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Unaudited Interim Condensed Consolidated Financial Statements of

NAV CANADA

Three and nine months ended May 31, 2020 and 2019

Interim Condensed Consolidated Statements of Operations (unaudited)

(millions of Canadian dollars)

	Notes	Three months ended May 31 2020	Three months ended May 31 2019	Nine months ended May 31 2020	Nine months ended May 31 2019
Revenue					
Customer service charges	3	$ 141	$ 338	$ 798	$ 986
Other revenue		18	13	47	39
		159	351	845	1,025
Operating expenses					
Salaries and benefits	4	244	261	786	761
Technical services		37	29	103	83
Facilities and maintenance		15	18	51	54
Depreciation and amortization	7, 8	41	39	117	115
Other		14	20	50	62
		351	367	1,107	1,075
Other (income) and expenses					
Finance income		(2)	(3)	(5)	(11)
Net interest expense relating to employee benefits		16	9	47	28
Other finance costs	6	127	19	158	56
Other net gains		(12)	(10)	(15)	(14)
		129	15	185	59
Net loss, before income tax and net movement in regulatory deferral accounts		(321)	(31)	(447)	(109)
Income tax recovery	6	(27)	-	(27)	-
Net loss, before net movement in regulatory deferral accounts		(294)	(31)	(420)	(109)
Net movement in regulatory deferral accounts related to net loss, net of tax	5	280	17	359	49
Net loss, after net movement in regulatory deferral accounts	1	$ (14)	$ (14)	$ (61)	$ (60)

See accompanying notes to unaudited interim condensed consolidated financial statements.

NAV CANADA

Interim Condensed Consolidated Statements of Comprehensive Loss (unaudited)

(millions of Canadian dollars)

	Notes	Three months ended May 31 2020	Three months ended May 31 2019	Nine months ended May 31 2020	Nine months ended May 31 2019
Net loss, after net movement in regulatory deferral accounts		$ (14)	$ (14)	$ (61)	$ (60)
Other comprehensive income (loss)					
Items that will be reclassified to income or (loss):					
Amortization of loss on cash flow hedge		-	-	1	-
Changes in fair value of cash flow hedges		-	(6)	-	(10)
Net movement in regulatory deferral accounts related to other comprehensive income		-	6	(1)	10
		-	-	-	-
Total other comprehensive income (loss)		-	-	-	-
Total comprehensive loss	1	$ (14)	$ (14)	$ (61)	$ (60)

See accompanying notes to unaudited interim condensed consolidated financial statements.

Interim Condensed Consolidated Statements of Financial Position (unaudited)

(millions of Canadian dollars)

	Notes	May 31 2020	August 31 2019
Assets			
Current assets			
Cash and cash equivalents	10	$ 918	$ 30
Accounts receivable and other		81	98
Investments		73	72
Other		14	13
		1,086	213
Non-current assets			
Investment in preferred interests	6	352	439
Property, plant and equipment	7	742	750
Intangible assets	8	884	906
Investment in equity-accounted investee		7	6
Related party loan receivable		3	3
Other non-current assets		2	1
		1,990	2,105
Total assets		3,076	2,318
Regulatory deferral account debit balances	5	2,263	2,087
Total assets and regulatory deferral account debit balances		$ 5,339	$ 4,405

See accompanying notes to unaudited interim condensed consolidated financial statements.

Interim Condensed Consolidated Statements of Financial Position (unaudited)

(millions of Canadian dollars)

	Notes	May 31 2020	August 31 2019
Liabilities			
Current liabilities			
Bank loan	9	$ 223	$ 8
Trade and other payables		253	242
Deferred revenue		16	7
Current portion of long-term debt	9	275	25
Other current liabilities		3	1
		770	283
Non-current liabilities			
Long-term debt	9	2,013	1,443
Employee benefits		2,364	2,226
Deferred tax liability	6	23	48
Lease liability		4	-
Other non-current liabilities		1	1
		4,405	3,718
Total liabilities		5,175	4,001
Equity			
Retained earnings (deficit)		(33)	28
Total equity		(33)	28
Total liabilities and equity		5,142	4,029
Regulatory deferral account credit balances	5	197	376
Commitments	11		
Total liabilities, equity and regulatory deferral account credit balances		$ 5,339	$ 4,405

See accompanying notes to unaudited interim condensed consolidated financial statements.

Interim Condensed Consolidated Statements of Changes in Equity (unaudited)

(millions of Canadian dollars)

	Retained earnings (deficit)	Accumulated other comprehensive income	Total
Balance August 31, 2018	$ 28	$ -	$ 28
Net loss after net movement in regulatory deferral accounts	(60)	-	(60)
Other comprehensive income (loss)	-	-	-
Balance May 31, 2019	$ (32)	$ -	$ (32)
Balance August 31, 2019	$ 28	$ -	$ 28
Net loss after net movement in regulatory deferral accounts	(61)	-	(61)
Other comprehensive income (loss)	-	-	-
Balance May 31, 2020	$ (33)	$ -	$ (33)

See accompanying notes to unaudited interim condensed consolidated financial statements.

Interim Condensed Consolidated Statements of Cash Flows (unaudited)

(millions of Canadian dollars)

	Notes	Three months ended May 31 2020	Three months ended May 31 2019	Nine months ended May 31 2020	Nine months ended May 31 2019
Cash flows from (used in):					
Operating					
Receipts from customer service charges		$ 166	$ 323	$ 835	$ 991
Other receipts		17	14	53	48
Government grants received	4	6	-	6	-
Payments to employees and suppliers		(249)	(284)	(806)	(857)
Pension contributions - current service		(23)	(23)	(69)	(71)
Other post-employment contributions		(2)	(1)	(6)	(3)
Interest payments		(17)	(20)	(53)	(60)
Interest receipts		-	1	1	2
		(102)	10	(39)	50
Investing					
Capital expenditures		(26)	(29)	(106)	(95)
Loans to related parties		-	-	-	11
		(26)	(29)	(106)	(84)
Financing					
Issuance of long-term debt	9	845	248	845	248
Repayment of long-term debt	9	(25)	(275)	(25)	(275)
Net proceeds from bank loans	9	179	40	215	55
Payment of lease liabilities		(1)	-	(2)	-
Disbursements from settlement of derivatives		-	(9)	-	(9)
Debt service reserve fund		(1)	-	(1)	(1)
		997	4	1,032	18
Cash flows from (used in) operating, investing and financing activities		869	(15)	887	(16)
Effect of foreign exchange on cash and cash equivalents		1	-	1	-
Increase (decrease) in cash and cash equivalents		870	(15)	888	(16)
Cash and cash equivalents at beginning of period		48	37	30	38
Cash and cash equivalents at end of period		$ 918	$ 22	$ 918	$ 22

See accompanying notes to unaudited interim condensed consolidated financial statements.

1. General Information

NAV CANADA was incorporated as a non-share capital corporation pursuant to Part II of the *Canada Corporations Act* to acquire, own, manage, operate, maintain and develop the Canadian civil air navigation system (the ANS), as defined in the *Civil Air Navigation Services Commercialization Act* (the ANS Act). NAV CANADA has been continued under the *Canada Not-for-profit Corporations Act*. The fundamental principles governing the mandate conferred on NAV CANADA by the ANS Act include the right to provide civil air navigation services and the exclusive ability to set and collect customer service charges for such services. NAV CANADA and its subsidiaries' (collectively, the Company) core business is to provide air navigation services, which is the Company's only reportable segment. The Company's air navigation services are provided primarily within Canada.

The charges for civil air navigation services provided by the Company are subject to the economic regulatory framework set out in the ANS Act. The ANS Act provides that the Company may establish new charges and amend existing charges for its services. In establishing new charges or revising existing charges, the Company must follow the charging principles set out in the ANS Act. These principles prescribe that, among other things, charges must not be set at levels which, based on reasonable and prudent projections, would generate revenue exceeding the Company's current and future financial requirements in relation to the provision of civil air navigation services. Pursuant to these principles, the Board of Directors of the Company (the Board), acting as rate regulator, approves the amount and timing of changes to customer service charges.

The Company plans its operations to result in an annual financial breakeven position on the consolidated statement of operations after recording adjustments to the rate stabilization account. As a result, we expect no net change in retained earnings on an annual basis. The impacts of rate regulation on the Company's interim condensed consolidated financial statements are described in note 5.

The ANS Act requires that the Company communicate proposed new or revised charges to customers in advance of their introduction and to consult thereon. Customers may make representations to the Company as well as appeal revised charges to the Canadian Transportation Agency on the grounds that the Company either breached the charging principles in the ANS Act or failed to provide statutory notice.

NAV CANADA is domiciled in Canada. The address of NAV CANADA's registered office is 77 Metcalfe Street, Ottawa, Ontario, Canada K1P 5L6. These interim condensed consolidated financial statements of NAV CANADA include the accounts of its subsidiaries.

The COVID-19 pandemic and the resulting economic contraction has had, and is expected to continue to have, a significant negative impact on global air traffic and on the aviation industry. NAV CANADA has seen the number of air traffic movements decline since March 2020 as a result of travel restrictions imposed by governments, the closing of international borders and the economic impact of the pandemic. As a result, the Company's customer service charges revenue has declined significantly as air carriers have reduced their operations, grounded fleets and cancelled flights and routes. The pandemic is expected to continue to have a negative impact on air travel globally and this will likely continue until such time as travel restrictions are eased and consumer demand for air travel returns. Industry participants are indicating it may be some time before they fully return to pre COVID-19 operating levels. We expect until this occurs that reduced air traffic activity will have a significant negative impact on the Company's operations and revenues.

The Company will continue to review, monitor and take actions to reduce capital and operating spending and cash outflows, while at the same time ensuring the continued fulfillment of the Company's mandate to safely operate and maintain the Canadian air navigation system as an essential service and to protect the safety of its employees.

2. Basis of presentation

(a) Statement of compliance

These interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standards (IAS) 34 *Interim Financial Reporting*. As permitted under this standard, these interim condensed consolidated financial statements do not include all of the disclosures required for annual consolidated financial statements prepared in accordance with International Financial Reporting Standards (IFRS) and should be read in conjunction with the Company's audited annual consolidated financial statements for the year ended August 31, 2019 (2019 annual consolidated financial statements).

These interim condensed consolidated financial statements were authorized for issue by the Board on July 10, 2020.

(b) Basis of measurement

These interim condensed consolidated financial statements have been prepared on the historical cost basis except for the following material items:

- financial instruments that are classified as fair value through profit or loss (FVTPL), which are measured at fair value; and
- defined benefit liabilities that are recognized as the net of the present value of defined benefit obligations and plan assets measured at fair value.

(c) Functional and reporting currency

These interim condensed consolidated financial statements are presented in Canadian dollars (CDN), which is the Company's functional and reporting currency, unless otherwise indicated. All information presented has been rounded to the nearest million dollars.

(d) Seasonality

The Company's operations have historically varied throughout the fiscal year, with highest revenue from air traffic experienced in the fourth quarter (June to August). This demand pattern is principally a result of the higher number of leisure travellers and their preference for travel in the summer months. Given the negative impact of the COVID-19 pandemic on air traffic volumes, it is expected that the normal seasonality pattern will not occur in the fiscal year ending August 31, 2020 (fiscal 2020). The Company has a cost structure that is largely fixed, and accordingly costs do not vary significantly throughout the year. The Company continues to review capital and operating expenditures, taking action to reduce spending and cash outflows where possible.

(e) Significant accounting policies

Significant accounting policies used in these interim condensed consolidated financial statements are disclosed in note 3 of the 2019 annual consolidated financial statements, except for the application of new standards, amendments and interpretations effective September 1, 2019 as described in note 2 (f) of the Company's November 30, 2019 interim condensed consolidated financial statements. The note details the impact and changes in accounting policies as a result of the adoption of IFRS 16 – *Leases*, effective September 1, 2019. No other changes to significant accounting policies have been made subsequently. The accounting policies have been applied consistently to all periods presented, unless otherwise indicated.

2. Basis of presentation (continued)

(f) Future accounting pronouncements

The International Accounting Standards Board (IASB) has issued a number of standards and amendments that are not yet effective. The Company continues to analyze these standards and amendments to determine the extent of their impact on its consolidated financial statements. At this time, the Company does not expect to adopt any of these standards or amendments before their effective dates.

<u>IAS 37 Provisions, Contingent Liabilities and Contingent Assets: Onerous Contracts - Cost of Fulfilling a Contract</u>

In May 2020, the IASB published *Onerous Contracts - Cost of Fulfilling a Contract* amending the standard regarding costs a company should include as the cost of fulfilling a contract when assessing whether a contract is onerous. The amendment clarifies that for the purpose of assessing whether a contract is onerous, the cost of fulfilling the contract includes both the incremental costs of fulfilling that contract and allocation of other costs that relate directly to fulfilling contracts.

The amendment is effective for annual periods beginning on or after January 1, 2022 with early application permitted. The extent of the impact of the changes have not yet been determined.

<u>IAS 1 Presentation of Financial Statements: Classification of Liabilities as Current or Non-current</u>

In January 2020, the IASB published *Classification of Liabilities as Current or Non-current* providing a more general approach to the classification of liabilities based on the contractual arrangements in place at the reporting date.

The amendment is effective for annual periods beginning on or after January 1, 2022 with early application permitted. In April 2020, the IASB published an exposure draft proposing to delay the effective date to annual periods beginning on or after January 1, 2023. The extent of the impact of the changes have not yet been determined.

(g) Critical accounting estimates and judgments

The preparation of these interim condensed consolidated financial statements requires management to make estimates and judgments about the future.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Accounting estimates will, by definition, seldom equal actual results.

Critical judgments and key sources of estimation uncertainty are disclosed in note 2 (d) of the 2019 annual consolidated financial statements, except for those related to the Company's investment in preferred interests of Aireon LLC (Aireon), which is accounted for as a financial instrument and designated as FVTPL. Refer to note 6 for discussion of the change in fair value of the investment in preferred interests.

(millions of Canadian dollars)

3. Revenue

Customer service charges by type of air navigation service provided were as follows:

	Three months ended		Nine months ended	
	May 31 2020	May 31 2019	May 31 2020	May 31 2019
Enroute [(1)]	$ 72	$ 171	$ 404	$ 495
Terminal [(2)]	56	133	314	389
Daily / annual / quarterly [(3)]	6	23	49	68
North Atlantic and international communication [(4)]	7	11	31	34
	$ 141	$ 338	$ 798	$ 986

Air traffic volumes, as measured by weighted charging units (a measure of the number of flights, aircraft size and distance flown), decreased 59.4% over the course of the three months ended May 31, 2020 as compared to the same period in the fiscal year ended August 31, 2019 (fiscal 2019) and decreased 20.3% year-over-year for the nine months ended May 31, 2020. Excluding the effect of an extra day for the leap year, air traffic volumes for the nine months ended May 31, 2020 decreased by 20.6% year-over-year. The significant decrease in air traffic volumes and associated customer service charges is mainly due to the impact of the COVID-19 pandemic.

(1) Enroute charges related to air navigation services provided or made available to aircraft during the enroute phase of the flight, whether they overfly Canadian-controlled airspace or take-off and/or land in Canada. This performance obligation is satisfied at a point in time.

(2) Terminal charges related to air navigation services provided or made available to aircraft at or in the vicinity of an airport. This performance obligation is satisfied at a point in time.

(3) Daily / annual / quarterly charges related to enroute and terminal air navigation services. These charges generally apply to propeller aircraft and the performance obligations are satisfied over the period in which air navigation services are made available.

(4) North Atlantic and international communication charges related to certain air navigation and communication services provided or made available to aircraft while in airspace over the North Atlantic Ocean. These services are provided outside of Canadian sovereign airspace but for which Canada has air traffic control responsibility pursuant to international agreements. The international communication charges also include services provided or made available while in Canadian airspace in the north. These performance obligations are satisfied at a point in time.

4. Salaries and benefits

In April 2020, the Company applied for the Canadian Emergency Wage Subsidy (CEWS) offered by the Government of Canada to help businesses keep workers on their payroll through the challenges posed by the COVID-19 pandemic. Under CEWS the Company is eligible to receive up to 75% of wages or a maximum of $847 per week per employee for up to 24 weeks, retroactive to March 15, 2020.

CEWS is provided to individuals, taxable corporations and partnerships consisting of eligible employers as well as non-profit organizations and registered charities that have seen a drop of at least 30% of their revenue (15% for the first month of the program). Eligible remuneration under the subsidy includes salary, wages, and other remuneration for which the Company would generally be required to withhold or deduct amounts to remit to the Receiver General of Canada on account of the employee’s income tax obligation.

(millions of Canadian dollars)

4. Salaries and benefits (continued)

During the three and nine months ended May 31, 2020, the Company recognized $12 as a reduction to Salaries and benefits in the consolidated statement of operations. The amount receivable at May 31, 2020 was $6.

5. Financial statement impact of regulatory accounting

(a) Regulatory Deferral Accounts

In accordance with disclosures required for entities subject to rate regulation, the Company's regulatory deferral account balances are as follows:

	August 31 2019	Regulatory deferral	Recovery/ reversal	May 31 2020
Regulatory deferral account debit balances				
Rate stabilization account (b) [1]	$ -	$ 78	$ -	$ 78
Deferred income tax	48	(25)	-	23
Employee benefits:				
Accumulating sick leave	27	-	(1)	26
Other post-employment benefits re-measurements	31	-	(4)	27
Pension contributions (c)	194	130	-	324
Pension re-measurements	1,653	-	-	1,653
Supplemental pension re-measurements	64	-	(3)	61
Long-term disability contributions	-	(1)	3	2
Realized hedging transaction	70	-	(1)	69
	$ 2,087	$ 182	$ (6)	$ 2,263
Regulatory deferral account (credit) balances				
Rate stabilization account (b) [1]	$ (93)	$ -	$ 93	$ -
Derivatives	(1)	-	-	(1)
Employee benefits:				
Long-term disability contributions	(1)	-	1	-
Change in the fair value of the investment in preferred interests	(274)	87	-	(187)
Investment in equity-accounted investee	(3)	(1)	-	(4)
Realized hedging transaction	(4)	-	1	(3)
Lease offset [2]	-	(2)	-	(2)
	$ (376)	$ 84	$ 95	$ (197)

[1] As at May 31, 2020, the balance of the rate stabilization account is in a debit position. Included in the regulatory deferral of $78 is the transfer of the credit position of $93 at August 31, 2019 fully offset by the deferral of unfavourable variances to budget, including the planned shortfall, of $171.

[2] The Company is deferring the non-cash impacts of accounting for its head office lease in accordance with IFRS 16 using regulatory accounting. Only actual cash payments made by the Company are included for rate setting purposes.

(millions of Canadian dollars)

5. Financial statement impact of regulatory accounting (continued)

(a) Regulatory Deferral Accounts (continued)

The table below shows the impact of rate stabilization adjustments and net movement in regulatory deferral accounts on the net income (loss) as reported in the interim condensed consolidated statement of operations:

	Three months ended May 31 2020	Three months ended May 31 2019	Nine months ended May 31 2020	Nine months ended May 31 2019
Before net movement in regulatory deferral accounts:				
Revenue	$ 159	$ 351	$ 845	$ 1,025
Operating expenses	351	367	1,107	1,075
Other (income) and expenses	129	15	185	59
Income tax recovery	(27)	-	(27)	-
	(294)	(31)	(420)	(109)
Net movement in regulatory deferral accounts:				
Rate stabilization adjustments (b)	169	11	171	10
Other regulatory deferral account adjustments:				
Employee benefit pension contributions	42	21	130	66
Other employee benefits	(2)	(3)	(4)	(5)
Investment in preferred interests, before tax	97	(14)	87	(25)
Investment in equity-accounted investee	-	1	(1)	-
Income tax	(26)	1	(25)	2
Realized hedging transactions	-	-	1	1
	111	6	188	39
	280	17	359	49
Net loss, after net movement in regulatory deferral accounts	$ (14)	$ (14)	$ (61)	$ (60)

(b) Rate Stabilization Account

The rate stabilization account balance is comprised of operating deferrals. Should actual revenue exceed the Company's actual expenses, such excess is reflected as a credit to the rate stabilization account. Conversely, should actual revenue be less than actual expenses, such shortfall is reflected as a debit to the rate stabilization account. A debit balance in the rate stabilization account represents amounts recoverable through future customer service charges, while a credit balance represents amounts returnable through reductions in future customer service charges. As at May 31, 2020, the rate stabilization account had a debit balance of $78 (refer to table below).

When establishing customer service charges, the Board considers the balance in the rate stabilization account, the extent to which operating costs are variable and available liquidity and sets the level as appropriate.

(millions of Canadian dollars)

5. Financial statement impact of regulatory accounting (continued)

(b) Rate Stabilization Account (continued)

During the quarter, the International Air Transport Association discontinued, with the consent of Air Canada as intervenor, its application for Judicial Review of the Canadian Transportation Agency's decision which upheld the Company's revised service charges implemented September 1, 2019 and January 1, 2020.

The table below shows the net movements in the rate stabilization account:

	Three months ended May 31 2020	Three months ended May 31 2019	Nine months ended May 31 2020	Nine months ended May 31 2019
Rate stabilization account credit balance, beginning of period	$ 91	$ 125	$ 93	$ 124
Variances from planned results:				
Revenue lower than planned	(216)	(3)	(231)	(4)
Operating expenses lower than planned	50	1	65	14
Other (income) and expenses (higher) lower than planned	(77)	13	(82)	27
Net movement in other regulatory deferral accounts	83	(17)	104	(33)
Total variances from planned results	(160)	(6)	(144)	4
Initial approved adjustment [(1)]	(9)	(5)	(27)	(14)
Net movement in rate stabilization account recorded in net loss	(169)	(11)	(171)	(10)
Rate stabilization account credit (debit) balance, end of period	$ (78)	$ 114	$ (78)	$ 114

(1) In order to achieve breakeven results of operations in fiscal 2020, the Board approved the fiscal 2020 budget with a reduction of the rate stabilization account as a result of a planned shortfall. As a result, $35 is being transferred out of the rate stabilization account evenly throughout the fiscal year (fiscal 2019 - $18).

(millions of Canadian dollars)

5. Financial statement impact of regulatory accounting (continued)

(c) Pension Contributions

Included in regulatory deferral account debit balances at May 31, 2020 is $324 relating to the recovery through customer service charges of pension contributions (August 31, 2019 - $194). The accrued pension benefit liability, net of regulatory deferrals is as follows:

	May 31 2020	August 31 2019
Employee benefit liability	$ (1,943)	$ (1,813)
Less:		
Regulatory deferrals of non-cash adjustments	1,653	1,653
Benefit contributions less than benefit expense	$ (290)	$ (160)
Regulatory debit balances - recovery of contributions	$ 324	$ 194
Regulatory expense cumulatively less than contributions	$ 34	$ 34

The Company uses a regulatory approach to determine the net charge to net income (loss) for pension benefit costs for its funded plans. The objective of this approach is to reflect the cash cost of the funded pension plans in net income (loss) by recording an adjustment to the related regulatory deferral account. These regulatory adjustments are the difference between the pension benefit costs as determined by IAS 19 *Employee Benefits* and the annual going concern cash cost of the plan. Included in the regulatory deferral related to pension contributions of $324, is the recovery of $10 of solvency deficiency contributions of $44 paid in the fiscal year ended August 31, 2017 (fiscal 2017). The remaining balance of $34 is expected to be recovered through future customer service charges. The funding of employee pension benefits as compared to the expense, net of regulatory adjustments, recorded in the consolidated statement of operations is summarized below.

	Three months ended		Nine months ended	
	May 31 2020	May 31 2019	May 31 2020	May 31 2019
Consolidated statement of operations				
Pension current service expense [1]	$ 54	$ 41	$ 163	$ 123
Net interest expense [1]	13	6	38	18
Less: Regulatory deferrals	(42)	(21)	(130)	(66)
	25	26	71	75
Company cash pension contributions				
Going concern current service	25	26	71	75
Regulatory recovery of fiscal 2017 solvency contributions	$ -	$ -	$ -	$ -

[1] For the three and nine months ended May 31, 2020, pension current service expense does not include $1 and $4 respectively, related to the Company’s unfunded pension plan (three and nine months ended May 31, 2019 - $1 and $4, respectively) and net interest expense does not include $1 and $3 respectively, related to the Company’s unfunded pension plan (three and nine months ended May 31, 2019 - $nil and $2 respectively).

6. Investment in preferred interests of Aireon

During Q3 fiscal 2020, the Company updated the fair value of its investment in preferred interests of Aireon to reflect the impact of the COVID-19 pandemic as it relates to the number and frequency of air traffic movements in the aviation sector in general and the resulting impact on Aireon's operations and revenues. While not all of Aireon's revenue will be impacted, overall revenue levels are expected to decline and the reduction in air traffic may delay the signing by Aireon of new customers for space-based air traffic surveillance data services. As at May 31, 2020, the Company adjusted the fair value of its investment in preferred interests to $255 U.S. ($352 CDN) from $330 U.S. ($439 CDN) as at August 31, 2019. Included in the fair value presented in the statement of financial position are dividends receivable of $55 U.S ($76 CDN) (August 31, 2019 - $47 U.S. ($63 CDN)).

In addition, as a result of the decrease in the fair value, the related net deferred tax liability decreased to $23 CDN as at May 31, 2020 (August 31, 2019 - $48 CDN).

The fair value as at May 31, 2020 was determined using a discounted cash flow model, where the valuation model considers the present value of expected future payments, discounted using a risk-adjusted discount rate. The critical assumptions and estimates used when determining the fair value are:

(a) discount rates – the discount rate range used is 15% - 17%, which is generally consistent with discount rates used by other investors in preferred and common equity interests of Aireon; and

(b) expected timing of future dividend payments – the timing of the payments based on Aireon's forecasted after-tax dividend payment schedule has been delayed to reflect the impact of COVID-19.

After regulatory accounting, the Company's investment in preferred interests of Aireon on the statement of financial position reflects the actual amounts paid by the Company (at the exchange rates prevailing on the dates of the transactions). The use of regulatory deferral accounts defers the accounting recognition of transactions related to the Company's investment in Aireon on the Company's consolidated statement of operations. As a result, there is no net impact on the Company's consolidated statement of operations for the three and nine months ended May 31, 2020 related to the Company's investment in Aireon. These amounts are not considered for rate setting purposes until realized in cash through the receipt of dividends net of tax.

(millions of Canadian dollars)

7. Property, plant and equipment

Property, plant and equipment are comprised of the following:

	Land and buildings[1]	Systems and equipment	Assets under development	Total
Cost				
Balance at August 31, 2019	$ 280	$ 745	$ 117	$ 1,142
IFRS 16 transitional amount	9	-	-	9
Additions	-	-	47	47
Transfers	5	96	(101)	-
Balance at May 31, 2020	$ 294	$ 841	$ 63	$ 1,198
Accumulated depreciation				
Balance at August 31, 2019	$ 69	$ 323	$ -	$ 392
Depreciation	16	48	-	64
Balance at May 31, 2020	$ 85	$ 371	$ -	$ 456
Carrying amounts				
At August 31, 2019	$ 211	$ 422	$ 117	$ 750
At May 31, 2020	$ 209	$ 470	$ 63	$ 742

(1) Included in Land and buildings is the right-of-use asset related to the Company's head office lease (refer to note 2 (e)). Depreciation of $2 was recognized during the nine months ended May 31, 2020 resulting in a carrying amount of $7 as at May 31, 2020.

(millions of Canadian dollars)

8. Intangible assets

Intangible assets are comprised of the following:

	Air navigation right	Purchased software	Internally developed software	Assets under development	Total
Cost					
Balance at August 31, 2019	$ 702	$ 195	$ 265	$ 39	$ 1,201
Additions	-	-	-	31	31
Transfers	-	2	27	(29)	-
Balance at May 31, 2020	$ 702	$ 197	$ 292	$ 41	$ 1,232
Accumulated amortization					
Balance at August 31, 2019	$ 125	$ 83	$ 87	$ -	$ 295
Amortization	19	14	20	-	53
Balance at May 31, 2020	$ 144	$ 97	$ 107	$ -	$ 348
Carrying amounts					
At August 31, 2019	$ 577	$ 112	$ 178	$ 39	$ 906
At May 31, 2020	$ 558	$ 100	$ 185	$ 41	$ 884

9. Loans and Borrowings

Note 14 to the Company's 2019 annual consolidated financial statements provides detail of the Company's interest-bearing loans and borrowings.

On May 29, 2020, the Company issued $850 of General Obligation Notes in two series: $550 Series MTN 2020-1 General Obligation Notes with an annual interest rate of 2.924%, maturing on September 29, 2051 and $300 Series MTN 2020-2 General Obligation Notes with an annual interest rate of 2.063%, maturing on May 29, 2030.

The balance of long-term debt as at May 31, 2020 is $2,288, of which $275 is classified as current. The amount in current debt relates to the $250 Series MTN 2011-1 General Obligation Notes that mature in February 2021, and the annual amortization payment of $25 for the Series 97-2 amortizing revenue bonds.

As at May 31, 2020, the Company has drawn $223 of cash from its syndicated credit facility in addition to the issue of $850 of General Obligation Notes. The net proceeds of these notes will be used for general corporate purposes, including the repayment of borrowings under the syndicated credit facility which will enhance the Company's liquidity reserves.

(millions of Canadian dollars)

10. Financial instruments and financial risk management

Summary of financial instruments

The following table presents the carrying amount of the Company's financial instruments, by classification category and includes the fair value hierarchy classification for each financial instrument as defined in note 15 of the 2019 annual consolidated financial statements. Excluding long-term debt, the carrying amount approximates the fair value for all of the Company's financial instruments.

	May 31, 2020		
	Amortized Cost	FVTPL	Fair value hierarchy
Financial assets			
Cash and cash equivalents [1]	$ 918	$ -	
Accounts receivable and other	72	-	
Current investments			
Debt service reserve fund	73	-	
Other current assets			
Derivative assets [2]	-	2	Level 2
Investment in preferred interests [3]	-	352	Level 3
Related party loan receivable	3	-	
Other non-current assets			
Non-current derivative assets [2]	-	1	Level 2
Long-term receivables	1	-	
	$ 1,067	$ 355	
Financial liabilities			
Bank loan [4]	$ 223	$ -	
Trade and other payables			
Trade payables and accrued liabilities	238	-	
Long-term debt (including current portion)			
Bonds and notes payable [5]	2,288	-	Level 2
Lease liability (including current portion) [6]	7	-	
	$ 2,756	$ -	

(millions of Canadian dollars)

10. Financial instruments and financial risk management (continued)

Summary of financial instruments (continued)

	August 31, 2019		
	Amortized Cost	FVTPL	Fair value hierarchy
Financial assets			
Cash and cash equivalents [1]	$ 30	$ -	
Accounts receivable and other	94	-	
Current investments			
Debt service reserve fund	72	-	
Other current assets			
Derivative assets [2]	-	1	Level 2
Investment in preferred interests [3]	-	439	Level 3
Related party loan receivable	3	-	
Other non-current assets			
Long-term receivables	1	-	
	$ 200	$ 440	
Financial liabilities			
Bank loan [4]	$ 8	$ -	
Trade and other payables			
Trade payables and accrued liabilities	233	-	
Derivative liabilities [2]	-	1	Level 2
Long-term debt (including current portion)			
Bonds and notes payable [5]	1,468	-	Level 2
	$ 1,709	$ 1	

(1) Cash and cash equivalents includes $285 of short-term investments (August 31, 2019 - $5). The cash balance as at May 31, 2020 is higher than August 31, 2019 mainly due to the $850 of General Obligation Notes.

(2) Current and non-current derivative assets and liabilities are recorded at fair value determined using prevailing foreign exchange market rates and interest rates at the reporting date.

(3) This instrument is recorded at fair value based on the valuation technique described in note 6.

(4) This bank loan was drawn from the Company's syndicated credit facility in the form of a Banker's Acceptance and has a discount rate based on the Canadian Dollar Offered Rate plus an applicable margin

(5) The fair value of the Company's bonds and notes payable are classified as Level 2 in the fair value hierarchy as they are determined using secondary market asking prices at the reporting date. As at May 31, 2020, the fair value was $2,578 (August 31, 2019 - $1,771), inclusive of accrued interest of $22 (August 31, 2019 - $20).

(6) The lease liability is measured on a discounted cash flow basis using the Company's incremental borrowing rate.

There have been no transfers between levels of the fair value hierarchy since August 31, 2019.

(millions of Canadian dollars)

10. Financial instruments and financial risk management (continued)

Level 3 financial instruments

The following table summarizes the changes in the fair value of the Company's investment in preferred interests of Aireon, which is classified as Level 3:

	Investment in preferred interests
Fair value as at August 31, 2019	$ 439
Net decrease in fair value [(1)]	(103)
Effect of foreign exchange [(2)]	16
Fair value as at May 31, 2020	$ 352

(1) Net decrease in fair value includes accrued dividend income and is included in Other finance costs on the consolidated statement of operations.

(2) Included in Other net gains on the consolidated statement of operations.

For the fair value of the investment in preferred interests of Aireon, reasonably possible changes at the reporting date to one of the significant unobservable inputs, holding other inputs constant, would have the following effects on net income (loss):

	Increase	Decrease
Timing of expected cash flow (change of 1 year)	$ 55	$ (41)
Risk-adjusted discount rate (1% movement (100 basis points))	$ (41)	$ 41

Derivative financial instruments

From time to time, the Company holds forward dated interest rate swap agreements and bond and foreign exchange forward agreements to hedge risks from fluctuations in foreign exchange rates and interest rates. The time frame and manner in which we manage these risks varies for each item based upon the Company's assessment of the risk and available alternatives for mitigating the risk. Details of the derivative financial instruments for which the Company has applied hedge accounting are as follows:

(1) The Company holds fifteen foreign exchange forward agreements with a total notional value of $50 U.S. ($68 CDN) to hedge monthly payments to Aireon related to satellite surveillance costs for fiscal 2020 and the fiscal year ending August 31, 2021 (fiscal 2021). The average contract rate is 1.36222. The carrying amount of these contracts is $1 as at May 31, 2020 and is included in other current assets.

As at August 31, 2019, the Company held twelve forward agreements to purchase a total of $29 U.S. ($38 CDN) with an average rate of 1.30444. The carrying amount of these contracts was $1 as at August 31, 2019 and is included in other current assets.

(2) The Company holds five foreign exchange forward agreements with a notional value of approximately $2 each to purchase a total of $8 U.S. ($11 CDN) to hedge payments related to the Company's insurance premiums in fiscal 2020 and 2021. The average contract rate is 1.36350. The carrying amount of these contracts is $nil as at May 31, 2020.

As at August 31, 2019, the Company held four forward contracts to purchase a total of $6 U.S. ($8 CDN) with an average rate of 1.31142. The carrying amount of these contracts was $nil as at August 31, 2019.

(millions of Canadian dollars)

10. Financial instruments and financial risk management (continued)

Derivative financial instruments (continued)

The Company's hedging relationships are subject to ineffectiveness should the timing of the forecasted transaction not occur as intended or as a result of changes in counterparty risk. For the three and nine months ended May 31, 2020 and 2019, the derivatives designated as cash flow hedges were considered to be fully effective and no ineffectiveness has been recognized in net loss.

For the three and nine months ended May 31, 2020, derivatives designated as cash flow hedges had no impact on other comprehensive income (OCI). For the three and nine months ended May 31, 2019, a loss of $6 and $10, respectively, were recorded in OCI, largely related to a bond forward contract that was closed in March 2019.

Financial risk management

The Company is exposed to several risks as a result of holding financial instruments, including interest rate risk, foreign exchange risk, price risk, credit risk and liquidity risk. The Company's exposure to financial risks and how the Company manages each of those risks are described in note 15 (a)-(c) to the 2019 annual consolidated financial statements. There were no significant changes to those risks or to the Company's management of exposure to those risks during the nine months ended May 31, 2020, except as noted below.

(a) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The following table summarizes financial assets and liabilities exposed to interest rate risk:

	May 31 2020	August 31 2019
Floating rate financial assets		
Cash and cash equivalents	$ 918	$ 30
Debt service reserve fund investments	73	72
Total floating rate financial assets	$ 991	$ 102
Floating rate financial liabilities		
Bank loan	$ 223	$ 8
Fixed rate financial liabilities		
Bonds and notes payable [(1)]	$ 2,288	$ 1,468

(1) Bonds and notes payable includes both short-term and long-term portion.

Investments included in the Company's cash and cash equivalents and debt service reserve fund earn interest at prevailing and fluctuating market rates. If interest rates decline, earnings on these instruments would fall. A 100 basis point change in variable interest rates would result in an annual difference of approximately $8 in the Company's earnings before rate stabilization adjustments (August 31, 2019 - $1).

The Company does not account for any fixed rate financial assets or liabilities as FVTPL. Therefore the impact of a change in interest rates at the reporting date on fixed rate assets or liabilities would not affect the Company's earnings, nor its equity.

10. Financial instruments and financial risk management (continued)

Financial risk management (continued)

(a) Interest rate risk (continued)

Interest rate risk related to the Company's fixed-interest long-term debt relates to the re-setting of interest rates upon maturity and refinancing of the debt. The Company mitigates this source of interest rate risk by spreading maturities of borrowings over periods currently up to and including 2051 so that only a portion of outstanding debt will mature in any given fiscal year.

(b) Foreign exchange risk

As at May 31, 2020, the Company's net exposure to foreign exchange risk related to the U.S. dollar has decreased from $445 CAD ($335 USD) to $346 CAD ($250 USD), largely due to the decrease in the fair value of the investment in preferred interests of Aireon. If the Canadian dollar strengthened or weakened by 10% against the U.S. dollar as at May 31, 2020, all other variables remaining constant, net income (loss) before net movement in regulatory deferral accounts would have been impacted by $32 (August 31, 2019 - $40).

(c) Other price risk

The fair value of the Company's investment in preferred interests of Aireon was determined using a discounted cash flow model. The estimated fair value of the investment may change in subsequent periods. Any such changes could be material and would be reflected in the statement of operations as they occur. A sensitivity analysis with respect to changes in the unobservable inputs to the valuations is discussed in the *Level 3 financial instruments* section above.

Aireon provides global satellite-based surveillance capability for air navigation service providers around the world. The following risks have been identified with respect to the Company's investment in preferred interests of Aireon:

- The reduction in air traffic across the globe as a result of the COVID-19 pandemic and travel restrictions put in place;
- The expectation that air traffic may not return to pre COVID-19 levels for some time, which will impact Aireon's revenue where billings are volumetric and reflect air traffic movements; and
- The expectation that the Company's receipt of dividends will therefore be delayed.

(d) Liquidity risk

As at May 31, 2020, the Company's credit facilities available for unrestricted use are $309 (August 31, 2019 - $374). On September 12, 2019, the Company's credit facility with a syndicate of Canadian financial institutions was increased by $175 to a total of $850. The credit facility is comprised of two equal tranches maturing on September 12, 2022 and September 12, 2024. As at May 31, 2020, the Company has drawn $223. The Company's syndicated credit facility is described further in note 14 of the 2019 annual consolidated financial statements.

On April 15, 2020, the Minister of Finance announced a moratorium on solvency special payments for the remainder of calendar 2020 which came into force on May 27, 2020. Under this moratorium, defined benefit plan sponsors are not required to make solvency special payments due for the months of March to November 2020.

As disclosed in note 9, on May 29, 2020, the Company completed an issue of $850 of General Obligation Notes. The net proceeds of these notes will be used for general corporate purposes, including the repayment of borrowings under the Company's syndicated credit facility which will enhance the Company's liquidity reserves.

(millions of Canadian dollars)

11. Commitments

The following table presents a maturity analysis of the Company's undiscounted contractual cash flows for its financial liabilities, capital commitments, contractual commitments and lease liabilities as at May 31, 2020:

	Remaining payments – for years ending August 31						
	Total	2020	2021	2022	2023	2024	Thereafter
Bank loan	$ 223	$ 223	$ -	$ -	$ -	$ -	$ -
Trade payables and accrued liabilities	227	227	-	-	-	-	-
Long-term debt (including current portion) [1], [2]	2,300	-	275	25	25	25	1,950
Interest payments [2]	1,495	18	83	78	76	74	1,166
Capital commitments	120	77	15	11	3	3	11
Operating contract commitments	16	1	4	3	3	2	3
Future lease liabilities [3]	59	-	-	-	2	3	54
Lease liability	7	1	3	3	-	-	-
Related party loan [4]	15	15	-	-	-	-	-
	$ 4,462	$ 562	$ 380	$ 120	$ 109	$ 107	$ 3,184

(1) Payments represent principal of $2,300. The Company intends to refinance principal maturities at their maturity dates. The Company may choose to repay a portion of these maturities with available cash and/or may increase the size of a re-financing to generate additional liquidity or for other purposes, and/or may choose to redeem in whole or in part an issue in advance of its scheduled maturity.

(2) Further details on interest rates and maturity dates on long-term debt are provided in note 9 and note 14 of the 2019 annual consolidated financial statements.

(3) The Company has entered into a commitment for the lease of head office space commencing in the fiscal year ending August 31, 2023. The annual commitment is approximately $3 with a term of 20 years. The current head office lease is set to expire on October 31, 2022.

(4) During the nine months ended May 31, 2020, the Company entered into an agreement with Aireon to provide a subordinated loan up to a total of $11 U.S. ($15 CDN).