entrepreneurs to support the creation of their businesses and accompany their growth (measured by client satisfaction).

**Employees** – To foster a culture of engagement, learning and growth (measured by employee commitment).

**Efficiency** – To establish effective and efficient processes to support local market understanding (measured by the loans productivity ratio).

**Financial** – To be profitable in order to grow while fulfilling BDC's public policy mandate [measured by the outstanding loans portfolio, the internal rate of return (IRR) of Venture Capital and BDC Consulting revenue] and to generate a return on common equity (ROE) at least equal to the government's long-term cost of funds.



The following table illustrates how BDC measures progress towards the corporate objectives.

| 2004 Objectives | 2004 Performance | 2005 Targets |
|---|---|---|
| 89% client satisfaction | 91% | 89% |
| 76% employee commitment | 77% | 77% |
| 49% productivity ratio | 49% | 47% |
| $7.4 billion in outstanding loans portfolio | $7.5 billion | $8.2 billion |
| 16.0% 10-year IRR – Total investments | 13.1% | 11.0% |
| $19.0 million in Consulting revenue | $20.0 million | $19.0 million |
| Return on common equity of 4.2% | 5.1% | 7.7% |

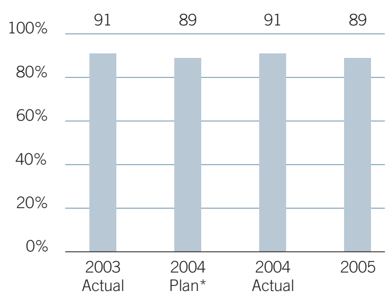
## PERFORMANCE AND CORPORATE OBJECTIVES

### Performance

**Client satisfaction**

Continued flexibility and valued relationships kept satisfied or very satisfied clients at 91%.

* 86% as per 2004 Corporate Plan
89% represents new internal objective.



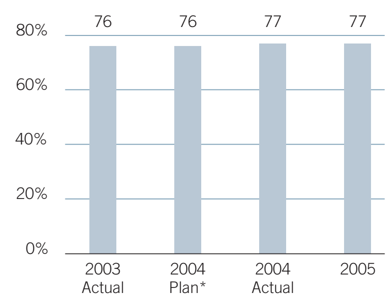

### 2005 Objectives

- Client satisfaction: 89%
- Increase the risk in the portfolio, a move that may decrease client satisfaction over time, due to pricing.

**Employee commitment**

Results from the Employee Engagement Survey showed an improvement to 77% from 76% in 2003, and from the internal objective of 76%, as commitment of BDC's greatest asset remains strong.

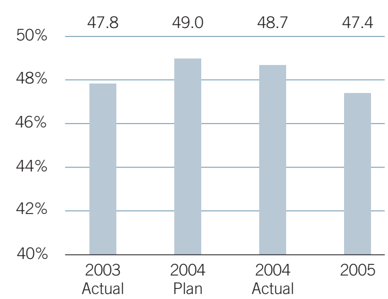
* 70% as per 2004 Corporate Plan
76% represents new internal objective.




- Employee commitment: 77%
- Enhance and develop leadership.
- Foster open and honest communication.
- Promote self-motivated, lifelong learning and career development.
- Support workforce diversity and differentiation in employee policies and programs.

**Loan productivity ratio**

As anticipated in the Plan, the productivity ratio increased by almost 1 percent from fiscal 2003, largely due to an $11 million increase in pension costs (the lower the ratio, the higher the efficiency achieved).



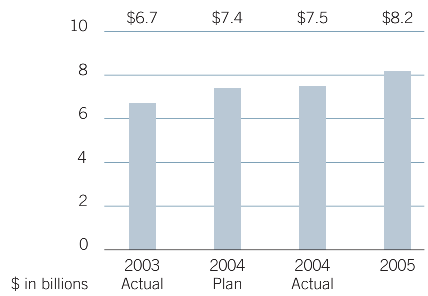

- Ratio: 47.4%
- Strive for efficiency gains through ongoing refinement of internal processes. Management will remain diligent in its cost control methods.
- Use technology efficiently and update current technology applications.

## PERFORMANCE AND CORPORATE OBJECTIVES

### Performance

#### Outstanding loan portfolio

A record $2.1 billion in net loan authorizations in fiscal 2004 supported strong growth in the portfolio, which stood at $7.5 billion at the end of the fiscal year.

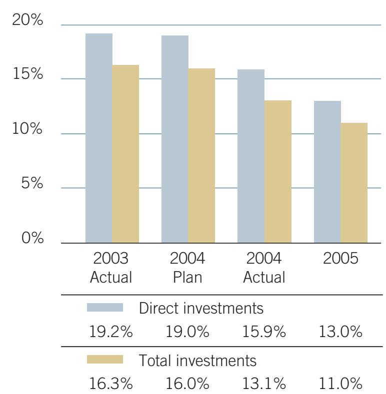



**2005 Objectives**

- Portfolio: $8.2 billion
- Increase risk tolerance in terms of transaction and borrower concentration.
- Broaden the scope of subordinate financing activity to address the needs of high-growth companies through the partnership with Caisse de dépôt et placement du Québec (CDP).

#### Venture Capital 10-year IRR

The slow recovery in the venture capital marketplace in 2004 negatively affected the 10-year IRR, forcing $37 million in write-downs during the year. The 10-year IRR on total investments was 13.1% in 2004 versus 16.3% in 2003.

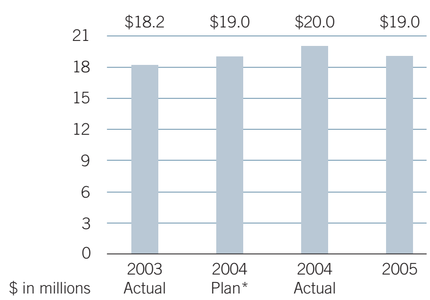



**2005 Objectives**

- Direct investments: 13.0%
- Total investments: 11.0%
- Continue to develop North American industry networks to create value for portfolio companies.
- Support investment opportunities in the seed and pre-seed environments.

#### Consulting revenue

BDC recorded Consulting revenues of $20.0 million, ahead of Plan and 2003.



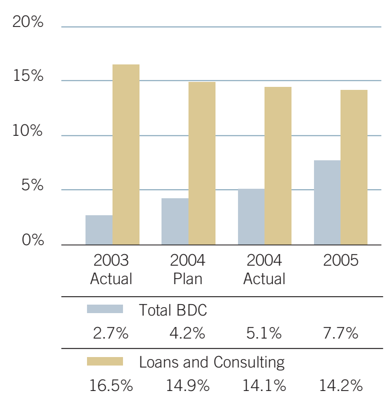

* $16.5 million as per 2004 Corporate Plan
$19 million represents new internal objective.

**2005 Objectives**

- Consulting revenue from activities: $19.0 million
- Continue integrating consulting services with financial services.

#### Return on common equity

- Total BDC ROE of 5.1% was a marked improvement over the 2.7% ROE in 2003, as a result of continued strong loans operations and the improvement in Venture Capital operations.
- ROE on Loans and Consulting was 14.1% in fiscal 2004 versus 16.5% in fiscal 2003, due to a higher average capital base.




**2005 Objectives**

- ROE: 7.7 %
- Generate an ROE at least equal to the government's long-term cost of funds.
- Increase ROE as a result of continued loans growth and continued improvements in Venture Capital.

## CLIENTS

BDC strives to create a unique and valued relationship with Canadian entrepreneurs to support the creation and growth of their businesses.

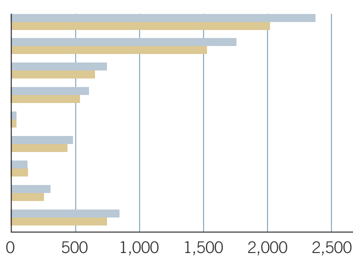
In response to client demand, BDC has been improving its lending processes over the last three years to provide better, faster and more flexible services. BDC makes 95 percent of its credit decisions at the regional level, closer to clients. In 2004, to add more value and facilitate contact between BDC and the client, Financial and Consulting Services were integrated under one line of business. Comprehensive knowledge of what clients need, continuous improvement and expert execution are at the forefront of BDC's relentless focus on clients.

**TOTAL LENDING COMMITTED / CLASSIFICATION BY PROVINCE OR TERRITORY**

| as at March 31 | | **2004** | | 2003 |
|---|---|---|---|---|
| | **Number of clients** | **Amount ($ in millions)** | Number of clients | Amount ($ in millions) |
| Newfoundland and Labrador | **1,147** | **$ 333** | 1,028 | $ 291 |
| Prince Edward Island | **137** | **50** | 142 | 45 |
| Nova Scotia | **648** | **177** | 660 | 174 |
| New Brunswick | **932** | **297** | 929 | 285 |
| Quebec | **7,882** | **3,310** | 7,347 | 2,956 |
| Ontario | **7,126** | **2,739** | 6,795 | 2,479 |
| Manitoba | **504** | **132** | 448 | 110 |
| Saskatchewan | **452** | **111** | 522 | 118 |
| Alberta | **1,502** | **488** | 1,385 | 453 |
| Northwest Territories and Nunavut | **67** | **34** | 72 | 31 |
| British Columbia | **2,310** | **661** | 2,312 | 633 |
| Yukon | **89** | **22** | 93 | 21 |
| **Total** | **22,796** | **$ 8,354** | 21,733 | $ 7,596 |

### Lending Authorized – Classification by Industry – Number

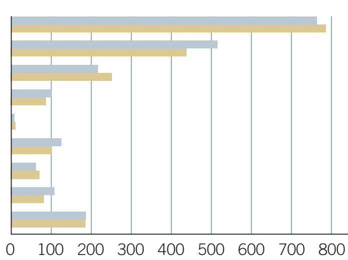
for the years ended March 31




| | **2004** | 2003 |
|---|---|---|
| Manufacturing | **2,375** | 2,018 |
| Wholesale and retail trade | **1,758** | 1,525 |
| Tourism | **743** | 648 |
| Business services | **605** | 534 |
| Agriculture and related | **36** | 40 |
| Construction | **478** | 434 |
| Commercial properties | **126** | 130 |
| Transportation and storage | **303** | 252 |
| Other | **844** | 745 |
| Total | **7,268** | 6,326 |

### Lending Authorized – Classification by Industry – Amount

for the years ended March 31 ($ in millions)



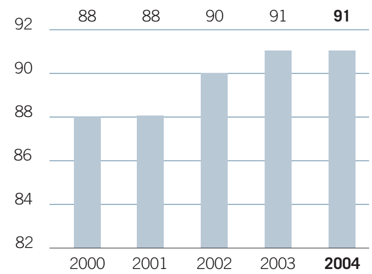

| | **2004** | 2003 |
|---|---|---|
| Manufacturing | **764** | 786 |
| Wholesale and retail trade | **515** | 461 |
| Tourism | **216** | 252 |
| Business services | **99** | 87 |
| Agriculture and related | **7** | 8 |
| Construction | **126** | 101 |
| Commercial properties | **62** | 70 |
| Transportation and storage | **108** | 82 |
| Other | **186** | 185 |
| Total | **2,083** | 2,032 |

This past fiscal year included unique challenges for many BDC clients. Severe acute respiratory syndrome (SARS), bovine spongiform encephalopathy (BSE), blackouts, forest fires, hurricanes and the substantial increase in the Canadian dollar versus its American counterpart all created challenges. BDC proactively helped clients meet these challenges, in the cases of SARS, Hurricane Juan and the western forest fires, by offering its eligible clients the opportunity to postpone capital payments on their loans for a four-month period, without penalty. BDC also provided its eligible clients access to an additional $50,000 loan to cover working capital shortages. In fiscal 2004, more than 6,000 postponements were granted to some 4,600 clients and more than 800 loans were authorized for a total of $37 million under the special initiatives for these crisis situations.

These initiatives, coupled with BDC's commitment to high service levels, maintained the excellent client satisfaction rating at 91 percent. BDC will continue its commitment to customer service by keeping lending decisions close to the client and ensuring that all employees are able, capable and prompt in responding to client needs in difficult times.

## Client Satisfaction Level

as at March 31 (percentage)




In fiscal 2005, BDC will pursue its strategy of assuming more risk in its portfolio through the growth of quasi-equity financing. Given its pricing-to-risk policy, BDC expects that higher prices may affect client satisfaction adversely, which could translate into a decline of two percentage points, from the current level of 91 percent to 89 percent.

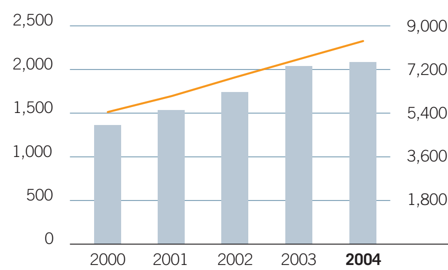
BDC authorized more than 7,000 loans for a total amount of $2,083 million in fiscal 2004; 73 percent of these loan transactions were for amounts of $250,000 or less, including 800 loans authorized under special initiatives to address the fiscal 2004 crises noted earlier.

This record year for authorizations increased BDC's lending commitment to $8.4 billion and the outstanding loans portfolio to $7.5 billion, as at March 31, 2004.

To further help Canadian entrepreneurs, BDC implemented an integrated approach that allows account managers to better identify clients' needs. As a result, clients receive more than just money – they also get help to develop and manage their businesses. This approach helped raise Consulting revenue above Plan as well as increasing the number of clients benefiting from BDC Consulting services.

## Total Lending Activities

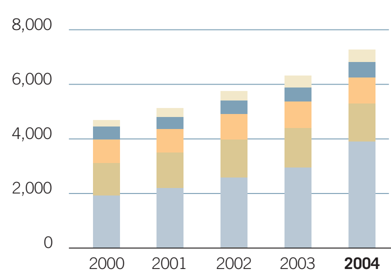
for the years ended March 31 ($ in millions)




| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Total lending authorized | 1,365 | 1,533 | 1,739 | 2,032 | **2,083** |
| Total lending committed as at March 31 | 5,446 | 6,057 | 6,827 | 7,596 | **8,354** |

## Lending Authorized – Classification by Size

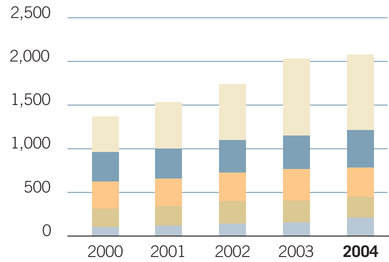
for the years ended March 31 (number of transactions)




| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| $100,000 or less | 1,922 | 2,203 | 2,574 | 2,944 | **3,919** |
| Over $100,000 to $250,000 | 1,189 | 1,260 | 1,398 | 1,438 | **1,361** |
| Over $250,000 to $500,000 | 857 | 877 | 918 | 962 | **940** |
| Over $500,000 to $1,000,000 | 488 | 484 | 524 | 543 | **593** |
| Over $1,000,000 | 231 | 278 | 329 | 439 | **455** |
| **Total** | 4,687 | 5,102 | 5,743 | 6,326 | **7,268** |

## Lending Authorized – Classification by Size

for the years ended March 31 ($ in millions)

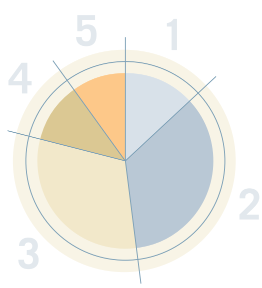



| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| $100,000 or less | 99 | 116 | 138 | 156 | **210** |
| Over $100,000 to $250,000 | 209 | 219 | 247 | 247 | **235** |
| Over $250,000 to $500,000 | 306 | 317 | 332 | 351 | **337** |
| Over $500,000 to $1,000,000 | 351 | 343 | 373 | 390 | **435** |
| Over $1,000,000 | 400 | 538 | 649 | 888 | **866** |
| **Total** | 1,365 | 1,533 | 1,739 | 2,032 | **2,083** |



## Number of Lending Customers by Geographic Area

as at March 31, 2004




| | | |
|---|---|---|
| 1 | Atlantic Provinces | 13% |
| 2 | Quebec | 35% |
| 3 | Ontario | 31% |
| 4 | Prairies, Northwest Territories and Nunavut | 11% |
| 5 | British Columbia and Yukon | 10% |

Over the last two years, BDC has prudently increased its risk profile by offering less-secured financing designed namely to support start-ups, R&D and productivity improvement. Part of this strategy involved focusing on the small business market (loans under $250,000). BDC realized that it needed teams across Canada to fulfill specific needs of this marketplace. BDC's 20 Entrepreneurship Centers throughout the country provide such expertise.

Every year, BDC clients are contacted through surveys, focus groups, interviews and visits. Through this continuous dialogue, BDC was able to reconfirm gaps in the marketplace. BDC's loan products are designed to fill gaps related to size, flexibility, risk and knowledge. In addition, BDC offers four specific loan product types, which are designed to meet the needs of four distinct market areas.

**Term Loans:** Offer a larger percentage of asset financing extended over a longer term.

**Co-Vision Loans** (loans up to $100,000): Provide financing for start-ups.

**Productivity Plus Loans (PPLs):** Provide financing for new or used equipment and machinery that are geared to improve the productivity of the business. PPLs provide up to an additional 25 percent of the total (maximum $500,000) for costs associated to acquire the equipment, such as costs related to installing and assembling the equipment and training the employees who use it.

**Innovation Loans** (loans up to $250,000): Provide financing for working capital needs to support the development and implementation of an innovation strategy.

## Business Solution Matrix

<table>
<tr><th></th><th colspan="3">Loan Purpose</th></tr>
<tr><th>Stage of development</th><th>Realty</th><th>Equipment</th><th>Working Capital</th></tr>
<tr><td>Start-up</td><td rowspan="4">Term Loans</td><td colspan="2">Co-Vision</td></tr>
<tr><td>Development</td><td>PPL Loans<br>100% financing</td><td rowspan="3">Innovation Loans</td></tr>
<tr><td>Expansion</td><td rowspan="2">PPL Loans<br>125% financing</td></tr>
<tr><td>Maturity</td></tr>
</table>

low — Risk → high

Subordinate financing is a hybrid financial instrument incorporating elements of both debt and equity financing. Including Innovation Loans, BDC authorizations represent over 70% of the Canadian subordinate financing market for transactions under $5 million. BDC's subordinate financing group has been operating since fiscal 2001, and its income, expenses and portfolio are included in Loans Operations results.

In August of 2003, BDC reached a three-year agreement with Caisse de dépôt et placement du Québec (CDP) to create a $300 million subordinate financing fund. This partnership, named AlterInvest Fund L.P., is funded equally by the two parties. BDC acts as general partner and handles all lending and managerial activities of the Fund, in exchange for fees. This partnership funds subordinate financing transactions ranging from $250,000 to $10 million across the country, thereby providing continued and significant support to growing businesses in need of specialized financing. As at March 31, 2004, the total portfolio was at $41.3 million.

Also part of this agreement was BDC's acquisition of $15.7 million from CDP of a 50% interest in the shares of AlterInvest Fund Inc. which holds a Quebec-based portfolio of subordinate debt for which BDC also acts as general partner. BDC takes its share of the income, expenses, assets, liabilities and equity from both these entities.

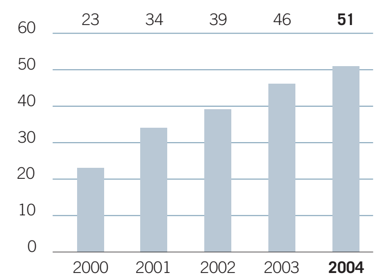
BDC Consulting employees and network of private sector consultants help entrepreneurs assess, plan and implement management solutions to support the development of their businesses.

Consulting Operations were involved in more than 3,000 projects during the year. Total revenue of $20.0 million increased by 10 percent from fiscal 2003, driven partially by increased integration of its activities with Loans Operations. Significant efforts have been deployed over the past years to nurture relationships with our customers.

These efforts have resulted in the fourth consecutive, year-over-year growth of repeat business.

## Consulting Repeat Business

for the years ended March 31 (percentage)

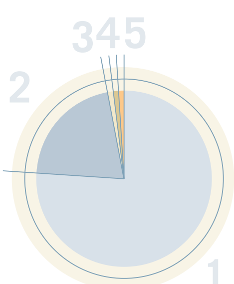



Consulting solutions are offered under four segments: growth, quality, export and e-business. Consulting services supporting the growth segment were most appealing to Canadian entrepreneurs last year, reflecting their needs and priorities. Entrepreneurs who used these services received management support in areas such as Operations Management, Human Resources and Strategic Planning from qualified practitioners. BDC earned 21% of its Consulting revenues from activities involving quality-related services, helping businesses achieve ISO and HACCP certification, among others.

Significant efforts were deployed by Consulting services in 2004 to develop methodologies in the areas of Operations Management and Human Resources. The development of an awareness diagnostic designed to help Canadian entrepreneurs improve their productivity was completed toward the end of the year and an increase in contract bookings in fiscal 2005, in this category, is expected. In response to customer demand, work was also initiated to develop and test a new methodology to guide business owners in the field of human resources management.

## Consulting Revenues by Activity

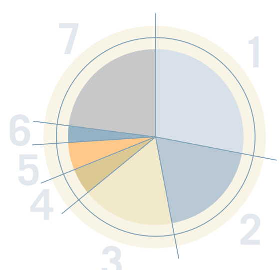
for the year ended March 31, 2004




| | | |
|---|---|---|
| 1 | Growth | 76% |
| 2 | Quality | 21% |
| 3 | Exporting | 1% |
| 4 | e-business | 1% |
| 5 | Other | 1% |

## Consulting Revenues by Type in Growth Segment

for the year ended March 31, 2004




| | | |
|---|---|---|
| 1 | SR&ED tax credit | 28% |
| 2 | Operating efficiency | 19% |
| 3 | Business planning | 17% |
| 4 | Diagnostic | 5% |
| 5 | Human resources | 5% |
| 6 | Marketing | 3% |
| 7 | Other | 23% |

There are persistent investment market gaps which inhibit the emergence of innovative firms in Canada. These gaps are identified as follows.

- Early-stage gap, whereby investments in early-stage companies are not the target of investors.
- Dollar gap, where per capita venture capital investments need to increase if Canada is to meet its objective of being a top three worldwide venture capital country.
- Institutional gap, as Canadian institutional investors are not nearly as active as their American counterparts.

BDC Venture Capital has been structured to fill these gaps by making investments using an internal organization aligned as follows.

- The Technology Seed Investment group
- Four internal specialized groups, designed to fill the early-stage gap
  - Life Sciences
  - Information Technologies
  - Telecommunications
  - Advanced technologies
- Fund-investing group, designed to support private venture capital fund managers and to increase institutional investing

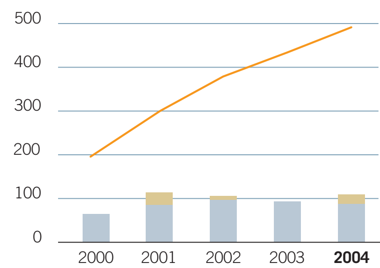


The Canadian venture capital investment market has shrunk tremendously in the past three years. Despite this and in accordance with BDC's mandate, investment activity remained steady in fiscal 2004 as BDC continued its commitment to provide financing to companies seeking venture capital. Including $22 million in venture funds, total investments authorized in fiscal 2004 amounted to $109 million, up by $16 million or 17 percent over fiscal 2003.

BDC generally assumes a small ownership position (5% to 15%) and participation on the Board of Directors of its investee companies.

## Venture Capital Activities

for the years ended March 31 ($ in millions)

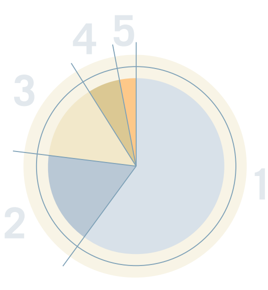



| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Direct investments authorized | 63 | 84 | 98 | 93 | **87** |
| Venture funds authorized | 0 | 30 | 8 | 0 | **22** |
| **Total authorized** | 63 | 114 | 106 | 93 | **109** |
| Total commitment as at March 31 | 195 | 296 | 374 | 430 | **491** |

BDC is focused on being an early-stage technology venture capital investor. During fiscal 2004, 77 percent of BDC's Venture Capital investments authorized were to companies in the seed, start-up or development stage.

## Number of Venture Capital Investments Authorized – Classification by Stage

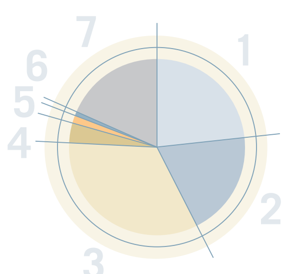
for the year ended March 31, 2004




| | | |
|---|---|---|
| 1 | Start-up/Seed | 60% |
| 2 | Development | 17% |
| 3 | Expansion | 14% |
| 4 | Turnaround | 6% |
| 5 | Venture funds | 3% |

## Venture Capital Commitment – Classification by Industry

as at March 31, 2004 ($ in millions)




| | | |
|---|---|---|
| 1 | Biotechnology/medical/health | 114 |
| 2 | Electronic | 95 |
| 3 | Communication and computer-related | 163 |
| 4 | Industrial | 18 |
| 5 | Energy | 7 |
| 6 | Other industries | 4 |
| 7 | Venture funds | 90 |

## EMPLOYEE COMMITMENT

Getting input from its employees on key issues that affect employee engagement is one of BDC's most valuable management information tools. In fiscal 2004, feedback was captured in four different ways: the yearly Employee Engagement Survey, focus groups on diversity, employee exit interviews and a cultural diagnostic geared at identifying current BDC core values.

In 2004, BDC initiated its second President's Leadership Forum. This forum brings together 10 leaders in an experimental leadership development program. This year, the objective will be to find ways to improve the effectiveness of BDC in supporting business growth in Canada and the leadership of its entrepreneurs. The President's Award of Excellence program also continued for a second year. It recognizes the dedication of employees who demonstrate excellence in their contribution to BDC's success.

Results from the annual Employee Engagement Survey show an improvement in employee commitment level to 77 percent from 76 percent in 2003. This result also surpasses the 76-percent performance objective set for fiscal 2004. Notwithstanding great uncertainty and workplace disruption experienced during the year, BDC employees remained strongly committed to BDC's raison d'être of making a difference in the Canadian entrepreneur market.

During fiscal 2004, BDC established a Diversity Committee, drawing on employees across the country. With the changing composition of Canadian society, BDC wants to ensure that its employees are aware of the incredible mosaic of races, cultures and religions that now make up Canada and the ways, as an institution, it can help these diverse groups thrive both as entrepreneurs and as BDC employees.

A cultural diagnostic was conducted with 400 BDC employees. The findings provided the basis for Management's key 2005 priority of reaffirming BDC's core values through a process of consultation with all employees and leaders. With this process, Management intends to reaffirm the five principal BDC core values and realign Human Resources practices accordingly.

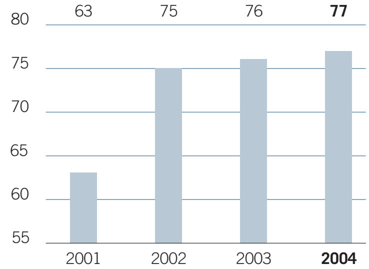
BDC entered the second year of the Career Management Process, which encourages self-assessment, learning and career development as a way to develop and retain talent. Employees take an active role in their career progression and professional development, while providing valuable information critical to the succession planning process.

BDC spent approximately $5 million in fiscal 2004 on training, about 2 percent of its total expenses, a figure that is consistent with previous years. Employee training is the key in allowing BDC to meet the challenges of today's rapidly changing business environment.

To add value to the marketplace, BDC must have the best players on its team. To retain its employees, BDC also needs to offer a stimulating and enriching work environment. BDC employees consistently rise to the challenges presented to them. In fiscal 2004, they made it possible for BDC to achieve a record year for loan authorizations of $2.1 billion, increase Consulting revenue by 10 percent, select great investment opportunities and help the commercialization of new technologies in Venture Capital operations.

### Employee Commitment Level

for the years ended March 31 (percentage)



# FINANCIAL STATEMENTS DISCUSSION

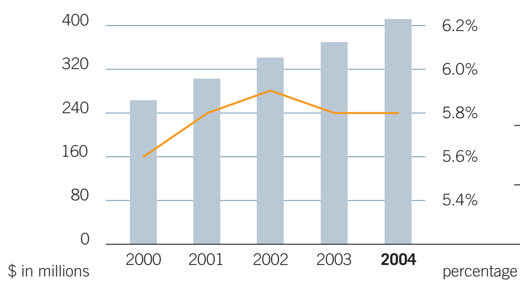
## LOAN OPERATIONS

BDC's principal asset is the loan portfolio, which generates interest income and other income from administration fees. That income totalled $573.4 million in fiscal 2004 compared to $520.8 million in fiscal 2003, while interest earned on cash and short-term investments amounted to $27.2 million versus $24.7 million in fiscal 2003. The aggregate interest income is reduced by interest expense of $189.9 million (fiscal 2003: $176.6 million) on BDC's borrowings, yielding net interest and other income of $410.7 million in fiscal 2004 (before provision for credit losses), 11 percent higher than in fiscal 2003 and consistent with the larger loan portfolio.

The loan portfolio, net of the allowance for credit losses, increased from $6.3 billion as at March 31, 2003 to $7.0 billion as at March 31, 2004 including BDC's 50 percent share in the BDC-CDP partnership. Portfolio growth is the result of disbursements of new loans, less principal repayments and increased allowance for credit losses.

### Loan Operations Net Interest and Other Income

for the years ended March 31



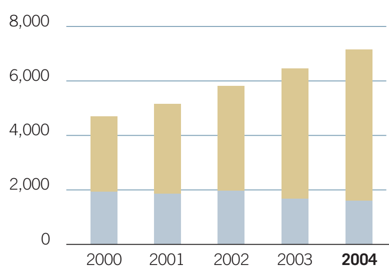

| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Net interest and other income (amount) | 263 | 302 | 341 | 369 | **411** |
| As a percentage of average portfolio (%) | 5.6 | 5.8 | 5.9 | 5.8 | **5.8** |

Loans are granted to clients at either floating or fixed interest rates, at their option, with the fixed rates at the time of commitment reflecting prevailing market rates. The interest rates charged to individual clients reflect BDC's cost of funds, plus a risk factor. At March 31, 2004, $5.5 billion of the performing loans portfolio produced interest income at floating rates averaging 6.7 percent (March 2003: 7.5 percent), while the remaining $1.6 billion earned fixed interest with rates averaging 8.2 percent (March 2003: 8.7 percent). As in fiscal 2003, clients opted increasingly for the floating rate to benefit from the lower prevailing rates.

BDC finances the $7.5 billion in total loans outstanding primarily by borrowing on the open market, closely matching borrowing terms and maturities with its lending activities.

### Performing Loan Portfolio

as at March 31 ($ in millions)




| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Fixed rate portfolio | 1,931 | 1,857 | 1,949 | 1,658 | **1,585** |
| Floating rate portfolio | 2,737 | 3,283 | 3,854 | 4,783 | **5,560** |
| **Total performing portfolio** | 4,668 | 5,140 | 5,803 | 6,441 | **7,145** |

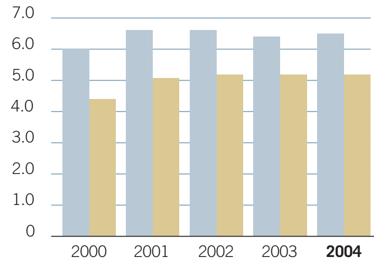
Net interest and other income must cover the provision for loan losses, and operating and administrative expenses, while generating enough net income to increase the capital base through retained earnings to support BDC's future lending activities.

### Allowance and Provision for Loan Losses

BDC's mission of supporting Canadian entrepreneurs includes financing, start-up, early-stage development and growth businesses. Early-stage business financing involves a higher risk portfolio, so consequently the probability of default of this loan category is greater. Accordingly, BDC maintains its cumulative allowance for credit losses at a prudent level that also reflects its long-term loan loss experience of 6 to 7 percent. The allowance of $488 million as at March 31, 2004 was $55 million higher than it was as at March 31, 2003, and represented 6.5 percent of the portfolio versus 6.4 percent a year ago.

## Allowance for Credit Losses

as at March 31 (percentage)




| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Total allowance as a % of total loan portfolio | 6.0 | 6.6 | 6.6 | 6.4 | **6.5** |
| General allowance as a % of performing loans portfolio | 4.4 | 5.1 | 5.2 | 5.2 | **5.2** |

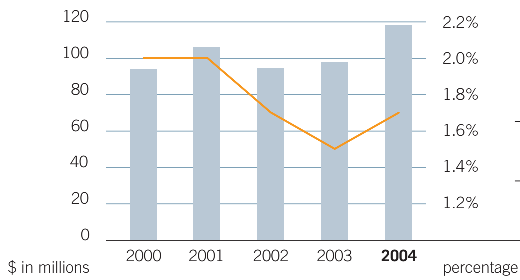
The cumulative allowance comprises a specific allowance of $115 million, which covers the net exposure from identified impaired loans and a general allowance of $373 million, which covers the exposure from the performing loans in the portfolio as at March 31, 2004. The general allowance represents 5.2 percent of the performing portfolio of $7.1 billion, in line with the ratio from a year ago.

Loan write-offs are charged to the specific allowance. During fiscal 2004, $65 million in loans was written off, compared to $74 million in 2003.

The total allowance, net of write-offs, is the cumulative result of annual provisions for credit losses charged to operating results. In fiscal 2004, provisions charged against income and credited to the allowance were $118 million, versus $98 million in fiscal 2003. The $118-million provision represents 1.7 percent of the average outstanding portfolio.

## Provision for Credit Loss

for the years ended March 31




| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Provision for credit loss (amount) | 94 | 106 | 95 | 98 | **118** |
| As a percentage of average portfolio (%) | 2.0 | 2.0 | 1.7 | 1.5 | **1.7** |

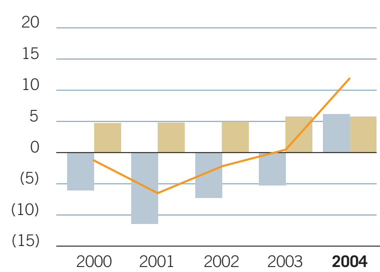
### Operating and Administrative Expenses

Loan operating and administrative expenses of $200 million were $24 million higher than the $176 million recorded in fiscal 2003, driven by an $11-million increase in the cost of BDC's pension plans, increasing staff levels and ongoing investments in information technology. As in prior years, salaries and benefits represented over half of the operating and administration expenses.

BDC's pension expense for its defined benefit plans is determined actuarially and is significantly influenced by actuarially based assumptions such as the discount rate applied to future liabilities, the expected rate of return on fund assets, inflation rates and other factors. Current prevailing interest rates and investment returns have significantly affected costs for sponsors of all such plans, and BDC's Loans operations pension expense in fiscal 2004 was $6.1 million, compared to a pension credit of $5.2 million in fiscal 2003. BDC also maintains supplemental pension plans, which are non-funded, and the related accounting expense of $2.9 million was charged against earnings for fiscal 2004.

## Loan Operations Pension Expense

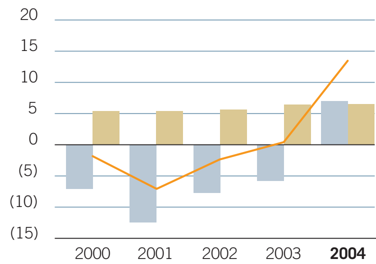
for the years ended March 31 ($ in millions)




| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Pension expense | (6.1) | (11.4) | (7.2) | (5.2) | **6.1** |
| Benefits to pensioners | 4.8 | 4.8 | 5.1 | 5.7 | **5.8** |
| Total employee future benefits expense | (1.3) | (6.6) | (2.1) | 0.5 | **11.9** |

## Total BDC Pension Expense

for the years ended March 31 ($ in millions)




| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Pension expense | (7.1) | (12.5) | (7.8) | (5.8) | **7.0** |
| Benefits to pensioners | 5.4 | 5.3 | 5.6 | 6.4 | **6.4** |
| Total employee future benefits expense | (1.7) | (7.2) | (2.2) | 0.6 | **13.4** |

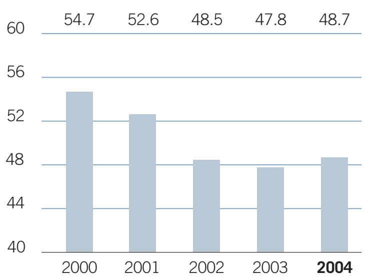
BDC's information and technology expenses (including salaries and benefits, equipment and other costs) amounted to $22 million, showing BDC's commitment to investing in and maintaining information technology hardware and software.

Premises and equipment costs for Loan operations of $27 million include leasing expenses for more than 80 BDC offices across Canada. This significant dollar figure reflects BDC's commitment to doing business throughout the country and BDC's decentralized decision-making process, closer to the client.

During fiscal 2004, BDC expanded its offices in St. John's, Moncton, Halton, Langley, Longueuil and Saint-Laurent. It also created temporary space in Québec City for the new Chaudière-Appalaches branch, which will move to a permanent site on the south shore of Québec City in fiscal 2005. These expansions will allow BDC to better serve its rapidly increasing client base. BDC plans to recruit additional employees to handle the expected increase in customer demand in future years.

## Loan Operations Productivity Ratio

for the years ended March 31 (percentage)




Other expenses of $57 million comprise staff training, publicity, marketing and miscellaneous office expenses. Such costs are closely monitored. Despite an $11-million increase in pension costs, the productivity ratio stood at the excellent level of 49 percent. This important measure compares operating expenses to net interest and other income, with a lower ratio indicating better productivity. At the same time, BDC maintained its client satisfaction rating at the 91-percent level in 2004, indicating concurrent high levels of employee productivity and client satisfaction.

The BDC registered pension plan (RPP) was, at December 2003, fully funded and continued to report an actuarial *funding* surplus that exceeded regulatory levels. Employer and employee contributions have been suspended since 1994 and 1997 respectively due to the funding surplus, although it is possible that contributions will be reinstated in the future. During calendar year 2003, the RPP surplus for *accounting* purposes increased from $42 million to $43 million, as the fund assets produced a positive return during the year.

The supplemental pension plans are largely non-funded and the actuarial deficit for accounting purposes on those plans was $33 million at December 2003. The actuarial deficit on other post-employment benefit plans (mainly healthcare) was $85 million and the annual cost of these plans amounting to $8.7 million has been charged to salary and benefit expense.

The latest actuarial projections show that the cost of the RPP will decrease in Fiscal 2005 as the realized gains on the fund assets in this past year will reduce the effect of prior years´ losses. The cost of benefit obligations to pensioners is expected to increase in fiscal 2005 due to higher healthcare costs and the effect of a lower interest rate used in actuarial projections of these obligations.

## CONSULTING OPERATIONS

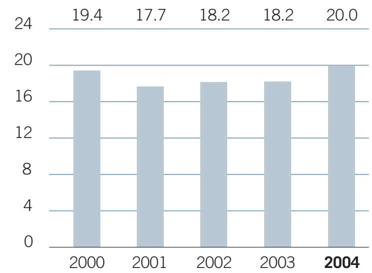
BDC changed the delivery of its consulting services in 2004 by integrating them with financial services. In addition to financing, loans managers review each client's needs to see whether the client can use any BDC Consulting products and will call upon Consulting managers to help in adding value to the client. Similarly, consulting managers are able to identify financing needs.

This change has led to a 10-percent increase in Consulting revenue from $18.2 million in fiscal 2003 to $20.0 million in fiscal 2004. Productivity increases resulted in a reduction of expenses keeping the operating loss at the $3.1-million level, despite a $0.9-million increase in pension costs. Excluding the pension cost increase, the profitability of Consulting operations increased by 30 percent.

In fiscal 2004, BDC had approximately 95 employees in the Consulting unit, with a national network of some 400 independent consultants who worked on more than 3,000 projects.

### Consulting Revenue

for the years ended March 31 ($ in millions)




## VENTURE CAPITAL

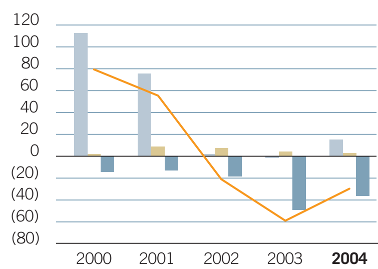
BDC Venture Capital has been in existence for over 20 years and has consistently ranked among the best venture capital investors in Canada.

Venture Capital's operating results for fiscal 2004 improved over fiscal 2003. Market conditions improved and there was a number of divestitures of successful investments, which resulted in net realized gains on investments of $12.7 million versus $3.7 million in 2003. Similarly, in 2004 the write-down on permanently impaired investments was $37 million, down from $50 million recorded in 2003, notwithstanding the higher portfolio. This created a loss from Venture Capital operations of $30.3 million, versus a loss of $59.5 million in fiscal 2003.

As the following graph demonstrates, Venture Capital results are subject to market volatility. In strong stock performance years, BDC has benefited from gains on its venture capital investments. However, in poor market years, BDC continued to provide venture capital financing in spite of reduced income. In fiscal 2000 and 2001, BDC recorded Venture Capital profits of $80 million and $56 million respectively, but the market conditions of the past three years have been unfavourable. BDC expects that in fiscal 2005, a recovery will push the Venture Capital results back towards a break-even point, if market conditions continue to improve during the year.

### Venture Capital Operations

for the years ended March 31 ($ in millions)

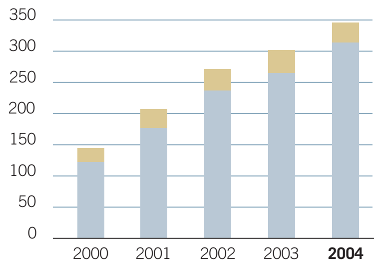



| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Net gains (losses) on investments | 112.7 | 75.8 | 1.7 | (1.9) | **14.9** |
| Other income | 1.6 | 8.4 | 7.0 | 4.0 | **2.7** |
| Write-down of investments | (14.7) | (13.3) | (18.9) | (50.0) | **(36.8)** |
| Venture capital operating profit (loss) | 80.0 | 56.2 | (21.0) | (59.5) | **(30.3)** |

During fiscal 2004, Venture Capital activities continued at a rapid pace. BDC authorized 68 direct investments during the year for $87 million with $44 million or 50 percent being first-round investments. In addition, $22 million in venture funds was authorized in fiscal 2004, which increased the total investments authorized to $109 million, $16 million more than the previous year. These investments boosted the net investment portfolio to $346 million from $302 million in 2003, with fair market value at approximately $366 million. Such assets are carried at cost, less any write-downs for permanent impairment. The fair market value of BDC's investments will fluctuate in future years as a function of prevailing market conditions and the risk inherent in the portfolio.

## Venture Capital – Total Investments Outstanding

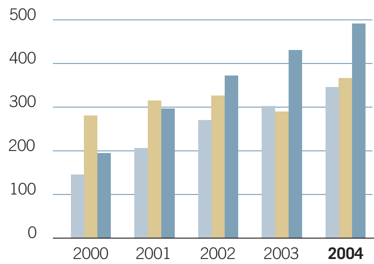
as at March 31 ($ in millions)



| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Direct investments | 123 | 178 | 237 | 265 | **314** |
| Venture funds | 22 | 28 | 34 | 37 | **32** |
| **Total investments** | 145 | 206 | 271 | 302 | **346** |

## Valuation of Venture Capital – Total Investments

as at March 31 ($ in millions)



| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Carrying value | 145 | 206 | 271 | 302 | **346** |
| Fair market value | 281 | 314 | 327 | 288 | **366** |
| Commitment | 195 | 296 | 374 | 430 | **491** |

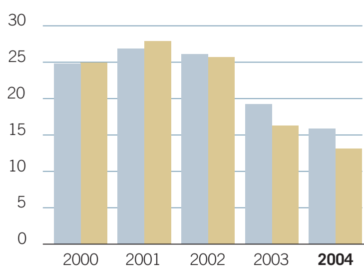
BDC has also invested in specialized venture capital funds, with a commitment of $60 million, of which $20 million has been disbursed to date.

BDC Venture Capital uses the internal rate of return (IRR) standard to measure the performance of the investment portfolio. IRR is the rate at which the present value of the cash flows equals the cost of the original investment. Part of this measure is dependent on an estimate of the current fair market value of assets.

In fiscal 2004, the 10-year IRR on direct investments was 15.9 percent, compared to 19.2 percent in 2003, reflecting prevailing market conditions over the past few years. The overall portfolio's IRR, which includes the seed and specialized funds, decreased from 16.3 percent in fiscal 2003 to 13.1 percent in 2004, showing both our increased asset base and the slow return to health of the venture capital industry.

## Venture Capital 10-year Internal Rate of Return

for the years ended March 31 (percentage)



| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Direct investments | 24.8 | 26.9 | 26.1 | 19.2 | **15.9** |
| Total investments | 24.9 | 27.9 | 25.6 | 16.3 | **13.1** |

## BALANCE SHEET

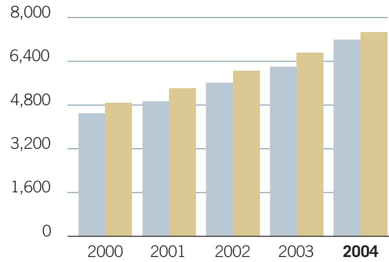
Total assets increased in fiscal 2004 from $7.8 billion to $8.8 billion, driven primarily by increases of $689 million and $44 million in the net loan and net investment portfolios respectively.

BDC operates within established liquidity parameters to ensure that sufficient funds are available to meet customer needs, while taking a balanced approach to money market requirements. Cash, short-term investments and securities at year-end amounted to $865 million, compared to $794 million at March 31, 2003.

The portfolios and liquidity assets totalling $8.2 billion comprise the principal assets of BDC and are funded by borrowings of $7.2 billion and shareholder's equity of $1.2 billion. Borrowings increased by $1.0 billion to fund the $0.7 billion growth in net portfolio, an increase in cash and securities of $71 million and the increase in unrealized gains and amounts receivable on derivatives of $201 million (shown in the Other assets note).

### Total Outstanding Loans vs Borrowings

as at March 31 ($ in millions)




| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Borrowings | 4,483 | 4,949 | 5,597 | 6,174 | **7,181** |
| Loans | 4,903 | 5,412 | 6,071 | 6,715 | **7,465** |

Fixed assets of $41 million comprise furniture, leasehold improvements and capitalized information technology investments, net of amortization.

Other assets of $580 million include unrealized gains and amounts receivable of $504 million on derivative financial instruments. They are offset by $102 million in unrealized losses and $101 million in accrued interest on borrowings.

Total shareholder's equity at year-end was $1,218 million, including an increase of $48 million in retained earnings net of dividends. This capital base will help BDC provide more support for the growing needs of small businesses. In fiscal 2003, BDC introduced a new common share dividend policy. The dividend is calculated based on a formula that takes into consideration BDC's financial performance. The dividend is applicable only to "new" common shares issued after fiscal 2002. For the eighth consecutive year, BDC declared a dividend payable to the Government of Canada. The total amount for fiscal 2004 was $10.7 million – $0.4 million on common shares based on fiscal 2003 performance, and $10.3 million on preferred shares – resulting in a cumulative total dividend of $77.7 million since fiscal 1997.

In addition, based on BDC's fiscal 2004 performance, common dividends of $3.3 million will be declared and paid in fiscal 2005.

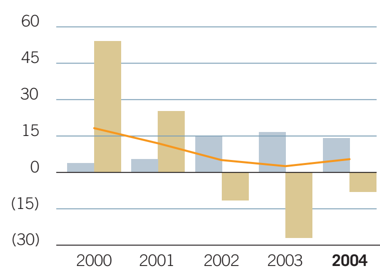
For the year ended March 31, 2004, BDC operated within all statutory limits stipulated in the *Business Development Bank of Canada Act*. At year-end, the debt-to-equity ratio was 5.9:1, comfortably better than the statutory limit of 12:1.

### Return on Common Equity

The return on common equity in fiscal 2004 increased almost twofold to 5.1 percent, from the 2.7 percent in 2003, as a result of strong Loans operations and the slight improvement in Venture Capital operations. The return on equity for Loans and Consulting operations, calculated on a stand-alone basis, was 14.1 percent for fiscal 2004 compared to 16.5 percent for 2003.

### Return on Common Equity

for the years ended March 31 (percentage)




| | 2000 | 2001 | 2002 | 2003 | **2004** |
|---|---|---|---|---|---|
| Loans and Consulting | 3.7 | 5.5 | 15.1 | 16.5 | **14.1** |
| Venture Capital | 54.1 | 25.2 | (11.6) | (27.0) | **(8.1)** |
| Total Bank | 18.7 | 12.6 | 5.7 | 2.7 | **5.1** |

## CORPORATE PLAN DISCUSSION

### Loans Operations: Comparison with 2004 Plan

Loan authorizations of $2.083 billion were essentially on Plan. Following high levels of authorizations in the last few years, the portfolio stood at $7.5 billion, also on Plan. BDC achieved Plan levels despite the negative market influences from SARS, Hurricane Juan, BSE and the forest fires in Western Canada. BDC met its operational objectives primarily as a result of the continued strong showing in Quebec, where loan authorizations increased by 20 percent in 2004.



Loan loss provisions of $118 million were slightly better than Plan, reflecting the good credit performance of the portfolio in 2004. Consequently, the net margin generated by the loan portfolio in 2004 was on Plan. BDC continued to take a prudent approach to loss provisioning, and maintained the general allowance at the same ratio as contemplated in the Corporate Plan, while the specific allowance driven by impaired loans increased slightly.

Operating and administrative expenses were tightly controlled. At $200 million, they were in line with Plan, reflecting steady employee productivity, sound internal controls and effective budgetary processes.

With all of the above factors performing well, the net income from Loans operations was $93 million for the year, better than the Plan level of $90 million.

*2005 Corporate Plan Outlook*

BDC expects continued growth in 2005, in both portfolio size and profitability – loan authorizations of $2.3 billion are targeted to increase the portfolio to $8.4 billion, while increasing risk is expected to require loss provisions of $140 million, compared to $118 million in fiscal 2004. BDC foresees the need for additional staff to handle the extra business and expects operating expenses to increase to $210 million. Barring any major changes to the Canadian economy, we see profit increasing to $105 million in 2005.

### Venture Capital: Comparison with 2004 Corporate Plan

Fiscal 2004 saw a return to growth in public market performance, which in turn strengthened divestitures during the year – investment income of $18 million was $12 million more than Plan. This increase was offset by write-downs of $37 million, which were $11 million more than Plan. Investment activity continued at a steady pace during the year. BDC authorized $109 million in total investments which was below the Plan level of $122 million. This unfavourable $13-million variance in authorizations was due mainly to a lower than anticipated level of direct investments. Operating expenses of $11 million were $3 million lower than Plan, and the net loss of $30 million was $4 million better than Plan.

*2005 Corporate Plan Outlook*

The Plan projects that market conditions will continue to improve and that Venture Capital's financial performance will gradually improve in fiscal 2005, with $102 million in direct authorizations, $30 million in revenues, $20 million in potential write-downs and a net loss of $5 million. Venture Capital portfolio is expected to grow to the $440-million range, by the end of fiscal 2005.

In the March 2004 budget, the Government of Canada announced its intention to invest $250 million of common equity in BDC. These monies have been earmarked in the following manner.

- $100 million in pre-seed and seed investments to nurture embryonic technologies
- $50 million to invest directly in innovative start-up and early-stage companies to further support the commercialization of enabling technologies
- $100 million to support the creation of specialized venture capital funds, to leverage additional private equity investment in leading-edge technologies.

Over the next several years, these investments will help BDC to fill gaps in the Canadian venture capital marketplace.

The typical cycle of venture capital investment is five to seven years so the returns from these investments will likely not be seen immediately.

## INTEGRATED RISK MANAGEMENT

### Overview

Sound risk management practices are designed to help BDC achieve its objectives and execute its strategies consistently with its mandate. BDC has well-established processes for evaluating and managing its business risks. Overall business risks are grouped into three risk categories: credit, market and operational. BDC considers all of its business risks on an integrated basis when making key operating decisions. For example, last fall Management and the Board approved a market strategy called Pricing for Risk, geared towards pricing risk appropriately while growing BDC's portfolio in target markets. The analysis leading and supporting the formulation of this strategy was conducted in the context of an overview of all BDC's risks and a strategic planning meeting prior to preparing the 2005-2009 Corporate Plan.



## RISK MANAGEMENT STRUCTURE AND RESPONSIBILITIES

### Board of Directors

- Approve risk policies, risk appetite and strategies.
- Ensure risk management and control framework is effective.
- Review portfolio and major risks and management plans.
- Review capital adequacy.

### Senior Management Team

- Establish risk and control framework.
- Identify, assess, mitigate, measure and report risk.
- Identify major risks and implement appropriate action plans.
- Recommend risk management policies and strategies.
- Identify risk owners and responsibilities and allocate resources.

### Asset and Liability Committee

Oversee Treasury funding activities and compliance with risk policies including matching of assets and liabilities.

### Credit Committee

Review and approve large loan transactions or recommend them to BDC's Credit and Investment Committee.

### Strategic Business Council

- Define target markets and gaps.
- Integrate management of projects affecting credit risk management and operations.

### Portfolio Outlook

Review loan portfolio concentrations, risk migration and quality and recommend actions.

**Governance:** The Board recently reviewed its governance practices, which were determined to be in accordance with best practices.

The Senior Management Team is responsible for all risks. Each year, identification of business risks is re-assessed through the Business Functional Unit Plan. Each unit is responsible for identifying the risks associated with achieving its objectives and running the business. These risks are then compiled into a Corporate Integrated Risk Management Plan and Management identifies the top 10 risks for BDC. The Board reviews these risks along with the action plan.

In addition, the Board receives regular risk reports from Management about BDC's exposure to emerging risks. The Integrated Risk and Portfolio Management Group, which reports directly to the Executive Vice President, Integrated Risk and Technology Management, coordinates these activities. It also manages the loan portfolio and determines BDC's asset and liability positions, thus supporting risk management of key operational groups such as Loans, Venture Capital, Credit Risk Management, Treasury and others.

**Asset and Liability Committee:** The Asset and Liability Committee, which includes senior officers of BDC's risk management function, periodically reviews the policies governing credit, market and liquidity risks related to BDC's operations. The Committee's policies are approved by the Board and ensure financial risks are responsibly managed to safeguard BDC's capital. These policies comply with the Department of Finance's financial risk management guidelines and industry best practices.

**Portfolio Outlook:** On a quarterly basis, Management holds a Portfolio Outlook meeting to oversee loan portfolio trends, risk indicators, concentrations, portfolio studies and loan quality assessments. Reports reviewed and decisions recommended form the basis of Management's actions and information for the Board.

**Strategic Business Council:** BDC's Strategic Business Council regularly reviews the relationship between business solutions, risk appetite and credit risk assessment tools. These elements are enhanced or revised as required to more flexibly meet the needs of clients and BDC's risk objectives. Therefore, the Council performs a loan portfolio risk integration role.

**Audit and Inspection:** BDC's Audit and Inspection team reviews branches and their loan portfolios for credit risk and compliance with policies and procedures in support of BDC objectives. Seventy percent of branches reviewed achieved the highest rating.

**Capital Management:** As a complementary lender, BDC is facing and purposely targeting higher levels of credit risk than the majority of private sector financial institutions. As such, sufficient earnings are required not only to compensate for this risk and maintain an adequate level of capital to cover expected and unexpected losses, but also to increase capital to enable BDC to grow its portfolio by providing additional financing to entrepreneurs. BDC's underlying capital management philosophy is to maximize the shareholder's objective to support active and healthy businesses while ensuring self-sufficiency in terms of financial strength to cover all phases of an economic cycle.

BDC has developed an economic capital model based on its own experience and industry best practices for measuring and monitoring capital adequacy. The model is used to measure the capital required to support expected and unexpected losses in credit risk, as well as market and operational risks. Capital adequacy is managed to ensure compliance with the 12:1 debt-to-equity ratio required by the *Business Development Bank of Canada Act*. Capital requirements for future growth are reviewed in the context of growth and risk tolerance objectives with Management, the Board and the shareholder annually when preparing the Corporate Plan.

BDC also operates within certain ratios between debt and equity according to various categories of financing, to determine the adequacy of its capital base.

| | |
|---|---|
| Commercial Lending | 10:1 |
| Subordinate Financing | 4:1 |
| Venture Capital | 1:1 |

## CREDIT RISK

### Loan Portfolio Risk Management

**Loan Credit Risk:** *Loan credit risk is the risk of financial loss that arises from the possibility of default on a loan.*

BDC's mandate requires it to lend to a high-risk segment of the Canadian commercial loan sector. As the portfolio comprises a disproportionately large volume of small loans, it is not possible to attribute ratings of independent credit agencies. Thus, credit decisions are based on the application of BDC's credit experience with like customers. Policies and procedures, together with risk assessment tools, support these business decisions. All loans are assessed within a risk-rating framework which is closely linked to a risk-pricing tool. The risk rating provides the basis for underwriting and management of all loans in the portfolio. Reports are routinely provided to Management and the Board. Underwriting decisions are decentralized and are subject to independent review and audit. All BDC's account managers and other managers across Canada are trained to assess overall credit risk.

**Environmental Risk:** *Environmental risk is a financial loss resulting from a loan with an environmental hazard that was unforeseen or improperly managed.*

BDC has a well-defined process for identifying and evaluating environmental risk at the time of authorization of a loan and a monitoring process to ensure that potential environmental risks continue to be identified and appropriately managed throughout the term of a loan.

#### Loan Portfolio Management

A portfolio management system provides BDC with weekly information on five key risk indicators for new loans and nine portfolio performance indicators. The system allows Management to quickly identify trends. Risk indicators are broken down by industry, geographic sector, business solution, loan size or any combination thereof. Exception reports enable Management to focus attention on corrective action as required. This system is cutting-edge in terms of risk management best practices, which allows BDC to take on risk in line with its mission.

#### Portfolio Strategies

The Strategic Business Council analyzes data and recommends portfolio strategies. Comprised of representatives from different areas of BDC, including field operations, marketing, portfolio risk management and credit risk management, each member ensures a balanced and integrated view of both market and risk strategies. As such, the Council supports the Senior Management Team and the Board in defining market gaps and implementing portfolio and market strategies.

### Loan Impairment

A special loans group manages accounts which are impaired or at risk of becoming impaired due to adverse market conditions. Despite significant increases in loan volumes, impaired loans amounted to $320 million at March 2004, compared to $280 million a year ago. The specific allowance for credit losses of $115 million is considered to be sufficient to cover the net loss exposure of these loans.

A general allowance of $373 million, representing 5.2 percent of the performing portfolio as at March 31, 2004, has been established. Based on its credit loss history over the past 20 years, BDC considers this allowance to be sufficient to cover the losses on the portfolio of performing loans of $7.1 billion.

**Loan Portfolio Concentration Risk:** *Concentration risk is the risk of several loans or borrowers in the same segment defaulting at the same time.*

Within the domestic Canadian economy, BDC's loan portfolio is well diversified – geographically, by industry sector and by stage of development.

## Treasury Credit Risk

**Liquidity Investments:** *Liquidity investment risk is the risk incurred when the quality of the issuing institution deteriorates during the transaction period, resulting in a loss for BDC.*

BDC's Treasury Department's primary responsibility with liquidity management is to ensure that BDC has the capacity to meet its payment obligations on a timely and cost-effective basis. BDC has a well-defined liquidity and investment management policy. The application of the policy is monitored daily by the Integrated Risk and Portfolio Management team. As such, limits are set on the funding and investment profile of the liquidity portfolio and minimum/maximum liquidity levels are calculated based on projected net cash outflows, thereby covering payment and commitment risks. BDC's policy provides clear guidelines for issuing institutions, all of which are rated above A-. As at March 31, 2004, 89 percent of BDC's liquidity investments were to mature within three months.

## Risk Exposure in Cash, Short-Term Investments and Securities

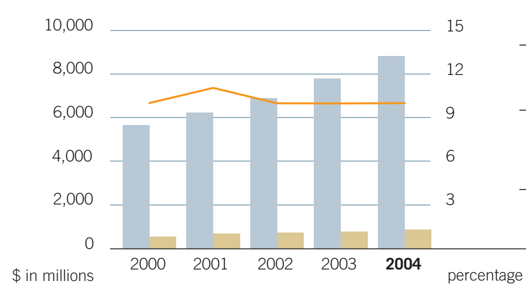
as at March 31, 2004 ($ in millions)

| | Term to maturity | | |
|---|---|---|---|
| Credit rating* | Less than 3 months | 3 months to 1 year | 1 to 5 years |
| AAA | 123.8 | 0.0 | 0.0 |
| AA- to AA+ | 342.0 | 9.9 | 82.1 |
| A to A+ | 307.6 | 0.0 | 0.0 |
| Total | 773.4 | 9.9 | 82.1 |

* From major credit agencies

## Liquidity Ratio

as at March 31




| | 2000 | 2001 | 2002 | 2003 | 2004 |
|---|---|---|---|---|---|
| Total assets (amount) | 5,666 | 6,226 | 6,897 | 7,791 | **8,809** |
| Cash, short-term investments and securities (amount) | 578 | 674 | 715 | 794 | **865** |
| Liquidity ratio | 10% | 11% | 10% | 10% | **10%** |

**Derivative Instruments:** *Issuer/counterparty risk is the risk of the non-performance of a counterparty and the possible default of a treasury asset or risk transfer transaction, such as a derivative instrument.*

BDC has established credit limits under its counterparty credit risk policy to monitor and manage the credit risk of derivatives. Counterparty credit risk exposure arises when such instruments have positive market value. BDC has entered into International Swaps and Derivatives Association (ISDA) agreements with counterparties to derivative transactions in accordance with industry practice. During the year, ISDA agreements have been renewed to include a credit support document which defines a collateral threshold amount required to protect BDC against risks such as a potential downgrading associated with a counterparty. It is also intended to limit credit risk exposure related to increases in market value of derivative products beyond a certain tolerance threshold.

### Counterparty Credit Risk Exposure

as at March 31, 2004 ($ in millions)

| | Term to maturity | | | |
|---|---|---|---|---|
| | Gross exposure | | | |
| Credit rating* | Less than 1 year | 1 to 3 years | 3 years and over | Net exposure** |
| AAA | 0.0 | 0.0 | 0.4 | 0.4 |
| AA- to AA+ | 1.7 | 17.6 | 247.3 | 51.2 |
| A to A+ | 7.7 | 38.2 | 100.2 | 59.9 |
| Total | 9.4 | 55.8 | 347.9 | 111.5 |

* From major credit agencies
** After the impact of master netting agreements and collateral held by BDC.

## MARKET RISK

*Market risk is the risk that the value of assets, liabilities or other financial instruments will vary because of changes in market prices, resulting in losses for BDC.*

Market risk includes exposure to interest rates, foreign exchange, liquidity and equity prices.

BDC funds its financing activities by issuing money market instruments (commercial paper) and capital market long-term notes. BDC monitors and manages the market risk exposures associated with these borrowing activities. Market risk factors, such as foreign exchange, equity or commodity prices, or other possible risk factors arising from funding activities are hedged by BDC at the transaction level. Movements in Canadian interest rates comprise the residual market risk exposure.

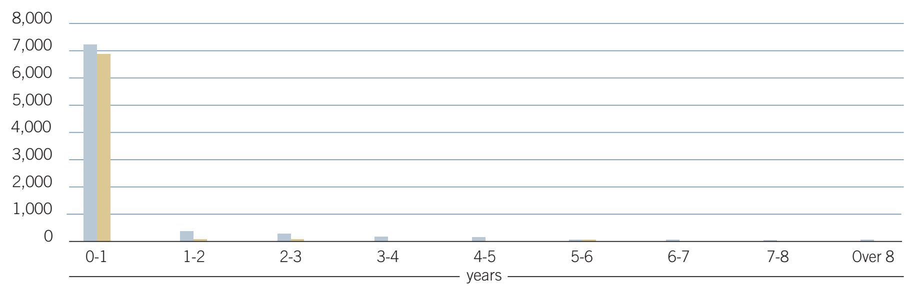
**Interest Rate Risk:** *Interest rate risk is the risk that market rate fluctuations lead to loss in value of financial instruments.*

Interest rate risk occurs when the terms of BDC's borrowings are not matched with the terms of its loans. BDC uses borrowing strategies and derivative instruments to minimize these differences.

The following graph shows the matching of BDC's lending assets with the borrowings that fund them as at March 31, 2004, accounting for the effect of derivative instruments.

### Interest Rate Sensitivity Asset and Liability Gap

as at March 31, 2004 ($ in millions)




| | 0-1 | 1-2 | 2-3 | 3-4 | 4-5 | 5-6 | 6-7 | 7-8 | Over 8 |
|---|---|---|---|---|---|---|---|---|---|
| Assets | 7,221 | 373 | 285 | 172 | 154 | 41 | 26 | 21 | 30 |
| Liabilities | 6,888 | 90 | 90 | – | – | 50 | – | – | – |

The Treasury Market Risk Management Policy provides guidance for the proactive management of market risk exposure arising from potential adverse movements in interest rates. The purpose of the policy is to minimize the impact of these variations on net interest income stability and BDC's economic value. As such, the policy sets the following controls and limits to ensure the appropriate matching of BDC's loan portfolio with equity and required debts.

- Sensitivity of economic value of equity by measurement of duration and value-at-risk (VAR). For this purpose, BDC uses a 99-percent confidence interval and a one-year moving historical database.
- Extreme test related to the variability of projected net interest income for the next 12 months, under a 2-percent interest rate variance scenario.

**Foreign Exchange Risk:** *Market fluctuations in foreign currencies when compared to local currency produce a loss in value.*

Loan assets are maintained in Canadian dollars, while borrowing liabilities originated in foreign currency are converted at the transaction level to Canadian dollars through the use of currency swaps and currency forward contracts.

**Venture Capital Investments:** By definition, venture capital investments are high risk. The return on the investment portfolio depends on the divestitures of successful investments. Successful investments are realizable privately or through transactions on public financial markets that depend on equity prices. BDC mitigates such risks through conservative valuation, syndication of investments and regular monitoring and divests its holdings on a phased basis, taking into account market conditions and applicable restrictions on such transactions.

## OPERATIONAL RISK

*Operational risk is the risk of potential losses arising from day-to-day errors caused by people, processes or systems, or from rare but severe events, such as natural disasters.*

BDC has well-defined internal control systems and processes in place for its business transactions. A comprehensive set of policies and procedures governs information processing, Loan operations, human resources management and other key operational functions. BDC's review of its top 10 risks includes action plans intended to address operational risks.

BDC has a comprehensive business recovery planning process to ensure continuity of its key business functions in case of disaster. It successfully tested this process during the year and continues to review and improve its contingency planning.

BDC manages the risks associated with technology and telecommunication failures through programs for replacement of computer systems and equipment. Security and control procedures are in place to respect privacy standards and to ensure that information is managed accurately and efficiently.

Written-off accounts are reviewed and the operational risks associated with loan operations are identified. From a compilation of these risks, BDC has pinpointed the risks that occur most often and established a training program, one of the aims of which is to eliminate the main behaviours underlying these operational losses.

# Management's Responsibility for Financial Information

The financial statements of the Business Development Bank of Canada were prepared and presented by Management in accordance with Canadian generally accepted accounting principles on a basis consistent with that of the preceding year. The information contained therein normally includes amounts requiring estimations which have been made based upon informed judgment as to the expected results of current transactions and events. The financial information presented elsewhere in this annual report is consistent with the financial statements.

In discharging its responsibility for the integrity, fairness and quality of the financial statements and for the accounting systems from which they are derived, Management maintains a system of internal control designed to provide reasonable assurance that transactions are authorized, assets are safeguarded and proper records are maintained. The system of internal control is augmented by audit and inspection staff who conduct periodic reviews of different aspects of the Bank's operations. In addition, the Vice-President, Audit and Inspection and the independent auditors have full and free access to the Audit Committee of the Board of Directors which is responsible for overseeing and reviewing management's internal control and reporting responsibilities. The Board of Directors, through the Audit Committee which is comprised of Directors who are not employees of the Bank, is responsible for reviewing and approving the audited annual financial statements.

The Bank's independent auditors, KPMG LLP, Chartered Accountants and the Auditor General of Canada have audited the Bank's financial statements and their report indicates the scope of their audit and their opinion on the financial statements.

André Bourdeau
Acting President and Chief Executive Officer

Alan B. Marquis
Senior Vice-President, Finance and Chief Financial Officer

Montreal, Canada
May 18, 2004

# Auditors' Report

To the Minister of Industry:

We have audited the balance sheet of the Business Development Bank of Canada as at March 31, 2004 and the statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Bank as at March 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the Bank that have come to our notice during our audit of the financial statements have, in all significant respects, been in accordance with Part X of the *Financial Administration Act* and regulations, the *Business Development Bank of Canada Act* and the by-laws of the Bank.

KPMG LLP
Chartered Accountants

Montreal, Canada
May 18, 2004

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 18, 2004

# Financial Statements



**BALANCE SHEET**

as at March 31 *($ in thousands)*

| | 2004 | 2003 |
|---|---|---|
| **ASSETS** | | |
| Cash and short-term investments (Note 3) | **$ 773,365** | $ 730,717 |
| Securities (Note 4) | **92,084** | 63,259 |
| | **865,449** | 793,976 |
| Loans, net of allowance for credit losses (Notes 5 and 6) | **6,977,544** | 6,288,636 |
| Venture capital investments (Note 7) | **345,624** | 301,945 |
| | **7,323,168** | 6,590,581 |
| Fixed assets, net of accumulated amortization | **40,669** | 33,712 |
| Other assets (Note 8) | **579,932** | 373,090 |
| | **620,601** | 406,802 |
| **TOTAL ASSETS** | **$ 8,809,218** | $ 7,791,359 |
| **LIABILITIES AND SHAREHOLDER'S EQUITY** | | |
| Accounts payable and accrued liabilities | **$ 58,297** | $ 56,555 |
| Accrued interest on borrowings | **121,329** | 89,151 |
| | **179,626** | 145,706 |
| Borrowings (Note 9) | | |
| Short-term notes | **3,383,398** | 3,265,368 |
| Long-term notes | **3,797,704** | 2,908,520 |
| | **7,181,102** | 6,173,888 |
| Other liabilities (Note 10) | **230,031** | 301,748 |
| **SHAREHOLDER'S EQUITY** | | |
| Share capital (Note 11) | **788,400** | 788,400 |
| Contributed surplus | **27,778** | 27,778 |
| Retained earnings | **402,281** | 353,839 |
| | **1,218,459** | 1,170,017 |
| Guarantees, contingent liabilities and commitments (Note 16) | | |
| **TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY** | **$ 8,809,218** | $ 7,791,359 |

The accompanying Notes to Financial Statements are an integral part of this statement.

Approved by the Board:

Terry B. Grieve, CA
Director
Chairperson Audit Committee

André Bourdeau
Director
Acting President and Chief Executive Officer

# Financial Statements

## STATEMENT OF INCOME AND RETAINED EARNINGS

For the years ended March 31 *($ in thousands)*

| | 2004 | 2003 |
|---|---|---|
| **LOANS** | | |
| Interest income | | |
| Interest on loans | **$ 540,859** | $ 490,027 |
| Short-term investments and securities | **27,194** | 24,747 |
| | **568,053** | 514,774 |
| Interest expense | **189,911** | 176,618 |
| Net interest income | **378,142** | 338,156 |
| Provision for credit losses (Note 6) | **118,000** | 98,000 |
| Net interest income after provision for credit losses | **260,142** | 240,156 |
| Other income | **32,534** | 30,800 |
| Income before operating and administrative expenses | **292,676** | 270,956 |
| Operating and administrative expenses (Note 12) | **200,121** | 176,449 |
| Income from Loans | **92,555** | 94,507 |
| **CONSULTING** | | |
| Revenue | **20,006** | 18,221 |
| Operating and administrative expenses (Note 12) | **23,141** | 21,363 |
| Loss from Consulting | **(3,135)** | (3,142) |
| **VENTURE CAPITAL** | | |
| Interest and dividends | **1,410** | 1,782 |
| Net realized gains on investments | **12,749** | 3,752 |
| Unrealized gains (losses) on temporary investments | **2,196** | (5,606) |
| Other | **1,242** | 2,237 |
| Investment income | **17,597** | 2,165 |
| Write-down of investments | **36,770** | 50,041 |
| Net investment loss | **(19,173)** | (47,876) |
| Operating and administrative expenses (Note 12) | **11,126** | 11,609 |
| Loss from Venture Capital | **(30,299)** | (59,485) |
| **NET INCOME** | **59,121** | 31,880 |
| **RETAINED EARNINGS** | | |
| Beginning of year | **353,839** | 334,142 |
| Dividends on common shares | **(397)** | – |
| Dividends on preferred shares | **(10,282)** | (12,183) |
| **END OF YEAR** | **$ 402,281** | $ 353,839 |

The accompanying Notes to Financial Statements are an integral part of this statement.

# Financial Statements



**STATEMENT OF CASH FLOWS**

For the years ended March 31 *($ in thousands)*

| | 2004 | 2003 |
|---|---|---|
| **CASH FLOWS PROVIDED BY OPERATING ACTIVITIES** | | |
| Net income | $ 59,121 | $ 31,880 |
| Adjustments to determine net cash flows: | | |
| Net realized gains on venture capital investments | (12,749) | (3,752) |
| Unrealized losses (gains) on venture capital temporary investments | (2,196) | 5,606 |
| Provision for credit losses and write-down of venture capital investments | 155,471 | 148,660 |
| Amortization of fixed assets | 9,004 | 8,977 |
| Changes in operating assets and liabilities: | | |
| Change in interest receivable on loans | (513) | (1,201) |
| Change in accrued interest on borrowings | (11,633) | (21,225) |
| Translation adjustment on borrowings and securities | 122,646 | (54,520) |
| Net change in unrealized gains and amounts receivable on derivative financial instruments | (200,996) | (149,282) |
| Net change in unrealized losses and amounts payable on derivative financial instruments | (33,121) | 123,672 |
| Net change in other assets and other liabilities | 1,518 | (1,315) |
| **NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES** | 86,552 | 87,500 |
| **CASH FLOWS USED IN INVESTING ACTIVITIES** | | |
| Net change in securities | (32,791) | 15,342 |
| Net change in securities purchased under resale agreements | (22,516) | 89,823 |
| Disbursements for loans | (2,074,051) | (2,141,799) |
| Disbursements for venture capital investments | (91,171) | (102,254) |
| Repayments of loans | 1,267,656 | 1,425,877 |
| Proceeds on sales of venture capital investments | 25,667 | 19,478 |
| Net acquisition of fixed assets | (15,961) | (13,777) |
| **NET CASH FLOWS USED IN INVESTING ACTIVITIES** | (943,167) | (707,310) |
| **CASH FLOWS PROVIDED BY FINANCING ACTIVITIES** | | |
| Issue of long-term notes | 1,716,473 | 1,472,654 |
| Repayment of long-term notes | (883,182) | (729,965) |
| Net change in short-term notes | 55,243 | (107,270) |
| Proceeds from issue of common shares | – | 190,000 |
| Dividends paid on common and preferred shares | (11,787) | (17,510) |
| **NET CASH FLOWS PROVIDED BY FINANCING ACTIVITIES** | 876,747 | 807,909 |
| **Net increase in cash and cash equivalents** | 20,132 | 188,099 |
| **Cash and cash equivalents at beginning of year** | 655,740 | 467,641 |
| **Cash and cash equivalents at end of year (note 3)** | $ 675,872 | $ 655,740 |
| **SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION** | | |
| Amount of interest paid in the year | $ 201,544 | $ 197,843 |

The accompanying Notes to Financial Statements are an integral part of this statement.

# Notes to Financial Statements

March 31, 2004 *($ in thousands except as otherwise indicated)*



## 1. ACT OF INCORPORATION, OBJECTIVES AND OPERATIONS OF THE CORPORATION

The Business Development Bank of Canada (BDC) is a Crown corporation which was established by an Act of Parliament on December 20, 1974 as the Federal Business Development Bank, and continued under its current name by an Act of Parliament on July 13, 1995. The Bank is wholly-owned by the Government of Canada and is exempt from income taxes.

The objectives of the Bank are to promote and assist in the establishment and development of business enterprises in Canada, especially small and medium-sized businesses, by providing a wide range of lending, investment and consulting services complementary to those of commercial financial institutions. The Bank offers to Canadian companies services tailored to meet the current needs of small and medium-sized businesses while earning an appropriate return on investment capital, which is used to further the Bank's activities.

To finance these objectives, the Bank issues debt instruments which are secured by the Government of Canada. *The Business Development Bank of Canada Act* also allows the issuance of hybrid capital instruments to provide the capital required for meeting the growing financial needs of Canadian small and medium-sized businesses. The Crown would not be liable for payment of amounts owing under such capital instruments.

## 2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles. As such, the preparation of financial statements requires that management make estimates and assumptions that affect reported amounts and disclosures in these statements. Actual results could differ from those estimates. Significant estimates include allowances for losses on loans and consideration of write-downs and disclosure of fair values of venture capital investments. A variation in the circumstances or economic conditions under which these estimates are made could result in a significant change in these management judgments. The significant accounting policies used in the preparation of these financial statements are summarized below.

***Securities***

Debt securities are carried at amortized cost with premiums and discounts amortized over the period to maturity. Where there has been a decline in value of a security that is other than temporary, the carrying value of the security is appropriately reduced. Interest revenue, gains and losses on disposal and adjustments to record any impairment in value that is other than temporary are included in income.

***Loans***

Loans are stated at principal amounts including accrued interest receivable, net of allowance for credit losses. Interest on loans is recorded as income on an accrual basis except for loans which are considered impaired.

Joint venture investments in loan portfolios are recorded using the proportionate consolidation method whereby the Bank's prorata share of each of the assets, liabilities, revenues and expenses that are subject to joint control is combined with similar items in the financial statements.

Loans are classified as impaired when there is a deterioration in credit quality to the extent that the Bank no longer has reasonable assurance that the full amount of principal and interest will be collected. When a loan becomes impaired, recognition of interest income ceases and any previously accrued interest that is unpaid is reversed against interest income. Any interest received on impaired loans is applied to the carrying amount of the loan unless the loan is fully secured and does not require a specific allowance, in which case interest income is recognized on a cash basis.

For impaired loans measured on the basis of expected future cash flows, as explained under *Allowance for credit losses*, the increase in present value attributable to the passage of time is recorded as interest income.

***Allowance for credit losses***

The allowance for credit losses is maintained at a level considered adequate to absorb the credit losses existing in the Bank's portfolio. It reflects management's best estimate of losses existing in the loan portfolio at the balance sheet date. The allowance is increased by an annual provision for credit losses which is charged against income and is reduced by write-offs, net of recoveries.

The allowance for credit losses is comprised of specific and general allowances.

Specific allowances are established on a loan-by-loan basis for impaired loans. The carrying amount of an impaired loan is reduced to its estimated realizable value by discounting the expected future cash flows at the effective interest rate inherent to the loan or, if cash flows cannot be reasonably determined, by using the estimated fair value of any underlying security, net of realization costs. Initial allowances as well as subsequent changes thereto are recorded through the provision for credit losses as an adjustment to the specific allowance.

The general allowance represents the best estimate of probable impairment attributable to the deterioration of credit quality in the remaining portfolio for which specific allowances cannot yet be determined. The amount is estimated based on historical loss experience and management's assessment of general economic and business conditions affecting the lending operations, recent loan loss experiences and trends in the credit quality of the loan portfolio.

## 2. SIGNIFICANT ACCOUNTING POLICIES (continued)

***Venture capital investments***

Venture capital investments are recorded at cost, whereby interest and dividends are included in income when received. Investments in specialized funds and seed capital funds over which the Bank has joint control or significant influence are accounted for using the proportionate consolidation or equity accounting method, respectively. Under these methods, the Bank accrues its share of the undistributed income or expenses of the funds. Gains or losses on disposal of investments are recognized in income when realized. However, when the value of an investment is permanently impaired, the investment is written down to recognize the loss.

Non-cash consideration received on disposal of investments is presented as temporary investments within venture capital investments and recorded at the lower of the value at the date of sale of the venture capital investment and current market value at the balance sheet date.

***Fixed assets and amortization***

Fixed assets are recorded at cost and amortized over their estimated useful lives, using the straight-line method as follows:

| | |
|---|---|
| Computer equipment and software | 3-7 years |
| Furniture and fixtures | 5 years |
| Leasehold improvements | over the term of the lease, maximum 15 years |

***Premiums, discounts and debt issue expenses***

Premiums, discounts and expenses related to the issue of debt are amortized on a straight-line basis over the term of the obligations to which they pertain and are charged to interest expense.

***Translation of foreign currencies***

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates prevailing on the balance sheet date. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at average exchange rates for the year.

All exchange gains and losses are included in determining net income for the year.

***Derivative financial instruments***

The Bank enters into derivative financial instruments to manage the interest rate, foreign exchange rate and equity market exposures arising from on-balance sheet positions. The Bank's policy is not to use derivative financial instruments for trading or speculative purposes. The Bank formally documents all relationships between hedging instruments and hedged items. This process includes linking all derivatives to specific assets and liabilities on the balance sheet.

Derivative financial instruments such as interest rate swaps and forward rate agreements are used as hedges of interest rate risk resulting from the repricing of assets and liabilities. The Bank designates its interest rate hedge agreements as hedges of underlying borrowings. These derivatives are accounted for on an accrual basis with the related interest revenue or expense recognized over the life of the hedged position as an adjustment to interest expense and presented in other assets and in accrued interest on borrowings.

Derivative financial instruments such as cross-currency interest rate swaps, equity-linked swaps, and forward foreign exchange contracts are used as hedges for foreign currency and equity market risk resulting from foreign currency denominated or equity-linked borrowings. Unrealized foreign exchange and equity translation gains and losses on these derivative financial instruments are respectively accrued in other assets and liabilities on the balance sheet and are recognized in income, offsetting the respective translation gains and losses on the underlying foreign currency or equity-linked borrowings. The forward premium or discount on forward foreign exchange contracts is amortized as an adjustment of interest expense over the term of the forward contract.

Premiums paid or received with respect to derivative financial instruments are deferred and amortized to interest expense over the lives of the derivative contracts.

***Employee future benefits***

The Bank maintains defined benefit pension plans for eligible employees. Annual valuations are performed by independent actuaries to determine the present value of accrued pension benefit obligation using the projected benefit method prorated on service and management's best estimate of expected plan investment performance, compensation escalation, retirement ages of employees and other factors. The discount rate used to determine present value is based on market interest rates for long-term high-quality debt instruments. The Bank also maintains, non-funded, supplemental pension plans and other benefits for eligible employees.

Components of the change in the Bank's benefit obligations from year to year and the calculation of the benefit expense are as follows:

*Current service cost* represents benefits earned in the current year. These are determined with reference to the current employees and to the amount of benefits they will be entitled to upon retirement, based on the provisions of the Bank's benefit plans.

*Interest cost on benefit obligation* represents the increase in the pension obligations that results from the passage of time.

*Actuarial gains or losses* may arise in two ways. First, each year the Bank's actuaries recalculate the benefit obligations and compare them to those estimated as at the prior year-end. The differences that arise from changes in assumptions or from plan experience being different from what was expected by management at the prior year-end are considered actuarial gains or losses. Secondly, actuarial gains or losses are created when there are

# Notes to Financial Statements

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 2. SIGNIFICANT ACCOUNTING POLICIES (continued)

differences between expected and actual returns on plan assets. At the beginning of each fiscal year, the Bank determines whether the cumulative actuarial loss (gain) is more than 10% of the greater of the pension plans asset or benefit obligation balances. Any amount that exceeds this 10% corridor is amortized to expense over the remaining service period of the Bank's active employees. Amounts that fall within the 10% corridor are not amortized.

*Expected return on plan assets* represents management's best estimate of the long-term rate of return on assets applied to the fair value of plan assets. Differences between expected and actual returns on plan assets are included in the actuarial gains and losses described above.

*Amortization of transitional assets* relates to a change in an accounting policy that came into effect on April 1, 2000. At that date, the Bank had a transitional asset that is being amortized to income on a straight line basis over the active remaining service life of the Bank's active employees that ranged from 8.5 years for the Registered Plan to 13 years for the other plans.

*Pension and Other Employee Future Benefit Assets*
Assets are set aside to satisfy the Bank's pension obligation related to the BDC's registered pension plan. Retirement benefits for the other supplemental plans are paid out of operations. The Other plans, which include the Employee Future Benefit Liability, are unfunded.

***Future accounting changes***

*Hedging Relationships*
The CICA issued Accounting Guideline 13, Hedging Relationships, which will become effective for the Bank on April 1, 2004. This guideline establishes certain qualifying conditions for the use of hedge accounting, which are more stringent and formalized than those under current standards. Commencing April 1, 2004, all derivative financial instruments that do not qualify for hedge accounting will be carried at fair value in the balance sheet, and changes in their fair value will be recorded in the statement of income. The Bank has reassessed its hedging relationships and has identified a limited number of hedging relationships that do not meet the criteria established in the guideline for hedge accounting. The effect of applying the transitional provisions established in the guideline is not significant to the Bank's financial position as at April 1, 2004.

*Venture capital investments*
The CICA has amended certain accounting standards that, in fiscal 2005, will require equity accounting for any investments directly held in the venture capital portfolio that are considered subject to significant influence by the Bank. Currently, any such investments would be accounted for on a cost basis. The impact of adopting this new standard on the 2005 financial statements of the Bank has not yet been determined.

## 3. CASH AND SHORT-TERM INVESTMENTS

| | **2004** | 2003 |
|---|---|---|
| Bank account balances, net of cheques outstanding | **$ (13,157)** | $ (5,187) |
| Short-term bank notes | **689,029** | 660,927 |
| Cash and cash equivalents | **675,872** | 655,740 |
| Securities purchased under resale agreements | **97,493** | 74,977 |
| | **$ 773,365** | $ 730,717 |

Short-term bank notes have maturities at the original acquisition date of less than 90 days.

The Bank enters into short-term agreements, whereby it purchases and simultaneously commits to resell securities at a specified price on a specified date. These transactions, which are a form of secured investing by the Bank, produce interest income over the term of the investments.

## 4. SECURITIES

| | Term to maturity | | | **2004** | 2003 |
|---|---|---|---|---|---|
| | Within 1 year | 1 to 3 years | Over 3 years | **Total** | Total |
| **Financial Institutions** | | | | | |
| Carrying value | $ 9,943 | $ 15,207 | $ 66,934 | **$ 92,084** | $ 63,259 |
| Yield | 6.70% | 4.47% | 1.22% | **2.31%** | 3.23% |
| Fair value | $ 10,152 | $ 15,603 | $ 67,079 | **$ 92,834** | $ 63,878 |
| **Swap Contracts** | | | | | |
| Notional amount | $ 10,000 | $ 15,000 | $ 70,500 | **$ 95,500** | $ 62,600 |
| Adjusted yield [(1)] | 2.47% | 2.52% | 2.43% | **2.45%** | 3.13% |
| Amounts denominated in foreign currencies included in the carrying value of securities | | | | | |
| | | US dollars - 2003 | $ 20,720 | | $ 30,388 |
| | | **US dollars - 2004** | $ 51,050 | **$ 66,934** | |

(1) After adjusting for the effect of related derivatives (see Note 14).

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 4. SECURITIES (continued)

All securities held as at March 31 were issued by Canadian entities at fixed & floating rates. Yields are based upon carrying values and contractual interest rates adjusted for amortization of premiums and discounts. Term to maturity classifications are based upon the contractual maturity of the security. Fair value is based on market quotes when available and may not be realized on sale. If quoted market prices are not available, fair values are estimated using quoted market prices of similar securities. Where appropriate, the Bank has entered into cross-currency interest rate and interest rate swaps to adjust the interest rate and the foreign exchange risks associated with the above securities.



## 5. LOANS

The following table summarizes the repricing or maturity dates, whichever is earlier, and the effective interest rates of loans outstanding as at March 31. The effective interest rates are computed on a weighted average basis.

| | **2004** | | 2003 | |
|---|---|---|---|---|
| Performing - floating | **$ 5,560,591** | **6.67%** | $ 4,783,194 | 7.45% |
| Performing - fixed | | | | |
| Under one year | **462,250** | **7.50%** | 535,817 | 8.06% |
| 1 to 2 years | **299,372** | **8.41%** | 246,150 | 8.60% |
| 2 to 3 years | **236,969** | **8.49%** | 253,176 | 9.12% |
| 3 to 4 years | **171,783** | **8.94%** | 174,654 | 9.11% |
| 4 to 5 years | **218,395** | **8.35%** | 148,687 | 9.48% |
| Over 5 years | **196,162** | **8.73%** | 299,437 | 8.78% |
| Performing | **7,145,522** | | 6,441,115 | |
| Impaired | **319,672** | | 280,260 | |
| Total loans | **7,465,194** | | 6,721,375 | |
| Allowance for credit losses | | | | |
| General | **(372,458)** | | (335,427) | |
| Specific | **(115,192)** | | (97,312) | |
| | **(487,650)** | | (432,739) | |
| Loans, net of allowance for credit losses | **$ 6,977,544** | | $ 6,288,636 | |

The average amount of loans, net of allowance for credit losses, was of $6,649,149 in 2004 ($5,959,328 in 2003).

The concentrations of the total loans outstanding by province and territory as at March 31 are set out in the table below. The largest concentration in one individual or closely related group of clients is less than 1%.

| **Geographic Distribution** | **2004** | | 2003 | |
|---|---|---|---|---|
| Newfoundland and Labrador | **$ 300,660** | **4.0%** | $ 251,633 | 3.8% |
| Prince Edward Island | **45,625** | **0.6%** | 42,965 | 0.6% |
| Nova Scotia | **165,849** | **2.2%** | 149,980 | 2.2% |
| New Brunswick | **265,975** | **3.6%** | 255,802 | 3.8% |
| Quebec | **3,018,833** | **40.4%** | 2,662,816 | 39.6% |
| Ontario | **2,386,339** | **32.0%** | 2,143,169 | 31.9% |
| Manitoba | **113,759** | **1.5%** | 92,803 | 1.4% |
| Saskatchewan | **102,284** | **1.4%** | 107,667 | 1.6% |
| Alberta | **430,786** | **5.8%** | 402,233 | 6.0% |
| British Columbia | **583,122** | **7.8%** | 563,670 | 8.4% |
| Yukon | **20,770** | **0.3%** | 20,416 | 0.3% |
| Northwest Territories and Nunavut | **31,192** | **0.4%** | 28,221 | 0.4% |
| Total loans outstanding | **$ 7,465,194** | **100.0%** | $ 6,721,375 | 100.0% |

# Notes to Financial Statements

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 6. ALLOWANCE FOR CREDIT LOSSES

The following table summarizes the changes in the allowance for credit losses as at March 31:

| | **2004** | 2003 |
|---|---|---|
| Balance at beginning of year | **$ 432,739** | $ 408,513 |
| Write-offs | **(64,756)** | (73,841) |
| Interest income due to accretion | **(3,877)** | (3,671) |
| Recoveries | **5,544** | 3,738 |
| | **369,650** | 334,739 |
| Provision for credit losses | **118,000** | 98,000 |
| Balance at end of year | **$ 487,650** | $ 432,739 |

## 7. VENTURE CAPITAL INVESTMENTS

The Bank maintains a portfolio of venture capital investments which is focused on companies having promising competitive positions in their respective marketplaces and strong growth potential. The concentrations of venture capital investments are listed below. The largest single investment within these sectors is 3.4% of total venture capital investments.

| | **2004** | | 2003 | |
|---|---|---|---|---|
| **Industry Sector** | **Carrying value** | **Fair value** | Carrying value | Fair value |
| Biotechnology/Medical/Health | **$ 91,640** | **$ 120,595** | $ 77,601 | $ 71,446 |
| Information Technology | **52,032** | **57,096** | 50,889 | 53,782 |
| Seed Funds | **12,440** | **12,440** | 20,718 | 17,459 |
| Specialized Funds | **19,572** | **19,626** | 15,929 | 16,281 |
| Electronics | **76,185** | **67,630** | 63,736 | 59,039 |
| Communications | **79,228** | **72,223** | 57,023 | 50,745 |
| Energy | **3,975** | **3,975** | 6,200 | 6,200 |
| Industrial | **6,715** | **6,819** | 4,400 | 4,806 |
| Consumer-related | **2,537** | **2,537** | 2,538 | 2,538 |
| Other | **1,300** | **3,030** | 2,911 | 5,295 |
| Venture capital investments | **$ 345,624** | **$ 365,971** | $ 301,945 | $ 287,591 |

(See Note 13 for determination of fair value)

The preceding table includes $10,458 ($8,030 in 2003) of temporary investments, with a fair value of $10,458 ($8,200 in 2003). The average carrying value of venture capital investments was $321,818 in 2004 ($292,415 in 2003).

Investments are generally held 4 to 7 years. Divestitures are made through listings of investee shares on public markets or the sale of the Bank's shares to other existing shareholders or to third parties. Investment yields vary from year to year due to the amount and timing of dividend and interest income received and divestitures made. Below is a summary of the venture capital portfolio by type of investment.

| **Carrying value** | **2004** | 2003 |
|---|---|---|
| Common shares | **$ 122,456** | $ 119,738 |
| Preferred shares | **178,398** | 151,663 |
| Debentures | **44,770** | 30,544 |
| Venture capital investments | **$ 345,624** | $ 301,945 |

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 7. VENTURE CAPITAL INVESTMENTS (continued)

The Bank has invested in $T^2C^2$ Bio, $T^2C^2$ Info, Western Technology and Eastern Technology seed funds over which it has joint control. Below is a summary of the Bank's recorded proportionate share of the assets, liabilities, revenues, expenses and cash flows of these funds.

| | **2004** | 2003 |
|---|---|---|
| Current assets | **$ 2,045** | $ 2,331 |
| Venture Capital investments | **9,375** | 17,227 |
| Other assets | **7** | 9 |
| Current liabilities | **10** | 10 |
| Investment income | **638** | 1,556 |
| Write-down on investments | **8,170** | 3,233 |
| Operating and administrative expenses | **577** | 1,145 |
| Loss from venture capital | **$ (8,109)** | $ (2,822) |
| Cash flows from (used in): | | |
| Operating activities | **$ (345)** | $ (1,023) |
| Investing activities | **209** | 2,565 |
| Financing activities | **(30)** | (3,150) |

## 8. OTHER ASSETS

| | **2004** | 2003 |
|---|---|---|
| Unrealized gains and amounts receivable on derivative financial instruments | **$ 503,561** | $ 302,565 |
| Accrued benefit asset | **60,831** | 62,606 |
| Unamortized debt issue expenses on long-term notes | **1,291** | 1,462 |
| Other | **14,249** | 6,457 |
| | **$ 579,932** | $ 373,090 |

Unrealized gains and amounts receivable on derivative financial instruments are receivable from counterparties under derivative contracts and generally correspond to foreign currency and other adjustments in the underlying borrowings. Unrealized losses and amounts payable to counterparties under derivative contracts are included in "Other liabilities" (see Note 10) and in "Accrued interest on borrowings".

## 9. BORROWINGS

The Bank issues debt instruments in world money and capital markets to fund its loan portfolio. Foreign currency and equity market risk is hedged through the use of derivatives, such that essentially all of the Bank's borrowings are effectively denominated in Canadian dollars and bear interest at Canadian fixed or floating rates. In addition, where appropriate, the Bank enters into interest rate and cross-currency interest rate swap contracts to hedge the related interest rate risks. The table below shows the outstanding notes as at March 31.

| | | | **2004** | | 2003 | |
|---|---|---|---|---|---|---|
| **Maturity date** | **Effective rate** | **Currency** | **Principal amount** | **Carrying value** | Principal amount | Carrying value |
| **Short-term notes** | | | | | | |
| 2004 | | USD | | | $ 800,907 | $ 1,160,611 |
| | | CDN | | | 2,115,249 | 2,104,757 |
| 2005 | 1.98%-3.16% | USD | $ 435,430 | **$ 566,884** | | |
| | | CDN | 2,825,448 | **2,816,514** | | |
| **Total short-term notes** | | | | **$ 3,383,398** | | $ 3,265,368 |

# Notes to Financial Statements

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 9. BORROWINGS (continued)

| | | | **2004** | | 2003 | |
|---|---|---|---|---|---|---|
| **Maturity date** | **Effective rate*** | **Currency** | **Principal amount** | **Carrying value** | Principal amount | Carrying value |
| **Long-term notes** | | | | | | |
| 2004 | | USD | $ – | **$ –** | 12,500 | $ 33,211 |
| | | CDN | – | **–** | 347,500 | 347,500 |
| 2005 | 2.21% | USD | 3,000 | **7,123** | – | – |
| | 1.92%-5.15% | CDN | 216,025 | **216,025** | 181,000 | 181,000 |
| 2006 | 1.80%-4.53% | CDN | 234,340 | **237,853** | 241,665 | 242,466 |
| 2007 | | EURO | – | **–** | 4,587 | 7,233 |
| | 1.75%-3.52% | CDN | 262,271 | **268,652** | 268,760 | 275,443 |
| 2008 | | USD | – | **–** | 5,000 | 7,336 |
| | 1.93%-2.12% | CDN | 265,600 | **265,600** | 265,600 | 265,600 |
| 2009 | 1.85% | USD | 43,000 | **56,379** | 50,000 | 73,361 |
| | 1.75%-2.02% | CDN | 256,032 | **263,919** | 268,032 | 272,890 |
| 2010 | 2.01% | USD | 15,000 | **19,667** | 25,000 | 36,680 |
| | 1.75%-1.96% | CDN | 186,461 | **202,590** | 186,461 | 195,683 |
| 2011 | 1.96% | YEN | 800,000 | **10,050** | – | – |
| | 1.96% | USD | 10,000 | **13,321** | 10,000 | 14,075 |
| | 1.76%-1.96% | CDN | 472,790 | **489,249** | 213,610 | 211,190 |
| 2012 | 1.75%-1.81% | CDN | 341,090 | **346,743** | – | – |
| 2013 | | YEN | – | **–** | 2,000,000 | 24,735 |
| | 1.94%-2.04% | USD | 36,000 | **47,201** | 71,000 | 104,171 |
| | 1.93% | CDN | 5,000 | **5,000** | 5,000 | 5,000 |
| 2014 | 1.93%-2.02% | YEN | 12,000,000 | **150,759** | – | – |
| | 1.90%-2.03% | USD | 183,800 | **240,201** | – | – |
| 2015 | 1.97% | YEN | 1,000,000 | **12,563** | 8,600,000 | 106,359 |
| 2016 | 1.93%-2.02% | YEN | 2,500,000 | **31,408** | – | – |
| 2018 | 1.95%-2.08% | YEN | 27,300,000 | **342,973** | 40,800,000 | 504,587 |
| 2019 | 1.91%-2.06% | YEN | 38,800,000 | **488,706** | – | – |
| | 1.96%-2.02% | USD | 62,329 | **81,722** | – | – |
| **Total long-term notes** | | | | **$ 3,797,704** | | $ 2,908,520 |

*The effective rates on long-term notes are after giving effect to swap contracts when applicable. Information as to the repricing dates of the interest rate swap contracts is included in Note 14.

The preceding table includes $3,672,679 in 2004 and $2,493,520 in 2003 of long-term notes payable which have been the subject of interest rate, cross-currency interest rate and equity-linked swap contracts and options with other financial institutions. These borrowings fund a portion of the Bank's floating interest rate loan portfolio and bear interest at effective rates that are reset monthly or quarterly. The remaining long-term notes payable bear interest at fixed rates.

The maturity dates for callable and extendable notes are presented based on their first option date.

The Bank has issued a number of structured notes for which interest and/or principal at maturity is linked to fluctuations in equity indices, currency rates, swap rates and other market references. Other notes may be called prior to maturity, or have their maturity extended, upon exercise of call or extension options by the Bank or the noteholders. The type of notes included in the previous table are as follows:

| | **2004** | 2003 |
|---|---|---|
| Interest-bearing notes | **$ 369,985** | $ 500,000 |
| Fixed and inverse floating rate notes | **929,886** | 477,188 |
| Managed futures | **1,110,170** | 594,767 |
| Notes linked to equity indices | **801,257** | 808,575 |
| Notes linked to currency rates | **216,086** | 177,903 |
| Notes linked to swap rates | **47,740** | 13,604 |
| Notes extendible beyond maturity | **10,000** | 10,000 |
| Other structured notes | **312,580** | 326,483 |
| | **$ 3,797,704** | $ 2,908,520 |

Long term notes of $1,376,751 may be called prior to maturity (in 2003: $807,911).

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 9. BORROWINGS (continued)

As at March 31, 2004, the payment requirements and maturities of long-term notes are as follows:

| | |
|---|---|
| 2005 | **$ 223,148** |
| 2006 | **237,853** |
| 2007 | **268,652** |
| 2008 | **265,600** |
| 2009 | **320,298** |
| 2010 and later | **2,482,153** |
| | **$ 3,797,704** |

## 10. OTHER LIABILITIES

| | **2004** | 2003 |
|---|---|---|
| Deferred income | **$ 482** | $ 590 |
| Accrued benefit liability | **103,732** | 96,905 |
| Unrealized losses and amounts payable on derivative financial instruments | **101,740** | 178,671 |
| Other | **24,077** | 25,582 |
| | **$ 230,031** | $ 301,748 |

## 11. SHARE CAPITAL AND STATUTORY LIMITATIONS

***Share Capital***

Authorized:

(a) An unlimited number of preferred shares without par value, non-voting, issuable in series;

(b) An unlimited number of common shares, having a par value of $100 (one hundred dollars) each.

| **Outstanding** | | **2004** | | | 2003 | |
|---|---|---|---|---|---|---|
| | **Number of shares** | **Amount** | **Dividend rate** | Number of shares | Amount | Dividend rate |
| Preferred shares | | | | | | |
| Class A - Series 1 | **500,000** | **$ 50,000** | **4.585%** | 500,000 | $ 50,000 | 4.585% |
| - Series 2 | **500,000** | **50,000** | **4.365%** | 500,000 | 50,000 | 6.545% |
| - Series 3 | **500,000** | **50,000** | **5.515%** | 500,000 | 50,000 | 5.515% |
| - Series 4 | **400,000** | **40,000** | **3.610%** | 400,000 | 40,000 | 3.760% |
| - Series 5 | **400,000** | **40,000** | **2.820%** | 400,000 | 40,000 | 3.910% |
| | | **230,000** | | | 230,000 | |
| Common shares | **5,584,000** | **558,400** | | 5,584,000 | 558,400 | |
| **Total Outstanding Share Capital** | | **$ 788,400** | | | $ 788,400 | |

*Class A Preferred Shares* have a fixed, preferential and cumulative dividend and are exchangeable at the option of the holder, with the approval of the Minister of Finance, for fully-paid common shares on the basis of one common share for each Class A Preferred Share. All dividends accumulated or declared and unpaid as at the date of exchange are payable by the Bank on a pro rata basis, as if such dividends had accrued from day-to-day. The dividend rates on Class A Preferred shares are for periods ranging from two to five years and are adjusted at the beginning of the subsequent period to equal the consolidated revenue fund lending rate published by the Minister of Finance, plus a specified premium ranging from 0.250% to 0.375%.

***Statutory Limitations***

The aggregate of borrowings and contingent liabilities of the Bank in the form of guarantees given by it may not exceed twelve times the shareholder's equity of the Bank.

Moreover, the paid-in capital of the Bank, the contributed surplus and any proceeds that have been prescribed as equity must not at any time exceed $1.5 billion.

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 12. OPERATING AND ADMINISTRATIVE EXPENSES

| | 2004 | | | 2003 | | |
|---|---|---|---|---|---|---|
| | **Loans** | **Consulting** | **Venture Capital** | Loans | Consulting | Venture Capital |
| Salaries and staff benefits | **$ 115,853** | **$ 19,280** | **$ 6,815** | $ 95,923 | $ 17,465 | $ 6,193 |
| Premises and equipment | **27,056** | **679** | **1,236** | 25,042 | 649 | 1,179 |
| Other expenses | **57,212** | **3,182** | **3,075** | 55,484 | 3,249 | 4,237 |
| | **$ 200,121** | **$ 23,141** | **$ 11,126** | $ 176,449 | $ 21,363 | $ 11,609 |

## 13. FAIR VALUE OF FINANCIAL INSTRUMENTS

The amounts set out below represent the fair values of on- and off-balance sheet financial instruments held or issued by the Bank using the valuation methods and assumptions referred to below. The estimated fair value amounts represent approximate amounts at which the instruments could be exchanged between willing parties. However, many of the financial instruments lack an available trading market. Therefore, in these cases fair values are estimated using present value and other valuation techniques which are significantly affected by the assumptions used. As such, the derived fair value estimates should not be interpreted as realizable values in an immediate settlement of the instruments.

The carrying values are not adjusted to reflect increases or decreases in fair values resulting from fluctuations in interest rates, as generally it is the Bank's intention to realize the value of these financial instruments over time by holding them to maturity.

| | 2004 | | | 2003 | | |
|---|---|---|---|---|---|---|
| | **Carrying value** | **Fair value** | **Fair value over (under) carrying value** | Carrying value | Fair value | Fair value over (under) carrying value |
| **Balance Sheet** | | | | | | |
| **Assets** | | | | | | |
| Cash and short-term investments | **$ 773,365** | **$ 773,365** | **$ –** | $ 730,717 | $ 730,717 | $ – |
| Securities (Note 4) | **92,084** | **92,834** | **750** | 63,259 | 63,878 | 619 |
| Loans, net of allowance for credit losses | **6,977,544** | **7,022,150** | **44,606** | 6,288,636 | 6,307,924 | 19,288 |
| Venture capital investments (Note 7) | **345,624** | **365,971** | **20,347** | 301,945 | 287,591 | (14,354) |
| Other assets | **259,203** | **259,203** | **–** | 144,498 | 144,498 | – |
| | **$ 8,447,820** | **$ 8,513,523** | **$ 65,703** | $ 7,529,055 | $ 7,534,608 | $ 5,553 |
| **Liabilities** | | | | | | |
| Accounts payable and accrued liabilities | **$ 58,297** | **$ 58,297** | **$ –** | $ 56,555 | $ 56,555 | $ – |
| Accrued interest on borrowings | **101,751** | **101,751** | **–** | 59,457 | 59,457 | – |
| Short-term notes | **3,383,398** | **3,383,398** | **–** | 3,265,368 | 3,265,368 | – |
| Long-term notes | **3,797,704** | **3,995,389** | **197,685** | 2,908,520 | 2,924,414 | 15,894 |
| Other liabilities | **6,148** | **6,148** | **–** | 5,689 | 5,689 | – |
| | **$ 7,347,298** | **$ 7,544,983** | **$ 197,685** | $ 6,295,589 | $ 6,311,483 | $ 15,894 |
| | | | **$ (131,982)** | | | $ (10,341) |
| **Derivative financial instruments (Note 14)** | **$ 130,099** | **$ 240,841** | **$ 110,742** | $ (43,923) | $ (60,327) | $ (16,404) |
| **Total** | | | **$ (21,240)** | | | $ (26,745) |

## 13. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Fair values are based on a range of valuation methods and assumptions which are as follows:

*Financial instruments valued at carrying value* - The estimated fair value of the following assets and liabilities is assumed to approximate carrying value as the items are short-term in nature:

- Cash and short-term investments
- Other assets
- Accounts payable and accrued liabilities
- Accrued interest on borrowings
- Short-term notes

*Securities* - The fair value of securities is provided in Note 4 to the financial statements.

*Loans* - For performing variable rate loans, estimated fair value is assumed to equal carrying value. For performing fixed rate loans, estimated fair value is determined using a discounted cash flow calculation that uses market interest rates currently charged for similar new loans at March 31 to expected maturity or repricing. For impaired loans, fair value is equal to carrying value in accordance with the valuation methods described in Note 2 under *Allowance for credit losses*.

*Venture capital investments* - For venture capital investments made during the current year, estimated fair value is assumed to equal the carrying value. For investments in publicly traded companies, fair value is the quoted share price at March 31. The fair value of other investments is estimated using earnings multiples.

*Long-term notes* - The fair value of long-term notes is based on quoted market prices for similar issues, or current rates offered to the Bank for notes of the same remaining maturity.

*Derivative financial instruments* - The fair value of derivative financial instruments is provided in Note 14 to the financial statements.

## 14. DERIVATIVE FINANCIAL INSTRUMENTS

As described in note 2, the Bank uses derivative financial instruments to manage the financial risk of certain on-balance sheet positions. These instruments are financial contracts whose value is derived from an underlying interest rate, foreign exchange rate, equity investment or index and depending on the circumstances, may include the following:

***Swaps***

Swaps involve the exchange of cash flow obligations on a specific notional amount, for a predetermined period. *Interest rate swaps* involve exchange of fixed and floating interest payments. *Cross-currency interest rate swaps* involve the exchange of both interest and notional amounts in two different currencies. For *equity-linked swaps*, one of the payments exchanged represents the variation in the equity index over time, and the other is based on agreed fixed or floating rates.

***Forwards and Futures***

*Forwards and futures* are contractual agreements to either buy or sell currencies or financial instruments at specified prices and dates in the future.

# Notes to Financial Statements

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 14. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The following table provides the fair value of the Bank's derivatives portfolio as at March 31 as presented by positive and negative fair values.

| | **2004** | | | 2003 | | |
|---|---|---|---|---|---|---|
| | **Positive** | **Negative** | **Net amount** | Positive | Negative | Net amount |
| **Derivative financial instruments** | | | | | | |
| Interest rate swap contracts | **$ 8,173** | **$ 1,990** | **$ 6,183** | $ 5,997 | $ 3,391 | $ 2,606 |
| Equity-linked swap contracts | **377,346** | **85,069** | **292,277** | 176,431 | 143,431 | 33,000 |
| Forward rate agreements | **106** | **29** | **77** | – | – | – |
| Cross-currency interest rate swap contracts | **27,384** | **75,067** | **(47,683)** | 7,074 | 39,286 | (32,212) |
| Currency forward contracts | **73** | **10,086** | **(10,013)** | – | 63,721 | (63,721) |
| **Total fair value** | **$ 413,082** | **$ 172,241** | **$ 240,841** | $ 189,502 | $ 249,829 | $ (60,327) |
| Less impact of master netting agreements | **116,843** | **116,843** | **–** | 66,225 | 66,225 | – |
| **Total** | **$ 296,239** | **$ 55,398** | **$ 240,841** | $ 123,277 | $ 183,604 | $ (60,327) |

The fair value of derivatives is determined using various methodologies including quoted market prices, where available, prevailing market rates for instruments with similar characteristics and maturities, and net present value analysis or other pricing methodologies as appropriate.

***Credit risk***

The notional amounts of financial instruments held by the Bank are not indicative of the credit or market risk exposure associated with the contracts. The risk of loss is related only to the possibility that a counterparty to a transaction does not perform as agreed. In the event of default by a counterparty, the risk to the Bank in these transactions would be limited to the prevailing currency and/or interest rate differentials as represented by the positive fair values of transactions that are in an unrealized gain position. The Bank limits its exposure to this type of risk by dealing only with financial institutions having credit ratings in accordance with the Department of Finance guidelines, and believes it does not have any significant concentrations in any individual financial institution.

The Bank continually monitors its position and the credit ratings of its counterparties and seeks to limit its credit exposure by entering into master netting agreements with counterparties. The credit risk associated with contracts in a favourable position is eliminated by a master netting agreement only to the extent that contracts in an unfavourable position with the same counterparty will not be settled before the favourable contracts. The Bank's overall exposure to credit risk on derivative instruments can change substantially within a short period since it is affected by each transaction subject to the arrangement.

| **Counterparty Credit Risk Exposure** | **Counterparty Ratings** | | | |
|---|---|---|---|---|
| | **AAA** | **AA- to AA+** | **A to A+** | **Total** |
| **Gross positive replacement cost** | **$ 387** | **$ 266,581** | **$ 146,114** | **$ 413,082** |
| **Impact of master netting agreements** | **–** | **(53,966)** | **(62,877)** | **(116,843)** |
| **Replacement cost (after master netting agreements)** | **$ 387** | **$ 212,615** | **$ 83,237** | **$ 296,239** |
| Replacement cost (after master netting agreements) - 2003 | $ – | $ 75,291 | $ 47,986 | $ 123,277 |
| **Number of counterparties** | | | | |
| **March 31, 2004** | **1** | **5** | **9** | |
| March 31, 2003 | 0 | 8 | 7 | |

# Notes to Financial Statements

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 14. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The following table summarizes the notional amount by terms to maturity or repricing dates and replacement costs on derivative financial instruments:

| | Term to maturity or repricing | | | | | | | | **2004** | | 2003 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Within 1 year | % | 1 to 3 years | % | 3 to 5 years | % | Over 5 years | % | **Notional amount** | **Replacement cost** | Notional amount | Replacement cost |
| **Interest rate contracts** | | | | | | | | | | | | |
| $CDN payable - fixed | $ 10,000 | 5.45 | $ 15,000 | 5.60 | $ – | – | $ – | – | **$ 25,000** | **$ –** | $ 102,092 | $ – |
| $CDN receivable - fixed | 14,355 | 4.58 | 125,000 | 3.82 | – | – | – | – | **139,355** | **3,812** | 109,963 | 3,236 |
| $US receivable - fixed | – | – | – | – | – | – | 41,201 | 7.00 | **41,201** | **459** | – | – |
| Basis swaps | 1,017,000 | n.a. | – | – | – | – | – | – | **1,017,000** | **274** | 150,000 | – |
| Equity-linked swap contracts | 85,354 | n.a. | 411,598 | n.a. | 778,567 | n.a. | 1,624,596 | n.a. | **2,900,115** | **377,346** | 2,098,414 | 176,431 |
| Other swap contracts | – | – | 18,812 | n.a. | – | – | – | – | **18,812** | **3,628** | 18,812 | 2,761 |
| | 1,126,709 | | 570,410 | | 778,567 | | 1,665,797 | | **4,141,483** | **385,519** | 2,479,281 | 182,428 |
| Forward rate agreements | 620,000 | n.a. | – | – | – | – | – | – | **620,000** | **106** | – | – |
| Cross-currency interest rate swap contracts | – | – | – | – | 137,580 | n.a. | 1,537,288 | n.a. | **1,674,868** | **27,384** | 1,023,714 | 7,074 |
| Total interest rate contracts | 1,746,709 | | 570,410 | | 916,147 | | 3,203,085 | | **6,436,351** | **413,009** | 3,502,995 | 189,502 |
| **Foreign exchange contracts** | | | | | | | | | | | | |
| Currency forward contracts | 440,823 | n.a. | – | – | – | – | – | – | **440,823** | **73** | 1,268,540 | – |
| Total foreign exchange contracts | 440,823 | | – | | – | | – | | **440,823** | **73** | 1,268,540 | – |
| **Total** | $ 2,187,532 | | $ 570,410 | | $ 916,147 | | $ 3,203,085 | | **$ 6,877,174** | **$ 413,082** | $ 4,771,535 | $ 189,502 |
| Less impact of master netting agreements | – | – | – | – | – | – | – | – | **–** | **116,843** | – | 66,225 |
| **Total** | $ 2,187,532 | | $ 570,410 | | $ 916,147 | | $ 3,203,085 | | **$ 6,877,174** | **$ 296,239** | $ 4,771,535 | $ 123,277 |

n.a. – not applicable or weighted rates are not significant

The notional amount represents the amount at which a rate or price is applied in order to calculate the exchange of cash flows.

Replacement cost represents the cost of replacing, at current market rates, all contracts in an unrealized gain position.

The rates represent the weighted average interest rates that the Bank has contracted to pay or to receive up to maturity or repricing. The floating side for almost all of the Canadian dollar swap contracts is based on one- or three-month Canadian Bankers' Acceptance. All amounts in U.S. dollars are converted into the Canadian dollar equivalent.

## 15. INTEREST RATE SENSITIVITY

Interest rate risk occurs when a liability is settled or re-priced at a time in the future that does not offset the asset that it is funding. These differences in duration cover both on- and off-balance sheet financial instruments. The Bank uses borrowing strategies and derivative instruments to continuously manage this risk with the objective of minimizing such differences

## 16. GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS

***Guarantees***

In February 2003, the CICA issued an accounting guideline on the disclosure of guarantees, which broadens the definition of guarantees and requires substantially expanded disclosure. This new guideline was effective for the Bank this year. As this guideline requires disclosure only, there was no impact on the Statement of Income and Balance Sheet.

A guarantee is a contract that contingently requires the guarantor to make payments to a third party based on (i) changes in an underlying interest rate, foreign exchange rate or other variable, including the occurrence or non-occurrence of an event, that is related to an asset, liability or equity security held by the guaranteed party, (ii) an indemnification provided to the third party with the characteristics listed above, (iii) another entity's failure to perform under an obligating agreement, or (iv) another entity's failure to perform related to its indebtedness. The various guarantees and indemnifications that the Bank provides to its customers and other third parties are presented below.

# Notes to Financial Statements

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 16. GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS (continued)

*Derivative instruments*

As part of its financing operations, the Bank has entered into a written credit derivative contract under which a counterparty is compensated for losses on a specified portfolio of loans, if a default or other defined triggering event occurs. Typically, a corporate or government entity is the counterparty to the written credit derivative contract that meets the characteristics of guarantees described above. The maximum potential amount of future payments on this written credit derivative is $47,133 and is included in the Balance Sheet under Other liabilities (Note 10).

*Indemnifications*

In the ordinary course of business, the Bank enters into many contracts which contain indemnification provisions, such as purchase contracts, employment contracts, service agreements and leasing arrangements. In such contracts, the Bank may indemnify counterparties to the contracts for certain aspects of the Bank's past conduct if other parties fail to perform, or if certain events occur, such as changes in laws and regulations (including tax legislation), changes in financial condition of third parties, infringements and breaches of representations and warranties, undisclosed liabilities, and loss caused by the actions of third parties, or as a result of litigation claims by third parties. These indemnification provisions will vary based upon the contract. In many cases, there are no pre-determined amounts or limits included in these indemnification provisions and the occurrence of contingent events that will trigger payment under them is difficult to predict. The nature of these indemnification contracts is such that the Bank cannot reasonably estimate the maximum potential future amount that may be payable to counterparties. Historically, the Bank has not made any significant payments under these indemnities.

***Contingent liabilities***

A class action recourse has been launched by some of the Bank's pensioners for surplus amounts in the Bank's Pension Plan. The outcome of this lawsuit is undeterminable.

A former President and Chief Executive Officer of the Bank who was released from his duties in February 2004, has instituted proceedings against the federal government for the recovery of damages allegedly resulting from the termination of this employment. Although named in the lawsuit as an impleaded party, the Bank is not a target of the litigation and no monetary or other demands have been made against it. Nonetheless, it is not currently determinable whether the Bank may ultimately be required to fund any settlement of this matter.

Due to the uncertainty of the outcome and amount of financial settlement, if any, with respect to the above-noted legal claims, no provisions have been recorded by the Bank.

Various legal proceedings arising from the normal course of business are pending against the Bank. Management believes that should the Bank be found liable pursuant to one or more of these proceedings, the aggregate liability resulting from such proceedings would not be material.

***Commitments***

Undisbursed amounts of authorized loans are approximately $894,000 at March 31, 2004. These loan commitments are for an average period of three months ($59,000-fixed rate; $835,000-floating rate). The effective interest rates on these loan commitments vary from 4.5% to 18.0%. These include the Bank's share of undisbursed amounts of authorized joint venture financings which is approximately $10,000 at March 31, 2004. The undisbursed amounts on authorized venture capital investments approximated $74,000 at March 31, 2004.

Future minimum lease commitments under operating leases related to the rental of Bank premises are approximately as follows:

| | | |
|---|---|---|
| 2005 | $ | **18,000** |
| 2006 | | **18,000** |
| 2007 | | **16,000** |
| 2008 | | **15,000** |
| 2009 | | **13,000** |
| 2010 - 2020 | | **80,000** |
| | **$** | **160,000** |

# Notes to Financial Statements

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 17. EMPLOYEE FUTURE BENEFITS

The Bank maintains defined benefit pension plans for eligible employees ("pension plan"), which provide post-retirement benefits based on number of years of service and average final pay. The Bank also provides health care benefits, life insurance and other benefits for employees and eligible retirees.

The following tables present, in aggregate, information on a calendar year basis concerning the employee future benefit plans:

| | Registered pension plan | | Supplemental pension plans | | Other plans | |
|---|---|---|---|---|---|---|
| | **2004** | 2003 | **2004** | 2003 | **2004** | 2003 |
| **Change in accrued benefit obligation** | | | | | | |
| *Balance at beginning of year* | **$ 380,192** | $ 360,939 | **$ 30,862** | $ 29,861 | **$ 81,567** | $ 74,595 |
| Current service cost | **13,935** | 13,054 | **854** | 1,002 | **3,079** | 3,112 |
| Interest cost on benefit obligation | **26,030** | 24,465 | **2,127** | 2,055 | **5,465** | 5,211 |
| Benefits paid | **(16,988)** | (17,686) | **(417)** | (388) | **(3,594)** | (2,887) |
| Actuarial (gain) loss | **7,767** | (580) | **3,211** | (1,668) | **(1,391)** | 1,536 |
| *Balance at end of year* | **410,936** | 380,192 | **36,637** | 30,862 | **85,126** | 81,567 |
| **Change in fair value of plan assets** | | | | | | |
| *Balance at beginning of year* | **$ 422,309** | $ 452,534 | **$ 3,607** | $ 3,827 | **$ –** | $ – |
| Employee contributions[1] | **–** | – | **–** | – | **–** | – |
| Employer contributions | **–** | – | **151** | 125 | **916** | 633 |
| Actual return on plan assets during the year | **48,599** | (12,539) | **36** | 43 | **–** | – |
| Benefits paid | **(16,988)** | (17,686) | **(417)** | (388) | **(916)** | (633) |
| *Balance at end of year* | **453,920** | 422,309 | **3,377** | 3,607 | **–** | – |
| **Surplus (deficit) at end of year** | **$ 42,984** | $ 42,117 | **$ (33,260)** | $ (27,255) | **$ (85,126)** | $ (81,567) |
| Employer contributions after December 31 | **–** | – | **532** | 36 | **750** | 153 |
| Unamortized transitional obligation (asset) | **(60,485)** | (73,927) | **783** | 516 | **1,775** | 1,972 |
| Unamortized net actuarial loss | **78,332** | 94,416 | **8,048** | 5,105 | **2,766** | 4,135 |
| **Accrued benefit asset (liability) at end of year[2]** | **$ 60,831** | $ 62,606 | **$ (23,897)** | $ (21,598) | **$ (79,835)** | $ (75,307) |

[1] Employees of the Bank are currently not required to contribute to the Pension Plans for current service. The Bank has the ultimate responsibility for ensuring that pension obligations are adequately funded over time. In specific circumstances, employees are allowed to contribute amounts to the Pension Plans for the recognition of years of service that are not already recognized.

[2] Net amount recognized in balance sheet as "Other liabilities" or "Other assets", as appropriate.

The unamortized net actuarial loss in the Bank's registered pension plan is $78,332 which exceeds 10% of the fair value of the plan assets by $32,940 at December 31, 2003. The unamortized net actuarial loss in the supplemental pension plans is $8,048 which exceeds 10% of the benefit obligation balance by $4,384 at December 31, 2003. These excess amounts will be amortized to pension expense over the expected average remaining service life of active employees, commencing April 1, 2004. As a result of these changes and other factors, pension expense is expected to decrease by approximately one million dollars in fiscal 2005. Amortization of accumulated net actuarial losses in periods subsequent to March 31, 2005 will be affected principally by the discount rate used to estimate benefit obligations and by the difference between future investment results and the expected return on plan assets.

# Notes to Financial Statements

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 17. EMPLOYEE FUTURE BENEFITS (continued)

Pension and other post-retirement expense is included in Salaries and Staff benefits and is as follows:

| | Registered pension plan | | Supplemental pension plans | | Other plans | |
|---|---|---|---|---|---|---|
| | **2004** | 2003 | **2004** | 2003 | **2004** | 2003 |
| **Plan expense (credit)** | | | | | | |
| Current service cost | **$ 13,935** | $ 13,054 | **$ 854** | $ 1,002 | **$ 3,079** | $ 3,112 |
| Interest cost on benefit obligation | **26,030** | 24,465 | **2,127** | 2,055 | **5,465** | 5,211 |
| Expected return on plan assets | **(31,036)** | (35,495) | **(130)** | (148) | **(22)** | – |
| Amortization of transitional obligation (asset) | **(13,441)** | (13,441) | **(267)** | (267) | **197** | 197 |
| Amortization of net actuarial loss | **6,287** | 231 | **362** | 621 | **–** | 55 |
| **Expense (credit) for the year ended March 31** | **$ 1,775** | $ (11,186) | **$ 2,946** | $ 3,263 | **$ 8,719** | $ 8,575 |

Included in the above accrued benefit obligation and value of plan assets at year-end are the following amounts in respect of plans that are not fully funded:

| | Supplemental pension plans | | Other plans | |
|---|---|---|---|---|
| | **2004** | 2003 | **2004** | 2003 |
| Fair value of plan assets | **$ 3,377** | $ 3,607 | **$ –** | $ – |
| Accrued benefit obligation | **36,637** | 30,862 | **85,126** | 81,567 |

As at December 31, 2003, the market value of assets in the Bank's registered pension plan is as follows:

| | |
|---|---|
| Cash and short-term investments | **$ 3,462** |
| Bonds | **163,395** |
| Common and preferred shares | **286,805** |
| Other assets less liabilities | **258** |
| Net assets available for benefits | **$ 453,920** |

The significant actuarial assumptions adopted in measuring the Bank's accrued benefit obligations (weighted averages) are as follows:

| | Registered pension plan | | Supplemental pension plans | | Other plans | |
|---|---|---|---|---|---|---|
| | **2004** | 2003 | **2004** | 2003 | **2004** | 2003 |
| **Significant actuarial assumptions** | | | | | | |
| Discount rate at beginning of year | **6.75%** | 6.70% | **6.75%** | 6.70% | **6.75%** | 6.70% - 6.75% |
| Discount rate at end of year | **6.25%** | 6.75% | **6.25%** | 6.75% | **6.25% - 6.75%** | 6.75% |
| Expected long-term rate of return on plan assets[1] | **7.50%** | 8.00% | **3.75%** | 4.00% | **–%** | – |

[1] The expected long-term return on plan assets is calculated using assets valued at fair market value.

The average rate of compensation increase is expected to be inflation which is assumed to be 3.25% (in 2003, 3.25%) plus a 0.5% productivity gain plus an adjustment for merit and promotion.

For measurement purposes, medical costs were assumed to increase with inflation, plus a further increase of 2.5% in 2005 graded down by 0.5% each year to 1.0% in 2008 and subsequent years (in 2003 an increase of 2.5% for 2004 graded down by 0.5% each year to 1.0% for 2007 and subsequent years).

The Bank has two benefit obligations: one for pension benefits and the other for other employee future benefits. These benefit obligations represent the amount of pension and other employee future benefits that the Bank's employees and retirees have earned by the December 31st prior to year-end. The Bank's pension expense is calculated at this date for the March 31st that follows. Post retirement benefits are based on valuations at March 31 of the prior year. Post employment benefits are calculated as at March 31, 2004.

The Bank's actuaries prepare annual valuations of benefit liabilities for pension and other employee future benefits that the employees and retirees of the Bank have earned as at March 31. These valuations are based on management's assumptions about discount rates, salary growth, expected average remaining service life, mortality and health care cost trends. The discount rate is determined by management with reference to market conditions in place at the December 31st immediately prior to the new fiscal year (April 1st). Other assumptions are determined with reference to long-term expectations.

March 31, 2004 *($ in thousands except as otherwise indicated)*

## 17. EMPLOYEE FUTURE BENEFITS (continued)

***Sensitivity of Assumptions***

The key weighted-average economic assumptions used in measuring the pension benefit liability, the supplemental pension plans and the other plans liabilities and their related expenses are summarized in the table below.

| Increase (decrease) in | | Registered pension plan expense | Supplemental pension plans expense | Other plans expense |
|---|---|---|---|---|
| Expected rate of return on assets | | 7.50% | 3.75% | n.a. |
| Impact of: | 1% increase | (4,138) | (19) | n.a. |
| | 1% decrease | 4,138 | 19 | n.a. |
| Discount rate | | 6.75% | 6.75% | 6.75% |
| Impact of: | 1% increase | (9,203) | (591) | 1 |
| | 1% decrease | 7,980 | 456 | 50 |
| Rate of compensation increase | | 4.35% | 4.35% | 4.35% |
| Impact of: | .25% increase | 508 | 132 | 47 |
| | .25% decrease | (568) | (132) | (47) |
| Assumed overall health care cost trend | | | | |
| Impact of: | 1% increase | n.a. | n.a. | (7,149) |
| | 1% decrease | n.a. | n.a. | 5,161 |

## 18. RELATED PARTY TRANSACTIONS

The Bank is related in terms of common ownership to all Government of Canada created departments, agencies and Crown corporations.The Bank entered into transactions with these entities in the normal course of business.

## 19. SEGMENTED RESULTS OF OPERATIONS

The operations of the Bank are grouped into two principal business segments comprising Loans and Venture Capital activities. Disclosure of each segment's revenues, expenses and net income is set out in the Statement of Income and the average assets of the Loan and Venture Capital portfolios are disclosed in notes 5 and 7 respectively.

## 20. COMPARATIVE FINANCIAL DATA

Certain comparative figures have been reclassified to conform with the presentation adopted in 2004.

# Five-Year Operational and Financial Summary

**OPERATIONAL STATISTICS**

for the years ended March 31 *($ in thousands)*

| | **2004** | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| **LOANS AND VENTURE CAPITAL** | | | | | |
| Total financing committed | | | | | |
| as at March 31 | | | | | |
| Amount | **$ 8,844,758** | $ 8,025,719 | $ 7,201,137 | $ 6,352,838 | $ 5,641,060 |
| Number of clients | **22,966** | 21,897 | 20,780 | 19,664 | 18,667 |
| Committed to lending clients | | | | | |
| as at March 31 | | | | | |
| Amount | **$ 8,354,022** | $ 7,595,964 | $ 6,826,948 | $ 6,056,761 | $ 5,445,990 |
| Number of clients | **22,796** | 21,733 | 20,625 | 19,533 | 18,568 |
| Committed to investment clients | | | | | |
| as at March 31 | | | | | |
| Amount | **$ 490,736** | $ 429,755 | $ 374,189 | $ 296,077 | $ 195,070 |
| Number of clients | **170** | 164 | 155 | 131 | 99 |
| Total financing authorized | | | | | |
| Net amount | **$ 2,191,459** | $ 2,124,596 | $ 1,845,425 | $ 1,647,032 | $ 1,428,312 |
| Number | **7,338** | 6 387 | 5,806 | 5,173 | 4,749 |
| Lending authorized | | | | | |
| Net amount | **$ 2,082,647** | $ 2,031,907 | $ 1,739,404 | $ 1,532,870 | $ 1,365,516 |
| Number | **7,268** | 6,326 | 5,743 | 5,102 | 4,687 |
| Investments authorized | | | | | |
| Net amount | **$ 108,812** | $ 92,689 | $ 106,021 | $ 114,162 | $ 62,796 |
| Number | **70** | 61 | 63 | 71 | 62 |

| | | | | | |
|---|---|---|---|---|---|
| **FINANCIAL STATISTICS** | | | | | |
| Net interest income and other income as a percentage of average loan portfolio | **5.8%** | 5.8% | 5.9% | 5.8% | 5.6% |
| Provision for credit losses as a percentage of average loan portfolio | **1.7%** | 1.5% | 1.7% | 2.0% | 2.0% |
| Operating and administrative expenses as a percentage of average loan portfolio | **2.8%** | 2.8% | 2.9% | 3.1% | 3.0% |
| Loan operations productivity ratio | **48.7%** | 47.8% | 48.5% | 52.6% | 54.7% |

| | | | | | |
|---|---|---|---|---|---|
| **CONSULTING REVENUE** | **$ 20,006** | $ 18,221 | $ 18,189 | $ 17,724 | $ 19,396 |

**FINANCIAL INFORMATION**

*($ in thousands)*

| | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| **STATEMENT OF INCOME** | | | | | |
| for the years ended March 31 | | | | | |
| Net Income (loss) | | | | | |
| Loans | **$ 92,555** | $ 94,507 | $ 80,458 | $ 37,254 | $ 25,320 |
| Consulting | **$ (3,135)** | $ (3,142) | $ (5,748) | $ (5,100) | $ (4,254) |
| Venture Capital | **$ (30,299)** | $ (59,485) | $ (20,977) | $ 56,168 | $ 80,039 |
| Net Income | **$ 59,121** | $ 31,880 | $ 53,733 | $ 88,322 | $ 101,105 |
| **BALANCE SHEET** | | | | | |
| as at March 31 | | | | | |
| Loans, net of allowance for credit losses | **$ 6,977,544** | $ 6,288,636 | $ 5,669,513 | $ 5,054,254 | $ 4,608,188 |
| Venture capital investments, net of accumulated write-down of investments | **$ 345,624** | $ 301,945 | $ 271,064 | $ 206,360 | $ 145,107 |
| Total assets | **$ 8,809,218** | $ 7,791,359 | $ 6,897,204 | $ 6,225,518 | $ 5,666,333 |
| Total shareholder's equity | **$ 1,218,459** | $ 1,170,017 | $ 960,320 | $ 923,304 | $ 783,826 |
| Total liabilities | **$ 7,590,759** | $ 6,621,342 | $ 5,936,884 | $ 5,302,214 | $ 4,882,507 |
| Average loan portfolio | **$ 7,136,429** | $ 6,402,284 | $ 5,749,376 | $ 5,194,279 | $ 4,736,601 |

# Glossary

### Allowance for Credit Losses
Represents an amount deemed adequate by management to fully provide for impairment in the existing loan portfolio. Allowance for credit losses can be specific or general and is recorded on the balance sheet as a deduction from loans.

### Debt to Equity Ratio
A measure to ensure BDC operates within its statutory limitations on debts, calculated as the aggregate of the borrowings and contingent liabilities over the total shareholder's equity. The statutory limitations of BDC's debt to equity ratio may not exceed 12:1.

### Derivatives Financial Instruments
Contracts whose value is "derived" from interest or foreign exchange rates, or equity or commodity prices. Use of derivatives allows for the transfer, modification or reduction of current or expected risks from changes in rates and prices.

### Direct Investments
Represents the investments made by BDC directly in the investee companies.

### Productivity Ratio
A measure of the efficiency with which BDC incurs expenses to generate income on its loan operations. It is calculated as operating and administrative expenses as a percentage of net interest and other income. A lower ratio indicates improved efficiency.

### General Allowance
Established by management to recognize credit losses in the existing performing loan portfolio, which have occurred as at the balance sheet date, but have not yet been specifically identified on an individual loan basis.

### Hedging
A risk management technique used to insulate financial results from market, interest rate or foreign currency exchange risk (exposure) arising from normal banking operations.

### Impaired Loans
Loans where, in management's opinion, there has been a deterioration of credit quality such that there is no longer reasonable assurance of the timely collection of the full amount of principal and interest.

### Investment Income
Income generated from BDC's venture capital investments, such as interest, dividends, and net realized gains on divestitures.

### Master Netting Agreement
Is a standardized bilateral contract that enables trading counterparties to agree to net collateral requirements; and, in a close-out situation, settlement amounts related to underlying master trading contracts relating to sales and purchases of financial instruments. The Master Netting Agreement offsets positive balances of one transaction with negative balances of another.

### Net Interest and other Income
The difference between what is earned on loan portfolio assets and securities, and what is paid on borrowings.

### Net Margin
Is the net interest and other income earned by the performing loan portfolio, expressed as a percentage of the total average loan portfolio.

### Performing portfolio
Loans for which there is reasonable assurance of the timely collection of principal and interest.

### Permanent Impairment
Investments become permanently impaired, in management's opinion, when one or more of the following conditions apply: (i) a prolonged period during which the quoted market value of the investment is less than carrying value; (ii) suspension of trading in the investee securities; (iii) continued and severe losses that were not planned for at time of investing; (iv) liquidity or going concern problems that cannot be resolved in the immediate future; (v) material negative deviation from budget or plan. This would include not only financial data but also qualitative data about investee and all aspects of its business, e.g.: product, markets, technology, etc.

### Provision for Credit Losses
A charge to income that represents an amount deemed adequate by management to fully provide for impairment in the existing loan portfolios, given the composition of the loan portfolios, the probability of default on the loans, the economic environment and the allowance for credit losses already established.

### Return on Common Equity (ROE)
Net income, less preferred share dividends, expressed as a percentage of average common equity.

### Consulting Revenue
Fees from services provided by the BDC's national network of consultants to assess, plan, and implement result-driven, cost-effective management solutions.

### Specific Allowance
Established by management to recognize credit losses in the existing loan portfolios, which have occurred and are identified on an individual loan basis, as at the balance sheet date.

### Swaps
Interest rate swaps are agreements to exchange streams of interest payments; typically one at a floating rate, the other at a fixed rate, over a specified period of time, based on notional principal amounts. Cross-currency swaps are agreements to exchange payments in different currencies over pre-determined periods of time.

### Write-down
To recognize the loss when the value of a venture capital investment is permanently impaired.

### Other definitions in the MD&A:

- Economic Capital – page 47
- Environmental Risk – page 47
- Foreign Exchange Risk – page 50
- Interest Rate Risk – page 49
- Internal Rate of Return (IRR) – page 43
- Issuer/Counterparty Risk – page 48
- Liquidity Investment Risk – page 48
- Loan Credit Risk – page 47
- Loan Portfolio Concentration Risk – page 48
- Market Risk – page 49
- Operational Risk – page 50

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Printed in Canada