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MANAGEMENT'S DISCUSSION AND ANALYSIS

ON FORM 51-102F1

THREE MONTHS ENDED

NOVEMBER 30, 2020

January 13, 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 months ended November 30, 2020 (Q1 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 Q1 fiscal 2021 (Q1 fiscal 2021 financial statements), our audited annual consolidated 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 consolidated financial statements for Q1 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 Q1 fiscal 2021 financial statements have been prepared in accordance with International Accounting Standards 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 January 13, 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. 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. 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 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, 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 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.

(millions of Canadian dollars)

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 November 30, 2020

	Three months ended November 30		
	2020	2019	$ Change
Revenue	$ 202	$ 364	$ (162)
Operating expenses	309	369	(60)
Other (income) and expenses	31	31	-
Net loss before net movement in regulatory deferral accounts	(138)	(36)	(102)
Net movement in regulatory deferral accounts [1]			
Rate stabilization adjustments:			
Favourable variances from planned results	(32)	(9)	(23)
Initial approved adjustment [2]	74	9	65
	42	-	42
Other regulatory deferral account adjustments:			
Employee benefit pension contributions	26	42	(16)
Other employee benefits	(1)	-	(1)
Investment in preferred interests, before tax	(2)	(2)	-
Investment in equity-accounted investee	-	(1)	1
Allowance for doubtful accounts	3	-	3
	26	39	(13)
	68	39	29
Net income (loss), after net movement in regulatory deferral accounts	$ (70)	$ 3	$ (73)

(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, 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 will be reflected in the rate stabilization account evenly throughout the fiscal year.

(millions of Canadian dollars)

Cash flows for the three months ended November 30, 2020

As shown below, cash and cash equivalents decreased by $369 during the three months ended November 30, 2020 (three months ended November 30, 2019 - decreased by $3) and the Company experienced negative free cash flow of $146 (three months ended November 30, 2019 - positive free cash flow of $6), 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 November 30		
	2020	2019	$ Change
Cash flows from (used in):			
Operating [(1)]	$ (131)	$ 44	$ (175)
Investing [(1)]	(14)	(38)	24
Financing [(1)]	(224)	(9)	(215)
Decrease in cash and cash equivalents	(369)	(3)	(366)
Cash and cash equivalents, beginning of period	689	30	659
Cash and cash equivalents, end of period	$ 320	$ 27	$ 293
Free cash flow (non-GAAP financial measure):			
Cash flows from (used in):			
Operations [(2)]	$ (131)	$ 44	$ (175)
Capital expenditures [(2)]	(18)	(37)	19
Proceeds from sale of property, plant and equipment [(2)]	4	-	4
Payment of lease liabilities [(2)]	(1)	(1)	-
Free cash flow	$ (146)	$ 6	$ (152)

(1) See “LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the three months ended November 30, 2020” for discussion of the changes in cash flows from the prior fiscal year.

(2) See the statement of cash flows in our Q1 fiscal 2021 financial statements.

(millions of Canadian dollars)

Financial position as at November 30, 2020

The following table outlines significant changes in our assets, liabilities and regulatory deferral accounts between August 31, 2020 and November 30, 2020:

	November 30 2020	August 31 2020	$ Change
Assets			
Current assets			
Cash and cash equivalents	$ 320	$ 689	$ (369)
Accounts receivable and other	73	77	(4)
Investments	218	218	-
Other current assets	8	9	(1)
	619	993	(374)
Non-current assets			
Property, plant and equipment	730	740	(10)
Intangible assets	862	874	(12)
Investment in preferred interests	338	336	2
Long-term receivables	36	1	35
Investment in equity-accounted investee	7	7	-
Employee benefits	3	4	(1)
Other non-current assets	3	3	-
	1,979	1,965	14
Total assets	2,598	2,958	(360)
Regulatory deferral account debit balances	2,180	2,112	68
Total assets and regulatory deferral account debit balances	$ 4,778	$ 5,070	$ (292)
Liabilities			
Current liabilities			
Bank loan	$ -	$ 223	$ (223)
Trade and other payables	234	262	(28)
Current portion of long-term debt	275	275	-
Deferred revenue	11	11	-
Other current liabilities	7	6	1
	527	777	(250)
Non-current liabilities			
Employee benefits	2,071	2,042	29
Long-term debt	2,013	2,013	-
Deferred tax liability	21	21	-
Lease liability	3	3	-
Other non-current liabilities	1	2	(1)
	4,109	4,081	28
Total liabilities	4,636	4,858	(222)
Equity			
Retained earnings (deficit)	(42)	28	(70)
Regulatory deferral account credit balances	184	184	-
Total liabilities, equity and regulatory deferral account credit balances	$ 4,778	$ 5,070	$ (292)

For a discussion of the changes in cash and cash equivalents (including those related to the bank loan) from August 31, 2020, see "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the three months ended November 30, 2020".

Long-term receivables include $35 of 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 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 November 30, 2020 reflects the earnings or loss 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[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 quarter of fiscal 2021 as compared to the same period 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 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.

The Company has a cost structure that is largely fixed, and accordingly costs do not vary significantly throughout the year. In response to the impact of the pandemic, the Company continues to review, monitor and take actions to reduce capital and operating 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.

To continue to address the significant revenue shortfall, some of the actions the Company has taken in Q1 fiscal 2021 include:

- increasing customer service charges, effective September 1, 2020, by an average of 29.5% on overall rate levels;
- continuing to access the Canada Emergency Wage Subsidy (CEWS) government relief program; and
- implementing cost-cutting measures where possible, including the elimination of temporary and permanent positions and launching level of service reviews for six air traffic control towers and aerodromes (see further discussion in "Operating Expenses" below).

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

2. Air Traffic and Customer Service Charges

Over the first three months of fiscal 2021, air traffic volumes, as measured by weighted charging units (WCU) (a measure of the number of flights, aircraft size and distance flown), decreased by 58.8%. The approved budget for fiscal 2021 assumed a decline of 59.9%. Air traffic volumes are currently assumed to decline by 14.6% 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.

In September 2020, the Canadian Transportation Agency (CTA) received an appeal by WestJet of the revised customer service charges implemented on September 1, 2020, requesting, among other things, the cancellation of the revised charges. The appeal alleged that the Company did not comply with two of the charging principles in the ANS Act. On January 12, 2021, the CTA dismissed the appeal filed by WestJet and in doing so, upheld the Company's revised service charges which came into effect on September 1, 2020.

3. Financing Activities

On November 27, 2020, the Company called for a joint meeting of holders of all outstanding bonds and holders of all outstanding series of notes and commenced solicitation of consents and proxies to consider amendments to each of the master trust indenture (MTI) governing the bonds and the general obligation indenture (GOI) governing the notes. The relief was sought in light of the significant decline in air traffic volumes and economic contraction resulting from the COVID-19 pandemic.

The Company received valid consents and proxies from bondholders in excess of the MTI requisite majority and from noteholders in excess of the GOI requisite majority prior to the election deadline for the consent solicitation on December 16, 2020. The extraordinary resolutions approving each of the MTI amendments and the GOI amendments were therefore passed and supplemental indentures, pursuant to which each of the amendments to the MTI and the GOI became effective, were entered into by the Company on December 18, 2020.

These 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.

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 quarter 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. Estimated severance and termination costs of $30 have been recorded in Salaries and benefits during the three months ended November 30, 2020 for restructuring activities approved to that date.

(millions of Canadian dollars)

Since the beginning of the COVID-19 pandemic, the Company has announced a reduction of approximately 900 jobs across the country (roughly 17.5% of the Company's pre-pandemic workforce). The restructuring of some of our organizational business units, the adjustments of our workforce and the proposed changes to our level of service are critical to align operations and services with air traffic and strengthening the sustainability of NAV CANADA.

The Company continues to avail itself of the CEWS offered by the Government of Canada. During the three months ended November 30, 2020, the Company recognized $42 from the CEWS government relief program, partially offsetting compensation costs.

5. Rate Stabilization Account

As at November 30, 2020, the rate stabilization account had a debit balance of $297 (see "RESULTS OF OPERATIONS – Amounts Considered for Rate Setting Purposes").

The rate stabilization account changed by $42 due to the $74 initially approved adjustment to the rate stabilization account resulting from the planned shortfall in fiscal 2021, partially offset by $32 of favourable variances from planned results. Rate stabilization adjustments are described under "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account".

RESULTS OF OPERATIONS

Revenue

The following table provides a summary of revenue by category. Our fiscal 2020 AIF and the notes to our Q1 fiscal 2021 financial statements provide more information about the different categories of our customer service charges.

	Three months ended November 30			
	2020	2019	$ Change	% Change
Enroute	$ 104	$ 182	$ (78)	(43%)
Terminal	69	132	(63)	(48%)
Daily / annual / quarterly	5	22	(17)	(77%)
North Atlantic and international communication	11	12	(1)	(8%)
Total customer service charges	189	348	(159)	(46%)
Other [1]	13	16	(3)	(19%)
	$ 202	$ 364	$ (162)	(45%)

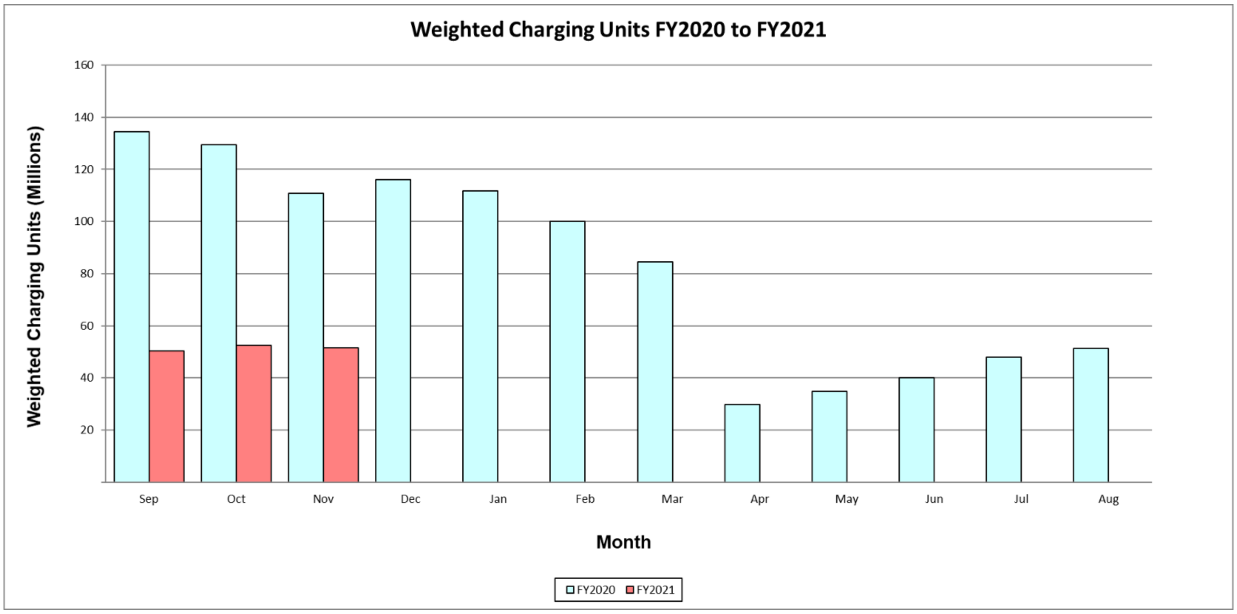
[1] Other revenue consists of service and development contracts, conference centre services at our facility in Cornwall (Ontario), the sale of civil aeronautical publications and other miscellaneous revenue.

Revenue from customer service charges for the three months ended November 30, 2020 decreased by $159 compared to the same period 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 negative air traffic growth of 58.8% year-over-year, as measured in WCUs, in the three months ended November 30, 2020. The decrease in air traffic volumes was 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 months ended November 30, 2020 decreased by $3 compared to the same period in fiscal 2020, primarily due to 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 Q1 fiscal 2021 continue to reflect the negative impact of the COVID-19 pandemic.



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

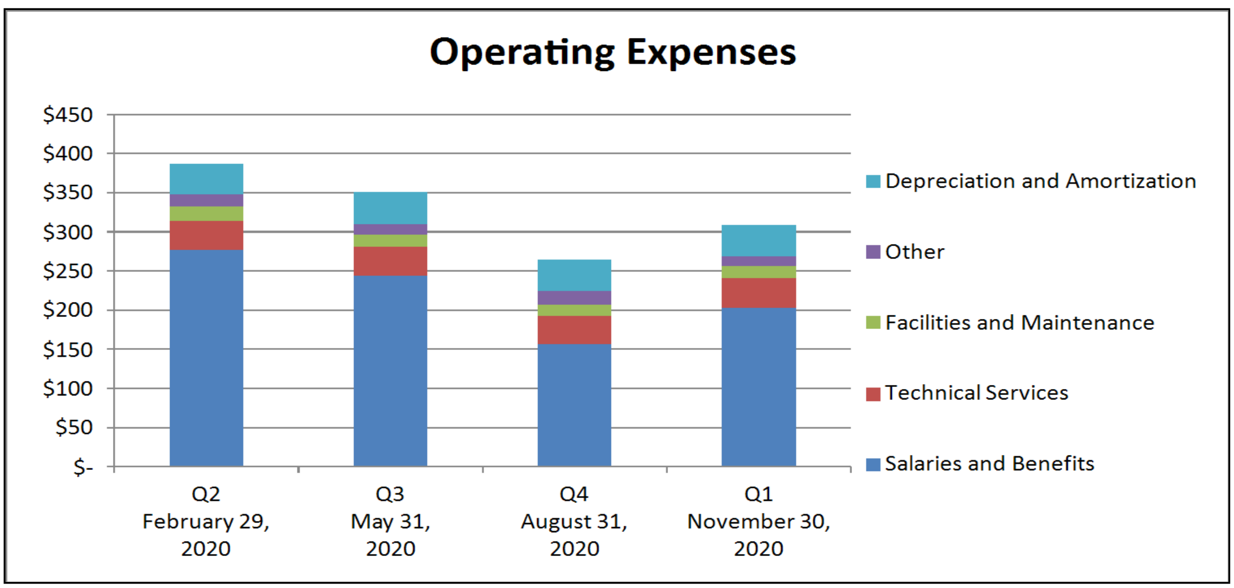
	Three months ended November 30			
	2020	2019	$ Change	% Change
Salaries and benefits	$ 203	$ 265	$ (62)	(23%)
Technical services	38	29	9	31%
Facilities and maintenance	15	18	(3)	(17%)
Depreciation and amortization	40	37	3	8%
Other	13	20	(7)	(35%)
	$ 309	$ 369	$ (60)	(16%)

Salaries and benefits expense in Q1 fiscal 2021 decreased by $62 compared to the same period in fiscal 2020 primarily due to lower overtime costs and CEWS receipts of $42, partially offset by severance and termination costs of $30 related to restructuring efforts approved in Q1 fiscal 2021.

Technical services costs increased by $9 in Q1 fiscal 2021, compared to the same period in fiscal 2020, primarily due to the costs associated with oceanic space-based surveillance data services, which the Company began incurring in January 2020.

Other expenses decreased by $7 in Q1 fiscal 2021 compared to the same period in fiscal 2020 primarily due to cost containment efforts resulting in lower travel, hospitality and relocation costs.

While our operating expenses have historically demonstrated a stable pattern, in the three months ended February 29, 2020, the Company ratified collective agreements with six bargaining agents, resulting in an increase in compensation costs. 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 significant reduction in overtime costs and the receipt of the CEWS beginning in May 2020 also helped to offset compensation costs. In Q1 fiscal 2021, the Company continued restructuring efforts, resulting in increased severance and termination costs. Company-wide cost reduction efforts have been a key focus, particularly with respect to discretionary expenditures.



(millions of Canadian dollars)

Other (Income) and Expenses

	Three months ended November 30		
	2020	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)	-
Total finance income	(4)	(4)	-
Net interest expense relating to employee benefits	14	15	1
Other finance costs			
Interest expense	23	20	(3)
Other gains, net of losses			
Foreign exchange losses	1	1	-
Other gains	(3)	(1)	2
	(2)	-	2
	$ 31	$ 31	$ -

(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 $3 in Q1 fiscal 2021 compared to the same period in fiscal 2020 mainly due to interest expense related to the $550 Series 2020-1 and $300 Series 2020-2 General Obligation Notes issued in May 2020.

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 November 30		
	2020	2019	$ Change
Rate stabilization account [(1)]	$ 42	$ -	$ 42
Other regulatory deferral accounts			
Employee benefit pension contributions	26	42	(16)
Other employee benefits	(1)	-	(1)
Investment in preferred interests, before tax	(2)	(2)	-
Investment in equity-accounted investee	-	(1)	1
Allowance for doubtful accounts	3	-	3
	$ 68	$ 39	$ 29

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

(millions of Canadian dollars)

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 Q1 fiscal 2021 was $26 compared to $42 in the same period in fiscal 2020. The decrease in Q1 fiscal 2021 is largely due to the decrease in pension current service costs as a result of a decrease in overall headcount and the future salary rate assumption at August 31, 2020 compared to August 31, 2019.

The $3 net movement in the allowance for doubtful accounts regulatory deferral account 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 consolidated financial statements. The table below shows the movements in the rate stabilization account.

	Three months ended November 30		
	2020	2019	$ Change
Credit (debit) balance on the statement of financial position, beginning of period	$ (255)	$ 93	$ (348)
Variances from planned results:			
Revenue higher (lower) than planned	8	(5)	13
Operating expenses lower than planned	16	9	7
Other (income) and expenses lower (higher) than planned	2	(6)	8
Net movement in other regulatory deferral accounts	6	11	(5)
Total variances from planned results	32	9	23
Initial approved adjustment	(74)	(9)	(65)
Net movement in rate stabilization account recorded in net income (loss)	(42)	-	(42)
Credit (debit) balance on the statement of financial position, end of period	$ (297)	$ 93	$ (390)

The $42 change in the rate stabilization account during Q1 fiscal 2021 is due to:

- the planned adjustment of $74, representing the Q1 fiscal 2021 portion of the anticipated $295 annual net loss at the time the fiscal 2021 budget was approved;

partially offset by:

- operating expenses that were $16 lower than planned primarily due to lower overtime and restructuring costs; and the Company's continued efforts to reduce discretionary spending amid the COVID-19 pandemic.
- revenue that was $8 higher than planned primarily due to higher air traffic volumes than planned;
- net movement in other regulatory deferral accounts that was $6 higher than planned primarily due to:

(millions of Canadian dollars)

  - a regulatory adjustment of $3 related to the allowance for doubtful accounts as a result of increased lifetime expected credit losses related to accounts receivable; and
  - a regulatory adjustment of $2 related to other employee benefits, largely due to the recognition of the long-term disability (LTD) plan deficit; and

- other (income) and expenses that were $2 lower than planned primarily due to net gains on the sale of the Company's Dash 8 aircraft.

Amounts Considered for Rate Setting Purposes

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

(a) air traffic results and forecasts;

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

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

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

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

	November 30 2020	August 31 2020	$ Change
Rate stabilization account debit balance	$ 297	$ 255	$ 42
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 period in fiscal 2020. The pandemic is expected to continue to have a negative impact on air travel 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.

Management continues to analyze the extent of the financial impact, which is expected to be material, depending on the duration of the pandemic. The Company has taken unprecedented steps to reduce operating costs as well as its ongoing and future capital program spending.

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

(millions of Canadian dollars)

Presented below are the Company's current projected annual consolidated results before rate stabilization for fiscal 2021 compared to fiscal 2020 actual results. The only change to these projections from those presented in our fiscal 2020 annual MD&A, are a reduction of forecasted overtime costs of $15 as current cost-containment measures are expected to remain in place.

	Fiscal 2021	Fiscal 2020	$ Change	% Change
Before rate stabilization				
Revenue	$ 1,098	$ 1,000	$ 98	10%
Operating expenses and other (income) and expenses, including other regulatory adjustments	1,393	1,348	45	3%
Net loss before rate stabilization adjustments	$ (295)	$ (348)	$ 53	

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 November 30, 2020, the Company had a net loss of $73. Our interest costs were $82. Consolidated earnings (after rate stabilization) before interest costs were $9, which is 0.11 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 $160. Our cash flow coverage was 2.06 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 November 30, 2020, 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.

(millions of Canadian dollars)

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.

SUMMARY OF QUARTERLY RESULTS

Quarterly Financial Information (unaudited)

	Three months ended			
	Q1 November 30 2020	Q4 August 31 2020	Q3 May 31 2020	Q2 February 29 2020
Revenue	$ 202	$ 155	$ 159	$ 322
Operating expenses	309	264	351	387
Other (income) and expenses	31	56	129	25
	(138)	(165)	(321)	(90)
Income tax recovery	-	(1)	(27)	-
Net income (loss) before net movement in regulatory deferral accounts	(138)	(164)	(294)	(90)
Net movement in regulatory deferral accounts related to net income (loss), net of tax				
Rate stabilization adjustments	42	177	169	2
Other regulatory deferral account adjustments	26	48	111	38
	68	225	280	40
Net income (loss) after net movement in regulatory deferral accounts	$ (70)	$ 61	$ (14)	$ (50)

	Three months ended			
	Q1 November 30 2019	Q4 August 31 2019	Q3 May 31 2019	Q2 February 28 2019
Revenue	$ 364	$ 412	$ 351	$ 317
Operating expenses	369	374	367	360
Other (income) and expenses	31	32	15	27
	(36)	6	(31)	(70)
Income tax recovery	-	(3)	-	-
Net income (loss) before net movement in regulatory deferral accounts	(36)	9	(31)	(70)
Net movement in regulatory deferral accounts related to net income (loss), net of tax				
Rate stabilization adjustments	-	21	11	3
Other regulatory deferral account adjustments	39	30	6	23
	39	51	17	26
Net income (loss) after net movement in regulatory deferral accounts	$ 3	$ 60	$ (14)	$ (44)

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 58.8% over the course of Q1 fiscal 2021, as measured in WCUs.

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 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 allowance for doubtful accounts.

(millions of Canadian dollars)

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 three months ended November 30, 2020.

As at November 30, 2020, we had $320 of cash and cash equivalents, $145 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 $590 of which $57 was undrawn (see "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Financing Strategy").

Cash flows for the three months ended November 30, 2020

	Three months ended November 30		
	2020	2019	$ Change
Cash flows from (used in):			
Operating	$ (131)	$ 44	$ (175)
Investing	(14)	(38)	24
Financing	(224)	(9)	(215)
Decrease in cash and cash equivalents	(369)	(3)	(366)
Cash and cash equivalents, beginning of period	689	30	659
Cash and cash equivalents, end of period	$ 320	$ 27	$ 293
Free cash flow (non-GAAP financial measure):			
Cash flows from (used in):			
Operations	$ (131)	$ 44	$ (175)
Capital expenditures (1)	(18)	(37)	19
Proceeds from sale of property, plant and equipment (1)	4	-	4
Payment of lease liabilities (1)	(1)	(1)	-
Free cash flow	$ (146)	$ 6	$ (152)

(1) See the statement of cash flows in our Q1 fiscal 2021 financial statements.

As shown above, cash and cash equivalents decreased by $369 for the three months ended November 30, 2020 and the Company experienced negative free cash flow of $146, which is a non-GAAP financial measure as discussed in "INTRODUCTION – Financial Highlights: Cash flows for the three months ended November 30, 2020".

Cash flows from operations for the three months ended November 30, 2020 were outflows of $131 compared to inflows of $44 for the three months ended November 30, 2019. The variance of $175 was primarily due to lower receipts from customer service charges of $198 as a result of the negative impact of COVID-19 pandemic on air traffic volumes and payment deferral provisions in the September 1, 2020 rate increase, higher pension current service contributions of $9 and higher interest payments of $9 related to the $850 General Obligation Notes issued in fiscal 2020, partially offset by $32 received under the CEWS government relief program to offset compensation costs and lower payments to employees and suppliers of $8.

Cash outflows from investing activities for the three months ended November 30, 2020 were $14 compared to $38 for the three months ended November 30, 2019. The decrease of $24 was primarily related to planned reductions to the Company's capital spending program to address the impact of the COVID-19 pandemic.

(millions of Canadian dollars)

Cash outflows from financing activities for the three months ended November 30, 2020 were $224 compared to $9 for the three months ended November 30, 2019. The increase was primarily due to repayment of $223 under the Company's syndicated credit facility.

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 November 30, 2020, 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
Credit facilities for general purposes available for unrestricted use	$ 573
Credit facilities for pension funding purposes:	
Letter of credit facilities for pension funding purposes [(4)]	$ 590
Less: Outstanding letters of credit for pension funding purposes [(4)]	533
Credit facilities for pension funding purposes available for unrestricted use	$ 57

(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, 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 November 30, 2020.

(2) At November 30, 2020, $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 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").

(4) The letter of credit facilities for pension funding purposes are comprised of four facilities with Canadian financial institutions totalling $590, which will mature on December 31, 2021, unless extended. At November 30, 2020, $533 was drawn for pension solvency funding purposes.

(millions of Canadian dollars)

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

	November 30 2020	August 31 2020
LONG-TERM DEBT:		
Bonds and notes payable		
Under the MTI	$ 425	$ 425
Under the GOI	1,875	1,875
	2,300	2,300
Adjusted for deferred financing costs and discounts	(12)	(12)
Total bonds and notes payable	2,288	2,288
Less: current portion of long-term debt	(275)	(275)
Total long-term debt	$ 2,013	$ 2,013
LIQUIDITY:		
Cash and cash equivalents	$ 320	$ 689
Short-term investments	145	145
Debt service reserve fund	73	73
	$ 538	$ 907
Undrawn committed borrowing capacity (1)	$ 905	$ 632

(1) $573 of this borrowing capacity is available for general purposes (August 31, 2020 - $350) and $57 is available for pension funding purposes as described in the previous table (August 31, 2020 - $7).

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	Aa2	Aa2	Stable
Standard & Poor's	AA	AA-	Negative

Our credit ratings remain unchanged from those described in our fiscal 2020 annual MD&A.

(millions of Canadian dollars)

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 2020 annual MD&A.

Contractual Obligations

A breakdown of contractual obligations as at November 30, 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	2021	2022	2023	2024	2025	Thereafter
Derivative liabilities	$ 4	$ 4	$ -	$ -	$ -	$ -	$ -
Long-term debt (including current portion) [1], [2]	2,300	275	25	25	25	25	1,925
Interest payments [2]	1,452	57	78	76	74	73	1,094
Capital commitments	104	42	13	8	6	7	28
Lease liability	6	3	3	-	-	-	-
Future lease liability[3]	59	-	-	2	3	3	51
Related party loan [4]	14	14	-	-	-	-	-
Total contractual obligations	$ 3,939	$ 395	$ 119	$ 111	$ 108	$ 108	$ 3,098

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

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

(millions of Canadian dollars)

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.

	November 30 2020	August 31 2020
Bonds and notes payable	$ 2,288	$ 2,288
Equity:		
Retained earnings (deficit)	(42)	28
Regulatory deferral accounts:		
Debit balances	(2,180)	(2,112)
Credit balances	184	184
Employee benefits:		
LTD asset	(3)	(4)
Liability for funded pension benefits	1,669	1,643
Liability for accumulating sick leave	16	16
Total capital	$ 1,932	$ 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 fund. 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 three months ended November 30, 2020, 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 three months ended November 30, 2020, 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 November 30, 2020, a 100 basis point change in variable interest rates would result in an annual difference of approximately $4 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 $4 during the three months ended November 30, 2020.

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

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 fiscal 2020 annual consolidated financial statements. The accounting policies have been applied consistently to all periods presented.

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 2020 annual consolidated financial statements.

The Company's critical accounting estimates and judgments applied in the preparation of the Company's Q1 fiscal 2021 financial statements are consistent with those applied and disclosed in our fiscal 2020 annual consolidated 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 November 30, 2020 that have materially affected or are reasonably likely to materially affect the Company's ICFR.