

# **CARGOJET INC.**

**Management's Discussion and Analysis  
Of Financial Condition and Results of Operations**

**For the Three Months and Year Ended December 31, 2016**

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# **CARGOJET INC.**

## **Management’s Discussion and Analysis of Financial Condition and Results of Operations**

### **For the Three months and Year Ended December 31, 2016**

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The following is the Management’s Discussion and Analysis (“MD&A”) of the consolidated financial condition and results of operations of Cargojet Inc. (“Cargojet” or the “Company”) for the three months and year ended December 31, 2016. The following also includes a discussion of and comparative operating results for the three months and year ended December 31, 2015.

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

The effective date of the MD&A is March 9, 2017. This MD&A should be read in conjunction with the consolidated financial statements of the Company and notes thereto for the years ended December 31, 2016 and 2015 (the “Consolidated Financial Statements”). The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada (“GAAP”), as set out in the Chartered Professional Accountant of Canada Handbook- Accounting (“CPA Handbook”), which incorporates International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”), except for any financial information specifically denoted otherwise. IFRS requires management to make certain judgments, estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements and the amount of revenue and expenses incurred during the reporting period. The results of operations for the periods reflected herein are not necessarily indicative of results that may be expected for future periods.

All amounts in the MD&A are expressed in Canadian dollars unless otherwise noted.

#### **EBITDA <sup>(A)</sup>, Adjusted EBITDA <sup>(B)</sup>, EBITDAR <sup>(C)</sup>, Adjusted EBITDAR <sup>(D)</sup> and Adjusted Free Cash Flow <sup>(E)</sup>**

Non-GAAP measures like EBITDA, Adjusted EBITDA, EBITDAR, Adjusted EBITDAR and Adjusted Free Cash Flow are not earning measures recognized by IFRS and do not have standardized meanings prescribed by IFRS. Therefore, EBITDA, Adjusted EBITDA, EBITDAR, Adjusted EBITDAR and Adjusted Free Cash Flow may not be comparable to similar measures presented by other issuers.

These alternative measures provide a more consistent basis to compare the performance of the Company between the periods and improve comparability between other companies including other airlines. They provide additional information to users of the MD&A to enhance their understanding of the Company’s financial performance. These measures are also used by the Company to guide its decisions on dividend policy, to set financial targets for its management incentive plans and to monitor the Company’s compliance with its debt covenants. Investors are cautioned that EBITDA, Adjusted EBITDA, EBITDAR, Adjusted EBITDAR and Adjusted Free Cash Flow should not be construed as an alternative to net income determined in accordance with IFRS as indicators of the Company’s performance or to cash flows from operating, investing and financing activities as measures of liquidity and cash flows. The calculations of EBITDA, Adjusted EBITDA, EBITDAR, Adjusted EBITDAR and Adjusted Free Cash Flow are shown on page 19 of the MD&A.

- (A) Please refer to End Note <sup>(A)</sup> included at the end of this MD&A.
- (B) Please refer to End Note <sup>(B)</sup> included at the end of this MD&A.
- (C) Please refer to End Note <sup>(C)</sup> included at the end of this MD&A.
- (D) Please refer to End Note <sup>(D)</sup> included at the end of this MD&A.
- (E) Please refer to End Note <sup>(E)</sup> included at the end of this MD&A.

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### **Key Factors Affecting the Business**

The results of operations, business prospects and financial condition of the Company are subject to a number of risks and uncertainties and are affected by a number of factors outside the control of the management of the Company. (See page 37 for a more complete discussion of the risks affecting the Company’s business.)

### **Caution Concerning Forward Looking Statements**

This MD&A includes certain forward-looking statements that are based upon current expectations which involve risks and uncertainties associated with our business and the environment in which the business operates. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements including those identified by the expressions “anticipate”, “believe”, “plan”, “estimate”, “expect”, “intend”, “project” and similar expressions to the extent they relate to the Company or its management. The forward-looking statements are not historical facts, but reflect Cargojet’s current expectations regarding future results or events. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations. Examples of the factors that can affect the results are government regulations, competition, seasonal fluctuations, international trade, weather patterns, retention of key personnel, labour relations, terrorist activity, general industry condition and economic sensitivity, the Company’s ability to manage growth and profitability, fuel prices, other cost controls and foreign exchange fluctuations, and capability of maintaining its fleet. The risk and uncertainties are detailed in the “Risk Factors” starting on page 37.

Forward looking statements are based on a number of material factors, expectations or assumptions of the Company which have been used to develop such statements and information but which may prove to be incorrect. Although the Company believes that the expectations reflected in such forward-looking statements or information are reasonable, undue reliance should not be placed on forward-looking statements because the Company can give no assurance that such expectations will prove to be correct. The statements are based on the following factors: the continued and timely development of infrastructure, continued availability of debt financing and cash flow, future commodity prices, currency, exchange and interest rates, regulatory framework regarding taxes and environmental matters in the jurisdictions in which the Company operates.

This document contains forward-looking statements that reflect management’s current expectations related to matters such as future financial performance and liquidity and capital resources of the Company. Specific forward-looking statements in this document include, but are not limited to, statements with respect to:

- Fleet Overview – Page 4,
- Results of operations for the year ended December 31, 2016 - Liquidity and capital resources – Page 32,
- Off balance sheet arrangements – Page 35, and
- Outlook – Page 44.

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## Management's Discussion and Analysis of Financial Condition and Results of Operations

For the Three months and Year Ended December 31, 2016

### Overview

### Financial Information and Operating Statistics Highlights

(Canadian dollars in millions, except where indicated)

	Three Month Period Ended				Year Ended			
	December 31,				December 31,			
	2016	2015	Change	%	2016	2015	Change	%
<b>Financial information</b>								
Revenues	\$94.1	\$84.3	\$9.8	11.6%	\$331.0	\$289.0	\$42.0	14.5%
Direct expenses	\$66.6	\$65.1	\$1.5	2.3%	\$245.2	\$250.7	(\$5.5)	-2.2%
<b>Gross margin</b>	<b>\$27.5</b>	<b>\$19.2</b>	<b>\$8.3</b>	<b>43.2%</b>	<b>\$85.8</b>	<b>\$38.3</b>	<b>\$47.5</b>	<b>124.0%</b>
Gross margin - %	29.2%	22.8%	6.4%		25.9%	13.3%	12.6%	
Selling, general & administrative expenses	\$19.3	\$10.5	\$8.8	83.8%	\$45.5	\$35.3	\$10.2	28.9%
Net finance costs & other gains and losses	\$9.0	\$8.1	\$0.9	11.1%	\$37.3	\$24.2	\$13.1	54.1%
<b>(Loss) earnings before income taxes</b>	<b>(\$0.8)</b>	<b>\$0.6</b>	<b>(\$1.4)</b>	<b>-233.3%</b>	<b>\$3.0</b>	<b>(\$21.2)</b>	<b>\$24.2</b>	<b>114.2%</b>
Income taxes	(\$0.2)	\$2.1	(\$2.3)	-109.5%	(\$0.6)	(\$3.2)	\$2.6	-81.1%
<b>Net (loss) earning</b>	<b>(\$1.0)</b>	<b>(\$1.5)</b>	<b>\$0.5</b>	<b>33.3%</b>	<b>\$2.4</b>	<b>(\$18.0)</b>	<b>\$20.4</b>	<b>113.3%</b>
(Loss) earnings per share - \$CAD								
Basic	(\$0.09)	(\$0.15)	\$0.06	40.0%	\$0.23	(\$1.86)	\$2.09	112.4%
Diluted	(\$0.09)	(\$0.15)	\$0.06	40.0%	\$0.22	(\$1.86)	\$2.08	111.8%
<b>EBITDA<sup>(1)</sup></b>	<b>\$17.4</b>	<b>\$17.6</b>	<b>(\$0.2)</b>	<b>-1.1%</b>	<b>\$75.8</b>	<b>\$34.6</b>	<b>\$41.2</b>	<b>119.1%</b>
EBITDA margin - %	18.5%	20.9%	-2.4%		22.9%	12.0%	10.9%	
<b>Adjusted EBITDA<sup>(1)</sup></b>	<b>\$27.9</b>	<b>\$18.8</b>	<b>\$9.1</b>	<b>48.5%</b>	<b>\$93.1</b>	<b>\$36.0</b>	<b>\$57.1</b>	<b>158.6%</b>
Adjusted EBITDA margin - %	29.6%	22.3%	7.3%		28.1%	12.5%	15.7%	
<b>EBITDAR<sup>(1)</sup></b>	<b>\$21.8</b>	<b>\$24.6</b>	<b>(\$2.8)</b>	<b>-11.3%</b>	<b>\$96.0</b>	<b>\$66.9</b>	<b>\$29.1</b>	<b>43.5%</b>
EBITDAR margin - %	23.2%	29.2%	-6.1%		29.0%	23.1%	5.9%	
<b>Adjusted EBITDAR<sup>(1)</sup></b>	<b>\$32.3</b>	<b>\$25.8</b>	<b>\$6.5</b>	<b>25.2%</b>	<b>\$113.3</b>	<b>\$68.3</b>	<b>\$45.0</b>	<b>65.9%</b>
Adjusted EBITDAR margin - %	34.3%	30.6%	3.7%		34.2%	23.6%	10.5%	
<b>Adjusted Free Cash flow<sup>(1)</sup></b>	<b>\$19.0</b>	<b>\$17.0</b>	<b>\$2.0</b>	<b>11.7%</b>	<b>\$49.9</b>	<b>\$13.1</b>	<b>\$36.8</b>	<b>280.9%</b>
<b>Operating statistics</b>								
Operating days <sup>(2)</sup>	49	49	-	-	199	198	1	0.5%
Average cargo revenue per operating day <sup>(3)</sup>	\$1.44	\$1.29	\$0.15	11.6%	\$1.27	\$1.11	\$0.16	14.4%
Block hours	7,525	6,308	1,217	19.3%	25,618	22,940	2,678	11.7%
Aircraft in operating fleet								
B727-200	6	7	(1)		6	7	(1)	
B757-200	5	5	-		5	5	-	
B767-200	1	3	(2)		1	3	(2)	
B767-300	8	7	1		8	7	1	
Challenger 601	2	-	2		2	-	2	
	22	22	-	-	22	22	-	-
Average volume per operating day (lbs.) <sup>(4)</sup>	1,299,691	1,255,205	44,486	3.5%	1,144,830	1,068,752	76,078	7.1%
Average head count	727	717	10	1.4%	727	717	10	1.4%

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1. EBITDA, Adjusted EBITDA, EBITDAR, Adjusted EBITDAR and Adjusted free cash flow are non-GAAP financial measures and are not earning measures recognized by IFRS. Please refer to page 1 of this MD&A for detailed discussion.
2. Operating days refer to the Company's overnight air cargo network operations that run primarily on Monday to Thursday with a reduced network operating on Friday.
3. Average cargo revenue per operating day refers to total overnight, ACMI and charter revenues earned by the Company per operating day.
4. Prior periods volumes have been amended to conform to the current year's method of calculation of volume.

### **Corporate Overview**

The Company is Canada's leading provider of time sensitive overnight air cargo services. Its main air cargo business is comprised of the following:

- Operating a domestic overnight air cargo co-load network between fourteen major Canadian cities;
- Providing dedicated aircraft to customers on an Aircraft, Crew, Maintenance and Insurance ("ACMI") basis, operating between points in Canada and the USA and between Canada and Colombia, Mexico and Peru;
- Operating scheduled international routes for multiple cargo customers between the USA and Bermuda and Canada and Germany; and
- Providing specialty charter service across North America, to the Caribbean and to Europe.

The Company operates its business across North America transporting time sensitive air cargo each business night utilizing its fleet of all-cargo aircraft. The Company's domestic overnight air cargo co-load network consolidates cargo received from customers and transports such cargo to the appropriate destination in a timely and safe manner. The Company continually monitors key performance indicators and uses this information to reduce costs and improve the efficiency of its services.

### **Fleet Overview**

The Company initiated a fleet expansion program early in 2014 to replace four of its Boeing 727-200 ("B727") aircraft with Boeing 757-200ER ("B757") aircraft due to increased customer demand on its core overnight network. The fleet was further expanded with Boeing 767-200ER ("B767-200") and Boeing 767-300ER ("B767-300") aircraft to provide additional required cargo capacity to its customers.

Note: See Caution Concerning Forward Looking Statements, page 2.

The table below sets forth the Company's operating fleet as at December 31, 2014, 2015 and December 31, 2016 as well as the Company's planned operating fleet for the year ending December 31, 2017:

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Type of Freighter Aircraft	Leased or Owned	Average Age	Number of Aircraft in Service				Maximum Payload (lbs.)	Range (miles)
			Actual			Plan		
			December 31,		December 31,	December 31,		
			2014	2015	2016	2017		
B767-300 <sup>(1) (2)</sup>	Finance Lease	23	3	5	5	5	125,000	6,000
B767-300 <sup>(2)</sup>	Owned	23	-	2	3	3	125,000	6,000
B767-200 <sup>(3)</sup>	Operating Lease	31	5	3	1	1	100,000	5,000
B757-200 <sup>(4)</sup>	Owned	29	1	2	2	4	80,000	3,900
B757-200 <sup>(5)</sup>	Operating Lease	27	3	3	3	2	80,000	3,900
B727-200 <sup>(6)</sup>	Owned	37	9	7	6	4	60,000	1,800
Challenger 601 <sup>(7)</sup>	Owned	30	-	1	2	2	6,000	3,300
<b>Total Aircraft</b>			<b>21</b>	<b>23</b>	<b>22</b>	<b>21</b>		

- In 2014, Cargojet took delivery of three B767-300 aircraft that were financed under the MLA (as defined on page 9 of this MD&A under “Aircraft Finance Leases and Loans”). In January 2015, Cargojet took delivery of one B767-300 aircraft financed under the MLA. Cargojet took delivery of one B767-300 aircraft in March 2015 under a lease with a term of six years and a purchase option in favour of Cargojet to purchase the aircraft after three years at a pre-determined price and was classified as a finance lease.
- Cargojet took delivery of one B767-300 aircraft in April 2015, one B767-300 aircraft in September 2015 and one B767-300 aircraft in January 2016. These aircraft were financed by loans. Two of these loans were repaid in September 2016, the third loan was repaid in February 2017 (refer to page 9 under “Aircraft Finance Leases and Loans”). In February 2017 Cargojet executed a Letter of Intent to purchase one B767-300 passenger aircraft as feed stock for future freighter conversions. This aircraft is not included in the table above.
- In 2014, Cargojet subleased one B767-200 aircraft from a Canadian airline. This sublease expired in March 2016 and the aircraft was returned in April 2016. Two B767-200 aircraft were leased on a short term basis that expired in July and August of 2015. Of the two remaining B767-200 aircraft under lease, one aircraft lease was extended to June 2018 and the other aircraft was returned to the lessor at the end of March 2016 after the expiry of the lease.
- In 2014, Cargojet purchased one previously leased B757-200 aircraft and purchased an additional B757-200 that underwent conversion from a passenger aircraft to freighter aircraft and became operational in early 2015. In Q4 2016, Cargojet purchased an additional B757-200 aircraft that is currently undergoing conversion from a passenger aircraft to freighter aircraft and is expected to be operational in Q2 2017. In February 2017 Cargojet executed a letter of Intent to purchase two additional B757-200 passenger aircraft as feed stock for future freighter conversions. These aircraft have not been included in the table above.
- In 2014, Cargojet leased two additional B757-200 aircraft and extended the lease of its existing B757-200 aircraft. The leases of the three B757-200 aircraft expire at the end of 2017, 2020 and 2022 respectively. Cargojet expects to purchase the B757-200 aircraft whose lease expires at the end of 2017.
- Cargojet retired two B727-200 aircraft in 2015 and retired one B727-200 aircraft in 2016. Cargojet expects to retire at least 2 more B727-200 aircraft in 2017.
- In 2014, Cargojet purchased five Challenger 601 aircraft. The Company entered into a charter agreement with a third party to operate and manage two of these aircraft to provide the aircraft for individual and corporate charterers. Two of these aircraft are currently in operation. Two of these aircraft are being considered for conversion to cargo operations and the fifth aircraft is being held for parts.

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### **Recent Events**

In February 2017, the Company entered into a lease agreement with respect to a new 62,000 square feet head office and warehouse area. The lessor of the property is indirectly beneficially owned by one of the Company's executive officers and directors. The transaction is in the normal course of business and will be measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. The lease was negotiated on behalf of the Company by the Directors excluding the subject Director and after an independent appraisal and review by outside counsel to ensure lease is on markets terms. The entering into of the lease is not subject to minority shareholder approval nor valuation requirements of Multilateral Instrument 61-101 - *Protection of Minority Security Holders in Special Transactions* as neither the fair market value of the subject matter of, nor the fair market value of the consideration for, the lease, insofar as it involves the Interested Party, does not exceed 25 per cent of the Company's current market capitalization.

The lease term is for a period of 15 years. The annual rental payments will be approximately \$1.0 million plus taxes, maintenance and insurance costs. The basic rent is subject to revision every five year at a predetermined rate per the terms of the lease.

### **Convertible Debentures – 4.65% due December 31, 2021**

In September 2016, \$125 million of unsecured subordinated convertible debentures were issued at a price of \$1,000 per debenture with a term of five years. These debentures bear a fixed interest rate of 4.65% per annum, payable semi-annually in arrears on June 30 and December 31 of each year, commencing December 31, 2016. The intended use of the net proceeds of the debentures is to refinance three US dollar denominated aircraft finance loans .

On or after December 31, 2019, but prior to December 31, 2020, 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 their principal amount per debenture plus accrued and unpaid interest, provided that the current market price of the common shares of the Company on the date on which the notice of redemption is given is at least 125% of the conversion price of \$58.65 per common share. On or after December 31, 2020, but prior to the maturity date of December 31, 2021, the debentures are redeemable at a price equal to their principal amount plus accrued and unpaid interest.

On redemption or at maturity on December 31, 2021, 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.



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Based on certain conditions, the debentures are convertible, at the holders' discretion, at \$58.65 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 \$58.65 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 \$0.25 per quarter (\$1.0 per annum) per share.

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.

### New Flights

Starting on June 10, 2016 the Company commenced cargo flights under an ACMI contract with another Canadian airline. The Company operates two flights per week between Canada and Mexico, and two flights per week between Canada and Colombia and Peru. Starting November 19, 2016 the Company expanded this contract to include one flight per week between Canada and Frankfurt, Germany.

### Redemption of 6.5% Convertible Debentures

On March 10, 2016 the Company issued a redemption notice pursuant to the convertible debenture indenture dated March 21, 2012 (the "Indenture") to redeem all of the outstanding debentures issued under the Indenture (the "6.5% Debentures") on April 28, 2016. Pursuant to the Indenture, the Company elected to satisfy its obligation to pay the redemption price of the 6.5% Debentures due at redemption by issuing that number of voting shares of the Company obtained by dividing the outstanding principal amount of the 6.5% Debentures by 95% of the volume weighted average trading price of the common voting shares on the TSX for the 20 consecutive trading days ending five trading days before the redemption date and to pay accrued and unpaid interest thereon up to but excluding the redemption date in cash to the holders of the 6.5% Debentures.

From December 31, 2015 to April 27, 2016 \$4.1 million of the outstanding 6.5% Debentures were converted into common voting shares of the Company by the holders thereof pursuant to the Indenture. The remaining \$0.2 million of the outstanding 6.5% Debentures were redeemed by issuing 8,184 common voting shares of the Company and paying accrued and unpaid interest in cash to the holders thereof.

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#### Syndicated Operating Facility

Effective September 20, 2016, the Company amended its revolving operating credit facility (the "facility") availed through its subsidiary Cargojet Airways Ltd., as borrower, with a syndicate of financial institutions (collectively, the "Lenders") by, amongst other things, increasing the maximum credit available from \$100 million to \$175 million and extending the maturity date by one year to expire on December 16, 2019. The facility is restricted to \$150 million until the debt of \$35 million owing under the B767-300 aircraft loan agreement dated March 31, 2015 with a US lender is repaid and the security provided in respect thereof is released and discharged. This loan was repaid and related security was released and discharged in February 2017. The facility can be extended annually with the consent of the Lenders, and bears interest, payable monthly, at the lead Lender's prime lending rate / US base rate plus 150 basis points to 200 basis points, dependent on the currency of the advance and certain financial ratios of the Company. No scheduled repayments of principal are required under the facility prior to maturity.

#### Canada Post Letter of Credit

On July 5, 2016, the Company cancelled a \$20 million of letter of credit issued to the Canada Post Group Of Companies ("CPGOC") under the terms of the Master Services Agreement ("MSA") after successfully completing the performance conditions specified in the MSA.

#### Acquisition of Property, Plant and Equipment

During the year ended December 31, 2016, the Company completed the modification of one of its Challenger 601 aircraft for \$3.0 million and financed the acquisition of one B767-300 aircraft for USD \$27.5 million pursuant to a USD \$55.0 million facility with a US based lender. This facility was repaid in September 2016. See Page below under "Aircraft Finance Leases and Loans" for more details. In 2016 the Company entered into an agreement to purchase one B757-200 aircraft which is undergoing conversion from passenger aircraft to freighter aircraft and is likely to be operational in early 2017.

#### Impairment of Challenger Aircraft

During the year ended December 31, 2016, the Company reviewed the carrying value of the two operational Challenger 601 aircraft capitalized as property, plant and equipment and estimated that the aircraft's recoverable value was less than its carrying value. The recoverable amount was determined on a fair value less costs to sell basis, fair value being the market value for similar aircraft. As a result, the Company reported a loss of \$1.4 million on impairment of property, plant and equipment for the year ended December 31, 2016.

The Company also reviewed the carrying value of the other three Challenger 601 aircraft included in property plant and equipment under development and determined that the recoverable amount was less than the carrying amount. Accordingly an impairment loss of \$2.5 million has been recognized on these assets for the year ended December 31, 2016.

For the purpose of calculating impairment the Company identified the two operational aircraft as one separate cash generating unit. The three aircraft included in property, plant and equipment under development were not in operations and were considered independent of others to generate cash flow and were assessed for impairment at an individual asset level based on their fair market value.

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The net book value as of December 31, 2016 of the two operational Challenger 601 aircraft is \$4.1 million and the net book value of the three Challenger 601 aircraft is \$3.8 million.

#### Aircraft Finance Leases and Loans

In 2014, the Company entered into a Master Capital Lease Agreement ("MLA") and two aircraft loan facility agreements (the "AFAs") with a Canadian equipment leasing and financing company. The Company is required to purchase the aircraft financed under the MLA at the end of the term of each lease at a predetermined price. The Company completed four finance leases to acquire four B767-300 aircraft under the MLA in the aggregate amount of \$120.0 million and refinanced two B757-200 aircraft owned by the Company under the AFAs in the aggregate amount of \$25.0 million. Each lease under the MLA and each loan under the AFAs have a term of seven years. The AFAs are secured by the related aircraft and all their components and records.

The amounts advanced under the MLA and the AFAs were advanced in two tranches, A and B, with tranche A under the MLA being 84% of the amounts advanced thereunder and under the AFAs being 91% of the amounts advanced thereunder. Tranche B in each case was equal to the balance of the total amounts advanced.

The estimated effective interest rate in respect of the MLA is 7.26%.

The MLA and the AFAs are subject to certain financial covenants. The Company was in compliance with all such covenants as at December 31, 2016.

Under the MLA and the AFAs, the Company paid arrangement fees in an amount equal to 0.75% of the amounts advanced and was required to pay additional fees (the "share based additional fees") equal to the positive difference between the price of 293,332 Cargojet common voting shares (233,332 with respect to the MLA and 60,000 with respect to the AFAs) on the TSX on the date of the MLA or the AFAs as the case may be 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 only be given on a day after the first anniversary of the applicable agreement and before the fourth anniversary of such agreement. The share based additional fees have been accounted for as cash settled share based compensation options. The Company entered into a total return swap agreement with a financial institution to manage its exposure under these arrangements (please see Page 12 under "Total Return Swap" in this regard). The Company has also paid success fees in the amount equal to 1.5% of the amount advanced under the MLA and the AFAs to an independent investment banking firm for its services towards completion of these transactions.

In September 2016, the Company received a written demand to pay the share based additional fees under the MLA and AFAs and paid \$4.6 million in full satisfaction thereof. As at December 2016, the total return swap having a fair value of \$5.2 million in favor of the Company was not settled.

On October 7, 2016, the Company prepaid the entire outstanding amount of its two AFAs including the prepayment fees. The prepayment resulted in a pre-tax loss of \$1.5 million including prepayment fees and unamortized transaction costs and recorded them as a loss on the extinguishment of debt.

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The Company also has a finance lease arrangement for a B767-300 aircraft that includes a bargain purchase option. The estimated effective interest rate for the lease facility during the period is 7.21%. The lease is expected to mature on the early exercisable date of the bargain purchase option in March 2018.

The Company executed a separate loan agreement on March 31, 2015 with a US based lender for USD \$27.5 million to acquire a B767-300 aircraft. The loan matures in April 2022 and is secured by the related aircraft and all its components and records. The funds under the loan were received on April 8, 2015. The estimated effective interest rate for this loan agreement is 8.52%. On February 1, 2017, the Company prepaid the entire outstanding amount of its loan facility with a US based lender including the prepayment fees using the revolving operating credit facility. The prepayment resulted in a pre-tax loss of \$2.2 million including prepayment fees and unamortized costs, which were recorded as a loss on the extinguishment of debt. The settlement also resulted in the pre-tax exchange loss of \$1.3 million.

In May 2015, the Company secured a loan facility of USD \$55.0 million with another US based lender to acquire two additional B767-300 aircraft. The Company drew down this loan facility to finance the acquisition of two B767-300 aircraft, one in September 2015 and the second in January 2016. On September 19, 2016, the Company prepaid the entire amount of these loans including the prepayment fees. The prepayment resulted in a pre-tax loss of \$6.0 million including prepayment fees and unamortized transaction costs. The Company used the proceeds of the convertible debenture issued in September 2016 to pay these loans. The terms of such debenture were significantly different from the original loan facility; therefore any costs associated with the prepayment were classified and recorded as loss on the extinguishment of debt.

### Share-Based Compensation

#### **Restricted Share Units**

In 2014, the Company adopted a restricted share unit plan (the "RSU Plan") pursuant to which the Company may grant restricted share units ("RSUs") and a stock option plan (the "Stock Option Plan"), pursuant to which the Company may grant stock options ("Options"), as part of its long term incentive plan. Each RSU granted to key executives entitled the holder to one common voting share of the Company on the settlement thereof.

During the year ended December 31, 2016, in accordance with the RSU Plan, the Company granted 27,033 RSUs to certain key executives. Each RSU had an average value of \$26.50 calculated as the volume weighted average closing price of the common voting shares of the Company on the TSX for the five trading days prior to the grant date. Of these RSUs granted, 8,896 RSUs vested and were settled on the grant date. Of the remaining 18,137 RSUs granted 9,126 and 9,011 RSUs will vest in each of the first quarters of 2017 and 2018 respectively.

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During the year ended December 31, 2016, the Company also granted 2,264 RSUs to two non-employee directors. Each RSU had an average value of \$26.50 calculated as the volume weighted average closing price of the common voting shares of the Company on the TSX for the five trading days prior to the grant dates. All 2,264 RSUs vested and were settled on the grant date. A third non-employee and non-Canadian director was paid \$0.02 million net of taxes of \$0.02 million to acquire 700 variable voting shares of the Company from the open market at an average value of \$26.96 per share. The withheld amount of \$0.02 million of tax was remitted by the Company. The transaction is classified as a cash settled share-based transaction. The value of RSUs granted to non-employee directors was determined by reference to the market value for similar services.

During the year ended December 31, 2016, 47,333 RSUs granted to executives in 2015 vested and were settled and an amount of \$1.3 million was transferred to the share capital account from contributed surplus. Since inception, in accordance with the RSU Plan, the RSUs granted to executives accrued notional dividend equivalents to 1,969 RSUs that were issued, vested and were settled upon the satisfaction of the vesting conditions of the related RSUs during the quarter. An amount of \$0.05 million was recognized as the share-based compensation.

The RSU activity for the comparative periods is summarized below:

	RSU's	\$
Balance at January 1, 2015	-	-
Granted in the period	153,851	4.1
Share dividend	-	
Share based compensation-Vested and settled	(45,189)	(1.2)
Share based compensation-Unvested and amortized	-	(1.4)
Forfeited during the period	-	-
Balance at December 31, 2015	108,662	1.5
Granted in the period	29,297	0.8
Share dividend	1,969	
Share based compensation-Vested and settled	(60,462)	(0.7)
Share based compensation-Unvested and amortized	-	(1.1)
Forfeited during the period	-	-
Balance at December 31, 2016	79,466	0.5

During the year ended December 31, 2016, the total share-based compensation expense of \$1.8 million related to settled and unvested RSUs is included in the consolidated statements of earnings (loss) and comprehensive income (loss) (for the year ended December 31, 2015 –\$2.6 million). Unrecognized share-based compensation expense as at December 31, 2016 related to these RSUs was \$0.5 million (December 31, 2015 – \$2.1 million) and will be amortized on a pro-rated basis in the consolidated statements of earnings (loss) and comprehensive income (loss) over the vesting period.

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**OPTIONS:**

The Options activity during the year ended December 31, 2016 is summarized below:

<b>OPTIONS (in Canadian dollars)</b>	Number of Options	Weighted average exercise price in \$
Balance as at January 1, 2016 (Series 1)	172,399	\$25.46
Granted during the year	280,406	\$29.34
Balance as at December 31, 2016	452,805	\$27.86
Vested & exercisable at December 31, 2016	176,561	\$30.70
Unvested at December 31, 2016	276,244	\$26.07

As at December 31, 2016 there were a total of 176,228 vested Options and the weighted average contractual life remaining of the outstanding Options, both vested and non-vested, is 3.7 years.

During the year ending December 31, 2016, the Company recognized an expense of \$1.4 million (for the year ended December 31, 2015 –\$0.3 million) in respect of the amortization of Options over the vesting period. The unrecognized value as at December 31, 2016 related to the Options was \$7.9 million (December 31, 2015 – \$0.8 million) and will be amortized on a pro-rated basis in the consolidated statements of earnings (loss) over the vesting period.

**Weighted average assumptions**

	<b>November 17, 2016</b>	<b>March 28, 2016</b>	<b>June 15, 2015</b>
	<b>Series 3</b>	<b>Series 2</b>	<b>Series 1</b>
Exercise price redemption	\$47.22	\$26.50	\$25.47
Expected volatility	32.96%	32.4%	22.6%
Option life in years	3	5	5
Dividend yield	1.41%	2.5%	2.4%
Risk free rate	1.75%	0.63%	0.94%
Vesting period	immediate	2016-2018	2016-2018
Options granted	38,440	241,966	172,399
Fair value per option on grant date	\$10.41	\$5.43	\$4.98

There has been no alteration of the terms and conditions of the above share based payment arrangements since the grant date.

**Total Return Swap**

The Company had an obligation to pay share-based additional fees under the MLA and AFAs. In September 2015, the Company entered into a total return swap agreement with a financial institution to

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manage its exposure under these arrangements. Under the total return swap agreement, the Company pays interest to the financial institution based on Canadian LIBOR on the total value of the notional equity amount which is equal to the total cost of the underlying shares. At the settlement of the total return swap agreement, the Company will receive or remit the net difference between the total value of the notional equity amount and the total proceeds of sales of the underlying shares. The Company did not designate the total return swap agreement as a cash flow hedge for accounting purposes.

On September 30, 2016, the Company settled its obligation under the cash settled stock appreciation rights by paying \$4.6 million. During the year ended December 31, 2016, the Company also recorded gains of \$5.1 million on the fair market valuation of the total return swap. Part of the gains on total return swap was settled by disposal of 31,632 of the underlying shares by the counterparty and the Company received \$0.8 million from the financial institution on January 4, 2017. The fair value of the underlying shares pending settlement as at December 31, 2016 was \$5.3 million in favour of the Company and is included under derivative financial instruments on the balance sheet. The net change in the fair value of the swap pending settlement as at December 31, 2016 was of \$4.3 million (December 31, 2015 - \$0.9 million) and is included as other gains in the consolidated statements of earnings (loss) and comprehensive income (loss).

### **Employee benefits**

In 2016 Company adopted an unfunded defined benefit pension plan for its CEO. A defined benefit plan is a post-employment benefit plan (pension plan) that is not a defined contribution plan. Defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. Company's net obligation in respect of defined benefit pension plan is calculated by estimating the amount of future benefit that employee have earned in return for his service in the current and prior periods; that benefit is discounted to determine its present value. The calculations are performed by qualified actuaries using the projected unit credit prorated on service method that incorporates Company's best estimates of future salary levels, other cost escalations, retirement age of employee and other actuarial factors. Due to the long-term nature of these plans, such estimates and assumptions are subject to inherent risks and uncertainties. These assumptions are determined by management and are reviewed by actuaries at least annually. The benefits under the plan will be reassessed annually by the qualified actuaries and the actuarial gain or loss in the fair value of the defined benefit plan will be recognized in the consolidated statement of earnings (loss) and comprehensive Income (loss). Changes to any of the above assumptions may affect the amounts of benefits obligations, expenses and re-measurements that we recognize. Past service costs arising from plan are recognized immediately in the statement of consolidated earnings (loss) and comprehensive income (loss).

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The Company has also adopted an Individual Pension Plan (the “IPP”) as a defined contribution plan for its CEO. A liability and an expense in the amount of the contribution payable to the IPP are recognized when an employee renders services. Contributions to the IPP are discounted when they are payable more than 12 months after the end of the annual reporting period in which an employee rendered the related services. The discount rate is determined by reference to market yields at the end of the reporting period on high-quality corporate bonds of the same currency and the term as the IPP. Effective December 31, 2016, up to and until the date as of the member’s Termination or Actual Retirement Date, whichever is earlier, the Company shall make yearly contribution to the plan in an amount equal to the lesser of (i) the Money Purchase Limit for the Plan Year and (ii) 18% of the Member’s compensation from the Company, as defined in for this purpose under the Income Tax Act, for the Plan Year. The Member shall not be required nor permitted to contribute to the Plan.

The movement in the defined benefit pension cost during the year is as follows:

	December 31, 2016	December 31, 2015
<b>Amounts in millions of CAD \$</b>	<b>\$</b>	<b>\$</b>
Balance as at January 1, 2016	-	-
Present value of defined benefit obligations	8.7	-
Balance as at December 31, 2016	8.7	-

The significant actuarial assumptions used in the measurement of accrued benefit obligations for the unfunded defined benefit plan are as follows:

Discount rate:	3.9% per year
Increase in pensionable earnings:	2.75% per year
Inflation:	2.0% per year
Longevity post retirement:	CPM 2014 mortality table with generational mortality improvements using CPM-B improvement scale.
Retirement age:	65 years

Private Placement of Shares

On September 28, 2016 the Company completed the private placement of 100,000 variable shares to one of its directors. The Company used the proceeds from such placement for general corporate and working capital purposes.



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### Revenues

The Company's revenues are primarily generated from its overnight air cargo service between fourteen major Canadian cities each business night. Most customers pre-purchase a guaranteed space and weight allocation on the Company's network and a corresponding guaranteed daily revenue amount is paid to the Company for this space and weight allocation. Remaining capacity is sold on an adhoc basis to contract and non-contract customers. Although a significant portion of overnight revenues are fixed due to guaranteed customer allocations, Cargojet's revenues will generally rise and fall with the overall level of customer volume typically expressed in pounds.

Revenues and shipping volumes from the Company's overnight air cargo service are seasonal. Customer demand is highest in the fourth quarter of each year due primarily to the increase in retail activity during the holiday season in December.

The Company's overnight air cargo service operates primarily on Monday to Thursday with a reduced network operating on Friday and on certain weekdays that are adjacent to certain statutory holidays. The Company defines the term "operating day" to refer to the days on which the full overnight air cargo network is in operations. Typically, each fiscal year will have between 197 and 199 operating days depending on the timing of certain statutory holidays and leap years. The variance in number of operating days between quarters and year over year will have an impact on comparative quarterly revenues.

The Company also generates revenue from a variety of other air cargo services:

- The Company provides domestic air cargo services for a number of international airlines between points in Canada that connect such airlines' gateways to Canada. This helps to support lower demand legs and provides a revenue opportunity with little or no incremental cost, as the flights are operating on regular schedules.
- The Company provides dedicated aircraft to customers on an adhoc and scheduled basis typically in the daytime and on weekends. Adhoc flights are sold under a one-time agreement while scheduled flights are sold under longer term agreements. The adhoc charter business targets livestock shipments, military equipment, emergency relief supplies and virtually any large shipment requiring immediate delivery across North America, to the Caribbean and to Europe. Scheduled charter business provides dedicated aircraft for recurring flights as required by the customer. Adhoc and scheduled flights are sold either on an "all in" basis or on an ACMI basis:
  - Under an all in adhoc or scheduled charter agreement, the customer will pay a single, all-inclusive fixed amount per flight. All costs of the flight including fuel, navigation fees and landing fees are borne by the Company and recognized in its financial statements as direct expenses.
  - Under an ACMI adhoc or scheduled charter agreement, the customer is responsible for all commercial activities and the Company is paid a fixed amount to operate the flight priced as a rate per block hour (see definition of "block hours" in Expenses on page 16). Variable flight costs such as fuel, navigation fees and landing fees are borne by the customer.

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- The Company operates an international route between Newark, New Jersey, USA and Hamilton, Bermuda. This provides a five-day per week air cargo service for multiple customers and is patterned after the domestic business that Cargojet has built in Canada. Customer contracts contain minimum daily revenue guarantees and the ability to pass through increases in fuel costs. Effective June 10, 2016 the Company commenced all cargo flights under contract between Canada and Colombia, Peru and Mexico with B767-300F aircraft. Starting November 19, 2016 the Company expanded this contract to include one flight per week between Canada and Frankfurt, Germany.

### **Expenses**

Direct expenses consist of fixed and variable expenses that are largely driven by the size of the Company's aircraft fleet and the volume of flight activity required by the level of customer demand. Fixed costs include aircraft lease costs, building lease costs, salaries for full-time employees in maintenance, flight operations, and commercial operations, depreciation and amortization, and insurance. Variable costs that are directly related to the volume of flight activity include fuel expense, navigation fees, landing fees and variable aircraft lease reserves related to engines, auxiliary power units, and landing gear.

Flight activity is measured in "block time" and is expressed in "block hours". Block time represents the total duration of a flight from the time the aircraft releases its brakes when it initially moves from the airport parking area prior to flight, to the time the brakes are set when it arrives at the airport parking area after the completion of the flight.

Administrative expenses are primarily costs associated with executive and corporate management and the overhead of the Company's business that include functions such as load scheduling, flight operations coordination, aircraft maintenance planning and engineering, client relations, administration, accounting, human resources and information systems. Administrative expenses include management bonuses, legal, audit and other consulting fees, bank charges, and data and communication expenses.

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**Results of Operations and Supplementary Financial Information**

(Canadian dollars in millions, except where indicated or an amount per share)

	Three month period ended December 31,		Year ended December 31,	
	2016 (unaudited)	2015 (unaudited)	2016 (audited)	2015 (audited)
	\$	\$	\$	\$
<b>Revenues</b>	<b>94.1</b>	84.3	<b>331.0</b>	289.0
<b>Direct expenses</b>	<b>66.6</b>	65.1	<b>245.2</b>	250.7
	<b>27.5</b>	19.2	<b>85.8</b>	38.3
General and administrative expenses	<b>18.5</b>	9.9	<b>43.2</b>	33.8
Sales and marketing expenses	<b>0.8</b>	0.6	<b>2.3</b>	1.5
Impairment of property, plant and equipment	-	-	<b>3.9</b>	-
Finance costs	<b>7.3</b>	6.9	<b>30.8</b>	22.8
Loss on extinguishment of debt	<b>1.5</b>	-	<b>7.5</b>	-
Other (gains) losses	<b>0.2</b>	1.2	<b>(4.9)</b>	1.4
	<b>28.3</b>	18.6	<b>82.8</b>	59.5
<b>EARNINGS (LOSS) BEFORE INCOME TAXES</b>	<b>(0.8)</b>	0.6	<b>3.0</b>	(21.2)
<b>Provision (recovery) of income taxes</b>				
Current	-	(0.1)	-	(0.1)
Deferred	<b>0.2</b>	2.2	<b>0.6</b>	(3.1)
<b>Net earnings (loss)</b>	<b>(1.0)</b>	(1.5)	<b>2.4</b>	(18.0)
<b>Earnings (loss) per share</b>				
Basic	<b>\$(0.09)</b>	\$(0.15)	<b>\$0.23</b>	\$(1.86)
Diluted	<b>\$(0.09)</b>	\$(0.15)	<b>\$0.22</b>	\$(1.86)
Average number of shares - basic (in thousands of shares)	<b>10,643</b>	10,094	<b>10,450</b>	9,685
Average number of shares - diluted (in thousands of shares)	<b>10,643</b>	10,094	<b>10,787</b>	9,685

# CARGOJET INC.

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### Summary of Most Recently Completed Consolidated Quarterly Results (unaudited)

(Canadian dollars in millions, except where indicated or an amount per share)

	Three Month Period Ended							
	Dec 31 2016	Sep 30 2016	Jun 30 2016	Mar 31 2016	Dec 31 2015	Sep 30 2015	Jun 30 2015	Mar 31 2015
<b>Revenues</b>	\$94.1	\$80.7	\$79.3	\$76.9	\$84.3	\$75.3	\$75.2	\$54.1
<b>Net (loss) earnings from continuing operations</b>	\$(1.0)	\$(4.8)	\$3.8	\$4.4	\$(1.5)	\$(2.2)	\$(6.1)	\$(8.3)
<b>(Loss) Earnings per Share</b>								
From continuing operations								
- Basic	\$(0.09)	\$(0.46)	\$0.36	\$0.43	\$(0.15)	\$(0.22)	\$(0.64)	\$(0.90)
- Diluted	\$(0.09)	\$(0.46)	\$0.36	\$0.43	\$(0.15)	\$(0.22)	\$(0.64)	\$(0.90)
<b>Average number of shares - basic (in thousands of shares)</b>	10,643	10,540	10,476	10,135	10,094	9,928	9,482	9,224
<b>Average number of shares - diluted (in thousands of shares)</b>	10,643	10,778	10,640	10,135	10,094	9,928	9,482	9,224

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**Calculation of EBITDA, Adjusted EBITDA, EBITDAR, Adjusted EBITDAR,**  
**Free Cash Flow and Adjusted Free Cash Flow**  
(Canadian dollars in millions, except where indicated)

	Three Month Period Ended		Year Ended	
	December		December	
	2016 (unaudited) \$	2015 (unaudited) \$	2016 (unaudited) \$	2015 (unaudited) \$
<b><u>Calculation of EBITDA and Adjusted EBITDA</u></b>				
Net earnings (loss)	(1.0)	(1.5)	2.4	(18.0)
Add:				
Interest	7.3	6.9	30.8	22.8
Provision (recovery) of deferred taxes	0.2	2.1	0.6	(3.2)
Depreciation of property, plant and equipment	10.9	10.1	42.0	33.0
<b>EBITDA</b>	<b>17.4</b>	<b>17.6</b>	<b>75.8</b>	<b>34.6</b>
Add:				
Gain on disposal of property, plant and equipment	-	(0.1)	-	(0.6)
Impairment of property, plant and equipment	-	-	3.9	-
Unrealized foreign exchange (gain) loss	2.3	3.8	(4.0)	8.5
Loss on extinguishment of debt	1.5	-	7.5	-
Unrealized loss(gain) on forward foreign exchange contracts	(1.1)	(2.2)	3.4	(4.9)
Gain on cash settled share based payment arrangement	(0.9)	(0.3)	(2.2)	(1.6)
Employee pension	8.7	-	8.7	-
<b>Adjusted EBITDA</b>	<b>27.9</b>	<b>18.8</b>	<b>93.1</b>	<b>36.0</b>
<b><u>Calculation of EBITDAR and Adjusted EBITDAR</u></b>				
EBITDA	17.4	17.6	75.8	34.6
Aircraft rent	4.4	7.0	20.2	32.3
<b>EBITDAR</b>	<b>21.8</b>	<b>24.6</b>	<b>96.0</b>	<b>66.9</b>
Add:				
Gain on disposal of property, plant and equipment	-	(0.1)	-	(0.6)
Impairment of property, plant and equipment	-	-	3.9	-
Unrealized foreign exchange (gain) loss	2.3	3.8	(4.0)	8.5
Loss on extinguishment of debt	1.5	-	7.5	-
Unrealized loss(gain) on forward foreign exchange contracts	(1.1)	(2.2)	3.4	(4.9)
Gain on cash settled share based payment arrangement	(0.9)	(0.3)	(2.2)	(1.6)
Employee pension	8.7	-	8.7	-
<b>Adjusted EBITDAR</b>	<b>32.3</b>	<b>25.8</b>	<b>113.3</b>	<b>68.3</b>
<b><u>Calculation of Standardized Free Cash Flow and Adjusted Free Cash</u></b>				
NET CASH GENERATED FROM OPERATING ACTIVITIES	20.3	7.6	62.0	20.1
Add : Effects of exchange rate changes	0.6	5.6	(0.6)	3.2
Less: Maintenance capital expenditures <sup>(1)</sup>	(2.5)	(0.4)	(9.1)	(9.1)
Add: Proceeds from disposal of property, plant and equipment	-	0.1	-	0.2
<b>Standardized free cash flow</b>	<b>18.4</b>	<b>12.9</b>	<b>52.3</b>	<b>14.4</b>
Changes in non-cash working capital items and deposits	0.6	4.0	(2.4)	(1.4)
Recovery for current income taxes	-	0.1	-	0.1
<b>Adjusted Free Cash flow</b>	<b>19.0</b>	<b>17.0</b>	<b>49.9</b>	<b>13.1</b>

1. Refer to the definition of maintenance capital expenditure in End note (E).

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**Review of Operations for the Three Month Periods ended December 31, 2016 and 2015**

**Net loss for the three month periods ended December 31, 2016 and 2015**

**(Canadian dollars in millions except where indicated)**

	Q4		CHANGE	
	2016	2015	\$	%
	(unaudited)	(unaudited)		
	\$	\$		
Core Overnight Revenues	58.2	54.6	3.6	6.6%
ACMI Revenues	9.0	4.3	4.7	109.3%
All-in Charter Revenues	3.5	4.3	(0.8)	-18.6%
Total overnight, ACMI and charter revenues	70.7	63.2	7.5	11.9%
Total Revenue - FBO	0.2	-	0.2	-
Total fuel and other cost pass through	22.5	20.6	1.9	9.2%
Fuel surcharge and other pass through revenues	22.7	20.6	2.1	10.2%
Lease and other revenue	0.7	0.5	0.2	40.0%
<b>Total revenues</b>	<b>94.1</b>	<b>84.3</b>	<b>9.8</b>	<b>11.6%</b>
Operating Days	49	49	-	-
<b>Average cargo revenue per operating day</b>	<b>1.44</b>	<b>1.29</b>	<b>0.15</b>	<b>11.6%</b>
<b>Direct expenses</b>				
Fuel Costs	18.4	17.7	0.7	4.0%
Depreciation	8.7	7.4	1.3	17.6%
Aircraft Cost	6.4	8.0	(1.6)	-20.0%
Heavy Maintenance Amortization	1.9	2.5	(0.6)	-24.0%
Maintenance Cost	5.4	5.5	(0.1)	-1.8%
Crew Costs	5.2	5.2	-	0.0%
Commercial and Other Costs	20.6	18.8	1.8	9.6%
<b>Total direct expenses</b>	<b>66.6</b>	<b>65.1</b>	<b>1.5</b>	<b>2.3%</b>
<b>Gross margin</b>	<b>27.5</b>	<b>19.2</b>	<b>8.3</b>	<b>43.2%</b>
<b>Gross margin %</b>	<b>29.2%</b>	<b>22.8%</b>	<b>6.4%</b>	
<b>SG&amp;A &amp; Marketing</b>				
General and Administrative Costs	18.2	9.7	8.5	87.6%
Sales costs	0.8	0.6	0.2	33.3%
Depreciation	0.3	0.2	0.1	50.0%
<b>Total SG&amp;A &amp; Marketing expenses</b>	<b>19.3</b>	<b>10.5</b>	<b>8.8</b>	<b>83.8%</b>
<b>Other SG&amp;A</b>				
Other losses	1.7	1.2	0.5	41.7%
Finance costs	7.3	6.9	0.4	5.8%
<b>Total other SG&amp;A</b>	<b>9.0</b>	<b>8.1</b>	<b>0.9</b>	<b>11.1%</b>
<b>(LOSS) EARNING BEFORE INCOME TAXES</b>	<b>(0.8)</b>	<b>0.6</b>	<b>(1.4)</b>	<b>-233.3%</b>
Income taxes-Current	-	0.1	(0.1)	-100.0%
Income Taxes-Deferred	(0.2)	(2.2)	2.0	90.8%
<b>Net (loss)</b>	<b>(1.0)</b>	<b>(1.5)</b>	<b>0.5</b>	<b>33.3%</b>
<b>(Loss) per share - \$ CAD</b>				
Basic	(0.09)	(0.15)	0.06	40.0%
Diluted	(0.09)	(0.15)	0.06	40.0%

# **CARGOJET INC.**

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

**For the Three months and Year Ended December 31, 2016**

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### **Highlights for the Three Month Periods ended December 31, 2016 and 2015**

- Total revenue for the three month period ended December 31, 2016 was \$94.1 million compared to \$84.3 million for the same period in 2015, representing an increase of \$9.8 million or 11.6%.
- Average cargo revenue excluding fuel surcharges and other cost pass-through revenues for the three month period ended December 31, 2016 was \$1.44 million per operating day compared to \$1.29 million for the same period in 2015, representing an increase of \$0.15 million or 11.6%.
- Adjusted EBITDA for the three month period ended December 31, 2016 was \$27.9 million compared to \$18.8 million for the same period in 2015, an increase of \$9.1 million or 48.4%.
- Adjusted EBITDAR for the three month period ended December 31, 2016 was \$32.3 million compared to \$25.8 million for the same period in 2015, an increase of \$6.5 million or 25.2%.
- Adjusted Free Cash Flow was an inflow of \$19.0 million for the three month period ended December 31, 2016 compared to an inflow of \$17.0 million for the same period in 2015, an increase of \$2.0 million or 11.8%.

### **Revenue**

Total revenue for the three month period ended December 31, 2016 was \$94.1 million, compared to \$84.3 million for the same period in 2015, representing an increase of \$9.8 million or 11.6%. The increase in total revenue was due primarily to the \$3.6 million increase in core overnight revenues, \$4.7 million increase in ACMI revenues, a \$1.9 million increase in fuel surcharge and other cost pass-through revenues, a \$0.2 million increase in FBO revenues and a \$0.2 million increase in other revenues. The increase was partially offset by a \$0.8 million decrease in all-in charter revenues.

Revenue related to the core overnight business excluding fuel surcharges and other cost pass-through revenues for the three month period ended December 31, 2016 was \$58.2 million compared to \$54.6 million for the same period in 2015, an increase of \$3.6 million or 6.6%. The increases were primarily due to revenue from contractual Consumer Price Index ("CPI") increases and revenue from new customers.

ACMI scheduled and adhoc charter revenues for the three month period ended December 31, 2016 were \$9.0 million, compared to \$4.3 million for the same period in 2015, an increase of \$4.7 million or 109.3%. The increase of \$4.7 million was primarily due to a new scheduled daily route to the USA, and additional flights to Colombia, Mexico and Peru, that started in June 2016.

All-in scheduled and adhoc charter revenues for the three month period ended December 31, 2016 were \$3.5 million compared to \$4.3 million for the same period in 2015, a decrease of \$0.8million or 18.6%. The decrease in all-in charter revenue was due primarily to lower adhoc charter activity.

Fuel surcharges and other cost pass-through revenues were \$22.7 million for the three month period ended December 31, 2016 compared to \$20.6 million for the same period in 2015. During the quarter, fuel surcharges increased due primarily to a 4.9% increase in fuel prices and an increase in pass-through revenues related to ACMI charters. Fuel surcharges and other cost pass-through revenues include \$0.2 million of fuel sales to third parties for the three month period ended December 31, 2016 compared to \$nil for the same period in 2015.

# **CARGOJET INC.**

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **For the Three months and Year Ended December 31, 2016**

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Other revenues consist primarily of maintenance revenue for aircraft line maintenance services provided to other airlines and passenger revenues from charter flights using its Challenger aircraft that started in 2016. Other revenues were \$0.7 million for the three month period ended December 31, 2016 compared to \$0.5 million for the same period in 2015, an increase of \$0.2 million or 40.0%.

#### **Direct Expenses**

Total direct expenses were \$66.6 million for the three month period ended December 31, 2016 compared to \$65.1 million for the same period in 2015. As a percentage of revenue, direct expenses decreased from 77.2% in 2015 to 70.8% for the same period in 2016. The overall decrease in direct expenses was due primarily to a \$1.6 million decrease in aircraft costs, a \$0.1 million decrease in maintenance costs, a \$0.6 million decrease in heavy maintenance costs, partially offset by a \$0.7 million increase in fuel costs, a \$1.8 million increase in commercial costs and other costs and a \$1.3 million increase in depreciation. For the three month period ended December 31, 2016 there were no one-time startup costs related to the CPGOC contract compared to \$1.3 million for the same period in 2015.

Fuel costs were \$18.4 million for the three month period ended December 31, 2016 compared to \$17.7 million for the same period in 2015. The \$0.7 million or 4.0% increase in fuel costs was due primarily to a 3% increase in block hours on the overnight network and a 5% increase in fuel prices. Any changes in fuel cost experienced by the Company due to changes in fuel prices are passed on to customers as an increase or decrease in their fuel surcharges.

Depreciation expense was \$8.7 million for the three month period ended December 31, 2016 compared to \$7.4 million for the same period in 2015. The \$1.3 million or 17.6% increase in depreciation expenses was due primarily to the addition of aircraft and other assets and reduction in the estimated useful life of B727-200 aircraft.

Aircraft costs were \$6.4 million for the three month period ended December 31, 2016 compared to \$8.0 million in 2015, representing a decrease of \$1.6 million or 20.0%. The decrease was due primarily to the lower fixed lease rental costs and variable lease costs during the three month period due to return of the two B767-200 aircraft at the expiry of their lease terms. This decrease was partially offset by higher sub charter costs. For the three month period ended December 31, 2016 there were no one-time startup costs related to the CPGOC contract compared to \$1.3 million for the same period in 2015. All operating aircraft leases are paid in US Dollars.

Heavy maintenance amortization costs were \$1.9 million for the three month period ended December 31, 2016 compared to \$2.5 million in 2015, representing a decrease of \$0.6 million or 24.0%. Heavy maintenance of aircraft occurs at regular and predetermined intervals and the costs related to these are deferred by the Company and amortized over a period of 24 months until the next scheduled heavy maintenance. The heavy maintenance component of the newly acquired aircraft is also deferred and amortized until the next scheduled event.

Maintenance costs were \$5.4 million for the three month period ended December 31, 2016 compared to \$5.5 million in 2015, representing a decrease of \$0.1 million or 1.8%. \$0.2 million of the decrease was primarily due to the reduced line maintenance costs as a result of return of two leased B767-200 aircraft and retiring one B727 aircraft in 2016. The decrease was partially offset by the purchase of one B767-300 aircraft in 2016.



# **CARGOJET INC.**

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **For the Three months and Year Ended December 31, 2016**

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Total crew costs including salaries, training and positioning was \$5.2 million for the three month period ended December 31, 2016 and 2015.

Commercial and other direct operating costs were \$20.6 million for the three month period ended December 31, 2016 compared to \$18.8 million in 2015 representing an increase of \$1.8 million or 9.6%. This increase comprised primarily of \$0.4 million of the increase in commercial salaries due to head count and annual rate increases, \$0.6 million higher landing, parking, deicing and ground service equipment costs due to increased activity in 2016, \$0.2 million of higher warehouse rent costs due to a one-time adjustment in property taxes, \$0.3 million increase in cartage and ground handling costs and \$0.3 million increase in insurance costs.

#### **Selling, General, Administrative & Marketing Expenses**

Selling, general and administrative ("SG&A") expenses for the three month period ended December 31, 2016 were \$19.3 million compared to \$10.5 million for the same period in 2015, representing an increase of \$8.8 million or 83.8%. The increase was primarily due to \$8.7 million increase in pension benefit cost for the CEO recognized at the inception of the defined benefit plan for past services and \$0.1 million increase in depreciation costs and \$0.2 million increase in sales and marketing costs, partially offset by \$0.2 million decrease in other SG&A expenses.

#### **Other Gains & Losses and Finance Costs**

Other losses and finance costs for the three month period ended December 31, 2016 were \$9.0 million compared to \$8.1 million for the same period in 2015, representing an increase of \$0.9 million or 11.1%. The increase was due primarily to \$0.4 million higher finance costs due to debt related to aircraft acquisitions, \$1.5 loss on extinguishment of debt due to prepayment of AFA's, partially offset by foreign exchange gains.

#### **Adjusted EBITDA**

Adjusted EBITDA for the three month period ended December 31, 2016 was \$27.9 million compared to EBITDA of \$18.8 million for the same period in 2015. The increase in Adjusted EBITDA of \$9.1 million was due primarily to the following:

- Increase on core overnight network and ACMI revenues
- Decrease in direct costs due to the optimization of the capacity on the overnight network and return of leased aircraft partially offset by increase in costs associated with higher operating activity.
- Elimination of start-up costs related to the CPGOC contract

#### **Adjusted EBITDAR**

Adjusted EBITDAR for the three month period ended December 31, 2016 was \$32.3 million compared to \$25.8 million for the same period in 2015, representing an increase of \$6.5 million or 25.2%. The increase in Adjusted EBITDAR during the period was due primarily to changes in Adjusted EBITDA partially offset by lower aircraft rent addback due to the expiry of the aircraft leases later in 2015 and in the first quarter of 2016.

**CARGOJET INC.**  
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**Current Income Taxes**

No provision for current income taxes were made for the three month period ended December 31, 2016 due to net taxable trade loss position, compare to a recovery of \$0.1 million for the three month period ended December 31, 2015

**Deferred Income Taxes**

The deferred income taxes for the three month period ended December 31, 2016 was recovery of \$0.2 million compared to a provision of \$2.2 million for the same period in 2015. Deferred taxes result from the change in temporary differences between the financial reporting and tax bases of certain balance sheet items for the period.

**Adjusted Free Cash Flow**

Adjusted free cash flow was an inflow of \$19.0 million for the three month period ended December 31, 2016, compared to an inflow of \$17.0 million for the same period in 2015, representing an increase of \$2.0 million. The increase in Adjusted Free Cash flow was due primarily to the increase in Adjusted EBITDA, partially offset by changes in non-cash working capital items and higher maintenance capital expenditures.

**Dividends**

Total dividends declared for the three month period ended December 31, 2016 were \$1.9 million or \$0.1750 per share. In comparison, total dividends declared for the three month period ended December 31, 2015 were \$1.5 million or \$0.1491 per share.

Record Date	Date Dividends Paid/Payable	Declared	Number of Shares	Per Share	Paid
		\$		\$	\$
September 20, 2016	September 20, 2016		10,543,331		1,845,053
December 20, 2016	January 05, 2017	1,862,589	10,643,365	0.1750	-
		1,862,589	-	0.1750	1,845,053

Record Date	Date Dividends Paid/Payable	Declared	Number of Shares	Per Share	Paid
		\$		\$	\$
September 18, 2015	October 05, 2015		10,090,241		1,504,455
December 18, 2015	January 05, 2016	1,507,171	10,108,453	0.1491	-
		1,507,171	-	0.1491	1,504,455

# **CARGOJET INC.**

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

**For the Three months and Year Ended December 31, 2016**

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### **Liquidity and Capital Resources**

Cash generated by operating activities after net changes in non-cash working capital balances and effect of exchange rate changes for the three month period ended December 31, 2016 was \$20.9 million compared to cash generated in operating activities of \$13.2 million for the same period in 2015. The \$7.7 million increase in cash was due primarily to the increase in EBITDA partially offset by the changes in non-cash working capital items and deposits.

Cash outflow from financing activities during the three month period ended December 31, 2016 was \$28.0 million (December 31, 2015 - Cash generated of \$6.5 million) and was comprised of repayment of borrowings of \$21.4 million (December 31, 2015- \$0.3 million), repayment of obligations under finance lease of \$4.8 million (December 31, 2015 - \$2.5 million), and dividends paid to shareholders of \$1.8 million (December 31, 2015 - \$1.5 million). There were no proceeds from borrowings during the three month period ended on December 31, 2016 (December 31, 2015- \$10.8 million).

Cash used in investing activities during the three month period ended December 31, 2016 was \$14.9 million (December 31, 2015 - \$14.4 million) and was primarily comprised of property, plant and equipment additions.

### **Capital Expenditures**

The property, plant and equipment additions of \$14.9 million in the current period (December 31, 2015 - \$14.4 million) were primarily comprised of additions to aircraft, aircraft spares, computer hardware and software, leasehold improvements, heavy maintenance and other equipment.

**CARGOJET INC.**  
**Management's Discussion and Analysis of Financial Condition**  
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For the Three months and Year Ended December 31, 2016

**Review of Operations for the year ended December 31, 2016 and 2015**  
**Net earnings (loss) for the year ended December 31, 2016 and 2015**

**(Canadian dollars in millions except where indicated)**

	YTD		CHANGE	
	2016 (audited) \$	2015 (audited) \$	\$	%
Core Overnight Revenues	209.2	191.6	17.6	9.2%
ACMI Revenues	30.6	12.8	17.8	139.1%
All-in Charter Revenues	13.3	15.2	(1.9)	-12.5%
Total overnight, ACMI and charter revenues	253.1	219.6	33.5	15.3%
Total Revenue - FBO	0.5	0.2	0.3	150.0%
Total fuel and other cost pass through	74.6	67.3	7.3	10.8%
Fuel surcharge and other pass through revenues	75.1	67.5	7.6	11.3%
Lease and other revenue	2.8	1.9	0.9	47.4%
<b>Total revenues</b>	<b>331.0</b>	<b>289.0</b>	<b>42.0</b>	<b>14.5%</b>
Operating Days	199	198	1	0.5%
<b>Average cargo revenue per operating day</b>	<b>1.27</b>	<b>1.11</b>	<b>0.16</b>	<b>14.4%</b>
<b>Direct expenses</b>				
Fuel Costs	59.2	68.2	(9.0)	-13.2%
Depreciation	33.6	25.1	8.5	33.9%
Aircraft Cost	25.7	35.7	(10.0)	-28.0%
Heavy Maintenance Amortization	7.4	7.0	0.4	5.7%
Maintenance Cost	21.5	21.2	0.3	1.4%
Crew Costs	22.0	22.4	(0.4)	-1.8%
Commercial and Other Costs	75.8	71.1	4.7	6.6%
<b>Total direct expenses</b>	<b>245.2</b>	<b>250.7</b>	<b>(5.5)</b>	<b>-2.2%</b>
<b>Gross margin</b>	<b>85.8</b>	<b>38.3</b>	<b>47.5</b>	<b>124.0%</b>
<b>Gross margin %</b>	<b>25.9%</b>	<b>13.3%</b>	<b>12.6%</b>	
<b>SG&amp;A &amp; Marketing</b>				
General and Administrative Costs	42.2	32.9	9.3	28.3%
Sales costs	2.3	1.5	0.8	53.3%
Depreciation	1.0	0.9	0.1	11.1%
<b>Total SG&amp;A &amp; Marketing expenses</b>	<b>45.5</b>	<b>35.3</b>	<b>10.2</b>	<b>28.9%</b>
<b>Other SG&amp;A</b>				
Other losses	6.5	1.4	5.1	364.3%
Finance costs	30.8	22.8	8.0	35.1%
<b>Total other SG&amp;A</b>	<b>37.3</b>	<b>24.2</b>	<b>13.1</b>	<b>54.1%</b>
<b>EARNINGS (LOSS) BEFORE INCOME TAXES</b>	<b>3.0</b>	<b>(21.2)</b>	<b>24.2</b>	<b>114.2%</b>
Income taxes-Current	-	0.1	(0.1)	-100.0%
Income Taxes-Deferred	(0.6)	3.1	(3.7)	-119.3%
<b>Net earnings (loss)</b>	<b>2.4</b>	<b>(18.0)</b>	<b>20.4</b>	<b>113.3%</b>
<b>Earnings (loss) per share - \$ CAD</b>				
Basic	0.23	(1.86)	2.09	112.4%
Diluted	0.22	(1.86)	2.08	112.0%

# CARGOJET INC.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

For the Three months and Year Ended December 31, 2016

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### Highlights for the Year ended December 31, 2016 and 2015

- Total revenue for the year ended December 31, 2016 was \$331.0 million compared to \$289.0 million for the same period in 2015, representing an increase of \$42.0 million or 14.5%.
- Average cargo revenue excluding fuel surcharges and other cost pass-through revenues for the year ended December 31, 2016 was \$1.27 million per operating day compared to \$1.11 million for the same period in 2015, representing an increase of \$0.16 million per operating day or 14.4%.
- Adjusted EBITDA for the year ended December 31, 2016 was \$93.1 million compared to \$36.0 million for the same period in 2015, an increase of \$57.1 million or 158.6%.
- Adjusted EBITDAR for the year ended December 31, 2016 was \$113.3 million compared to \$68.3 million for the same period in 2015, an increase of \$45.0 million or 65.9%.
- Adjusted Free Cash Flow was an inflow of \$49.9 million for the year ended December 31, 2016 compared to an outflow of \$13.1 million for the same period in 2015, an increase of \$36.8 million or 280.9%.

### Revenue

Total revenue for the year ended December 31, 2016 was \$331.0 million, compared to \$289.0 million for the same period in 2015, representing an increase of \$42.0 million or 14.5%. The increase in total revenue was due primarily to the \$17.6 million increase in core overnight revenues, \$17.8 million increase in ACMI revenues, \$7.6 million increase in fuel surcharge and other cost pass-through revenues and \$0.9 million increase in lease and other revenue partially offset by \$1.9 million decrease in all-in charter revenues.

Revenue related to the core overnight business excluding fuel surcharges and other cost pass-through revenues for the year ended December 31, 2016 was \$209.2 million compared to \$191.6 million for the same period in 2015, an increase of \$17.6 million or 9.2%. The increase was primarily due to the 7.1% increase in volumes from the new CPGOC contract that began on April 1, 2015, CPI price increases and increased volumes other existing customers.

ACMI scheduled and adhoc charter revenue for the year ended December 31, 2016 was \$30.6 million, compared to \$12.8 million for the same period in 2015, an increase of \$17.8 million or 139.1%. The increase of \$18.7 million was due to additional block hours flown to the USA, South America, Northern Canada and to Europe. Adhoc ACMI revenues decreased by \$0.9 million due to lower customer demand.

All-in scheduled and adhoc charter revenue for the year ended December 31, 2016 was \$13.3 million compared to \$15.2 million for the same period in 2015, a decrease of \$1.9 million or 12.5%. The decrease in all-in charter revenue was due primarily to lower adhoc charter activity.

# **CARGOJET INC.**

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

**For the Three months and Year Ended December 31, 2016**

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Fuel surcharges and other cost pass-through revenues were \$75.1 million for the year ended December 31, 2016 compared to \$67.5 million for the same period in 2015. During the period, fuel surcharges increased due to a 4.3% increase in the shipping volumes and revenues from new and existing customers that attracted fuel surcharges. The increase in fuel surcharges was partially offset by a 12.9% decline in fuel prices. Fuel surcharges and other cost pass-through revenues also consist of fuel sales to third parties of \$0.5 million for the year ended December 31, 2016 compared to \$0.2 million for the same period in 2015.

Other revenues consist primarily of hangar rental revenues, maintenance revenues for aircraft line maintenance provided to other airlines and passenger revenue on challenger series of aircraft. Other revenues for the year ended December 31, 2016 were \$2.8 million compared to \$1.9 million for the same period in 2015.

### **Direct Expenses**

Total direct expenses were \$245.2 million for the year ended December 31, 2016 compared to \$250.7 million for the year ended December 31, 2015. As a percentage of revenue, direct expenses ratio decreased from 86.7% in 2015 to 74.1% for the same period in 2016. The overall decrease in direct expenses was due primarily to a \$9.0 million decrease in fuel costs, \$10.0 million decrease in aircraft costs and, \$0.4 million decrease in crew cost, partially offset by a \$8.5 million increase in depreciation, \$4.7 million increase in commercial and other costs, \$0.4 million increase in heavy maintenance amortization, and \$0.3 million increase in maintenance costs. For the year month period ended December 31, 2016 direct expenses included \$1.1 million of one-time startup costs related to the CPGOC contract compared to \$15.3 million for the same period in 2015.

Fuel costs were \$59.2 million for the year ended December 31, 2016 compared to \$68.2 million for the same period in 2015. The \$9.0 million or 13.2% decrease in fuel costs was due primarily to a 12.9% decline in fuel prices and the optimization of capacity on the overnight network resulting in lower block hours, partially offset by increase in the block hours due to the start of the CPGOC contract on April 1, 2015. Any changes in fuel cost experienced by the Company due to changes in fuel prices are passed on to customers as an increase or decrease in their fuel surcharges.

Depreciation expense was \$33.6 million for the year ended December 31, 2016 compared to \$25.1 million for the same period in 2015. The \$8.5 million or 33.9% increase in depreciation expenses was due primarily to the addition of aircraft and other assets and reduction in the estimated useful life of B727-200 aircraft.

Aircraft costs were \$25.7 million for the year ended December 31, 2016 compared to \$35.7 million in 2015, representing a decrease of \$10.0 million or 28.0%. The decrease in aircraft costs was due primarily to lower fixed lease costs of \$9.3 million due to the return of the four B767-200 aircraft at the expiry of their lease terms and a decrease of \$2.8 million in the variable lease reserve costs due to the decrease in block hours flown. This decrease was partially offset by \$2.1 million of higher sub-charter costs related to a new route on the overnight network. For the year ended December 31, 2016 aircraft costs included \$1.1 million of one-time startup costs related to the CPGOC contract compared to \$10.6 million for the same period in 2015. All operating aircraft leases are paid in US Dollars.

## **CARGOJET INC.**

# **Management's Discussion and Analysis of Financial Condition and Results of Operations**

**For the Three months and Year Ended December 31, 2016**

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Heavy maintenance amortization costs were \$7.4 million for the year ended December 31, 2016 compared to \$7.0 million for the same period in 2015, representing an increase of \$0.4 million or 5.7%. Heavy maintenance of aircraft occurs at regular and predetermined intervals and the costs related to these are deferred by the Company and amortized over a period of 24 months until the next scheduled heavy maintenance.

Maintenance costs were \$21.5 million for the year ended December 31, 2016 compared to \$21.2 million in 2015, representing an increase of \$0.3 million or 1.4%. \$1.3 million of the increase was due to the hiring of additional maintenance personnel primarily due to the expansion of the fleet and a \$0.4 million increase in rental costs due to new and expanded maintenance facilities partially offset by \$1.4 million lower line maintenance costs due to an unscheduled maintenance event that occurred in 2015.

Total crew costs including salaries, training and positioning were \$22.0 million for the year ended December 31, 2016 compared to \$22.4 million in 2015, representing a decrease of \$0.4 million or 1.8%. This decrease was due primarily to the costs of onetime startup training incurred in 2015 partially offset by additional crew salaries and positioning costs required by the new ACMI routes in 2016. For the year ended December 31, 2016 crew costs did not include any one-time startup costs related to the CPGOC contract compared to \$3.4 million for the same period in 2015.

Commercial and other direct operating costs were \$75.8 million for the year ended December 31, 2016 compared to \$71.1 million for the same period in 2015, representing an increase of \$4.7 million or 6.6%. This increase comprised primarily of \$2.1 million of the increase in commercial salaries, \$0.8 million higher navigation costs due to additional block hours, \$2.1 million higher landing, parking deicing and ground service equipment costs, \$0.6 million of higher warehouse rent partially offset by \$0.8 million decrease in linehaul and cartage costs, and \$0.1 million of decrease in Ground handling costs. For the year ended December 31, 2016 commercial costs did not include any one-time startup costs related to the CPGOC contract compared to \$1.3 million for the same period in 2015.

### **Selling, General and Administrative Expenses**

Selling, general and administrative ("SG&A") expenses for the year ended December 31, 2016 were \$45.5 million compared to \$35.3 million for the same period in 2015, representing an increase of \$10.2 million or 28.9%. This increase was due primarily due to \$1.1 million of increase in salaries and allowances, \$8.7 million of increase in pension benefit costs for the CEO for past services, \$2.9 million increase due to a one-time settlement of stock appreciation rights, \$0.5 million increase in the communication costs, \$0.8 million increase in sales and marketing costs, \$0.7 million increase in bonuses and incentives, and \$0.2 million increase in other SG&A costs. This increase was partially offset by a \$4.7 million net realized exchange gain on the settlement of USD denominated debt and valuation of monetary assets and liabilities and, for the year ended December 31, 2016 SG&A expenses did not include any one-time startup costs related to the CPGOC contract compared to \$0.8 million for the same period in 2015.

# **CARGOJET INC.**

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

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### **Other Losses and Finance Costs**

Other losses and finance costs for the year ended December 31, 2016 were \$37.3 million compared to \$24.2 million for the same period in 2015 representing an increase of \$13.1 million or 54.1%. This increase was comprised primarily of \$8.0 million increase in finance costs, \$7.5 million increase due to loss on extinguishment of debt and \$3.9 million higher impairment charges recognized for the shortfall in recoverable value of Challenger aircraft below its carrying value, \$0.6 million of gain on disposal of property, plant and equipment in 2015 and \$0.7 million gain on cash settled share based payment arrangement in 2015, partially offset by \$3.4 million of gain on change in fair value of non-hedge derivatives and \$4.2 million net unrealized exchange gains on USD denominated aircraft debt and foreign exchange contracts.

### **Adjusted EBITDA**

Adjusted EBITDA for the year ended December 31, 2016 was \$93.1 million compared to \$36.0 million for the same period in 2015. The increase in Adjusted EBITDA of \$57.1 million or 158.6% was due primarily to the following:

- The increase in core overnight revenues and fuel surcharges due to the full service start-up of the CPGOC contract on April 1, 2015
- Increase in ACMI revenues
- Decrease in direct costs due to the optimization of capacity on the overnight network
- Lower startup costs in 2016 related to the CPGOC contract
- Realized exchange gain on settlement of debt in USD currency

partially offset by:

- The higher operating costs due to higher block hours and increase in fleet size required by the CPGOC contract

### **Adjusted EBITDAR**

Adjusted EBITDAR for the year ended December 31, 2016 was \$113.3 million compared to \$68.3 million for the same period in 2015, representing an increase of \$45.0 million or 65.9%. The increase in Adjusted EBITDAR during the period was due primarily to changes in Adjusted EBITDA partially offset by the return of four B767-200 aircraft at the end of their lease terms.

### **Net Finance Costs**

Net finance costs were \$30.8 million for the year ended December 31, 2016 compared to \$22.8 million for the same period in 2015. The increase is primarily due to the interest costs relating to funds borrowed specifically or generally to acquire and/or modify aircraft and other assets.

### **Current Income Taxes**

The provision for current income taxes for the year ended December 31, 2016 was \$nil compared to a recovery \$0.1 million in 2015.



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**For the Three months and Year Ended December 31, 2016**

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**Deferred Income Taxes**

The deferred income taxes recognized for the year ended December 31, 2016 was a provision of \$0.6 million compared to a recovery of \$3.1 million for the same period in 2015. Deferred taxes result from the change in temporary differences between the financial reporting and tax bases of certain balance sheet items for the period.

**Adjusted Free Cash Flow**

Adjusted free cash flow was an inflow of \$49.9 million for the year ended December 31, 2016, compared to an inflow of \$13.1 million for the same period in 2015, representing an increase of \$36.8 million. The increase in Adjusted Free Cash flow was due primarily due to the increase in Adjusted EBITDA, and changes in non-cash working capital items and deposits.

**Dividends**

Total dividends declared for the year ended December 31, 2016 were \$6.8 million or \$0.6482 per share. In comparison, total dividends declared for the year month period ended December 31, 2015 were \$5.8 million or \$0.5964 per share.

Record Date	Date Dividends		Number of Shares	Per Share	Paid
	Paid/Payable	Declared			
		\$		\$	\$
December 18, 2015	January 5, 2016	-	10,108,457		1,507,171
March 21, 2016	April 5, 2016	1,515,152	10,161,982	0.1491	1,515,152
June 20, 2016	July 5, 2016	1,570,865	10,535,645	0.1491	1,570,865
September 20, 2016	October 5, 2016	1,845,053	10,543,331	0.1750	1,845,053
December 20, 2016	January 5, 2017	1,862,589	10,643,365	0.1750	-
		6,793,659	-	0.6482	6,438,241

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Record Date	Date Dividends		Number of Shares	Per Share	Paid
	Paid/Payable	Declared			
		\$		\$	\$
December 19, 2014	January 5, 2015	-	9,174,427		1,367,906
March 20, 2015	April 3, 2015	1,409,579	9,453,907	0.1491	1,409,579
June 19, 2015	July 3, 2015	1,425,692	9,561,988	0.1491	1,425,692
September 18, 2015	October 5, 2015	1,504,455	10,090,241	0.1491	1,504,455
December 18, 2015	January 5, 2016	1,507,171	10,108,453	0.1491	-
		5,846,897	-	0.5964	5,707,632

**Liquidity and Capital Resources**

Cash generated in operating activities after net changes in non-cash working capital balances and effect of exchange rate changes for the year ended December 31, 2016 was \$61.4 million compared to cash generated in operating activities of \$23.3 million for the same period in 2015. The \$38.1 million increase in cash was due primarily to the increase in EBITDA and changes in non-cash working capital items and deposits.

Cash used in financing activities during the year ended December 31, 2016 was \$5.6 million (December 31, 2015 cash provided from financing activities – \$102.1 million) comprised of repayment of borrowings \$137.4 (December 31, 2015-\$1.3 million), repayment of obligations under finance lease of \$22.4 million (December 31, 2015 – \$10.2 million), and dividends paid to shareholders of \$6.4 million (December 31, 2015 – \$5.7 million). The deficit was partially offset with proceeds from borrowings of \$38.0 million (December 31, 2015 – \$119.3 million), proceeds from debenture issuance of \$119.3 million (December 31, 2015 \$nil) and proceeds from private placement of \$3.3 million (December 31, 2015 \$nil)

Cash used in investing activities during the year ended December 31, 2016 was \$59.6 million (December 31, 2015- \$119.4 million) and was primarily comprised of property, plant and equipment additions.

The Company had a working capital deficit as at December 31, 2016, representing the difference between total current assets and current liabilities, of \$43.0 million, compared to a working capital deficit of \$5.4 million as at December 31, 2015. The increase of \$37.6 million is primarily due to the increase in the current portion of the borrowings, increase in the trade and other payables, decrease in cash balance and deposits, partially offset by increase in trade and other receivables due to timing of the collections

Note: See Caution Concerning Forward Looking Statements, page 2.

Management anticipates that the cash flow from operations and the unutilized balance of the Company's credit facility will be adequate to manage the operations of the Company. There are no provisions in debt, lease or other arrangements that could trigger an additional funding requirement or early payment based on current or expected results. There are no circumstances that management is aware of that would impair the Company's ability to undertake any transaction which is essential to the Company's operations.

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**Capital Expenditures**

The property, plant and equipment additions of \$59.8 million in the current year were primarily comprised of additions to aircraft, engines, ground equipment, leasehold improvements, heavy maintenance and other equipment.

Selected Annual Information

(Canadian dollars in million, except where indicated)

	<b>Years Ended December 31</b>		
	<b>2016</b>	2015	2014
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Revenue	331.0	289.0	192.4
Direct expenses	245.2	250.7	173.6
Gross margin	85.8	38.3	18.8
Selling, general & administrative expenses and income taxes	83.4	56.3	28.3
Net (loss) income	2.4	(18.0)	(9.5)
(Loss) earning per share - CAD\$			
Basic	0.23	(1.86)	(1.07)
Diluted	0.22	(1.86)	(1.07)
EBITDA (1)	75.8	34.6	5.3
Adjusted EBITDA (1)	93.1	36.0	6.4
EBITDAR (1)	96.0	66.8	31.1
Adjusted EBITDAR (1)	113.3	68.3	32.1
Adjusted Free Cash Flow (1)	49.9	13.1	(5.5)
Cash, cash equivalents and short term investments	2.2	6.0	-
Total assets	462.5	450.8	285.3
Total long-term liabilities	314.5	350.0	186.2
Total liabilities	395.9	396.0	219.9
Dividends per share - CAD\$	\$0.6482	\$0.5964	\$0.5964

(1) EBITDA, Adjusted EBITDA and Adjusted Free Cash Flow are non -GAAP financial measures and are not earning measures recognized by IFRS. Please refer page 1 of this MD&A for detailed discussion

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**Financial Condition**

The following is a comparison of the financial position of the Company as at December 31, 2016 to the financial position of the Company as at December 31, 2015.

**Accounts Receivable**

Accounts receivable as at December 31, 2016 amounted to \$25.7 million compared to \$23.0 million as at December 31, 2015. The increase of \$2.7 million was due to the timing of cash collections from the customers and adjustments in the value of the derivatives. The quality of the Company's net receivable balances and its current collections, in management's opinion, remain excellent.

**Property, Plant and Equipment**

As at December 31, 2016, property, plant and equipment were \$371.1 million compared to \$357.3 million as at December 31, 2015. The \$13.8 million net increase in property, plant and equipment was primarily due to additions of \$59.8 million partially offset by amortization of \$42.0 million and impairment of \$3.9 million. .

**Trade and Other Payables**

Trade and other payables as at December 31, 2016 were \$30.4 million compared to \$27.0 million as at December 31, 2015. The increase of \$3.4 million was due primarily to the provision of pension obligation of \$8.7 partly offset by lower third party liabilities due to the timing of supplier payments.

**Finance Leases**

The finance leases are in respect of the lease of five B767-300 aircraft. Total finance leases excluding the current portion were \$117.6 million as at December 31, 2016 compared to \$140.2 as at December 31, 2015. The change was due to the scheduled monthly installments and prepayments made in the current period.

**Provisions**

Provisions as at December 31, 2016 and 2015 were \$2.4 million and comprised of maintenance liabilities for leased aircraft estimated to be incurred at the end of their lease terms.

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**Summary of Contractual Obligations**

As at December 31, 2016 <b>(Canadian dollars in millions)</b>	Total	Payments due by Year				
		2017	2018	2019	2020	Thereafter
	\$	\$	\$	\$	\$	\$
Finance leases	130.3	12.7	46.8	11.9	9.7	49.2
Provisions	2.4	0.7	-	-	-	1.7
Borrowings	35.7	35.7	-	-	-	-
Convertible Debentures	181.1	-	-	68.4	-	112.7
Operating leases	50.0	12.9	9.2	7.2	5.4	15.3
	399.5	62.0	56.0	87.5	15.1	178.9

**Off-Balance Sheet Arrangements**

The Company's primary off-balance sheet arrangements are as follows:

(a) The Company has provided indemnities under lease agreements for the use of various operating facilities and leased aircraft. Under the terms of these agreements, the Company agrees to indemnify the lessors of aircraft and facilities for various items including, but not limited to, all liabilities, losses, suits and damages arising during, on or after the term of the agreement. The maximum amount of any potential future payment cannot be reasonably estimated.

(b) Indemnities have been provided to all directors and officers of the Company for various items including, but not limited to, all costs to settle suits or actions due to association with the Company, subject to certain restrictions. The Company has purchased directors' and officers' liability insurance to mitigate the cost of any potential future suits or actions. The term of the indemnification is not explicitly defined, but is limited to the period over which the indemnified party served as a director or officer of the Company. The maximum amount of any potential future payment cannot be reasonably estimated.

(c) In the normal course of business, the Company has entered into agreements that include indemnities in favour of third parties, such as purchase and sale agreements, confidentiality agreements, engagement letters with advisors and consultants, outsourcing agreements, leasing contracts, information technology agreements and service agreements. These indemnification agreements may require the Company to compensate counterparties for losses incurred by the counterparties as a result of breaches in representation and regulations or as a result of litigation claims or statutory sanctions that may be suffered by the counterparty as a consequence of the transaction. The terms of these indemnities are not explicitly defined and the maximum amount of any potential reimbursement cannot be reasonably estimated.

Note: See Caution Concerning Forward Looking Statements, page 2.

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(d) The Company participates in six Fuel Facility Corporations ("FFC") along with other airlines that contract for fuel services at various major airports in Canada. Each FFC operates on a cost recovery basis. The purpose of the FFC is to own and finance the system that distributes fuel to the contracting airlines, including leasing the required land rights. The aggregate debt of these FFC and any liabilities of environmental remediation costs are not considered part of the Financial Statements of the Company and are not consolidated. The airlines that participate in FFC guarantee on a pro-rata basis of this debt based on system usage. There is no major change in the total assets and total debts of these FFC as disclosed in the MD&A for the year ended December 31, 2016. The Company's pro rata share of the FFC's assets and debt is approximately 8% before taking into consideration the value of assets that secure the obligations and cost sharing that would occur among other participating airlines. The Company views the potential for losses in respect of the FFC as remote.

The nature of these indemnification agreements prevents the Company from making a reasonable estimate of the maximum exposure due to the difficulties in assessing the amount of liability which stems from the unpredictability of future events and the unlimited coverage offered to counterparties.

Historically, the Company has not made any payments under such or similar indemnification agreements and therefore no amount has been accrued in the balance sheet with respect to these agreements.

#### **Major Customers**

During the year ended December 31, 2016, the Company had sales to three customers that represented 66.27% of the total revenues (December 31, 2015 – 63.1%). These sales are provided under service agreements that expire over various periods to April 2025.

#### **Contingencies**

The Company has provided irrevocable standby letters of credit totaling approximately \$24.1 million as at December 31, 2016. The other guarantees are provided to financial institutions as security for its corporate credit cards, and to a number of vendors as a security for the Company's ongoing leases and purchases.

On February 14, 2017, the Company cancelled a \$6.6 million letter of credit following the repayment of an aircraft loan.

#### **Related Party Transactions**

In February 2017, the Company entered into a lease agreement with respect to a new 62,000 square feet head office and warehouse area. The lessor of the property is indirectly beneficially owned by one of the Company's executive officers and directors. See Page 6 Recent events for further details.

On September 28, 2016 the Company completed the private placement of 100,000 variable voting shares to one of its directors. The Company intends to use the proceeds from such placement for general corporate and working capital purposes. The Company had no other transactions with related parties except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship agreements.

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### **Risk Factors**

#### **Risks Related to the Business**

##### **Loss of Customer Contracts**

The Company's ten largest customers accounted for approximately 79.4% of 2016 revenues of the Company and the Company's top three customers each accounted for over 10% of the Company's 2016 revenues. The loss of any one of these contracts of the Company would cause immediate disruption and would adversely affect the Company's revenues. Any such loss could have a material adverse effect on the results of operations of the Company and there is no assurance that the contracts will be renewed for an additional term or that the commercial terms of any such renewal would be as favorable to the Company as the existing contracts. The inability of the Company to renew these contracts could have a material adverse effect on the Company's business, results of operations or financial condition.

Most of the Company's contracts with its customers are for a term of three to ten years with the ability to terminate generally upon six to eighteen months' notice or if the Company is not meeting specified performance targets. When these contracts expire, there is no assurance that the contracts will be renewed for an additional term or that the commercial terms of any such renewal would be as favorable to the Company as existing contracts. The inability of the Company to renew these contracts could have a material adverse effect on the Company's business, results of operations or financial condition.

In 2014, the Company was awarded the Domestic Air Cargo Network Services ("DACNS") contract and signed the Master Services Agreement ("MSA") with the Canada Post Group of Companies ("CPGOC") for an initial seven-year term with three thirty-six months renewal options held by the CPGOC. The terms of contract require the Company to maintain specific on time performance metrics and provide minimum levels of dedicated cargo space. To fulfill its requirements under the contract, the Company has made material investments in its fleet, equipment and the hiring of new personnel. The cancellation of the MSA without penalty would have a material adverse effect on the Company's business, results of operations and financial conditions.

##### **Credit Facilities, Finance Lease and Loan Agreement and their Restrictive Covenants**

The ability of the Company to make distributions, pay dividends or make other payments or advances will be subject to applicable laws and contractual restrictions contained in the instruments governing any indebtedness and finance lease obligations. The degree to which the Company is leveraged could have important consequences to the shareholders, including: (i) a portion of the Company's cash flow from operations will be dedicated to the payment of the principal of and interest on the indebtedness and amounts payable under the finance leases, thereby reducing funds available for future operations and distribution to the Company; (ii) certain of the Company's borrowings and finance lease obligations will be at variable rates of interest, which exposes the Company to the risk of increased interest rates; and (iii) the Company's ability to obtain additional financing for working capital, capital expenditures or acquisitions in the future may be limited. The Company's ability to make scheduled payments of principal and interest and other amounts on, or to refinance, its indebtedness and finance lease obligations will depend on its future operating performance and cash flow, which are subject to prevailing economic conditions, prevailing interest rate levels, and financial, competitive, business and other factors, many of which are beyond its control. These factors might inhibit the Company from refinancing the indebtedness and finance lease obligations at all or on favorable terms.

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The instruments governing the Company's indebtedness and finance lease obligations contain restrictive covenants that limit the discretion of management with respect to certain business matters. These covenants place restrictions on, among other things, the ability of the Company to incur additional indebtedness, to create liens or other encumbrances, to pay dividends or make certain other payments, investments, loans and guarantees and to sell or otherwise dispose of assets and merge or consolidate with another entity. In addition, such instruments contain financial covenants that require the Company to meet certain financial ratios and financial conditions tests. A failure to comply with these obligations could result in an event of default which, if not cured or waived, could permit acceleration of the relevant indebtedness. If the obligations under these instruments were to be accelerated, there can be no assurance that the Company's assets would be sufficient to satisfy such obligations in full. In addition, there can be no assurance that future borrowing or equity financing will be available to the Company or available on acceptable terms, in an amount sufficient to fund the Company's refinancing needs and other obligations arising on the maturity of such instruments, including the obligations to purchase the aircraft subject to the finance leases.

### **Canada — US Open Skies**

The current Canada — US "Open Skies" agreement provides regulation of the airline industry, including the air cargo industry, within Canada and currently provides protection of domestic national carriers in each country. The agreement allows cross-border flights between Canada and the United States but provides major restrictions on carriers from operating flight routes between two points within the other's country. The most recent amendments negotiated between the two countries reinforced the restriction of cabotage and does not allow United States carriers to establish domestic flight routes within Canada and Canadian carriers including the Company to establish domestic routes within the United States. There is no assurance that this "Open Skies" agreement will continue in its present form in the future. Increased competition resulting from the liberalization or revocation of this agreement could affect the Company's ability to compete for a market share, which in turn could have a material adverse effect on the Company's business, results of operations or financial condition.

### **Competition**

The Company competes within the industry of air-cargo courier services with other dedicated air cargo carriers. In addition, the Company competes for market share with motor carriers, express companies and other air couriers and airlines who offer cargo services on their regularly scheduled passenger flights. In addition to competition from competitors, new companies may enter the domestic air cargo industry and may be able to offer services at discounted rates. Concentrating only on the air cargo industry does not allow the Company to compete in different modes of freight transportation which may provide a cheaper alternative to air cargo. The Company's inability to compete for a market share of the air cargo industry under these circumstances could have a material adverse effect on the Company's business, results of operations or financial condition.

### **Government Regulations**

The Company's operations are subject to complex aviation, transportation, environmental, labour, employment and other laws, treaties and regulations. These laws and regulations generally require the Company to maintain and comply with a wide variety of certificates, permits, licenses and other approvals.



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The Company's inability to maintain required certificates, permits or licenses, or to comply with applicable laws, ordinances or regulations, could result in substantial fines or possible revocation of its authority to conduct operations.

The Company is routinely audited by various regulatory bodies including Transport Canada and the Canadian Transportation Agency to ensure compliance with all flight operation and aircraft maintenance requirements. To date, the Company has successfully passed all audits, however, there can be no assurance that the Company will pass all audits in the future. Failure to pass such audits could result in fines or grounding of the aircraft which could have a material adverse effect on the Company's business, results of operations or financial condition.

The Company is subject to certain federal, provincial and local laws and regulations relating to environmental protection, including those governing past or present releases of hazardous materials. Certain of these laws and regulations may impose liability on certain classes of persons for the costs of investigation or remediation of such contamination, regardless of fault or the legality of the original disposal. These persons include the present or former owner or a person in care or control of a contaminated property and companies that generated, disposed of or arranged for the disposal of hazardous substances found at the property. As a result, the Company may incur costs to clean up contamination present on, at or under its facilities, even if such contamination was present prior to the commencement of the Company's operations at the facility and was not caused by its activities which could have a material adverse effect on the Company's business, results of operations or financial condition.

The Company cannot provide any assurance that existing laws, agreements, treaties or regulations will not be revised or that new laws, agreements, treaties or regulations, which could have an adverse impact on the Company's operations, will not be adopted or become applicable to the Company. For example, the Company's aircraft currently meet Transport Canada and FAA Stage III noise abatement guidelines. Any future implementation of Stage IV noise abatement guidelines would require the Company to incur expenses to ensure its aircraft meet such guidelines which expenses could negatively impact the Company's earnings. The Company also cannot provide any assurance that it will be able to recover any or all increased costs of compliance from its customers or that the business and financial condition of the Company will not be adversely affected by future changes in applicable laws and regulations.

### **Insurance**

The Company's operations are subject to risks normally inherent in the air-cargo industry, including potential liability which could result from, among other circumstances, personal injury or property damage arising from disasters, accidents or incidents involving aircraft operated by the Company or its agents. The availability of, and ability to collect on, insurance coverage is subject to factors beyond the control of the Company. There can be no assurance that insurance coverage will be sufficient to cover one or more large claims, or that the applicable insurer will be solvent at the time of any covered loss. There can be no assurance that the Company will be able to obtain insurance at acceptable levels and costs in the future. The Company may become subject to liability for hazards which it cannot or may not elect to insure because of high premium costs or other reasons or for occurrences which exceed maximum coverage under its policies. The occurrence of an aircraft-related accident or mishap involving the Company could have a material adverse effect on the Company's business, results of operations or financial condition. In addition, the Company does not carry any business interruption insurance.

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### **Maintaining Leased Aircraft and Availability of Future Aircraft**

The Company currently owns and operates six B727-200, two B757-200, and three B767-300 and has five B767-300 aircraft under finance lease. It also leases one B767-200 and three B757-200 aircraft. The Company also acquired five Challenger 601 aircraft in 2014, two of which are operating under a charter agreement with a third party and two are being considered for conversion for cargo operations and one is split into parts for use as spares. The success of the Company will depend, in part, on its ability to replace owned aircraft when necessary and to maintain favorable leases for its leased aircraft. There can be no assurance that the Company will be able to lease or purchase aircraft in the future on acceptable terms or to maintain favorable leases for its aircraft or be able to arrange financing for its current commitment of aircraft purchases or future replacements and expansions. Such risk could have a material adverse effect on the Company's business, results of operations or financial condition.

### **Fixed Costs**

The Company is subject to a high degree of operating leverage. Since fixed costs comprise a proportion of the operating costs of each flight route, the expenses of each flight route do not vary proportionately with the amount of shipments that the Company carries. Accordingly, a decrease in the Company's revenues could result in a disproportionately higher decrease in the Company's earnings as expenses would remain unchanged.

### **Fuel Prices**

The Company requires significant quantities of fuel for its aircraft. Historically, fuel costs represented 25% to 30% of the Company's direct operating cost. The Company is therefore exposed to commodity price risk associated with variations in the market price for petroleum products. The price of fuel is sensitive to, among other things, the price of crude oil, which has increased dramatically over the past few years, refining costs, and the cost of delivering the fuel. Although the Company historically has implemented fuel surcharges to mitigate the earnings impact of unusually high fuel prices, competitive and other pressures may prevent the Company from passing these costs on to its customers in the future. The Company cannot provide any assurance that its supply of fuel will continue uninterrupted, that rationing will not be imposed or that the prices of, or taxes on, fuel will not increase significantly in the future. An extremely high fuel cost could adversely affect customer volumes as other cheaper modes of transportation are sought. Increases in prices that the Company is unable to pass on to its customers could have a material adverse effect on the Company's business, results of operations or financial condition.

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### **Costs Related to Mechanical and Maintenance Problems and Replacement of Equipment and Parts**

Maintenance costs will increase as our fleet ages. It includes overhaul of engines, landing gears, APUs and airframes in addition to ongoing maintenance requirements. The Company has a maintenance program schedule and monitors the maintenance of aircraft for owned and leased aircraft. Although costs related to mechanical problems and to maintenance for the Company's aircraft have been forecasted and funded pursuant to its leasing arrangements and maintenance agreements, the actual costs may be higher than those anticipated. Unexpected repairs relating to mechanical problems and to maintenance are beyond the control of the Company and may have a material adverse effect on the Company's business, results of operations or financial condition. In addition, the ability of the Company to obtain equipment and replacement parts on satisfactory terms when required is not always certain. Any inability to obtain equipment or parts, or to obtain the required equipment or parts on satisfactory terms and on a timely basis could have a material adverse effect on the Company's business, results of operations or financial condition.

### **Foreign Exchange Fluctuations**

The Company undertakes sales and purchase transactions including aircraft maintenance cost, lease payments, loan payments, crew training and certain operating costs in foreign currencies, and therefore is subject to gains and losses due to fluctuations in the foreign currencies. Changes in the value of the Canadian dollar relative to the United States dollar could have a negative effect on the profitability of the Company. For the year ended December 31, 2016, the Company had a net cash flow exposure to the United States dollar of approximately U.S. \$8.0 million and to the Euro of approximately €1.0 million. As of the date of this MD&A, the Company is exposed to fluctuations in the US-dollar exchange rate relating to one B767-300 lease agreement. To the extent that the Company does not adequately hedge its foreign exchange risk, changes in the exchange rate between the Canadian dollar and the United States dollar may have a material adverse effect on the Company's business, results of operations or financial condition.

### **Ability to Maintain Profitability and Manage Growth**

There can be no assurance that the Company's business and growth strategy will enable the Company to sustain profitability in future periods. The Company's future operating results will depend on a number of factors, including general economic conditions and consumer confidence.

There can be no assurance that the Company will be successful in achieving its strategic plan or that this strategic plan will enable the Company to grow at historical rates or to sustain profitability. Failure to successfully execute any material part of the Company's strategic plan could have a material adverse effect on the Company's business, result of operations or financial condition.

There can be no assurance that the Company will be able to effectively manage its growth, and any failure to do so could have a material adverse effect on the Company's business, results of operations or financial condition.

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### **Industry Risk and Economic Sensitivity**

The Company serves numerous industries and customers that experience significant fluctuations in demand based on economic conditions and other factors beyond the control of the Company. Demand for the Company's services could be materially adversely affected by downturns in the businesses of its customers. The Company's revenues are impacted by the health of the economy in the regional markets in which the Company operates. Although the Company cannot specifically correlate the impact of macro-economic conditions on its business activities, the Company believes that a decline in economic conditions in Canada may result in decreased demand for the services the Company provides and, to the extent that this decline continues or increases in severity, the Company's business, results of operations or financial condition could be materially adversely affected.

### **Terrorist Activity**

The terrorists' attacks of September 11, 2001 and their aftermath negatively impacted the air cargo industry. Additional terrorist attacks, the fear of such attacks or increased hostilities could further negatively impact the air cargo industry. The Company could experience a decrease in the use of its air cargo network as a means of transporting goods domestically and internationally and an increase in costs.

### **Dependence on Key Personnel**

The Company's success will be substantially dependent on the continued services of senior management of the Company. The loss of the services of one or more key members of senior management of the Company could have a material adverse effect on the Company's business, results of operations or financial condition. In addition, the Company's continued growth depends on the ability of the Company to attract and retain skilled managers and employees and the ability of its personnel to manage the Company's growth. The inability to attract and retain key personnel could have a material adverse effect on the Company's business, results of operations or financial condition.

### **Labour Relations**

On October 19, 2012, 65 of the Company's pilots were certified as a union by the Canadian Industrial Relations Board (the "CIRB"). As of the date hereof, 147 of the Company's pilots are certified as a union by the CIRB. The National Automobile, Aerospace, Transportation and General Workers Union of Canada (CAW – Canada) was certified as the bargaining agent for the Company's pilots. The Company entered into a five year collective agreement with the union representing the Company's pilots. The pilots ratified the agreement in July 2013. On June 1, 2015, the CIRB certified all cargo agents and load planners of the Company at Halifax International Airport, consisting of 18 employees as at the date hereof, with Unifor being certified as the bargaining agent for such employees. Effective November 10, 2015, the Company entered into a collective agreement with Unifor in respect of these employees expiring December 31, 2018. Currently, none of the Company's other employees are unionized. The maintenance of a productive and efficient labour environment and the successful negotiation of a collective bargaining agreement cannot be assured. Protracted and extensive work stoppages or labour disruptions such as strikes or lockouts could have a material adverse effect on the Company's business, results of operations or financial condition.

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### **Severe Weather Patterns**

The Company serves numerous industries and customers that experience significant fluctuations in demand based on economic conditions and other factors beyond the control of the Company. Demand for the Company's services could be materially adversely affected by downturns in the businesses of its customers. Severe weather during any extended period could prevent shipments from being delivered on a timely basis and could force flight cancellations. Any extended delay in meeting time sensitive shipping deadlines could have a material adverse effect on the Company's business, results of operations or financial condition.

### **Seasonal Fluctuations**

Traditionally, the Company has experienced its best operating results in the third and fourth quarters of each year. Shipping activity is usually the best in the fourth quarter as a result of the holiday season and is usually the lowest in the first quarter. Accordingly, the seasonal nature of the business of the Company will affect the quarterly financial results of operation of the Company that will be reported.

### **Dependence on International Trade**

The principal businesses of the Company are indirectly related to, and future performance is dependent upon, the volume of international trade, including cross-border trade between Canada and the US. Such trade is influenced by many factors, including North American and overseas economic and political conditions, major work stoppages, wars, terrorist acts or security operations, exchange controls, currency fluctuations and Canadian, US and foreign laws relating to duties, trade restrictions, foreign investment and taxation. There can be no assurance that trade-related events beyond the control of the Company, such as failure to reach or adopt trade agreements and an increase in trade restrictions, will not have a material adverse effect on the Company's business, results of operations or financial condition.

### **Future Sales of Voting Shares by the directors and officers of Cargojet**

The directors and officers of Cargojet directly and indirectly hold in aggregate 1,858,824 voting Shares, or approximately 17.46% of the outstanding Voting Shares. If the directors and officers of Cargojet sell substantial amounts of Voting Shares in the public market, the market price of the Voting Shares could decrease. The perception among the public that these sales will occur could also produce such an effect.

### **Income Tax Matters**

Cargojet is subject to federal and provincial income taxes. Although the Company is of the view that all expenses to be claimed by the Company and its subsidiaries in the determination of their respective incomes under the Tax Act will be reasonable and deductible by the appropriate entity in accordance with the applicable provisions of the Tax Act, and that the allocations of income and loss of Cargojet Holdings Limited Partnership ("CHLP") and Cargojet Partnership ("CJP") to be made for purposes of the Tax Act will be reasonable, there can be no assurance that the Tax Act or the interpretation of the Tax Act will not change, or that Canada Revenue Agency ("CRA") or the provincial taxing authority will agree. Counsel can provide no opinion with respect to the reasonableness of any expense or of the allocation of income by a partnership. If CRA or any provincial tax authority successfully challenges the deductibility of expenses or the allocation of income, Cargojet's liability to income tax may increase.

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### **Increase in Interest Rates**

One of the factors that may influence the price of the Voting Shares in public trading markets will be the annual cash-on-cash return from dividends by the Company on the Voting Shares compared to cash-on-cash returns on other financial instruments. Thus, an increase in market interest rates will result in higher cash-on-cash returns on other financial instruments, which could adversely affect the market price of the Voting Shares.

### **Outlook**

Note: See Caution Concerning Forward Looking Statements, page 2

During the quarter ended December 31, 2016, the Company experienced growth in all of its revenue streams, thereby increasing its total overnight, charter and ACMI business by 11.6% compared to the same period in 2015. The Company anticipates that the revenues will continue to sustain growth due to the continued development and strengthening of its relationships with existing customers and establishing new relationship with national/international carriers to establish new ACMI routes to the USA and South America and adhoc charters. The Company continues to retain all of its major customers. Since 2014, the Company has been adding aircraft, staff and network capacity to accommodate the growing demand in its overnight core network. The Company continues to redesign its overnight network to optimize capacity to match customer demand and will continue to do so going forward. This improved the gross margin and EBITDA by optimizing costs of its current operation. The Company will continue to evaluate its investments in fixed assets to ensure high returns on its investments and are in balance with its outlook of global economic conditions.

The Company proactively manages its fleet capacity and maintains its strong on-time performance. Management expects to achieve organic growth within its existing customer base and to obtain new customers for both its domestic and international routes as the Company continues its efforts to build on its competitive market position.

The Company also continues to recover fuel price increases through fuel surcharges. Any fuel cost increases due to higher fuel prices are passed on to customers as an increase in fuel surcharge and billed to customers on a cost recovery basis only. Similarly, any cost savings due to lower fuel prices are passed on to customers as a decrease in fuel surcharge. Management is confident that the Company will continue to fully recover any future increases in fuel costs. The new CPGOC contract also has a variable price component that will allow Company to recover costs related to fuel prices increases.

Management's principal objective is to maximize free cash flow available for dividends by continuing to provide quality air cargo services, increasing the range of these services, focusing on improving efficiencies and cost controls, and growing the business organically and through strategic and accretive acquisitions. Management continuously reviews and evaluates all of the foregoing initiatives especially those that can improve cash flow.

Future strategic initiatives may be financed from working capital, cash flow from operations, borrowing or the issuance of securities. Any decisions regarding the above, including further increases or decreases in dividends, will be considered and determined as appropriate by the Board of Directors of the Company.

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### **Critical accounting judgments and key sources of estimation uncertainty**

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period. By their nature, judgments and estimates may change in light of new facts and circumstances in the internal and external environment. The following judgments are those deemed by management to be material to the preparation of the financial statements.

### **Critical accounting judgments**

*Componentization of property, plant and equipment and goodwill:* The componentization of the Company's property, plant and equipment is based on judgment in relation to the determination of components is based cost of the component relative to total cost of an asset and whether these components have different useful lives for determination of depreciation.

*Impairment of property, plant and equipment:* Assessment of impairment is based on management's judgment of whether there are sufficient internal and external factors that would indicate that an asset or cash generating unit (CGU) is impaired. The determination of CGUs is also based on management's judgment and is an assessment of the smallest group of assets that generate cash inflows independently of other assets. Factors considered include whether an active market exists for the output produced by the asset or group of assets as well as how management monitors and makes decisions about operations.

*Classification of leases:* Assessing whether a lease is a finance lease or an operating lease is based on management's judgment of the criteria applied in IAS 17 – Leases. The most prevalent leases are those for aircraft.

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**Critical Estimates**

The table below discloses the methodology and assumptions used by management in the assessment of the accounting estimates.

<b>Critical Accounting Estimate</b>	<b>Methodology and Assumptions</b>
Financial instruments	The issuance of a compound instrument, such as convertible debentures, requires the Company to estimate the debt and equity components of the instruments issued or repurchased. The component parts of the convertible debentures are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangement. At the date of issue, the fair value of the liability is measured separately using an estimated market rate for a similar liability without an equity component and the residual is allocated to the conversion option.
Impairment of property, plant and equipment and goodwill	At the end of each reporting period, the Company reviews the carrying amounts of its property, plant and equipment, intangibles and goodwill to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been Adjusted. If the recoverable amount of an asset or cash-generating unit is estimated to be less than its carrying amount, the carrying amount of the asset or cash-generating unit is reduced to its recoverable amount. Determining whether goodwill is impaired requires the Company to determine the recoverable amount of the cash-generating unit. To determine the recoverable amount of the cash-generating unit, management is required to estimate its fair value by evaluating expected future cash flow using an appropriate growth rate, margins, and a suitable discount rate to calculate the value in use.
Deferred taxes	Deferred tax assets are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future. The Company reviews the carrying amount of deferred tax assets at the end of each reporting period and assess its recoverability using forecasts that are based on the actual operating results and the expected future performance based on management’s estimates and assumptions of revenue growth and the development. The deferred tax assets are reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.



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Provisions	The Company has estimated that it will incur certain maintenance costs at the end of its aircraft lease terms and has recorded a maintenance provision liability for these costs. Such costs have been estimated based on contractual commitments, current and estimated future aircraft utilization rate, Company’s maintenance program, rates provided by current maintenance service providers and Company specific history. The Company reviews the provisions at each reporting period to determine the change in estimated liability. The company believes that the assumptions used are reasonable based on the information currently available but the final payments may change materially due to change in timing, cost of maintenance or discount rates.
Cash settled share based payment arrangement	The cost and related liability of the stock appreciation rights under a MLA with an equipment finance and leasing company recognized using Black-Scholes option pricing model involving assumptions including discount rates and early exercise dates. Due to the long-term nature of these rights, such estimates are subject to significant uncertainty.
Employee future benefits	The cost and related liabilities of the Corporation’s pensions, other post-retirement and post-employment benefit programs are determined using actuarial valuations. The actuarial valuations involve assumptions including discount rates, future salary increases, mortality rates and future benefit increases. Also, due to the long-term nature of these programs, such estimates are subject to significant uncertainty.

**Outstanding Share Data**

The Company’s common voting shares are listed under the symbol “CJT”, variable voting shares under the symbol “CJT.A” and convertible debentures are listed under the symbol “CJT.DB.A” and “CJT.DB.B” and “CJT.DB.C” on the Toronto Stock Exchange (“TSX”). The following table sets out the shares of the Company outstanding and securities convertible into shares of the Company as of December 31, 2016:

<b>Capital</b>	<b>Authorized/ Principal</b>	<b>Outstanding number of shares</b>	<b>Number of Shares underlying Convertible securities</b>
Common Voting Shares	Unlimited	10,408,794	-
Variable Voting Shares	Unlimited	234,571	-
Convertible Debentures - 5.5%	\$ 73,778,000	-	2,566,191
Convertible Debentures - 4.65%	\$ 125,000,000	-	2,131,287

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### Information Disclosure Controls and Procedures and Internal Controls over Financial Reporting

Disclosure controls and procedures within the Company are designed to provide reasonable assurance that appropriate and timely decisions are made regarding public disclosure. This is accomplished through the establishment of systems that identify and communicate relevant information to persons responsible for preparing public disclosure items, in accordance with the Disclosure Policy adopted jointly by the Directors of the Company.

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and its preparation of financial statements for external purposes in accordance with IFRS.

An evaluation of the effectiveness of the Company's disclosure controls and procedures and internal controls over financial reporting, as defined under the rules of the Canadian Securities Administrators, was conducted at December 31, 2016 by management. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the disclosure controls and procedures and internal controls over financial reporting of the Company are effective. This MD&A was reviewed by the Disclosure Officers of the Company (individuals authorized to communicate with the public about information concerning the Company), the Audit Committee and the Board of Directors of the Company, all of whom approved it prior to its publication.

### Financial Reporting Update

#### **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. The standard supersedes all previous versions of IFRS 9 and is effective for periods beginning on or after January 1, 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 that will replace IAS 18 Revenue and related interpretations. 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 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 and improve guidance for multiple-element arrangements. The IASB standard is available for early application with mandatory adoption required for fiscal years commencing on or after January 1, 2018. The Company is currently assessing the impact of this standard.

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*Leases:* In January 2016, the IASB issued IFRS 16, *Leases*, which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e., the customer ("lessee") and the supplier ("lessor"). IFRS 16 replaces the previous lease standard, IAS 17 *Leases*, and related interpretations. The most significant effect of the new requirements will be an increase in lease assets and financial liabilities as IFRS 16 eliminates the classification of leases as either operating leases or finance leases for a lessee. All leases are 'capitalized' by recognizing the present value of the lease payments and showing them either as lease assets (right-of-use assets) or together with property, plant and equipment. If lease payments are made over time, a company also recognizes a financial liability representing its obligation to make future lease payments. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements.

*Income taxes:* IAS 12, has been revised to incorporate amendments issued by the IASB in January 2016. The amendments clarify how to account for deferred tax assets related to debt instruments measured at fair value. The amendments are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted. The Company does not expect the adoption of this standard to have a significant impact on the Company's disclosures as it does not have any debt instruments that are measured at fair value.

IFRS 2, Share-based payments ("IFRS 2"), has been amended to address (i) certain issues related to the accounting for cash settled awards, and (ii) the accounting for equity settled awards that include a "net settlement" feature in respect of employee withholding taxes. IFRS 2 is effective for annual periods beginning on or after January 1, 2018. The Company is currently evaluating the impact of adopting this standard on its consolidated financial statements.

### **End Notes**

<sup>(A)</sup> "EBITDA" is defined as earnings before interest, taxes, depreciation and amortization. EBITDA is calculated as net income or loss excluding the following: depreciation, and aircraft heavy maintenance amortization, interest on long-term debt, deferred income taxes and provision for current income taxes. EBITDA is a term used by the Company that does not have a standardized meaning prescribed by IFRS and is therefore unlikely to be comparable to similar measures used by other issuers. EBITDA is a measure of the Company's operating profitability and by definition, excludes certain items as detailed above. These items are viewed by management as non-cash (in the case of depreciation and amortization of aircraft heavy maintenance expenditures,), or non-operating (in the case of interest on long-term debt and provision for current income taxes). The underlying reasons for exclusion of each item are as follows:

**Depreciation** - as a non-cash item, depreciation has no impact on the determination of EBITDA.

**Interest on long-term debt** - interest on long-term debt is a function of the Company's treasury/financing activities and represents a different class of expense than those included in EBITDA.

**Deferred income taxes** - the calculation of deferred income taxes is a function of temporary differences between the financial reporting and the tax basis of balance sheet items for calculating tax expense and is separate from the daily operations of the Company.

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**Provision for current income taxes** – the provision for current income taxes is a non-operating item and represents a different class of expense than those included in EBITDA.

**Aircraft heavy maintenance amortization** - aircraft heavy maintenance amortization represents a non-cash item and is excluded from EBITDA.

- (B) "Adjusted EBITDA" is defined as earnings before interest, taxes, depreciation, amortization, and other adjustments. Adjusted EBITDA is calculated as net income or loss excluding the following: depreciation, aircraft heavy maintenance amortization, interest on long-term debt, deferred income taxes, provision for current income taxes, gain or loss on disposal of property, plant and equipment, amortization of maintenance deposits, impairment of property plant and equipment, unrealized foreign exchange gains or losses and employee pension. Adjusted EBITDA is the term used by the Company that does not have a standardized meaning prescribed by IFRS and is therefore unlikely to be comparable to similar measures used by other issuers. Adjusted EBITDA is measure of the Company's operating profitability and by definition, excludes certain items as detailed above. These items are viewed by management as non-cash (in the case of depreciation, and aircraft heavy maintenance amortization, gain or loss on disposal of property, plant and equipment, gain or loss on disposal of intangible assets, amortization of maintenance deposits, unrealized foreign exchange gains and losses and deferred income taxes), or non-operating (in the case of interest on long-term debt and provision for current income taxes). The underlying reasons for exclusion of each item are as follows:

**Depreciation** - as a non-cash item, depreciation has no impact on the determination of Adjusted EBITDA.

**Interest on long-term debt** - interest on long-term debt is a function of the Company's treasury/financing activities and represents a different class of expense than those included in Adjusted EBITDA.

**Deferred income taxes** - the calculation of deferred income taxes is a function of temporary differences between the financial reporting and the tax basis of balance sheet items for calculating tax expense and is separate from the daily operations of the Company.

**Provision for current income taxes** – the provision for current income taxes is a non-operating item and represents a different class of expense than those included in Adjusted EBITDA.

**Gain or loss on disposal of property, plant and equipment** - the gain or loss arising from the disposal of property, plant and equipment is a non-cash item and has no impact on the determination of Adjusted EBITDA.

**Unrealized foreign exchange loss (gain)** - the unrealized gain or loss arising from the valuation of the foreign exchange balances at the period end is a non-cash item and has no impact on the determination of Adjusted EBITDA.

**Aircraft heavy maintenance amortization** - aircraft heavy maintenance amortization represents a non-cash item and is excluded from Adjusted EBITDA.

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**Gain or loss on forward foreign exchange contracts-** the gain or loss arising from the forward foreign exchange contracts is a non-cash item and has no impact on the determination of Adjusted EBITDA.

**Gain or loss on fair value of cash settled share based payment arrangement** - the gain or loss arising from the fair value of cash settled share based payment arrangement is a non-cash item and has no impact on the determination of Adjusted EBITDA.

**Gain or loss on fair value of total return swap** - the gain or loss arising from the fair value of cash settled share based payment arrangement is a non-cash item and has no impact on the determination of Adjusted EBITDA.

**Loss on settlement of cash settled share based payment arrangement** - the loss arising from the settlement of cash settled share based payment arrangement is a function of the Company's treasury/financing activities and represents a different class of expense than those included in Adjusted EBITDA.

**Gain on settlement of total return swap** - the gain arising from the settlement of total return swap is a function of the Company's treasury/financing activities and represents a different class of expense than those included in Adjusted EBITDA.

**Loss on extinguishment of debts** –The loss on extinguishment of a long term debt is a function of the company's treasury/financing activities and represents a different loss of expense than those included in Adjusted EBITDTA.

**Employee Pension** – the provision for employee pension is a non-operating item and represents a different class of expense than those included in EBITDA.

(C) "EBITDAR" is defined as earnings before interest, taxes, depreciation amortization and aircraft rent. EBITDAR is calculated as EBITDA excluding aircraft rents. EBITDAR is a measure commonly used in the airline industry to evaluate results by excluding differences in the method by which an airline finances its aircraft.

(D) "Adjusted EBITDAR" is defined as earnings before interest, taxes, depreciation amortization, other adjustments and aircraft rent. Adjusted EBITDAR is calculated as Adjusted EBITDA excluding aircraft rents. Adjusted EBITDAR is a measure commonly used in the airline industry to evaluate results by excluding differences in the method by which an airline finances its aircraft.

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(E) "Adjusted Free Cash Flow" is a term, which does not have a standardized meaning prescribed by IFRS and is therefore unlikely to be comparable to similar measures used by other companies. The objective of presenting this non-IFRS measure is to calculate the amount, which is available for dividend distributions to shareholders. Adjusted Free Cash Flow is not necessarily indicative of cash available to fund cash needs and should not be considered an alternative to cash flow as a measure of liquidity. All references in the Management's Discussion and Analysis to "Adjusted Free Cash Flow" have the meaning set out in this note.

In November 2010, the Canadian Institute of Chartered Accountants ("CICA") issued a consultation guidance titled *Reporting Supplementary Financial Measures, General Principles* ("The Guidance"). The Guidance approved the continuation of previously published guidance on EBITDA and free cash flow as they continue to be relevant in the post IFRS environment.

Standardized Free Cash Flow is defined as "Cash flows from operating activities as reported in the IFRS financial statements, including operating cash flows provided from or used in discontinued operations; total maintenance capital expenditures minus proceeds from the disposition of capital assets other than those of discontinued operations, as reported in the IFRS financial statements; and dividends, when stipulated, unless deducted in arriving at cash flows from operating activities."

The Company has adopted a measurement called Adjusted Free Cash Flow to supplement net earnings as a measure of operating performance. Adjusted Free Cash Flow is defined by the Company as Standardized Free Cash Flow as defined by the CICA, less operating cash flows provided from or used in discontinued operations, changes in working capital, plus the provision for current income taxes.

The underlying reasons for the inclusion and exclusion of each item are as follows:

**Changes in working capital** - Changes in non-cash working capital items and deposits represent timing differences in the Company's working capital from year to year. These items are expected to be recoverable or payable shortly from the balance sheet date. Since it only represents short-term timing differences, it should be excluded from standardized free cash flow to determine a more representative measure of cash that is available for dividend distributions.

**Provision for current income taxes** – The expected cash outflows from the provision of current income tax is deducted to determine cash that is available for dividend distributions as it has priority over dividend distribution.

**Maintenance capital expenditures** - These are defined as any fixed assets acquired during a reporting period to maintain the Company's aircraft fleet and other assets at the level required to continue operating the existing business. They also include any capital expenditure required to extend the operational life of the fleet including heavy maintenance. Maintenance capital expenditures exclude any capital expenditures that result in new and additional capacity required to grow operational revenue and cash flows.