



Interim Condensed Consolidated Financial Statements
July 31, 2014
(Unaudited)

DISCOVERY AIR INC.

Interim Condensed Consolidated Statements of Financial Position (Unaudited)

(thousands of Canadian dollars)	Note	July 31, 2014	January 31, 2014
Assets			
Current assets:			
Trade and other receivables		\$ 44,137	\$ 24,040
Income taxes receivable		868	3,931
Inventory		24,622	23,553
Prepaid expenses and other		8,885	8,162
Assets held for sale	5	2,712	-
		81,224	59,686
Property and equipment		183,329	187,852
Long term receivables		3,024	3,430
Goodwill		37,861	37,861
Intangible assets		4,288	6,389
Investments in associates		5,207	4,937
		\$ 314,933	\$ 300,155
Liabilities and Shareholders' equity			
Current liabilities:			
Operating line of credit	7	\$ 19,662	\$ 11,307
Trade and other payables		29,402	27,817
Contingent consideration for business acquisition		-	750
Current portion of loans and borrowings	6	7,408	7,669
Other current loans and borrowings	6(f)	28,112	-
		84,584	47,543
Loans and borrowings	6	126,219	153,612
Deferred income taxes		19,713	22,146
		145,932	175,758
Shareholders' equity:			
Share capital	8	83,059	68,469
Contributed surplus		11,462	11,353
Deficit		(9,571)	(2,946)
Accumulated other comprehensive loss		(533)	(22)
Total equity		84,417	76,854
		\$ 314,933	\$ 300,155

See accompanying notes to the interim condensed consolidated financial statements.

DISCOVERY AIR INC.

Interim Condensed Consolidated Statements of Profit (Loss)

(Unaudited)		For the three months ended		For the six months ended	
(thousands of Canadian dollars, except per share amounts)	Note	July 31, 2014	July 31, 2013	July 31, 2014	July 31, 2013
Revenue		\$ 56,813	\$ 72,308	\$ 97,896	\$ 115,902
Expenses		46,536	51,787	89,028	97,940
Depreciation of property, equipment and intangible assets		5,593	6,310	10,866	11,915
		4,684	14,211	(1,998)	6,047
Finance costs		4,224	4,131	8,893	8,224
Share of profit from associates (net of income tax)		(548)	(496)	(998)	(865)
Other gains	10	(626)	(1,680)	(638)	(1,680)
		3,050	1,955	7,257	5,679
Profit (loss) before income taxes		1,634	12,256	(9,255)	368
Income tax provision (recovery):					
Current		78	2,502	78	(132)
Deferred		445	517	(2,708)	8
		523	3,019	(2,630)	(124)
Profit (loss)		\$ 1,111	\$ 9,237	\$ (6,625)	\$ 492
Profit (loss) attributable to:					
Non-controlling interest		-	(2)	-	57
Shareholders' of Discovery Air Inc.		1,111	9,239	(6,625)	435
		\$ 1,111	\$ 9,237	\$ (6,625)	\$ 492
Basic earnings (loss) per share	9	\$ 0.03	\$ 0.62	\$ (0.28)	\$ 0.03
Diluted earnings (loss) per share	9	\$ 0.03	\$ 0.40	\$ (0.28)	\$ 0.03

Interim Condensed Consolidated Statements of Comprehensive Income (Loss)

(Unaudited)		For the three months ended		For the six months ended	
(thousands of Canadian dollars)		July 31, 2014	July 31, 2013	July 31, 2014	July 31, 2013
Profit (loss)		\$ 1,111	\$ 9,237	\$ (6,625)	\$ 492
Other comprehensive loss:					
Exchange differences on translation of foreign operation		(42)	(356)	(511)	(313)
Total comprehensive income (loss)		\$ 1,069	\$ 8,881	\$ (7,136)	\$ 179
Total comprehensive income (loss) attributable to:					
Non-controlling interest		-	(2)	-	57
Shareholders' of Discovery Air Inc.		1,069	8,883	(7,136)	122
		\$ 1,069	\$ 8,881	\$ (7,136)	\$ 179

See accompanying notes to the interim condensed consolidated financial statements.

DISCOVERY AIR INC.

Interim Condensed Consolidated Statements of Shareholders' Equity

(Unaudited)

(thousands of Canadian dollars)

	Note	Share capital	Contributed surplus	Retained earnings (deficit)	Accumulated other comprehensive income (loss)	Non-controlling interest	Total equity
Balance at January 31, 2014		\$ 68,469	\$ 11,353	\$ (2,946)	\$ (22)	\$ -	\$ 76,854
Loss		-	-	(6,625)	-	-	(6,625)
Other comprehensive loss		-	-	-	(511)	-	(511)
Share-based compensation		-	109	-	-	-	109
Common share issue (net of transaction costs)	8	14,590	-	-	-	-	14,590
Balance at July 31, 2014		\$ 83,059	\$ 11,462	\$ (9,571)	\$ (533)	\$ -	\$ 84,417
Balance at January 31, 2013		\$ 68,469	\$ 11,078	\$ 15,009	\$ 64	\$ 8	\$ 94,628
Profit		-	-	435	-	57	492
Other comprehensive loss		-	-	-	(313)	-	(313)
Share-based compensation		-	162	-	-	-	162
Balance at July 31, 2013		\$ 68,469	\$ 11,240	\$ 15,444	\$ (249)	\$ 65	\$ 94,969

See accompanying notes to the interim condensed consolidated financial statements.

DISCOVERY AIR INC.

Interim Condensed Consolidated Statements of Cash Flows
(Unaudited)

(thousands of Canadian dollars)	Note	For the six months ended	
		July 31, 2014	July 31, 2013
Cash provided by (used in)			
Operating activities:			
Profit (loss)		\$ (6,625)	\$ 492
Adjustments for:			
Current tax provision (recovery)		78	(132)
Deferred tax provision (recovery)		(2,708)	8
Finance costs		8,893	8,224
Share-based compensation		(171)	-
Depreciation of property, equipment and intangible assets		10,866	11,915
Share of profit from associates		(998)	(865)
Other gains	10	(638)	(1,680)
		8,697	17,962
Change in non-cash operating working capital	11	(20,734)	(24,524)
Interest paid		(3,483)	(3,220)
Net income taxes received		2,912	1,674
Net cash used by operating activities		(12,608)	(8,108)
Investing activities:			
Dividends received		735	-
Acquisition of property and equipment		(9,806)	(8,350)
Long term receivable collections		139	129
Proceeds on disposal of property and equipment		4,513	137
Proceeds on sale of subsidiary and investment		-	1,216
Net cash used in investing activities		(4,419)	(6,868)
Financing activities:			
Proceeds from operating line of credit	7	8,355	14,762
Loans and borrowings transaction costs		(228)	(61)
Proceeds from loans and borrowings	6	23,088	-
Repayment of contingent consideration for business acquisition		(750)	(750)
Repayment of loans, borrowings and finance leases	6	(28,028)	(4,781)
Common share issue	8	14,590	-
Net cash provided by financing activities		17,027	9,170
Decrease in cash		-	(5,806)
Cash, balance beginning of period		-	5,806
Cash, balance end of period		\$ -	\$ -

See accompanying notes to the interim condensed consolidated financial statements.

DISCOVERY AIR INC.

Notes to Interim Condensed Consolidated Financial Statements
(Unaudited)

For the six months ended July 31, 2014 and 2013

1. Reporting entity:

Discovery Air Inc. (the “**Corporation**”) was incorporated on November 12, 2004 under the *Ontario Business Corporations Act* and on March 27, 2006 was continued under the *Canada Business Corporations Act*. The Corporation’s Class A common voting shares (the “**Class A Shares**”) are traded on the Toronto Stock Exchange (“**TSX**”) under the symbol “DA.A”. The Corporation also has Class B common variable voting shares (the “**Class B Shares**”), which are not listed for trading on any exchange (the Class B Shares and the Class A Shares are collectively referred to as the “**Shares**”). The address of the registered office was changed on June 11, 2013 to 170 Attwell Drive, Suite 370, Etobicoke, Ontario. The Corporation operates through two business segments, “**Aviation**” and “**Corporate Support and Other**”. Through direct and indirect subsidiaries, the Corporation operates over 160 aircraft with over 850 team members.

2. Basis of preparation:

Statement of compliance:

The Corporation prepares its interim condensed consolidated financial statements in accordance with International Accounting Standard (“IAS”) 34, Interim Financial Reporting. These interim condensed consolidated financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the Corporation’s audited annual consolidated financial statements for the year ended January 31, 2014, which were prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

3. Significant accounting policies:

These interim condensed consolidated financial statements have been prepared using the same accounting policies and methods of computation as the Corporation’s most recent annual audited consolidated financial statements for the year ended January 31, 2014.

In July 2014, the IASB issued IFRS 9, Financial Instruments (“IFRS 9”). IFRS 9 simplifies the measurement and classification of financial assets by reducing the number of measurement categories and removing complex rule-driven embedded derivative guidance in IAS 39, Financial Instruments: Recognition and Measurement. The new standard also provides for a fair value option in the designation of a non-derivative financial liability and its related classification and measurement, as well as for a new hedge accounting model more closely aligned with risk management activities undertaken by entities. IFRS 9 is to be applied retrospectively and is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The Corporation is currently assessing the impact of the new standard on its financial statements.

In May 2014, the IASB issued IFRS 15, Revenue from Contracts with Customers (“IFRS 15”). IFRS 15 provides a comprehensive framework for recognition, measurement and disclosure of revenue from contracts with customers, excluding contracts within the scope of the standards on leases, insurance contracts and financial instruments. IFRS 15 is to be applied retrospectively and is effective for annual periods beginning on or after January 1, 2017 with early adoption permitted. The Corporation is currently assessing the impact of the new standard on its financial statements.

4. Business combinations:

On December 17, 2013, the Corporation, through a subsidiary of Discovery Air Defence Services Inc. (“**Defence Services**”), acquired Advanced Training Systems International, Inc. by way of a merger of that entity with and into Advanced Training Systems International Corp. (“**ATSI**”) for \$7.2 million (U.S. \$6.6 million plus adjustments of U.S. \$0.2 million). ATSI is a U.S. airborne training services company based in Mesa, Arizona. It owns a fleet of ten Douglas A-4 Skyhawk aircraft and offers airborne training services, including, among other services, tactical “Red Air” services, fighter lead-in training, electronic warfare, radar theory and other combat tactics. ATSI was acquired in order to facilitate the expansion of Defence Services’ airborne training services into the U.S. and other international markets. At the time of acquisition ATSI’s predecessor entity had minimal operations and revenues, however it previously provided airborne training services to the U.S. Navy, U.S. Air Force and the Canadian Armed Forces, and has also provided advanced operational test and evaluation services such as air-to-air refueling trials. The estimated fair values of the ATSI assets acquired approximate the purchase price. The measurements used in determining the fair values have been based on inputs that are not observable in the market due to the unique nature of the assets being acquired and therefore reflect a level 3 fair value measurement. The Corporation considered similar aircraft in its current fleet as well as assessments from third party experts with military asset procurement backgrounds. The Corporation expects to finalize the

DISCOVERY AIR INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)
(Unaudited)

For the six months ended July 31, 2014 and 2013

preliminary purchase price allocation before the end of fiscal 2015. Foreign exchange gains and losses arising from translating ATSI's results and financial position into Canadian dollars are recorded in other comprehensive loss.

A summary of net assets acquired is as follows:

(thousands of Canadian dollars)

Net assets acquired	(preliminary)
Cash	\$ 14
Other current assets	2,030
Property and equipment	5,320
Current liabilities	(128)
	<hr/> \$ 7,236 <hr/>

5. Assets held for sale:

In June 2014, the Corporation's Aviation segment, accepted an offer to sell an aircraft for proceeds of US\$2.5 million. The transaction was completed in August 2014 with a realized gain of \$0.4 million.

In July 2014, the Corporation's Corporate Support and Other segment accepted an offer to sell a building for proceeds of \$0.6 million. The transaction is expected to close during the third quarter of fiscal 2015 at the assets net book value.

For both asset disposals no loan repayment will be required.

DISCOVERY AIR INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)
(Unaudited)

For the six months ended July 31, 2014 and 2013

6. Loans and borrowings:

(thousands of Canadian dollars)

	Note	July 31, 2014	January 31, 2014
10.00% secured convertible debentures, maturing March 22, 2017 (" Secured Debentures ")		\$ 88,581	\$ 84,204
8.375% unsecured convertible debentures, maturing June 30, 2016 (" Unsecured Debentures ")		32,757	32,348
Long-term secured debt bearing interest at the BA rate plus 5.15%, maturing April 1, 2019	6(a)	18,306	-
Long-term secured debt bearing interest of lender's base rate plus 3.00%, maturing March 15, 2017		14,834	15,812
Long-term secured debt bearing interest at the BA rate plus 4.55%, maturing March 1, 2019	6(b)	1,473	-
Long-term unsecured debt bearing a fixed interest rate of 9.00%, maturing July 22, 2015	6(c)	1,345	1,701
Long-term secured debt incurred by subsidiary companies bearing fixed and floating interest rates at a weighted average of 3.74% (January 31, 2014 - 4.4%), maturing fiscal 2015 through fiscal 2017		656	780
Long-term secured debt bearing interest of lender's base rate plus 1.50%, maturing February 15, 2016	6(d)	-	12,730
Long-term secured debt bearing interest of BA rate plus 4.55%, maturing March 26, 2017	6(e)	-	9,631
Finance leases		3,787	4,075
Loans and borrowings		\$ 161,739	\$ 161,281
Less current portion of loans and borrowings		\$ 7,408	\$ 7,669
Less other current loans and borrowings	6(f)	\$ 28,112	\$ -
		\$ 126,219	\$ 153,612

- (a) On March 31, 2014, the Corporation entered into a \$21.5 million term loan agreement to refinance five existing loans (see notes 6(d)) and 6(e)). On June 13, 2014 the loan was amended for a \$2.5 million loan repayment related to the sale of aircraft, to require monthly payments of \$362,000 for the following twelve months and \$210,000 per month thereafter, with the balance due at maturity on April 1, 2019. The loan bears interest at a rate equal to the three-month Canadian dollar banker's acceptance rate ("**BA rate**") plus 5.15% per annum. The loan is secured by charges on specific aircraft, as well as certain subsidiary guarantees and general security agreements. Transaction costs of \$154,000 are netted against the carrying value of the loan and are being accreted to the loan's face value based on the loan's effective interest rate of 6.59% per annum. The agreement requires that the Corporation observe a variety of nonfinancial covenants, maintain a minimum debt service coverage ratio and not exceed a specified level of total liabilities to tangible net worth (see note 6(f)).
- (b) On January 31, 2014, the Corporation entered into a \$1.6 million term loan agreement to finance a previously acquired aircraft. Proceeds were advanced in full on February 18, 2014. The loan matures on March 1, 2019 and is repayable in monthly instalments of \$19,000, with the balance due at maturity. The loan bears interest at a rate equal to the three-month Canadian dollar BA rate plus 4.55% per annum. The loan is secured by charge on the aircraft, as well as certain subsidiary guarantees and general security agreements. Transaction costs of \$75,000 are netted against the carrying value of the loan and are being accreted to the loan's face value based on the loan's effective interest rate of 7.06% per annum. The agreement requires that the

DISCOVERY AIR INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)
(Unaudited)

For the six months ended July 31, 2014 and 2013

Corporation observe a variety of nonfinancial covenants, maintain a minimum fixed charge coverage and not exceed a specified level of leverage.

- (c) On June 22, 2012, the Corporation entered into a \$4.5 million term loan agreement to refinance a maturing debt. On June 12, 2014 the loan was amended to postpone the principal payments for three months, and adjust the maturity date to July 22, 2015. The loan bears a fixed interest rate of 9.00% and is payable monthly. The loan is secured by a subordinated general security agreement with the Corporation and certain of its subsidiaries. Transaction costs of \$104,000 are netted against the carrying value of the loan and are being accreted to the loan's face value based on the loan's effective interest rate of 10.22% per annum. The agreement requires that the Corporation observe a variety of non-financial covenants and maintain a minimum fixed charge coverage (see note 6(f)).
- (d) On May 2, 2012, the Corporation entered into a \$15.0 million secured term loan agreement and had drawn \$13.8 million. The loan matures on February 15, 2016 and is repayable through an annual curtailment each February equal to 1/10th of the original amounts drawn and monthly payments of interest. The loan bears an interest rate equal to the greater of: (i) 4.50%, and (ii) the lender's floating base rate plus 1.50% per annum. On April 1, 2014, this loan was repaid with proceeds from a new loan (see note 6(a)).
- (e) On March 26, 2012, the Corporation entered into four secured term loan agreements for an aggregate principal amount of \$14.2 million. The loans mature on March 26, 2017 and are repayable in aggregate monthly instalments of \$185,000, with the balance due at maturity. The loans bear interest at a rate equal to the one-month Canadian dollar BA rate plus 4.55% per annum. On April 1, 2014, these loans were repaid with proceeds from a new loan (see note 6(a)).
- (f) The Corporation is required to maintain a minimum fixed charge coverage ratio and minimum debt service coverage ratio under several loan agreements. As of July 31, 2014, the Corporation was in breach of these ratios with certain of its lenders. From each of these lenders, subsequent to the end of the quarter, the Corporation obtained waivers of these covenants for the second quarter and have pre-emptively waived or amended the covenant for the third quarters of its fiscal 2015 year. Since the waivers were obtained after July 31, the otherwise non-current debt due to these lenders was reclassified as a current obligation.

The Corporation is also required to comply with several other financial covenants in its debt agreements, including: a debt leverage covenant, which requires the Corporation to maintain a total debt to EBITDA (as specifically defined in the Secured Debentures) ratio of not more than 6.00:1.00 (the "**Debt Leverage Covenant**"), and a pledged asset ratio covenant, which requires the Corporation to provide the holders of the Secured Debentures with a first-lien security interest over assets having an appraised value equal to a prescribed ratio of the adjusted principal amount of the Secured Debentures (the "**PAR Covenant**"); a trailing four quarter consolidated EBITDAR to fixed charge ratio; a debt service coverage ratio; a total liabilities to tangible net worth ratio; and a total funded debt to EBITDAR ratio. The Corporation's ability to remain in compliance with its financial covenants is dependent on a number of factors, including (i) the profitability of its operations, (ii) its ability to generate cash flows, and (iii) the adequacy of the security pledged to its lenders in relation to its debt levels. Since interest on the Secured Debentures is paid in kind (i.e., accrues and is added to the principal amount of the Secured Debentures), the aggregate value of the assets that must be pledged to remain in compliance with the PAR Covenant increases over time. The Corporation required and received prior to the end of the quarter ended July 31, 2014 a waiver of the Debt Leverage Covenant for that quarter and PAR Covenant, though the Corporation was in compliance with the PAR Covenant for the quarter ended July 31, 2014. The Corporation also received irrevocable waivers from the Debt Leverage Covenant and the PAR Covenant for the quarters ending October 31, 2014 and January 31, 2015. There is no assurance that following the periods covered by the waivers that the Corporation will be able to remain in compliance with the Debt Leverage Covenant or the PAR Covenant.

Subsequent to July 31, 2014 the Secured Debentures were amended to increase the Debt Leverage Covenant to 7.80:1.00 for the period ending April 30, 2015 and to decrease the PAR Covenant to 1.41:1.00 and 1.37:1.00 for the periods ending April 30, 2015 and July 31, 2015, respectively. In connection with the amendment the Corporation agreed to not request the Secured Debenture holders subordinate their security interest in the assets of the Corporation, and the Secured Debenture holders shall not be required to subordinate their security interest in the assets of the Corporation, prior to the later of December 31, 2016, and the date on which the Corporation is in compliance with the covenants (subject to certain exclusions) in the Secured Debentures for the eight quarters preceding the request. While this restriction is in effect the Secured Debenture holders are not permitted to convert any or all of the Secured Debentures into Shares, except in connection with the maturity of the Secured Debentures, or in connection with or following a Change of Control (as defined in the Secured Debentures). The Corporation also consented not to incur additional indebtedness without the prior consent of the Secured Debentures holders on yet-to-be acquired assets until August 1, 2015.

DISCOVERY AIR INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)
(Unaudited)

For the six months ended July 31, 2014 and 2013

In addition, lenders' consent is required, among other things, to incur additional indebtedness beyond a defined amount, pay dividends or make other distributions or repurchase or redeem its capital stock, prepay, redeem or repurchase certain debt, sell assets, and move aircraft internationally.

Repayments on or in respect of the outstanding loans and borrowings as at July 31, 2014 for each of the next five years and thereafter are as follows:

(thousands of Canadian dollars)

Within 1 year	\$	35,520
Within 2 years		33,508
Within 3 years		89,014
Within 4 years		451
Within 5 years		1,224
Thereafter		2,022
Total	\$	161,739

Interest expense on or in respect of loans and borrowings for the three and six months ended July 31, 2014, was \$4.1 million (July 31, 2013 - \$3.9 million) and \$8.2 million (July 31, 2013 - \$7.7 million), respectively.

7. Operating line of credit:

On August 1, 2012, the Corporation entered into a committed operating line of credit ("**Operating Line**") that matures on April 9, 2015 and which bears interest at the lender's prime rate plus 2% with an option to use bankers' acceptance rates upon payment of a 3% stamping fee. The Operating Line has a maximum borrowing limit of \$15.0 million, increasing up to \$25.0 million during the Corporation's peak operating period of March 1 through October 31. Aggregate borrowings are also limited to eligible accounts receivable and inventory, subject to an allowance for specific reserves. The Operating Line, which may be used by the Corporation for working capital and general corporate purposes, is secured by a first charge on the receivables and inventory of the Corporation and certain of its subsidiaries, general security agreements and other customary security agreements. The credit agreement requires that the Corporation observe a variety of nonfinancial covenants, maintain a minimum debt service coverage ratio and not exceed a specified level of total liabilities to tangible net worth. As of July 31, 2014, the Corporation was in breach of its minimum debt service coverage ratio with the lender. Subsequent to the end of the quarter, the Corporation obtained a waiver of this covenant for the quarter ended July 31, 2014 and modification of the covenant for the quarter ended October 31, 2014. In addition to financial covenants, every November through February the Corporation is required to have no advances outstanding under the line of credit for 30 consecutive days. This requirement was waived for fiscal 2014 and the Corporation was in compliance with all other applicable covenants.

In connection with the rights offering (the "**Offering**", see note 8), the Corporation's operating lender temporarily provided an immediate \$10.0 million increase in the Operating Line (by way of an increase in the Corporation's borrowing base), and a commitment to increase the overall limit of the operating facility by \$10.0 million. This commitment expired and was repaid on May 2, 2014 with the proceeds from Shares issued pursuant to the standby purchase agreement between Clairvest and the Corporation, dated February 24, 2014 ("**Standby Purchase Agreement**") in relation to the Offering.

As at July 31, 2014, the Corporation had available a borrowing capacity of \$24.8 million, against which \$1.0 million was applied to issue letters of credit and \$19.7 million was drawn (January 31, 2014 - \$11.3 million).

DISCOVERY AIR INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)
(Unaudited)

For the six months ended July 31, 2014 and 2013

8. Share capital:

Issued and outstanding:

(thousands of Canadian dollars, except for shares)

	July 31, 2014		January 31, 2014	
	Shares	Amount	Shares	Amount
Class A Shares				
Outstanding, beginning of year	14,510,855	\$ 67,431	14,510,855	\$ 67,431
Issued from rights offering (net of transaction costs)	16,999,293	14,209	-	-
Outstanding, end of period	31,510,148	\$ 81,640	14,510,855	\$ 67,431
Class B Shares				
Outstanding, beginning of year	44,760	\$ 1,038	44,760	\$ 1,038
Issued from rights offering (net of transaction costs)	442,567	381	-	-
Outstanding, end of period	487,327	\$ 1,419	44,760	\$ 1,038
	31,997,475	\$ 83,059	14,555,615	\$ 68,469

In February 2014, the Corporation announced its intent to complete the Offering in order to raise up to \$15.0 million of equity capital through the sale of Shares. Under the Offering, the Corporation distributed a total of 14,555,661 rights to its shareholders of record on April 1, 2014 entitling them to subscribe for up to an aggregate of 17,441,860 Shares at a price of \$0.86 per Share. Clairvest Group Inc. ("**Clairvest**") agreed, in accordance with the terms of the Standby Purchase Agreement, to purchase from the Corporation such number of Shares that were available to be purchased, but not otherwise subscribed for under the Offering, up to a predetermined cap. Clairvest also agreed to provide the Corporation with a subordinated, secured loan in the event that Clairvest was unable (due to the cap) to backstop the entire Offering and the Corporation was unable to raise gross proceeds from the Offering in an amount of \$15.0 million.

The Offering was completed in April 2014. The Corporation raised approximately \$1.7 million in gross proceeds from the issuance of 1,952,009 Class A Shares. In May 2014 the Corporation issued 15,047,284 Class A Shares and 442,567 Class B Shares, for gross proceeds of \$13.3 million (at \$0.86 per Share) to Clairvest and/or certain of its funds and co-investors pursuant to the Standby Purchase Agreement in relation to the Offering. In connection with the closing of this transaction, the holders of the Corporation's Secured Debentures have irrevocably agreed to waive their right to direct (in certain circumstances) the manner in which 50% of the Common Shares held by certain current and former management shareholders are voted. As a result of the Offering and the issuance of Shares pursuant to the Standby Purchase Agreement, the Unsecured Debentures conversion price changed to \$6.53 per Share (formerly \$7.30 per Share).

DISCOVERY AIR INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)
(Unaudited)

For the six months ended July 31, 2014 and 2013

9. Earnings per share:

(thousands of Canadian dollars, except per share amounts)

	For the three months ended		For the six months ended	
	July 31, 2014	July 31, 2013	July 31, 2014	July 31, 2013
Basic earnings (loss) per share:				
Profit (loss) attributable to shareholders	\$ 1,111	\$ 9,239	\$ (6,625)	\$ 435
Weighted average number of Shares outstanding	31,829	14,867	23,516	14,867
Basic profit (loss) per share	\$ 0.03	\$ 0.62	\$ (0.28)	\$ 0.03
Diluted Earnings per share:				
Profit (loss) attributable to shareholders	\$ 1,111	\$ 9,239	\$ (6,625)	\$ 435
Dilutive adjustments:				
- Interest savings from assumed conversion of convertible debt	\$ -	\$ 2,319	\$ -	\$ -
Adjusted profit (loss) attributable to shareholders	\$ 1,111	\$ 11,558	\$ (6,625)	\$ 435
Weighted average number of Shares outstanding	31,829	14,867	23,516	14,867
Dilutive adjustments:				
- Assumed conversion of convertible debt	-	14,059	-	-
- Share options	-	-	-	-
Weighted average number of Shares outstanding assuming dilution	31,829	28,926	23,516	14,867
Diluted earnings (loss) per share	\$ 0.03	\$ 0.40	\$ (0.28)	\$ 0.03

The weighted average number of shares has been retrospectively adjusted for the bonus element of the rights issued pursuant to the Offering. The Shares attributable to the bonus element was 310,983.

For the three and six months ended July 31, 2014, 14,575,132 (six months ended July 31, 2013, 14,059,361) potentially dilutive instruments were excluded from the computation of dilutive earnings per share as they were anti-dilutive. Despite the Corporation's Class A Share price as at July 31, 2014 and 2013 being below the conversion price of the Unsecured Debentures and Secured Debentures, IAS 33, Earnings per share, considers these debentures dilutive if the interest savings per share (net of tax) is less than the basic earnings per share.

10. Other gains:

(thousands of Canadian dollars)

	For the three months ended		For the six months ended	
	July 31, 2014	July 31, 2013	July 31, 2014	July 31, 2013
Gain on disposal of property and equipment	\$ (626)	\$ (18)	\$ (638)	\$ (18)
Gain on sale of subsidiary	-	(414)	-	(414)
Gain on contingent consideration of business acquisition	-	(1,248)	-	(1,248)
	\$ (626)	\$ (1,680)	\$ (638)	\$ (1,680)

DISCOVERY AIR INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)
(Unaudited)

For the six months ended July 31, 2014 and 2013

11. Change in non-cash operating working capital:

(thousands of Canadian dollars)

	For the six months ended	
	July 31, 2014	July 31, 2013
Restricted cash	\$ -	\$ 543
Trade and other receivables	(19,012)	(25,562)
Inventory	(1,964)	(1,375)
Prepaid expenses	(833)	(653)
Trade and other payables	1,075	2,523
	\$ (20,734)	\$ (24,524)

12. Fair value of financial assets and liabilities:

Fair value estimation:

The Corporation classifies its fair value measurements by reference to the following fair value measurement hierarchy:

1. Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
2. Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
3. Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

Carrying values for assets and liabilities classified as loans and receivables and financial liabilities at amortized cost (excluding loans and borrowings) approximate their fair value due to their short-term nature.

The fair value of the Secured Debentures and Unsecured Debentures as at July 31, 2014 was \$110.6 million (January 31, 2014 - \$95.0 million) as compared to a carrying value of \$121.3 million (January 31, 2014 - \$116.6 million). At July 31, 2014 and January 31, 2014 the fair value of the Unsecured Debentures was based on the closing trade price on the TSX (level 1) and the fair value for the Secured Debentures was based on management's estimates using observable market inputs (level 2).

The fair value of the Corporation's variable rate loans and borrowings approximates their carrying value, as the applicable interest rate is at a floating market rate.

13. Related party transactions:

Transactions with associates:

For the three and six months ended July 31, 2014, the Corporation's revenues include \$5.8 million and \$9.4 million (July 31, 2013 - \$7.4 million and \$13.5 million), respectively and the Corporation's expenses include \$0.7 million and \$1.3 million (July 31, 2013 - \$0.7 million and \$1.5 million), respectively, from transactions with the Corporation's associates. As at July 31, 2014, \$3.7 million (January 31, 2014 - \$1.6 million) of the Corporation's accounts receivable were due from associates and \$0.7 million (January 31, 2014 - \$0.7 million) of the Corporation's accounts payable were due to associates.

14. Commitments and contingencies:

The Corporation has annual lease obligations for aircraft and premises. During the three and six months ended July 31, 2014, the Corporation incurred \$4.8 million (July 31, 2013 - \$5.5 million) and \$7.2 million (July 31, 2013 - \$7.6 million) in operating lease expenses, respectively. Future minimum lease payments under non-cancellable leases are due as follows:

DISCOVERY AIR INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)
(Unaudited)

For the six months ended July 31, 2014 and 2013

(thousands of Canadian dollars)

Within 1 year	\$	8,750
Within 2 years		4,495
Within 3 years		3,082
Within 4 years		1,631
Within 5 years		1,468
Thereafter		8,441
	\$	27,867

The lease terms range from a period of 1 to 50 years, the majority of which are renewable at the end of the lease term at market rates.

15. Segmented information:

The Corporation's reportable segments are "**Aviation**", which includes Great Slave Helicopters Ltd. ("**GSH**"), Defence Services, Air Tindi Ltd. ("**Air Tindi**"), and Discovery Air Fire Services Inc. ("**Fire Services**") and "**Corporate Support and Other**", which includes Discovery Air Technical Services Inc. ("**Technical Services**"), Discovery Mining Services Ltd. ("**Mining Services**"), Discovery Air Innovations Inc. ("**Innovations**"), and Corporate (corporate reflects direct corporate overhead costs). In assessing the reportable segments, the Corporation considered the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. The Aviation segment aggregates operating units that have substantially the same basis of deriving revenues, infrastructure to conduct operations and regulatory environment. Corporate Support and Other contains operating units which do not meet the basis for aggregation under Aviation and individually represent less than 10% of the Corporation's total assets, annual revenues and annual earnings.

The revenues disclosed in the tables are from external customers. There are inter-segment revenues, however they are eliminated on consolidation. For the three and six months ended July 31, 2014, Corporate Support and Other segment inter-segment revenue was \$0.1 million (July 31, 2013 - \$0.3 million), and \$0.2 million (July 31, 2013 - \$0.6 million), respectively.

The Corporation's businesses are, to varying degrees, seasonal in nature. Seasonality and other factors such as weather conditions can affect the comparability of results from one period to another, particularly from quarter to quarter. Some of the seasonal factors that impact quarterly results are as follows: there is increased demand for the services provided by GSH, Fire Services, Air Tindi, and Mining Services normally commencing in the late spring and continuing through to the end of the summer; Defence Services revenue-generating opportunities are significantly higher in the February to June and September to November time periods; though Defence Services revenues are relatively predictable over a twelve month period, they can vary substantially from month to month depending on weather conditions and its customers' priorities; weather conditions can have an impact on flight activity from one period to another, especially in the Corporation's fire suppression activities; the Corporation attempts to perform most major repairs and refurbishment during the slower periods of revenue-generating potential; and repair and maintenance on aircraft do not occur evenly throughout the year and the timing of related expenses within a year may vary from one period to another.

DISCOVERY AIR INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)
(Unaudited)

For the six months ended July 31, 2014 and 2013

(thousands of Canadian dollars)	For the three months ended July 31, 2014			For the three months ended July 31, 2013		
	Aviation	Corporate Support and Other	Total	Aviation	Corporate Support and Other	Total
Revenue	\$ 49,309	\$ 7,504	\$ 56,813	\$ 63,610	\$ 8,698	\$ 72,308
Expenses	36,738	9,798	46,536	40,233	11,554	51,787
Depreciation of property, equipment and intangible assets	5,121	472	5,593	6,005	305	6,310
	7,450	(2,766)	4,684	17,372	(3,161)	14,211
Share of (profit) loss from associates (net of income tax)	(999)	451	(548)	(189)	(307)	(496)
	8,449	(3,217)	5,232	17,561	(2,854)	14,707
Finance costs			4,224			4,131
Other gains			(626)			(1,680)
Profit before income taxes			1,634			12,256
Income tax provision:						
Current			78			2,502
Deferred			445			517
			523			3,019
Profit			\$ 1,111			\$ 9,237
Profit (Loss) attributable to:						
Non-controlling interest			-			(2)
Shareholders' of Discovery Air Inc.			\$ 1,111			\$ 9,239
Segment assets	\$ 293,325	\$ 21,608	\$ 314,933	\$ 290,537	\$ 31,088	\$ 321,625
Capital expenditures	\$ 5,542	\$ 130	\$ 5,672	\$ 2,155	\$ 1,005	\$ 3,160
Investments in associates	\$ 5,180	\$ 27	\$ 5,207	\$ 3,044	\$ 1,301	\$ 4,345

DISCOVERY AIR INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)
(Unaudited)

For the six months ended July 31, 2014 and 2013

(thousands of Canadian dollars)	For the six months ended July 31, 2014			For the six months ended July 31, 2013		
	Aviation	Corporate Support and Other	Total	Aviation	Corporate Support and Other	Total
Revenue	\$ 81,274	\$ 16,622	\$ 97,896	\$ 98,754	\$ 17,148	\$ 115,902
Expenses	68,865	20,163	89,028	75,110	22,830	97,940
Depreciation of property, equipment and intangible assets	9,940	926	10,866	11,119	796	11,915
	2,469	(4,467)	(1,998)	12,525	(6,478)	6,047
Share of profit from associates (net of income tax)	(985)	(13)	(998)	(191)	(674)	(865)
	3,454	(4,454)	(1,000)	12,716	(5,804)	6,912
Finance costs			8,893			8,224
Other gains			(638)			(1,680)
Profit (loss) before income taxes			(9,255)			368
Income tax provision (recovery):						
Current			78			(132)
Deferred			(2,708)			8
			(2,630)			(124)
Profit (loss)			\$ (6,625)			\$ 492
Profit (Loss) attributable to:						
Non-controlling interest			-			57
Shareholders' of Discovery Air Inc.			\$ (6,625)			\$ 435
Segment assets	\$ 293,325	\$ 21,608	\$ 314,933	\$ 290,537	\$ 31,088	\$ 321,625
Capital expenditures	\$ 9,536	\$ 270	\$ 9,806	\$ 6,262	\$ 2,088	\$ 8,350
Investments in associates	\$ 5,180	\$ 27	\$ 5,207	\$ 3,044	\$ 1,301	\$ 4,345