

## **Management's Discussion and Analysis of Results of Operations and Financial Condition For the Six Months Ended March 31, 2016**

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 six months ended March 31, 2016 and should be read in conjunction with the Company's Condensed Consolidated Interim Financial Statements and notes thereto for the six months ended March 31, 2016. 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 30<sup>th</sup> unless otherwise noted. This MD&A has been prepared as of May 25, 2016.

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](http://www.bluedrop.com). Additional information regarding the Company, including all continuous disclosure documents, can be obtained on SEDAR at [www.sedar.com](http://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 25, 2016 and are subject to change after such date.*

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## COMPANY OVERVIEW

Bluedrop's business is organized and managed as two complementary lines of e-Learning based training businesses.

Bluedrop Training and Simulation is one of Canada's leading providers of comprehensive training solutions for the defence sector. With over 40 years' experience and hundreds of training devices delivered it prides itself on its resume and skilled work force. Bluedrop Training and Simulation provides a full suite of products and services ranging from training needs analysis and design, courseware and technical documentation, training information management systems, training program delivery, virtual reality based trainers and simulators and in service support for larger simulators and programs. It services all branches of the defence sector including naval, air force and army operations as well as other security agencies.

Bluedrop Learning Networks is pioneering the development and adoption of a SaaS based training and delivery platforms providing large scale customers with the ability to engage, track training and monitor training of large users groups spread out over multiple locations. It provides the complete service offering and solutions to meet the operational requirements of its clients from designing the training requirement, to building custom content, to operating and supporting the training and delivery platform. Revenues are generated from recurring platform licences, custom courseware development, consulting services, and the sale of commercial off-the-shelf courses.



## DISCUSSION OF OPERATIONS

### Bluedrop Training and Simulation

During the six months ended March 31, 2016 the Bluedrop Training and Simulation business unit continued to yield strong revenues and gross margins and made significant investments in development of simulation technology.

The business unit recognized significant revenues in the first half of fiscal 2016 as a result of strong revenues on US contracts, in addition to gains on two fixed price projects as a result of anticipated reduced costs at completion. The Company also recorded \$2.2 million of revenue associated with new simulator product sales in the period. The Bluedrop Training and Simulation business unit ended the quarter with an estimated revenue backlog<sup>1</sup> of \$45.2 million, with the increase from the prior quarter primarily attributed to the renewal of a multiyear contract to provide staffing support for the Maritime Helicopter Training Centre (MHTC). The business unit continues to pursue several multi-year renewals, extension bids and new contracts.

The business unit continued to focus on developing strategic product based offerings with a goal of working with large scale aerospace equipment manufacturers to develop low cost simulation offerings. On July 8, 2015, Bluedrop Training and Simulation and The Boeing Company ("Boeing") announced a partnership to develop a next generation rear crew trainer for the CH-47 Chinook Helicopter. The program is supported by Industry Canada's Investment Framework and the new Value Proposition guidelines. During the quarter the company increased development expenditures as an integrator for advanced simulators.

### Bluedrop Learning Networks

During the six months ended March 31, 2016, the Bluedrop Learning Networks business unit continued pursuits in the Occupational Health and Safety and US Workforce Development verticals. Additionally, the business unit continued research and development investments in the *Bluedrop360™* platform.

The business unit continues to pursue multiple market opportunities and the ended the quarter with an estimated revenue backlog<sup>1</sup> of \$6.7 million.

During the first quarter of fiscal 2016, the business unit reached the commercialization phase of the *Bluedrop360™* platform by launching a significant customer on the platform in the Occupational Health and Safety vertical. Given the shift to a commercialization phase, the company discontinued capitalization of expenditures related to the *Bluedrop360™* platform. In March 2016, Bluedrop Learning Networks and Pacific Gateway announced a US Workforce Development initiative that adapts the platform for the US Workforce Development market. The company continued to incur expenditures aiming at improving the platform's functionality and adapting the offering to meet the needs of these market verticals.

### Corporate

During the six months ended March 31, 2016, management continued to monitor financial requirements and maintained appropriate working capital and cash availability positions ending the period with \$3.3 million in cash and no draw on the bank line of credit.

On December 11, 2015, the Company entered into an arrangement to extend the maturity date on an unsecured convertible debenture for \$3.0 million for one year from December 30, 2016 to December 30, 2017. The new arrangement improved the Company's short term net working capital position and provided cash availability to undertake strategic growth initiatives in the business units. On March 31, 2016, the Company repaid the 16% unsecured term loan pursuant to an early repayment agreement entered into with the lender. The term loan had an original maturity date of August 2016. The early repayment will reduce finance costs for the remainder of the fiscal period.

The Company continued to monitor fluctuations in foreign currency exchange rates which could significantly impact cash flows from contracts with US customers. The Company has entered into hedging instruments subsequent to the balance sheet date to mitigate the impact of foreign currency fluctuations throughout the remainder of fiscal 2016.

On March 22, 2016 the company announced intentions to undertake a normal course issuer bid ("NCIB"). Under the terms of the NCIB, the Company may acquire up to 2% of the total issued and outstanding shares in a 30 day period, up to a maximum of 4,949,330 shares during the 12 month period ended March 30, 2017, representing approximately 5% of the public float of the Company prior to commencement of the NCIB. Such purchases will be made through the facilities of the TSX Venture Exchange ("TSXV").

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<sup>1</sup> See section titled "Non-GAAP Financial Measures"

## FINANCIAL RESULTS OF OPERATIONS

The following tables and discussion compare Bluedrop's operating results for the three months ended and six months ended March 31, 2016 to the same periods in the prior fiscal year.

(Canadian dollars in thousands)	Three months ended March 31		Change (2016 vs. 2015)	
	2016	2015	\$	%
<b>Revenue</b>				
Services revenue	4,663	4,231	432	10%
Product sales	3,733	1,112	2,621	236%
	8,396	5,343	3,053	57%
<b>Direct costs</b>	4,917	3,188	1,729	54%
<b>Gross profit</b>	3,479	2,155	1,324	61%
Gross profit percentage	41%	40%		
<b>Expenses</b>				
Sales and marketing	541	469	72	15%
General and administration	1,410	1,171	239	20%
Research and development costs	1,073	-	1,073	100%
Government assistance	(977)	(247)	(730)	296%
Share-based compensation	30	70	(40)	-57%
Finance costs	433	427	6	1%
Depreciation and amortization	261	212	49	23%
Other gains and losses	-	44	(44)	-100%
	2,771	2,146	625	29%
<b>Earnings (loss) before income taxes</b>	708	9	699	7767%
Income taxes	352	(4)	356	-8900%
<b>Net earnings (loss)</b>	356	13	343	2638%

(Canadian dollars in thousands)	Six months ended March 31		Change (2016 vs. 2015)	
	2016	2015	\$	%
<b>Revenue</b>				
Services revenue	9,463	7,604	1,859	24%
Product sales	4,684	2,088	2,596	124%
	14,147	9,692	4,455	46%
<b>Direct costs</b>	7,622	5,903	1,719	29%
<b>Gross profit</b>	6,525	3,789	2,736	72%
Gross profit percentage	46%	39%		
<b>Expenses</b>				
Sales and marketing	1,037	895	142	16%
General and administration	2,585	2,107	478	23%
Research and development costs	1,782	-	1,782	100%
Government assistance	(1,671)	(438)	(1,233)	282%
Share-based compensation	59	140	(81)	-58%
Finance costs	864	837	27	3%
Depreciation and amortization	522	427	95	22%
Other gains and losses	-	(428)	428	-100%
	5,178	3,540	1,638	46%
<b>Earnings before income taxes</b>	1,347	249	1,098	441%
Income taxes	758	133	625	470%
<b>Net earnings</b>	589	116	473	408%

## Revenue

For the three months ended March 31, 2016 revenues were \$8,395,804, an increase of \$3,053,198 (57%) as compared to the same period in 2015. For the six months ended March 31, 2016 revenues were \$14,147,191, an increase of \$4,455,239 (46%) as compared to the same period in 2015.

The following tables illustrate the change in revenues from each identified operating segment for the three and six months ended March 31, 2016.

Revenue	Three months ended March 31				Change (2016 vs. 2015)	
	2016	% of total	2015	% of total	\$	%
	<i>Bluedrop Training and Simulation</i>	7,170	85%	4,508	84%	2,662
<i>Bluedrop Learning Networks</i>	1,226	15%	835	16%	391	47%
	<u>8,396</u>	100%	<u>5,343</u>	100%	<u>3,053</u>	57%

Revenue	Six months ended March 31				Change (2016 vs. 2015)	
	2016	% of total	2015	% of total	\$	%
	<i>Bluedrop Training and Simulation</i>	11,761	83%	8,017	83%	3,744
<i>Bluedrop Learning Networks</i>	2,386	17%	1,675	17%	711	42%
	<u>14,147</u>	100%	<u>9,692</u>	100%	<u>4,455</u>	46%

During the first half of fiscal 2016, the Bluedrop Training and Simulation results reflected higher revenues on US currency revenue transactions as a result of favorable exchange rate fluctuations over the previous period, in addition to gains on two fixed price projects as a result of anticipated reduced costs at completion. The Company also recorded \$2.2 million of revenue associated with new simulator product sales in the period. The Bluedrop Learning Networks operations realized higher revenues as a result of increased courseware development activity on a large US workforce development project.

## 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 three months ended March 31, 2016 total direct costs were \$4,916,908, an increase of \$1,729,138 (54%) over the same quarter in the prior fiscal year. For the six months ended March 31, 2016 total direct costs were \$7,621,535, an increase of \$1,718,417 (29%) over the same quarter in the prior fiscal year.

The increase is primarily attributed to materials costs associated with delivery of a simulator product sale in the period.

## Gross profit

For the three months ended March 31, 2016 gross profit was \$3,478,896, an increase of \$1,324,060 (61%) over the same quarter in the prior period. The reported gross profit percentage for the three months ended March 31, 2016 was 41% as compared to 40% for the same period in the prior year.

For the six months ended March 31, 2016 gross profit was \$6,525,656, an increase of \$2,736,822 (72%) over the same quarter in the prior period. The reported gross profit percentage for the six months ended March 31, 2016 was 46% as compared to 39% for the same period in the prior year.

The Bluedrop Training and Simulation business unit gross profit for the six months ended March 31, 2016 was \$5,212,536 versus \$3,017,090 for the same period in 2015. The gross profit percentage was 44% for the current period versus 38% for the prior period. The significantly higher gross profit in 2016 was a result of higher revenues on US currency revenue transactions as a result of favorable exchange rate fluctuations over the previous period, in addition to gains on two fixed price projects as a result of anticipated reduced costs at completion. In addition, the Company recorded \$2.2 million of revenue associated with new simulator product sales in the period.

The Bluedrop Learning Networks business unit gross profit for the six months ended March 31, 2016 was \$1,313,120 as compared to \$771,744 for the same period in 2015, resulting in a gross margin of 55% versus 46% for the same period in 2015. The increase in gross profit percentage was a direct result of higher revenues as a result of increased courseware development activity on a large US workforce development project as noted above.

### **Sales and marketing**

For the three months ended March 31, 2016 sales and marketing expenses were \$541,123, an increase of \$72,568 (15%) over the same quarter in the prior period. For the six months ended March 31, 2016 sales and marketing expenses were \$1,037,484, an increase of \$142,875 (16%) over the same quarter in the prior period.

The increase in sales and marketing is a result of higher expenditure and additional resources to facilitate strategic growth.

### **General and administration**

For the three months ended March 31, 2016 general and administration expenses were \$1,410,127, an increase of \$239,112 (20%) over the same quarter in the prior period. For the six months ended March 31, 2016 general and administration expenses were \$2,585,324, an increase of \$478,286 (23%) over the same quarter in the prior period.

The increase is reflective of higher expenditure in certain administration functions to facilitate strategic growth including additional resources added throughout fiscal 2015. In addition, the company incurred foreign currency exchange losses of \$189,394 in the first half of fiscal 2016 compared to a gain of \$250,967 in the same period in the prior year.

### **Government assistance**

For the three months ended March 31, 2016 government assistance included in income was \$977,564, an increase of \$730,210 (295%) over the same quarter in the prior period. For the six months ended March 31, 2016 government assistance included in income was \$1,671,058, an increase of \$1,232,859 (281%) over the same quarter in the prior period.

During the six months ended March 31, 2016, the Company recognized \$1,083,513 of indirect government assistance associated with expenditures on the development of a next generation rear crew trainer for the CH-47 Chinook Helicopter.

### **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 \$58,963 as share-based compensation expense for the six months ended March 31, 2016 and \$140,038 for the same period in 2015. During the quarter ended March 31, 2016, the Company issued an additional 700,000 share options.

The Company has an employee share purchase plan which permits employees to subscribe to common shares of the Company through payroll deductions. The Company may provide financial assistance with respect to the plan by way of loan, guarantee or otherwise. The Company has reserved a maximum of 2,969,597 common shares under the employee share purchase plan. As at March 31, 2016 no shares were outstanding under the plan.

### **Finance costs**

For the three months ended March 31, 2016 finance costs were \$433,282, an increase of \$5,813 (1%) over the same quarter in the prior period. For the six months ended March 31, 2016 finance costs were \$863,298, an increase of \$27,400 (3%) over the same quarter in the prior period

The increase in the six months ended March 31, 2016 is primarily a result of \$49,434 additional accretion on other financial liabilities as a result of a revaluation increase in the liabilities at fiscal year-end September 30, 2015.

There were no advances of long term debt or other long term financial liabilities in the quarter. On March 31, 2016 the Company repaid a 16% unsecured term loan in the amount of \$600,000 from an entity controlled by the Company's beneficial controlling shareholder and director.

### **Depreciation and amortization**

For the three months ended March 31, 2016 depreciation and amortization expense was \$261,112, an increase of \$48,614 (23%) over the same quarter in the prior year. For the six months ended March 31, 2016 depreciation and amortization expense was \$521,750, an increase of \$95,107 (22%) over the same quarter in the prior year.

The increase is primarily the result of \$1,177,714 of intangible asset additions in the prior fiscal year. During the six months ended March 31, 2016 the Company invested \$102,008 in capital assets. There were no additions to intangible assets in the three months ended March 31, 2016.

### **Other gains and losses**

During the prior period ended March 31, 2015 the Company recorded other gains of \$428,177.

On December 30, 2014 the Company entered into an early discounted settlement agreement to repay the secured convertible term note acquired in the acquisition of Atlantis Systems Corp. Under the agreement the Company paid \$1,125,000 on settlement of the debt. As at the settlement date the principal and accrued interest payable was \$1,595,422, resulting in a gain on settlement of \$470,422.

### **Income taxes**

For the three months ended March 31, 2016 income tax expense was \$352,297 as compared to a recovery of \$3,884 in the same period in the prior year. For the six months ended March 31, 2016 income tax expense was \$758,021 as compared to \$133,015 in the same period in the prior year. The difference in the income tax expense is a result of the increased taxable income over the comparative period.

## QUARTERLY INFORMATION

The table below provides a summary of operating results for the Company for each quarter in the current and previous fiscal periods. 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	2016	2016	2015	2015	2015	2015	2014	2014
	Q2 Mar-31	Q1 Dec-31	Q4 Sep-30	Q3 Jun-30	Q2 Mar-31	Q1 Dec-31	Q4 Sep-30	Q3 Jun-30
<b>Revenue</b>								
<i>Bluedrop Training and Simulation</i>	\$ 7,170	\$ 4,591	\$ 4,986	\$ 4,416	\$ 4,508	\$ 3,509	\$ 3,672	\$ 3,653
<i>Bluedrop Learning Networks</i>	\$ 1,226	\$ 1,160	\$ 1,142	\$ 937	\$ 835	\$ 840	\$ 689	\$ 864
	8,396	5,751	6,128	5,353	5,343	4,349	4,361	4,517
<b>Direct costs</b>	4,917	2,704	2,904	3,093	3,188	2,715	2,532	2,831
<b>Gross profit</b>	3,479	3,047	3,224	2,260	2,155	1,634	1,829	1,686
Gross profit percentage	41%	53%	53%	42%	40%	38%	42%	37%
<b>Expenses</b>								
Sales and marketing	541	496	639	522	469	426	515	491
General and administration	1,410	1,175	1,162	1,343	1,171	936	1,244	1,247
Research and development costs	1,073	709	127	-	-	-	-	-
Acquisition and restructuring costs	-	-	-	-	-	-	223	12
Government assistance	(977)	(693)	(266)	146	(247)	(191)	(114)	(329)
Share-based compensation	30	29	29	26	70	70	14	80
Finance costs	433	431	736	426	427	409	87	382
Depreciation and amortization	261	261	252	220	212	214	338	215
Other gains and losses	-	-	-	-	44	(472)	113	(212)
	2,771	2,408	2,679	2,683	2,146	1,392	2,420	1,886
<b>Earnings (loss) before income taxes</b>	708	639	545	(423)	9	242	(591)	(200)
Income taxes (recovery)	352	406	(75)	3	(4)	137	445	(22)
<b>Net earnings (loss)</b>	\$ 356	\$ 233	\$ 620	\$ (426)	\$ 13	\$ 105	\$ (1,036)	\$ (178)

### Fiscal 2016

During the first quarter of fiscal 2016, the Company maintained an increased level of revenues and gross margins as a result of improved revenues in both business units. During the quarter the company increased its investment in research and development associated with the CH-47 Chinook rear crew trainer and the *Bluedrop360™* platform. These expenditures were mostly offset by government assistance and other funding related to those expenditures. The company recorded significant tax expense associated with the higher taxable income.

In the second quarter of fiscal 2016, the Bluedrop Training and Simulation business unit recorded a significant increase in revenues and direct costs associated with increased simulation product sales in the period. In addition, the company continued increased investment in research and development associated with the CH-47 Chinook rear crew trainer and the *Bluedrop360™* platform, with costs significantly offset by related government assistance.

### Fiscal 2015

During the first quarter of fiscal 2015, the Company recognized lower costs as a result of cost reduction strategies implemented late in 2014. In addition the Company recorded a gain on settlement due to early repayment of a term debt which is included in other gains and losses.

During the second quarter of fiscal 2015, revenues increased in the Bluedrop Training and Simulation business. This was a result of increasing revenues on US dollar contracts due to favorable foreign exchange rate fluctuations as well as an increase in revenue on a significant percentage complete contract due to a decrease in the estimated costs to complete. The Company increased spending in general and administration functions to facilitate future strategic growth.

In the third quarter of fiscal 2015, the Company continued to recognize higher revenues and gross margins and increased strategic spending in general and administration functions. The Company recorded an expense in government assistance related to a loss provision for SR&ED credit related to prior tax years.



During the final quarter of fiscal 2015 revenue growth continued. This was a result of increased revenues on US dollar contracts due to favorable foreign exchange rate fluctuations as well as an increased courseware development and professional services activities. Finance cost increases are attributed to revaluation of financial liabilities at the balance sheet date.

#### **Fiscal 2014**

On December 31, 2013 the Company acquired Atlantis and the results of the combined operations are included in the last three quarters of fiscal 2014. The acquisition of Atlantis Systems Corp. resulted in significant acquisition related costs in the year.

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.

#### **LIQUIDITY AND CAPITAL RESOURCES**

For the six months ended March 31, 2016 the Company generated cash and cash equivalents of \$126,695 (2015 – \$1,265,332).

##### **Operating activities**

For the six months ended March 31, 2016 the Company's generated cash from operating activities of \$1,835,707 compared to cash generated of \$2,113,737 for the same period in the prior year.

Changes in non-cash working capital related to operating activities consumed cash of \$913,814 during 2016. This included a decrease in deferred revenue of \$864,241, offset by a \$596,480 decrease in unbilled revenue, due to differences in the timing of project execution and billing milestones. In addition, deferred development funding decreased by \$335,431 due to utilization of funding for research and development activities.

##### **Investing activities**

For the six months ended March 31, 2016 the Company consumed cash of \$102,008 for investing activities compared to cash consumed of \$451,311 for the same period in the prior year.

The Company invested \$102,008 in property and equipment during the period.

##### **Financing activities**

For the six months ended March 31, 2016 the Company used \$1,607,004 of cash in financing activities as compared to cash used of \$397,094 from financing activities for the same period in the prior year.

During the period, the Company used cash of \$1,447,484 for repayments of long term debt and interest. This included the early repayment of the 16% unsecured term loan, from an entity controlled by the Company's beneficial controlling shareholder and director, in the amount of \$600,000 at March 31, 2016.

##### **Cash and credit availability**

As at March 31, 2016, the Company held cash and cash equivalents of \$3,323,326.

The Company has a 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. The revolving operating facility is repayable on demand and bears interest at Royal Bank prime plus 1.95%. The Company has provided a General Security Agreement as security for this indebtedness. At March 31, 2016 the line of credit was undrawn.

## 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 March 31, 2016:

<b>Scheduled payments due by period</b> (Canadian dollars in thousands)	<b>Long term debt</b>	<b>Capital leases</b>	<b>Operating leases</b>	<b>Total</b>
2016 (year ended September 30)	805	11	359	1,175
2017	1,960	12	705	2,677
2018	3,689	-	705	4,394
2019	479	-	698	1,177
2020	283	-	686	969
Thereafter	346	-	1,864	2,210
	\$ 7,562	\$ 23	\$ 5,017	\$ 12,602

## SHARE INFORMATION

At March 31, 2016 the Company had issued 98,986,609 common shares and 12,938,330 share options that can be exercised when vested to obtain an equivalent number of common shares.

The Company has an employee share purchase plan which permits employees to subscribe to common shares of the Company through payroll deductions. The Company may provide financial assistance with respect to the plan by way of loan, guarantee or otherwise. The Company has reserved a maximum of 2,969,597 common shares under the employee share purchase plan. As at March 31, 2016 no shares were outstanding under the plan.

In addition, the Company has two outstanding convertible notes which, if converted, would result in the issuance of 24,166,667 of common shares.

### Normal Course Issuer Bid

On March 22, 2016 the Company announced its intentions to undertake a normal course issuer bid ("NCIB"). During April 2016, subsequent to the balance sheet date, the Company completed initial purchases under the NCIB program, purchasing and cancelling 802,500 common shares at an average price of \$0.14 per share. The purchased shares represent 0.8% of the Common Shares outstanding prior to commencement of the NCIB program.

In May 2016, as of the date of this MD&A, the Company purchased an additional 14,000 of the Company's shares, which will be cancelled. Under the terms of the NCIB, the Company may acquire up to 2% of the total issued and outstanding shares in a 30 day period, up to a maximum of 4,949,330 shares during the 12 month period ended March 30, 2017, representing approximately 5% of the public float of the Company prior to commencement of the NCIB.

Such purchases will be made through the facilities of the TSX Venture Exchange ("TSXV"). Shareholders may obtain a copy of the Notice of Intention to Make a Normal Course Issuer Bid filed by the Company with the TSXV in respect of the NCIB, without charge, by contacting 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 six months ended March 31, 2016:

- The Company recorded rent expense of \$141,120 for the six months ended March 31, 2016 (2015 - \$131,040) for rental of premises from 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, 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 \$469,481 for the six months ended March 31, 2016 (2015 - \$395,700) 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 \$29,946 for the six months ended March 31, 2016 (2015 - \$86,592) for share based compensation to its key management personnel (as described above).
- During the second quarter of fiscal 2015, The Company received financing of \$600,000 in the form of an 18 month unsecured term loan from an entity controlled by the Company's beneficial controlling shareholder. The term loan bears interest, payable monthly, at 16% per annum and is subordinated to existing senior credit and other term facilities. The terms of the loan provide that early repayment can be made by Bluedrop, without penalty, by providing 90 days notice. The Company recorded finance costs of \$48,132 related to the loan during the three months ended March 31, 2016 (2015 - \$37,625). The loan was repaid in full on March 31, 2016.
- The Company has provided share purchase loans to a director of the Company. As collateral for the non-interest bearing share purchase loans, the borrower has granted the Company a security interest in a portion of the shares purchased. The loans are repayable in full on or before dates ranging between June 27, 2017 and January 31, 2018. As at March 31, 2016 the amount receivable was \$169,816 (September 30, 2015 - \$169,816).

## ACCOUNTING ESTIMATES

In the process of applying the Company's accounting policies, management has made certain judgments, estimates, and assumptions which affect the amounts recognized in the Consolidated 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 recognized deferred tax assets in the Company's financial statements for the period ended March 31, 2016. 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.

(e) Classification of financial arrangements

The Company has entered into complex financing arrangements in the form of conditionally repayable government grants with below-market interest rates. Management uses significant judgement in selection and application of accounting policies related to these arrangements.

(f) Deferred development funding

The Company has entered into an arrangement with a third party whereby the third party has provided Bluedrop with funding towards development costs under Canada's Industrial and Regional Benefits (IRB) Policy in a non-exchange transaction. While the funding is not provided directly from government, the substance of the transaction is an indirect form of government assistance with the third party acting as an intermediary between a Government agency and Bluedrop. As such the arrangement has been accounted for in accordance with IAS 20 - Accounting for Government Grants and Disclosure of Government Assistance.

### 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 financial liabilities

The Company has received long term debt financing at below-market interest rates and through issue of convertible notes. 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.

(b) 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.

(c) 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.

(d) 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.

## NON-GAAP FINANCIAL MEASURES

This MD&A includes non-GAAP financial measures. Non-GAAP measures do not have a standardized meaning prescribed by the Company's GAAP and therefore should not be compared with similar measures presented by other companies. Management has provided these measures as we believe they are useful supplemental information to users of the Company's financial statements and MD&As. These measures should not be used as an alternative for performance measures calculated in accordance with GAAP.

### (a) Backlog

Backlog is a non-GAAP measure that represents the expected value of orders we have received but have not yet executed. The Company considers an item part of backlog when we have a legally binding commercial agreement with a client that includes enough detail about each party's obligations to form the basis for a contract or an order. Some contracts are executed over a long-term period and are subject to renewal periods. A contract renewal item is only included in backlog when the customer has authorized the renewal.

## 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 March 31, 2016 approximately 73% of trade receivables were due from five customers (September 30, 2015 – 80% from six customers). 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 March 31, 2016 was nil (September 30, 2015 - \$8,374). At March 31, 2016 the Company's trade accounts receivable included amounts over 90 days old totaling \$134,954 (September 30, 2015 – \$130,289) 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 2015 and 2016 the Company continued to execute on its business plan of driving growth.

The Bluedrop Training & Simulation group in 2015 demonstrated that it is well positioned as a training partner of choice for prime contractors. In July it was announced that Boeing would provide funding for the development of a next generation rear crew trainer for the Chinook helicopter. Additionally, Boeing committed to a five year plan to provide sales and marketing support for future product sales and to include the new device in their global supply chain. The Bluedrop Training and Simulation group plans on launching more software-based simulation products as a major area of strategic focus.

The Bluedrop Learning Networks group was re-aligned during the 2015 fiscal year to focus on four key market verticals where our technology and expertise provides customers with low cost and efficient solutions. The four key verticals include Canadian Workforce, US Workforce, NGO/Not-For-Profit and Occupational Health & Safety. We have positioned the Bluedrop Learning Networks group as pioneers behind Integrated Skills Management, a new product category that exceeds the limitations of traditional Learning Management Systems. Going forward the Bluedrop Learning Networks group will be focused on adding new larger scale clients with many users who require a complete training solution to engage, track training, deliver online learning and manage the entire training experience. The new SaaS *Bluedrop360*<sup>™</sup> Training and Delivery Platform is the central part of this service and the aim is to increase long term recurring revenue.

