

Condensed Consolidated Interim Financial Statements of

**CARGOJET INC.**

For the three and six month periods ended June 30, 2012 and 2011

*(unaudited – expressed in Canadian dollars)*

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# CARGOJET INC.

## Condensed Consolidated Interim Balance Sheets

As at June 30, 2012 and December 31, 2011

(unaudited, in Canadian dollars)

	Note	June 30, 2012 \$	December 31, 2011 \$
<b>ASSETS</b>			
<b>CURRENT ASSETS</b>			
Trade and other receivables		9,987,350	10,744,026
Inventories		580,600	700,626
Prepaid expenses and deposits		3,603,376	2,300,663
Current portion of notes receivable		821,102	821,102
Current portion of finance lease receivable		293,017	293,017
Assets held for sale		-	45,000
		<u>15,285,445</u>	<u>14,904,434</u>
<b>NON-CURRENT ASSETS</b>			
Property, plant and equipment		42,592,860	43,999,601
Notes receivable		2,074,048	2,418,568
Finance lease receivable		495,733	623,693
Goodwill		46,169,976	46,169,976
Intangible assets		1,000,000	1,000,000
Deposits		5,132,078	5,521,614
Deferred income taxes on assets held for sale		-	3,567
		<u>112,750,140</u>	<u>114,641,453</u>
<b>LIABILITIES</b>			
<b>CURRENT LIABILITIES</b>			
Overdraft		151,132	110,235
Trade and other payables		11,622,276	10,580,082
Income taxes payable		85,338	734,000
Dividends payable		1,135,066	1,079,112
Borrowings	5	851,639	757,677
Finance leases		5,068	35,135
		<u>13,850,519</u>	<u>13,296,241</u>
<b>NON-CURRENT LIABILITIES</b>			
Borrowings	5	5,106,526	10,562,566
Convertible debentures	4	24,956,473	23,916,542
Deferred income taxes	3	4,636,448	3,249,721
		<u>48,549,966</u>	<u>51,025,070</u>
<b>EQUITY</b>			
		<u>64,200,174</u>	<u>63,616,383</u>
		<u>112,750,140</u>	<u>114,641,453</u>

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

# CARGOJET INC.

## Condensed Consolidated Interim Statements of Income

Three and six month periods ended June 30, 2012 and 2011

(unaudited, in Canadian dollars)

	Note	Three months ended		Six months ended	
		June 30,		June 30,	
		2012	2011	2012	2011
		\$	\$	\$	\$
REVENUES		40,487,080	41,182,046	80,623,008	82,289,552
DIRECT EXPENSES		33,260,100	33,264,009	67,863,472	67,120,574
		7,226,980	7,918,037	12,759,536	15,168,978
General and administrative expenses		3,882,264	5,030,436	8,399,206	9,480,778
Sales and marketing expenses		116,294	83,146	217,030	255,291
Loss on disposal of plant, property and equipment		-	166,120	-	212,522
Finance costs		970,400	815,291	1,902,989	1,614,385
Finance income		(58,124)	(54,959)	(116,303)	(123,306)
Loss (gain) on derivative contracts		-	(73,649)	-	568,261
Loss on debenture redemption	4	554,603	-	554,603	-
		5,465,437	5,966,385	10,957,525	12,007,931
EARNINGS BEFORE INCOME TAXES		1,761,543	1,951,652	1,802,011	3,161,047
PROVISION FOR (RECOVERY OF) INCOME TAXES	3				
Current		-	600,000	-	900,029
Deferred		714,093	(55,561)	725,256	(429,078)
		714,093	544,439	725,256	470,951
NET INCOME		1,047,450	1,407,213	1,076,755	2,690,096
EARNINGS PER SHARE	7				
- Basic		0.13	0.18	0.13	0.34
- Diluted		0.13	0.18	0.13	0.34

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

# CARGOJET INC.

## Condensed Consolidated Interim Statements of Comprehensive Income

Three and six month periods ended June 30, 2012 and 2011

(unaudited, in Canadian dollars)

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	Three months ended		Six months ended	
	June 30,		June 30,	
Note	2012	2011	2012	2011
	\$	\$	\$	\$
<b>NET INCOME</b>	1,047,450	1,407,213	1,076,755	2,690,096
<b>OTHER COMPREHENSIVE INCOME</b>				
Transfer of losses on foreign exchange contracts to net income, net of income taxes of \$Nil (2011 - \$26,703 and \$53,407)	-	54,104	-	108,208
<b>TOTAL COMPREHENSIVE INCOME</b>	1,047,450	1,461,317	1,076,755	2,798,304

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# CARGOJET INC.

## Condensed Consolidated Interim Statements of Changes in Equity

Six month periods ended June 30, 2012 and 2011

(unaudited, in Canadian dollars)

	Note	Shareholders' capital	Share-based compensation reserve	Conversion option	Reserve for surplus on debenture repurchases	Other comprehensive income	Deficit	Total shareholders' equity
		\$	\$	\$	\$	\$	\$	\$
Balance, December 31, 2011		67,341,167	275,643	1,271,503	-	-	(5,271,930)	63,616,383
Net income and comprehensive income		-	-	-	-	-	1,076,755	1,076,755
Treasury shares		(11,727)	-	-	-	-	-	(11,727)
Share-based compensation		-	(55,645)	-	-	-	-	(55,645)
Conversion option on debenture redemption		-	-	(1,271,503)	1,271,503	-	-	-
Conversion option on debenture issuance	4	-	-	2,509,576	-	-	-	2,509,576
Deferred tax on conversion option		-	-	(665,038)	-	-	-	(665,038)
Dividends	6	-	-	-	-	-	(2,270,130)	(2,270,130)
<b>Balance, June 30, 2012</b>		<b>67,329,440</b>	<b>219,998</b>	<b>1,844,538</b>	<b>1,271,503</b>	<b>-</b>	<b>(6,465,305)</b>	<b>64,200,174</b>
Balance, December 31, 2010		-	-	-	-	(144,274)	(4,823,170)	(4,967,444)
Net income		-	-	-	-	-	2,690,096	2,690,096
Other comprehensive income		-	-	-	-	108,208	-	108,208
Total comprehensive income		-	-	-	-	108,208	2,690,096	2,798,304
Income trust conversion		67,784,167	-	1,778,326	-	-	-	69,562,493
Conversion option		-	-	(506,823)	-	-	-	(506,823)
Treasury shares		(443,090)	-	-	-	-	-	(443,090)
Share-based compensation		-	137,821	-	-	-	-	137,821
Dividends	6	-	-	-	-	-	(2,086,281)	(2,086,281)
<b>Balance, June 30, 2011</b>		<b>67,341,077</b>	<b>137,821</b>	<b>1,271,503</b>	<b>-</b>	<b>(36,066)</b>	<b>(4,219,355)</b>	<b>64,494,980</b>

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

# CARGOJET INC.

## Condensed Consolidated Interim Statements of Cash Flows

Six month periods ended June 30, 2012 and 2011

(unaudited, in Canadian dollars)

	Six months ended	
	June 30,	
Note	2012	2011
	\$	\$
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	1,076,755	2,690,096
Items not affecting cash		
Depreciation of property, plant and equipment	4,233,741	4,720,175
Share-based compensation	229,064	259,556
Finance costs	1,902,989	1,614,385
Interest paid	(1,486,388)	(1,339,363)
Loss on purchase of debentures	4 554,603	-
Loss on disposal of property, plant and equipment	-	212,522
Non-cash interest on notes receivable	(84,325)	(122,697)
Non-cash interest on finance lease receivable	(22,872)	-
Income tax provision	725,256	470,951
Income tax payments	(648,662)	(1,621,966)
Transfer of losses on derivatives from other comprehensive income	-	161,615
Change in fair value on non-hedge derivatives	-	568,261
	6,480,160	7,613,535
Changes in non-cash working capital items and deposits		
Trade and other receivables	756,676	2,871,376
Inventories	120,026	448,486
Prepaid expenses and deposits	(913,177)	393,768
Trade and other payables	1,042,194	(2,470,444)
<b>NET CASH GENERATED BY OPERATING ACTIVITIES</b>	<b>7,485,879</b>	<b>8,856,721</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Repayment of borrowings	(5,433,773)	(4,460,191)
Proceeds from borrowings	-	591,076
Repayment of finance leases payable	(30,067)	(106,192)
Proceeds from debenture issuance	4 27,305,000	-
Repayment of debenture	4 (24,655,000)	-
Purchase of treasury shares	(296,437)	(564,825)
Dividends paid to shareholders	(2,214,176)	(1,342,893)
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(5,324,453)</b>	<b>(5,883,025)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Payments for property, plant and equipment	(2,827,000)	(5,213,921)
Proceeds from disposal of property, plant and equipment	45,000	909,710
Collections of notes receivable	428,845	252,759
Collections of finance lease receivable	150,832	-
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(2,202,323)</b>	<b>(4,051,452)</b>
<b>NET CHANGE IN CASH</b>	<b>(40,897)</b>	<b>(1,077,756)</b>
<b>CASH (OVERDRAFT), BEGINNING OF PERIOD</b>	<b>(110,235)</b>	<b>621,522</b>
<b>OVERDRAFT, END OF PERIOD</b>	<b>(151,132)</b>	<b>(456,234)</b>

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

# CARGOJET INC.

## Notes to the Condensed Consolidated Interim Financial Statements

June 30, 2012 and 2011

(unaudited – in Canadian Dollars)

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### 1. NATURE OF THE BUSINESS

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

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

These condensed consolidated interim financial statements (the “financial statements”) were approved and authorized for issuance by the Board of Directors on August 9, 2012.

### 2. BASIS OF PRESENTATION

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

These financial statements do not include all of the information required for full annual financial statements, and should be read in conjunction with the Company’s audited consolidated financial statements for the year ended December 31, 2011.

The Company has followed the same basis of presentation, accounting policies and method of computation for these financial statements as disclosed in the annual audited consolidated financial statements for the year ended December 31, 2011.

### 3. INCOME TAXES

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

	Three month periods ended June 30,		Six month periods ended June 30,	
	2012	2011	2012	2011
	\$	\$	\$	\$
Earnings before income taxes	1,761,543	1,951,652	1,802,011	3,161,047
Income tax provision at the combined basic rate of 26.5%	466,809	517,188	477,533	837,677
Effect of changes in tax rates	262,440	-	262,440	-
Permanent and other differences	(15,156)	27,251	(14,717)	(366,726)
Income tax expense	714,093	544,439	725,256	470,951

# CARGOJET INC.

## Notes to the Condensed Consolidated Interim Financial Statements

June 30, 2012 and 2011

(unaudited – in Canadian Dollars)

### 3. INCOME TAXES (CONTINUED)

The tax effect of significant temporary differences and loss carry forwards is as follows:

	June 30, 2012	December 31, 2011
	\$	\$
Property, plant and equipment	3,132,850	2,945,589
Intangible assets	(600,036)	(586,604)
Operating loss carryforward	(1,013,268)	(1,478,268)
Notes receivable	(74,956)	(91,795)
Financing costs	(347,457)	(6,444)
Convertible debentures	983,665	196,390
Finance lease receivable	209,100	229,178
Deferred heavy maintenance	2,346,550	2,041,675
Net deferred income tax liability	4,636,448	3,249,721

### 4. CONVERTIBLE DEBENTURES

#### Convertible Debentures – 6.5% due April 30, 2017

In March 2012, \$28.8 million of unsecured subordinated convertible debentures were issued with a term of five years. These debentures bear a fixed interest rate of 6.5% per annum, payable semi-annually in arrears on April 30 and October 31 of each year, commencing April 30, 2012.

On or after April 30, 2015, but prior to April 30, 2016, the debentures are redeemable, in whole at any time or in part from time to time, at the option of the Company at a price equal to at least \$1,000 per debenture plus accrued and unpaid interest, provided that the current market price of the common shares of the Company on the date on which the notice of redemption is given is at least 125% of the conversion price of \$11.75 per common share. After April 30, 2016, but prior to the maturity date of April 30, 2017, the debentures are redeemable at a price equal to \$1,000 per debenture plus accrued and unpaid interest. On redemption or at maturity on April 30, 2017, the Company has the option to repay the debentures in either cash or freely tradable voting shares of the Company. The number of common shares to be issued will be determined by dividing the aggregate amount of the principal amount of the debentures by 95% of the current market price of the common shares.

Based on certain conditions, the debentures are convertible, at the holders' discretion, at \$11.75 per voting share at any time prior to the close of business on the earliest of the business day immediately preceding the maturity date; 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 \$11.75 per voting share is subject to adjustment in certain circumstances, including the payment of a cash dividend or distribution to holders of voting shares in excess of \$0.142 per quarter (\$0.568 per annum).

# CARGOJET INC.

## Notes to the Condensed Consolidated Interim Financial Statements

June 30, 2012 and 2011

(unaudited – in Canadian Dollars)

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### 4. CONVERTIBLE DEBENTURES (CONTINUED)

#### Convertible Debentures – 6.5% due April 30, 2017 (continued)

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

The principal amount of the debentures has been allocated between its debt component and the conversion option and has been classified separately on the balance sheet. The fair value of the debt component was determined using an estimated market rate for a similar liability without an equity component and the residual was allocated to the conversion option.

The debt component is measured at amortized cost. The balance of the debt component at June 30, 2012 consisted of the following:

	June 30, 2012
	\$
Principal balance	28,750,000
Less:	
Issuance costs	(1,312,192)
Conversion option at inception	(2,642,384)
Accretion	161,049
Balance	24,956,473

The conversion option, net of related issuance costs of \$132,808, has been recorded in shareholders' equity. Factoring in issuance costs, the effective interest rate on the debentures is 10.01%.

Interest expense on the debentures for the three and six month periods ended June 30, 2012 totaled \$460,788 and \$517,106, respectively.

#### Convertible Debentures – 7.5%

In May 2012, the Company redeemed \$24,655,000 principal amount of the convertible debentures (\$24,100,397 net of the related unamortized issuance costs and the portion allocated to the conversion option) at par or \$1,000 per convertible debenture. At redemption, the Company allocated \$24,655,000 to the liability component redeemed. The redemption of the convertible debentures resulted in a loss of \$554,603.

Interest expense on the debentures for the three and six month periods ended June 30, 2012 totaled \$157,160 and \$618,175, respectively (2011 - \$461,015 and \$916,963, respectively).

# CARGOJET INC.

## Notes to the Condensed Consolidated Interim Financial Statements

June 30, 2012 and 2011

(unaudited – in Canadian Dollars)

### 5. BORROWINGS

Borrowings consist of the following:

	June 30, 2012	December 31, 2011
	\$	\$
Revolving credit facility	4,329,142	9,123,300
Fixed loans - Cargojet Airways Ltd.	1,629,023	2,196,943
	5,958,165	11,320,243
Less current portion	851,639	757,677
Long-term portion	5,106,526	10,562,566

The Company has a revolving credit facility with a Canadian chartered bank. The credit facility is to a maximum of \$25.0 million and bears interest at bank prime plus 1.75% and is repayable on maturity, December 31, 2013. The credit facility is subject to customary terms and conditions for borrowers of this nature, including, for example, limits on incurring additional indebtedness and granting liens or selling assets without the consent of the lenders. The credit facility is subject to the maintenance of certain financial covenants. The Company was in compliance with all covenants as at June 30, 2012.

The credit facility is secured by the following:

- general security agreement over all assets of the Company;
- guarantee and postponement of claim to a maximum of \$35.0 million in favour of Cargojet Partnership (a wholly-owned subsidiary of the Company) and certain other entities of the Company; and
- assignment of insurance proceeds, payable to the bank.

The Company also maintains fixed loans with another Canadian chartered bank through its subsidiary Cargojet Airways Ltd. ("CJA"). The fixed loans bear interest at rates ranging from 8.1% to 8.2%. They are secured by the regional aircraft owned by CJA and the Company's notes receivable. The loans are repayable in monthly installments plus interest and will mature by August 2014. The Company also has provided a standby letter of credit of \$780,000 to the bank which is held against the fixed loans.

The following is the future minimum repayment schedule for the fixed loans related to CJA:

	\$
2012	442,254
2013	846,961
2014	339,808
	1,629,023
Less current portion	851,639
Long-term portion	777,384

Interest expense on the borrowings for the three and six month periods ended June 30, 2012 totaled \$171,915 and \$425,589, respectively (2011 - \$172,733 and \$ 395,245, respectively).

# CARGOJET INC.

## Notes to the Condensed Consolidated Interim Financial Statements

June 30, 2012 and 2011

(unaudited – in Canadian Dollars)

### 6. SHAREHOLDERS' CAPITAL

#### Share capital

The following table shows shareholders' capital as at June 30, 2012:

	Number	Amount \$
Variable voting shares	225,445	1,911,655
Common voting shares	7,716,225	65,429,512
Outstanding December 31, 2011	7,941,670	67,341,167
Changes during the period		
Treasury stock purchase	(39,275)	(296,437)
Distributed in connection with share-based compensation	33,455	284,710
Outstanding, June 30, 2012	7,935,850	67,329,440
Consisting of:		
Variable voting shares	510,045	4,298,548
Common voting shares	7,425,805	63,030,892

#### Dividends

Dividends to shareholders declared for the three and six month periods ended June 30, 2012 amounted to \$1,135,065 (\$0.142 per share) and \$2,270,130 (\$0.284 per share), respectively, and for the three and six month periods ended June 30, 2011 amounted to \$1,079,111 (\$0.135 per share) and \$2,086,281 (\$0.261 per share), respectively.

### 7. EARNINGS PER SHARE

The following table shows the computation of basic earnings per share for the three and six month periods ended June 30, 2012 and 2011:

Basic earnings per share	Three month periods ended June 30,		Six month periods ended June 30,	
	2012	2011	2012	2011
Net income	\$ 1,047,450	\$ 1,407,213	\$ 1,076,755	\$ 2,690,096
Weighted average number of shares	7,993,416	7,993,416	7,993,416	7,993,416
Basic earnings per share	\$ 0.13	\$ 0.18	\$ 0.13	\$ 0.34

The shares held under the long-term incentive plan have been included in the calculation of basic earnings per share for three and six month periods ended June 30, 2012 and 2011 as they participate in dividend distributions. The effect of the convertible debentures has been excluded from the calculation of diluted earnings per share for the three and six month periods ended June 30, 2012 and 2011 as the impact would be anti-dilutive.

# **CARGOJET INC.**

## **Notes to the Condensed Consolidated Interim Financial Statements**

**June 30, 2012 and 2011**

**(unaudited – in Canadian Dollars)**

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### **8. LONG-TERM INCENTIVE PLAN**

For the three and six month periods ended June 30, 2012, share-based compensation expense totaled \$60,777 and \$281,377, respectively, including withholding taxes of \$52,313 paid on behalf of the eligible employees. For the three and six month periods ended June 30, 2011, share-based compensation expense totaled \$68,911 and \$359,231, respectively, including withholding taxes of \$99,675 paid on behalf of the eligible employees.

#### **2012 Awards**

In March 2012, pursuant to the Company's long-term incentive plan ("LTIP"), an amount of \$348,750 was approved as LTIP to the executive officers and senior management. Accordingly, the Company purchased 39,275 shares from the open market at an average price of \$7.55. As at June 30, 2012, 7,580 of these shares had vested and \$63,210 was transferred from share-based compensation reserve to shareholders' capital. The balance of LTIP award not vested as at June 30, 2012 was \$233,227.

#### **2011 Awards**

In the six month period ended June 30, 2012, 25,875 of the treasury shares had vested and \$221,500 was transferred from share-based compensation reserve to shareholders' capital.

### **9. U.S. DOLLAR FORWARD SALE CONTRACTS**

On June 30, 2012, the Company entered into a forward contract to sell \$2.5 million USD with the maturity date of July 31, 2012. The contract has been recorded at fair value with any change in fair value recorded in net income. As at June 30, 2012 the fair value of the instrument was equal to nil and no unrealized gain or loss has been recognized during the period ended June 30, 2012. As at June 30, 2012 there were no other forward contracts outstanding.

### **10. SUBSEQUENT EVENTS**

On July 26, 2012, the Company purchased a B727 aircraft for \$1.2 million.