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MANAGEMENT'S DISCUSSION AND ANALYSIS

ON FORM 51-102F1

THREE AND SIX MONTHS ENDED

FEBRUARY 28, 2021

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INTRODUCTION

This management's discussion and analysis (MD&A) relates to the unaudited interim consolidated financial position, results of operations, comprehensive income (loss) and cash flows for the three and six months ended February 28, 2021 (Q2 fiscal 2021) of NAV CANADA and its subsidiaries (also referred to in this MD&A as we, our, us or the Company). It should be read in conjunction with our unaudited interim condensed consolidated financial statements for Q2 fiscal 2021 (Q2 fiscal 2021 financial statements), our audited annual consolidated financial statements (annual financial statements) and the accompanying notes for the year ended August 31, 2020 (fiscal 2020), our fiscal 2020 annual MD&A, as well as our 2020 Annual Information Form dated October 22, 2020 (fiscal 2020 AIF). Additional information about NAV CANADA, including our financial statements for Q2 fiscal 2021 and fiscal 2020, our fiscal 2020 annual MD&A, and our fiscal 2020 AIF are filed on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

Our financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). Our Q2 fiscal 2021 financial statements have been prepared in accordance with International Accounting Standard (IAS) 34 *Interim Financial Reporting*. Our Audit & Finance Committee reviewed this MD&A and our Board of Directors (the Board) approved it before it was filed.

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

Caution Concerning Forward-Looking Information

This MD&A and, in particular, but without limitation, sections "INTRODUCTION – Significant Financial Matters" and "RESULTS OF OPERATIONS – Financial Outlook" 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" and the like, as well as future or conditional verbs such as "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. Examples of risk and uncertainties include geopolitical unrest, terrorist attacks and the threat of terrorist attacks, war, epidemics or pandemics 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, government interventions or restrictions on or concerning air travel, 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 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 2020 AIF. The forward-looking statements contained in this MD&A represent our expectations as of April 8, 2021 and are subject to change after this date.

In March 2020, the COVID-19 outbreak was declared a pandemic by the World Health Organization. Given the rapidly evolving circumstances surrounding the COVID-19 pandemic and resulting economic contraction, there is more uncertainty associated with the assumptions underlying the forward-looking information contained in this MD&A. These assumptions include the following: the COVID-19 pandemic and resulting economic contraction will continue to have a significant negative impact on global air traffic and the aviation industry, and the duration and scope of such impact is unknown; the post-pandemic economic recovery is likely to be gradual and may be uneven; that long term growth in economic recovery will provide the basis for increased aviation 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. These assumptions are based on information currently available to the Company. Refer to our fiscal 2020 annual MD&A and "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 essentially to achieve breakeven financial results on the consolidated statement of operations on an annual basis. Due to seasonal and other fluctuations, such as the COVID-19 pandemic discussed in "INTRODUCTION – Significant Financial Matters", in air traffic 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 take into account estimated air traffic volumes 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 volumes resulting from unforeseen events. We meet these objectives through the use of a "rate stabilization" mechanism.

In preparing our financial statements we reflect the impact of rate regulation. 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 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.

(millions of Canadian dollars)

Financial Highlights

The COVID-19 pandemic and the resulting economic contraction continues to have a significant negative impact on global air traffic and the aviation industry. The significant decrease in air traffic volumes and associated customer service charges impacted revenue commencing in the third quarter of fiscal 2020. See "INTRODUCTION – Significant Financial Matters" for further discussion of the impacts of the COVID-19 pandemic on the Company and its financial results.

Results of operations for the three months ended February 28, 2021

	Three months ended		
	February 28 2021	February 29 2020	$ Change
Revenue	$ 179	$ 322	$ (143)
Operating expenses	317	387	(70)
Other (income) and expenses	40	25	15
Income tax expense	2	-	2
Net loss, before net movement in regulatory deferral accounts	(180)	(90)	(90)
Net movement in regulatory deferral accounts [(1)]			
Rate stabilization adjustments:			
Unfavourable (favourable) variances from plan	8	(7)	15
Initial approved adjustment [(2)]	73	9	64
	81	2	79
Other regulatory deferral account adjustments:			
Employee benefit pension contributions	36	46	(10)
Other employee benefits	(3)	(2)	(1)
Investment in preferred interests, before tax	4	(8)	12
Income tax	2	1	1
Realized hedging transactions	1	1	-
Allowance for doubtful accounts	2	-	2
	42	38	4
	123	40	83
Net loss, after net movement in regulatory deferral accounts	$ (57)	$ (50)	$ (7)

(1) The Company is subject to legislation that regulates the level of its charges (see "INTRODUCTION – Financial Strategy and Rate Regulation"). The timing of the recognition of certain revenue and expenses recovered through charges is recorded through movements in regulatory deferral accounts (see "RESULTS OF OPERATIONS – Net Movement in Regulatory Deferral Accounts Related to Net Income (Loss)").

(2) In order to achieve breakeven results of operations in the fiscal year ending August 31, 2021 (fiscal 2021), 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 is being reflected in the rate stabilization account evenly throughout the fiscal year.

(millions of Canadian dollars)

Cash flows for the three months ended February 28, 2021

As shown below, cash and cash equivalents increased by $178 during the three months ended February 28, 2021 (three months ended February 29, 2020 - $21) and the Company experienced negative free cash flow of $139 (three months ended February 29, 2020 - $24), which is a non-GAAP (Generally Accepted Accounting Principle) 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 generated from operations, less capital expenditures, investments in Aireon and 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.

	Three months ended		
	February 28 2021	February 29 2020	$ Change [(1)]
Cash flows from (used in):			
Operating	$ (118)	$ 19	$ (137)
Investing	50	(42)	92
Financing	247	44	203
Cash flows from operating, investing and financing activities	179	21	158
Effect of foreign exchange on cash and cash equivalents	(1)	-	(1)
Increase in cash and cash equivalents	178	21	157
Cash and cash equivalents, beginning of period	320	27	293
Cash and cash equivalents, end of period	$ 498	$ 48	$ 450
Free cash flow (non-GAAP financial measure):			
Cash flows from (used in):			
Operations [(2)]	$ (118)	$ 19	$ (137)
Capital expenditures [(2)]	(20)	(43)	23
Payment of lease liabilities [(2)]	(1)	-	(1)
Free cash flow	$ (139)	$ (24)	$ (115)

(1) See "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the three months ended February 28, 2021" for discussion of the changes in cash flows from the prior fiscal year.

(2) See the statement of cash flows in our Q2 fiscal 2021 financial statements.

(millions of Canadian dollars)

Results of operations for the six months ended February 28, 2021

	Six months ended		
	February 28 2021	February 29 2020	$ Change
Revenue	$ 381	$ 686	$ (305)
Operating expenses	626	756	(130)
Other (income) and expenses	71	56	15
Income tax expense	2	-	2
Net loss, before net movement in regulatory deferral accounts	(318)	(126)	(192)
Net movement in regulatory deferral accounts [(1)]			
Rate stabilization adjustments:			
Favourable variances from planned results	(24)	(16)	(8)
Initial approved adjustment [(2)]	147	18	129
	123	2	121
Other regulatory deferral account adjustments:			
Employee benefit pension contributions	62	88	(26)
Other employee benefits	(4)	(2)	(2)
Investment in preferred interests, before tax	2	(10)	12
Investment in equity-accounted investee	-	(1)	1
Income tax	2	1	1
Realized hedging transactions	1	1	-
Allowance for doubtful accounts	5	-	5
	68	77	(9)
	191	79	112
Net loss, after net movement in regulatory deferral accounts	$ (127)	$ (47)	$ (80)

(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 in fiscal 2021, 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 is being reflected in the rate stabilization account evenly throughout the fiscal year.

(millions of Canadian dollars)

Cash flows for the six months ended February 28, 2021

As shown below, cash and cash equivalents decreased by $191 during the six months ended February 28, 2021 (six months ended February 29, 2020 - increase of $18) and the Company experienced negative free cash flow of $285 (six months ended February 29, 2020 - $18), which is a non-GAAP financial measure as discussed in "INTRODUCTION – Financial Highlights: Cash flows for the three months ended February 28, 2021".

	Six months ended		
	February 28 2021	February 29 2020	$ Change [1]
Cash flows from (used in):			
Operating	$ (249)	$ 63	$ (312)
Investing	36	(80)	116
Financing	23	35	(12)
Cash flows from (used in) operating, investing and financing activities	(190)	18	(208)
Effect of foreign exchange on cash and cash equivalents	(1)	-	(1)
Increase (decrease) in cash and cash equivalents	(191)	18	(209)
Cash and cash equivalents, beginning of period	689	30	659
Cash and cash equivalents, end of period	$ 498	$ 48	$ 450
Free cash flow (non-GAAP financial measure):			
Cash flows from (used in):			
Operations [2]	$ (249)	$ 63	$ (312)
Capital expenditures [2]	(38)	(80)	42
Proceeds from sale of property, plant and equipment [2]	4	-	4
Payment of lease liabilities [2]	(2)	(1)	(1)
Free cash flow	$ (285)	$ (18)	$ (267)

(1) See "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the six months ended February 28, 2021" for discussion of the changes in cash flows from the prior fiscal year.

(2) See the statement of cash flows in our Q2 fiscal 2021 financial statements.

(millions of Canadian dollars)

Financial position as at February 28, 2021

The following table outlines significant changes in our assets, liabilities and regulatory deferral accounts between August 31, 2020 and February 28, 2021:

	February 28 2021	August 31 2020	$ Change
Assets			
Current assets			
Cash and cash equivalents	$ 498	$ 689	$ (191)
Accounts receivable and other	54	77	(23)
Investments	148	218	(70)
Other current assets	14	9	5
	714	993	(279)
Non-current assets			
Property, plant and equipment	723	740	(17)
Intangible assets	845	874	(29)
Investment in preferred interests	334	336	(2)
Long-term receivables	51	1	50
Investment in equity-accounted investee	7	7	-
Employee benefits	4	4	-
Other non-current assets	3	3	-
	1,967	1,965	2
Total assets	2,681	2,958	(277)
Regulatory deferral account debit balances	1,649	2,112	(463)
Total assets and regulatory deferral account debit balances	$ 4,330	$ 5,070	$ (740)
Liabilities			
Current liabilities			
Bank loan	$ -	$ 223	$ (223)
Trade and other payables	208	262	(54)
Current portion of long-term debt	25	275	(250)
Deferred revenue	15	11	4
Other current liabilities	7	6	1
	255	777	(522)
Non-current liabilities			
Employee benefits	1,459	2,042	(583)
Long-term debt	2,511	2,013	498
Deferred tax liability	22	21	1
Lease liability	2	3	(1)
Other non-current liabilities	1	2	(1)
	3,995	4,081	(86)
Total liabilities	4,250	4,858	(608)
Equity			
Retained earnings (deficit)	(99)	28	(127)
Regulatory deferral account credit balances	179	184	(5)
Total liabilities, equity and regulatory deferral account credit balances	$ 4,330	$ 5,070	$ (740)

For a discussion of the changes in cash and cash equivalents (including those related to current investments and bank loans) from August 31, 2020, see "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the six months ended February 28, 2021".

Long-term receivables are deferred payments related to the September 1, 2020 service charge increase. For the Company's fiscal 2021, the portion of monthly invoices related to the service charge increase can be deferred and will become payable in equal installments over the following five fiscal years. See "LIQUIDITY AND CAPITAL RESOURCES – Financial Instruments and Risk Management".

The change in long-term debt (including the current portion) is discussed in "INTRODUCTION – Significant Financial Matters: Financing Activities".

The change in non-current employee benefit liabilities is mainly a result of the re-measurement gains related to the Company's funded pension plans recorded during the six months ended February 28, 2021. These changes along with the related changes in regulatory deferral account debit balances are discussed further in "RESULTS OF OPERATIONS – Other Comprehensive Income (Loss)".

We plan our operations to essentially be in an annual financial breakeven position after expenses are met through customer service charges and other revenue sources, and after adjustments are made to the rate stabilization account. As a result, the balance in the retained earnings account at the end of each fiscal year has remained stable at $28. Any variation from this amount at the end of any interim period reflects seasonal or other fluctuations in revenue and expenses. The balance in retained earnings (deficit) as at February 28, 2021 reflects the loss up to that date.

Significant Financial Matters[1]

The following items have significant financial importance to the Company:

1. Coronavirus ("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. As a result, the Company's customer service charges revenue declined significantly in the first and second quarters of fiscal 2021 as compared to the same periods in fiscal 2020 (see "Air Traffic and Customer Service Charges" below). The pandemic is expected to continue to have a negative impact on demand for air travel domestically and globally until such time as travel restrictions are eased, airline passenger concerns about air travel due to COVID-19 subside, and consumer demand for air travel returns.

In response to the impact of the pandemic, the Company continues to review, monitor and take actions to reduce capital and operational 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 of its employees.

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

To continue to address the significant revenue shortfall, some of the actions the Company has taken in the first two quarters of fiscal 2021 include:

- increasing customer service charges, effective September 1, 2020, by an average of 29.5% on base rate levels, resulting in an estimated revenue increase of $173 for fiscal 2021 (refer to "RESULTS OF OPERATIONS – Financial Outlook");
- continuing to access the Canada Emergency Wage Subsidy (CEWS) government relief program, recognizing $58 as a reduction to Salaries and benefits expenses for the six months ended February 28, 2021 (refer to "Operating Expenses" below);
- implementing cost-saving measures where possible, including the elimination of temporary and permanent positions (see further discussion in "Operating Expenses" below);
- launching level of service reviews; and
- raising funds through the issuance of $500 in General Obligations Notes (See "Financing Activities" below).

2. Air Traffic and Customer Service Charges

Over the first six months of fiscal 2021, air traffic volumes, as measured by 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), decreased 57.4%. Excluding the effect of an extra day for the leap year in fiscal 2020, air traffic volumes in the first six months of fiscal 2021 decreased 57.2%. The approved budget for fiscal 2021 assumed a decrease of 14.6%. Air traffic volumes are currently expected to decline by 37.7% in fiscal 2021 on a year-over year basis.

The Company revised its customer service charges effective September 1, 2020, increasing charges by an average of 29.5% on overall rate levels. The service charge increase includes 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 monthly invoices related to the service charge increase can be deferred and will become payable in equal installments over the following five fiscal years.

3. Financing Activities

During Q2 fiscal 2021, the Company received the requisite amount of valid consents and proxies to amend each of the master trust indenture (MTI) governing the Company's outstanding bonds and the general obligation indenture (GOI) governing the Company's outstanding notes, effective December 18, 2020. The relief was obtained in light of the significant decline in air traffic volumes and economic contraction resulting from the COVID-19 pandemic.

The amendments temporarily relieve the Company from complying 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.

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 will be used for general corporate purposes.

4. Operating Expenses

Since the onset of the 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.

During the first two quarters of fiscal 2021, the Company continued restructuring efforts to address the significant decline in air traffic volumes. On September 22, 2020 and December 9, 2020, the Company announced workforce reductions through the elimination of permanent jobs. The job cuts were across all departments and included operational students. The Company has worked with its bargaining agents to implement these reductions while respecting the terms of collective agreements. During the six months ended February 28, 2021, estimated severance and termination costs of $29 were recognized as a part of Salaries and benefits expense.

The Company's restructuring efforts are expected to result in a reduction of its workforce by approximately 770 people across the country (roughly 15.1% of the Company's pre-pandemic workforce). The restructuring of some of our business units, the adjustments of our workforce and the proposed changes to our level of service are critical to aligning operations and services with air traffic and strengthening the sustainability of NAV CANADA.

In light of the impacts of the pandemic on our finances, the Company continues to have discussions with its bargaining agents to identify alternatives to workforce adjustments. Subsequent to February 28, 2021, the Company reached an agreement with the Professional Institute of the Public Service of Canada (PIPSC), whereby employees represented by PIPSC will forego 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.

The Company continues to avail itself of the CEWS offered by the Government of Canada. During the three and six months ended February 28, 2021, the Company recognized $16 and $58, respectively, from the CEWS government relief program, partially offsetting compensation costs. The Company expects to continue to qualify for this program through its end date of June 30, 2021.

5. Rate Stabilization Account

As at February 28, 2021, the rate stabilization account had a debit balance of $378 (see "RESULTS OF OPERATIONS – Amounts Considered for Rate Setting Purposes").

The rate stabilization account changed by $123 due to the $147 initially approved adjustment to the rate stabilization account resulting from the planned shortfall in fiscal 2021, partially offset by $24 of net favourable variances from planned results. Rate stabilization adjustments are described under "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account".

(millions of Canadian dollars)

RESULTS OF OPERATIONS

Revenue

The following table provides a summary of revenue by category. Our fiscal 2020 AIF and the notes to our Q2 fiscal 2021 financial statements provide more information about the different categories of our customer service charges.

	Three months ended			
	February 28 2021	February 29 2020	$ Change	% Change
Enroute	$ 96	$ 150	$ (54)	(36%)
Terminal	64	126	(62)	(49%)
Daily / annual / quarterly	5	21	(16)	(76%)
North Atlantic and international communication	12	12	-	-%
Total customer service charges	177	309	(132)	(43%)
Other [1]	2	13	(11)	(85%)
	$ 179	$ 322	$ (143)	(44%)

	Six months ended			
	February 28 2021	February 29 2020	$ Change	% Change
Enroute	$ 200	$ 332	$ (132)	(40%)
Terminal	133	258	(125)	(48%)
Daily / annual / quarterly	10	43	(33)	(77%)
North Atlantic and international communication	23	24	(1)	(4%)
Total customer service charges	366	657	(291)	(44%)
Other [1]	15	29	(14)	(48%)
	$ 381	$ 686	$ (305)	(44%)

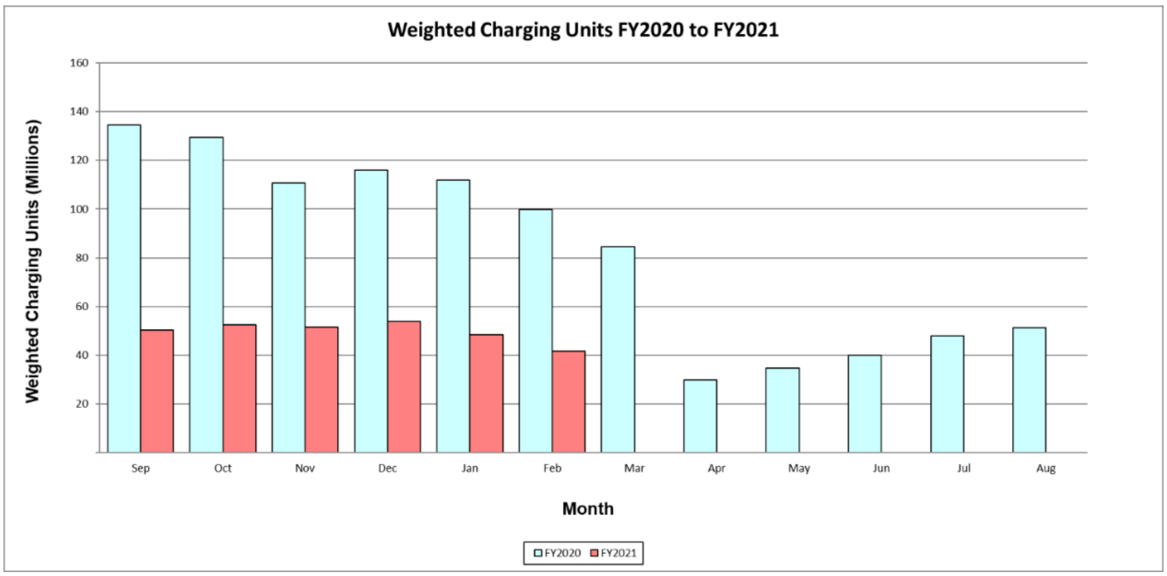
(1) Other revenue consists of service and development contracts, conference centre services at our facility in Cornwall (Ontario), the sale of civil aeronautical publications and other miscellaneous revenue.

Revenue from customer service charges for the three and six months ended February 28, 2021 decreased by $132 and $291, respectively, compared to the same periods in fiscal 2020, primarily due to the COVID-19 pandemic which continues to have a significant negative impact on air traffic volumes. The Company saw air traffic decrease 57.4% year-over-year, as measured in WCUs. Excluding the effect of an extra day for the leap year in fiscal 2020, air traffic volumes in the first six months of fiscal 2021 decreased 57.2%. This has been partially offset by revised customer service charges, effective September 1, 2020, that increased overall rate levels by an average of 29.5%.

Other revenue for the three and six months ended February 28, 2021 decreased $11 and $14, respectively, compared to the same periods in fiscal 2020, primarily due to decreased 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 volumes (as measured in WCUs) in Q2 fiscal 2021 continue to reflect the negative impact of the COVID-19 pandemic, which impacted revenue commencing in the third quarter of fiscal 2020.



Future air traffic volumes may be influenced by numerous factors, including the speed of recovery of air traffic following the COVID-19 pandemic, 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, 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.

(millions of Canadian dollars)

Operating Expenses

	Three months ended			
	February 28 2021	February 29 2020	$ Change	% Change
Salaries and benefits	$ 210	$ 277	$ (67)	(24%)
Technical services	41	37	4	11%
Facilities and maintenance	14	18	(4)	(22%)
Depreciation and amortization	38	39	(1)	(3%)
Other	14	16	(2)	(13%)
	$ 317	$ 387	$ (70)	(18%)

Salaries and benefits expense in the three months ended February 28, 2021 decreased by $67 compared to the same period in fiscal 2020 primarily due to CEWS receipts, as the Company did not begin to receive payments from the program until May 2020. In addition, overtime costs were lower as a result of the significant decrease in air traffic volumes, as the COVID-19 pandemic did not begin to impact air traffic volumes until March 2020. Salaries and benefit costs were also lower as a result of cost-saving measures taken to address the impacts of the pandemic, including management compensation reductions, ending the terms of temporary employees, as well as offering early retirement incentives.

	Six months ended			
	February 28 2021	February 29 2020	$ Change	% Change
Salaries and benefits	$ 413	$ 542	$ (129)	(24%)
Technical services	79	66	13	20%
Facilities and maintenance	29	36	(7)	(19%)
Depreciation and amortization	78	76	2	3%
Other	27	36	(9)	(25%)
	$ 626	$ 756	$ (130)	(17%)

Salaries and benefits expense in the six months ended February 28, 2021 decreased by $129 compared to the same period in fiscal 2020 primarily due to CEWS receipts, as the Company did not begin to receive payments from the program until May 2020. In addition, overtime costs were lower as a result of the significant decrease in air traffic volumes as a result of the COVID-19 pandemic, which did not begin to impact air traffic volumes until March 2020. The impact of cost-saving measures taken related to salaries to address the impacts of the pandemic, including management compensation reductions, ending the terms of temporary employees, as well as offering early retirement incentives are largely offset by severance and termination costs related to restructuring efforts undertaken in fiscal 2021.

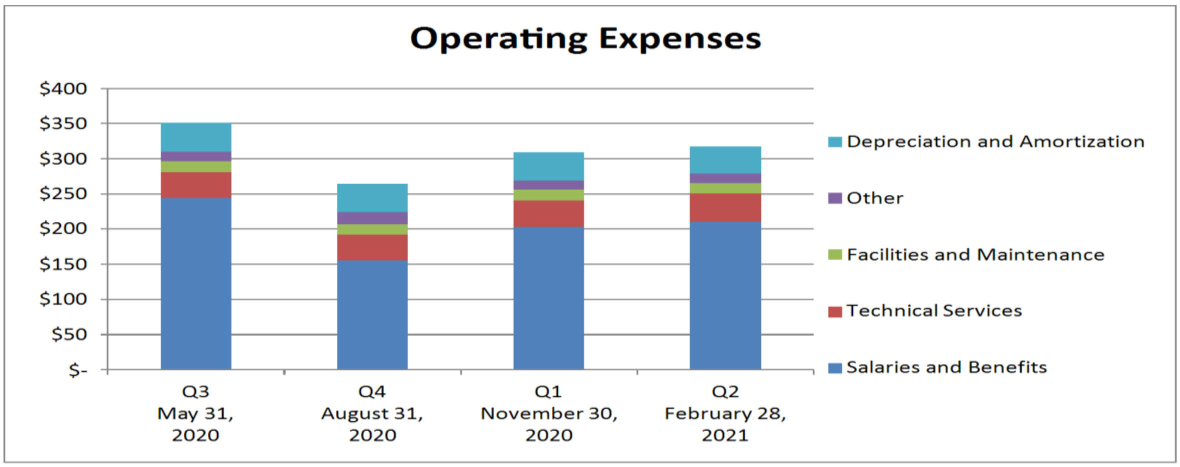
Technical services expense in the six months ended February 28, 2021 increased by $13, compared to the same period in fiscal 2020 primarily due to the cost of oceanic space-based surveillance data services, which came into effect beginning January 2020.

Facilities and maintenance expense in the six months ended February 28, 2021 decreased by $7 compared to the same period in fiscal 2020 primarily due to location lock downs and the closure of the NAV CENTRE to the general public as a result of the pandemic.

(millions of Canadian dollars)

Other expenses decreased in the six months ended February 28, 2021 by $9 compared to the same period in fiscal 2020 primarily due to cost containment efforts resulting in lower travel and relocation costs.

While our operating expenses have historically demonstrated a stable pattern, beginning in the three months ended May 31, 2020, the Company was impacted by the COVID-19 pandemic resulting in a significant decline in air traffic volumes. The reduction in air traffic volumes led to a reduction in overtime costs and the receipt of the CEWS beginning in May 2020 which helped to partially offset compensation costs. In Q1 fiscal 2021, the Company continued restructuring efforts, resulting in an increase in severance and termination costs. Operating expenses in Q2 fiscal 2021 have been consistent with Q1 fiscal 2021. Company-wide cost reduction efforts have been a key focus, particularly with respect to discretionary expenditures.



Other (Income) and Expenses and Income Tax Expense

	Three months ended February 28 2021	Three months ended February 29 2020	$ Change
Finance income			
Interest income	$ (1)	$ -	$ 1
Net change in fair value of financial assets at FVTPL (1)			
Investment in preferred interests	(3)	(3)	-
Other investments	1	(2)	(3)
	(2)	(5)	(3)
Total finance income	(3)	(5)	(2)
Net interest expense relating to employee benefits	13	16	3
Other finance costs			
Interest expense	24	17	(7)
Other (gains) and losses			
Foreign exchange (gains) and losses	6	(3)	(9)
	$ 40	$ 25	$ (15)
Income tax expense	$ 2	$ -	$ (2)

(millions of Canadian dollars)

	Six months ended		
	February 28 2021	February 29 2020	$ Change
Finance income			
Interest income	$ (2)	$ (1)	$ 1
Net change in fair value of financial assets at FVTPL (1)			
Investment in preferred interests	(6)	(6)	-
Other investments	1	(2)	(3)
	(5)	(8)	(3)
Total finance income	(7)	(9)	(2)
Net interest expense relating to employee benefits	27	31	4
Other finance costs			
Interest expense	47	37	(10)
Other (gains) and losses			
Foreign exchange (gains) and losses	7	(2)	(9)
Share of net gain of equity-accounted investee	-	(1)	(1)
Other gains	(3)	-	3
	4	(3)	(7)
	$ 71	$ 56	$ (15)
Income tax expense	$ 2	$ -	$ (2)

(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.

Interest expense increased by $7 and $10, respectively, during the three and six months ended February 28, 2021 compared to the same periods in 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.

Foreign exchange losses increased by $9 during the three and six months ended February 28, 2021 compared to the same periods in 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.

(millions of Canadian dollars)

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

The net movement in regulatory deferral accounts related to net income (loss) represents the 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.

	Three months ended		
	February 28 2021	February 29 2020	$ Change
Rate stabilization account (1)	$ 81	$ 2	$ 79
Other regulatory deferral accounts			
Employee benefit pension contributions	36	46	(10)
Other employee benefits	(3)	(2)	(1)
Investment in preferred interests, before tax	4	(8)	12
Income tax	2	1	1
Realized hedging transactions	1	1	-
Allowance for doubtful accounts	2	-	2
	$ 123	$ 40	$ 83

	Six months ended		
	February 28 2021	February 29 2020	$ Change
Rate stabilization account (1)	$ 123	$ 2	$ 121
Other regulatory deferral accounts			
Employee benefit pension contributions	62	88	(26)
Other employee benefits	(4)	(2)	(2)
Investment in preferred interests, before tax	2	(10)	12
Investment in equity-accounted investee	-	(1)	1
Income tax	2	1	1
Realized hedging transactions	1	1	-
Allowance for doubtful accounts	5	-	5
	$ 191	$ 79	$ 112

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

To adjust the total pension benefit expense to reflect the cash contributions to be recovered through rate setting, the net movement in the employee benefit pension contributions regulatory deferral account for the three and six months ended February 28, 2021 was $36 and $62, respectively, compared to $46 and $88 for the three and six months ended February 29, 2020. The decrease in the regulatory deferral account 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 change in the net movement in regulatory deferral accounts of the Company's investment in preferred interests of Aireon, before tax of $12 during the three and six months ended February 28, 2021, is primarily due to foreign exchange losses as a result of fluctuation of the Canadian dollar against the U.S. dollar.

(millions of Canadian dollars)

The $2 and $5 net movement in the allowance for doubtful accounts regulatory deferral account for the three and six months ended February 28, 2021, respectively, is a result of deferring the non-cash impact of accounting for lifetime expected credit losses. 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 2020 annual financial statements. The table below shows the movements in the rate stabilization account.

	Three months ended		
	February 28 2021	February 29 2020	$ Change
Credit (debit) balance on the statement of financial position, beginning of period	$ (297)	$ 93	$ (390)
Variances from planned results:			
Revenue lower than planned	(31)	(10)	(21)
Operating expenses lower than planned	22	6	16
Other (income) and expenses (higher) lower than planned	(7)	1	(8)
Net movement in other regulatory deferral accounts	8	10	(2)
Total variances from planned results	(8)	7	(15)
Initial approved adjustment	(73)	(9)	(64)
Net movement in rate stabilization account recorded in net loss	(81)	(2)	(79)
Credit (debit) balance on the statement of financial position, end of period	$ (378)	$ 91	$ (469)

The change of $81 in the rate stabilization account during Q2 fiscal 2021 is due to:

- the planned adjustment of $73, representing the Q2 fiscal 2021 portion of the anticipated $295 annual net loss at the time the fiscal 2021 budget was approved;
- revenue that was $31 lower than planned primarily due to lower air traffic volumes as well as lower revenue from service and development contracts;
- other expenses that were $7 higher than planned primarily due to net foreign exchange losses on our investment in preferred interests of Aireon;

partially offset by:

- operating expenses that were $22 lower than planned primarily due to unbudgeted receipts from the CEWS, lower overtime costs and the Company's continued efforts to reduce discretionary spending amid the COVID-19 pandemic; and

(millions of Canadian dollars)

- net movement in other regulatory deferral accounts that was $8 higher than planned primarily due to a regulatory adjustment of $7 related to the deferral of foreign exchange losses on our investment in preferred interests of Aireon.

	Six months ended		
	February 28 2021	February 29 2020	$ Change
Credit (debit) balance on the statement of financial position, beginning of period	$ (255)	$ 93	$ (348)
Variances from planned results:			
Revenue lower than planned	(23)	(15)	(8)
Operating expenses lower than planned	38	15	23
Other (income) and expenses higher than planned	(5)	(5)	-
Net movement in other regulatory deferral accounts	14	21	(7)
Total variances from planned results	24	16	8
Initial approved adjustment	(147)	(18)	(129)
Net movement in rate stabilization account recorded in net loss	(123)	(2)	(121)
Credit (debit) balance on the statement of financial position, end of period	$ (378)	$ 91	$ (469)

The $123 movement in the rate stabilization account during the six months ended February 28, 2021 is primarily due to:

- the planned adjustment of $147, representing half of the anticipated annual net loss at the time the fiscal 2021 budget was approved;

- revenue that was $23 lower than planned primarily due to lower air traffic volumes as well as lower revenue from service and development contracts; and

- other expenses that were $5 higher than planned, primarily due to net foreign exchange losses of $8 on our investment in preferred interests of Aireon, partially offset by $3 net gains on the sale of the Company's Dash 8 aircraft;

partially offset by:

- operating expenses that were $38 lower than planned, primarily due to unbudgeted receipts from the CEWS, lower overtime and restructuring costs than planned and the Company's continued efforts to reduce discretionary spending amid the COVID-19 pandemic; and

- net movement of $14 in other regulatory deferral accounts that was higher than planned primarily due to:

    - a regulatory adjustment of $8 related to the deferral of foreign exchange losses on our investment in preferred interests of Aireon; and

(millions of Canadian dollars)

- a regulatory adjustment of $5 related to the allowance for doubtful accounts as a result of increased lifetime expected credit losses related to accounts receivable.

Other Comprehensive Income (Loss)

The accounting recognition of other comprehensive income (loss) amounts are 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.

	Three and six months ended		
	February 28 2021	February 29 2020	$ Change
Items that will not be reclassified to income or (loss):			
Re-measurements of employee defined benefit plans	$ 647	$ -	$ 647
Net movement in regulatory deferral accounts	(647)	-	(647)
	-	-	-
Items that will be reclassified to income or (loss):			
Amortization of loss on cash flow hedges	$ 1	$ 1	$ -
Net movement in regulatory deferral accounts	(1)	(1)	-
	-	-	-
Total other comprehensive income (loss)	$ -	$ -	$ -

Re-measurement gains on the Company's funded plans of $647 were recorded during the three and six months ended February 28, 2021 as a result of an increase in the discount rate to 3.2% at February 28, 2021 (August 31, 2020 – 2.8%). The re-measurement gains were comprised of actuarial gains of $621 and a return on plan assets $26 greater than expected based on the discount rate at August 31, 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.

(millions of Canadian dollars)

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:

	February 28 2021	August 31 2020	$ Change
Rate stabilization account debit balance	$ 378	$ 255	$ 123
Regulatory pension cash contributions to be recovered at a later date	$ 34	$ 34	$ -

Financial Outlook[2]

As noted previously under "INTRODUCTION - Caution Concerning Forward-Looking Information" and "INTRODUCTION - Significant Financial Matters", the Company continues to see a significant decline in the number of air traffic movements as compared to the same periods in fiscal 2020 as a result of the COVID-19 pandemic, which impacted revenue commencing in the third quarter of fiscal 2020.

The pandemic is expected to continue to have a negative impact on air travel domestically and globally until such time as travel restrictions are eased and consumer demand for air travel returns. Industry participants are indicating it may be some time before they fully return to pre COVID-19 operating levels. We expect until this occurs that reduced air traffic activity will have a material negative impact on the Company's operations and revenues.

Presented below are the Company's current projected annual consolidated results before rate stabilization for fiscal 2021 compared to fiscal 2020 actual results. These projections reflect the assumption that air traffic movements will not recover in fiscal 2021 and that recovery will be delayed into our fiscal year ending August 31, 2022. In developing its forecast for the remainder of fiscal 2021, the Company noted several critical uncertainties in January and February, including:

- continued occurrence of secondary COVID-19 outbreaks;
- emergence and travel-related spread of new COVID-19 strains;
- additional travel restrictions and quarantine requirements;
- lagging Canadian vaccine distribution; and
- lack of aviation industry specific support in Canada.

This is a subjective assessment and assumes that the international air travel restrictions, scheduled carrier flight reductions and a general reluctance to travel by consumers would continue. Significant easing of travel restrictions and in government actions to limit or curtail COVID-19 transmission both domestically and internationally could result in commercial air traffic recovering more quickly than forecast.

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

(millions of Canadian dollars)

The Company continues to assess the impact of the revenue reductions on operations and is reducing operating costs and capital spending where possible.

	Fiscal 2021	Fiscal 2020	$ Change	% Change
Before rate stabilization				
Revenue	$ 808	$ 1,000	$ (192)	(19%)
Operating expenses and other (income) and expenses, including other regulatory adjustments	1,286	1,348	(62)	(5%)
Net loss before rate stabilization adjustments	$ (478)	$ (348)	$ (130)	

Revenue

Revenue in fiscal 2021 is expected to decrease to $808 from $1,000 in fiscal 2020 primarily due to a forecasted decline in air traffic volumes of 37.7% on a year-over-year basis, as measured in WCUs, partially offset by the increase in customer service charge base rates by an average of 29.5%, effective September 1, 2020 (see "RESULTS OF OPERATIONS – Revenue") as well as a decrease in other revenues.

In our Q1 fiscal 2021 MD&A, we had disclosed anticipated revenue of $1,098 for fiscal 2021 and forecasted a 14.6% decline in air traffic volume. The decrease in revenue is due to continued travel restrictions and reduced consumer demand as a result of the COVID-19 pandemic and the expectation that this will impact revenue from customer service charges longer than originally anticipated.

Operating Expenses and Other (Income) and Expenses

Operating expenses and other (income) and expenses before rate stabilization for fiscal 2021 are expected to be $1,286. This is a decrease of 5% compared to fiscal 2020 primarily due to:

- reduced overtime costs as a result of the decrease in air traffic movements for the full year;
- reduced compensation levels largely due to early retirements in fiscal 2020 through the Company's early retirement incentive program and higher forecasted CEWS receipts as a result of the extension of the program to June 30, 2021 offsetting the costs associated with workforce reductions; and
- reduced travel and facilities costs as well as professional fees, as the Company continues to reduce discretionary spending where possible;

partially offset by:

- increased satellite surveillance costs, as we began paying for oceanic space-based surveillance data services in January 2020, in addition to the domestic space-based surveillance data services which commenced in September 2019;
- increased operational requirements, largely related to telecommunications and systems maintenance and development costs to ensure the safe operation and maintenance of the air navigation system as an essential service;
- increased pension current service contributions, largely due to the timing of the true-up of contributions based on the January 1, 2020 funding valuation filed in September 2020; and

- increased interest costs as a result of the Company’s higher debt levels.

The Company continues to look at its operations, including staffing and level of service required to meet air traffic levels and ensure the safe operation and maintenance of the air navigation system.

In our Q1 fiscal 2021 MD&A, we had disclosed anticipated operating expenses and other (income) and expenses, before rate stabilization of $1,393 for fiscal 2021. The decrease of $107 is primarily due to increased CEWS receipts due to extension of the program to June 30, 2021, lower overtime costs as a result of the forecasted decrease in air traffic volumes and lower operational expenses as the Company continues to work to identify cost-savings where possible.

Cash Flows

Given the expected net cash outflows from operations, investing and financing activities in fiscal 2021, the Company’s cash position is currently anticipated to be $201 as at August 31, 2021 (August 31, 2020 - $689).

This cash outlook includes anticipated annual cash outflows from operating activities of $525, largely due to reduced customer service charge revenue as a result of lower air traffic volumes and the ability for customers to defer cash payments of the September 1, 2020 increase in base rates. Other receipts are also anticipated to be lower as a result of lower forecasted other revenues. Payments to employees and suppliers are expected to increase, largely due to costs associated with workforce reductions along with the payment of economic increases deferred in fiscal 2020 to fiscal 2021. We also expect higher pension contributions due to the timing of the true-up of contributions based on the January 1, 2020 funding valuation filed in September 2020. In addition, the Company’s interest payments have increased as a result of increased debt levels. Partially offsetting these increased cash outflows are higher CEWS receipts as a result of the extension of the program to June 30, 2021.

Expected net cash outflows from financing activities of $3 relate to payment of lease liabilities. The repayment of the $250 Series MTN 2011-1 General Obligation Notes and bank loans of $223 (net of expenses), as well as the annual amortization payment of $25 for the Series 97-2 amortizing revenue bonds are offset by the issuance of $500 of General Obligation Notes.

The expected cash outflows from operating and financing activities are partially offset by $40 of cash inflows from investing activities, largely due to proceeds from the maturity of short-term investments, partially offset by lower capital expenditures.

In our Q1 fiscal 2021 MD&A, we had disclosed an anticipated cash position of $94 at the end of fiscal 2021. The increase is largely due to the issuance of an additional $200 of General Obligation Notes and higher CEWS receipts as a result of the extension of the program, partially offset by lower receipts from customer service charges and other revenue as a result of lower anticipated revenues.

Rate Stabilization Account

The Company currently anticipates that the rate stabilization account will be in a debit position of $733 at the end of fiscal 2021 (August 31, 2020 – $255). This is mainly as a result of the impact of the COVID-19 pandemic on air traffic volumes resulting in a significant decrease in 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 Q1 fiscal 2021 MD&A, we had disclosed a rate stabilization account debit balance of $550 at the end of fiscal 2021. The increase of $183 is largely due to the anticipated reduction in air traffic volumes as a result of continued travel restrictions and reduced consumer demand for air travel, partially offset by overall reductions to operating expenses and other (income) and expenses before rate stabilization as discussed above.

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. As a result of the COVID-19 pandemic, the normal seasonality pattern is not expected to occur in fiscal 2021 and will impact the earnings coverage ratio as well.

For the twelve months ended February 28, 2021, the Company had a net loss of $80. Our interest costs were $89. Consolidated earnings (after rate stabilization) before interest costs were $9, which is 0.10 times our interest requirement for this period and below our one-to-one earnings coverage ratio target due to the impact of the pandemic. Depreciation and amortization expense for this period was $159. Our cash flow coverage was 1.89 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 February 28, 2021, we were in full compliance with our debt indentures, including the MTI's requirements regarding the reserve funds, the flow of funds and with the rate covenants, as well as the liquidity and other provisions of the GOI. As discussed in "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, as the case may be, in respect of its fiscal years ending August 31, 2021, 2022 and 2023.

Related Party Transactions

The Company's related parties include its key management personnel, subsidiaries, joint ventures, entities in which it has a significant influence and registered pension plans for its employees. The transactions with these related parties are not materially different from what was reported in the fiscal 2020 annual MD&A.

(millions of Canadian dollars)

SUMMARY OF QUARTERLY RESULTS

Quarterly Financial Information (unaudited)

	Three months ended			
	Q2 February 28 2021	Q1 November 2020	Q4 August 31 2020	Q3 May 31 2020
Revenue	$ 179	$ 202	$ 155	$ 159
Operating expenses	317	309	264	351
Other (income) and expenses	40	31	56	129
	(178)	(138)	(165)	(321)
Income tax expense (recovery)	2	-	(1)	(27)
Net loss before net movement in regulatory deferral accounts	(180)	(138)	(164)	(294)
Net movement in regulatory deferral related to net income (loss), net of tax				
Rate stabilization adjustments	81	42	177	169
Other regulatory deferral account	42	26	48	111
	123	68	225	280
Net income (loss) after net movement in regulatory deferral accounts	$ (57)	$ (70)	$ 61	$ (14)

	Three months ended			
	Q2 February 29 2020	Q1 November 2019	Q4 August 31 2019	Q3 May 31 2019
Revenue	$ 322	$ 364	$ 412	$ 351
Operating expenses	387	369	374	367
Other (income) and expenses	25	31	32	15
	(90)	(36)	6	(31)
Income tax recovery	-	-	(3)	-
Net income (loss) before net movement in regulatory deferral accounts	(90)	(36)	9	(31)
Net movement in regulatory deferral related to net income (loss), net of tax				
Rate stabilization adjustments	2	-	21	11
Other regulatory deferral account	38	39	30	6
	40	39	51	17
Net income (loss) after net movement in regulatory deferral accounts	$ (50)	$ 3	$ 60	$ (14)

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 volumes. 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 is not expected to occur in fiscal 2021. The Company's air traffic volumes decreased 56.1% over the course of Q2 of fiscal 2021, as measured in WCUs (decrease of 55.6% excluding the effect of an extra day for the leap year in fiscal 2020).

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 take actions to reduce capital and operating 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 long-term disability (LTD) experience and funding requirements;
- changes in the investment in preferred interests of Aireon, before tax;
- changes in income taxes; and
- changes in allowance for doubtful accounts.

LIQUIDITY AND CAPITAL RESOURCES

Our fiscal 2020 annual MD&A explains how we manage our cash and capital resources. There have been no changes in that approach for the six months ended February 28, 2021.

As at February 28, 2021, we had $498 of cash and cash equivalents, $75 of short-term investments 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 $593 of which $54 was undrawn (see "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Financing Strategy").

(millions of Canadian dollars)

Cash flows for the three months ended February 28, 2021

	Three months ended		
	February 28 2021	February 29 2020	$ Change
Cash flows from (used in):			
Operating	$ (118)	$ 19	$ (137)
Investing	50	(42)	92
Financing	247	44	203
Cash flows used in operating, investing and financing activities	179	21	158
Effect of foreign exchange on cash and cash equivalents	(1)	-	(1)
Increase in cash and cash equivalents	178	21	157
Cash and cash equivalents, beginning of period	320	27	293
Cash and cash equivalents, end of period	$ 498	$ 48	$ 450
Free cash flow (non-GAAP financial measure):			
Cash flows from (used in):			
Operations	$ (118)	$ 19	$ (137)
Capital expenditures (1)	(20)	(43)	23
Payment of lease liabilities (1)	(1)	-	(1)
Free cash flow	$ (139)	$ (24)	$ (115)

(1) See the statement of cash flows in our Q2 fiscal 2021 financial statements.

As shown above, cash and cash equivalents increased by $178 for the three months ended February 28, 2021 and the Company experienced negative free cash flow of $139, which is a non-GAAP financial measure as discussed in "INTRODUCTION – Financial Highlights: Cash flows for the three months ended February 28, 2021".

Cash flows from operations for the three months ended February 28, 2021 were outflows of $118 compared to inflows of $19 for the three months ended February 29, 2020. The variance of $137 was primarily due to lower receipts from customer service charges of $161 as a result of the negative impact of the COVID-19 pandemic on air traffic volumes and payment deferral provisions in the September 1, 2020 rate increase, lower other receipts of $9 and higher pension current service contributions of $5, partially offset by $26 received under the CEWS government relief program to offset compensation costs and $15 lower payments to employees and suppliers.

Cash flows from investing activities for the three months ended February 28, 2021 were inflows of $50 compared to outflows of $42 for the three months ended February 29, 2020. The change of $92 was primarily related to proceeds of $70 from the maturity of short-term investments and planned reductions to the Company's capital spending program to address the impact of the COVID-19 pandemic in fiscal 2021.

Cash inflows from financing activities for the three months ended February 28, 2021 were $247 compared to $44 for the three months ended February 29, 2020. The increase was primarily due to the issuance of $500 of General Obligation Notes, partially offset by the repayment of the $250 Series MTN 2011-1 General Obligation Notes.

(millions of Canadian dollars)

Cash flows for the six months ended February 28, 2021

	Six months ended		
	February 28 2021	February 29 2020	$ Change
Cash flows from (used in):			
Operating	$ (249)	$ 63	$ (312)
Investing	36	(80)	116
Financing	23	35	(12)
Cash flows from (used in) operating, investing and financing activities	(190)	18	(208)
Effect of foreign exchange on cash and cash equivalents	(1)	-	(1)
Increase (decrease) in cash and cash equivalents	(191)	18	(209)
Cash and cash equivalents, beginning of period	689	30	659
Cash and cash equivalents, end of period	$ 498	$ 48	$ 450
Free cash flow (non-GAAP financial measure):			
Cash flows from (used in):			
Operations	$ (249)	$ 63	$ (312)
Capital expenditures (1)	(38)	(80)	42
Proceeds from sale of property, plant and equipment (1)	4	-	4
Payment of lease liabilities (1)	(2)	(1)	(1)
Free cash flow	$ (285)	$ (18)	$ (267)

(1) See the statements of cash flows of our Q2 fiscal 2021 financial statements.

As shown above, cash and cash equivalents decreased by $191 during the six months ended February 28, 2021 and the Company experienced negative free cash flow of $285, which is a non-GAAP financial measure as discussed in "INTRODUCTION – Financial Highlights: Cash flows for the three months ended February 28, 2021".

Cash flows from operations for the six months ended February 28, 2021 were outflows of $249 compared to inflows of $63 for the six months ended February 29, 2020, primarily due to lower receipts from customer service charges of $359 as a result of the negative impact of the COVID-19 pandemic on air traffic volumes and payment deferral provisions in the September 1, 2020 rate increase, higher pension current service contributions of $14, higher interest payments of $10 and lower other receipts of $8, partially offset by $58 received under the CEWS government relief program to offset compensation costs and $23 lower payments to employees and suppliers.

Cash flows from investing activities for the six months ended February 28, 2021 were inflows of $36 compared to outflows of $80 in the six months ended February 29, 2020. The change of $116 was primarily related to proceeds of $70 from the maturity of short-term investments and planned reductions to the Company's capital spending program to address the impact of the COVID-19 pandemic.

Cash inflows from financing activities for the six months ended February 28, 2021 were $23 compared to $35 for the six months ended February 29, 2020. The decrease was primarily due to the issuance of $500 of General Obligation Notes, partially offset by the repayment of the $250 Series MTN 2011-1 General Obligation Notes and the repayment of $223 under the Company's syndicated credit facility.

(millions of Canadian dollars)

Liquidity and Financing Strategy

Our liquidity and financing strategy remains unchanged from that disclosed in our fiscal 2020 annual MD&A.

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.

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 February 28, 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 fund allocation [(3)]		275
Available for unrestricted use	$	573
Credit facilities for pension funding purposes:		
Letter of credit facilities for pension funding purposes [(4)]	$	593
Less: Outstanding letters of credit for pension funding purposes [(4)]		539
Undrawn committed borrowing capacity	$	54

(1) As of February 28, 2021, 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 September 12, 2022 and September 12, 2024, respectively. In March 2021, the terms of the credit facility were extended such that the two tranches will mature 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. 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 February 28, 2021.

(2) At February 28, 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").

(4) The letter of credit facilities for pension funding purposes are comprised of four facilities with Canadian financial institutions totalling $593, which will mature on December 31, 2021, unless extended. At February 28, 2021, $539 was drawn for pension solvency funding purposes.

(millions of Canadian dollars)

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

	February 28 2021	August 31 2020
LONG-TERM DEBT:		
Bonds and notes payable		
Under the MTI	$ 425	$ 425
Under the GOI	2,125	1,875
	2,550	2,300
Adjusted for deferred financing costs and discounts	(14)	(12)
Total bonds and notes payable	2,536	2,288
Less: current portion of long-term debt	(25)	(275)
Total long-term debt	$ 2,511	$ 2,013
LIQUIDITY:		
Cash and cash equivalents	$ 498	$ 689
Short-term investments	75	145
Debt service reserve fund	73	73
Undrawn committed borrowing capacity	848	625
Total Liquidity	$ 1,494	$ 1,532

Credit Ratings

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

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

On January 15, 2021, S&P affirmed the Company's AA long-term issuer credit and senior secured debt ratings, and its AA- subordinated debt rating with a negative outlook. S&P later issued an annual review report on March 11, 2021, stating that despite the current difficult operating environment, NAV CANADA's credit profile benefits from characteristics S&P considers unique, including its legislated perpetual monopoly over civil air navigation services in Canadian-controlled airspace and, of particular importance, the almost unfettered ability to set rates to cover its operating costs. Despite these strengths, S&P noted that "NAV CANADA's market position has been affected by the unprecedented and protracted decline in air passenger volume stemming from the pandemic and the resultant impaired rate-setting environment."

S&P stated that "the negative outlook reflects an at least one-in-three chance that we could lower the ratings in the next two years if traffic volumes do not recover in line with our current baseline assumptions, leading to a protracted weakness in NAV CANADA's financial standing."

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:

(millions of Canadian dollars)

- 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."

On February 8, 2021, S&P and Moody's affirmed NAV CANADA's credit ratings ahead of the Company's

issuance of its General Obligation Notes.

Cash Requirements

The following information about our contractual obligations and other commitments summarizes certain of our liquidity and capital resource requirements that have changed from those reported in our fiscal 2020 annual MD&A.

Contractual Obligations

A breakdown of contractual obligations as at February 28, 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	2021	2022	2023	2024	2025	Thereafter
Derivative liabilities	$ 4	$ 4	$ -	$ -	$ -	$ -	$ -
Long-term debt (including current portion) (1), (2)	2,550	25	25	25	225	25	2,225
Interest payments (2)	1,450	39	82	80	78	75	1,096
Capital commitments	128	51	18	11	12	8	28
Lease liability	5	2	3	-	-	-	-
Future lease liability (3)	59	-	-	2	3	3	51
Related party loan (4)	14	14	-	-	-	-	-
Total contractual obligations	$ 4,210	$ 135	$ 128	$ 118	$ 318	$ 111	$ 3,400

(millions of Canadian dollars)

(1) Payments represent principal of $2,550. The Company intends to refinance principal maturities at their maturity dates. The Company may choose to repay a portion of these maturities with available cash and/or may increase the size of a re-financing to generate additional liquidity or for other purposes, and/or may choose to redeem in whole or in part an issue in advance of its scheduled maturity.

(2) Further details on interest rates and maturity dates on long-term debt are provided in note 14 of the 2020 annual financial statements and note 9 of the Q2 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.

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

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

The Company's contributions to its pension plans are discussed in the fiscal 2020 annual MD&A.

Capital Management

The Company views capital as the sum of its issued long-term debt, retained earnings (deficit) 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.

	February 28 2021	August 31 2020
Bonds and notes payable	$ 2,536	$ 2,288
Equity:		
Retained earnings (deficit)	(99)	28
Regulatory deferral accounts:		
Debit balances	(1,649)	(2,112)
Credit balances	179	184
Employee benefits:		
LTD asset	(4)	(4)
Liability for funded pension benefits	1,058	1,643
Liability for accumulating sick leave	16	16
Total capital	$ 2,037	$ 2,043

Management's approach and objectives when managing capital remain unchanged from those described in our fiscal 2020 annual MD&A.

Financial Instruments and Risk Management

Reserve Funds and Financial Instruments

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 requirements of the debt service reserve fund and the operations and maintenance reserve fund remain unchanged from that described in our fiscal 2020 annual MD&A.

Financial Risk Management

The Company is exposed to several risks as a result of holding financial instruments, including interest rate risk, foreign exchange risk, price risk, credit risk and liquidity risk. The Company's exposure to financial risks and how the Company manages each of those risks are described in the Company's fiscal 2020 annual MD&A. There were no significant changes to those risks or to the Company's management of exposure to those risks during the six months ended February 28, 2021, except as discussed below and as noted under the heading "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Financing Strategy".

Interest Rate Risk: Investments included in the Company's cash and cash equivalents and debt service reserve fund earn interest at prevailing and fluctuating market rates. If interest rates decline, earnings on these instruments would fall. During the six months ended February 28, 2021, the Company repaid borrowings of $223 under its syndicated credit facility. As a result of the repayment and change in cash and cash equivalents, as at February 28, 2021, a 100 basis point change in variable interest rates would result in an annual difference of approximately $6 in the Company's earnings before rate stabilization adjustments (August 31, 2020 - $1).

Credit Risk: The Company revised its customer service charges effective September 1, 2020, increasing charges by an average of 29.5% on overall rate levels. The 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 service charge increase can be deferred and will become payable in equal installments over the following five fiscal years. 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 doubtful accounts 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 trend for customer collections, the Company recorded an expected credit loss allowance of $2 and $6 during the three and six months ended February 28, 2021.

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

Significant accounting policies used in the Q2 fiscal 2021 financial statements are disclosed in note 3 of the fiscal 2020 annual financial statements. The accounting policies have been applied consistently to all periods presented.

Future Accounting Pronouncements

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

The Company has the following update regarding its progress in implementing future standards:

<u>IAS 8 Definition of Accounting Estimates</u>

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.

The amendment is effective for annual periods beginning on or after January 1, 2023 with early application permitted.

<u>IAS 1 Disclosure of Accounting Policies</u>

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.

The amendment is effective for annual periods beginning on or after January 1, 2023 with early application permitted.

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of our Q2 fiscal 2021 financial statements requires management to make estimates and judgments about the future.

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

Critical judgments and key sources of estimation uncertainty are disclosed in note 2 (d) of the 2020 annual financial statements.

The Company's critical accounting estimates and judgments applied in the preparation of the Company's Q2 fiscal 2021 financial statements are consistent with those applied and disclosed in our fiscal 2020 annual financial statements and as described in the fiscal 2020 annual MD&A.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

There have been no changes to the Company's internal control over financial reporting (ICFR) during the three months ended February 28, 2021 that have materially affected or are reasonably likely to materially affect the Company's ICFR.