Condensed Consolidated Interim Financial Statements of

CARGOJET INC.

For the three and nine month periods ended September 30, 2014 and 2013

(unaudited – expressed in Canadian Dollars)

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CARGOJET INC.
Condensed Consolidated Interim Balance Sheets
As at September 30, 2014 and December 31, 2013
(unaudited, in Canadian dollars)

	Note	September 30, 2014	December 31, 2013
		$	$
ASSETS			
CURRENT ASSETS			
Cash		24,285,468	441,506
Trade and other receivables		13,387,769	15,399,458
Inventories		825,152	1,062,981
Prepaid expenses and deposits		3,150,851	982,972
Income taxes receivable		4,583	-
Current portion of notes receivable		822,928	821,102
Current portion of finance lease receivable		192,664	311,653
		42,669,415	19,019,672
NON-CURRENT ASSETS			
Property, plant and equipment	3	145,668,511	45,844,731
Notes receivable		173,521	977,224
Finance lease receivable		-	98,591
Goodwill		46,169,976	46,169,976
Intangible assets		1,000,000	1,000,000
Deposits		5,809,661	3,040,678
		241,491,084	116,150,872
LIABILITIES			
CURRENT LIABILITIES			
Trade and other payables		20,590,758	16,797,283
Income taxes payable		-	2,162,510
Provisions	5	1,957,750	-
Dividends payable		1,363,656	1,191,819
Finance leases	4	4,257,795	20,280
		28,169,959	20,171,892
NON-CURRENT LIABILITIES			
Borrowings		-	1,675,223
Finance leases	4	59,085,332	257,170
Provisions	5	279,577	1,760,916
Convertible debentures	6	78,766,470	25,940,908
Deferred income taxes	7	3,810,840	3,801,932
		170,112,178	53,608,041
EQUITY		71,378,906	62,542,831
		241,491,084	116,150,872

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

CARGOJET INC.

Condensed Consolidated Interim Statements of (Loss) Income and Comprehensive (Loss) Income

Three month and nine month periods ended September 30, 2014 and 2013

(unaudited, in Canadian dollars)

	Note	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
		$	$	$	$
REVENUES		47,227,118	43,416,122	135,277,684	126,857,190
DIRECT EXPENSES		43,271,218	37,828,004	122,293,863	110,094,546
		3,955,900	5,588,118	12,983,821	16,762,644
General and administrative expenses		6,121,212	4,062,399	15,705,311	12,573,660
Sales and marketing expenses		161,031	109,569	452,405	250,838
(Gain) loss on disposal of property, plant and equipment		(42,353)	147,384	(42,353)	147,384
Finance costs		831,170	820,862	2,937,398	2,427,264
Finance income		(29,064)	(32,968)	(111,903)	(112,247)
Impairment on property, plant and equipment	3	-	-	-	281,275
		7,041,996	5,107,246	18,940,858	15,568,174
(LOSS) INCOME BEFORE INCOME TAXES		(3,086,096)	480,872	(5,957,037)	1,194,470
(RECOVERY OF) PROVISION FOR INCOME TAXES	7				
Current		-	325,000	-	1,015,000
Deferred		(810,299)	(69,030)	(1,416,146)	(758,156)
		(810,299)	255,970	(1,416,146)	256,844
NET (LOSS) INCOME AND COMPREHENSIVE (LOSS) INCOME		(2,275,797)	224,902	(4,540,891)	937,626
(LOSS) EARNINGS PER SHARE	9				
- Basic		(0.25)	0.03	(0.52)	0.12
- Diluted		(0.25)	0.03	(0.52)	0.12

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

CARGOJET INC.

Condensed Consolidated Interim Statements of Changes in Equity

Nine month periods ended September 30, 2014 and 2013
(unaudited, in Canadian dollars)

	Note	Shareholders' capital	Share-based compensation reserve	Conversion option	Reserve for surplus on debenture repurchases	Deficit	Total shareholders' equity
		$	$	$	$	$	$
Balance, December 31, 2013		67,202,190	392,665	1,844,538	1,271,503	(8,168,065)	62,542,831
Net loss and comprehensive loss		-	-	-	-	(4,540,891)	(4,540,891)
Treasury shares - net	8	(59,773)	-	-	-	-	(59,773)
Share-based compensation	8,10	-	(21,578)	-	-	-	(21,578)
Conversion option on debenture issuance	6	-	-	6,618,078	-	-	6,618,078
Deferred tax on conversion option	7	-	-	(1,753,791)	-	328,737	(1,425,054)
Convertible debenture - conversion	6	12,301,481	-	(868,826)	868,826	-	12,301,481
Dividends	8	-	-	-	-	(4,036,188)	(4,036,188)
Balance, September 30, 2014		79,443,898	371,087	5,839,999	2,140,329	(16,416,407)	71,378,906
Balance, December 31, 2012		67,329,440	341,554	1,844,538	1,271,503	(6,316,764)	64,470,271
Net Income and comprehensive Income		-	-	-	-	937,626	937,626
Treasury shares - net		(127,250)	-	-	-	-	(127,250)
Share-based compensation		-	(34,139)	-	-	-	(34,139)
Dividends	8	-	-	-	-	(3,991,113)	(3,991,113)
Balance, September 30, 2013		67,202,190	307,415	1,844,538	1,271,503	(9,370,251)	61,255,395

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

CARGOJET INC.
Condensed Consolidated Interim Statements of Cash Flows
Nine month periods ended September 30, 2014 and 2013
(unaudited, in Canadian dollars)

	Note	Nine months ended September 30, 2014	2013
		$	$
CASH FLOWS FROM OPERATING ACTIVITIES			
Net (loss) income		(4,540,891)	937,626
Items not affecting cash			
Depreciation of property, plant and equipment	3	8,467,224	8,565,682
Share-based compensation	10	440,429	431,486
Finance costs		2,937,398	2,427,263
Effects of exchange rate changes on provision	5	108,494	-
(Gain) loss on disposal of property, plant and equipment		(42,353)	147,384
Impairment on property, plant and equipment	3	-	281,275
Non-cash interest on notes receivable		(55,812)	(89,533)
Non-cash interest on finance lease receivable		(11,309)	(22,602)
Income tax (recovery) provision		(1,416,146)	256,844
		5,887,034	12,935,425
Items affecting cash			
Interest paid		(2,217,280)	(1,785,165)
Income tax payments		(2,167,092)	(564,511)
		1,502,662	10,585,749
Changes in non-cash working capital items and deposits			
Trade and other receivables		2,011,689	(2,349,950)
Inventories		237,829	180,831
Prepaid expenses and deposits		(4,936,862)	1,395,266
Trade and other payables		3,793,475	1,818,370
NET CASH GENERATED BY OPERATING ACTIVITIES		2,608,793	11,630,267
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayment of borrowings		(1,675,223)	(1,139,659)
Proceeds from borrowings		-	3,602,676
Repayment of obligations under finance leases		(647,573)	-
Proceeds from sale and leaseback of property, plant and equipment	4	31,942,800	-
Purchase of treasury shares		(521,780)	(592,875)
Proceeds from debenture issuance	6	70,734,456	-
Dividends paid to shareholders		(3,864,351)	(3,991,113)
NET CASH GENERATED (USED) BY FINANCING ACTIVITIES		95,968,329	(2,120,971)
CASH FLOWS FROM INVESTING ACTIVITIES			
Payments for property, plant and equipment	3	(75,773,730)	(10,253,039)
Payment of provision for lease return conditions		(177,349)	-
Proceeds from disposal of property, plant and equipment		131,340	-
Collections of notes receivable		857,689	857,690
Collections of finance lease receivable		228,890	208,181
NET CASH USED IN INVESTING ACTIVITIES		(74,733,160)	(9,187,168)
NET CHANGE IN CASH		23,843,962	322,129
CASH, BEGINNING OF PERIOD		441,506	149,976
CASH, END OF PERIOD		24,285,468	472,104

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

1. NATURE OF THE BUSINESS

Cargojet Inc. ("Cargojet" or "the Company") operates a domestic overnight air cargo co-load network between thirteen 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 November 6, 2014.

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., Cargojet Airways Ltd. ("CJA") and Cargojet Partnership ("CJP").

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, 2013.

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, 2013.

Accounting standards effective for 2014

Effective January 1, 2014, the following new or amended accounting standards were effective for the Company:

New standards implemented

Financial instruments: Asset and liability offsetting

In December 2011, the International Accounting Standard Board ("IASB") amended IAS 32, *Financial Instruments: Presentation* ("IAS 32") to clarify the requirements which permit offsetting a financial asset and liability in the financial statements. The IAS 32 amendments were applied retrospectively for annual periods beginning on or after January 1, 2014. The implementation of the IAS 32 amendments did not have a significant impact on the Company.

2. BASIS OF PREPARATION (CONTINUED)

New standards implemented (continued)

Impairment of assets

In May 2013, the IASB amended IAS 36, *Impairment of Assets* ("IAS 36"), to clarify the requirement to disclose information about the recoverable amount of assets for which an impairment loss has been recognized or reversed. The IAS 36 amendments were applied retrospectively for annual periods beginning on or after January 1, 2014. The implementation of the IAS 36 amendments did not have a significant impact on the Company.

Financial Instruments: Novation of derivatives and continuation of hedge accounting

In September 2013, the IASB issued *Novation of Derivatives and Continuation of Hedge Accounting, Amendments to IAS 39*. This amendment to IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39") provides an exception to the requirement to discontinue hedge accounting in situations where over-the-counter derivatives designated in hedging relationships are directly or indirectly novated to a central counterparty as a consequence of laws or regulations, or the introduction of laws or regulations. The IAS 39 amendments were applied retrospectively for annual periods beginning on or after January 1, 2014. The implementation of the IAS 39 amendments did not have a significant impact on the Company.

Levies

In May 2013, the IASB issued IFRIC Interpretation 21, *Levies* ("IFRIC 21"), which is an interpretation of IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. IFRIC 21 clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. IFRIC 21 is effective for annual periods beginning on or after January 1, 2014 and must be applied retrospectively. The implementation of IFRIC 21 did not have a significant impact on the Company.

Standards, amendments and interpretations issued and not yet adopted

The following new standards, amendments and interpretations have been issued but are not effective for the nine month period ended September 30, 2014, and, accordingly, have not been applied in preparing these interim financial statements.

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

2. BASIS OF PREPARATION (CONTINUED)

Standards, amendments and interpretations issued and not yet adopted (continued)

Financial instruments (continued)

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, 2017 and is to be applied using the retrospective or the modified transition approach. The standard will address accounting for loyalty programs, warranties and breakage. Management is currently assessing the impact of this standard.

(unaudited – in Canadian Dollars)

3. PROPERTY, PLANT AND EQUIPMENT

Cost	Balance as at January 1, 2014	Additions / Transfers	Disposals / Transfers	Balance as at September 30, 2014
	$	$	$	$
Aircraft hull	13,815,039	303,169	(335,911)	13,782,297
Engines	15,179,630	1,110,753	-	16,290,383
Spare parts	1,629,443	186,216	-	1,815,659
Ground equipment	8,760,539	1,044,360	-	9,804,899
Rotable spares	14,229,426	2,780,442	-	17,009,868
Computer hardware and software	4,452,200	1,454,389	-	5,906,589
Furniture and fixtures	1,309,710	40,416	-	1,350,126
Leasehold improvements	5,353,942	2,175,334	-	7,529,276
Vehicles	991,449	138,189	-	1,129,638
Hangar facility	15,768,875	2,970,474	-	18,739,349
Property, plant and equipment under development	-	94,072,931	-	94,072,931
Deferred heavy maintenance	10,978,704	2,105,943	(2,360,379)	10,724,268
	92,468,957	108,382,616	(2,696,290)	198,155,283

Accumulated Depreciation	Balance as at January 1, 2014	Depreciation	Disposals / Transfers	Impairment	Balance as at September 30, 2014	Net Book Value, September 30, 2014
	$	$	$	$	$	$
Aircraft hull	6,156,053	1,162,988	(244,299)	-	7,074,742	6,707,555
Engines	9,075,550	1,267,923	-	-	10,343,473	5,946,910
Spare parts	-	-	-	-	-	1,815,659
Ground equipment	5,346,265	642,487	-	-	5,988,752	3,816,147
Rotable spares	7,364,973	1,071,329	-	-	8,436,302	8,573,566
Computer hardware and software	3,592,568	308,293	-	-	3,900,861	2,005,728
Furniture and fixtures	801,769	74,629	-	-	876,398	473,728
Leasehold improvements	3,979,918	362,696	-	-	4,342,614	3,186,662
Vehicles	575,916	67,065	-	-	642,981	486,657
Hangar facility	4,533,939	354,253	-	-	4,888,192	13,851,157
Property, plant and equipment under development	-	-	-	-	-	94,072,931
Deferred heavy maintenance	5,197,275	3,155,561	(2,360,379)	-	5,992,457	4,731,811
	46,624,226	8,467,224	(2,604,678)	-	52,486,772	145,668,511

(unaudited – in Canadian Dollars)

3. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

Cost	Balance as at January 1, 2013	Additions / Transfers	Disposals / Transfers	Balance as at December 31, 2013
	$	$	$	$
Aircraft hull	12,914,254	1,284,591	(383,806)	13,815,039
Engines	13,730,810	3,226,775	(1,777,955)	15,179,630
Spare parts	1,572,637	56,806	-	1,629,443
Ground equipment	8,359,363	427,371	(26,195)	8,760,539
Rotable spares	13,352,170	873,275	3,981	14,229,426
Computer hardware and software	4,309,223	142,977	-	4,452,200
Furniture and fixtures	1,225,177	84,533	-	1,309,710
Leasehold improvements	4,711,872	642,070	-	5,353,942
Vehicles	763,340	225,030	3,079	991,449
Hangar facility	14,950,992	817,883	-	15,768,875
Deferred heavy maintenance	19,675,588	3,987,858	(12,684,742)	10,978,704
	95,565,426	11,769,169	(14,865,638)	92,468,957

Accumulated Depreciation	Balance as at January 1, 2013	Depreciation	Disposals / Transfers	Impairment	Balance as at December 31, 2013	Net Book Value, December 31, 2013
	$	$	$	$	$	$
Aircraft hull	5,290,057	1,150,784	(284,788)	-	6,156,053	7,658,986
Engines	8,167,395	2,128,656	(1,501,776)	281,275	9,075,550	6,104,080
Spare parts	-	-	-	-	-	1,629,443
Ground equipment	4,538,796	806,391	1,078	-	5,346,265	3,414,274
Rotable spares	5,829,528	1,532,968	2,477	-	7,364,973	6,864,453
Computer hardware and software	3,135,130	458,015	(577)	-	3,592,568	859,632
Furniture and fixtures	691,477	110,332	(40)	-	801,769	507,941
Leasehold improvements	3,607,930	378,922	(6,934)	-	3,979,918	1,374,024
Vehicles	483,775	89,147	2,994	-	575,916	415,533
Hangar facility	4,084,508	449,431	-	-	4,533,939	11,234,936
Deferred heavy maintenance	13,026,680	4,424,420	(12,253,825)	-	5,197,275	5,781,429
	48,855,276	11,529,066	(14,041,391)	281,275	46,624,226	45,844,731

During the three month period ended September 30, 2014, the Company has sold one aircraft that was previously owned and recorded as property, plant and equipment under development, and leased back from an equipment leasing company under the agreement as disclosed in Note 4 for $31,942,800 (2013- $nil).

Property, plant and equipment under development includes $68,606,016 relating to two aircraft under finance lease that is not yet available for use (2013 - $nil). The remaining balance of $25,466,915 (2013 - $nil) relates to the purchase and/or modification of aircraft and other property, plant and equipment that is not yet available for use.

During the period $2,205,635 (2013 - $nil) of interest costs was capitalized to property, plant and equipment under development that includes paid interest of $1,800,912 and accretion of $404,723 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 the specific borrowings, ranging between 7.35% to 8.77%.

3. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

In March 2013, the Company reviewed the carrying value of its used engines and estimated that the recoverable amount was less than the book value. The Company reduced the net book value of the used engines to fair value by $281,275 and reported a loss on impairment of property, plant and equipment.

Depreciation expense on property, plant and equipment for the three and nine month periods ended September 30, 2014 totaled $2,793,835 and $8,467,224, respectively (2013 - $2,942,514 and $8,565,682, respectively).

4. FINANCE LEASES

The Company executed a Master Capital 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. During the period, the Company completed two finance leases under this MLA including one sales and leaseback of an aircraft completed during the quarter. These leases expire from June 2021to September 2021 and provides for the transfer of ownership of the aircraft at the end of the lease term at a pre-determined price. Accordingly, these leases are classified as a finance lease and a corresponding lease obligations were recognized in the financial statements. These lease facilities are arranged in two tranches: A and B, each with its own schedule of principal and interest payment. The estimated effective interest rate ranges from 7.35% to 7.37%. These leases are guaranteed by the Company and its subsidiaries.

The aggregate tranche A comprises 80% of the lease contract amount. 60% of the tranche A principal amount is repayable in equal monthly installments during the 84 month amortization term. The first payment is due on the delivery date and thereafter is due in advance on the first business day of each month. The remaining 40% of the amount in respect of the lease contract is payable at the termination of the contract.

The aggregate tranche B comprises 20% of the lease contract amount. The basic rent due in respect of the lease contract shall be equal to the interest on tranche B amount advanced in respect of the lease contract, compounded monthly and payable quarterly in arrears over the tranche B term of 48 months. The first interest payment is due on the first business day of the month occurring 90 days after the delivery date. It further provides for quarterly payment of a variable amount on account of the principal tranche B amount equal to 50 % of the free cash flow generated for the previous fiscal quarter, provided that any such payment shall not exceed 1/16 of the outstanding amount of tranche B for the lease contract. The balance amount of the lease contract is payable at the termination of the contract.

The Company has agreed to pay an arrangement fee in the amount equal to 0.75% of the amount of the finance leases. The Company also agreed to pay an additional fee in respect of each lease contract in an amount equal to the positive difference between the price of 58,333 shares of Cargojet (CJT-A) being $22.99 per share and the twenty day volume weighted average closing price for such share as of the date preceding the date on which the lessor demands the payment by a written notice, provided that such notice can be given on a day after the first anniversary of the MLA and before the fourth anniversary of such agreement. The additional fee have been accounted for as a share based compensation option.

The company has also agreed to pay a success fee in the amount equal to 1.5% of the amount of the finance leases to an independent investment banking firm for its services towards completion of the transaction.

The above notes fees are considered as initial direct costs of the finance leases and have been capitalized to the respective finance lease assets.

(unaudited – in Canadian Dollars)

4. FINANCE LEASES (CONTINUED)

The arrangement includes certain financial covenants with respect to the Company's profitability. The Company was in compliance with all covenants as at September 30, 2014.

Finance lease include other borrowings of $262,393 (December 31, 2013 - $277,450), consisting of an obligation under a finance lease and bears an interest rate of 8.0%. The amount is repayable in monthly installments over the period to April 2018.

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 September 30, 2014.

	Minimum lease payments	Present value of minimum lease payments
	$	$
Not later than one year	7,884,258	3,709,095
Later than one year and not later than five years	43,501,349	29,208,875
Later than five years	33,727,461	29,876,457
	85,113,068	62,794,427
Less: interest	22,318,641	-
Obligations under finance leases	62,794,427	62,794,427
Fair value of share based additional fees option	548,700	548,700
Total obligations under finance leases	63,343,127	63,343,127
Less: current portion	4,257,795	4,257,795
Non-current portion	59,085,332	59,085,332

Interest amount on the lease contract for the three and nine month periods ended September 30, 2014 totaled $701,887 and $712,820, respectively (2013 - $nil and $5,709, respectively), of which $695,570 (2013 - $nil) was capitalized to the cost of property, plant and equipment.

5. 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 as follows:

	September 30, 2014	September 30, 2013
	$	$
Balance, beginning of period	1,760,916	1,543,784
Recognition of provision for lease return conditions	431,086	-
Accretion	114,180	78,735
Payment of provision for lease return conditions	(177,349)	-
Effects of exchange rate changes on the provision balance	108,494	55,843
Balance, end of period	2,237,327	1,678,362
Less: current portion	1,957,750	-
Non-current portion	279,577	1,678,362

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 Company specific history.

(unaudited – in Canadian Dollars)

5. PROVISIONS (CONTINUED)

Accretion expense of $114,180 (2013 - $78,735) 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.

6. CONVERTIBLE DEBENTURES

Convertible Debentures – 6.5% due April 30, 2017

The balance of convertible debentures as at September 30, 2014 and December 31, 2013 consists of:

	September 30, 2014	December 31, 2013
	$	$
Principal balance	15,208,000	28,750,000
Less:		
Issuance costs	(694,115)	(1,312,192)
Conversion option at inception	(1,397,752)	(2,642,384)
Accretion	901,632	1,145,484
Balance	14,017,765	25,940,908

Interest expense on the debentures for the three and nine month periods ended September 30, 2014 totaled $363,308 and $1,321,775, respectively (2013 - $640,513 and $1,905,245, respectively).

Based on certain conditions, the debentures are convertible, at the holders' discretion, at $11.75 per voting share at any time prior to the close of business on the earliest of the business day immediately preceding the maturity date.

During the nine month period ended September 30, 2014, convertible debentures with an aggregate principal amount of $13,542,000 were converted, at the holders' discretion, into 1,152,496 voting shares of the Company ($11.75 per voting share). Accordingly, the Company derecognized $12,301,481 of the liability for convertible debentures, representing the amortized cost carrying 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 $868,826 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.

Convertible Debentures – 5.5% due June 30, 2019

In April 2014, $74.0 million 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.

On or after June 30, 2017, but prior to June 30, 2018, the debentures are redeemable, in whole at any time or in part from time to time, at the option of the Company at a price equal to at least $1,000 per debenture plus accrued and unpaid interest, provided that the current market price of the common shares of the

6. CONVERTIBLE DEBENTURES (CONTINUED)

Convertible Debentures – 5.5% due June 30, 2019 (continued)

Company on the date on which the notice of redemption is given is at least 125% of the conversion price of $28.75 per common share. On or after June 30, 2018, but prior to the maturity date of June 30, 2019, the debentures are redeemable at a price equal to $1,000 per debenture plus accrued and unpaid interest. On redemption or at maturity on June 30, 2019, the Company has the option to repay the debentures in either cash or freely tradable voting shares of the Company. The number of common shares to be issued will be determined by dividing the aggregate amount of the principal amount of the debentures by 95% of the current market price of the common shares.

Based on certain conditions, the debentures are convertible, at the holders' discretion, at $28.75 per voting share at any time prior to the close of business on the earliest of the business day immediately preceding the maturity date; if called for redemption, on the business day immediately preceding the date specified by the Company for redemption of the debentures; or if called for repurchase pursuant to a change of control, on the business day immediately preceding the payment date. The Company also has the right at any time to purchase debentures in the market, by tender or by private contract subject to regulatory requirements, provided, however, that if an event of default has occurred and is continuing, the Company or any of its affiliates will not have the right to purchase the debentures by private contract. The conversion rate of $28.75 per voting share is subject to adjustment in certain circumstances, including the payment of a cash dividend or distribution to holders of voting shares in excess of $0.225 per quarter ($0.900 per annum).

In the event of a change in control, as defined in the indenture, the Company will be required to make an offer to the holders of debentures to repurchase the debentures at a price equal to 100% of the principal amount plus accrued and unpaid interest. In addition, if a change in control occurs in which 10% or more of the consideration consists of cash, certain equity securities or other property not traded or intended to be traded immediately following such transaction on a recognized exchange, holders of the debentures will be entitled to convert their debentures and, subject to certain limitations, receive an additional amount of voting shares to those that they would otherwise be entitled at the normal conversion rate. The amount of such additional voting shares will depend on the effective date and the price paid per voting share in the transaction constituting the change in control.

The principal amount of the debentures has been allocated between its debt and equity components. The carrying amount of the debt component was established by measuring the fair value of a similar liability (with similar terms, credit status and embedded non-equity derivative features) but without an associated equity component. The carrying amount of the equity component, presented separately in the reserve for 'conversion option' in the statement of changes in equity, was then determined by deducting the fair value of the liability component from the fair value of the debentures as a whole.

(unaudited – in Canadian Dollars)

6. CONVERTIBLE DEBENTURES (CONTINUED)

Convertible Debentures – 5.5% due June 30, 2019 (continued)

The debt component is measured at amortized cost. The balance of the debt component as at September 30, 2014 and December 31, 2013 consists of:

	September 30, 2014	December 31, 2013
	$	$
Principal balance	74,000,000	-
Less:		
Issuance costs	(3,265,544)	-
Conversion option at inception	(6,618,078)	-
Accretion	632,327	-
Balance	64,748,705	-

The conversion option, net of related issuance costs of $305,532, has been recorded in shareholders' equity. Factoring in issuance costs, the effective interest rate on the debentures is 8.77%.

Interest expense on the debentures for the three and nine month periods ended September 30, 2014 totaled $1,410,720 and $2,349,534, respectively (2013 - $nil). Interest amount of $1,509,065 (2013 – $nil) was capitalized to the cost of property, plant and equipment under development.

7. INCOME TAXES

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

	Three month periods ended September 30, 2014	Three month periods ended September 30, 2013	Nine month periods ended September 30, 2014	Nine month periods ended September 30, 2013
	$	$	$	$
(Loss) Income before income taxes	(3,086,096)	480,872	(5,957,037)	1,194,470
Income tax (recovery) provision at the combined basic rate of 26.5% (2013 - 26.5%)	(817,815)	127,431	(1,578,615)	316,535
Permanent and other differences	7,516	128,539	162,469	(59,691)
Income tax (recovery) provision	(810,299)	255,970	(1,416,146)	256,844

(unaudited – in Canadian Dollars)

7. INCOME TAXES (CONTINUED)

The tax effect of significant temporary differences is as follows:

	September 30, 2014	December 31, 2013
	$	$
Property, plant and equipment	3,124,939	2,866,634
Intangible assets	(535,199)	(564,854)
Operating loss carryforward	(1,906,057)	-
Notes receivable	(9,894)	(24,683)
Financing costs	402,054	(272,534)
Convertible debentures	2,001,557	744,409
Provision for lease retirement costs	227,225	224,703
Finance lease receivable	45,586	108,715
Long-term incentive plan	(98,531)	(104,057)
Deferred heavy maintenance	559,160	823,599
Net deferred income tax liability	3,810,840	3,801,932

The conversion of the Company's 6.5% convertible debentures during the period (Note 6) resulted in a decrease to the temporary difference between the carrying amount of the liability for convertible debentures and the corresponding tax base. Accordingly, the Company recognized the resulting decrease in deferred tax liability of $328,737 directly in deficit.

8. SHAREHOLDERS' CAPITAL

Share capital

The following table shows the change in shareholders' capital from December 31, 2013 to September 30, 2014:

	Number	Amount
		$
Variable voting shares	256,395	2,172,852
Common voting shares	7,673,416	65,029,338
Outstanding, December 31, 2013	7,929,811	67,202,190
Changes during the period		
Voting shares issued on conversion of convertible debentures	1,152,496	12,301,481
Treasury stock purchase	(24,819)	(521,780)
Distributed in connection with share-based compensation	45,076	462,007
Outstanding, September 30, 2014	9,102,564	79,443,898
Consisting of:		
Variable voting shares	98,545	860,065
Common voting shares	9,004,019	78,583,833
Outstanding September 30, 2014	9,102,564	79,443,898

No preferred shares are issued or outstanding.

(unaudited – in Canadian Dollars)

8. SHAREHOLDERS' CAPITAL (CONTINUED)

Dividends

Dividends to shareholders declared for the three and nine month periods ended September 30, 2014 amounted to $1,363,655 ($0.1491 per share) and $4,036,187 ($0.4473 per share), respectively, and for the three and nine month periods ended September 30, 2013 amounted to $1,191,818 ($0.1491 per share) and $3,991,113 ($0.4993 per share), respectively.

9. (LOSS) EARNINGS PER SHARE

The following table shows the computation of basic (loss) earnings per share for the three and nine month periods ended September 30, 2014 and 2013:

	Three month periods ended September 30,		Nine month periods ended September 30,	
Basic (loss) earnings per share	2014	2013	2014	2013
Net (loss) income	$ (2,275,797)	$ 224,902	$ (4,540,891)	$ 937,626
Weighted average number of shares	9,090,395	7,993,416	8,787,550	7,993,416
Total basic (loss) earnings per share	$ (0.25)	$ 0.03	$ (0.52)	$ 0.12

The shares held under the long-term incentive plan have been included in the calculation of basic (loss) earnings per share for the three and nine month periods ended September 30, 2014 and 2013 as they participate in dividend distributions. The effect of the convertible debentures has been excluded from the calculation of diluted (loss) earnings per share for the three and nine month periods ended September 30, 2014 and 2013 as the impact would be anti-dilutive.

10. LONG-TERM INCENTIVE PLAN

For the three and nine month periods ended September 30, 2014, share-based compensation expense totaled $89,495 and $532,524, respectively, including withholding taxes of $92,095 paid on behalf of the eligible employees.

2014 Awards

In March 2014, in accordance with the Company's long-term incentive plan (the "Plan" or "LTIP"), an amount of $613,875 was approved to the executive officers and senior management. Accordingly, the Company purchased 24,819 shares from the open market at an average price of $21.02 per share. As at September 30, 2014, 5,353 of these shares had vested and $112,530, net of withholding taxes of $92,095, was transferred from share-based compensation reserve to shareholders' capital. The balance of LTIP award not vested at September 30, 2014 was $409,250.

Prior Years' Awards

In the nine month period ended September 30, 2014, 39,723 of the treasury shares had vested and $349,477 was transferred from share-based compensation reserve to shareholder's capital. The balance of LTIP award not vested at September 30, 2014 was $232,500.