MANAGEMENT'S DISCUSSION AND ANALYSIS

ON FORM 51-102F1

THREE AND NINE MONTHS ENDED

MAY 31, 2016

July 14, 2016

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NAV CANADA

MANAGEMENT'S DISCUSSION AND ANALYSIS
Q3 FISCAL 2016
(in millions of dollars)

INTRODUCTION

This management's discussion and analysis (MD&A) relates to the unaudited interim consolidated financial condition, results of operations, comprehensive income and cash flows for the three and nine months ended May 31, 2016 (Q3 fiscal 2016) 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 consolidated financial statements for Q3 fiscal 2016, our audited consolidated financial statements and the accompanying notes for the year ended August 31, 2015 (fiscal 2015) as well as our 2015 Annual Information Form dated October 23, 2015 (fiscal 2015 AIF). Additional information about the Company, including our consolidated financial statements for Q3 fiscal 2016 and fiscal 2015, and our fiscal 2015 AIF are filed on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

Our consolidated financial statements are prepared in Canadian dollars (CDN) and in accordance with IFRS. Our Audit & Finance Committee reviewed this MD&A and our Board of Directors (the Board) approved it before it was filed.

Caution Concerning Forward-Looking Information

This MD&A and, in particular, but without limitation, sections "INTRODUCTION – Significant Financial Matters – Air Traffic and Customer Service Charges", "RESULTS OF OPERATIONS – Financial Outlook", "LIQUIDITY AND CAPITAL RESOURCES – Treasury Management and Financial Risk Mitigation – Pension Plans" and "LIQUIDITY AND CAPITAL RESOURCES – Capital Expenditures and Other Investments" of this MD&A, contain certain statements about NAV CANADA's future expectations. These statements are generally identified by words like "anticipate", "plan", "believe", "intend", "expect", "estimate", "approximate" 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 quite different from those expressed or implied in these statements. Examples include terrorist attacks, war, epidemics or pandemics, natural disasters, weather patterns, environmental concerns, 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), credit losses on investments, 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 2015 AIF. The forward-looking statements contained in this MD&A represent our expectations as of July 14, 2016 and are subject to change after this date. 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 statements 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.

First Annual Reporting under IFRS

The year ending August 31, 2016 (fiscal 2016) is the Company's first annual reporting period under IFRS. Previous annual consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles Part V – Pre-changeover accounting standards (Canadian GAAP or CGAAP). Comparative figures for fiscal 2015 have been restated to comply with IFRS. For a summary of the impact of adoption of IFRS, refer to "CHANGES IN ACCOUNTING POLICIES – Transition to IFRS".

Other comparative figures presented in this MD&A for periods prior to fiscal 2015 have not been restated and are presented as prepared under Canadian GAAP. Consequently, this information may no longer be comparable.

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 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 expenditures. 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 a "rate stabilization" mechanism, as explained hereafter.

In preparing our consolidated financial statements, 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 turns out to be 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 the process of determining future customer service charges, we take into account the balance of the rate stabilization account, adjusted "notionally" for the non-credit related portion of the fair value adjustments that have been provided on restructured and other investments in ABCP.

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 as described above, we consider the Company's current and future financial requirements, the "notional" balance of the rate stabilization account and the recovery of pension contributions on a cash basis (see "RESULTS OF OPERATIONS – Revenue – Customer Service Charges", "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.

(in millions of dollars)

Financial Highlights for the three months ended May 31, 2016

The Company has achieved positive financial performance in Q3 fiscal 2016 as compared to its approved budget, as reflected by the $9 of favourable variances from planned results shown below:

	Three months ended May 31		
	2016	2015	Change
Revenue	$ 337	$ 329	$ 8
Operating expenses	319	304	15
Other (income) and expenses	34	37	(3)
	(16)	(12)	(4)
Net movement in regulatory deferral accounts			
Rate stabilization adjustments:			
Favourable variances from planned results	(9)	(8)	(1)
Initial approved adjustment	(7)	(2)	(5)
Additional drawdown related to pension	-	10	(10)
	(16)	-	(16)
Other regulatory deferral account adjustments:			
Employee benefit pension contributions	19	5	14
Other employee benefits	(1)	-	(1)
Investment in preferred interests, net of tax	6	(2)	8
Realized hedging transactions	-	1	(1)
	24	4	20
	8	4	4
Net income (loss), after rate stabilization and regulatory deferral account adjustments	$ (8)	$ (8)	$ -

For the three months ended May 31, 2016, the Company had a net loss of $8. Excluding rate stabilization and other regulatory deferral account adjustments, the Company had a net loss of $16. Given the normal seasonality of air traffic and the fact that our costs are predominantly fixed in nature, a net loss is expected for this quarter.

The Company is subject to legislation that regulates the level of its charges (see "INTRODUCTION – Financial Strategy and Rate Regulation"), and the timing of recognition of certain revenue and expenses is adjusted through movements in regulatory deferral accounts. The net movement in regulatory deferral accounts for the three months ended May 31, 2016 was an income of $8 as compared to an income of $4 over the same period in fiscal 2015. The increase is due to $20 more of regulatory adjustments for certain transactions to adjust the accounting recognition to the periods in which they will be considered for rate setting, partially offset by $16 higher deferrals of favourable results through rate stabilization adjustments.

(in millions of dollars)

As shown below, the Company experienced negative free cash flow of $2 for the three months ended May 31, 2016, which is a non-GAAP (Generally Accepted Accounting Principles) financial measure (see "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the three months ended May 31, 2016" for additional information on non-GAAP financial measures).

	Three months ended May 31			
	2016	2015	Change	%
Cash flows from:				
Operations [1]	$ 28	$ 52	$ (24)	(46%)
Investing [1]	(30)	(32)	2	(6%)
Financing [1]	15	(25)	40	
Cash flows from operating, investing and financing activities	13	(5)	18	
Effect of foreign exchange on cash and cash equivalents	-	1	(1)	
Increase (decrease) in cash and cash equivalents	13	(4)	17	
Cash and cash equivalents, beginning of period	59	198	(139)	(70%)
Cash and cash equivalents, end of period	$ 72	$ 194	$ (122)	(63%)
Free cash flow (non-GAAP financial measure):				
Cash flows from:				
Operations [1]	$ 28	$ 52	$ (24)	
Capital expenditures [2]	(30)	(31)	1	
Free cash flow	$ (2)	$ 21	$ (23)	

(1) See "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the three months ended May 31, 2016" for discussion of the changes in cash flows from the prior year.

(2) See the statements of cash flows of our Q3 fiscal 2016 interim consolidated financial statements.

(in millions of dollars)

Financial Highlights for the nine months ended May 31, 2016

The Company has achieved positive financial performance in first three quarters of fiscal 2016 as compared to its approved budget, as reflected by the $33 of favourable variances from planned results shown below:

	Nine months ended May 31		
	2016	2015	Change
Revenue	$ 988	$ 950	$ 38
Operating expenses	922	897	25
Other (income) and expenses	89	79	10
Income tax expense	1	1	-
	(24)	(27)	3
Net movement in regulatory deferral accounts			
Rate stabilization adjustments:			
Favourable variances from planned results	(33)	(25)	(8)
Initial approved adjustment	(23)	(6)	(17)
Additional drawdown related to pension	-	24	(24)
	(56)	(7)	(49)
Other regulatory deferral account adjustments:			
Employee benefit pension contributions	40	22	18
Other employee benefits	(4)	2	(6)
Investment in preferred interests, net of tax	(6)	(33)	27
Realized hedging transactions	1	1	-
	31	(8)	39
	(25)	(15)	(10)
Net income (loss), after rate stabilization and regulatory deferral account adjustments	$ (49)	$ (42)	$ (7)

For the nine months ended May 31, 2016, the Company had a net loss of $49. Excluding rate stabilization adjustments and net movement in regulatory deferral account adjustments, the Company had a net loss of $24. The net loss has improved by $33 from that budgeted due to higher than planned revenue of $16 and lower than planned expenses of $25, partially offset by lower than planned regulatory deferrals of $8.

The net movement in regulatory deferral accounts for the nine months ended May 31, 2016 was an expense of $25 as compared to an expense of $15 over the same period in fiscal 2015. The increase of $10 is due to $49 higher deferrals of favourable results through rate stabilization adjustments, partially offset by $39 more of regulatory adjustments for certain transactions to adjust the accounting recognition to the periods in which they will be considered for rate setting.

(in millions of dollars)

As shown below, the Company experienced positive free cash flow of $31 for the nine months ended May 31, 2016, which is a non-GAAP financial measure (see "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the three months ended May 31, 2016" for additional information on non-GAAP financial measures).

	Nine months ended May 31			
	2016	2015	Change	%
Cash flows from:				
Operations [1]	$ 124	$ 125	$ (1)	(1%)
Investing [1]	(65)	(99)	34	(34%)
Financing [1]	(218)	(26)	(192)	
Cash flows from operating, investing and financing activities	(159)	-	(159)	
Effect of foreign exchange on cash and cash equivalents	1	1	-	
Increase (decrease) in cash and cash equivalents	(158)	1	(159)	
Cash and cash equivalents, beginning of period	230	193	37	19%
Cash and cash equivalents, end of period	$ 72	$ 194	$ (122)	(63%)
Free cash flow (non-GAAP financial measure):				
Cash flows from:				
Operations [1]	$ 124	$ 125	$ (1)	
Capital expenditures [2]	(93)	(72)	(21)	
Investment in preferred interests [2]	-	(36)	36	
Free cash flow	$ 31	$ 17	$ 14	

(1) See "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the nine months ended May 31, 2016" for discussion of the changes in cash flows from the prior year.

(2) See the statements of cash flows of our Q3 fiscal 2016 interim consolidated financial statements.

Significant Financial Matters

The following items have significant financial importance to the Company:

1. Rate Stabilization Account

As at May 31, 2016, the rate stabilization account (see "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account") had a credit balance of $137 and the "notional" balance of the rate stabilization account was a credit balance of $155, which is above its target for fiscal 2016 (see "RESULTS OF OPERATIONS – Amounts Considered for Rate Setting Purposes").

The rate stabilization account improved by $56 during the first nine months of fiscal 2016. This improvement was due to $33 of favourable variances from planned results arising mainly from higher than planned revenue and lower than planned operating expenses, and the $23 initially approved adjustment to the rate stabilization account. Rate stabilization drawdowns (adjustments) are described under "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account".

2. Air Traffic and Customer Service Charges[1]

During Q3 fiscal 2016, air traffic volumes increased by 3.0% year-over-year. For the nine months ended May 31, 2016, air traffic volumes increased by 3.6% year-over-year. Excluding the effect of an extra day for the leap year, traffic growth in the first nine months of fiscal 2016 grew 3.2%. A 2.7% increase had been assumed in the budget for the nine months ended May 31, 2016, whereas the approved budget for the full fiscal year had assumed an increase of 2.0%. The Company's current forecast for air traffic growth in fiscal 2016 is 2.8%.

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

Based on the current strength of the rate stabilization account and our positive financial outlook for fiscal 2016 (see "RESULTS OF OPERATIONS – Financial Outlook") and for the fiscal year ending August 31, 2017 (fiscal 2017), the Company will be implementing a temporary one-year rate reduction in addition to revisions to base rates, each effective September 1, 2016.

The temporary adjustment will provide a reduction to charges for all services during fiscal 2017 and will represent on average a 3.7% reduction from current base rates. The Company will also be implementing revisions to its base rates in order to ensure they are aligned with costs. These adjustments will result in an average reduction of 3.9% from existing base rates, on an ongoing basis. Customer savings as a result of these revisions are estimated at approximately $100 for fiscal 2017 and approximately $50 for the fiscal year ending August 31, 2018 (fiscal 2018) when the temporary adjustments expire.

The Company issued a notice of revised service charges for consultation on April 8, 2016, providing details of the proposed revisions. The consultation period concluded on July 6, 2016. The Company intends to issue an announcement later in July 2016 detailing the implementation of the revised charges.

3. Pension Plans

The Company continues to meet the funding requirements of its two defined benefit registered pension plans in accordance with the regulations of the Office of the Superintendent of Financial Institutions Canada (OSFI). Actuarial valuations for funding purposes are performed annually as at January 1 and are required to be filed with OSFI by June of the same year. The funding regulations require actuarial valuations to be performed on both a going concern and a solvency basis.

The Company funds its registered pension plans based on the most recently filed actuarial valuations. Accordingly, contributions for the annual period beginning July 1, 2016 are based on the January 1, 2016 actuarial valuations. The actuarial valuations performed as at January 1, 2016 reported a going concern deficit of $76 and a statutory solvency deficiency of $306.

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

We use an annual measurement date of August 31 for determining the accounting surplus or deficit and establishing pension costs for the coming fiscal year. The Company's pension plans had an accounting deficit of $866 as at the annual measurement date of August 31, 2015 and an accounting deficit of $1,075 as at May 31, 2016. The increase of $209 in the deficit position during fiscal 2016 is due to actuarial accounting expense exceeding Company contributions by $42 and net actuarial losses of $167. The $167 of net actuarial losses are due to a $347 actuarial loss from a 30 basis point decrease in the discount rate partially offset by a return on plan assets $93 greater than the expected return based on the discount rate, actuarial gains of $63 from demographic changes and $24 due to positive experience on the defined benefit obligation.

The differences in the reported surplus or deficit positions between the accounting and funding valuations (going concern and solvency) are primarily due to: (a) different discount rates used to value the obligations of the plans based on each valuation's required actuarial methodology; (b) the use of three year averaging of solvency ratios to determine the statutory solvency deficiency for funding purposes; (c) the use of asset smoothing over five years for the going concern valuation, while the solvency and accounting valuations are based on market values of assets and liabilities at a point in time (as of their respective measurement dates); and (d) the different dates at which the valuations are performed.

Further information on the Company's pension plans is discussed under the heading "LIQUIDITY AND CAPITAL RESOURCES – Treasury Management and Financial Risk Mitigation – Pension Plans".

4. Investment in Space-Based Aircraft Surveillance through Aireon LLC:

In November 2012, the Company entered into agreements (the November 2012 agreements) setting out the terms of its participation in Aireon, a joint venture with Iridium Communications Inc. (Iridium). Aireon's mandate is to provide global satellite-based surveillance capability for air navigation service providers (ANSPs) around the world through Automatic Dependent Surveillance-Broadcast (ADS-B) receivers built as an additional payload on the Iridium NEXT satellite constellation. It is expected that Iridium's launch schedule will enable Aireon to commence commercial operations by calendar year 2018.

The Company's overall investment in Aireon is expected to be implemented in five stages for up to a total of $150 U.S. ($197 CDN) by calendar year 2017. In December 2013, the November 2012 agreements were amended to provide for the making of an aggregate investment in Aireon by three additional major ANSPs, namely ENAV (Italy), the Irish Aviation Authority (IAA), and Naviair (Denmark) (the Additional Investors). As at May 31, 2016, the Company has invested $120 U.S. ($157 CDN) (August 31, 2015 - $120 U.S. ($158 CDN)), completing three out of the five stages of its investment in Aireon, and is represented by four out of the eleven directors on Aireon's board of directors. The next stage investment is expected to be made during fiscal 2017. The Company's investment in Aireon is in preferred interests, which are redeemable and convertible to common equity as described below.

In accordance with the amended agreements, a portion of Iridium's existing common equity interest in Aireon will be redeemed for a payment from Aireon of $120 U.S. ($157 CDN) to finalize the ownership interests of all of Aireon's investors. Upon this redemption and the related conversion of all preferred interests into common equity interests, NAV CANADA will hold 51% of the fully diluted common equity interests of Aireon, ENAV will hold 12.5%, and each of IAA and Naviair will hold 6%, with the remaining 24.5% being retained by Iridium. This redemption is expected to occur by calendar year 2020.

As at May 31, 2016, the Company's total fully diluted common equity interest on a post conversion basis is 36.5% (August 31, 2015 – 36.5%).

5. Settlement of Collective Agreements

All eight of our collective agreements are in force with contract expiries ranging from March 2017 to February 2018. Since the beginning of fiscal 2016, seven collective agreements (listed below), representing approximately 89% of our unionized workforce, have been ratified.

On October 1, 2015, the Company announced the ratification of a one year extension to the collective agreement covering approximately 1,900 air traffic controllers following negotiations with the Canadian Air Traffic Control Association (CATCA) Unifor Local 5454. The extension continues the current agreement until March 31, 2017, while adding a 2.5% salary increase for the additional year.

On November 23, 2015, the Company announced the ratification of a one year extension to the collective agreement covering approximately 640 Air Traffic Specialists following negotiations with the Air Traffic Specialists Association of Canada (ATSAC), Unifor Local 2245. The extension continues the current agreement until April 30, 2017, while adding a 2.5% salary increase for the additional year.

On December 21, 2015, the Company announced the ratification of a one year extension to the collective agreement with Unifor Local 1016, which represents approximately 260 employees working as Air Traffic Operational Training Specialists in Area Control Centres as well as a variety of positions in the Ottawa area involved with Aeronautical Information Management, Flight Billing, Notice to Airmen and National Systems Control Centre. The extension continues the current agreement until June 30, 2017, while adding a 2.5% salary increase for the additional year.

On January 25, 2016, the Company announced the ratification of a one year extension to the collective agreement with the Canadian Association of Financial Officers (ACFO) representing approximately 25 financial workers. The extension continues the current agreement until February 6, 2018, while adding a 2.5% salary increase for the additional year.

On February 29, 2016, the Company announced the ratification of a one year extension to the collective agreement with the Public Service Alliance of Canada (PSAC) representing approximately 265 members involved in a variety of work including clerical and administrative, drafting and illustration, educational support, engineering and scientific support, general labour and trades, general services, information services, commercial relations, revenue collection and customer service. The extension continues the current agreement until December 31, 2017, while adding a 2.5% salary increase for the additional year.

On April 11, 2016, the Company announced the ratification of a one year extension to the collective agreement with the International Brotherhood of Electrical Workers Local 2228 (IBEW) representing approximately 620 employees. The extension continues the current agreement until December 31, 2017, while adding a 2.5% salary increase for the additional year.

On June 10, 2016, the Company announced the ratification of a one year extension to the collective agreement with the Canadian Federal Pilots Association (CFPA) representing approximately 35 pilots who perform Aeronautical Information Services, Flight Inspection and Air Navigation Service Design. The extension continues the current agreement until April 30, 2017, while adding a 2.5% salary increase for the additional year.

All of the Company's eight collective agreements include the following significant changes in the pension area:

(a) All new employees represented by CATCA, ATSAC, CFPA, ACFO, IBEW and Unifor Local 1016 as at January 1, 2014, are required to join Part B of the NAV CANADA Pension Plan (NCPP), which has a non-contributory defined benefit design. Previously, new employees represented by these unions had the alternative of joining Part A of the NCPP, which has a contributory defined benefit design and under which pension benefits are automatically indexed to inflation. Effective October 1, 2014, all new employees represented by the Professional Institute of the Public Service of Canada (PIPSC) are required to join Part B of the NCPP. Effective December 1, 2014, all new employees represented by PSAC are required to join Part B of the NCPP. Previously, new employees represented by PIPSC and PSAC were required to join Part A of the NCPP. Part B of the NCPP provides for a lower level of benefits that are not indexed. Part B was introduced effective January 1, 2009 and has been mandatory for new non-unionized employees since that time. The Company expects that its current service pension costs will decline significantly over time, as new employees join Part B of the NCPP.

(b) In the unlikely event of plan termination, the automatic Consumer Price Index (CPI) indexing of pension benefits for active (non-retired) members under Part A of the NCPP will be replaced by fixed rate indexing to the extent that surplus assets would remain. Therefore, automatic CPI indexing for these members will no longer be considered as part of the annual actuarial valuation of the NCPP's solvency liabilities. However, automatic CPI indexing of pensions will continue to be paid to all current retirees and to all plan members who retire under Part A, as long as the NCPP remains in operation. The arbitration decisions and/or settled agreements also require that CATCA, ATSAC, CFPA, ACFO, IBEW, Unifor Local 1016, PIPSC and PSAC would have to agree to the termination of the NCPP, in respect of their members, before such a termination could occur.

    This change should not have any effect on employees or pensioners; however, it will significantly improve the solvency position of the NCPP, thereby reducing the Company's required solvency funding requirements, which are currently being met with letters of credit. Further information on the Company's going concern and solvency funding of its registered pension plans is discussed under the heading "LIQUIDITY AND CAPITAL RESOURCES – Treasury Management and Financial Risk Mitigation – Pension Plans".

(c) Other pension changes have been introduced that (i) remove, for future service, the automatic CPI indexing of pension benefits between members' pre-retirement departure dates and pension commencement dates; and (ii) restore as pensionable the 1% non-pensionable wage increase that had been agreed to in the 2005 CATCA and 2006 ATSAC rounds of bargaining and certain non-pensionable wages that had been agreed to in the 2011 IBEW round of bargaining.

The Company has communicated with OSFI, and OSFI has indicated that they agree with (a) and (c) above, but, on a preliminary basis, not with (b). The Company will continue to pursue implementation of (b) in a manner that considers OSFI's preliminary concerns and achieves the fundamental objectives of the change initiative. The arbitration decisions acknowledge that union leadership has joined the Company in the past in making representations to OSFI to support the changes in (b) above and will continue to do so at any future meeting with OSFI, or subsequent related processes.

Should OSFI approve (b) above (which formed part of the arbitration panels' decisions as well as the negotiated settlements referred to above), each collective agreement shall then be subject to a wage re-opener. That is, the parties would return to the bargaining table and discuss whether or not additional compensation is appropriate. In most instances, an arbitration panel would retain jurisdiction over the matter should the parties be unable to agree on an appropriate outcome.

6. Financing Activities

On February 24, 2016, the Company issued $250 Series MTN 2016-1 General Obligation Notes, due February 23, 2046. The notes bear interest at the rate of 3.534% per annum. After considering issue costs and the settlement of forward dated interest rate swap agreements the Company had entered into in June of 2012 to hedge interest costs related to the issue, the effective interest rate to the Company will be approximately 4.896%. The proceeds of these notes along with surplus cash were used to repay the Company's $450 Series MTN 2006-1 General Obligation Notes that matured on February 24, 2016.

As at May 31, 2016, the Company has drawn $40 by way of a banker's acceptance loan from the Company's revolving credit facility.

(in millions of dollars)

RESULTS OF OPERATIONS

Revenue

The following table provides a breakdown of our revenue by category. Our fiscal 2015 AIF and the notes to our interim consolidated financial statements for Q3 fiscal 2016 provide more information about the different categories of our customer service charges.

	Three months ended May 31			
	2016	2015	Change	%
Enroute	$ 173	$ 167	$ 6	4%
Terminal	119	118	1	1%
Daily / annual / quarterly	21	20	1	5%
North Atlantic and international communication	13	11	2	18%
Total customer service charges	326	316	10	3%
Other	11	13	(2)	(15%)
	$ 337	$ 329	$ 8	2%

Other revenue consists of sales or licensing of technology, provision of equipment maintenance services, conference centre services and accommodation rentals at our facility in Cornwall (Ontario), the sale of civil aeronautical information products and other miscellaneous revenue.

Revenue for Q3 fiscal 2016 was $337 compared to $329 for Q3 fiscal 2015. The $8 increase is primarily due to a $10 increase in customer service charge revenue arising from an increase of 3.0% in air traffic volumes during Q3 fiscal 2016.

	Nine months ended May 31			
	2016	2015	Change	%
Enroute	$ 499	$ 477	$ 22	5%
Terminal	350	345	5	1%
Daily / annual / quarterly	61	58	3	5%
North Atlantic and international communication	35	32	3	9%
Total customer service charges	945	912	33	4%
Other	43	38	5	13%
	$ 988	$ 950	$ 38	4%

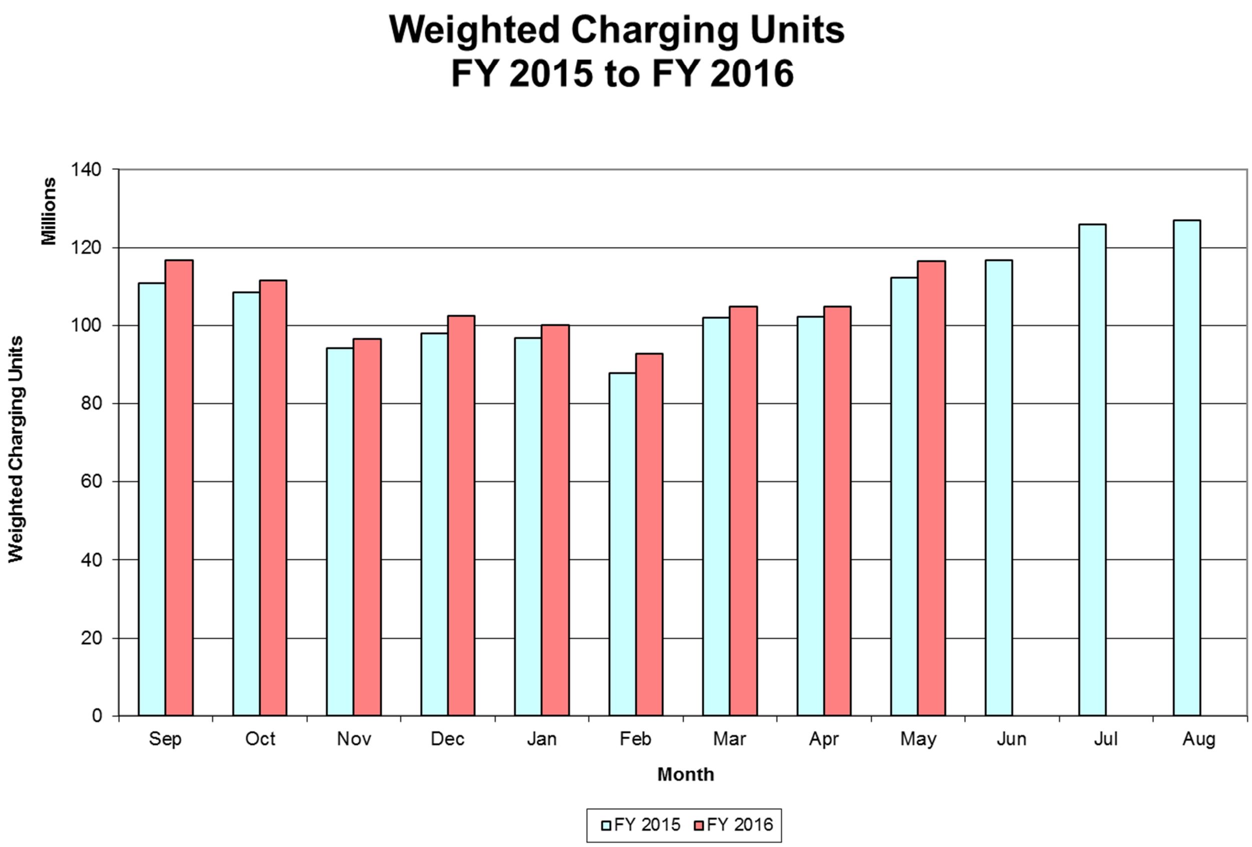
Revenue for the nine months ended May 31, 2016 was $988 compared to $950 for the nine months ended May 31, 2015. The $38 increase is due to:

- a $33 increase in customer service charge revenue arising from an increase of 3.6% in air traffic volumes during fiscal 2016; and
- a $5 increase in other revenue due to an increase in revenue from technology service and development contracts and other miscellaneous revenue.

Air Traffic

Air traffic increased by 3.0% in Q3 fiscal 2016 when compared to Q3 fiscal 2015 and increased by 3.6% in the first nine months of fiscal 2016. Excluding the effect of an extra day for the leap year, the growth was 3.2% in the first nine months of fiscal 2016. This increase is illustrated in the following chart showing air traffic by month since September 2014.

The chart illustrates the seasonal variations in traffic. The chart shows traffic in "weighted charging units", which reflect the number of flights, aircraft size and distance flown.



Traffic, as expressed in weighted charging units, has been higher in each of the first nine months of fiscal 2016 than in the comparable months in fiscal 2015.

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, air carrier competition, airline restructurings and insolvencies, terrorist activities, epidemics or pandemics, weather patterns, natural disasters, environmental concerns, demographic patterns and other factors.

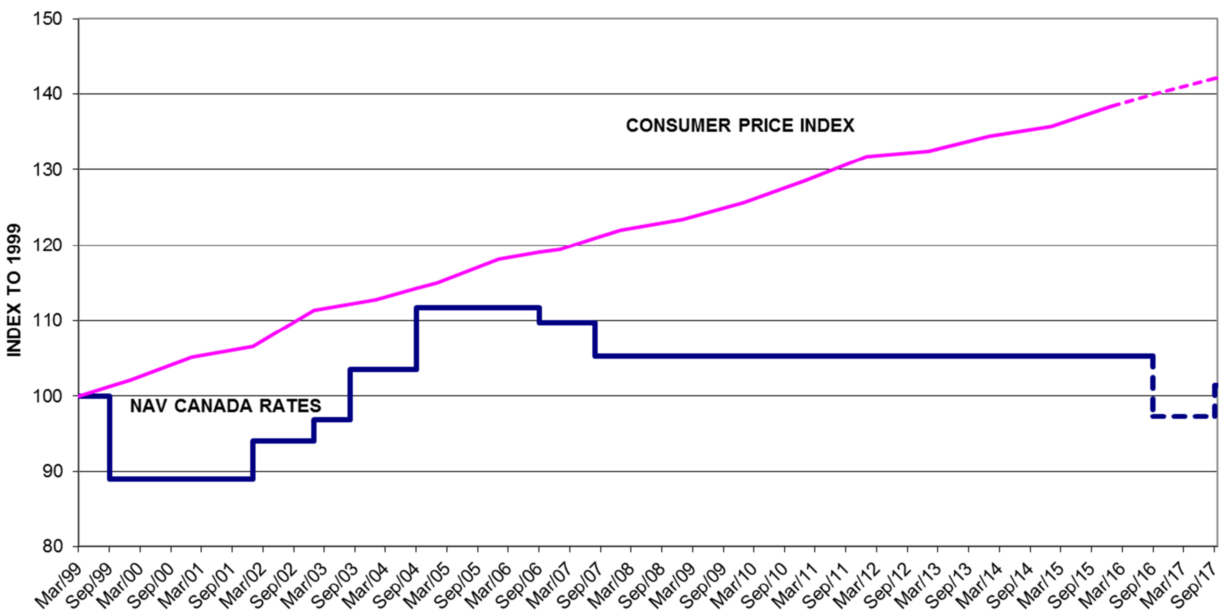
Customer Service Charges[2]

The level of our customer service charges is a function of our costs, the required level of service, air traffic volumes, revenue from non-aeronautical sources, the "notional" balance of the rate stabilization account (see "RESULTS OF OPERATIONS – Amounts Considered for Rate Setting Purposes") and the recovery of pension contributions on a cash basis.

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

The following chart illustrates the evolution of our levels of customer service charges over time. On average, customer service charges are approximately 5% higher than they were when fully implemented sixteen years ago in March 1999, which is approximately 34 percentage points less than the change in the CPI since March 1999. In addition, the level of our current service charges is about one third below the former Air Transportation Tax that the charges replaced.

HISTORY OF NAV CANADA RATE CHANGES(1)
VERSUS CONSUMER PRICE INDEX(2)



1. Average changes since charges were fully implemented on March 1, 1999
2. Consumer Price Index - Growth assumed to be 1.5 per cent for 2016 and beyond

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

(in millions of dollars)

As can be seen in the chart above, the Company has not had an overall rate increase in over eleven years, and has implemented two rate decreases during that period. The chart also depicts the revised service charges that the Company will be implementing effective September 1, 2016 (discussed below).

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

Based on the current strength of the rate stabilization account and our positive financial outlook for fiscal 2016 (see "RESULTS OF OPERATIONS – Financial Outlook") and for fiscal 2017, the Company will be implementing a temporary one-year rate reduction in addition to revisions to base rates, each effective September 1, 2016.

The temporary adjustment will provide a reduction to charges for all services during fiscal 2017 and will represent on average a 3.7% reduction from current base rates. The Company will also be implementing revisions to its base rates in order to ensure they are aligned with costs. These adjustments will result in an average reduction of 3.9% from existing base rates, on an ongoing basis. Customer savings as a result of these revisions are estimated at approximately $100 for fiscal 2017 and approximately $50 for fiscal 2018 when the temporary adjustments expire.

The Company issued a notice of revised service charges for consultation on April 8, 2016, providing details of the proposed revisions. The consultation period concluded on July 6, 2016. The Company intends to issue an announcement later in July 2016 detailing the implementation of the revised charges.

Operating Expenses

	Three months ended May 31			
	2016	2015	Change	%
Salaries and benefits	$ 220	$ 213	$ 7	3%
Technical services	29	26	3	12%
Facilities and maintenance	17	18	(1)	(6%)
Depreciation and amortization	36	33	3	9%
Other	17	14	3	21%
	$ 319	$ 304	$ 15	5%

Salaries and benefits expense in Q3 fiscal 2016 increased by $7 compared to Q3 fiscal 2015 due to increased compensation levels and higher overtime costs, partially offset by higher labour costs capitalized to projects.

Technical services expenses increased by $3 in Q3 fiscal 2016 compared to Q3 fiscal 2015, mainly due to increased systems maintenance and development costs.

Facilities and maintenance expenses were comparable to Q3 fiscal 2015.

Depreciation and amortization increased by $3 in Q3 fiscal 2016 as a result of an increased cost base of property, plant and equipment and intangible assets compared to Q3 fiscal 2015.

Other operating expenses also increased by $3 compared to Q3 fiscal 2015 as a result of increased travel, training and other miscellaneous expenditures.

(in millions of dollars)

	Nine months ended May 31			
	2016	2015	Change	%
Salaries and benefits	$ 638	$ 620	$ 18	3%
Technical services	87	84	3	4%
Facilities and maintenance	50	50	-	- %
Depreciation and amortization	106	101	5	5%
Other	41	42	(1)	(2%)
	$ 922	$ 897	$ 25	3%

Salaries and benefits expense for the nine months ended May 31, 2016 increased by $18 compared to the nine months ended May 31, 2015 primarily due to increased compensation levels and higher overtime and fringe benefit costs, partially offset by lower pension current service costs and higher labour costs capitalized to projects.

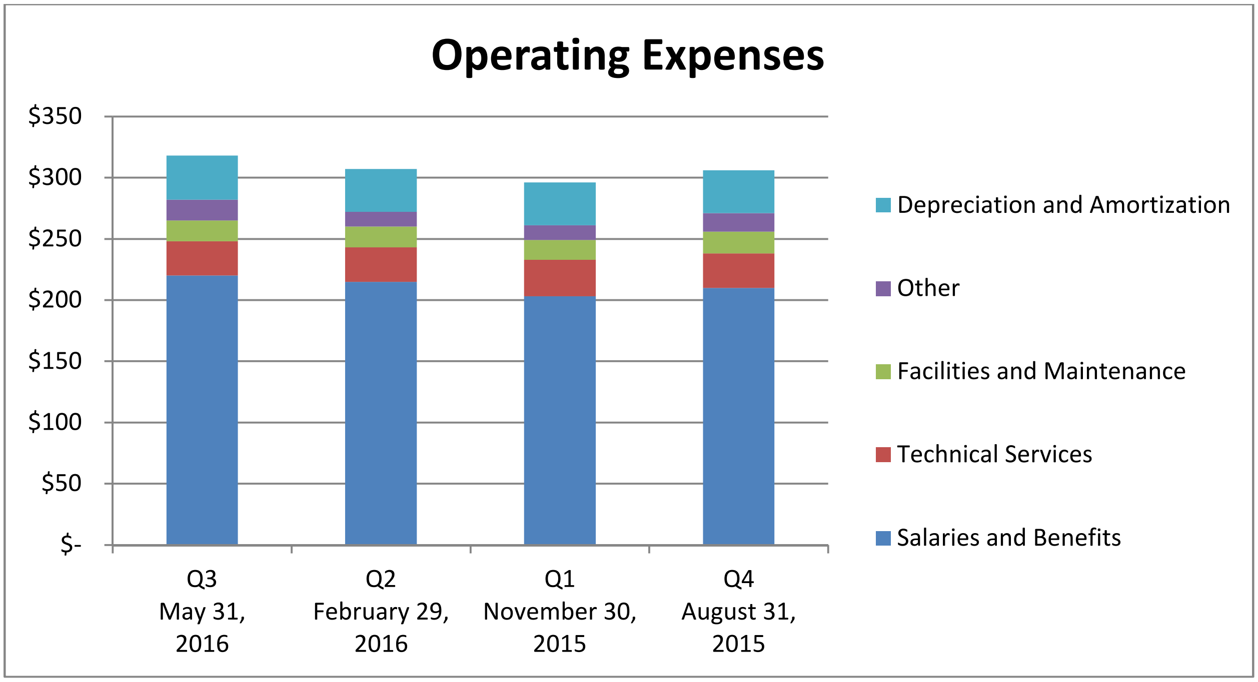
Technical services expenses increased by $3 in fiscal 2016, mainly due to increased systems maintenance and development costs.

Facilities and maintenance expenses were comparable to fiscal 2015.

Depreciation and amortization increased by $5 in fiscal 2016 as a result of an increased cost base of property, plant and equipment and intangible assets.

Other operating expenses decreased by $1 in fiscal 2016 compared to fiscal 2015 mainly due to commodity taxes paid in prior years that were refunded to the Company during Q2 fiscal 2016, partially offset by higher travel costs and professional fees.

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



(in millions of dollars)

Other (Income) and Expenses

	Three months ended May 31		
	2016	2015	Change
Finance income			
Interest income	$ (1)	$ (3)	$ (2)
Net change in fair value of financial assets at FVTPL[1]			
MAV II, ABCP and other investments	(2)	(1)	1
Investment in preferred interests	(2)	(3)	(1)
	(4)	(4)	-
	(5)	(7)	(2)
Net interest costs relating to employee benefits	10	13	3
Other finance costs			
Interest expense	22	29	7
Other (gains) and losses	7	2	(5)
	$ 34	$ 37	$ 3

[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 income decreased by $2 compared to Q3 fiscal 2015 primarily due to the termination of the cross border transaction in August 2015.

The net change in fair value of financial assets at FVTPL is comparable to Q3 fiscal 2015. Positive fair value adjustments on Master Asset Vehicle II (MAV II), ABCP and other investments of $2 in Q3 fiscal 2016 were recorded compared to positive fair value adjustments of $nil and interest income of $1 in Q3 fiscal 2015, and a decrease in dividend income from the investment in preferred interests of $1 in Q3 fiscal 2016 compared to Q3 fiscal 2015.

The $3 decrease in net interest costs relating to employee benefits in Q3 fiscal 2016 is primarily due to the impact of higher discount rates.

The $7 decrease in other finance costs in Q3 fiscal 2016 is primarily due to the termination of the cross border transaction in August 2015 and lower interest costs on long-term debt due to the annual $25 principal repayment on the Series 97-2 bonds and the decrease in principal of $200 with the refinancing of the $450 Series MTN 2006-1 General Obligation Notes with the $250 Series MTN 2016-1 General Obligation Notes and surplus cash.

Other (gains) and losses increased by $5 in Q3 fiscal 2016 compared to Q3 fiscal 2015 mainly due to higher unrealized foreign exchange gains on the investment in Aireon due to the fluctuation of the Canadian dollar against the U.S. dollar.

(in millions of dollars)

	Nine months ended May 31		
	2016	2015	Change
Finance income			
Interest income	$ (2)	$ (11)	$ (9)
Net change in fair value of financial assets at FVTPL[1]			
MAV II, ABCP and other investments	(5)	(1)	4
Investment in preferred interests	(8)	(7)	1
	(13)	(8)	5
	(15)	(19)	(4)
Net interest costs relating to employee benefits	31	40	9
Other finance costs			
Interest expense	72	86	14
Other (gains) and losses	1	(28)	(29)
	$ 89	$ 79	$ (10)

[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 income decreased by $9 compared to fiscal 2015 primarily due to the termination of the cross border transaction in August 2015.

The net change in fair value of financial assets at FVTPL increased by $5 compared to fiscal 2015, as a result of recording positive fair value adjustments on MAV II, ABCP and other investments of $4 and interest income of $1 in fiscal 2016 compared to negative fair value adjustments of $1 and interest income of $2 in fiscal 2015, and an increase in dividend income from the investment in preferred interests of $1.

The $9 decrease in net interest costs relating to employee benefits in fiscal 2016 is primarily due to the impact of higher discount rates.

The $14 decrease in other finance costs in fiscal 2016 is primarily due to the termination of the cross border transaction in August 2015 and lower interest costs on long-term debt due to the annual $25 principal repayment on the Series 97-2 bonds and the decrease in principal of $200 with the refinancing of the $450 Series MTN 2006-1 General Obligation Notes with the $250 Series MTN 2016-1 General Obligation Notes and surplus cash.

Other (gains) and losses decreased by $29 in fiscal 2016 compared to fiscal 2015 mainly due to lower unrealized foreign exchange gains on the investment in Aireon due to the fluctuation of the Canadian dollar against the U.S. dollar.

(in millions of dollars)

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

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

	Three months ended May 31		
	2016	2015	Change
Rate stabilization account	$ (16)	$ -	$ (16)
Other regulatory deferral accounts			
Employee benefit pension contributions	19	5	14
Other employee benefits	(1)	-	(1)
Investment in preferred interests, net of tax	6	(2)	8
Realized hedging transactions	-	1	(1)
	$ 8	$ 4	$ 4

The movements in the rate stabilization account in Q3 fiscal 2016 are a result of favourable variances from planned results of $9 (Q3 fiscal 2015 - $8) and the initial approved transfer to the rate stabilization account of $7 (Q3 fiscal 2015 - $2). In fiscal 2015, these movements were offset by the recording of additional regulatory recovery of pension contributions of $10. No additional regulatory recovery of pension contributions has been recorded in fiscal 2016 as these amounts were fully recovered as at August 31, 2015.

The net movements in the employee benefit pension contributions regulatory deferral account for Q3 fiscal 2016 increased by $14 compared to Q3 fiscal 2015. Regulatory adjustments to adjust the total pension benefit expense to the level of pension contributions to be recovered through rate setting were $19 in fiscal 2016 compared to $15 in fiscal 2015. In fiscal 2015, the regulatory adjustments of $15 were partially offset by the recognition of additional regulatory recovery of pension contributions of $10. No additional regulatory recovery of pension contributions has been recorded in fiscal 2016 as these amounts were fully recovered as at August 31, 2015. Our approach is to recover the Company's cash contributions to the funded pension plans for both current service costs and special payment contributions.

The $8 increase in the investment in preferred interests regulatory deferral account in Q3 fiscal 2016 was primarily due to the regulatory deferral of higher unrealized foreign exchange losses recorded due to the fluctuation of the Canadian dollar against the U.S. dollar. The impacts to net income (loss) related to the Company's investment in preferred interests of Aireon are deferred until realized in cash through the receipt of dividends net of tax.

The net regulatory movements related to other employee benefits and realized hedging transactions did not change significantly from Q3 fiscal 2015.

(in millions of dollars)

	Nine months ended May 31		
	2016	2015	Change
Rate stabilization account	$ (56)	$ (7)	$ (49)
Other regulatory deferral accounts			
Employee benefit pension contributions	40	22	18
Other employee benefits	(4)	2	(6)
Investment in preferred interests, net of tax	(6)	(33)	27
Realized hedging transactions	1	1	-
	$ (25)	$ (15)	$ (10)

The movements in the rate stabilization account are detailed in the table below.

The net movements in the employee benefit pension contributions regulatory deferral account for the nine months ended May 31, 2016 increased by $18 compared to the same period in fiscal 2015. Regulatory adjustments to adjust the total pension benefit expense to the level of pension contributions to be recovered through rate setting were $40 in fiscal 2016 compared to $46 in fiscal 2015. In fiscal 2015, the regulatory adjustments of $46 were partially offset by the recognition of additional regulatory recovery of pension contributions of $24. No additional regulatory recovery of pension contributions has been recorded in fiscal 2016 as these amounts were fully recovered as at August 31, 2015. Our approach is to recover the Company's cash contributions to the funded pension plans for both current service costs and special payment contributions.

The $6 decrease in the net movements of other employee benefits regulatory deferral accounts in fiscal 2016 is due to the amortized recovery of IFRS impacts as of September 1, 2014 related to other post-employment ($2), retiring allowances ($1) and accumulating sick leave benefits ($1) and a change of $2 in the long-term disability (LTD) plan funding requirement. For LTD contributions, our recovery approach is to recover the Company's annual cash contributions to the plans. Our recovery approach for non-vesting accumulating sick leave benefits is to recover the sick leave benefits when they are used and paid in cash. Vested accumulating sick leave benefits are recovered in the period in which employees render service. Re-measurements of other post-employment benefits and the supplemental pension benefits are recovered over the expected average service period of the plan members.

The $27 increase in the investment in preferred interests regulatory deferral account in fiscal 2016 was primarily due to the regulatory deferral of lower unrealized foreign exchange gains recorded due to the fluctuation of the Canadian dollar against the U.S. dollar. The impacts to net income (loss) related to the Company's investment in preferred interests of Aireon are deferred until realized in cash through the receipt of dividends net of tax.

The realized hedging transactions regulatory deferral account is comparable to fiscal 2015. The recovery approach for realized interest rate hedging transactions is to defer the impacts until the debt instrument is issued and recognize the realized gain or loss over the term of the debt instrument that was hedged, using the effective interest rate method.

(in millions of dollars)

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 9 of our Q3 fiscal 2016 interim consolidated financial statements. The table below shows the movements in the rate stabilization account.

	Nine months ended May 31		
	2016	2015	Change
Credit balance on the statement of financial position, beginning of period	$ 81	$ 76	$ 5
Variances from planned results:			
Revenue higher than planned, before initial approved adjustment	16	14	2
Operating expenses lower than planned, before drawdown related to pension	27	32	(5)
Other (income) and expenses lower than planned	(2)	(13)	11
Net movement in other regulatory deferral accounts	(8)	(8)	-
Total variances from planned results	33	25	8
Initial approved adjustment	23	6	17
Additional drawdown related to pension	-	(24)	24
Net movement in rate stabilization account recorded in net income (loss)	56	7	49
Credit balance on the statement of financial position, end of period	$ 137	$ 83	$ 54

The $56 improvement in the rate stabilization account during the nine months ended May 31, 2016 is primarily due to the planned adjustment of $23, representing two thirds of the anticipated net income for fiscal 2016 at the time the fiscal 2016 budget was approved, and the following variances from our approved fiscal 2016 budget:

- revenue that was $16 higher than planned due to an increase in customer service charge revenue, arising from higher air traffic, and an increase in other revenues; and
- operating expenses that were $27 lower than planned mainly due to lower pension current service cost expense, technical services, facilities and maintenance expenses and a recovery of commodity taxes previously paid, partially offset by an increase in depreciation and amortization expense;

partially offset by:

- net movement of $8 in regulatory deferral accounts primarily due to a regulatory deferral credit that was $19 lower than planned for pensions due to a 40 basis point increase in the discount rate from when the fiscal 2016 budget was approved and a regulatory deferral debit that was $12 higher than planned to defer the impacts to net income (loss) related to the Company's investment in preferred interests of Aireon.

(in millions of dollars)

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 May 31		
	2016	2015	Change
Items that will not be reclassified to income or (loss):			
Re-measurements of employee defined benefit plans	$ (155)	$ 265	$ (420)
Net movement in regulatory deferral accounts	155	(265)	420
	-	-	-
Items that will be reclassified to income or (loss):			
Changes in fair value of cash flow hedges	6	17	(11)
Net movement in regulatory deferral accounts	(6)	(17)	11
	-	-	-
Total other comprehensive income (loss)	$ -	$ -	$ -

Re-measurement losses of employee defined benefit plans in Q3 fiscal 2016 are a result of net actuarial losses of $155, due to a 30 basis point decrease in the discount rate of $348 and negative demographic changes of $7, partially offset by a return on plan assets $176 greater than the expected return based on the discount rate and $24 of actuarial gains due to positive experience on the defined benefit obligations. In Q3 fiscal 2015, the net actuarial gains of $265 were mainly due to a 30 basis point increase in the discount rate of $356 and positive impacts from demographic changes of $31, partially offset by a return on plan assets $124 less than the expected return based on the discount rate.

During Q3 fiscal 2016, positive fair value adjustments of $6 were recorded on the Company's interest rate hedges related to the re-financing of debt instruments that will mature in the fiscal year ending August 31, 2019 (fiscal 2019). In Q3 fiscal 2015, positive fair value adjustments of $17 were recorded on interest rate hedges related to the refinancing of debt maturing in fiscal 2016 and fiscal 2019.

(in millions of dollars)

	Nine months ended May 31		
	2016	2015	Change
Items that will not be reclassified to income or (loss):			
Re-measurements of employee defined benefit plans	$ (177)	$ 290	$ (467)
Net movement in regulatory deferral accounts	177	(290)	467
	-	-	-
Items that will be reclassified to income or (loss):			
Changes in fair value of cash flow hedges	(68)	(17)	(51)
Net movement in regulatory deferral accounts	68	17	51
	-	-	-
Total other comprehensive income (loss)	$ -	$ -	$ -

Re-measurement losses of employee defined benefit plans in the nine months ended May 31, 2016 are a result of net actuarial losses of $177, due to a 10 basis point decrease in the discount rate of $357, partially offset by a return on plan assets $93 greater than the expected return based on the discount rate, actuarial gains of $63 from demographic changes and $24 due to positive experience on the defined benefit obligations. For the nine months ended May 31, 2015, the net actuarial gains of $290 were mainly due to a return on plan assets $371 greater than the expected return based on the discount rate and actuarial gains of $31 from demographic changes, partially offset by actuarial losses of $114 due to a 10 basis point decrease in the discount rate.

During Q2 fiscal 2016, the Company cash-settled interest rate hedges related to the re-financing of debt instruments that matured in February 2016. A loss of $51 on the forward dated interest rate swap agreements was recognized in other comprehensive income (loss) and is being reclassified to net income (loss) using the effective interest rate method over the 30-year term of the hedged Series MTN 2016-1 General Obligation Notes.

In addition, in the nine months ended May 31, 2016, negative fair value adjustments of $68 were recorded on the Company's interest rate hedges related to the re-financing of debt instruments that will mature in fiscal 2019. In fiscal 2015, negative fair value adjustments of $17 were recorded on interest rate hedges related to the re-financing of debt maturing in fiscal 2016 and fiscal 2019.

Retained Earnings (Deficit)

The balance in retained earnings (deficit) as at May 31, 2016 reflects the earnings up to that date. We plan our operations to essentially result in an annual financial breakeven position after expenditures 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 (deficit) 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 planned fluctuations in revenue and expenses.

(in millions of dollars)

Amounts Considered for Rate Setting Purposes

As discussed under "INTRODUCTION – Financial Strategy and Rate Regulation", when establishing customer service charges the Board considers the Company's current and future financial requirements as well as:

(a) the current and anticipated balance in the rate stabilization account, adjusted notionally for the non-credit related portion of the fair value variance from face value on investments, as compared to its target balance; and

(b) the recovery of pension contributions on a cash basis.

The table below shows the "notional" credit balance of the rate stabilization account as compared to its target balance and the amount of regulatory pension expense cumulatively greater than contributions.

		May 31 2016	August 31 2015	Change
(a) Rate stabilization account credit balance		$ 137	$ 81	$ 56
Fair value variances on ABCP investments [1]		15	19	(4)
Face value variance on MAV II Class A-2 notes when purchased in fiscal 2011		3	3	-
Credit loss provisions on ABCP investments		-	(1)	1
Net non-credit related fair value variances from face value		18	21	(3)
"Notional" balance of the rate stabilization account [1]		155	102	53
Target balance of the rate stabilization account [2],[3]		(100)	(98)	(2)
Excess of the rate stabilization account from its target balance	(A)	$ 55	$ 4	$ 51
(b) Pension contributions in excess of pension expense		$ (157)	$ (197)	$ 40
Regulatory credit balance - recovery of contributions		157	197	(40)
Regulatory expense cumulatively greater than contributions	(B)	$ -	$ -	$ -
Amount to be returned over time through rate setting	(A + B)	$ 55	$ 4	$ 51

As at August 31, 2015, the amount to be returned over time through rate setting was $4, including the impacts of the Company's transition to IFRS of $4. There has been an increase in the amount to be returned over time through rate setting to $55 during the first nine months of fiscal 2016.

(1) The fair value variance from face value on restructured ABCP investments held by the Company as at May 31, 2016 of $18 includes cumulative fair value adjustments on these investments of $15 and $3 realized fair value variance on MAV II Class A-2 notes when purchased in fiscal 2011. The $15 in fair value adjustments has reduced the amount in the rate stabilization account. The Company currently estimates that the full fair value variance from face value of $18 will be recovered over time, as the fair value of these investments should ultimately reflect the face value of the notes less credit losses, which are currently estimated at $nil. Accordingly, $18 has been added to the rate stabilization account credit balance to arrive at the "notional" balance of the rate stabilization account.

(2) The long-term target credit balance of the rate stabilization account is 7.5% of total planned annual expenses net of other (income) expenses, excluding non-recurring items, on an ongoing basis. For fiscal 2016, the target balance is $100.

(3) The fiscal 2015 target balance was determined under Canadian GAAP. Beginning in fiscal 2016, the target balance has been determined under IFRS.

Financial Outlook[3]

The Company's status as a fully privatized, non-share capital corporation where all stakeholders are involved but none have control, is a key strength of our model. Our financial results demonstrate the success of this model and our determined efforts to continue as a global industry leader.

Our success is evident in our safety and service levels, in our initiatives to control costs while improving productivity and in our successful and continuing modernization of the ANS. These initiatives, combined with increases in air traffic volumes have produced positive financial performance in the past several years and year-to-date in fiscal 2016. Our financial performance has allowed the Company to keep rates stable for over eleven years.

Global political and economic conditions can quickly change. While we remain optimistic about long-term outlooks for aviation and air traffic growth, we strive to be prepared for changing conditions and will continue to monitor our financial requirements on an ongoing basis.

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

(in millions of dollars)

Presented below are the Company's current projected annual consolidated results before rate stabilization for fiscal 2016 compared to fiscal 2015 results.

	Year ended August 31			
	2016	2015	Change	%
Before rate stabilization				
Revenue	$ 1,373	$ 1,334	$ 39	3%
Operating expenses and other (income) and expenses, including other regulatory adjustments	1,312	1,329	(17)	(1%)
Net income (loss) before rate stabilization adjustments	$ 61	$ 5	$ 56	

Revenue

Total revenue for fiscal 2016 is expected to increase by approximately 2.9% or $39 from $1,334 in fiscal 2015 due to growth in air traffic that is expected to approximate 2.8%. See also "LIQUIDITY AND CAPITAL RESOURCES – Treasury Management and Financial Risk Mitigation" and "RESULTS OF OPERATIONS – Revenue – Customer Service Charges".

In the Q2 fiscal 2016 MD&A, the Company had disclosed anticipated revenue of $1,369 for fiscal 2016. The $4 increase in our anticipated revenue for fiscal 2016 is primarily due to an increase in the expected growth in air traffic, from 2.5% to 2.8%.

Operating Expenses and Other (Income) and Expenses

Operating expenses and other (income) and expenses before rate stabilization for fiscal 2016 are expected to be $1,312. This is a decrease of $17 compared to fiscal 2015 due to:

- lower expected pension expense, including finance costs due to lower expected pension contributions on which the regulatory pension expense is based;
- refunds of $7 relating to commodity taxes paid in prior years;
- higher forecasted positive fair value adjustments on investments of $11 as compared to negative fair value adjustments of $4 in fiscal 2015; and
- decreased finance costs as a result of lower debt levels in fiscal 2016 compared to fiscal 2015;

partially offset by:

- higher compensation levels, including increased overtime and fringe benefit costs;
- increased operational requirements in the areas of technical services, facilities and systems maintenance as well as travel;
- the effects of inflation.

Across the Company, there is an ongoing focus on cost management. Over the past several years the Company has been able to achieve cost decreases per flight hour while continuing to deliver safe and efficient service. We remain focused on cost saving measures that are consistent with safety, which is our top priority. Our efforts are aimed at managing staffing levels and discretionary expenses, as well as continuing to implement process improvement initiatives and efficiencies.

In the Q2 fiscal 2016 MD&A, the Company had disclosed anticipated operating expenses and other (income) and expenses, before rate stabilization of $1,310. The $2 increase forecasted is primarily due to decreased finance income as a result of lower anticipated interest income and negative fair value adjustments on foreign exchange forward contracts.

Cash Flows

Given the expected net cash flows from operations and cash flows from investing and financing activities in fiscal 2016, the Company's cash position is currently expected to increase to $74 as at August 31, 2016 (August 31, 2015 - $230). This cash outlook is based on anticipated annual cash outflows from investing and financing activities of $104 and $260, respectively, partially offset by cash inflows from operations of $208. Cash outflows include the repayment of long-term debt of $475, projected capital expenditures of $133, and disbursements from the settlement of interest rate swaps of $51. These cash outflows are partially offset by the issuance of long-term debt of $248 and a cash receipt of $26 of input tax credits related to the termination of the cross border transaction during fiscal 2015. The Company anticipates that its bank loans will be repaid in full by August 31, 2016. As discussed below, the Company has adequate existing sources of financing to cover all of its anticipated cash flow requirements.

In the Q2 fiscal 2016 MD&A, the Company had disclosed an anticipated cash position of $78 by the end of fiscal 2016. The $4 decrease in our forecasted cash position to the end of fiscal 2016 is primarily due to a decrease in anticipated cash inflows from operations as a result of higher pension contribution payments, partially offset by the increase in revenue from customer service charges.

Rate Stabilization Account

The Company currently anticipates that the rate stabilization account will have a credit balance of $142 at the end of fiscal 2016, resulting from estimated revenue of $1,373 and total expenses and other (income) loss of $1,312 (before rate stabilization). It is anticipated that the "notional" balance of the rate stabilization account will be a credit balance of approximately $153 at the end of fiscal 2016, which is above the Company's target balance of $100 by $53.

In the Q2 fiscal 2016 MD&A, the Company had forecast an anticipated rate stabilization account credit balance of $140 at the end of fiscal 2016. The forecasted $2 increase in the rate stabilization account to the end of fiscal 2016 is due to an increase in the planned net income by $2 based on the changes in the forecast discussed above.

As noted previously, the Company intends to implement revisions to its customer service charges, effective September 1, 2016.

In addition to revising our base rates in order to ensure they are aligned with costs, we are proposing a temporary one-year reduction in base rates, representing on average a 3.7% reduction from current base rates. The purpose of the one-year temporary rate reduction is to return to customers the $53 noted above, representing our estimate of the amount by which the notional balance of the rate stabilization account will exceed its target balance at the end of fiscal 2016.

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 May 31, 2016, our interest cost was $99. Consolidated earnings (after rate stabilization) before interest were $92, which is 0.93 times our interest requirement for the year and slightly below our one-to-one target. Depreciation and amortization expense for this period was $141. Our cash flow coverage was 2.35 times our interest requirements 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 costs (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 insignificant.

We maintain a debt service reserve fund and an operations and maintenance reserve fund 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 May 31, 2016, 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 venture and registered pension plans for its employees. During the three and nine months ended May 31, 2016, total amounts paid by us to these related parties, directly or indirectly, were $33 and $102 (three and nine months ended May 31, 2015 - $28 and $90) primarily related to contributions to the Company's registered pension plans of $29 and $90 (three and nine months ended May 31, 2015 - $25 and $80). Total amounts received or receivable from these related parties during the three and nine months ended May 31, 2016 were $5 and $18 (three and nine months ended May 31, 2015 - $8 and $18) primarily related to reimbursement for certain costs from the Company's pension plans and accrued dividend income on the investment in preferred interests of Aireon. As at May 31, 2016, the Company has accounts receivable of $1 (August 31, 2015 - $1) and an accrued dividend receivable of $23 (August 31, 2015 - $15) from Aireon. Additional details of these transactions are disclosed in note 25 of our Q3 fiscal 2016 interim consolidated financial statements.

(in millions of dollars)

SUMMARY OF QUARTERLY RESULTS

Quarterly Financial Information (unaudited)

	Three months ended			
	Q3 May 31 2016 IFRS	Q2 February 29 2016 IFRS	Q1 November 30 2015 IFRS	Q4 August 31 2015 IFRS
Revenue	$ 337	$ 309	$ 342	$ 384
Operating expenses	319	307	296	305
Other (income) and expenses	34	25	30	24
	(16)	(23)	16	55
Income tax expense	-	1	-	1
Net income (loss) before net movement in regulatory deferral accounts	(16)	(24)	16	54
Net movement in regulatory deferral accounts related to net income (loss), net of tax				
Rate stabilization adjustments	(16)	(19)	(21)	2
Other regulatory deferral account adjustments	24	4	3	(14)
	8	(15)	(18)	(12)
Net income (loss) after net movement in regulatory deferral accounts	$ (8)	$ (39)	$ (2)	$ 42

	Three months ended			
	Q3 May 31 2015 IFRS	Q2 February 28 2015 IFRS	Q1 November 30 2014 IFRS	Q4 August 31 2014 CGAAP(1)
Revenue	$ 329	$ 296	$ 325	$ 350
Operating expenses(2)	304	300	293	284
Other (income) and expenses(3)	37	17	25	23
	(12)	(21)	7	43
Income tax expense	-	1	-	-
Net income (loss) before net movement in regulatory deferral accounts	(12)	(22)	7	43
Net movement in regulatory deferral accounts related to net income (loss), net of tax				
Rate stabilization adjustments	-	-	(7)	-
Other regulatory deferral account adjustments	4	(11)	(1)	-
	4	(11)	(8)	-
Net income (loss) after net movement in regulatory deferral accounts	$ (8)	$ (33)	$ (1)	$ 43

(1) Financial information prepared in accordance with Canadian GAAP is presented after rate stabilization and net of regulatory adjustments. Regulatory adjustments are not shown separately from the underlying transactions as they are under IFRS.

(2) For financial information prepared in accordance with Canadian GAAP, operating expenses includes depreciation and amortization expenses which were classified as other expenses in the Company's previous Canadian GAAP consolidated financial statements.

(3) For financial information prepared in accordance with Canadian GAAP, other (income) and expenses includes interest expense and fair value adjustments and other as presented in the Company's previous Canadian GAAP consolidated financial statements.

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. The second quarter (December to February) typically has the lowest air traffic volumes. Air traffic for Q3 fiscal 2016 was 3.0% higher on average than in Q3 fiscal 2015.

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 and derivative instruments which change based on market factors and changes in expectations of credit losses; 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, initial approved drawdown or adjustment and additional regulatory recoveries of pension contributions that were recorded in quarterly reporting periods when the "notional" balance of the rate stabilization account, determined under Canadian GAAP, was greater than the target balance (see "LIQUIDITY AND CAPITAL RESOURCES – Treasury Management and Financial Risk Mitigation – Pension Plans");
- changes in employee benefit pension contributions;
- changes in other employee benefits, including LTD funding requirements;
- changes in the investment in preferred interests of Aireon, net of tax; and
- changes in realized hedging transactions.

(in millions of dollars)

LIQUIDITY AND CAPITAL RESOURCES

Working Capital Requirements

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

We establish customer service charge base rates to essentially achieve a financial breakeven position on an annual basis, after considering regulatory adjustments. The inclusion of non-cash depreciation and amortization expenses in the calculation of service charge rates typically leads to positive cash flows from operations. Our strategy is to use these positive cash flows to fund capital expenditures and to replenish our working capital, if required. In addition, our strategy is to maintain a financial structure and credit ratings that will allow the Company to access the capital markets to meet debt maturities as they come due. Should we believe that conditions are not appropriate to undertake a refinancing at a particular time or should we experience a temporary downturn in revenue from seasonal or other factors, the Company has sufficient cash and committed credit facilities at its disposal. As at May 31, 2016, we had $72 of cash and cash equivalents and committed credit facilities of $1,190, of which $423 was available for use as described in the following table.

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 May 31, 2016, the credit facilities are utilized as follows:

Credit facilities:	
Credit facility with a syndicate of Canadian financial institutions (1)	$ 675
Letter of credit facilities for pension funding purposes (2)	515
Total available credit facilities	1,190
Less: Outstanding letters of credit (2)	457
Less: Bank loan	40
Undrawn committed borrowing capacity	693
Less: Operations and maintenance reserve fund allocation (3)	270
Credit facilities available	$ 423

(1) The Company's credit facility with a syndicate of Canadian financial institutions in the amount of $675 is comprised of two equal tranches maturing on September 12, 2018 and September 12, 2020. The credit facility agreement provides for loans at varying rates of interest based on certain benchmark interest rates, specifically the Canadian prime rate and the Canadian bankers' acceptance rate, and on the Company's credit rating at the time of drawdown. A utilization fee is also payable on borrowings in excess of 25% of the available facility. The Company is required to pay commitment fees, which are dependent on the Company's credit rating. The Company is in compliance with the credit facility covenants as at May 31, 2016.

(in millions of dollars)

(2) The letter of credit facilities for pension funding purposes are comprised of four facilities with Canadian financial institutions totalling $515, which will mature on December 31, 2016, unless extended. The Company intends to seek extensions of the maturity dates. Of the $457 in letters of credit shown above as outstanding as at May 31, 2016, $445 was drawn for pension solvency funding purposes.

(3) The operations and maintenance reserve fund may be used to pay operating and maintenance expenses, if required (see also "LIQUIDITY AND CAPITAL RESOURCES – Reserve Funds and Financial Instruments").

Cash flows for the three months ended May 31, 2016

	Three months ended May 31			
	2016	2015	Change	%
Cash flows from:				
Operations	$ 28	$ 52	$ (24)	(46%)
Investing	(30)	(32)	2	(6%)
Financing	15	(25)	40	
Cash flows from operating, investing and financing activities	13	(5)	18	
Effect of foreign exchange on cash and cash equivalents	-	1	(1)	
Increase (decrease) in cash and cash equivalents	13	(4)	17	
Cash and cash equivalents, beginning of period	59	198	(139)	(70%)
Cash and cash equivalents, end of period	$ 72	$ 194	$ (122)	(63%)
Free cash flow (non-GAAP financial measure):				
Cash flows from:				
Operations	$ 28	$ 52	$ (24)	
Capital expenditures (1)	(30)	(31)	1	
Free cash flow	$ (2)	$ 21	$ (23)	

(1) See the statements of cash flows of our Q3 fiscal 2016 interim consolidated financial statements.

As shown above, the Company experienced negative free cash flow of $2 for the three months ended May 31, 2016, which is a non-GAAP 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 and investments in Aireon and other subsidiaries. Management places importance on this indicator as it assists in measuring the impact of its investment program on the Company's financial resources.

(in millions of dollars)

Cash flows from operations for the three months ended May 31, 2016 decreased by $24 from the three months ended May 31, 2015, primarily due to higher payments to employees and suppliers of $22.

Cash outflows from investing activities for the three months ended May 31, 2016 were $2 lower than in the three months ended May 31, 2015.

Cash flows from financing activities for the three months ended May 31, 2016 were inflows of $15 compared to outflows of $25 for the three months ended May 31, 2015. The inflows are a result of net proceeds from bank loans of $40, partially offset by the annual $25 principal repayment of the Series 97-2 bonds.

For the three months ended May 31, 2015, our cash balance decreased by $4. This was primarily due to capital expenditures of $31 and the $25 repayment of the Series 97-2 bonds, partially offset by cash inflows from operations of $52.

Cash flows for the nine months ended May 31, 2016

	Nine months ended May 31			
	2016	2015	Change	%
Cash flows from:				
Operations	$ 124	$ 125	$ (1)	(1%)
Investing	(65)	(99)	34	(34%)
Financing	(218)	(26)	(192)	
Cash flows from operating, investing and financing activities	(159)	-	(159)	
Effect of foreign exchange on cash and cash equivalents	1	1	-	
Increase (decrease) in cash and cash equivalents	(158)	1	(159)	
Cash and cash equivalents, beginning of period	230	193	37	19%
Cash and cash equivalents, end of period	$ 72	$ 194	$ (122)	(63%)
Free cash flow (non-GAAP financial measure):				
Cash flows from:				
Operations	$ 124	$ 125	$ (1)	
Capital expenditures [1]	(93)	(72)	(21)	
Investment in preferred interests [1]	-	(36)	36	
Free cash flow	$ 31	$ 17	$ 14	

(1) See the statements of cash flows of our Q3 fiscal 2016 interim consolidated financial statements.

As shown above, the Company experienced positive free cash flow of $31 for the nine months ended May 31, 2016, which is a non-GAAP financial measure as discussed in “LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the three months ended May 31, 2016”.

Cash flows from operations for the nine months ended May 31, 2016 decreased by $1 from the nine months ended May 31, 2015, primarily due to higher receipts from customer service charges of $41 and higher other receipts of $5, partially offset by higher payments to employees and suppliers of $37 and higher pension contributions of $9.

Cash outflows from investing activities for the nine months ended May 31, 2016 were $34 lower than in the nine months ended May 31, 2015 primarily due to the receipt of recoverable input tax payments of $26 on the termination of the cross border transaction and the fact that there was no equivalent investment in preferred interests of Aireon during the nine months ended May 31, 2016 (nine months ended May 31, 2015 - $36). The decrease was partially offset by higher capital expenditures of $21 and lower proceeds from ABCP of $8.

Cash outflows from financing activities for the nine months ended May 31, 2016 were $218 compared to $26 for the nine months ended May 31, 2015. The outflows are a result of the repayment of the $450 Series MTN 2006-1 General Obligation Notes that matured on February 24, 2016, the payment of $51 to settle the interest rate swap agreements that were entered into to hedge the Series MTN 2016-1 notes noted below and the annual $25 principal repayment of the Series 97-2 bonds. These outflows were partially offset by the issuance of the $250 Series MTN 2016-1 General Obligation Notes ($248 net of transaction costs), net proceeds from bank loans of $40 and a $20 drawdown of surplus funds from the debt service reserve fund.

For the nine months ended May 31, 2015, our cash balance increased by $1. This was primarily due to cash inflows from operations of $125 and proceeds from ABCP of $10, partially offset by capital expenditures of $72, an additional investment in preferred interest of Aireon of $36 and the $25 repayment of the Series 97-2 bonds.

Sources of Liquidity

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

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

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

(in millions of dollars)

On November 6, 2015, the Company filed a base shelf prospectus (Base Shelf Prospectus) qualifying up to $500 of General Obligation Notes to be issued pursuant to the Company's medium term notes program. On February 24, 2016 the Company issued $250 of Series MTN 2016-1 General Obligation Notes in order to refinance a portion of the Company's $450 Series MTN 2006-1 General Obligation Notes that matured on February 24, 2016. The Base Shelf Prospectus will expire in December 2017. The Company has no other scheduled maturities or principal repayments during the 25 month term of the Base Shelf Prospectus, other than the Series 97-2 amortizing bonds annual payment of $25. The remaining capacity under the Base Shelf Prospectus may be used to pre-fund a future maturity or to generate funds for other corporate purposes.

As at May 31, 2016, we had a committed bank credit facility in the amount of $675. The facility is comprised of two equal tranches that will expire on September 12, 2018 and September 12, 2020, unless extended. The Company has also entered into four letter of credit facilities totalling $515 in order to provide additional capacity for pension funding purposes. The letter of credit facilities will expire on December 31, 2016, unless extended. The Company intends to seek extensions of the maturity dates.

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

	May 31 2016	August 31 2015
LONG-TERM DEBT:		
Bonds and notes payable		
Under the Master Trust Indenture	$ 525	$ 550
Under the General Obligation Indenture	1,200	1,400
	1,725	1,950
Adjusted for deferred financing costs and discounts	(7)	(6)
Total bonds and notes payable	1,718	1,944
Less: current portion	(25)	(225)
Total non-current loans and borrowings	$ 1,693	$ 1,719
LIQUIDITY (excludes MAV II, restructured ABCP and other notes shown below):		
Cash and cash equivalents	$ 72	$ 230
Debt service reserve fund	94	113
	$ 166	$ 343
Undrawn committed borrowing capacity (1)	$ 693	$ 663
MAV II, RESTRUCTURED ABCP AND OTHER NOTES:		
Face value (2)	$ 293	$ 296
Fair value variance from face value	(18)	(22)
	$ 275	$ 274

(1) $423 is available as described under "LIQUIDITY AND CAPITAL RESOURCES – Working Capital Requirements".

(2) See also "LIQUIDITY AND CAPITAL RESOURCES – Treasury Management and Financial Risk Mitigation – Liquidity Risk".

(in millions of dollars)

Credit Ratings

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

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

On March 30, 2016, S&P announced that they were affirming the Company's ratings and outlook. They stated that the Company's credit profile "reflects our view of NAV CANADA's monopoly over an essential service, legislated ability to levy user charges on airlines to meet financial requirements, and solid debt service coverage ratios (DSCRs)." In S&P's view, "the Company's high debt burden, air travel demand exposure, and large statutory solvency-based pension deficiency constrain the ratings." Their stable outlook reflects an expectation that the Company will post DSCRs in the 1.2-2.2x range over the next three years and hold the notional rate stabilization account balance close to its targeted 7.5% of total planned annual expenses. They also expect that the Company will look to secure additional Letter of Credit capacity in the event that its pension solvency funding requirements materially exceed S&P's base-case scenario.

On February 24, 2016, DBRS issued a press release indicating that they had assigned a rating of AA (low) with Stable trend to the Company's $250 million Series MTN 2016-1 General Obligation Notes. They indicated that this rating is consistent with ratings previously assigned by DBRS on the Company's outstanding General Obligation Debt and that the AA rating and Stable trend assigned to the Company's Senior Debt is also unchanged. They stated that "should air traffic materially decline, DBRS expects that the Company would set its rates and charges to maintain a DSCR (debt service coverage ratio) appropriate for its ratings."

On February 10, 2016, Moody's issued a press release affirming NAV CANADA's base line credit assessment (BCA) at aa2 and its senior secured rating at Aa2. At the same time, they upgraded the senior unsecured (General Obligation debt) rating to Aa2 from Aa3 and assigned the Aa2 rating to the $250 million 30-year Series 2016-1 notes. Moody's stated that "the affirmation of the BCA and of the senior secured rating for NAV CANADA reflects the strong operating and financial performance over the past few years". They stated that this performance was underpinned by sustained aeronautical traffic growth and that NAV CANADA was able to meet all its obligations (including pension plan related obligations) without any rate increases. They also highlighted that the Company financed all its capital expenditures through cash flows and was able to repay debt with further reductions in debt likely in fiscal 2016 and 2017. Moody's noted their expectation that rates will be decreased in the latter part of the calendar year should traffic growth continue. They stated "we expect that NAV CANADA will be prudent in its assumption for future traffic growth and obligations when deciding the quantum of the rate decrease and that it will ensure that its financial profile remains solid."

Moody's explained that "the upgrade of the senior unsecured rating reflects the fact that there is a declining amount of secured debt within the overall capital structure of NAV CANADA and that while there is some additional protection in the form of security for the senior secured debt, it is not enough to result in a full notch difference with the rating of the senior unsecured debt."

(in millions of dollars)

On June 1, 2015, DBRS issued a press release confirming the Company's ratings and outlook. The press release was followed by a rating report on June 2, 2015. DBRS stated that "the rating confirmation incorporates the good traffic growth experienced during the last several months, but the rating remains tempered by the potential volatility inherent in the air travel industry and the magnitude of NAV CANADA's pension obligations". DBRS noted the Company's air traffic forecast for fiscal 2015 of 4.1% year over year growth and stated that "achieving the forecast growth could be challenging, given the continuing unease regarding global market conditions and potential geopolitical challenges" (actual growth for fiscal 2015 was 4.6%). They stated that the forecast "would lead to a Debt Service Coverage Ratio (DSCR) of approximately 1.9 times, which remains supportive of the rating".

A credit rating is not a recommendation to buy, sell, or hold securities and may be subject to revision or withdrawal at any time by the rating organization. Our fiscal 2015 AIF contains more detailed information about the credit ratings, including each rating agency's rationale for assigning the given rating.

Restructured and Other Investments in ABCP

(See also "LIQUIDITY AND CAPITAL RESOURCES" and "CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS")

In January 2009, third party sponsored ABCP in Canada was restructured by the Pan Canadian Investors Committee. Pursuant to the terms of the restructuring plan, holders of third party sponsored ABCP exchanged their short-term notes for longer-term notes. The restructuring plan: (i) extended the maturity of the third party sponsored ABCP to provide for a maturity similar to that of the underlying assets; (ii) pooled certain series of the third party sponsored ABCP that are supported in whole or in part by underlying synthetic assets; and (iii) mitigated the margin call obligations of the existing conduits that have margin call risk and created a structure to address margin calls should they occur.

The Company holds the following investments in MAV II, restructured ABCP and other investments (that were not subject to the restructuring by the Pan Canadian Investors Committee) as at May 31, 2016:

	Face value	Fair value variances	Fair value
MAV II notes			
Class A-1	$ 191	$ (10)	$ 181
Class A-2	94	(7)	87
	285	(17)	268
ABCP	7	(1)	6
Other notes	1	-	1
Total	$ 293	$ (18)	$ 275

The MAV II notes were issued by a trust referred to as the "Master Asset Vehicle II", which includes a pooling of leveraged investments as well as traditional assets and cash. The leveraged investments are subject to a potential requirement to post additional collateral based on certain triggers being met (a margin call). Traditional assets are un-levered investments and include residential and commercial mortgage backed securities, corporate credit and cash equivalents. The Class A-1 and A-2 notes provide for the payment of interest on a quarterly basis, provided that the three month Canadian Dollar Offered Rate is above 50 basis points and the trust has generated sufficient cash earnings to make the payment.

The Company elected to receive notes issued by MAV II, in which investors are not required to advance funds to meet future margin calls, should they occur. A margin funding facility has been arranged for MAV II to meet potential margin calls. This margin funding facility is being provided by certain international and Canadian banks.

The other notes, comprised of Ineligible Asset Tracking notes, also received as a result of the restructuring of third party sponsored ABCP, track the performance and repayment of the related underlying assets that have significant exposure to the U.S. residential mortgage market.

The restructured notes are designated as FVTPL. Changes in fair value are recorded in income as they arise. As shown in the table above, the fair value of these notes is $275 as at May 31, 2016, which is $18 below the face value of the notes. The Company's fair value hierarchy and its fair value methodologies are discussed in note 21 to our Q3 fiscal 2016 interim consolidated financial statements. The Company has used a discounted cash flow approach to determine the fair value of these investments, incorporating available information regarding market conditions as at the measurement date, May 31, 2016. The estimates arrived at by the Company are subject to measurement uncertainty and are dependent on market conditions as at the measurement date.

The future value of our investments in MAV II, ABCP and other notes cannot be predicted with any degree of certainty. The asset provider counterparties to these transactions have the right to require that additional collateral be posted under these transactions if certain triggers are breached. If the collateral requirements are not met, the asset providers may unwind the trades and liquidate collateral to cover their losses. This would likely lead to the loss of a significant portion or all of our MAV II notes with a face value as at May 31, 2016 of $285. The likelihood of this occurring has been made more remote by certain features of the restructuring, including the provision of a margin funding facility, the adoption of more remote spread/loss triggers, the pooling of trades, and the retention of cash and traditional assets as collateral. In addition, a significant number of the high risk assets originally held within MAV II have now matured without incurring losses. As at May 31, 2016, the highest index referenced in the spread/loss triggers was at 3% of its trigger level.

The *Dodd-Frank Wall Street Reform and Consumer Protection Act* was passed in the United States in July 2010. Regulations and definitions in support of this legislation were expected to be developed and enacted by July 2011 but some of the regulations have been significantly delayed. Should regulations enacted in the future apply to MAV II or to the underlying assets held by MAV II, it is possible that they will have a detrimental effect on the value of the Company's investments in MAV II notes.

There is no assurance that the fair value of the Company's investments in MAV II, ABCP and other notes will not decline or that significant deterioration in financial markets will not cause losses on the individual collateralized debt obligations or margin calls in excess of MAV II's ability to meet them, resulting in significant credit losses. The estimated fair value of the Company's investments, including the expected credit losses, may change in subsequent periods. Any such changes could be material and would be reflected in the statement of operations as they occur.

Reserve Funds and Financial Instruments

Financial instruments are also discussed in note 21 to our Q3 fiscal 2016 interim consolidated financial statements. 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 debt service reserve fund is maintained in cash and qualified investments deposited with the Trustee. An amount equal to or greater than one year's debt service (excluding General Obligation Indenture debt) is required to be maintained. The debt service reserve fund also counts toward our minimum cash liquidity level under the General Obligation Indenture, which is one year's interest on all debt.

The operations and maintenance reserve fund requirements are met with an allocation of $270 in undrawn availability under our committed credit facilities. At a fiscal year end the fund must cover at least one quarter of the annual operating and maintenance expenses. This fund also serves to meet the minimum liquidity level under the General Obligation Indenture, which consists of the minimum cash liquidity level mentioned above plus one quarter of the previous year's operating and maintenance expenses.

As at May 31, 2016, 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.

Treasury Management and Financial Risk Mitigation

Credit Risk on Investments: In order to mitigate the risk of losses arising from investment activities, we invest only in highly-rated and short-term obligations. Excluding investments in MAV II, ABCP and other notes and Aireon, the Company limits investments to obligations of the federal government, certain provincial governments, entities guaranteed by a federal or provincial government or other obligations of entities rated by at least two rating agencies in the top two categories for long-term debt or the highest category for short-term debt. Asset backed securities must be sponsored by a Schedule I bank and may not contain synthetic assets. Our portfolio is diversified, with dollar and percentage limits on investment counterparties. None of the Company's holdings in cash equivalents or in current investments are past due or impaired, and all have long-term ratings in either the AAA or AA category or short-term ratings in the highest category (DBRS R1 (high)). (See also discussion under "LIQUIDITY AND CAPITAL RESOURCES – Restructured and Other Investments in ABCP").

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

- maturities of borrowings are currently spread over periods up to and including 2046 so that only a portion of outstanding debt will mature in any given fiscal year; and
- forward-dated interest rate swap agreements have been entered into in order to mitigate the impact of fluctuating interest rates on interest costs relating to the Company's expected debt issue in April 2019.

A second source of interest rate risk, as shown in note 21 to our Q3 fiscal 2016 interim consolidated financial statements, is that the Company has $441 invested in financial assets and $40 in financial liabilities that bear interest at floating rates. Earnings on the financial assets will fall when interest rates decline. In the current low interest rate environment, the Company has positioned itself to benefit from increased earnings on floating rate assets as a result of rising interest rates without a significant offsetting increase in interest expense.

Interest rate risk relating to our pension plans is discussed below under "Pension Plans".

Liquidity Risk: We are also exposed to liquidity risk. We mitigate this risk by monitoring current and expected liquidity requirements, taking into account trends in air traffic and expected contributions to our pension plans, to ensure that we maintain sufficient reserves of cash, cash equivalents, investments and/or available undrawn credit facilities to meet our liquidity requirements in the short and longer term. Under the Company's Master Trust Indenture and General Obligation Indenture, the Company is required to maintain certain reserve funds and liquidity levels, as described in note 20 to our Q3 fiscal 2016 interim consolidated financial statements.

As at May 31, 2016, the Company had $693 of undrawn availability under its committed credit facilities and had allocated $270 of this facility to meet its operations and maintenance reserve fund requirement under the Master Trust Indenture. The Company has investments in highly rated short-term obligations in its debt service reserve fund. The Company believes that it has sufficient available liquidity to meet its operating needs.

Based on current information, the Company does not expect the degree of liquidity of the notes received upon restructuring of third party sponsored ABCP to have a material adverse impact on its business or its ongoing compliance with financial covenants. The Company plans to maintain sufficient liquidity from other sources in order to hold the notes to maturity should it continue to believe that this is the appropriate strategy to maximize the value of the notes.

Refinancing Risk: We are exposed to re-financing risk with respect to our bond maturities, including the $25 annual amortizing payment due on the series 97-2 bonds. We mitigate this risk by maintaining committed revolving 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 also has the Base Shelf Prospectus in place that is valid for a 25 month period until December 6, 2017.

Foreign Exchange Risk: The Company is exposed to foreign exchange risk on sales and purchases that are denominated in currencies other than the functional currency of the Company. However, the Company invoices and receives the vast majority of its revenue in Canadian dollars and also incurs operating expenses and capital expenditures primarily in Canadian dollars. The majority of the Company's exposure to foreign exchange risk relates to the U.S. dollar (U.S.). The Company does not have a significant exposure arising from other currencies. As shown in note 21 to our Q3 fiscal 2016 interim consolidated financial statements, the Company has $265 ($201 U.S.) of net exposure to U.S. dollar foreign exchange risk that is primarily related to the Company's investment in preferred interests of Aireon, after tax.

The Company designates certain of its forward contracts as cash flow hedging instruments to hedge the Company's exposure to the impact of exchange rate fluctuations. As at May 31, 2016, the Company has purchased $15 U.S. ($16 CDN) to hedge the Canadian dollar cost related to a portion of its outstanding commitment to acquire additional preferred interests in Aireon.

The foreign exchange rate sensitivity is the net amount of foreign exchange rate exposure of the items at the reporting date, less foreign currency hedges. As at May 31, 2016, if the Canadian dollar strengthened or weakened by 10% against the U.S. Dollar, all other variables remaining constant, net income (loss) before net movement in regulatory deferral accounts would have been impacted by $24.

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

In order to mitigate the risk of losses arising from investment activities, the Company only invests in highly-rated (see credit risk discussion above) and short-term instruments, excluding investments in MAV II, ABCP and other notes and Aireon. The price risks associated with investments in MAV II, ABCP and other notes are discussed under "LIQUIDITY AND CAPITAL RESOURCES – Restructured and Other Investments in ABCP".

The investment in preferred interests of Aireon is subject to price risk. The fair value may fluctuate over time due to, among other things, economic conditions and the cash flows of Aireon. Aireon is a start-up company and any such changes in the fair value could be material. A change of 5% in the fair value of the investment in preferred interests would impact finance income (other finance costs) by approximately $10 U.S. ($13 CDN) as at May 31, 2016.

The estimated fair value of the Company's investments, including the estimate of expected credit losses, may change in subsequent periods. Any such changes could be material and would be reflected in the statement of comprehensive income as they occur.

Rating Triggers: We are also exposed to risks related to the level of our credit ratings. Specifically, our credit facility agreements contain a pricing scale that is based on our credit ratings. If our senior debt ratings were to fall below AA (or equivalent) and/or our General Obligation Indenture debt ratings were to fall below AA- (or equivalent) our cost of borrowing under the facilities would increase, as would the commitment fees payable under the facilities. The Company's ratings were confirmed in March 2016 by S&P, in February 2016 by Moody's, and in June 2015 by DBRS (see "LIQUIDITY AND CAPITAL RESOURCES – Credit Ratings").

Collection of Accounts Receivable: We have strong credit policies. We have established a maximum credit limit of $4 for our largest air navigation services customers and we have other credit control measures that reduce our credit exposure. Our general payment terms provide for payment periods of 30 days for air navigation services and for payment periods of up to 45 days for some other types of services, but shorter payment terms are imposed where customer circumstances warrant. Our credit policies also require payments in advance or satisfactory security to be posted under certain circumstances.

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

- Economic climate – Air traffic generally is influenced by economic growth or decline. For example, during an economic downturn, growth rates in air traffic generally decline. Since a substantial portion of air traffic is international, traffic volumes are influenced by both Canadian and global economic circumstances. On an annual basis, a 1.0% change in air traffic volumes flown in Canadian airspace corresponds to approximately a $13 change in our revenue before rate stabilization.

- Aviation fuel prices – As fuel represents a major portion of airline operating costs, a change in the price of fuel can affect air traffic demand to the extent that the change is passed on to consumers.
- Terrorist activities, epidemics, pandemics, natural disasters, environmental concerns or weather patterns may all affect air traffic volumes within the airspace for which the Company provides air navigation services.

Our strategy is to mitigate the immediate impact of a sudden decline in air traffic with the least disruption possible to our customer base. We do this with our rate stabilization mechanism, which reduces short-term volatility in customer service charges. Our rate stabilization account tracks and accumulates revenue and expense variances from planned levels (whether positive or negative), so that they may be factored into the setting of future customer service charges. We also mitigate the impact of sudden declines in air traffic by maintaining substantial liquidity in the form of our reserve funds and unrestricted available credit facilities (see discussion under "Liquidity Risk" above).

Pension Plans[4]:

Required pension contributions to the Company's pension plans are determined by annual actuarial valuations for funding purposes performed as at January 1 (see below under "Pension Contributions (Going Concern and Solvency)"). Our latest actuarial valuations (for funding purposes) as at January 1, 2016 were completed and filed with OSFI in June 2016.

Pension Plans' Accounting Deficit: The Company's pension plans had an accounting deficit of $866 as at the annual measurement date of August 31, 2015 and an accounting deficit of $1,075 as at May 31, 2016. The increase of $209 in the deficit position during fiscal 2016 is due to actuarial accounting expense exceeding Company contributions by $42 and net actuarial losses of $167. The $167 of net actuarial losses are due to a $347 actuarial loss from a 30 basis point decrease in the discount rate, partially offset by a return on plan assets $93 greater than the expected return based on the discount rate, actuarial gains of $63 from demographic changes and $24 due to positive experience on the defined benefit obligation. The accounting deficit at August 31, 2015 decreased from a deficit of $1,174 at September 1, 2014, mainly due to re-measurements resulting in actuarial gains of $101, primarily from a 10 basis point increase in the discount rate, other actuarial gains of $32 and $249 of return on plan assets higher than the expected return based on the discount rate, partially offset by pension expense that exceeded pension contributions by $75. The market-based discount rate used to determine pension obligations is based on the yield on long-term high quality corporate bonds, with maturities matching the estimated cash flows of the plan. A 0.25% decrease in the discount rate would increase the accounting deficit by approximately $269. Conversely, a 0.25% increase in the discount rate would decrease the deficit by approximately $251.

Pension Expenses: Annual pension benefit costs can increase by approximately $20 from a 0.25% decrease in the discount rate used in actuarial calculations, or decrease by approximately $20 from a 0.25% increase in the discount rate.

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

(in millions of dollars)

Regulatory Recovery of Pension Costs: The Company uses a regulatory approach for pension costs to determine the net impact charged to net income (loss). The objective of this approach is to reflect the Company's cash contributions to the pension plans, including contributions made in the past that have not yet been expensed. To accelerate the recovery of such pension contributions, the Board approved, effective September 1, 2010, that if at the end of a quarterly reporting period there remained an accumulated amount of pension contributions not yet recovered through customer service charges and if the "notional" balance in the rate stabilization account was greater than the target balance, the excess over the target would be recorded as an additional regulatory debit adjustment to the net movement in regulatory deferral accounts related to pension benefits recognized in net income (loss) in the reporting period. As of August 31, 2015, the accumulated amount of pension contributions had been recovered through customer service charges. The pension contributions for the nine months ended May 31, 2016 have also been recovered through customer service charges.

The recovery of pension benefit costs (charged to the statement of operations) was as follows:

	Nine months ended May 31	
	2016	2015
Pension benefit costs (Per IAS 19 *Employee Benefits*)		
Current service costs	$ 109	$ 112
Net interest costs related to employee benefits	24	33
Net movement in regulatory deferral account related to pensions		
Regulatory decrease	(40)	(46)
Additional recovery of prior pension contributions	-	24
Recovery of pension benefit costs	$ 93	$ 123

Pension Contributions (Going Concern and Solvency): The actuarial valuations for funding purposes of the pension plans performed as at January 1, 2016 reported a going concern deficit of $76 (January 1, 2015 – a deficit of $268).

The regulations governing the funding of federally regulated pension plans include a solvency test, which assumes the plans are terminated as at the valuation date. The actuarial valuations performed as at January 1, 2016 reported a statutory solvency deficiency of $306 (January 1, 2015 – a statutory solvency deficiency of $556).

Going concern pension contributions for fiscal 2016 are expected to be $108 (fiscal 2015 - $118), including $16 (fiscal 2015 - $27) of special payments.

(in millions of dollars)

The Company is currently meeting its pension solvency funding requirements with letters of credit. Pension funding regulations came into effect in April 2011 permitting solvency special payments to be replaced by letters of credit, provided the total value of the letters of credit does not exceed 15% of the pension plan's assets. As of May 31, 2016, the Company has put in place letters of credit totalling $445 (representing 9% of registered pension plan assets as at May 31, 2016) to meet its cumulative pension solvency funding requirements to the end of calendar year 2016. For the annual period beginning July 1, 2016, letters of credit will be based on the January 1, 2016 actuarial valuations.

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

Insurance: Our aviation liability insurance program was renewed in the amount of $5,034 U.S. ($6,599 CDN) on November 15, 2015. This insurance, placed with syndicates at Lloyd's of London and other international insurers, covers all of our ANS operations for both bodily injury and property damage liability claims. Since September 2001, the Government of Canada has maintained a program that protects the Company from a terrorist-related loss in excess of our own insurance. This program ended on June 30, 2016. In anticipation of this expiry, the Company has purchased war liability coverage of $2,000 U.S. ($2,622 CDN) per occurrence with $4,000 U.S. ($5,244 CDN) in the aggregate for periods subsequent to June 30, 2016. This coverage is underwritten by a number of international insurers. It is non-cancellable in nature. The cost of this insurance is not significant to the Company.

Contractual Obligations

A breakdown of contractual obligations for the next five fiscal years and thereafter is presented in the following table.

	Remaining payments – for years ending August 31						
	Total	2016	2017	2018	2019	2020	Thereafter
Bank loan	$ 40	$ 40	$ -	$ -	$ -	$ -	$ -
Derivative liabilities	28	-	1	-	27	-	-
Long-term debt (including current portion) (1), (2)	1,725	-	25	375	375	25	925
Interest payments (2)	726	18	85	83	74	53	413
Operating leases	34	2	6	6	5	5	10
Purchase obligations (3)	117	20	24	19	10	12	32
Investment in preferred interests in Aireon (4)	36	-	36	-	-	-	-
Total contractual obligations	$ 2,706	$ 80	$ 177	$ 483	$ 491	$ 95	$ 1,380

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.

(1) Payments represent principal of $1,725. 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 date.

(2) Further details on interest rates and maturity dates on long-term debt are provided in note 20 to our Q3 fiscal 2016 interim consolidated financial statements.

(3) The Company has firm commitments for the acquisition of PP&E and intangible assets amounting to $117 as at May 31, 2016 (May 31, 2015 - $45).

(4) Payments represent contractual obligations to invest in preferred interests of Aireon, subject to conditions pursuant to the agreements. Amounts are presented in $CDN translated using the $U.S. foreign exchange rate at the current reporting date with the exception of the $15 U.S. ($16 CDN) investment in fiscal 2017 that is translated using the hedged rate. In March 2016, the November 2012 agreements were amended to reflect the extension of the fourth tranche investment milestone deadline to fiscal 2017.

The Company's letters of credit are discussed under the heading "LIQUIDITY AND CAPITAL RESOURCES – Working Capital Requirements".

The Company's contributions to its pension plans are discussed under the heading "LIQUIDITY AND CAPITAL RESOURCES – Treasury Management and Financial Risk Mitigation – Pension Contributions (Going Concern and Solvency)".

Capital Expenditures and Other Investments[5]

Planning capital expenditures in respect of systems, technology, buildings and equipment forms part of our annual budgeting process. As part of this planning, we review proposed capital expenditures against safety, financial and business needs justification criteria, considering the Company's unique status as a provider of essential safety-critical infrastructure.

During Q3 fiscal 2016 we invested $32 in capital projects (cash outflows of $30) compared to $28 in Q3 fiscal 2015 (cash outflows of $31). Investments were made in systems enhancements, functional upgrades, equipment upgrades and replacements, facility replacements and refurbishment and other projects to meet safety and other operational requirements.

We anticipate spending approximately $133 on capital projects in fiscal 2016, including approximately $38 of directly attributable internal labour and travel costs.

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

(in millions of dollars)

Capital Management

The Company is a non-share capital corporation and, as discussed in note 1 to our Q3 fiscal 2016 interim consolidated financial statements, must not set customer service charges higher than what is needed to meet its current and future financial requirements for the provision of civil air navigation services. 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 certain employee benefits, 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.

	May 31 2016	August 31 2015
Bonds and notes payable	$ 1,718	$ 1,944
Equity:		
Retained earnings (deficit)	(21)	28
Regulatory deferral accounts:		
Debit balances	(1,368)	(1,131)
Credit balances	466	448
Employee benefits:		
LTD asset	(4)	(3)
Liability for funded pension benefits	1,011	808
Liability for accumulating sick leave	21	21
Total capital	$ 1,823	$ 2,115

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

The Company's main objectives when managing capital are:

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

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

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

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

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

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

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

LEGAL PROCEEDINGS

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

CHANGES IN ACCOUNTING POLICIES

Transition to IFRS

The Company has adopted IFRS in fiscal 2016, resulting in an IFRS transition date of September 1, 2014 due to the requirement for one year of comparative figures. The adoption of IFRS has not changed our underlying business activities and does not alter the Company's approach to determining the level of customer service charges. This approach is based upon the charging principles within the ANS Act which prescribe, among other things, that charges must not be set at levels which, based on reasonable and prudent projections, would generate revenue exceeding the Company's current and future financial requirements in relation to the provision of civil air navigation services.

IFRS employs a conceptual framework that is similar to Canadian GAAP; however, significant differences exist in certain matters of recognition, measurement and disclosure. While adoption of IFRS has not changed our actual cash flows, it has had a substantial impact on the Company's significant accounting policies, and has subsequently resulted in changes to our reported financial position and results of operations.

The following discussion describes the significant adjustments made in restating our Canadian GAAP consolidated financial statements to IFRS for the three and nine months ended May 31, 2015 and year ended August 31, 2015 as well as the consolidated statement of financial position as at September 1, 2014. Refer to note 28 to the Q1 fiscal 2016 and note 27 to the Q3 fiscal 2016 interim consolidated financial statements for detailed reconciliations between Canadian GAAP and IFRS. The notes to these reconciliations provide explanations for each major difference.

Exemptions applied

IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as at the reporting date. However, it also provides for certain optional and mandatory exemptions for first time IFRS adopters. We assessed each of the mandatory and optional exemptions in detail and applied those outlined in note 28 to the Q1 fiscal 2016 interim consolidated financial statements.

Significant IFRS accounting policy differences

Rate regulated accounting

As permitted under Canadian GAAP, the Company followed specific accounting policies unique to a rate-regulated business. Under IFRS the use of regulatory accounting is permitted, and the transition impacts are related primarily to presentation and disclosure. Under Canadian GAAP regulatory adjustments were presented net on the same line on the statements of operations as the underlying transaction where applicable (i.e. movement in regulatory pension expense was recorded on the same line as pension expense). Under IFRS, regulatory adjustments are presented separately from the underlying transaction on the consolidated statements of operations and comprehensive income as net movement in regulatory deferral accounts.

Employee benefits, net of regulatory liability

Under Canadian GAAP, actuarial gains and losses for defined pension benefits and other post-employment benefits were deferred off balance sheet and amortized to earnings before rate stabilization using a "corridor" approach. Under IFRS, the Company recognizes these actuarial gains and losses in other comprehensive income (loss) in the period they are incurred, with no subsequent reclassification to net income (loss). In addition, under Canadian GAAP vested past service costs were deferred and amortized. Under IFRS, vested past service costs are recognized immediately as an expense in the period they are incurred.

Under Canadian GAAP, the costs of providing LTD benefits are charged to operations as they occur, which is consistent with IFRS. Under Canadian GAAP, non-vesting accumulating sick leave benefits were not recognized as a liability until the leave was taken; only vested sick leave benefits were recorded and actuarial gains and losses and past service costs were deferred off balance sheet and amortized to earnings using a "corridor" approach. Under IFRS, a liability for both vested and non-vesting accumulating sick leave benefits are recorded and actuarial gains and losses on vested and non-vesting sick leave and past service costs are recognized in net income in the period they are incurred.

Cross border transaction, net of regulatory liability

Under Canadian GAAP, although the Company was considered to have a variable economic interest in NC ANS QTE 2003-1 Statutory Trust (the Statutory Trust), the structured entity that was created by a U.S. entity at the inception of the transaction, the Company was not considered to be the primary beneficiary of the Statutory Trust, and therefore was not required to consolidate this entity. Accordingly, capital lease obligations, payment undertaking agreements and reserve funds were recognized on the Company's balance sheet upon entering into the transaction. Under IFRS, the Statutory Trust is fully consolidated in the Company's consolidated financial statements up to the termination of the capital lease transaction on August 6, 2015, as the Company is exposed to and has the power to control the returns of the Statutory Trust. The capital lease obligation was eliminated in the consolidated financial statements, and the Company recognized the long-term debt owed by the Statutory Trust on the cross border transaction. As a result of these adjustments upon transitioning to IFRS, there was no net impact on retained earnings.

The interest expense on the long-term debt is offset by interest income on the payment undertaking agreements resulting in no net effect on the Company's net income (loss) in fiscal 2015.

Future Accounting Pronouncements

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

IAS 1 – Presentation of Financial Statements

In December 2014, the IASB issued Disclosure Initiative (Amendments to IAS 1 *Presentation of Financial Statements*). These amendments improve the existing presentation and disclosure requirements and encourage entities to apply professional judgment regarding disclosure and presentation in their financial statements. These amendments are effective for annual periods beginning on or after January 1, 2016. Earlier application is permitted. The Company expects that these amendments will not have a material impact on its consolidated financial statements.

IFRS 9 – Financial Instruments

IFRS 9 will replace IAS 39 – *Financial Instruments: recognition and measurement*. This new standard introduces new requirements for the classification and measurement of financial assets and liabilities. It introduces a new general hedge accounting standard, which will align hedge accounting more closely with risk management. It also modifies the existing impairment model by introducing a new 'expected credit loss' model for calculating impairment.

IFRS 9 is effective for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. Earlier application is permitted.

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 introduces a new revenue recognition model for contracts with customers. The model contains two approaches for recognizing revenue, at a point in time or over time, and features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The new standard is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

IFRS 16 – Leases

In January 2016, the IASB issued IFRS 16, completing its project to improve the financial reporting of leases. The new standard will replace IAS 17 – *Leases*, and it sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract. For lessees, IFRS 16 eliminates the classification of leases as either operating or finance leases that exist under IAS 17, and requires recognition of assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. IFRS 16 substantially carries forward the lessor accounting requirements under IAS 17, maintaining the classification of leases as operating or finance leases, and accounting for the lease according to its classification. IFRS 16 is to be applied retrospectively, using either a full retrospective approach or a modified retrospective approach, for annual periods beginning on or after January 1, 2019. Earlier application is permitted, but only if IFRS 15 has also been adopted.

<u>IAS 7 – Statement of Cash Flows</u>

In January 2016, the IASB issued amendments to IAS 7 *Statement of Cash Flows* as part of the IASB's Disclosure Initiative. These amendments require entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including changes from cash flows and non-cash changes. These amendments are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted.

<u>IAS 12 – Income Taxes</u>

In January 2016, the IASB issued amendments to IAS 12 *Income Taxes*. These amendments clarify how to account for deferred tax assets related to debt instruments measured at fair value. These amendments are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted.

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

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

Critical Judgments

Depreciation and amortization methods

Depreciation and amortization methods for property, plant and equipment and intangible assets are based on management's judgment of the most appropriate method to reflect the pattern of an asset's future economic benefit expected to be consumed. For these purposes, management considers industry standards, manufacturer guidelines and company-specific history and experience, among other factors.

Impairment of property, plant and equipment and intangible assets

In carrying out impairment reviews of property, plant and equipment, intangible assets and/or cash-generating units, significant assumptions have to be made when assessing the recoverable amount. The most important assumptions relate to the continuing right to provide civil air navigation services and the exclusive ability to set and collect customer service charges for such services. If changes in such expectations arise, impairment charges may be required which would materially impact operating results.

Joint arrangements

The Company has determined that the structure of its investment in preferred interests of Aireon is a joint venture. Judgment is required in determining the existence of joint control and the classification of a joint arrangement. A party has joint control over an arrangement when unanimous consent is required of the parties sharing control for strategic financial and operating decisions. Joint arrangements that provide all parties with rights to the net assets of the entities under the arrangements are classified as joint ventures. The Company has used judgment in assessing the factors that determine joint control, including identifying Aireon's key strategic financial and operating decisions.

Key Sources of Estimates and Assumption Uncertainties

Employee Benefits

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

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

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

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

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

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

Refer to note 2 of our Q3 fiscal 2016 interim consolidated financial statements for more detailed information on key sources of estimation and uncertainty related to employee benefits.

Restructured and Other Investments in ABCP

See "LIQUIDITY AND CAPITAL RESOURCES – Treasury Management and Financial Risk Mitigation – Liquidity Risk" and "Credit Risk on Investments".

Investments in notes received upon restructuring of ABCP in January 2009 by the Pan-Canadian Investors Committee are designated as FVTPL. The Company has determined the fair value using a discounted cash flow approach incorporating available information regarding market conditions as at the measurement date. At the time of the restructuring the majority of ABCP investments were converted into new financial instruments, the MAV II notes, with maturities matching the underlying assets and bearing interest rates commensurate with the nature of the underlying assets and their associated cash flows. The Company has determined that the fair value of these notes is $18 below their face value as at May 31, 2016. This estimate is subject to measurement uncertainty and is dependent on market conditions as at the measurement date, as well as expectations of future credit losses. A change of 50 basis points in the market discount factor used to determine the value of the notes would impact the fair value adjustment by approximately $1. There is no assurance that the value of these investments, including the estimate of expected credit losses, will not change in subsequent periods. Any such changes could be material and would be reflected in the statement of operations as they occur.

As at May 31, 2016, an active market for purposes of a Level 1 accounting valuation has not developed for the restructured notes. If an active market for the restructured notes were to develop in the future, the Company would change its valuation technique to determine the fair value of its notes using quoted market prices.

Investment in Preferred Interests of Aireon

The Company's investment in Aireon is in preferred interests, which are redeemable and convertible to common equity interests. Until the Company exercises its right to convert its preferred interests to common interests, it does not have access to Aireon's residual net assets and accordingly this investment is accounted for as a financial instrument. The Company elected to designate the investment in preferred interests as a financial asset at FVTPL. As there is no active market for Aireon's equity instruments and the interests acquired by the Additional Investors have substantially the same characteristics as those acquired by the Company, the Company used the price paid by the Additional Investors as a basis to estimate the fair value of Aireon and its investment in the entity through preferred interests in subsequent reporting periods. The measurement is subject to estimation uncertainty and is dependent on the successful achievement of operational, technical and financial objectives by Aireon and Iridium. See "LIQUIDITY AND CAPITAL RESOURCES – Treasury Management and Financial Risk Mitigation – Other Price Risk".

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

Property, Plant and Equipment and Intangible Assets

The Company makes estimates about the expected useful lives of property, plant and equipment and intangible assets. In addition, the componentization of the Company's property, plant and equipment and intangible assets, namely buildings, is based on management's best estimates of what components constitute a significant cost in relation to the total cost of an asset and whether these components have similar or dissimilar patterns of consumption and useful lives for purposes of calculating depreciation and amortization. These estimates are based on data and information from vendors, industry practice and company-specific history. Estimates and assumptions are evaluated annually. Changes to these estimates, which can be significant, could be caused by a variety of factors including changes in expected future usage, physical wear and tear, and company-specific history and experience. Any adjustments necessary would be accounted for through depreciation and amortization expense on a prospective basis.

The estimated useful life for buildings is 15 to 40 years, with an average remaining useful life of 7 years for existing buildings. The estimated useful life for systems and equipment is 3 to 25 years. Air navigation systems and equipment are generally depreciated over 10 to 15 years. Business systems including software, servers and peripherals are generally depreciated over 3 to 8 years. The air navigation right is amortized over a period of 46 years, which is the recovery period established by the Board, acting as the rate regulator. Purchased and internally-developed software are amortized over 5 to 20 years.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

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

Disclosure Controls and Procedures

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

Internal Control over Financial Reporting

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

Changes to ICFR

There have been no changes to the Company's ICFR during the quarter ended May 31, 2016 that have materially affected or are reasonably likely to materially affect the Company's ICFR.