



**MANAGEMENT'S DISCUSSION AND  
ANALYSIS**

**ON FORM 51-102F1**

**THREE AND NINE MONTHS ENDED**

**MAY 31, 2018**

**July 12, 2018**



## TABLE OF CONTENTS

<b>INTRODUCTION</b> .....	1
Caution Concerning Forward-Looking Information.....	1
Our Business .....	1
Financial Strategy and Rate Regulation.....	2
Financial Highlights.....	3
Significant Financial Matters.....	8
<b>RESULTS OF OPERATIONS</b> .....	12
Revenue .....	12
Operating Expenses .....	15
Other (Income) and Expenses (Including Income Tax (Recovery) Expense).....	17
Net Movement in Regulatory Deferral Accounts Related to Net Income (Loss) .....	19
Movements in Rate Stabilization Account .....	21
Other Comprehensive Income (Loss).....	22
Amounts Considered for Rate Setting Purposes.....	24
Financial Outlook .....	25
Earnings and Cash Flow Coverage.....	27
Related Party Transactions .....	27
<b>SUMMARY OF QUARTERLY RESULTS</b> .....	28
Quarterly Financial Information (unaudited) .....	28
Discussion of Quarterly Results .....	29
<b>LIQUIDITY AND CAPITAL RESOURCES</b> .....	29
Cash flows for three months ended May 31, 2018.....	30
Cash flows for nine months ended May 31, 2018 .....	31
Liquidity and Financing Strategy .....	32
Credit Ratings .....	34
Cash Requirements .....	35
Capital Management.....	38
Financial Instruments and Risk Management .....	38
<b>CHANGES IN ACCOUNTING POLICIES</b> .....	40
Future Accounting Pronouncements .....	40
<b>CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS</b> .....	42
<b>DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING</b> .....	42

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

## **INTRODUCTION**

This management's discussion and analysis (MD&A) relates to the unaudited interim consolidated financial position, results of operations, comprehensive income and cash flows for the three and nine months ended May 31, 2018 (Q3 fiscal 2018) of NAV CANADA and its subsidiaries (also referred to in this MD&A as we, our, us or the Company). It should be read in conjunction with our unaudited interim condensed consolidated financial statements for Q3 fiscal 2018 (Q3 fiscal 2018 financial statements), our audited annual consolidated financial statements and the accompanying notes for the year ended August 31, 2017 (fiscal 2017), our fiscal 2017 annual MD&A, as well as our 2017 Annual Information Form dated October 26, 2017 (fiscal 2017 AIF). Additional information about NAV CANADA, including our consolidated financial statements for Q3 fiscal 2018 and fiscal 2017, our fiscal 2017 annual MD&A, and our fiscal 2017 AIF are filed on the System for Electronic Document Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com).

Our financial statements are prepared in Canadian dollars (CDN) and in accordance with International Financial Reporting Standards (IFRS). Our Q3 fiscal 2018 financial statements have been prepared in accordance with International Accounting Standards (IAS) 34 *Interim Financial Reporting*. Our Audit & Finance Committee reviewed this MD&A and our Board of Directors (the Board) approved it before it was filed.

### **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" 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 2017 AIF. The forward-looking statements contained in this MD&A represent our expectations as of July 12, 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 statement. We disclaim any intention or obligation to update or revise any forward-looking statements included in this document whether as a result of new information, future events or for any other reason, except as required by applicable securities legislation.

### **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.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

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.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

**Financial Highlights**

**Results of operations for the three months ended May 31, 2018**

The Company recorded a net loss of \$8 in Q3 fiscal 2018 (Q3 fiscal 2017 - \$8). Excluding rate stabilization and other regulatory deferral account adjustments, the Company recorded a net loss of \$8 (Q3 fiscal 2017 - \$35). Given the normal seasonality of air traffic and the fact that our costs are predominantly fixed in nature, a net loss is expected for this quarter.

	Three months ended May 31		
	2018	2017	Change
Revenue	\$ 349	\$ 332	\$ 17
Operating expenses	361	348	13
Other (income) and expenses	(14)	16	(30)
Income tax (recovery) expense	10	3	7
Net income (loss), before rate stabilization and regulatory deferral account adjustments	(8)	(35)	27
Net movement in regulatory deferral accounts			
Rate stabilization adjustments:			
Unfavourable (favourable) variances from planned results	11	(8)	19
Initial approved adjustment <sup>(1)</sup>	2	10	(8)
	13	2	11
Other regulatory deferral account adjustments:			
Employee benefit pension contributions	24	27	(3)
Other employee benefits	(2)	8	(10)
Investment in preferred interests, before tax	(46)	(8)	(38)
Investment in equity-accounted investee	-	(5)	5
Income tax	10	3	7
Realized hedging transactions	1	-	1
	(13)	25	(38)
	-	27	(27)
Net loss, after rate stabilization and regulatory deferral account adjustments	\$ (8)	\$ (8)	\$ -

<sup>(1)</sup> In order to achieve breakeven results of operations in fiscal 2018, the Board approved a reduction of the rate stabilization account as a result of a planned shortfall. As a result, \$10 is being transferred out of the rate stabilization account evenly throughout the fiscal year (fiscal 2017 - \$38). For the three months ended May 31, 2018, \$2 has been transferred from the rate stabilization account (three months ended May 31, 2017 - \$10).

The Company is subject to legislation that regulates the level of its charges (see "INTRODUCTION – Financial Strategy and Rate Regulation"). The timing of the recognition of certain revenue and expenses recovered through charges is recorded through movements in regulatory deferral accounts. The net movement in regulatory deferral accounts for the three months ended May 31, 2018 was \$nil as compared to an income of \$27 over the same period in fiscal 2017. This change in regulatory deferrals of \$27 is due to higher unfavourable results deferred through rate stabilization adjustments of \$11 and a \$38 net decrease in regulatory deferral adjustments to adjust the accounting recognition of certain transactions to the periods in which they will be considered for rate setting.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

**Cash flows for the three months ended May 31, 2018**

As shown below, cash and cash equivalents decreased by \$106 during the three months ended May 31, 2018 and the Company experienced negative free cash flow of \$30, 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.

	Three months ended May 31		
	2018	2017	Change
<b>Cash flows from:</b>			
Operations <sup>(1)</sup>	\$ 9	\$ (1)	\$ 10
Investing <sup>(1)</sup>	(48)	(32)	(16)
Financing <sup>(1)</sup>	(67)	(25)	(42)
<b>Decrease in cash and cash equivalents</b>	<b>(106)</b>	<b>(58)</b>	<b>(48)</b>
Cash and cash equivalents, beginning of period	134	276	(142)
<b>Cash and cash equivalents, end of period</b>	<b>\$ 28</b>	<b>\$ 218</b>	<b>\$ (190)</b>
<b>Free cash flow (non-GAAP financial measure):</b>			
Cash flows from:			
Operations <sup>(2)</sup>	\$ 9	\$ (1)	\$ 10
Capital expenditures <sup>(2)</sup>	(39)	(37)	(2)
Proceeds from sale of investment in subsidiary <sup>(2)</sup>	-	4	(4)
<b>Free cash flow</b>	<b>\$ (30)</b>	<b>\$ (34)</b>	<b>\$ 4</b>

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

(2) See the statement of cash flows in our Q3 fiscal 2018 financial statements.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

**Results of operations for the nine months ended May 31, 2018**

The Company recorded a net loss of \$50 for the nine months ended May 31, 2018 (nine months ended May 31, 2017 - \$42). Excluding rate stabilization and other regulatory deferral account adjustments, the Company recorded a net loss of \$65 (nine months ended May 31, 2017 - \$99). Given the normal seasonality of air traffic and the fact that our costs are predominantly fixed in nature, a net loss is expected for the nine months ended May 31, 2018.

	Nine months ended May 31		
	2018	2017	Change
Revenue	\$ 1,001	\$ 960	\$ 41
Operating expenses	1,041	997	44
Other (income) and expenses	34	53	(19)
Income tax (recovery) expense	(9)	9	(18)
Net income (loss), before rate stabilization and regulatory deferral account adjustments	(65)	(99)	34
Net movement in regulatory deferral accounts			
Rate stabilization adjustments:			
Unfavourable (favourable) variances from planned results	2	(37)	39
Initial approved adjustment <sup>(1)</sup>	7	29	(22)
	9	(8)	17
Other regulatory deferral account adjustments:			
Employee benefit pension contributions	78	89	(11)
Other employee benefits	(4)	5	(9)
Investment in preferred interests, before tax	(62)	(34)	(28)
Investment in equity-accounted investee	-	(5)	5
Income tax	(7)	9	(16)
Realized hedging transactions	1	1	-
	6	65	(59)
	15	57	(42)
Net loss, after rate stabilization and regulatory deferral account adjustments	\$ (50)	\$ (42)	\$ (8)

<sup>(1)</sup> In order to achieve breakeven results of operations in fiscal 2018, the Board approved a reduction of the rate stabilization account as a result of a planned shortfall. As a result, \$10 is being transferred out of the rate stabilization account evenly throughout the fiscal year (fiscal 2017 - \$38). For the nine months ended May 31, 2018, \$7 has been transferred from the rate stabilization account (nine months ended May 31, 2017 - \$29).

The net movement in regulatory deferral accounts for the nine months ended May 31, 2018 was an income of \$15 as compared to an income of \$57 over the same period in fiscal 2017. This change in regulatory deferrals of \$42 is due to unfavourable results of \$9 deferred through rate stabilization adjustments (fiscal 2017 - favourable results of \$8) offset by a \$59 net decrease in regulatory deferral adjustments to adjust the accounting recognition of certain transactions to the periods in which they will be considered for rate setting.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

**Cash flows for the nine months ended May 31, 2018**

As shown below, cash and cash equivalents decreased by \$194 during the nine months ended May 31, 2018 and the Company experienced negative free cash flow of \$145, which is a non-GAAP financial measure as discussed in "INTRODUCTION – Financial Highlights: Cash flows for the three months ended May 31, 2018".

	Nine months ended May 31		
	2018	2017	Change
<b>Cash flows from:</b>			
Operations <sup>(1)</sup>	\$ (26)	\$ 58	\$ (84)
Investing <sup>(1)</sup>	(126)	179	(305)
Financing <sup>(1)</sup>	(42)	(135)	93
<b>Cash flows from operating, investing and financing activities</b>	(194)	102	(296)
Effect of foreign exchange on cash and cash equivalents	-	(3)	3
<b>Increase (decrease) in cash and cash equivalents</b>	(194)	99	(293)
Cash and cash equivalents, beginning of period	222	119	103
<b>Cash and cash equivalents, end of period</b>	<u>\$ 28</u>	<u>\$ 218</u>	<u>\$ (190)</u>
<b>Free cash flow (non-GAAP financial measure):</b>			
Cash flows from:			
Operations <sup>(2)</sup>	\$ (26)	\$ 58	\$ (84)
Capital expenditures <sup>(2)</sup>	(124)	(97)	(27)
Investment in preferred interests <sup>(2)</sup>	-	(16)	16
Income tax refund (payment) on investment in preferred interests <sup>(2)</sup>	5	(5)	10
Proceeds from sale of investment in subsidiary <sup>(2)</sup>	-	4	(4)
<b>Free cash flow</b>	<u>\$ (145)</u>	<u>\$ (56)</u>	<u>\$ (89)</u>

<sup>(1)</sup> See "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the nine months ended May 31, 2018" for discussion of the changes in cash flows from the prior fiscal year.

<sup>(2)</sup> See the statement of cash flows in our Q3 fiscal 2018 financial statements.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

**Financial position as at May 31, 2018:**

The following table outlines significant changes in our assets and liabilities between August 31, 2017 and May 31, 2018:

	May 31 2018	August 31 2017	Change
<b>Assets</b>			
Current assets			
Cash and cash equivalents	\$ 28	\$ 222	\$ (194)
Accounts receivable and other	97	107	(10)
Investments	71	95	(24)
Other current assets	9	11	(2)
	<u>205</u>	<u>435</u>	<u>(230)</u>
Non-current assets			
Investment in preferred interests	412	350	62
Related party loans receivable	12	2	10
Employee benefits	7	11	(4)
Investment in equity-accounted investee	7	7	-
Property, plant and equipment	712	705	7
Intangible assets	931	930	1
Other non-current assets	1	1	-
	<u>2,082</u>	<u>2,006</u>	<u>76</u>
Total assets	<u>2,287</u>	<u>2,441</u>	<u>(154)</u>
Regulatory deferral account debit balances	<u>1,428</u>	<u>1,475</u>	<u>(47)</u>
Total assets and regulatory deferral account debit balances	<u>\$ 3,715</u>	<u>\$ 3,916</u>	<u>\$ (201)</u>
<b>Liabilities</b>			
Current liabilities			
Bank loans	\$ 40	\$ -	\$ 40
Trade and other payables	216	229	(13)
Derivative liabilities	6	1	5
Deferred revenue	7	6	1
Customer service charges refund	-	60	(60)
Current portion of long-term debt	275	375	(100)
	<u>544</u>	<u>671</u>	<u>(127)</u>
Non-current liabilities			
Long-term debt	1,219	1,220	(1)
Employee benefits	1,539	1,586	(47)
Deferred tax liability	48	55	(7)
Derivative liabilities	-	12	(12)
Other non-current liabilities	2	2	-
	<u>2,808</u>	<u>2,875</u>	<u>(67)</u>
Total liabilities	<u>3,352</u>	<u>3,546</u>	<u>(194)</u>
<b>Equity</b>			
Retained earnings (deficit)	(22)	28	(50)
Regulatory deferral account credit balances	<u>385</u>	<u>342</u>	<u>43</u>
Total liabilities, equity and regulatory deferral account credit balances	<u>\$ 3,715</u>	<u>\$ 3,916</u>	<u>\$ (201)</u>

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

For a discussion of the changes in cash and cash equivalents from August 31, 2017, see "LIQUIDITY AND CAPITAL RESOURCES – Cash flows for the nine months ended May 31, 2018".

See "INTRODUCTION – Significant Financial Matters" for discussion of the significant changes in current and long-term investments, including the investment in preferred interests of Aireon and long-term debt during the nine months ended May 31, 2018.

The change in non-current employee benefit liabilities are mainly a result of the net re-measurement gains of employee defined benefit plans recorded during the nine months ended May 31, 2018 and the settlement of curtailed severance benefits. These changes, along with the related changes in regulatory deferral account debit balances, are discussed further in "RESULTS OF OPERATIONS – Other Comprehensive Income (Loss)".

The balance in retained earnings (deficit) as at May 31, 2018 reflects the earnings up to that date. We plan our operations to essentially result in an annual financial breakeven position after expenses are met through customer service charges and other revenue sources, and after adjustments are made to the rate stabilization account. As a result, the balance in the retained earnings (deficit) account at the end of each fiscal year has remained stable at \$28. Any variation from this amount at the end of any interim period reflects seasonal or other planned fluctuations in revenue and expenses.

### **Significant Financial Matters**

The following items have significant financial importance to the Company:

#### **1. Rate Stabilization Account**

As at May 31, 2018, the rate stabilization account (see "RESULTS OF OPERATIONS – Movements in Rate Stabilization Account") had a credit balance of \$122, 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 \$9 during the nine months ended May 31, 2018 due to \$2 of unfavourable variances from planned results and the \$7 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<sup>1</sup>**

During the first nine months of fiscal 2018, air traffic volumes increased by 5.0% 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 fiscal 2018 is 4.7%.

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.

Strong traffic results in fiscal 2018 along with traffic growth projections for the fiscal year ending August 31, 2019 (fiscal 2019) has enabled the Company to propose to cancel the average 0.4% rate increase that was set to begin on September 1, 2018, effectively continuing the one-year temporary rate reduction implemented on September 1, 2017. On average, our customers will pay the same rates in fiscal 2019 as they did in fiscal 2018.

---

<sup>1</sup> Note: See "INTRODUCTION – Caution Concerning Forward-Looking Information", page 1

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

In accordance with the ANS Act, the Company issued a notice of revised service charges for consultation on May 28, 2018, providing details of the proposed revisions. The consultation period concludes on July 31, 2018.

### **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 will be 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 and filed with OSFI in June 2018, reported a going concern surplus of \$503 (2017 - \$242). 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 (as discussed in our fiscal 2017 annual MD&A), 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.

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 \$1,278 as at May 31, 2018 as compared to an accounting deficit of \$1,295 as at the annual measurement date of August 31, 2017. The \$17 decrease in the deficit position during the nine months ended May 31, 2018 is due to net actuarial gains of \$106, partially offset by actuarial accounting expense exceeding Company contributions by \$89. The \$106 of net actuarial gains are due to a return on plan assets \$226 greater than the expected return based on the discount rate of 3.60% at August 31, 2017, partially offset by actuarial losses of \$120 from a 10 basis point decrease in the discount rate to 3.50%.

During Q3 fiscal 2018, there were no significant events or changes to the Company's defined pension plans that would require a revaluation. As such, no revaluation was performed and no changes in re-measurements of the plans were recorded in the Company's statement of other comprehensive income for the three months ended May 31, 2018.

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 2017, the Company announced the ratification of new collective agreements with four of its unions: the Canadian Air Traffic Control Association Unifor Local 5454 (CATCA), the Air Traffic Specialists Association of Canada (ATSAC), the Professional Institute of the Public Service of Canada (PIPSC) and the Canadian Association of Financial Officers.

During Q2 fiscal 2018, the Company announced the ratification of its collective agreement with the Canadian Federal Pilots Association, which represents approximately 50 pilots. The two year agreement covers the period from May 1, 2017 to April 30, 2019.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

During Q3 fiscal 2018, the Company announced the ratification of its collective agreement with the International Brotherhood of Electrical Workers, which represents approximately 650 members. The two year agreement covers the period January 1, 2018 to December 31, 2019.

During Q3 fiscal 2018, the Company also announced the conclusion of the bargaining cycle with Unifor Local 1016, which represents approximately 270 members. The two-year agreement covers the period July 1, 2017 to June 30, 2019.

Negotiations have commenced with the remaining union, comprising approximately 7% of our represented workforce, whose contract expired on December 31, 2017.

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

As discussed in note 4 to the Q3 fiscal 2018 financial statements, on May 15, 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 air navigation service provide (ANSP), to provide for the making of an additional investment of \$69 U.S. (\$89 CDN) in Aireon by NATS.

As at May 31, 2018, the Company's investment in Aireon is \$150 U.S. (\$194 CDN) (August 31, 2017 - \$150 U.S. (\$187 CDN)). Following the 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. (\$155 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 May 31, 2018, the Company's total fully diluted common equity interest on a post conversion basis 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 of preferred interests in Aireon to determine the fair value of its investment as at May 31, 2018, as it was determined that this represents the best estimate of fair value. As at May 31, 2018, the fair value of the Company's investment in preferred interests of Aireon has increased to \$412 (August 31, 2017 - \$350).

On December 22, 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 May 31, 2018 of \$38 U.S. (\$48 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 were to be repaid on the earlier of June 29, 2018 and the date at which Aireon receives funding under a senior credit facility. In May 2018, the bridge loan agreement was amended to extend the maturity date to the earlier of September 30, 2019 and the date on which the initial funding under a senior credit facility is made. The amount of financial commitment under the amended agreement remains the same. As at May 31, 2018, Aireon has drawn \$7 U.S. (\$10 CDN) under the agreement.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

---

**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.

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 for both bond forward agreements.

**RESULTS OF OPERATIONS**

**Revenue**

The following table provides a breakdown of our revenue by category. Our fiscal 2017 AIF and the notes to our fiscal 2017 annual consolidated financial statements provide more information about the different categories of our customer service charges.

	Three months ended May 31			
	2018	2017	Change	%
Enroute	\$ 172	\$ 165	\$ 7	4%
Terminal	127	121	6	5%
Daily / annual / quarterly	24	21	3	14%
North Atlantic and international communication	11	12	(1)	(8%)
Total customer service charges	334	319	15	5%
Other	15	13	2	15%
	<u>\$ 349</u>	<u>\$ 332</u>	<u>\$ 17</u>	<u>5%</u>

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

Revenue for Q3 fiscal 2018 was \$349 compared to \$332 for Q3 fiscal 2017. The \$17 increase is primarily due to a 5.3% growth in air traffic volumes during Q3 fiscal 2018.

Effective September 1, 2017, the Company implemented revisions to its 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 on September 1, 2016.

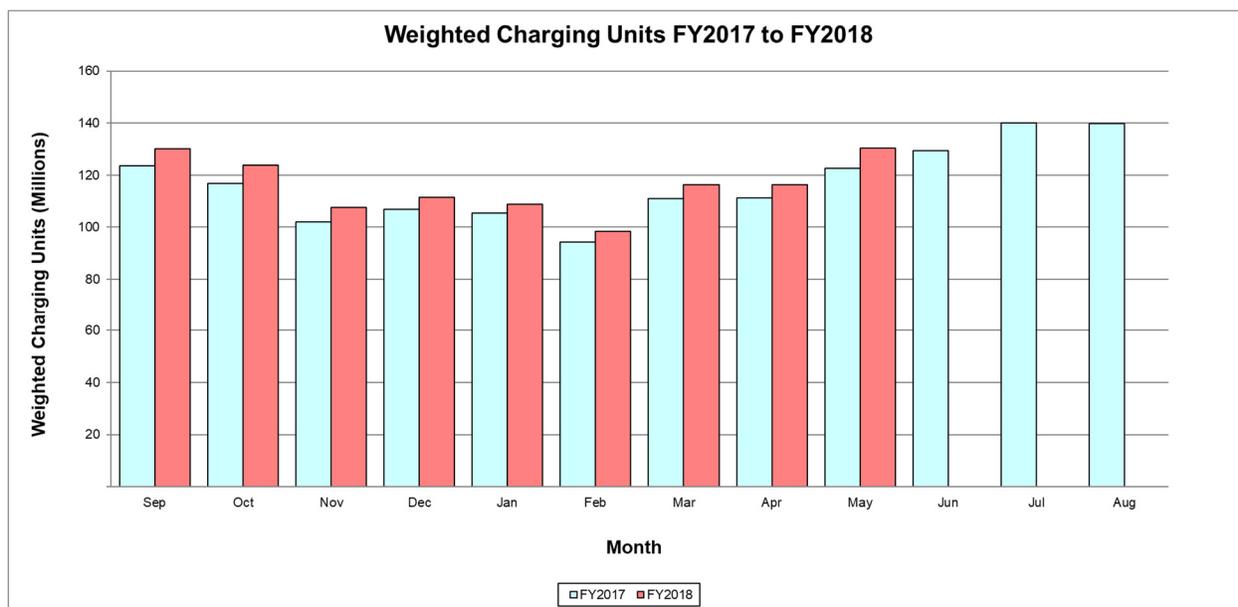
**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

	Nine months ended May 31			
	2018	2017	Change	%
Enroute	\$ 492	\$ 474	\$ 18	4%
Terminal	371	351	20	6%
Daily / annual / quarterly	67	61	6	10%
North Atlantic and international communication	32	32	-	-%
Total customer service charges	962	918	44	5%
Other	39	42	(3)	(7%)
	<u>\$ 1,001</u>	<u>\$ 960</u>	<u>\$ 41</u>	<u>4%</u>

Revenue for the nine months ended May 31, 2018 was \$1,001 compared to \$960 for the nine months ended May 31, 2017. The \$41 increase is due to a \$44 increase in customer service charge revenue arising from a 5.0% growth in air traffic volumes during fiscal 2018, partially offset by a decrease of \$3 in other revenue mainly related to service and development contracts.

**Air Traffic**

Air traffic growth for the first nine months of fiscal 2018 reflects normal seasonality. The chart shows traffic in "weighted charging units", a measure of the number of flights, aircraft size and distance flown.



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.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

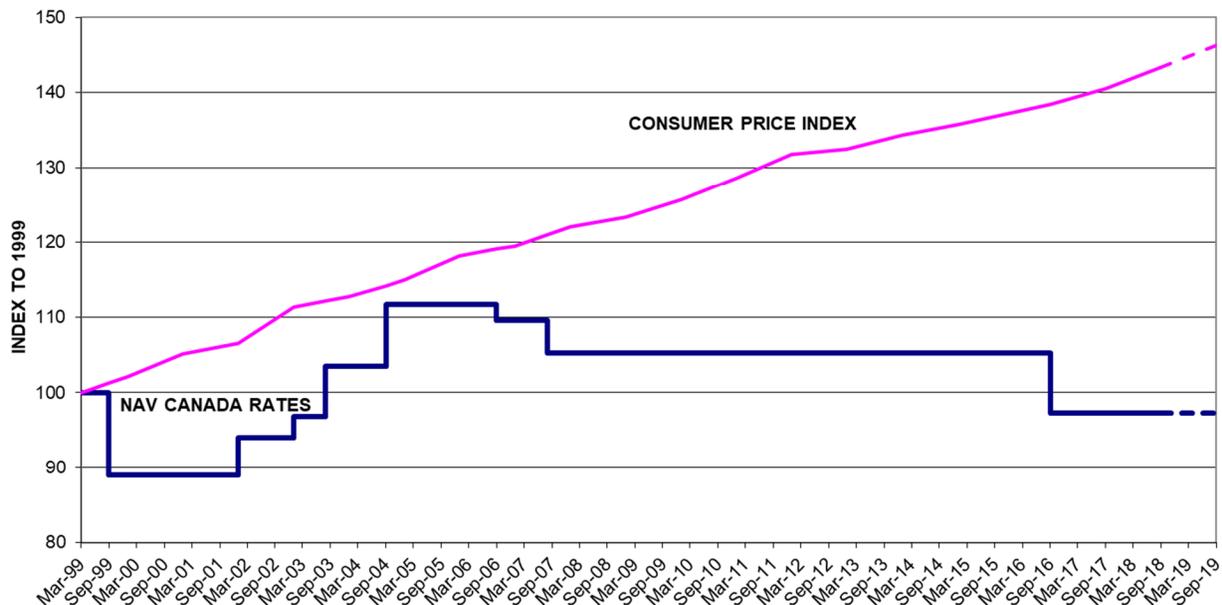
**Customer Service Charges<sup>2</sup>**

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. The chart also depicts the revised customer service charges that became effective September 1, 2016 and September 1, 2017. Effective September 1, 2017, 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 43 percentage points less than the change in the Consumer Price Index (CPI) since March 1999.

**HISTORY OF NAV CANADA RATE CHANGES<sup>(1),(3)</sup>  
VERSUS CONSUMER PRICE INDEX<sup>(2)</sup>**



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
3. NAV CANADA announced a rate provision proposal that would decrease rates by an average of 0.4 per cent. This effectively continues the one-year temporary rate reduction that was implemented on September 1, 2017.

<sup>2</sup> Note: See “INTRODUCTION – Caution Concerning Forward-Looking Information”, page 1

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(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 the Company has proposed effective 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.

Strong traffic results in fiscal 2018 (see "RESULTS OF OPERATIONS – Financial Outlook") along with traffic growth projections for fiscal 2019 has enabled the Company to propose to cancel the average 0.4% rate increase that was set to begin on September 1, 2018, effectively continuing the one-year temporary rate reduction implemented on September 1, 2017. On average, our customers will pay the same rates in fiscal 2019 as they did in fiscal 2018.

In accordance with the ANS Act, the Company issued a notice of revised service charges for consultation on May 28, 2018, providing details of the proposed revisions. The consultation period concludes on July 31, 2018.

**Operating Expenses**

	Three months ended May 31			
	2018	2017	Change	%
Salaries and benefits	\$ 256	\$ 249	\$ 7	3%
Technical services	30	27	3	11%
Facilities and maintenance	17	17	-	-%
Depreciation and amortization	39	37	2	5%
Other	19	18	1	6%
	<u>\$ 361</u>	<u>\$ 348</u>	<u>\$ 13</u>	<u>4%</u>

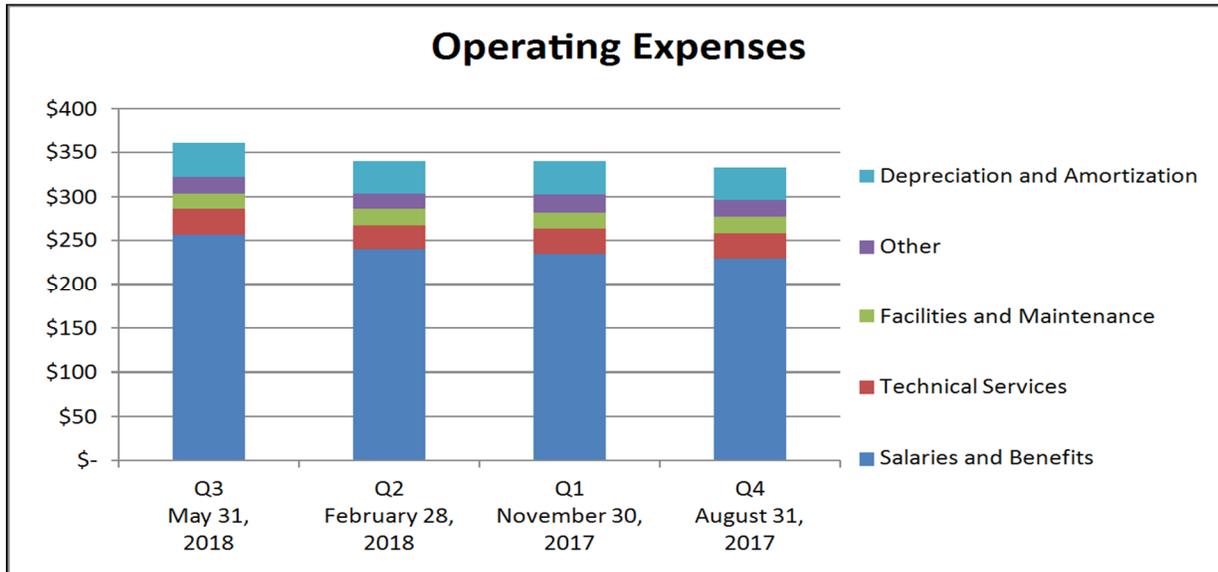
	Nine months ended May 31			
	2018	2017	Change	%
Salaries and benefits	\$ 731	\$ 696	\$ 35	5%
Technical services	86	83	3	4%
Facilities and maintenance	54	53	1	2%
Depreciation and amortization	114	110	4	4%
Other	56	55	1	2%
	<u>\$ 1,041</u>	<u>\$ 997</u>	<u>\$ 44</u>	<u>4%</u>

Salaries and benefits expense for the three and nine months ended May 31, 2018 increased by \$7 and \$35, respectively, compared to the three and nine months ended May 31, 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, partially offset by the \$9 curtailment loss incurred for the voluntary elimination and settlement of severance benefits for employees recorded in the three and nine months ended May 31, 2017.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

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



**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

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

	Three months ended May 31		
	2018	2017	Change
Finance income			
Interest income	\$ (1)	\$ (1)	\$ -
Net change in fair value of financial assets at FVTPL <sup>(1)</sup>			
MAV II, ABCP and other investments <sup>(2)</sup>	(1)	(1)	-
Investment in preferred interests	(42)	(2)	40
	<u>(43)</u>	<u>(3)</u>	<u>40</u>
Total finance income	<u>(44)</u>	<u>(4)</u>	<u>40</u>
Net interest costs relating to employee benefits	14	14	-
Other finance costs			
Interest expense	20	19	(1)
Other (gains) and losses			
Foreign exchange gains	(4)	(6)	(2)
Realized gain on sale of investment in subsidiary	-	(2)	(2)
Unrealized gain on sale of investment in subsidiary	-	(5)	(5)
	<u>(4)</u>	<u>(13)</u>	<u>(9)</u>
	<u>\$ (14)</u>	<u>\$ 16</u>	<u>\$ 30</u>
Income tax expense	<u>\$ 10</u>	<u>\$ 3</u>	<u>\$ (7)</u>

<sup>(1)</sup> The net change in fair value of financial assets at fair value through profit or loss (FVTPL) includes interest and dividend income related to those financial assets.

<sup>(2)</sup> Master Asset Vehicle II (MAV II), asset-backed commercial paper (ABCP) and other investments

The net change in fair value of financial assets at FVTPL increased by \$40 in Q3 fiscal 2018 compared to Q3 fiscal 2017. Positive fair value adjustments of \$39 and dividend income of \$3 were recorded in Q3 fiscal 2018 on the investment in preferred interests of Aireon compared to dividend income of \$2 in Q3 fiscal 2017. The positive fair value adjustments were a result of the increase in fair value based on the price paid by NATS for an investment of preferred interests in Aireon in May 2018.

In Q3 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 Technologies Inc. (Searidge).

Income tax increased by \$7 in Q3 fiscal 2018 compared to Q3 fiscal 2017 as a result of the increase in net deferred tax liabilities related to the Company's investment in preferred interests of Aireon. The increase in deferred taxes is based on the increase in fair value of the investment recorded in Q3 fiscal 2018.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

	Nine months ended May 31		
	2018	2017	Change
Finance income			
Interest income	\$ (3)	\$ (2)	\$ 1
Net change in fair value of financial assets at FVTPL			
MAV II, ABCP and other investments	(2)	(15)	(13)
Investment in preferred interests	(48)	(22)	26
	<u>(50)</u>	<u>(37)</u>	<u>13</u>
Total finance income	<u>(53)</u>	<u>(39)</u>	<u>14</u>
Net interest costs relating to employee benefits	41	41	-
Other finance costs			
Interest expense	58	60	2
Redemption premium	-	10	10
	<u>58</u>	<u>70</u>	<u>12</u>
Other (gains) and losses			
Foreign exchange gains	(12)	(12)	-
Realized gain on sale of investment in subsidiary	-	(2)	(2)
Unrealized gain on sale of investment in subsidiary	-	(5)	(5)
	<u>(12)</u>	<u>(19)</u>	<u>(7)</u>
	<u>\$ 34</u>	<u>\$ 53</u>	<u>\$ 19</u>
Income tax (recovery) expense	<u>\$ (9)</u>	<u>\$ 9</u>	<u>\$ 18</u>

The net change in fair value of financial assets at FVTPL increased by \$14 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 \$39 and dividend income of \$9 were recorded in fiscal 2018 on the investment in preferred interests of Aireon compared to positive fair value adjustments of \$14 and dividend income of \$8 in fiscal 2017.

The \$12 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.

Income tax decreased by \$18 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 increase in fair value of the investment recorded in Q3 fiscal 2018.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 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.

	Three months ended May 31		
	2018	2017	Change
Rate stabilization account	\$ 13	\$ 2	\$ 11
Other regulatory deferral accounts			
Employee benefit pension contributions	24	27	(3)
Other employee benefits	(2)	8	(10)
Investment in preferred interests, before tax	(46)	(8)	(38)
Investment in equity-accounted investee	-	(5)	5
Income tax	10	3	7
Realized hedging transactions	1	-	1
	<u>\$ -</u>	<u>\$ 27</u>	<u>\$ (27)</u>

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 Q3 fiscal 2018 decreased by \$3 compared to Q3 fiscal 2017. Regulatory adjustments to adjust the total pension benefit expense to the level of pension contributions to be recovered through rate setting were \$24 in Q3 fiscal 2018 compared to \$27 in Q3 fiscal 2017. Included in the Q3 fiscal 2018 regulatory deferral related to pension contributions of \$24 is the planned recovery of \$2 of the \$44 solvency deficiency contributions made in fiscal 2017.

The net movement in the other employee benefits regulatory deferral account decreased by \$10 in Q3 fiscal 2018 compared to Q3 fiscal 2017. The decrease is primarily due to the regulatory deferral of the curtailment loss of \$9 recorded in Q3 fiscal 2017 as a result of the voluntary elimination and settlement of severance benefits for employees represented by the Canadian Air Traffic Controller Association (CATCA). No similar regulatory deferral was recorded in Q3 fiscal 2018.

The \$38 decrease in the investment in preferred interests regulatory deferral account in Q3 fiscal 2018 is primarily due to the regulatory deferral of the \$39 increase in fair value of the investment, with no similar regulatory deferral recorded in Q3 fiscal 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 Q3 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 \$7 increase in Q3 fiscal 2018 compared to Q3 fiscal 2017 is a result of the increase in net deferred tax liabilities related to the investment in preferred interests of Aireon which is due to the increase in fair value of the investment.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

	Nine months ended May 31		
	2018	2017	Change
Rate stabilization account	\$ 9	\$ (8)	\$ 17
Other regulatory deferral accounts			
Employee benefit pension contributions	78	89	(11)
Other employee benefits	(4)	5	(9)
Investment in preferred interests, before tax	(62)	(34)	(28)
Investment in equity-accounted investee	-	(5)	5
Income tax	(7)	9	(16)
Realized hedging transactions	1	1	-
	<u>\$ 15</u>	<u>\$ 57</u>	<u>\$ (42)</u>

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 nine months ended May 31, 2018 decreased by \$11 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 \$78 in fiscal 2018 compared to \$89 in fiscal 2017. Included in the fiscal 2018 regulatory deferral related to pension contributions of \$78 is the planned recovery of \$7 of the \$44 solvency deficiency contributions made in fiscal 2017.

The net movement in the other employee benefits regulatory deferral account decreased by \$9 in fiscal 2018 compared to fiscal 2017. The decrease is due to the regulatory deferral of the curtailment loss of \$9 recorded in fiscal 2017 as a result of the voluntary elimination and settlement of severance benefits for employees represented by CATCA. No similar regulatory deferral was recorded in fiscal 2018.

The \$28 decrease in the investment in preferred interests regulatory deferral account for the nine months ended May 31, 2018 is primarily due to the regulatory deferral of the \$39 increase in fair value of the investment, compared to an increase of \$14 recorded in the nine months ended May 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 \$16 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 increase in fair value of the investment recorded in Q3 fiscal 2018.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**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 2017 financial statements. The table below shows the movements in the rate stabilization account.

	Nine months ended May 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	10	31	(21)
Operating expenses higher than planned	(7)	(18)	11
Other (income) and expenses lower (higher) than planned	61	(6)	67
Net movement in other regulatory deferral accounts	(66)	30	(96)
Total variances from planned results	(2)	37	(39)
Initial approved adjustment	(7)	(29)	22
Net movement in rate stabilization account recorded in net income (loss)	(9)	8	(17)
Credit balance on the statement of financial position, end of period	\$ 122	\$ 177	\$ (55)

The \$9 decrease in the rate stabilization account during the nine months ended May 31, 2018 is primarily due to:

- net movement of \$66 in regulatory deferral accounts that was less favourable than planned primarily due to:
    - a net regulatory expense \$51 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;
    - a regulatory expense for pensions that was \$8 higher than planned primarily due to higher pension contributions than planned;
- partially offset by:
- a regulatory adjustment of \$2 to recognize a surplus on long-term disability (LTD) benefits; and
- operating expenses that were \$7 higher than planned, primarily due to higher salaries and benefits expense, partially offset by lower technical services and other miscellaneous expenses; and

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

- the planned adjustment of \$7, representing three-quarters of the anticipated \$10 annual net loss at the time the fiscal 2018 budget was approved.

partially offset by:

- other (income) and expense that was \$61 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 \$10 higher than planned due to a 5.0% increase in air traffic volumes compared to the budgeted increase of 4.3% for the nine months ended May 31, 2018.

**Other Comprehensive Income (Loss)**

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

	Three months ended May 31		
	2018	2017	Change
Items that will not be reclassified to income or (loss):			
Re-measurements of employee defined benefit plans	\$ -	\$ (219)	\$ 219
Net movement in regulatory deferral accounts	-	219	(219)
	-	-	-
Items that will be reclassified to income or (loss):			
Changes in fair value of cash flow hedges	(4)	(6)	2
Net movement in regulatory deferral accounts	4	6	(2)
	-	-	-
Total other comprehensive income (loss)	\$ -	\$ -	\$ -

During Q3 fiscal 2018, there were no significant events or changes to the Company's defined pension and other post-employment benefit plans that would require a revaluation. As such, no revaluation was performed and no changes in re-measurements of the plans were recorded in the Company's statement of other comprehensive income. In Q3 fiscal 2017, the re-measurement losses of \$219 were a result of actuarial losses of \$550, primarily due to a 40 basis point decrease in the discount rates to 3.50%, partially offset by a return on plan assets \$307 greater than the expected return based on the discount rate of 3.40% at August 31, 2016 and actuarial gains of \$24 due to positive experience on the defined benefit obligation.

During Q3 fiscal 2018, negative fair value adjustments of \$4 were recorded primarily on the Company's interest rate hedges related to the re-financing of debt instruments that will mature in fiscal 2019. During Q3 fiscal 2017, negative fair value adjustments of \$6 were recorded on the same interest rate hedges.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

	Nine months ended May 31		
	2018	2017	Change
Items that will not be reclassified to income or (loss):			
Re-measurements of employee defined benefit plans	\$ 100	\$ 257	\$ (157)
Net movement in regulatory deferral accounts	(100)	(257)	157
	-	-	-
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	4	30	(26)
Net movement in regulatory deferral accounts	(5)	(31)	26
	-	-	-
Total other comprehensive income (loss)	\$ -	\$ -	\$ -

Re-measurement gains on employee defined benefit plans in the nine months ended May 31, 2018 of \$100 were recorded during Q1 fiscal 2018 and are a result of a return on plan assets \$226 greater than the expected return based on the discount rate of 3.60% at August 31, 2017, partially offset by actuarial losses of \$126 from a 10 basis point decrease in the discount rate to 3.50%. For fiscal 2017, the net re-measurement gains of \$257 were mainly a result of a return on plan assets \$239 greater than the expected return based on the discount rate at August 31, 2016 of 3.40% and actuarial gains of \$18 due to a 10 basis point increase in the discount rate to 3.50%.

In fiscal 2018, positive fair value adjustments of \$4 were recorded primarily on the Company's interest rate hedges related to the re-financing of debt instruments that will mature in fiscal 2019. In fiscal 2017, positive fair value adjustments of \$30 were recorded on the same interest rate hedges.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(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.

	May 31 2018	August 31 2017	Change
(a) Rate stabilization account credit balance	\$ 122	\$ 131	\$ (9)
Target balance of the rate stabilization account <sup>(1)</sup>	<u>(104)</u>	<u>(101)</u>	<u>(3)</u>
Excess of the rate stabilization account from its target balance	(A)\$ <u>18</u>	\$ <u>30</u>	\$ <u>(12)</u>
(b) Pension contributions in excess of pension expense	32	(53)	85
Regulatory balance - recovery of contributions	<u>(69)</u>	<u>9</u>	<u>(78)</u>
Regulatory expense cumulatively lower than contributions	(B)\$ <u>(37)</u>	\$ <u>(44)</u>	\$ <u>7</u>
Amount to be (recovered) returned over time through rate setting	(A + B)\$ <u>(19)</u>	\$ <u>(14)</u>	\$ <u>(5)</u>

<sup>(1)</sup> 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 is \$104.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

**Financial Outlook<sup>3</sup>**

Presented below are the Company's current projected annual consolidated results before rate stabilization for fiscal 2018 compared to fiscal 2017 results.

	Fiscal 2018	Fiscal 2017	Change	%
<b>Before rate stabilization</b>				
Revenue before customer service charges refund	\$ 1,406	\$ 1,351	\$ 55	4%
Customer service charges refund	-	(60)	60	(100%)
	<u>1,406</u>	<u>1,291</u>	<u>115</u>	<u>9%</u>
Operating expenses and other (income) and expenses, including other regulatory adjustments	<u>1,414</u>	<u>1,329</u>	<u>85</u>	<u>6%</u>
Net income (loss) before rate stabilization adjustments	<u>\$ (8)</u>	<u>\$ (38)</u>	<u>\$ 30</u>	

**Revenue**

Revenue before customer service charges refund for fiscal 2018 is expected to increase by approximately 4.0% or \$55 from \$1,351 in fiscal 2017 primarily due to forecasted air traffic growth of 4.7%. In fiscal 2018, there is no customer service charges refund offsetting revenue like that accrued at August 31, 2017. As discussed in "RESULTS OF OPERATIONS – Revenue", the revised charges, effective September 1, 2017, effectively continue the 3.9% temporary rate reduction that was implemented in fiscal 2017.

In our Q2 fiscal 2018 MD&A, we had disclosed anticipated revenue of \$1,402 for fiscal 2018. The increase of \$4 in the forecast is primarily due to an increase in other revenue.

**Operating Expenses and Other (Income) and Expenses**

Operating expenses and other (income) and expenses before rate stabilization for fiscal 2018 are expected to be \$1,414. This is an increase of 6.3% or \$85 compared to fiscal 2017 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;
- increased operational requirements impacting technical services expenses;
- the \$10 planned regulatory recovery of pension solvency contributions;
- lower positive fair value adjustments on investments, excluding the investment in preferred interests of Aireon;
- higher LTD benefit costs due to positive experience recorded in fiscal 2017; and
- the effects of inflation;

<sup>3</sup> Note: See "INTRODUCTION – Caution Concerning Forward-Looking Information", page 1

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

partially offset by:

- decreased finance costs as a result of lower debt levels in fiscal 2018 compared to fiscal 2017.

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 Q2 fiscal 2018 MD&A, we had disclosed anticipated operating expenses and other (income) and expenses, before rate stabilization of \$1,412 for fiscal 2018. The increase of \$2 is primarily related to an increase in overtime costs to meet operational requirements, partially offset by an increase in salaries and benefits capitalized to projects and decreases in other operating expenses.

### **Cash Flows**

Given the expected net cash flows from operations and cash flows from investing and financing activities in fiscal 2018, the Company's cash position is currently expected to decrease to \$28 as at August 31, 2018 from \$222 as at August 31, 2017. This cash outlook is based on anticipated annual cash inflows from operating activities of \$70, which is net of the impact of the \$60 customer service charges refund to customers and the \$42 settlement of the curtailed severance benefits, offset by cash outflows from investing and financing activities of \$189 and \$75, respectively. Investing activities include cash outflows for capital expenditures of \$186 (excluding capitalized interest of \$5), the bridge loan financing of \$10 to Aireon, partially offset by the receipt of income taxes receivable of \$5. Financing net cash outflows are primarily comprised of \$375 for the repayment of long-term debt and the disbursement of \$5 on settlement of a bond forward, partially offset by the issuance of \$275 in medium term notes, a release of \$25 from the debt service reserve fund and net proceeds from bank loans of \$8. As discussed below, the Company has adequate existing sources of financing to cover all of its anticipated cash flow requirements.

In our Q2 fiscal 2018 MD&A, we had disclosed an anticipated cash position of \$50 by the end of fiscal 2018, including proceeds from bank loans of \$7. Our cash position anticipated at the end of fiscal 2018 is \$22 lower due to the bridge loan financing to Aireon, the settlement of the bond forward, higher capital expenditures and lower cash inflows from operations.

### **Rate Stabilization Account**

As noted above, the Company has implemented revisions to its customer service charges, effective September 1, 2017 which effectively continue the 3.9% temporary rate reduction that was implemented in fiscal 2017.

The Company currently anticipates that the rate stabilization account will have a credit balance of \$122 at the end of fiscal 2018, resulting from estimated revenue of \$1,406 and total operating expenses and other (income) and expense (including other regulatory adjustments) of \$1,414 (before rate stabilization). The target balance of the rate stabilization account in fiscal 2018 is \$104.

In our Q2 fiscal 2018 MD&A, we had forecast an anticipated rate stabilization account credit balance of \$120 at the end of fiscal 2018. The increase in the forecasted credit balance at August 31, 2018 is due to the forecasted increase in revenue, partially offset by the increase in other (income) and expense (including other regulatory adjustments).

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

### **Earnings and Cash Flow Coverage**

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

For the twelve months ended May 31, 2018, the Company had a net loss of \$8. Our interest costs were \$78. Consolidated earnings (after rate stabilization) before interest was \$70, which is 0.90 times our interest requirement for the fiscal year and just below our one-to-one target. Depreciation and amortization expense for this period was \$151. Our cash flow coverage was 2.83 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 May 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 and registered pension plans for its employees. The transactions with these related parties are not materially different from what was reported in the fiscal 2017 annual MD&A, with the exception of the loan receivable from Aireon discussed in "INTRODUCTION – Significant Financing Matters" and note 4 of the Q3 fiscal 2018 financial statements. As at May 31, 2018, Aireon has drawn \$7 U.S. (\$10 CDN) under the bridge loan agreement.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

**SUMMARY OF QUARTERLY RESULTS**

**Quarterly Financial Information (unaudited)**

	Three months ended			
	Q3 May 31 2018	Q2 February 28 2018	Q1 November 30 2017	Q4 August 31 2017
Revenue	\$ 349	\$ 305	\$ 347	\$ 331
Operating expenses	361	340	340	333
Other (income) and expenses	(14)	30	18	44
	2	(65)	(11)	(46)
Income tax (recovery) expense	10	(19)	-	5
Net income (loss) before net movement in regulatory deferral accounts	(8)	(46)	(11)	(51)
Net movement in regulatory deferral accounts related to net income (loss), net of tax				
Rate stabilization adjustments	13	(7)	3	46
Other regulatory deferral account adjustments	(13)	8	11	47
	-	1	14	93
Net income (loss) after net movement in regulatory deferral accounts	<u>\$ (8)</u>	<u>\$ (45)</u>	<u>\$ 3</u>	<u>\$ 42</u>

	Three months ended			
	Q3 May 31 2017	Q2 February 28 2017	Q1 November 30 2016	Q4 August 31 2016
Revenue	\$ 332	\$ 296	\$ 332	\$ 405
Operating expenses	348	328	\$ 321	\$ 316
Other (income) and expenses	16	15	\$ 22	\$ 27
	(32)	(47)	(11)	62
Income tax (recovery) expense	3	5	\$ 1	\$ 1
Net income (loss) before net movement in regulatory deferral accounts	(35)	(52)	(12)	61
Net movement in regulatory deferral accounts related to net income (loss), net of tax				
Rate stabilization adjustments	2	(3)	\$ (7)	\$ (32)
Other regulatory deferral account adjustments	25	21	\$ 19	\$ 20
	27	18	12	(12)
Net income (loss) after net movement in regulatory deferral accounts	<u>\$ (8)</u>	<u>\$ (34)</u>	<u>\$ -</u>	<u>\$ 49</u>

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

### Discussion of Quarterly Results

The quarterly variations in revenue mainly reflect seasonal fluctuations. Typically, revenue is highest in our fourth quarter (June to August) as a result of increased air traffic in the summer months. The second quarter (December to February) typically has the lowest air traffic volumes. Air traffic for Q3 fiscal 2018 was 5.3% higher on average than in Q3 fiscal 2017. Effective September 1, 2017, the Company implemented revisions to its service charges resulting in a decrease on average by 3.5% as well as a temporary one-year rate reduction of 0.4%. This effectively continues the 3.9% one-year temporary rate reduction that was implemented September 1, 2016.

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 in fiscal 2017;
- 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

Our fiscal 2017 annual MD&A explains how we manage our cash and capital resources. There have been no changes in that approach for the nine months ended May 31, 2018. The following sections discuss changes in our cash and capital resources since August 31, 2017.

As at May 31, 2018, we had \$28 of cash and cash equivalents and committed credit facilities of \$1,190, of which \$354 was available for unrestricted use (see "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Financing Strategy").

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

**Cash flows for the three months ended May 31, 2018**

	Three months ended May 31		
	2018	2017	Change
<b>Cash flows from:</b>			
Operations	\$ 9	\$ (1)	\$ 10
Investing	(48)	(32)	(16)
Financing	(67)	(25)	(42)
<b>Decrease in cash and cash equivalents</b>	<b>(106)</b>	<b>(58)</b>	<b>(48)</b>
Cash and cash equivalents, beginning of period	134	276	(142)
<b>Cash and cash equivalents, end of period</b>	<b>\$ 28</b>	<b>\$ 218</b>	<b>\$ (190)</b>
<b>Free cash flow (non-GAAP financial measure):</b>			
Cash flows from:			
Operations	\$ 9	\$ (1)	\$ 10
Capital expenditures <sup>(1)</sup>	(39)	(37)	(2)
Proceeds from sale of investment in subsidiary <sup>(1)</sup>	-	4	(4)
<b>Free cash flow</b>	<b>\$ (30)</b>	<b>\$ (34)</b>	<b>\$ 4</b>

<sup>(1)</sup> See the statement of cash flows in our Q3 fiscal 2018 financial statements.

As shown above, cash and cash equivalents decreased by \$106 for the three months ended May 31, 2018 and the Company experienced negative free cash flow of \$30, which is a non-GAAP financial measure as discussed in "INTRODUCTION – Financial Highlights: Cash flows for the three months ended May 31, 2018".

Cash flows from operations for the three months ended May 31, 2018 were inflows of \$9 compared to outflows of \$1 for the three months ended May 31, 2017, primarily due to \$23 lower pension solvency deficiency payments, \$6 higher receipts from customer service charges and \$3 lower pension special payments, partially offset by \$12 higher payments to employees and suppliers and \$8 lower other receipts.

Cash outflows from investing activities for the three months ended May 31, 2018 were \$48 compared to \$32 for the three months ended May 31, 2017. In Q3 fiscal 2018, investment in capital projects was \$46 (cash outflows of \$39) compared to \$40 in Q3 fiscal 2017 (cash outflows of \$37). In addition, the Company provided bridge financing of \$10 to Aireon in Q3 fiscal 2018. In Q3 fiscal 2017, cash outflows were partially offset by proceeds of \$4 from the sale of a portion of the Company's investment in Searidge.

Cash outflows from financing activities for the three months ended May 31, 2018 were \$67 compared to \$25 for the three months ended May 31, 2017. The outflows in Q3 fiscal 2018 were a result of the repayment of the \$350 Series MTN 2013-1 General Obligation Notes, which were partially repaid with the issuance of the \$275 Series MTN 2018-1 General Obligation Notes (\$273 net of transaction fees). The Company also paid the annual \$25 principal repayment of the Series 97-2 amortizing revenue bonds and disbursed \$5 to settle a bond forward in Q3 fiscal 2018. Partially offsetting these net outflows were net proceeds from bank loans of \$40 in Q3 fiscal 2018.

For the three months ended May 31, 2017, our cash and cash equivalents balance decreased by \$58. This was primarily due to cash outflows for capital projects of \$37 and the annual \$25 principal repayment of the Series 97-2 amortizing revenue bonds.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

**Cash flows for the nine months ended May 31, 2018**

	Nine months ended May 31		
	2018	2017	Change
<b>Cash flows from:</b>			
Operations	\$ (26)	\$ 58	\$ (84)
Investing	(126)	179	(305)
Financing	(42)	(135)	93
<b>Cash flows from operating, investing and financing activities</b>	(194)	102	(296)
Effect of foreign exchange on cash and cash equivalents	-	(3)	3
<b>Increase (decrease) in cash and cash equivalents</b>	(194)	99	(293)
Cash and cash equivalents, beginning of period	222	119	103
<b>Cash and cash equivalents, end of period</b>	<u>\$ 28</u>	<u>\$ 218</u>	<u>\$ (190)</u>
<b>Free cash flow (non-GAAP financial measure):</b>			
Cash flows from:			
Operations	\$ (26)	\$ 58	\$ (84)
Capital expenditures <sup>(1)</sup>	(124)	(97)	(27)
Investment in preferred interests <sup>(1)</sup>	-	(16)	16
Income tax refund (payment) on investment in preferred interests <sup>(1)</sup>	5	(5)	10
Proceeds from sale of investment in subsidiary <sup>(1)</sup>	-	4	(4)
<b>Free cash flow</b>	<u>\$ (145)</u>	<u>\$ (56)</u>	<u>\$ (89)</u>

<sup>(1)</sup> See the statements of cash flows of our Q3 fiscal 2018 financial statements.

As shown above, cash and cash equivalents decreased by \$194 for the nine months ended May 31, 2018 and the Company experienced negative free cash flow of \$145, which is a non-GAAP financial measure as discussed in "INTRODUCTION – Financial Highlights: Cash flows for the three months ended May 31, 2018".

Cash flows from operations for the nine months ended May 31, 2018 were outflows of \$26 compared to inflows of \$58 for the nine months ended May 31, 2017, primarily due to higher payments to employees and suppliers of \$49, the payment of \$42 to settle curtailed severance benefits and lower receipts from customer service charges of \$12 (net of the impact of the refund of customer service charges of \$60), partially offset by \$23 lower pension solvency deficiency payments.

Cash flows from investing activities for the nine months ended May 31, 2018 were outflows of \$126 compared to inflows of \$176 in the nine months ended May 31, 2017. The Company invested \$123 in capital projects during the nine months ended May 31, 2018 (cash outflows of \$124) compared to \$102 in the nine months ended May 31, 2017 (cash outflows of \$97). The Company also provided bridge financing of \$10 to Aireon. The cash outflows in fiscal 2018 were partially offset by an income tax refund of \$5 on the Company's investment in preferred interests of Aireon. In fiscal 2017, we received \$293 of proceeds from MAV II notes, other notes and restructured ABCP compared to \$1 received in fiscal 2018. Proceeds of \$4 were also received from the sale of a portion of the Company's investment in Searidge. The fiscal 2017 cash inflows were partially offset by an additional \$16 investment in preferred interests and an income tax payment of \$5 related to that investment.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

---

Cash outflows from financing activities for the nine months ended May 31, 2018 were \$42 compared to \$135 for the nine months ended May 31, 2017. The outflows in fiscal 2018 were a result of the repayment of the \$350 Series MTN 2013-1 General Obligation Notes, which were partially repaid with the issuance of the \$275 Series MTN 2018-1 General Obligation Notes (\$273 net of transaction fees). The Company also paid the annual \$25 principal repayment of the Series 97-2 amortizing revenue bonds and disbursed \$5 to settle a bond forward in fiscal 2018. Partially offsetting these net outflows were net proceeds from bank loans of \$40 and a \$25 drawdown of surplus funds from the debt service reserve fund during fiscal 2018.

For the nine months ended May 31, 2017, our cash and cash equivalents balance increased by \$99. This was primarily due to proceeds of \$293 from MAV II notes and restructured ABCP and cash inflows from operations of \$58, partially offset by the early redemption of \$100 of the \$350 Series MTN 2009-1 General Obligation Notes at a redemption price of \$110, cash outflows for capital projects of \$97, the annual \$25 principal repayment of the Series 97-2 amortizing revenue bonds, the additional \$16 investment in preferred interests of Aireon, along with an income tax payment of \$5 related to that investment.

### Liquidity and Financing Strategy

Our liquidity and financing strategy remains unchanged from that disclosed in our fiscal 2017 annual MD&A.

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 issued a Base Shelf Prospectus on November 9, 2017 that is valid for a 25 month period.

On March 29, 2018, the Company issued \$275 Series MTN 2018-1 General Obligation Notes due on March 30, 2048. 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 has a revolving credit facility with a syndicate of Canadian financial institutions and separate letter of credit facilities for pension funding purposes. As at May 31, 2018, the credit facilities are utilized as follows:

Credit facilities:	
Credit facility with a syndicate of Canadian financial institutions <sup>(1) (2)</sup>	\$ 675
Letter of credit facilities for pension funding purposes <sup>(3)</sup>	515
Total available credit facilities	1,190
Less: Outstanding letters of credit for pension funding purposes <sup>(3)</sup>	494
Less: Outstanding letters of credit for other purposes <sup>(2)</sup>	12
Less: Bank loan	40
Undrawn committed borrowing capacity	644
Less: Operations and maintenance reserve fund allocation <sup>(4)</sup>	290
Credit facilities available for unrestricted use	\$ 354

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

- (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. The credit facility agreement provides for loans at varying rates of interest based on certain benchmark interest rates, specifically the Canadian prime rate and the Canadian bankers' acceptance rate, and on the Company's credit rating at the time of drawdown. A utilization fee is also payable on borrowings in excess of 25% of the available facility. The Company is required to pay commitment fees, which are dependent on the Company's credit rating. The Company is in compliance with the credit facility covenants as at May 31, 2018.
- (2) At May 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 May 31, 2018, \$494 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").

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

	May 31 2018	August 31 2017
<b>LONG-TERM DEBT:</b>		
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	<u>\$ 1,219</u>	<u>\$ 1,220</u>
<b>LIQUIDITY:</b>		
Cash and cash equivalents	\$ 28	\$ 222
Debt service reserve fund	71	95
	<u>\$ 99</u>	<u>\$ 317</u>
Undrawn committed borrowing capacity <sup>(1)</sup>	<u>\$ 644</u>	<u>\$ 701</u>

- (1) \$354 of this borrowing capacity is available as described in the previous table (August 31, 2017 - \$411).

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

---

**Credit Ratings**

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

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

On March 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."

Our credit ratings provided by DBRS remain unchanged from those described in our fiscal 2017 annual MD&A.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

### **Cash Requirements**

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

### **Pension Plans**

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 the OSFI in June 2018.

**Pension Plans' Accounting Deficit:** The Company's pension plans had an accounting deficit of \$1,278 as at May 31, 2018 as compared to an accounting deficit of \$1,295 as at the annual measurement date of August 31, 2017. The \$17 decrease in the deficit position during the nine months ended May 31, 2018 is primarily due to net actuarial gains of \$106, partially offset by actuarial accounting expense exceeding Company contributions by \$89. The \$106 of net actuarial gains are primarily due to a return on plan assets \$226 greater than the expected return based on the discount rate of 3.60% at August 31, 2017, partially offset by actuarial losses of \$120 from a 10 basis point decrease in the discount rate to 3.50%. During Q3 fiscal 2018, there were no significant events or changes to the Company's defined pension plans that would require a revaluation. As such, no revaluation was performed and no changes in re-measurements of the plans were recorded in the Company's statement of other comprehensive income for the three months ended May 31, 2018.

**Regulatory Recovery of Pension Costs:** As described in our fiscal 2017 annual MD&A, 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 nine months ended May 31, 2018, \$7 has been recorded as a regulatory expense to recover the cost. The remaining balance of \$37 is expected to be recovered through future customer service charges.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(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:

	Three months ended		Nine months ended	
	May 31 2018	May 31 2017	May 31 2018	May 31 2017
<b>Consolidated statement of operations</b>				
Pension current service costs <sup>(1)</sup>	\$ 44	\$ 43	\$ 130	\$ 130
Net finance costs <sup>(1)</sup>	10	11	31	33
<i>Less: Regulatory deferrals</i>	<i>(24)</i>	<i>(27)</i>	<i>(78)</i>	<i>(89)</i>
	<u>30</u>	<u>27</u>	<u>83</u>	<u>74</u>
<b>Company cash contributions</b>				
Going concern current service	27	24	75	71
Going concern special payments	-	3	-	3
Solvency deficiency payments	1	24	1	24
	<u>28</u>	<u>51</u>	<u>76</u>	<u>98</u>
Regulatory recovery (deferral) of fiscal 2017 solvency contributions	\$ 2	\$ (24)	\$ 7	\$ (24)

<sup>(1)</sup> For the three months ended May 31, 2018, pension current service costs do not include \$1 related to the Company's unfunded pension plan (three months ended May 31, 2017 - \$1) and net finance costs do not include \$1 related to the Company's unfunded pension plan (three months ended May 31, 2017 - \$nil). For the nine months ended May 31, 2018, pension current service costs do not include \$3 related to the Company's unfunded pension plan (nine months ended May 31, 2017 - \$2) and net finance costs do not include \$3 related to the Company's unfunded pension plan (nine months ended May 31, 2017 - \$1).

**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 May 31, 2018, the Company has put in place letters of credit totaling \$494 to meet its calendar 2018 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.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

Beginning July 1, 2017, solvency contributions are determined on a pre-amendment basis while discussions with OSFI are ongoing. On a preliminary basis, going concern pension contributions for fiscal 2018 are expected to be \$96, with no requirement for cash special payments. For the annual period beginning July 1, 2018, funding requirements will be based on the January 1, 2018 actuarial valuations.

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

**Contractual Obligations**

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

	Remaining payments – for years ending August 31						
	Total	2018	2019	2020	2021	2022	Thereafter
Bank loan	\$ 40	\$ 40	\$ -	\$ -	\$ -	\$ -	\$ -
Derivative liabilities	6	-	6	-	-	-	-
Long-term debt (including current portion) <sup>(1), (2)</sup>	1,500	-	275	25	275	25	900
Interest payments <sup>(2)</sup>	826	19	78	62	55	48	564
Capital commitments <sup>(3)</sup>	119	54	17	16	6	4	22
Operating leases	167	2	9	8	7	9	132
Related party loan <sup>(4)</sup>	28	-	-	28	-	-	-
<b>Total contractual obligations</b>	<b>\$ 2,686</b>	<b>\$ 115</b>	<b>\$ 385</b>	<b>\$ 139</b>	<b>\$ 343</b>	<b>\$ 86</b>	<b>\$ 1,618</b>

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 8 to our Q3 fiscal 2018 financial statements.
- (3) The Company has firm commitments for the acquisition of property, plant and equipment and intangible assets amounting to \$119 as at May 31, 2018 (August 31, 2017 - \$141).
- (4) This is the undrawn commitment under the bridge financing agreement with Aireon. As at May 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".

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
(in millions of dollars)

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

### Capital Management

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

	May 31 2018	August 31 2017
Bonds and notes payable	\$ 1,494	\$ 1,595
Equity:		
Retained earnings (deficit)	(22)	28
Regulatory deferral accounts:		
Debit balances	(1,428)	(1,475)
Credit balances	385	342
Employee benefits:		
LTD asset	(7)	(11)
Liability for funded pension benefits	1,175	1,198
Liability for accumulating sick leave	22	22
Total capital	<u>\$ 1,619</u>	<u>\$ 1,699</u>

Management's approach and objectives when managing capital remain unchanged from those described in our fiscal 2017 annual MD&A.

### Financial Instruments and Risk Management

#### Reserve Funds and Financial Instruments

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 requirements of the debt service reserve fund and the operations and maintenance reserve fund remain unchanged from that described in our fiscal 2017 annual MD&A.

#### Financial Risk Management

The Company is exposed to several risks as a result of holding financial instruments, including interest rate risk, foreign exchange risk, price risk, credit risk and liquidity risk. The Company's exposure to financial risks and how the Company manages each of those risks are described in the Company's fiscal 2017 annual MD&A. There were no significant changes to those risks or to the Company's management of exposure to those risks during the nine months ended May 31, 2018, except as noted below.

**Foreign Exchange Risk:** The Company's exposure to foreign exchange risk related to the U.S. dollar has increased since August 31, 2017 as a result of the increase in fair value of its investment in preferred interests of Aireon to \$412 CAD (\$318 U.S.) (August 31, 2017 - \$350 CAD (\$281 U.S.)). As at May 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 (August 31, 2017 - \$30).

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

**Other Price Risk<sup>4</sup>:** The fair value of the Company's investment in Aireon increased to \$412 as at May 31, 2018 (August 31, 2017 - \$350). A change of 5% in the fair value would impact finance income (other finance costs) by approximately \$14 U.S. (\$18 CDN) as at May 31, 2018 (August 31, 2017 - \$12 U.S. (\$15 CDN)).

Aireon will provide global satellite-based surveillance capability for air navigation service providers 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;
- the technology may not function as intended;
- agreements for data sales may not reach anticipated levels; 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) (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.

**Insurance:** Our aviation liability insurance program was last renewed on November 15, 2017 with liability limits of \$5,250 U.S. (\$6,803 CDN). The Company successfully secured an increase in the limits from \$5,034 U.S. (\$6,523 CDN) to \$5,250 U.S. (\$6,803 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. (\$2,592 CDN) per occurrence with \$4,000 U.S. (\$5,183 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.

---

<sup>4</sup> Note: See "INTRODUCTION – Caution Concerning Forward-Looking Information", page 1

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

### **CHANGES IN ACCOUNTING POLICIES**

The Company's Q3 fiscal 2018 financial statements were prepared in accordance with IAS 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board (IASB). Significant accounting policies used in the Q3 fiscal 2018 financial statements are disclosed in note 3 of the Company's fiscal 2017 annual consolidated financial statements, except for the application of new standards, amendments and interpretations effective or early adopted September 1, 2017 as described in note 2 (f) to the Company's Q1 fiscal 2018 financial statements, which detail the impact and changes in accounting policies as a result of the adoption of IFRS 9 – *Financial Instruments* (IFRS 9) effective September 1, 2017 and changes noted below related to the Company's investment in preferred interest of Aireon. The accounting policies have been applied consistently to all periods presented, unless otherwise indicated.

In May 2018, NATS made an investment in preferred interests of Aireon ("INTRODCUTION – 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 May 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.

### **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 to determine the extent of their impact on its consolidated financial statements. At this time, the Company does not expect to adopt any of the standards or amendments noted in our fiscal 2017 annual MD&A before their respective effective dates.

The Company has the following update regarding its progress in implementing future standards:

#### IFRS 15 – Revenue from Contracts with Customers

The Company continues to assess 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 2019. A detailed review of its current contracts under the standard's five-step model is underway. To date, the Company has determined that 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 expected to be significant. As the project team continues their review, this impact will be quantified.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

The following amendments issued by the IASB, and not already disclosed in the Company's 2017 annual consolidated financial statements, have been assessed as having a possible effect on the Company in the future:

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 account of 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 intends to adopt the amendments to IAS 28, IAS 19 and the amendments from the annual improvements process in its financial statements for the annual period beginning on September 1, 2019. The extent of the impact of the amendments has not yet been determined.

**NAV CANADA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Q3 FISCAL 2018**  
**(in millions of dollars)**

---

## **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. 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.

The Company's critical accounting estimates and judgments applied in the preparation of the Company's Q3 fiscal 2018 financial statements are consistent with those applied and disclosed in our fiscal 2017 annual consolidated financial statements and as described in the fiscal 2017 annual MD&A, except those impacted by the changes in the Company's investment in preferred interests of Aireon and further discussed below:

### **Critical Judgments**

As a result of the changes in the Company's investment in preferred interests of Aireon (as described in the "INTRODUCTION – Significant Financial Matters"), the Company no longer has joint control or classifies its investment as a joint arrangement. There are no other critical judgments with respect to the investment in preferred interests of Aireon.

### **Key Sources of Estimates and Assumption Uncertainties**

#### **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 May 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.

## **DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING**

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 changes to the Company's ICFR during the three months ended May 31, 2018 that have materially affected or are reasonably likely to materially affect the Company's ICFR.