MANAGEMENT'S DISCUSSION AND ANALYSIS

ON FORM 51-102F1

YEAR ENDED

AUGUST 31, 2018

October 25, 2018

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INTRODUCTION

This management's discussion and analysis (MD&A) relates to the consolidated financial condition, results of operations, comprehensive income and cash flows for the year ended August 31, 2018 (fiscal 2018) of NAV CANADA (also referred to in this MD&A as we, our, us or the Company). It should be read in conjunction with our audited consolidated financial statements and the accompanying notes for the year ended August 31, 2018 (fiscal 2018 financial statements) as well as our 2018 Annual Information Form dated October 25, 2018 (fiscal 2018 AIF). Additional information about NAV CANADA, including our financial statements for fiscal 2018 and the year ended August 31, 2017 (fiscal 2017) and our fiscal 2018 AIF are filed on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

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

Caution Concerning Forward-Looking Information

This MD&A and, in particular, but without limitation, sections "INTRODUCTION – Significant Financial Matters: Air Traffic and Customer Service Charges", "RESULTS OF OPERATIONS – Revenue: Customer Service Charges", "RESULTS OF OPERATIONS – Financial Outlook", "LIQUIDITY AND CAPITAL RESOURCES – Cash Requirements: Pension Plans", "LIQUIDITY AND CAPITAL RESOURCES – Cash Requirements: Capital Expenditures and Other Investments" and "LIQUIDITY AND CAPITAL RESOURCES – Financial Instruments and Risk Management" of this MD&A, contain certain statements about NAV CANADA's future expectations. These statements are generally identified by words like "anticipate", "plan", "believe", "intend", "expect", "estimate", "approximate" and the like, as well as future or conditional verbs such as "will", "should", "would" and "could", or negative versions thereof. Because forward-looking statements involve future risks and uncertainties, actual results may be quite different from those expressed or implied in these statements. Examples include geopolitical unrest, terrorist attacks and the threat of terrorist attacks, war, epidemics or pandemics, natural disasters, weather patterns, environmental concerns, cyber security attacks, labour negotiations, arbitrations, workforce recruitment, training and retention, general aviation industry conditions, air traffic levels, the use of telecommunications and ground transportation as alternatives to air travel, capital market and economic conditions, the ability to collect customer service charges and reduce operating costs, the success of our investment in space-based aircraft surveillance through Aireon LLC (Aireon), credit losses on investments, changes in interest rates, changes in laws, tax changes, adverse regulatory developments or proceedings and lawsuits. Some of these risks and uncertainties are explained under "Risk Factors" in our fiscal 2018 AIF. The forward-looking statements contained in this MD&A represent our expectations as of October 25, 2018 and are subject to change after this date. Readers of this MD&A are cautioned not to place undue reliance on any forward-looking statements. We disclaim any intention or obligation to update or revise any forward-looking statements included in this document whether as a result of new information, future events or for any other reason, except as required by applicable securities legislation.

Our Business

NAV CANADA is the private sector, non-share capital company that operates Canada's civil air navigation system (ANS). With operations across Canada, we provide air navigation services to aircraft owners and operators within Canadian–controlled airspace. These services include air traffic control, flight information, weather briefings, airport advisories, aeronautical information and electronic navigation aids.

The core business of the Company is to manage and operate the ANS and related services in a safe, efficient and cost effective manner. Our mandate covers both Canadian airspace and airspace delegated to Canada under international agreements.

Financial Strategy and Rate Regulation

In establishing new customer service charges or revising existing charges, we must follow the charging principles set out in our governing legislation, the *Civil Air Navigation Services Commercialization Act* (ANS Act), which prevents us from setting customer service charges higher than what is needed to meet our financial requirements for the provision of air navigation services. Pursuant to these principles, the Board approves the amount and timing of changes to customer service charges. The Board also approves the Company's annual budget where the amounts to be recovered through customer service charges for the ensuing year are determined. Our aim is essentially to achieve breakeven financial results on the consolidated statement of operations on an annual basis. Due to seasonal and other fluctuations in air traffic and given that our costs are predominantly fixed in nature, our quarterly financial results may not achieve a breakeven position, after recording adjustments to the rate stabilization account. This is illustrated in the table under the heading "SUMMARY OF QUARTERLY RESULTS – Quarterly Financial Information (unaudited)".

As noted above, customer service charges are set based on the Company's financial requirements, which take into account estimated air traffic volumes and planned expenses. Since actual revenue and expenses will differ from these estimates, methods to accumulate the variances are required so that they may be taken into account when setting future customer service charges. There is also a need to absorb the immediate effect of unpredictable factors – mainly fluctuations in air traffic volumes resulting from unforeseen events. We meet these objectives through the use of a "rate stabilization" mechanism.

In preparing our consolidated financial statements we reflect the impact of rate regulation. As such, the timing of recognition of certain revenue and expenses differs from what would otherwise be expected for companies that are not subject to regulatory statutes governing the level of charges. For example, we adjust our net income (loss) through transfers to or from the rate stabilization account, based on variations from the amounts that were used when establishing customer service charges. If our actual revenue exceeds actual expenses, the excess is reflected as a credit to the rate stabilization account and is returnable to customers through future customer service charges. Similarly, if actual revenue turns out to be less than actual expenses, the revenue shortfall is reflected as a debit to the rate stabilization account and is recoverable from customers through future customer service charges (see "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account").

In addition, for certain transactions where the timing of the cash flows differs significantly from the accounting recognition, the Company recognizes regulatory deferral account debits and credits in order to adjust the accounting recognition to the period in which they will be considered for rate setting. These transactions are generally considered for rate setting when the amounts are expected to be realized in cash.

When determining the level of customer service charges, we consider the Company's current and future financial requirements (see "RESULTS OF OPERATIONS – Net Movement in Regulatory Deferral Accounts Related to Net Income (Loss)" and "RESULTS OF OPERATIONS – Amounts Considered for Rate Setting Purposes").

Our financial strategy is to fulfil our essential services mandate based on a sound financial foundation, reflected in part through high credit ratings in the financial markets. Maintaining this strong foundation requires a prudent approach that balances the interests of our key stakeholders while complying with our statutory and contractual obligations.

(in millions of dollars)

Selected Annual Financial Information

The following table shows selected consolidated financial information of the Company for fiscal 2018, fiscal 2017 and the fiscal year ended August 31, 2016 (fiscal 2016). This information has been derived from the Company's consolidated financial statements.

	Years ended August 31		
	2018	2017	2016
Revenue[1]	$ 1,415	$ 1,291	$ 1,393
Net income (loss) after rate stabilization and regulatory deferral account adjustments	$ -	$ -	$ -
Total assets	$ 2,334	$ 2,441	$ 2,517
Total regulatory deferral account debit balances	$ 954	$ 1,475	$ 1,708
Total current liabilities	$ 526	$ 671	$ 233
Total non-current financial liabilities[2]	$ 1,219	$ 1,232	$ 1,748
Total non-current liabilities, including non-current financial liabilities	$ 2,340	$ 2,875	$ 3,488
Total regulatory deferral account credit balances	$ 394	$ 342	$ 476

(1) Revenue in the table above is presented before rate stabilization adjustments and net of the one-time customer service charges refund in fiscal 2017.

(2) Non-current financial liabilities include long-term debt and derivative liabilities. See note 17 to our fiscal 2018 financial statements.

Revenue:

In fiscal 2018, the Company implemented revisions to its customer service charges resulting in a decrease on average of 3.5% as well as a temporary one-year rate reduction of 0.4%. This effectively continued the 3.9% one-year temporary rate reduction that was implemented for fiscal 2017. Revenue for fiscal 2018 increased over fiscal 2017 due to an increase in air traffic of 5.1% and the one-time fiscal 2017 refund to customers of $60. See "RESULTS OF OPERATIONS – Revenue" for more details on revenue balances.

In fiscal 2017, the Company implemented lower revised service charges (7.6% on average), which resulted in decreased revenue from customer service charges. The decrease was partially offset by an increase in air traffic of 5.1% as compared to fiscal 2016. In addition, the Company recorded a one-time refund to customers of approximately $60.

Net income (loss), after rate stabilization and regulatory deferral account adjustments:

In keeping with the Company's financial strategy and rate stabilization mechanism, breakeven financial results were achieved in fiscal 2018, fiscal 2017 and fiscal 2016. See "RESULTS OF OPERATIONS" for further details on net income (loss) after rate stabilization and regulatory deferral account adjustments.

Total assets:

Total assets as at August 31, 2018 were $2,334 which is a decrease of $107 compared to August 31, 2017 primarily due to:

- a $184 decrease in cash and cash equivalents (see "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the year ended August 31, 2018");
- a $24 decrease in current investments primarily due to the withdrawal of surplus funds from the debt service reserve fund; and
- a $9 decrease in employee benefits related to the Company's long-term disability (LTD) plans resulting from higher benefit expense than contributions paid;

partially offset by:

- a $68 increase in the investment in preferred interests of Aireon primarily due to the increase in fair value arising from the price paid by NATS, the United Kingdom's air navigation service provider (ANSP) for their investment in Aireon (see "SIGNIFICANT FINANCIAL MATTERS – Investment in Space-Based Aircraft Surveillance through Aireon") as well as a $12 increase in preferred dividends receivable;
- a $32 increase in property, plant and equipment and intangible assets; and
- a $10 increase in other non-current assets due to bridge financing provided to Aireon (see "SIGNIFICANT FINANCIAL MATTERS – Investment in Space-Based Aircraft Surveillance through Aireon").

Total assets as at August 31, 2017 were $2,441 which is a decrease of $76 compared to August 31, 2016 primarily due to:

- a $278 decrease in current investments as a result of the maturity and receipt of the remaining principal balances of $293 of Master Asset Vehicle II (MAV II) Class A-1 and A-2 notes, restructured asset-backed commercial paper (ABCP) and investment in other notes, partially offset by the release of fair value provisions on these investments of $14. The proceeds were used to reduce debt levels, to fund the Company's pension plan, and to fund a portion of the capital asset program; and
- a $23 decrease in intangible assets;

partially offset by:

- a $103 increase in cash and cash equivalents;
- a $59 increase in the investment in preferred interests of Aireon primarily due to completion of the tranche 4 and tranche 5 investments and an increase in preferred dividends receivable during the year, partially offset by unrealized foreign exchange losses as a result of fluctuation in the Canadian dollar against the U.S. dollar;
- a $41 increase in property, plant and equipment;
- an $11 increase in employee benefits related to the Company's LTD plans resulting from lower benefit expense than contributions paid; and

- a $7 carrying value as at August 31, 2017 of the Company's investment in equity-accounted investee (See "INTRODUCTION – Significant Financial Matters: Investment in Equity-Accounted Investee").

Total regulatory deferral account debit balances:

See "RESULTS OF OPERATIONS – Net Movement in Regulatory Deferral Accounts Related to Net Income (Loss)" and "RESULTS OF OPERATIONS – Other Comprehensive Income (Loss)".

Total regulatory deferral account debit balances as at August 31, 2018 decreased by $521 compared to August 31, 2017 primarily due to:

- a $608 decrease in the regulatory deferral account related to the deferral of fiscal 2018 pension re-measurement gains; and
- a $21 decrease in the regulatory deferral accounts relating to other post-employment benefit re-measurements to defer re-measurement gains for fiscal 2018 of $14 and recover $8 related to costs deferred in prior years;

partially offset by:

- a $98 increase in the regulatory deferral account related to employee benefit pension contributions to adjust the total pension benefit expense to the level of going concern and solvency pension contributions to be recovered through rate setting; and
- a $22 increase in the regulatory deferral account related to supplemental pension re-measurements.

Total regulatory deferral account debit balances as at August 31, 2017 decreased by $233 compared to August 31, 2016 primarily due to:

- a $231 decrease in the regulatory deferral account related to deferring fiscal 2017 pension re-measurement gains; and
- a $41 decrease in the regulatory deferral account related to derivative liabilities as a result of unrealized fair value gains of $38 on forward-dated interest rate swap agreements maturing in April 2019 and the settlement of the foreign exchange forward contract entered into to hedge the Company's tranche 4 investment in preferred interests of Aireon;

partially offset by:

- a net increase of $26 in regulatory deferrals related to supplemental pension re-measurements primarily due to actuarial losses and negative experience on the defined benefit obligation;
- an $11 increase in regulatory deferrals related to future income taxes, mainly as a result of the increase in the fair value of the Company's investment in preferred interests of Aireon; and
- a net increase of $3 in regulatory deferrals related to other post-employment re-measurements which includes the deferral of curtailment expense of $11 incurred on the elimination and settlement of severance benefits for employees represented by collective agreements for three unions (see "INTRODUCTION – Significant Financial Matters: Collective Agreements").

Total current liabilities:

The Company's total current liabilities as at August 31, 2018 decreased by $145 compared to August 31, 2017 primarily due to:

- a $60 decrease in the accrual of the $60 one-time refund of customer service charges which was issued in fiscal 2018; and
- a $100 decrease in the current portion of long-term debt due to the reclassification of the $250 Series MTN 2009-1 General Obligation notes that mature in April 2019 to current debt as compared to the $350 Series MTN 2013-1 General Obligation Notes that matured in April 2018;

partially offset by:

- a $17 increase in trade and other payables.

The Company's total current liabilities as at August 31, 2017 increased by $438 compared to August 31, 2016 primarily due to:

- a $350 increase in the current portion of long-term debt due to the reclassification of the $350 Series MTN 2013-1 General Obligation Notes that matured in April 2018 to current debt;
- accrual of the $60 one-time refund of customer service charges as discussed in the Revenue section above; and
- a $28 increase in trade and other payables.

Total non-current liabilities (including non-current financial liabilities):

The Company's total non-current liabilities as at August 31, 2018 decreased by $535 compared to August 31, 2017 primarily due to:

- a $12 decrease in derivative liabilities as a result of unrealized fair value adjustments on bond forward agreements maturing in April 2019;
- a $516 decrease in the employee benefit liability including a $419 decrease in accrued pension obligations of $491 and $51 in other defined benefit obligations, partially offset by a $27 increase in supplemental pension obligations; and
- a $6 decrease in the deferred income tax liability related to the Company's investment in preferred interests of Aireon, mainly as a result of the change in the U.S. federal corporate income tax rate from 35% to 21% partially offset by the increase in the fair value of the investment.

The Company's total non-current liabilities as at August 31, 2017 decreased by $613 compared to August 31, 2016 primarily due to:

- a $474 decrease in long-term debt due to the reclassification of the $350 Series MTN 2013-1 General Obligation Notes that matured in April 2018 to current debt, the redemption of $100 of the $350 Series MTN 2009-1 General Obligation Notes in December 2016 and the $25 principal payment on the Series 97-2 amortizing revenue bonds (see "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Financing Strategy");
- a $108 net decrease in employee benefit liabilities including a $148 decrease in accrued pension obligations partially offset by a $28 increase in supplemental pension obligations and an increase of $17 in severance benefit obligations; and

- a $42 decrease in derivative liabilities related to forward-dated interest rate swap agreements due to positive fair value adjustments;

partially offset by:

- a $10 increase in the deferred income tax liability related to the Company's investment in preferred interests of Aireon, mainly as a result of the increase in the fair value of the investment due to additional investments made during fiscal 2017.

Total regulatory deferral account credit balances:

See "RESULTS OF OPERATIONS – Net Movement in Regulatory Deferral Accounts Related to Net Income (Loss)" and "RESULTS OF OPERATIONS – Other Comprehensive Income (Loss)".

Total regulatory deferral account credit balances as at August 31, 2018 increased by $52 compared to August 31, 2017 primarily due to:

- a $68 increase in regulatory deferrals related to the Company's investment in Aireon from the deferral of unrealized positive fair value adjustments, dividends earned and the deferral of unrealized foreign exchange losses;

partially offset by:

- a $9 decrease in the regulatory deferral related to employee benefit pension contributions bringing the account into a debit position as described above; and

- a net decrease of $7 in the rate stabilization account due to the initial Board approved adjustment of $10 partially offset by favourable variances from planned results of $3.

Total regulatory deferral account credit balances as at August 31, 2017 decreased by $134 compared to August 31, 2016 primarily due to:

- a $127 decrease in regulatory deferrals related to employee benefit pension contributions to adjust the total pension benefit expense to the level of going concern pension contributions to be recovered through rate setting; and

- a $38 decrease in the rate stabilization account as a result of the initial Board-approved adjustment for fiscal 2017;

partially offset by:

- a net increase of $23 in regulatory deferrals related to the Company's investment in Aireon from the deferral of unrealized positive fair value adjustments and dividends earned, partially offset by the deferral of unrealized foreign exchange losses;

- an $8 regulatory deferral of LTD contributions resulting from lower benefit expense than contributions paid; and

- a $4 deferral of the unrealized gain on the Company's remaining 50% interest in Searidge Technologies Inc. (Searidge), partially offset by the Company's share of the net assets of Searidge for the year ended August 31, 2017.

(in millions of dollars)

Financial Highlights

Results of operations for the year ended August 31, 2018

	Year ended August 31		
	2018	2017	Change
Revenue	$ 1,415	$ 1,291	$ 124
Operating expenses	1,396	1,330	66
Other (income) and expenses	60	97	(37)
Income tax (recovery) expense	(8)	14	(22)
Net income (loss), before rate stabilization and regulatory deferral account adjustments	(33)	(150)	117
Net movement in regulatory deferral accounts			
Rate stabilization adjustments:			
Favourable variances from planned results	(3)	(60)	57
Customer service charges refund	-	60	(60)
Initial approved adjustment [(1)]	10	38	(28)
	7	38	(31)
Other regulatory deferral account adjustments:			
Employee benefit pension contributions	107	127	(20)
Other employee benefits	(9)	(1)	(8)
Investment in preferred interests, before tax	(68)	(25)	(43)
Investment in equity-accounted investee	1	(4)	5
Income tax	(6)	14	(20)
Realized hedging transactions	1	1	-
	26	112	(86)
	33	150	(117)
Net loss, after rate stabilization and regulatory deferral account adjustments	$ -	$ -	$ -

(1) The Company approved a $10 transfer out of the rate stabilization account to be recorded in fiscal 2018 (fiscal 2017 – $38), in order to achieve planned breakeven results of operations. The adjustment was transferred evenly out of the rate stabilization account throughout the fiscal year.

In keeping with our financial strategy and rate stabilization mechanism, the Company achieved breakeven financial results for fiscal 2018. Excluding rate stabilization and other regulatory deferral account adjustments, the Company recorded a net loss of $33 in fiscal 2018 (fiscal 2017 - $150). The Company achieved positive financial performance in fiscal 2018 as compared to its approved budget, as reflected by the $3 of favourable variances from planned results shown above.

The favourable variances from planned results in fiscal 2017 were offset by the recording of a one-time refund of customer service charges of $60. This refund was issued in fiscal 2018.

(in millions of dollars)

The net movement in regulatory deferral accounts for fiscal 2018 was a net income of $33 as compared to a net income of $150 in the prior fiscal year. The change of $117 is primarily due to the recognition of the $60 customer service charges refund in fiscal 2017 and the planned transfer out of the rate stabilization account of $10 compared to the transfer out of the rate stabilization account of $38 in fiscal 2017 and $86 less regulatory adjustments for certain transactions to adjust the accounting recognition to the periods in which they will be considered for rate setting.

As shown below, cash and cash equivalents decreased by $184 during the year ended August 31, 2018 and the Company experienced negative free cash flow of $86, which is a non-GAAP (Generally Accepted Accounting Principles) financial measure. Non-GAAP financial measures do not have any standardized meaning prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers. The Company defines free cash flow as cash generated from operations, less capital expenditures and investments in Aireon and equity related investments. Management places importance on this indicator as it assists in measuring the impact of its investment program on the Company's financial resources.

	Year ended August 31		
	2018	2017	Change
Cash flows from:			
Operations (1)	$ 85	$ 143	$ (58)
Investing (1)	(178)	98	(276)
Financing (1)	(91)	(135)	44
Cash flows from operating, investing and financing activities	(184)	106	(290)
Effect of foreign exchange on cash and cash equivalents	-	(3)	3
Increase (decrease) in cash and cash equivalents	(184)	103	(287)
Cash and cash equivalents, beginning of period	222	119	103
Cash and cash equivalents, end of period	$ 38	$ 222	$ (184)
Free cash flow (non-GAAP financial measure):			
Cash flows from:			
Operations (2)	$ 85	$ 143	$ (58)
Capital expenditures (2)	(176)	(157)	(19)
Investment in preferred interests (2)	-	(36)	36
Income tax refund (payment) on investment in preferred interests (2)	5	(5)	10
Proceeds from sale of investment in subsidiary (2)	-	4	(4)
Free cash flow	$ (86)	$ (51)	$ (35)

(1) See "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the year ended August 31, 2018" for discussion of the changes in cash flows from the prior fiscal year.

(2) See the statement of cash flows in our fiscal 2018 financial statements.

Significant Financial Matters

The following items have significant financial importance to the Company:

1. Rate Stabilization Account

As at August 31, 2018, the rate stabilization account (see "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account") had a credit balance of $124, which is above its target of $104 for fiscal 2018 (see "RESULTS OF OPERATIONS – Amounts Considered for Rate Setting Purposes").

The rate stabilization account decreased by $7 during the year ended August 31, 2018 due to $3 of favourable variances from planned results offset by the $10 initially approved adjustment to the rate stabilization account. Rate stabilization adjustments are described under "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account".

2. Air Traffic and Customer Service Charges[1]

Over the course of fiscal 2018, air traffic volumes increased by 5.1% year-over-year. The approved budget for fiscal 2018 had assumed growth of 4.2% for the year. The Company's current annual forecast for air traffic growth for the year ending August 31, 2019 (fiscal 2019) is 3.6%.

We continuously monitor our financial requirements and air traffic, and regularly update our financial forecasts to account for changes in the economic environment. On a quarterly basis, we review the most current information available from aviation industry sources as well as forecasts of macro-economic indicators; we then modify our forecasts accordingly and consider the need for a change in rates.

On August 7, 2018, the Company issued an announcement detailing the implementation of revised customer service charges for fiscal 2019. Strong traffic results in fiscal 2018 along with traffic growth projections for fiscal 2019 has enabled the Company to implement revised customer service charges, whereby existing base rates decreased by an average of 0.4% on September 1, 2018. This effectively continues the one-year temporary rate reduction implemented on September 1, 2017. On average, customers will pay the same rates in fiscal 2019 as they did in fiscal 2018, however the rate revisions vary by service charge and therefore some customers will pay more while others will pay less.

3. Pension Plans

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

Going concern contributions for the annual period beginning July 1, 2018 are based on the January 1, 2018 actuarial valuations, with a retroactive adjustment to the beginning of the calendar year. The actuarial valuations performed as at January 1, 2018 reported a going concern surplus of $503 (2017 - $242).

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

A statutory solvency surplus of $561 was reported as at January 1, 2018 (2017 - $334) based on the assumption that the September 1, 2016 plan text restatement, which included the plan termination amendment that is currently subject to OSFI's review, was in effect on the valuation date. Had the amendment not been included, there would have been a statutory solvency deficiency of $89 as of January 1, 2018 (2017 - $289). The amendment does not impact the going concern valuation.

As at August 31, 2018, the Company has put in place letters of credit totaling $495 to meet its cumulative pension solvency funding requirements on a pre-amendment basis. Outstanding letters of credit represent 9% of solvency liabilities on a post-amendment basis and 8% on a pre-amendment basis. The Company funded its calendar 2018 solvency funding requirements of $18 with letters of credit. Solvency contributions will continue to be funded on a pre-amendment basis while discussions with OSFI are ongoing.

All of the Company's eight collective agreements include the following significant changes in the pension area, which were achieved either through negotiation or arbitration in the fiscal years ended August 31, 2013, 2014 and 2015:

(a) All new employees represented by the Canadian Air Traffic Control Association (CATCA) Unifor Local 5454, the Air Traffic Specialists Association of Canada (ATSAC) Unifor Local 2245, the Canadian Federal Pilots Association (CFPA), the Canadian Association of Financial Officers (ACFO), the International Brotherhood of Electrical Workers Local 2228 (IBEW) and Unifor Local 1016 as at January 1, 2014, are required to join Part B of the NAV CANADA Pension Plan (NCPP), which has a non-contributory defined benefit design. Previously, new employees represented by these unions had the alternative of joining Part A of the NCPP, which has a contributory defined benefit design and under which pension benefits are automatically indexed to inflation. Effective October 1, 2014, all new employees represented by the Professional Institute of the Public Service of Canada (PIPSC) are required to join Part B of the NCPP. Effective December 1, 2014, all new employees represented by the Public Service Alliance of Canada (PSAC) are required to join Part B of the NCPP. Previously, new employees represented by PIPSC and PSAC were required to join Part A of the NCPP. Part B of the NCPP provides for a lower level of benefits that are not indexed. Part B was introduced effective January 1, 2009 and has been mandatory for new non-unionized employees since that time. The Company expects that its current service pension costs will decline significantly over time, as new employees join Part B of the NCPP.

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

    This change should not have any effect on employees or pensioners; however, it will significantly improve the solvency position of the NCPP, thereby reducing the Company's required solvency funding requirements, which are currently being met with a combination of cash contributions and letters of credit.

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

The Company has communicated with OSFI, and OSFI has indicated that they agree with (a) and (c) above, but resolution of (b) remains outstanding. While the Company waits for clarification on OSFI’s view of (b), it has filed its required actuarial funding valuation report as at January 1, 2018 on the basis that (b) is approved, while continuing to fund on a pre-amendment basis. The Company will continue to pursue implementation of (b) in a manner available to plan sponsors under the *Pension Benefits Standards Act, 1985*. The arbitration decisions acknowledge that union leadership has joined the Company in the past in making representations to OSFI to support the changes in (b) above and will continue to do so at any future meeting with OSFI, or subsequent related processes.

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

We use an annual measurement date of August 31 to determine the accounting surplus or deficit and to establish pension costs for the coming fiscal year. The Company’s pension plans had an accounting deficit of $831 as at the annual measurement date of August 31, 2018 (2017 - $1,295). The $464 decrease in the deficit position during the year ended August 31, 2018 is primarily due to actuarial gains of $586 partially offset by actuarial accounting expense exceeding Company contributions by $122. The $586 of actuarial gains are primarily due to a $280 net actuarial gain (mainly from a 20 basis point increase in the real discount rate to 3.80% from 3.60% at August 31, 2017) and a return on plan assets $306 greater than the expected return based on the discount rate at August 31, 2017.

Further information on the Company’s pension plans is discussed under the heading “LIQUIDITY AND CAPITAL RESOURCES – Cash Requirements: Pension Plans”.

4. Collective Agreements

Approximately 87% of our workforce is unionized under eight collective agreements. During fiscal 2018, the Company announced the ratification of new collective agreements with three of its unions: CFPA, IBEW and Unifor Local 1016.

As at the end of fiscal 2018, collective agreements had been renewed with seven of eight bargaining units covering approximately 93% of our represented employees. The PSAC agreement, representing approximately 7% of our represented employees, remains outstanding although it is expected to be renewed before the end of the calendar year.

Throughout fiscal 2019, collective agreements with each of CATCA, ATSAC, CFPA, PIPSC and Unifor Local 1016, representing approximately 78% of our represented employees, will open again for renewal.

Should OSFI approve the plan termination amendment discussed under “INTRODUCTION – Significant Financial Matters: Pension Plans” (which formed part of the arbitration panels’ decisions as well as the negotiated settlements referred to), each collective agreement would then be subject to a re-opening of negotiations on wages. That is, the parties would return to the bargaining table and discuss whether or not additional compensation is appropriate. In most instances, an arbitration panel would retain jurisdiction over the matter should the parties be unable to agree on an appropriate outcome.

5. Investment in Space-Based Aircraft Surveillance through Aireon:

As discussed in note 11 to the fiscal 2018 financial statements, in May 2018, Aireon's Limited Liability Company Agreement was amended and a subscription agreement was entered into between Aireon and NATS (collectively the May 2018 agreements), the United Kingdom's ANSP, to provide for the making of an investment of $69 U.S. ($90 CDN) in Aireon by NATS. As at August 31, 2018, the Company's investment in Aireon is $150 U.S. ($196 CDN) (August 31, 2017 - $150 U.S. ($187 CDN)). Following entering into the May 2018 agreements, the Company is represented by five out of the eleven directors on Aireon's board of directors.

In accordance with the May 2018 agreements, a portion of Iridium Communication Inc.'s (Iridium's) existing common equity interest in Aireon will be redeemed for a payment from Aireon of $120 U.S. ($156 CDN) to finalize the ownership interests of all Aireon's investors. Upon this redemption and the related conversion of all preferred interests into common equity interests, NAV CANADA will hold 45.3% of the fully diluted common equity interests of Aireon (51% prior to the NATS investment), ENAV and NATS will each hold 11.1%, and each of the Irish Aviation Authority (IAA) and Naviair will hold 5.3%, with the remaining 21.8% being retained by Iridium. This redemption is subject to Aireon's availability of funds and is expected to occur by August 31, 2021.

As at August 31, 2018, the Company's total fully diluted common equity interest on a post conversion basis and prior to the redemption by Iridium is 37.2% (August 31, 2017 - 40.9%).

Upon the initial investment by ENAV, IAA and Naviair in February 2014, the price paid by these three investors for preferred interests in Aireon with substantially the same characteristics was considered to be a reliable estimate of the fair value of Aireon. The Company used this valuation to measure the fair value of its investment in Aireon as at August 31, 2017. Following the investment by NATS in May 2018, the Company has used the price paid by NATS for an investment in preferred interests in Aireon to determine the fair value of its investment as at August 31, 2018, as it was determined that this represents the best estimate of fair value. As at August 31, 2018, the fair value of the Company's investment in preferred interests of Aireon has increased to $418 (August 31, 2017 - $350).

In December 2017, the U.S. government passed legislation to reduce the federal corporate income tax rate from 35% to 21%. The Company's net deferred tax liability as at August 31, 2018 of $38 U.S. ($49 CDN) (August 31, 2017 - $45 U.S. ($55 CDN)) reflects this new rate.

On February 28, 2018, the Company entered into an agreement with Aireon to provide bridge financing, up to a total of $29 U.S. ($38 CDN), with an annual interest rate of 11%. Amounts drawn under the agreement are to be repaid on the earlier of September 30, 2019 and the date on which the initial funding under a senior credit facility is made. As at August 31, 2018, Aireon has drawn $7 U.S. ($10 CDN) under the agreement.

6. Financing Activities

In August 2017, the Company entered into a bond forward transaction in the amount of $137 in order to mitigate a portion of the potential impact of rising interest rates on the cost of refinancing the $350 Series MTN 2013-1 General Obligation Notes that matured on April 19, 2018. This bond forward agreement was closed in January 2018 as a result of changes in our refinancing plans and a new bond forward agreement for the same amount was entered into simultaneously to align with the revised plan.

(in millions of dollars)

On March 29, 2018, the Company issued $275 Series MTN 2018-1 General Obligation Notes due on March 30, 2048. The notes have an annual interest rate of 3.293%. The proceeds of these notes were used to partially repay the Company's $350 Series MTN 2013-1 General Obligation Notes that matured on April 19, 2018. The remainder of the maturity was repaid with available cash and by drawing on the Company's syndicated credit facility. The Company also closed the bond forward agreement that had been entered into in January 2018. The Company incurred a net loss of $2 in closing both bond forward agreements.

In fiscal 2015, the Company entered into forward-dated interest rate swaps ("swaps") in order to hedge $200 of an expected 30-year refinancing of the $250 debt maturity in April 2019. In June 2018, the Company settled these swaps at a loss of $8 and entered into a bond forward in the amount of $190. The bond forward allows us to remain hedged against movements in the Government of Canada benchmark rate while removing exposure to future movements in the swap spread. The loss of $8 will be deferred and amortized over the life of the originally anticipated issue (30 years).

RESULTS OF OPERATIONS

Revenue

The following table provides a breakdown of our revenue by category. Our fiscal 2018 AIF and the notes to our fiscal 2018 annual consolidated financial statements provide more information about the different categories of our customer service charges.

	Year ended August 31			
	2018	2017	Change	%
Enroute	$ 704	$ 676	$ 28	4%
Terminal	517	488	29	6%
Daily / annual / quarterly	93	84	9	11%
North Atlantic and international communication	45	46	(1)	(2%)
Total customer service charges	1,359	1,294	65	5%
Customer service charges refund	-	(60)	60	(100%)
Other	56	57	(1)	(2%)
	$ 1,415	$ 1,291	$ 124	10%

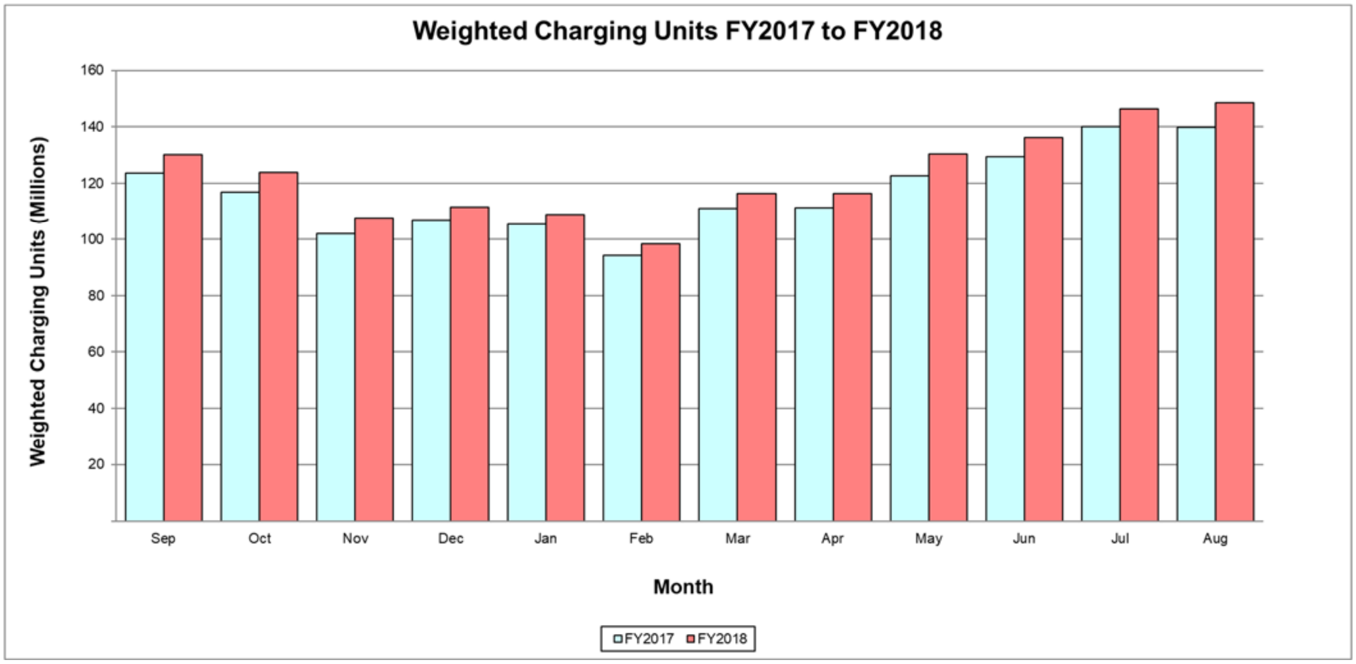
Other revenue consists of service and development contracts, conference centre sales at our facility in Cornwall (Ontario), the sale of civil aeronautical publications and other miscellaneous revenue.

Revenue for fiscal 2018 was $1,415 compared to $1,291 for fiscal 2017. The $124 increase is primarily due to:

- a $65 increase in customer service charges revenue arising from an increase of 5.1% in air traffic volumes during fiscal 2018; and
- a $60 one-time refund of customer service charges revenue.

Air Traffic

Air traffic growth for fiscal 2018 increased by 5.1% when compared to fiscal 2017. The following chart shows traffic in "weighted charging units", a measure of the number of flights, aircraft size and distance flown for fiscal 2018, compared to fiscal 2017.



Future air traffic volumes may be influenced by numerous factors, including the rate of economic growth or decline, changing air passenger demand, aircraft capacity utilization levels, fuel costs, changes in air carrier operations, air carrier competition, airline restructurings and insolvencies, terrorist activities, epidemics or pandemics, weather patterns, natural disasters, environmental concerns, demographic patterns and other factors.

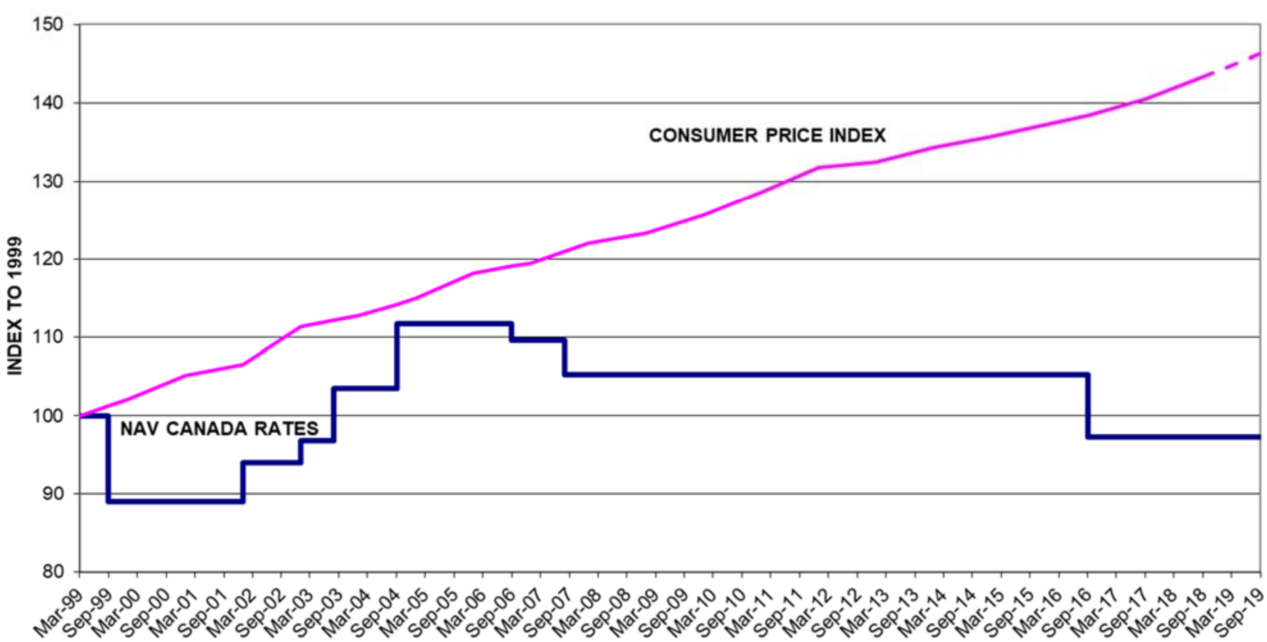
Customer Service Charges[2]

The levels of our customer service charges are a function of our costs, the required level of service, air traffic volumes and revenue from non-aeronautical sources (see "RESULTS OF OPERATIONS – Amounts Considered for Rate Setting Purposes").

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

The following chart illustrates the evolution of our levels of customer service charges over time.

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



1. Average changes since charges were fully implemented on March 1, 1999
2. Consumer Price Index - Growth assumed to be 2.0 per cent for 2018 and beyond

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

(in millions of dollars)

As can be seen in the chart above, the Company has not had an overall rate increase since fiscal 2005, and has implemented four rate decreases since the rates were implemented in 1999. The chart also depicts the revised service charges that came into effect September 1, 2018 (discussed below).

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

On August 7, 2018, the Company announced the implementation of revised charges, which came into effect on September 1, 2018. Strong traffic results in fiscal 2018 along with traffic growth projections for fiscal 2019 enabled the Company to implement revised service charges, whereby existing base rates decreased by an average of 0.4% on September 1, 2018. This effectively continues the one-year temporary rate reduction implemented on September 1, 2017. On average, customers will pay the same rates in fiscal 2019 as they did in fiscal 2018, however, the rate revisions vary by service charge and therefore some customers will pay more while others will pay less.

Effective September 1, 2018, the revised customer service charges were on average 3% lower than when they were first implemented on a full cost recovery basis in March 1999, which is approximately 47 percentage points less than the change in the CPI since March 1999.

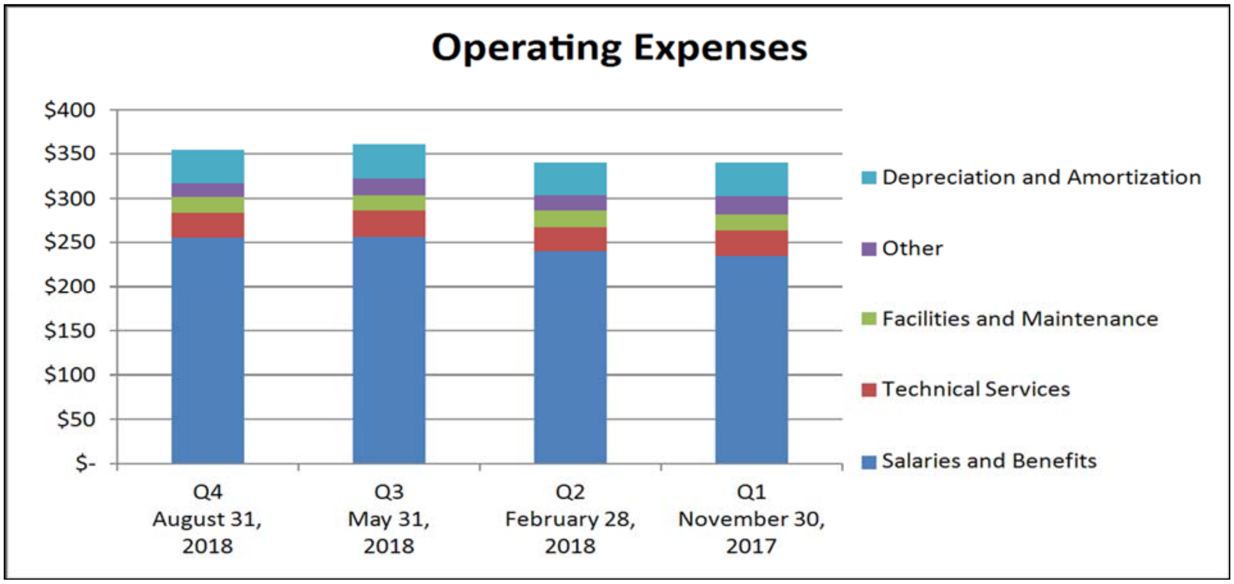
Operating Expenses

	Year ended August 31			
	2018	2017	Change	%
Salaries and benefits	$ 986	$ 925	$ 61	7%
Technical services	114	112	2	2%
Facilities and maintenance	72	72	-	0%
Depreciation and amortization	152	147	5	3%
Other	72	74	(2)	(3%)
	$ 1,396	$ 1,330	$ 66	5%

Salaries and benefits expense for the year ended August 31, 2018 increased by $61, compared to fiscal 2017 primarily due to increased compensation levels and overtime costs arising from negotiated increases in collective agreements, increased staffing requirements to meet air traffic growth and activities related to supporting projects and maintaining optimum staffing levels across the country, and increased costs relating to LTD partially offset by the $11 curtailment loss incurred for the voluntary elimination and settlement of severance benefits for employees recorded in fiscal 2017.

Depreciation and amortization increased by $5 in fiscal 2018 as a result of an increased cost base of property, plant and equipment and intangible assets compared to fiscal 2017.

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



The increase in salaries and benefits in Q3 and Q4 of fiscal 2018 is a result of increased activity in the warmer months of the year due to higher seasonal air traffic volumes.

(in millions of dollars)

Other (Income) and Expenses (Including Income Tax (Recovery) Expense)

	Year ended August 31		
	2018	2017	Change
Finance income			
Interest income	$ (4)	$ (3)	$ 1
Net change in fair value of financial assets at FVTPL			
MAV II, ABCP and other investments	(2)	(15)	(13)
Investment in preferred interests	(52)	(37)	15
	(54)	(52)	2
Total finance income	(58)	(55)	3
Net interest costs relating to employee benefits	54	55	1
Other finance costs			
Interest expense	77	80	3
Redemption premium	-	10	10
	77	90	13
Other (gains) and losses			
Foreign exchange (gains) losses	(14)	12	26
Realized gain on sale of investment in subsidiary	-	(2)	(2)
Unrealized gain on sale of investment in subsidiary	-	(5)	(5)
Share of net loss of equity-accounted investee	1	1	-
Other losses	-	1	1
	(13)	7	20
	$ 60	$ 97	$ 37
Income tax (recovery) expense	$ (8)	$ 14	$ 22

The net change in fair value of financial assets at fair value through profit or loss (FVTPL) increased by $2 compared to fiscal 2017. Positive fair value adjustments of $2 on MAV II, ABCP and other investments were recorded in fiscal 2018 compared to $15 in fiscal 2017. Positive fair value adjustments of $40 and dividend income of $12 were recorded in fiscal 2018 on the investment in preferred interests of Aireon compared to positive fair value adjustments of $26 and dividend income of $11 in fiscal 2017.

The $13 decrease in other finance costs is primarily due to the redemption premium of $10 incurred in fiscal 2017 related to the early redemption of $100 of the $350 Series MTN 2009-1 General Obligation Notes. No similar costs were incurred in fiscal 2018.

In fiscal 2017, the Company recorded realized gains of $2 and unrealized gains of $5 on the sale of a portion of the Company's investment in Searidge. No similar gains were recognized in fiscal 2018.

The $26 increase in foreign exchange gains is primarily due to recording unrealized foreign exchange gains of $14 on the investment in Aireon in fiscal 2018 due to the fluctuation of the Canadian dollar against the U.S. dollar, compared to losses of $12 in fiscal 2017.

Income tax decreased by $22 in fiscal 2018 compared to fiscal 2017 as a result of the decrease in net deferred tax liabilities related to the Company's investment in preferred interests of Aireon due to the change in the U.S. federal corporate income tax rate from 35% to 21%, partially offset by the tax effect of the increase in fair value of the investment recorded in the third quarter of fiscal 2018.

(in millions of dollars)

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

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

	Year ended August 31		
	2018	2017	Change
Rate stabilization account	$ 7	$ 38	$ (31)
Other regulatory deferral accounts			
Employee benefit pension contributions	107	127	(20)
Other employee benefits	(9)	(1)	(8)
Investment in preferred interests, before tax	(68)	(25)	(43)
Investment in equity-accounted investee	1	(4)	5
Income tax	(6)	14	(20)
Realized hedging transactions	1	1	-
	$ 33	$ 150	$ (117)

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

The net movement in the employee benefit pension contributions regulatory deferral account for the year ended August 31, 2018 decreased by $20 compared to the same period in fiscal 2017. Regulatory adjustments to adjust the total pension benefit expense to the level of pension contributions to be recovered through rate setting were $107 in fiscal 2018 compared to $127 in fiscal 2017. Included in the fiscal 2018 regulatory deferral related to pension contributions of $107 is the planned recovery of $10 of the $44 solvency deficiency contributions made in fiscal 2017.

The net movement in the other employee benefits regulatory deferral account increased by $8 in fiscal 2018 compared to fiscal 2017. The increase is due to the regulatory recovery of past actuarial re-measurements relating to other benefits of $7 and the deferral of vesting and non-vesting sick leave of $5, partially offset by a loss relating to LTD of $3 in fiscal 2018. In fiscal 2017 a regulatory deferral of $1 was recorded.

The $43 increase in the investment in preferred interests regulatory deferral account for the year ended August 31, 2018 is primarily due to the regulatory deferral of the $68 increase in fair value of the investment, compared to an increase of $25 recorded in the year ended August 31, 2017.

The net movement in the investment in equity-accounted investee regulatory deferral accounts relates to the deferral of the unrealized gain of $5 on the Company's remaining 50% interest in Searidge recorded in fiscal 2017. No similar regulatory deferral was recorded in fiscal 2018.

The net movement in the income tax regulatory deferral account includes the deferral of future income tax liabilities related to the Company's investment in preferred interests of Aireon as well as its remaining 50% interest in Searidge. The $20 decrease in fiscal 2018 compared to fiscal 2017 is a result of the decrease in net deferred tax liabilities related to the investment in preferred interests of Aireon which is due to the change in the U.S. federal corporate income tax rate from 35% to 21%, partially offset by the tax effect of the increase in fair value of the investment recorded in Q3 fiscal 2018.

(in millions of dollars)

Movements in Rate Stabilization Account

Our rate stabilization mechanism and accounting are described at the beginning of this MD&A and in notes 1 and 8 of our fiscal 2018 financial statements. The table below shows the movements in the rate stabilization account.

	Year ended August 31		
	2018	2017	Change
Credit balance on the statement of financial position, beginning of period	$ 131	$ 169	$ (38)
Variances from planned results:			
Revenue higher than planned	24	56	(32)
Operating expenses higher than planned	(13)	(28)	15
Other (income) and expenses lower (higher) than planned	62	(25)	87
Net movement in other regulatory deferral accounts	(70)	57	(127)
Total variances from planned results	3	60	(57)
Initial approved adjustment	(10)	(38)	28
Net movement in rate stabilization account recorded in net income (loss)	(7)	(38)	31
Credit balance on the statement of financial position, end of period	$ 124	$ 131	$ (7)

The $7 decrease in the rate stabilization account during the year ended August 31, 2018 is primarily due to:

- net movement of $70 in regulatory deferral accounts that was less favourable than planned primarily due to:
    - a net regulatory expense $53 higher than planned related to the Company's investment in preferred interests of Aireon, to defer the increase in fair value of the investment and unrealized foreign exchange gains due to the fluctuation of the Canadian dollar against the U.S. dollar;
    - a regulatory expense $10 higher than planned for income tax to defer the decrease in net deferred tax liabilities related to the investment in preferred interests of Aireon partially offset by the deferral of the tax effect of the increase in fair value of Aireon recorded in Q3 fiscal 2018; and
    - a regulatory expense for pensions that was $7 higher than planned primarily due to higher pension contributions than planned;
- operating expenses that were $13 higher than planned, primarily due to higher salaries and benefits expense, partially offset by lower technical services and other miscellaneous expenses; and
- the planned adjustment of $10, representing the anticipated $10 annual net loss at the time the fiscal 2018 budget was approved;

(in millions of dollars)

partially offset by:

- other (income) and expense that was $62 lower than planned primarily due to the increase in the fair value of the investment in preferred interests of Aireon, the decrease in net deferred tax liabilities related to that investment, arising from the decrease in the U.S. federal corporate income tax rate, as well as foreign exchange gains higher than planned; and
- revenue that was in total $24 higher than planned due to a 5.1% increase in air traffic volumes compared to the budgeted increase of 4.2% for the year ended August 31, 2018 as well as higher other revenue than planned of $12.

Other Comprehensive Income (Loss)

The accounting recognition of other comprehensive income (loss) amounts are offset by regulatory deferrals in order to defer the accounting recognition to the periods in which they will be considered for rate setting. These transactions are generally considered for rate setting when the amounts are expected to be realized in cash, with the exception of the cash flows related to hedging instruments, which are considered for rate setting in the same period as the underlying hedged transaction, and re-measurements of unfunded defined employee benefit plans, which are considered for rate setting over the employees' average expected remaining service period.

	Year ended August 31		
	2018	2017	Change
Items that will not be reclassified to income or (loss):			
Re-measurements of employee defined benefit plans	$ 600	$ 209	$ 391
Net movement in regulatory deferral accounts	(600)	(209)	(391)
	-	-	-
Items that will be reclassified to income or (loss):			
Amortization of loss on cash flow hedge	1	1	-
Changes in fair value of cash flow hedges	5	38	(33)
Net movement in regulatory deferral accounts	(6)	(39)	33
	-	-	-
Total other comprehensive income (loss)	$ -	$ -	$ -

Net re-measurement gains on employee defined benefit of $600 were recorded during fiscal 2018. These were primarily due to a return on plan assets $306 greater than the expected return based on the real discount rate of 3.60% at August 31, 2017, actuarial gains of $264 due to a 20 basis point increase in the real discount rate to 3.80% and $35 due to net positive impacts from demographics partially offset by $5 net negative experience on the defined benefit obligations. For fiscal 2017, the net re-measurement gains of $209 were primarily due to actuarial gains of $121 due to a 20 basis point increase in the real discount rate to 3.60%, a return on plan assets $64 greater than the expected return based on the discount rate at August 31, 2016 and $24 due to positive experience on the defined benefit obligations.

In fiscal 2018, positive fair value adjustments of $5 were recorded on the Company's interest rate hedges related to the re-financing of debt instruments that will mature in fiscal 2019 as well as bond forward agreements that were settled in fiscal 2018. In fiscal 2017, positive fair value adjustments of $38 were recorded on interest rate hedges.

(in millions of dollars)

Amounts Considered for Rate Setting Purposes

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

(a) the current and anticipated balance in the rate stabilization account as compared to its target balance; and

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

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

		August 31 2018	August 31 2017	Change
(a) Rate stabilization account credit balance		$ 124	$ 131	$ (7)
Target balance of the rate stabilization account (1)		(104)	(101)	(3)
Excess of the rate stabilization account from its target balance	(A)	$ 20	$ 30	$ (10)
(b) Pension contributions in excess of pension expense		64	(53)	117
Regulatory balance - recovery of contributions		(98)	9	(107)
Regulatory expense cumulatively lower than contributions	(B)	$ (34)	$ (44)	$ 10
Amount to be (recovered) returned over time through rate setting	(A + B)	$ (14)	$ (14)	$ -

(1) The long-term target credit balance of the rate stabilization account is 7.5% of total planned annual expenses net of other (income) and expenses, excluding non-recurring items, on an ongoing basis. For fiscal 2018, the target balance was $104.

The target rate stabilization account balance for fiscal 2019 is $110.

Financial Outlook[3]

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

Our success is evident in our safety and service levels, in our initiatives to control costs while improving productivity and in our successful and continuing modernization of the ANS. These initiatives, combined with increases in air traffic volumes, have produced positive financial performance in the past several years. Our financial performance has allowed us to avoid overall rate increases for the past thirteen years and to reduce rates four times over that period.

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

(in millions of dollars)

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

Presented below are the Company's current projected annual consolidated results before rate stabilization for fiscal 2019 compared to fiscal 2018 results.

	Fiscal 2019	Fiscal 2018	Change	%
Before rate stabilization				
Revenue	$ 1,446	$ 1,415	$ 31	2%
Operating expenses and other (income) and expenses, including other regulatory adjustments	1,465	1,422	43	3%
Net income (loss) before rate stabilization adjustments	$ (19)	$ (7)	$ (12)	

Revenue

Revenue in fiscal 2019 is expected to increase by approximately 2% or $31 from $1,415 in fiscal 2018 primarily due to forecasted air traffic growth of 3.6%, partially offset by a decrease in other revenue. As discussed in "RESULTS OF OPERATIONS – Revenue", the revised charges, effective September 1, 2018, effectively continue the 0.4% temporary rate reduction that was implemented in fiscal 2018.

In our Q3 fiscal 2018 MD&A, we had disclosed anticipated revenue of $1,406 for fiscal 2018. The increase of $9 in revenues is primarily due to higher air traffic growth as well as higher other revenue in Q4 fiscal 2018.

Operating Expenses and Other (Income) and Expenses

Operating expenses and other (income) and expenses before rate stabilization for fiscal 2019 are expected to be $1,465. This is an increase of 3% or $43 compared to fiscal 2018 mainly due to:

- increased compensation levels and overtime costs arising from inflationary increases in collective agreements, increased staffing requirements to meet air traffic growth and support projects, and increased training of air traffic controllers to maintain optimum staffing levels across the country;
- first partial year of satellite surveillance charges;
- increased operational requirements impacting accommodation and technical services expenses;
- lower foreign exchange gains; and
- the effects of inflation.

Across the Company, we remain focused on cost saving measures that are consistent with safety, which is our top priority. Our efforts are aimed at managing staffing levels and discretionary expenses, as well as continuing to implement process improvement initiatives and efficiencies.

In our Q3 fiscal 2018 MD&A, we had disclosed anticipated operating expenses and other (income) and expenses, before rate stabilization of $1,414 for fiscal 2018. The increase of $8 is mainly due to higher compensation related operating expenses.

Cash Flows

Given the expected net cash flows from operations and cash flows from investing and financing activities in fiscal 2019, the Company's cash position is currently expected to decrease to $31 as at August 31, 2019 from $38 as at August 31, 2018. This cash outlook is based on anticipated annual cash inflows from operating activities of $151 and financing activities of $20, partially offset by cash outflows from investing activities of $168. Financing net cash inflows are primarily comprised of the issuance of $225 in medium term notes and net proceeds from bank loans of $73, partially offset by $275 for the repayment of long-term debt and interest of $2 related to the debt service reserve fund. Investing activities include cash outflows for capital expenditures of $170, partially offset by the receipt of proceeds from the settlement of derivatives of $2. As discussed below, the Company has adequate existing sources of financing to cover all of its anticipated cash flow requirements.

In our Q3 fiscal 2018 MD&A, we had disclosed an anticipated cash position of $28 by the end of fiscal 2018, including net proceeds from bank loans of $8. Our cash position at the end of fiscal 2018 is $10 higher mainly due to higher receipts from customer service charges with no net proceeds from bank loans.

Rate Stabilization Account

As noted above, the Company has implemented revisions to its customer service charges, effective September 1, 2018 which effectively continue the 0.4% temporary rate reduction that was implemented in fiscal 2017.

The Company currently anticipates that the rate stabilization account will have a credit balance of $104 at the end of fiscal 2019, resulting from estimated revenue of $1,446 and total operating expenses and other (income) and expense (including other regulatory adjustments) of $1,465 (before rate stabilization). The target balance of the rate stabilization account in fiscal 2019 is $110.

In our Q3 fiscal 2018 MD&A, we had forecast an anticipated rate stabilization account credit balance of $122 at the end of fiscal 2018. The rate stabilization account credit balance at the end of fiscal 2018 was $124.

Earnings and Cash Flow Coverage

During a fiscal year, quarterly revenue will reflect seasonal or other fluctuations in the airline industry and therefore our net results vary from quarter to quarter. Our mandate to operate on essentially a financial breakeven basis results in a planned earnings coverage ratio – calculated on the basis of earnings before interest divided by interest expense – that is close to one-to-one. However, the seasonal nature of our revenue may result in an earnings coverage ratio of less than one-to-one for any interim period.

For the twelve months ended August 31, 2018, the Company had breakeven results. Our interest costs were $77. Consolidated earnings (after rate stabilization) before interest was $77, which equals our interest requirement for the fiscal year and meets our one-to-one earnings coverage ratio target. Depreciation and amortization expense for this period was $152. Our cash flow coverage was 2.97 times our interest requirement for this period.

Earnings coverage ratio and cash flow coverage are non-GAAP financial measures and do not have any standardized meaning prescribed by IFRS. The earnings coverage ratio and cash flow coverage are provided pursuant to and in compliance with National Instrument 44-102 *Shelf Distributions* of the Canadian Securities Administrators. The Company calculates the earnings coverage ratio on the basis of earnings before interest expense on financial liabilities at amortized cost (interest expense) divided by interest expense. Cash flow coverage is calculated on the basis of earnings (after rate stabilization) before interest expense, depreciation and amortization divided by interest expense. Under the *Income Tax Act* (Canada), NAV CANADA, excluding its subsidiaries, is not subject to income taxes and accordingly, no deduction for income taxes has been made. After the application of rate regulated accounting, the provision for income taxes related to our taxable subsidiaries is insignificant.

We maintain a debt service reserve fund and an operations and maintenance reserve fund under our Master Trust Indenture and we are subject to liquidity covenants under our General Obligation Indenture, designed to cover 12 months interest on borrowings and 25% of our annual operating and maintenance expenses. As at August 31, 2018, we were in full compliance with our debt indentures, including the Master Trust Indenture's requirements regarding the reserve funds, the flow of funds and with the rate covenants, as well as the liquidity and other provisions of the General Obligation Indenture.

Related Party Transactions

The Company's related parties include its key management personnel, subsidiaries, joint ventures, entities in which it has a significant influence and registered pension plans for its employees. During the year ended August 31, 2018, total amounts paid by us to these related parties, directly or indirectly, were $121 (year ended August 31, 2017 - $149) primarily related to contributions to the Company's registered pension plans of $97 (year ended August 31, 2017 - $135). Total amounts received or receivable from these related parties during the year ended August 31, 2018 were $27 (year ended August 31, 2017 - $26) primarily related to reimbursement for certain costs from the Company's pension plans and accrued dividend income on the investment in preferred interests of Aireon. As at August 31, 2018, the Company has accounts receivable of less than $1 (August 31, 2017 - $3) and an accrued dividend receivable of $46 (August 31, 2017 - $32) from Aireon. As at August 31, 2018, the Company has a long-term loan receivable of $2 outstanding from Searidge and a long-term loan receivable of $10 outstanding from Aireon. Additional details of these transactions are disclosed in note 21 of our fiscal 2018 financial statements.

(in millions of dollars)

SUMMARY OF QUARTERLY RESULTS

Quarterly Financial Information (unaudited)

	Three months ended			
	Q4 August 31 2018	Q3 May 31 2018	Q2 February 28 2018	Q1 November 30 2017
Revenue	$ 414	$ 349	$ 305	$ 347
Operating expenses	355	361	340	340
Other (income) and expenses	26	(14)	30	18
	33	2	(65)	(11)
Income tax (recovery) expense	1	10	(19)	-
Net income (loss) before net movement in regulatory deferral accounts	32	(8)	(46)	(11)
Net movement in regulatory deferral accounts related to net income (loss), net of tax				
Rate stabilization adjustments	(2)	13	(7)	3
Other regulatory deferral account adjustments	20	(13)	8	11
	18	-	1	14
Net income (loss) after net movement in regulatory deferral accounts	$ 50	$ (8)	$ (45)	$ 3

	Three months ended			
	Q4 August 31 2017	Q3 May 31 2017	Q2 February 28 2017	Q1 November 30 2016
Revenue	$ 331	$ 332	$ 296	$ 332
Operating expenses	333	348	328	321
Other (income) and expenses	44	16	15	22
	(46)	(32)	(47)	(11)
Income tax (recovery) expense	5	3	5	1
Net income (loss) before net movement in regulatory deferral accounts	(51)	(35)	(52)	(12)
Net movement in regulatory deferral accounts related to net income (loss), net of tax				
Rate stabilization adjustments	46	2	(3)	(7)
Other regulatory deferral account adjustments	47	25	21	19
	93	27	18	12
Net income (loss) after net movement in regulatory deferral accounts	$ 42	$ (8)	$ (34)	$ -

Discussion of Quarterly Results

The quarterly variations in revenue mainly reflect seasonal fluctuations. Typically, revenue is highest in our fourth quarter (June to August) as a result of increased air traffic in the summer months. The second quarter (December to February) typically has the lowest air traffic volumes. Air traffic for Q4 fiscal 2018 was 5.3% higher on average than in Q4 fiscal 2017. Strong traffic results in fiscal 2018 along with traffic growth projections for fiscal 2019 has enabled the Company to implement revised service charges, whereby existing base rates decreased by an average of 0.4% on September 1, 2018. This effectively continues the one-year temporary rate reduction implemented on September 1, 2017. On average, customers will pay the same rates in fiscal 2019 as they did in fiscal 2018.

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

Other (income) and expenses fluctuate primarily due to:

- fair value adjustments on investments, including the investment in preferred interests of Aireon, which change based on market factors and changes in expectations of credit losses;
- changes in net interest costs relating to employee benefits as a result of changes in annual discount rates; and
- changes in foreign exchange (gains) or losses as a result of the strengthening or weakening of the Canadian dollar compared to foreign currencies in which the Company transacts, mainly the U.S. dollar.

Net movement in regulatory deferral accounts related to net income (loss) fluctuates due to:

- changes in the rate stabilization account based on variances from planned results and the initial approved adjustment;
- the recovery of pension solvency deficiency contributions made;
- changes in employee benefit pension contributions and expense;
- changes in other employee benefits, including positive or negative LTD experience and funding requirements;
- changes in the investment in preferred interests of Aireon, before tax;
- changes in the investment in equity-accounted investee;
- changes in income taxes; and
- changes in unrealized hedging transactions.

LIQUIDITY AND CAPITAL RESOURCES

The following sections explain how we manage our cash and capital resources.

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

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

As at August 31, 2018, we had $38 of cash and cash equivalents and committed credit facilities of $1,190, of which $388 was available for unrestricted use (see "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Financing Strategy").

(in millions of dollars)

Cash flows for the year ended August 31, 2018

	Year ended August 31		
	2018	2017	Change
Cash flows from:			
Operations	$ 85	$ 143	$ (58)
Investing	(178)	98	(276)
Financing	(91)	(135)	44
Cash flows from operating, investing and financing activities	(184)	106	(290)
Effect of foreign exchange on cash and cash equivalents	-	(3)	3
Increase (decrease) in cash and cash equivalents	(184)	103	(287)
Cash and cash equivalents, beginning of period	222	119	103
Cash and cash equivalents, end of period	$ 38	$ 222	$ (184)
Free cash flow (non-GAAP financial measure):			
Cash flows from:			
Operations	$ 85	$ 143	$ (58)
Capital expenditures (1)	(176)	(157)	(19)
Investment in preferred interests (1)	-	(36)	36
Income tax refund (payment) on investment in preferred interests (1)	5	(5)	10
Proceeds from sale of investment in subsidiary (1)	-	4	(4)
Free cash flow	$ (86)	$ (51)	$ (35)

(1) See the statements of cash flows of our fiscal 2018 financial statements.

As shown above, cash and cash equivalents decreased by $184 for the year ended August 31, 2018 and the Company experienced negative free cash flow of $86, which is a non-GAAP financial measure. Non-GAAP financial measures do not have any standardized meaning prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers. The Company defines free cash flow as cash generated from operations, less capital expenditures and investments in Aireon and equity related investments. Management places importance on this indicator as it assists in measuring the impact of its investment program on the Company's financial resources.

Cash flows from operations for the year ended August 31, 2018 decreased by $58 as compared to the year ended August 31, 2017, primarily due to the refund of customer service charges of $60 (composed of $33 cash refund and $27 issue of credit notes against receipts from customer service charges), lower receipts from other revenues of $13, higher payments to employees and suppliers of $62, settlement of curtailed severance benefits of $42, higher going concern pension contributions of $5 and net other receipts and payments of $1, partially offset by higher net receipts from customer service charges of $76, pension solvency deficiency payments of $44 made in fiscal 2017 but not in fiscal 2018 and lower interest payments of $6.

Cash flows from investing activities for the year ended August 31, 2018 were outflows of $178 compared to inflows of $98 for the year ended August 31, 2017. During the year ended August 31, 2018, we received $1 of proceeds from MAV II notes, other notes and restructured ABCP compared to $293 received in the year ended August 31, 2017. Additionally, a refund of $5 for income taxes paid in fiscal 2017 was received as well as $2 proceeds from the settlement of derivatives. These cash inflows were offset by cash investment (excluding capitalized interest) of $176 in capital projects compared to $157 in the year ended August 31, 2017 and $36 of the final tranche investment in the preferred interests of Aireon made in fiscal 2017. In addition, we loaned $10 to Aireon as part of the investor bridge loan financing agreement.

Cash outflows from financing activities for the year ended August 31, 2018 were $91 compared to $135 for the year ended August 31, 2017. The outflows of $91 were a result of refinancing the $350 Series MTN 2013-1 through the issue of the $275 Series MTN 2018-1, the $25 repayment of Series 97-2 and the settlement of financing derivatives of $13, partially offset by the receipts of $24 from the debt service reserve fund.

Liquidity and Financing Strategy

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

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

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

We are exposed to re-financing risk with respect to our bond and note maturities, including the $25 annual amortizing payment due on the Series 97-2 amortizing revenue bonds. We mitigate this risk by maintaining committed credit facilities in an amount sufficient to meet our refinancing needs in the event of temporary capital market disruptions or lack of access to the market for any reason. The Company has put in place a Base Shelf Prospectus that is valid until December 9, 2019.

(in millions of dollars)

The Company has a revolving credit facility with a syndicate of Canadian financial institutions and separate letter of credit facilities for pension funding purposes. As at August 31, 2018, the credit facilities are utilized as follows:

Credit facilities:	
Credit facility with a syndicate of Canadian financial institutions (1) (2)	$ 675
Letter of credit facilities for pension funding purposes (3)	515
Total available credit facilities	1,190
Less: Outstanding letters of credit for pension funding purposes (3)	495
Less: Outstanding letters of credit for other purposes (2)	12
Undrawn committed borrowing capacity	683
Less: Operations and maintenance reserve fund allocation (4)	295
Credit facilities available for unrestricted use	$ 388

(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, 2020 and September 12, 2022. Subsequent to August 31, 2018, these maturity dates were extended to September 12, 2021 and September 12, 2023. The credit facility agreement provides for loans at varying rates of interest based on certain benchmark interest rates, specifically the Canadian prime rate and the Canadian bankers' acceptance rate, and on the Company's credit rating at the time of drawdown. The Company is required to pay commitment fees, which are dependent on the Company's credit rating. The Company is in compliance with the credit facility covenants as at August 31, 2018.

(2) At August 31, 2018, $12 was drawn from an uncommitted revolving credit facility (including letters of credit with a value of $2 issued on behalf of Searidge). In connection with this facility, an allocation of $25 with a Canadian financial institution has been made under its $675 committed credit facility.

(3) The letter of credit facilities for pension funding purposes are comprised of four facilities with Canadian financial institutions totalling $515, which will mature on December 31, 2018, unless extended. At August 31, 2018, $495 was drawn for pension solvency funding purposes.

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

(in millions of dollars)

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

	August 31 2018	August 31 2017
LONG-TERM DEBT:		
Bonds and notes payable		
Under the Master Trust Indenture	$ 475	$ 500
Under the General Obligation Indenture	1,025	1,100
	1,500	1,600
Adjusted for deferred financing costs and discounts	(6)	(5)
Total bonds and notes payable	1,494	1,595
Less: current portion of long-term debt	(275)	(375)
Total long-term debt	$ 1,219	$ 1,220
LIQUIDITY:		
Cash and cash equivalents	$ 38	$ 222
Debt service reserve fund	71	95
	$ 109	$ 317
Undrawn committed borrowing capacity [(1)]	$ 683	$ 701

(1) $388 of this borrowing capacity is available as described in the previous table (August 31, 2017 - $411).

Credit Ratings

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

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

DBRS issued a press release on September 5, 2018 confirming the Company's ratings and outlook. DBRS stated that the Company's "credit profile is supported by a solid operating framework, strong traffic conditions and declining debt; however, pension deficiencies remain large and significant user-fee reductions undertaken in F2017 are expected to continue to pressure credit metrics in the near term.

The DBRS report cited the following strengths of the Company as determinants of the rating they assigned:

- Legislated monopoly to provide essential service;
- Statutory right to set rates within guidelines;
- Strong powers to enforce payments;
- Competitive fee structure;
- Sizeable contingency reserve funds.

They also identified the following challenges faced by the Company:

- Inherent risks associated with the air travel business;
- Large pension deficit;
- Essentiality of services limits ability to cut costs;
- Counter-cyclical fee setting approach.

On March 14, 2018, S&P issued a press release affirming the Company's ratings and stable outlook. The press release noted the Company's credit strengths as holding a monopoly over an essential transportation service, legislated ability to levy user charges on airlines to meet financial requirements and sound debt service coverage (DSC). They noted that the Company's debt metrics continue to improve thanks to a declining debt level.

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

On February 15, 2018, Moody's issued a credit opinion affirming NAV CANADA's base line credit assessment at Aa2 and its senior and subordinated ratings at Aa2. Moody's noted the Company's following credit strengths:

- Essential infrastructure asset for the Canadian air transportation system;
- Monopoly provider of civil air navigation services over a very large airspace;
- Legislated right to establish and levy rates and charges as needed to meet financial requirements resulting in good degree of cash flow predictability;
- Continued strong traffic growth;
- Manageable capital expenditure program.

They also noted the following credit challenges:

- Defined benefit pension plan creates recurring calls on cash;
- Periods of weak debt service coverage ratio when the Company depletes its rate stabilization account.

They stated that "the rating outlook is stable, reflecting our expectation that NAV CANADA will be prudent and take into account its overall financial position and upcoming obligations when contemplating a rate decrease and, vice versa, that it will implement the necessary rate increases if traffic growth does not materialize."

A credit rating is not a recommendation to buy, sell, or hold securities and may be subject to revision or withdrawal at any time by the rating organization. Our fiscal 2018 AIF contains more detailed information about the credit ratings, including each rating agency's rationale for assigning the given rating.

We are also exposed to risks related to the level of our credit ratings. Specifically, our credit facility agreement contains a pricing scale that is based on our credit ratings. If our senior debt ratings were to fall below AA (or equivalent) and/or our General Obligation Indenture debt ratings were to fall below AA- (or equivalent) our cost of borrowing under the facility would increase, as would the commitment fees payable under the facility.

Cash Requirements

The following information about our contractual obligations and other commitments summarizes certain of our liquidity and capital resource requirements.

Pension Plans[4]

Required pension contributions to the Company's pension plans are determined by annual actuarial valuations for funding purposes performed as at January 1 (see below under "Pension Contributions (Going Concern and Solvency)"). Our latest actuarial valuations (for funding purposes) as at January 1, 2018 were completed and filed with OSFI in June 2018.

Pension Plans' Accounting Deficit: The Company's pension plans had an accounting deficit of $831 as at August 31, 2018 as compared to an accounting deficit of $1,295 as at the annual measurement date of August 31, 2017. The $464 decrease in the deficit position during the year ended August 31, 2018 is primarily due to net actuarial gains of $586 partially offset by actuarial accounting expense exceeding Company contributions by $122. The $586 of actuarial gains are primarily due to actuarial gains of $255 due to a 20 basis point increase in the real discount rate to 3.80%, $36 due to net positive impacts from demographics, partially offset by $11 net negative experience on the defined benefit obligations and a return on plan assets $306 greater than the expected return based on the discount rate at August 31, 2017.

The accounting deficit of $1,295 as at the annual measurement date of August 31, 2017 decreased from an accounting deficit of $1,415 as at August 31, 2016. The $120 decrease in the deficit position during the year ended August 31, 2017 is primarily due to actuarial gains of $205 and solvency deficiency contributions of $44, partially offset by actuarial accounting expense exceeding Company contributions by $127. The $205 of actuarial gains are primarily due to a $117 actuarial gain from a 20 basis point increase in the real discount rate to 3.60% from 3.40% at August 31, 2016, a return on plan assets $64 greater than the expected return based on the discount rate at August 31, 2016 and $24 due to positive experience on the defined benefit obligations.

The market-based real discount rate used to determine pension obligations is based on the yield on long-term high quality corporate bonds, with maturities matching the estimated cash flows of the plan. A 0.25% decrease in the discount rate would increase the accounting deficit by approximately $328. Conversely, a 0.25% increase in the discount rate would decrease the deficit by approximately $307.

Pension Expenses: Annual pension benefit costs can increase by approximately $26 from a 0.25% decrease in the real discount rate used in actuarial calculations, or decrease by approximately $24 from a 0.25% increase in the real discount rate.

Regulatory Recovery of Pension Costs: The Company uses a regulatory approach for pension costs to determine the net impact charged to net income (loss). The objective of this approach is to expense the cost of the Company's going concern cash contributions to the funded pension plans. In fiscal 2017, the Company made solvency cash contributions of $44 which were deferred. During the year ended August 31, 2018, $10 has been recorded as a regulatory expense to recover the cost. The remaining balance of $34 is expected to be recovered through future customer service charges.

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

(in millions of dollars)

The funding of employee benefits as compared to the expense, net of regulatory adjustments, recorded in the consolidated statement of operations for the Company's funded pension plans is as follows:

	Years ended August 31 2018	2017
Consolidated statement of operations		
Pension current service costs [1]	$ 173	$ 174
Net finance costs [1]	41	44
Less: Regulatory deferrals	(107)	(127)
	107	91
Company cash contributions		
Going concern current service	97	91
Solvency deficiency payments	-	44
	97	135
Regulatory recovery (deferral) of fiscal 2017 solvency contributions	$ 10	$ (44)

(1) Pension current service costs do not include $4 related to the Company's unfunded pension plan (year ended August 31, 2017 - $2) and net finance costs do not include $3 related to the Company's unfunded pension plan (year ended August 31, 2017 - $2).

Pension Contributions (Going Concern and Solvency): The actuarial valuations for funding purposes of the pension plans performed as at January 1, 2018 reported a going concern surplus of $503 (2017 – $242).

The regulations governing the funding of federally regulated pension plans include a solvency test, which assumes the plans are terminated as at the valuation date. The actuarial valuations performed as at January 1, 2018 reported a statutory solvency surplus of $561 (2017 - $334) based on the assumption that the September 1, 2016 plan text restatement, which included the plan termination amendment that is currently subject to OSFI's review, was in effect on the valuation date. Had the amendment not been included, there would have been a statutory solvency deficiency of $89 as of January 1, 2018 (2017 – $289). The amendment does not impact the going concern valuation.

The Company has the option of meeting its pension solvency funding requirements with letters of credit or cash contributions. Pension funding regulations were amended in June 2017 permitting the letters of credit maximum to be based on 15% of solvency liabilities instead of assets. As at August 31, 2018, the Company has put in place letters of credit totaling $495 (2017 - $477) to meet its cumulative pension solvency funding requirements, on a pre-amendment basis, as per the January 1, 2018 actuarial valuations. Outstanding letters of credit represent 9% of solvency liabilities on a post-amendment basis and 8% on a pre-amendment basis. Solvency contributions will continue to be funded on a pre-amendment basis while discussions with OSFI are ongoing.

Going concern pension contributions for fiscal 2018 were $97, with no requirement for cash special payments. For the annual period beginning July 1, 2018, funding requirements are based on the January 1, 2018 actuarial valuations. On a preliminary basis, going concern pension contributions for fiscal 2019 are expected to be $96 with no requirement for cash special payments.

(in millions of dollars)

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

Risks Associated with the Defined Benefit Plans: The nature of these benefit obligations exposes the Company to a number of risks, the most significant of which is funding risk. Funding risk can be expressed as the probability of an unusually high level of required pension contributions or significant fluctuation in required pension contributions.

Adverse changes in the value of plan assets of funded plans, long-term return and inflation expectations, interest rates and life expectancy could have a significant impact on pension funding requirements. The funded plan invests in assets that expose it to a range of investment risks. It has strategies, policies and processes in place to manage these risks.

More specifically, funding risk is managed as follows:

(i) interest rate and inflation risk are managed via implementation of a liability driven investment strategy that focuses on reducing the interest rate and inflation risk mismatch between the plan assets and its pension benefit obligations; and

(ii) market risk, credit risk and liquidity risk related to the plan assets are managed through diversification amongst different asset classes, securities, risk factors and geographies while adhering to established investment policies and guidelines.

Contractual Obligations

A breakdown of contractual obligations as at August 31, 2018 for the next five fiscal years and thereafter is presented in the following table.

	Remaining payments – for years ending August 31						
	Total	2019	2020	2021	2022	2023	Thereafter
Long-term debt (including current portion) [1], [2]	1,500	275	25	275	25	25	875
Interest payments [2]	807	78	62	55	48	46	518
Capital commitments [3]	103	53	18	6	4	3	19
Operating leases[4]	84	7	6	5	4	4	58
Related party loan [5]	28	28	-	-	-	-	-
Total contractual obligations	$ 2,522	$ 441	$ 111	$ 341	$ 81	$ 78	$ 1,470

Total contractual obligations exclude commitments for goods and services in the ordinary course of business. Also excluded are other long-term liabilities mainly due to reasons of uncertainty of timing of cash flows and items that are non-cash in-nature.

(1) Payments represent principal of $1,500. The Company intends to refinance principal maturities at their maturity dates. The Company may choose to repay a portion of these maturities with available cash, and/or may increase the size of a re-financing to generate additional liquidity or for other purposes, and/or may choose to redeem, in whole or in part, an issue in advance of its scheduled maturity date.

(2) Further details on interest rates and maturity dates on long-term debt are provided in note 18 to our fiscal 2018 financial statements.

(3) The Company has firm commitments for the acquisition of property, plant and equipment and intangible assets amounting to $103 as at August 31, 2018 (August 31, 2017 - $141).

(4) Operating lease payments represent the future minimum lease payments, excluding operating costs.

(5) This is the undrawn commitment under the bridge financing agreement with Aireon. The total bridge financing available is $29 U.S. ($38 CDN). As at August 31, 2018, Aireon has drawn $7 U.S. ($10 CDN).

The Company's letters of credit are discussed under the heading "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Financing Strategy".

The Company's contributions to its pension plans are discussed under the heading "LIQUIDITY AND CAPITAL RESOURCES – Cash Requirements: Pension Plans".

Capital Expenditures and Other Investments[5]

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

During fiscal 2018 we invested $185 in capital assets (cash outflows of $176, excluding capitalized interest of $5) compared to $171 in fiscal 2017 (cash outflows of $157, excluding capitalized interest of $3). Investments were made in systems enhancements, functional upgrades, equipment upgrades or replacements, facility replacements or refurbishment and other projects to meet safety and other operational requirements.

We anticipate investing approximately $175 on capital assets in fiscal 2019.

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

(in millions of dollars)

Capital Management

The Company views capital as the sum of its issued long-term debt, retained earnings and accumulated other comprehensive income, regulatory deferral accounts and certain employee benefits, as depicted in the following table. This definition of capital is used by management and may not be comparable to measures presented by other companies.

	August 31 2018	August 31 2017
Bonds and notes payable	$ 1,494	$ 1,595
Equity:		
Retained earnings	28	28
Regulatory deferral accounts:		
Debit balances	(954)	(1,475)
Credit balances	394	342
Employee benefits:		
LTD asset	(2)	(11)
Liability for funded pension benefits	707	1,198
Liability for accumulating sick leave	18	22
Total capital	$ 1,685	$ 1,699

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

The Company's main objectives when managing capital are:

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

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

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

(iv) to ensure the funding of regulatory requirements such as funding defined benefit pension plan contributions;

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

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

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

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

There were no changes in the Company's approach to capital management during the year ended August 31, 2018.

Financial Instruments and Risk Management

Reserve Funds and Financial Instruments

Financial instruments are also disclosed in note 17 to the fiscal 2018 financial statements. Under the Master Trust Indenture, we maintain a debt service reserve fund and an operations and maintenance reserve fund. We are also required to meet certain minimum liquidity levels under the General Obligation Indenture.

The debt service reserve fund is maintained in cash and qualified investments deposited with our Trustee. An amount equal to or greater than one year's debt service (excluding General Obligation Indenture debt) is required to be maintained. The debt service reserve fund also counts toward our minimum cash liquidity level under the General Obligation Indenture, which is one year's interest on all debt.

The operations and maintenance reserve fund requirements are met with an allocation of $295 in undrawn availability under our committed credit facility. At a fiscal year end the fund must cover at least one quarter of our annual operating and maintenance expenses. This fund also serves to meet the minimum liquidity level under the General Obligation Indenture, which consists of the minimum liquidity level mentioned above plus one quarter of the previous year's operating and maintenance expenses.

As at August 31, 2018, we were in full compliance with our debt indentures, including the Master Trust Indenture's requirements regarding the reserve funds, the flow of funds and rate covenants, as well as the liquidity and other provisions of the General Obligation Indenture.

Financial Risk Management

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

- maturities of borrowings are currently spread over periods up to and including 2046 so that only a portion of outstanding debt will mature in any given fiscal year; and

- a bond forward has been entered into in order to mitigate the potential impact of rising interest rates on the cost of refinancing the Series MTN 2009-1 General Obligation Notes that will mature on April 17, 2019.

A second source of interest rate risk is that the Company has $109 invested in financial assets that bear interest at floating rates. Earnings on the financial assets will fall when interest rates decline. In the current low interest rate environment, the Company has positioned itself to benefit from increased earnings on floating rate assets as a result of rising interest rates without an offsetting increase in interest expense.

Interest rate risk relating to our pension plans is discussed above under "LIQUIDITY AND CAPITAL RESOURCES – Cash Requirements: Pension Plans".

Foreign Exchange Risk: The Company is exposed to foreign exchange risk on sales and purchases that are denominated in currencies other than the functional currency of the Company. However, the Company invoices and receives the vast majority of its revenue in Canadian dollars and also incurs operating expenses and capital expenditures primarily in Canadian dollars. The majority of the Company's exposure to foreign exchange risk relates to the U.S. dollar (U.S.). The Company does not have a significant exposure arising from other currencies. The Company has $427 ($327 U.S.) of net exposure to U.S. dollar foreign exchange risk that is primarily related to the Company's investment in preferred interests of Aireon.

The Company designates certain of its forward contracts as cash flow hedging instruments to hedge the Company's exposure to the impact of exchange rate fluctuations. As at August 31, 2018, the Company has designated less than $1 (fair value) of its forward contracts as cash flow hedging instruments.

As at August 31, 2018, the Company holds seven forward contracts with a notional value of approximately $1 CDN each to purchase a total of $5 U.S. ($7 CDN) to hedge monthly payments to Aireon related to satellite surveillance costs in fiscal 2019.

The foreign exchange rate sensitivity is the net amount of foreign exchange rate exposure of the items at the reporting date, less foreign currency hedges. As at August 31, 2018, if the Canadian dollar strengthened or weakened by 10% against the U.S. dollar, all other variables remaining constant, net income (loss) before net movement in regulatory deferral accounts would have been impacted by $38.

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

In order to mitigate the risk of losses arising from investment activities, the Company only invests in highly-rated (see credit risk discussion below) and short-term instruments, excluding Aireon and Searidge.

The investment in preferred interests of Aireon is subject to price risk. The fair value may fluctuate over time due to, among other things, economic conditions and the expected cash flows of Aireon. Aireon is a start-up company and any such changes in the fair value could be material. A change of 5% in the fair value of the investment in preferred interests would impact finance income (other finance costs) by approximately $14 U.S. ($18 CDN) as at August 31, 2018.

Aireon will provide global satellite-based surveillance capability for ANSPs around the world. It is expected that Aireon will commence operations in calendar year 2019.

The following risks have been identified with respect to the Company's investment in preferred interests of Aireon:

- further delays may occur;
- agreements for data sales may not reach anticipated levels or that their conclusion will be delayed; and
- short or long-term bridge financing may not be obtained.

Aireon's liquidity has been under pressure due to delays in launching the satellites on which Aireon's payloads are hosted. For this reason, the payment of the Company's fourth and fifth tranche investments were brought forward with certain milestones waived. Aireon has secured a short-term facility with certain of its investors, of which the Company has committed $29 U.S. ($38 CDN). As at August 31, 2018, Aireon had drawn $7 U.S. ($10 CDN). (see "INTRODUCTION – Significant Financial Matters"). Aireon is currently working to secure long-term financing with a major international bank. It is expected that the bridge financing will provide Aireon with sufficient liquidity until such time as the system comes into operation. Further delays however may put pressure on Aireon's liquidity, which may in turn require further bridge financing.

The Company believes the investment in preferred interests of Aireon will provide the returns it is seeking.

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

Credit Risk on Investments: Other than the Company's investments in Aireon and Searidge, in order to mitigate the risk of losses arising from investment activities, we invest only in highly-rated and short-term obligations. The Company limits investments to obligations of the federal government, certain provincial governments, entities guaranteed by a federal or provincial government or other obligations of entities rated by at least two rating agencies in the top two categories for long-term debt or the highest category for short-term debt. Asset backed securities must be sponsored by a Schedule I bank and may not contain synthetic assets. Our portfolio is diversified, with dollar and percentage limits on investment counterparties. None of the Company's holdings in current investments as at August 31, 2018 are past due or impaired, and all have long-term ratings in either the AAA or AA category or short-term ratings in the highest category (DBRS R1 (high)).

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

Liquidity Risk: We are also exposed to liquidity risk. We mitigate this risk by monitoring current and expected liquidity requirements, taking into account trends in air traffic and expected contributions to our pension plans, to ensure that we maintain sufficient reserves of cash, cash equivalents, investments and/or available undrawn credit facilities to meet our liquidity requirements in the short and longer term. Under the Master Trust Indenture and General Obligation Indenture, the Company is required to maintain certain reserve funds and liquidity levels, as described in note 16 to our fiscal 2018 consolidated financial statements.

As at August 31, 2018, the Company had $683 of undrawn availability under its committed credit facilities and had allocated $295 of this facility to meet its operations and maintenance reserve fund requirement under the Master Trust Indenture. The Company has investments in highly rated short-term obligations in its debt service reserve fund. The Company believes that it has sufficient available liquidity to meet its operating needs.

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

- Economic climate – Air traffic generally is influenced by economic growth or decline. For example, during an economic downturn, growth rates in air traffic generally decline. Since a substantial portion of air traffic is international, traffic volumes are influenced by both Canadian and global economic circumstances. On an annual basis, a 1.0% change in air traffic volumes flown in Canadian airspace corresponds to approximately a $14 change in our revenue before rate stabilization.

- Aviation fuel prices – As fuel represents a major portion of airline operating costs, a change in the price of fuel can affect air traffic demand to the extent that the change is passed on to consumers.

- Terrorist activities, epidemics, pandemics, natural disasters, environmental changes, weather patterns or events may all affect air traffic volumes within the airspace for which the Company provides air navigation services.

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

Insurance: Our aviation liability insurance program was last renewed on November 15, 2017 with liability limits of $5,250 U.S. ($6,846 CDN). The Company successfully secured an increase in the limits from $5,034 U.S. ($6,564 CDN) to $5,250 U.S. ($6,846 CDN). This insurance, placed with syndicates at Lloyd's of London and other international insurers, covers all of our ANS operations liabilities to third parties for both bodily injury and property damage. In June 2016, the Government of Canada ended a program they had maintained since shortly after September 11, 2001 that protected the Company from a terrorist-related loss in excess of our own insurance. As a result, the Company purchased war liability coverage of $2,000 U.S. ($2,608 CDN) per occurrence with $4,000 U.S. ($5,216 CDN) in the aggregate for periods subsequent to June 30, 2016. This insurance is non-cancellable in nature. The cost of this insurance is not significant to the Company.

The Company is contractually obligated to indemnify the Government of Canada for any loss suffered by or claimed against it which is covered by the Company's aviation operations liability insurance.

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

(in millions of dollars)

CHANGES IN ACCOUNTING POLICIES

A summary of the Company's significant accounting policies are described in note 3 to the fiscal 2018 financial statements.

The Company has early adopted all of the requirements of IFRS 9 (2014) - *Financial Instruments* (IFRS 9) with a date of initial application of September 1, 2017. This standard replaces IAS 39 - *Financial Instruments: recognition and measurement* (IAS 39) and introduces new requirements for the classification and measurement of financial assets and liabilities. It introduces a new general hedge accounting standard, which aligns hedge accounting more closely with risk management. It also modifies the existing impairment model by introducing a new 'expected credit loss' model for calculating impairment. This new standard also increases required disclosures about an entity's risk management strategy, cash flows from hedging activities and the impact of hedge accounting on the consolidated financial statements.

IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach is based on how an entity manages its financial instruments and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities have been carried forward in IFRS 9.

The following summarizes the classification and measurement changes for the Company's financial assets and financial liabilities as a result of the adoption of IFRS 9:

	IAS 39	IFRS 9
Financial assets		
Cash and cash equivalents	Loans and receivables	Amortized cost
Accounts receivable and other	Loans and receivables	Amortized cost
Debt service reserve fund	Available-for-sale	Amortized cost
Investment in preferred interests	FVTPL(1)	FVTPL
Derivative assets	FVTPL	FVTPL
Financial liabilities		
Trade and other payables	Other financial liabilities	Amortized cost
Derivative liabilities	FVTPL	FVTPL
Bonds and notes payable	Other financial liabilities	Amortized cost

(1) Under IAS 39, these financial assets were designated as at FVTPL because they contain one or more embedded derivatives and the entire hybrid (combined) contract was designated as at FVTPL rather than separating embedded derivatives. These assets have been classified as mandatorily measured at FVTPL under IFRS 9.

The adoption of IFRS 9 did not result in any measurement adjustments to our financial assets and financial liabilities. The impact of the change in the impairment model was not significant as the Company's credit-impaired financial assets are not significant. The detailed accounting policy is described in note 3 to the fiscal 2018 financial statements.

The adoption of IFRS 9 did not result in any changes in the eligibility of existing hedge relationships, the accounting for derivative financial instruments designated as effective hedging instruments or the line items in which they are included in the consolidated statements of financial position.

The Company has applied IFRS 9 retrospectively but has elected not to restate comparatives in accordance with the transition requirements. As a result, the comparative information provided continues to be in accordance with the Company's previous accounting policy as disclosed in our 2017 annual consolidated financial statements.

In May 2018, NATS made an investment in preferred interests of Aireon ("INTRODUCTION – Significant Financial Matters"). As a result of this investment, the Company's total fully diluted common equity interest on a post-conversion basis is 37.2% (August 31, 2017 – 40.9%). The Company has determined that the structure of its investment in Aireon is no longer a joint venture; however, the Company is able to exert significant influence over the strategy, financial and operating activities of Aireon.

As at August 31, 2018, the Company's share of Aireon's net assets is $nil and therefore the Company's share of Aireon's net income (loss) and other comprehensive income (OCI) is $nil. Until the Company exercises its right to convert its preferred interests to common interests, it does not have access to Aireon's net assets and accordingly this investment continues to be accounted for as a financial instrument classified and measured at FVTPL.

IAS 7 – Statement of Cash Flows

In January 2016, the IASB issued amendments to IAS 7 as part of the IASB's Disclosure Initiative. These amendments require entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including changes from cash flows and non-cash changes. These amendments are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted. These amendments do not result in any changes to the Company's consolidated financial statements.

IAS 12 – Income Taxes

In January 2016, the IASB issued amendments to IAS 12. These amendments clarify how to account for deferred tax assets related to debt instruments measured at fair value. These amendments are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted. These amendments do not impact the Company's consolidated financial statements.

Future Accounting Pronouncements

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

IFRS 15 – Revenue from Contracts with Customers

The Company has assessed the anticipated impact of IFRS 15 - Revenue from Contracts with Customers (IFRS 15) on its consolidated financial statements. IFRS 15 will be adopted in the Company's fiscal year ending August 31, 2019. A detailed review of its current contracts under the standard's five-step model was completed. The recognition and measurement of customer service charges revenue, which represents approximately 96% of total annual revenue, will not change upon adoption of IFRS 15. The impact on adoption to the Company's revenue is largely related to service and development contracts included in other revenue on the consolidated statement of operations and is not significant.

In accordance with the transition provisions, IFRS 15 will be adopted retrospectively. The effect on net earnings to revenue contracts in progress at September 1, 2017 is $nil. Disclosures related to the Company's contracts with customers will be enhanced as required by IFRS 15.

IFRS 16 – Leases

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

The Company is in the process of assessing the anticipated impact of IFRS 16 on its consolidated financial statements. The Company has formed a project team, identified its current contracts containing lease components and is conducting a detailed review of those contracts to determine the accounting impacts. The Company anticipates using the modified retrospective approach on transition to IFRS 16.

IFRIC 22 – Foreign Currency Transactions and Advance Consideration

This interpretation clarifies that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. IFRIC 22 is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The Company does not expect the interpretation to have a material impact on its consolidated financial statements.

IFRIC 23 – Uncertainty over Income Tax Treatments

This interpretation clarifies the accounting for uncertainties in income taxes. The interpretation is to be applied to the determination of taxable profit or loss, tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. IFRIC 23 is effective for annual reporting periods beginning on or after January 1, 2019. Earlier application is permitted. The Company does not expect the interpretation to have an impact on its consolidated financial statements upon adoption.

IAS 28 – Investments in Associates and Joint Ventures

In October 2017, the IASB issued narrow-scope amendments to IAS 28 - *Investments in Associates and Joint Ventures* (IAS 28), clarifying that long-term interests in associates and joint ventures, to which the equity method is not applied, are in the scope of both IFRS 9 (including its impairment requirements) and IAS 28. The amendments are effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted.

The amendments to IAS 28 clarify that:

- an entity applies IFRS 9 to other interests in associates and joint ventures, including long-term interests to which the equity method is not applied and which, in substance, form part of the net investment in those associates and joint ventures;
- an entity applies the requirements in IFRS 9 to long-term interests before applying the loss absorption and impairment requirements in IAS 28; and
- in applying IFRS 9, the entity does not take into account any adjustments to the carrying amount of long-term interests that arise from applying IAS 28.

IAS 19 – Employee Benefits

In February 2018, the IASB issued amendments to IAS 19 – *Employee Benefits* clarifying that on amendment, curtailment or settlement of a defined benefit plan, an entity now uses updated actuarial assumptions to determine its current service cost and net interest for the period and that the effect of the asset ceiling is disregarded when calculating the gain or loss on any settlement of the plan and is dealt with separately in OCI. The amendments apply for plan amendments, curtailments or settlements that occur on or after January 1, 2019. Earlier application is permitted.

Annual Improvements to IFRS – 2015-2017 Cycle

On December 12, 2017, as part of the annual improvements process, the IASB issued narrow-scope amendments to IFRS 3 – *Business Combinations,* IFRS 11 – *Joint Arrangements*, IAS 12 – *Income Taxes* and IAS 23 – *Borrowing Costs*. The amendments are effective for annual reporting periods beginning on or after January 1, 2019, with early application permitted. Each of the amendments has its own specific transition requirements. The Company does not expect these annual improvements to have an impact on its consolidated financial statements.

The Company intends to adopt the amendments to IAS 28, IAS 19, IFRIC 23 and the amendments from the annual improvements process in its financial statements for the annual period beginning on September 1, 2019.

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

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

Critical Judgments

Investment in Preferred Interests of Aireon

The Company's investment in preferred interests of Aireon is accounted for as a financial instrument and designated as FVTPL. In May 2018, NATS made an investment in preferred interests of Aireon. The Company used the price paid by that investor (see "INTRODUCTION – Significant Financial Matters") as a basis to estimate the fair value of Aireon and its investment in the entity through preferred interests as at August 31, 2018. The measurement is subject to estimation uncertainty and is dependent on the successful achievement of operational, technical and financial objectives by Aireon and Iridium. Following the investment the Company also determined that it no longer had joint control of Aireon with Iridium, but retained a significant influence over the affairs of Aireon.

Key Sources of Estimates and Assumption Uncertainties

Employee Benefits

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

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

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

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

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

Funding of the pension plans’ deficits (as determined in funding valuations in accordance with OSFI regulations) in prior years resulted in pension contributions significantly higher than pension benefit expenses charged to the statement of operations. Our estimates for future pension contributions are discussed above under the heading “LIQUIDITY AND CAPITAL RESOURCES – Cash Requirements: Pension Plans”.

Refer to note 2 of our fiscal 2018 consolidated financial statements for more detailed information on key sources of estimation and uncertainty related to employee benefits.

Investment in Preferred Interests of Aireon

The Company’s investment in Aireon is in preferred interests, which are redeemable and convertible to common equity interests. Until the Company exercises its right to convert its preferred interests to common interests, it does not have access to Aireon’s residual net assets and accordingly this investment is accounted for as a financial instrument classified and measured at FVTPL. In May 2018, NATS made an investment in preferred interests of Aireon (see “INTRODUCTION – Significant Financial Matters”). As there is no active market for Aireon’s equity instruments and the interests acquired by NATS have substantially the same characteristics as those acquired by the Company, the Company used the price paid by NATS as a basis to estimate the fair value of Aireon and its investment in the entity through preferred interests as at August 31, 2018. The measurement is subject to estimation uncertainty and is dependent on the successful achievement of operational, technical and financial objectives by Aireon. See “LIQUIDITY AND CAPITAL RESOURCES – Financial Instruments and Risk Management: Financial Risk Management”.

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

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

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

Disclosure Controls and Procedures

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

Management, under the supervision of the certifying officers, has evaluated the effectiveness of the DC&P and based on that evaluation, the certifying officers have concluded that the DC&P were effective as at August 31, 2018.

Internal Control over Financial Reporting (ICFR)

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

Management, under the supervision of the certifying officers, has evaluated the effectiveness of ICFR and based on that evaluation, the certifying officers have concluded that the Company's ICFR was effective as at August 31, 2018.

Changes to ICFR

A material change in internal control over financial reporting (ICFR) is a change that has or is reasonably likely to materially affect the issuer's ICFR. A material change in ICFR occurred during Q1 fiscal 2018 with the implementation of the BenPlus system which streamlined pension administration by replacing manual processes with workflow capability and electronic pension files. Given the materiality of the transactions processed by the pension administration system, we consider the change to be a material change in ICFR. We have determined that ICFR under the new BenPlus system has been appropriately designed.

There have been no other changes to the Company's ICFR during the year ended August 31, 2018 that have materially affected or are reasonably likely to materially affect the Company's ICFR and there was no change to the Company's ICFR during Q4 fiscal 2018.