chorus aviation inc.

Unaudited Interim Condensed Consolidated Financial Statements
June 30, 2014

chorus aviation inc.

Unaudited Consolidated Statements of Financial Position

(expressed in thousands of Canadian dollars)

	June 30, 2014 $	December 31, 2013 $
Assets		
Current assets		
Cash and cash equivalents	106,418	159,901
Restricted cash	3,320	3,320
Accounts receivable – trade and other	66,658	76,891
Inventories	47,164	45,121
Prepaid expenses and deposits	22,492	22,896
Total current assets	246,052	308,129
Property and equipment	576,774	594,650
Goodwill	6,693	6,693
Other assets	52,183	67,453
	881,702	976,925
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	212,061	207,334
Current portion of obligations under finance leases	3,518	3,356
Current portion of long-term incentive plan	2,929	—
Current portion of long-term debt	31,991	31,354
Dividends payable	13,584	13,786
Convertible debentures (note 4)	—	78,535
Income tax payable	—	1,737
Total current liabilities	264,083	336,102
Obligations under finance leases	1,285	3,073
Long-term debt	356,464	371,445
Deferred income tax (note 5)	42,067	35,790
Other long-term liabilities	45,268	44,534
	709,167	790,944
Equity	172,535	185,981
	881,702	976,925

Economic dependence (note 7)
Contingencies (note 9)

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

Unaudited Consolidated Statements of Changes in Equity

(expressed in thousands of Canadian dollars)

	Capital $	Deficit $	Contributed surplus $	Equity component of convertible debentures $	Total $
Balance - December 31, 2012	3,628	(932,315)	1,051,305	9,497	132,115
Net income for the period	—	17,079	—	—	17,079
Other comprehensive income for the period (net of tax)	—	15,068	—	—	15,068
Comprehensive income for the period	—	32,147	—	—	32,147
Dividends	—	(27,903)	—	—	(27,903)
Repurchase of shares under normal course issuer bid	(48)	—	(2,517)	—	(2,565)
Share issuance for stock-based compensation plans	1,566	—	(3,068)	—	(1,502)
Expense related to stock-based compensation plans	—	—	1,278	—	1,278
Balance - June 30, 2013	5,146	(928,071)	1,046,998	9,497	133,570
Net income for the period	—	44,787	—	—	44,787
Other comprehensive income for the period (net of tax)	—	30,525	—	—	30,525
Comprehensive income for the period	—	75,312	—	—	75,312
Dividends	—	(22,977)	—	—	(22,977)
Repurchase of shares under normal course issuer bid	(30)	—	(1,411)	—	(1,441)
Expense related to stock-based compensation plans	—	—	1,517	—	1,517
Balance - December 31, 2013	5,116	(875,736)	1,047,104	9,497	185,981
Net income for the period	—	42,120	—	—	42,120
Other comprehensive loss for the period (net of tax)	—	(15,289)	—	—	(15,289)
Comprehensive income for the period	—	26,831	—	—	26,831
Dividends	—	(27,370)	—	—	(27,370)
Repurchase of shares under normal course issuer bid (note 6)	(75)	—	(7,219)	—	(7,294)
Redemption of convertible debentures (note 6)	—	—	9,497	(9,497)	—
Conversion of convertible debentures (note 6)	9	—	—	—	9
Expense related to stock-based compensation plans	—	—	471	—	471
Reclassification of stock-based compensation from equity settled to cash settled liability (note 3)	—	—	(6,093)	—	(6,093)
Balance - June 30, 2014	5,050	(876,275)	1,043,760	—	172,535

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

Unaudited Consolidated Statements of Income
For the three and six-month periods ended June 30, 2014 and 2013

(expressed in thousands of Canadian dollars, except earnings per share)

	Three months ended June 30,		Six months ended June 30,	
	2014	**2013**	**2014**	**2013**
	$	**$**	**$**	**$**
Operating revenue (note 7)				
Passenger	414,300	407,328	825,121	820,720
Other	3,536	2,969	7,296	5,857
	417,836	410,297	832,417	826,577
Operating expenses (note 7)				
Salaries, wages and benefits	103,419	100,681	207,534	209,259
Aircraft fuel	96,651	89,406	192,112	186,099
Depreciation and amortization	16,395	16,247	32,482	29,638
Food, beverage and supplies	4,373	4,778	8,624	8,777
Aircraft maintenance materials, supplies and services	41,889	37,874	81,443	75,066
Airport and navigation fees	42,303	50,196	81,789	98,271
Aircraft rent	23,001	22,234	46,653	45,130
Terminal handling services	24,326	25,141	55,321	58,875
Other	31,211	32,037	60,959	62,930
	383,568	378,594	766,917	774,045
Operating income	34,268	31,703	65,500	52,532
Non-operating income (expenses)				
Interest revenue	216	368	537	593
Interest expense	(3,984)	(6,537)	(10,149)	(11,516)
Gain on disposal of property and equipment	71	27	87	87
Foreign exchange gain (loss)	11,817	(13,008)	(1,784)	(18,047)
Other	500	—	500	750
	8,620	(19,150)	(10,809)	(28,133)
Income before income taxes	42,888	12,553	54,691	24,399
Income tax expense (note 5)				
Current income tax	(414)	(317)	(546)	(679)
Deferred income tax	(5,976)	(4,337)	(12,025)	(6,641)
	(6,390)	(4,654)	(12,571)	(7,320)
Net income	36,498	7,899	42,120	17,079
Earnings per share, basic	0.30	0.06	0.34	0.14
Earnings per share, diluted	0.29	0.06	0.34	0.14

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

chorus aviation inc.

Unaudited Consolidated Statements of Comprehensive Income
For the three and six-month periods ended June 30, 2014 and 2013

(expressed in thousands of Canadian dollars)

	Three months ended June 30,		Six months ended June 30,	
	2014	**2013**	**2014**	**2013**
	$	**$**	**$**	**$**
Net income	36,498	7,899	42,120	17,079
Other comprehensive (loss) income				
Items that will not be subsequently reclassified to the statements of income				
Actuarial (loss) gain on employee benefit liabilities, net of tax (recovery) expense of ($2,256 and $5,748) and (2013 - $4,614 and $5,543)	(5,998)	12,526	(15,289)	15,068
Comprehensive income	30,500	20,425	26,831	32,147

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

Unaudited Consolidated Statements of Cash Flows

For the three and six-month periods ended June 30, 2014 and 2013

(expressed in thousands of Canadian dollars)

	Three months ended June 30,		Six months ended June 30,	
	2014	**2013**	**2014**	**2013**
	$	**$**	**$**	**$**
Cash provided by (used in)				
Operating activities				
Net income	36,498	7,899	42,120	17,079
Charges (credits) to operations not involving cash				
Depreciation and amortization	16,395	16,247	32,482	29,638
Amortization of prepaid aircraft rent and related fees	595	526	1,191	1,131
Gain on disposal of property and equipment	(71)	(27)	(87)	(87)
Stock-based compensation	64	643	471	1,278
Unrealized foreign exchange (gain) loss on long-term debt and finance leases	(14,301)	13,529	411	19,095
Current income tax expense	414	317	546	679
Deferred income tax expense	5,976	4,337	12,025	6,641
Accretion of debt component of convertible debentures	163	438	1,675	869
Other	2,610	1,882	4,647	2,439
	48,343	45,791	95,481	78,762
Net changes in non-cash balances related to operations (note 10)	(1,571)	953	(2,974)	928
	46,772	46,744	92,507	79,690
Financing activities				
Repayment of obligations under finance leases	(852)	(730)	(1,689)	(1,436)
Long-term borrowings	—	3,482	—	120,968
Repayment of long-term borrowings	(7,801)	(6,196)	(14,715)	(10,179)
Restricted cash related to aircraft financing	—	—	—	(5,930)
Redemption of convertible debentures (note 4)	(20,201)	—	(80,201)	—
Repurchase of shares under normal course issuer bid	(7,294)	(2,565)	(7,294)	(2,565)
Dividends	(13,786)	(18,662)	(27,572)	(37,264)
	(49,934)	(24,671)	(131,471)	63,594
Investing activities				
Additions to property and equipment	(7,906)	(18,535)	(14,606)	(141,471)
Proceeds on disposal of property and equipment	71	27	87	87
Decrease in restricted cash related to letters of credit	—	1,205	—	2,696
	(7,835)	(17,303)	(14,519)	(138,688)
Net change in cash and cash equivalents during the periods	(10,997)	4,770	(53,483)	4,596
Cash and cash equivalents – Beginning of periods	117,415	118,132	159,901	118,306
Cash and cash equivalents – End of periods	106,418	122,902	106,418	122,902
Cash payments of interest	4,660	3,196	8,665	5,182
Cash receipts of interest	203	365	581	669
Cash payments of tax	293	882	2,493	1,501
Cash and cash equivalents comprise:				
Cash	106,418	97,924	106,418	97,924
Term deposits and fixed income securities	—	24,978	—	24,978

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

(expressed in thousands of Canadian dollars, except shares, share prices and earnings per share)

1 General information

Chorus Aviation Inc. ("Chorus") was incorporated on September 27, 2010 pursuant to the *Canada Business Corporations Act*. On November 18, 2010, Chorus incorporated Aviation General Partner Inc. to act as general partner for Jazz Aviation LP (the "Partnership"). On January 5, 2011, substantially all of the assets of Jazz Air LP were transferred to the Partnership and the airline business previously carried on by Jazz Air LP is now carried on by the Partnership. On February 28, 2011, Chorus incorporated Chorus Leasing I Inc., Chorus Leasing II Inc., and Chorus Leasing III Inc. (collectively, the "Initial LeaseCos"), which were established for the sole purpose of acquiring Q400 NextGen turboprop aircraft ("Q400 aircraft") and related equipment with financing from Export Development Canada ("EDC"). On December 31, 2012, the Initial LeaseCos were reorganized as follows: Chorus Leasing I Inc. and Chorus Leasing II Inc. amalgamated to form Chorus Leasing Amalco (2012) Inc. ("Amalco"), and Chorus Leasing III Inc. then acquired the assets and liabilities of Amalco. Amalco was then wound up into Chorus Aviation Inc.

On November 28, 2013, Chorus incorporated Chorus Aviation Holdings Inc. ("CAHI") and CAHI incorporated Chorus Airport Services Inc. ("CASI"). CAHI was established to act as a holding company and CASI was established for the purpose of providing airport handling services. On December 31, 2013, Chorus' subsidiaries were reorganized as follows: Chorus incorporated Jazz Aviation Holdings Inc. ("JAHI"), JAHI incorporated Jazz Aircraft Financing Inc. ("JAFI") and JAFI incorporated Jazz Leasing Inc. ("JLI"). Chorus Leasing III Inc. and 7503695 Canada Inc. amalgamated to form Chorus Leasing III Inc. ("CL3 Amalco"). CL3 Amalco transferred the majority of its assets to JLI and JAFI assumed the EDC financing obligations from CL3 Amalco. CL3 Amalco was then wound up into Chorus Aviation Inc.

The registered office of Chorus is located at 100 King Street West, 1 First Canadian Place, Suite 6100, P.O. Box 50, Toronto, Ontario, M5X 1B8 and its country of domicile is Canada.

References to Chorus in the following notes to the consolidated financial statements refer, as the context may require, to Chorus Aviation Inc. and its subsidiaries collectively, Chorus and one or more of its current and former subsidiaries, one or more of Chorus' current and former subsidiaries, or Chorus itself. In the context of the Amended and Restated Capacity Purchase Agreement, references to Chorus are exclusively intended to refer to the Partnership.

Chorus is a holding company with various aviation interests. Its principal business is the Partnership which operates the largest regional airline, and the second largest airline in Canada after Air Canada, based on fleet size. Through the Partnership, Chorus provides a significant part of Air Canada's domestic and transborder network. Chorus is economically and commercially dependent upon Air Canada and one of its subsidiaries, as, in addition to being Chorus' primary source of revenue, these entities currently provide significant services and aircraft to Chorus. Chorus and Air Canada are parties to an Amended and Restated Capacity Purchase Agreement, effective January 1, 2006, as amended by agreements (the "Rate Amending Agreements") dated July 6, 2009, August 6, 2012 and June 3, 2013 and amending agreements (the "CPA Amending Agreements") dated September 22, 2009, March 8, 2011 and June 6, 2013 (collectively, the "CPA"), under which Air Canada currently purchases the greater part of Chorus' fleet capacity on aircraft operated by Chorus (the "Covered Aircraft") at predetermined rates (the "Rates").

Under the CPA, Chorus experiences greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters of the calendar year. Chorus has substantial fixed costs that do not meaningfully fluctuate with passenger demand in the short-term. Chorus' revenues do not fluctuate significantly with passenger load factors.

2 Basis of presentation

These financial statements are in compliance with International Accounting Standards 34, Interim Financial Reporting ("IAS 34"). Accordingly, certain information included in annual financial statements prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board, have been omitted or condensed. The preparation of financial statements in accordance with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying Chorus' accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements, have been set out in note 3 of Chorus' annual consolidated financial statements for the year ended December 31, 2013. These financial statements should be read in conjunction with Chorus' consolidated financial statements for the year ended December 31, 2013.

These financial statements have been authorized for issuance by the Board of Directors on August 13, 2014.

3 Significant accounting policies

Except as otherwise indicated hereunder, these financial statements have been prepared using the same policies and methods of computation as the annual consolidated financial statements of Chorus for the year ended December 31, 2013.

Update to accounting policies

Stock-based compensation

Long-term incentive plan

In the first quarter of 2014, pursuant to Chorus' long-term incentive plan ("LTIP") eligible employees were given the option to elect prior to vesting whether to receive cash or shares for their restricted share units ("RSU") that vested in the quarter. As a result, effective February 24, 2014 the RSU obligation changed from an equity settled obligation, accounted for in contributed surplus, to a cash settled obligation, recognized in the appropriate short and long-term liability accounts in the Statement of Financial Position. The liability is adjusted quarterly to reflect the number of RSUs expected to vest and the fair market value of the RSUs at the end of the reporting period. Changes to the outstanding RSU liability are accounted for in salaries, wages and benefits expense in the Statement of Income.

Stock options

In the second quarter of 2014, the Board of Directors granted equity-settled stock options with a three year vesting period pursuant to the LTIP. The fair value of the stock options are determined at the time of the grant using a Black-Scholes option pricing model. The fair value of the options are recognized as expense over the vesting period, based on the number of options expected to vest, with a corresponding entry to equity.

Amendments to standards

IFRS 9, Financial Instruments, has been amended to bring into effect a substantial overhaul of hedge accounting that will allow entities to better reflect the risk management activities in their financial statements. Chorus early adopted the amendments to this standard effective January 1, 2014. The amendments to this standard have no impact on Chorus' consolidated financial statements.

(expressed in thousands of Canadian dollars, except shares, share prices and earnings per share)

3 Significant accounting policies (continued)

Accounting standards issued but not yet applied

The IASB issued IFRS 15, “Revenue from Contracts with Customers” ("IFRS 15") effective for annual periods beginning on or after January 1, 2017. IFRS 15 establishes a new control-based revenue recognition model and replaces IAS 18, “Revenue”, IAS 11, “Construction Contracts”, and some revenue related interpretations. Chorus is currently evaluating the impact of the new standard on its consolidated financial statements.

4 Convertible debentures

On each of February 10, 2014 and June 20, 2014 (the "Early Redemption Dates"), Chorus exercised its right to redeem outstanding 9.50% convertible unsecured subordinated debentures ("Debentures") in the aggregate principal amount of $80,201. On June 20, 2014, prior to redemption, $9 of the Debenture principal was converted to equity. Chorus redeemed the Debentures by paying the outstanding principal amount of the redeemed Debentures (the "Redemption Price"), together with all accrued and unpaid interest thereon up to but excluding the Early Redemption Dates. The Debentures that were redeemed ceased to bear interest from, and subsequent to, the Early Redemption Dates. Chorus used surplus cash to pay the Redemption Price together with all accrued and unpaid interest thereon as described above. As a result of the conversion and redemption, $9,497 of the equity component of the Debentures has been reclassified to contributed surplus in the Statement of Changes in Equity and the Debenture liability has been extinguished.

5 Income taxes

The effective rate on Chorus' earnings before income tax differs from the expected amount that would arise using the combined Canadian Federal and Provincial statutory income tax rates. A reconciliation of the difference is as follows:

	Three months ended June, 30,			
	2014 %	**2014 $**	**2013 %**	**2013 $**
Income tax expense at the Canadian statutory tax rate	29.2	12,540	25.1	3,152
Recognition of previously unrecognized cumulative eligible capital	(5.6)	(2,426)	(21.1)	(2,654)
Net impact of capital items (1)	(9.9)	(4,244)	35.4	4,447
Non-deductible expenses	1.2	520	2.3	289
Impact of tax rate changes and tax rate differential	—	—	(4.6)	(580)
Income tax expense	14.9	6,390	37.1	4,654

(expressed in thousands of Canadian dollars, except shares, share prices and earnings per share)

5 Income taxes (continued)

	Six-months ended June, 30,			
	2014	**2014**	**2013**	**2013**
	%	**$**	**%**	**$**
Income tax expense at the Canadian statutory tax rate	28.4	15,514	25.5	6,229
Recognition of previously unrecognized cumulative eligible capital	(8.9)	(4,886)	(21.5)	(5,245)
Net impact of capital items (1)	1.0	530	24.6	6,012
Non-deductible expenses	2.5	1,413	3.8	904
Impact of tax rate changes and tax rate differential	—	—	(2.4)	(580)
Income tax expense	23.0	12,571	30.0	7,320

(1) The impact of capital items is mainly related to the foreign exchange fluctuations on the long-term debt associated with the purchase of the Q400 aircraft, of which the impact of the non-deductible (non-taxable) portion of any unrealized loss (gain) is considered in the calculation of income tax expense at the end of each period. To the extent that a capital loss is recorded for accounting purposes, the benefit of the deductible portion of the loss is recognized only to the extent that it is probable that the loss will be utilized. Income tax expense related to unrealized foreign exchange gains recorded in a period is reduced by previously unrecognized income tax assets related to unrealized foreign exchange losses. Chorus does not have a plan in place to utilize the deductible portion of the balance of the foreign exchange losses, accordingly no deferred tax asset has been recognized related to the foreign exchange losses. As at June 30, 2014, approximately 4% of the cumulative impact of the foreign exchange fluctuations since the issuance of the debt have been realized through principal repayments.

In addition to the tax deductible amounts recognized as deferred tax assets in the financial statements, Chorus has other tax deductible amounts of approximately $491,329, as at June 30, 2014, related to cumulative eligible capital. In accordance with the initial recognition exemption, as outlined in IAS 12, the benefit of these deductible expenditures cannot be recognized in the financial statements until such time that those benefits can be applied to reduce current tax expense. During the three and six months ended June 30, 2014, Chorus utilized a total of $8,879 ($2,426 tax effected) and $17,886 ($4,886 tax effected), respectively, of these previously unrecognized tax deductions to reduce its taxable income. During the three and six months ended June 30, 2013, Chorus utilized a total of $9,547 ($2,654 tax effected) and $19,232 ($5,245 tax effected), respectively, of these previously unrecognized tax deductions to reduce its taxable income.

As at June 30, 2014, Chorus had $24,357 (December 31, 2013 - $20,363) of allowable capital losses that have not been recognized as a deferred tax asset, as Chorus has no current plan in place to utilize these losses.

(expressed in thousands of Canadian dollars, except shares, share prices and earnings per share)

6 Capital stock

Capital stock

a) Authorized:

An unlimited number of Class A Variable Voting Shares, no par value ("Variable Voting Shares"); and
An unlimited number of Class B Voting Shares, no par value ("Voting Shares")

Issued and outstanding:

	Number of Shares[1]	$
Shares issued and outstanding December 31, 2012	124,015,471	3,628
Shares issued[2]	398,355	1,566
Shares repurchased[3]	(1,871,800)	(78)
Shares issued and outstanding December 31, 2013	122,542,026	5,116
Shares issued[4]	1,713	9
Shares repurchased[5]	(1,793,800)	(75)
Shares issued and outstanding June 30, 2014	120,749,939	5,050

1) References to "Shares" above are inclusive of Variable Voting Shares and Voting Shares. As at June 30, 2014, Chorus had 4,397,234 Variable Voting Shares (December 31, 2013 - 4,789,193) and 116,352,705 Voting Shares (December 31, 2013 - 117,752,833).
2) On February 25, 2013 Chorus issued 398,355 Voting Shares to satisfy the vesting of the stock-based compensation plans. The shares were issued at market price at closing on the day of issuance, net of the amount Chorus paid in withholding taxes on behalf of the employees.
3) On March 14, 2013, Chorus announced that it had received approval from the Toronto Stock Exchange to make a normal course issuer bid to purchase up to 11,093,612 Shares during the period March 18, 2013 to no later than March 17, 2014. From April 1 to December 31, 2013, Chorus repurchased and cancelled 1,871,800 Shares under its normal course issuer bid at an aggregate cost of $4,006. Share capital was reduced by $78 and the remaining $3,928 was accounted for as a reduction of contributed surplus.
4) On June 20, 2014, $9 of Debenture principal was converted into 1,713 Shares.
5) On March 27, 2014, Chorus announced that it had received approval from the Toronto Stock Exchange to implement a second normal course issuer bid to purchase up to 12,168,157 Shares during the period March 31, 2014 to no later than March 30, 2015. From April 1, 2014 to June 30, 2014, Chorus purchased and cancelled 1,793,800 Shares under its normal course issuer bid at an aggregate cost $7,294. Share capital was reduced by $75 and the remaining $7,219 was accounted for as a reduction of contributed surplus. Prior to June 30, 2014 Chorus had trade confirmations with respect to the purchase of an additional 66,200 Shares but settlement for those trades was not effected until after June 30, 2014. Settlement has now been effected and those additional 66,200 Shares have also been cancelled. Any further Shares purchased under the normal course issuer bid will also be cancelled.

b) Stock options

On May 20, 2014, Chorus granted 5,350,000 stock options to certain executive employees of the company. The options have a three year vesting period and expire five years from the date of grant. The share price at the time of the grant was $3.84 and all options have a strike price of $4.50. Expected volatility was determined by calculating the historical volatility of the Chorus shares over a period equal to the expected life of the options, five years. The risk free rate is based on the the Government of Canada three to five year monthly average bond yield. Dividend yield is based on the average yield since Chorus announced the current dividend rate of $0.45 per share on December 10, 2013. The fair value of the options on the grant date, calculated using the Black-Scholes share option pricing model, is estimated to be $1,771.

During the three and six months ended June 30, 2014, Chorus expensed $64 related to stock-based compensation expense, with an offsetting entry to contributed surplus in the statement of changes in equity. At June 30, 2014 there are no options that are exercisable.

(expressed in thousands of Canadian dollars, except shares, share prices and earnings per share)

7 Economic dependence

The transactions between Air Canada, and its subsidiary (Air Canada Capital Ltd.), and Chorus are summarized in the table below:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	$	$	$	$
Operating revenue				
Air Canada	411,324	402,594	819,654	813,733
Operating expenses				
Air Canada	16,152	16,530	36,519	37,971
Air Canada Capital Ltd.	21,149	19,954	42,653	39,620

The following balances with Air Canada and its subsidiary (Air Canada Capital Ltd.) are included in the financial statements:

	June 30, 2014 $	December 31, 2013 $
Accounts receivable		
Air Canada	59,264	58,682
Accounts payable and accrued liabilities		
Air Canada	68,496	60,403
Air Canada Capital Ltd.	7,786	7,768

Other

Air Canada provides certain supplies from third parties, primarily fuel, to Chorus and subsequently collects payment from Chorus. As these transactions and balances merely represent a method of settlement for transactions in the normal course of business, they have not been separately disclosed. Air Canada also provides ground handling services.

Substantially all of the trade receivable from Air Canada relates to outstanding balances under the CPA.

The balances in accounts payable and accrued liabilities are payable on normal trade terms and have arisen from the services provided by the applicable party.

8 Financial instruments and fair values

Financial assets and liabilities have been classified into categories that determine their basis of measurement and, for items measured at fair value, whether changes in fair value are recognized in the statement of income or comprehensive income. Those categories are: fair value through profit or loss; fair value through other comprehensive income; and amortized cost. With the exception of the items noted below, all financial instruments have fair values that approximate carrying value due to their short-term nature.

Chorus' financial instruments consist of cash and cash equivalents, restricted cash, accounts receivable, asset backed commercial paper, accounts payable and accrued liabilities, dividends payable, LTIP liability, obligations under finance leases and long-term debt.

The following financial instruments have fair values that differ from carrying value:

- Long-term debt

  At June 30, 2014, the fixed rate term loans had a fair value of $391,195 compared to a carrying value of $388,455. The fair values were calculated by discounting the future cash flow of the respective long-term debt at the estimated yield to maturity of similar debt instruments.

9 Contingencies

The Canada Business Corporations Act, as amended (the "CBCA") provides that the Directors will act honestly and in good faith with a view to the best interest of Chorus and, in connection with that duty, will exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. The CBCA and bylaws of Chorus provide that each Director will be entitled to indemnification from Chorus in respect of the exercise of the Director's power and the discharge of the Director's duties, provided that the Director acted honestly and in good faith with a view to the best interests of all shareholders, or in the case of a criminal or administrative action proceeding that is enforced by a monetary penalty, where the Director had reasonable grounds for believing that his/her conduct was lawful. Chorus and its subsidiaries have agreed to indemnify their respective directors and officers against certain costs and damages incurred by the directors and officers as a result of lawsuits or any other judicial, administrative or investigative proceeding in which the directors and officers are sued as a result of their service. The directors and officers are also covered by directors' and officers' liability insurance. No claims with respect to such occurrences have been made and, as such, no amount has been recorded in these financial statements with respect to these indemnifications.

Various other lawsuits and claims that have arisen in the normal course of business are pending by and against Chorus. The provisions, if any, that have been recorded are not material. It is the opinion of management that final determination of these claims will not have a material adverse effect on the financial position or the results of Chorus.

Chorus enters into various operating agreements and real estate licenses or leases, which in some cases permit Chorus to use certain premises and/or operate at certain airports, and which in other cases lease space in Chorus' facilities to its tenants. It is common in such commercial license or lease transactions for the licensee or tenant to agree to indemnify the landlord for tort liabilities that arise out of or relate to its use or occupancy of the licensed or leased premises. In certain cases, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but generally excludes any liabilities caused by their gross negligence or willful misconduct. In addition, the licensee or tenant, as the case may be, typically indemnifies the landlord for any environmental liability that arises out of or relates to its use or occupancy of the leased or licensed premises.

(expressed in thousands of Canadian dollars, except shares, share prices and earnings per share)

9 Contingencies (continued)

In aircraft, engine and other equipment ("Equipment") financing or leasing agreements, Chorus typically indemnifies the financing or leasing parties, directors acting on their behalf and other related parties against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the Equipment and for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, but generally excluding any liabilities caused by their gross negligence or willful misconduct. In addition, in certain equipment financing or leasing transactions, Chorus typically provides indemnities in respect of certain tax consequences.

When Chorus enters into other types of leases and technical service agreements with service providers, primarily service providers who operate an airline as their main business, Chorus has from time to time agreed to indemnify the other party against liabilities that arise from third party claims, whether or not these liabilities arise out of or relate to the negligence of the other party, but generally excluding liabilities that arise from the other parties' gross negligence or wilful misconduct.

10 Statement of cash flows - supplementary information

Net changes in non-cash balances related to operations:

	Three months ended June 30,		Six months ended June 30,	
	2014	**2013**	**2014**	**2013**
	$	**$**	**$**	**$**
Decrease (increase) in accounts receivable – trade and other	1,504	18,530	5,651	(1,995)
Decrease (increase) in inventories	630	(5,882)	(2,043)	(6,779)
(Increase) decrease in prepaid expenses	(5,134)	1,706	(140)	905
(Increase) decrease in other assets	(1,813)	1,728	(6,760)	1,799
Increase (decrease) in accounts payable and accrued liabilities	3,689	(10,923)	356	11,743
Increase in current portion of long-term incentive plan	625	—	884	—
Decrease in other long-term liabilities	(1,072)	(4,206)	(922)	(4,745)
	(1,571)	953	(2,974)	928