Condensed Consolidated Interim Financial Statements of

CARGOJET INC.

For the Three and Six Month Periods Ended June 30, 2015 and 2014

(unaudited – expressed in Canadian Dollars)

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CARGOJET INC.

Condensed Consolidated Interim Balance Sheets

As at June 30, 2015 and December 31, 2014

(unaudited, in Canadian dollars)

	Note	June 30, 2015	December 31, 2014
		$	$
ASSETS			
CURRENT ASSETS			
Trade and other receivables		24,415,573	19,101,892
Inventories		853,638	624,713
Prepaid expenses and deposits		3,374,798	3,877,024
Income taxes receivable		2,643,005	2,643,004
Current portion of notes receivable		593,330	651,638
Current portion of finance lease receivable		-	114,771
		31,880,344	27,013,042
NON-CURRENT ASSETS			
Property, plant and equipment	3	324,067,698	203,944,786
Notes receivable		6,470	184,007
Goodwill	4	46,434,976	46,169,976
Intangible assets	4	2,000,000	1,000,000
Deposits		5,445,158	7,022,548
Deferred income taxes	9	140,792	-
		409,975,438	285,334,359
LIABILITIES			
CURRENT LIABILITIES			
Trade and other payables		28,403,639	23,323,465
Provisions	7	-	1,725,516
Dividends payable		1,425,692	1,367,907
Borrowings	5	2,247,484	504,897
Finance leases	6	13,141,620	6,782,482
		45,218,435	33,704,267
NON-CURRENT LIABILITIES			
Borrowings	5	89,666,670	13,981,944
Finance leases	6	143,116,473	87,592,527
Provisions	7	2,073,377	1,290,145
Convertible debentures	8	76,228,478	78,966,406
Deferred income taxes	9	-	4,375,293
		356,303,433	219,910,582
EQUITY		53,672,005	65,423,777
		409,975,438	285,334,359

The accompanying notes are an integral component of the condensed consolidated interim financial statements.

CARGOJET INC.

Condensed Consolidated Interim Statements of Loss and Comprehensive Loss

Three month and six month periods ended June 30, 2015 and 2014

(unaudited, in Canadian dollars)

	Note	Three months ended June 30, 2015	Three months ended June 30, 2014	Six months ended June 30, 2015	Six months ended June 30, 2014
		$	$	$	$
REVENUES		75,224,404	44,334,965	129,302,710	88,050,567
DIRECT EXPENSES	10	67,895,003	39,142,989	121,000,853	79,022,645
		7,329,401	5,191,976	8,301,857	9,027,922
General and administrative expenses	11	8,205,973	4,607,142	15,340,610	9,584,099
Sales and marketing expenses		321,554	171,215	637,089	291,373
Finance costs		5,869,749	1,413,412	10,093,009	2,106,228
Finance income		(8,954)	(57,132)	(30,550)	(82,839)
Other losses	12	800,141	-	1,335,399	-
		15,188,463	6,134,637	27,375,557	11,898,861
LOSS BEFORE INCOME TAXES		(7,859,062)	(942,661)	(19,073,700)	(2,870,939)
RECOVERY OF INCOME TAXES	9				
Deferred		(1,771,770)	(253,178)	(4,688,119)	(605,847)
NET LOSS AND COMPREHENSIVE LOSS		(6,087,292)	(689,483)	(14,385,581)	(2,265,092)
LOSS PER SHARE	14				
- Basic		(0.64)	(0.08)	(1.54)	(0.26)
- Diluted		(0.64)	(0.08)	(1.54)	(0.26)

The accompanying notes are an integral component of the condensed consolidated interim financial statements.

CARGOJET INC.

Condensed Consolidated Interim Statements of Changes in Equity

Six month periods ended June 30, 2015 and 2014

(unaudited, in Canadian dollars)

	Note	Shareholders' capital	Share-based compensation reserve	Conversion option	Reserve for surplus on debenture repurchases	Deficit	Total shareholders' equity
		$	$	$	$	$	$
Balance, January 1, 2015		79,758,600	460,581	5,818,250	2,162,078	(22,775,732)	65,423,777
Net loss and comprehensive loss		-	-	-	-	(14,385,581)	(14,385,581)
Treasury shares - net	13	437,125	-	-	-	-	437,125
Share-based compensation	15	1,231,436	(56,293)	-	-	-	1,175,143
Deferred tax on conversion option - net		-	-	-	-	92,966	92,966
Convertible debenture - conversion	8	3,763,846	-	(257,850)	257,850	-	3,763,846
Dividends	13	-	-	-	-	(2,835,271)	(2,835,271)
Balance, June 30, 2015		85,191,007	404,288	5,560,400	2,419,928	(39,903,618)	53,672,005
Balance, January 1, 2014		67,202,190	392,665	1,844,538	1,271,503	(8,168,065)	62,542,831
Net loss and comprehensive loss		-	-	-	-	(2,265,092)	(2,265,092)
Treasury shares - net		(59,773)	-	-	-	-	(59,773)
Conversion option on debenture issuance		-	-	6,618,078	-	-	6,618,078
Share-based compensation		-	(111,073)	-	-	-	(111,073)
Deferred tax on conversion option - net		-	-	(1,753,791)	-	312,486	(1,441,305)
Convertible debenture - conversion		11,585,808	-	(818,975)	818,975	-	11,585,808
Dividends		-	-	-	-	(2,672,532)	(2,672,532)
Balance, June 30, 2014		78,728,225	281,592	5,889,850	2,090,478	(12,793,203)	74,196,942

The accompanying notes are an integral component of the condensed consolidated interim financial statements.

CARGOJET INC.

Condensed Consolidated Interim Statements of Cash Flows

Six month periods ended June 30, 2015 and 2014

(unaudited, in Canadian dollars)

	Note	Six months ended June 30, 2015	2014
		$	$
CASH FLOWS USED IN OPERATING ACTIVITIES			
Net loss		(14,385,581)	(2,265,092)
Depreciation of property, plant and equipment	3	14,321,200	5,673,389
Share-based compensation		1,612,268	350,934
Finance costs		10,093,009	2,106,228
Effects of exchange rate changes on provision		232,610	7,635
Change in fair value of cash settled share based payment arrangement	12	(2,941)	-
Gain on disposal of property, plant and equipment		(471,411)	-
Unrealized loss on foreign exchange forward contracts	12	1,809,751	-
Non-cash interest on notes receivable		(11,647)	(41,088)
Non-cash interest on finance lease receivable		(1,298)	(8,461)
Income tax recovery		(4,688,119)	(605,847)
		8,507,839	5,217,698
Items affecting cash			
Interest paid		(9,174,600)	(1,510,827)
Income tax payments		-	(2,409,256)
		(666,761)	1,297,615
Changes in non-cash working capital items and deposits			
Trade and other receivables		(5,313,681)	1,795,463
Inventories		(228,924)	171,433
Prepaid expenses and deposits		2,079,616	(2,940,613)
Trade and other payables		3,270,422	(3,770,882)
NET CASH USED IN OPERATING ACTIVITIES		(859,327)	(3,446,984)
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayment of borrowings		(227,028)	(1,685,162)
Proceeds from borrowings		77,654,341	-
Repayment of obligations under finance leases		(5,106,075)	(408,004)
Purchase of treasury shares		-	(521,780)
Proceeds from debenture issuance		-	70,734,456
Dividends paid to shareholders	13	(2,777,486)	(2,510,555)
NET CASH FROM FINANCING ACTIVITIES		69,543,752	65,608,955
CASH FLOWS USED IN INVESTING ACTIVITIES			
Payments for property, plant and equipment	3	(68,155,087)	(52,873,400)
Proceeds from disposal of property, plant and equipment		107,101	-
Payment of provision for lease return conditions		-	(118,183)
Acquisition of business	4	(1,000,000)	-
Collections of notes receivable		247,492	428,843
Collections of finance lease receivable		116,069	158,174
NET CASH USED IN INVESTING ACTIVITIES		(68,684,425)	(52,404,566)
NET CHANGE IN CASH		-	9,757,405
CASH, BEGINNING OF PERIOD		-	441,506
CASH, END OF PERIOD		-	10,198,911

1. NATURE OF THE BUSINESS

Cargojet Inc. (“Cargojet” or the “Company”) operates a domestic overnight air cargo co-load network between fourteen major Canadian cities. The Company also provides dedicated aircraft to customers on an Aircraft, Crew, Maintenance and Insurance (“ACMI”) basis, operating between points in Canada and the USA. As well, the Company operates scheduled international routes for multiple cargo customers between the USA and Bermuda.

Cargojet is publicly listed with shares and convertible debentures traded on the Toronto Stock Exchange (“TSX”). The Company is incorporated and domiciled in Canada and the registered office is located at 350 Britannia Road East, Units 5 and 6, Mississauga, Ontario.

These condensed consolidated interim financial statements (the “financial statements”) were approved and authorized for issuance by the Board of Directors on August 11, 2015.

2. BASIS OF PREPARATION

The financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”), using International Accounting Standard 34, *Interim Financial Reporting* (“IAS 34”).

These financial statements include the accounts of the Company and its wholly-owned subsidiaries, Cargojet GP Inc. (“CGP”), Cargojet Holdings Limited Partnership (“CHLP”), and CHLP’s wholly-owned subsidiaries, Cargojet Holdings Ltd. (“CJH”), CJH’s wholly-owned subsidiary 2422311 Ontario Inc., CJH’s wholly-owned subsidiary ACE Air Charter Inc. (“ACE”), ACE’s wholly-owned subsidiaries ACE Maintenance Ontario Inc. (“ACEM”), 2166361 Ontario Inc. (“ACEO”), and ACEO’s wholly-owned subsidiary Navigatair Inc. (“NAVIGATAIR”), CJH’s wholly-owned subsidiary Cargojet Airways Ltd. (“CJA”) and Cargojet Partnership (“CJP”).

All intra-company balances and transactions are eliminated in full upon consolidation.

These financial statements do not include all of the information required for full annual financial statements, and should be read in conjunction with the Company’s audited consolidated financial statements for the year ended December 31, 2014.

Except as noted below, the Company has followed the same basis of presentation, accounting policies and method of computation for these financial statements as disclosed in the annual audited consolidated financial statements for the year ended December 31, 2014.

Accounting policies: Share based payments

Restricted share units

Restricted share units are granted to non-employee directors and certain key executives which are measured at the market value of the Company’s voting shares on the date of the grant based on the units granted to the non-employee directors and certain key executives. The cost of the restricted share units are recognized as a compensation expense with a corresponding increase in equity over the related service period provided to the Company as vested.

Stock options

Stock options are granted to non-employee directors and certain key executives which are measured at the market value of the Company's voting shares on the date of the grant based on the options granted to the non-employee directors and certain key executives. The cost of the stock options are recognized as a compensation expense with a corresponding increase in equity over the related service period provided to the Company as vested.

Standards, amendments and interpretations issued and not yet adopted

Financial instruments: In July 2014, the IASB issued IFRS 9 (2014), *Financial Instruments* ("IFRS 9"), which replaces *IAS 39, Financial Instruments: Recognition and Measurement* ("IAS 39") in its entirety.

IFRS 9 uses a single approach to determine whether a financial asset or liability is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. For financial assets, the approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. For financial liabilities measured at fair value, fair value changes due to changes in an entity's credit risk are presented in other comprehensive income ("OCI") instead of net income unless this would create an accounting mismatch. IFRS 9 sets a new general hedge accounting model. The new general hedge accounting model more closely aligns hedge accounting with risk management activities undertaken by entities when hedging their financial and non-financial risk exposures as it provides more opportunities to apply hedge accounting. The standard introduced a new expected loss impairment model. The standard is applied retrospectively with some exceptions related to the hedge accounting requirements and the restatement of prior periods for classification and measurement including impairment. The standard supersedes all previous versions of IFRS 9 and is effective for periods beginning on or after 1 January 2018. Early adoption is permitted. The Company is assessing the potential impact of this standard.

Revenue from contracts with customers: On May 28, 2014, the IASB and the FASB jointly issued *IFRS 15, Revenue from Contracts with Customers* ("IFRS 15"), a converged standard on the recognition of revenue from contracts with customers. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standard will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. Application of the standard is mandatory and applies to nearly all contracts with customers: the primary exceptions are leases, financial instruments and insurance contracts. The IASB standard is available for early application with mandatory adoption required for fiscal years commencing on or after January 1, 2018 and is to be applied using the retrospective or the modified transition approach. The standard will address accounting for loyalty programs, warranties and breakage. The Company is currently assessing the impact of this standard.

(unaudited – in Canadian Dollars)

3. PROPERTY, PLANT AND EQUIPMENT

Cost	Balance as at January 1, 2015	Additions / Transfers	Disposals / Transfers	Balance as at June 30, 2015
	$	$	$	$
Aircraft hull	87,051,394	85,151,430	-	172,202,824
Engines	51,804,055	37,177,290	(2,240,862)	86,740,483
Spare parts	1,913,434	260,906	-	2,174,340
Ground equipment	11,558,082	5,766,012	-	17,324,094
Rotable spares	18,499,673	4,059,483	(11,623)	22,547,533
Computer hardware and software	6,239,712	1,110,441	-	7,350,153
Furniture and fixtures	1,614,218	240,670	-	1,854,888
Leasehold improvements	10,057,690	-	-	10,057,690
Vehicles	2,166,811	502,887	-	2,669,698
Hangar and cross-dock facilities	16,635,221	7,641,695	(1,000,000)	23,276,916
Property, plant and equipment under development	35,336,205	(17,422,435)	-	17,913,770
Deferred heavy maintenance	18,063,454	10,616,442	-	28,679,896
	260,939,949	135,104,821	(3,252,485)	392,792,285

Accumulated Depreciation	Balance as at January 1, 2015	Depreciation	Disposals / Transfers	Balance as at June 30, 2015	Net Book Value, June 30, 2015
	$	$	$	$	$
Aircraft hull	7,781,407	3,537,439	-	11,318,846	160,883,978
Engines	11,294,934	4,147,425	(2,240,862)	13,201,497	73,538,986
Spare parts	-	-	-	-	2,174,340
Ground equipment	6,213,177	553,392	-	6,766,569	10,557,525
Rotable spares	8,911,958	933,785	-	9,845,743	12,701,790
Computer hardware and software	4,039,097	327,229	-	4,366,326	2,983,827
Furniture and fixtures	904,421	61,596	-	966,017	888,871
Leasehold improvements	5,062,955	1,336,049	-	6,399,004	3,658,686
Vehicles	692,368	164,739	-	857,107	1,812,591
Hangar and cross-dock facilities	5,008,274	266,232	(350,914)	4,923,592	18,353,324
Property, plant and equipment under development	-	-	-	-	17,913,770
Deferred heavy maintenance	7,086,573	2,993,314	-	10,079,887	18,600,010
	56,995,164	14,321,200	(2,591,776)	68,724,587	324,067,698

(unaudited – in Canadian Dollars)

Cost	Balance as at January 1, 2014	Additions / Transfers	Disposals / Transfers	Balance as at December 31, 2014
	$	$	$	$
Aircraft hull	13,815,039	73,572,267	(335,911)	87,051,395
Engines	15,179,630	36,624,425	-	51,804,055
Spare parts	1,629,443	459,539	(175,548)	1,913,434
Ground equipment	8,760,539	2,797,543	-	11,558,082
Rotable spares	14,229,426	4,270,247	-	18,499,673
Computer hardware and software	4,452,200	1,787,512	-	6,239,712
Furniture and fixtures	1,309,710	304,508	-	1,614,218
Leasehold improvements	5,353,942	4,703,748	-	10,057,690
Vehicles	991,449	1,175,362	-	2,166,811
Hangar facility	15,768,875	866,346	-	16,635,221
Property, plant and equipment under development	-	35,336,205	-	35,336,205
Deferred heavy maintenance	10,978,704	9,445,129	(2,360,379)	18,063,454
	92,468,957	171,342,831	(2,871,838)	260,939,950

Accumulated Depreciation	Balance as at January 1, 2014	Depreciation	Disposals / Transfers	Balance as at December 31, 2014	Net Book Value, December 31, 2014
	$	$	$	$	$
Aircraft hull	6,156,053	1,869,653	(244,299)	7,781,407	79,269,988
Engines	9,075,550	2,219,384	-	11,294,934	40,509,121
Spare parts	-	-	-	-	1,913,434
Ground equipment	5,346,265	866,912	-	6,213,177	5,344,905
Rotable spares	7,364,973	1,546,985	-	8,911,958	9,587,715
Computer hardware and software	3,592,568	446,529	-	4,039,097	2,200,615
Furniture and fixtures	801,769	102,652	-	904,421	709,797
Leasehold improvements	3,979,918	1,083,037	-	5,062,955	4,994,735
Vehicles	575,916	116,452	-	692,368	1,474,443
Hangar facility	4,533,939	474,335	-	5,008,274	11,626,947
Property, plant and equipment under development	-	-	-	-	35,336,205
Deferred heavy maintenance	5,197,275	4,249,677	(2,360,379)	7,086,573	10,976,881
	46,624,226	12,975,616	(2,604,678)	56,995,164	203,944,786

Property, plant and equipment under development consists of $17,913,770 (2014 - $35,336,205) and relates to the purchase and/or modification primarily of aircraft that are not yet available for use.

During the six month period ended June 30, 2015, the Company completed the acquisition of one Boeing B767-300 aircraft under the Master Lease Agreement as disclosed in Note 6, one Boeing B767-300 under a lease arrangement classified as a finance lease in accordance with the terms of the lease as disclosed in Note 6, one Boeing B767-300 under a loan agreement with a commercial lender as disclosed in Note 5 and one Boeing B757-200 aircraft under the Aircraft Facility Arrangement as disclosed in Note 5.

(unaudited – in Canadian Dollars)

During the six month period ended June 30, 2015, the Company acquired a new air cargo logistics facility for a total consideration of $5,750,000 comprised of a cash settlement of $4,750,000 and an exchange of a building owned by it for $1,000,000. A gain of $350,915 was recognized in the period on the exchange of the building.

For the six month period ended June 30, 2015, $1,180,015 (2014 - $455,824) of interest costs were capitalized to property, plant and equipment under development that includes paid interest of $917,193 (2014 - $388,519) and accretion of $262,822 (2014 - $67,305) relating to funds borrowed specifically to acquire and/or modify certain assets. The capitalization rate used to determine the amount of interest costs eligible for capitalization was equal to the effective interest rate applicable to specific borrowings, ranging between 7.23% to 8.77% (2014 – 7.37% to 8.77%).

For the six month period ended June 30, 2015, the Company also capitalized the fair value of cash settled share based payment arrangements related to specific aircraft finance leases of $462,073 (2014 - $nil) to the qualifying assets.

Depreciation expense on property, plant and equipment for the three and six month period ended June 30, 2015 totaled $8,294,527 and $14,321,200, respectively (2014 - $2,857,964 and $5,673,389, respectively).

4. BUSINESS COMBINATION

On January 30, 2015, the Company acquired all of the outstanding shares of ACE, thus obtaining control. Cash consideration paid for the acquisition in the first quarter was $1,000,000. The Company determined that the transaction represented a business combination with the Company being identified as an acquirer. The Company accounted for the combination under the acquisition method.

The Company acquired intangibles assets comprised of an air operator certificate and certain licenses. The Company recognized goodwill on this acquisition because of the recognition of a deferred tax liability for the difference between the assigned values and the tax base of the license acquired. The Company's purchase price allocation for the acquisition was as follows:

	$
Goodwill	265,000
License	1,000,000
Deferred tax liability	(265,000)
Consideration paid	1,000,000

The purchase price allocation is preliminary and based on the Company's management's best estimates. The final purchase price allocation is subject to adjustment pending compilation of additional information related to the transaction.

(unaudited – in Canadian Dollars)

5. BORROWINGS

Borrowings consist of the following:

	June 30, 2015	December 31, 2014
	$	$
Revolving credit facility	33,612,939	4,827,425
Aircraft facility arrangement	58,054,820	9,402,246
Other borrowings	246,395	257,170
	91,914,154	14,486,841
Less current portion	2,247,484	504,897
Long-term portion	89,666,670	13,981,944

Interest expense on the borrowings for the three and six months period ended June 30, 2015 totaled $1,731,987 and $2,414,322, respectively (2014 - $289,681 and $415,068, respectively).

Aircraft facility arrangements

In 2014, the Company executed first and second Aircraft Facility Arrangements ("AFA") with an equipment finance and leasing company for $25 million available in a non-revolving credit facility to refinance the acquisition of two Boeing 757-200 aircraft. During the six month period ended June 30, 2015, the Company availed the second facility limit under this AFA. This facility matures in January 2022 and is secured by a transfer of right, title and interest of ownership of the aircraft and all its components and records. Each loan under this credit facility is arranged in two tranches: A and B, each with its own schedule of principal and interest payments. The estimated effective interest rate for the facility availed during the period is 8.04%.

The AFA is subject to the maintenance of certain financial covenants. The Company was in compliance with all covenants as at June 30, 2015.

In April 2015, the Company also executed and availed a loan agreement with a commercial lending company for USD $27.5 million to refinance the acquisition of one Boeing 767-300 aircraft. This facility expires in April 2022 and is secured by the aircraft and all its components and records. The estimated effective interest rate for the facility availed during the period is 8.17%.

In June 2015, the Company secured a loan facility of USD $82.5 million with a US based lender to acquire additional B767-300 aircraft. As at June 30, 2015, the facility was undrawn. The loans will be secured by purchased aircraft and all of their components and records.

(unaudited – in Canadian Dollars)

The following is a schedule of future minimum annual payments under the AFA and aircraft loan agreement together with the balance of the obligation as at June 30, 2015.

	$
2015	856,818
2016	1,844,145
2017	4,828,457
2018	6,708,162
2019	9,033,781
Thereafter	34,328,915
Obligations under AFA	57,600,278
Fair value of cash settled share based payment arrangement	454,542
Total obligations under AFA	58,054,820
Less current portion	2,224,627
Long-term portion	55,830,193

Interest expense on the AFA and loan arrangement for the three and six months period totaled $1,144,854 and $1,652,100, respectively (2014 – $nil).

6. FINANCE LEASES

In 2014, the Company executed a Master Lease Agreement ("MLA") with an equipment finance and leasing company for up to $100 million in capital lease financing to acquire up to 3 Boeing 767-300 aircraft. The MLA was expanded to a 4th Boeing 767-300 aircraft under the same terms and conditions. During the six months period ended June 30, 2015, the Company completed the fourth finance lease under this MLA. This lease expires in January 2022 and provides for the transfer of ownership of the aircraft at the end of the lease term at a pre-determined price. Accordingly, this lease is classified as a finance lease and a corresponding lease obligation was recognized in the financial statements. Each lease under this lease facility is arranged in two tranches: A and B, each with its own schedule of principal and interest payments. The estimated effective interest rate is 7.23%. The leases under the MLA are guaranteed by the Company and its subsidiaries.

The arrangement is subject to the maintenance of certain financial covenants. The Company was in compliance with all covenants as at June 30, 2015.

The Company also has a finance lease arrangement for a Boeing 767-300 aircraft that includes a bargain purchase option. The estimated effective interest rate for this lease is 7.20%. The lease expires on March 2021 and the Company can exercise the bargain purchase option in March 2018.

(unaudited – in Canadian Dollars)

The following is a schedule of future minimum annual lease payments for aircraft under finance leases together with the balance of the obligation as at June 30, 2015.

	Minimum lease payments	Present value of minimum lease payments
	$	$
Not later than one year	22,158,647	11,218,918
Later than one year and not later than five years	141,097,293	109,223,313
Later than five years	34,757,826	33,893,160
	198,013,766	154,335,391
Less: interest	43,678,375	-
Obligations under finance leases	154,335,391	154,335,391
Fair value of cash settled share based payment arrangement	1,922,702	1,922,702
Total obligations under finance leases	156,258,093	156,258,093
Less: current portion	13,141,620	13,141,620
Non-current portion	143,116,473	143,116,473

Interest amount on the finance leases for the three and six months period totaled $2,840,892 and $5,224,060 (2014 - $nil), of which $284,281 (2014 - $nil) was capitalized to the cost of property, plant and equipment.

7. PROVISIONS

The Company's aircraft operating lease agreements require leased aircraft to be returned to the lessor in a specified operating condition. The Company has estimated that it will incur certain maintenance costs at the end of the lease terms and has recorded a maintenance provision liability for these costs. The change in the carrying amount of the provision is related to the revision of timing of future cash outflow of one underlying asset and settlement of the obligation of second underlying asset. A reconciliation of the carrying amount of the provision is as follows:

	June 30 2015	June 30 2014
	$	$
Balance, beginning of period	3,015,661	1,760,916
Recognition of provision for lease return conditions	-	431,086
Derecognition of provision for lease return conditions	(909,963)	-
Settlement of provision for lease return conditions	(337,248)	(118,183)
Accretion	72,317	72,884
Effects of exchange rate changes on the provision balance	232,610	7,635
Balance, end of period	2,073,377	2,154,338
Less: current portion	-	231,176
Non-current portion	2,073,377	1,923,162

(unaudited – in Canadian Dollars)

The provision for lease return conditions represents the present value of management's best estimate of the future outflow of economic benefits that will be required to settle the obligation at the end of the leases. Such costs have been estimated based on contractual commitments and the Company specific history. Accretion expense of $72,317 (2014 - $72,884) has been recorded in the period as part of finance costs in the condensed consolidated interim statement of loss. The provision has been added to the cost of deferred heavy maintenance included in property, plant and equipment and is being amortized over the remaining terms of the leases.

8. CONVERTIBLE DEBENTURES

The balances of convertible debentures at June 30, 2015 and December 31, 2014 consists of the following :

	June 30, 2015	December 31, 2014
	$	$
Convertible Debentures - 6.5%	10,226,426	13,802,461
Convertible Debentures - 5.5%	66,002,052	65,163,945
Balance	76,228,478	78,966,406

Convertible Debentures – 6.5% due April 30, 2017

In March 2012, $28,750,000 of unsecured subordinated convertible debentures were issued with a term of five years. These debentures bear a fixed interest rate of 6.5% per annum, payable semi-annually in arrears on April 30 and October 31 of each year, commencing April 30, 2012.

During the period, convertible debentures with an aggregate principal amount of $4,019,000 (2014 - $12,765,000) were converted, at the holders' discretion, into 342,037 (2014 – 1,086,369) voting shares of the Company. Accordingly, the Company derecognized $3,763,846 (2014 - $11,585,808) of the liability for convertible debentures, representing the amortized carrying cost amount of the liability immediately prior to conversion in respect of the debentures for which the holders' exercised their right to convert, and recognized shareholders' capital of the same amount. The corresponding conversion option of $257,850 (2014 - $818,975) was transferred from the reserve for conversion option to the reserve for surplus on debenture repurchases in the statement of changes in equity. No gain or loss was recognized upon conversion of the debentures.

(unaudited – in Canadian Dollars)

The balances of convertible debentures at June 30, 2015 and December 31, 2014 consists of the following:

	June 30, 2015	December 31, 2014
	$	$
Principal balance	10,850,000	14,869,000
Less:		
Issuance costs	(495,210)	(678,643)
Conversion option at inception	(997,213)	(1,366,595)
Accretion	868,849	978,699
Balance	10,226,426	13,802,461

Interest expense on the debentures for the three and six months period ended June 30, 2015 totaled $269,529 and $604,868, respectively (2014 - $398,285 and $958,467, respectively).

Convertible Debentures – 5.5% due June 30, 2019

In April 2014, $74,000,000 of unsecured subordinated convertible debentures were issued with a term of five years. These debentures bear a fixed interest rate of 5.5% per annum, payable semi-annually in arrears on June 30 and December 31 of each year, commencing December 31, 2014.

The debt component is measured at amortized cost. The balance of the debt component as at June 30, 2015 and December 31, 2014 consists of the following:

	2015	2014
	$	$
Principal balance	74,000,000	74,000,000
Less:		
Issuance costs	(3,265,544)	(3,265,544)
Conversion option at inception	(6,618,078)	(6,618,078)
Accretion	1,885,674	1,047,567
Balance	66,002,052	65,163,945

Interest expense on the debentures for the three and six months periods ended June 30, 2015 totaled $1,443,507 and $2,856,381, respectively (2014 - $939,013 and $939,013, respectively). For the six months period ended June 30, 2015 interest amount of $895,735 (2014 – $278,194) was capitalized to the cost of property, plant and equipment.

CARGOJET INC.
Notes to the Condensed Consolidated Interim Financial Statements
June 30, 2015 and 2014
(unaudited – in Canadian Dollars)

9. INCOME TAXES

The reconciliation between the Company's statutory and effective tax rate is as follows:

	Three month periods ended June 30, 2015	Three month periods ended June 30, 2014	Six month periods ended June 30, 2015	Six month periods ended June 30, 2014
	$	$	$	$
Loss before income taxes	(7,859,062)	(942,661)	(19,073,700)	(2,870,939)
Recovery of income tax at the combined basic rate of 26.5% (2014 - 26.5%)	(2,082,651)	(249,805)	(5,054,531)	(760,799)
Permanent and other differences	310,881	(3,373)	366,412	154,952
Recovery of income tax	(1,771,770)	(253,178)	(4,688,119)	(605,847)

The tax effect of significant temporary differences is as follows:

	June 30, 2015	December 31, 2014
	$	$
Property, plant and equipment	3,500,928	3,705,261
Operating loss carryforward	(7,736,922)	(1,667,841)
Licenses	265,000	-
Intangible assets	(506,929)	(525,315)
Derivative contracts	(479,584)	-
Notes receivable	(1,361)	(5,992)
Financing costs	(1,506,337)	(1,126,787)
Convertible debentures	1,576,675	1,846,047
Provision for lease retirement costs	(326,622)	(468,485)
Finance lease receivable	-	30,415
Long-term incentive plan	(36,150)	(122,247)
Deferred heavy maintenance	5,110,510	2,710,237
Net deferred income tax (asset) liability	(140,792)	4,375,293

The Company acquired all of the outstanding shares of ACE as disclosed in Note 4 and recognized a deferred tax liability for the difference between the assigned values and the tax base of the license acquired.

10. DIRECT EXPENSES

	Three month periods ended June 30, 2015	Three month periods ended June 30, 2014	Six month periods ended June 30, 2015	Six month periods ended June 30, 2014
	$	$	$	$
Fuel costs	19,869,847	14,563,492	32,413,491	30,766,443
Maintenance costs	5,158,024	2,859,821	10,803,789	5,773,300
Heavy maintenance amortization	1,645,471	1,074,610	2,953,595	2,260,582
Aircraft costs	10,225,265	5,813,221	19,385,040	10,128,810
Crew costs	5,836,685	3,472,503	10,716,165	6,438,209
Direct depreciation	6,422,643	1,635,191	10,929,223	3,174,812
Commercial and other costs	18,737,068	9,724,152	33,799,550	20,480,490
Direct expenses	67,895,003	39,142,989	121,000,853	79,022,646

(unaudited – in Canadian Dollars)

11. GENERAL AND ADMINISTRATIVE EXPENSES

	Three month periods ended June 30,		Six month periods ended June 30,	
	2015	2014	2015	2014
	$	$	$	$
Salaries and benefits	4,436,462	3,084,449	8,863,499	6,046,406
Depreciation and amortization	226,417	148,163	438,382	298,058
Other general and administrative expenses	3,543,094	1,374,530	6,038,729	3,239,635
General and administrative expenses	8,205,973	4,607,142	15,340,610	9,584,099

12. OTHER LOSSES

Other losses consist of the following:

	Three month periods ended June 30,		Six month periods ended June 30,	
	2015	2014	2015	2014
	$	$	$	$
Gain on disposal of property, plant and equipment	(419,075)	-	(471,411)	-
Net loss on forward foreign exchange contracts	1,116,630	-	1,809,751	-
Loss (gain) on cash settled share based payment arrangement	102,586	-	(2,941)	-
Other losses, net	800,141	-	1,335,399	-

13. SHAREHOLDERS' CAPITAL

Issued and outstanding

The following table shows the changes in shareholders' capital from December 31, 2014 to June 30, 2015:

	Number	Amount
		$
Variable voting shares	98,545	860,744
Common voting shares	9,032,869	78,897,856
Outstanding December 31, 2014	9,131,414	79,758,600
Changes during the period		
Voting shares issued on conversion of convertible debentures	342,037	3,763,846
Share based compensation (Note 15)	45,189	1,231,436
Distributed in connection with share-based compensation	33,619	437,125
Outstanding June 30, 2015	9,552,259	85,191,007
Consisting of:		
Variable voting shares	101,317	904,052
Common voting shares	9,450,942	84,286,955
Outstanding June 30, 2015	9,552,259	85,191,007

Common voting shares outstanding as at June 30, 2015 excludes treasury shares.

(unaudited – in Canadian Dollars)

No preferred shares are issued or outstanding.

Dividends

Dividends to shareholders declared for the three and six month periods ended June 30, 2015 amounted to $1,425,692 ($0.1491 per share) and $2,835,271 ($0.2982 per share), respectively and for the three and six month periods ended June 30, 2014 amounted to $1,353,796 ($0.1491 per share) and $2,672,532 ($0.2982 per share), respectively.

14. LOSS PER SHARE

The following table shows the computation of basic loss per share for the three and six month periods ended June 30, 2015 and 2014:

	Three month periods ended June 30,				Six month periods ended June 30,			
Basic loss per share		2015		2014		2015		2014
Net loss	$	(6,087,292)	$	(689,483)	$	(14,385,581)	$	(2,265,092)
Weighted average number of shares		9,482,432		8,949,266		9,353,788		8,633,619
Total basic loss per share	$	(0.64)	$	(0.08)	$	(1.54)	$	(0.26)

The shares held under the long-term incentive plan have been included in the calculation of basic earnings per share for the three and six month periods ended June 30, 2015 and 2014 as they participate in dividend distributions. The effect of the convertible debentures has been excluded from the calculation of diluted earnings per share for the three and six month periods ended June 30, 2015 and 2014 as the impact would be anti-dilutive.

15. SHARE BASED COMPENSATION

In 2014, the Company adopted a restricted share unit (“RSU”) plan and a stock option plan as part of its long term incentive plan.

(unaudited – in Canadian Dollars)

During the six month period ended June 30, 2015, in accordance with the plan, the Company granted 147,150 RSUs (six month period ended June 30, 2014 – nil) to certain key executives. Each RSU granted to key executives was equal to one common share. Each RSU had an average value of $26.83 calculated as the volume weighted average closing price of the common voting shares of the Company for the five trading days prior to the grant date. A total of 38,488 RSUs vested immediately. For the six month period ended June 30, 2015, the Company recorded share based compensation expense of $1,048,382 with respect to the vested RSUs. Of the remaining 108,662 RSUs granted, 47,332 will vest in each of the first quarters of 2016 and 2017 and 13,998 RSUs will vest in first quarter of 2018. Share based compensation expense of $177,339 related to unvested RSUs is included in the condensed consolidated interim statement of loss for the three and six month period ended June 30, 2015. Unrecognized share based compensation expense as at June 30, 2015 related to these RSUs was $2,721,794 (June 30, 2014 – $nil) and will be amortized on a prorated basis in the consolidated statement of income or loss over the vesting period.

During the six month period ended June 30, 2015, the Company also granted 6,701 RSUs to non-employee directors. Each RSU granted to non-employee directors was equal to one common share and had an average value of $27.38 per RSU calculated as the volume weighted average closing price of the common voting shares of the Company for the five trading days prior to the grant dates. The value of RSUs granted to non-employee directors was determined by reference to the market value for similar services. All 6,701 RSUs vested immediately. For the six month period ended June 30, 2015, the Company recorded share based compensation expense of $183,054 with respect to the vested RSUs.

During the six month period ended on June 30, 2015, the Company granted 172,399 stock options at an average exercise price of $25.46 which had a fair value of $858,547 or $4.98 for each option (six month period ended June 30, 2014 - $nil). Each share option granted can be converted to one common share at the exercised price. The exercise price was calculated as the volume weighted average closing price of the common voting shares of the Company for the five trading days prior to the grant date. The options were valued using the Black Scholes option valuation model.

Inputs into the Black Scholes option valuation model were as follows:

Grant date share price	$25.27
Exercise price	$25.46
Expected volatility	22.6%
Option life	5 years
Dividend yield	2.4%
Risk free rate	0.94%

Stock options have a five-year term and vest in each of the first quarters of 2016, 2017 and 2018. Each stock option is exercisable into one common share of the Company at the exercise price specified in the terms of the option agreement. The option based compensation expense will be amortized on a prorated basis in the consolidated statement of income or loss over the vesting period. The Company recognized an expense of $24,505 (June 30, 2014 – $nil) in respect of the amortization of options over the vesting period. The unrecognized value as at June 30, 2015 related to these options was $834,042 (June 30, 2014 – $nil) and will be amortized on a prorated basis in the consolidated statement of income or loss over the vesting period.

16. FINANCIAL INSTRUMENTS

Fair values

The fair value of the convertible debentures, based on discounted cash flow as at June 30, 2015, was approximately $76,228,478 (December 31, 2014 – $75,834,000). The fair value of the long-term debt as disclosed in Note 5 was approximately equal to its carrying value. The fair values of the notes receivables and finance lease receivable as at June 30, 2015 and December 31, 2014 were approximately equal to their carrying values. The fair values of all other financial assets and liabilities approximate their carrying values given the short-term nature of these items.

At June 30, 2015, the Company had foreign exchange forward contracts outstanding to buy US$ 54.4 million at a weighted average contracted rate of 1.2712 (December 31, 2014 – nil). The derivative contracts are recorded at fair market value, which fair value is classified as Level 2 under the fair value hierarchy. The estimated net loss on the foreign exchange forward contracts of $1,809,751 for the period is included in other losses on the condensed consolidated interim statement of loss.

There are no other assets or liabilities recorded at fair value as at June 30, 2015 and December 31, 2014.