2006 Annual Report
Agropur cooperative

Just for you!

agropur


Sealtest
1% M.F.
STRAWBERRY MILK
Champfleury
Garlic/Ail
Irresistible
Lemon/Citr
agropur
Cheddar
island FARMS
Vanilla plus Smoothie
Strawberry / Fraises
ULTRA CRÈME
Québon
Crème champêtre
CHEVRITA
pure
Source
OLYMPIC
Organic
ORIGINAL
Beurre salé
Nat'rel
Lactose Free
Sans lactose
Skim Milk
Lait écrémé
Prestigio
Ricotta
COUNTRY CREAM
FRENCH VANILLA
agro
pur
Minigo
DUO


pure
Canadian Reserve
VINTAGE CHEDDAR
Yoplait
Yoptimal
immuni+
Island FARMS
Vanilla plus
French Vanilla & Mango
YOGURT
pure
Complimentis
Mild Cheddar Cheese
Fromage cheddar doux
520 g
Natrel
pro
PROBIOTIC milk beverage
breuvage laitier PROBIOTIQUE
Nutrition 24
Britannia
CHEDDAR
LATE VINTAGE
Yoplait
YOP
L'EXTRA
GRAND CAMEMBERT
OKA
Classique
Yoplait
Tubes
Mozzarella
agropur
BRIE TRIPLE CRÈME
Québon

Agropur

For nearly 70 years, Agropur cooperative has worked daily to offer consumers pure, healthy products that can be distinguished by their good taste, authenticity and superior quality. Strengthened by the support of its 3,939 members and 4,000 employees, the Cooperative annually processes nearly 1.9 billion litres of milk in its 20 plants spread throughout Canada and one plant in the United States. With sales of $2.3 billion, Agropur occupies a prime position among the leaders of the Canadian dairy industry. Connected to its milieu, Agropur is constantly in tune with the needs and expectations of its consumers, customers, employees and members, as well as the markets.

Agropur. Products just for you.

Agropur.

Products just for you.

Message from the Chairman

"Agropur cooperative is an organization in tune with its members."

Since 1938, Agropur has been in tune with its consumers, customers and employees, as well as the market place, and has always strived to respond to the needs and requirements of each.

As a cooperative, Agropur is also in tune with its members. In 2002, the latter went through a major reflection process, which paved the way for the adoption, in 2003, of a proposal outlining the organization's main strategic orientations. Discussions regarding membership subsequently helped bring out members' reluctance regarding this issue and some requested that reflection on this topic continue over the medium term. Since then, the Canadian and global economic and dairy environments have undergone considerable change. In order to identify the Cooperative's development milestones and find answers to the questions left hanging in 2003, a reflexion exercise will be initiated among our members starting March 2007.

On-farm milk quality has always been and continues to be an important issue for Agropur. As a result, the Cooperative and its members share a common goal: delivering top-quality milk from the farm to the table. Agropur can be proud of the initiative taken eight years ago and the excellent results achieved by its members in terms of milk quality.

In addition, discussions were held with the Fédération des producteurs de lait du Québec (Quebec Federation of Milk Producers) to have the program developed and adapted to the farm by the Cooperative, using the *HACCP Prerequisites Program* of our Quality Assurance Department, and applied by the Federation for the benefit of all Quebec milk producers.

In a climate where Canadian agriculture and agrifoods are facing numerous challenges, it is reassuring to see that our Cooperative is holding its own. However, certain clouds looming on the horizon may cast a shadow over our dairy situation, such as World Trade Organization (WTO) trade negotiations, which left their mark on the year 2006.

It should be noted that in December 2005, the 149 member countries went one step further by adopting the principles necessary to establish the final terms and conditions of an agreement. These principles are mainly as follows: export subsidies would be completely eliminated by 2013; domestic subsidies that have trade-distorting effects would be reduced on the basis that countries that subsidize the most would have to further reduce their support; lastly, the highest tariffs would be reduced the most significantly, but special conditions would have to apply for sensitive products.

Armed with this agreement in principle, the countries continued negotiations to establish the final terms and conditions of the agreement in order to determine how, at what rate, and how much. Since they were unable to agree on these terms and conditions, the negotiations were suspended in late July 2005. Even though, officially, all the countries want the negotiations to resume as quickly as possible, in actual fact, the suspension of the negotiations could endure. However, nothing can be taken for granted; we must continue to monitor this issue and prepare to adjust to the possible impacts that such an agreement could have on the Canadian dairy industry.

The milk ingredient issue also poses a problem, particularly for the country's milk producers. The decision taken by the federal court in January 2006 permits imports of milk protein concentrates above import quotas, making one more dent in the Canadian dairy system. Not only can manufacturers import butter oil and sugar mixes without limits or restrictions, but they can now import milk proteins at prices lower than those on the domestic market.

Agropur supports the demands of producers who want to find a permanent solution to this problem. However, to remain competitive on the market, the Cooperative must be on an equal footing with its competitors. Upon the initiative of the federal minister of Agriculture and Agri-foods, discussions on this topic were held between producers and processors to find permanent solutions. At the time of going to press, the minister was to announce a new regulation regarding certain dairy product standards within the coming months.

Lastly, the current level of international dairy product prices, compared with domestic prices, obliges us to stay on our guard. Canada is now at risk. In fact, given the value of the Canadian dollar, a slight drop in international butter and powder prices could lead certain players – processors, brokers or retailers – to import foreign dairy products for resale on the domestic market, thereby displacing our own products. For example, last June, despite tariff quotas of 299%, several thousand kilograms of butter from the United States were sold in Canada.

Agropur supports the Canadian dairy system. The latter has benefited and continues to benefit the chain of stakeholders in the industry. However, with even lower exports forecast for 2013, a relatively small domestic market and, above all, minimal global growth, the enterprise is now being forced to look outside the country to ensure its future growth. As its founders said in 1938, "The Cooperative has no borders". It is this same spirit that continues to drive Agropur's desire to expand.

Since 2001, Agropur has allocated $350 million in patronage dividends to its members, which demonstrates the kind of economic impact a healthy cooperative can have on communities. Obviously, the results for 2006 would not have been possible without the effort and involvement of our employees, especially the management team and the Board of Directors, to whom I would like to extend my sincere thanks. I would also like to acknowledge those who represent Agropur in various organizations and committees with which the enterprise is involved.

Serge Riendeau
Chairman

Message from the Chief Executive Officer

"The ever-improving results posted for 2006 allow Agropur to continue to forge ahead."

All the divisions turned in a positive performance, boosting the organization's sales to $2.3 billion. In 2006, earnings surpassed the $100 million mark for the very first time, reaching a new peak of $110 million.

Despite a fluid milk price war among retailers, Natrel nevertheless managed to increase its sales. This growth stems primarily from the acquisition of the Island Farms dairy in British Columbia in January 2005. Sales price increases were offset by a rise in operating costs. For their part, the cheese divisions also saw their sales improve, due mainly to a general increase in volume from their plants and higher sales to their primary customers. For its part, our Ultima Foods joint venture recorded a sales increase this year, mirroring the sharp rise in the consumption of fresh dairy products in Canada over the past few years.

In order to support growth and maintain the pace, Agropur announced a $40 million investment last August for the construction of a storage and distribution centre for its two cheese divisions, administrative offices, and a state-of-the-art research and development centre.

In 2006, Agropur demonstrated its ability to innovate by introducing on the market new probiotic-enriched products, such as Natrel Pro milk and Yoptimal immuni+ yogourt. The development of these types of products obviously requires considerable effort on the part of multidisciplinary teams, good inter-divisional cooperation, modern research facilities and an international-calibre research staff. In this regard, the new research and development centre will help our organization maintain its position at the forefront of the Canadian dairy industry, assume a leadership role in Canadian R & D, and increase its efforts in order to keep pace with the rest of the world, particularly Europe.

Ultima Foods, for its part, is completing the expansion work required at its Granby, Quebec plant in order to meet demand. This represents an investment of about $40 million over three years. The company also plans to inject more than $18.5 million (excluding the purchase of land) over two years for a project to relocate its head office and national distribution centre. Larger premises became necessary as a result of the steady sales growth experienced by our joint venture during the past few years.

Occupational health and safety is a priority in all of the organization's workplaces and is not just a financial concern. Too often, our employees are put at risk and we must do our utmost to protect them. To this end, an objective of zero lost-time accidents has been established. Senior management members, managers and employees are working daily to make this objective a reality by the year 2009.

The pressures on the Canadian dairy system are constantly mounting, and point to more difficult years ahead for our organization. World Trade Organization (WTO) negotiations, low-cost dairy ingredient imports, increasing domestic prices, sharp appreciation of the Canadian dollar, technological development, concentration of distribution, and consolidation of dairy processing are among the many reasons that are forcing our organization to adopt a clear, common vision and a well thought-out orientations.

Fortunately, our Cooperative is in excellent financial health. Agropur must pursue its development both on the domestic market, where real opportunities still exist – specifically regarding innovation and certain markets such as yogourt and other value-added products – and on international markets, where we can position ourselves to take advantage of the growth of the international dairy industry.

Certain projects are currently under analysis or negotiation and may be completed during 2007. Thus, Agropur could set up operations in the United States, South America or elsewhere in the world, thereby making our desire to pursue our development beyond our borders and position ourselves on the international dairy scene a reality.

With a healthy financial situation and competitive results, Agropur is in a good position to meet the challenges that lie ahead. As a result of the work of the members of the Board of Directors and the Management Committee, our members, our employees, our suppliers, as well as our associated agents and contracters, each of whom I would like to sincerely thank, Agropur has experienced a very productive year. We have at our disposal all the tools we need to forge ahead and conquer new markets.

Pierre Claprood
Chief Executive Officer

In tune with consumers

Agropur strives daily to reinvent milk in order to reveal the various facets of its personality.

Our challenge? To renew ourselves by going off the beaten path, while simultaneously preserving the authenticity and purity of our products. Our objective? To offer top-quality products that meet the growing needs of consumers who are concerned about their diet and increasingly demanding about the products they consume.

Innovative and in tune with the needs of its customers, Agropur continually invests in the research and development of new products that can improve consumers' health. To remain a leader in the Canadian dairy industry, the Cooperative plans to build high-tech research and development facilities. Equipped with modern laboratories to accelerate and enhance R & D in the organization, this new research and development centre will include a pilot plant featuring the equipment necessary to recreate a production environment comparable to that of conventional dairy plants. Dedicated entirely to research and development, this centre will constitute a first in the Canadian agrifood industry.

Over the past few years, lactose-free, calcium-enriched, omega 3 and probiotic milk products have been introduced on the market. With the arrival of new products responding to the needs of consumers, the cheese market was not to be outdone. To continue to grow, Agropur must be at the forefront of needs and trends. As new ideas are hatched, innovative products are constantly being launched.

After leading the way with the introduction of several value-added products, such as milk with extra calcium, Natrel Nutrition 24 and Natrel Omega-3 milk, Agropur innovated once again this year by launching Natrel Pro, the first milk in the country to be enriched with two active probiotic cultures that promote intestinal health and strengthen the body's natural defences.

In the same vein, Ultima Foods created Yoptimal immuni+, the only yogourt to offer a unique combination of two complementary active probiotic cultures made from natural fruit and green tea extracts containing polyphenols, powerful antioxidants effective in the maintenance of overall good health.

With a product line that is expanding yearly, Agropur today occupies a prime place in the refrigerators of consumers, who have good reason to put their trust in the Cooperative.

Our delicious cheeses also remain very popular, proving veritable winners year after year as evidenced by the numerous distinctions earned in 2006.

Britannia cheddar captured the spotlight at the *World Championship Cheese Contest*, in Wisconsin, U.S.A., by ranking first at this prestigious event in the "aged cheddar" category. Over the past ten years, this is the seventh time that Agropur's cheddars have reached the podium of this international contest – including three times as the world's best aged cheddar, thereby making Agropur the most decorated participant.

Marketed in England under the Canadian Reserve label, Agropur's aged cheddar also distinguished itself at the *Nantwich International Cheese Show* (England), where it earned second prize.

At the *American Cheese Society* competition, held in Oregon, U.S.A., first prizes were awarded to plain Délicrème, Ricotta Prestigio and 3-year-old Britannia, while the foursome comprising 3-year-old Britannia, Providence Oka, Brie L'Extra Double Crème and plain Délicrème brought home four first prizes at the *Royal Agricultural Winter Fair* in Toronto, Canada. Lastly, plain Délicrème walked away with first prize at the *British Empire Show* in Belleville, Canada.

In tune with customers

While consumers are the focal point of Agropur's mission, its relationship with its customers remains a priority since it is they who build special relations with consumers.

It is important for the organization to establish closer ties with its customers and offer them impeccable service. Warehouse stores, retail markets, manufacturers, hotels, restaurants, institutions are all important to Agropur and must be handled with the utmost respect.

To this end, Agropur cooperative will invest nearly $40 million in the construction of a refrigerated complex combining the distribution centres of its two cheese divisions, as well as an administrative centre for the Fine Cheese Division and a research and development centre. This major investment will make the Montreal suburb of Longueuil the organization's main business centre and will eventually transform this site into Agropur's cheese distribution hub in Canada.

For Agropur, it is about much more than just selling cheese. Aware that consumers are well-informed shoppers, the Fine Cheese Division ensures that the personnel in the grocery stores we serve know the ABCs of our products. Training sessions on the special attributes of each cheese are therefore offered to grocery store chains, helping them stand apart through more personalized service.

Natrel's sales team can now rely on a new work tool: a portable computer notepad aimed at maintaining and enhancing our leadership position in the eyes of customers through the rapidity and accuracy of information. Category management, planograms and customer promotions are among the aspects that have been reviewed and improved. Ultimately, sales time is focused entirely on customers – where it should be.

The slogan *Driven by customer needs*, adopted by the Cheese and Functional Products Division, represents a veritable organizational culture change that encourages all areas of the Division to align their efforts with those of Customer Service by improving, among other things, the speed at which they react and respond to customer requests. This approach clearly reflects the Division's desire to establish closer ties with the retail market, particularly, the food service sector. All the Division's employees keep "customer focus" in mind as they do their utmost to establish closer ties with customers and distinguish themselves through quality service.

While they do not enjoy the reputation of major labels, functional products represent a large share of the sales of the Division, which makes sure to improve them for the benefit of its target audience, processors.

In order to support a level of growth reaching nearly 10% over the past few years, as well as distinguish itself from the competition, Ultima Foods must constantly innovate. During the previous two years, in response to constant consumer demand for added-value products, Ultima brought seven new products to market.

In tune with employees

Agropur gives great importance to its employees' wellbeing and, in turn, to occupational health and safety.

The financial impact of a plant production shutdown is always significant, but the organization never loses sight of the human aspect of a work accident. For the Cooperative, it is unacceptable that any of our employees be exposed to danger, which is why we encourage them to adopt safe behaviour. We readily invest in the latest equipment for our workplaces, in order to protect the health and safety of our employees.

Over the past year, several collective agreements of five years or more were signed, thereby ensuring, in most workplaces, a labour peace beneficial to both the organization and its employees.

Communication also plays a vital role in the organization. The creation of the position of Vice-President, Communications and Public Relations clearly reflects senior management's desire to make communications a priority, both internally and externally. In addition to an internal newsletter published six times a year, several activities, such as the annual meeting of senior management employees, the presentation of divisional/strategic plans, the occupational health and safety meeting, and the employee service recognition program, provide other opportunities to build closer ties with our employees. Also, in order to keep in touch with our workplaces, the Chief Executive Officer and the Presidents of our three divisions conduct an annual tour. In addition to visiting our facilities, they take the time to meet and talk with our employees. This approach promotes better communication and understanding, as well as bringing employees and senior management closer together. The annual presentation of our strategic plans is also an ideal opportunity for our Divisional Presidents to maintain contact with our employees.

By virtue of our various acquisitions, Agropur has achieved national stature and, in turn, inherited the features associated with this type of organization, such as regional, linguistic and cultural differences. Far from being harmful, these changes have, instead, increased the organization's desire to ensure good communications with its employees. Agropur has, therefore, maintained a human dimension and kept in tune with its employees. Many employees have the opportunity to make a career within the Cooperative and move up the ranks, thanks to our successful manpower planning process.

At Agropur, the philosophy is simple: the healthy growth of the organization can only take place with the support of competent human resources. The Cooperative's development depends on our ability to develop the many talents within our ranks.

In tune with markets

With the globalization of markets, it is no longer possible for an organization like Agropur to conduct market analyses without taking into account what is happening elsewhere.

Today, it is essential to have a clear vision and an overall perspective of the world dairy market. Over the past ten years, the industry has undergone many transformations and has seen its activities converge. Consolidation continues and we, at Agropur, are actively responding to these global changes.

At Natrel, in order to accelerate the pace of developing, creating and launching new products, the Marketing Department has been restructured to incorporate divisional research and development activities.

At our Don Mills facility, following the implementation of a computerized inventory management system providing a link between the plant and the refrigerated warehouse, our operation can now fully assume its role as the distribution hub for all of southern Ontario.

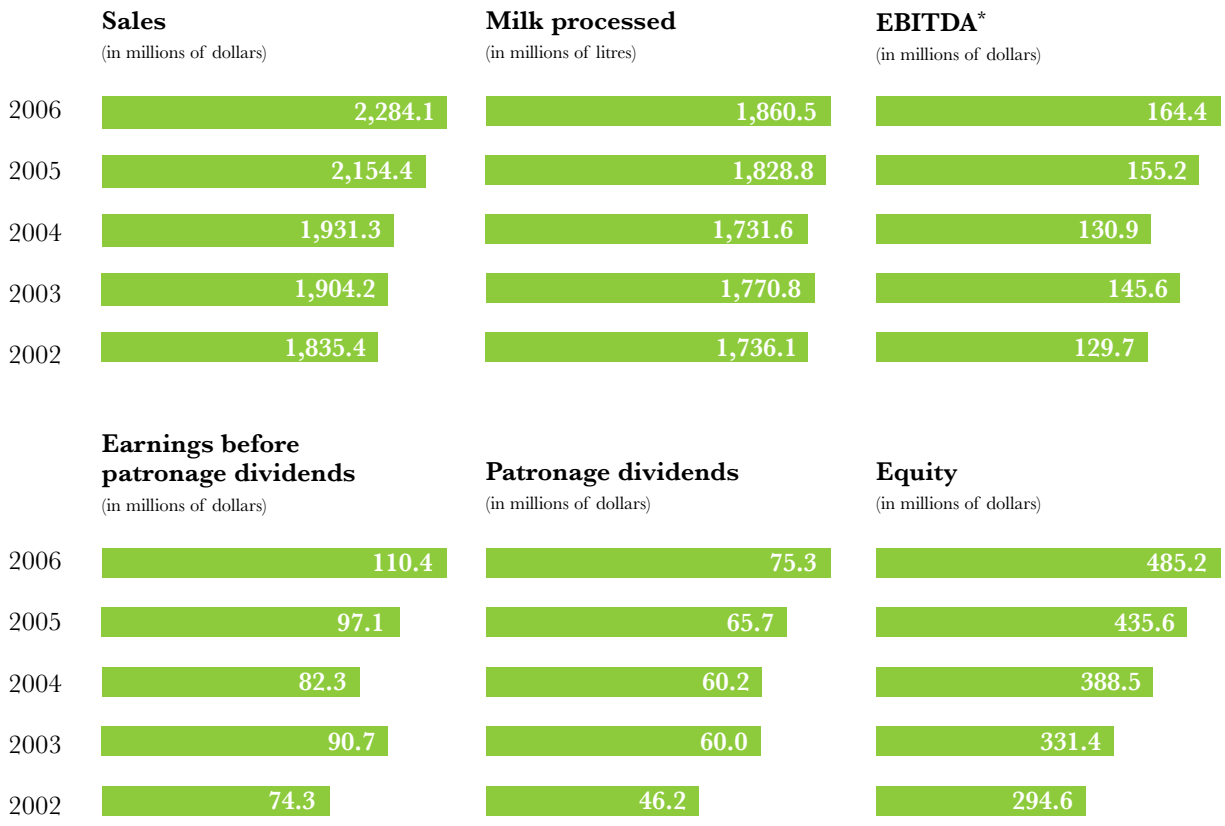
Changes to the positions of President and Vice-President, Marketing have breathed new life into our Fine Cheese Division, which continues to strive on the popularity of our existing brands, while developing and adapting our product line to market needs. The Division strives to continue to lead the way by increasing fine cheese sales in both Eastern and Western Canada.

At Ultima Foods, efforts invested outside of Quebec have paid off, with a noticeable increase in sales and market shares. The popularity of Yoplait Source in the diet product segment continues to grow, generating additional sales, while Yop drinkable yogourt also helped maintain sales growth by posting volume increases. Other products such as Creamy, Tubes and Minigo continued to perform well.

Proud of our Quebec roots and the important role we play in the Canadian economy, Agropur is determined to forge ahead. Firmly focused on the future, the organization intends to pursue its growth and development, while staying abreast of any potentially profitable business opportunities.

Highlights

	2006	2005
Sales (in millions of dollars)	2,284.1	2,154.4
Milk processed (in millions of litres)	1,860.5	1,828.8
Earnings before patronage dividends (in millions of dollars)	110.4	97.1
Asset acquisitions (in millions of dollars)	52.3	35.9
Total assets (in millions of dollars)	845.3	777.4
Number of members	3,939	4,060
Number of employees	4,008	3,900



* Earnings before patronage dividends, interest, taxes, depreciation and amortization and gain on disposal of assets

Financial review

In 2006, for the first time in its history, Agropur saw earnings before patronage dividends surpass the $100 million mark. This improvement is all the more impressive since all our product lines contributed positively.

Results

Sales rose by 6%, reaching nearly $2.3 billion. Without taking inflation into account, this increase can be attributed primarily to slightly higher volumes of available milk and continuing growth in the yogourt and fine cheese business units. It should also be noted that Island Farms, acquired at the end of the first quarter of 2005, was responsible for $26 million of this increase.

Earnings before interest, taxes, depreciation and amortization (EBITDA) stood at $164.4 million, up by $9.2 million. The Cheese and Functional Products Division benefited from a modest increase in available milk and saw a shift of butter and powder activities toward cheese activities. The Division also took full advantage of the savings generated by the closure, in 2005, of the Saint-Alexandre plant in Quebec. While the Fine Cheese group, like Ultima Foods, managed to improve its performance mainly as a result of volume increases, it also had to face fierce competition. As for Natrel, the contribution of the acquisition carried out in 2005 made the difference in its results. Of note is that, overall, the group was able to cope with a major rise in energy costs. Lastly, our U.S. subsidiary saw a slight turnaround in its results, until it experienced a production mishap, which has since been corrected. The remaining balance of goodwill not depreciated last year was written off this year.

The Cooperative's earnings before patronage dividends stood at $110 million. The Board of Directors approved patronage dividends at a rate of 6.4% of the value of members' milk deliveries (equivalent to $4.54/hl). These dividends are payable in a proportion of 25% cash and 75% investment shares. Combined with the different redemptions approved by the Board of Directors, a total of $46 million will be paid to members during the first quarter of 2007.

Cash flow

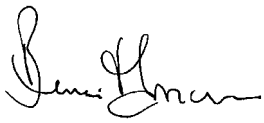
Operating activities generated cash flows of $148 million, an increase of 5.4%. Working capital remained relatively stable and debt was reimbursed according to normal maturity. The balance of available funds was allocated in virtually equal proportions to investments, members and cash. Acquired fixed assets, totalling $52 million, represented a record investment level that will most likely be exceeded in 2007.

Balance sheet

The financial situation improved once again in 2006. Non-cash assets stood at $691 million, up by $16 million over the previous year. During the same period, equity rose by 11%, reaching $485 million, while the average capital held by members totalled around $80,000.

Conclusion

Agropur was able to finance the numerous projects undertaken in 2006 internally. Several business opportunities were examined, but none materialized. The agenda remains full for 2007, during which we hope to see the results of the efforts made this year.



Benoit Gagnon
Chief financial officer

Auditors' report

December 15, 2006

To the Members of Agropur cooperative

We have audited the consolidated balance sheet of **Agropur cooperative** as at October 28, 2006 and the consolidated statements of earnings and reserve and cash flows for the year then ended. These financial statements are the responsibility of the Cooperative'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 consolidated financial statements present fairly, in all material respects, the financial position of the Cooperative as at October 28, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Consolidated statement of earnings and reserve

(in thousands of dollars)	notes	**2006**	2005
Sales		**2,284,117**	2,154,446
Operating expenses		**2,119,722**	1,999,286
Earnings from operations before the following items		**164,395**	155,160
Depreciation and amortization	3	**53,170**	53,506
Net financial expenses (revenues)	3	**(3,234)**	38
Gain on disposal of assets		**(1,329)**	(142)
Income taxes of subsidiaries and joint ventures		**5,402**	4,610
Earnings before patronage dividends and the Cooperative's income taxes		**110,386**	97,148
Patronage dividends	4	**75,317**	65,650
Cooperative's income taxes		**12,425**	11,200
Net earnings		**22,644**	20,298
Reserve – Beginning of year		**149,748**	129,450
Reserve – End of year		**172,392**	149,748

Consolidated statement of cash flows

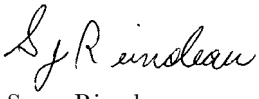
(in thousands of dollars)	notes	**2006**	2005
CASH FLOWS FROM			
Operating activities			
Earnings before patronage dividends and the Cooperative's income taxes		**110,386**	97,148
Cooperative's income taxes payable		**(14,049)**	(9,601)
Items not involving use of funds			
Depreciation and amortization		**53,170**	53,506
Future income taxes of subsidiaries and joint ventures		**54**	(327)
Other		**(1,329)**	(136)
		148,232	140,590
Change in non-cash items	5	**1,711**	18,664
		149,943	159,254
Financing activities			
Repayment of long-term debt		**(4,412)**	(6,428)
Investing activities			
Business acquisition		**-**	(55,100)
Purchase of fixed assets		**(52,328)**	(35,920)
Proceeds on disposal of assets		**2,855**	2,851
Variance on cross-currency swap agreement renewal to hedging		**638**	1,193
		(48,835)	(86,976)
Activities with members and on share capital			
Patronage dividends payable in cash	4	**(18,829)**	(16,412)
Issuance of shares	13	**46**	76
Redemption of shares	13	**(29,560)**	(22,473)
		(48,343)	(38,809)
Net change in cash position during the year		**48,353**	27,041
Cash position – Beginning of year		**99,501**	72,460
Cash position – End of year		**147,854**	99,501

Cash position consists of cash and temporary investment and of bank overdrafts and bank loans.

Consolidated balance sheet

(in thousands of dollars)	notes	October 28, **2006**	October 29, 2005
ASSETS			
Current assets			
Cash and temporary investment		**154,598**	102,449
Accounts receivable		**130,677**	123,467
Inventories	6	**197,242**	185,828
Prepaid expenses		**7,390**	9,104
Future income taxes	7	**4,053**	2,476
		493,960	423,324
Fixed assets	8	**269,581**	256,304
Other assets	9	**81,801**	97,726
		845,342	777,354
LIABILITIES			
Current liabilities			
Bank overdrafts and bank loans		**6,744**	2,948
Accounts payable and accrued liabilities	11	**303,670**	285,468
Income taxes		**6,428**	6,394
Current portion of long-term debt	12	**4,320**	4,330
		321,162	299,140
Long-term debt	12	**22,965**	27,367
Future income taxes	7	**15,990**	15,240
		360,117	341,747
EQUITY			
Share capital	13	**312,833**	285,859
Reserve		**172,392**	149,748
		485,225	435,607
		845,342	777,354

Approved by the Board of Directors



Serge Riendeau
Director

René Grimard
Director

Notes to consolidated financial statements

October 28, 2006

1. STATUTES OF INCORPORATION

Agropur cooperative ("the Cooperative") was established on August 29, 1938 under the Act Respecting Cooperative Agricultural Associations and, since October 26, 2000, has been governed by the Canadian Cooperatives Act.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements include the accounts of the Cooperative and its subsidiaries as well as its share of the assets, liabilities, revenues and expenses of joint ventures.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts in the financial statements.

Inventories

Finished goods and goods in process are valued at the lower of average cost and net realizable value. Raw materials are valued at the lower of cost and replacement value, cost being determined under the first-in, first-out method.

Fixed assets

Fixed assets are recorded at cost, net of applicable government grants.

Depreciation is calculated over the estimated useful lives of the assets based on the following methods and rates:

Buildings	Diminishing balance	5%
Equipment	Diminishing balance	15% and 20%
Office furniture	Diminishing balance	20%
Computer equipment	Straight-line	20% and 25%
Rolling stock	Diminishing balance	30%

Other assets

Other assets consist mainly of goodwill which is amortized on a straight-line basis over periods not exceeding 20 years. The Cooperative determines if a permanent impairment in the value of goodwill has occurred. To support this valuation, the Cooperative determines mainly whether estimated future cash flows on an undiscounted basis exceed the net book value of assets purchased.

Furthermore, deferred charges for procurement contracts are accounted for and amortized on a straight-line basis according to the duration of the agreements.

Employee future benefits

The Cooperative accounts for its obligations under the employee benefit plans and related costs net of the plan assets. The cost of pension and other retirement benefits earned by employees is determined from actuarial calculations according to the projected benefit method prorated on years of service based on management's best estimate assumptions about the investment returns on the plans, salary projections and the retirement ages of employees. Assets and accrued benefit obligations are evaluated three months before the date of the financial statements. The fair value of assets is determined using the fair market value. The estimated rate of return on the plan assets is based on the long-term estimated rate of return and the value of the plan assets assessed at fair value. The excess of the net actuarial gain (loss) over 10% of accrued benefit obligations, or over 10% of the fair value of the plan assets where such amount is higher, is amortized over the average remaining service life of employees. The cost of past services resulting from changes to the plans is amortized over the average remaining service life of employees.

Income taxes

Income taxes are accounted for using the liability method of tax allocation. Under this method, future income taxes are calculated on the difference between the tax basis and the carrying amount of the various assets and liabilities. Future income tax assets and liabilities are measured using the tax rates that are expected to be in effect in the years when the timing differences are expected to reverse. Income tax assets are recognized when it is more likely than not that the asset will be realized.

Translation of foreign currencies

Foreign currency transactions

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate prevailing at the balance sheet date, whereas transactions denominated in foreign currencies are translated at the average monthly exchange rates for the period. The resulting foreign currency translation gains and losses, net of hedging operations, are included in the statement of earnings.

Foreign operation

All assets and liabilities of the self-sustaining subsidiary operating in the United States are translated into Canadian dollars at the exchange rate prevailing at the balance sheet date. Revenues and expenses are translated at the average exchange rates for the period. Foreign currency gains and losses are mitigated through hedging operations using cross-currency swaps.

Hedging

The Cooperative documents the risk management strategy for establishing the relationship to apply hedge accounting. At the signing of the hedging contract, management documents the hedged item (an asset, a liability or an anticipated transaction), details of the hedging instrument used and the valuation method of effectiveness. Realized gains or losses on hedges are deferred until realization of the hedged item for best matching in the statement of earnings.

3. EARNINGS

The following items are included in the consolidated statement of earnings:

(in thousands of dollars)	**2006**	2005
Depreciation of fixed assets	**37,644**	34,878
Amortization of other assets	**15,526**	18,628
Interest on long-term debt	**868**	913

Considering a decrease in profitability of a subsidiary, the Cooperative has written off this subsidiary's goodwill, for an impact of $1,700,000 in 2006 (impairment loss in 2005 – $3,000,000).

Moreover, leasehold improvements were written off, for an impact of $819,000.

4. PATRONAGE DIVIDENDS

The patronage dividends to members are paid $18,829,000 (2005 – $16,412,000) in cash and $56,488,000 (2005 – $49,238,000) through the issuance of investment shares.

5. CASH FLOWS

Cash flows related to non-cash items have increased (decreased) as follows:

(in thousands of dollars)	**2006**	2005
Accounts receivable	**(7,373)**	1,470
Inventories	**(11,510)**	(14,727)
Prepaid expenses	**1,713**	1,269
Accounts payable and accrued liabilities	**17,948**	23,366
Income taxes	**32**	10,648
Other assets – Employee future benefits	**628**	(2,812)
Other assets – Procurement agreements and others	**273**	(550)
	1,711	18,664

Net interest received amounts to $1,619,000 (paid in 2005 – $1,777,000). Income taxes paid amount to $19,309,000 (2005 – $4,125,000).

6. INVENTORIES

(in thousands of dollars)	**2006**	2005
Finished goods	**172,973**	162,715
Raw materials, goods in process and supplies	**24,269**	23,113
	197,242	185,828

7. FUTURE INCOME TAXES

The main components of the Cooperative's future income tax assets and liabilities are as follows:

(in thousands of dollars)	**2006**	2005
Future income tax assets		
Accrued expenses, provisions and other reserves that are tax deductible only at the time of disbursement	**4,053**	2,476
Future income tax liabilities		
Fixed and other assets	**15,990**	15,240

8. FIXED ASSETS

(in thousands of dollars)	Cost	Accumulated depreciation	**2006** Net	2005 Net
Land	21,617	-	**21,617**	16,860
Buildings	146,418	61,295	**85,123**	78,838
Equipment	412,843	271,154	**141,689**	139,782
Office furniture	5,652	4,951	**701**	620
Computer equipment	40,544	29,420	**11,124**	13,762
Rolling stock	33,262	23,935	**9,327**	6,442
	660,336	390,755	**269,581**	256,304

Fixed assets include unamortized work in progress of $7,997,000.

9. OTHER ASSETS

(in thousands of dollars)	**2006**	2005
Goodwill	**65,508**	77,820
Employee future benefits (note 17)	**6,512**	7,140
Procurement agreements and others	**9,781**	12,766
	81,801	97,726

10. BANK LOANS

The Cooperative and its joint ventures have lines of credit to a maximum of $101,676,000 which bear interest at variable rates generally not exceeding the prime rate. Bank loans are not secured by any of the Cooperative's assets. As at October 28, 2006, letters of credit are issued for a total value of $568,000.

11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

(in thousands of dollars)	**2006**	2005
Members	**115,654**	103,110
Third parties	**188,016**	182,358
	303,670	285,468

12. LONG-TERM DEBT

(in thousands of dollars)	**2006**	2005
Loans contracted under a term credit agreement, bearing interest at an average rate of 6.48%[1]	**23,679**	27,732
Other loans[2]	**3,606**	3,965
	27,285	31,697
Current portion	**4,320**	4,330
	22,965	27,367

(1) The loans are secured by Series A - 2000 bonds with a par value of $225,000,000. The bonds, bearing interest at prime rate, were issued and pledged under a trust deed signed on December 1, 2000 to guarantee loans contracted by the Cooperative under a term credit agreement which limits the lenders' rights over the pledged bonds to the real loan amounts.

This trust deed contains certain commitments made by the Cooperative to maintain certain financial ratios and the obligation to refrain from charging the assets.

Term loan	Original par value	Repayment method	Balance at maturity
A	$40,000,000	$4,000,000 annually from October 2003 to October 2007	$20,000,000 in October 2008

(2) The loans include among others the proportionate share of the joint ventures' loans, whose share of assets are pledged to secure the loan amounts to $1,110,000.

Estimated principal repayments of the long-term debt required over the next years are as follows:

(in thousands of dollars)	
2007	**4,320**
2008	**19,816**
2009	**3,149**

13. SHARE CAPITAL

The following constitutes a summary of certain privileges, rights and conditions related to the Cooperative's shares. Reference can be made to the statutes of the Cooperative for the full text of these conditions.

The share capital of the Cooperative's members is variable and unlimited as to the number of shares in each class that can be issued, with the exception of Class C investment shares whose number is limited to 100,000,000. The shares have a nominal value of $1 each, with the exception of member shares ($100), Class M investment shares, Series 1 ($20), Series 2 ($1,500), Series 3 ($400) and Series 4 (to be determined when first issued).

When joining, new members subscribe to one member share and 10 Class M investment shares. Voting rights are restricted to one vote per member.

In consideration of patronage dividends, the following investment shares are issued: either Class A, Series A1 (A before 2004) and Class B, Series B1 (B before 2004), or Class C, Series AAA and BBB, as per the member's choice.

Class A, Series A and A1 and Class B, Series B and B1 investment shares are eligible under the Registered Retirement Savings Plan when converted into Class C, Series AA and BB investment shares respectively. Class C, Series AA and BB investment shares can be held by auxiliary members. No Class A, Series D and Class B, Series E investment shares formerly signed under the Cooperative Investment Plan have been issued since January 1, 1996.

Class A, Series L investment shares were authorized to serve as partial payment for a business acquisition in 2001.

Class C, Series AAA and BBB investment shares are issued according to the terms governing the Class A, Series A and A1 and Class B, Series B and B1 investment shares respectively, under the Cooperative Investment Plan. These investment shares are also eligible under the Registered Retirement Savings Plan.

Member shares as well as all classes of the investment shares are redeemable under certain conditions at their par value upon resolution of the Board of Directors. Share redemptions are subject to certain financial ratios. In addition, for Class A, Series D, Class B, Series E and Class C, Series AAA and BBB investment shares, issued before 2004, the law requires that the reserve be increased by 50% of the amount of the redemption since issuance.

At year-end, shares issued and fully paid were as follows:

(in thousands of dollars)	**2006**	2005
Member shares	**395**	409
Investment shares		
Class A, Series A, A1 and D	**159,092**	143,542
Class A, Series L	**6,931**	12,303
Class B, Series B, B1 and E	**76,349**	68,990
Class C, Series AA	**24,806**	22,167
Class C, Series BB	**11,637**	10,427
Class C, Series AAA	**19,675**	15,517
Class C, Series BBB	**8,853**	7,016
Class M, Series 1, 2 and 3	**5,095**	5,488
	312,833	285,859

During the year, share capital changed as follows:

(in thousands of dollars)	**2006**	2005
Balance – Beginning of year	**285,859**	259,018
Issuance of shares as payment for patronage dividends	**56,488**	49,238
Instalments on member shares and Class M investment shares	**46**	76
Redemption of shares in cash	**(29,560)**	(22,473)
Balance – End of year	**312,833**	285,859

During the year, an amount of $7,597,000 (2005 – $7,065,000) was transferred from Class A and B shares to Class C shares.

As at October 28, 2006, inactive members held shares of the Cooperative for a total amount of $733,000 (2005 – $9,605,000).

14. FINANCIAL INSTRUMENTS

Fair value

The book value of financial instruments is assumed to approximate their fair value due to their short-term maturity. These financial instruments generally include cash and temporary investments, accounts receivable, bank overdrafts and bank loans, and accounts payable and accrued liabilities.

Interest rate risk

The financial assets and liabilities do not bear interest, except for cash, temporary investment and long-term debt.

The Cooperative's long-term debt bears interest at variable rates. Interest rate swap agreements have been contracted to fix an original loan of $40,000,000 at a weighted average rate of 6.48%. As at October 28, 2006, the cancellation agreement cost amounts to $550,000.

HEDGING AGAINST FOREIGN EXCHANGE RISK

Currency forward contracts

The Cooperative hedges against foreign exchange risks for projected future transactions by means of currency forward contracts, mainly in U.S. dollars, euros and pounds sterling. Foreign currency gains and losses are recorded in earnings at the expiry of these contracts. At the presentation date of the financial information, the foreign exchange contracts, spread over periods not exceeding one year, approximate the fair market value and are as follows:

Purchases	2,005,000	US
Sales	3,480,000	US
Purchases	11,750,000	euros
Sales	2,700,000	GBP

Cross-currency swaps

The Cooperative has concluded a cross-currency swap agreement to hedge the net investment in the U.S. subsidiary, having the effect of translating capital of US$5,500,000 into capital of CA$6,251,000 at maturity in July 2007.

15. INVESTMENTS IN JOINT VENTURES

The Cooperative's share in the statements of earnings, cash flows and balance sheets of the joint ventures is summarized as follows:

(in thousands of dollars)	**2006**	2005
Assets	**71,627**	62,782
Liabilities	**35,570**	33,059
Sales	**142,256**	125,090
Cash flows from operating activities	**8,003**	15,941
Cash flows from investing activities	**(10,274)**	(8,525)

16. COMMITMENTS AND CONTINGENCIES

a) Commitments relating mainly to operating leases are as follows:

(in thousands of dollars)	
Total commitments (including 7,297 for next year)	**35,391**

b) The Cooperative is party to litigations in the normal course of business. Even if the outcome of these litigations cannot be expressed with certainty, the related liability is recorded when it is likely that it will result in a loss and that the amount can be estimated. Furthermore, management estimates that the losses that could result from these litigations will be negligible.

c) The Cooperative is the subject of legal proceedings from a former independent distributor, for an amount of $13,057,000. Management believes that the Cooperative will not incur any significant loss resulting from these proceedings.

17. EMPLOYEE FUTURE BENEFITS

Employee future benefits relate mainly to pension plans. The obligations of the defined benefit plans are based on the employee's length of service and the pay of the last years of service. The pension benefits can be adjusted according to a formula based on the return on plan assets and the consumer price index. The actuarial valuation of the plans are performed at least every three years, the last valuations were performed mainly in January 2005 and January 2006.

Net expense is as follows:

(in thousands of dollars)	**2006**	2005
Defined contribution plans		
Net expense	**5,524**	4,837
Defined benefit plans		
Current service cost	**2,789**	1,728
Interest cost on accrued benefit obligation	**3,843**	3,664
Actual return on plan assets	**(4,436)**	(7,749)
Difference between actual return and expected return	**633**	4,198
Actuarial loss (gain) on accrued benefit obligation	**(3,102)**	11,458
Difference between actual actuarial loss and the amount recognized for the year	**4,487**	(10,582)
Amortization of transitional balance	**(903)**	(903)
Net expense	**3,311**	1,814

The information on defined benefit plans is as follows:

(in thousands of dollars)	**2006**	2005
Plan assets		
Fair value – beginning of year	**61,774**	54,628
Actual return on plan assets	**4,436**	7,749
Employer contributions	**5,000**	2,229
Employee contributions	**818**	740
Benefits paid	**(3,379)**	(3,572)
Transfer to another plan	**(1,940)**	-
Fair value – end of year	**66,709**	61,774

The above contributions approximate the total cash payments. Equity securities included 55% (2005 – 57%) of total plan assets, invested mainly in Canada.

(in thousands of dollars)	**2006**	2005
Accrued benefit obligation		
Balance – beginning of year	**73,167**	59,149
Current service cost	**2,789**	1,728
Interest cost	**3,843**	3,664
Employee contributions	**818**	740
Benefits paid	**(3,379)**	(3,572)
Actuarial loss (gain)	**(3,102)**	11,458
Transfer to another plan	**(1,940)**	-
Balance – end of year	**72,196**	73,167

(in thousands of dollars)	**2006**	2005
Employee future benefits assets		
Funding status – plan assets net of obligations (deficit)	**(5,487)**	(11,393)
Less: Transitional assets at the beginning, unrecorded and to be amortized	**(4,119)**	(5,022)
Plus: Actuarial loss, unrecorded and to be amortized	**15,510**	20,630
Plus: Employer contributions after valuation date	**608**	2,925
Employee future benefits assets	**6,512**	7,140

For pension plans with an accrued benefit obligation that was higher than the assets, the accrued benefit obligation is $60,229,000 (2005 – $64,165,000) and the assets are $52,008,000 (2005 – $51,030,000).

Employee future benefits assets are presented with other assets in the balance sheet.

	2006	2005
Weighted-average assumptions		
Accrued benefit obligation		
Discount rate	**5.50%**	5.25%
Long-term inflation rate of salary expense	**4.00%**	4.00%
Net benefit expense		
Discount rate	**5.25%**	6.25%
Expected return on plan assets	**6.50%**	7.00%
Long-term inflation rate of salary expense	**4.00%**	4.00%

The Cooperative participates in multi-employer defined benefit plans for certain unionized employee groups. These plans are accounted for as defined contribution plans. Contributions for the year amount to $624,000.

18. SEGMENT DISCLOSURES

The Cooperative carries on the business of processing and selling dairy products within a regulated raw milk sourcing environment. Processed products are distributed to a large number of customers, including major Canadian food chains and industrial customers. Assets are located mainly in Canada. In addition, sales are made primarily in Canada. The Cooperative's Board has determined that Agropur carries on business in only one operating sector, dairy products.

Four customers represent respectively more than 10% of the sales figure, for a sales volume amounting to $1,087,000,000.

19. COMPARATIVE FIGURES

Certain comparative figures have been reclassified in order to conform with the current year's presentation.

Board of Directors

RENÉ GRIMARD [1,2]
Vice-Chairman
Des Appalaches 1995

SERGE RIENDEAU [1]
Chairman
Estrie 1991

ROGER DAOUST [1]
Salaberry 1993

FRANÇOIS PELLETIER
Yamaska 2002

ROGER BEAULIEU
Est du Québec 2000

DANIEL LAMY [2]
Berthier / Maskinongé 2004

LORNA JEAN NEVEU
Laurentides / Lanaudière 1996

DENIS VALLÉE [2]
Lac Saint-Pierre 1991

ROGER MASSICOTTE
Mauricie / Portneuf 2003

LUC CHASSÉ
Des Seigneuries 2006

MICHEL COUTURE [1,2]
De L'Érable 2001

RENÉ MOREAU [1,2]
Bois-Francs 1998

GAÉTAN JODOIN
Granby 1996

DARIE GAGNÉ
Chaudière 1997

JEAN FILIATRAULT
Acton 1993

Legend: Director/Administrative region/Year elected to the Board
[1] Executive Committee members [2] Directors whose term expires in 2007; however, they can be re-elected.

Management Committee

From left to right

Robert Gour
President
Fine Cheese Division

Pierre Claprood
Chief Executive Officer

Louis Lefebvre
President
Cheese and Functional
Products Division

Benoit Gagnon
Chief Financial Officer

Serge Paquette
President
Division Natrel

Michel Leclair
Vice-President
Quality Assurance

Denis Lachance
Vice-President
Legal Affairs and
Corporate Secretary

Jacques R. Rolland
Vice-President
Research and Development

Jean Brodeur
Vice-President
Communications
and Public Relations

Scott McDonald
Vice-President
Human Resources

Dominique Benoit
Vice-President
Institutional Business and
Member Relations

Agropur cooperative
101 Roland-Therrien Blvd
Suite 600
Longueuil, Quebec
J4H 4B9
450 646-1010

Cheese and Functional Products Division
510 Principale Street
Granby, Quebec
J2G 7G2
450 375-1991

Fine Cheese Division
6500 Henri-Bourassa Blvd East
Montréal-Nord, Quebec
H1G 5W9
514 321-6100

Division Natrel
101 Roland-Therrien Blvd
Suite 600
Longueuil, Quebec
J4H 4B9
450 646-1010

Ultima Foods Inc.*
2177 Fernand-Lafontaine Blvd
Longueuil, Quebec
J4G 2V2
450 651-3737

* Joint venture

agropur

agropur.com