

## Management's Discussion and Analysis of Results of Operations and Financial Condition For the three months ended December 31, 2017

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, 2017, 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, 2017. 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 February 28, 2018.

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 may contain "forward-looking information", as defined in applicable Canadian securities legislation. Forward-looking information typically contains statements with words such as "plans", "expects", "anticipates", "budgets", "forecasts", "strategy", "goals", "objectives", "could", "would", "should", "may", "might", "intends", "believes", "potential", "target", "targeting" or similar words suggesting future outcomes or statements regarding an outlook. Forward-looking information is based on the current estimates, opinions and beliefs of Bluedrop (as defined herein), as well as various assumptions and information currently available to Bluedrop. Although Bluedrop believes the expectations expressed in such forward-looking information are based on reasonable assumptions, there can be no assurance that such forward-looking information will prove to be accurate, and actual results and future events could differ materially from those anticipated in such information. Forward-looking information in this MD&A includes, among other things, statements regarding Bluedrop's business objectives and growth strategies, expected developments, future payments of dividends, market conditions in the economy generally and Bluedrop's marketing strategy. Forward-looking information is based on a number of factors and assumptions which have been used to develop such information, but which may prove to be incorrect, including, but not limited to, assumptions in connection with the continuance of Bluedrop and its subsidiaries as a going concern and general economic and market conditions.*

*Factors that could cause actual results to differ materially from those in forward-looking information include general economic and business conditions, development and operating risks, uninsurable risks, competition, government regulation, losses and write-downs, restrictions contained in future loan facilities, dependence on key employees, personnel losses, failure of plant, equipment or process to operate as anticipated, power outages, accidents and labour disputes. For additional information with respect to risk factors applicable to Bluedrop, reference should be made to the section in this MD&A entitled "Risk Factors", as well as Bluedrop's continuous disclosure materials filed from time to time with Canadian securities regulatory authorities, including, but not limited to, Bluedrop's annual and interim management's discussion and analysis.*

*Any financial outlook or future-oriented financial information in this MD&A, as defined by applicable securities legislation, has been approved by management of Bluedrop as of the date of this MD&A. Such financial outlook or future-oriented financial information is provided for the purpose of providing information about management's current expectations and plans relating to the future. Readers are cautioned that such outlook or information should not be used for purposes other than for which it is disclosed in this MD&A.*

*The forward-looking information contained in this MD&A is made as of the date of this MD&A and Bluedrop does not undertake to update publicly or revise the forward-looking information contained in this MD&A, whether as a result of new information, future events or otherwise, except as required by applicable securities laws.*

## 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 platform providing large scale customers with the ability to engage, track training and monitor training of large user groups spread out over multiple locations. Their goal is often to digitize manual processes for large populations, even entire Provinces or States. 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, 2017, the Bluedrop Training and Simulation business yielded strong revenues and gross margins, and continued to make significant investments in the development of simulation technology. The business unit earned revenue of \$4.5 million, an increase of 36% compared to the prior period of \$3.3 million, which was primarily due to an increase in revenues associated with delivery against a large simulation project in the period. The Bluedrop Training and Simulation business unit ended the quarter with an estimated revenue backlog<sup>1</sup> of \$28.6 million. 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. Subsequent to quarter end, on January 8, 2018, the Company signed a \$1.1 million contract to build a hoist training solution for Public Services and Procurement Canada under the Build in Canada Innovation Program.

### Bluedrop Learning Networks

During the three months ended December 31, 2017, the Bluedrop Learning Networks business unit continued pursuits in the Occupational Health & Safety and Workforce Development verticals. The business unit also continued research and development investments in the *Bluedrop360™* platform. The business unit generated revenue of \$0.6 million, down compared to the prior period of \$1.4 million which was due to a large courseware contract in the prior period.

The business unit continues to pursue multiple market opportunities and ended the quarter with an estimated revenue backlog<sup>1</sup> of \$3.4 million. During the first quarter, the provincial Government of Newfoundland and Labrador entered into an agreement in principle with the Company to pilot a workforce development platform over a four-year period.

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

## Corporate

During the three months ended December 31, 2017, management continued to monitor financial requirements and maintained appropriate working capital and cash availability positions ending the year with \$1.8 million in cash and no draw on the bank line of credit.

On March 31, 2017, the Company received approval from the TSX Venture Exchange for a further normal course issuer bid to acquire up to an aggregate of 5,052,889 outstanding common shares. During the quarter ended December 31, 2017, 242,000 shares were purchased for \$44,301. The purchases resulted in a decrease to share capital and deficit of \$12,100 and \$32,201, respectively. The new bid will expire March 30, 2018.

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.

During the second quarter of fiscal 2017, the Company 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. The Company completed the final draw of \$385,537 on the facility in the quarter. The loan has been recorded using the effective interest method and the difference between the proceeds received and fair value is recognized as government assistance in the statement of operations.

On November 17, 2017, the Company repaid in full the 14.0% unsecured convertible term loan in the aggregate principal amount of \$3,000,000. The debenture was set to mature on December 30, 2017.

## FINANCIAL RESULTS OF OPERATIONS

The following tables and discussion compare Bluedrop's operating results for the three months ended December 31, 2017, to the same period in the prior fiscal year.

(Canadian dollars in thousands)	Three months ended December 31		Change (2017 vs. 2016)	
	2017	2016	\$	%
<b>Revenue</b>				
Services revenue	3,567	3,898	(331)	-8%
Product sales	1,555	821	734	89%
	5,122	4,719	403	9%
<b>Direct costs</b>	3,248	2,591	657	25%
<b>Gross profit</b>	1,874	2,128	(254)	-12%
Gross profit percentage	37%	45%		
<b>Expenses</b>				
Sales and marketing	382	457	(75)	-16%
General and administration	1,146	1,193	(47)	-4%
Research and development costs	507	728	(221)	-30%
Government assistance	(325)	(658)	333	-51%
Share-based compensation	4	19	(15)	-79%
Finance costs	395	436	(41)	-9%
Depreciation and amortization	217	262	(45)	-17%
Other gains and losses	(3)	46	(49)	-107%
	2,323	2,483	(160)	-6%
<b>Earnings before income taxes</b>	(449)	(355)	(94)	26%
Income taxes	(125)	62	(187)	-302%
<b>Net earnings</b>	(324)	(417)	93	-22%

## Revenue

For the three months ended December 31, 2017, revenues were \$5,122,203 an increase of \$402,755 (9%) as compared to the same period in 2016.

The following tables illustrate the change in revenues from each identified operating segment for the three months ended December 31, 2017.

	Quarter ended December 31				Change (2017 vs. 2016)	
	2017	% of total	2016	% of total	\$	%
<b>Revenue</b>						
<i>Bluedrop Training and Simulation</i>	4,515	88%	3,321	70%	1,194	36%
<i>Bluedrop Learning Networks</i>	607	12%	1,398	30%	(791)	-57%
	<u>5,122</u>	100%	<u>4,719</u>	100%	<u>403</u>	9%

During the first quarter of fiscal 2018, the Training and Simulation business saw an increased level of revenues compared to the prior period which was directly related to delivery against a large simulation product contract in the quarter. The Bluedrop Learning Networks operations realized lower revenues as a result of a major workforce development contract being completed in the prior year.

## 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, 2017, total direct costs were \$3,248,589 an increase of \$657,668 (25%) over the same quarter in the prior year. The increase is primarily due to the increase in product revenue for the quarter.

## Gross profit

For the three months ended December 31, 2017, gross profit was \$1,873,614 a decrease of \$254,913 (12%) over the same period in the prior year. The reported gross profit percentage for the three months ended December 31, 2017, was 37% as compared to 45% for the same period in the prior year.

The Bluedrop Training and Simulation business unit gross profit for the three months ended December 31, 2017, was \$1,565,456 versus \$1,370,333 for the same quarter in the prior period. The gross profit percentage was 35% for the current period versus 41% for the prior period. The Training and Simulation gross margin decreased during the year as a result of a change in product mix associated with ongoing construction of a simulator sale in the period.

The Bluedrop Learning Networks business unit gross profit for the three months ended December 31, 2017 was \$308,158 as compared to \$758,194 for the same quarter in the prior period. The gross profit percentage was 51% for the current period vs 54% for the prior period. The decrease in gross profit was consistent with the decrease in revenue, which was related to a large workforce contract being completed in the prior year.

## Sales and marketing

For the three months ended December 31, 2017, sales and marketing expenses were \$381,706, a decrease of \$75,673 (17%) over the same period in the prior year. The overall decrease in costs for three months ended was primarily related to lower labour costs during the period.

## General and administration

For the three months ended December 31, 2017, general and administration expenses were \$1,145,961, a decrease of \$47,692 (4%) over the same period in the prior year. The decrease for the three months ended was a result of lower labour costs compared to the same periods in the prior year.

### Research and development costs

For the three months ended December 31, 2017, research and development costs were \$507,478 a decrease of \$220,879 (30%) over the same period in the prior year. The decrease in research in development costs is due to high expenditures in the prior period associated with development of the Boeing Chinook rear crew trainer program which was completed in late fiscal 2017.

The Training and Simulation business unit invested \$203,921 during the quarter for costs associated with the research development of future simulation products. In addition, the Learning Networks business unit invested \$303,557 during the fiscal year for costs mostly associated with enhancements to the in service *Bluedrop360™* platform.

### Government assistance

For the three months ended December 31, 2017, government assistance included in income was \$325,420, a decrease of \$332,427 (51%) over the same period in the prior year.

The decrease in government assistance for the three months ended December 31, 2017, compared to the same period in the prior year primarily related to consumption of the funding related to the development of the Boeing Chinook rear crew mission trainer, as the program was completed in the fourth quarter of fiscal 2017. The Company recognized \$367,606 of government assistance related to the Boeing program in the prior 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 \$3,750 as share-based compensation expense for the quarter ended December 31, 2017, and \$18,855 for the same quarter in 2016. The decrease in share-based compensation expense was a result of certain options reaching the end of their vesting period.

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, 2017, no shares were outstanding under the plan.

### Finance costs

For the quarter ended December 31, 2017, finance costs were \$394,916, a decrease of \$40,362 (9%) over the same quarter in the prior period. The decrease in finance costs for the three months ended was a result of decreased costs associated with interest on long term debt.

During the first quarter of the prior period, \$525,000 of unsecured convertible term notes were converted into common shares, further reducing finance costs for the three months ended December 31, 2017. On November 17<sup>th</sup>, 2018, the remaining \$3,000,000 unsecured convertible term note was repaid in full. The decrease in long term debt resulted in decreased interest on long term debt.

During the quarter, the Company completed its final draw against 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 installments of \$50,000 commencing October 1, 2018.

### Depreciation and amortization

For the quarter ended December 31, 2017, depreciation and amortization expense was \$216,999, a decrease of \$44,698 (17%) over the same quarter in the prior year.

The decrease was primarily a result of certain intangible technology assets nearing the end of their useful life for depreciation purposes.

## 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, as well as any provisions for aging account balances during the period, or impairment losses. For the quarter ended December 31, 2017, the Company recorded a gain of \$2,997, compared to a loss of \$45,585 during the same quarter in the prior year.

The increase in other gains and losses for the quarter was primarily the result of favorable foreign exchange rate fluctuations compared to the prior period.

## Income taxes

For the quarter ended December 31, 2017, deferred income tax expense was a recovery of \$125,098, as compared to an expense of \$62,384 in the same period in the prior year. The tax recovery is a result of recognition of tax assets associated with losses in the first quarter of fiscal 2018.

## 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	2018	2017	2017	2017	2017	2016	2016	2016
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
	Dec-31	Sep-30	Jun-30	Mar-31	Dec-31	Sep-30	Jun-30	Mar-31
<b>Revenue</b>								
<i>Bluedrop Training and Simulation</i>	\$ 4,515	\$ 4,801	\$ 5,476	\$ 5,500	\$ 3,321	\$ 4,196	\$ 4,490	\$ 6,869
<i>Bluedrop Learning Networks</i>	\$ 607	\$ 563	\$ 974	\$ 1,359	\$ 1,398	\$ 1,331	\$ 1,146	\$ 1,226
	5,122	5,364	6,450	6,859	4,719	5,527	5,636	8,095
<b>Direct costs</b>	3,248	2,509	3,898	4,338	2,591	2,832	3,162	4,791
<b>Gross profit</b>	1,874	2,855	2,552	2,521	2,128	2,695	2,474	3,304
Gross profit percentage	37%	53%	40%	37%	45%	49%	44%	41%
<b>Expenses</b>								
Sales and marketing	382	421	401	399	457	365	611	541
General and administration	1,146	1,001	1,045	1,104	1,193	1,258	1,146	1,202
Research and development costs	507	866	629	651	728	986	1,084	1,073
Government assistance	(325)	(1,380)	(384)	(1,046)	(658)	(1,214)	(1,350)	(977)
Share-based compensation	4	5	6	15	19	18	5	30
Finance costs	395	362	97	413	436	674	396	433
Depreciation and amortization	217	214	238	255	262	325	264	261
Other gains and losses	(3)	(10)	345	(41)	46	228	51	208
	2,323	1,479	2,377	1,750	2,483	2,640	2,207	2,771
<b>Earnings (loss) before income taxes</b>	(449)	1,376	175	771	(355)	55	267	533
Income taxes (recovery)	(125)	(1,269)	92	335	62	(493)	170	298
<b>Net earnings (loss)</b>	\$ (324)	\$ 2,645	\$ 83	\$ 436	\$ (417)	\$ 548	\$ 97	\$ 235

## Fiscal 2018

During the first quarter of fiscal 2018, the Company continued normal levels of operating activities. The Training and Simulation business unit saw a decrease in gross margin. The decrease in gross margin is a result of a change in product mix associated with the delivery against lower margin simulator projects. The quarter also saw a decrease in government assistance and research and development costs as the Boeing rear crew mission trainer reached completion in the fourth quarter of fiscal 2017.

## 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 later in 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 developed the Boeing rear crew mission training program.

In the second quarter of fiscal 2017, revenues and direct costs were back up to normal levels, however the Training and Simulation business unit saw a decrease in gross margin. The decrease in gross margin is a result of a change in product mix associated with the delivery against a lower margin simulator in the prior period. The quarter also saw an increase in government assistance as the Company recognized funding on a below-market interest rate loan. This offset the decrease in government assistance recognized on the Boeing rear crew mission training program as research and development costs continued to decrease as the project neared completion.

During the third quarter of fiscal 2017 revenues remained strong and the Company continued to control costs as gross margins were 40%. The quarter saw a provision for an aging customer balance from the Learning Networks business unit being impaired resulting in a \$339,119 charge to the consolidated statement of comprehensive income during the quarter. The Company revalued the unsecured royalty obligation during the quarter due to a change in forecasted future cashflows. This resulted in a gain of \$337,400 which is included in finance costs in the consolidated statements of comprehensive income. The Company also completed the Boeing rear crew mission trainer in the third quarter and, as a result, decreased government assistance for that period.

During the fourth quarter of fiscal 2017, the Company continued normal levels of operating activities. Higher government assistance was recognized as the Company recognized additional funding on a below-market interest rate loan and ongoing DMTC programs remained strong. Finance costs returned to normal levels during the quarter as the revaluation of a financial liability in the third quarter resulted in a gain offsetting these costs. In addition, the Company recognized \$1.3 million of additional tax assets associated with previously unrecognized tax losses.

## Fiscal 2016

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.

## LIQUIDITY AND CAPITAL RESOURCES

For the three months ended December 31, 2017, the Company used cash of \$391,657 (2016 –\$1,964,190).

### Operating activities

For the three months ended December 31, 2017, the Company consumed cash from operating activities of \$300,209 compared to \$1,231,107 for the same period in the prior year.

Changes in non-cash working capital related to operating activities consumed cash of \$322,836 during the period. This was primarily driven by a decrease in deferred revenue of \$945,361 offset by an decrease in accounts receivable of \$1,153,988 as a result of differences in the timing of project execution and billing milestones compared to year end. In addition accounts payable decreased by \$422,335 primarily due to timing of annual labor incentive plan payments.

### Investing activities

For the three months ended December 31, 2017, the Company generated cash of \$2,992,751 for investing activities compared to cash consumed of \$18,397 for the same period in the prior year. The increase in cash is a result of withdrawing GIC investments held in restricted cash of \$3,000,000. The proceeds were used to settle the 14% unsecured convertible note.

### Financing activities

For the three months ended December 31, 2017, the Company consumed cash of \$3,191,404 in financing activities as compared to \$731,878 from financing activities for the same period in the prior year.

During the quarter, the Company repaid the 14% unsecured convertible term note and other long-term debt totaling \$3,378,230. The Company also received advances of long term debt in the quarter totaling \$385,537. The decrease in repayments of other financial liabilities during the period was related to the Company amending certain terms of the unsecured royalty obligation in the prior fiscal year, which required the Company to pay a minimum royalty of \$40,000 per month until May 31, 2017, after which time the minimum decreased to \$17,541 per month.

### Cash and credit availability

As at December 31, 2017, the Company held cash of \$1,757,712.

The Company has a short-term bank operating line of credit that was renewed on April 17<sup>th</sup>, 2017. The line of credit is a maximum of the lesser of \$2,500,000 and defined marginable accounts receivable minus specified liabilities. The revolving facility is repayable on demand and bears interest at Royal Bank prime plus 2.20%. The Company has provided a General Security Agreement as security for this indebtedness. Prior to this renewal, the maximum credit available was the lesser of \$3,500,000 and defined marginable accounts receivable minus specified liabilities, with the same security, terms and conditions, and interest rate. At December 31, 2017, 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, 2017:

Scheduled payments due by period (Canadian dollars in thousands)	Long term debt	Finance leases	Operating leases	Total
2018 (Year ended September 30th)	1,521	30	571	2,122
2019	2,513	40	755	3,308
2020	888	28	752	1,668
2021	811	5	752	1,568
2022	735	-	450	1,185
Thereafter	600	-	863	1,463
	\$ 7,068	\$ 103	\$ 4,143	\$ 11,314

## FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company's financial assets and liabilities are exposed to various risk factors that may affect the fair value presentation of the amount ultimately received or paid on settlement of its assets and liabilities.

A summary of the major financial instrument risks and the Company's approach to management of these risks are outlined below:

### (a) Interest rate risk

The Company's obligations under finance leases are at fixed interest rates. A significant portion of long-term debt is at interest rates which are fixed or are non-interest bearing. As such, the Company's exposure to fluctuations in interest rates is not considered material.

### (b) Currency risk

Currency risk is the risk to the Company's earnings that arise from fluctuations of foreign exchange rates and the degree of volatility of these rates. The Company is exposed to foreign currency exchange risk on transactions incurred in US dollars. During the three months ended December 31, 2017, the Company recorded a \$103,939 gain on foreign currency (2016 - \$27,663). The Company monitors fluctuations in exchange rates and uses derivative instruments to reduce its exposure to foreign currency risk.

On December 31, 2017, the Company held 1 outstanding foreign exchange contract with a maturity date of January 31, 2018 to sell US \$350,000 into Canadian dollars at a rate of CA\$1.34 to yield \$469,000. On December 31, 2017, the Company recorded an unrealized gain of \$28,966 included in other current assets representing the change in fair value of these outstanding contracts since inception and their initial measurement.

During the three months ended December 31, 2017, the Company recorded revenue of \$3,113,866 from contracts denominated in US dollars (2016 - \$2,581,292). A 5% change in the U.S. dollar exchange rate would result in a \$155,693 impact on revenue recognized (2016 - \$129,064).

As at the December 31, 2017, the Company held receivables of \$1,482,063 from contracts denominated in US dollars (September 30, 2017 - \$1,759,340). A 5% change in the US dollar exchange rate would result in a \$74,103 (September 30, 2017 - \$87,967) impact on revenue recognized.

### (c) Credit risk

Credit risk arises from the potential that a counter party will fail to perform its obligations. The Company is exposed to credit risk from customers. In order to reduce its credit risk, the Company reviews a new customer's credit history before extending credit and conducts regular reviews of its existing customers' credit performance. The Company's maximum exposure to credit risk corresponds to the carrying value of accounts receivable and unbilled work in progress. Three customers accounted for 79% of revenue (2016 – three customers - 66%) and three customers accounted for 88% of the Company's trade receivables at December 31, 2017 (September 30, 2017 – five customers - 80%).

An allowance for doubtful accounts is established based upon factors surrounding the credit risk of specific accounts, historical trends and other information. The allowance for doubtful accounts at December 31, 2017, was \$328,331 (September 30, 2017 – \$325,884). At December 31, 2017, the Company's trade accounts receivable included amounts over 90 days old totaling \$68,579 which were not considered to be impaired and therefore not included in the allowance for doubtful accounts (September 30, 2017 - \$295,616).

### (d) Liquidity risk

Liquidity risk is the risk that the Company may not have cash available to satisfy financial liabilities as they come due. The Company actively maintains a committed credit facility to ensure that it has sufficient funds to meet current and foreseeable future financial requirements at a reasonable cost.

## SHARE INFORMATION

As at February 27, 2018, the Company had issued 99,299,276 common shares and 10,043,517 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 February 28, 2018, no shares were outstanding under the plan.

### Normal Course Issuer Bid

On March 31, 2017, the Company received approval from the TSX Venture Exchange for a further normal course issuer bid to acquire up to an aggregate of 5,052,889 outstanding common shares. As of December 31, 2017, 1,624,000 common shares had been repurchased under the new plan at an average price of \$0.18 per share. The new bid will expire March 30, 2018.

During the three months ended December 31, 2017, 242,000 shares were purchased for \$44,301. The purchases resulted in a decrease to share capital and deficit of \$12,100 and \$32,201, respectively.

Such purchases will be made through the facilities of the 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, 2017:

- The Company recorded rent expense of \$73,080 for the three months ended December 31, 2017 (2016 - \$70,560) for rental of premises from a company controlled by Emad Rizkalla, 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. On September 28, 2017, the Company renewed the lease for the four-year renewal term, which expires on December 31, 2021. The lease includes an initial net lease rate for two years with escalation provisions periodically thereafter.
- The Company recognized an expense of \$170,525 for the three months ended December 31, 2017 (2016 - \$172,925) 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 \$1,054 for the three months ended December 31, 2017 (2016 - \$9,933) for share based compensation to its key management personnel (as described above).
- The Company has provided share purchase loans to a company controlled by Derrick Rowe, the Executive chairman 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. As at December 31, 2017, the aggregate balance of the loans was \$169,816. The maturity date of the notes is December 31, 2019.

## 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 recognized deferred tax assets in the Company's financial statements for the year ended September 30, 2017. 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 is 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.

### NEW AND FUTURE ACCOUNTING STANDARDS

The following new or amended standards are effective for annual periods beginning on or after the dates indicated below, with earlier adoption permitted. The Company has not early adopted these standards and is currently assessing the impact they will have on its consolidated financial statements.

(a) IFRS 9: Financial Instruments

IFRS 9 introduces new requirements for the classification and measurement of financial assets. Under IFRS 9, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows.

IFRS 9 also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness, however it will provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship.

Special transitional requirements have been set for the application of the new general hedging model.

The Company intends to adopt IFRS 9 in its consolidated financial statements for the annual period beginning on October 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

(b) IFRS 15: Revenue from Contracts with Customers

The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized.

The new standard applies to contracts with customers. It does not apply to insurance contracts, financial instruments or lease contracts, which fall in the scope of other IFRSs. The clarifications to IFRS 15 provide additional guidance with respect to the five-step analysis, transition, and the application of the Standard to licenses of intellectual property.

The Company intends to adopt IFRS 15 and the clarifications in its consolidated financial statements for the annual period beginning on October 1, 2018. We have elected to apply IFRS 15 retrospectively and thus will restate our comparative results, with an opening adjustment to equity as at October 1, 2018.

We have conducted a preliminary assessment of the effects of the application of IFRS 15 on our interim and annual consolidated financial statements. Our preliminary analysis has identified that revenue from the sale of certain training devices currently considered as construction contracts and accounted for under the percentage-of-completion method will not meet the requirements for revenue recognition over time. This change will result in the deferral of revenue recognition to the date when control is transferred to the customer instead of revenue recognition over the construction period. The extent of the impact of adoption of the standard has not yet been determined, but could cause material fluctuations in the amount of 'Product sales' revenue recognized between reporting periods.

(c) IFRS 16: Leases

This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments.

This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided.

The Company intends to adopt IFRS 16 in its consolidated financial statements for the annual period beginning on October 1, 2019. The Company does not expect the standard to have a material impact on the financial statements.

## 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.

## DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Disclosure controls and procedures (“DC&P”) are intended to provide reasonable assurance that material information is gathered and reported to senior management to permit timely decisions regarding public disclosure. Internal controls over financial reporting (“ICFR”) are intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with Canadian generally accepted accounting principles. TSX Venture-listed companies are not required to provide representations in their annual and interim filings relating to the establishment and maintenance of DC&P and ICFR, as defined in Multinational Instrument MI 52-109.

In particular, the CEO and CFO certifying officers do not make any representations relating to the establishment and maintenance of (a) controls and other procedures designed to provide reasonable assurance that information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation, and (b) processes to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with the issuer’s GAAP.

## RISK FACTORS

The Corporation’s business is subject to a number of risks and uncertainties. The primary risks and uncertainties are described below.

- (a) Bluedrop’s revenue and operating results can be difficult to predict and can fluctuate, which may harm results of operations

Bluedrop’s revenue is difficult to forecast and may fluctuate from quarter to quarter. In addition, Bluedrop’s operating results may not follow any past trends. The factors affecting Bluedrop’s revenue and results, many of which are outside of Bluedrop’s control, include:

- limited number of long-term purchase commitments from customers and the risk that those contracts will not lead to revenues as expected or at all;
- competitive conditions in the industry, including Bluedrop’s strategic initiatives or Bluedrop’s competitors, new products or services, product or services announcements and changes in Bluedrop’s pricing policy or Bluedrop’s competitors;
- market acceptance of Bluedrop’s products and services;
- Bluedrop’s ability to maintain existing relationships and to create new relationships with channel partners;
- varying size, timing and contractual terms of orders for Bluedrop’s products and services, which may delay the recognition of revenues;
- the discretionary nature of purchase and budget cycles of Bluedrop’s end users and changes in their budgets for, and timing of, learning and training related purchases;
- the length and variability of the sales cycle for Bluedrop’s products;
- Bluedrop’s strategic decisions or Bluedrop’s competitors, such as acquisitions, divestitures, spin-offs, joint ventures, strategic investments or changes in business strategy;
- product stability and security could be compromised;
- recruitment and retention of management and other personnel is critical to Bluedrop’s ability to develop, market and support its products and services as planned;
- general weakening of the Canadian economy resulting in a decrease in the overall demand for learning and training related products and services or otherwise affecting the capital investment level of businesses with respect to Bluedrop’s simulator training systems; and
- timing of product development and new product initiatives.

Because Bluedrop’s revenue is dependent upon a relatively small number of customers, even minor variations in the rate and timing of conversion of its sales prospects into revenue could cause Bluedrop to plan or budget inaccurately, and those variations could adversely affect Bluedrop’s financial results. Delays, reductions in the amount or cancellations of end-user’s purchases would adversely affect Bluedrop’s business, results of operations and financial condition.

Any of the foregoing factors could have a material adverse effect on Bluedrop’s business, results of operations or financial condition.

- (b) Failure to manage Bluedrop's business or growth successfully may adversely affect its operating results

Bluedrop's ability to manage its business will be substantially dependent upon Bluedrop's ability to efficiently and effectively allocate resources to conduct research and development, launch new products and software in a timely and efficient manner, provide sales and marketing activities, provide adequate financial management and provide customer support services. Accordingly, Bluedrop's future results of operations will depend on the continuing ability of Bluedrop's officers and other key employees to conduct business effectively and to improve operations. Bluedrop's ability to support the growth of its business will be substantially dependent on having in place highly-trained employees and sufficient internal and third-party resources. Failure to manage successfully any such business shortfalls may have a material adverse effect on Bluedrop's business, results of operations and financial condition.

- (c) Bluedrop's success depends on its ability to develop new products and services and enhance its existing products and services

To keep pace with technological developments, satisfy increasingly sophisticated customer requirements and achieve market acceptance of its products and services, Bluedrop must enhance and improve existing products and services and also continue to introduce new products and services. If Bluedrop is unable to successfully develop new products and services or enhance and improve its existing products and services or if Bluedrop fails to position and/or price its products and services to meet market demand, Bluedrop's business and operating results will be adversely affected.

Accelerated product introductions and short software life-cycles require high levels of expenditures for research and development that could adversely affect Bluedrop's operating results. Further, any new products or software Bluedrop develops could require long development and testing periods and may not be integrated in a timely manner or may not achieve the broad market acceptance necessary to generate significant revenue.

- (d) Weaker than expected market acceptance of new products and services or new versions of Bluedrop's current products and services

Bluedrop's business may be adversely affected if its new products and services or new features do not achieve acceptance among customers. Bluedrop has developed and is continuing to develop products and services incorporating new technology and will pursue those products and services that Bluedrop expects to have the best chance for success based on Bluedrop's expectations of future market demand. However, there can be no assurances that development-stage products and software will be successfully completed or, if developed, will achieve significant customer acceptance. If Bluedrop is unable to successfully define, develop and introduce competitive new products and services, and enhance existing products and services, Bluedrop's business, financial condition and results of operations could be materially adversely affected.

- (e) Bluedrop is dependent on the expansion of its current, and development of new, distribution channels

Bluedrop sells its products and services directly to its customers and to parties with whom Bluedrop has strategic relationships. Bluedrop expects to continue to utilize these relationships to sell to companies and organizations that will utilize its products and services.

A material loss of any customers or strategic partners, either as a result of competitive products and services offered by other companies or Bluedrop's inability to penetrate its respective market segment, could have a material adverse effect on Bluedrop's business, financial condition and results of operations. There can be no assurances that Bluedrop will continue to attract customers and strategic partners and any inability to do so could materially adversely affect Bluedrop's business, financial condition and results of operations.

- (f) Bluedrop's ability to recruit and retain management and other qualified personnel is crucial to its ability to develop, market and support its products and services

Bluedrop's continued growth and success is largely dependent on the experience, abilities and dedication of its management and technical personnel. As Bluedrop 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 Bluedrop'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 Bluedrop's ability to promptly satisfy its customer needs and may therefore impede Bluedrop'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 Bluedrop's growth. The loss of certain key employees could have a significant impact on Bluedrop's business, results of operations and financial condition.

- (g) If Bluedrop's intellectual property is not adequately protected, Bluedrop may lose its competitive advantage.

Bluedrop relies on a combination of contractual provisions, copyright, trademarks, trade secrets and licenses to establish and protect its proprietary rights. Despite Bluedrop's best efforts to protect its intellectual property rights, unauthorized parties may attempt to copy aspects of Bluedrop's products and services to obtain information Bluedrop regards as proprietary. Policing unauthorized use of Bluedrop's proprietary technology, if required, may be difficult, time-consuming and costly. There can be no assurances that Bluedrop's means of protecting its proprietary rights will be adequate. Failure to protect its proprietary rights could have a material adverse effect on Bluedrop's business, results of operations and financial condition.

To protect its intellectual property, Bluedrop may become involved in litigation, which could result in substantial expenses, divert the attention of its management, cause significant delays, materially disrupt the conduct of its business or adversely affect its revenue, financial condition and results of operations.

- (h) If Bluedrop is unable to maintain the security of its systems, its business, financial condition and operating results could be harmed

The occurrence of a security breach, or perception of such a breach, in the operation of Bluedrop's business or by third parties using Bluedrop's products and services could harm its business, financial condition and operating results. Bluedrop may have access to confidential information, including passwords, financial information or other personal information from Bluedrop's customers. If, in handling this information, Bluedrop fails to comply with its customer's privacy policies or applicable privacy and security laws, Bluedrop could incur civil liability to government agencies, customers and individuals whose privacy was compromised. In addition, third parties may attempt to breach Bluedrop's security or inappropriately use Bluedrop's products and services through computer viruses, electronic break-ins and other disruptions. If successful, confidential information may be improperly obtained and Bluedrop could be subject to lawsuits and other liability. Any internal or external security breaches could harm Bluedrop's reputation and any perception of security risks, whether or not valid, could inhibit market acceptance of Bluedrop's products and services.

- (i) Bluedrop may be unable to identify and complete acquisitions, and acquisitions could divert management's attention and financial resources, may negatively affect Bluedrop's operating results, and could cause significant dilution to shareholders

Bluedrop may seek to further expand operations by acquiring additional complementary businesses, products or technologies. There can be no assurances that Bluedrop will be able to identify, acquire or profitably manage additional businesses or successfully integrate any acquired businesses, products, services or technologies into Bluedrop's business units without substantial expense, delays or other operational or financial problems. Furthermore, acquisitions may involve a number of special risks, including diversion of management's attention, expenses of amortizing the acquired company's intangible assets, failure to retain key personnel, unanticipated events or circumstances and legal liabilities, some of which could have a material adverse effect on Bluedrop's business, results of operations and financial condition. Acquisitions could also result in the potentially dilutive issuance of equity securities. Any failure to manage Bluedrop's acquisition strategy successfully could have a material adverse effect on Bluedrop's business, results of operations and financial condition.

- (j) Products and software issues may result in increases in Bluedrop's costs and/or lost revenue opportunities

Bluedrop's products and technologies are complex. Although Bluedrop employs vigorous testing and quality assurance, its products and software may contain defects or errors, particularly when first introduced or as new versions are released. Bluedrop may not discover such defects or errors until after a product or service has been released and used by the end-users. Defects and errors in Bluedrop's products and services could materially adversely affect its reputation, result in significant costs to Bluedrop, delay planned release dates and impair Bluedrop's ability to sell its products and services in the future. The costs incurred in correcting any product defect or error may be substantial and could adversely affect Bluedrop's operating margins. While Bluedrop plans to continually test its products and services and to work with end-users to identify and correct defects and errors, defects and errors in Bluedrop's products may still be found in the future.

(k) System failure could harm Bluedrop's reputation and operating results

System network failure or disruption of service, whether within Bluedrop's control or third parties, could impair Bluedrop's customers' ability to utilize its products and services for an indeterminate period of time. Bluedrop's operations depend upon its ability to maintain and protect computer systems within Bluedrop's facilities.

(l) Growth in the learning and training software business may not continue

The overall market for learning and training software products and services has experienced significant growth in recent years. There can be no assurances that the market for Bluedrop's products and services will continue to grow, that firms and organizations within the industries will adopt Bluedrop's products and services to train their employees or that Bluedrop will be able to independently establish additional markets for its products and services. If the various markets in which Bluedrop's products and services compete fail to grow or grow more slowly than Bluedrop currently anticipates, or if Bluedrop is unable to establish markets for its new products and services, its business, results of operations and financial condition could be materially adversely affected.

(m) Increased competition could have an adverse effect on Bluedrop's business

The markets for Bluedrop's products and services are highly competitive. As some of these markets continue to develop, additional competitors with more established and larger marketing and technical resources than Bluedrop may enter the market and competition may intensify. In addition, current competitors may develop products and services that are comparable or superior to Bluedrop's products and services or achieve greater market acceptance due to pricing, sales channels or other factors.

As the demand for Bluedrop's products and services increases, the quality, functionality and breadth of competing products and services will likely improve, and new competitors may enter the market. Further, the adoption of widespread industry standards may make it easier for new market entrants or existing competitors to improve their existing products and services, to offer some or all of the products and services Bluedrop offers or may offer in the future, or to offer new products or services that Bluedrop does not offer. Bluedrop can provide no assurances that its products and services will compete successfully with the products and services of Bluedrop's competitors.

Bluedrop's ability to successfully differentiate itself from its competitors and thereby establish a sustainable and profitable presence and effectively compete in the learning and training software market cannot be assured. Competitors are seeking to gain market share by introducing new technology and new products and services which may make it more difficult to sell Bluedrop's products and services. Activities of Bluedrop's competitors could have a negative impact on Bluedrop by creating increased pricing pressure, reduce profit margins, increasing sales and marketing expense or result in the loss of Bluedrop's market share. If Bluedrop is unable to effectively respond to these competitive factors, its business, results from operations and financial condition could be materially adversely affected.

(n) Third parties may allege that Bluedrop infringes on their intellectual property

The industries in which Bluedrop competes have other participants, who own, or claim to own, intellectual property. Although Bluedrop has conducted prudent reviews of Bluedrop's products and software to ensure that it does not knowingly use unlicensed intellectual property, third parties may allege that Bluedrop infringes on their intellectual property. Should such an allegation be made, the outcome of any litigation is impossible to predict and, should the outcome be unfavourable to it, Bluedrop may not be able to negotiate acceptable, or indeed any, licensing terms. Such an event could materially adversely affect Bluedrop's business, results of operations and financial condition.

In addition, some of Bluedrop's competitors have, or are affiliated with companies having, substantially greater resources than Bluedrop and these competitors may be able to sustain the costs of complex intellectual property litigation to a greater degree and for a longer period of time than Bluedrop. Regardless of their merit, any such claims could:

- be time consuming to evaluate and defend;
- result in costly litigation;
- cause product or service delivery delays or stoppages;
- subject Bluedrop to significant liabilities;
- require Bluedrop to enter into costly royalty or licensing agreements; and
- require Bluedrop to modify or stop using the infringing technology.

(o) A continued general economic downturn may negatively affect Bluedrop

A continued downturn in the global economic environment has the potential to negatively impact Bluedrop in a number of respects, including:

- impaired ability to reliably forecast revenue and profitability;
- increased pressure to reduce selling prices;
- increased potential for cancellation or loss of sales opportunities; and
- customers may experience financial difficulty leading to increased accounts receivable collection risk.

Market volatility and uncertainty in the global financial and credit markets could cause many of Bluedrop's corporate and governmental customers to reduce their level of capital and operating expenditures. Decreased capital and operating spending could have a material adverse effect on the demand for Bluedrop's products and services and business, results of operations, cash flows and overall financial condition.

Volatility in the financial markets may adversely impact the availability of credit and funding already arranged and the availability and cost of credit and capital in the future, which could result in the delay or cancellation of possible future acquisitions. The disruptions in the financial markets may have an adverse impact on regional and world economies and credit markets which could negatively impact the capital and operating expenditures of Bluedrop's corporate and government customers. These conditions may reduce the willingness or ability of customers and prospective customers to commit funds to purchase Bluedrop's products and services, or their ability to pay for Bluedrop's products and services after purchase or initial subscription. These conditions could result in bankruptcy or insolvency for Bluedrop's corporate customers which would impact Bluedrop's revenues and cash collections. These conditions could also result in pricing pressure, less favourable financial terms and an increased level of risk assumed in Bluedrop's contracts. Bluedrop is unable to predict the likely duration and severity of the current disruption in global financial markets and adverse economic conditions in North America and around the world.

(p) Economic and geopolitical uncertainty may negatively affect Bluedrop

The market for Bluedrop's products and services depends on economic and geopolitical conditions affecting the broader market. Economic conditions globally are beyond Bluedrop's control. In addition, acts of terrorism and the outbreak of hostilities and armed conflicts between countries can create geopolitical uncertainties that may affect the global economy. Downturns in the economy or geopolitical uncertainties may cause end-users to delay, reduce or cancel orders or subscriptions for Bluedrop's products and services, any of which could have a material adverse effect on Bluedrop's business, results of operations and financial position.

(q) Bluedrop derives a substantial part of its revenue from a few key customers

A key element of Bluedrop's business strategy is to expand the market for its products and services by expanding its relationships with major defence contractors and governmental agencies in the learning and training software business. In order to implement that strategy, Bluedrop will have to foster its existing relationships, and to form new relationships with defence contractors, governmental agencies and other corporate entities. There can be no assurance that Bluedrop will be able to develop additional relationships that existing relationships will continue or be successful in achieving their purposes, or that such companies or organizations will not form competing relationships.

(r) Bluedrop's revenues are substantially concentrated in two market categories

The Training and Simulation Business generated 88% of Bluedrop's revenues, and the Learning Networks Business generated 12% of Bluedrop's revenues, in the financial three months ended December 31, 2017. A decline in demand for these products and services as a result of competition, technological change or other factors could have a material adverse effect on Bluedrop's business, results of operations and financial condition.

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

(s) Bluedrop's business faces risks associated with public budgets, spending policies and government assistance programs

Bluedrop sells its products and services to, among other customers, governments and governmental entities. 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.

Bluedrop's business also relies on government assistance programs such as federal and provincial tax credit programs. These programs can be amended or terminated by the applicable government with little or no notice to Bluedrop. Bluedrop's claims under these assistance programs may also be rejected, which could negatively impact Bluedrop's income and financial condition.

- (t) Bluedrop's revenues from customer contracts are subject to the creditworthiness of its customers

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. Bluedrop utilizes credit evaluation, approval and monitoring processes intended to mitigate potential credit risks with respect to trade receivables. Bluedrop's maximum exposure to credit risk, with respect to accounts receivable and unbilled work in progress corresponds to the carrying value.

- (u) Bluedrop's ability to obtain funding from new equity or additional debt may be limited

Bluedrop depends on equity and debt financing to fund the ongoing development of the Corporation's technology assets. Raising additional funding on a timely basis may be adversely impacted by uncertain market conditions and the availability of appropriate financing opportunities. Bluedrop's inability to access sufficient funding for its operations or any intended acquisitions could have an adverse effect on its 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. During the second quarter of the fiscal year, 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. As of December 31, 2017, the Company has drawn \$3.0 million on this loan. 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 early stages of the launch. The Company continues to target key initial accounts to validate the products and platform services in 2018 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 relatively slow start to the 2017 fiscal year but reached the fourth milestone on the construction of the Bell 206 Level 7 Flight Device during the fourth quarter, with delivery expected in the third quarter of fiscal 2018. The \$1.5 million of research and development in 2017 resulted in significant advances in developing the Chinook Rear Crew Mission Trainer ("RCMT"), which was completed and delivered to Boeing during the fourth quarter. The RCMT is a unique training device that allows rear crew operators to rehearse missions and specific tasks in a virtual and augmented reality environment. The product has been designed to allow for further cost-effective adaptations of the RCMT and part task trainers to other Original Equipment Manufacturer ("OEM") platforms for additional rotary wing or fixed wing configurations for both defence or civilian training applications. 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 2017. The development of this proprietary technology to ensure the end user value proposition is well demonstrated is a key strategic focus for the business unit. 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. Management of the Company is continuing to explore opportunities in the workplace compliance market through partnering with other stakeholders that will create a scalable, lower-cost option to sell the platform to new stakeholders, balancing large customer sales cycles. The platform has also been successfully deployed in a workforce skills enhancement program in the US with an objective of reducing

delivery costs and improving outcomes for job seekers. During the fourth quarter, the Province of Newfoundland and Labrador entered into an agreement in principle with Bluedrop Learning Networks to utilize this technology over a four-year term. The business unit will continue to pursue several other opportunities throughout fiscal 2018.

