
Management's Discussion and Analysis of Results of Operations and Financial Condition For the Nine Months Ended June 30, 2014

This Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A") of Bluedrop Performance Learning Inc. ("Bluedrop" or "the Company") provides the reader with a view and analysis, from the perspective of management, of Bluedrop's financial results for the nine months ended June 30, 2014 and should be read in conjunction with the Company's Condensed Consolidated Interim Financial Statements and notes thereto for the nine months ended June 30, 2014. All financial information has been prepared in accordance with International Financial Reporting Standards. All monetary amounts are stated in Canadian dollars. References to years are to the fiscal years ended September 30th unless otherwise noted. This MD&A has been prepared as of August 29, 2014.

The information contained in this MD&A represents only a portion of current information available on Bluedrop. Readers are encouraged to read this document together with prior annual and quarterly reports, news releases and corporate presentations which are available by visiting the Company's website at www.bluedrop.com. Additional information regarding the Company, including all continuous disclosure documents, can be obtained on SEDAR at www.sedar.com. If you require a hard copy of any of these documents please call the main office number (709)-739-9000.

Caution Regarding Forward-Looking Information

This MD&A contains certain forward-looking statements which may be based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to strategies, expectations, planned operations or future actions. Forward-looking statements are identified by the use of terms and phrases such as "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "predict", "project", "will", "would", and similar terms and phrases, including references to assumptions.

Forward-looking statements, by their nature, are based on assumptions, including those described herein and are subject to risks and uncertainties that may cause actual results or events to differ materially from the results or events predicted in this discussion. The Company is subject to the risks outlined in the "Risk Factors" section of this MD&A. No assurance can be provided that the results or performance expressed in or implied by forward-looking statements within this MD&A will occur, or if they do, that any benefits may be derived from them. The forward-looking statements contained in this MD&A represent Bluedrop's expectations as of May 30, 2014 and are subject to change after such date.

Going Concern

The consolidated financial statements have been prepared on a going concern basis, which assumes that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business.

During the nine months ended June 30, 2014, the Company realized a net loss of \$2,825,430 and used cash flow from operations of \$1,840,500. As at June 30, 2014 the Company had a negative working capital position of \$1,559,333, including a term debt of \$1,514,888 maturing on June 30, 2015. These conditions create a material uncertainty which casts significant doubt on the Company's ability to continue as a going concern.

A significant portion of the net loss for the nine months is a direct result of one-time acquisition and restructuring costs of \$1,889,096 associated with the business combination at December 31, 2013. Given the one time nature of the costs resulting from the business combination, management believes that it will have sufficient cash flow to meet its operating expenses in the next twelve months. However, funding from new equity or additional term debt will be required to retire the debt of \$1,514,888 due on June 30, 2015 and to fund ongoing development of the Company's technology assets.

Raising additional funding on a timely basis may be adversely impacted by uncertain market conditions and the availability of appropriate financing opportunities. The outcome of these initiatives cannot be predicted at this time.

COMPANY OVERVIEW

Bluedrop's business is organized and managed as two complementary lines of business.

The Bluedrop Learning Networks business (formerly CoursePark Learnings Services) provides learning management solutions and content to private and public sector customers. *CoursePark™* is an innovative cloud-based learning management solution for individuals, corporations and other organizations. Following the commercial release of *CoursePark™* in 2011, revenues are generated from custom courseware development, licencing and subscription fees, consulting services and the sale of commercial off-the-shelf courses.

The Bluedrop Training and Simulation business (formerly Defence & Aerospace) provides custom courseware development, training products, low cost simulation and resource augmentation solutions to improve the safety, productivity and efficiency of military and civil aviation personnel.

The Company's corporate office is located in St. John's, Newfoundland and Labrador, Canada. The Company currently has over 165 employees working at five offices in Canada.

BUSINESS COMBINATION

On December 31, 2013 the Company, under a Plan of Arrangement, acquired all the issued and outstanding common shares of Atlantis Systems Corp. (Atlantis), a publically traded company listed on the TSX Venture - NEX Exchange. Atlantis is a custom courseware developer and provider of training and simulation products to the defence and aerospace industry. The business combination allows the Company to facilitate continued growth in training and simulation operations in domestic markets and provides a foundation for future growth into international markets.

The cash consideration transferred in the Plan of Arrangement was \$1,000,000. The long term debt agreements of Atlantis were renegotiated concurrent with the acquisition. The Company has assumed \$2,500,000 of long term debt, \$1,000,000 of which was repaid immediately following the acquisition. The remaining principal and accrued interest is repayable on or before June 30, 2015. The term loan bears interest at 8% per annum. The debenture is convertible at a conversion price of \$0.15 per common share, being at a rate of 6,667 common shares per \$1,000 principal amount of debenture. Upon conversion, any accrued interest shall be converted into common shares at the conversion price.

The value of goodwill was calculated as the excess of the fair value of the consideration transferred over the fair value of the identifiable assets acquired and liabilities assumed. This goodwill is not deductible for income tax purposes.

Provisional value of assets acquired and liabilities assumed

Cash	\$	89,551
Accounts receivable		2,031,297
Work in progress		616,333
Prepaid expenses		18,164
Deferred tax asset		1,894,000
Intangible Assets		46,193
Goodwill		1,259,876
Property plant and equipment		240,022
Accounts payable and accruals		(1,982,147)
Deferred revenue		(673,453)
Long term debt		(2,434,836)
Long term payables		(105,000)
	\$	1,000,000

The allocation of the consideration to assets and liabilities is subject to a final determination of the fair value of selected assets and liabilities and a final determination of the tax losses and timing differences which comprise the deferred tax asset.

Direct transaction costs in the amount of \$1,572,454 have been expensed during the nine months ended June 30, 2014. Costs include legal fees, advisory services, restructuring costs and employee termination benefits associated with the acquisition.

RESULTS OF OPERATIONS

The following tables and discussion compare Bluedrop's operating results for the three and nine months ended June 30, 2014 to the same period ended June 30, 2013.

(Canadian dollars in thousands)	Three months ended June 30		Change (2014 vs. 2013)	
	2014	2013	\$	%
Revenue				
Services revenue	3,742	2,828	914	32%
Product sales	775	422	353	84%
	4,517	3,250	1,267	39%
Direct costs	2,788	1,516	1,272	84%
Gross profit	1,729	1,734	(5)	0%
Gross profit percentage	38%	53%		
Expenses				
Sales and marketing	491	741	(250)	-34%
General and administration	1,290	1,069	221	21%
Acquisition and restructuring costs	12	-	12	100%
Government assistance	(336)	(307)	(29)	9%
Share-based compensation	80	6	74	1233%
Finance costs	384	89	295	331%
Depreciation and amortization	227	206	21	10%
Other gains and losses	(212)	-	(212)	-100%
	1,936	1,804	132	7%
Earnings (loss) before income taxes	(207)	(70)	(137)	196%
Income taxes	(23)	(16)	(7)	44%
Net Earnings (loss)	(184)	(54)	(130)	241%

(Canadian dollars in thousands)	Six months ended June 30		Change (2014 vs. 2013)	
	2014	2013	\$	%
Revenue				
Services revenue	9,271	7,502	1,769	24%
Product sales	1,762	1,070	692	65%
	11,033	8,572	2,461	29%
Direct costs	6,798	4,621	2,177	47%
Gross profit	4,235	3,951	284	7%
Gross profit percentage	38%	46%		
Expenses				
Sales and marketing	1,999	2,037	(38)	-2%
General and administration	3,566	2,830	736	26%
Acquisition and restructuring costs	1,889	-	1,889	100%
Government assistance	(987)	(1,079)	92	-9%
Share-based compensation	207	288	(81)	-28%
Finance costs	879	264	615	233%
Depreciation and amortization	620	616	4	1%
Other gains and losses	(206)	-	(206)	-100%
	7,967	4,956	3,011	61%
Loss before income taxes	(3,732)	(1,005)	(2,727)	271%
Income taxes	(908)	(159)	(749)	471%
Net loss	(2,824)	(846)	(1,978)	234%

Revenue

For the quarter ended June 30, 2014 revenues were \$4,517,110, an increase of \$1,267,431 (39%) as compared to the same period in 2013. For the nine months ended June 30, 2014 revenues were \$11,032,346, an increase of \$2,461,196 (29%) as compared to the same period in 2013.

The following tables illustrate the change in revenues from each identified operating segment for the three and nine months ended June 30, 2014.

	Three months ended June 30				Change (2014 vs. 2013)	
	2014	% of total	2013	% of total	\$	%
Revenue						
<i>Bluedrop Training and Simulation</i>	3,653	81%	2,095	64%	1,558	74%
<i>Bluedrop Learning Networks</i>	864	19%	1,155	36%	(291)	-25%
	<u>4,517</u>	100%	<u>3,250</u>	100%	<u>1,267</u>	39%

	Nine months ended June 30				Change (2014 vs. 2013)	
	2014	% of total	2013	% of total	\$	%
Revenue						
<i>Bluedrop Training and Simulation</i>	8,168	74%	5,913	69%	2,255	38%
<i>Bluedrop Learning Networks</i>	2,865	26%	2,659	31%	206	8%
	<u>11,033</u>	100%	<u>8,572</u>	100%	<u>2,461</u>	29%

Revenues in the Bluedrop Learning Networks business were significantly higher in the quarter primarily as a result of higher amortized license revenues as a result of CoursePark™ licensing sales in mid fiscal 2013.

On December 31, 2013 the Company acquired Atlantis. The results of the Atlantis operations have been included in the Bluedrop Training and Simulation results in the second quarter of fiscal 2014.

Direct costs

Direct costs include all labour costs plus materials, supplies, third party services and travel costs directly associated with projects, as well as any royalties that may be payable as a result of revenues generated from licenced products.

For the quarter ended June 30, 2014 total direct costs were \$2,788,041, an increase of \$1,271,696 (84%) over the same quarter in the prior fiscal year. For the nine months ended June 30, 2014 total direct costs were \$6,797,545, an increase of \$2,176,075 (47%) over the same period in the prior fiscal year.

For an explanation of the significant increase in direct costs please refer to the commentary on gross profit below.

Gross profit

For the quarter ended June 30, 2014 gross profit was \$1,729,069, a decrease of \$4,265 (0%) over the same quarter in the prior period. The reported gross profit percentage for the quarter ended June 30, 2014 was 38% as compared to 53% for the same period in the prior year.

For the nine months ended June 30, 2014 gross profit was \$4,234,801, an increase of \$285,121 (7%) over the same quarter in the prior period. The reported gross profit percentage for the nine months ended June 30, 2014 was 38% as compared to 46% for the same period in the prior year.

The Bluedrop Training and Simulation business unit gross profit for the nine months ended June 30, 2014 was \$2,365,211 versus \$2,360,096 for the same period in 2013. The gross profit percentage was 29% for the current period versus 40% for the prior period. The significant decrease in Bluedrop Training and Simulation gross profit percentage was primarily a result of delays in executing several professional service contracts which were anticipated to begin in the first quarter. During the nine months ended June 30, 2014, the Bluedrop Training and Simulation business unit experienced less billable hours and utilization than expected. Subsequent to the balance sheet date, the Company implemented cost reductions within the

billable base of employees to align the new combined operation with the current backlog and contracts in place or in final stages of completion.

The Bluedrop Learning Networks business unit gross profit for the nine months ended June 30, 2014 was \$1,869,590 as compared to \$1,589,584 for the same period in 2013, resulting in a gross margin of 65% versus 60% for the same period in 2013. The increase in gross profit was as a result of higher amortized license revenues as a result of CoursePark™ licensing sales in mid Fiscal 2013.

Sales and marketing

For the quarter ended June 30, 2014 sales and marketing expenses were \$490,941, a decrease of \$250,229 (34%) over the same quarter in the prior period. For the nine months ended June 30, 2014 sales and marketing expenses were \$1,998,880, a decrease of \$37,927 (2%) over the same period in the prior fiscal year.

The decrease in sales and marketing is a result of the re-allocation of resources as a result of restructuring activities in the quarter. In addition, certain costs incurred in prior quarters were determined to be capital in nature and were adjusted during the three months ended June 30, 2014.

General and administration

For the quarter ended June 30, 2014 general and administration expenses were \$1,290,049, an increase of \$220,751 (21%) over the same quarter in the prior period. For the nine months ended June 30, 2014 general and administration expenses were \$3,566,470, an increase of \$736,075 (26%) over the same period in the prior fiscal year.

The overall increase was due to increased administrative costs associated with growth of the business. In addition, the acquisition of Atlantis resulted in increased general and administration costs in the past two quarters ended June 30, 2014.

Acquisition and restructuring costs

On December 31, 2013 the Company, under a Plan of Arrangement, acquired all the issued and outstanding common shares of Atlantis Systems Corp.

During the nine months ended June 30, 2014, Acquisition related costs in the amount of \$1,572,454 have been expensed, including \$8,630 in the quarter then ended. Costs include legal fees, advisory services, restructuring costs and employee termination benefits associated with the acquisition.

In addition, restructuring costs of \$316,642 have been expensed in the period.

Government assistance

For the quarter ended June 30, 2014 government assistance included in income was of \$336,356, an increase of \$29,409 (10%) over the same quarter in the prior period. For the nine months ended June 30, 2014 government assistance included in income was of \$986,907, a decrease of \$92,335 (9%) over the same period in the prior fiscal year.

During the nine months ended June 30, 2014, funding related to the Nova Scotia Digital Media Tax Credit program decreased by \$104,292 over the same period in 2013. During the first quarter of the prior fiscal period, the Company recognized \$122,585 of credits related to the year ended September 30, 2012.

Share-based compensation

Pursuant to its 2011 Stock Option Plan, the Company has reserved a maximum of 16,827,718 of the issued and outstanding common shares of the Company for issuance on the exercise of share options. The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option pricing model.

The Company recorded \$80,263 as share-based compensation expense for the quarter ended June 30, 2014 (2013 - \$5,969) and \$207,397 for the nine months ended June 30, 2014 (2013 - \$288,089) and recorded a corresponding increase

in the share option reserve. During the nine months ended June 30, 2014, the Company granted 9,248,284 options to certain directors, officers and employees of the Company.

Finance costs

For the quarter ended June 30, 2014 finance costs were \$383,804, an increase of \$88,955 (331%) over the same quarter in the prior period. For the nine months ended June 30, 2014 finance costs were \$879,440, an increase of \$615,727 (233%) over the same period in the prior fiscal year.

The increase in the first nine months of fiscal 2014 is primarily a result of a \$534,225 increase in interest and accretion on long term debt as a result of additional borrowings in the period used to fund the acquisition of Atlantis. During the period, advances of long term debt were \$4,951,294.

Depreciation and amortization

For the quarter ended June 30, 2014 depreciation and amortization expense was \$226,585, an increase of \$20,905 (10%) over the same quarter in the prior year. For the nine months ended June 30, 2014 depreciation and amortization expense was \$619,996, an increase of \$3,533 (1%) over the same period in the prior fiscal year.

The increase in depreciation and amortization expense is mainly related to increased investments in deferred development costs.

The Company invested \$942,128 in capital assets and intangible assets during the nine months ended June 30, 2014. The additions were offset by government assistance totaling \$550,123 towards the cost of these assets. In addition, the Company added \$286,215 of capital assets and intangible assets (excluding goodwill) as a result of the acquisition of Atlantis.

Other gains and losses

During the quarter ended June 30, 2014, the Company disposed of courseware assets in exchange for \$275,000 USD. The disposed assets and proceeds, net of costs to sell, have been included in Other gains and losses on the statement of comprehensive loss.

Income taxes

For the quarter ended June 30, 2014 income tax recovery was \$23,455 as compared to \$15,537 in the same quarter in the prior year. For the nine months ended June 30, 2014 income tax recovery was \$907,912 as compared to \$158,749 in the same period in the prior year.

The income tax recovery is directly related to the loss incurred in the quarter.

QUARTERLY INFORMATION

The table below provides a summary of operating results for the Company for each quarter in the current and previous fiscal periods. Certain quarterly information below has been restated and more fully described in note 5 of the Annual Financial Statements for the year ended September 30, 2013. This table and commentary following illustrates some of the trends within the business and the impact on margins and profits of certain types of revenue-generating activities.

(Canadian dollars in thousands)

Fiscal year	2014	2014	2014	2013	2013	2013	2013	2012
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
	Jun-30	Mar-31	Dec-31	Sep-30	Jun-30	Mar-31	Dec-31	Sep-30
Revenue								
<i>Bluedrop Training and Simulation</i>	\$ 3,653	\$ 3,589	\$ 926	\$ 2,058	\$ 2,095	\$ 2,117	\$ 1,701	\$ 1,597
<i>Bluedrop Learning Networks</i>	\$ 864	\$ 889	\$ 1,111	\$ 898	\$ 1,155	\$ 674	\$ 830	\$ 667
	4,517	4,478	2,037	2,956	3,250	2,791	2,531	2,264
Direct costs	2,788	2,756	1,253	1,422	1,516	1,666	1,439	1,061
Gross profit	1,729	1,722	784	1,534	1,734	1,125	1,092	1,203
Gross profit percentage	38%	38%	38%	52%	53%	40%	43%	53%
Expenses								
Sales and marketing	491	764	744	730	741	689	606	670
General and administration	1,290	1,293	984	975	1,069	969	792	744
Acquisition and restructuring costs	12	211	1,666	-	-	-	-	-
Government assistance	(336)	(422)	(229)	183	(307)	(346)	(426)	(362)
Share-based compensation	80	54	73	75	6	131	151	204
Finance costs	384	378	118	118	89	87	87	78
Depreciation and amortization	227	217	177	209	206	206	204	175
Other gains and losses	(212)	6	-	539	-	-	-	-
	1,936	2,501	3,533	2,829	1,804	1,736	1,414	1,509
Earnings (loss) before income taxes	(207)	(779)	(2,749)	(1,295)	(70)	(611)	(322)	(306)
Income taxes (recovery)	(23)	(216)	(668)	(418)	(16)	(127)	(16)	(120)
Net earnings (loss)	\$ (184)	\$ (563)	\$ (2,081)	\$ (877)	\$ (54)	\$ (484)	\$ (306)	\$ (186)

Fiscal 2014

During the first quarter of fiscal 2014, the Company acquired all the issued and outstanding common shares of Atlantis Systems Corp. resulting in significant acquisition related costs in the quarter. The Bluedrop Training and Simulation business experienced decreased revenues and gross profit in the first quarter as a result of delays in executing several professional service contracts which were anticipated to begin in the quarter. The delays were remediated in the second quarter. In addition at December 31, 2013 the Company acquired Atlantis. The results of the Atlantis operations are included in the second and third quarter of fiscal 2014. Bluedrop Learning Networks continued growth in both of its CoursePark™ licensing sales and courseware development functions.

During the third quarter of 2014, the Company disposed of courseware assets in exchange for proceeds of \$275,000USD. The disposed assets and proceeds, net of costs to sell, have been included in other gains and losses

Fiscal 2013

During the first quarter of fiscal 2013, the Bluedrop Training and Simulation business experienced decreased revenues and gross profit as a result of delays in executing various follow on deliverables associated with a single contract that was put in a temporary hiatus status. The Company took steps to deploy the affected employees in the second quarter but not without some delays which resulted in less billable hours and utilization than expected. Bluedrop Learning Networks continued growth in both of its CoursePark™ licensing sales and courseware development functions.

Costs associated with sales and marketing and general and administration costs continued to rise throughout 2013 as a result of continued investment in the business. In the fourth quarter of 2013 management recorded an impairment loss as a result of a strategic review of assets in both the Bluedrop Learning Networks and Bluedrop Training and Simulation businesses.

LIQUIDITY AND CAPITAL RESOURCES

For the nine months ended June 30, 2014 the Company generated cash and cash equivalents of \$332,589 (2013 – \$277,096).

Operating activities

For the nine months ended June 30, 2014 the Company's used cash from operating activities of \$1,840,500 compared to cash used of \$267,761 for the same period in the prior year.

Non-cash working capital related to operating activities decreased by \$672,436 during 2014. Accounts receivable related to operating activities decreased by \$1,255,092 primarily as a result of the collection of receivables acquired in the business combination and the collection of operating government assistance accrued at year end. In addition, work in progress increased by \$90,037 and deferred revenue increased by \$136,202 as a result of timing differences between project revenue recognition and contract payment schedules. Accounts payable decreased by \$687,953 primarily as a result of expenditures related to the acquisition of Atlantis.

As at the balance sheet date, there was a significant decrease in working capital compared to the prior period due to the increased accounts payable balance as a result of short term acquisition activities. Accounts payable at June 30, 2014 included \$92,250 associated with acquisition costs and \$745,293 of employee termination benefits payable. Management anticipates sufficient cash flow from operations to discharge the payables.

Investing activities

For the nine months ended June 30, 2014 the Company consumed cash of \$871,569 for investing activities compared to cash generated of \$367,001 for the same period in the prior year. The net cash outflow as a result of the acquisition of Atlantis was \$910,449.

During the quarter ended June 30, 2014, the Company disposed of courseware assets in exchange for proceeds of \$275,000USD.

Investment in intangible assets for the period was \$167,515 primarily related to the development of *CoursePark*[™]. In addition, the Company invested \$142,681 in property and equipment.

Changes in non-cash working capital for the period included a \$91,034 decrease in government assistance receivables related to investing activities.

Financing activities

For the nine months ended June 30, 2014 the Company generated \$3,044,658 in cash from financing activities as compared to \$177,856 for financing activities for the same period in the prior year.

Financing activities for the nine months ended June 30, 2014 included a \$4,951,294 of advances of long term debt, offset by repayments of \$1,461,019 against long term debt, and \$276,469 of interest paid.

Cash and credit availability

At June 30, 2014 the Company had not drawn against its short term borrowing facilities.

On April 26, 2012, the Company executed a Credit Facilities Agreement with Royal Bank of Canada increasing its short-term bank operating line of credit to a maximum of the lesser of \$2,000,000 and defined marginable accounts receivable minus specified liabilities. In addition the Company has a VISA travel and expense credit facility of \$200,000 and a lease facility of \$250,000 to support future investment in capital assets.

On December 17, 2013, the Company amended the above Credit Facilities Agreement with Royal Bank of Canada to increase its short-term bank operating line of credit to a maximum of the lesser of \$3,500,000 and defined marginable accounts receivable minus specified liabilities.

CONTRACTUAL OBLIGATIONS

The following table contains a summary of the Company's contractual obligations and commitments to make future payments under contracts including debt, finance leases and operating leases at June 30, 2014:

Scheduled payments due by period (Canadian dollars in thousands)	Long term debt	Capital leases	Operating leases	Total
2014 (year ended September 30)	257	21	214	492
2015	2,918	53	770	3,741
2016	1,202	32	657	1,891
2017	3,785	12	629	4,426
2018	569	-	626	1,195
Thereafter	1,090	-	917	2,007
	\$ 9,821	\$ 118	\$ 3,813	\$ 13,752

PROVISIONS AND CONTINGENT LIABILITIES

(a) Conditionally Repayable Grants

To June 30, 2014 the Company had recognized ACOA-AIF contributions of \$2,531,111 pursuant to a 2008 agreement, as amended and ACOA-AIF contributions of \$2,507,462 pursuant to a 2012 agreement. The Company must repay the contributions by annual instalments calculated as 5% of the gross revenues generated from products and services resulting from the research funded. A continuity of the amount of the provision recognized is as follows:

	June 30 2013	September 30 2013
Opening balance	\$ 1,186,545	469,903
Accretion	151,284	65,786
Royalties paid or payable	(45,751)	(51,082)
Additions and revaluations	41,758	701,938
	\$ 1,333,836	1,186,545

SHARE INFORMATION

At June 30, 2014 the Company had issued 98,986,609 common shares and 15,024,430 share options that can be exercised when vested to obtain an equivalent number of common shares. During the nine months ended June 30, 2014, the Company granted 9,248,284 share options to certain directors, officers and employees of the Company.

RELATED PARTY TRANSACTIONS

Transactions with related parties are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Significant related party transactions are reviewed and approved by the Audit Committee of the Board. The following is a summary of related party transactions during the quarter ended June 30, 2014:

- The Company recorded rent expense of \$65,520 for the quarter ended June 30, 2014 (2013 - \$65,520) for rental of premises from LB2P a company controlled by the Company's President & Chief Executive Officer. Effective October 1, 2011 the Company entered into a 6 year lease, with a 4 year renewal option, with LB2P for 100% of the premises available for lease at 18 Prescott Street, St. John's, NL. The lease includes an initial net lease rate for two years with escalation provisions periodically thereafter.
- The Company recognized an expense of \$156,200 for the quarter ended June 30, 2014 (2013 - \$153,869) for fees, salaries and benefits to its key management personnel for services rendered. Key management is considered to be members of the Board of Directors, the President & Chief Executive Officer and the Chief Financial Officer. The Executive Chairman's fees are paid to a corporation under his control.

- The Company recognized an expense of \$47,512 for the quarter ended June 30, 2014 (2013 – \$8,123) for share based compensation to its key management personnel (as described above).

ACCOUNTING ESTIMATES

In the process of applying the Corporation's accounting policies, management has made certain judgments, estimates, and assumptions which affect the amounts recognized in the Condensed Consolidated Interim Financial Statements. The Company has identified the following policies where critical judgments, estimates and assumptions are made and where actual results could be materially different.

Significant management judgements

The following are significant management judgements in applying the accounting policies that have the most significant impact on the financial statements:

(a) Revenue recognition

Revenue from services contracts is recognized on a percentage of completion basis, measured by the percentage of costs incurred to date to the estimated total costs for each contract. Judgment is used in determining the stage of completion and estimates of costs to complete. The Company employs sophisticated project management tools to assist with the management of projects and the recognition of revenue on a percentage completion basis. Management regularly reviews the systems, processes and calculations relating to percentage completion on significant contracts, making adjustments as required.

(b) Income taxes

Uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. The Company records income tax expense (recovery) based on management's interpretation of the tax regulations and its assumptions about the timing of income and expenses for tax purposes. Actual tax assessments or future changes to assumptions could result in future adjustments to recorded tax expense.

The Company has recorded a deferred tax asset in the Company's financial statements for the period ended June 30, 2014. Management considers that it is more likely than not that these tax assets will be realized. The ultimate realization of these assets is dependent upon the Company's ability to generate sufficient taxable income to offset the tax losses carried forward as well as the reversal of the differences between the carrying amount of items on the statement of financial position and their corresponding tax basis. If future circumstances indicate that it is no longer probable that these tax assets will be realized, the carrying value of the tax asset will be reduced, resulting in a charge against income and a reduction of equity.

(c) Government assistance

The Company receives government assistance pursuant to specific contractual funding agreements and is also eligible to receive cash tax credits under the Scientific Research and Experimental Development (SRED) and Digital Media Tax Credit (DMTC) programs. Claims relating to specific funding agreements are based on the defined eligible costs pursuant to the agreements. Contributions are recognized when the related expenditures are incurred and/or when significant milestones have been achieved in a funded project.

Credits under the SRED and DMTC programs are recorded when amounts can be reasonably estimated and receipt is reasonably assured. Government assistance may be overstated if the underlying project is determined to be ineligible or if certain costs claimed are determined to be ineligible.

(d) Development costs

Distinguishing the research and development phases of internal development projects and determining whether the recognition requirements for the capitalization of development costs are met requires judgement. After capitalization, management monitors whether the recognition requirements continue to be met and whether there are any indicators that capitalized costs may be impaired.

Estimation uncertainty

The following are significant estimates used in recognition and measurement of assets, liabilities, income and expense. The actual results may differ from these estimates:

(a) Fair value of provisions

Management uses valuation techniques in determining the fair values of its provisions related to conditionally repayable grants. Significant estimates include the amount and timing of future cash flows and discount rates used in measurement of the fair value.

(b) Fair value of financial liabilities

The Company has received long term debt financing at below-market interest rates. The fair value of these financial liabilities are determined using discount rates expected to be incurred on similar debt in a fair market. Management has exercised judgement in estimating the applicable discount rate used in measuring the fair value of financial liabilities at below-market interest rates.

(c) Impairment of non-financial assets

In assessing impairment, management estimates the recoverable amount of each asset or cash-generating units, based on expected future cash flows, and uses an interest rate to discount them. Estimation uncertainty relates to assumptions about future operating results and the determination of a suitable discount rate.

(d) Revenue recognition

Revenue from services contracts is recognized on a percentage of completion basis, measured by the percentage of costs incurred to date to the estimated total costs for each contract. Changes to the estimate of percentage complete or estimated costs to complete could have a material impact on the carrying values of work in progress or deferred revenue and a material impact on future revenue.

(e) Share-based compensation

Management has made certain estimates and assumptions when calculating the fair value of share options. The significant assumptions include estimates of expected volatility, expected life and expected risk-free rate of return. Management also makes certain assumptions with respect to the number of options expected to vest. Changes in these assumptions may result in a material change to share-based compensation expense.

RISKS

The Company and its business are subject to a number of risks and uncertainties. The primary risks and uncertainties are described below.

Customer risk

The Company's products and services are sold directly to governments or governmental entities and to original equipment manufacturers and training integrators which have contracts with governments. These sales are subject to specific additional risk, such as delays in funding, termination of contracts or sub-contracts at the convenience of the government, termination, reduction or modification of contracts or sub-contracts in the event of changes in the government's policies or as a result of budgetary constraints, and increased or unexpected costs resulting in losses or reduced profits under fixed price contracts.

The Company's business strategy includes plans to diversify sources of revenue by expanding its product and service offerings in the Bluedrop Training and Simulation business and by expanding its sales channels and courseware content portfolio for the Bluedrop Learning Networks business.

Credit risk

Credit risk arises from the potential that a customer or counterparty will fail to meet its contractual obligations. Concentration of credit risk may arise from exposure to a single debtor or to a group of debtors having similar characteristics, such as their ability to meet their obligations, or their expectation to be similarly affected by changes in economic or other conditions. The Company utilizes credit evaluation, approval and monitoring processes intended to

mitigate potential credit risks with respect to trade receivables.

The Company's maximum exposure to credit risk, with respect to accounts receivable and unbilled work in progress corresponds to the carrying value. At June 30, 2014 approximately 45% of trade receivables were due from three customers (September 30, 2013 – 58% from one customer). In accordance with contract terms, the Company bills certain customers in advance of the completion of work and records such billings as deferred revenue.

An allowance for doubtful accounts is established at each balance sheet date based upon factors surrounding the credit risk of specific accounts, historical trends and other information. The allowance for doubtful trade accounts receivable at June 30, 2014 was \$Nil (September 30, 2013 - \$Nil). At J, 2014 the Company's trade accounts receivable included amounts over 90 days old totaling \$209,776 (September 30, 2013 – \$256,434) which were not considered to be impaired and therefore not included in the allowance for doubtful accounts.

Recruitment and retention risks

Bluedrop's continued growth and success is largely dependent on the experience, abilities and dedication of its management and technical personnel. As the Company expands in areas and activities requiring additional expertise, it will require additional management and technical personnel. The market is tight and competition is intense for highly-skilled management, technical, research and development people and other employees to support the Company's growth. Loss of the services of any of its key officers or employees, or failure to recruit additional key executive and technical personnel may adversely affect the Company's ability to promptly satisfy its customer needs and may therefore impede the Company's growth objectives.

There can be no assurances that Bluedrop can retain its current key officers and employees or attract and retain additional key employees to support the Company's growth. The loss of certain key employees could have a significant impact on the Company's business, results of operations and financial condition.

OUTLOOK

During 2012 and 2013 Bluedrop has continued to execute on its business plan of driving growth. Over this period the Company has continued to hire key management and technical personnel, has received ISO 9001:2008 certification for three of its offices, fostered key strategic relationships, invested in strategic intangible assets, secured an arrangement with a key low-cost simulator developer and has continued the commercial roll out of *CoursePark*TM.

On December 31, 2013 the Company acquired all the issued and outstanding common shares of Atlantis Systems Corp., a publically traded company providing custom courseware development and training and simulation products to the defence and aerospace industry. The business combination will allow the Company to facilitate continued growth in training and simulation operations in the Bluedrop Training and Simulation business and provide a foundation for future growth into international markets.

The Bluedrop Learning Networks business will continue to invest in its *CoursePark*TM platform. In 2014, the Company will continue to develop opportunities in its current Canadian market, while aiming for growth in international markets.