

Unaudited Consolidated Financial Statements of

NAV CANADA

Three months ended November 30, 2009

NAV CANADA

Consolidated Balance Sheets (unaudited)

(in millions of dollars)

	November 30 2009	August 31 2009
Assets		
Current assets		
Cash and cash equivalents	\$ 219	\$ 221
Accounts receivable	78	86
Current portion of capital lease obligations reserve fund (note 11)	31	32
Other	9	10
	<u>337</u>	<u>349</u>
Reserve funds		
Debt service (note 6)	107	107
Capital lease obligations (notes 5 and 11)	496	506
	<u>603</u>	<u>613</u>
Investments and other (note 5)	177	176
Accrued pension and other benefits (notes 10 and 14)	432	390
Capital assets		
Property, plant and equipment (note 7)	673	671
Intangible assets (note 8)	1,101	1,105
	<u>1,774</u>	<u>1,776</u>
	<u>\$ 3,323</u>	<u>\$ 3,304</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 179	\$ 190
Current portion of long-term debt (note 9)	25	25
Current portion of capital lease obligations (note 11)	31	32
	<u>235</u>	<u>247</u>
Rate stabilization account (note 10)	2	1
Long-term liabilities		
Long-term debt (note 9)	2,216	2,216
Capital lease obligations (note 11)	496	508
Regulatory liabilities (note 10)	153	108
Other (note 12)	199	196
	<u>3,064</u>	<u>3,028</u>
	3,301	3,276
Retained earnings (note 3)		
	<u>22</u>	<u>28</u>
	<u>\$ 3,323</u>	<u>\$ 3,304</u>

See accompanying notes to unaudited consolidated financial statements.

NAV CANADA

Consolidated Statements of Operations and Retained Earnings (unaudited)

Three months ended November 30

(in millions of dollars)

	2009	2008
Revenue		
Customer service charges (note 13)	\$ 271	\$ 287
Other	10	9
	<u>281</u>	<u>296</u>
Rate stabilization (note 10)	20	13
	<u>301</u>	<u>309</u>
Operating expenses		
Salaries and benefits	176	180
Technical services	25	25
Facilities and maintenance	12	12
Other	15	18
	<u>228</u>	<u>235</u>
Rate stabilization (note 10)	18	14
	<u>246</u>	<u>249</u>
Other expenses		
Interest (note 9 (d))	29	29
Depreciation and amortization (notes 7 and 8)	31	32
	<u>60</u>	<u>61</u>
Rate stabilization (note 10)	1	2
	<u>61</u>	<u>63</u>
Other income (loss)		
Fair value adjustments (notes 2 (f) and 5)	2	(41)
Rate stabilization (note 10)	(2)	44
	<u>-</u>	<u>3</u>
	<u>307</u>	<u>309</u>
Excess of expenses over revenue and other income (loss) (note 1)	\$ (6)	\$ -
Retained earnings, beginning of period	28	28
Retained earnings, end of period	<u>\$ 22</u>	<u>\$ 28</u>

See accompanying notes to unaudited consolidated financial statements.

NAV CANADA

Consolidated Statements of Cash Flows (unaudited)

Three months ended November 30

(in millions of dollars)

	2009	2008
Cash and cash equivalents provided by (used for):		
Operations		
Excess of expenses over revenue and other income (loss)	\$ (6)	\$ -
Items not involving cash:		
Depreciation and amortization	31	32
Pension costs (note 14)	33	29
Other post-employment benefit costs	4	4
Fair value adjustments	-	42
Change in rate stabilization account (note 10)	1	(42)
Other	-	1
	<u>63</u>	<u>66</u>
Pension contributions (note 14)	(31)	(26)
Other post-employment benefits payments	(4)	(3)
Change in non-cash working capital items related to operations	6	10
	<u>34</u>	<u>47</u>
Financing		
Bank loans, net (note 9)	-	(35)
Debt service reserve fund	-	(1)
	<u>-</u>	<u>(36)</u>
Investing		
Capital expenditures (notes 7 and 8)	(36)	(20)
	<u>(36)</u>	<u>(20)</u>
Decrease in cash and cash equivalents	(2)	(9)
Cash and cash equivalents, beginning of period	<u>221</u>	<u>59</u>
Cash and cash equivalents, end of period	<u>\$ 219</u>	<u>\$ 50</u>

Cash and cash equivalents are comprised of short-term investments with original terms to maturity of three months or less of \$ 220 million (November 30, 2008 - \$ 56 million) and cash net of outstanding cheques of (\$ 1) million (November 30, 2008 - (\$ 6) million).

See accompanying notes to unaudited consolidated financial statements.

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Notes to Consolidated Financial Statements (unaudited)

Three months ended November 30, 2009 and 2008

1. Nature of operations:

NAV CANADA (the "Company") was incorporated without share capital pursuant to Part II of the *Canada Corporations Act* to acquire, own, manage, operate, maintain and develop the Canadian civil air navigation system (the "ANS"), as defined in the *Civil Air Navigation Services Commercialization Act* (the "ANS Act"). The fundamental principles governing the mandate conferred on the Company by the ANS Act include the right to provide civil air navigation services and the exclusive ability to set and collect customer service charges for such services. The Company's core business is to provide air navigation services for which it collects customer service charges. This is the Company's only reportable segment. The Company's air navigation services are provided primarily within Canada.

The charges for civil air navigation services provided by the Company are subject to the economic regulatory framework set out in the ANS Act. The ANS Act provides that the Company may establish new charges and amend existing charges for its services. In establishing new charges or revising existing charges, the Company must follow the charging principles as set out in the ANS Act. These principles prescribe that, among other things, charges must not be set at levels which, based on reasonable and prudent projections, would generate revenues exceeding the Company's current and future financial requirements in relation to the provision of civil air navigation services. Pursuant to these principles, the Board of Directors of the Company, acting as rate regulator, approves the amount and timing of changes to customer service charges. The impacts of rate regulation on the Company's financial statements are described in note 10.

The Company plans its operations to essentially result in an annual financial breakeven position after recording adjustments to the rate stabilization account (note 10).

The ANS Act requires that the Company communicate proposed new or revised charges to customers in advance of their introduction and to consult thereon. Customers may make representations to the Company as well as appeal revised charges to the Canadian Transportation Agency on the grounds that the Company either breached the charging principles in the ANS Act or failed to provide statutory notice.

The Company is exempt from income taxes as it carries on its operations without monetary gain to its members.

2. Significant accounting policies:

(a) Financial statement presentation:

The unaudited interim consolidated financial statements are based upon accounting policies consistent with those used and described in the Company's audited annual consolidated financial statements for the fiscal year ended August 31, 2009 ("fiscal 2009"), except as explained in note 2 (c). In accordance with Canadian generally accepted accounting principles, these interim financial statements do not include all of the financial statement disclosures included in the fiscal 2009 audited annual consolidated financial statements and should be read in conjunction with the fiscal 2009 audited annual consolidated financial statements.

These consolidated financial statements include the accounts of the Company's wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in these consolidated financial statements.

Certain comparative figures have been reclassified to conform to the current year's financial statement presentation as described in note 2 (c).

Revenues derived from providing air navigation services reflect the seasonal fluctuations experienced by the airline industry. This seasonality results in quarterly financial results that may not be indicative of the year's financial results. Operating expenses are generally incurred evenly throughout the year.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

2. Significant accounting policies (continued):

(b) Rate regulation:

The timing of recognition of certain revenues and expenses differs from what would otherwise be expected for companies that are not subject to regulatory statutes governing the level of their charges, the effect of which is described in note 10.

(c) Changes in accounting policies:

Effective September 1, 2009, the Company adopted CICA Handbook Section 3064, Goodwill and Intangible Assets, which replaced Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development Costs. This Section establishes guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Commencing September 1, 2009, capital assets have been presented and disclosed as two separate categories, namely property, plant and equipment and intangible assets. Intangible assets include the air navigation right and computer software. These reclassifications have been applied retroactively in accordance with the transition provisions of the standard.

Effective September 1, 2009, the Company adopted the amendment to CICA Handbook Section 1100, Generally Accepted Accounting Principles ("GAAP") that removed a temporary exemption pertaining to the application of the Section to the recognition and measurement of assets and liabilities arising from rate regulation. As permitted by Canadian GAAP, the Company has applied standards issued by the Financial Accounting Standards Board in the U.S. as another source of Canadian GAAP. The U.S. Statement of Financial Accounting Standards No. 71 – "Accounting for the effects of certain types of regulation" ("FAS 71") allows for the recognition and measurement of rate regulated assets and liabilities. Consequently, regulatory liabilities relating to special pension contributions and long-term disability contributions collected through customer service charges have been reclassified and disclosed separately. In addition, the Company changed its policy for capitalizing internal labour costs that are directly attributable to capital assets under development. Previously, capitalization of internal labour costs had been limited to significant internally developed systems meeting certain criteria. Changes related to the adoption of this amendment to Section 1100 have been applied prospectively in accordance with the transition provisions of the standard.

(d) Use of estimates:

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect reported amounts and disclosures in these financial statements. Actual results could differ from those estimates. Significant management estimates include assumptions used in estimating the current year's pension and other post-employment benefits costs, the useful lives of capital assets, asset retirement obligations, fair value of investments as well as estimates related to collective agreements.

(e) Cash and cash equivalents:

Cash and cash equivalents are defined as cash and short-term investments with original terms to maturity of three months or less. Such short-term investments are recorded at fair value.

(f) Investments:

All investments are designated as financial assets held-for-trading and are recorded at fair value. Financial instruments not traded in an active market are valued using indicative market prices (if available) or a discounted cash flow approach. Fair value adjustments (including interest income and realized and unrealized gains and losses) are recognized in the statement of operations.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

2. Significant accounting policies (continued):

(g) Capital assets:

Capital assets consist of property, plant and equipment and intangible assets. The majority of the Company's capital assets are located in Canada.

Capital assets are carried at cost less accumulated depreciation and amortization. Capital assets are depreciated or amortized from the time an asset is substantially completed and ready for productive use. Capital assets are not amortized while under development.

The cost of capital assets under development includes materials, labour and other costs that are directly attributable to the development of a capital asset. Interest costs are not capitalized.

Capital assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in the normal course of business.

Depreciation and amortization of capital assets are calculated on a straight-line basis using the following estimated useful lives:

Capital asset	Estimated Useful life (years)
Property, plant and equipment	
Buildings	15 to 40
Systems and equipment	3 to 20
Intangible assets	
Air navigation right	46
Purchased software	3 to 20
Internally generated software	3 to 20

(h) Revenue recognition:

Revenue is recognized as services are provided and collection is reasonably assured.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

2. Significant accounting policies (continued):

(i) Employee future benefits:

The Company has established and maintains defined benefit pension plans for its employees. The plans provide benefits based on age, length of service and best average earnings. Employee contribution rates vary by position and by plan. The majority of employees and retirees are members of a plan that provides benefits that are indexed for inflation. The Company also provides certain health care, life insurance, other post-employment benefits to eligible retirees and their dependents, and long-term disability benefits to eligible employees. The costs of providing these pension and other post-employment benefits are charged to operations as employees render services. The costs of these benefits are actuarially determined using the projected benefits method prorated on services and are based on assumptions that reflect management's best estimates of expected investment performance, compensation, retirement ages of employees, health-care costs and other factors. The discount rate used to determine the present value of accrued pension and other benefits is based on market interest rates for long-term high quality debt instruments. Expected return on pension plan assets is based on a market-related value of plan assets, which recognizes investment gains and losses over a five-year period. The costs of providing long-term disability benefits are charged to operations as they occur.

Adjustments to post-employment benefits arising from plan amendments are amortized on a straight-line basis over the expected average remaining period of service of the employees covered by the amendments. Adjustments to post-employment benefits arising from transitional balances upon adoption of the current accounting policy on September 1, 2000 are being amortized on a straight-line basis over the expected average remaining period of service of the employees covered by the post-employment benefits, ending on August 31, 2013. Adjustments to long-term disability benefits arising from plan amendments are recognized immediately in the period in which they arise.

Amortization of actuarial gains and losses for post-employment benefits is recognized as a cost for the year if the unamortized net actuarial gain or loss at the beginning of the year exceeds 10% of the greater of the value of the accrued benefit obligation or the market-related value of the plans' assets. The unamortized amount in excess of 10% of the greater of the value of the accrued benefit obligation and the market-related value of the plans' assets is amortized over the average remaining service life of active employees (approximately 14 years). Actuarial gains and losses for long-term disability benefits are recognized immediately in the period in which they arise.

A curtailment loss is recognized in the income of the plan when it is probable that the curtailment will occur and the net effects can be reasonably estimated. A curtailment gain is recognized in the income of the plan when an event giving rise to a curtailment has occurred. Gains and losses on settlements of post-employment benefit plans are recognized by the plan when settlement occurs. The settlement and curtailment gains and losses are recognized in the Company's statement of operations based on the plan year established by the measurement date of the plan. When the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

The cumulative excess of pension contributions over pension expense and the cumulative excess of long-term disability contributions over long-term disability expense are included in accrued pension and other benefits on the balance sheet (note 14). The accrued post-employment benefit liability other than pensions and the accrued pension liability for supplemental pension benefits in excess of tax limits for federally registered pension plans are included in other long-term liabilities (notes 12 and 14).

The Company uses an annual measurement date of May 31 for estimating the accounting surplus or deficit of the pension, other post-employment and long-term disability plans and establishing benefits costs for the ensuing fiscal year, both of which are dependent on the measurement factors at that time.

Actuarial valuations for funding purposes are performed at least every three years, or annually if the pension plans have a deficit. The latest actuarial valuation for funding purposes of the Company's pension plans was performed as of January 1, 2009 and the next actuarial valuation will be performed as of January 1, 2010.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

2. Significant accounting policies (continued):

(j) Foreign currency translation:

Monetary assets and liabilities denominated in foreign currencies are translated at the prevailing rates of exchange at the balance sheet date. Transactions denominated in foreign currencies are translated at the exchange rates prevailing on the transaction dates. Foreign exchange gains and losses are included in the statement of operations, with the exception of unrealized gains and losses associated with the capital leasing transactions (note 4 (b) (iii)).

(k) Asset retirement obligations:

An asset retirement obligation is recognized in the period in which the Company incurs a legal obligation to restore land, and/or remove buildings, systems or equipment, if reasonably estimable. The fair value of the liability is equal to the present value of the estimated future restoration or removal expenditures. When the liability is initially recorded, an equivalent amount is capitalized as an inherent cost of the associated buildings, systems or equipment. In each subsequent period, the carrying amount of the asset retirement obligation is adjusted to reflect the fair value of the obligation due to the passage of time and revisions to the timing or amount of cash flows. The capitalized cost is depreciated over the useful life of the capital asset.

Some of the Company's air navigation system assets, particularly those located on leased sites, may have asset retirement obligations. The majority of these leases are long-term in nature with continuous renewal rights. All other leased facilities are renewed continuously, as the Company is required by the ANS Act to provide air navigation services indefinitely. As a result, no retirement date can be determined and consequently a reasonable estimate of the fair value of any related asset retirement obligations for these facilities cannot be made at this time. If at some future date it becomes possible to estimate the fair value of these asset retirement obligations, the obligation will be recognized at that time.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

2. Significant accounting policies (continued):

(l) Future accounting pronouncements:

In January 2009, the Canadian Accounting Standards Board (“AcSB”) issued Handbook Section 1601, Consolidated Financial Statements and Section 1602, Non-controlling Interests, which replace Section 1600, Consolidated Financial Statements. Section 1601 establishes the standards for the preparation of consolidated financial statements while Section 1602 establishes the standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. Sections 1601 and 1602 will apply to interim and annual consolidated financial statements relating to periods commencing on or after January 1, 2011. The Company does not expect the adoption of these Sections to have a material impact on the consolidated financial statements.

In January 2009, the AcSB issued Handbook Section 1582, Business Combinations, which replaces Section 1581, Business Combinations. This Section will apply, on a prospective basis, to future business combinations for which the acquisition date is on or after January 1, 2011. Earlier adoption is permitted as of the beginning of a fiscal year provided Section 1601, Consolidated Financial Statements and 1602 Non-controlling Interests are also adopted at the same time. This new standard effectively harmonizes the accounting for business combinations under Canadian GAAP with International Financial Reporting Standards (“IFRS”). The Company does not expect the adoption of this Section to have a material impact on the consolidated financial statements.

In June 2009, the AcSB issued amendments to Handbook Section 3862, Financial Instruments Disclosures, to improve disclosures of fair value measurements and liquidity risk. The Company will adopt these disclosure requirements prospectively commencing with its consolidated financial statements for the year ending August 31, 2010. The Company does not expect the adoption of these amendments to have a material impact on the consolidated financial statements.

On February 13, 2008 the AcSB announced the adoption of International Financial Reporting Standards (“IFRS”) for publicly accountable enterprises, effective for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. IFRS will be adopted by the Company commencing with its 2012 fiscal year. Hence, the Company’s IFRS transition date is September 1, 2010, due to the requirement for one year of comparative figures.

The Company’s IFRS transition project consists of three phases: scope and plan, analyze and design, and implement and review. The Company has substantially completed the first two phases of the project.

The transition from current Canadian GAAP to IFRS is a significant undertaking that may materially affect the Company’s reported financial position and results of operations. Final accounting policy selections will be made at the beginning of the project’s final phase due to the significance to the Company’s financial reporting of the International Accounting Standards Board’s ongoing projects, particularly its project on rate regulated activities. The Company is unable to reasonably estimate the impact of transition on the Company’s financial reporting at this time.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

3. Capital disclosures:

The Company is a non-share capital corporation and, as discussed in note 1, must not set customer service charges higher than what is required to meet its current and future financial requirements for the provision of air navigation services. The Company plans its operations to essentially result in an annual financial breakeven position after recording adjustments to the rate stabilization account. The Company views capital as the sum of its issued long-term debt, retained earnings, rate stabilization account and other regulatory liabilities, less the accrued pension and other benefit assets, 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. The Company's capital is as follows:

	(millions)	
	November 30 2009	August 31 2009
Long-term debt (note 9)	\$ 2,241	\$ 2,241
Retained earnings	22	28
Rate stabilization account liability (note 10)	2	1
Regulatory liabilities (note 10)	153	108
Accrued pension and other benefit assets (note 14)	(432)	(390)
Accumulated deficit	(255)	(253)
Total capital	\$ 1,986	\$ 1,988

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 off balance sheet obligations such as funding obligations of its registered defined benefit pension plans.

The Company's main objectives when managing capital are:

- to safeguard the Company's ability to continue as a going concern;
- to provide funds for the ongoing acquisition of systems and equipment necessary to implement and maintain a modern, cost-efficient ANS technology platform;
- to ensure the funding of working capital requirements and reserve funds; and
- to maintain the Company's credit ratings to facilitate access to capital markets at competitive interest rates.

There were no changes in our approach to capital management during the three months ended November 30, 2009.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

4. Financial instruments:

(a) Summary of financial instruments:

Fair value is defined as the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The best evidence of fair value is quoted bid or ask prices in an active market. Quoted prices are not always available for transactions in inactive or illiquid markets. In these instances, internal models, normally with observable market-based inputs, are used to estimate fair value. Where financial instruments trade in inactive markets, or when using models where observable parameters do not exist, as described in notes 5 (a) and (b), greater management judgment is required for valuation purposes. Financial instruments traded in a less active market have been valued using indicative market prices, discounted cash flow models or other valuation techniques. Fair value estimates normally do not consider forced or liquidation sales. The calculation of estimated fair value is based on market conditions at a specific point in time and therefore may not be reflective of future fair values.

At November 30, 2009, the classification of the Company's financial instruments, as well as their carrying amounts and fair values are as follows:

		(millions)	
Financial assets and liabilities	Classification	Carrying amount	Fair value
Cash and cash equivalents ¹	Held-for-trading ⁸	\$ 219	\$ 219
Accounts receivable ¹	Loans and receivables	78	78
Reserve funds:			
Debt service ¹	Held-for-trading ⁸	107	107
Capital lease obligations ²	Held-for-trading ⁸	32	32
Capital lease obligations – payment undertaking agreements ³	Held-to-maturity	495	538
Investments ²	Held-for-trading ⁸	165	165
Long-term derivative asset ⁴	Fair value	12	12
Accounts payable and accrued liabilities ¹	Other financial liabilities	179	179
Long-term debt			
Bank loans - revolving credit facility ⁵	Held-for-trading ⁸	-	-
Bonds and notes payable ⁶	Other financial liabilities	2,241	2,497
Capital lease obligations ³	Capital lease	527	538
Derivative liabilities ⁷	Fair value	-	-

¹ Due to the short term maturity of these financial assets and liabilities, their respective carrying amounts approximate their fair value.

² These financial assets are comprised of investments in Master Asset Vehicle II ("MAV II") and Ineligible Asset Tracking notes and other asset-backed commercial paper ("ABCP") which are discussed in note 5.

³ The fair value is calculated as the present value of the expected future cash flows. Prevailing market interest rates for the corresponding term are used for discounting.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

4. Financial instruments (continued):

(a) Summary of financial instruments (continued):

⁴ The long-term derivative asset is recorded at fair value determined by discounting future cash flows under the applicable contract. Changes in fair value are recorded in the statement of operations. The Company's long-term derivative asset consists of an embedded put option.

⁵ The carrying value of the bank loan which is a revolving credit facility is equal to its fair value, as the interest rates on this debt are periodically repriced to market. The amount of change in the fair value of the bank loan attributable to credit risk is negligible.

⁶ Bonds and notes payable are initially recognized at fair value, net of financing fees. They are subsequently measured at amortized cost. Any difference between the carrying amount and the redemption amount is recognized in the statement of operations over the life of the bond or note payable using the effective interest rate method. The fair value of the Company's bonds and notes payable is determined using quoted market prices for these issues.

⁷ Short-term derivative assets and liabilities are recorded at fair value determined using forward exchange market rates at the balance sheet date. Changes in their fair value are recorded in the statement of operations. The Company's derivative assets and liabilities consist of forward contracts to purchase or sell foreign currencies. The fair value of derivative assets is insignificant due to their nominal value, short term to maturity and spot rates.

⁸ These financial instruments were classified or designated as held-for-trading upon initial recognition by the Company either due to the presence of embedded derivatives or their original short term to maturity. Investments in MAV II and Ineligible Asset Tracking notes and other ABCP are discussed in note 5.

There has been no change in classification of financial instruments since August 31, 2009.

(b) Risk management:

The Company is exposed to several risks as a result of holding financial instruments. The following is a description of these risks and how they are managed.

(i) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, foreign exchange risk and other price risk. Interest rate risk and foreign exchange risk are discussed below. The price risks associated with investments in MAV II and Ineligible Asset Tracking notes and other ABCP are further discussed in note 5.

(ii) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

4. Financial instruments (continued):

(b) Risk management (continued):

(ii) Interest rate risk (continued)

The following table summarizes financial assets and liabilities exposed to interest rate risk:

	(millions)	
	November 30 2009	August 31 2009
Floating rate financial assets and liabilities:		
Cash equivalents	\$ 220	\$ 224
Debt service reserve fund investments	107	107
Capital lease obligations reserve fund	5	5
Investments in MAV II and Ineligible Asset Tracking notes, and other ABCP	192	192
Bank loans - revolving credit facility	-	-
Bonds and notes payable	(250)	(250)
Net position	<u>\$ 274</u>	<u>\$ 278</u>
Fixed rate financial liabilities:		
Bonds and notes payable	<u>\$ 2,000</u>	<u>\$ 2,000</u>

Investments included in the Company's cash and cash equivalents and debt service reserve fund earn interest at prevailing and fluctuating market rates. The investments in MAV II notes described in note 5 also earn interest at variable rates. There is also interest rate risk related to the floating rate notes and bank loans when drawn. Floating rate investments are purchased to the extent possible with terms that match the interest rate-setting dates on floating rate notes so that declines in interest earnings are offset by declines in interest expense on the notes. A 100 basis point change in variable interest rates would result in an annual difference of approximately \$ 3 million in the Company's earnings before rate stabilization.

Interest rate risk related to the Company's fixed-interest long-term debt relates to the re-setting of interest rates upon maturity and refinancing of the debt. The Company mitigates this source of interest rate risk by spreading maturities of borrowings over periods currently up to and including 2027 so that only a portion of outstanding debt will mature in any given fiscal year.

The Company has not entered into any derivative contracts to manage interest rate risk.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

4. Financial instruments (continued):

(b) Risk management (continued):

(iii) Foreign exchange risk

The Company is exposed to foreign exchange risk on sales and purchases that are denominated in currencies other than in the functional currency of the Company. However, the Company invoices and receives the vast majority of its revenues in Canadian dollars and also incurs operating expenses and capital expenditures mostly in Canadian dollars. Accordingly, the Company does not have a significant exposure to losses arising from fluctuations in exchange rates. In addition, except for the capital leasing transactions assets and liabilities mentioned below, the Company's exposure to assets and liabilities denominated in foreign currencies is nominal.

In some cases, the Company uses forward exchange contracts to purchase or sell foreign currencies to mitigate its foreign exchange risk on contractual agreements in foreign currencies.

As a result of entering into the capital leasing transactions described in note 11, the Company has capital lease obligations and payment undertaking agreements (that are part of the capital lease obligations reserve funds) denominated in U.S. dollars. The U.S. dollar cash flows from the payment undertaking agreements, comprising funding commitments from two financial institutions, have been structured to fully meet the U.S. dollar capital lease obligations. As at November 30, 2009 the payment undertaking agreements were \$ 469 million U.S. (\$ 495 million CDN) and the capital lease obligations were \$ 499 million U.S. (\$ 527 million CDN). The Company has designated a portion of the capital lease obligation reserve funds as a cash flow hedge of the capital lease obligations. Unrealized gains and losses from translating these financial instruments to Canadian dollars at the balance sheet date are deferred and are included in other regulatory liabilities (note 10 (F)). The Company currently expects no further net effect on its cash flows or results of operations from these transactions.

(iv) Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The maximum credit risk to which the Company is exposed as at November 30, 2009 represents the carrying amount of cash equivalents, accounts receivable, reserve funds, investments and forward contracts to purchase or sell foreign currencies.

Cash equivalents and the debt service reserve fund are invested in accordance with the Company's restrictive investment policy to manage credit risk. The Company invests only in short-term obligations – usually for periods of 90 days or less. Excluding investments in MAV II, Ineligible Asset Tracking notes and other ABCP, described in note 5, 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 in the top two categories for long-term debt or the highest category for short-term debt by at least two rating agencies. The Company's portfolio is diversified, with dollar and percentage limits on investment counterparties.

Credit risk with respect to investments in MAV II and Ineligible Asset Tracking notes and other ABCP is discussed in note 5.

As a result of entering into the capital lease transactions described in note 11, the Company has capital lease payment undertaking agreements (that are part of the capital lease obligations reserve funds). The U.S. dollar cash flows from the payment undertaking agreements, comprising funding commitments from two financial institutions, have been structured to fully meet the U.S. dollar capital lease obligations. The capital lease payment undertaking agreements are provided by two financial institutions, rated by Standard and Poor's as AA- negative and A+ stable, respectively. The payment undertaker that is rated A+ has collateralized its obligations with AAA rated securities issued or guaranteed by the U.S. government.

NAV CANADA

Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

4. Financial instruments (continued):

(b) Risk management (continued):

(iv) Credit risk (continued)

The Company provides air navigation services to various aircraft operators, including small general aviation aircraft as well as Canadian and foreign commercial air carriers. Credit limits and compliance with payment terms are monitored by the Company to manage its exposure to credit loss. The Company has established a maximum credit limit of \$ 4 million for its largest customers, and it has other credit control measures that have reduced its exposure in this regard. The Company's general payment terms provide for payment periods of 30 days, but shorter payment terms are imposed where customer circumstances warrant. The Company's credit policies also require payments in advance or satisfactory security to be posted under certain circumstances.

The Company establishes an allowance for doubtful accounts that represents its estimate of incurred losses in respect to accounts receivable. The main components of this allowance are a specific provision that relates to individually significant exposures, and a general provision established for losses that have been incurred but not yet attributed to specific customers. The general provision is determined based on historical data of payment statistics for similar accounts.

As at November 30, 2009 no account represented more than 10% of total accounts receivable and the accounts of all the Company's major customers were current. The aging of accounts receivable at November 30, 2009 was:

	(millions)			
	November 30, 2009			August 31 2009
	Gross balance	Allowance	Net balance	Net balance
Current	\$ 78	\$ -	\$ 78	\$ 85
Past due 31-60 days	-	-	-	1
Past due 61-90 days	-	-	-	-
Past due over 91 days	2	(2)	-	-
Total	\$ 80	\$ (2)	\$ 78	\$ 86

There was no significant change to the Company's allowance for doubtful accounts during the three month period ended November 30, 2009.

(v) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to evaluate current and expected liquidity requirements under both normal and stressed conditions to ensure that it maintains sufficient reserves of cash and cash equivalents or an available undrawn committed credit facility to meet its liquidity requirements in the short and longer term.

NAV CANADA

Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

4. Financial instruments (continued):

(b) Risk management (continued):

(v) Liquidity risk (continued)

The following table presents the contractual terms to maturity of the financial liabilities owed by the Company as at November 30, 2009:

		Remaining payments - for years ending August 31						
		(millions)						
		Total	2010	2011	2012	2013	2014	Thereafter
Accounts payable and accrued liabilities		\$ 179	\$ 179	\$ -	\$ -	\$ -	\$ -	\$ -
Long-term debt (including current portion)	(1), (2)	2,250	275	275	275	25	25	1,375
Interest payments	(2)	993	82	105	97	87	85	537
Operating leases		79	5	6	6	6	6	50
Purchase obligations		101	101	-	-	-	-	-
Other long-term obligations	(3)	199	8	5	7	6	8	165
Total contractual obligations		<u>\$ 3,801</u>	<u>\$ 650</u>	<u>\$ 391</u>	<u>\$ 385</u>	<u>\$ 124</u>	<u>\$ 124</u>	<u>\$ 2,127</u>

Based on very preliminary estimates of the funded status and economic assumptions applicable for the actuarial valuation of the pension plans as of January 1, 2010, pension contributions are expected to change from \$ 109 million in fiscal 2009 to approximately \$ 90 - 140 million in fiscal 2010. Depending on the effective date of regulations resulting from the federal government's October 2009 proposals regarding pension solvency funding, the requirement to post letters of credit during fiscal 2010 may vary between \$ nil and \$ 85 million. The letter of credit requirement for pension solvency requirements (related to temporary solvency funding relief in 2006) has decreased from \$ 69 million to \$ 27 million by January 1, 2010.

- (1) Payments represent principal of \$ 2,250 million. The Company intends to refinance principal maturities and bank loans at their maturity dates. The Company may choose to repay a portion of these maturities with available cash.
- (2) Further details on interest rates and maturity dates on long-term debt are provided in Note 9 to these consolidated financial statements.
- (3) Payments include long-term obligations for asset retirement, post-employment benefits and accrued benefit pension liability for the Company's supplemental pension plans.

NAV CANADA**Notes to Consolidated Financial Statements (unaudited) (continued)***Three months ended November 30, 2009 and 2008***5. Investments and other:**

The Company held short-term and long-term investments, which were included in the following balance sheet accounts at their carrying values:

	(millions)				
	November 30, 2009				
	Short-term investments	MAV II and Ineligible Asset Tracking notes	Derivative asset	ABCP not subject to Montreal Accord	Total
Cash and cash equivalents	\$ 220	\$ -	\$ -	\$ -	\$ 220
Debt service reserve fund	107	-	-	-	107
Capital lease obligation reserve fund	5	27	-	-	32
Investments and other	-	154	12	11	177
	\$ 332	\$ 181	\$ 12	\$ 11	\$ 536
		Note 5 (a)	Note 5 (a)	Note 5 (b)	

	(millions)				
	August 31, 2009				
	Short-term investments	MAV II and Ineligible Asset Tracking notes	Derivative asset	ABCP not subject to Montreal Accord	Total
Cash and cash equivalents	\$ 224	\$ -	\$ -	\$ -	\$ 224
Debt service reserve fund	107	-	-	-	107
Capital lease obligation reserve fund	5	27	-	-	32
Investments and other	-	154	11	11	176
	\$ 336	\$ 181	\$ 11	\$ 11	\$ 539
		Note 5 (a)	Note 5 (a)	Note 5 (b)	

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

5. Investments and other (continued):

(a) Master Asset Vehicle ("MAV II") and Ineligible Asset Tracking notes:

The Company holds the following investments in MAV II and Ineligible Asset Tracking notes and derivative asset as at November 30, 2009:

	(millions)					
	Face Value as at August 31 2009	Principal Repayment	Write Off	Face Value as at November 30 2009	Fair Value Adjustment as at November 30 2009	Fair Value as at November 30 2009
MAV II notes						
Class A-1	\$ 191	\$ -	\$ -	\$ 191	\$ (64)	\$ 127
Class A-2	81	-	-	81	(37)	44
Class B	15	-	-	15	(10)	5
Class C	9	-	-	9	(9)	-
	<u>296</u>	<u>-</u>	<u>-</u>	<u>296</u>	<u>(120)</u>	<u>176</u>
Ineligible Asset Tracking notes	46	-	-	46	(41)	5
	<u>342</u>	<u>-</u>	<u>-</u>	<u>342</u>	<u>(161)</u>	<u>181</u>
Derivative asset	-	-	-	-	12	12
	<u>\$ 342</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 342</u>	<u>\$ (149)</u>	<u>\$ 193</u>

	(millions)					
	Face Value Received Upon Restructuring January 21 2009	Principal Repayment	Write Off	Face Value as at August 31 2009	Fair Value Adjustment as at August 31 2009	Fair Value as at August 31 2009
MAV II notes						
Class A-1	\$ 192	\$ (1)	\$ -	\$ 191	\$ (64)	\$ 127
Class A-2	81	-	-	81	(37)	44
Class B	15	-	-	15	(10)	5
Class C	9	-	-	9	(9)	-
	<u>297</u>	<u>(1)</u>	<u>-</u>	<u>296</u>	<u>(120)</u>	<u>176</u>
Ineligible Asset Tracking notes	56	(4)	(6)	46	(41)	5
	<u>353</u>	<u>(5)</u>	<u>(6)</u>	<u>342</u>	<u>(161)</u>	<u>181</u>
Derivative asset	-	-	-	-	11	11
	<u>\$ 353</u>	<u>\$ (5)</u>	<u>\$ (6)</u>	<u>\$ 342</u>	<u>\$ (150)</u>	<u>\$ 192</u>

NAV CANADA

Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

5. Investments and other (continued):

(a) Master Asset Vehicle ("MAV II") and Ineligible Asset Tracking notes (continued):

In January 2009, under the oversight of the Ontario Superior Court and as proposed by the Pan Canadian Investors Committee ("the Committee"), the third party sponsored ABCP programs were restructured under the Montreal Accord. Upon the restructuring, the Company received notes with a face value of \$ 297 million and a fair value of \$ 175 million of various classes issued by a trust referred to as the "Master Asset Vehicle II" ("MAV 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 credit card receivables, residential and commercial mortgage backed securities and cash equivalents. The pooling of the leveraged investments, the traditional assets and cash is expected to increase the stability of the notes by using the traditional assets and available cash to meet any potential margin calls. The Class A-1 and A-2 notes provide for the payment of interest on a quarterly basis. The Class B and C notes will accrue interest with payments to be made only after the principal and interest on Class A-1 and A-2 notes have been fully paid.

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. In addition, a senior margin funding facility has been arranged with the governments of Canada and the provinces of Ontario, Quebec and Alberta.

Upon restructuring, the Company also received Ineligible Asset Tracking notes with a face value of \$ 56 million and a fair value of \$ 8 million. The Ineligible Asset Tracking notes will track the performance and repayment of the related underlying assets in certain conduits that have significant exposure to the U.S. residential mortgage market. In fiscal 2009, subsequent to the restructuring, the Company received \$ 4 million in principal repayments against these notes. In addition, the trustee had issued a notice with respect to \$ 6 million of the Company's holdings indicating that the principal of the notes has been fully eroded and will result in a redemption value of \$ nil. These notes were written off by the Company in the prior year.

The replacement notes are classified as held for trading financial assets and are carried at fair value. Changes in fair value are recorded in income as they arise. The fair value of these notes and derivative asset is \$ 193 million, which is \$ 149 million below face value as at November 30, 2009. The Company is aware of a limited number of trades in the replacement notes that occurred prior to November 30, 2009, but does not consider them to be of sufficient volume or value to constitute an active market. Accordingly, the Company has not used these trades to determine the fair value of its notes. As described below, 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, November 30, 2009. The estimates arrived at by the Company are subject to measurement uncertainty and are dependent on market conditions as at the measurement date.

Subsequent to the measurement date, a number of investment dealers have continued efforts to establish a market for the restructured notes and a small number of transactions have been publicly announced. If an active market for the restructured notes were to develop in the future, the Company will change its valuation technique to determine the fair value of its notes using quoted market prices.

NAV CANADA

Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

5. Investments and other (continued):

(a) Master Asset Vehicle ("MAV II") and Ineligible Asset Tracking notes (continued):

The Company's total estimate for expected credit losses on the replacement notes as at November 30, 2009 is \$ 38 million; this amount is included in the fair value adjustment of \$ 149 million. The estimate of expected credit losses with respect to Ineligible Asset Tracking notes was arrived at by estimating the expected realization of the underlying assets; in most cases this resulted in an expected credit loss of 100%. The Class A-1 and A-2 notes have been assigned a rating of A and BBB (low) respectively by DBRS. The Company has estimated the effect of losses on the underlying assets within MAV II and as a result, has provided for estimated credit losses equivalent to approximately 38% of the face value of the Class B notes and 100% of the face value of Class C notes.

The Company has used a discounted cash flow approach to determine the fair value of these investments, taking into account the expected risk and return profile of the notes in comparison to market returns. After deducting the estimated credit losses referred to above, the Company also used a discount factor appropriate for a high yield instrument for the Ineligible Asset Tracking notes. A discount factor derived from a U.S. residential mortgage market index was not used because this would have double-counted the potential credit losses that had already been specifically provided for.

The derivative asset reflects the benefits of an agreement with a financial institution from which the Company had purchased third party sponsored ABCP. Under the terms of the agreement, the Company's losses on Ineligible Asset Tracking notes and MAV II notes derived from the ABCP purchased from that financial institution would be limited. The terms of the related revolving credit facility are described in note 9 (c). The derivative asset has been discounted using a discount factor reflective of the credit profile of the financial institution.

The Company used the following expected rates and discount factors at November 30, 2009:

<u>Restructured Notes</u>	<u>Return</u>	<u>Market Discount Factor</u>
MAV II Class A-1	BAs minus 50 basis points	BAs plus 5.6%
MAV II Class A-2	BAs minus 50 basis points	BAs plus 8.4%
MAV II Class B	BAs minus 50 basis points	BAs plus 9.2%
MAV II Class C	Nil	100% Provision
Ineligible Asset Tracking notes	BAs plus 30 basis points	BAs plus 12.6%

The Company believes that the market discount factors shown above are reflective of functioning market returns for products with similar maturities and risk profiles to the MAV II notes.

NAV CANADA

Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

5. Investments and other (continued):

(b) ABCP not subject to Montreal Accord:

The Company holds ABCP investments that were not subject to the Montreal Accord restructuring referred to in (a) above, with a face value of \$ 20 million. This amount includes:

- (i) \$ 10 million of third party sponsored ABCP in a trust that was not covered by the Montreal Accord restructuring. The funds in this conduit are now subject to a legal dispute between the asset provider and the trust sponsor.
- (ii) \$ 10 million of bank sponsored ABCP for which a restructuring has been completed. This trust is rated A (low) by DBRS. It continues to pay interest on a monthly basis.

The carrying value of these notes was as follows as at November 30, 2009:

	Face Value	(millions) Fair Value Adjustment	Fair Value
ABCP not subject to Montreal Accord	\$ 20	\$ (9)	\$ 11

Included in the determination of the above fair value adjustment is an amount representing expected credit losses of \$ 3 million.

The Company uses a discounted cash flow approach to determine the fair value of these notes. The expected return on these notes is BAs to BAs plus 33 basis points. The market discount factor is BAs plus 5.6% to BAs plus 9.2%.

(c) Sensitivity

The use of the discounted cash flow approach described above resulted in a carrying value for total investments in MAV II and Ineligible Asset Tracking notes, derivative asset and other ABCP not subject to the Montreal Accord of \$ 204 million on notes with a face value of \$ 362 million. The difference of \$ 158 million is composed of fair value adjustments due to the discounting of cash flows at market rates of \$ 117 million and an estimate of credit losses net of the benefits of the agreement with a financial institution of \$ 41 million.

A change of 50 basis points in the market discount factors would impact the fair value adjustment by approximately \$ 7 million. There is no assurance that the fair value of the Company's investments in MAV II and Ineligible Asset Tracking notes, other ABCP and derivative asset will not decline further, or that significant further deterioration in financial markets will not cause margin calls in excess of MAV II's ability to meet them, resulting in a significant credit loss. 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 operations as they occur.

NAV CANADA

Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

6. Reserve funds:

Pursuant to the Master Trust Indenture (note 9), the Company is required to establish and maintain certain reserve funds, as follows:

Operations and maintenance reserve fund:

The Company is required to maintain a reserve fund of at least 25% of its prior year's annual operating and maintenance expenses, as defined in the Master Trust Indenture. At November 30, 2009, the Company met this requirement with an allocation of \$ 250 million in undrawn availability under its committed credit facility (note 9). If at any fiscal year end the amount in the operations and maintenance reserve fund is less than 25% of the Company's operating and maintenance expense for the year (before rate stabilization, depreciation, amortization, interest and extraordinary expenses), the Company must, at a minimum, increase the balance in the fund to the required level over the following four fiscal quarters through additional contributions or an allocation of its committed credit facility.

Debt service reserve fund:

At the end of each fiscal year, the amount in the debt service reserve fund must be equal to the annual projected debt service requirement (principal amortization, interest and fees) on outstanding Master Trust Indenture obligations determined in the manner required by the Master Trust Indenture. Any additional contributions required to be made to the debt service reserve fund must, at a minimum, be made in equal instalments over the following four fiscal quarters. Funds deposited into the debt service reserve fund are held by a Trustee and are released only to pay principal, interest and fees owing in respect of outstanding borrowings under the Master Trust Indenture except that, provided no event of default has occurred and is continuing, surplus funds may be released from time to time at the request of the Company. At November 30, 2009 the Company had a balance of \$ 107 million of cash and investments in the debt service reserve fund.

The Company met all reserve fund requirements at November 30, 2009.

The above reserve funds are restricted for the purposes described above. The restricted use of the capital lease obligations reserve fund including the current portion is described in note 11.

Pursuant to the General Obligation Indenture (note 9), the Company is required to maintain certain liquidity levels similar to the reserve fund requirements of the Master Trust Indenture. Specifically, the Company must maintain a minimum liquidity level equal to twelve months net interest expense plus 25% of the annual operating and maintenance expenses. Liquidity is defined to include all cash and qualified investments, amounts held in the operations and maintenance and debt service reserve funds and any undrawn amounts available under a committed credit facility. In addition, the Company must maintain cash liquidity equal to twelve months net interest expense. Cash liquidity includes cash and qualified investments held in the reserve funds maintained under the Master Trust Indenture.

The Company met the liquidity covenants of the General Obligation Indenture for the period ended November 30, 2009.

NAV CANADA**Notes to Consolidated Financial Statements (unaudited) (continued)***Three months ended November 30, 2009 and 2008***7. Property, plant and equipment:**

Property, plant and equipment were comprised of the following:

	(millions)			
		November 30 2009		August 31 2009
	Cost	Accumulated Depreciation	Net Book Value	Net Book Value
Land and buildings	\$ 294	\$ (128)	\$ 166	\$ 170
Systems and equipment	798	(445)	353	364
Property, plant and equipment under development	113	-	113	95
	<u>1,205</u>	<u>(573)</u>	<u>632</u>	<u>629</u>
Net increase from capital leases	61	(20)	41	42
	<u>\$ 1,266</u>	<u>\$ (593)</u>	<u>\$ 673</u>	<u>\$ 671</u>

As a result of the implementation of Section 3064 as described in note 2 (c), software with a net book value of \$ 278 million as at August 31, 2009 has been reclassified to intangible assets.

Effective September 1, 2009, the Company changed its policy for capitalizing internal labour costs that are directly attributable to capital assets under development as described in note 2 (c). During the three month period ended November 30, 2009, the Company capitalized \$ 7 million of internal labour and travel costs (November 30, 2008 - \$ nil) to property, plant and equipment.

The net increase from capital leases is being depreciated over the terms of the leases (note 11).

As at November 30, 2009 the cost of assets under capital leases was \$ 623 million (August 31, 2009 - \$ 623 million), and accumulated depreciation and other credits amounted to \$ 516 million (August 31, 2009 - \$ 513 million).

The Company recorded depreciation expense of \$ 20 million during the three months ended November 30, 2009 (November 30, 2008 - \$ 16 million). Pursuant to a regular review of the estimates of the useful lives of property, plant and equipment, the useful lives of certain building components were changed effective September 1, 2009. This change is expected to increase depreciation expense for fiscal 2010 by approximately \$ 6 million (\$ 1 to 2 million quarterly).

Total cost and accumulated depreciation were \$ 1,244 million and \$ 573 million respectively at August 31, 2009.

NAV CANADA**Notes to Consolidated Financial Statements (unaudited) (continued)***Three months ended November 30, 2009 and 2008***8. Intangible assets:**

Intangible assets were comprised of the following:

	(millions)			August 31
	Cost	November 30 2009 Accumulated Amortization	Net Book Value	2009 Net Book Value
Air navigation right	\$ 1,367	\$ (546)	\$ 821	\$ 827
Purchased software	216	(65)	151	154
Internally generated software	63	(19)	44	45
Intangible assets under development	85	-	85	79
	<u>\$ 1,731</u>	<u>\$ (630)</u>	<u>\$ 1,101</u>	<u>\$ 1,105</u>

As a result of the implementation of Section 3064 as described in note 2 (c), software with a net book value of \$ 278 million as at August 31, 2009 has been reclassified from property, plant and equipment.

Effective September 1, 2009, the Company changed its policy for capitalizing internal labour costs that are directly attributable to capital assets under development as described in note 2 (c). During the three month period ended November 30, 2009, the Company capitalized \$ 7 million of internal labour and travel costs (November 30, 2008 - \$ 1 million) to intangible assets.

The Company recorded amortization expense of \$ 11 million during the three months ended November 30, 2009 (November 30, 2008 - \$ 16 million). Effective September 1, 2009, the period over which the rate regulator has approved the recovery of the air navigation right through customer service charges was extended for a further 13 years, resulting in an estimated useful life of 46 years from the date of the acquisition of the right. This change results in a \$ 16 million decrease in amortization expense annually (\$ 4 million quarterly).

Total cost and accumulated amortization were \$ 1,723 million and \$ 618 million respectively at August 31, 2009.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

9. Long-term debt:

The Company's initial acquisition of the Canadian civil air navigation system and its ongoing requirements are financed with debt. Until February 21, 2006, all indebtedness was incurred and secured under a Master Trust Indenture that provided the Company with a maximum borrowing capacity, which declines each year. On February 21, 2006, the Company entered into a new indenture (the "General Obligation Indenture") that established a new unsecured borrowing program that qualifies as subordinated debt under the Master Trust Indenture. The borrowing capacity under the General Obligation Indenture does not decline each year. In addition, there is no limit on the issuance of notes under the General Obligation Indenture so long as the Company is able to meet an additional indebtedness test.

(a) Security:

The Master Trust Indenture established a borrowing platform secured by an assignment of revenue and the debt service reserve fund. The General Obligation Indenture is unsecured, but provides a set of positive and negative covenants similar to those of the Master Trust Indenture. In addition, under the terms of the General Obligation Indenture, no further indebtedness may be incurred under the Master Trust Indenture, other than borrowings under the credit facility (see note 9 (c) below). As bonds mature or are redeemed under the Master Trust Indenture, they may be replaced with notes issued under the General Obligation Indenture. Borrowings under the General Obligation Indenture are unsecured and subordinated to prior payment of Master Trust Indenture obligations.

NAV CANADA**Notes to Consolidated Financial Statements (unaudited) (continued)***Three months ended November 30, 2009 and 2008***9. Long-term debt (continued):**

(b) Borrowings:

Long-term debt outstanding was comprised of the following:

	(millions)	
	November 30 2009	August 31 2009
Bank loan - Revolving credit facility	\$ -	\$ -
Bonds and notes payable		
Issued under the Master Trust Indenture:		
7.40% revenue bonds, series 96-3, maturing June 1, 2027	250	250
7.56% amortizing revenue bonds, series 97-2, maturing March 1, 2027	450	450
	<u>700</u>	<u>700</u>
Issued under the General Obligation Indenture:		
5.304% general obligation notes, series MTN 2009-1, maturing April 17, 2019	350	350
4.713% general obligation notes, series MTN 2006-1, maturing February 24, 2016	450	450
3.434% general obligation notes, series MTN 2009-2, maturing April 17, 2012	250	250
4.428% general obligation notes, series MTN 2006-2, maturing February 24, 2011	250	250
Floating rate medium-term notes, series MTN 2007-1, maturing May 3, 2010	250	250
	<u>1,550</u>	<u>1,550</u>
Total bonds and notes payable	2,250	2,250
Less: deferred financing costs	(9)	(9)
Carrying value of total bonds and notes payable	<u>2,241</u>	<u>2,241</u>
Total long-term debt	2,241	2,241
Less: current portion	(25)	(25)
Total long-term debt outstanding	<u>\$ 2,216</u>	<u>\$ 2,216</u>

The Company is in compliance with all covenants of the Master Trust Indenture and General Obligation Indenture as at November 30, 2009.

The Company intends to refinance the series MTN 2007-1 floating rate medium-term notes on a long-term basis on or before their maturity date of May 3, 2010 and has the ability to do so by utilizing the Company's undrawn credit facility, if required. The series 96-3 and 97-2 bonds and the series MTN 2009-1, MTN 2006-1, and MTN 2006-2 notes are redeemable in whole or in part at the option of the Company at any time at the higher of par and the Canada yield price plus redemption premium. The series 97-2 bonds are amortizing bonds repayable in 20 consecutive equal annual instalments of principal payable on March 1 of each year commencing March 1, 2008 until maturity on March 1, 2027. The instalment of principal due within the next twelve months relating to these amortizing bonds is classified in the current portion of long-term debt.

NAV CANADA

Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

9. Long-term debt (continued):

(c) Credit facilities:

The Company has revolving credit facilities with a syndicate of Canadian financial institutions totalling \$ 883 million, of which \$ 683 will expire on May 31, 2012 and \$ 200 million will expire on November 2, 2010, unless extended. As at November 30, 2009, \$ 69 million of the credit facility was used to provide a letter of credit under pension solvency relief regulations (note 14). Of the \$ 814 million undrawn borrowing capacity, \$ 250 million was allocated to meet the operations and maintenance reserve fund requirement. The Company has also restricted \$ 83 million of the credit facility to be utilized only if required, in respect of the capital leasing transactions referred to in note 11.

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 33% 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 November 30, 2009.

The Company has also entered into two revolving credit facilities with a financial institution totalling \$ 55 million. The facilities expire as follows: \$ 12 million in June 2011 and \$ 43 million in May 2012, with options to renew both facilities annually until May 2016. Portions of the facilities are secured with MAV II notes. Amounts not secured by the notes are unsecured and constitute Subordinated Indebtedness under the Company's Master Trust Indenture, ranking pari passu with the Company's General Obligation notes. The credit facilities contain a covenant to maintain a certain level of business with the financial institution. The Company is in compliance with the credit facility covenants as at November 30, 2009. As at November 30, 2009, no amount has been drawn against these facilities.

(d) Interest:

Interest on the series MTN 2007-1 floating rate notes is determined quarterly. These notes bear interest at 6 basis points over the Canadian 90-day bankers' acceptance rate. The interest rate for bank loans is based on Canadian bankers' acceptance rates.

Interest expense for the three months ended November 30, 2009 includes interest of \$ 29 million on other financial liabilities (November 30, 2008 – \$ 29 million).

The Company made interest payments of \$ 31 million during the three months ended November 30, 2009 (November 30, 2008 - \$ 22 million).

NAV CANADA

Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

10. Financial statement impact of rate regulation:

In order to mitigate the effect on its operations of unpredictable and uncontrollable factors, principally unanticipated fluctuations in air traffic levels, the Company maintains a rate stabilization mechanism. Amounts are added to or deducted from the rate stabilization account based upon variations from amounts used when establishing customer service charges.

The following are the changes in the rate stabilization account for the three months ended November 30:

	(millions)	
	2009	2008
Rate stabilization account		
Liability balance, beginning of period	\$ 1	\$ 4
Change in rate stabilization amounts during the period:		
Approved drawdown (A)	(14)	-
Revenue	(6)	(13)
Operating expenses	18	14
Other expenses	1	2
Other income (loss)	2 1	(44) (41)
Liability balance, end of period	\$ 2	\$ (37)

When establishing customer service charges, the rate regulator, which is the Company's Board of Directors, considers the balance in the rate stabilization account, adjusted notionally for the non-credit related portion of the fair value adjustment on investments. As at November 30, 2009, the balance in the rate stabilization account adjusted notionally for the \$ 117 million non-credit related fair value adjustment (see note 5 (c)) was \$ 119 million. The long-term target liability balance of the rate stabilization account is 7.5% of total planned annual expenses net of other income, excluding non-recurring items, on an ongoing basis. For fiscal 2010, the target balance is \$ 93 million.

(A) Approved drawdown

In June 2009, the Board of Directors approved a \$ 57 million drawdown of the rate stabilization account to be recorded during the 2010 fiscal year, in order to achieve planned breakeven results of operations in fiscal 2010. The approved drawdown is to be applied in equal instalments throughout fiscal 2010. Accordingly, during the three month period ended November 30, 2009, \$ 14 million was transferred to revenue from the rate stabilization account.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

10. Financial statement impact of rate regulation (continued):

In accordance with disclosures required for entities subject to rate regulation, the Company's regulatory liability balances are as follows:

	(millions)	
	November 30 2009	August 31 2009
Rate stabilization account		
Operating deferrals (B)	\$ 122	\$ 121
Gains on leasing transactions (C)	38	39
Fair value adjustments (D)	(158)	(159)
Rate stabilization account liabilities	<u>\$ 2</u>	<u>\$ 1</u>
Regulatory liabilities		
Regulatory pension and long-term disability liabilities (E)	\$ 144	\$ 100
Other regulatory liabilities (F)	9	8
Regulatory liabilities	<u>\$ 153</u>	<u>\$ 108</u>

(B) Operating deferrals

Should actual revenues exceed the Company's actual expenses, such excess is reflected as a liability (or as a reduction of an asset) in the rate stabilization account. Conversely, should actual revenues be less than actual expenses, such shortfall is reflected as an asset (or as a reduction of a liability) in the rate stabilization account. An asset balance in the rate stabilization account represents amounts recoverable through future customer service charges, while a liability balance represents amounts returnable through adjustments to future customer service charges.

(C) Gains on leasing transactions

During fiscal 2004, the Company realized \$ 56 million of net present value benefits (net of expenses) under two capital leasing transactions, which were reflected as gains in the Company's financial statements for that year. Under Canadian generally accepted accounting principles applicable to companies that are not subject to regulatory statutes governing the level of their charges, these benefits would have been recorded over the terms of the long-term capital leases. Included in the rate stabilization account at November 30, 2009 is an amount of \$ 38 million, representing the remaining portion of the gain that would not have been recorded as of November 30, 2009 under Canadian generally accepted accounting principles applicable to companies not subject to regulatory statutes governing the level of their charges.

(D) Fair value adjustments

In the three months ended November 30, 2009, the Company recorded a \$ 1 million reduction in fair value adjustments on its investments and derivative asset. As at November 30, 2009 the total of fair value adjustments recorded on the Company's balance sheet against investments and derivative asset was \$ 158 million.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

10. Financial statement impact of rate regulation (continued):

(E) Regulatory pension and long-term disability liabilities

Included in regulatory liabilities at November 30, 2009 is \$ 132 million (August 31, 2009 - \$ 100 million) relating to the recovery through customer service charges of special pension contributions and \$ 12 million (August 31, 2009 - \$ nil) relating to the recovery of long-term disability contributions through customer service charges (note 14). These regulatory liabilities reflect the recovery to date of the related accrued pension and other benefit assets as at November 30, 2009 as follows:

	(millions)		
	Pension	Long-term disability	Total
Accrued pension and other benefit assets	\$ 417	\$ 15	\$ 432
Regulatory liabilities	(132)	(12)	(144)
	<u>\$ 285</u>	<u>\$ 3</u>	<u>\$ 288</u>

(F) Other regulatory liabilities

Other regulatory liabilities at November 30, 2009 consist of \$ 9 million (August 31, 2009 – \$ 8 million) unrealized foreign currency translation hedging gains.

11. Capital leasing transactions:

During fiscal 2004, the Company entered into two long-term leasing transactions with U.S. entities. These transactions involved the lease/leaseback of certain of the Company's air navigation equipment and software with appraised values of \$ 274 million and \$ 349 million, respectively. The leasebacks to the Company have terms of 24 years, with purchase options after 20 years.

As a result of the leaseback transactions, the Company has long-term capital lease obligations that are reflected on the consolidated balance sheet. These capital lease obligations have been collateralized through payment undertaking agreements using \$ 561 million of the proceeds that were received on the head lease transactions. These payment undertaking agreements are included in the capital lease obligations reserve fund on the consolidated balance sheet. The capital lease obligations reserve fund is comprised of:

- (i) payment undertaking agreements, initially in the amount of \$ 561 million, with two financial institutions pursuant to which they are obligated to make the required lease payments;
- (ii) investments of the Company's \$ 56 million net present value benefits resulting from these transactions; and
- (iii) interest earned on investments and payment undertaking agreements, net of any lease payments made.

There is no foreign exchange risk that arises from these leasing transactions, since the U.S. dollar cash flows from the payment undertaking agreements have been structured to fully meet the U.S. dollar capital lease obligations. The amounts at which the capital lease obligations and the payment undertaking agreements are reflected in the financial statements vary with the prevailing Canadian/U.S. dollar rate of exchange at the balance sheet date. Unrealized gains and losses from translating these financial instruments to Canadian dollars at the balance sheet date are deferred.

NAV CANADA**Notes to Consolidated Financial Statements (unaudited) (continued)***Three months ended November 30, 2009 and 2008***11. Capital leasing transactions (continued):**

Remaining capital lease payments are due as follows:

	(millions)
Years ending August 31:	
Remainder of fiscal 2010	\$ 31
2011	32
2012	31
2013	32
2014	32
Later years, through 2028	633
Net minimum lease payments	791
Less: Amount representing interest (at approximately 5%)	264
Present value of net minimum capital lease payments	527
Less: current portion	(31)
Total long-term capital lease obligations	\$ 496

Interest expense during the three months ended November 30, 2009 of \$ 6 million relating to the capital lease obligations, and the amortization of the net increase from capital leases (note 7) are fully offset by and are recorded net of interest income of \$ 7 million from the payment undertaking agreements included in the capital lease obligations reserve fund.

At the inception of these leasing transactions the U.S. entities created special purpose entities, the activities of which are limited to receiving lease payments and making payments to third parties and the U.S. entities. While the Company is considered to have a variable economic interest in the special purpose entities, it is not considered to be the primary beneficiary of these special purpose entities and therefore is not required to consolidate such entities.

12. Other long-term liabilities:

Other long-term liabilities were comprised of the following:

	(millions)	
	November 30 2009	August 31 2009
Accrued post-employment benefit liabilities other than pensions (note 14)	\$ 154	\$ 152
Accrued pension benefit liability - supplemental pension benefits	44	43
Asset retirement obligations	1	1
	\$ 199	\$ 196

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

13. Customer service charges:

Customer service charges by type of service provided for the three months ended November 30 were as follows:

	(millions)	
	2009	2008
En route	\$ 143	\$ 154
Terminal	105	108
Daily / annual / quarterly	12	12
North Atlantic and international communication	11	13
	<u>\$ 271</u>	<u>\$ 287</u>

Customer service charges include:

- i) En route charges related to air navigation services provided or made available to aircraft during the en route phase of the flight, whether they overfly Canadian-controlled airspace or take-off or land in Canada;
- ii) Terminal charges related to air navigation services provided or made available to aircraft at or in the vicinity of an airport;
- iii) Daily / annual / quarterly charges related to en route and terminal air navigation services. These charges generally apply to propeller aircraft; and
- iv) North Atlantic and international communication charges related to certain air navigation and communication services provided or made available to aircraft while in airspace over the North Atlantic Ocean, which is outside of Canadian sovereign airspace but for which Canada has air traffic control responsibility pursuant to international agreements. The international communication charges also include services provided or made available while in Canadian airspace in the north.

The Company has two customers each of which represents more than 10% of total revenues of the Company before rate stabilization. Revenue from the largest customer was \$ 52 million (2008 - \$ 71 million) and revenue from the second largest customer was \$ 31 million (2008 - \$ 33 million) for the three months ended November 30, 2009, representing 30% (2008 – 35%) of the total revenues of the Company before rate stabilization. The revenues from these two major customers arose from all types of service.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

14. Employee future benefits:

The Company maintains defined benefit plans that provide pension, other post-employment and long-term disability benefits to employees. The Company uses an annual measurement date of May 31 for estimating the accounting surplus or deficit and establishing benefit costs for the coming fiscal year, both of which are dependent on the measurement factors at that time.

Information about the Company's post-employment benefit plans, using the measurement date of May 31, was as follows:

	(millions)			
	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
Benefit obligations	\$ 3,023	\$ 3,124	\$ 192	\$ 245
Fair value of plan assets	2,525	3,076	49	51
Funded status (deficit)	\$ (498)	\$ (48)	\$ (143)	\$ (194)

The increase in the pension plan accounting deficit from \$ 48 million at May 31, 2008 to \$ 498 million at May 31, 2009 arose primarily as a result of negative investment returns on plan assets, partially offset by an increase in the discount rate and a decrease in the assumed rate of inflation, both used to measure the pension obligation.

The decrease in the other benefit obligations arose primarily as a result of the curtailment and settlement of certain post-employment benefit programs in the fourth quarter of fiscal 2009 and the changes in the discount rate and assumed inflation rate used to measure the obligations, partially offset by new obligations resulting from one of the Company's recently negotiated collective agreements.

Weighted-average assumptions, using the measurement date of May 31, were as follows:

	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
Benefit obligations at end of year				
Discount rate	6.10%	6.00%	5.90%	5.95%
Rate of inflation	2.25%	2.75%	2.25%	2.75%
Benefit costs during the year				
Discount rate	6.00%	5.40%	5.95%	5.40%
Rate of inflation	2.75%	2.75%	2.75%	2.75%
Expected long term rate of return on plan assets	6.75%	6.75%		

NAV CANADA**Notes to Consolidated Financial Statements (unaudited) (continued)***Three months ended November 30, 2009 and 2008***14. Employee future benefits (continued):**

The Company's benefit costs, which are included in salaries and benefits on the consolidated statements of operations and retained earnings for the three months ended November 30, were as follows:

	(millions)			
	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
Benefit costs	\$ 4	\$ 13	\$ 4	\$ 4
Regulatory recovery of special pension and long-term disability contributions (note 10 (E))	31	16	-	-
	35	29	4	4
Less: amounts capitalized	(2)	-	-	-
Benefit costs	\$ 33	\$ 29	\$ 4	\$ 4

Pension expense for fiscal 2010 is estimated to be approximately \$ 133 million, consisting of pension benefit costs of \$ 15 million and \$ 125 million relating to the recovery of special pension contributions, less \$ 7 million included in the cost of capital assets as a result of the Company changing its policy for capitalizing internal labour costs directly attributable to capital assets under development effective September 1, 2009.

The Company's contributions for the three months ended November 30 were as follows:

	(millions)	
	2009	2008
Company contributions to funded and unfunded pension plans	\$ 31	\$ 26
Benefits paid directly to beneficiaries for other non-funded post-employment benefits	2	1
Company contributions to the funded long-term disability plan	2	2
	\$ 35	\$ 29

The regulations governing federally regulated pension plans require actuarial valuations on both a going concern and solvency basis. The actuarial valuation performed as at January 1, 2009 reported a going concern deficit of \$ 451 million and a solvency deficit of \$ 156 million. The Company is contributing to the pension plans in accordance with the actuarial valuations. As at November 30, 2009, the Company had a \$ 69 million letter of credit to secure pension solvency funding requirements under the 2006 federal funding regulations.

In October 2009, the federal government released a plan for the reform of the legislative and regulatory framework governing federally regulated private pension plans. The funding period for solvency deficits will remain at 5 years but past deficits will be consolidated on a permanent basis for establishing solvency special payments resulting in a fresh start every year. Funding will be based on an average of solvency ratios over the three most recent consecutive years, based on market value of assets. Special solvency payments may be replaced by letters of credit provided the total value of the letters of credit does not exceed 15% of the pension plan assets. It is possible that the new solvency funding rules will be in place for actuarial valuations performed as of January 1, 2010, but certain details of the new funding rules, including transitional issues from the current funding rules, remain to be finalized.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

14. Employee future benefits (continued):

Based on very preliminary estimates of the funded status and economic assumptions applicable for the actuarial valuation of the pension plans as of January 1, 2010 and the Company's understanding of the federal government's October 2009 plan for the reform of federally regulated pension plans, pension contributions are expected to change from \$ 109 million in fiscal 2009 to approximately \$ 90 - 140 million in fiscal 2010. Depending on the effective date of regulations resulting from the federal government's October 2009 proposals regarding pension solvency funding, the requirement to post letters of credit during fiscal 2010 may vary between \$ nil and \$ 85 million. The letter of credit requirement for pension solvency requirements (related to temporary solvency funding relief in 2006) has decreased from \$ 69 million to \$ 27 million by January 1, 2010. The amount of the required Company contributions and additional letters of credit in future years will be dependent on the investment experience of plan assets, the discount rates that will be used in future actuarial valuations to determine plan liabilities, as well as changes in pension funding requirements that may be enacted.

Other post-employment benefits are not funded. Long-term disability benefits are funded.

Information about the Company's accrued pension and other benefit assets and liabilities are as follows:

	(millions)	
	November 30 2009	August 31 2009
Accrued pension and other benefit assets		
Pension	\$ 417	\$ 388
Long-term disability	15	2
	<u>432</u>	<u>390</u>
Accrued pension and other benefit liabilities (note 12)	(44)	(43)
Pension – supplemental pension benefits	(154)	(152)
Other post-employment benefits	(198)	(195)
	<u>(198)</u>	<u>(195)</u>
Net accrued pension and other benefit assets	<u>\$ 234</u>	<u>\$ 195</u>

The accrued pension and other benefit assets represent the cumulative excess of pension and long-term disability contributions over benefit costs. The accrued benefit liabilities represent the cumulative excess of supplemental pension and other post employment costs over contributions. During the three months ended November 30, 2009, the net of the accrued pension and other benefit assets and liabilities increased by \$ 39 million due to pension contributions of \$ 31 million, other benefit contributions of \$ 4 million, reclassification of long-term disability contributions of \$ 12 million to regulatory liabilities partially offset by benefit costs of \$ 8 million.

As a result of the implementation of amendments to Section 1100 as described in note 2 (c), the regulatory liabilities relating to special pension contributions of \$ 100 million were reclassified as at August 31, 2009 from the accrued pension and other benefit assets to regulatory liabilities (November 30, 2009 - \$ 132 million).

The Company intends to recover over time through customer service charges the balance of the accrued pension and other benefit assets (see note 10 (E)).

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

15. Transactions with the Government of Canada:

The Company has arrangements with a number of federal government departments for the provision of various services, such as weather forecasting and observation, and facilities, based on commercially negotiated terms and conditions.

The Company also has an agreement with the Department of National Defence (“DND”) relating to the exchange of a variety of services with DND such as airspace controls, facilities, information and protocols and systems, for mutual benefit without significant cost or expense to either party.

The Government of Canada has maintained an indemnification program at no cost to the Company, which protects the Company from a terrorist-related loss that may be in excess of the Company’s insurance coverage. This program is renewed every 120 days. The Company is contractually obligated to indemnify the Government of Canada for any loss suffered by or claimed against it which is covered by the Company’s aviation operations liability insurance.

16. Commitments:

At November 30, 2009, commitments for capital expenditures amounted to \$ 101 million.

Minimum payments under operating leases are due as follows:

	<u>(millions)</u>
Years ending August 31:	
Remainder of fiscal 2010	5
2011	6
2012	6
2013	6
2014	6
2015 and thereafter	50
	<u>\$ 79</u>

These amounts exclude any payments required under the leasing transactions described in note 11, long-term debt described in note 9, as well as contribution requirements related to the pension solvency deficit described in note 14.

NAV CANADA

Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

17. Guarantees:

The Company has not provided any material guarantees other than indemnification commitments typically provided in the ordinary course of business as described below. These indemnification commitments require the Company to compensate the counterparties for costs and losses incurred as a result of various events and are similar to the type of indemnifications required by the Company from suppliers of services and products, or by other companies in the aviation industry.

The Company has provided the following significant indemnification commitments:

Capital leasing transactions

As described in note 11, the Company has entered into two leasing transactions with respect to a portion of its air navigation equipment and software. In connection with these transactions the Company has agreed to indemnify the other parties to the transactions for certain costs or liabilities, including with respect to certain taxes that may be imposed on such party with respect to the leased equipment, or as a result of such party's participation in the leasing transactions. These indemnification commitments will survive the termination of the leasing transactions, but only with respect to events that occur prior to the termination of the leasing transactions. These indemnification commitments do not provide for any limit on the maximum amount of the potential indemnification.

The Company has collateralized its obligations to pay base rent under the leasing transactions by entering into payment undertaking agreements with two financial institutions. In certain circumstances the Company may be required to replace such collateral with similar collateral. Furthermore, the Company is required to provide additional collateral for the Company's contingent obligations under the leasing transactions if: (i) the long term senior unsecured debt obligations of the Company are not rated at least A+ by Standard & Poor's and A1 by Moody's Investors Service or (ii) the Company's rights and powers under the ANS Act are substantially reduced.

The replacement of existing collateral, or the provision of additional collateral, may result in the Company incurring significant costs.

The Company may be required to make early termination payments under the leasing transactions in the event that any portion of the leased equipment is lost or destroyed, and such equipment is not replaced by the Company. Such termination payments may be in excess of the collateral provided for such purpose. The maximum amount by which such early termination payments would exceed the amounts payable under the payment undertaking agreements and the invested net present value benefits is approximately \$ 62 million.

If a financial institution that has entered into a payment undertaking agreement with the Company should fail to meet its obligations under such payment undertaking agreement for any reason, the Company will still be obligated to make the payments that are required pursuant to the leasing transactions.

Despite the downgrade of one equity payment undertaker's credit rating during the quarter, which required it to post collateral, the Company considers it unlikely that any of the above noted events will occur and that the described payments will be required.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

17. Guarantees (continued):

Provision of service and system sales

- (i) The Company has entered into five agreements for the sale and maintenance of technology that would indemnify the counterparties up to a maximum of \$ 1 billion for each occurrence and in the aggregate for losses sustained as a result of the negligence of the Company. In addition, the Company has entered into one agreement for the sale and maintenance of technology that would indemnify the counterparty up to a maximum of the Company's ANS liability insurance coverage of U.S. \$ 3.7 billion. The Company's ANS liability insurance provides coverage for these indemnification commitments. These indemnities survive termination of the agreements.
- (ii) The Company entered into an agreement with Natural Resources Canada, which has now ended, for the production of civil aeronautical information products, which would indemnify the counterparty up to a maximum of \$ 100 million for each occurrence and in the aggregate, for losses sustained by the counterparty arising out of or in any way connected with the agreement. The Company's liability insurance provides coverage for this indemnification commitment. This indemnity survives termination of the agreement.

Banking and credit agreements

The Company has agreed to indemnify its banks against costs or losses resulting from changes in laws and regulations, which would increase the banks' costs and from any legal claims resulting from defaults, misrepresentations, negligence, wilful misconduct of the Company or from environmental liabilities. These indemnification commitments extend for an unlimited period of time and do not provide for any limit on the maximum potential amount.

Indemnity with respect to third party sponsored ABCP

In connection with the restructuring of third party sponsored ABCP (see note 5), the Company agreed to indemnify the indenture trustees of the ABCP trusts should the trustees suffer certain losses only as a result of acting in accordance with extraordinary resolutions passed by the requisite number of noteholders of the trusts. As part of the indemnity agreement, the Company acknowledged that the trustees have the benefit of existing contractual indemnities under the trust indenture and agreed to subordinate its recoveries to any entitlement of the trustees. Further, all members of the Committee committed to provide additional protection beyond the contractual indemnification afforded by the trust indentures. The protection provided by members of the Committee is on a several basis and pro rata among the Committee members based upon their respective and aggregate investments in third party sponsored ABCP. The Company estimates that its share of the additional protection could amount to \$ 16 million. While the indemnity survives the closing of the ABCP restructuring, the terms of the court sanctioned restructuring plan have effectively eliminated the Company's exposure.

Other agreements

In the ordinary course of business the Company provides indemnification commitments to counterparties in transactions such as service arrangements, provision of maintenance services, system sales, sales of assets, licensing agreements, leasing and site usage transactions, contribution agreements, and director and officer indemnification commitments. These indemnification commitments require the Company to compensate the counterparties for costs and losses as a result of various events such as results of litigation claims, environmental contamination or statutory sanctions that may be suffered by a counterparty or third party as a consequence of the transaction or in limited cases, for liabilities arising from acts performed by or the negligence of the indemnified parties. The terms of these indemnification commitments vary based on the contract. Certain indemnification agreements extend for an unlimited period and generally do not provide for any limit on the maximum potential amount. The nature of these indemnification commitments does not permit a reasonable estimate of the aggregate potential amount that could be required to be paid. The Company has acquired liability insurance that provides coverage for most of the indemnification commitments described in this paragraph.

Historically, the Company has not made any significant payments under any indemnification commitments and no material amount has been accrued in the financial statements with respect to these indemnification commitments.

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Notes to Consolidated Financial Statements (unaudited) (continued)

Three months ended November 30, 2009 and 2008

18. Contingencies:

The Company has been named in a class action by certain passengers, named in actions by certain other passengers, and given notice of potential claims by certain other passengers who were on board an Air France aircraft that was unable to stop on the runway and was thereby destroyed at Lester B. Pearson International Airport in Toronto, Ontario on August 2, 2005. The class action alleges damages in the amount of \$ 150 million, and alleges negligence against several parties including NAV CANADA. All of the defendants other than NAV CANADA in the class action have agreed to settle with the class action plaintiffs for approximately \$ 14 million plus interest. The Ontario Court has approved some of these amounts and will likely approve the remainder as a fair and reasonable partial settlement of the class action claims. The class action suit against NAV CANADA continues. As a certified class action, certain claimants may opt out of the class action and proceed with their own actions. Forty-five passengers have opted out of the class action. Certain of those passengers are currently pursuing separate actions alleging negligence against NAV CANADA and others, claiming damages totalling \$ 405 million. Air France has also named the Company in an action arising from the incident. This action by Air France against the Company and others alleges negligence and seeks damages of \$ 178 million (relating to the destroyed aircraft) and compensation for any money Air France is required to pay out. The Government of Canada is also a defendant in that lawsuit and claims indemnification for damages and costs from NAV CANADA and others if it is found liable. The Greater Toronto Airport Authority has also named the Company and others in an action arising from the incident, claiming damages of \$ 1 million for damage to the airport property. The Company believes that these actions and these potential claims against NAV CANADA are without merit and will defend against them. Having reviewed the allegations and other known relevant factors, including the availability of insurance, the Company does not expect these proceedings to have any material adverse effect on the consolidated financial position or results of operations of the Company. No provision has been made in the Company's consolidated financial statements for any potential liability relating to these actions and potential claims.

The Company is party to other 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.