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MANAGEMENT'S DISCUSSION AND ANALYSIS

ON FORM 51-102F1

THREE AND SIX MONTHS ENDED

FEBRUARY 29, 2020

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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 29, 2020 (Q2 fiscal 2020) 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 2020 (Q2 fiscal 2020 financial statements), our audited annual consolidated financial statements and the accompanying notes for the year ended August 31, 2019 (fiscal 2019), our fiscal 2019 annual MD&A, as well as our 2019 Annual Information Form dated October 24, 2019 (fiscal 2019 AIF). Additional information about NAV CANADA, including our consolidated financial statements for Q2 fiscal 2020 and fiscal 2019, our fiscal 2019 annual MD&A, and our fiscal 2019 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 2020 financial statements have been prepared in accordance with International Accounting Standards (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: Air Traffic and Customer Service Charges" 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 include geopolitical unrest, terrorist attacks and the threat of terrorist attacks, war, epidemics or pandemics and related travel advisories, natural disasters, weather patterns, environmental concerns, 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 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 2019 AIF. The forward-looking statements contained in this MD&A represent our expectations as of April 14, 2020 and are subject to change after this date. Subsequent to February 29, 2020, the COVID-19 outbreak was declared a pandemic by the World Health Organization. The situation is dynamic and fluid with the impact on the aviation industry being more significant. 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 the 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 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 consolidated 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.

Financial Highlights

Results of operations for the three months ended February 29, 2020

	Three months ended		
	February 29 2020	February 28 2019	Change
Revenue	$ 322	$ 317	$ 5
Operating expenses	387	360	27
Other (income) and expenses	25	27	(2)
Net loss before net movement in regulatory deferral accounts	(90)	(70)	(20)
Net movement in regulatory deferral accounts [1]			
Rate stabilization adjustments:			
Favourable variances from planned results	(7)	(1)	(6)
Initial approved adjustment [2]	9	4	5
	2	3	(1)
Other regulatory deferral account adjustments:			
Employee benefit pension contributions	46	25	21
Other employee benefits	(2)	(2)	-
Investment in preferred interests, before tax	(8)	-	(8)
Income tax	1	-	1
Realized hedging transactions	1	-	1
	38	23	15
	40	26	14
Net loss, after net movement in regulatory deferral accounts	$ (50)	$ (44)	$ (6)

[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 year ending August 31, 2020 (fiscal 2020), the Board approved a reduction of the rate stabilization account as a result of a planned shortfall. As a result, $35 is being transferred out of the rate stabilization account evenly throughout the fiscal year (fiscal 2019 - $18).

Cash flows for the three months ended February 29, 2020

As shown below, cash and cash equivalents increased by $21 during the three months ended February 29, 2020 (three months ended February 28, 2019 - decreased by $7) and the Company experienced negative free cash flow of $24 (three months ended February 28, 2019 - $32), 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 29 2020	February 28 2019	Change
Cash flows from (used in):			
Operating [1]	$ 19	$ 2	$ 17
Investing [1]	(42)	(23)	(19)
Financing [1]	44	14	30
Increase (decrease) in cash and cash equivalents	21	(7)	28
Cash and cash equivalents, beginning of period	27	44	(17)
Cash and cash equivalents, end of period	$ 48	$ 37	$ 11
Free cash flow (non-GAAP financial measure):			
Cash flows from (used in):			
Operations [2]	$ 19	$ 2	$ 17
Capital expenditures [2]	(43)	(34)	(9)
Free cash flow	$ (24)	$ (32)	$ 8

(1) See “LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the three months ended February 29, 2020” for discussion of the changes in cash flows from the prior fiscal year.

(2) See the statement of cash flows in our Q2 fiscal 2020 financial statements.

Results of operations for the six months ended February 29, 2020

The Company recorded a net loss of $47 for the six months ended February 29, 2020 (six months ended February 28, 2019 - $46). Excluding rate stabilization and other regulatory deferral account adjustments, the Company recorded a net loss of $126 (six months ended February 28, 2019 - $78). Given the normal seasonality of air traffic and the fact that our costs are predominantly fixed in nature, a net loss is expected for the six months ended February.

	Six months ended		
	February 29 2020	February 28 2019	Change
Revenue	$ 686	$ 674	$ 12
Operating expenses	756	708	48
Other (income) and expenses	56	44	12
Net loss, before net movement in regulatory deferral accounts	(126)	(78)	(48)
Net movement in regulatory deferral accounts [(1)]			
Rate stabilization adjustments:			
Favourable variances from planned results	(16)	(10)	(6)
Initial approved adjustment [(2)]	18	9	9
	2	(1)	3
Other regulatory deferral account adjustments:			
Employee benefit pension contributions	88	45	43
Other employee benefits	(2)	(2)	-
Investment in preferred interests, before tax	(10)	(11)	1
Investment in equity-accounted investee	(1)	(1)	-
Income tax	1	1	-
Realized hedging transactions	1	1	-
	77	33	44
	79	32	47
Net loss, after net movement in regulatory deferral accounts	$ (47)	$ (46)	$ (1)

(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 2020, the Board approved a reduction of the rate stabilization account as a result of a planned shortfall. As a result, $35 is being transferred out of the rate stabilization account evenly throughout the fiscal year (fiscal 2019 - $18).

Cash flows for the six months ended February 29, 2020

As shown below, cash and cash equivalents increased by $18 during the six months ended February 29, 2020 (six months ended February 28, 2019 - decrease of $1) and the Company experienced negative free cash flow of $18 (six months ended February 28, 2019 - $26), which is a non-GAAP financial measure as discussed in "INTRODUCTION – Financial Highlights: Cash flows for the three months ended February 29, 2020".

	Six months ended		
	February 29 2020	February 28 2019	Change
Cash flows from (used in):			
Operating [1]	$ 63	$ 40	$ 23
Investing [1]	(80)	(55)	(25)
Financing [1]	35	14	21
Increase (decrease) in cash and cash equivalents	18	(1)	19
Cash and cash equivalents, beginning of period	30	38	(8)
Cash and cash equivalents, end of period	$ 48	$ 37	$ 11
Free cash flow (non-GAAP financial measure):			
Cash flows from (used in):			
Operations [2]	$ 63	$ 40	$ 23
Capital expenditures [2]	(80)	(66)	(14)
Payment of lease liabilities [2]	(1)	-	(1)
Free cash flow	$ (18)	$ (26)	$ 8

(1) See "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the six months ended February 29, 2020" for discussion of the changes in cash flows from the prior fiscal year.

(2) See the statement of cash flows in our Q2 fiscal 2020 financial statements.

Financial position as at February 29, 2020

The following table outlines significant changes in our assets, liabilities and regulatory deferral accounts between August 31, 2019 and February 29, 2020:

	February 29 2020	August 31 2019	Change
Assets			
Current assets			
Cash and cash equivalents	$ 48	$ 30	$ 18
Accounts receivable and other	92	98	(6)
Investments	73	72	1
Other current assets	14	13	1
	227	213	14
Non-current assets			
Investment in preferred interests	449	439	10
Property, plant and equipment	750	750	-
Intangible assets	893	906	(13)
Investment in equity-accounted investee	7	6	1
Related party loan receivable	3	3	-
Other non-current assets	2	1	1
	2,104	2,105	(1)
Total assets	2,331	2,318	13
Regulatory deferral account debit balances	2,171	2,087	84
Total assets and regulatory deferral account debit balances	$ 4,502	$ 4,405	$ 97
Liabilities			
Current liabilities			
Bank loan	$ 45	$ 8	$ 37
Trade and other payables	230	242	(12)
Deferred revenue	17	7	10
Current portion of long-term debt	275	25	250
Other current liabilities	3	1	2
	570	283	287
Non-current liabilities			
Long-term debt	1,193	1,443	(250)
Employee benefits	2,318	2,226	92
Deferred tax liability	49	48	1
Lease liability	5	-	5
Other non-current liabilities	1	1	-
	3,566	3,718	(152)
Total liabilities	4,136	4,001	135
Equity			
Retained earnings (deficit)	(19)	28	(47)
Regulatory deferral account credit balances	385	376	9
Total liabilities, equity and regulatory deferral account credit balances	$ 4,502	$ 4,405	$ 97

For a discussion of the changes in cash and cash equivalents (including the bank loan) from August 31, 2019, see "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the six months ended February 29, 2020".

The change in non-current employee benefit liabilities are the result of the impact of current service costs, net finance costs and contributions on each of the Company's benefit plans.

The balance in retained earnings (deficit) as at February 29, 2020 reflects the earnings up to that date. 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.

Significant Financial Matters

The following items have significant financial importance to the Company:

1. Rate Stabilization Account

As at February 29, 2020, the rate stabilization account (see "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account") had a credit balance of $91 (see "RESULTS OF OPERATIONS – Amounts Considered for Rate Setting Purposes").

The rate stabilization account decreased by $2 during fiscal 2020 due to $16 of favourable variances from planned results, offset by the $18 initially approved adjustment to the rate stabilization account. Rate stabilization adjustments are described under "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account".

2. Air Traffic and Customer Service Charges[1]

Over the course of fiscal 2020, air traffic volumes, as measured by weighted charging units (WCU) (a measure of the number of flights, aircraft size and distance flown), increased by 0.1%. Excluding the effect of an extra day for the leap year, air traffic volumes in the first six months of fiscal 2020 experienced negative growth of 0.4%. The approved budget for fiscal 2020 assumed growth of 3.7% for the year. Given the fluidity of the situation, it is impossible to forecast with any precision, at this time, the full impact or duration of the COVID-19 pandemic.

On January 23, 2020, the Canadian Transportation Agency (CTA) upheld the Company's revised service charges which had been appealed by the International Air Transport Association (IATA) in September 2019. In February 2020, IATA, as supported by Air Canada, filed a Judicial Review application in relation to the CTA's decision. As a result, the decision of the CTA, in favour of NAV CANADA, cannot be considered final. The outcome of this Judicial Review application is indeterminable at this time.

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

3. Salaries and benefits

Approximately 87% of our workforce is unionized under eight collective agreements.

During Q2 fiscal 2020, the Company announced the ratification of new collective agreements with two of its unions: Canadian Air Traffic Control Association (CATCA) and Air Traffic Specialists Association of Canada (ATSAC) and tentative agreements with four additional unions: the Professional Institute of the Public Service of Canada (PIPSC), the International Brotherhood of Electrical Workers (IBEW), Canadian Air Navigation Specialists Association (CANSA) Unifor local 1016 and the Association of Canadian Financial Officers (ACFO).

Subsequent to Q2 fiscal 2020, the Company announced the ratification of new collective agreements with PIPSC, CANSA and ACFO.

Collective agreements are now in place for 84% of our represented workforce, with tentative agreements for an additional 15%.

The Company's agreement with the Canadian Federal Pilot Association (CFPA) expired on April 30, 2019 and negotiations are ongoing with the union.

4. Subsequent events

Subsequent to February 29, 2020, the COVID-19 outbreak was declared a pandemic by the World Health Organization.

As a private not-for profit company, our revenues come from our aviation customers, namely airlines, air cargo operators, other commercial air operators and general aviation.

NAV CANADA foresees a material decline in revenues given the significant drop in air traffic while we continue to operate what is largely a fixed cost business required to provide essential air navigation services throughout Canada. As an operation with annual costs and revenues approximating $1,400, dealing with this situation is not simple.

Given the fluidity of the situation, it is impossible to forecast with any precision, at this time, the full impact of this pandemic. However, we currently anticipate that it will be significant.

Having experienced revenue shocks in 2001-2003 (including 9/11, the Iraq war, SARS and airline insolvencies) and 2008 (economic recession and H1N1), we have taken measures over the years to enhance the sustainability of NAV CANADA and our ability to absorb such shocks and to minimize negative consequences for the aviation industry. These measures include:

- the maintenance of a positive balance in our rate stabilization account, designed specifically to absorb changes in traffic levels up to a point without necessitating rate changes;
- enhancing our credit worthiness and liquidity reserves;
- decreasing debt levels;
- adding alternate sources of revenue to offset some decline in traffic levels; and
- employing strict control of both operating and capital costs, where possible.

Taken together, these measures allow us to continue to operate the air navigation system safely and to support the aviation industry at this time.

RESULTS OF OPERATIONS

Revenue

The following table provides a breakdown of our revenue by category. Our fiscal 2019 AIF and the notes to our Q2 fiscal 2020 financial statements provide more information about the different categories of our customer service charges.

	Three months ended			
	February 29 2020	February 28 2019	Change	%
Enroute	$ 150	$ 147	$ 3	2%
Terminal	126	126	-	-%
Daily / annual / quarterly	21	21	-	-%
North Atlantic and international communication	12	10	2	20%
Total customer service charges	309	304	5	2%
Other [(1)]	13	13	-	-%
	$ 322	$ 317	$ 5	2%

	Six months ended			
	February 29 2020	February 28 2019	Change	%
Enroute	$ 332	$ 324	$ 8	2%
Terminal	258	256	2	1%
Daily / annual / quarterly	43	45	(2)	(4%)
North Atlantic and international communication	24	23	1	4%
Total customer service charges	657	648	9	1%
Other [(1)]	29	26	3	12%
	$ 686	$ 674	$ 12	2%

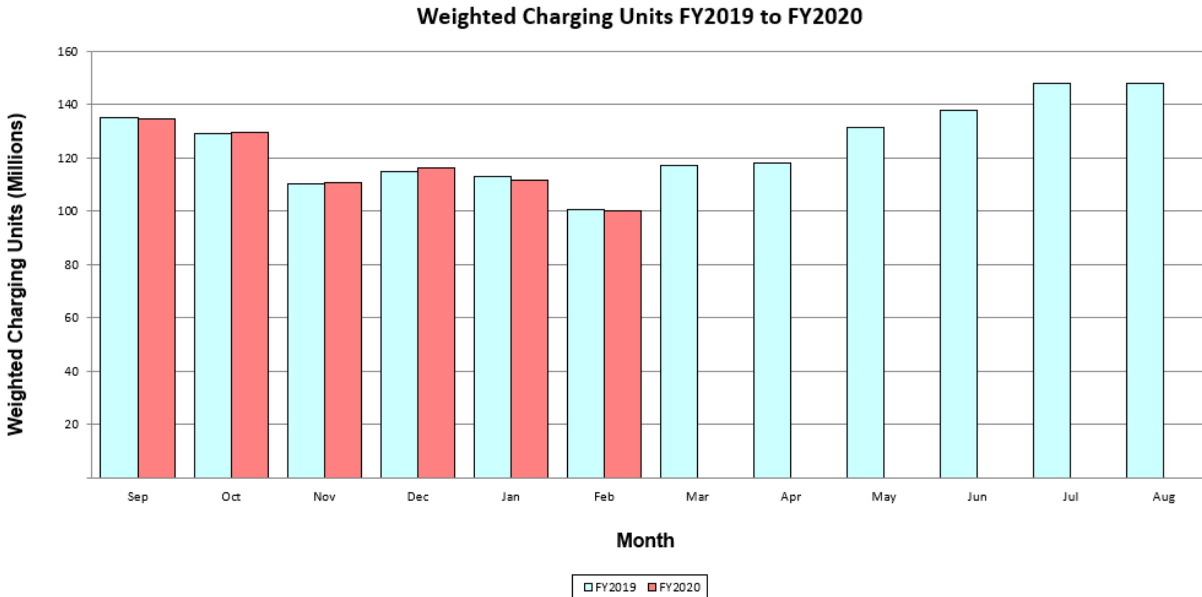
(1) Other revenue consists of service and development contracts, conference centre services at our facility in Cornwall (Ontario), the sale of civil aeronautical publications and other miscellaneous revenue.

Revenue for the three and six months ended February 29, 2020 increased by $5 and $12, respectively, compared to the same periods in fiscal 2019, and reflects revised customer service charges, whereby existing base rates increased on average by 0.8%, effective September 1, 2019, to recover the cost of domestic space-based surveillance data services and by 3.6% on average, effective January 1, 2020, to recover the cost of oceanic space-based surveillance data services.

In addition, the Company saw air traffic growth of nil and 0.1%, respectively, year-over-year, as measured by WCUs (negative growth of 1.1% and 0.4%, respectively, excluding the effect of an extra day for the leap year).

Air Traffic

Air traffic growth for the first six months of fiscal 2020 reflects normal seasonality and increased by 0.1% when compared to the first six months of fiscal 2019. The chart below shows traffic in WCUs.



Future air traffic volumes may be influenced by numerous factors, including the rate of economic growth or decline, changing air passenger demand, 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, epidemics or pandemics (such as COVID-19), weather patterns, natural disasters, environmental concerns and demographic patterns.

Operating Expenses

	Three months ended			
	February 29 2020	February 28 2019	Change	%
Salaries and benefits	$ 277	$ 255	$ 22	9%
Technical services	37	27	10	37%
Facilities and maintenance	18	19	(1)	(5%)
Depreciation and amortization	39	38	1	3%
Other	16	21	(5)	(24%)
	$ 387	$ 360	$ 27	8%

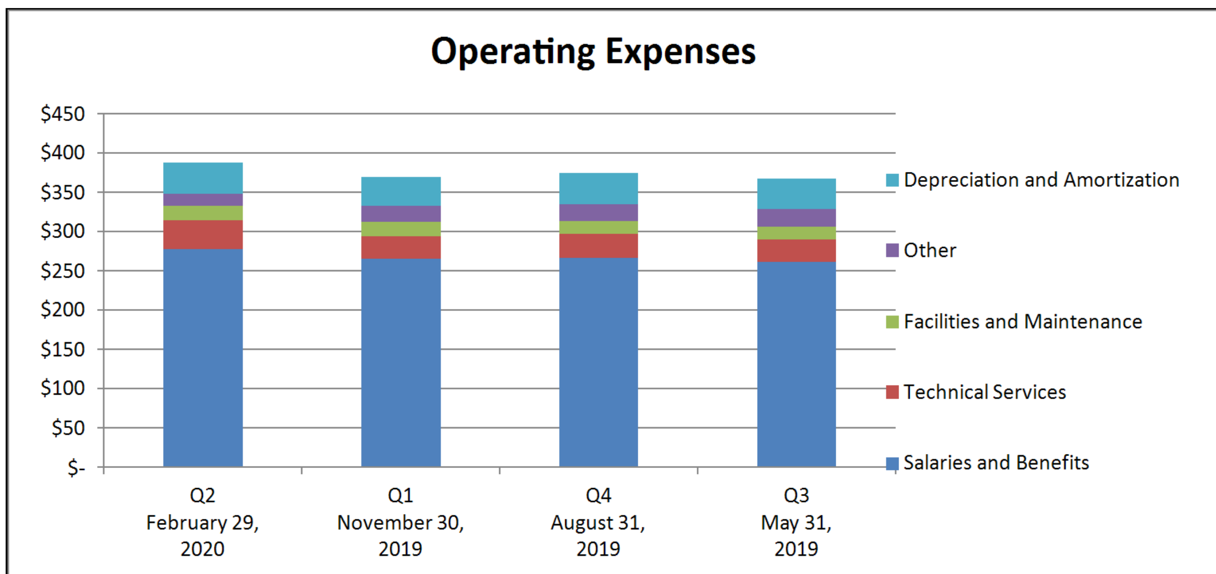
	Six months ended			
	February 29 2020	February 28 2019	Change	%
Salaries and benefits	$ 542	$ 500	$ 42	8%
Technical services	66	54	12	22%
Facilities and maintenance	36	36	-	-%
Depreciation and amortization	76	76	-	-%
Other	36	42	(6)	(14%)
	$ 756	$ 708	$ 48	7%

Salaries and benefits expense in the three and six months ended February 29, 2020 increased by $22 and $42 respectively, compared to February 28, 2019 primarily due to increased pension current service costs as a result of a 90 basis point decrease in the discount rate at August 31, 2019 compared to August 31, 2018 as well as increased compensation levels and increased staffing requirements to meet air traffic growth, to support projects and to train air traffic controllers.

Technical services expense in the three and six months ended February 29, 2020 increased by $10 and $12 respectively, compared to February 28, 2019 primarily due to the cost of domestic and oceanic space-based surveillance data services of $10 and $13, respectively, in fiscal 2020.

Other expenses decreased in the three and six months ended February 29, 2020 by $5 and $6 respectively, compared to February 28, 2019 primarily due to Company-wide efforts to reduce discretionary spending.

As illustrated in the table below, the majority of our operating expenses are incurred evenly throughout the year.



Other (Income) and Expenses

	Three months ended		
	February 29 2020	February 28 2019	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	(2)	-	2
Total finance income	(5)	(4)	1
Net interest expense relating to employee benefits	16	9	(7)
Other finance costs			
Interest expense	17	18	1
Other (gains) and losses			
Foreign exchange (gains) and losses	(3)	4	7
	$ 25	$ 27	$ 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.

Net interest expense relating to employee benefits increased by $7 in Q2 fiscal 2020 compared to Q2 fiscal 2019 primarily due to lower interest income, partially offset by lower interest expense due to the decrease in discount rates at August 31, 2019 compared to August 31, 2018.

The $7 net increase in foreign exchange gains and losses mainly relates to fluctuation of the CDN dollar against the US dollar on the Company's investment in preferred interests of Aireon.

	Six months ended		
	February 29 2020	February 28 2019	Change
Finance income			
Interest income	$ (1)	$ (2)	$ (1)
Net change in fair value of financial assets at FVTPL [1]			
Investment in preferred interests	(6)	(6)	-
Other investments	(2)	-	2
	(8)	(6)	2
Total finance income	(9)	(8)	1
Net interest expense relating to employee benefits	31	19	(12)
Other finance costs			
Interest expense	37	37	-
Other gains, net of losses			
Foreign exchange gains	(2)	(3)	(1)
Share of net loss of equity-accounted investee	(1)	(1)	-
	(3)	(4)	(1)
	$ 56	$ 44	$ (12)

[1] The net change in fair value of financial assets at FVTPL includes interest and dividend income related to those financial assets.

Net interest expense relating to employee benefits increased by $12 during the six months ended February 29, 2020 compared to the six months ended February 28, 2019 primarily due to lower interest income, partially offset by lower interest expense due to the decrease in discount rates at August 31, 2019 compared to August 31, 2018.

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 29 2020	February 28 2019	Change
Rate stabilization account [(1)]	$ 2	$ 3	$ (1)
Other regulatory deferral accounts			
Employee benefit pension contributions	46	25	21
Other employee benefits	(2)	(2)	-
Investment in preferred interests, before tax	(8)	-	(8)
Income tax	1	-	1
Realized hedging transactions	1	-	1
	$ 40	$ 26	$ 14

(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 amount of contributions to be recovered through rate setting, the net movement in the employee benefit pension contributions regulatory deferral account for Q2 fiscal 2020 was $46 compared to $25 in Q2 fiscal 2019. The increase in fiscal 2020 is largely due to the increase in pension current service costs and net interest expense as a result of a decrease in the discount rate at August 31, 2019 compared to August 31, 2018.

The $8 net movement in regulatory deferral of the Company's investment in preferred interests, before tax is primarily due to the change in the regulatory deferral of unrealized foreign exchange gains and losses due to the fluctuation of the CDN dollar against the US dollar.

	Six months ended		
	February 29 2020	February 28 2019	Change
Rate stabilization account [(1)]	$ 2	$ (1)	$ 3
Other regulatory deferral accounts			
Employee benefit pension contributions	88	45	43
Other employee benefits	(2)	(2)	-
Investment in preferred interests, before tax	(10)	(11)	1
Investment in equity-accounted investee	(1)	(1)	-
Income tax	1	1	-
Realized hedging transactions	1	1	-
	$ 79	$ 32	$ 47

(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 amount of contributions to be recovered through rate setting, the net movement in the employee benefit pension contributions regulatory deferral account for the six months ended February 29, 2020 was $88 compared to $45 for the six months ended February 28, 2019. The increase is largely due to the increase in pension current service costs and net interest expense as a result of a decrease in the discount rate at August 31, 2019 compared to August 31, 2018.

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 2019 annual consolidated financial statements. The table below shows the movements in the rate stabilization account.

	Three months ended		
	February 29 2020	February 28 2019	Change
Credit balance on the statement of financial position, beginning of period	$ 93	$ 128	$ (35)
Variances from planned results:			
Revenue lower than planned	(10)	-	(10)
Operating expenses lower than planned	6	1	5
Other (income) and expenses lower than planned	1	2	(1)
Net movement in other regulatory deferral accounts	10	(2)	12
Total variances from planned results	7	1	6
Initial approved adjustment	(9)	(4)	(5)
Net movement in rate stabilization account recorded in net income (loss)	(2)	(3)	1
Credit balance on the statement of financial position, end of period	$ 91	$ 125	$ (34)

The $2 decrease in the rate stabilization account during Q2 fiscal 2020 is primarily due to:

- revenue that were $10 lower than planned primarily due to lower air traffic growth than planned; and
- the planned adjustment of $9, representing the Q2 fiscal 2020 portion of the anticipated $35 annual net loss at the time the fiscal 2020 budget was approved.

partially offset by:

- net movement of $10 in other regulatory deferral accounts that was higher than planned primarily due to:
    - a regulatory expense for pension benefits that was $13 higher than planned primarily due to higher pension current service costs as a result of a decrease in the discount rate at August 31, 2019 compared to that used to prepare the fiscal 2020 budget; offset by

  - a regulatory adjustment of $4 related to the deferral of foreign exchange gains on our investment in preferred interests of Aireon; and

- operating expenses that were $6 lower than planned primarily due to lower operational costs.

	Six months ended		
	February 29 2020	February 28 2019	Change
Credit balance on the statement of financial position, beginning of period	$ 93	$ 124	$ (31)
Variances from planned results:			
Revenue lower than planned	(15)	(1)	(14)
Operating expenses lower than planned	15	13	2
Other (income) and expenses (higher) lower than planned	(5)	14	(19)
Net movement in other regulatory deferral accounts	21	(16)	37
Total variances from planned results	16	10	6
Initial approved adjustment	(18)	(9)	(9)
Net movement in rate stabilization account recorded in net income (loss)	(2)	1	(3)
Credit balance on the statement of financial position, end of period	$ 91	$ 125	$ (34)

The $2 decrease in the rate stabilization account during the six months ended February 29, 2020 is primarily due to:

- the planned adjustment of $18, representing half of the anticipated $35 annual net loss at the time the fiscal 2020 budget was approved;
- revenues that were $15 lower than planned primarily due to lower air traffic growth than planned; and
- other (income) and expenses that were $5 higher than planned primarily due to higher net interest expense related to employee benefits offset by higher foreign exchange gains on our investment in preferred interests of Aireon; and

partially offset by:

- net movement of $21 in other regulatory deferral accounts that was higher than planned primarily due to a regulatory expense for pension benefits that was $21 higher than planned primarily due to higher pension current service costs as a result of a decrease in the discount rate at August 31, 2019 compared to that used to prepare the fiscal 2020 budget; and
- operating expenses that were $15 lower than planned primarily due to lower operational costs.

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 months ended		
	February 29 2020	February 28 2019	Change
Items that will be reclassified to income or (loss):			
Amortization of loss on cash flow hedge	$ 1	$ -	$ 1
Changes in fair value of cash flow hedges	-	(9)	9
Net movement in regulatory deferral accounts	(1)	9	(10)
Total other comprehensive income (loss)	$ -	$ -	$ -

	Six months ended		
	February 29 2020	February 28 2019	Change
Items that will be reclassified to income or (loss):			
Amortization of loss on cash flow hedge	$ 1	$ -	$ 1
Changes in fair value of cash flow hedges	-	(4)	4
Net movement in regulatory deferral accounts	(1)	4	(5)
Total other comprehensive income (loss)	$ -	$ -	$ -

There were no significant events or changes to the Company's defined benefit pension and other post-employment benefit plans that would require a revaluation during the three and six months ended February 29, 2020 and February 28, 2019.

During the three and six months ended February 29, 2020, amortization of loss of $1 and $1, respectively, were recorded on the Company's cash flow hedges. During the three and six months ended February 28, 2019, negative fair value adjustments of $9 and $4, respectively, were recorded on the Company's interest rate hedges related to the re-financing of debt instruments that matured in fiscal 2019.

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) our 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 and the 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:

	February 29 2020	August 31 2019	Change
Rate stabilization account credit balance	$ 91	$ 93	$ (2)
Regulatory pension cash contributions to be recovered at a later date	$ (34)	$ (34)	$ -

Financial Outlook

As noted previously under "INTRODUCTION - Caution Concerning Forward-Looking Information" and "INTRODUCTION - Significant Financial Matters", the Company has seen a decline in air traffic movements as compared to the same period in fiscal 2019. The impact on air traffic movements is due to flight and route cancellations and the introduction of fleet groundings, travel advisories and restrictions occasioned by the COVID-19 pandemic.

While it is still too early to say what the extent of the impact will be on our future results, we anticipate the reduced activity will have a significant negative impact on NAV CANADA's business and results of operations. To address the anticipated revenue shortfall, the Company has commenced a detailed assessment of the impact of the pandemic on its operations nationally.

Apart from the impact of this pandemic on our revenues and operations, there may also be disruptions, including to supply chains and third-party service providers, as well as potential disruptions to our workforce. We are working diligently to minimize the impact.

The assets of the pension plan are invested in a well-diversified portfolio with a long-term focus. It is too early to determine the extent of the impact of the market downturn on the funded status of the pension plan, but it could be material.

The pandemic may also impact the cost of capital in the future which may arise from disrupted credit markets and possible credit ratings action.

Given the rapidly evolving situation, Management continues to analyze the extent of the financial impact, which could be material, depending on the duration of the pandemic. The Company has already taken steps to reduce operating costs as well as its ongoing and future capital program spending. At certain times during this period, the Company also intends to access its liquidity to support its operations.

Earnings and Cash Flow Coverage

During a fiscal year, quarterly revenue 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 February 29, 2020, the Company had a net loss of $1. Our interest costs were $74. Consolidated earnings (after rate stabilization) before interest costs were $73, which is 0.99 times our interest requirement for the fiscal year and just under our one-to-one target. Depreciation and amortization expense for this period was $154. Our cash flow coverage was 3.07 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 our Master Trust Indenture and we are subject to liquidity covenants under our General Obligation Indenture, designed to cover 12 months interest on borrowings and 25% of our annual operating and maintenance expenses. As at February 29, 2020, we were in full compliance with our debt indentures, including the Master Trust Indenture'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 General Obligation Indenture.

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 2019 annual MD&A with the exception of an agreement with Aireon to provide a subordinated loan, up to a total of $11 U.S. ($15 CDN), which was entered into during the three months ended February 29, 2020.

SUMMARY OF QUARTERLY RESULTS

Quarterly Financial Information (unaudited)

	Three months ended			
	Q2 February 29 2020	Q1 November 30 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 accounts related to net income (loss), net of tax				
Rate stabilization adjustments	2	-	21	11
Other regulatory deferral account adjustments	38	39	30	6
	40	39	51	17
Net income (loss) after net movement in regulatory deferral accounts	$ (50)	$ 3	$ 60	$ (14)

	Three months ended			
	Q2 February 28 2019	Q1 November 30 2018	Q4 August 31 2018	Q3 May 31 2018
Revenue	$ 317	$ 357	$ 414	$ 349
Operating expenses	360	348	355	361
Other (income) and expenses	27	17	26	(14)
	(70)	(8)	33	2
Income tax (recovery) expense	-	-	1	10
Net income (loss) before net movement in regulatory deferral accounts	(70)	(8)	32	(8)
Net movement in regulatory deferral accounts related to net income (loss), net of tax				
Rate stabilization adjustments	3	(4)	(2)	13
Other regulatory deferral account adjustments	23	10	20	(13)
	26	6	18	-
Net income (loss) after net movement in regulatory deferral accounts	$ (44)	$ (2)	$ 50	$ (8)

Discussion of Quarterly Results

The quarterly variations in revenue mainly reflect 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 Company's air traffic growth for Q2 fiscal 2020 was flat on a year over year basis, as measured in WCU (negative growth of 1.1% excluding the effect of an extra day for the leap year). In fiscal 2020, the Company implemented revised service charges, whereby existing base rates increased on average by 0.8%, effective September 1, 2019 and by 3.6% on average, effective January 1, 2020, to recover the cost of space-based surveillance data services (as disclosed in our fiscal 2019 annual MD&A).

The majority of our operating expenses are incurred evenly throughout the year.

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 annual 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 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 the investment in equity-accounted investee;
- changes in income taxes; and
- changes in unrealized hedging transactions.

LIQUIDITY AND CAPITAL RESOURCES

Our fiscal 2019 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 29, 2020.

As at February 29, 2020, we had $48 of cash and cash equivalents and committed credit facilities of $1,390, of which $495 was available for unrestricted use (see "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Financing Strategy").

Cash flows for the three months ended February 29, 2020

	Three months ended		
	February 29 2020	February 28 2019	Change
Cash flows from (used in):			
Operating	$ 19	$ 2	$ 17
Investing	(42)	(23)	(19)
Financing	44	14	30
Increase (decrease) in cash and cash equivalents	21	(7)	28
Cash and cash equivalents, beginning of period	27	44	(17)
Cash and cash equivalents, end of period	$ 48	$ 37	$ 11
Free cash flow (non-GAAP financial measure):			
Cash flows from (used in):			
Operations	$ 19	$ 2	$ 17
Capital expenditures [1]	(43)	(34)	(9)
Free cash flow	$ (24)	$ (32)	$ 8

[1] See the statement of cash flows in our Q2 fiscal 2020 financial statements.

As shown above, cash and cash equivalents increased by $21 for the three months ended February 29, 2020 and the Company experienced negative free cash flow of $24, which is a non-GAAP financial measure as discussed in "INTRODUCTION – Financial Highlights: Cash flows for the three months ended February 29, 2020".

Cash flows from operations for the three months ended February 29, 2020 were inflows of $19 compared to inflows of $2 for the three months ended February 28, 2019. The variance of $17 was primarily due to higher receipts from customer service charges of $9, higher other receipts of $5 and lower payments to employees and suppliers of $3.

Cash outflows from investing activities for the three months ended February 29, 2020 were $42 compared to $23 for the three months ended February 28, 2019. In Q2 fiscal 2020, investment in capital projects was $43 compared to $34 in Q2 fiscal 2019, which was partially offset by $11 cash inflows from the repayment of the bridge financing from Aireon.

Cash flows from financing activities for the three months ended February 29, 2020 were inflows of $44 compared to inflows of $14 for the three months ended February 28, 2019. The increase in Q2 fiscal 2020 was primarily a result of the additional proceeds from bank loans of $44 (three months ended February 28, 2019 - $15).

Cash flows for the six months ended February 29, 2020

	Six months ended		
	February 29 2020	February 28 2019	Change
Cash flows from (used in):			
Operating	$ 63	$ 40	$ 23
Investing	(80)	(55)	(25)
Financing	35	14	21
Increase (decrease) in cash and cash equivalents	18	(1)	19
Cash and cash equivalents, beginning of period	30	38	(8)
Cash and cash equivalents, end of period	$ 48	$ 37	$ 11
Free cash flow (non-GAAP financial measure):			
Cash flows from (used in):			
Operations	$ 63	$ 40	$ 23
Capital expenditures (1)	(80)	(66)	(14)
Payment of lease liabilities (1)	(1)	-	(1)
Free cash flow	$ (18)	$ (26)	$ 8

(1) See the statements of cash flows of our Q2 fiscal 2020 financial statements.

As shown above, cash and cash equivalents increased by $18 for the six months ended February 29, 2020 and the Company experienced negative free cash flow of $18, which is a non-GAAP financial measure as discussed in "INTRODUCTION – Financial Highlights: Cash flows for the three months ended February 29, 2020".

Cash flows from operations for the six months ended February 29, 2020 were inflows of $63 compared to inflows of $40 for the six months ended February 28, 2019, primarily due to lower payments to employees and suppliers of $16 and lower interest payments of $4.

Cash outflows from investing activities for the six months ended February 29, 2020 were $80 compared to $55 in the six months ended February 28, 2019. The Company invested $80 in capital projects during the six months ended February 29, 2020 compared to $66 in the six months ended February 28, 2019 which was partially offset by $11 cash inflows from the repayment of the bridge financing from Aireon.

Cash inflows from financing activities for the six months ended February 29, 2020 were $35 compared to $14 for the six months ended February 28, 2019. The inflows in fiscal 2020 were primarily due to $36 additional proceeds for bank loans compared to $15 in the same period of fiscal 2019.

Liquidity and Financing Strategy

Our liquidity and financing strategy remains unchanged from that disclosed in our fiscal 2019 annual MD&A.

We are exposed to re-financing 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 29, 2020, the credit facilities are utilized as follows:

Credit facilities:	
Credit facility with a syndicate of Canadian financial institutions [1] [2]	$ 850
Letter of credit facilities for pension funding purposes [3]	540
Total available credit facilities	1,390
Less: Outstanding letters of credit for pension funding purposes [3]	530
Less: Outstanding letters of credit for other purposes [2]	10
Less: Bank loan	45
Undrawn committed borrowing capacity	805
Less: Operations and maintenance reserve fund allocation [4]	310
Credit facilities available for unrestricted use	$ 495

(1) The Company's credit facility with a syndicate of Canadian financial institutions in the amount of $850 is comprised of two equal tranches maturing on September 12, 2022 and September 12, 2024. 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 29, 2020.

(2) At February 29, 2020, $10 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 letter of credit facilities for pension funding purposes are comprised of four facilities with Canadian financial institutions totalling $540. Two of the credit facilities, representing $250, are set to mature on December 31, 2020 and the remaining facilities will expire on December 31, 2021. At February 29, 2020, $530 was drawn for pension solvency funding purposes.

(4) The operations and maintenance reserve fund 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").

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

	February 29 2020	August 31 2019
LONG-TERM DEBT:		
Bonds and notes payable		
Under the Master Trust Indenture	$ 450	$ 450
Under the General Obligation Indenture	1,025	1,025
	1,475	1,475
Adjusted for deferred financing costs and discounts	(7)	(7)
Total bonds and notes payable	1,468	1,468
Less: current portion of long-term debt	(275)	(25)
Total long-term debt	$ 1,193	$ 1,443
LIQUIDITY:		
Cash and cash equivalents	$ 48	$ 30
Debt service reserve fund	73	72
	$ 121	$ 102
Undrawn committed borrowing capacity (1)	$ 805	$ 684

(1) $495 of this borrowing capacity is available as described in the previous table (August 31, 2019 - $374).

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

As a result of the COVID-19 pandemic, on April 1, 2020, S&P revised its outlook on the Company to negative from stable and affirmed its 'AA' long-term issuer credit and senior secured debt ratings, and 'AA-' senior subordinated debt rating. In revising its outlook to negative, S&P noted that the revision reflects a one-in-three chance that they could lower the ratings over the next 12 to 24 months. S&P indicated they would consider doing so should a prolonged traffic downturn or slow traffic recovery post-pandemic lead to large and sustained deterioration in financial metrics.

S&P noted that they “expect NAV CANADA to withstand the significant pressure that the traffic decline is exerting on its cash flows, as it possesses adequate liquidity and no large debt issues until February 2021”. They also noted that the cascading effects of the pandemic and the uncertainty of the travel curtailment make it difficult to forecast a recovery pattern, though they anticipate that the outbreak of the virus will peak between June and August 2020.

S&P stated that they expect NAV CANADA will preserve strong relationships with domestic financial institutions, maintaining its track record of access to external liquidity. In assessing our ability to manage external shocks, S&P points to the Company's legislated ability to fully adjust user charges to meet our financial obligations with the view that good debt service metrics provide additional financial capacity.

On March 5, 2020, S&P issued a credit opinion affirming the Company's ratings and stable outlook. The credit opinion noted the Company's credit strengths as holding a monopoly over an essential transportation service, legislated ability to levy user charges on airlines to meet financial requirements and strong financial performance. They noted that the Company's debt metrics are largely stable.

S&P stated that NAV CANADA has "adequate liquidity and financial flexibility, thanks to healthy levels of unrestricted reserves and available lines of credit, and very strong debt capacity". S&P noted the Company's legislated perpetual monopoly over civil air navigation services in Canadian-controlled airspace and the fact that its air traffic volumes depend not on any one region, but the entire country and international airspace assigned to Canada by treaty. S&P therefore considers the Company's service area to be more diversified than that of airport operators.

On April 8, 2020, Moody's affirmed NAV CANADA's ratings and stable outlook. The ratings action reflects NAV CANADA's strong liquidity profile. The "liquidity sources, combined with cost management measures, planned liquidity enhancement measures and capital expenditure reductions that are being considered, will provide NAV CANADA with the ability to withstand the material declines in passenger traffic that we expect in 2020 and possibly still into 2021."

Moody's stated that "the stable rating outlook reflects our expectation that NAV CANADA will implement the necessary rate increases to compensate for lower levels of activity as a result of the coronavirus outbreak."

On February 28, 2020, 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;
- Continued traffic growth, albeit weaker in the near-term due to the on-going grounding of the Boeing 737 MAX 8 aircraft and the impact of the coronavirus; and
- Manageable capital expenditure program.

They also noted the following credit challenges:

- Defined benefit pension plan creates recurring calls on cash;
- Periods of weak debt service coverage ratio when the Company depletes its rate stabilization account and/or when there are unexpected declines in air traffic.

Moody's stated that "the rating outlook is stable, reflecting our expectation that NAV CANADA will be prudent and take into account its overall financial position and upcoming obligations when contemplating a rate decrease and, vice versa, that it will implement the necessary rate increases if traffic growth slows down and/or expenses increase."

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 that reported in our fiscal 2019 annual MD&A.

Contractual Obligations

A breakdown of contractual obligations as at February 29, 2020 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	2020	2021	2022	2023	2024	Thereafter
Bank loan	$ 45	$ 45	$ -	$ -	$ -	$ -	$ -
Long-term debt (including current portion) [1], [2]	1,475	25	275	25	25	25	1,100
Interest payments [2]	946	34	63	56	54	52	687
Capital commitments	103	52	23	11	3	3	11
Operating contract commitments	16	2	4	3	3	1	3
Future lease liabilities[3]	59	-	-	-	2	3	54
Lease liability	8	2	3	3	-	-	-
Related party loan [4]	15	15	-	-	-	-	-
Total contractual obligations	$ 2,667	$ 175	$ 368	$ 98	$ 87	$ 84	$ 1,855

[1] Payments represent principal of $1,475. 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 2019 annual consolidated financial statements.

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

[4] During the three months ended February 29, 2020, the Company entered into an agreement with Aireon to provide a subordinated loan, up to a total of $11 U.S. ($15 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 2019 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 29 2020	August 31 2019
Bonds and notes payable	$ 1,468	$ 1,468
Equity:		
Retained earnings (deficit)	(19)	28
Regulatory deferral accounts:		
Debit balances	(2,171)	(2,087)
Credit balances	385	376
Employee benefits:		
LTD liability	1	3
Liability for funded pension benefits	1,901	1,813
Liability for accumulating sick leave	17	17
Total capital	$ 1,582	$ 1,618

Management's approach and objectives when managing capital remain unchanged from those described in our fiscal 2019 annual MD&A.

Financial Instruments and Risk Management

Reserve Funds and Financial Instruments

Under the Master Trust Indenture, we maintain a debt service reserve fund and an operations and maintenance reserve fund. We are also required to meet certain minimum liquidity levels under the General Obligation Indenture. The requirements of the debt service reserve fund and the operations and maintenance reserve fund remain unchanged from that described in our fiscal 2019 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 2019 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 29, 2020, except for changes in our liquidity risk as noted under the heading "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Financing Strategy" and anticipated future impacts of the COVID-19 pandemic as discussed under the heading "INTRODUCTION – Significant Financial Matters".

Insurance

Our aviation liability insurance program was last renewed on November 15, 2019 for one year. 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 significant 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

With the exception of the matter discussed in “INTRODUCTION – Significant Financial Matters: Air Traffic and Customer Service Charges”, 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 these interim condensed consolidated financial statements are disclosed in note 3 of the 2019 annual consolidated financial statements, except for the application of new standards, amendments and interpretations effective September 1, 2019 as described in note 2 (f) of the Company’s November 30, 2019 interim condensed consolidated financial statements. The note details the impact and changes in accounting policies as a result of the adoption of IFRS 16 – *Leases*, effective September 1, 2019. No other changes to significant accounting policies have been made subsequently. The accounting policies have been applied consistently to all periods presented, unless otherwise indicated.

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

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

Critical judgments and key sources of estimation uncertainty are disclosed in note 2 (d) of the 2019 annual consolidated financial statements.

The Company’s critical accounting estimates and judgments applied in the preparation of the Company’s Q2 fiscal 2020 financial statements are consistent with those applied and disclosed in our fiscal 2019 annual consolidated financial statements and as described in the fiscal 2019 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 29, 2020 that have materially affected or are reasonably likely to materially affect the Company’s ICFR.