

AIR CANADA



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ANNUAL INFORMATION FORM**

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Glossary

Available Seat Miles or ASMs: A measure of passenger capacity calculated by multiplying the total number of seats available for passengers by the miles flown;

Codeshare or Codesharing: Refers to a commercial agreement between airlines where an air carrier sells air transportation under its own airline designator code and the actual transportation is provided by the other air carrier;

Passenger Load Factor: A measure of passenger capacity utilization derived by expressing revenue passenger miles as a percentage of available seat miles;

Revenue Passenger Miles or RPMs: Total number of revenue passengers carried, including frequent flyer redemptions, multiplied by the miles they are flown; and

Yield: Average revenue per revenue passenger mile.

Explanatory Notes

Air Canada and the Corporation -- References herein to Air Canada are references to Air Canada itself and references to the "Corporation" include references, as the context may require, to Air Canada and its subsidiaries collectively, Air Canada and one or more of its subsidiaries, one or more of Air Canada's subsidiaries, or Air Canada itself.

Currency -- All currency amounts used in this document are stated in Canadian dollars, unless otherwise indicated.

Statistical Information -- Part of the data and statistics pertaining to growth rates, market shares and market segments, as well as other industry data and statistics contained in this document have been derived from statistics and other information accumulated internally by Air Canada and from external sources or upon assumptions or estimates made by Air Canada. Canadian and global industry statistics have been obtained from the Aviation Statistics Centre of Statistics Canada and the International Civil Aviation Organization ("ICAO").

Trademarks -- The following trademarks are owned by Air Canada and are used in this document in italics to identify products or services offered by the Corporation: *Aeroplan*, *Air Canada Tango*, *AC Jetz*, *Air Canada Jazz*, *ZIP*, *destina.ca*, *Acetek*, *Air Canada Vacations*, *Executive First*, *Executive Class*, *AC Expedair*, *AC Priority*, *Hospitality Service*, *Rapidair*, *Maple Leaf Lounge*, *AC WEBSAVER*, and *Aeroplan Super Elite*. The *enRoute* trademark is also owned by Air Canada. *Star Alliance* is a trademark of Air Canada, Deutsche Lufthansa AG ("Lufthansa"), Scandinavian Airlines System, Denmark-Norway-Sweden ("SAS"), Thai Airways International Public Company Limited ("Thai Airways") and United Air Lines Inc. ("United Airlines" or "United").

Forward-Looking Statements

This annual information form contains certain "forward-looking statements", which involve a number of risks and uncertainties. As a result of many factors including acts or potential acts of terrorism, government regulations and government mandated restrictions on operations and pricing, fuel prices, industry restructuring, labour negotiations, the economic environment in general including foreign exchange and interest rates, the airline competitive and pricing environment, industry capacity decisions and new entrants as well as external events, actual results could differ from expected results and the differences could be material (see "Risk Factors").

TABLE OF CONTENTS

	<u>Page</u>		<u>Page</u>
IA THE CORPORATION.....	5	Aircraft Purchases and Deliveries	32
Incorporation	5	Planned Capital Expenditures	
Corporate Structure	6	and Financing	33
IB REGULATORY ENVIRONMENT.....	7	Fuel.....	35
Domestic	7	Employees	36
Canada-U.S. Air Services Agreement.....	8	Properties and Facilities.....	37
International.....	8	Insurance	38
International Air Policy.....	9	IV RISK FACTORS.....	39
Air Charter Policy	10	V MANAGEMENT DISCUSSION AND	
Recent Developments.....	10	ANALYSIS OF RESULTS	43
IC INDUSTRY OVERVIEW AND		VI SELECTED CONSOLIDATED	
COMPETITIVE ENVIRONMENT.....	12	FINANCIAL INFORMATION	43
Domestic Market.....	12	VII MARKET FOR THE NEGOTIATION	
Transborder and International Markets.....	12	OF SECURITIES	45
II DEVELOPMENT OF THE BUSINESS OF		Price Range and Trading Volume of Air	
THE CORPORATION.....	14	Canada Shares.....	45
Corporate Profile	14	Common Shares.....	45
Corporate Reorganization of Air Canada and		Class A Non-Voting Common Shares	45
its Subsidiaries	14	VIII DIVIDEND RECORD.....	47
Recent Events	15	IX DIRECTORS AND OFFICERS.....	48
Three-Year Summary:		Directors.....	48
Evolution of Business.....	19	Officers.....	50
Acquisition of Canadian Airlines		X RESTRICTIONS ON VOTING	
Corporation	19	SECURITIES.....	52
Integration	19	XI ADDITIONAL INFORMATION.....	53
Economic Environment	20		
Regulatory Environment.....	21		
Other Developments	21		
III DESCRIPTION OF THE BUSINESS OF			
THE CORPORATION.....	22		
Passenger Operations and Route Networks..	22		
Domestic	23		
Transborder (Canada — United States).....	23		
International.....	24		
Products and Services.....	24		
Cargo Operations	26		
Other Operations	27		
<i>Aeroplan</i>	27		
<i>Technical Services</i>	27		
<i>Other Revenues</i>	28		
Star Alliance	28		
Other Alliances.....	29		
Fleet Overview.....	30		
<i>Widebody Aircraft</i>	31		
<i>Narrowbody Aircraft</i>	31		

IA THE CORPORATION

Incorporation

Air Canada was established by the Parliament of Canada on April 10, 1937, as the national airline to provide essential air transport, cargo and mail services across Canada. Air Canada was originally incorporated as Trans-Canada Air Lines, under the Trans-Canada Air Lines Act as a wholly-owned subsidiary of Canadian National Railway Corporation, which itself was wholly-owned by the Government of Canada. Air Canada was reorganized and continued under the Air Canada Act, 1977 at which time it became a direct wholly-owned subsidiary of the Government of Canada.

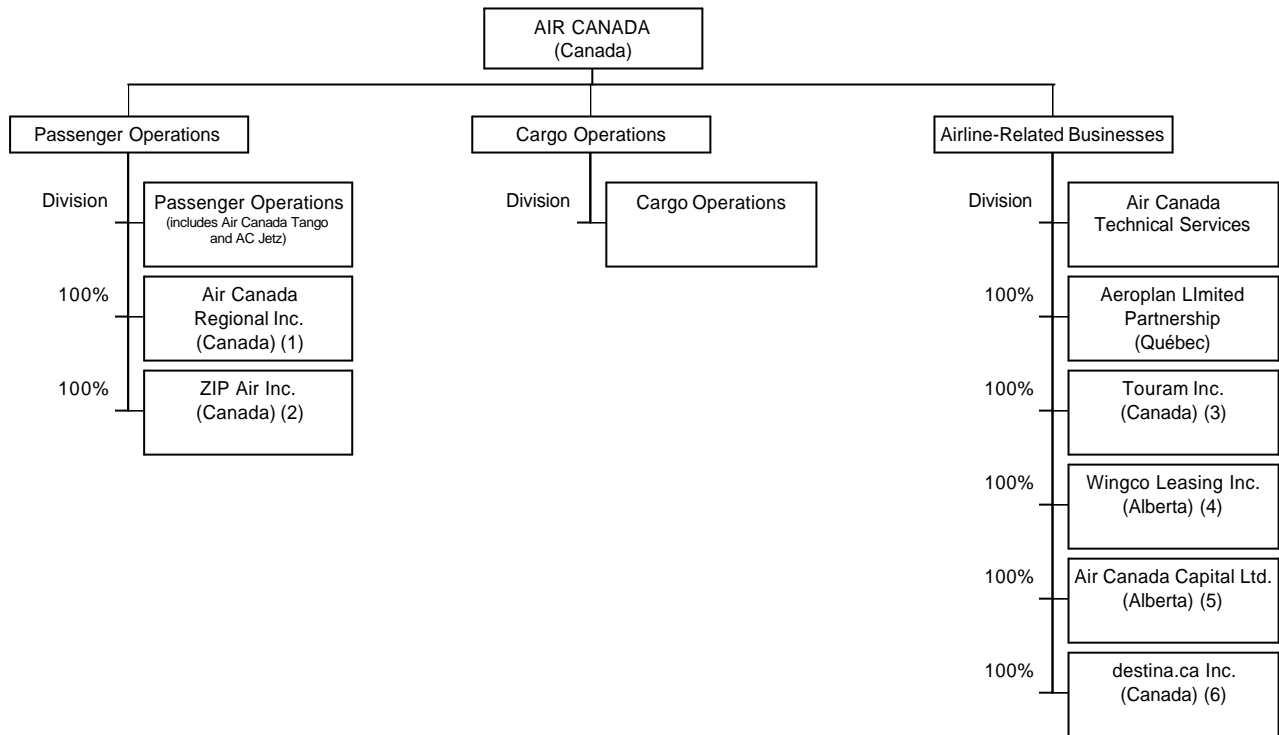
In August 1988, the Air Canada Public Participation Act authorized the continuance of Air Canada under the Canada Business Corporations Act and the issuance and sale of shares to the public. In October 1988, Air Canada completed its initial public offering of 30.8 million Common Shares. Following this offering, the Government of Canada continued to hold 57% of the Common Shares. In July 1989, a secondary offering of the Government of Canada's 57% common shareholding in Air Canada was completed and Air Canada became a fully publicly-owned corporation.

Air Canada's Articles were amended by Articles of Amendment in May 1994, in order to create a new class of shares designated as Class A Non-Voting Common Shares. The Common Shares of Air Canada are listed on The Toronto Stock Exchange and the Class A Non-Voting Common Shares are listed on The Toronto Stock Exchange and quoted on the NASDAQ Stock Market. In December 1999, the Articles were further amended to create Class A Convertible Non-Voting Preferred Shares, Series 1 and Series 2, and the Corporation issued 10 million Class A Convertible Non-Voting Preferred Shares, Series 1 ("Convertible Preferred Shares") for cash consideration of \$233 million. In July 2001, the Articles were amended to modify individual ownership restrictions applicable to the Common Shares of Air Canada and in February, 2002, the Articles were amended and restated in order to remove such individual ownership restrictions.

The registered and principal office of Air Canada is located at the Air Canada Headquarters Building, Air Canada Centre, 7373 Côte Vertu Boulevard West, Saint-Laurent, Québec, H4Y 1H4.

Corporate Structure

The following table lists Air Canada's major subsidiaries and divisions, including their jurisdictions of incorporation and the percentage of common equity held or controlled directly or indirectly by Air Canada:



- (1) Air Canada Regional Inc. operates under one brand name, Air Canada Jazz, since April 1st, 2002.
- (2) ZIP Air Inc. carries on business under the name ZIP with operations planned to commence in late Summer of 2002.
- (3) Touram Inc. carries on business under the name of *Air Canada Vacations*.
- (4) Wingco Leasing Inc. is a leasing company whose main business is the leasing of commuter aircraft to Air Canada Regional Inc.
- (5) Air Canada Capital Ltd. is a company whose main business is the leasing of aircraft to Air Canada.
- (6) destina.ca Inc. commenced business on April 24, 2002.

Certain subsidiaries, each of which represents not more than 10% of the consolidated assets and not more than 10% of the consolidated sales and operating revenues of Air Canada, and all of which, in the aggregate, represent not more than 20% of the total consolidated assets and the total consolidated sales and operating revenues of Air Canada at December 31, 2001, have been omitted.

IB REGULATORY ENVIRONMENT

In Canada, civil air transportation, including policy, maintenance standards, operations standards, safety and ground and navigation facilities, is wholly within federal government jurisdiction and is the responsibility of the Minister of Transport. Since 1996, air navigation services in Canada have been provided by NAV Canada, a privatized company. In addition, most major airports are operated by local airport authorities that are also privatized companies.

The National Transportation Act, 1987 (Canada) significantly reduced the economic regulation of the industry in Southern Canada effective January 1988 and, to a lesser extent, the regulation of civil air transportation on routes in Northern Canada. This Act established the National Transportation Agency ("NTA"), which reported through the Minister of Transport to the Governor in Council. The NTA issued air carrier licenses for both domestic and international services and regulated international air fares and conditions of carriage. In May 1996, the Canada Transportation Act was passed by the Federal Parliament to replace the National Transportation Act, 1987 and to further reduce regulation in the industry. Most provisions of the previous National Transportation Act applicable to air carriers remained in force. However, effective May 1996, Northern Canada routes became subject to the same regulatory framework as Southern Canada routes. The NTA was renamed the Canadian Transportation Agency ("CTA"). The CTA continues to exercise licensing authority and enforces the requirement that a carrier applying for a domestic or international license as a Canadian carrier show that it is "Canadian" as defined in the Canada Transportation Act. A "Canadian" carrier is defined as being controlled by Canadians and having at least 75% of its voting interests owned and controlled by Canadians.

Domestic

The 1987 deregulation of the airline industry allowed carriers to establish fares and conditions of carriage without government regulation in Southern Canada and with reduced regulation in Northern Canada. In 1996, the remaining regulation in Northern Canada was eliminated. On non-competitive routes, the CTA was given the power, on receipt of a complaint, to disallow certain fare increases. Confidential contracts were permitted for domestic air services giving passengers and shippers the ability to negotiate price and service agreements directly with the airlines. Under the Canada Transportation Act, there is free market entry provided a carrier can show that it is "Canadian" as defined in the Act, can operate safely, is suitably insured and meets the minimum financial requirements set out in the Air Transportation Regulations.

In July 2000, the Government of Canada amended the Canada Transportation Act to address the competitive airline environment in Canada and ensure protection for consumers. The legislation increased the powers of the CTA with respect to pricing on non-competitive domestic routes, and domestic terms and conditions of carriage. In addition, the legislation granted new powers to the Competition Bureau concerning anti-competitive airline behaviour and incorporated undertakings made to the Competition Bureau whereby Air Canada, in connection with the acquisition of Canadian Airlines, accepted certain conditions in order to promote and maintain airline competition in Canada. Also included in the legislation were commitments made by Air Canada to the Minister of Transport in December 1999 regarding the provision of domestic service to small communities served by Air Canada, Canadian Airlines or any of their wholly-owned subsidiaries for a three-year period as well as commitments to employees regarding involuntary layoffs or involuntary relocations.

As of May 1, 2002, approximately 25 domestic pricing complaints had been forwarded to Air Canada for response since the foregoing legislation was passed. In March 2001, the CTA issued its first decision concerning the reasonableness of fares on a non-competitive domestic route and determined that the lowest year-round excursion fare offered by Air Canada on its services between Vancouver and Prince Rupert, British Columbia in August 2000 was unreasonable. However, the CTA subsequently decided not to order Air Canada to reduce its fare on the basis that Air Canada had already introduced a lower fare and Hawkair, a competing airline, had initiated service on that route. Since then, the CTA issued six decisions that upheld the reasonableness of Air Canada's fares on the following routes: Calgary-Kamloops, Toronto-Regina, Toronto-Saskatoon, Toronto-St. John's, Toronto-Victoria and Vancouver-Smithers. As of May 1, 2002,

approximately 20 complaints had also been filed concerning Air Canada's terms and conditions of carriage and 75% of the complaints had been dismissed or withdrawn. The Agency has recently ruled that Air Canada's domestic and transborder change fee is neither unreasonable nor unduly discriminatory and upheld Air Canada's right to prohibit back-to-back ticketing.

Canada-U.S. Air Services Agreement

In February 1995, a new air services agreement was implemented between Canada and the United States, replacing the previous bilateral agreement, which restricted market access and fares. This agreement gave Canadian air carriers unlimited route rights to provide "own aircraft" services between Canada and the United States. U.S. carriers were granted unlimited route rights between the United States and Canada, subject to certain restrictions in Toronto, Montréal and Vancouver over a maximum three-year phase-in period, which ended in February 1998. Unlimited codesharing was allowed between any city in Canada and the United States, except for codeshare services to/from Toronto, Montréal and Vancouver, where certain restrictions applied during the transition period. The carriage of local traffic between points within one country by airlines of the other country continues to be prohibited.

Under the 1995 Canada-U.S. agreement, rules governing fare levels and the requirement to file tariffs (excluding rules tariffs) with government authorities were eliminated. Carriers of both countries are free to set their own prices for transborder services according to market forces. Prices may only be disallowed under special circumstances if the authorities of both countries agree, for example in response to predatory or monopoly pricing behaviour in a specific city-pair market. In September 1997, the United States Department of Transportation granted Air Canada and United Airlines anti-trust immunity for their marketing alliance. This authority has allowed the two airlines to more closely coordinate strategic, commercial and network planning between Canada and the United States with some restrictions on the San Francisco to Toronto and Chicago to Toronto routes.

In November 1997, Canada and the United States concluded an agreement that allows American and Canadian carriers to codeshare, via each other's territory, with carriers from other countries provided the other country allows codesharing and the carriers hold the underlying rights to serve that country. As a result, Air Canada increased its codesharing with certain *Star Alliance* partners via Canada and the United States.

In December 2001, Air Canada proposed that the Canadian and American Governments pursue an "Open Skies Plus" agreement consisting of a full U.S. "Open Skies" model agreement plus the ability for carriers of each country to carry the domestic traffic of the other country over their own hubs - what is referred to as "modified sixth freedom". Air Canada's proposal followed on the Minister of Transport's statement that the government would look at options such as "more foreign competition or modified sixth freedoms" as an alternative to re-regulation, to increase competition in the Canadian domestic market. The two governments were urged to build on the success of the 1995 Canada-U.S. Open Skies Agreement by removing restrictions in the existing agreement generating more choices and competition within Canada and the United States and beyond each other's country to the rest of the world.

Canadian and American carriers continue to be able to operate charter air services between any point in Canada and any point in the United States.

International

International scheduled air services are regulated by the governments involved. The Minister of Transport has the authority to designate which Canadian carriers may serve scheduled international routes. International route rights are obtained through bilateral negotiations between Canada and foreign countries. Bilateral agreements provide for the rights which may be exercised over agreed routings and the conditions under which the airlines may operate, including, among

others, the number of airlines which may operate, the capacity and/or flight frequencies that may be provided and the controls over tariffs to be charged. Most bilateral agreements to which Canada is a party provide for the designation of more than one Canadian air carrier, while some provide for the designation of only one Canadian air carrier. In general, bilateral agreements between Canada and European countries are more liberal in terms of controls on capacity and flight frequencies than those between Canada and Asian nations.

International Air Policy

In December 1994 and March 1995, the Minister of Transport introduced a new international air transportation policy applicable to international scheduled services by Canadian air carriers (excluding services to the United States). The international policy provided for second carrier designation in country markets where passenger trips on scheduled services exceed a threshold of 300,000 per year. The following country markets meet the 300,000-scheduled passenger trip threshold: United Kingdom, France, Germany, Hong Kong, Japan, Taiwan and more recently Mexico.

The international air transportation policy also established a process for the allocation of route rights in unserved or "under-utilized" markets. Canadian air carriers may apply for designation to operate scheduled services to countries presently not served by a Canadian air carrier or where the currently designated Canadian air carrier is under-utilizing its designation ("Use It or Lose It" principle). A designation is deemed "under-utilized" if the incumbent carrier operates less than twice weekly flights on a year-round basis using its own equipment, or is codesharing with a foreign carrier without using its own equipment on a significant portion of the itinerary and is not operating at daily or near daily frequencies during peak periods. The Government of Canada reviews the unserved or "under-utilized" routes on a periodic basis and may award designations in response to air carriers' applications.

In late December 1999, the Government of Canada announced a new competitive framework for Canada's international air services and bilateral relations, which include:

- the immediate availability of all current and future markets exceeding 300,000 annual scheduled passengers to any Canadian carriers interested in operating scheduled services subject to the necessary rights (including designation and capacity) being available;
- a review and liberalization of Canada's international air charter policy, beginning in early 2000;
- a review of Canada's international air policy beginning in one year;
- for any countries not allocated, the government will, upon request, conduct a carrier selection in accordance with the current practice; and
- the retention of the current country designations and assignments and related route rights awarded to Air Canada and the former Canadian Airlines.

In February 2001, the Minister of Transport announced the launch of an international air services policy review to address competition in the international market with the release of a consultation document for stakeholder review and comment. The Minister of Transport stated that the objective of this review is to liberalize Canada's policy for scheduled international air services, including how Canada approaches the negotiation and management of air traffic rights with other countries. A new policy is expected to come into effect following completion of the consultation phase. There have been no developments in this matter since last year.

Air Charter Policy

Charter operations are generally not covered by bilateral agreements, although charter services are covered under the Canada-U.S. air services agreement. Canadian government policy permits any Canadian airline to operate charter services between Canada and any point in the world subject to prior approval of the Canadian and other appropriate regulatory authorities. Charter services are used by Air Canada to provide service to foreign points where it is not the designated airline or to generate additional revenues from aircraft that would otherwise be idle.

A policy governing international passenger charter air services was announced in April 2000 by the Minister of Transport. This policy removed restrictions such as advance booking, minimum-stay requirements and prohibitions on one-way travel. To preserve a distinction between international charter and scheduled air services, this policy retains the requirements that the entire seating capacity of an aircraft be chartered and that international charter carriers be prohibited from selling seats directly to the public.

The operations of Air Canada are also subject to other treaties and international agreements to which Canada is a party.

Recent Developments

In February 2001, the Competition Bureau released, for consultation, draft Enforcement Guidelines outlining the approach it proposed to take in enforcing the “abuse of dominance” provisions of the Competition Act for the airline industry. Air Canada provided its comments on the draft Guidelines in May 2001. However, the Competition Bureau has advised that it will not finalize the Guidelines until the Competition Tribunal has reached a decision in a case brought by the Commissioner of Competition against Air Canada, that is described below.

In March 2001, the Competition Bureau made an application under the “abuse of dominance” provisions of the Competition Act, seeking an order prohibiting Air Canada from charging fares on flights on certain routes in Eastern Canada that would allegedly not cover its “avoidable costs” of providing the service. Air Canada subsequently challenged the Competition Bureau’s application for an order, which, if granted, could prohibit Air Canada from matching fares or otherwise being price competitive on those routes. Air Canada disagrees with the Competition Bureau’s finding that it engaged in anti-competitive practices directed against other carriers and the Bureau’s interpretation of “avoidable costs”. During 2001, hearings were held before the Competition Tribunal for clarification of certain rules relating to pricing behaviour in the domestic market including, in particular, the application of the “avoidable cost” test set out in the Regulations Respecting Anti-Competitive Acts of Persons Operating a Domestic Service. The hearings were adjourned in October 2001 and are to be resumed in the Fall of 2002. It is not possible to determine the potential outcome of the initiatives by the Competition Bureau. If the avoidable cost test proposed by the Competition Bureau is accepted, the potential impact upon the way in which Air Canada operates across its system could be materially adverse to Air Canada and could impose unworkable constraints on its operations.

In April 2001, the Government of Canada introduced Bill C-23, an Act to amend the Competition Act and the Competition Tribunal Act. Bill C-23 passed third reading in the House of Commons in December 2001 and third reading in the Senate on May 9, 2002. The Bill is subject to a further vote of the House of Commons on a technical amendment. If proclaimed in force, Bill C-23 will, among other things, give individuals the right to seek relief directly from the Competition Tribunal (instead of first dealing with the Competition Bureau) in regards to exclusive dealing, tied selling, market restriction and “refusal to deal” practices. Bill C-23 will also give the Competition Tribunal the power to issue an interim order to prevent certain anti-competitive behaviour specified in the Competition Act, while maintaining the current power of the Commissioner of Competition to issue interim orders preventing certain anti-competitive behaviour on the part of domestic air carriers. The Competition Tribunal will also be given the authority to levy a penalty of up to \$15 million against a domestic air carrier if the Tribunal found that the carrier has abused its dominant position in the market.

As a consequence of the September 11, 2001 terrorist attacks in the United States, the Minister of Transport issued new air security measures, including increased passenger and baggage screening and enhanced security procedures at check-in and on board the aircraft. Other countries served by Air Canada, such as the United States and the United Kingdom, imposed similar security requirements. The Corporation's priority has been to ensure the safety and security of all passengers and employees on all flights. In addition to these new measures, Air Canada has reinforced the cockpit doors on all of its mainline operating aircraft and has required its passengers to produce valid identification prior to boarding all flights. In December 2001, the Minister of Transport announced several security initiatives including, a new Canadian Air Transport Security Authority responsible for the provision of key air security services, an expanded program of armed police on aircraft to cover selected domestic and international flights and an air traveller's security charge (which came into effect on April 1, 2002).

On February 2, 2002, Bill C-38, an Act to amend the Air Canada Public Participation Act became effective and removed the 15% limit on individual ownership of voting shares in Air Canada. While the limit on individual ownership has been removed, the Corporation continues to be subject to a 25% restriction on non-resident ownership. See "Restrictions on Voting Securities".

IC INDUSTRY OVERVIEW AND COMPETITIVE ENVIRONMENT

Domestic Market

The Corporation is the sole major full service airline in Canada and had a leading market share in 2001. Based on January 2002 Official Airline Guide data, the Corporation provided for approximately 67% of the total number of domestic scheduled seats available in the first quarter of 2002. In the Canadian market, the Corporation competes with four scheduled and charter airlines. In 2001, WestJet Airlines, a low-fare carrier based in Western Canada, and the Corporation's largest scheduled domestic competitor, expanded its domestic ASM capacity by 57% and, in early 2002, was contemplating the commencement of new non-stop services between Toronto and certain Western Canada destinations in 2002.

Based on International Air Transport Association ("IATA") forecasts (post September 11, 2001), growth in traffic (as measured by RPMs) in the Canadian domestic airline market is estimated to be 4.0% on average over the period 2001-2005. From 1992 to 2001, growth in traffic averaged 4.6%. The following table shows the combined domestic and international traffic growth in RPMs, the capacity growth in ASMs, and the yearly percentage changes since 1992 for major Canadian scheduled carriers:

	Scheduled Service			
	<u>RPMs(1)</u> (billions)	<u>RPM Growth</u> (%)	<u>ASMs(1)</u> (billions)	<u>ASM Growth</u> (%)
2001.....	39.7	(5.9)	54.2	(7.5)
2000.....	42.2	3.9	58.6	3.0
1999.....	40.6	2.3	56.9	2.3
1998.....	39.7	3.2	55.6	3.7
1997.....	38.4	10.2	53.7	4.2
1996.....	34.9	11.6	51.5	8.1
1995.....	31.2	15.0	47.6	14.4
1994.....	27.2	5.0	41.6	5.3
1993.....	25.9	(2.0)	39.6	(2.4)
1992.....	26.4	6.3	40.5	4.9

(1) Source: Aviation Statistics Centre, Statistics Canada. Based on Level 1 and Level 1A air carriers as defined by the Minister of Transport.

Transborder and International Markets

Competition in the transborder market is primarily from the major U.S. airlines. Based on January 2002 Official Airline Guide data, the Corporation provided for approximately 55% of the total number of transborder scheduled seats available in the first quarter 2002. Management believes that over one-half of transborder passengers are Canadian, which helps support the Corporation's leading market position. U.S. airlines with transborder operations include American Airlines, Delta Airlines and Continental. The Corporation operates transborder routes from across Canada to and from destinations across the United States, on a direct non-stop basis, while the U.S. airlines tend to operate flights to their hubs for connecting flights.

Since the advent of Open Skies in 1995, the transborder market has grown at a higher rate than the Canadian domestic market. This trend may not continue. Based on IATA forecasts (post September 11, 2001), growth in traffic (as measured by RPMs) in the transborder airline market is estimated to be 3.4% on average over the period 2001-2005.

Competition in the Trans-Atlantic and Trans-Pacific markets is primarily from major foreign airlines, with competition from charter carriers on higher-density routes and particularly during peak travel seasons. Major U.S. Airlines also provide indirect competition by flying Canadians through their hubs to international markets. The continued strengthening of major airline alliances, such as *Star Alliance* and *oneworld*, has consolidated operations in the Trans-Atlantic and Trans-Pacific markets. Based on January 2002 Official Airline Guide data, the Corporation provided for approximately 47% and 49%, respectively, of the total number of Trans-Atlantic and Trans-Pacific scheduled seats available in the first quarter 2002. In the premium business travel segments, airlines are significantly enhancing product offerings (e.g., flatbed seats in premium classes) in order to attract and retain high yield business travellers. In the Trans-Pacific market, the emergence of polar routes has provided opportunities for new non-stop services from Eastern North American cities to Asian cities, which may reduce the importance of Western hubs to Asia.

Based on IATA forecasts (post September 11, 2001), growth in traffic (as measured by RPMs) in the Trans-Atlantic market is estimated to be 2.3% on average over the period 2001-2005, while in the Trans-Pacific market, growth is anticipated to be flat.

Since 1992, there has been considerable traffic growth on scheduled commercial services as well as capacity growth. The following table shows global traffic and capacity levels for scheduled services operated by commercial airlines worldwide:

	<u>RPMs(1)</u> <u>(billions)</u>	<u>RPM Growth</u> <u>(%)</u>	<u>ASMs(1)</u> <u>(billions)</u>	<u>ASM Growth</u> <u>(%)</u>
2000.....	1,875.2	7.9	2,646.4	5.1
1999.....	1,738.5	6.5	2,517.0	5.5
1998.....	1,633.0	2.1	2,384.7	2.9
1997.....	1,598.8	5.8	2,316.4	4.6
1996.....	1,511.0	8.2	2,214.4	6.1
1995.....	1,397.0	7.1	2,087.0	6.0
1994.....	1,304.8	7.7	1,969.3	5.2
1993.....	1,211.3	1.1	1,872.4	2.8
1992.....	1,198.6	4.5	1,820.7	5.4

(1) Source: Civil Aviation Statistics of the World — ICAO.

II DEVELOPMENT OF THE BUSINESS OF THE CORPORATION

Corporate Profile

The Corporation is Canada's sole major domestic and international full-service airline, providing scheduled and charter air transportation for passengers and cargo. Air Canada is the 8th largest North American airline and 12th largest airline in the world, based on RPMs. The Corporation carries approximately 30 million passengers annually and at March 31, 2002, employed approximately 38,440 full-time equivalent employees.

The Corporation, Air Canada Tango ("Tango") and the Corporation's regional airline subsidiary, Air Canada Regional Inc., serve 164 direct destinations with their fleet of 325 aircraft. The Corporation's primary hubs are located in Toronto, Montréal and Vancouver, each of which has extensive access to domestic, transborder and international markets. Through commercial agreements with other affiliated regional airlines, an additional 22 destinations are served for a total of 186 direct destinations on five continents. The Corporation is the largest provider of scheduled passenger services in the Canada-U.S., as well as in the Canada-Europe and Canada-Pacific Rim markets. The Corporation's cargo division serves numerous destinations in Canada and internationally, with sales representation in some 70 countries.

The Corporation operates an extended global network in conjunction with its international partners. Air Canada is a founding member of Star Alliance, the world's largest airline alliance group. Other founding members are United Airlines, Lufthansa, SAS and Thai Airways. They were joined in 1997 by Brazil's VARIG, in 1999 by Air New Zealand and All Nippon Airways, and in 2000 by Singapore Airlines, Mexicana, British Midland and Austrian Airlines Aviation Group. Through its strategic and commercial partnerships with Star Alliance members and several other airlines, Air Canada offers service to over 750 destinations.

Aeroplan, Air Canada's loyalty program, rewards members with travel rewards both for flying on Air Canada and its airline partners, and for purchasing services from other program participants. The Corporation encourages brand loyalty through Aeroplan, which has six million members, and through credit card and other merchant affiliations. Air Canada holds a 100% interest in Touram Inc., which operates under the name Air Canada Vacations, a major Canadian tour operator. Air Canada also operates a large aircraft and engine maintenance business providing maintenance services to airlines and other customers, and provides other airlines with ground handling and other contract services.

Corporate Reorganization of Air Canada and its Subsidiaries

Effective January 1, 2001, Air Canada and CAIL were amalgamated and continued as one corporation, with the amalgamated entity being known as Air Canada. Similarly, effective January 1, 2001, Air Canada Regional Inc. having acquired the assets and operations of Air Nova Inc. and Air Ontario Inc. in December, 2000 was amalgamated with AirBC Limited, Canadian Regional Airlines (1998) Ltd. and Canadian Regional Airlines Ltd., with the amalgamated entity being known as Air Canada Regional Inc., which currently operates as Air Canada Jazz.

In October 2001, Air Canada established Aeroplan Limited Partnership, as a limited partnership wholly-owned by Air Canada.

Recent Events

Business Process Re-engineering

As a result of the economic slowdown that became apparent in late 2000, the Corporation increased its focus on cost reduction and revenue improvement initiatives to return the Corporation to profitability as soon as possible. Several major undertakings were launched under the umbrella of the Securing Our Future ("SOF") re-engineering program. All these undertakings took on added urgency following the events of September 11, 2001.

SOF is a program, which resulted from extensive management analysis and benchmarking that produced over 170 cost-saving and revenue enhancement initiatives. SOF initiatives include the following: the addition of more economy seating (see "Fleet Capacity and Strategy"), the introduction of new technology in the scheduling, Yield management and pricing areas, fuel burn savings projects, the re-negotiation of supply agreements, the re-evaluation and release of surplus real estate and other assets, the re-design of products and workflow, the development of on-line booking technology and the reduction of distribution costs such as commissions and Computer Reservation System fees. A number of these initiatives have been implemented and have resulted in improved revenue and cost performance. An objective of SOF is to make business process re-engineering a permanent part of the Corporation's culture.

One of the major areas of focus is the development and implementation of strategies to utilize the Internet and other electronic media, particularly in creating new and lower cost channels of distribution. The Corporation continues to encourage customers to book and check-in electronically. In terms of booking, the Corporation has websites for Air Canada, Air Canada Jazz, Tango, Aeroplan and destina.ca Inc. ("destina.ca"), the Corporation's Internet travel services portal. Regardless of the booking method, the use of electronic ticketing is becoming much more prevalent. In terms of electronic check-in, the Corporation has made significant investments in Express self-service check-in kiosks available at major Canadian airports. In Canada, over one-third of the Corporation's passengers check-in via these fast check-in kiosks.

The Corporation has continued to focus on the high yield business passenger by providing frequency to major business centres and providing a high quality customer experience with such products as the Maple Leaf Lounges and concierge service. In addition, the Corporation has continued to pursue new revenue opportunities. During 2001, the Corporation targeted the rapidly growing price sensitive leisure and business passenger segments, with the launch of Tango and AC Jetz. In regards to Tango, the strategy is to expand Tango operations in North America to provide low-fare, point-to-point, no-frills service to price conscious consumers. In addition, another strategy is to establish a subsidiary company to provide low-fare, short-haul service with dedicated aircraft. Thus, in April 2002, the Corporation announced the launch of its low cost carrier, ZIP Air Inc. ("ZIP"), planned for start-up in late Summer 2002.

In addition to the initiatives listed above, the Corporation is also pursuing a number of measures intended to grow the Corporation's profitability from a non-airline perspective. The Corporation has identified a number of existing areas of expertise that it intends to develop and grow into profitable stand-alone businesses. This portfolio of businesses currently includes Aeroplan, destina.ca, Air Canada Technical Services, and ACETEK Composites (a joint venture with the Manitoba government to repair and manufacture aircraft composite parts using a variety of innovative technologies).

Fleet and Capacity Strategy

Starting in 2001, the Corporation realigned capacity in order to address the slowdown in business travel resulting from the economic downturn. This was done primarily by reducing frequencies on certain high frequency routes or where required, by combining frequencies by operating larger aircraft. This enabled Air Canada to maintain a full presence on its traditional network while reducing its operating costs and allowing for redeployment opportunities on incremental revenue opportunities.

In 2002, the Corporation will continue to monitor capacity and demand to ensure the optimal allocation of seats and assignment of aircraft types to maximize load factors and revenues. The Corporation's fleet and capacity strategy is to improve scheduling efficiency to match aircraft size to market demand with the objective of releasing large aircraft from the fleet.

The aircraft removals post September 11, 2001, represented the Corporation's largest aircraft downsizing. Many of the Corporation's oldest aircraft were retired or sold, including several Boeing 767-200, Boeing 737-200 and Fokker F28 aircraft, and the entire DC-9 fleet. A number of remaining Boeing 737-200 aircraft are planned to be assigned to new ventures. Furthermore, in 2002, five widebody aircraft (four Airbus A340-300 and one Boeing 747-400) will be returned to their lessors at the end of their leases. Management plans to replace most of these aircraft over the next three years with already committed Airbus aircraft. Sixteen new Airbus narrowbody aircraft will be delivered by the end of 2002, providing replacement capacity for some of the retired aircraft. Starting in 2003, six older Airbus A320 aircraft are planned to be replaced with committed Airbus A319 or A320 aircraft operating leases at approximately the same lease cost. At Air Canada Regional Inc., a large number of the Fokker F28 aircraft have been permanently parked with the remainder planned to be replaced by 50-seat Canadair Regional Jets ("CRJ") on order during 2002. By year-end 2002, this fleet modernization program will enable Air Canada to operate one of the youngest fleets among major airlines. The fleet modernization strategy is also expected to provide:

- Savings on fuel, training and maintenance expense; and
- Flexibility in timing the restoration of capacity with the recovery in the economy.

Additional cost reduction benefits are also planned through fleet simplification. The Airbus family of A319/A320/A321 aircraft consists of different sizes of the same aircraft. Air Canada plans to expand this family of aircraft to represent approximately half of the mainline fleet by year-end 2002. Associated cost savings are expected for the following reasons: aircraft commonality will reduce pilot certification and training costs and will increase flexibility in scheduling aircraft to better match customer demand. Similar commonality exists with the Airbus A330/A340 widebody aircraft.

To further address the decline in business travel and support our drive to reduce unit costs, the Corporation has undertaken a reconfiguration program, which added economy class seating on Airbus A320, Boeing 767 and 737 aircraft and reduced business class seating on Airbus A320 and Boeing 737 aircraft, while maintaining industry leading seat pitch standards. This seat reconfiguration program added approximately 2.5% more capacity at little additional cost. By the end of April 2002, this program had been implemented on approximately one-half of the Airbus A319 fleet, with the remainder of the existing A319 aircraft to be reconfigured by the end of the Summer 2002 period.

Launch of ZIP

On April 19, 2002, Air Canada announced that it planned to launch ZIP, a wholly-owned independently operated low-fare carrier, in late Summer 2002. The new carrier will be based in Western Canada and will operate primarily short-haul routes with connections to and from Air Canada's worldwide network. ZIP will have a start-up fleet of six Boeing 737-200 aircraft in a 117-seat all economy configuration. The fleet is planned to eventually increase to 20 Boeing 737-200 aircraft, all to be transferred from the existing Air Canada mainline fleet. ZIP will initiate its operations with flights between Vancouver and Calgary, replacing existing Air Canada network flights. Within its first year of operation, ZIP is planned to serve additional markets across Canada.

The launch of a low-fare airline is a critical component of the Corporation's response to growing consumer demand for low-fare travel and will also allow the Corporation to reduce unit costs. The Corporation's focus and strategy for 2002 is to reduce unit costs by, among other things, utilizing existing aircraft more effectively.

ZIP will be based in Western Canada and will have its own management and fleet. In addition, ZIP will have worldwide network connections to Air Canada and Air Canada Jazz. ZIP will contract with the Corporation for the provision of

certain services such as pilots and maintenance, but will operate independently of the Corporation for many other functions. Final start-up date, flying schedule and fares will be made public in due course.

Tango Expansion

In November 2001, the Corporation introduced Tango. Tango operates as a separately branded product, but with significantly lower unit costs than Air Canada's full service product. The lower cost structure is due principally to the underlying product design. Tango aircraft operate in an all-economy configuration with 159 seats on Airbus A320 aircraft as opposed to 140 seats on the mainline aircraft. Ticket sales are made exclusively by way of electronic ticketing. Over 80% of Tango flights are booked on Tango's dedicated website at www.flytango.ca thus, reducing distribution and call centre costs. Tango operates a fleet of distinctly branded aircraft and offers an "all extras are optional" in-flight service where food and amenities are an additional cost to the passenger and additional revenue to the Corporation.

Due to favourable customer response and increased demand for Tango services, the Corporation is planning to significantly expand Tango operations in the Spring/Summer period of 2002. Tango is planning to increase operations from six Airbus A320 aircraft in late 2001 to 11 Airbus A320 aircraft (159 seats) and 10 Boeing 737-200 aircraft (117 seats) in an all-economy configuration for a total of 21 aircraft. For the Summer peak flying, Air Canada estimates that Tango will make up almost 20% of domestic flying capacity as measured by available seat miles. The Tango operation is planned to be moved to Toronto's Pearson International Airport – Terminal 3, in June 2002.

The Tango network is expected to serve 23 Canadian cities for the Summer 2002 period including: Victoria, Vancouver, Abbotsford, Kelowna, Edmonton, Calgary, Regina, Saskatoon, Winnipeg, Toronto, Ottawa, Thunder Bay, Windsor, London, Québec City, Montréal, Halifax, Fredericton, Saint John, Charlottetown, St. John's, Deer Lake and Gander. Tango will offer up to 98 daily departures and 686 weekly departures linking markets from coast to coast.

destina.ca

On April 24, 2002, Air Canada officially launched destina.ca, a wholly-owned full-service online travel site. destina.ca is Canada's newest online travel site offering customers low prices and one-stop travel shopping, reservation and destination information services with access to up to 450 airlines, 53,000 hotels and 52 car rental agencies.

destina.ca is offering special awards of Aeroplan miles for all airfare purchases made on the destina.ca site, as well as hotel and car rental bookings. destina.ca also distributes the Corporation's Internet-only fares and is the preferred channel of distribution for the sale of the Corporation's discounted surplus capacity. In addition to the products and services currently available, special rates and services are being negotiated with preferred travel partners to offer low prices to destina.ca's customers. Partnerships with cruise lines, tour operators and event organizers are planned for the future. destina.ca has entered into a 15-year agreement with Aeroplan to be the exclusive online travel site in the Aeroplan program.

Canadian Air Transport Security Authority

Following the December 2001 budget announcement on air security measures, the Government of Canada announced in late March 2002, the creation of the Canadian Air Transport Security Authority ("CATSA"), which is responsible for the provision of several key aviation security services to ensure an effective aviation security system across Canada. As of April 1, 2002, CATSA assumed the cost for pre-board screening, operational responsibility for all screening equipment at airports, including explosives detection systems, and for contracting with the RCMP for protective officers on board aircraft. In addition, CATSA will gradually assume operational responsibility for pre-board screening services at airports on a site-by-site basis over the coming months. Transport Canada and CATSA will work closely with the aviation industry to ensure a smooth, seamless transition to these new arrangements. CATSA is a federal crown corporation reporting to the Minister of Transport. In order to fund these new air security measures, the Government of Canada introduced a new Air Traveler Security Charge of \$12 one-way effective April 1, 2002.

In April 2002, the Government of Canada also announced the finalization of new regulations to reinforce cockpit doors on Canadian registered aircraft to provide further protection to flight crews and Canadian air travellers. The new regulations are designed to prevent forcible intrusions into flight crew compartments. In the December 2001 budget, \$35 million was allocated by the Government to assist Canadian operators with these aircraft modifications. The Corporation had already reinforced cockpit doors on all its mainline fleet by November 2001.

Air Canada Jazz

In late March 2002, Air Canada Regional Inc., previously operating as AirBC, Air Nova, Air Ontario and Canadian Regional, marked the completion of a two-year consolidation process with the introduction of a new brand name and look, Air Canada Jazz. The Jazz name, logo, website and aircraft livery represent a new marketing strategy for the regional airlines. Air Canada Regional Inc. provides close to 800 flights each business day to 80 destinations in Canada and the United States, utilizing a fleet of Fokker F28 (soon to be retired), British Aerospace 146, Bombardier CRJ (beginning in May 2002), Dash 8-100/300 and Beech 1990 D aircraft. The rollout of the new Air Canada Jazz brand will be conducted over a period of several months.

Changes to Travel Agent Commission Structure

In March 2002, following the lead of major U.S. full service carriers, the Corporation revised its travel agent commission structure to eliminate traditional base commission payments for tickets issued in certain markets. Effective April 22, 2002, travel agent base commission payments were eliminated for tickets issued in Canada. Tickets issued for travel on Tango were not affected by the new commission structure. Effective March 23, 2002, travel agent base commission payments were also eliminated for tickets issued in the U.S., Puerto Rico and the U.S. Virgin Islands. Tickets issued outside of these markets are not affected by the new commission structure. Air Canada has expanded its incentive commission program to provide accredited travel agents in Canada with a revenue-earning stream.

Fuel Surcharge Adjustments

In April 2002, the Corporation announced that its domestic fuel surcharge of \$7.50 one-way was reverting to \$15.00 on all tickets issued as of April 11, 2002 for travel within Canada. The surcharge adjustment was in response to escalating fuel prices. The Corporation first introduced a fuel surcharge of \$15.00 one-way on May 22, 2001, for tickets issued as of May 31, 2001, in response to sustained high fuel prices. The surcharge was reduced by 50% on November 21, 2001 as a result of the decrease in fuel prices. As at April 2002, the Corporation's domestic surcharge compared to an US\$18.60 (CDN\$27.16) fuel-related one-way domestic surcharge by major U.S. carriers. U.S. carriers have not reduced the surcharge since implementation in 2000. The Corporation is in the process of implementing a similar fuel surcharge on certain international destinations.

Reduced Claim Under Airline Compensation Package Relating to September 11, 2001 Losses

In mid-April 2002, the Corporation was advised by Transport Canada that its claim under the Airline Compensation Program for losses incurred as a result of the closure of Canadian airspace in the days following the terrorist attacks of September 11, 2001, had been reduced to approximately \$60 million by excluding lost revenue from lost ticket sales during the September 11 to 16, 2001 period for flights subsequent to September 16. As a result, the Corporation took a charge of approximately \$37 million against non-operating expense in the first quarter of 2002.

Three-Year Summary: Evolution of Business

Acquisition of Canadian Airlines Corporation

- In 1999, the Corporation fended off a hostile takeover bid with the help of certain Star Alliance partners (United and Lufthansa) and Canadian Imperial Bank of Commerce, that helped fund a \$1.1 billion share buyback in opposition of the hostile takeover bid.
- The takeover bid was defeated and the Corporation's proposal to restructure the Canadian airline industry was accepted, which led to the financial restructuring of Canadian Airlines Corporation ("CAC") and Canadian Airlines International Limited's ("CAIL") \$3.5 billion of debt and lease obligations. In 1999, 853350 Alberta Ltd. ("853350 Alberta") was incorporated, with the Corporation owning 10% of its common shares, for the purpose of acquiring the common shares of CAC and the preferred shares of CAIL. On January 4, 2000, 853350 Alberta acquired approximately 82% of the issued and outstanding common shares and non-voting shares of CAC. On January 5, 2000, 853350 Alberta purchased from a wholly-owned subsidiary of AMR Corporation its investment in convertible preferred shares of CAIL. At the same time, AMR Corporation relinquished all rights related to its shareholdings in CAIL. The Corporation advanced funds to 853350 Alberta from its internal funds to provide the financing for these transactions.
- During that period, it was established that CAC was in significant financial difficulty and would require a debt restructuring with its creditors.
- Effective February 2, 2000, CAC and CAIL suspended payments to lenders and aircraft lessors on a temporary basis.
- On March 24, 2000, CAC was granted an order under the Companies' Creditors Arrangement Act (Canada) and an ancillary order under section 304 of the United States Bankruptcy Code, pursuant to which CAC was required to present a plan of arrangement setting out the terms of the restructuring of its debt and other obligations. Air Canada made financing available during the debt restructuring process. The Corporation entered into an agreement with CAIL's operating bank to increase CAIL's operating line of credit by \$75 million.
- Following approval by the creditors, the Court of Queen's Bench of Alberta approved the plan of arrangement on June 27, 2000, resulting in the compromise of the indebtedness owed to secured noteholders and certain affected unsecured creditors of CAC. In connection with the plan, CAIL became a wholly-owned subsidiary of 853350 Alberta. Subsequently, the Corporation acquired the remaining 90% of the common shares of 853350 Alberta. CAC is now a non-operating company without any significant assets.
- Following the approval by the court on June 27, 2000 of the plan of arrangement of CAC, the Corporation assumed control of CAIL for accounting purposes.
- The completion of CAIL's debt restructuring in late June 2000 resulted in savings of approximately \$500 million on a present value basis. Once the Corporation gained control of CAIL, the integration process began.

Integration of Canadian Airlines

- The process of integrating the operations of the Corporation and CAIL included the following steps:
 - Combining schedules, operating authorities, passenger and cargo terminal operations, system operation centres, computer systems, accounting, head offices and frequent flyer programs;

- Negotiating long term labour agreements with all but one union;
 - Training CAIL employees on Air Canada systems;
 - Removing redundant domestic capacity and re-deploying aircraft to the transborder network;
 - Adding overseas destinations (including Sydney and Shanghai);
 - Ordering 32 aircraft for either growth or fleet renewal;
 - Establishing one set of commercial policies and practices;
 - Producing standardized procedures and manuals for the merged carrier;
 - Creating a single countrywide regional airline system;
 - Converting Aeroplan and technical operations into profit centres to enhance their income generating capacity;
 - Combining the two airlines' operations at Toronto's Pearson International Airport, the Corporation's largest hub; and
 - Securing preferred access to Toronto airport's new mega-terminal opening in 2003 (Phase 1);
 - Implementing an integrated network schedule for the Corporation, CAIL and their regional carriers.
- The Corporation completed the integration of software applications, including the two airlines' reservation systems, call centres and flight information displays in airports.
 - The Corporation negotiated to allow Air Canada and CAIL staff to work side by side, rather than wait for third parties to merge labour groups and obtained union approval for the interim step of intermingling employees.
 - The corporate amalgamation of Air Canada and CAIL was completed on January 2, 2001.
 - All regional operations were merged into Air Canada Regional Inc.
 - On March 29, 2001, Transport Canada granted Air Canada an amended single Air Operator Certificate (AOC), allowing for the complete consolidation of CAIL's operations, maintenance and aircraft under the Air Canada operator certificate.

Economic Environment

- At the end of 2000, the airline industry faced a sudden slowdown in business travel. The Corporation cut its planned 2001 capacity growth to zero, parked up to eight older widebodies and reduced employment levels by 3,500 employees, primarily through voluntary separation packages and attrition.
- The economic slowdown continued culminating in the collapse of the technology sector in the Spring of 2001 and the further decrease in high-yield business travel.
- The events of September 11, 2001 dramatically impacted the global airline industry. The Corporation took immediate action to reduce capacity, labour expense and other costs and arranged financing to ensure liquidity.
- In 2002, traffic levels have progressively demonstrated an improving trend, thus the Corporation is cautiously planning to adjust flying capacity especially going into the Summer period, which is historically the Corporation's strongest period.

Regulatory Environment

- In late 1999, the Corporation agreed to certain undertakings to the Competition Bureau to be able to acquire CAIL, including the divestiture of a limited number of slots and airport facilities.
- In mid-February 2000, the Government of Canada tabled a package of proposed legislation to govern the competitive airline environment in Canada and ensure protection for consumers, some of the proposed changes were:
 - Increased powers for the Canadian Transport Agency (CTA) regarding domestic airline pricing, fares and conditions of carriage; and
 - New powers for the Competition Bureau to regulate anti-competitive or predatory airline behavior.

Other Developments

- Several Securing our Future (SOF) initiatives were implemented, including a seat reconfiguration and fleet modernization program.
- In 2001, the Corporation formalized Air Canada Technical Services (ACTS) as a division of the Corporation.
- In October 2001, Aeroplan was established as a separate wholly-owned limited partnership.
- In November 2001, the Corporation successfully launched Tango, a low cost “no frills” carrier. Following the success of Tango, the Corporation is planning to expand the number of aircraft and routes to be served by Tango.
- In April 2002, the Corporation announced it is planning to launch ZIP, a wholly-owned, independently operated low fare carrier, to be based in Western Canada.
- Since April 1, 2002, Air Canada Jazz was launched as a new brand for Air Canada’s regional operations.
- On April 24, 2002, destina.ca, Canada’s newest online travel and the exclusive partner of Aeroplan, was launched.

III DESCRIPTION OF THE BUSINESS OF THE CORPORATION

Passenger transportation is the principal business of the Corporation and, in 2001, represented 84.5% of total operating revenues, while cargo revenues accounted for 6% of total operating revenues.

The following table sets out the Corporation's consolidated operating revenues from domestic and international routes (including passenger and cargo) and other operating revenues for the periods indicated. In 2000, Canadian Airlines accounted for \$1,765 million of operating revenues for the July to December period.

Operating Revenues			
Year ended December 31			
(millions)			
	1999	2000	2001
Domestic routes.....	\$2,619	\$3,654	\$3,743
International routes.....	3,288	4,837	4,958
Other operating revenues...	<u>536</u>	<u>805</u>	<u>910</u>
Total.....	<u>\$6,443</u>	<u>\$9,296</u>	<u>\$9,611</u>

Passenger Operations and Route Networks

The Corporation provides direct passenger air transportation to approximately 164 destinations, operates, on average, approximately 1,375 scheduled flights each day and carries approximately 30 million passengers annually. The Corporation operates significant domestic, transborder and international routes networks. In 2000, Canadian Airlines accounted for \$1,544 million of passenger revenues for the July to December period.

Passenger Revenues			
Year ended December 31			
(millions)			
	1999	2000	2001
Domestic.....	\$2,510	\$3,508	\$3,585
Transborder.....	1,671	2,245	2,114
Other International.....	<u>1,339</u>	<u>2,196</u>	<u>2,424</u>
Total.....	<u>\$5,520</u>	<u>\$7,949</u>	<u>\$8,123</u>

The Corporation's primary hubs are located in Toronto, Montréal and Vancouver, which serve domestic, transborder and international markets, respectively. Toronto's Lester B. Pearson International Airport ("Pearson") is the Corporation's largest hub and, in 2001, its passengers accounted for approximately 63% of the passenger traffic. The Corporation is the principal tenant in Pearson's Terminal 1 and Terminal 2. A new terminal is currently being built, and the Corporation plans to fully consolidate all of its operations in the new terminal by 2005. In 2001, the Corporation and the Greater Toronto Airports Authority ("GTAA") signed a comprehensive memorandum of understanding regarding the Corporation's future operations and the development of Pearson, the Corporation's main hub. The GTAA is proceeding with a major development project at Pearson to replace the Corporation's Terminal 1 and 2 with a new passenger terminal and to add an additional runway. The Corporation and its Star Alliance partners will occupy the first phase of the new passenger terminal at Pearson which is expected to be completed by late 2003 with the balance of the Corporation's operations relocating to the new terminal in 2005.

The Corporation operates a hub at the Montréal International Airport — Dorval; and in 2001, its passengers accounted for approximately 64% of the passenger traffic. Montréal is a hub for domestic, transborder and international (primarily Trans-Atlantic) traffic. The Corporation also operates a hub at Vancouver's International Airport; and 2001, its passengers accounted for approximately 57% of the passenger traffic. Vancouver is a hub for domestic, transborder and international (primarily Trans-Pacific) traffic.

Domestic

The Corporation provides an extensive network and product offering across Canada with scheduled passenger service directly to 68 Canadian cities and communities. Domestic passenger revenues accounted for 44% of total passenger revenues in 2001. The most important Canadian routes in terms of operating revenues are the transcontinental routes linking Toronto, Montréal and Ottawa with major Western Canadian cities, including Winnipeg, Calgary, Edmonton and Vancouver. The Corporation operates several short-haul commuter routes, including *Rapidair* routes. Frequent service linking major centres within Western Canada is also offered with numerous flights between Calgary and Vancouver and between Calgary and Edmonton. In addition to transcontinental and commuter routes, the Corporation provides service between and within Central Canada, the Prairies and the Atlantic Provinces.

In November 2001, Tango was introduced into the domestic marketplace as a form of lower cost supplemental point-to-point flying, mainly on long haul routes. Tango started its operations by flying to eight Canadian cities (see “Products and Services”).

The Corporation's regional operations form an integral part of the Corporation's domestic passenger strategy. A significant portion of the Corporation's passengers either originate from or are destined to small cities and communities. The Corporation has linked its mainline and regional networks in order to serve connecting passengers more efficiently and to provide valuable traffic feed to the Corporation's mainline routes. The Corporation's mainline and regional operations coordinate marketing, flight schedules, ticketing and ground handling in order to ensure convenient passenger connections. The regional operations, which operate under the brand name of *Air Canada Jazz*, provide service throughout Canada, and to certain destinations in Northeastern and Northwestern United States.

Agreements have been put in place with small independent domestic airlines that operate mainly 18-seat aircraft in markets, which are considered too small for the Corporation to serve directly. These airlines operate flights under the Corporation's designator code and provide service to an additional 22 destinations. The Corporation does not own any equity interests in these carriers.

Transborder (Canada — United States)

With the most non-stop destinations and flights, the Corporation carries more passengers between Canada and the United States than any other airline. The Corporation now directly serves 86 routes to 47 transborder destinations with over 1,387 weekly flights. The Corporation's network reach is also augmented by extensive connections and codesharing with Star Alliance partner, United Airlines. In 2001, transborder passenger revenues represented 26% of total passenger revenues.

During 2001, the Corporation continued its Canadair Regional Jet transborder expansion strategy and introduced new non-stop services to markets such as Charleston, Greensboro, White Plains, Indianapolis and Norfolk. With changing economic conditions and the decline in business revenues, the Corporation's network was revisited, both in terms of frequency and gauge, in order to maximize profitability. Numerous services were terminated in 2001 pending a return in demand. (Montréal/Winnipeg–Denver, Vancouver–Spokane, Edmonton–Chicago, Ottawa-Raleigh/Durham, Ottawa–San Jose). Capacity was reassigned to sun leisure destinations where demand was expected to grow.

The Corporation's first quarter capacity to the United States (excluding sun destinations) was reduced by 16%, as a

result of the decline in the transborder market (excluding sun destinations). This led to the cancellation of services between Toronto–Cincinnati, Vancouver–Dallas, Edmonton/Vancouver Denver, Toronto–Fort Wayne/Kalamazoo, Toronto–Norfolk and Montréal–Portland (Maine). The Corporation however, increased capacity on the sun destinations, during the first quarter, by 38%, resulting in a total decline of 1.4 per cent in transborder capacity. The Corporation’s focus remains on aligning capacity to meet recovering demand and new market opportunities, while maintaining a strong competitive presence in the market.

International

The Corporation has a significant international network, which is enhanced by strategic and commercial alliances with other Star Alliance members. Currently, the Corporation provides scheduled service directly to 43 cities in Europe, the Middle East, the Caribbean and Asia and provides seasonal charter service to two additional Caribbean destinations. In 2001, international passenger revenues from the Atlantic and Pacific regions represented approximately 17% and 9% of total passenger revenues, respectively. In 2001, international passenger revenues represented approximately 30% of total passenger revenues. In 2001, Pacific passenger revenues grew by 31% reflecting the impact of adding Canadian Airlines’ large Asian route network for the full year 2001. In 2001, South Pacific, Caribbean, Mexico and South America passenger revenues were up 38% over 2000, due mainly to the addition of Canadian Airlines operations including a new service to Sydney, Australia in 2000.

In the aftermath of September 11, 2001, a further number of short term capacity reductions were implemented on both Trans-Atlantic and Trans-Pacific routes for the fourth quarter 2001 through to the end of the first quarter 2002, in order to address market softness. The market which was the most significantly impacted was Japan, resulting in the temporary cancellation of nonstop Toronto-Narita and Vancouver-Nagoya services for the balance of the Winter schedule.

With the softening of business markets in 2001, an opportunity arose to redeploy capacity to leisure/sun markets, where demand was expected to continue to grow. In order to capture a greater share of this segment, service to Mexico, and the Caribbean was increased significantly for the Winter schedule period. New nonstop flights were introduced to Cancun, Puerto Vallarta, Grand Cayman and San Juan. With the failure of Canada 3000 in the Fall, additional capacity was added where demand warranted. Air Canada Vacation charter services were also increased.

Products and Services

The Corporation has an ongoing program to offer superior value products, services and on-board amenities to its customers, particularly its high value business travelers. The Corporation offers a mix of product alternatives to its passengers: Executive First on Trans-Atlantic and Trans-Pacific flights; Executive Class on all domestic and transborder flights (except the Corporation's regional services) and Hospitality Class. Executive First is an enhanced business class product similar to First Class but at business class fares. Executive First provides customers with more legroom and improved in-flight dining, electronic sleeper seats, individual audio and video entertainment and satellite communication technology with global access to telephone and fax services.

The Corporation's products and services also include:

- the largest Canadian domestic route network;
- high frequency *Rapidair* and *Air Canada Jazz* service in Eastern Canada linking Toronto, Montréal and Ottawa and *Rapidair* services in Western Canada linking Vancouver, Calgary and Edmonton;
- in November 2001, the Corporation launched Tango, its low fare, “no frills” brand, and by the end of 2001, was operating six Airbus A320 aircraft to eight Canadian cities. Expansion plans call for the addition of five A320 and the introduction of 10 Boeing 737-200 aircraft to the Tango fleet by mid-2002. The network is expected to grow to

serve 23 Canadian cities from coast to coast. Tango aircraft operate in a one-class configuration and the service has been designed as an “all options are extra” simple offering. The fares are priced as one-way, no Saturday stay or advance purchase requirements and a simple procedure for flight changes. Market acceptance has surpassed expectation and the Corporation plans to capitalize on the growing demand for “no frills” travel by strategically expanding the Tango brand;

- a significant international network enhanced by the Corporation's *Star Alliance* membership;
- *Maple Leaf Lounges*, which provide business travelers with advanced computer, office and communication equipment in a quiet, convenient working environment as well as entertainment centres at Montréal, Toronto, Ottawa, Calgary, Vancouver, Los Angeles and London (Heathrow) airports; and
- on-board entertainment on most flights longer than one hour offering the daily news and more flight offering full-length feature movies.

As a result of the Corporation delivering a quality product and service, the Corporation was again voted “Best Business Class to Canada” by the readers of Business Traveler magazine, in February 2002. This is the second year that the Corporation received top honours for its business class service in the magazine’s readers’ survey. Over the previous eight consecutive years, the Corporation had won the formerly named “Best Airline for Travel to Canada” category.

Approximately 85% of the Corporation's passenger ticket sales were made by travel agents in 2001. The Corporation has strategic relationships with numerous travel agencies throughout the world. The Corporation is also expanding integrated systems for electronic commerce to enhance its product offerings:

- Electronic ticketing is available throughout Canada, in the United States and in many international service points for travel on Air Canada and selected *Star Alliance* partners. Electronic ticketing simplifies ticketing, streamlines refund and travel change transactions for customers and reduces distribution costs. By year-end 2001, approximately 60% of the Corporation’s tickets sold worldwide were electronic tickets, representing 70% of all tickets issued where electronic ticketing is available.
- Air Canada and United Airlines also have an inter-airline (interline) electronic ticketing service, making it possible for customers to use a single electronic ticket for travel on more than one airline. The service is the first electronic ticketing initiative that actually bridges two different airline computer reservations systems. Furthermore, during 2001, this interline capability was extended to the travel agency community.
- The Corporation’s comprehensive website, "www.aircanada.ca", allows individual passengers to make reservations, purchase tickets and access up-to-date schedule and corporate information, as well as conveniently view their *Aeroplan* eligible miles balance or trace cargo shipments; The Corporation also operates the following websites: www.flytango.ca; www.destina.ca; www.aeroplan.com; www.flyjazz.ca and www.4321zip.ca.
- During 2001, the Corporation introduced self-service airport check-in kiosks at Edmonton and Halifax, bringing the number of self-service kiosks to 152 by year-end. Self-service kiosks are also located at Toronto, Montréal, Ottawa, Winnipeg, Calgary and Vancouver. Over 10,000 customers daily use this fast alternative for check-in. The self-service kiosk allows customers to obtain boarding passes, confirm or select their seat, select frequent flyer program for mileage accrual, stand by for an earlier flight or request an upgrade or baggage check.
- In April 2002, the Corporation began using new wireless, mobile, IBM self-service kiosks in a trial program to help expedite passenger check-in at Toronto’s Pearson. The mobile kiosks represent the first jointly-developed solution resulting from the strategic partnership recently formed by IBM and the Corporation. The wireless mobile kiosks are based on the IBM self-service kiosk system that the Corporation has been using since 1998. The mobile IBM

self-service kiosks bring the convenience of quick check-in directly to the customer while using Air Canada's infrastructure. Air Canada plans to add additional mobile kiosk capabilities later this year, and as part of its strategic partnership with IBM, is also exploring how wireless technology can bring similar benefits and efficiencies to other operational areas such as maintenance and sales.

- Personal Ticket Office, a powerful online booking and ticketing software product for airlines, hotels and car rental reservations is offered to the Corporation's top tier frequent flyer customers.

Cargo Operations

The Corporation's cargo division provides direct air cargo service to approximately 160 Canadian and international destinations and has sales representation in over 70 countries. Cargo operations generated \$578 million in operating revenues in 2001. Cargo services offered by the Corporation include: guaranteed choice of flight airport-to-airport services for high priority shipments (*AC Expedair* and *AC Priority*), and air freight services (*AC Air Freight*), to Air Canada destinations worldwide.

The following table sets out the Corporation's cargo revenues from domestic and international operations for the periods indicated (mainline operations). In 2000, Canadian Airlines accounted for \$105 of cargo revenues for the July to December period.

	Year ended December 31		
	(millions)		
	1999	2000	2001
Domestic.....	\$109	\$146	\$158
International.....	<u>278</u>	<u>396</u>	<u>420</u>
Total.....	<u>\$387</u>	<u>\$542</u>	<u>578</u>

Air cargo services are provided on most scheduled domestic, transborder and international passenger flights. The Corporation is a major domestic air cargo carrier and is the largest supplier of air cargo services to Canada Post Corporation.

In April 2002, the Corporation and Canada Post Corporation renewed their long standing cargo and passenger services contract. This contract which includes carriage of mail and corporate passenger travel, has been extended for a further five years for domestic service, three years for transborder and international service and two years for corporate travel.

In January 2002, the Corporation opened a new modern cargo terminal at Toronto's Pearson. The new airport infield facility is designed to accommodate Air Canada Cargo's future growth, with 50% more capacity, 42% more overhead door access to the cargo building and ample customer parking. The new cargo terminal is an integral part of the GTAA's 10-year master plan to redesign and modernize Pearson.

In international markets, the Corporation provides cargo services on passenger aircraft including Boeing 747-400 combination aircraft, which carry cargo in the rear of the main deck. The Corporation has expanded its cargo network through alliances with other airlines. Trucking company agreements have further enhanced the cargo network in Europe and North America. The cargo division has implemented electronic data interchange technology, which allows customers to receive on-line updates of their shipments.

Other Operations

The Corporation operates in one business segment, air transportation and related services. The services within that segment are as follows (in 2000, Canadian Airlines accounted for \$116 million of other revenues for the July to December period):

	Year ended December 31		
	(millions)		
	1999	2000	2001
Other revenues			
Aeroplan	\$142	\$211	\$230
Technical Services	151	180	224
Other	243	414	456
Total other revenues	\$536	\$805	\$910

Aeroplan

With six million members in its database, Aeroplan has become one of Canada's leading and largest loyalty programs. Operating as the Corporation's frequent flyer program, Aeroplan's objective is to generate loyalty within its existing membership and attract new members on behalf of over 70 partners across the travel and non-travel market sectors.

The Aeroplan Frequent Flyer Program offers mileage accumulation as an incentive to the Corporation's and other partners' customers. Flyers on Air Canada, any one of the Star Alliance member airlines or other partner airlines are able to accumulate miles toward travel rewards worldwide on Air Canada and Star Alliance members. Aeroplan also manages the tier membership programs for the Corporation's most frequent flyers. The Prestige, Elite and Super-Elite tiers are designed to provide a multi-level benefits program to Air Canada's customers in return for their continued and frequent use of Air Canada as their first choice for air transportation. Aeroplan also offers complementary programs like the Aeroplan Business Incentive Program, which is used by small to medium businesses to generate customer and employee loyalty.

On October 1st, 2001 Aeroplan became a separate entity wholly-owned by the Corporation and continues to develop its capabilities as a loyalty management company. As one of its main strategies, Aeroplan will accelerate the development of its technology base to leverage its core capabilities in database management, market segmentation, research, hosting and customer relationship management (CRM) and continue to develop features to complement these capabilities. To this end, the next evolutionary step was the introduction on May 1st, 2002 of Aeroplan's dedicated website (www.aeroplan.com), that allows for fast and full redemption capabilities online for its members. Aeroplan has 1050 call centre employees, 730 of which are located in British Columbia. Aeroplan employs people in Montréal, Toronto, Calgary and Vancouver.

Technical Services

In 2001, the Corporation formalized Air Canada Technical Services ("ACTS") as a separate division, with the mandate to compete on a global basis as an aircraft maintenance, repair and overhaul profit centre. ACTS is responsible for the maintenance, engineering and repair of the Corporation's aircraft fleet and provides maintenance services to numerous third parties. The mandate for ACTS is to enhance shareholder value by capturing profitable third party contracts either directly or through cooperation agreements, joint ventures or other arrangements. The Corporation is currently finalizing arrangements to establish ACTS as a profit centre within the Corporation with the long-term objective of completing joint venture arrangements or alternate business structures to expand this technical service business. These operations generated \$224 million in operating revenues in 2001 by selling maintenance and engineering services, materials and

other services. The Corporation provided these services to over 60 customers in 2001, including United Airlines, Lufthansa, Atlantic Coast Airlines, the Department of National Defense, Pratt & Whitney and America West. Air Canada's primary maintenance facilities are located in Toronto, Montréal, Vancouver, Calgary and Winnipeg.

In March 2002, the Corporation secured a five-year US\$60 million agreement for the maintenance and repair of Atlantic Coast Airlines' fleet of Canadair Regional Jets. In 2001, Atlantic Coast Airlines also awarded ACTS a 16-year US\$285 million contract for the maintenance and repair of components for its Canadair Regional Jet fleet. Maintenance work is being performed at the Corporation's Dorval Maintenance Centre.

Other Revenues

Other revenues include, amongst others, revenues from Air Canada Vacations, passenger, cargo and ground handling services to numerous airlines.

The Corporation's wholly-owned subsidiary, Touram Inc., conducts business under the trade names *Air Canada Vacations* and *Netair*. *Air Canada Vacations* is a major Canadian tour operator, offering leisure and vacation packages which include air transportation supplied by Air Canada, hotel accommodations, car rentals and cruises. *Netair* sells surplus seat inventory exclusively to travel agents covering air travel only. In 2001, Touram Inc. arranged travel for over 134,000 passengers. *Air Canada Vacations* offers tour products to 91 destinations in North America and the Caribbean. Vacation packages are provided to 43 of the U.S. cities where Air Canada operates and to 26 vacation destinations in Canada.

The Corporation also provides passenger, cargo and ground handling services to numerous airlines, including major foreign airlines at Canadian and international airports. These services include airport passenger check-in, ticketing, baggage handling, cargo handling and processing, as well as aircraft ramp handling.

Star Alliance

The Star Alliance has grown, since its inception in 1997, to include the following 14 airlines: Air Canada, United Airlines, Lufthansa, SAS, Thai Airways, VARIG, Air New Zealand, All Nippon Airways, Austrian Airlines (including Lauda Air and Tyrolean Airways), Singapore Airlines, British Midland and Mexicana Airlines. The Corporation has agreed with United Airlines and Lufthansa to maintain their joint relationship until 2009, and not to enter into strategic alliances with anyone outside *Star Alliance* until preferred shares of Air Canada held by these partners are redeemed (with some exceptions). The preferred shares cannot be redeemed until 2009 or such earlier time as either United Airlines or Lufthansa leave *Star Alliance* except in limited circumstances.

The *Star Alliance* network provides access to over 750 cities across the globe, with reciprocal participation in frequent flyer programs and use of airport lounges. The *Star Alliance* facilitates codesharing and traveler connections and transfers by providing customers with a higher level of service between network connection points. The airlines have implemented initiatives such as common utilization of facilities and are focusing on capturing potential synergies in areas such as joint purchasing. In addition, Air Canada now codeshares with all of the members. The following is a summary of some of the Corporation's arrangements with *Star Alliance* partners, United Airlines and Lufthansa:

United Airlines

The United Airlines alliance provides extensive access to U.S., South American, Asian and South Pacific destinations via Air Canada's and United Airlines' hubs in Canada and the United States, respectively, as well as reciprocal frequent flyer programs and one stop check-in. Since the beginning of 1998, approximately 875 codeshare flights per day have been added, building high frequency services, which cater to the needs of the business traveler. Codesharing with United

Airlines allows the Corporation to indirectly serve over 35 additional destinations in the United States.

In September 1997, the Corporation and United Airlines obtained from the U.S. Department of Transportation approval for "anti-trust immunity", subject to certain conditions, for their alliance agreement in order to further expand their transborder alliance activities. Anti-trust immunity enables Air Canada and United Airlines to jointly develop and extend seamless travel products between Canada and the United States with coordination in areas such as marketing, advertising and distribution, pricing, inventory and yield management, frequent flyer programs and route and schedule coordination, as well as other areas which were previously restricted. The carriers are required to resubmit their alliance agreement to the U.S. Department of Transportation for further review by September 2002.

Lufthansa

Air Canada and Lufthansa have a strategic alliance offering codesharing, one-stop check-in, reciprocal frequent flyer programs, schedule coordination and shared passenger handling services. Non-stop flights under codeshare arrangements are offered from Vancouver, Calgary, Toronto and Montréal to Lufthansa's main hub at Frankfurt, with connections to destinations in Europe, the Middle East, Africa and Asia. Lufthansa has also expanded its codesharing on Air Canada routes to additional Canadian and U.S. destinations. Air Canada and Lufthansa jointly introduced Montréal-Frankfurt service on Air Canada aircraft and have expanded the joint services to all non-stop Canada-Germany routes, including Toronto-Munich.

Other Alliances

In addition to *Star Alliance*, Air Canada has joint marketing, codesharing or commercial relationships with the following international airlines:

Airline	Region
Royal Jordanian	Jordan
Korean Air ⁽¹⁾	Seoul-Vancouver route
Alitalia	Italy
EVA Air	Taiwan
Air Jamaica	Jamaica
Spanair	Spain

(1) Commercial arrangement for codesharing on Air Canada operated flights only.

As a member of the IATA, the Corporation has multilateral interline traffic agreements with many international air carriers, enabling it to offer for sale air transportation services between Canada and most countries worldwide.

Fleet Overview

Air Canada's mainline total fleet and operating fleet, excluding Air Canada Regional Inc. aircraft, at March 31, 2002, is as described below:

	Total Number of Aircraft	Number of Operating Aircraft ⁽¹⁾	Average Age of Operating Aircraft (Years)	Operating Aircraft - Owned	Operating Aircraft - Capital Lease	Operating Aircraft - Operating Lease ⁽²⁾	On Order ⁽³⁾	Options
Widebody Aircraft								
Airbus A340-600	-	-	-	-	-	-	3	-
Airbus A340-500	-	-	-	-	-	-	2	7 ⁽⁴⁾
Airbus A340-300	11	11	4.8	-	-	11	-	8 ⁽⁴⁾
Airbus A330-300	8	8	1.5	-	-	8	-	8 ⁽⁴⁾
Boeing 747-400	7	7	10.3	-	1	6	-	-
Boeing 747-200	3	-	-	-	-	-	-	-
Boeing 767-300	33	33	8.6	-	3	30	-	-
Boeing 767-200	23	18	16.8	12	-	6	-	-
Narrowbody Aircraft								
Airbus A321	5	5	0.3	-	-	5	7	-
Airbus A320	48	48	10.1	0	1	47	8 ⁽⁵⁾	-
Airbus A319	39	39	4.0	-	-	39	9	-
Boeing 737-200	42	30	20.8	3	4	23	-	-
DC-9	23	-	-	-	-	-	-	-
Canadair Regional Jet	25	25	6.5	2	-	23	-	-
Total Aircraft	267	224	9.6	17	9	198	29	23

(1) Excludes three owned Boeing 747-200, five owned or leased Boeing 767-200, 23 owned DC-9 and eight owned or leased Boeing 737-200 aircraft which have been removed from service. The owned aircraft were available for sale as at March 31, 2002. Also excludes four Boeing 737-200 aircraft which were also subleased.

(2) Air Canada retains a residual value interest in a significant number of leased aircraft through purchase options.

(3) On order aircraft includes 19 aircraft under committed purchase contracts and 10 aircraft under committed operating leases.

(4) Air Canada has the ability to convert the option aircraft into Airbus A340-300, Airbus A330-300, Airbus A340-500 or 600 aircraft, subject to certain conditions.

(5) Four of the Airbus A320 orders under operating leases may be converted to Airbus A319 aircraft subject to certain conditions.

Air Canada Regional Inc.'s total fleet and operating fleet at March 31, 2002 is as described below:

	Total Number of Aircraft	Number of Operating Aircraft ⁽¹⁾	Average Age of Total Fleet (Years)	Total Aircraft - Owned ⁽²⁾	Total Aircraft - Operating Lease ⁽³⁾	On Order
Regional Airlines						
Canadair Regional Jet	-	-	-	-	-	10 ⁽⁴⁾
British Aerospace BAe 146	10	7	12.8	-	10	-
Fokker F28	29	11	28.2	29	-	-
de Havilland DHC-8-300	26	22	11.8	21	5	-
de Havilland DHC-8-100	62	57	13.5	55	7	-
Beech 1900D	5	4	5.6	5	-	-
Total Aircraft	132	101	16.1	110	22	10

- (1) Excludes 18 Fokker F28 aircraft of which one was leased to a third party and 17 have been retired as well as the equivalent of 13 aircraft removed from service: three BAe 146, four DHC-8-300, five DHC-8-100 and one Beech 1900D. Of these aircraft, the equivalent of three BAe 146, four DHC-300 and one DHC-100 are planned to return to active service during 2002 (four DHC-100 will be returned to the lessors in 2002).
- (2) Includes aircraft owned by the Corporation and its subsidiaries.
- (3) Excludes five leased Jetstream aircraft, of which three were subleased to a third party and two were surplus.
- (4) Subsequent to December 31, 2001, arrangements were completed for the acquisition by Air Canada Regional Inc. of 10 Canadair Regional Jets under operating lease.

Widebody Aircraft

The Corporation's operating widebody fleet is comprised of 77 aircraft, configured in two classes of service, Executive First or Executive Class and Hospitality Class.

The Airbus A340 is a four-engine technologically advanced 284-seat aircraft with low operating costs and is well suited to the long-range, medium density Trans-Pacific and Trans-Atlantic routes that Air Canada serves. Air Canada operates the Airbus A340 aircraft mainly on Trans-Pacific routes. The Airbus A330 aircraft is a twin-engine version of the Airbus A340 that the Corporation operates mainly on Trans-Atlantic routes.

The Boeing 747-400 aircraft, used primarily on Trans-Atlantic and Trans-Pacific routes, is a four-engine high capacity, long-range aircraft. The Combi configuration, which seats 299 passengers and has significant cargo capacity, is well suited for European medium density passenger routes in important cargo markets. In full passenger configuration, the aircraft seats 425 passengers and is used on high-density Trans-Pacific routes.

The Boeing 767 is a twin-engine aircraft offering a high degree of fuel efficiency with corresponding low operating costs. As of March 31, 2002, the Corporation had 33 Boeing 767-300 long-range aircraft in service that are used mainly on international routes; eleven of Air Canada's in service 18 Boeing 767-200 aircraft have long-range capability and are used mainly on Trans-Atlantic routes.

Narrowbody Aircraft

The Corporation operates 147 narrowbody aircraft, configured in two classes of service: Executive Class and Hospitality Class (except for Canadair Regional Jets, which are only in Hospitality Class). Air Canada operates 92 Airbus narrowbody aircraft.

The Airbus A320 aircraft is a 140-seat (159-seat in Tango configuration) fuelefficient, technologically advanced twin-engine commercial aircraft. Features include increased cabin space, reduced noise levels and longer range. Air Canada

operates A319 aircraft, which complement the Airbus A320 fleet and are well suited for the Corporation's North American route network. The twin-engine Airbus A319 offers 120 seats and is essentially a shortened version of the Airbus A320 aircraft with the same engines, operating systems and cockpit. Compared to alternative fleet types, the Airbus A319 offers increased scheduling flexibility, interchangeability of air crew with the Airbus A320 and savings in pilot training, aircraft maintenance, fleet introduction and inventory costs. The Airbus A319 delivers improved range and significantly greater cargo carrying capacity than the DC-9 and B737-200 aircraft.

Air Canada became the first operator in Canada and the second in North America of the Airbus A321 aircraft when it took delivery of five aircraft in 2001. The Airbus A321 aircraft is the largest narrowbody aircraft in the Airbus family with 166 seats.

The 100-seat Boeing 737-200 are twin-engine aircraft used on many of the Corporation's short and medium-haul North American routes. As at March 31, 2002, Air Canada had 30 B737-200 aircraft in operation. Some of the aircraft are being converted to the 117-seat, all-economy configuration for Tango expansion and the planned start-up of ZIP.

The Corporation operates 25 50-seat Canadair Regional Jets, which are well-suited to provide direct point-to-point services, particularly to lower density markets on routes under 1,000 miles. The Corporation is operating the Canadair Regional Jets on transborder and selected domestic routes in order to capitalize on market opportunities and to build traffic levels toward the operation of larger jet aircraft. The Canadair Regional Jet has been a major factor in the Corporation's successful U.S. transborder expansion strategy.

Aircraft Purchases and Deliveries

The table below outlines the Corporation's planned acquisition of aircraft in the 2002 to 2004 period as at March 31, 2002. These aircraft will either be acquired through committed purchases with corresponding planned lease financing or through committed operating leases.

<i>Aircraft Type</i>	2002		2003		2004		Total
	Purchase with Financing	2002 Lease	Purchase with Financing	2003 Lease	Purchase With Financing	2004 Lease	
Mainline							
Airbus A340-600	-	-	3	-	-	-	3
Airbus A340-500	2	-	-	-	-	-	2
Airbus A321 (1)	5	-	2	-	-	-	7
Airbus A320 (2)	-	2	-	3	-	3	8
Airbus A319	5	2	2	-	-	-	9
Total Mainline	12	4	7	3	-	3	29
Regional Airlines							
Canadair Regional Jet	-	10	-	-	-	-	10
Total Aircraft	12	14	7	3	-	3	39

(1) In early 2002, Air Canada deferred delivery of two Airbus A321 aircraft by 12 months to 2003.

(2) Four Airbus A320 planned leases, one in 2003 and three in 2004, can be converted to Airbus A319 aircraft subject to certain conditions.

The Corporation has commitments for the delivery under long-term operating leases of two Airbus A320 and two Airbus A319 aircraft in 2002, three Airbus A320 aircraft in 2003 and three Airbus A320 aircraft in 2004. As these aircraft commitments are for delivery under operating leases, they are not included in the capital expenditure table (see "Planned Capital Expenditures and Financing").

In April 2002, the Corporation signed letters of intent with lessors, for two Boeing 767-300 and three Airbus A321 aircraft on operating leases with terms varying from three to five years and rentals based on the number of hours flown. These aircraft are not shown in the delivery table above.

Widebody Aircraft. The Corporation has commitments to acquire two new generation Airbus A340-500 aircraft planned for delivery in 2002 and three A340-600 aircraft planned for delivery in 2003. The Airbus A340-500 aircraft, seating 264 passengers, will be the longest range airliner in the world capable of providing non-stop service on routes such as Toronto-Hong Kong on a year-round basis. The Airbus A340-600, seating 335 passengers, is designed for high-density routes such as Toronto-London and Toronto-Frankfurt. The Corporation has requested Airbus Industrie to consider deferring certain orders for aircraft deliveries in 2002 and 2003.

The widebody Airbus aircraft the Corporation is acquiring are expected to bring operational and maintenance cost savings compared to other fleet types through efficiencies and commonality with other Airbus aircraft already operated by the Corporation. In addition to its committed purchases and leases, the Corporation has 23 options to purchase Airbus A340 and Airbus A330 aircraft to provide for international growth opportunities as they arise.

Narrowbody Aircraft. For the remainder of 2002, at the mainline level, the Corporation will be taking delivery of the following narrowbody aircraft, as part of its continuing efforts to streamline its fleet: seven A319 aircraft, two A320 and five A321 aircraft.

Furthermore, in December 2001, the Corporation signed a commitment to lease six Airbus A319 or Airbus A320, for delivery in 2003 and 2004, to coincide with the planned return of similar aircraft when their leases expire.

At the regional level, the Corporation will be taking delivery of ten Canadair Regional Jets, under operating leases.

Planned Capital Expenditures and Financing

The table below summarizes the Corporation's committed and planned capital expenditures, after committed aircraft financing, for the 2002 to 2004 period as at March 31, 2002.

(\$ Millions) ⁽¹⁾	2002	2003	2004
Committed aircraft expenditures before committed financing	919	735	-
Committed aircraft financing	(918)	(733)	-
Net committed aircraft expenditures after Financing	1	2	-
Planned expenditures for aircraft, engines, inventory, modifications and refurbishments ⁽²⁾	90	189	246
Other planned or projected property and equipment expenditures ⁽²⁾	137	229	206
Planned and committed capital expenditures, after committed financing	228	420	452

(1) US dollar amounts are converted at the rate of CDN\$1.5926 per US dollar.

(2) Capital expenditure amounts subject to change between categories

Committed aircraft expenditures before committed financing represent final payments for purchases of new aircraft assuming that the Corporation purchases all aircraft prior to any lease financing arrangement.

Committed aircraft financing is in place for Airbus A319 and A321 aircraft totalling up to US\$516 million. All other committed Airbus aircraft purchases have committed financing of 85% equal to US\$520 million. The financing amounts shown above assume that the financing facilities are fully utilized under sale and leaseback arrangements. Subject to financial conditions, the Corporation may purchase rather than lease some of these aircraft.

At March 31, 2002, net committed aircraft expenditures after financing amounted to \$1 million in 2002, \$2 million in 2003 and zero in 2004. In 2002, the Corporation deferred delivery, until 2003, of two A321 aircraft originally scheduled for delivery in 2002.

Planned expenditures for aircraft, engines, inventory, modifications and refurbishments include the planned but uncommitted purchase of one leased B767-300 aircraft in 2003 and two leased B767-300 aircraft in 2004 which have favourable purchase option prices at lease termination.

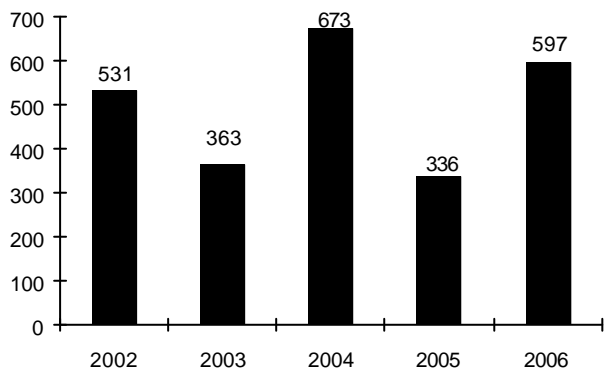
Other planned or projected property and equipment expenditures are for committed, planned or projected capital spending on information technology projects, airport improvements, maintenance facility upgrades, ground and computer equipment and facilities as well as expenditures by subsidiaries. In 2001, the Corporation introduced measures to reduce capital spending through stringent controls and authorization processes on all uncommitted capital expenditures. These measures continue to be in effect in 2002.

All uncommitted capital expenditures are subject to change based on management's assessment of future market and financial conditions.

The accompanying chart summarizes the Corporation's mandatory debt and capital lease principal repayments for the years 2002 to 2006, at December 31, 2001.

Mandatory debt and capital lease repayments

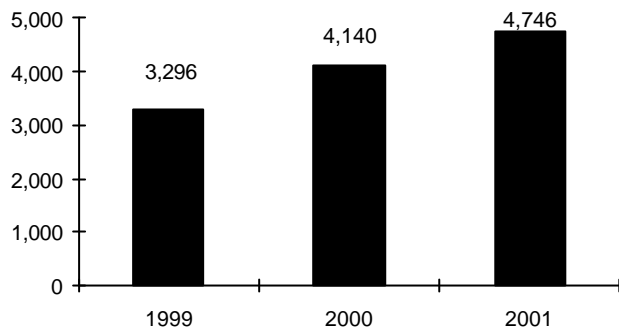
\$M



The accompanying chart summarizes the Corporation's long-term debt and capital lease obligations for the last three years, at December 31, 2001.

Long-term debt* and capital lease obligations

\$M



* Includes subordinated perpetual debt and current portion of long-term debt.

Fuel

Aircraft fuel is a major expense to the Corporation. The Corporation may enter into contracts, not exceeding two years, with unrelated creditworthy financial intermediaries and oil companies to manage its exposure to crude oil and fuel price volatility. As at March 31, 2002, the Corporation had effectively hedged approximately 9% of its anticipated consolidated fuel consumption for the remainder of 2002, through financial swap agreements on West Texas Intermediate crude oil (WTI). This coverage translates into an equivalent annual average WTI price of US\$22.87 per barrel. Furthermore, the Corporation had hedged an additional 13% of its anticipated remaining 2002 consumption with range option collars protecting Air Canada above the high WTI average range option price of US\$21.38 per barrel and fixing Air Canada at the low average range option price of US\$15.96 per barrel in the event the WTI price dropped below US\$15.96 per barrel. Based on 2002 projected volumes, a US\$1 per barrel movement in the price of crude oil would result in an approximate CDN\$23 million change in 2002 fuel expense for Air Canada, net of fuel hedges, assuming that refining spreads between WTI and jet fuel as well as foreign exchange rates remain constant.

Employees

During 2001, the Corporation had an average of 42,590 employees, measured on a full-time equivalent (FTE) basis as compared to 43,514 employees on a combined Air Canada and Canadian Airlines basis in 2000.

At March 31, 2002, the Corporation had an average of 38,440 FTE employees, as described below, 12% down from the high level in 2000:

<u>Employee Group</u>	<u>Union (1)</u>	<u>FTE Employees 1st Qtr 2002</u>	<u>Agreement Expiry Date</u>
Mainline-related			
Management & administrative support employees	N/A	4,507	N/A
Pilots	ACPA	3,136	April 2004
Flight attendants	CUPE	6,331	October 2001 (AC) and June 2004 (CAIL)
Customer sales & service agents	CAW	6,141	March 2004
Maintenance, ramp & cargo employees	IAMAW	11,334	June 2005 (AC) and June 2002 (CAIL)
Other unionized employees	various	2,244	From 2004 to 2005
Total Mainline-related		<hr style="border-top: 1px solid black;"/> 33,693	
Regional Airlines and other subsidiaries	various	4,747	
Consolidated total		<hr style="border-top: 1px solid black;"/> <hr style="border-top: 3px double black;"/> 38,440	

(1) ACPA: Air Canada Pilots' Association; CUPE: Canadian Union of Public Employees; CAW: Canadian Auto Workers Union; IAMAW: International Association of Machinists and Aerospace Workers.

The Corporation has successfully concluded long-term labour agreements with all but one of its major unions until 2004 or 2005: Air Canada Pilots' Association ("ACPA"), Canadian Auto Workers Union ("CAW") representing sales and service agents, Canadian Union of Public Employees ("CUPE") covering former Canadian Airlines' flight attendants and International Association of Machinists and Aerospace Workers ("IAMAW") covering maintenance, cargo and airport ramp service personnel. Although Air Canada has an agreement with IAMAW until 2005 with respect to wage increases, working conditions and benefits will be negotiated starting in or before June 2002. Intermingling of work between Air Canada's and Canadian Airlines' IAMAW employees began in early 2001. Negotiated settlements covering common work rules for the CAW and CUPE (Canadian Airlines) labour groups were implemented in 2001 as well. A work force integration agreement with ACPA took effect in December 2001. In 2002, Air Canada is renegotiating a collective agreement with approximately 8,500 of its flight attendants who are represented by CUPE. Negotiations commenced in the Fall of 2001 and will continue with the assistance of a mediator agreed to by the parties.

In 2001, Air Canada Regional Inc. successfully negotiated single collective labour agreements with their major unions, including pilots, flight attendants and maintenance workers for implementation in April 2002. There remains one outstanding collective agreement to be finalized between Air Canada Regional Inc. and its customer service agents, which is currently under negotiation.

Properties and Facilities

The following describes principal properties owned or leased by Air Canada

<u>Principal Properties</u>	<u>Description</u>	<u>Approx. Gross Internal Floor Area (Sq. Ft.)</u>	<u>Nature of Title</u>
Vancouver International Airport Terminal Facilities	Counters, offices, passenger and baggage handling facilities	187,000	Leased with options until 2005
Vancouver Technical Operations Centre	Offices, hangars, shops, flight kitchen, simulator, test cell facilities	1,076,000	Owned facilities on leased land; lease and options until 2048
Vancouver South Hangar	Offices, hangars, shops, stores	270,000	Owned facilities on leased land lease until 2009
Calgary International Airport	Hangar , Commissary, Ground Support Equipment (“GSE”), and Warehouse	272,000	Owned facility on leased land; lease and options until 2020
Calgary International Airport	Office facilities	106,000	Five floors of leased space until 2009. Currently, all floors are sub-leased until 2006 with options to renew until 2008.
Winnipeg Air Canada Building	Offices and computer centre	366,000	Building on long-term lease to 2013; on owned land
Winnipeg Airport Maintenance Base	Offices, aircraft maintenance hangars and workshops	300,000	Owned facilities on leased land; lease and options until 2015
Winnipeg Cargo Building	Offices, Cargo	124,000	Owned facilities on leased land; lease until 2008
Toronto - Pearson International Airport Terminals 1 & 2 Facilities	Counters, offices, passenger and baggage handling facilities and commuter terminal	323,000	New long-term leases until 2003 for Terminal 1 and 2005 for Terminal 2
Toronto - Pearson International Airport Maintenance Base	Offices, simulator building, hangars and workshops	1,305,000	Owned facilities on leased land ; lease and options until 2012
Toronto - Air Canada Office Tower - Adjacent to Air Canada Centre	Offices and reservation call centre	162,000	9 floors of a 14-story complex; owned facilities on owned land

<u>Principal Properties</u>	<u>Description</u>	<u>Approx. Gross Internal Floor Area (Sq. Ft.)</u>	<u>Nature of Title</u>
Toronto - Cargo Facility	Offices, Cargo & Equipment Maintenance Building ("EMB")	445,000	Owned facility on leased land
Montréal International Airport - Dorval Terminal Facilities	Counters, offices, passenger and baggage handling facilities	162,000	Premises leased on a long term basis until 2014
Montréal International Airport Maintenance Base	Offices, computer centre, aircraft maintenance, hangars, workshops and training facilities	2,115,000	Owned facilities on leased land ; lease and option until 2051
Montréal Air Canada Centre Air Canada Headquarters	Head office and training facilities	256,000	Owned facilities on leased land ; lease and option until 2051
Montréal Office Building – Air Canada Call Centre	Offices, reservations and Aeroplan call centres	220,000	Owned facilities on owned land
Halifax Hangar Base	Offices, Hangar, and Cargo	110,000	Owned facilities on leased land lease and options until 2021

Air Canada operates terminal, maintenance and/or cargo facilities under long term leases at Toronto, Montréal, Vancouver, Calgary, London (England) and Los Angeles.

Pursuant to the Air Canada Public Participation Act, Air Canada must maintain its head office in the City of Montréal. Major operational and overhaul facilities must be maintained in Montréal, Winnipeg, and Mississauga.

Insurance

Air Canada and other airlines have experienced a dramatic rise in the cost of aviation insurance since September 11, 2001. For the year 2002, the Corporation's aviation insurance is expected to increase by approximately \$70 million compared to insurance costs in effect prior to September 11, 2001. Additionally, the previous level of third party war risk liability insurance was limited to US\$50 million by aviation insurers shortly after September 11, 2001. The Government of Canada, similarly to governments of other countries, agreed to provide an indemnity for essential aviation service operators which, in Canada, include air carriers, airports and NAV CANADA, in order to restore the war risk liability coverage to what existed previously. The government indemnity is a temporary measure, until such time as a longer term commercially accepted alternative solution is found. Some insurers have indicated their willingness to provide limited coverage, while alternative market solutions are under development. The replacement of the indemnity is expected to result in further insurance cost increases in 2002. In accordance with its established risk management practice, Air Canada continues to maintain adequate levels of insurance to protect the Corporation's assets and operations. Such insurance is comparable to insurance coverage carried by other major international airlines.

IV RISK FACTORS

The following are risks related to the Corporation and the airline industry:

Leverage

The Corporation has a significant amount of indebtedness. This level of indebtedness may increase the Corporation's vulnerability to general adverse economic and industry conditions and require the dedication by the Corporation of a substantial portion of its cash flow from operations to payments on its indebtedness, thereby reducing the availability of the Corporation's cash flow to fund working capital and capital expenditures and other general corporate purposes. This level of indebtedness could also limit the Corporation's flexibility in planning for, or reacting to, changes in its business and the airline industry.

Economic Conditions

Prevailing economic conditions have a significant impact on the demand for air transportation. Airline operating results are sensitive to the cyclical nature of the economy. Airline fares have fluctuated significantly in the past and may fluctuate significantly in the future. The Corporation is not able to predict with certainty market conditions and the fares it will charge. There can be no assurance that the Corporation's fares will not decline from current levels. A slowdown in economic growth in North America, like the one experienced in the last year, would have the effect of reducing demand for air travel in Canada generally, and together with the other factors discussed herein would impact the Corporation's profitability in the short term. Any prolonged or severe weakness of the economy and the Corporation's markets could have a material adverse effect on the Corporation's business, financial condition or results of operations, especially given the high leverage of the Corporation and its substantial fixed cost structure.

Seasonal Nature of the Business

The Corporation has historically experienced considerably greater demand for its services in the second and third quarters of the calendar year and significantly lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the Spring and Summer months. The Corporation has substantial fixed costs in its cost structure that do not meaningfully fluctuate with passenger demand in the short-term. Seasonably low passenger demand results in significantly lower operating cash flow and margins in the first and fourth quarters for each calendar year compared to the second and third quarters.

Fuel Costs

Fuel costs represent a major portion of the Corporation's operating costs. Fuel prices fluctuate widely depending on international market conditions, political events and exchange rates of foreign currencies. Higher fuel costs will continue to impact costs in 2002 as long as fuel prices remain at current levels.

The price of jet fuel is sensitive to, among other things, the price of crude oil, the refining costs to produce jet fuel and the transportation costs to deliver the product to its ultimate destination. These components are priced in U.S. dollars, creating both commodity and exchange rate sensitivity.

Regulatory Matters

The airline industry is subject to extensive municipal, federal and international government regulations relating to airline safety, security and scheduling as well as to local, provincial, federal and international environmental laws. Additional laws and regulations have been proposed from time to time which could impose additional requirements or

restrictions on airline operations. Also, as the leading carrier in the domestic market, the operations of the Corporation are subject to stricter scrutiny by government agencies that regulate the airline industry and competitive practices in Canada than other airlines operating in Canada. Consequently, the Corporation may be the only airline subject to current and new regulations from these agencies.

In February 2001, the Minister of Transport announced its review of the current air services policy with the objective of liberalizing Canada's policy for scheduled international air services to potentially allow for additional Canadian competitors to have international route rights. Adoption of these or any other regulations by the federal government that would grant international routes to competitors of the Corporation or restrict the ability of the Corporation to offer competitive fares on any of its routes could significantly decrease the revenues or profitability of the Corporation.

Additionally, in February 2001, the Competition Bureau released for consultation draft guidelines outlining the approach it proposes to take in enforcing the abuse of dominance provision of the Competition Act as it applies to the airline industry. These guidelines, if implemented, would set out how the Competition Bureau would calculate whether Air Canada was operating or increasing capacity at fares that do not cover the avoidable cost of providing the services. They also describe uses of commissions, incentives, loyalty programs or corporate discounts that would be regarded as anti-competitive. The implementation of any of these limitations may have a material adverse effect on the Corporation's business, financial condition or results of operations.

Although these initiatives described above may provide some guidance to industry participants about how they may conduct their business, there is still sufficient uncertainty as to the regulatory framework governing the manner in which the Corporation may conduct its business. The Corporation cannot give any assurances that new regulations, or revisions to the existing regulations, that are materially adverse to the Corporation's operations, will not be adopted. See "Regulatory Environment – Recent Developments" for a further discussion of current and proposed regulations and policies for the Canadian airline industry.

Competition and Related Regulatory Matters

The Corporation operates within a highly competitive industry. If other carriers enter the Corporation's domestic market, it could have a material adverse effect on the Corporation's business, financial condition or results of operations. As a result of the "Open Skies" agreement between Canada and the United States in February 1995, U.S. carriers became able to operate routes in the Corporation's transborder market. If additional U.S. carriers were to enter the Corporation's transborder market, it could have a material adverse effect on the Corporation's business, financial condition or results of operations. Additionally, carriers have used discount fares to stimulate traffic during periods of reduced demand to generate cash flow and to increase market share. The Corporation's ability to reduce fares to compete with other carriers may be limited by government initiatives to encourage competition, which may have a material adverse effect on the Corporation's business, financial condition or results of operations.

As part of the Competition Bureau's efforts to enforce provisions of the Competition Act as they apply to the airline industry, on March 5, 2001, the Commissioner of Competition (the "Commissioner") filed an application with the Competition Tribunal under the abuse of dominance provisions of the Competition Act, seeking an order prohibiting Air Canada from operating or increasing capacity on seven routes in Eastern Canada if such capacity is operated or increased at fares that do not cover its avoidable cost of providing the service. If the avoidable cost test proposed by the Competition Bureau is accepted, the potential impact upon the way in which Air Canada operates across its system could be materially adverse to Air Canada and could impose unworkable constraints on its operations. If the Commissioner is successful in obtaining this order, Air Canada would be required to raise its fares on these routes, which could lead to reduced demand on these routes. If the Commissioner commences inquiries or brings similar applications with respect to significant other competitive domestic routes and such applications are successful, it could have a material adverse effect on Air Canada's results of operations or financial position. The hearings are to be resumed in the Fall of 2002. It is not possible to determine the potential outcome of the initiatives by the Competition Bureau.

Pursuant to certain amendments to the Canada Transportation Act passed in July 2000, the Canadian Transportation Agency (the "CTA") has the power, upon receipt of a complaint, to determine the reasonableness of passenger fares and cargo rates on routes within Canada where there is no or limited competition. As of May 1, 2002, approximately 25 domestic pricing complaints and 20 other complaints concerning terms and conditions of carriage have been forwarded to Air Canada for response. In March 2001, the CTA issued its first decision concerning the reasonableness of fares on a non-competitive route and determined that the lowest year-round fare offered by Air Canada on its services between Vancouver and Prince Rupert, British Columbia in August 2000 was unreasonable. The CTA subsequently decided not to order Air Canada to reduce its fare on the basis that Air Canada had already introduced a lower fare and a competing airline had initiated service on that route. Since then, the CTA has upheld the reasonableness of Air Canada's fares on six domestic routes. However, if a large number of complaints are successful, the Corporation may have to reduce its fares and/or its terms and conditions of carriage on a number of domestic routes. This could have an adverse effect on the Corporation's results of operations or financial position. See "Regulatory Environment - Domestic".

Terrorist Attacks

The occurrence of another terrorist attack (whether domestic or international and whether involving the Corporation or another entity) could have a material adverse impact on the Corporation, its finances and/or its operations.

Third Party War Risk Insurance

There is a risk that the Government of Canada may not continue to provide an indemnity for third party war risk liability coverage prior to the availability of a commercially reasonable alternative solution such as the International Civil Aviation Organization's ("ICAO") plan, which is currently under development. The objective of the ICAO plan is to set up a non-profit making single purpose insurance company which would cover third party war liability in excess of \$US 50 million. Initial support would be provided by the various governments, with their respective contributions based on their ICAO contribution percentage. Airlines would pay a premium on a per passenger segment basis. In the event that the Government of Canada does not continue to provide an indemnity for third party war risk liability coverage as described above, the Corporation may not have adequate third party war risk liability insurance, which could result in the grounding of aircraft. In addition, the replacement of the government indemnity may only be commercially available at extremely high costs. Both scenarios could have a material adverse effect on the Corporation's business, financial condition or results of operation.

Employee Relations

Most of the Corporation's employees are unionized. The collective bargaining agreements to which the Corporation is bound expire or are subject to expiry at various times in the future. The Corporation's inability to renew these contracts could result in work stoppages and other labour disturbances, which could have a material adverse effect on the Corporation. In 2002, Air Canada is renegotiating a collective agreement with approximately 8,500 of its flight attendants who are represented by CUPE. Negotiations commenced in the Fall of 2001 and will continue with the assistance of a mediator agreed to by the parties. In addition, labour problems at the Corporation's Star Alliance partners, including United Airlines, could result in lower demand for connecting traffic with Air Canada which could have a material adverse effect on the Corporation's business, financial condition or results of operations. Collective bargaining agreements covering a majority of unionized employees contain clauses that could restrict layoffs under certain circumstances.

Foreign Exchange

The financial results of airlines with international operations are highly sensitive to fluctuations in foreign exchange rates. The Corporation's financial results are sensitive to the changing value of the Canadian dollar. In particular, the Corporation has a significant annual net outflow of U.S. dollars and is affected by fluctuations in the Canada/U.S. dollar exchange rate. The Corporation incurs significant expenses in U.S. dollars for such items as fuel, aircraft rental charges, interest payments, debt repayments and computer reservations systems fees. Any significant further deterioration of the

Canadian dollar relative to the U.S. dollar would increase the unit costs of the Corporation relative to the U.S. competitors and have a material adverse effect on the Corporation's business, financial condition or results of operations.

Casualty Losses

Due to the nature of its business, the Corporation may be subject to liability claims arising out of accidents or disasters involving aircraft on which the Corporation's customers are travelling or involving aircraft of other carriers maintained or repaired by the Corporation, including claims for serious personal injury or death. Although the Corporation believes that it maintains adequate insurance, there can be no assurance that the insurance coverage will be sufficient to cover one or more large claims. Additionally, any accident or disaster involving one of the Corporation's aircraft or an aircraft of another carrier maintained or repaired by the Corporation could significantly harm the Corporation's reputation for safety, which would have a material adverse effect on the Corporation's business, financial condition or results of operations.

NAVCAN Strike

The air traffic controllers employed by NAV Canada and represented by CATCA have been without a collective agreement since March 31, 2001. On March 26, 2002, the Canada Industrial Relations Board ("CIRB") issued a decision pursuant to which it directed the parties to negotiate in order to reach an agreement. CATCA will not be entitled to declare a general strike until the process before the CIRB is completed which may take up to 6 months. Depending on which services would be affected by a general strike of the air controllers, this could have a material adverse effect on the Corporation's business, financial condition or results of operations.

V MANAGEMENT DISCUSSION AND ANALYSIS OF RESULTS

The information that appears under the heading "Management Discussion and Analysis of Results" ("MD&A") on pages 20 to 42 inclusively of the Air Canada 2001 Annual Report is incorporated herein by reference.

VI SELECTED CONSOLIDATED FINANCIAL INFORMATION

Three-year consolidated financial information for the Corporation is as follows:

	<u>Year ended December 31</u>		
	(millions)		
	<u>1999</u>	<u>2000</u>	<u>2001</u>
Operating revenues:			
Passenger.....	\$5,520	\$7,949	\$8,123
Cargo.....	387	542	578
Other.....	<u>536</u>	<u>805</u>	<u>910</u>
Total operating revenues	\$6,443	\$9,296	\$9,611
Operating expenses:			
Salaries and wages.....	1,503	2,159	2,495
Benefits.....	257	411	527
Aircraft fuel	622	1,371	1,593
Depreciation, amortization and obsolescence.....	311	408	441
Commissions	420	521	476
Food, beverages and supplies.....	264	367	435
Aircraft maintenance, materials and supplies	334	465	569
Airport and navigation fees.....	492	657	738
Aircraft rent.....	513	713	959
Other.....	<u>1,350</u>	<u>1,963</u>	<u>2,109</u>
Total operating expenses	<u>\$6,066</u>	<u>\$9,035</u>	<u>\$10,342</u>
Operating income before the undernoted item.....	\$ 377	\$ 261	\$ (731)
Non-recurring labour expenses	—	178	—
Operating income (loss)	<u>\$ 377</u>	<u>\$ 83</u>	<u>\$ (731)</u>
Non-operating income (expense):			
Net-interest expense.....	(154)	(210)	(275)
Other.....	<u>38</u>	<u>0</u>	<u>15</u>
Total non-operating income (expense).....	<u>\$ (116)</u>	<u>\$ (210)</u>	<u>\$ (260)</u>
Income (loss) before income taxes	\$ 261	\$ (127)	\$ (991)
Recovery of (provision for) income tax.....	<u>(121)</u>	<u>45</u>	<u>(263)</u>
Income (loss) for the year.....	<u>\$ 140</u>	<u>\$ (82)</u>	<u>\$ (1,254)</u>
Earnings:			
Earnings (loss) per Share (1)			
-basic	0.76	(0.69)	(10.43)
-diluted	0.75	(0.69)	(10.43)
EBITDAR before non-recurring labour expenses (2).	1,201	1,382	669
Cash Flow from Operations (3)	680	140	(1,072)

Total assets.....	6,796	9,732	8,901
Long-term debt and capital lease obligations (including current portion).....	2,414	3,300	3,939
Subordinated perpetual debt.....	882	840	807
Shareholders' equity (including convertible debentures)	363	316	(938)

- (1) Per share amounts have been calculated using the weighted average number of Common Shares and Class A Non-Voting Common Shares outstanding during the year.
- (2) "EBITDAR" is defined as earnings (operating income) before depreciation, amortization, aircraft rent and non-recurring labour expenses. The term "EBITDAR" used in this Annual Information Form does not have a standardized meaning prescribed by GAAP and therefore may not be comparable to similar measures presented by other publicly-traded companies. Air Canada uses "EBITDAR", which is a non-GAAP measure, to assess the operating performance of its on-going business. See MD&A for reconciliation of non-GAAP measures to GAAP measures.
- (3) Operating cash flow was: \$(691) million in 2001, \$202 million in 2000 and \$776 million in 1999, when cash outflows pertaining to scheduled aircraft lease payments in excess of aircraft rent expense are excluded.
- (4) The results of 2000 include the results of the former Canadian Airlines for the period July to December 2000. The results of 2001 include a full year of the former Canadian Airlines. Thus, these three years of results are not entirely comparable.

Quarterly consolidated financial information (unaudited) for the Corporation is as follows:

	4 th Qtr	3 rd Qtr	2 nd Qtr	1 st Qtr	4 th Qtr	3 rd Qtr	2 nd Qtr	1 st Qtr
	<u>2001</u>	<u>2001</u>	<u>2001</u>	<u>2001</u>	<u>2000</u>	<u>2000</u>	<u>2000</u>	<u>2000</u>
	(in millions except per share figures)							
Operating revenues:								
Passenger	\$1,732	\$2,208	\$2,215	\$1,968	\$2,172	\$2,691	\$1,732	\$1,354
Cargo	153	136	139	150	174	162	105	101
Other	<u>232</u>	<u>242</u>	<u>210</u>	<u>226</u>	<u>244</u>	<u>209</u>	<u>171</u>	<u>181</u>
Total operating revenues	2,117	2,586	2,564	2,344	2,590	3,062	2,008	1,636
Operating expenses	<u>2,425</u>	<u>2,644</u>	<u>2,636</u>	<u>2,637</u>	<u>2,858</u>	<u>2,763</u>	<u>1,775</u>	<u>1,639</u>
Operating income (loss)	(308)	(58)	(72)	(293)	(268)	299	233	(3)
Net income (loss)	\$(380)	\$(598)	\$(108)	\$(168)	\$(274)	\$101	\$124	\$(33)
Earnings (loss) per Share								
-basic	(3.16)	(4.97)	(0.90)	(1.40)	(2.28)	0.84	1.03	(0.27)
-diluted	(3.16)	(4.97)	(0.90)	(1.40)	(2.28)	0.72	0.88	(0.27)

The average number of Common Shares outstanding used in the calculation of earnings (loss) per Common Share is weighted on a quarterly basis. As a result, the sum of quarterly information per Common Share may not equal the annual information per Common Share for that year.

VII MARKET FOR THE NEGOTIATION OF SECURITIES

The Common Shares of the Corporation are listed on The Toronto Stock Exchange and the Class A Non-Voting Common Shares of the Corporation are listed on The Toronto Stock Exchange and quoted on the NASDAQ Stock Market.

Price Range and Trading Volume of Air Canada Shares

Common Shares

The following table lists the high and low market prices and trading volume of the Common Shares of Air Canada on The Toronto Stock Exchange, where applicable, for the periods indicated.

<u>Period</u>	<u>High</u>	<u>Low</u>	<u>Volume</u>
2002			
March	\$7.00	\$4.95	12,112,035
February	5.25	4.30	7,064,396
January	5.75	4.95	11,593,804
2001			
Fourth Quarter	\$5.78	\$1.64	121,892,500
Third Quarter	8.90	3.00	48,743,396
Second Quarter	10.70	7.50	31,795,869
First Quarter	14.60	7.45	43,292,640
2000			
Fourth Quarter	\$17.50	\$12.10	28,243,691
Third Quarter	20.50	14.40	31,067,015
Second Quarter	21.50	13.75	36,004,926
First Quarter	18.30	7.80	45,981,127

Class A Non-Voting Common Shares

The following table lists the high and low market prices and trading volume of the Class A Non-Voting Common Shares on The Toronto Stock Exchange, where applicable, for the periods indicated.

<u>Period</u>	<u>High</u>	<u>Low</u>	<u>Volume</u>
2002			
March	\$4.99	\$3.30	2,243,513
February	3.52	2.85	1,433,811
January	4.04	3.20	2,403,651
2001			
Fourth Quarter	\$3.93	\$1.15	20,765,300
Third Quarter	7.16	2.15	7,854,154
Second Quarter	8.65	6.00	9,837,545
First Quarter	12.40	6.00	14,718,633
2000			
Fourth quarter	\$15.45	\$10.00	4,376,137
Third quarter	18.10	11.75	8,359,069
Second quarter	19.25	11.90	8,582,354
First quarter	16.35	7.00	14,763,953

High and low prices of the Class A Non-Voting Common Shares quoted in US dollars and the trading volumes on the NASDAQ Stock Market are listed in the table below:

<u>Period</u>	<u>High</u> (US Dollars)	<u>Low</u> (US Dollars)	<u>Volume</u>
2002			
March	\$3.13	\$2.07	1,640,704
February	2.22	1.80	644,808
January	2.52	2.01	1,171,278
2001			
Fourth quarter	\$2.76	\$0.75	9,408,167
Third quarter	4.70	1.40	1,154,392
Second quarter	5.55	3.75	199,115
First quarter	8.25	3.75	440,607
2000			
Fourth quarter	\$10.00	\$6.25	336,386
Third quarter	12.13	8.03	338,943
Second quarter	12.75	7.94	388,799
First quarter	11.19	4.88	1,106,243

VIII DIVIDEND RECORD

The Corporation has not paid dividends on its Common Shares or Class A Non-Voting Common Shares in the last five years. Air Canada has no current plans to pay dividends on its Common Shares or Class A Non-Voting Common Shares. Its present dividend policy is to retain earnings to finance capital expenditures and other cash requirements. Air Canada's dividend policy will be reviewed periodically depending on the Corporation's financial position, cash flow from operations, earnings and other factors.

IX DIRECTORS AND OFFICERS

Directors

The name, municipality of residence and principal occupation of each of the directors are set forth below:

<u>Name and Municipality of Residence</u>	<u>Principal Occupation</u>	<u>Director Since</u>	<u>Common Shares</u>	<u>Class A Non-Voting Common Shares</u>
HON. W. DAVID ANGUS, Q.C. (1) (2) Montréal, Québec	Senior Partner Stikeman Elliott (Barristers & Solicitors)	March 1985	17,925	-
J.V. RAYMOND CYR, O.C, LL.D. (2) (3) Montréal, Québec	Chairman of Polyvalor Inc. (research and telecommunications company)	April 1990	12,925	3,125
JOHN F. FRASER, O.C. (2) (5) Winnipeg, Manitoba	Chairman of the Board Air Canada	April 1989	25,596	-
DAVID A. GANONG (3) (4) St. Stephen, New Brunswick	President Ganong Bros. Limited (chocolate and confectionery manufacturer)	August 1988	9,925	-
PIERRE MARC JOHNSON, B.A., LL.L, M.D., Ph.D. (hc), F.R.S.C. (1) (4) Montréal, Québec	Senior Counsel Heenan Blaikie (Canadian law firm)	May 2000	5,959	-
EVA LEE KWOK (4) (5) West Vancouver, British Columbia	Chair and Chief Executive Officer Amara International Investment Corp. (real estate investment, land development and cross- cultural development)	May 1998	7,208	1,000
FERNAND LALONDE, Q.C. (1) (2) Westmount, Québec	Counsel PouliotMercure (Barristers & Solicitors)	March 1988	8,925	-
HON. EDWARD C. LUMLEY, P.C. , LL.D. (3) (5) South Lancaster, Ontario	Vice Chairman BMO Nesbitt Burns (investment banking)	April 1994	8,925	-
ROBERT A. MILTON (4) Westmount, Québec	President and Chief Executive Officer Air Canada	August 1999	11,984	44,007

PAUL D. MITCHELL, LL.D. (1) (5) Waterloo, Ontario	Chairman of the Board (Retired) McNeil Consumer Healthcare Canada (pharmaceuticals)	March 1985	8,925	-
DAVID P. O'BRIEN (2) (3) Calgary, Alberta	Chairman of EnCana Corporation (oil and gas company)	May 1998	7,208	-
RONALD W. OSBORNE (4) (5) Toronto, Ontario	President and Chief Executive Officer Ontario Power Generation Inc. (hydro electric energy company)	May 1999	16,186	-
JOHN C. POPE (1) (3) Lake Forest, Illinois	Chairman of PFI Group (investment firm)	May 1999	6,186	5,000

-
- (1) Member of Audit Committee
 - (2) Member of Human Resources and Compensation Committee
 - (3) Member of Strategic Planning Committee
 - (4) Member of Investment Policy Committee
 - (5) Member of Corporate Governance and Nominating Committee

Each of the directors has held the principal occupation listed above in the last five years except as follows:

Prior to May 1997, John F. Fraser, O.C. was Vice Chairman of Russell Metals Inc. (formerly Federal Industries Ltd.). In September 1996, Pierre Marc Johnson joined the law offices of Heenan Blaikie as Senior Counsel and from October 1988 to September 1996, Mr. Johnson was Senior Counsel with the law firm of Guy & Gilbert while from 1989 to 1998, Mr. Johnson was Professor of law at McGill University; prior to January 1997, Eva Lee Kwok was President and Director of Amara International Corp. and in 1995-1996, Mrs. Lee Kwok was President and Managing Director of Melcorp Mercantile Inc.; prior to June 2001, Mr. Fernand Lalonde was counsel at the law firm Leduc Leblanc; prior to August 1999, Robert A. Milton was President and Chief Operating Officer, prior to May 1999, Mr. Milton was Executive Vice President and Chief Operating Officer; prior to April 2002, Mr. David O'Brien was Chairman and Chief Executive Officer of PanCanadian Energy Corporation and prior to October 2001, Mr. O'Brien was Chairman President and Chief Executive Officer of Canadian Pacific Limited; prior to March 1998, Ronald W. Osborne was President and Chief Executive Officer of Bell Canada Inc., prior to September 1997, Mr. Osborne was President of BCE Inc. and prior to May 1996, Mr. Osborne was Executive Vice President and Chief Financial Officer of BCE Inc.; prior to November 1999, John C. Pope was Chairman of MotivePower Industries.

At the May 14, 2002 shareholders' meeting, the directors were elected until the next annual meeting of shareholders or until their successors are appointed or elected. The Corporation does not have an executive committee of the Board of Directors.

Officers

The name, municipality of residence, position held with Air Canada and years of industry experience of each of the officers are as set forth below:

<u>Name and Municipality of Residence</u>	<u>Position held</u>	<u>Years of Airline Industry Experience</u>
J.M. BAKER..... Westmount, Québec	Senior Vice President & General Counsel	7
W.G. BREDT..... Hudson Heights, Québec	Vice President, Safety, Security & Environment	28
M. BREWER..... Dorval, Québec	Executive Vice President, Commercial	21
P. BROTTA..... Pointe-Claire, Québec	Executive Vice President, Planning & Cost Management	30
R.J. DUCHESNE..... Montréal, Québec	President and Chief Executive Officer, <i>Aeroplan</i>	16
L. FOURNEL..... Lachine, Québec	President and Chief Executive Officer, <i>destina.ca</i>	23
P.R. GARRATT..... Austin, Québec	Vice President, Financial Planning & Controller	36
R.G. GIGUERE..... Mississauga, Ontario	Executive Vice President, Operations	28
K. HOWLETT..... Delta, British Columbia	Vice President, Labour Relations	29
A. KEUNG..... Saint-Laurent, Québec	Vice President, Information Technology & Chief Information Officer	18
P. LÉTOURNEAU, Q.C. Saint-Laurent, Québec	Vice President and Corporate Secretary	22
G.R. MACCORMACK..... Montréal, Québec	Senior Vice President, International and Alliances	35
N. MANGER..... Pointe-Claire, Québec	Vice President, Airports	30
S. MARKEY..... Rockliffe Park, Ontario	Vice President, Government Relations & Regulatory Affairs	7
R.A. MILTON..... Westmount, Québec	President & Chief Executive Officer	19

C. MORIN..... Montréal, Québec	Vice President, Cargo	17
A. PATERSON..... Oakville, Ontario	President & Chief Operating Officer, Air Canada Vacations	15
M.R. PETERSON..... Beaconsfield, Québec	Executive Vice President & Chief Financial Officer	28
D.D. PORT..... Etobicoke, Ontario	Senior Vice President, Customer Service	31
D. POUDRETTE..... Verdun, Québec	Vice President, Corporate Initiatives	17
R. REID..... Oakville, Ontario	Vice President, System Operations Control	25
M. ROSENBERG..... Toronto, Ontario	Vice President, Sales and Product Distribution	32
C. ROVINESCU..... Westmount, Québec	Executive Vice President, Corporate Development & Strategy	14
S. WELSCHEID..... Montréal, Québec	Vice President, People	22
R. WOHSIGL..... Beaconsfield, Québec	President, Air Canada Technical Services	12

All the above officers of Air Canada have been engaged in their present occupation, or have been actively engaged in the affairs of Air Canada or related companies in executive or other capacities, in both instances for more than five years, except for C. Rovinescu who, prior to April 2000, was Managing Partner of Stikeman Elliott, Montréal; R. Wohnsigl who, prior to August 1997, was Vice President, Aircraft Maintenance at US Airways Group, Inc.; Montie Brewer who, prior to 2002, was Senior Vice President – Planning at United Airlines and, prior to 2001 was President of United Shuttle and Vice President, Alliances for United Airlines; Kevin Howlett, who prior to 2002 was Vice President, Labour Relations and Corporate Safety at Air Canada Regional Inc. and, prior to 2000, was Vice President, Labour Relations at Canadian Airlines International Inc.; and, Allister Paterson, who, prior to 2002 was Executive General Manager, Commercial at Air New Zealand Group and, prior to 1998 was Vice President, Sales North America at Canadian Airlines International Inc.

From January 4, 2000 to July 5, 2000, R.A. Milton, C. Rovinescu and M.R. Peterson were directors of Canadian Airlines Corporation and P. Brotto was an officer of CAC.

As at the date hereof, the directors and officers of Air Canada as a group hold 0.20% of the Common Shares of Air Canada.

X RESTRICTIONS ON VOTING SECURITIES

Pursuant to the Air Canada Public Participation Act, Air Canada is required, *inter alia*, to include in its Restated Articles of Incorporation certain constraints on the issue, transfer, ownership and voting of its Common Shares.

The Corporation's Restated Articles of Incorporation provide that the Corporation may not accept subscriptions for voting shares, issue voting shares, register or recognize the transfer of voting shares or the purchase or otherwise the acquisition of voting shares of Air Canada if, as a result of such subscription, issue, transfer or purchase, voting shares of Air Canada to which are attached, in the aggregate, more than 25% (or any higher percentage that the Governor in Council may, by regulation, specify) of the votes that may ordinarily be cast to elect directors of Air Canada are or would be held, beneficially owned or controlled, directly or indirectly, by non-residents of Canada. In addition, such Articles provide that the total number of votes cast by or on behalf of non-residents at any meeting shall not be greater than 25% (or any higher percentage that the Governor in Council may, by regulation, specify) of the total number of votes, which may be cast at such meeting.

Air Canada's Restated Articles of Incorporation also provide restrictions similar to the ones described above with respect to subscriptions, issues, transfers or purchases which would cause Air Canada to cease to be Canadian as defined in the Canada Transportation Act. The applicable provisions of the Canada Transportation Act require that holders of scheduled domestic, scheduled international and non-scheduled international licences be Canadian, that is, in the case of the Corporation, that it be controlled in fact by Canadians and that at least 75% of its voting interests be owned and controlled by Canadians, as this term is defined in such Act.

The constraints on ownership rights contained in Air Canada's Articles require Air Canada to refuse to recognize all ownership rights which would otherwise be attached to any voting shares held contrary to such constrained share provisions, by deeming all such shares to be struck from the register of securities

The constraints described above do not apply to voting shares held by way of security only. Furthermore, they do not apply to voting shares of Air Canada held by one or more underwriters solely for the purpose of distributing the shares to the public, or by any person acting as an intermediary in the payment of funds or the delivery of securities in connection with trades in securities and providing centralized facilities for the clearing of trades in securities.

Air Canada's Restated Articles of Incorporation grant to the Board of Directors all powers necessary to give effect to the ownership restrictions, including all powers contemplated by the provisions of the Canada Business Corporations Act and regulations thereunder relating to constrained share corporations.

Air Canada has adopted various procedures and processes with respect to the transfer of shares to ensure that the 25% limitation on non-resident ownership of voting shares is respected. In addition, Air Canada has adopted such procedures and processes in order to monitor the number of its voting shares owned by Canadians under the Canada Transportation Act to ensure that the provisions of that statute are respected.

Further details concerning Air Canada's restrictions on voting securities, including applicable definitions, are provided in the Air Canada Notice of Annual Meeting of Shareholders and Management Proxy Circular dated March 13, 2002 (the "Proxy Circular").

XI ADDITIONAL INFORMATION

Additional information, including directors' and officers' remuneration, indebtedness of officers, executive stock options and interests of management and others in material transactions, where applicable, is contained in the Proxy Circular. Financial information, including consolidated comparative audited financial statements, is provided in the Air Canada 2001 Annual Report.

The following documents can be obtained upon request from the Vice President & Corporate Secretary of Air Canada, Air Canada Headquarters Building, Air Canada Centre, P.O. Box 14000, Station Airport, Dorval, Québec, H4Y 1H4:

- (i) this Annual Information Form, together with any document incorporated herein by reference;
- (ii) the Annual Report of Air Canada and any interim financial statements filed with Securities Commissions subsequent to the audited financial statements for Air Canada's most recently completed financial year;
- (iii) the Proxy Circular; and
- (iv) any other documents that are incorporated by reference into a preliminary short form prospectus or a short form prospectus pursuant to which securities of Air Canada are in the course of a distribution.

Except when securities of Air Canada are in the course of distribution pursuant to a short form prospectus or a preliminary short form prospectus, Air Canada may require the payment of a reasonable charge from persons, other than security holders of Air Canada, requesting copies of these documents.