Unaudited Consolidated Financial Statements of

NAV CANADA

Three and six months ended February 28, 2014

NAV CANADA

Consolidated Balance Sheets (unaudited)

(in millions of dollars)

	February 28 2014	August 31 2013
Assets		
Current assets		
Cash and cash equivalents	$ 192	$ 171
Accounts receivable and other (note 3)	86	99
Current portion of capital lease obligations reserve fund (notes 4 and 10)	43	13
Other	13	13
	334	296
Regulatory asset (notes 5 and 9)	16	-
Reserve funds		
Debt service (note 4)	112	111
Capital lease obligations (notes 4 and 10)	201	225
	313	336
Investments and other		
Investments (note 4)	240	227
Investment in preferred interests (notes 4 and 5)	62	59
Embedded derivative on investment in preferred interests (notes 4 and 5)	41	-
Long-term dividend receivable (notes 4 and 5)	4	1
Long-term derivative asset (note 4)	24	29
	371	316
Accrued pension and other benefits (notes 9 and 14)	313	365
Capital assets		
Property, plant and equipment (note 6)	649	666
Intangible assets (note 7)	1,026	1,042
	1,675	1,708
	$ 3,022	$ 3,021
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	$ 176	$ 193
Current portion of long-term debt (note 8)	25	25
Current portion of capital lease obligations (note 10)	43	13
	244	231
Rate stabilization account (note 9)	67	53
Long-term liabilities		
Long-term debt (notes 8 and 9)	1,974	1,974
Capital lease obligations (note 10)	174	200
Regulatory liabilities (note 9)	317	303
Future income tax liability (note 5)	16	-
Other (note 11)	236	232
	2,717	2,709
	3,028	2,993
Retained earnings (deficit) (note 17)	(6)	28
	$ 3,022	$ 3,021

See accompanying notes to unaudited consolidated financial statements.

NAV CANADA

Consolidated Statements of Operations and Retained Earnings (Deficit) (unaudited)

(in millions of dollars)

	Three months ended February 28 2014	Three months ended February 28 2013	Six months ended February 28 2014	Six months ended February 28 2013
Revenue				
Customer service charges (note 12)	$ 271	$ 262	$ 569	$ 552
Other (note 12)	10	15	20	26
	281	277	589	578
Rate stabilization (note 9)	(4)	6	(8)	16
	277	283	581	594
Operating expenses				
Salaries and benefits (note 13)	203	191	399	374
Technical services	27	30	54	57
Facilities and maintenance	16	15	31	28
Other	12	12	25	27
	258	248	509	486
Rate stabilization (note 9)	(4)	4	(7)	15
	254	252	502	501
Other expenses				
Interest	26	26	52	52
Depreciation and amortization	34	34	68	68
	60	60	120	120
Rate stabilization (note 9)	-	1	-	1
	60	61	120	121
Other loss (income)				
Fair value adjustments and other (note 4)	(11)	(15)	(20)	(23)
Rate stabilization (note 9)	7	14	13	21
	(4)	(1)	(7)	(2)
	310	312	615	620
Excess of expenses over revenue and other loss (income) (note 1)	$ (33)	$ (29)	$ (34)	$ (26)
Retained earnings, beginning of period	27	31	28	28
Retained earnings (deficit), end of period	$ (6)	$ 2	$ (6)	$ 2

See accompanying notes to unaudited consolidated financial statements.

NAV CANADA

Consolidated Statements of Cash Flows (unaudited)

(in millions of dollars)

	Three months ended February 28 2014	Three months ended February 28 2013	Six months ended February 28 2014	Six months ended February 28 2013
Cash and cash equivalents provided by (used for):				
Operations				
Receipts from customer service charges	$ 277	$ 264	$ 580	$ 574
Other receipts	8	7	17	14
Payments to employees and suppliers	(225)	(221)	(431)	(428)
Pension contributions (note 14)	(22)	(21)	(40)	(41)
Other post-employment contributions (note 14)	(4)	(4)	(8)	(8)
Long-term disability plan deficit payment (note 14)	(2)	(2)	(2)	(2)
Interest payments	(25)	(27)	(52)	(52)
Interest receipts	2	1	3	2
	9	(3)	67	59
Investing				
Capital expenditures	(18)	(27)	(45)	(61)
Investment in preferred interests (notes 4 and 5)	-	-	-	(16)
Recoverable input tax payments on termination of capital lease transaction	-	-	-	21
Capital lease obligation reserve fund	-	-	-	(1)
	(18)	(27)	(45)	(57)
Financing				
Debt service reserve fund	(1)	-	(1)	-
	(1)	-	(1)	-
Increase (decrease) in cash and cash equivalents	(10)	(30)	21	2
Cash and cash equivalents, beginning of period	202	121	171	89
Cash and cash equivalents, end of period	$ 192	$ 91	$ 192	$ 91

Cash and cash equivalents are comprised of interest bearing bank balances, net of outstanding cheques, of $135 (February 28, 2013 – $91) and short-term investments with original terms to maturity of three months or less of $57 (February 28, 2013 – $nil).

See accompanying notes to unaudited consolidated financial statements.

1. Nature of operations:

NAV CANADA was incorporated as a non-share capital corporation 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"). NAV CANADA has been continued under the *Canada Not-for-profit Corporations Act*. The fundamental principles governing the mandate conferred on NAV CANADA 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 core business of NAV CANADA and its subsidiaries (collectively, the "Company") is to provide air navigation services, for which it collects customer service charges. The core business 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 ("the Board of Directors"), 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 9.

The Company plans its operations to essentially result in an annual financial breakeven position after recording adjustments to the rate stabilization account (note 9).

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.

NAV CANADA is exempt from income taxes as it meets the definition of a not-for-profit organization under the *Income Tax Act* (Canada); however, its subsidiaries operating in Canada and other jurisdictions are subject to Canadian and foreign taxes.

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, 2013 ("fiscal 2013") and are in accordance with Canadian generally accepted accounting principles Part V – Pre-changeover accounting standards ("Canadian GAAP"). These interim financial statements do not include all of the financial statement disclosures included in the Company's fiscal 2013 audited annual consolidated financial statements and should be read in conjunction with such financial statements.

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.

(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 9.

2. Significant accounting policies (continued):

(c) Future accounting pronouncements – International Financial Reporting Standards ("IFRS"):

In February 2013, the Canadian Accounting Standards Board ("AcSB") issued an amendment dated March 2013 to the Introduction to Part 1 of the CPA Canada Handbook allowing qualifying entities with rate-regulated activities to adopt IFRS for the first time no later than interim and annual financial statements relating to annual periods beginning on or after January 1, 2015. The Company is a qualifying entity and decided to avail itself of the deferral. As this optional deferral is not reflected in National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards*, the Company applied for and received from the Ontario Securities Commission ("OSC"), the Company's principal securities regulator, an exemption from, and deferral of, the mandatory changeover date to IFRS subject to certain conditions including, among others, the requirement to provide updated discussion in its annual and interim Management's Discussion and Analysis ("MD&A") regarding its preparations for changeover to IFRS and, if possible, the expected effect of the changeover on its financial statements. In November 2013, the AcSB decided against permitting further deferrals of the mandatory implementation date for first-time adoption of IFRS by rate-regulated entities. Accordingly, the Company will adopt IFRS in fiscal 2016, resulting in an IFRS transition date of September 1, 2014 due to the requirement for one year of comparative figures.

In September 2012, the International Accounting Standards Board ("IASB") decided to restart its comprehensive project on rate-regulated activities with a discussion paper ("DP") rather than an exposure draft ("ED"). Restarting the comprehensive project with a DP will allow the IASB to conduct a full analysis of the accounting impacts of the various forms of rate regulation; however, it will increase the time required to complete the project. The IASB expects to publish the DP relating to a final standard in the second quarter of calendar 2014. Given the time needed to develop a final standard, the IASB decided in December 2012 to develop an interim standard, to provide temporary guidance on accounting for rate-regulated activities for first-time adopters of IFRS. In January 2014, the IASB published the interim standard, Regulatory Deferral Accounts, which essentially allows the Company to continue to account for regulatory deferral account balances under IFRS in accordance with existing Canadian GAAP. The interim standard introduces limited changes to previous accounting practices which are primarily related to presentation and disclosure. The Company will continue to monitor developments in this area.

The transition from Canadian GAAP to IFRS is a significant undertaking that will materially affect the Company's reported financial position and results of operations. The Company is actively monitoring ongoing IASB projects, giving consideration to any proposed changes by the IASB as the Company finalizes its policy determinations. The Company also actively monitors regulatory updates on IFRS adoption in Canada, as issued by the Canadian Securities Administrators and the OSC.

As the Company has been granted exemptive relief by the OSC and is permitted to avail itself of the optional deferral referred to above, the Company is required to quantify the estimated differences between IFRS and Canadian GAAP based on an IFRS transition date of September 1, 2014. The estimated differences between IFRS and Canadian GAAP currently expected to be material to the Company's statement of financial position are in the areas of employee benefits and capital lease transactions. Although these differences are expected to be material, the Company has the ability to use regulatory accounting to offset some of these differences under the interim IFRS standard Regulatory Deferral Accounts. This assessment is based on available information and the Company's expectations as of the date of these financial statements and thus is subject to change based on new facts and circumstances.

2. Significant accounting policies (continued):

(c) Future accounting pronouncements – International Financial Reporting Standards ("IFRS") (continued):

Employee benefits, net of regulatory liability

Under Canadian GAAP, actuarial gains and losses are deferred off balance sheet and amortized to earnings before rate stabilization using a "corridor" approach. Under IFRS, the Company expects to recognize actuarial gains and losses in other comprehensive income in the period they are incurred, with no subsequent reclassification to earnings. As a consequence, actuarial gains and losses that have been deferred off balance sheet under Canadian GAAP will be recognized on the balance sheet upon transition to IFRS. This change will not affect the determination of customer service charges, as the Company uses a rate-regulated approach in determining the recovery of pension costs (described in note 9).

In June 2011, the IASB issued revisions to the standard for accounting for employee benefits. These revisions will apply to interim and annual consolidated financial statements (for issuers reporting under IFRS) relating to fiscal years commencing on or after January 1, 2013. This will require the Company to adopt these revisions as of the IFRS transition date of September 1, 2014. The Company is currently assessing the impact of these revisions on its consolidated financial statements upon transition to IFRS.

The impact on transition to IFRS will be based on actual balances at the date of transition. Based on the pension accounting deficit at August 31, 2013 of $660, the impact upon transition to IFRS on the accrued defined pension benefits is the elimination of the accrued pension asset of $362 recognized under Canadian GAAP, an increase in the accrued pension liability of $606 and a corresponding decrease in retained earnings (increase in the deficit) of $968. The Company expects to fully offset this impact by recording a corresponding regulatory debit (decrease in the deficit) of $968.

Capital lease transaction, net of regulatory liability

Final policy determinations and impact analyses have been completed for the Company's cross-border capital lease transaction. Under Canadian GAAP, capital lease obligations – payment undertaking agreement reserve funds and capital lease obligations were recognized on the Company's balance sheet upon entering into the capital lease transaction. Under IFRS, these assets and liabilities will be derecognized from the opening IFRS statement of financial position as they do not meet the criteria of an asset or liability under IFRS. There is no impact on retained earnings (deficit) as a result of these adjustments. The risks associated with this cross-border transaction will continue to be disclosed under IFRS reporting.

Although the adoption of IFRS will materially affect the Company's reported financial position, changing to IFRS will not significantly affect customer service charges. This is because the Company will continue to follow a rate regulated approach in determining the rates it charges to customers for air navigation services.

3. Accounts receivable and other:

Accounts receivable and other were comprised of the following:

	February 28 2014	August 31 2013
Trade receivables (note 16 (d))	$ 63	$ 78
Accrued receivables and unbilled work in progress	25	20
Input tax receivables	-	3
Allowance for doubtful accounts (note 16 (d))	(2)	(2)
	$ 86	$ 99

The Company's exposure to credit and foreign exchange risks, and to impairment losses related to accounts receivable is described in note 16.

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 note 4 (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.

4. Financial instruments (continued):

(a) Summary of financial instruments (continued):

At February 28, 2014, the classification of the Company's financial instruments, as well as their carrying amounts and fair values are as follows:

Financial assets and liabilities	Classification	Carrying amount	Fair Value
Cash and cash equivalents [1]	Held-for-trading [9]	$ 192	$ 192
Accounts receivable [1]	Loans and receivables	86	86
Other current assets			
Derivative assets [2]	Derivative financial assets	3	3
Reserve funds			
Debt service [1]	Held-for-trading [9]	112	112
Capital lease obligations [3]	Held-for-trading [9]	36	36
Capital lease obligations – payment undertaking agreement [4]	Held-to-maturity	208	227
Investments and other			
MAV II and ABCP [3]	Held-for-trading [9]	240	240
Preferred interests in Aireon LLC [5]	Loans and receivables	62	62
Embedded derivative on investment in preferred interests [6]	Derivative financial assets	41	41
Long-term dividend receivable [5]	Loans and receivables	4	1
Long-term derivative assets [2]	Derivative financial assets	24	24
Accounts payable and accrued liabilities [1]	Other financial liabilities	176	176
Long-term debt			
Bonds and notes payable [7]	Other financial liabilities	1,999	2,301
Capital lease obligations [4]	Other financial liabilities	217	227
Other long-term liabilities			
Non-derivative financial liability [8]	Other financial liabilities	2	2

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

[2] Short-term and long-term derivative assets and liabilities are recorded at fair value determined using prevailing forward foreign exchange market rates and interest rates at the balance sheet date. The Company uses derivative financial instruments to manage risks from fluctuations in foreign exchange rates and interest rates. The Company's long-term derivative assets consist of forward dated interest rate swap agreements. Where permissible, the Company accounts for these financial instruments as cash flow hedges which ensures that counterbalancing gains and losses are recognized in income in the same period. With hedge accounting, changes in the fair value of derivative financial instruments designated as cash flow hedges are deferred and are included in regulatory assets or regulatory liabilities (note 9 (f)). When an anticipated transaction is subsequently recorded, the regulatory amounts deferred are reclassified to a regulatory liability or asset within the related asset or liability (notes 9 (h) and (i)). At the inception of entering into a hedging contract, the relationship between the hedged item and the hedging item is formally documented, in accordance with the Company's risk management objectives and strategies. The effectiveness of the hedging relationship, as discussed below, is assessed at inception of the contract related to the hedging item and then again at each balance sheet date to ensure the relationship is and will remain effective. Where hedge accounting is

4. Financial instruments (continued):

(a) Summary of financial instruments (continued):

not permissible and derivatives are not designated in a hedging relationship, they are classified as held-for-trading and the changes in fair value are immediately recognized in the statement of operations.

(3) These financial assets are comprised of investments in Master Asset Vehicle II ("MAV II"), Ineligible Asset Tracking notes and asset-backed commercial paper ("ABCP") that are discussed in note 4 (b).

(4) The fair value I s calculated as the present value of the expected future cash flows. Prevailing market interest rates for the corresponding term are used for discounting.

(5) As discussed in note 5, preferred interests in Aireon LLC ("Aireon") provide for a dividend calculated from the date of issuance, and will be redeemed for cash in three annual instalments beginning on November 19, 2020 (in the event the preferred interests have not been converted to common equity or redeemed by that time). These non-derivative financial assets with fixed payments are measured at amortized cost. Dividends are not considered for rate setting purposes until the cash is received. This is achieved by recording a regulatory liability (note 9 (g)).

(6) The Company may at any time and from time to time elect to convert all or a portion of its preferred interests in Aireon into common interests (note 5). This election is an embedded derivative and as such is separated from the host contract and accounted for as a stand-alone derivative instrument. This instrument is recorded at fair value.

(7) Bonds and notes payable are initially recognized at fair value, net of financing fees, premiums, discounts and regulatory assets and liabilities due to cash settlements on hedging transactions that qualify as effective hedges for accounting purposes. They are subsequently measured at amortized cost. Any difference between the carrying amount and the maturity 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.

(8) The non-derivative financial liability consists of a put option liability that is recorded at fair value using a discounted cash flow approach. One of the Company's subsidiary's shareholder agreements contains a put option whereby the non-controlling shareholders may require that the Company purchase all of the non-controlling shareholders' shares of this subsidiary at any time between June 30, 2015 and September 30, 2015, at the fair value of the shares determined at that time.

(9) 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, Ineligible Asset Tracking notes and ABCP are discussed in note 4 (b).

There has been no change in classification of financial instruments since August 31, 2013.

(b) Fair value hierarchy:

Financial instruments recorded at fair value on the balance sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1	Quoted prices (unadjusted) in active markets for identical assets or liabilities.
Level 2	Inputs other than quoted prices included in Level 1 that are observable for the assets or liabilities either directly (i.e. as prices) or indirectly (i.e. derived from prices).
Level 3	Inputs for the assets or liabilities that are not based on observable market data (unobservable inputs).

The method used to determine the fair value of financial instruments is described in note 4 (a).

4. Financial instruments (continued):

(b) Fair value hierarchy (continued):

The table below illustrates the classification of the Company's financial instruments valued and recognized at fair value:

	February 28, 2014			
	Level 1	Level 2	Level 3	Total
Financial assets:				
Cash and cash equivalents	$ 192	$ -	$ -	$ 192
Other current assets				
Derivative assets	-	3	-	3
Debt service reserve fund	112	-	-	112
Capital lease obligations reserve fund	-	-	36	36
Investments – MAV II and ABCP	-	-	240	240
Long-term derivative assets	-	24	-	24
Embedded derivative on investment in preferred interests	-	41	-	41
	$ 304	$ 68	$ 276	$ 648
Financial liabilities:				
Other long-term liabilities				
Non-derivative financial liability	$ -	$ -	$ 2	$ 2
	$ -	$ -	$ 2	$ 2

	August 31, 2013			
	Level 1	Level 2	Level 3	Total
Financial assets:				
Cash and cash equivalents	$ 171	$ -	$ -	$ 171
Other current assets				
Derivative asset	-	2	-	2
Debt service reserve fund	111	-	-	111
Capital lease obligations reserve fund	-	-	34	34
Investments – MAV II and ABCP	-	-	227	227
Long-term derivative assets	-	29	-	29
	$ 282	$ 31	$ 261	$ 574
Financial liabilities:				
Other long-term liabilities				
Non-derivative financial liability	$ -	$ -	$ 2	$ 2
	$ -	$ -	$ 2	$ 2

4. Financial instruments (continued):

(b) Fair value hierarchy (continued):

Level 3 financial instruments consist of the following investments in MAV II notes, Ineligible Asset Tracking notes and ABCP investments not subject to the restructuring (discussed below) as at February 28, 2014 and August 31, 2013:

	February 28, 2014			August 31, 2013		
	Face value	Fair value variances	Fair value	Face value	Fair value variances	Fair value
MAV II notes						
Class A-1	$ 191	$ (13)	$ 178	$ 191	$ (22)	$ 169
Class A-2	94	(8)	86	94	(13)	81
	285	(21)	264	285	(35)	250
Ineligible Asset Tracking notes	2	(1)	1	2	(2)	-
ABCP	20	(9)	11	20	(9)	11
	$ 307	$ (31)	$ 276	$ 307	$ (46)	$ 261

The MAV II notes received as a result of the restructuring of third party sponsored ABCP by the Pan-Canadian Investors Committee in January 2009 include a pooling of leveraged investments as well as traditional assets and cash. The leveraged investments are subject to a potential requirement to post additional collateral based on certain triggers being met (a margin call). Traditional assets are un-levered investments and include residential and commercial mortgage backed securities, corporate credit and cash equivalents. The Class A-1 and A-2 notes provide for the payment of interest on a quarterly basis provided that the three month Canadian Dealer Offered Rate (“CDOR”) rate is above 50 basis points. The MAV II notes benefit from a margin funding facility to meet potential margin calls. This margin funding facility is being provided by certain international and Canadian banks.

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

Within its Level 3 financial instruments, the Company holds the following ABCP investments:

(i) $10 of third party sponsored ABCP in a trust that was not covered by the January 2009 restructuring of third party sponsored ABCP. The funds in this conduit are subject to a legal dispute between the asset provider and the trust sponsor.

(ii) $10 of bank sponsored ABCP for which a restructuring has been completed. This trust is rated A(sf) by DBRS. It continues to pay interest on a monthly basis.

The Company is aware of a number of trades in the restructured notes that have occurred prior to February 28, 2014, but does not consider them to constitute an active market for purposes of a Level 1 valuation. 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, February 28, 2014. The estimates arrived at by the Company are subject to measurement uncertainty and are dependent on market conditions as at the measurement date.

4. Financial instruments (continued):

(b) Fair value hierarchy (continued):

If an active market for the restructured notes were to develop in the future, the Company would change its valuation technique to determine the fair value of its notes using quoted market prices.

The Company's total provision for expected credit losses on Level 3 investments as at February 28, 2014 is $5. This amount is included in the fair value variance from face value on investments of $31. 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. As of February 28, 2014, the Class A-1 and A-2 notes were rated AA (low) (sf) and A (low) (sf) respectively by DBRS. As these are investment grade ratings, the Company has not provided for any credit losses with respect to the Class A-1 and A-2 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 used a discount factor appropriate for a high yield instrument for the Ineligible Asset Tracking notes.

The Company has used the following expected rates and discount factors at February 28, 2014:

Restructured notes	Return	Market discount factor
MAV II Class A-1	BAs minus 50 basis points	BAs plus 1.9%
MAV II Class A-2	BAs minus 50 basis points	BAs plus 2.7%
Ineligible Asset Tracking notes	BAs plus 30 basis points	BAs plus 27.0%
Other ABCP	BAs to BAs plus 33 basis points	BAs plus 2.3% and BAs plus 24.0%

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

The following table summarizes the changes in the fair value of financial instruments classified in Level 3 during the six months ended February 28, 2014. The balance at February 28, 2013 is provided for comparative purposes.

	February 28, 2014			February 28, 2013
	MAV II and Ineligible Asset Tracking notes	Other ABCP	Total	Total
Fair value as at September 1	$ 250	$ 11	$ 261	$ 238
Net decrease in fair value provision	14	-	14	20
Net decrease in credit provision	1	-	1	-
Fair value as at February 28	$ 265	$ 11	$ 276	$ 258

During the first six months of the fiscal year ending August 31, 2014 ("fiscal 2014"), the Company decreased its fair value provision, which is determined using a discounted cash flow approach, by $14 as a result of the use of lower discount factors in keeping with improvement in the market conditions for MAV II notes and the underlying assets within MAV II.

5. Investment in preferred interests of Aireon LLC:

On November 19, 2012, the Company entered into agreements (the "November 2012 agreements") setting out the terms of its participation as an investor in Aireon. Aireon's mandate is to provide global satellite-based surveillance capability for air navigation service providers ("ANSPs") around the world through Automatic Dependent Surveillance-Broadcast ("ADS-B") receivers built as an additional payload on the Iridium NEXT satellite constellation, which is expected to be launched by Iridium Communications Inc. ("Iridium") within the 2015-2017 time period.

Under the terms of the November 2012 agreements, the Company's overall investment in Aireon is expected to be implemented in stages for up to a total of $150 U.S. ($166 CDN) by calendar 2017 (including $55 U.S. ($61 CDN) excluding transaction costs invested in fiscal 2013). If all investment stages are completed, the Company will have purchased preferred interests which, upon conversion to common equity interests, will represent 51% of the fully diluted common equity of Aireon. The preferred interests provide for a 5% dividend (except for the second stage investment described below that provides for a 10% dividend), calculated from the date of issuance, and will be redeemed for cash in three annual instalments beginning on November 19, 2020 (in the event the preferred interests have not been converted to common equity or redeemed by that time).

The Company's investment is expected to be made in five stages, each subject to the satisfaction of various operational, technical, commercial, regulatory and financial conditions. The staged investments are contingent upon the successful achievement by Aireon and Iridium of certain specific milestones with respect to, among other things, development of the ADS-B payload, deployment of the Iridium NEXT satellite constellation, marketing Aireon's ADS-B service to potential ANSP customers, and regulatory approvals of the technology's use. The final stage of the investment is scheduled for late in calendar 2017.

The payment for the first stage investment of preferred interests amounting to $15 U.S. ($15 CDN) and representing, on a post conversion basis, 5.1% of the fully diluted common equity of Aireon was made in November 2012. In June 2013, the Company made the payment for its second stage investment in Aireon preferred interests in the amount of $40 U.S. ($42 CDN), representing, on a post conversion basis, an additional 13.6% of Aireon's fully diluted common equity, bringing its total interest on a post conversion basis to 18.7% of Aireon's fully diluted common equity. At that time the November 2012 agreements were modified as follows:

(i) Certain conditions precedent to the Company's second and subsequent staged investments were either amended or deleted.

(ii) The dividend rate on the second stage investment made in June 2013 was set at 10% rather than 5%, whereas the dividend rate on the Company's other preferred interests remained at 5%.

(iii) The circumstances under which the Company could obtain the option to acquire additional preferred interests described under (b) below were amended.

In December 2013, the November 2012 agreements were modified again to provide for the making of an aggregate investment of $120 U.S. ($133 CDN) in Aireon by three additional major ANSPs (namely ENAV (Italy), the Irish Aviation Authority ("IAA"), and Naviair (Denmark)) (collectively, the "Additional Investors"). The investment in Aireon by the Additional Investors is expected to be made in four stages between the 2014 and 2017 calendar years as key milestones are met, in exchange for preferred interests in Aireon. It is expected that in calendar 2018, a portion of Iridium's existing common equity interest in Aireon will be redeemed for a payment from Aireon of $120 U.S. ($133 CDN) to finalize the ownership interests of all of Aireon's investors. Upon this redemption and the related conversion of all preferred interests into common interests, NAV CANADA will hold 51% of the fully diluted common equity interests of Aireon, ENAV will hold 12.5%, and each of IAA and Naviair will hold 6%, with the remaining 24.5% being retained by Iridium.

5. Investment in preferred interests of Aireon LLC (continued):

In February 2014, the Additional Investors made their first stage investment in Aireon. As a result, the Company's total fully diluted common equity interest on a post conversion basis was reduced from 18.7% to 17.29%.

The total of the Company's preferred interest investments of $62 CDN (including transaction costs) in Aireon has been classified as loans and receivables within financial assets and is measured at amortized cost. The following embedded derivatives were initially identified:

(a) The Company may at any time and from time to time elect to convert all or a portion of its preferred interests in Aireon into common equity interests.

(b) Under certain circumstances, the Company could obtain an option, exercisable at its sole discretion, to acquire additional preferred interests, in aggregate amount not to exceed 19% of the fully diluted common equity in Aireon, at a fixed rate per basis point. This option expired when the Additional Investors made their first stage investment in Aireon in February 2014.

Embedded derivatives are to be separated from the host contract and accounted for as stand-alone derivative instruments. Prior to the investment by the Additional Investors, the Company considered that amortized cost measurement represented the most reliable measure of the value of its investment in Aireon, as Aireon is a private company in start-up phase without any operations; accordingly, fair value could not be determined reliably for the embedded derivatives. The price paid by the Additional Investors in February 2014 is considered to be a reliable estimate of the fair value of Aireon, and the Company has used this valuation to measure the embedded derivative described in (a) above as at February 28, 2014 (note 4).

The Company's future income tax assets and liabilities at February 28, 2014 relate to its investment in Aireon. They are comprised of future income tax liabilities amounting to $21 U.S. ($24 CDN) (year ended August 31, 2013– $3 CDN) primarily due to the increase in the fair value of the embedded derivative discussed above and tax assets amounting to $7 U.S. ($8 CDN) (year ended August 31, 2013 – $4 CDN) for operating losses and research and development expenses carried forward that have been allocated to the Company. The future income tax assets and liabilities are netted on the balance sheet and amount to a future income tax liability of $14 U.S. ($16 CDN). The operating losses carried forward will begin to expire in calendar year 2033.

The balance sheet impact of the Company's investment in preferred interests of Aireon is comprised of the following:

	February 28 2014	August 31 2013
Regulatory asset	$ 16	$ -
Investment in preferred interests	62	59
Embedded derivative on investment in preferred interests	41	-
Long-term dividend receivable	4	1
Regulatory liabilities		
Embedded derivative on investment in preferred interests	(41)	-
Unrealized foreign exchange gain on the investment	(4)	(1)
Accrued dividend on preferred interests	(4)	(1)
Future income tax liability	(16)	-
	$ 58	$ 58

5. Investment in preferred interests of Aireon LLC (continued):

The net balance sheet impact of the Company's investment in preferred interests of Aireon above reflects the actual amounts paid for the Company's investment in Aireon (at the exchange rates prevailing on the dates of the transactions and including unamortized transaction costs). As at February 28, 2014 the net regulatory accounting liability balances of $33 (August 31, 2013 – $2) comprised of a regulatory asset of $16 (August 31, 2013 – $nil) and regulatory liabilities of $49 (August 31, 2013 – $2) above, defer the accounting recognition of transactions related to the Company's investment in Aireon on the Company's consolidated statement of operations. As a result, there is no impact on the Company's consolidated statement of operations for the six months ended February 28, 2014 related to the Company's investment in Aireon. These amounts are not considered for rate setting purposes until realized in cash.

6. Property, plant and equipment:

Property, plant and equipment were comprised of the following:

	February 28, 2014			August 31, 2013
	Cost	Accumulated depreciation	Net book value	Net book value
Land and buildings	$ 360	$ (199)	$ 161	$ 168
Systems and equipment	1,096	(678)	418	418
Property, plant and equipment under development	59	-	59	68
	1,515	(877)	638	654
Net increase from capital lease	30	(19)	11	12
	$ 1,545	$ (896)	$ 649	$ 666

7. Intangible assets:

Intangible assets were comprised of the following:

	February 28, 2014			August 31, 2013
	Cost	Accumulated amortization	Net book value	Net book value
Air navigation right	$ 1,367	$ (652)	$ 715	$ 727
Purchased software	288	(132)	156	152
Internally developed software	202	(62)	140	145
Intangible assets under development	12	-	12	15
Goodwill	3	-	3	3
	$ 1,872	$ (846)	$ 1,026	$ 1,042

8. Long-term debt:

Because NAV CANADA is a non-share capital corporation, 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 an 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 and the amount of the bank credit facility that is secured under the Master Trust Indenture is limited to the amount of outstanding bonds issued under the Master Trust Indenture. At February 28, 2014, this amount is $600 and will decline by $25 on March 1 of every year in conjunction with the annual principal repayment of the series 97-2 amortizing bonds. The remaining $75 of the $675 credit facility (see note 8 (c) below) ranks pari passu to the borrowings under the General Obligation Indenture. The $600 portion of the credit facility along with the $250 series 96-3 bonds and $350 series 97-2 bonds gives a total of $1,200 of indebtedness secured under the Master Trust Indenture and ranking ahead of General Obligation Indenture debt.

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 repayment is subordinated and postponed to prior payment of Master Trust Indenture obligations unless the Company can meet an additional indebtedness test.

8. Long-term debt (continued):

(b) Borrowings:

Long-term debt outstanding was comprised of the following:

	February 28 2014	August 31 2013
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	350	350
	600	600
Issued under the General Obligation Indenture:		
4.397% general obligation notes, series MTN 2011-1 maturing February 18, 2021	250	250
5.304% general obligation notes, series MTN 2009-1, maturing April 17, 2019	350	350
1.949% general obligation notes, series MTN 2013-1, maturing April 19, 2018	350	350
4.713% general obligation notes, series MTN 2006-1, maturing February 24, 2016	450	450
	1,400	1,400
Total bonds and notes payable	2,000	2,000
Adjusted for deferred financing costs and discounts	(8)	(8)
Adjusted for regulatory realized hedging transaction asset (note 9 (h))	(1)	(2)
Adjusted for regulatory realized hedging transaction liability (note 9 (i))	8	9
Carrying value of total bonds and notes payable	1,999	1,999
Less: current portion	(25)	(25)
Total long-term debt outstanding	$ 1,974	$ 1,974

8. Long-term debt (continued):

(c) Credit facilities:

The Company's credit facilities are utilized as follows:

	February 28 2014
Credit facilities	
Credit facility with a syndicate of Canadian financial institutions [1]	$ 675
Letter of credit facilities for pension funding purposes [2]	375
Total available credit facilities	1,050
Less: Outstanding letters of credit [2]	253
Undrawn committed borrowing capacity	797
Less: Operations and maintenance reserve fund allocation [3]	250
Less: Capital lease transaction restriction	25
Credit facilities available	$ 522

[1] The Company's credit facility with a syndicate of Canadian financial institutions in the amount of $675 is comprised of two equal tranches maturing on September 12, 2016 and September 12, 2018. The credit facility agreement provides for loans at varying rates of interest based on certain benchmark interest rates, specifically the Canadian prime rate and the Canadian bankers' acceptance rate, and on the Company's credit rating at the time of drawdown. A utilization fee is also payable on borrowings in excess of 25% of the available facility. The Company is required to pay commitment fees, which are dependent on the Company's credit rating. The Company is in compliance with the credit facility covenants as at February 28, 2014.

[2] The letter of credit facilities for pension funding purposes are comprised of three equal facilities that will expire on December 31, 2014 unless extended prior to that date. Of the $253 in letters of credit shown above as outstanding at February 28, 2014, $239 was drawn from the $375 credit facilities for pension solvency funding purposes (see note 14).

[3] The operations and maintenance reserve fund may be used to pay operating and maintenance expenses, if required.

9. Financial statement impact of rate regulation:

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

	February 28 2014	August 31 2013
Regulatory asset		
Future income tax (a)	$ 16	$ -
Rate stabilization account liability		
Operating deferrals (b)	$ 85	$ 85
Gains on capital lease transaction (c)	10	11
Fair value adjustments (d)	(28)	(43)
	$ 67	$ 53
Regulatory liabilities		
Regulatory pension and long-term disability liabilities (e)	$ 242	$ 269
Regulatory unrealized hedging transactions liabilities (f)	24	29
Other regulatory liabilities (g)	51	5
	$ 317	$ 303
Long-term debt		
Regulatory realized hedging transaction asset (h)	$ (1)	$ (2)
Regulatory realized hedging transaction liability (i)	8	9
	$ 7	$ 7

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.

When establishing customer service charges, the Board of Directors, considers the balance in the rate stabilization account, adjusted notionally for the non-credit related portion of the fair value variance from face value on investments. The Board of Directors also considers the balance of the accrued pension benefit asset (net of its regulatory liability) when determining the level of customer service charges, as discussed in note 9 (e) below.

The long-term target liability balance of the rate stabilization account is 7.5% of total planned annual expenses net of other loss (income), excluding non-recurring items, on an ongoing basis. For fiscal 2014, the target balance is $93 (fiscal 2013 – $93). As at February 28, 2014, the balance in the rate stabilization account adjusted notionally for the $26 net non-credit related fair value variance from face value on investments (see note 4 (b)) and after recording additional pension expense as described in note 9 (e) below, was a liability of $93 (February 28, 2013 – $93).

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

The table below shows the impact of rate stabilization adjustments on the excess of expenses over revenue and other loss (income) as reported in the statement of operations:

	Three months ended February 28 2014	Three months ended February 28 2013	Six months ended February 28 2014	Six months ended February 28 2013
Before rate stabilization				
Revenue	$ 281	$ 277	$ 589	$ 578
Expenses	318	308	629	606
Other loss (income)	(11)	(15)	(20)	(23)
	(26)	(16)	(20)	(5)
Rate stabilization adjustments				
Favorable variances from planned results	(12)	(19)	(26)	(33)
Initial approved drawdown (adjustment)*	(2)	4	(5)	8
Additional drawdown related to pension**	7	2	17	4
	(7)	(13)	(14)	(21)
Excess of expenses over revenue and other loss (income), after rate stabilization	$ (33)	$ (29)	$ (34)	$ (26)

* The initial approved drawdown (adjustment) is combined with the revenue variances from planned results on the statement of operations.

** The additional drawdown related to pension is combined with the operating expenses variances from planned results on the statement of operations.

The following are the changes in the rate stabilization account for the six months ended:

	February 28 2014		February 28 2013	
Rate stabilization account				
Liability balance, beginning of period		$ 53		$ 31
Variances from planned results:				
Revenue higher (lower) than planned, before approved adjustment (drawdown)	3		(8)	
Operating expenses lower than planned, before drawdown related to pension	10		19	
Other expenses lower than planned	-		1	
Other income higher than planned	13	26	21	33
		79		64
Initial approved adjustment (drawdown) (j)		5		(8)
Additional drawdown related to pension		(17)		(4)
Liability balance, end of period		$ 67		$ 52

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

(a) Future income tax:

As at February 28, 2014, the Company had a future income tax liability of $16 (August 31, 2013 – $nil) within one of its wholly owned subsidiaries due to temporary differences (note 5). Income taxes are not considered for rate setting purposes until the temporary differences are realized. The recognition of income taxes on the Company's consolidated statement of operations has been fully offset by the application of regulatory accounting (note 5).

(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 future customer service charges.

(c) Gains on capital lease transaction:

Included in the rate stabilization account at February 28, 2014 is an amount of $10 (August 31, 2013 – $11), representing the portion of the gain on the remaining capital lease transaction that would not have been recorded as of February 28, 2014 under Canadian GAAP applicable to companies not subject to regulatory statutes governing the level of their charges.

(d) Fair value adjustments:

As at February 28, 2014, the total of fair value variances from face value on investments recorded on the Company's balance sheet was $31, of which $28 is from fair value adjustment losses recorded on investments currently held by the Company. During the six months ended February 28, 2014 this amount decreased, primarily due to positive fair value adjustments of $14 on its investments based on lower discount factors in keeping with market conditions and a decrease in the credit loss provision of $1.

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

(e) Regulatory pension and long-term disability liabilities:

Included in regulatory liabilities at February 28, 2014 is $237 (August 31, 2013 – $263) relating to the recovery through customer service charges of special pension contributions and $5 (August 31, 2013 – $6) of long-term disability ("LTD") contributions (note 14). Accrued pension and other benefit assets, net of their regulatory liabilities as at February 28, 2014 and February 28, 2013 are as follows:

	February 28, 2014			February 28, 2013
	Pension	LTD	Total	Total
Accrued pension and other benefit assets (note 14)	$ 308	$ 5	$ 313	$ 407
Regulatory liabilities				
Balance, September 1, prior calendar year	(263)	(6)	(269)	(316)
Regulatory decrease	43	1	44	31
Additional rate stabilization drawdown related to pension	(17)	-	(17)	(4)
Balance, end of period	(237)	(5)	(242)	(289)
Accrued pension and other benefit assets, net of their regulatory liabilities	$ 71	$ -	$ 71	$ 118

The accrued pension and other benefit assets, net of their related regulatory liabilities, represent the cumulative amounts by which Company contributions to the pension and LTD benefit plans have exceeded the amounts expensed. The Company intends to recover the accrued pension benefit asset, net of its regulatory liability balance, through customer service charges over time.

The Company uses a regulatory approach to determine its expense for pension and LTD, which is charged to the statement of operations. The objective of this approach is to establish benefit expense to reflect the cash cost of the plans. The difference between the pension and LTD expense for regulatory purposes and pension benefit and LTD costs as determined by CPA Canada Handbook Section 3461, Employee Future Benefits, is included in pension and LTD expense in salary and benefits expense on the statement of operations and in the pension and LTD regulatory liability on the balance sheet.

For several years prior to fiscal 2008, pension expense was lower than the Company's actual contributions to the pension plan. In 2008, the Board of Directors approved a policy by which the fiscal 2008 cumulative balance of contributions made in excess of pension expense would be expensed over a period no longer than 15 years. Accordingly for fiscal 2014, the regulatory approach for determining annual pension expense for the Company's registered pension plans includes an amount equal to the Company's originally planned annual pension contributions ($83), plus an amount ($19) to reduce the net cumulative balance of recoverable pension contributions made in the past in excess of pension expense plus an amount related to supplemental pension benefits in excess of tax limits for federally registered pension plans ($3).

To further accelerate the reduction of the balance in the accrued pension benefit asset (net of its regulatory liability), the Board of Directors approved, effective September 1, 2010, that if at the end of a quarterly reporting period the "notional" balance (described above) in the rate stabilization account is greater than the target balance, the excess over the target will be recorded as additional pension expense in the reporting period. For the six months ended February 28, 2014 this amounted to an additional $17 (six months ended February 28, 2013 – $4) of pension expense. During the six months ended February 28, 2014, the accrued pension benefit asset, net of its related regulatory liability, decreased by $28 from $99 as at August 31, 2013 to $71 at February 28, 2014.

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

(f) Regulatory unrealized hedging transactions liabilities:

Regulatory unrealized hedging transactions liabilities as at February 28, 2014 and August 31, 2013 are as follows:

	February 28 2014	August 31 2013
Unrealized fair value gains on forward dated interest rate swap agreements [(i)]	$ (24)	$ (29)

[(i)] The Company intends to cash settle these forward dated interest rate swap agreements in February 2016.

When the anticipated refinancings occur, the realized gains or losses are reclassified to a regulatory realized hedging transaction asset or liability that is presented within long-term debt (see notes 9 (h) and 9 (i)).

(g) Other regulatory liabilities:

Other regulatory liabilities as at February 28, 2014 and August 31, 2013 are as follows:

	February 28 2014	August 31 2013
Regulatory liabilities on investment in preferred interests [(1)]		
Embedded derivative on investment in preferred interests	$ 41	$ -
Unrealized foreign exchange gain	4	1
Accrued dividends on investment in preferred interests	4	1
Unrealized foreign currency translation gains on net capital lease obligations	2	3
	$ 51	$ 5

[(1)] The fair value adjustment on embedded derivative, the unrealized foreign exchange gain, and accrued dividends on preferred interests are not considered for rate setting purposes until realized in cash. The recognition of these items on the Company's consolidated statement of operations has been fully offset by the application of regulatory accounting (note 5).

(h) Regulatory realized hedging transaction asset:

The regulatory realized hedging transaction asset at February 28, 2014 consists of the remaining $1 (August 31, 2013 – $2) deferred loss on the bond forward that was settled April 16, 2013, which has been applied to the series MTN 2013-1 obligation.

(i) Regulatory realized hedging transaction liability:

The regulatory realized hedging transaction liability at February 28, 2014 consists of the remaining $8 (August 31, 2013 – $9) deferred gain on the bond forward settled February 18, 2011 which has been applied to the series MTN 2011-1 obligation.

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

(j) Initial approved adjustment (drawdown):

The Board of Directors approved an $11 transfer to the rate stabilization account to be recorded in fiscal 2014, in order to achieve planned breakeven results of operations. The adjustment is being transferred from revenue evenly throughout the year. As at February 28, 2014, $5 has been transferred from revenue to the rate stabilization account.

With respect to fiscal 2013, the Board of Directors approved a $16 drawdown of the rate stabilization account to be recorded in fiscal 2013, in order to achieve planned breakeven results of operations. The drawdown was transferred to revenue evenly throughout the year. Accordingly, as at February 28, 2013, $8 was transferred to revenue from the rate stabilization account.

10. Capital lease transaction:

The capital lease transaction is included on the consolidated balance sheets as follows:

	February 28 2014	August 31 2013
Current portion of capital lease obligations reserve fund	$ 43	$ 13
Capital lease payment undertaking agreements reserve fund	165	191
Property, plant and equipment	11	12
Current portion of capital lease obligations	(43)	(13)
Capital lease obligations	(174)	(200)
Other regulatory liabilities	(2)	(3)
	$ -	$ -

Remaining capital lease payments are due as follows:

Years ending August 31:	
2014	$ 1
2015	58
2016	19
2017	17
2018	17
Later years, through 2028	170
Net minimum lease payments	282
Less: amount representing interest (at approximately 5%)	(65)
Present value of net minimum capital lease payments	217
Less: current portion	(43)
Total long-term capital lease obligations	$ 174

11. Other long-term liabilities:

Other long-term liabilities were comprised of the following:

	February 28 2014	August 31 2013
Accrued post-employment benefit liabilities other than pensions (note 14)	$ 179	$ 176
Accrued pension benefit liability – supplemental pension benefits (note 14)	55	54
Non-derivative financial liability (note 4)	2	2
	$ 236	$ 232

12. Revenue:

Customer service charges by type of service provided were as follows:

	Three months ended February 28 2014	Three months ended February 28 2013	Six months ended February 28 2014	Six months ended February 28 2013
Enroute	$ 135	$ 130	$ 293	$ 282
Terminal	109	108	220	218
Daily / annual / quarterly	17	14	35	31
North Atlantic and international communication	10	10	21	21
	$ 271	$ 262	$ 569	$ 552

Other revenue was as follows:

	Three months ended February 28 2014	Three months ended February 28 2013	Six months ended February 28 2014	Six months ended February 28 2013
Service and development contracts	$ 7	$ 12	$ 13	$ 19
Conference centre services	1	1	3	3
Aeronautical publications	1	1	2	2
Other	1	1	2	2
	$ 10	$ 15	$ 20	$ 26

The Company has two customers each of which represents more than 10% of total revenues before rate stabilization. For the six months ended February 28, 2014, revenue from the largest customer was $103 (six months ended February 28, 2013 – $104) and revenue from the second largest customer was $68 (six months ended February 28, 2013 – $64), together representing 29% (six months ended February 28, 2013 – 29%) of the total revenues of the Company before rate stabilization. The revenues from these two major customers arose from air navigation services.

13. Salaries and benefits:

Salaries and benefits expenses were comprised of the following:

	Three months ended February 28 2014	Three months ended February 28 2013	Six months ended February 28 2014	Six months ended February 28 2013
Salaries and other	$ 131	$ 126	$ 263	$ 252
Overtime	19	18	38	37
Fringe benefits (note 14)	20	21	30	32
Pensions (notes 9 (e) and 14)	33	26	68	53
	$ 203	$ 191	$ 399	$ 374

14. Employee future benefits:

The Company maintains defined benefit plans that provide pension, other post-employment and LTD benefits to employees. The Company uses an annual measurement date of May 31 when estimating the accounting surplus or deficit of its plans 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 pension benefits and LTD plans, using the measurement date of May 31, is as follows:

	Pension benefits		LTD		Other benefits	
	2013	2012	2013	2012	2013	2012
Benefit obligations	$ 4,863	$ 4,656	$ 34	$ 33	$ 201	$ 203
Fair value of plan assets	3,974	3,650	35	33	-	-
Funded status surplus (deficit)	$ (889)	$ (1,006)	$ 1	$ -	$ (201)	$ (203)

The pension plans had an accounting deficit of $889 as at the annual measurement date of May 31, 2013. This accounting deficit at May 31, 2013 decreased from a deficit of $1,006 at May 31, 2012, primarily due to positive investment experience on plan assets, partially offset by past service costs incurred.

14. Employee future benefits (continued):

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

	Pension benefits		LTD		Other benefits	
	2013	2012	2013	2012	2013	2012
Benefit obligations at end of year						
Discount rate	4.20%	4.20%	2.78%	2.89%	4.06%	4.02%
Rate of inflation	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
Benefit costs during the year						
Discount rate	4.20%	5.10%	2.78%	2.89%	4.02%	4.94%
Rate of inflation	2.00%	2.25%	2.00%	2.00%	2.00%	2.25%
Expected long-term rate of return on plan assets	6.00%	6.25%	-	-	-	-

The Company's benefit costs, which are included in salaries and benefits on the statements of operations and retained earnings (deficit) and in capital expenditures for the six months ended February 28 were as follows:

	Pension benefits		LTD		Other benefits	
	2014	2013	2014	2013	2014	2013
Benefit costs	$ 95	$ 82	$ 4	$ 4	$ 8	$ 8
Regulatory decrease (note 9 (e))	(43)	(31)	(1)	-	-	-
Additional rate stabilization drawdown related to pension (note 9 (e))	17	4	-	-	-	-
	69	55	3	4	8	8
Less: amount capitalized	(1)	(2)	-	(1)	(1)	-
Benefit expense	$ 68	$ 53	$ 3	$ 3	$ 7	$ 8

Pension expense for fiscal 2014 is currently estimated to be $119 (fiscal 2013 – $112) consisting of pension benefit costs of $191, partially offset by $69 relating to regulatory pension adjustments and $3 included in the cost of capital assets.

14. Employee future benefits (continued):

The Company's contributions to its benefit plans for the six months ended February 28 were as follows:

	2014	2013
Company contributions to funded and unfunded pension plans	$ 41	$ 43
Benefits paid directly to beneficiaries for other non-funded post-employment benefits	4	4
Company contributions to the funded LTD plan	4	4
Payment of LTD plan deficit	2	2
	51	53
Less: amounts capitalized	(2)	(3)
	$ 49	$ 50

Pension (other than the supplemental pension plan) and LTD benefits are funded. Other post-employment benefits are not funded.

Actuarial valuations for pension funding purposes are performed annually as at January 1 and are required to be filed with the Office of the Superintendent of Financial Institutions Canada ("OSFI") by June of the same year. The regulations governing the funding of federally regulated pension plans require actuarial valuations to be performed on both a going concern and a solvency basis. The actuarial valuations performed as at January 1, 2013 that were filed in June 2013 reported a going concern surplus of $188 and a statutory solvency deficiency of $629.

In October 2009, the federal government released a plan for the reform of the legislative and regulatory framework governing federally regulated private pension plans. It was announced that the funding period for solvency deficiencies would remain at 5 years but past deficits would be consolidated on a permanent basis for establishing solvency special payments, resulting in a fresh start every year. Following a transition phase, funding of solvency deficits would be based on an average of solvency ratios over the three most recent consecutive years, based on the market value of assets (statutory solvency deficiency). The funding regulations relating to the determination of statutory solvency deficiencies were adopted by the Company as of January 1, 2012. Regulations came into effect on April 1, 2011 permitting solvency special payments to be replaced by letters of credit provided the total value of the letters of credit does not exceed 15% of the pension plan's assets.

The Company is currently meeting its statutory pension solvency funding requirements with letters of credit. As at February 28, 2014, the Company has put in place letters of credit totalling $239 to meet its cumulative pension solvency funding requirements. Because the Company funds the pension plan based on the most recently filed actuarial valuations, the letters of credit (for pension funding purposes) will increase to $282 by June 2014, after which contributions and letters of credit for the annual period beginning July 1, 2014 will be based on the January 1, 2014 actuarial valuations.

The amount of required Company contributions and additional letters of credit for the remainder of fiscal 2014 and future years will be dependent on the investment experience of plan assets, the discount rates and other assumptions that will be used in future actuarial valuations to determine plan liabilities, as well as any changes in pension plan design or funding requirements that may be enacted.

14. Employee future benefits (continued):

In February 2014, the Canadian Institute of Actuaries ("CIA") released its final report summarizing the results of a Canadian pensioner mortality study. The CIA's final report reflects comments received and additional information following the release of its draft report in July 2013. The 2014 Public Sector Mortality Table included in the CIA's final report is consistent with the results of the Company's recent study of its own limited pensioner mortality experience. An estimate of the impact of adopting these unadjusted base mortality rates and improvement scales contained in the 2014 Public Sector Mortality Table is an increase in the pension plan's going concern liabilities of approximately $265 and an increase in the pension plan's solvency liabilities of approximately $380. The Company is currently reviewing pensioner mortality and other economic and demographic assumptions, to be adopted for use in the January 1, 2014 actuarial valuations of the pension plan. The actuarial report will be finalized in the coming months and filed with OSFI in June 2014. On a very preliminary basis, going concern pension contributions for the fiscal year ending August 31, 2014 are estimated to be $98 (2013 – $84) including $17 (2013 – $nil) of going concern special payments. This preliminary estimate takes into consideration the potential impact of revised mortality assumptions described above.

Information about the Company's accrued employee future benefits assets and liabilities are as follows:

	February 28 2014	August 31 2013
Accrued pension and other benefits asset		
Pension	$ 308	$ 362
Long-term disability	5	3
	313	365
Accrued pension and other benefit liabilities (note 11)		
Pension – supplemental pension benefits	(55)	(54)
Other post-employment benefits	(179)	(176)
	(234)	(230)
Net accrued employee future benefits	$ 79	$ 135

The net accrued pension and other benefits asset represents the cumulative excess of pension and LTD contributions over benefit costs. The accrued benefit liabilities represent the cumulative excess of supplemental pension and other post-employment costs over contributions. During the six months ended February 28, 2014, the net of the accrued employee future benefits assets and liabilities decreased by $56 due to benefit contributions of $51, more than offset by $107 of benefits costs.

15. Guarantees:

The Company has not provided any material guarantees other than indemnification commitments typically provided in the ordinary course of business as described in the Company's audited annual consolidated financial statements for fiscal 2013. The Company's ANS liability insurance coverage was renewed in the amount of $5,031 U.S. ($5,572 CDN) on November 15, 2013.

16. Financial 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.

(a) 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 4 (b). The use of the discounted cash flow approach described in note 4 (b) resulted in a carrying value for these investments of $276 on notes with a face value of $307. The difference of $31 is composed of fair value variances of $26 due to the discounting of cash flows at market rates and an estimate of credit losses of $5.

A change of 50 basis points in the market discount factors would impact the fair value variance by approximately $4. There is no assurance that the fair value of the Company's investments in MAV II and Ineligible Asset Tracking notes and other ABCP will not decline, or that significant 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.

(b) 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.

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

	February 28 2014	August 31 2013
Floating rate financial assets:		
Cash and cash equivalents	$ 192	$ 171
Debt service reserve fund investments	112	111
Investments in MAV II, Ineligible Asset Tracking notes and other ABCP	276	261
Total floating rate financial assets	$ 580	$ 543
Fixed rate financial liabilities:		
Bonds and notes payable	$ 2,000	$ 2,000

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 also earn interest at variable rates. If interest rates were to decline, earnings on these instruments would fall. A 100 basis point change in variable interest rates would result in an annual difference of approximately $6 in the Company's earnings before rate stabilization.

16. Financial risk management (continued):

(b) Interest rate risk (continued):

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. In addition, the Company has International Swaps and Derivatives Association ("ISDA") Agreements in place and, in November 2010, entered into a bond forward transaction in order to mitigate the impact of fluctuating interest rates on interest costs relating to the Company's MTN 2011-1 issue, which settled on February 18, 2011. A gain of $11 on the bond forward was deferred and included in long-term debt. This gain has been applied to the series MTN 2011-1 obligation and is being amortized to income using the effective interest rate method.

In June 2012, the Company entered into forward dated interest rate swap agreements totaling $200 under which the Company will notionally pay a fixed rate of interest in exchange for receiving a floating rate of interest based on the three month CDOR rate with the purpose of mitigating the potential impact of rising interest rates on the cost of refinancing a portion of the Company's $450 Series MTN 2006-1 notes that will mature on February 24, 2016. The Company intends to cash settle these agreements in February 2016 and offset any gain or loss at that time against a portion of the cost of refinancing the above mentioned notes.

In July 2012, the Company entered into a bond forward transaction in the amount of $250 with the purpose of mitigating the potential impact of rising interest rates on the cost of refinancing the Company's $250 Series MTN 2010-1 notes that matured on April 29, 2013. A loss of $2 on the bond forward was deferred and included in long-term debt. The loss has been applied to the series MTN 2013-1 obligation and is being amortized to income using the effective interest rate method.

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

(c) Foreign exchange risk:

The Company is exposed to foreign exchange risk on sales and purchases that are denominated in currencies other than the Canadian dollar, which is the functional currency of the Company. The Company invoices and receives the vast majority of its revenues in Canadian dollars and also incurs operating expenses and capital expenditures primarily in Canadian dollars. 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. Accordingly, the Company does not have a significant exposure to losses arising from fluctuations in exchange rates, except for assets and liabilities relating to the capital lease transaction and the investments in and contractual obligations relating to the investment in preferred interests in Aireon mentioned below.

As a result of entering into a capital lease transaction (note 10), the Company has a capital lease obligation 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 February 28, 2014, the payment undertaking agreements were $188 U.S. ($208 CDN) and the capital lease obligation was $196 U.S. ($217 CDN). The Company has designated a portion of the capital lease obligation reserve fund as a cash flow hedge of the capital lease obligation. 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 9 (g)). The Company currently expects no further net effect on its cash flows or results of operations from these transactions.

16. Financial risk management (continued):

(c) Foreign exchange risk (continued):

Pursuant to the November 2012 agreements, the Company acquired preferred interests in Aireon and has agreed to acquire additional preferred interests pursuant to the terms and conditions of such agreements (note 5). These agreements were modified in December 2013 to allow the Additional Investors to invest in Aireon. The agreements are denominated in U.S. dollars. As at February 28, 2014, the Company's investment in preferred interests was $55 U.S. ($61 CDN excluding transaction costs) and the Company's outstanding commitment was $95 U.S. ($105 CDN) (see note 16 (e)). The Company has entered into a hedging instrument that will limit the Canadian dollar cost related to $65 U.S. ($72 CDN) of the outstanding commitment. This instrument does not meet the requirements for hedge accounting.

(d) 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 February 28, 2014 represents the carrying amount of cash equivalents, accounts receivable, reserve funds, investments, forward contracts to purchase or sell foreign currencies and forward dated interest rate swaps.

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 4 (b), the Company limits investments to obligations of the federal government, certain provincial governments, entities guaranteed by a federal or provincial government or other obligations of entities rated by at least two rating agencies in the top two categories for long-term debt or the highest category for short-term debt. The Company does not invest in instruments with exposure to underlying synthetic assets. 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 4 (b).

The Company's additional planned investments in preferred interests of Aireon are subject to the satisfaction of certain conditions, increasing the likelihood of the successful achievement of Aireon's mandate and reducing the Company's overall risk of a financial loss on its investment in Aireon.

As a result of entering into a capital lease transaction, 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 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 at February 28, 2014 by Standard & Poor's as AA- stable and A stable and by Moody's as Aa3 stable and A2 negative.

Accounts receivable are primarily short-term receivables from customers that arise in the normal course of business. The Company provides air navigation services to various aircraft operators, including Canadian and foreign commercial air carriers as well as small general aviation aircraft. 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 for its largest air navigation services customers, and it has other credit control measures that reduce its credit exposure. The Company's general payment terms provide for payment periods of 30 days for air navigation services and payment periods of up to 45 days for some other types of services. 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.

16. Financial risk management (continued):

(d) Credit risk (continued):

The Company establishes an allowance for doubtful accounts that represents its estimate of incurred losses in respect to accounts receivable.

As at February 28, 2014, one account relating to the Company's service and development contracts represented more than 10% of total accounts receivable and other. The total amount for this customer of $10 is presented as unbilled work in progress (note 3).

The aging of trade accounts receivable was as follows:

	February 28, 2014			August 31, 2013
	Gross balance	Allowance	Net balance	Net balance
0-30 days	$ 59	$ -	$ 59	$ 68
31-60 days	-	-	-	3
61-90 days	-	-	-	1
Over 91 days	4	(2)	2	4
Total	$ 63	$ (2)	$ 61	$ 76

As at February 28, 2014, $3 of trade accounts receivable (August 31, 2013 – $7) were past due. The balance of past due amounts not provided for in our allowance for doubtful accounts relates primarily to the Company's service and development contracts and are considered collectible.

There was no significant change to the Company's allowance for doubtful accounts during the six months ended February 28, 2014.

(e) 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.

16. Financial risk management (continued):

(e) Liquidity risk (continued):

The following table presents the contractual terms to maturity of the financial liabilities owed by the Company and its contractual commitments as at February 28, 2014:

	Remaining payments – for years ending August 31						
	Total	2014	2015	2016	2017	2018	Thereafter
Accounts payable and accrued liabilities	$ 176	$ 176	$ -	$ -	$ -	$ -	$ -
Long-term debt (including current portion) [(1), (2)]	2,000	25	25	475	25	375	1,075
Interest payments [(2)]	687	50	101	89	76	74	297
Operating leases	61	4	7	7	7	7	29
Purchase obligations	22	17	4	1	-	-	-
Other long-term obligations [(3)]	236	5	11	11	11	11	187
Investment in preferred interests in Aireon [(4)]	105	72	17	-	-	16	-
Total contractual obligations	$ 3,287	$ 349	$ 165	$ 583	$ 119	$ 483	$ 1,588

(1) Payments represent principal of $2,000. 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 or may increase the size of a re-financing to generate additional liquidity or for other purposes.

(2) Further details on interest rates and maturity dates on long-term debt are provided in note 8 to these financial statements.

(3) Includes long-term obligations for post-employment benefits, accrued pension benefit liability for the Company's supplemental pension plans and other.

(4) Payments represent contractual obligations to invest in preferred interests of Aireon subject to conditions pursuant to the agreements described in note 5. It is now anticipated that, of the $72 shown above in fiscal 2014, $33 U.S. ($37 CDN) will be invested in the fiscal year ending August 31, 2015. Amounts are presented in $CDN translated using the $U.S. foreign exchange rate at the current balance sheet date.

The Company’s contributions to the pension plan are discussed in note 14 to these financial statements.

17. 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 needed to meet its current and future financial requirements for the provision of civil air navigation services. The Company views capital as the sum of its issued long-term debt, retained earnings (deficit), rate stabilization account and other regulatory liabilities, less the accrued pension and other benefits asset, 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:

	February 28 2014	August 31 2013
Carrying value of total bonds and notes payable (note 8)	$ 1,999	$ 1,999
Retained earnings (deficit)	(6)	28
Regulatory asset (note 9)	(16)	-
Rate stabilization account liability (note 9)	67	53
Regulatory liabilities (note 9)	317	303
Accrued pension and other benefits asset (note 14)	(313)	(365)
Accumulated surplus	49	19
Total capital	$ 2,048	$ 2,018

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 defined benefit pension plans.

The Company's main objectives when managing capital are:

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

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

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

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

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

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

There were no changes in the Company's approach to capital management during the six months ended February 28, 2014.