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MANAGEMENT'S DISCUSSION AND ANALYSIS

ON FORM 51-102F1

YEAR ENDED

AUGUST 31, 2021

October 21, 2021

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INTRODUCTION

This management's discussion and analysis (MD&A) relates to the consolidated financial position, results of operations, comprehensive income and cash flows for the year ended August 31, 2021 (fiscal 2021) of NAV CANADA (also referred to in this MD&A as we, our, us or the Company). It should be read in conjunction with our audited consolidated financial statements (financial statements) and the accompanying notes for the year ended August 31, 2021 (fiscal 2021 financial statements) as well as our 2021 Annual Information Form dated October 21, 2021 (fiscal 2021 AIF). Additional information about NAV CANADA, including our financial statements for fiscal 2021 and the year ended August 31, 2020 (fiscal 2020) and our fiscal 2021 AIF are filed on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

Our financial statements are prepared in Canadian dollars (CDN), in accordance with International Financial Reporting Standards (IFRS) and are comprised of the accounts of NAV CANADA and its subsidiaries. Our Audit & Finance Committee reviewed this MD&A and our Board of Directors (the Board) approved it before it was filed.

Caution Concerning Forward-Looking Information

This MD&A and, in particular, but without limitation, sections "INTRODUCTION – Significant Financial Matters", "RESULTS OF OPERATIONS – Revenue: Customer Service Charges", "RESULTS OF OPERATIONS – Financial Outlook", "LIQUIDITY AND CAPITAL RESOURCES – Cash Requirements: Pension Plans" and "LIQUIDITY AND CAPITAL RESOURCES – Cash Requirements: Capital Expenditures and Other Investments" of this MD&A, contain certain statements about NAV CANADA's future expectations. These statements are generally identified by words like "anticipate", "plan", "believe", "intend", "expect", "estimate", "approximate", "forecast" and the like, as well as future or conditional verbs such as "may", "will", "should", "would" and "could", or negative versions thereof. Because forward-looking statements involve future risks and uncertainties, actual results may be different from those expressed or implied in these statements and these differences may be material. Examples of risks and uncertainties the Company faces include geopolitical unrest, terrorist attacks and the threat of terrorist attacks, war, epidemics or pandemics, government interventions and related travel advisories, climate change and environmental factors (including weather systems and other natural phenomena and factors arising from manmade sources), cyber security attacks, labour negotiations, arbitrations, workforce recruitment, training and retention, general aviation industry conditions, air traffic levels, the use of telecommunications and ground transportation as alternatives to air travel, capital market and economic conditions, the ability to collect customer service charges and reduce operating costs, the ultimate success of our investment in space-based aircraft surveillance through Aireon LLC (Aireon), changes in interest rates, changes in laws, tax changes, adverse regulatory developments or proceedings and lawsuits. Some of these risks and uncertainties are explained under "Risk Factors" in our fiscal 2021 AIF. The forward-looking statements contained in this MD&A represent our expectations as of October 21, 2021 and are subject to change after this date.

Our forward-looking statements are based on information currently available to the Company. Given the rapidly evolving circumstances surrounding the COVID-19 pandemic, including the occurrence of new variants and resulting government-implemented restrictions, there is significant uncertainty associated with various assumptions underlying the forward-looking information contained in this MD&A. These assumptions include but are not limited to the following: the impact of COVID-19 and vaccination levels on global and domestic air traffic and on the aviation industry in the near-term; the likelihood that the post-pandemic economic recovery may be gradual and uneven; long-term growth in economic recovery and a return to a willingness to travel will provide the basis for increased air travel demand in the future; no other significant event such as a natural disaster or other calamity will occur that has an impact on the ordinary course of business or the macroeconomic environment. Refer to "INTRODUCTION – Significant Financial Matters" for further discussion of the impact on NAV CANADA.

Readers of this MD&A are cautioned not to place undue reliance on any forward-looking statement. We disclaim any intention or obligation to update or revise any forward-looking statement included in this document whether as a result of new information, future events or for any other reason, except as required by applicable securities legislation.

Our Business

NAV CANADA is the private sector, non-share capital company that operates Canada's civil air navigation system (ANS). With operations across Canada, we provide air navigation services to aircraft owners and operators within Canadian–controlled airspace. These services include air traffic control, flight information, weather briefings, airport advisories, aeronautical information and electronic navigation aids.

The core business of the Company is to manage and operate the ANS and related services in a safe, efficient and cost effective manner. Our mandate covers both Canadian airspace and airspace delegated to Canada under international agreements.

Financial Strategy and Rate Regulation

In establishing new customer service charges or revising existing charges, we must follow the charging principles set out in our governing legislation, the *Civil Air Navigation Services Commercialization Act* (ANS Act), which prevents us from setting customer service charges higher than what is needed to meet our financial requirements for the provision of air navigation services. Pursuant to these principles, the Board approves the amount and timing of changes to customer service charges. The Board also approves the Company's annual budget where amounts to be recovered through customer service charges for the ensuing year are determined. Our aim is to achieve breakeven financial results on the consolidated statement of operations on an annual basis. Due to seasonal and other fluctuations in air traffic, such as the COVID-19 pandemic discussed in "INTRODUCTION – Significant Financial Matters", and given that our costs are predominantly fixed in nature, our quarterly financial results may not achieve a breakeven position, after recording adjustments to the rate stabilization account. This is illustrated in the table under the heading "SUMMARY OF QUARTERLY RESULTS – Quarterly Financial Information (unaudited)".

As noted above, customer service charges are set based on the Company's financial requirements, which consider, among other things, estimated air traffic levels, the statutory requirement to provide air navigation services and planned expenses. Since actual revenue and expenses will differ from these estimates, methods to accumulate the variances are required so that they may be taken into account when setting future customer service charges. There is also a need to absorb the immediate effect of unpredictable factors – mainly fluctuations in air traffic levels resulting from unforeseen events. We meet these objectives through the use of a "rate stabilization" mechanism.

We reflect the impact of rate regulation in our financial statements. As such, the timing of recognition of certain revenue and expenses differs from what would otherwise be expected for companies that are not subject to regulatory statutes governing the level of charges. For example, we adjust our net income (loss) through transfers to or from the rate stabilization account, based on variations from the amounts that were used when establishing customer service charges. If our actual revenue exceeds actual expenses, the excess is reflected as a credit to the rate stabilization account and is returnable to customers through future customer service charges. Similarly, if actual revenue is less than actual expenses, the revenue shortfall is reflected as a debit to the rate stabilization account and is recoverable from customers through future customer service charges (see "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account").

(in millions of dollars)

In addition, for certain transactions where the timing of the cash flows differs significantly from the accounting recognition, the Company recognizes regulatory deferral account debits and credits in order to adjust the accounting recognition to the period in which they will be considered for rate setting. These transactions are generally considered for rate setting when the amounts are expected to be realized in cash.

When determining the level of customer service charges, we consider the Company's current and future financial requirements (see "RESULTS OF OPERATIONS – Net Movement in Regulatory Deferral Accounts Related to Net Income (Loss)" and "RESULTS OF OPERATIONS – Amounts Considered for Rate Setting Purposes").

Our financial strategy is to fulfil our essential services mandate based on a sound financial foundation, reflected in part through high credit ratings in the financial markets. Maintaining this strong foundation requires a prudent approach that balances the interests of our key stakeholders while complying with our statutory and contractual obligations.

Selected Annual Financial Information

The following table shows selected consolidated financial information of the Company for fiscal 2021, fiscal 2020 and the fiscal year ended August 31, 2019 (fiscal 2019). This information has been taken from the Company's financial statements.

	Years ended August 31		
	2021	2020	2019
Revenue [1]	$ 870	$ 1,000	$ 1,437
Net income (loss) after rate stabilization and regulatory deferral account adjustments	$ -	$ -	$ -
Total assets	$ 2,466	$ 2,951	$ 2,318
Total regulatory deferral account debit balances	$ 1,714	$ 2,112	$ 2,087
Total current liabilities	$ 240	$ 770	$ 283
Total non-current financial liabilities [2]	$ 2,487	$ 2,014	$ 1,444
Total non-current liabilities, including non-current financial liabilities	$ 3,766	$ 4,081	$ 3,718
Total regulatory deferral account credit balances	$ 146	$ 184	$ 376

(1) Revenue in the table above is presented before rate stabilization adjustments.

(2) Non-current financial liabilities include long-term debt and derivative liabilities. See note 15 to our fiscal 2021 financial statements.

Revenue

The COVID-19 pandemic and the resulting economic contraction continues to have a significant negative impact on global air traffic and on the aviation industry. The COVID-19 pandemic began impacting air traffic levels in mid-fiscal 2020 and since then, air traffic levels, as measured in weighted charging units (WCUs) (a measure of the number of billable flights, aircraft size and distance flown in Canadian airspace and the basis for movement-based service charges), has continued to trend well below levels seen in fiscal 2019.

In fiscal 2021, the Company's customer service charges revenue decreased by $115 as compared to fiscal 2020. Air traffic levels, as measured in WCUs, decreased 32.7% on a year-over-year basis and 55.7% as compared to fiscal 2019. In addition, other revenue decreased by $15 as compared to fiscal 2020. See "RESULTS OF OPERATIONS – Revenue" for more details.

During fiscal 2020, the Company experienced a decrease in air traffic, as measured in WCUs, of 34.1% as compared to fiscal 2019, resulting in decreased revenue from customer service charges of $454. Revenue from service and development contracts for the sale of air traffic management technology solutions increased by $23, partially offset by a decrease in conference centre sales of $3 and other miscellaneous revenue of $3.

Net income (loss), after rate stabilization and regulatory deferral account adjustments

In keeping with the Company's financial strategy and the use of the rate stabilization mechanism, breakeven financial results were achieved in fiscal 2021, fiscal 2020 and fiscal 2019. See "RESULTS OF OPERATIONS" for further details on net income (loss) after rate stabilization and regulatory deferral account adjustments.

Total assets

Total assets as at August 31, 2021 were $2,466 which is a decrease of $485 compared to August 31, 2020 primarily due to:

- a $370 decrease in cash and cash equivalents (see "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the year ended August 31, 2021");
- a $145 decrease in short-term investments as a result of maturity of short-term investments during the period;
- a $55 decrease in intangible assets and $23 decrease in property, plant and equipment, as a result of depreciation and amortization exceeding investments in capital assets;
- a $37 decrease in the investment in preferred interests of Aireon primarily due to the decrease in the fair value to reflect the continued impact of the COVID-19 pandemic, partially offset by annual accrued dividend income; and
- a $4 decrease in employee benefits related to the Company's long-term disability (LTD) plans resulting from higher benefit expense than contributions paid;

partially offset by:

- a $28 increase in accounts receivable and a $112 increase in long-term receivables as a result of the payment deferral mechanisms related to the September 1, 2020 customer service charge increase, provided to ease the cash flow burden of the increase on customers in the Company's fiscal 2021, along with a $8 increase in other receivables.

Total assets as at August 31, 2020 were $2,951 which is an increase of $633 compared to August 31, 2019 primarily due to:

- a $773 increase in current assets primarily due to a $659 increase in cash and cash equivalents and an increase of $145 in short term investments as a result of additional debt financing during the period to increase liquidity reserves, partially offset by a $28 decrease in accounts receivable and other as well as a net decrease of $4 in other current assets; and

- a $4 increase in employee benefits related to the Company's LTD plans resulting from higher contributions paid than benefit expense;

partially offset by:

- a $103 decrease in the investment in preferred interests of Aireon primarily due to the decrease in the fair value to reflect the impact of the COVID-19 pandemic, partially offset by annual accrued dividend income;

- a $32 decrease in intangible assets, mainly due to amortization of the air navigation right; and

- a $10 decrease in property, plant and equipment.

Total regulatory deferral account debit balances

See "RESULTS OF OPERATIONS – Net Movement in Regulatory Deferral Accounts Related to Net Income (Loss)" and "RESULTS OF OPERATIONS – Other Comprehensive Income (Loss)".

Total regulatory deferral account debit balances as at August 31, 2021 decreased by $398 compared to August 31, 2020 primarily due to:

- a $933 decrease in the regulatory deferral accounts related to pension benefits to defer re-measurement gains of $928 for fiscal 2021 and recover $5 related to net re-measurement losses on supplemental pension benefits deferred in prior years (see "LIQUIDITY AND CAPITAL RESOURCES – Cash Requirements: Pension Plans");

- a $12 decrease in the regulatory deferral accounts related to other post-employment benefits to defer net re-measurement gains of $5 for fiscal 2021 and recover $7 related to net re-measurement losses deferred in prior years; and

- a $9 decrease in the regulatory deferral account related to the deferred tax liability primarily due to the reduction of the fair value of the Company's investment in preferred interests of Aireon to reflect the continuing impact of the COVID-19 pandemic;

partially offset by:

- a $401 increase in the debit rate stabilization account balance as a result of the budgeted shortfall for fiscal 2021 and additional unfavourable variances from budget that are largely driven by the negative air traffic levels experienced due to the COVID-19 pandemic and the decrease in associated revenues;

- a $147 increase in the regulatory deferral account related to employee benefit pension contributions to adjust the total pension benefit expense to the level of going concern pension contributions recovered through rate setting; and

- a $12 increase in the regulatory deferral account related to the allowance for expected credit losses associated with deferred payments of September 1, 2020 customer service charges increases.

Total regulatory deferral account debit balances as at August 31, 2020 increased by $25 compared to August 31, 2019 primarily due to:

- a $255 increase in the debit rate stabilization account balance as a result of the account changing from a credit balance of $93 as at August 31, 2019 primarily due to unfavourable variances from budget that are largely driven by negative air traffic levels experienced due to the COVID-19 pandemic and the decrease in associated revenues; and

- a $177 increase in the regulatory deferral account related to employee benefit pension contributions to adjust the total pension benefit expense to the level of going concern pension contributions recovered through rate setting;

partially offset by:

- a $347 decrease in the regulatory deferral account related to pension re-measurement gains;

- a $27 decrease in the regulatory deferral account related to the deferred tax liability primarily due to the reduction of the fair value of the Company's investment in preferred interests of Aireon to reflect the impact of the COVID-19 pandemic;

- a $26 decrease in the regulatory deferral account related to supplemental pension benefits to defer re-measurement gains of $22 for fiscal 2020 and recover $4 related to costs deferred in prior years; and

- a $5 decrease in the regulatory deferral accounts related to other post-employment benefits to defer net re-measurement gains of $2 for fiscal 2020 and recover $7 related to costs deferred in prior years.

Total current liabilities

The Company's total current liabilities as at August 31, 2021 decreased by $530 compared to August 31, 2020 primarily due to:

- a $250 decrease in the current portion of long-term debt due to the repayment of the $250 Series MTN 2011-1 General Obligation Notes on February 18, 2021;

- a $223 decrease in bank loans as the Company repaid funds drawn in fiscal 2020 under its syndicated credit facility; and

- a $58 decrease in trade and other payables;

partially offset by:

- a $4 increase in deferred revenue.

The Company's total current liabilities as at August 31, 2020 increased by $487 compared to August 31, 2019 primarily due to:

- a $250 increase in the current portion of long-term debt due to the $250 Series MTN 2011-1 General Obligation Notes that matured on February 18, 2021;
- a $215 increase in bank loans as the Company drew on its syndicated credit facility to address near-term liquidity needs as a result of the COVID-19 pandemic;
- a $20 increase in trade and other payables; and
- a $5 increase in other current liabilities related to derivative liabilities and the current portion of lease liabilities;

partially offset by:

- a $3 decrease in deferred revenue.

Total non-current liabilities (including non-current financial liabilities)

The Company's total non-current liabilities as at August 31, 2021 decreased by $315 compared to August 31, 2020 primarily due to:

- a net $776 decrease in employee benefit liabilities, which includes a $778 decrease in accrued pension obligations, largely due to actuarial re-measurement gains as a result of increases in discount rates; and
- a $9 decrease in the deferred tax liability primarily due to the reduction of the fair value of the Company's investment in preferred interests of Aireon to reflect the continued impact of the COVID-19 pandemic.

partially offset by:

- a $474 increase in long-term debt primarily due to the issuance of the $300 Series 2021-1 General Obligation Notes, maturing on February 9, 2026 and $200 Series 2021-2 General Obligation Notes, maturing on February 9, 2024, partially offset by the reclassification to current liabilities of the $25 principal payment on the Series 97-2 amortizing revenue bonds (see "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Financing Strategy");

The Company's total non-current liabilities as at August 31, 2020 increased by $363 compared to August 31, 2019 primarily due to:

- a $570 increase in long-term debt primarily due to the issuance of the $550 Series MTN 2020-1 General Obligation Notes, maturing on September 29, 2051 and $300 Series MTN 2020-2 General Obligation Notes, maturing on May 29, 2030, to increase liquidity reserves, partially offset by the reclassification to current liabilities of the $250 Series MTN 2011-1 General Obligation Notes that matured on February 18, 2021 and $25 principal payment on the Series 97-2 amortizing revenue bonds;

partially offset by:

- a net $184 decrease in employee benefit liabilities, which includes a $186 decrease in accrued pension obligations, largely due to actuarial re-measurement gains as a result of changing future salary assumptions; and
- a $27 decrease in the deferred tax liability primarily due to the decrease in fair value of the Company's investment in preferred interests of Aireon to reflect the impact of the COVID-19 pandemic.

Total regulatory deferral account credit balances

See "RESULTS OF OPERATIONS – Net Movement in Regulatory Deferral Accounts Related to Net Income (Loss)" and "RESULTS OF OPERATIONS – Other Comprehensive Income (Loss)".

Total regulatory deferral account credit balances as at August 31, 2021 decreased by $38 compared to August 31, 2020 primarily due to:

- a $37 decrease in the regulatory deferral related to the Company's investment in preferred interests of Aireon primarily due to the decrease in fair value of the investment, partially offset by annual accrued dividend income.

Total regulatory deferral account credit balances as at August 31, 2020 decreased by $192 compared to August 31, 2019 primarily due to:

- a $93 decrease in the rate stabilization account credit balance as a result of the account changing from a credit balance as at August 31, 2019 to a debit balance of $255 as at August 31, 2020 primarily due to unfavourable variances from budget that are largely driven by negative air traffic levels experienced due to the COVID-19 pandemic and the decrease in associated revenues; and
- a $103 decrease in the regulatory deferral related to the Company's investment in preferred interests of Aireon primarily due to the decrease in fair value of the investment, partially offset by annual accrued dividend income;

partially offset by:

- a $4 increase in regulatory deferrals of LTD contributions.

(in millions of dollars)

Financial Highlights

Results of operations for the year ended August 31, 2021

	Years ended August 31		
	2021	2020	$ Change
Revenue	$ 870	$ 1,000	$ (130)
Operating expenses	1,278	1,371	(93)
Other (income) and expenses	176	241	(65)
Income tax recovery	(7)	(28)	21
Net loss, before net movement in regulatory deferral accounts	(577)	(584)	7
Net movement in regulatory deferral accounts [(1)]			
Rate stabilization adjustments:			
Unfavourable variances from planned results	106	313	(207)
Initial approved adjustment [(2)]	295	35	260
	401	348	53
Other regulatory deferral account adjustments:			
Employee benefit pension contributions	147	177	(30)
Other employee benefits	(13)	(18)	5
Investment in preferred interests, before tax	37	103	(66)
Income tax	(9)	(27)	18
Allowance for expected credit losses	12	-	12
Other	2	1	1
	176	236	(60)
	577	584	(7)
Net income (loss), after net movement in regulatory deferral accounts	$ -	$ -	$ -

(1) See "RESULTS OF OPERATIONS – Net Movement in Regulatory Deferral Accounts Related to Net Income (Loss)".

(2) In order to achieve breakeven results of operations after the application of rate regulated accounting, the Board approved the fiscal 2021 budget with an increase to the debit position of the rate stabilization account as a result of a planned shortfall of $295 (fiscal 2020 - $35), which has been reflected in the rate stabilization account evenly throughout the fiscal year.

(in millions of dollars)

Cash flows for the year ended August 31, 2021

As shown below, cash and cash equivalents decreased by $370 during fiscal 2021 (fiscal 2020 - increase of $659) and the Company experienced negative free cash flow of $509 (fiscal 2020 - $231), which is a non-GAAP (Generally Accepted Accounting Principles) financial measure. Non-GAAP financial measures do not have any standardized meaning prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers. The Company defines free cash flow as cash flow generated from operations, less capital expenditures, investments in Aireon, equity related investments and principal payments of lease liabilities. Management places importance on this indicator as it assists in measuring the impact of its investment program on the Company's financial resources.

	Years ended August 31		
	2021	2020	$ Change [1]
Cash flows from (used in)			
Operating	$ (425)	$ (96)	$ (329)
Investing	64	(277)	341
Financing	(3)	1,031	(1,034)
Cash flows from (used in) operating, investing and financing activities	(364)	658	(1,022)
Effect of foreign exchange on cash and cash equivalents	(6)	1	(7)
Increase (decrease) in cash and cash equivalents	(370)	659	(1,029)
Cash and cash equivalents, beginning of period	689	30	659
Cash and cash equivalents, end of period	$ 319	$ 689	$ (370)
Free cash flow (non-GAAP financial measure)			
Cash flows from (used in):			
Operations [2]	$ (425)	$ (96)	$ (329)
Capital expenditures [2]	(85)	(132)	47
Proceeds from sale of property, plant and equipment [2]	4	-	4
Payment of lease liabilities [2]	(3)	(3)	-
Free cash flow	$ (509)	$ (231)	$ (278)

(1) See "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the year ended August 31, 2021" for discussion of the changes in cash flows from the prior fiscal year.

(2) See the statement of cash flows in our fiscal 2021 financial statements.

Significant Financial Matters[1]

The following items have significant financial importance to the Company:

1. COVID-19 pandemic

The COVID-19 pandemic and the resulting economic contraction continues to have a significant negative impact on global air traffic and on the aviation industry. The COVID-19 pandemic began impacting air traffic levels in mid-fiscal 2020 and since then, air traffic levels, as measured in WCUs, have continued to trend well below levels seen in fiscal 2019.

Air traffic levels, as measured in WCUs, increased in the fourth quarter of fiscal 2021, as compared to levels seen in the same period of fiscal 2020. The increase in air traffic levels is as a result of an increase in passenger demand as travel restrictions imposed by governments are beginning to ease and as international borders gradually re-open.

As compared to fiscal 2019, customer service charges revenue was 41.1% lower, despite the increase in customer service charges as of September 1, 2020. It is expected that the COVID-19 pandemic and resulting economic contraction will continue to have a significant negative impact on global air traffic and the aviation industry in the near-term and the post-pandemic economic recovery may be gradual and uneven.

The Company continues to review, monitor and manage spending, 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 and well-being of its employees, while positioning itself to support a post-pandemic recovery in air travel.

To continue to address the significant revenue shortfall, some of the actions the Company took in fiscal 2021 include:

- increasing customer service charges, effective September 1, 2020, by an average of 29.5% on base rate levels, resulting in a revenue increase of $190 based on air traffic levels for fiscal 2021;
- continuing to access government COVID-19 support programs, including the Canada Emergency Wage Subsidy (CEWS), recognizing $114 as a reduction to Salaries and benefits expense for fiscal 2021 and the Canada Emergency Rent Subsidy, recognizing $1 as a reduction to Facilities and maintenance expense;
- reducing overall capital spending from pre-pandemic levels in fiscal 2019;
- receiving temporary relief from compliance with the rate covenants and certain provisions under the additional indebtedness covenants under each of the master trust indenture (MTI) and the general obligation indenture (GOI);
- implementing cost-saving measures where possible, including the elimination of 650 temporary and permanent positions; and
- raising funds through the issuance of $500 in General Obligations Notes to address liquidity requirements and to repay maturing debt.

2. Air Traffic and Customer Service Charges

Over the course of fiscal 2021, air traffic levels, as measured in WCUs, decreased 32.7% as compared to fiscal 2020. In comparison to pre-pandemic levels experienced over fiscal 2019, air traffic levels have decreased 55.7%.

[1] Note: See "INTRODUCTION – Caution Concerning Forward-Looking Information", page 1

The Company revised its customer service charges effective September 1, 2020, increasing charges by an average of 29.5% on base rate levels. This revision was required to allow the Company to achieve a minimum level of revenue in fiscal 2021, thereby facilitating the additional borrowings needed in fiscal 2020 to provide NAV CANADA with sufficient liquidity to weather the COVID-19 pandemic. The customer service charge increase included provisions to ease the cash flow burden of the increase on customers through payment deferral mechanisms. For NAV CANADA's fiscal 2021, the portion of invoices related to the customer service charge increase could be deferred and will become payable by customers in equal installments over the following five fiscal years, beginning in the fiscal year ending August 31, 2022 (fiscal 2022).

3. Operating Expenses

Since the onset of the COVID-19 pandemic, the Company has taken unprecedented measures to drive down operating expenses, including eliminating executive positions, reducing management salary and bonus programs, making changes to part of the pension plan applicable to executives and management, ending terms for temporary employees, reaching agreements with bargaining units to suspend programs, offering early retirement and departure incentives to employees and reducing all non-essential and non-critical activities across the Company.

On September 22, 2020 and December 9, 2020, the Company announced workforce reductions through the elimination of permanent jobs, impacting approximately 350 people. The job cuts were across all departments and included operational students. The Company's restructuring efforts since the onset of the COVID-19 pandemic have resulted in a reduction of its workforce by approximately 650 people across the country (roughly 12.7% of the Company's pre-pandemic workforce). The restructuring of some of our business units and the adjustments of our workforce were critical to aligning operations and services with air traffic and strengthening the sustainability of NAV CANADA.

In light of the impacts of the COVID-19 pandemic on our finances, the Company continues to have discussions with its bargaining agents to identify alternatives to workforce adjustments. During fiscal 2021, the Company reached an agreement with the Professional Institute of the Public Service of Canada (PIPSC), whereby employees represented by PIPSC have foregone wage increases for the next two years (May 1, 2021 and May 1, 2022) in order to avoid layoffs for the same period of time. The agreement also includes an extension of the current collective agreement to April 30, 2026 and allows for wage increases of 2% in each of the additional three years of the agreement.

Approximately 88% of our workforce is unionized under eight collective agreements. As at August 31, 2021, the Company has ratified collective agreements in place with six of its bargaining agents. Agreements with the Canadian Federal Pilots Association and Public Service Alliance of Canada expired on April 30, 2019 and December 31, 2020, respectively. Negotiations with these two unions are ongoing.

4. Investment in Preferred Interests of Aireon

As at August 31, 2021, the Company measured the fair value of its investment in preferred interests at $299 CDN ($237 U.S.) (August 31, 2020 - $336 CDN ($258 U.S.)). The fair value reflects the continued impact of the COVID-19 pandemic on international air traffic and the resulting impact on Aireon's operations and revenue. Included in the fair value presented in the statement of financial position are dividends receivable of $80 CDN ($64 U.S) (August 31, 2020 - $76 CDN ($58 U.S.)). The carrying value remains above the initial investment cost.

In addition, as a result of the reduction of the fair value, the related net deferred tax liability decreased to $12 CDN ($10 U.S.) as at August 31, 2021 (August 31, 2020 - $21 CDN ($16 U.S.)).

(in millions of dollars)

5. Financing Activities

Effective December 18, 2020, the Company received the requisite amount of valid consents and proxies to temporarily relieve the Company from complying with the rate covenants and certain provisions under the additional indebtedness covenants under each of the MTI, governing the Company's outstanding bonds, and the GOI, governing the Company's outstanding notes. The relief was obtained in light of the significant decline in air traffic levels and economic contraction resulting from the COVID-19 pandemic and apply to its fiscal years ending August 31, 2021, 2022 and 2023.

On February 9, 2021, the Company issued $500 of General Obligation Notes in two series: $300 Series 2021-1 General Obligation Notes with an annual interest rate of 0.937%, maturing on February 9, 2026 and $200 Series 2021-2 General Obligation Notes with an annual interest rate of 0.555%, maturing on February 9, 2024.

On February 18, 2021, the Company repaid the $250 Series MTN 2011-1 General Obligation Notes with net proceeds of the issuance. Remaining proceeds of the notes issued are being used for general corporate purposes.

6. Rate Stabilization Account

As at August 31, 2021, the rate stabilization account had a debit balance of $656 (see "RESULTS OF OPERATIONS – Amounts Considered for Rate Setting Purposes").

The rate stabilization account changed by $401 due to the $295 initially approved adjustment to the rate stabilization account resulting from the planned shortfall in fiscal 2021 and $106 of net unfavourable variances from planned results. Rate stabilization adjustments are described under "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account".

RESULTS OF OPERATIONS

Revenue

The following table provides a summary of revenue by category. Our fiscal 2021 AIF and the notes to our fiscal 2021 financial statements provide more information about the different categories of our customer service charges.

	Years ended August 31			
	2021	2020	$ Change	% Change
Enroute	$ 455	$ 476	$ (21)	(4%)
Terminal	284	364	(80)	(22%)
Daily / annual / quarterly	22	53	(31)	(58%)
North Atlantic and international communication	54	37	17	46%
Total customer service charges	815	930	(115)	(12%)
Other (1)	55	70	(15)	(21%)
	$ 870	$ 1,000	$ (130)	(13%)

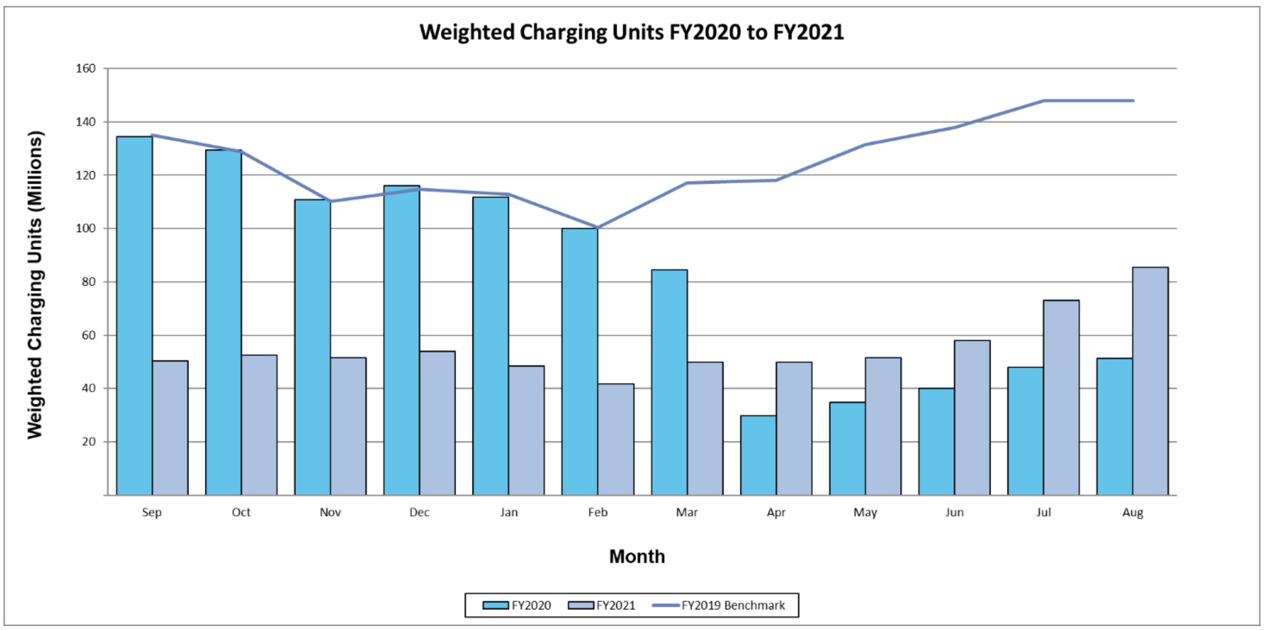
(1) Other revenue consists of service and development contracts, conference centre sales at the NAV CENTRE, which is our facility in Cornwall (Ontario), the sale of civil aeronautical publications and other miscellaneous revenue.

Revenue for fiscal 2021 was $870 compared to $1,000 for fiscal 2020. The $130 decrease is due to:

- a $115 decrease in customer service charges revenue arising from a decrease of 32.7% in air traffic levels, partially offset by revised customer service charges, effective September 1, 2020, that increased base rate levels by an average of 29.5%.
- a $15 decrease in other revenue, primarily due to lower revenue from service and development contracts and the closure of the NAV CENTRE to the general public as a result of the COVID-19 pandemic.

Air Traffic

Air traffic levels (as measured in WCUs) in fiscal 2021 continue to reflect the ongoing negative impact of the COVID-19 pandemic, which impacted revenue commencing in the third quarter of fiscal 2020. Air traffic levels began to increase during the fourth quarter of fiscal 2021, exceeding the levels seen in the same period of fiscal 2020, however they remained significantly lower than pre-pandemic levels seen in fiscal 2019.



Future air traffic levels may be influenced by numerous factors, including the speed of recovery of air traffic following the COVID-19 pandemic, the proportion of the general public fully vaccinated, new COVID-19 variants, other epidemics or pandemics, rate of economic growth or decline, changing air passenger demand or willingness to fly, aircraft capacity utilization levels, fuel costs, changes in air carrier operations and behaviours, general aviation industry conditions, air carrier competition, airline restructurings and insolvencies, terrorist activities, geopolitical uncertainty, government interventions, travel restrictions and closings of borders to air travel, climate change and environmental factors (including weather systems and other natural phenomena and factors arising from manmade sources) and demographic patterns.

Customer Service Charges[2]

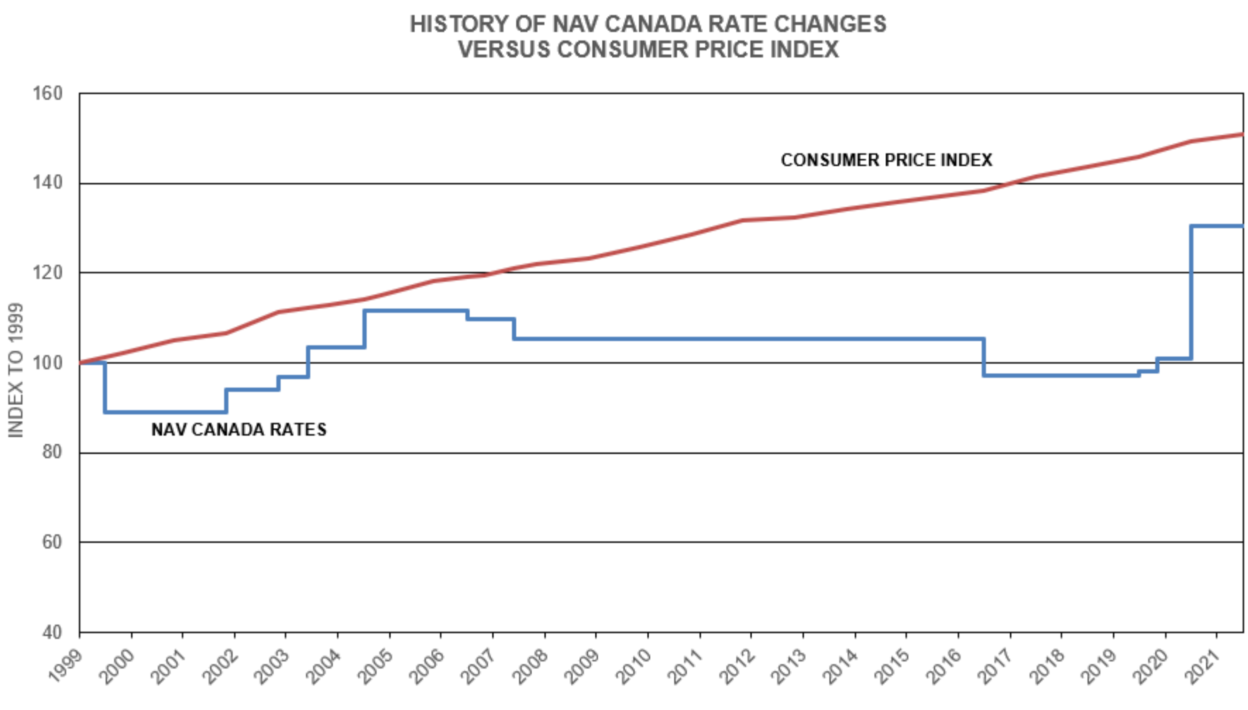
The level of our customer service charges is a function of our costs, financial requirements, the required level of service, air traffic levels and revenue from non-aeronautical sources (see "RESULTS OF OPERATIONS – Amounts Considered for Rate Setting Purposes").

Our business operates 24 hours a day, 365 days a year, providing an essential, national and international safety infrastructure. Given that the majority of our costs are predominantly fixed in nature and are directly related to service delivery, we have relatively few opportunities to significantly reduce these costs further without reducing service, which is not acceptable in most cases. We continue to focus on cost management and productivity improvements. This assists in keeping customer service charges as low as possible, while continuing to meet our safety and service obligations.

We continuously monitor our financial requirements and air traffic, and regularly update our financial forecasts to account for changes in the economic environment. On a quarterly basis, we consider the need for a change in rates.

The Company revised its customer service charges effective September 1, 2020, increasing charges by an average of 29.5% on base rate levels. Including this revision, service charges as at August 31, 2021 are on average 30.5% higher than when they were fully implemented in 1999. As a result of cost controls and increases in air traffic levels over the same period, the change in customer service charges is below the change in the CPI by approximately 20.4 percentage points.

The following chart illustrates the evolution of our levels of customer service charges over time.



1. Average changes since charges were fully implemented on March 1, 1999.
2. Consumer Price Index - Forecast from the January 2021 Consensus Economics publication.

[2] Note: See "INTRODUCTION – Caution Concerning Forward-Looking Information", page 1

(in millions of dollars)

Operating Expenses

	Years ended August 31			
	2021	2020	$ Change	% Change
Salaries and benefits	$ 837	$ 942	$ (105)	(11%)
Technical services	161	139	22	16%
Facilities and maintenance	59	66	(7)	(11%)
Depreciation and amortization	156	157	(1)	(1%)
Other	65	67	(2)	(3%)
	$ 1,278	$ 1,371	$ (93)	(7%)

Salaries and benefits expense for fiscal 2021 decreased by $105 compared to fiscal 2020 primarily due to:

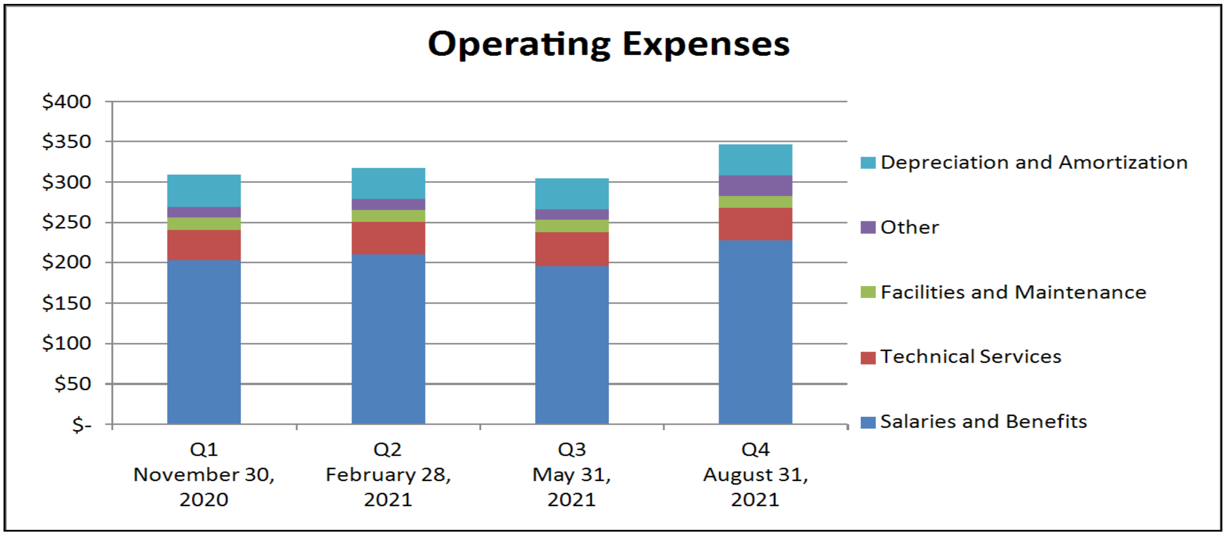
- higher CEWS receipts, as the Company did not begin to receive payments from the program until May 2020;
- lower overtime costs, largely due to the significant decrease in air traffic levels as a result of the COVID-19 pandemic;
- lower pension current service costs as a result of a decrease in overall staffing levels and the future salary rate assumption at August 31, 2020 compared to August 31, 2019, partially offset by curtailment expense of $12 related to pension benefits as a result of a significant reduction of active employees covered by the plan; and
- cost-savings as a result of measures taken to address the impacts of the COVID-19 pandemic, including management compensation reductions, elimination of temporary and permanent positions, as well as early retirement incentives offered in the fourth quarter of fiscal 2020; offset by severance and termination costs related to the restructuring efforts undertaken in fiscal 2021.

Technical services expense for fiscal 2021 increased by $22, compared to fiscal 2020 primarily due to oceanic space-based surveillance data services, which came into effect in January 2020.

Facilities and maintenance expenses decreased by $7 in fiscal 2021 compared to fiscal 2020 primarily due to location lock downs and the closure of the NAV CENTRE to the general public as a result of the COVID-19 pandemic.

Our operating expenses were relatively stable throughout fiscal 2021 as the Company continued to focus on cost management, particularly with respect to discretionary expenditures. During the first and second quarter of fiscal 2021, the Company's restructuring efforts resulted in an increase in severance and termination costs. Savings related to these efforts began to be realized in the third quarter. During the fourth quarter, these savings were offset by the recognition of a curtailment expense related to pension benefits and higher overtime costs as a result of increasing air traffic levels and coverage for leaves over the summer months.

(in millions of dollars)



Other (Income) and Expenses (Including Income Tax Recovery)

	Years ended August 31		
	2021	2020	$ Change
Finance income			
Interest income	$ (3)	$ (2)	$ 1
Net change in fair value of financial assets at FVTPL [(1)]			
Other investments	1	(1)	(2)
Total finance income	(2)	(3)	(1)
Net interest expense relating to employee benefits	55	62	7
Other finance costs			
Interest expense	89	79	(10)
Net change in fair value of financial assets at FVTPL [(1)]			
Investment in preferred interests	24	100	76
	113	179	66
Other			
Foreign exchange losses	11	4	(7)
Share of net gain of equity-accounted investee	-	(1)	(1)
Other gains	(1)	-	1
	10	3	(7)
	$ 176	$ 241	$ 65
Income tax recovery	$ (7)	$ (28)	$ (21)

[(1)] The net change in fair value of financial assets at fair value through profit or loss (FVTPL) includes interest and dividend income related to those financial assets.

Net interest expense relating to employee benefits decreased by $7 during the year ended August 31, 2021 compared to the year ended August 31, 2020 due to higher interest income and lower interest expense as a result of the decrease in discount rates at August 31, 2020 compared to August 31, 2019.

(in millions of dollars)

Interest expense increased by $10 during fiscal 2021 compared to fiscal 2020 primarily due to interest expense related to the $550 Series 2020-1 and $300 Series 2020-2 General Obligation Notes issued in May 2020.

The net change in fair value of the investment in preferred interests of Aireon in fiscal 2021, was a loss of $24 as compared to a loss of $100 for fiscal 2020. The reduction recorded in fiscal 2021 was $36 CDN ($30 U.S.) as compared to a reduction of $112 CDN ($82 U.S.) recorded in fiscal 2020 due to the continuing impact of the COVID-19 pandemic. The reductions were partially offset by the accrual of dividend income of $12 CDN ($9 U.S.) and $13 CDN ($10 U.S.) for fiscal 2021 and 2020, respectively.

Foreign exchange losses increased by $7 during fiscal 2021 compared to fiscal 2020 primarily due to the impact of the fluctuation of the Canadian dollar against the U.S. dollar on the Company's investment in preferred interests of Aireon.

The fiscal 2021 income tax recovery is largely due to the reduction in the net deferred tax liability as a result of the reduction of the fair value of the investment in preferred interests of Aireon.

Net Movement in Regulatory Deferral Accounts Related to Net Income (Loss)

The net movement in regulatory deferral accounts related to net income (loss) represents regulatory accounting adjustments, including the rate stabilization mechanism, to adjust the accounting recognition of certain transactions to the periods in which they will be considered for rate setting.

	Years ended August 31		
	2021	2020	$ Change
Rate stabilization account [1]	$ 401	$ 348	$ 53
Other regulatory deferral accounts:			
Employee benefit pension contributions	147	177	(30)
Other employee benefits	(13)	(18)	5
Investment in preferred interests, before tax	37	103	(66)
Income tax	(9)	(27)	18
Allowance for expected credit losses	12	-	12
Other	2	1	1
	$ 577	$ 584	$ (7)

[1] The movements in the rate stabilization account are detailed in the table below under "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account".

The decrease in the net movement in the employee benefit pension contributions regulatory deferral account to adjust the total pension benefit expense to reflect the cash amount of contributions to be recovered through rate setting is largely due to the decrease in pension current service costs as a result of a decrease in overall staffing levels and the future salary rate assumption at August 31, 2020 compared to August 31, 2019. The net movement also includes the deferral of curtailment expense of $12 recorded during fiscal 2021 as a result of a significant reduction of active employees covered by the pension plan due to workforce reductions implemented in the first half of the fiscal year.

The net movement in the other employee benefits regulatory deferral accounts for fiscal 2021 of $13 is largely due to the recovery of net re-measurement losses previously deferred related to the Company's supplemental pension and other post-employment benefits plans. Annual re-measurements are deferred and recovered over the expected average service period of plan members.

(in millions of dollars)

The change in the net movement in regulatory deferral accounts of the Company's investment in preferred interests, before tax of $66 during fiscal 2021, is primarily due to the lower reduction of the fair value of the investment in preferred interests of Aireon during fiscal 2021 as compared to the reduction during fiscal 2020, as well as the change in foreign exchange impacts due to fluctuation of the Canadian dollar against the U.S. dollar.

The change in the net movement in regulatory deferral of income tax of $18 during fiscal 2021 reflects the decrease in the net deferred tax liability as a result of the decrease in fair value of the investment in preferred interests of Aireon.

The $12 net movement in the allowance for expected credit losses regulatory deferral account during fiscal 2021 is a result of deferring the non-cash impact of accounting for lifetime expected credit losses recorded on the deferred customer service charge base rate increase. See "LIQUIDITY AND CAPITAL RESOURCES – Financial Instruments and Risk Management".

Movements in Rate Stabilization Account

Our rate stabilization mechanism and accounting are described at the beginning of this MD&A and in notes 1 and 7 of our fiscal 2021 financial statements. The table below shows the net movements in the rate stabilization account.

	Years ended August 31		
	2021	2020	$ Change
Credit (debit) balance, beginning of period	$ (255)	$ 93	$ (348)
Variances from planned results:			
Revenue lower than planned	(228)	(518)	290
Operating expenses lower than planned	95	194	(99)
Other (income) and expenses higher than planned	(35)	(112)	77
Net movement in other regulatory deferral accounts	62	123	(61)
Total variances from planned results	(106)	(313)	207
Initial approved adjustment	(295)	(35)	(260)
Net movement in rate stabilization account recorded in net income (loss)	(401)	(348)	(53)
Credit balance, end of period	$ (656)	$ (255)	$ (401)

The $401 net movement in the rate stabilization account during the year ended August 31, 2021 is primarily due to:

- the planned adjustment of $295, representing the anticipated annual net loss at the time the fiscal 2021 budget was approved;
- revenue $228 lower than planned primarily due to lower air traffic levels (as measured in WCUs) as well as lower revenue from service and development contracts; and

- other (income) and expenses $35 higher than planned, primarily due to:
  - the net reduction of the fair value of the investment in preferred interests of Aireon of $29;
  - foreign exchange losses of $12 on our investment in preferred interests of Aireon; partially offset by
  - an income tax recovery of $7 largely due to the reduction of the fair value of the investment in preferred interests of Aireon;

partially offset by:

- operating expenses that were $95 lower than planned, primarily due to unbudgeted CEWS receipts, lower overtime and restructuring costs than planned and the Company's continued efforts to manage discretionary spending amid the COVID-19 pandemic; and
- net movement in other regulatory deferral accounts that was $62 higher than planned primarily due to:
  - a regulatory adjustment $13 higher than planned primarily due to higher pension curtailment expense recorded at August 31, 2021;
  - a regulatory adjustment of $29 to offset the reduction of the fair value of the investment in preferred interests of Aireon;
  - a regulatory adjustment of $12 related to the deferral of foreign exchange losses on our investment in preferred interests of Aireon; and
  - a regulatory adjustment of $12 related to the allowance for expected credit losses as a result of increased lifetime expected credit losses recorded on the receivable amount from the deferral of the customer service charge base rate increase; partially offset by
  - a regulatory adjustment of $7 related to the deferral of income tax recoveries largely due to the reduction of the fair value of the investment in preferred interests of Aireon.

Other Comprehensive Income (Loss)

The accounting recognition of other comprehensive income (loss) amounts are completely offset by regulatory deferrals in order to defer the accounting recognition to the periods in which they will be considered for rate setting. These transactions are generally considered for rate setting when the amounts are expected to be realized in cash, with the exception of the cash flows related to hedging instruments, which are considered for rate setting in the same period as the underlying hedged transaction, and re-measurements of unfunded defined employee benefit plans, which are considered for rate setting over the employees' average expected remaining service period.

(in millions of dollars)

	Years ended August 31		
	2021	2020	$ Change
Items that will not be reclassified to income or (loss)			
Re-measurements of employee defined benefit plans	$ 933	$ 367	$ 566
Net movement in regulatory deferral accounts	(933)	(367)	(566)
	-	-	-
Items that will be reclassified to income or (loss)			
Amortization of loss on cash flow hedges	$ 1	$ 1	$ -
Changes in fair value of cash flow hedges	3	(4)	7
Net movement in regulatory deferral accounts	(4)	3	(7)
	-	-	-
Total other comprehensive income (loss)	$ -	$ -	$ -

Net re-measurement gains on employee defined benefit plans of $933 were recorded during fiscal 2021. This was primarily due to a return on plan assets $446 greater than expected based on the discount rate of 2.80% at August 31, 2020, actuarial gains of $470 largely due to a 30 basis point increase in the discount rate to 3.10% at August 31, 2021 and experience adjustments of $17. For fiscal 2020, the net re-measurement losses of $367 were primarily due to a return on plan assets $276 greater than expected based on the discount rate of 2.90% at August 31, 2019, actuarial gains of $156 largely due to changes in future salary increase assumptions, partially offset by net negative impacts from demographics and experience adjustments of $65.

During fiscal 2021, the Company recognized positive fair value adjustments of $3 on the Company's foreign exchange hedges, as compared to negative fair value adjustments of $4 in fiscal 2020.

Amounts Considered for Rate Setting Purposes

As discussed under "INTRODUCTION – Financial Strategy and Rate Regulation", when establishing customer service charges the Company monitors quarterly and considers, among other things:

(a) air traffic results and forecasts;

(b) financial and operating requirements, including our current and anticipated balance in the rate stabilization account and the extent to which our operating costs are variable and can be contained;

(c) the recovery of pension contributions on a cash basis; and

(d) updates to our financial forecasts, debt servicing and financial requirements, and resulting financial coverage ratios.

The table below shows the balance of the rate stabilization account and the amount of regulatory pension cash contributions to be recovered at a later date:

	August 31 2021	August 31 2020	$ Change
Rate stabilization account debit balance	$ 656	$ 255	$ 401
Regulatory pension cash contributions to be recovered at a later date	$ 34	$ 34	$ -

(in millions of dollars)

Financial Outlook[3]

As noted previously under "INTRODUCTION - Caution Concerning Forward-Looking Information" and "INTRODUCTION - Significant Financial Matters", the COVID-19 pandemic began impacting revenue commencing in the third quarter of fiscal 2020. Since that time, air traffic levels, as measured in WCUs, has continued to trend well below pre-pandemic volumes.

While the full duration and scope of the COVID-19 pandemic on air traffic is not known, it is expected to continue to have a negative impact on air travel domestically and globally in the near-term. As government restrictions on air travel are slowly being relaxed, the willingness to resume air travel has increased, resulting in an upward trend in movement-based air traffic revenues; a trend noted in the fourth quarter of fiscal 2021. The Company anticipates that air traffic will continue to recover, however the extent of the recovery and its timing remains subject to significant variation. In anticipation of a recovery, the Company is positioning itself to support a recovery in the aviation industry, which we see occurring as air carriers restore routes, vaccination levels increase and travel restrictions are removed.

Presented below are the Company's current projected annual consolidated results before rate stabilization for our fiscal 2022 compared to fiscal 2021 actual results. These projections reflect the assumption that air traffic levels will continue to recover in fiscal 2022. In developing its forecast, the Company noted several critical uncertainties, including:

- continued occurrence of COVID-19 outbreaks;
- emergence and travel-related spread of new COVID-19 variants;
- additional or continued travel restrictions and quarantine requirements; and
- global vaccination rates.

The Company continues to assess the impact of the revenue reductions on operations and is managing operating costs and capital spending accordingly.

	Fiscal 2022	Fiscal 2021	$ Change	% Change
Before rate stabilization				
Revenue	$ 1,317	$ 870	$ 447	51%
Operating expenses and other (income) and expenses, including other regulatory adjustments	1,402	1,271	131	10%
Net loss before rate stabilization adjustments	$ (85)	$ (401)	$ 316	

Revenue

Revenue in fiscal 2022 is expected to increase to $1,317 from $870 in fiscal 2021 primarily due to a forecasted increase in air traffic levels of 54.0% on a year-over-year basis, as measured in WCUs. In comparison to fiscal 2019, however, air traffic levels are expected to be 31.7% lower.

In our Q3 fiscal 2021 MD&A, we had disclosed anticipated revenue of $798 for fiscal 2021 and forecasted a 59.2% decline in air traffic levels as compared to fiscal 2019. The increase in revenue is due to the easing of travel restrictions and increased consumer demand in the last quarter of fiscal 2021, resulting in a decline in air traffic levels of 55.7% as compared to fiscal 2019.

[3] Note: See "INTRODUCTION – Caution Concerning Forward-Looking Information", page 1

Operating Expenses and Other (Income) and Expenses

Operating expenses and other (income) and expenses before rate stabilization for fiscal 2022 are expected to be $1,402. This is an increase of 10% compared to fiscal 2021 primarily due to:

- lower CEWS receipts offsetting compensation costs as a result of the end of the program in October 2021;
- increased overtime costs as a result of the expected increase in air traffic levels and resumption of training and other activities that were halted at the onset of the COVID-19 pandemic; and
- increased travel and facilities costs, as activities put on hold at the onset of the COVID-19 pandemic or delayed as a result of the COVID-19 pandemic are expected to resume or increase;

partially offset by:

- reduced compensation levels, largely due to early retirements in fiscal 2020 and workforce reductions in fiscal 2021; and
- reduced pension current service contributions, largely due to the timing of the adjustment of contributions in September 2020 following the filing of the January 1, 2020 funding valuation.

In our Q3 fiscal 2021 MD&A, we had disclosed anticipated operating expenses and other (income) and expenses, before rate stabilization of $1,276 for fiscal 2021. The reduction is a result of continued management of discretionary spending.

Cash Flows

Given the expected net cash outflows from operations, investing and financing activities in fiscal 2022, the Company's cash position is currently anticipated to be $205 as at August 31, 2022 (August 31, 2021 - $319).

This cash outlook includes anticipated net cash inflows from operating activities of $32, largely due to increased customer service charge revenue as a result of higher air traffic levels and the repayment of one-fifth of the fiscal 2021 deferred cash payment of the September 1, 2020 increase in base rates. Pension contributions are also expected to be lower as the fiscal 2021 contributions included the adjustment of contributions based on the January 1, 2020 funding valuation filed in September 2020. These net cash inflows are partially offset by significantly lower CEWS receipts as a result of the end of the program in October 2021.

The net operating cash inflows are expected to be fully offset by cash outflows from investing activities of $118 for capital expenditures and cash outflows from financing activities of $28, related to the annual amortization payment of $25 for the Series 97-2 amortizing revenue bonds and the payment of lease liabilities.

In our Q3 fiscal 2021 MD&A, we had disclosed an anticipated cash position of $233 at the end of fiscal 2021. The increase is largely due to higher receipts from customer service charges, lower payments to employees and suppliers and lower capital expenditures than anticipated.

Rate Stabilization Account

The Company currently anticipates that the rate stabilization account will be in a debit position of $741 at the end of fiscal 2022 (August 31, 2021 – $656). This is mainly as a result of the continued impact of the COVID-19 pandemic on air traffic levels resulting in lower customer service charge revenue compared to the Company's operational requirements in order to ensure the safe operation and maintenance of the air navigation system as an essential service and to protect the safety of its employees. The current and anticipated balance in the rate stabilization account (see "RESULTS OF OPERATIONS – Amounts Considered for Rate Setting Purposes") is a consideration in the setting of rates as well as future cost containment measures to be taken.

In our Q3 fiscal 2021 MD&A, we had disclosed an anticipated rate stabilization account debit balance of $733 at the end of fiscal 2021. The decrease of $77 is due to air traffic levels better than expected and lower operating expenses as a result of continued cost management.

Earnings and Cash Flow Coverage

During a fiscal year, quarterly revenue from customer service charges will reflect seasonal or other fluctuations in the airline industry and therefore our net results vary from quarter to quarter. Our mandate to operate on essentially a financial breakeven basis results in a planned earnings coverage ratio – calculated on the basis of earnings before interest divided by interest expense – that is close to one-to-one. However, the seasonal nature of our revenue may result in an earnings coverage ratio of less than one-to-one for any interim period.

For the twelve months ended August 31, 2021, consistent with the nature of our operating structure, the Company had breakeven results. Our interest costs were $89. Consolidated earnings (after rate stabilization) before interest costs were $89, which equals our requirement for the fiscal year and meets our one-to-one earnings coverage ratio target. Depreciation and amortization expense for this period was $156. Our cash flow coverage was 2.75 times our interest requirement for this period.

Earnings coverage ratio and cash flow coverage are non-GAAP financial measures and do not have any standardized meaning prescribed by IFRS. The earnings coverage ratio and cash flow coverage are provided pursuant to and in compliance with National Instrument 44-102 *Shelf Distributions* of the Canadian Securities Administrators. The Company calculates the earnings coverage ratio on the basis of earnings before interest expense on financial liabilities at amortized cost (interest expense) divided by interest expense. Cash flow coverage is calculated on the basis of earnings (after rate stabilization) before interest expense, depreciation and amortization divided by interest expense. Under the *Income Tax Act* (Canada), NAV CANADA, excluding its subsidiaries, is not subject to income taxes and accordingly, no deduction for income taxes has been made. After the application of rate regulated accounting, the provision for income taxes related to our taxable subsidiaries is not significant.

We maintain a debt service reserve fund and an operations and maintenance reserve under the MTI and we are subject to liquidity covenants under the GOI, designed to cover 12 months interest on borrowings and 25% of our annual operating and maintenance expenses. As at August 31, 2021, we were in full compliance with our debt indentures. The Company has received temporary relief from compliance with the rate covenants and certain provisions under the additional indebtedness covenants under each of the MTI and the GOI, as the case may be, in respect of its fiscal years ending August 31, 2021, 2022 and 2023.

(in millions of dollars)

Related Party Transactions

The Company's related parties include its key management personnel, subsidiaries, joint ventures and associates and registered pension plans for its employees.

The Company's transactions with these related parties for the years ended August 31, were as follows:

	2021	2020
Key management personnel compensation	$ 9	$ 16
Purchase of data services (1)	55	38
Hardware and software purchases	-	1
	$ 55	$ 39
Cost recoveries (2)	$ 10	$ 15
Dividend income	12	13
	$ 22	$ 28

(1) The Company has a 12-year commitment with Aireon to purchase data services, which commenced in March 2019. The estimated total remaining commitment is $567 CDN ($440 U.S.).
(2) Cost recoveries include reimbursement for certain costs from the Company's pension plans and Aireon.

Contributions paid to the Company's registered pension plans are disclosed under the heading "LIQUIDITY AND CAPITAL RESOURCES – Cash Requirements: Pension Plans".

Outstanding balances as at August 31 were:

	2021	2020
Dividends receivable	$ 80	$ 76
Receivable from pension plan	9	6
Long-term loan receivable	3	3
Total	$ 92	$ 85

The Company also entered into an agreement with Aireon in January 2020 to provide a subordinated loan up to a total of $14 CDN ($11 U.S.).

Additional details of these transactions are disclosed in note 19 of our fiscal 2021 financial statements.

(in millions of dollars)

SUMMARY OF QUARTERLY RESULTS

Quarterly Financial Information (unaudited)

	Three months ended			
	Q4 August 31 2021	Q3 May 31 2021	Q2 February 28 2021	Q1 November 2020
Revenue	$ 293	$ 196	$ 179	$ 202
Operating expenses	347	305	317	309
Other (income) and expenses	19	86	40	31
	(73)	(195)	(178)	(138)
Income tax expense (recovery)	-	(9)	2	-
Net loss before net movement in regulatory deferral accounts	(73)	(186)	(180)	(138)
Net movement in regulatory deferral accounts				
Rate stabilization adjustments	159	119	81	42
Other regulatory deferral account adjustments	33	75	42	26
	192	194	123	68
Net income (loss) after net movement in regulatory deferral accounts	$ 119	$ 8	$ (57)	$ (70)

	Three months ended			
	Q4 August 31 2020	Q3 May 31 2020	Q2 February 29 2020	Q1 November 2019
Revenue	$ 155	$ 159	$ 322	$ 364
Operating expenses	264	351	387	369
Other (income) and expenses	56	129	25	31
	(165)	(321)	(90)	(36)
Income tax recovery	(1)	(27)	-	-
Net loss before net movement in regulatory deferral accounts	(164)	(294)	(90)	(36)
Net movement in regulatory deferral accounts				
Rate stabilization adjustments	177	169	2	-
Other regulatory deferral account adjustments	48	111	38	39
	225	280	40	39
Net income (loss) after net movement in regulatory deferral accounts	$ 61	$ (14)	$ (50)	$ 3

Discussion of Quarterly Results

Historically, the quarterly variations in revenue have mainly reflected seasonal fluctuations. Typically, revenue is highest in our fourth quarter (June to August) as a result of increased air traffic in the summer months, and the second quarter (December to February) has the lowest air traffic levels. The COVID-19 pandemic and the resulting economic contraction continues to have a significant negative impact on global air traffic and the aviation industry, therefore the normal seasonality pattern did not occur in fiscal 2021. The Company's air traffic levels increased 55.7% over the course of the fourth quarter of fiscal 2021 as compared to the same period in fiscal 2020, as measured in WCUs. However, in comparison to pre-pandemic levels experienced over the same period of fiscal 2019, air traffic levels decreased 50.1%.

The majority of our operating expenses are incurred evenly throughout the year. To offset the significant reduction in revenue as a result of the COVID-19 pandemic, the Company continues to review, monitor and manage spending.

Other (income) and expenses fluctuate primarily due to:

- fair value adjustments on investments, including the investment in preferred interests of Aireon, which change based on market factors and changes in expectations of credit losses;
- changes in net interest expense relating to employee benefits as a result of changes in discount rates; and
- changes in foreign exchange (gains) or losses as a result of the strengthening or weakening of the Canadian dollar compared to foreign currencies in which the Company transacts, mainly the U.S. dollar.

Net movement in regulatory deferral accounts related to net income (loss) fluctuates largely due to:

- changes in the rate stabilization account based on variances from planned results and the initial approved adjustment;
- the recovery of pension solvency deficiency contributions made;
- changes in employee benefit pension contributions and expense;
- changes in other employee benefits, including positive or negative LTD experience and funding requirements;
- changes in the investment in preferred interests of Aireon, before tax;
- changes in income taxes; and
- changes in expected credit losses.

LIQUIDITY AND CAPITAL RESOURCES

The following sections explain how we manage our cash and capital resources.

Our non-cash current assets are less than our current liabilities. This results from accounts receivable collections that are more rapid than the settlement of accounts payable and accrued liabilities. Should our working capital requirements increase, the Company has adequate credit facilities and cash as noted below.

(in millions of dollars)

The inclusion of non-cash depreciation and amortization expenses in the calculation of service charge rates typically leads to positive cash flows from operations. Our strategy is to use these positive cash flows to fund capital expenditures and to replenish our working capital, if required. In addition, our strategy is to maintain a financial structure and credit ratings that will allow the Company to access the capital markets to meet debt maturities as they come due. Should we believe that conditions are not appropriate to undertake a refinancing at a particular time or should we experience a temporary downturn in revenue from seasonal or other factors, the Company has sufficient cash and committed credit facilities at its disposal.

As a result of the COVID-19 pandemic, the Company had negative cash flows from operations of $425 in fiscal 2021 (fiscal 2020 - $96). Since the onset of the COVID-19 pandemic, the Company has increased its long-term debt by $1,100, made adjustments to its workforce to reduce compensation costs, accessed the CEWS program and exercised prudent management of discretionary costs.

As at August 31, 2021, we had $319 of cash and cash equivalents and undrawn committed credit facilities for general purposes of $848, all of which provided the Company with available liquidity. In addition, we had letter of credit facilities for pension funding purposes of $621 of which $27 was undrawn (see "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Financing Strategy").

Cash flows for the year ended August 31, 2021

	Years ended August 31		
	2021	2020	$ Change
Cash flows from (used in)			
Operating	$ (425)	$ (96)	$ (329)
Investing	64	(277)	341
Financing	(3)	1,031	(1,034)
Cash flows from (used in) operating, investing and financing activities	(364)	658	(1,022)
Effect of foreign exchange on cash and cash equivalents	(6)	1	(7)
Increase (decrease) in cash and cash equivalents	(370)	659	(1,029)
Cash and cash equivalents, beginning of period	689	30	659
Cash and cash equivalents, end of period	$ 319	$ 689	$ (370)
Free cash flow (non-GAAP financial measure)			
Cash flows from (used in):			
Operations	$ (425)	$ (96)	$ (329)
Capital expenditures [(1)]	(85)	(132)	47
Proceeds from sale of property, plant and equipment [(1)]	4	-	4
Payment of lease liabilities [(1)]	(3)	(3)	-
Free cash flow	$ (509)	$ (231)	$ (278)

(1) See the statement of cash flows in our fiscal 2021 financial statements.

As shown above, cash and cash equivalents decreased by $370 in fiscal 2021 and the Company experienced negative free cash flow of $509, which is a non-GAAP financial measure as discussed in "INTRODUCTION – Financial Highlights: Cash flows for the year ended August 31, 2021".

Cash outflows from operations for fiscal 2021 were $425 compared to $96 for fiscal 2020, primarily due to lower receipts from customer service charges of $304 as a result of the negative impact of the COVID-19 pandemic on air traffic levels and payment deferral provisions in the September 1, 2020 rate increase, lower other receipts of $19, higher interest payments of $16 and higher pension current service contributions of $18. The cash outflows were partially offset by higher government grants of $29, largely related to the CEWS program.

Cash flows from investing activities for fiscal 2021 were inflows of $64 compared to outflows of $277 for fiscal 2020. The change of $341 was primarily related to proceeds of $145 from the maturity of short-term investments purchased in fiscal 2020 and reductions to the Company's capital spending program, largely related to the COVID-19 pandemic.

Cash flows from financing activities for fiscal 2021 were outflows of $3 compared to inflows of $1,031 for fiscal 2020. During fiscal 2021, the Company issued General Obligation Notes for net proceeds of $498 and repaid the $250 Series MTN 2011-1 General Obligation Notes as well as $223 under the Company's syndicated credit facility. During fiscal 2020, the Company issued General Obligation Notes for net proceeds of $845 and also drew $215 from its syndicated credit facility to address near-term liquidity needs as a result of the COVID-19 pandemic.

Liquidity and Financing Strategy

As a corporation without share capital, the Company finances its operations with borrowed money. When the Company was created, we developed a financing plan called the Capital Markets Platform. All borrowings were incurred and secured under a MTI, which initially provided a total drawn and undrawn borrowing capacity of $3,000. The MTI provides for a gradually escalating reduction of the initial borrowing capacity over 33 years.

In February 2006, we entered into a separate trust indenture (the GOI), which established a borrowing program that qualifies as subordinated debt under the MTI. As subordinated debt, General Obligation Notes are not subject to the mandatory annual debt reduction provisions of the MTI. Provided we meet an additional indebtedness test, we are not limited in the amount of debt we can issue under the GOI. Under the terms of the GOI, no new indebtedness may be incurred under the MTI. Therefore, as bonds mature or are redeemed under the MTI, they will be replaced with General Obligation Notes or borrowings under our credit facility described below.

Borrowings under the MTI are secured by an assignment of revenue and a security interest over the debt service reserve fund and revenue account maintained under the MTI. The GOI is unsecured but contains positive and negative covenants similar to the MTI.

As noted previously under "INTRODUCTION - Significant Financial Matters", the Company has received temporary relief from compliance with the rate covenants and certain provisions under the additional indebtedness covenants under each of the MTI and the GOI.

We are exposed to refinancing risk with respect to our bond and note maturities, including the $25 annual amortizing payment due on the Series 97-2 amortizing revenue bonds. We mitigate this risk by maintaining committed credit facilities in an amount sufficient to meet our refinancing needs in the event of temporary capital market disruptions or lack of access to the market for any reason.

(in millions of dollars)

The Company has a revolving credit facility with a syndicate of Canadian financial institutions and separate letter of credit facilities for pension funding purposes. As at August 31, 2021, the credit facilities are utilized as follows:

Credit facilities for general purposes:		
Credit facility with a syndicate of Canadian financial institutions (1) (2)	$	850
Less: Outstanding letters of credit for other purposes (2)		2
Undrawn committed borrowing capacity		848
Less: Operations and maintenance reserve allocation (3)		275
Available for unrestricted use	$	573
Credit facilities for pension funding purposes:		
Letter of credit facilities for pension funding purposes (4)	$	621
Less: Outstanding letters of credit for pension funding purposes (4)		594
Undrawn committed borrowing capacity	$	27

(1) The Company's credit facility with a syndicate of Canadian financial institutions in the amount of $850 was comprised of two equal tranches maturing on March 26, 2024 and March 26, 2026, respectively. The credit facility agreement provides for loans at varying rates of interest based on certain benchmark interest rates, specifically the Canadian prime rate and the Canadian bankers' acceptance rate, and on the Company's credit rating at the time of drawdown. A utilization fee is also payable on borrowings in excess of 25% of the available facility. The Company is required to pay commitment fees, which are dependent on the Company's credit rating. The Company is in compliance with the credit facility covenants as at August 31, 2021.

(2) At August 31, 2021, $2 was drawn from an uncommitted revolving credit facility. In connection with this facility, an allocation of $25 with a Canadian financial institution has been made under its $850 committed credit facility.

(3) The operations and maintenance reserve may be used to pay operating and maintenance expenses, if required (see also "LIQUIDITY AND CAPITAL RESOURCES – Financial Instruments and Risk Management: Reserve Funds and Financial Instruments"). Subsequent to August 31, 2021, the allocation amount was reduced to $257 based on actual fiscal 2021 operating and maintenance expenses.

(4) The letter of credit facilities for pension funding purposes are comprised of four facilities with Canadian financial institutions, which will mature on December 31, 2021, unless extended.

(in millions of dollars)

The table below shows our long-term debt, liquidity and investments profile.

	August 31 2021	August 31 2020
LONG-TERM DEBT		
Bonds and notes payable		
Under the MTI	$ 400	$ 425
Under the GOI	2,125	1,875
	2,525	2,300
Adjusted for deferred financing costs	(13)	(12)
Total bonds and notes payable	2,512	2,288
Less: current portion of long-term debt	(25)	(275)
Total long-term debt	$ 2,487	$ 2,013
LIQUIDITY		
Cash and cash equivalents	$ 319	$ 689
Short-term investments	-	145
Debt service reserve fund	73	73
Undrawn committed borrowing capacity	848	625
Total Liquidity	$ 1,240	$ 1,532

Credit Ratings

The Company's debt obligations have been assigned the following credit ratings and outlooks:

Rating Agency	Senior Debt	General Obligation Notes	Outlook
Moody's Investors Service (Moody's)	Aa2	Aa2	Stable
Standard & Poor's (S&P)	AA-	A+	Negative

On June 7, 2021, S&P lowered the Company's long-term issuer credit and senior secured debt ratings by one notch to AA- from AA, and its subordinated debt rating to A+ from AA- while the outlook remains negative.

The action was driven by sustained low air traffic levels which are expected to persist further into fiscal 2022, resulting in negative earnings before interest, depreciation and amortization and weakened debt metrics beyond their previous expectations. S&P states that they believe that the Company's key financial metrics will begin to demonstrate a material improvement beyond fiscal 2022 and that the deterioration in financial metrics is not reflective of the Company's longer-term creditworthiness and inherent credit strengths.

S&P noted the Company's following credit strengths:

- Monopolistic business position as the national provider of essential air navigation services (nonmilitary) within Canadian-controlled airspace and legislated ability to levy user charges on airlines to meet financial requirements;

- A relatively wealthy service area, with gross domestic product per capita of almost U.S. 44,400 dollars, covering all of Canada (and beyond), limiting localized economic risks; and
- An experienced and prudent management team that we believe is quickly reacting to adverse market conditions.

They also noted the following credit challenges:

- Protracted weakness in activity levels as a result of the ongoing pandemic is having a significant impact on the company's financial performance, with weak debt service coverage and very high debt leverage expected through fiscal 2022;
- Significantly reduced cash flow generation ability and a weakened rate-setting environment while flight volumes remain materially depressed;
- Limited ability to reduce service levels in line with decline in activity levels; and
- Reliance on lines of credit considered as part of a vulnerable liquidity position.

On September 16, 2021, S&P released its latest report and there have been no changes to their base case assumptions or view of upside or downside risks.

On January 26, 2021, Moody's issued a credit opinion affirming NAV CANADA's base line credit assessment at Aa2 and its senior and subordinated ratings at Aa2. Moody's noted the Company's following credit strengths:

- Essential infrastructure asset for the Canadian air transportation system;
- Monopoly provider of civil air navigation services over a very large airspace;
- Legislated right to establish and levy rates and charges as needed to meet financial requirements resulting in good degree of cash flow predictability; and
- Manageable capital expenditure program.

They also noted the following credit challenges:

- Material short-term negative impact of the coronavirus outbreak on revenues due to reduced air traffic activity; and
- Defined benefit pension plan creates recurring calls on cash.

Moody's stated that "the stable rating outlook reflects our expectation that NAV CANADA will continue to implement the necessary rate increases to compensate for lower levels of air traffic activity as a result of the coronavirus outbreak and that it will maintain a strong liquidity profile."

Cash Requirements

The following information about our contractual obligations and other commitments summarizes certain of our liquidity and capital resource requirements.

Pension Plans[4]

The Company continues to meet the funding requirements of its two defined benefit registered pension plans, the NAV CANADA Pension Plan (NCPP) and the NAV CANADA Executive Pension Plan (NCEPP), in accordance with the regulations of the Office of the Superintendent of Financial Institutions Canada (OSFI). Effective January 1, 2021 and subject to OSFI approval, the NCEPP will be merged into the NCPP, with executive pensionable service accruing before April 1, 2022 continuing to be defined by the current NCEPP provisions, but within the NCPP. With the relative sizes of the two plans, the merger has minimal impact on the NCPP and no impact on NAV CANADA's aggregate obligations. However, until OSFI grants its approval, the two plans will continue to operate independently.

Required pension contributions to the Company's pension plans are determined by annual actuarial valuations for funding purposes performed as at January 1 (see below under "Pension Contributions (Going Concern and Solvency)"). Our latest actuarial valuation of the NCPP (for funding purposes), including the impact of the merger, was performed as at January 1, 2021 and filed with OSFI in June 2021.

Pension Plans' Accounting Deficit: The Company's pension plans had an accounting deficit of $992 as at the annual measurement date of August 31, 2021 ($1,771 as at August 31, 2020). The decrease of $779 in the deficit position during fiscal 2021 is primarily due to actuarial gains of $928 partially offset by actuarial accounting expense exceeding Company contributions by $149. The $928 of actuarial gains are primarily due to a return on plan assets $446 greater than expected based on the discount rate of 2.80% at August 31, 2020, actuarial gains of $461 largely due to a 30 basis point increase in the discount rate to 3.10% at August 31, 2021, and experience adjustments of $21.

The accounting deficit was $1,771 as at the annual measurement date of August 31, 2020 ($1,957 as at August 31, 2019). The decrease of $186 in the deficit position during fiscal 2020 is primarily due to actuarial gains of $369 partially offset by actuarial accounting expense exceeding Company contributions by $183. The $369 of actuarial gains are primarily due to a return on plan assets $276 greater than expected based on the discount rate of 2.90% at August 31, 2019, actuarial gains of $157 largely due to changes in future salary increase assumptions, partially offset by net negative impacts from demographics and experience adjustments of $64.

The market-based discount rate used to determine pension obligations is based on the yield on long-term high quality corporate bonds, with maturities matching the estimated cash flows of the plan. A 0.25% decrease in the discount rate would increase the accounting deficit by approximately $390. Conversely, a 0.25% increase in the discount rate would decrease the deficit by approximately $364.

Pension Expenses: Annual pension benefit costs can increase by approximately $23 from a 0.25% decrease in the discount rate used in actuarial calculations or decrease by approximately $23 from a 0.25% increase in the discount rate.

Regulatory Recovery of Pension Costs: The Company uses a regulatory approach for pension costs to determine the net impact charged to net income (loss). The objective of this approach is to expense the cost of the Company's going concern cash contributions to the funded pension plans. In the fiscal year ended August 31, 2017 (fiscal 2017), the Company made solvency deficiency contributions of $44 which were deferred. During the fiscal year ended August 31, 2018, $10 was recorded as a regulatory expense to recover part of the contributions. The remaining balance of $34 is expected to be recovered through future customer service charges.

[4] Note: See "INTRODUCTION – Caution Concerning Forward-Looking Information", page 1

(in millions of dollars)

The funding of employee benefits as compared to the expense, net of regulatory adjustments, recorded in the consolidated statement of operations for the Company's funded pension plans is as follows:

	Years ended August 31	
	2021	2020
Consolidated statement of operations		
Pension current service expense [(1)]	$ 198	$ 218
Curtailment expense [(2)]	12	-
Net interest expense [(1)]	45	50
Less: Regulatory deferrals	(147)	(177)
	108	91
Company cash pension contributions		
Going concern current service	108	91
Regulatory recovery of fiscal 2017 solvency contributions	$ -	$ -

[(1)] Pension current service expense does not include $3 related to the Company's unfunded pension plan (fiscal 2020 - $5) and net interest expense does not include $4 related to the Company's unfunded pension plan (fiscal 2020 - $4).

[(2)] The Company recorded a curtailment expense on its pension benefit plans which is included in salaries and benefits expense. The curtailment expense results from workforce reductions in the first half of fiscal 2021 which resulted in a significant reduction of active employees covered by the plan.

Pension Contributions (Going Concern and Solvency): The actuarial valuations for funding purposes of the pension plans performed as at January 1, 2021 reported a going concern surplus of $1,297 (January 1, 2020 – $933).

The regulations governing the funding of federally regulated pension plans include a solvency test, which assumes the plans are terminated as at the valuation date. The actuarial valuations performed as at January 1, 2021 reported a statutory solvency deficit of $501 as of January 1, 2021 (January 1, 2020 - $192).

The Company has the option of meeting its pension solvency funding requirements with letters of credit or cash contributions, with the maximum letters of credit based on 15% of solvency liabilities. As at August 31, 2021, the Company has put in place letters of credit totaling $594 to meet its cumulative pension solvency funding requirements, including $61 in fiscal year 2021. Outstanding letters of credit represent 7% of solvency liabilities.

Going concern pension contributions for fiscal 2021 were $108, with no requirement for cash special payments. Once the valuations are filed, going concern pension contributions are based on the January 1, 2021 actuarial valuations. On a preliminary basis, going concern pension contributions for fiscal 2022 are expected to be $98 with no requirement for cash special payments. The decrease over fiscal 2021 contributions is largely due to the timing of the adjustment of contributions in September 2020 following the filing of the January 1, 2020 funding valuation.

The amount of required Company contributions and additional letters of credit for future years will be dependent on the investment experience of plan assets, the discount rates and other assumptions that will be used in future actuarial valuations to determine plan liabilities, as well as any changes in pension plan design or funding requirements that may be enacted.

(in millions of dollars)

Risks Associated with the Defined Benefit Plans: The nature of these benefit obligations exposes the Company to a number of risks, the most significant of which is funding risk. Funding risk can be expressed as the probability of an unusually high level of required pension contributions or significant fluctuation in required pension contributions.

Adverse changes in the value of plan assets of funded plans, long-term return and inflation expectations, interest rates and life expectancy could have a significant impact on pension funding requirements. The funded plan invests in assets that expose it to a range of investment risks. It has strategies, policies and processes in place to manage these risks.

More specifically, funding risk is managed as follows:

(i) interest rate and inflation risk are managed via implementation of a liability driven investment strategy that focuses on reducing the interest rate and inflation risk mismatch between the plan assets and its pension benefit obligations; and

(ii) market risk, credit risk and liquidity risk related to the plan assets are managed through diversification amongst different asset classes, securities, risk factors and geographies while adhering to established investment policies, guidelines and collateral requirements.

Contractual Obligations

A breakdown of contractual obligations as at August 31, 2021 for the next five fiscal years and thereafter is presented in the following table. Total contractual obligations exclude commitments for goods and services in the ordinary course of business. Also excluded are other long-term liabilities mainly due to reasons of uncertainty of timing of cash flows and items that are non-cash in-nature.

	Remaining payments – for years ending August 31						
	Total	2022	2023	2024	2025	2026	Thereafter
Derivative liabilities	$ 1	$ 1	$ -	$ -	$ -	$ -	$ -
Long-term debt (including current portion) (1), (2)	2,525	25	25	225	25	325	1,900
Interest payments (2)	1,410	82	80	78	75	72	1,023
Capital commitments	124	65	11	12	8	5	23
Lease liability	3	3	-	-	-	-	-
Future lease liabilities(3)	59	-	2	3	3	3	48
Related party loan (4)	14	14	-	-	-	-	-
Total contractual obligations	$ 4,136	$ 190	$ 118	$ 318	$ 111	$ 405	$ 2,994

(1) Payments represent principal of $2,525. 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 13 of the fiscal 2021 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.

(in millions of dollars)

(4) The Company has an agreement with Aireon to provide a subordinated loan up to a total of $14 CDN ($11 U.S.).

The Company's letters of credit are discussed under the heading "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Financing Strategy".

Capital Expenditures and Other Investments[5]

Planning capital expenditures in respect of systems, technology, buildings and equipment forms part of our annual budgeting process. As part of this planning, we review proposed capital expenditures against safety, financial and business needs justification criteria, considering the Company's unique status as a provider of essential safety-critical infrastructure. As a result of the COVID-19 pandemic, significant reductions were made to the Company's originally planned fiscal 2021 capital program.

During fiscal 2021, the Company invested $91 in capital assets (cash outflows of $85, excluding capitalized interest of $2) compared to $107 in fiscal 2020 (cash outflows of $132, excluding capitalized interest of $2). Investments were made in systems enhancements, functional upgrades, equipment upgrades or replacements, facility replacements or refurbishment and other projects to meet safety and other operational requirements.

We anticipate spending approximately $120 on capital assets in fiscal 2022.

Capital Management

The Company views capital as the sum of its issued long-term debt, retained earnings and accumulated other comprehensive income, regulatory deferral accounts and balances under certain employee benefit plans, as depicted in the following table. This definition of capital is used by management and may not be comparable to measures presented by other companies.

	August 31 2021	August 31 2020
Bonds and notes payable	$ 2,512	$ 2,288
Equity:		
Retained earnings	28	28
Regulatory deferral accounts:		
Debit balances	(1,714)	(2,112)
Credit balances	146	184
Employee benefits:		
LTD asset	-	(4)
Liability for funded pension benefits	876	1,643
Liability for accumulating sick leave	17	16
Total capital	$ 1,865	$ 2,043

In addition to tracking its capital as defined above for purposes of managing capital adequacy, the Company also takes into consideration known contingent exposures and obligations such as rate setting decisions made by the Board.

[5] Note: See "INTRODUCTION – Caution Concerning Forward-Looking Information", page 1

The Company's main objectives when managing capital are:

(i) to safeguard the Company's ability to continue as a going concern;

(ii) to provide funds for the ongoing acquisition of systems and equipment necessary to implement and maintain a modern, cost-efficient ANS technology platform;

(iii) to ensure the funding of reserve funds as well as working capital and liquidity requirements;

(iv) to ensure the funding of regulatory requirements such as funding defined benefit pension plan contributions;

(v) to maintain the Company's credit ratings to facilitate access to capital markets at competitive interest rates; and

(vi) to minimize interest costs incurred by the Company subject to appropriate risk mitigation actions.

Given that the Company has no share capital, these objectives are achieved through a process that determines an appropriate period and level of cost recoveries through customer service charge rate setting, as well as the appropriate amount of debt and committed credit facilities. This process includes the Company's operational and capital budgeting process and considers the overall economic and capital market environments. The level of debt and committed credit facilities are approved by the Board. The Company is not subject to any externally imposed capital requirements.

Management's responses to managing capital during the current economic period, including variable air traffic and pension funding requirements, are addressed in other sections of this MD&A.

There were no changes in the Company's approach to capital management during the year ended August 31, 2021.

Financial Instruments and Risk Management

Reserve Funds and Financial Instruments

Financial instruments are also disclosed in note 15 to the fiscal 2021 financial statements. Under the MTI, we maintain a debt service reserve fund and an operations and maintenance reserve. We are also required to meet certain minimum liquidity levels under the GOI.

The debt service reserve fund is maintained in cash and qualified investments deposited with our Trustee. An amount equal to or greater than one year's debt service on MTI debt is required to be maintained. The debt service reserve fund also counts toward our minimum cash liquidity level requirement under the GOI, which is one year's interest on all debt. The GOI also requires a minimum liquidity level to be maintained which is equal to the minimum cash liquidity level plus the operations and maintenance reserve requirement which is defined as one quarter of the previous year's operating and maintenance expenses. The operations and maintenance reserve requirement is met with an allocation of undrawn availability under our committed credit facility.

As at August 31, 2021 we were in full compliance with our debt indentures.

Financial Risk Management

Interest Rate Risk: We are exposed to the risk that net interest expense will increase as a result of changes in market interest rates. One aspect of this risk relates to the possibility that maturing bonds may need to be re-financed at higher interest rates. We mitigate this source of interest rate risk in the following ways:

- maturities of borrowings are currently spread over periods up to and including 2051 so that only a portion of outstanding debt will mature in any given fiscal year; and

- the Company periodically enters into hedging arrangements as required to mitigate the impact of rising interest rates on the cost of refinancing debt.

A second source of interest rate risk is that the Company has $392 invested in financial assets that bear interest at floating rates. Earnings on the financial assets will fall when interest rates decline. In the current low interest rate environment, the Company has positioned itself to benefit from increased earnings on floating rate assets as a result of rising interest rates without an offsetting increase in interest expense.

Interest rate risk relating to our pension plans is discussed above under "LIQUIDITY AND CAPITAL RESOURCES – Cash Requirements: Pension Plans".

Foreign Exchange Risk: The Company is exposed to foreign exchange risk on sales and purchases that are denominated in currencies other than in the functional currency of the Company. However, the Company invoices and receives the vast majority of its revenue in Canadian dollars and also incurs operating expenses and capital expenditures primarily in Canadian dollars. The majority of the Company's exposure to foreign exchange risk relates to the U.S. dollar. The Company does not have a significant exposure arising from other currencies. The Company has $297 ($235 U.S.) of net exposure to U.S. dollar foreign exchange risk that is primarily related to the Company's investment in preferred interests of Aireon.

The Company designates certain of its forward contracts as cash flow hedging instruments to hedge the Company's exposure to the impact of exchange rate fluctuations. As at August 31, 2021, the Company has designated $1 (fair value) of its forward contracts as cash flow hedging instruments.

The foreign exchange rate sensitivity is the net amount of foreign exchange rate exposure of the items at the reporting date, less foreign currency hedges. As at August 31, 2021, if the Canadian dollar strengthened or weakened by 10% against the U.S. dollar, all other variables remaining constant, net income (loss) before net movement in regulatory deferral accounts would have been impacted by $29.

Other Price Risk: Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or foreign exchange risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

In order to mitigate the risk of losses arising from investment activities, the Company only invests in highly-rated (see credit risk discussion below) and short-term instruments, excluding Aireon and Searidge Technologies Inc.

During fiscal 2021, the Company reviewed and adjusted the fair value of its investment in preferred interests of Aireon. The fair value was determined using a discounted cash flow model. The estimated fair value of the investment in preferred interests of Aireon 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 valuation is discussed in note 15 of the fiscal 2021 financial statements.

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 global reduction in air traffic 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 Company's receipt of dividends will therefore be delayed.

Credit Risk on Investments: The Company limits investments to obligations of the federal government, certain provincial governments, entities guaranteed by a federal or provincial government or other obligations of entities rated by at least two rating agencies in the top two categories for long-term debt or the highest category for short-term debt. Asset backed securities must be sponsored by a Schedule I bank and may not contain synthetic assets. Our portfolio is diversified, with dollar and percentage limits on investment counterparties. None of the Company's holdings in current investments as at August 31, 2021 are past due or impaired, and all have long-term ratings in either the AAA or AA category or short-term ratings in the highest category.

Collection of Accounts Receivable: We have strong credit policies and have established a maximum credit limit of $4 for our largest air navigation services customers, with the exclusion for deferred payments, and have other credit control measures that reduce our credit exposure. Our general payment terms provide for payment periods of thirty days for air navigation services and payment periods of up to forty-five days for some other types of services, but shorter payment terms are imposed where customer circumstances warrant. Our credit policies also require payments in advance or satisfactory security to be posted under certain circumstances for all receivable amounts, including amounts that have been deferred for later collection, where NAV CANADA acting reasonably and in good faith is of the opinion that NAV CANADA charges will not be paid when due. However, while we have strong credit policies, we remain at risk should we be unable to collect amounts from customers as they come due in excess of the security we hold.

The Company revised its customer service charges effective September 1, 2020, increasing customer service charges by an average of 29.5% on base rate levels. The customer service charge increase includes provisions to ease the cash flow burden of the increase on customers through payment deferral mechanisms. For the Company's fiscal 2021, the portion of monthly invoices related to the customer service charge increase could be deferred and will become payable by customers in equal installments over the next five fiscal years, beginning in fiscal 2022. These provisions increase the Company's exposure to credit risk as payments required in advance and security deposits under the Company's credit policies may not be sufficient to cover potential losses.

The Company establishes an allowance for expected credit losses that represents its estimate of lifetime expected credit losses to be incurred in respect of accounts receivable. Given the high degree of uncertainty caused by the COVID-19 pandemic, the estimates and judgments made by management in the preparation of the expected credit loss allowance are subject to estimation uncertainty. Based on the Company's current estimates and assumptions, including but not limited to current and forecasted economic and credit conditions as well as recent trends for customer collections, the Company recorded an expected credit loss allowance of $13 during the year ended August 31, 2021. There were no significant balances past due.

Liquidity Risk: The Company mitigates this risk by monitoring current and expected liquidity requirements, taking into account trends in air traffic and expected contributions to our pension plans, to ensure that we maintain sufficient reserves of cash, cash equivalents, investments and/or available undrawn credit facilities to meet our liquidity requirements in the short and longer term. Under the MTI and GOI, the Company is required to maintain certain reserve funds and liquidity levels, as described in note 13 to our fiscal 2021 financial statements.

As at August 31, 2021, the Company had $848 of undrawn availability under its committed credit facilities and had allocated $275 of this facility to meet its operations and maintenance reserve fund requirement under the MTI. The Company has investments in highly rated short-term obligations in its debt service reserve fund. The Company believes that it has sufficient available liquidity to meet its operating needs.

Cash Flow Variances arising from Air Traffic levels: We are exposed to unpredictable changes in air traffic levels that directly affect the Company's cash flows, such as recessions (2009), terrorist attacks (2001), epidemics and pandemics (COVID-19 - 2020; SARS - 2004), air carrier financial difficulties, changes in air carrier operations (Boeing 737 Max grounding – 2019) and changing weather patterns that may cause flights to move into or out of Canadian air space. Future traffic levels could be influenced by a number of factors, including:

- Economic climate – Air traffic generally is influenced by economic growth, decline or uncertainty. For example, during an economic downturn, growth rates in air traffic generally decline. Since a substantial portion of air traffic is international, traffic levels are influenced by both Canadian and global economic circumstances. On an annual basis (using typical air traffic levels, excluding the impact of COVID-19), a 1.0% change in air traffic levels flown in Canadian airspace corresponds to approximately a $14 change in our revenue before rate stabilization.

- Aviation fuel prices – As fuel represents a major portion of airline operating costs, a change in the price of fuel can affect air traffic demand to the extent that the change is passed on to consumers.

- Terrorist activities, epidemics, pandemics, passenger willingness to travel, government restrictions on air travel, natural disasters, environmental concerns or weather patterns may all affect air traffic levels within the airspace for which the Company provides air navigation services.

Our strategy is to mitigate the immediate impact of a sudden decline in air traffic with the least disruption possible to our customer base. We do this with our rate stabilization mechanism, which reduces short-term volatility in customer service charges. Our rate stabilization account tracks and accumulates revenue and expense variances from planned levels (whether positive or negative), so that they may be factored into the setting of future customer service charges. The Company continues to review, monitor and manage capital and operating spending and cash outflows to help offset the significant decline in revenue.

We also mitigate the impact of sudden declines in air traffic by maintaining substantial liquidity in the form of our reserve funds and unrestricted available credit facilities (see discussion under "Liquidity Risk" above).

Insurance

Our aviation liability insurance program was last renewed on November 15, 2020 and we intend to renew it on November 15, 2021. This insurance covers all of our ANS liabilities to third parties. The Company also carries other lines of insurance at levels deemed to be appropriate by management for the nature of our business. The cost of this insurance is not material to the Company.

The Company is contractually obligated to indemnify the Government of Canada for any loss suffered by or claimed against it which is covered by the Company's aviation operations liability insurance.

Legal Proceedings

The Company is party to certain legal proceedings in the ordinary course of its business. Management does not expect the outcome of any of these proceedings to have a material adverse effect on the consolidated financial position or results of operations of the Company.

CHANGES IN ACCOUNTING POLICIES

A summary of the Company's significant accounting policies are described in note 3 to the fiscal 2021 financial statements.

There have been no new standards, amendments or interpretations adopted by the Company effective September 1, 2020.

Future Accounting Pronouncements

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

The amendments described below are applicable for reporting periods beginning on or after January 1, 2023. The extent of the impact of these amendments on the Company has not yet been determined.

IAS 8 Definition of Accounting Estimates

In February 2021, the IASB published Definition of Accounting Estimates (Amendments to IAS 8) to introduce a definition of accounting estimates and include other amendments to IAS 8 to help entities distinguish changes in accounting policies from changes in accounting estimates.

IAS 1 Disclosure of Accounting Policies

In February 2021, the IASB issued Disclosure of Accounting Policies (Amendments to IAS 1 and IFRS Practice Statement 2) with amendments that are intended to help preparers in deciding which accounting policies to disclose in their financial statements.

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of financial statements in conformity with IFRS requires management to make estimates and judgments that affect the reported amounts of revenue and expenses during the period, the reported amounts of assets and liabilities, and the disclosure of commitments and contingencies at the date of the financial statements. These estimates and judgments are based on historical experience, current conditions and various other assumptions made by management that are believed to be reasonable under the circumstances. By their nature, these estimates and judgments are subject to uncertainty and the amounts currently reported in the Company's financial statements could, in future, prove to be inaccurate.

The following accounting estimates and judgments are based on management's assumptions and are considered to be critical as they involve matters that are highly uncertain. Any changes from those estimates and judgments could have a material impact on our financial statements. The estimates and judgments are reviewed on an ongoing basis.

Key Sources of Estimates and Assumption Uncertainties

Employee Benefits

We account for pension, other post-employment benefits and other long-term benefits as required by IAS 19 *Employee Benefits*.

Under IFRS, the amounts reported in our consolidated financial statements are determined using actuarial assumptions regarding the estimation of future benefit obligations and investment performance of plan assets. These assumptions include, but are not limited to, the discount rate used to estimate the future benefit obligation, the rate of compensation increase, inflation, mortality, health-care cost trends and expected average remaining years of service of employees. The amounts impacted are the employee benefits asset and liability on the statement of financial position, salaries and benefits and net finance costs relating to employee benefits on the statement of operations, and re-measurements of employee defined benefit plans on the statement of comprehensive income.

While these assumptions reflect management's best estimates, differences in actual results or changes in assumptions could materially affect employee benefit obligations and future net benefit plan costs.

The most significant assumptions used to calculate the net costs of our employee benefit plans are the discount rate used to determine employee benefit obligations including pensions and pensioner mortality assumptions.

The discount rate is the interest rate used to determine the present value of the future expected cash flows that will be needed to meet employee benefit obligations. It is based on the yield on long-term high quality corporate bonds, with maturities matching the estimated cash flows of the plan.

Funding of the pension plans' deficits (as determined in funding valuations in accordance with OSFI regulations) in prior years resulted in pension contributions significantly higher than pension benefit expenses charged to the statement of operations. Our estimates for future pension contributions are discussed above under the heading "LIQUIDITY AND CAPITAL RESOURCES – Cash Requirements: Pension Plans".

Refer to note 2 of our fiscal 2021 financial statements for more detailed information on key sources of estimation and uncertainty related to employee benefits.

Investment in Preferred Interests of Aireon

The Company's investment in Aireon is in preferred interests, which are redeemable and convertible to common equity interests. Until the Company exercises its right to convert its preferred interests to common interests, it does not have access to Aireon's residual net assets and accordingly this investment is accounted for as a financial instrument classified and measured at FVTPL.

The fair value of the Company's investment in preferred interests of Aireon is determined using a discounted cash flow model, which considers the present value of expected future payments, discounted using a risk-adjusted discount rate. The cash flow projections reflect the continued impact of the COVID-19 pandemic on international air traffic and the resulting impact on Aireon's operations and revenue. The critical assumptions and estimates used when determining the fair value are:

- 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
- expected timing and amount of future dividend payments – the timing and amount of the payments based on Aireon's forecasted after-tax dividend payment schedule has been adjusted to reflect the impact of the COVID-19 pandemic.

The Company continues to monitor the status of Aireon in order to determine whether there are any indicators that would impact Aireon's fair value. Changes in the valuation of Aireon as a whole could materially affect the valuation of the investment in preferred interests, with changes reflected in the statement of operations as required. The investment in preferred interests of Aireon is subject to price risk. The fair value may fluctuate over time due to, among other things, economic conditions and the cash flows of Aireon.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

In accordance with National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*, the Company has filed certificates signed by the President and Chief Executive Officer and the Vice President and Chief Financial Officer that, among other things, report on the design and effectiveness of disclosure controls and procedures (DC&P) and the design and effectiveness of internal control over financial reporting (ICFR).

Disclosure Controls and Procedures

The Company has designed DC&P to provide reasonable assurance that material information relating to the Company is made known to the President and Chief Executive Officer and the Vice President and Chief Financial Officer, particularly during the period in which the annual filings are being prepared, and that information required to be disclosed to satisfy the Company's continuous disclosure obligations is recorded, processed, summarized and reported within the time periods specified by applicable Canadian securities legislation.

Management, under the supervision of the certifying officers, has evaluated the effectiveness of the DC&P and based on that evaluation, the certifying officers have concluded that the DC&P were effective as at August 31, 2021.

Internal Control over Financial Reporting

The Company has designed ICFR using the framework established in "Internal Control – Integrated Framework" issued in 2013 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. In designing and evaluating internal controls, it should be recognized that due to inherent limitations, any controls, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and may not prevent or detect misstatements.

Management, under the supervision of the certifying officers, has evaluated the effectiveness of ICFR and based on that evaluation, the certifying officers have concluded that the Company's ICFR was effective as at August 31, 2021.

Changes to ICFR

A material change in ICFR is a change that has or is reasonably likely to materially affect the issuer's ICFR.

There have been no changes to the Company's ICFR during the year ended August 31, 2021 that have materially affected or are reasonably likely to materially affect the Company's ICFR and there were no changes to the Company's ICFR during Q4 fiscal 2021.