
Management's Discussion and Analysis of Results of Operations and Financial Condition For the three months Ended December 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 three months ended December 31, 2016, and should be read in conjunction with the Company's Condensed Consolidated Interim Financial Statements and notes thereto for the three months ended December 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 30th unless otherwise noted. This MD&A has been prepared as of March 1, 2017.

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 March 1, 2017 and are subject to change after such date.

COMPANY OVERVIEW

Bluedrop is an innovator in both the development of workplace e-learning and simulation as well as the way large organizations deliver, track and manage training. The Company serves the world's leading aerospace and defence organizations as well as broad cross sections of organizations focused on managing system wide health and safety, and developing the skills of external workforces. Bluedrop is creating the workforce of the future by improving the effectiveness, speed and costs of training and delivery management.

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 three months ended December 31, 2016, the Bluedrop Training and Simulation business unit signed two significant contracts and continued to make significant investments in the development of simulation technology.

The business units revenue decreased over the previous quarter as a result of lower courseware development activities in the period. The Bluedrop Training and Simulation business unit ended the quarter with an estimated revenue backlog¹ of \$44.7 million. During the quarter, the Company signed two significant contracts including an extension to the courseware production support for the Army Learning Support Centre ("ALSC") of over \$4.0 million and a \$5.5 million contract to deliver a Bell 206 Level 7 Flight Training Device to the Contracted Flying Training and Support ("CFTS") Program. 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. In 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. The company has targeted completion of the rear crew trainer by the third quarter of fiscal 2017.

Bluedrop Learning Networks

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

During the quarter the business unit recorded increased revenues associated with courseware development activities for two large workforce development projects. The business unit continues to pursue multiple market opportunities and the ended the quarter with an estimated revenue backlog¹ of \$5.1 million.

During the first quarter of fiscal 2017, the Company continued to incur expenditures aiming at improving the platforms functionality and adapting the offering to meet the needs of both market verticals.

Corporate

During the three months ended December 31, 2016, management continued to monitor financial requirements and maintained appropriate working capital and cash availability positions ending the quarter with \$1.1 million in cash and no draw on the bank line of credit.

On March 31, 2016, the company commenced a normal course issuer bid ("NCIB") to acquire up to an aggregate of 4,949,330 outstanding common shares. The bid will expire on March 30, 2017. During the first quarter of fiscal 2017, the Company purchased 764,500 common shares under the NCIB program. As of December 31, 2016, 2,200,500 common shares had been repurchased under the NCIB, at an average price of \$0.16 per share.

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 to mitigate the impact of foreign currency fluctuations.

Subsequent to the quarter end, the Company announced that it had secured a \$3.0 million funding contribution under the Atlantic Canada Opportunities Agency Business Development Program to assist with working capital requirements for growth initiatives of the Company. The unsecured, non-interest bearing loan is repayable in 60 monthly instalments of \$50,000 commencing October 1, 2018. As of March 1, 2017, the Company has not drawn any contributions under the program.

¹ 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 December 31, 2016, to the same period in the prior fiscal year.

(Canadian dollars in thousands)	Three months ended December 31		Change (2016 vs. 2015)	
	2016	2015	\$	%
Revenue				
Services revenue	3,898	4,619	(721)	-16%
Product sales	821	952	(131)	-14%
	4,719	5,571	(852)	-15%
Direct costs	2,591	2,629	(38)	-1%
Gross profit	2,128	2,942	(814)	-28%
Gross profit percentage	45%	53%		
Expenses				
Sales and marketing	457	496	(39)	-8%
General and administration	1,193	1,193	-	0%
Research and development costs	728	709	19	3%
Government assistance and other funding	(658)	(693)	35	-5%
Share-based compensation	19	29	(10)	-34%
Finance costs	436	431	5	1%
Depreciation and amortization	262	261	1	0%
Other gains and losses	46	(18)	64	-356%
	2,483	2,408	75	3%
Earnings (loss) before income taxes	(355)	534	(889)	-166%
Income taxes	62	373	(311)	-83%
Net earnings (loss)	(417)	161	(578)	-359%

Revenue

For the three months ended December 31, 2016, revenues were \$4,719,448, a decrease of \$851,748 (15%) as compared to the same period in 2015.

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

Revenue	Three months ended December 31				Change (2016 vs. 2015)	
	2016	% of total	2015	% of total	\$	%
<i>Bluedrop Training and Simulation</i>	3,321	70%	4,411	79%	(1,090)	-25%
<i>Bluedrop Learning Networks</i>	1,398	30%	1,160	21%	238	21%
	4,719	100%	5,571	100%	(852)	-15%

During the first quarter of fiscal 2017, the Training and Simulation business saw a decreased level of revenues which was directly related to the timing and procurement of sales opportunities being pushed out to the second quarter of fiscal 2017. The decrease in revenue compared to the same quarter in the prior period was a result of the Bluedrop Training and Simulation reflecting revenue pickups in the first quarter of fiscal 2016 as a result of completing two fixed price percent complete projects at lower costs than forecast. The Bluedrop Learning Networks operations realized higher revenues as a result of increased courseware development activity on two workforce development projects in the US and Middle East.

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 licensed products.

For the three months ended December 31, 2016 total direct costs were \$2,590,921, a decrease of \$38,008 (1%) over the same quarter in the prior fiscal year. The Company was able to maintain a similar billable base to the prior quarter.

Gross profit

For the three months ended December 31, 2016, gross profit was \$2,128,527, a decrease of \$813,740 (28%) over the same quarter in the prior period. The reported gross profit percentage for the three months ended December 31, 2016 was 45% as compared to 53% for the same period in the prior year.

The Bluedrop Training and Simulation business unit gross profit for the three months ended December 31, 2016 was \$1,370,333 versus \$2,311,796 for the same period in 2015. The gross profit percentage was 41% for the current period versus 52% for the prior period. The significantly higher gross profit in the prior period was a result of completing two fixed price percent complete projects in the first quarter of fiscal 2016 at lower costs than forecast, resulting in a revenue and gross profit pickup during that period.

The Bluedrop Learning Networks business unit gross profit for the three months ended December 31, 2016 was \$758,194 as compared to \$630,471 for the same period in 2015, resulting in a gross profit percentage of 54% in both periods.

Sales and marketing

For the three months ended December 31, 2016, sales and marketing expenses were \$457,379, a decrease of \$38,982 (8%) over the same quarter in the prior period, which was a result of lower labour costs during the period.

General and administration

For the three months ended December 31, 2016, general and administration expenses were \$1,193,653 which remained consistent with the comparative quarter.

Research and development costs

For the three months ended December 31, 2016, research and development costs were \$728,357, an increase of 19,396 (3%) over the same period in the prior year.

The Training and Simulation business unit invested \$416,185 in the quarter for costs associated with the development of the Boeing Chinook rear crew trainer program. The Learning Networks business unit invested \$312,172 in the quarter for costs mostly associated with enhancements to the in service *Bluedrop360™* platform.

Government assistance

For the three months ended December 31, 2016, government assistance included in income was \$657,847, a decrease of \$35,647 (5%) over the same quarter in the prior period.

The decrease in government assistance for the three months ended December 31, 2016, compared to the same quarter in the prior period primarily related to decreased development costs on the Boeing rear crew mission training project as it nears completion. The decrease in costs results in lower government assistance revenue recognized during the period.

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 \$18,855 as share-based compensation expense for the three months ended December 31, 2016, and \$29,457 for the same period in 2015.

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 December 31, 2016, no shares were outstanding under the plan.

Finance costs

For the three months ended December 31, 2016, finance costs were \$435,548, an increase of \$4,902 (1%) over the same quarter in the prior period.

The increase in the three months ended December 31, 2016 is primarily a result of accretion on other financial liabilities due to a revaluation increase in the liabilities at fiscal year end September 30, 2016. This was offset by lower accretion on long term debt in the period.

There were no advances of long term debt or other long term financial liabilities in the quarter.

Depreciation and amortization

For the three months ended December 31, 2016, depreciation and amortization expense was \$261,697, which is consistent with the same quarter in the comparative period.

Other gains and losses

Included in other gains and losses are realized and unrealized gains and losses as a result of foreign exchange rate fluctuations. For the three months ended December 31, 2016, the Company recorded a loss of \$45,585 compared to a gain of \$18,214 during the same period in the prior quarter.

The change is attributable to unfavorable foreign exchange rate fluctuations during the quarter ended December 31, 2016, compared to favorable fluctuations in the comparative period.

Income taxes

For the three months ended December 31, 2016, income tax expense was \$62,384, as compared to \$373,331 in the same period in the prior year. The decrease in the income tax expense is a result of decreased 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	2017	2016	2016	2016	2016	2015	2015	2015
	Q1 Dec-31	Q4 Sep-30	Q3 Jun-30	Q2 Mar-31	Q1 Dec-31	Q4 Sep-30	Q3 Jun-30	Q2 Mar-31
Revenue								
<i>Bluedrop Training and Simulation</i>	\$3,321	\$ 4,196	\$ 4,490	\$ 6,869	\$ 4,411	\$ 4,986	\$ 4,416	\$ 4,507
<i>Bluedrop Learning Networks</i>	\$1,398	\$ 1,331	\$ 1,146	\$ 1,226	\$ 1,160	\$ 1,142	\$ 937	\$ 835
	4,719	5,527	5,636	8,095	5,571	6,128	5,353	5,342
Direct costs	2,591	2,832	3,162	4,791	2,629	2,904	3,093	3,188
Gross profit	2,128	2,695	2,474	3,304	2,942	3,224	2,260	2,154
Gross profit percentage	45%	49%	44%	41%	53%	53%	42%	40%
Expenses								
Sales and marketing	457	365	611	541	496	639	522	469
General and administration	1,193	1,258	1,146	1,202	1,193	1,231	1,257	1,357
Research and development costs	728	986	1,084	1,073	709	127	-	-
Government assistance	(658)	(1,214)	(1,350)	(977)	(693)	(266)	146	(247)
Share-based compensation	19	18	5	30	29	29	26	69
Finance costs	436	674	396	433	431	736	426	427
Depreciation and amortization	262	325	264	261	261	252	220	212
Other gains and losses	46	228	51	208	(18)	(69)	86	(143)
	2,483	2,640	2,207	2,771	2,408	2,679	2,683	2,144
Earnings (loss) before income taxes	(355)	55	267	533	534	545	(423)	10
Income taxes (recovery)	62	(493)	170	298	373	(75)	3	(4)
Net earnings (loss)	\$ (417)	\$ 548	\$ 97	\$ 235	\$ 161	\$ 620	\$ (426)	\$ 14

Fiscal 2017

During the first quarter of fiscal 2017, the Company saw a decreased level of revenues and direct costs which was directly related to the timing and procurement of sales opportunities being pushed out to the second quarter of fiscal 2017. Despite the decrease in revenues during the first quarter, the Company was able to control its costs and maintain a gross profit margin of 45%, which is within the Company's normal range. The quarter also saw a decrease in government assistance and research and development costs as the Training and Simulation business wraps up the Boeing rear crew mission training program.

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.

In the third quarter of fiscal 2016, revenue and direct costs returned to their normal levels following the sale of the simulation products during the second quarter. In addition, the Company recognized government assistance of \$312,885 related to Newfoundland and Labrador Digital Media Tax Credits.

During the fourth quarter of fiscal 2016, the Company continued normal levels of operating activities. Higher government assistance was recognized related to the ongoing DMTC programs and finance charges increased primarily due to the revaluation of financial liabilities. In addition, the Company recorded an impairment loss of \$320,366 related to certain

technology assets associated with the *CoursePark™* platform, while also recognizing additional tax assets associated with previously unrecognized tax losses.

Fiscal 2015

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.

LIQUIDITY AND CAPITAL RESOURCES

For the three months ended December 31, 2016, the Company used cash and cash equivalents of \$1,964,190 (2016 – \$1,028,464).

Operating activities

For the three months ended December 31, 2016, the Company consumed cash from operating activities of \$1,213,915 compared to \$491,119 for the same period in the prior year.

Changes in non-cash working capital related to operating activities consumed cash of \$1,637,122 during the first quarter of 2017. This included an increase in deferred revenue of \$617,386 due to differences in the timing of project execution and billing milestones. This was offset by a decrease in accounts payable and accruals of \$604,945 as a result of timing of purchases near the end of the quarter. In addition, accounts receivable increased by \$1,139,547 as a result of a significant billing milestone which occurred near the end of the quarter and deferred development funding decreased by \$367,606 due to the Boeing rear crew mission trainer program nearing completion.

Investing activities

For the three months ended December 31, 2016, the Company consumed cash of \$18,397 for investing activities compared to cash consumed of \$48,840 for the same period in the prior year. The investment in both periods related to purchases of property and equipment.

Financing activities

For the three months ended December 31, 2016, the Company used cash of \$731,878 in financing activities as compared to cash used of \$488,505 from financing activities for the same quarter in the prior year.

During the period, the Company used cash of \$382,829 for repayments of long term debt and interest, which included the repayments on the RBC term debt of \$3.0 million which was secured at the end of fiscal 2016. The company also consumed \$129,418 of cash for shares purchases under the normal course issuer bid during the period.

The increase in repayments of other financial liabilities during the quarter was related to the Company amending certain terms of the unsecured royalty obligation in the prior fiscal year, which now requires the Company to pay a minimum royalty of \$40,000 per month until May 31, 2017. The Company made royalty payments of \$120,000 during the quarter ended December 31, 2016, compared to \$58,336 in the same period in the prior year.

Cash and credit availability

As at December 31, 2016, the Company held cash and cash equivalents of \$1,147,162.

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 December 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 December 31, 2016:

Scheduled payments due by period (Canadian dollars in thousands)	Long term debt	Finance leases	Operating leases	Total
2017	4,818	15	705	5,538
2018	2,003	11	705	2,719
2019	1,550	11	694	2,255
2020	223	11	686	920
2021	208	8	616	832
Thereafter	84	-	1,077	1,161
	\$ 8,886	\$ 56	\$ 4,483	\$ 13,425

Included in the long-term debt obligations for 2017 is \$3.0 million of an unsecured convertible term note which is due December 30, 2017. Repayment of this debt will be funded by the \$3.0 million restricted cash presented on the statement of financial position.

SHARE INFORMATION

At December 31, 2016, the Company had issued 100,982,776 common shares and 11,405,852 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 December 31, 2016, no shares were outstanding under the plan.

During the quarter ended December 31, 2016, \$525,000 of unsecured convertible term notes were converted into common shares at a price of \$0.15 per share for a total share issuance of 3,500,000. As at December 31, 2016, the Company had an outstanding convertible note which, if converted, would result in the issuance of 20,000,000 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 the first quarter of 2017, the Company completed purchases under the NCIB program, purchasing and cancelling 764,500 common shares at an average price of \$0.15 per share. The purchase resulted in a decrease to share capital and retained earnings of \$38,225 and \$91,193, respectively. The Company has repurchased a total of 2,200,500 common shares under the 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"). 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 three months ended December 31, 2016:

- The Company recorded rent expense of \$70,560 for the three months ended December 31, 2016 (2015 - \$70,560) 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 \$172,925 for the three months ended December 31, 2016 (2015 - \$298,525) 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 \$9,933 for the three months ended December 31, 2016 (2015 - \$15,633) for share based compensation to its key management personnel (as described above).
- 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 December 31, 2016 the amount receivable was \$169,816 (September 30, 2015 - \$169,816), \$119,589 of this amount has been classified as current.

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 December 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 December 31, 2016, approximately 85% of trade receivables were due from four customers (September 30, 2016 – 80% from five 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 December 31, 2016 was nil (September 30, 2016 - nil). At December 31, 2016, the Company's trade accounts receivable included amounts over 90 days old totaling \$279,304 (September 30, 2016 – \$50,356) 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

The Company continues to take steps toward strengthening the balance sheet through improved operations and entering into several significant financing arrangements. The Company's intention is to reduce or eliminate the last of the expensive debt taken on to fund the Atlantis acquisition. Subsequent to the quarter end, Bluedrop secured a \$3.0 million funding contribution under the Atlantic Canada Opportunities Agency Business Development Program to assist with working capital requirements for growth initiatives. The Company remains fully committed to the product strategy and goal of transforming Bluedrop into more of a product and proprietary technology based business while still growing its services business. This transformation is expected to take some time to be fully realized and management does not anticipate major unit volumes or major service volumes to be realized within the first year of launch. The Company continues to target key initial accounts to validate the products and platform services in 2017 that will add revenues but more importantly provide the industry validation needed to scale the opportunities.

The Bluedrop Training and Simulation business unit had a slow first quarter but was able to control its costs and maintain a gross margin of 41%. The \$2.4 million of research and development in 2016 resulted in significant advances in developing the Chinook based, Boeing Rear Crew Mission Trainer ("RCMT"), which is now near completion with delivery expected by the third quarter of Fiscal 2017. This is a unique training device that allows rear crew operators to rehearse missions and specific tasks in a virtual and augmented reality environment. The platform is designed to allow for further adaptations of the RCMT and part task trainers to other Original Equipment Manufacturer ("OEM") platforms for additional rotary wing or fixed wing applications for both defence or civilian search and rescue trainers applications at a much lower cost than the initial Chinook unit. The objective is to create a new class of rear crew complete mission trainers and rear crew task trainers adaptable across multiple platforms and markets. By combining emerging technologies with strong OEM partnerships and market access, the business unit is focused on achieving its business goals.

The Learning Networks business unit continued to build more capabilities and features into its Bluedrop360 platform as it invested heavily in research and development in fiscal 2016 and the first quarter of fiscal 2017. The new platform was successfully implemented for an occupational health and safety compliance application in Canada where it now provides regulators, employers and employees a secure web based tracking system for multiple users and multiple certification validations. The platform has also been successfully deployed in a workforce skills enhancement program in the US where it is reducing delivery costs and improving outcomes for job seekers. The development of this proprietary technology is a key strategic focus for the business unit and while it has had some very positive initial customer experiences the long sales cycle and the early adopter nature of the market has made the Company focus even more on the larger accounts and making sure the end users value proposition is well demonstrated.