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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;

Code-share or Code-sharing: Refers to a commercial agreement between air carriers where an air carrier sells air transportation under its own 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 to identify products or services offered by the Corporation: Aeroplan, Air Canada Jetz, Air Canada Jazz, ZIP, ACTS, Destina.ca, Acetek, Air Canada Vacations, Executive First, Executive Class, AC Expedair, AC Priority, AC Air Freight, AC Lynx, 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").

TABLE OF CONTENTS

IA THE CORPORATION	3	III DESCRIPTION OF THE BUSINESS OF THE CORPORATION.....	24
Incorporation.....	3	Passenger Operations and Route Networks.....	24
Corporate Structure.....	4	Domestic	25
IB REGULATORY ENVIRONMENT.....	4	Transborder (Canada — United States).....	26
Domestic Services	5	International	26
Transborder Services	6	Products and Services	27
International Services	7	Cargo Operations	28
Charter Services	7	Other Operations.....	29
Security Initiatives.....	8	Aeroplan.....	29
IC INDUSTRY OVERVIEW AND COMPETITIVE ENVIRONMENT	9	Destina.ca	30
Domestic Market	9	Technical Services	30
Transborder and International Markets	9	Other Revenues	31
II DEVELOPMENT OF THE BUSINESS OF THE CORPORATION	10	Star Alliance and Other Alliances	31
Corporate Profile	10	United Airlines	32
Filing for Protection Under CCAA.....	11	Lufthansa.....	32
Progress in the Restructuring Process.....	12	Fleet Overview	32
DIP Financing	12	Widebody Aircraft	33
CIBC Financing.....	13	Narrowbody Aircraft (Air Canada and ZIP).....	33
Amex Agreements.....	13	Regional Jet and Turboprop Aircraft (Air Canada and Air Canada Jazz).....	34
Real Estate Facilities and Contracts Renegotiation and/or Repudiation.....	13	Fuel	34
Equity Solicitation Process	13	Insurance.....	34
Standby Purchase Agreement	15	Employees.....	34
Negotiations with Aircraft Lessors.....	16	Properties and Facilities	36
Global Restructuring Agreement	16	IV MANAGEMENT DISCUSSION AND ANALYSIS OF RESULTS.....	37
New Fleet	16	V SELECTED CONSOLIDATED FINANCIAL INFORMATION.....	38
Settlement of Pilots' Arbitration Proceedings	17	VI MARKET FOR SECURITIES	39
Arrangements with Unions.....	17	VII DIVIDEND RECORD	39
Pension Plans	18	VIII DIRECTORS AND OFFICERS	39
Greater Toronto Airports Authority	19	Directors	39
Three-Year Summary: Evolution of Business	19	Officers	41
Integration of Canadian Airlines	19	IX RESTRICTIONS ON VOTING SECURITIES	43
Economic Environment	20	X ADDITIONAL INFORMATION.....	44
Regulatory Environment	21	Evaluation of Disclosure Controls and Procedures	45
Asset Sales	21		
Business Process Re-engineering.....	21		
Fleet and Capacity Initiatives.....	22		
Subsidiaries and Divisions.....	23		
Aeroplan.....	23		
ZIP.....	23		
Air Canada Jazz	23		

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 following which Air Canada became entirely publicly-owned.

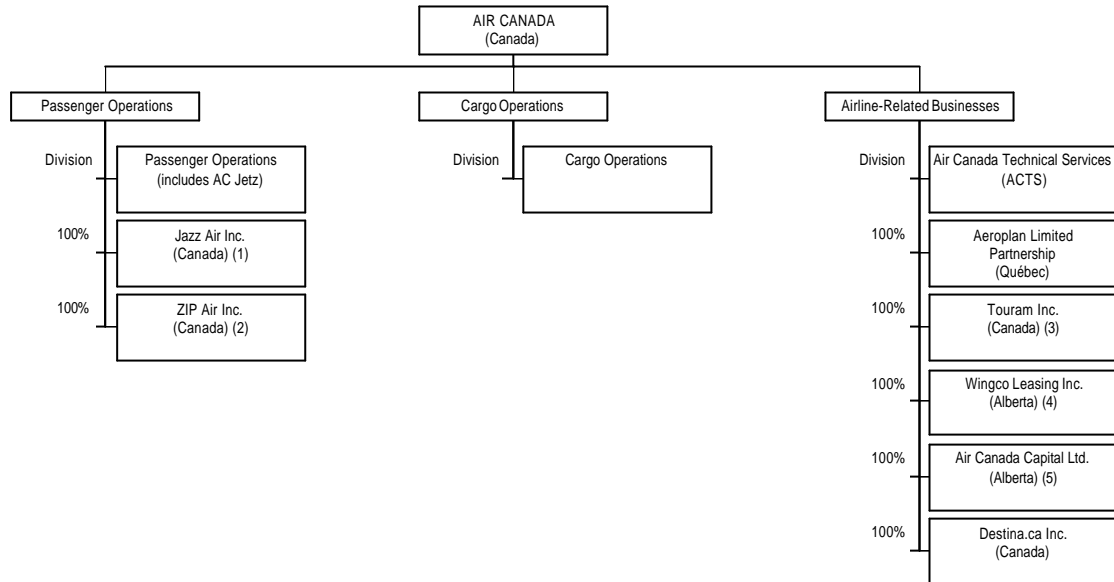
Air Canada's Articles were amended by Articles of Amendment in May 1994, in order to create a new class of shares designated as Class A Non-Voting Common Shares. In December 1999, the Articles were further amended to create Class A Convertible Non-Voting Preferred Shares, Series 1 and Series 2, and the 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 again amended to modify individual ownership restrictions applicable to the Common Shares of Air Canada and further amended and restated in order to remove such individual ownership restrictions in February 2002.

The Common Shares and the Class A Non-Voting Common Shares of Air Canada are listed on The Toronto Stock Exchange, under the symbols "AC" and "AC.A", respectively.

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) Jazz Air Inc. (formerly Air Canada Regional Inc.) operates under one brand name, Air Canada Jazz, since April 1, 2002.
- (2) ZIP Air Inc. carries on business under the name ZIP. Operations commenced in September 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 Jazz Air Inc. and third party airlines operating under capacity purchase agreements.
- (5) Air Canada Capital Ltd. is a company whose main business is the leasing of aircraft to Air Canada and ZIP Air Inc.

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 the Corporation, 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 the Corporation at December 31, 2003, have been omitted.

IB REGULATORY ENVIRONMENT

In Canada, commercial air transportation, including policy, maintenance standards, operations standards, safety and ground and navigation facilities, falls 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, all major Canadian airports are operated by local airport authorities that are also privatized companies.

The *National Transportation Act*, 1987 significantly reduced the economic regulation of the domestic airline industry and 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, 1987* applicable to air carriers remained in force. The NTA was renamed the Canadian Transportation Agency ("CTA"). The CTA continues to exercise licensing authority.

Domestic Services

The 1987 deregulation of the domestic airline industry allowed carriers to establish fares and conditions of carriage without government regulation in Southern Canada and with reduced regulation in Northern Canada. On non-competitive routes, the CTA was given the power, on receipt of a complaint, to disallow certain fare increases. In 1996, the remaining regulation in Northern Canada was eliminated. Under the *Canada Transportation Act*, there is free market entry provided a carrier can show that: (i) it is "Canadian", defined in the Act as being controlled in fact by Canadians and having at least 75% of its voting interests owned and controlled by Canadians; (ii) it can operate safely; (iii) it is suitably insured; and (iv) it meets the minimum financial requirements set out in the *Air Transportation Regulations*.

In July 2000, the Government of Canada amended the *Canada Transportation Act*, the *Competition Act* and the *Air Canada Public Participation Act* to address the competitive airline environment in Canada and ensure protection for consumers. The amending 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 Commissioner of Competition whereby Air Canada, in connection with the acquisition of Canadian Airlines International Limited ("CAIL"), accepted certain conditions in order to promote and maintain airline competition in Canada.

One of the new powers granted was the ability of the Commissioner of Competition to issue cease and desist orders against alleged anti-competitive behaviour of domestic air carriers. Air Canada challenged this power before the courts in the Province of Quebec on the basis that it was unconstitutional. On January 16, 2003, the Quebec Court of Appeal rendered its decision declaring this power as being inoperative since it conflicted with the due process provisions of the *Canadian Bill of Rights*. Leave to appeal has been granted to the Federal Government of the Quebec Court of Appeal's decision. 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, CAIL or any of their wholly-owned subsidiaries for a three-year period as well as commitments to employees regarding involuntary layoffs or involuntary relocations. The commitments made by Air Canada to the Minister of Transport expired on January 4, 2003.

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. The Competition Bureau has advised, however, that it will not finalize the guidelines until the Competition Tribunal has reached a decision in a case brought in March 2001 by the Commissioner of Competition 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 if such fares would not cover its "avoidable cost" of providing this service. By agreement of Air Canada and the Commissioner of Competition, the application was divided into two phases. Phase I was a technical exercise involving a review of all of Air Canada's costs over time periods from April 2000 to March 2001 and a determination of which of those cost items would be considered avoidable costs. The Competition Tribunal released its reasons on findings regarding Phase I on July 22, 2003. Although the decision does not constitute a determination that Air Canada breached the *Competition Act* by abusing its dominant position, which is an issue to be determined in Phase II of the application, the broadly crafted avoidable

cost test adopted by the Competition Tribunal in its July 22, 2003 decision could be materially adverse to Air Canada and could impose unworkable constraints on its operations.

In June 2002, the Government of Canada proclaimed into force Bill C-23, an Act to amend the *Competition Act*. Bill C-23, among other things, gives individuals the right to seek relief directly from the Competition Tribunal (instead of first dealing with the Competition Bureau) with regards to exclusive dealing, tied selling, market restriction and "refusal to deal" practices. The Competition Tribunal has also been given the authority to levy a penalty of up to \$15 million against a domestic air carrier if the Competition Tribunal finds that the carrier has abused its dominant position in the market.

On April 27, 2004, the Government of Canada amended the Canadian Computer Reservation Systems (CRS) Regulations to lessen the regulatory requirements and place greater reliance on market forces in the distribution system that will result in market efficiencies and reduced costs for airlines. With the amendments, airlines with at least 10% market share are no longer required to participate in all CRSs operating in Canada and have the freedom to select the levels of participation that best serve their operations. Also, all airlines and CRS vendors are now permitted to freely negotiate fees on strictly commercial terms.

Transborder Services

In February 1995, a new air services agreement, the Open Skies 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, Montreal and Vancouver over a maximum three-year phase-in period, which ended in February 1998. Unlimited Code-sharing was allowed between any city in Canada and the United States, except for Code-share services to/from Toronto, Montreal and Vancouver, where certain restrictions applied during the transition period. The carriage of local traffic between points within one country by carriers of the other country continues to be prohibited.

Under the Open Skies 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 on specific routes. In September 1997, the U.S. Department of Transportation granted Air Canada and United Airlines anti-trust immunity for their marketing alliance. This authority has allowed the two carriers 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. The carriers re-submitted their alliance agreement for review in September 2002 and the U.S. Department of Transportation did not provide any comment or raise any issue.

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

International Services

Scheduled international air services are regulated by the Canadian and foreign governments involved. The Minister of Transport has the authority to designate which Canadian air 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 carriers may operate, including, among others, the number of carriers 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 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 countries.

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 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.

In May 2002, the Minister of Transport introduced a liberalized multiple designation policy applicable to scheduled international air services by Canadian carriers (excluding services to the United States). Previously, only one Canadian carrier could be designated to serve a foreign country market not exceeding 300,000 one-way scheduled passenger trips per year. Today, any Canadian carrier may apply to be designated to serve any foreign country, regardless of the size of the air travel market. If the number of Canadian carriers permitted is restricted under existing bilateral agreements, the Canadian government has indicated that it will pursue negotiations with the appropriate countries to seek the necessary rights for Canadian carriers.

In addition, an incumbent carrier's designation in a particular market will be subject to reallocation only in circumstances where the bilateral agreement limits designation and the carrier is not operating its own aircraft or Code-share services. The Minister of Transport also announced that other issues raised during the 2001 international air services policy review such as Canada's approach to bilateral negotiations would be reconsidered when the Canadian airline industry recovers from the economic downturn and the events of September 11, 2001.

In 2003, the European Union and the United States commenced air transport negotiations aimed at further liberalizing Europe-U.S. air services. While several European Union members already have open skies agreements in force with the United States, four members maintain more restrictive bilateral agreements in terms of market access and pricing. Several rounds of negotiations have been held but it is uncertain whether the talks will yield a new multilateral agreement and when such agreement might be reached. Although there was some discussion about having Canada observe these negotiations, Canada is not attending the negotiations.

Charter Services

Charter operations are generally not covered by bilateral agreements, although charter services are covered under the Canada-U.S. Open Skies Agreement. Canadian government policy permits any Canadian carrier 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 operated 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.

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

Security Initiatives

Following the September 11, 2001 terrorist attacks, the Minister of Transport issued new air security measures, including increased passenger and baggage screening and enhanced security procedures at check-in gates and on board the aircraft. Other countries served by Air Canada, such as the United States and the United Kingdom, imposed similar security requirements. Air Canada's priority has been to ensure the safety and security of all passengers and crew members 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. The air traveller's security charge was introduced on April 1, 2002 and effective March 1, 2003, was reduced to \$14 from \$24 per round-trip, for domestic travel in Canada. On April 1, 2004, the charge was further reduced to \$12 for domestic travel, and \$20 for transborder and international travel.

In October 2002, the Canada Revenue Agency implemented its Advance Passenger Information initiative to identify potentially high-risk individuals and address other border security issues. In March 2003, it also established a Passenger Name Record program. Canadian and foreign carriers are now required by regulation to provide the Minister of National Revenue with specific personal information on all passengers and crew members on board international flights destined to Canada at the time of departure, as well as to provide, upon request, access to passenger name records in the carriers' internal reservation systems. The United States, the United Kingdom, Australia, New Zealand, Mexico and South Korea have proposed similar information requirements with respect to flights operating into and/or from their territory.

On May 6, 2004, Bill C-7, an Act to amend certain Acts of Canada in order to enhance public safety (known as the *Public Safety Act*, 2002) received royal assent. The legislation amends certain provisions of the *Aeronautics Act* so as to further develop the scope and objectives of the existing national aviation security regime. The amendments include requirements for Canadian carriers and foreign carriers operating into Canada to provide, upon request, information concerning specified flights or persons to the Minister of Transport, Royal Canadian Mounted Police and Canadian Security Intelligence Service for transportation security or national security purposes. These amendments came into force on May 11, 2004.

IC INDUSTRY OVERVIEW AND COMPETITIVE ENVIRONMENT

Domestic Market

The Corporation is Canada's largest domestic full service airline. Based on February 2004 Official Airline Guide ("OAG") data, the Corporation provided for approximately 52% of the total number of domestic scheduled seats available in the first quarter of 2004. In the Canadian market, the Corporation competes with several scheduled and charter airlines most of which are low-cost airlines. In 2003, WestJet, a low-cost carrier based in Western Canada, and the Corporation's largest scheduled domestic competitor, expanded its domestic ASM capacity by approximately 48%.

The following table shows the combined domestic and international traffic growth in RPMs, the capacity growth in ASMs, and the annual percentage changes for the period 1993-2002 for Canadian scheduled carriers:

	<u>Scheduled Service</u>			
	RPMs⁽¹⁾ (billions)	RPM Growth (%)	ASMs⁽¹⁾ (billions)	ASM Growth (%)
2002.....	49.7	(8.9)	66.3	(11.5)
2001 ⁽²⁾	54.5	(2.2)	74.9	(3.3)
2000.....	55.8	15.8	77.5	12.5
1999.....	48.2	3.4	68.9	3.5
1998.....	46.6	8.6	66.6	9.4
1997.....	42.9	9.2	60.9	3.0
1996.....	39.3	15.9	59.1	11.1
1995.....	33.9	16.1	53.2	15.2
1994.....	29.2	7.4	46.2	8.5
1993.....	27.2	(2.5)	42.6	(3.2)

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

(2) 2001 numbers were restated by the Aviation Statistics Centre.

Transborder and International Markets

Competition in the transborder market is primarily from the major U.S. airlines. Based on February 2004 OAG data, the Corporation provided for approximately 43% of the total number of transborder scheduled seats available in the first quarter of 2004. Management believes that over one-half of transborder passengers are Canadian, which helps support the Corporation's market position. U.S. airlines with transborder operations include American Airlines, Delta Airlines, Continental Airlines and United Airlines. 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. Major U.S. carriers introduced numerous transborder non-stop services throughout 2003, as the domestic marketplace remained sluggish. With respect to the South American market, there is no significant direct competition from the local carriers.

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 February 2004 OAG data, the Corporation provided for approximately 51% of the total number of international (excluding the U.S.) scheduled seats available in the first quarter of 2004. In the premium business travel segments, some airlines are 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 ICAO forecasts, for the period 2003 to 2005, growth in traffic (as measured by RPMs) is estimated to be the following: approximately 9.9% in the North American market, approximately 10.6% in the Trans-Atlantic market and approximately 12.0% in the Trans-Pacific market.

Since 1993, 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> (billions)	<u>RPM Growth</u> (%)	<u>ASMs⁽¹⁾</u> (billions)	<u>ASM Growth</u> (%)
2002	1,828.7	0.4	2,569.3	(2.6)
2001	1,820.8	(2.9)	2,639.0	(0.3)
2000	1,874.9	7.8	2,646.2	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

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

II DEVELOPMENT OF THE BUSINESS OF THE CORPORATION

Corporate Profile

Air Canada is Canada's largest domestic and international full service airline and the largest provider of scheduled passenger services in the domestic market, the Canada-U.S. market as well as in the Canada-Europe and Canada-Pacific markets. Air Canada operates a significant domestic, transborder and international network. Passenger transportation is the principal business of Air Canada and, in 2003, represented 82% of its total operating revenues. During 2003, Air Canada, ZIP Air Inc. ("ZIP") and Air Canada Jazz operated, on average, approximately 1,246 scheduled flights each day and carried approximately 28 million passengers with a fleet of 308 aircraft. At December 31, 2003, Air Canada provided direct passenger air transportation to 148 destinations and, through commercial agreements with other affiliated regional airlines, an additional 17 destinations were served, for a total of 165 direct destinations on five continents. Air Canada's primary hubs are located in Toronto, Montreal and Vancouver. Toronto's Pearson International Airport ("Pearson") is Air Canada's largest hub and, in 2003, its passengers accounted for approximately 56% of daily passenger traffic at Pearson. Air Canada is the

principal tenant in Pearson's Terminal 1 New and Terminal 2. In April 2004, Air Canada moved its domestic operations and international check-in to Terminal 1 New, the first phase of the new passenger handling facilities at Pearson. Air Canada operates a hub at Montreal's Pierre-Elliott Trudeau International Airport and, in 2003, its passengers accounted for approximately 52% of Montreal's passenger traffic. Montreal is a hub for domestic, transborder and international (primarily trans-Atlantic) traffic. In 2003, Air Canada further strengthened its Montreal hub by adding new non-stop links and frequencies on high volume markets. Air Canada also operates a hub at Vancouver's International Airport and, in 2003, its passengers accounted for 50% of Vancouver's passenger traffic. Vancouver is a hub for domestic, transborder and international (primarily Trans-Pacific) traffic.

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. The other members of Star Alliance include United Airlines, Lufthansa, SAS, Thai Airways, VARIG, Air New Zealand, All Nippon Airways, Singapore Airlines, British Midland ("bmi"), Austrian Airlines (including Lauda Air and Tyrolean Airways), Asiana Airlines, Spanair, LOT Polish Airlines and U.S. Airways. Through its strategic and commercial partnerships with Star Alliance members and several other airlines, Air Canada offers service to over 700 destinations.

Aeroplan Limited Partnership ("Aeroplan"), is a limited partnership owned by the Corporation. Aeroplan, the Corporation's loyalty program, rewards members with travel rewards both for flying on Air Canada (ZIP and Air Canada Jazz) 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.

Destina.ca, is the Corporation's wholly-owned on-line travel site and is a major partner of Aeroplan. Destina.ca rewards customers with Aeroplan miles for on-line purchases and features Canadian content and time saving functions for booking air transportation, hotels and car rental.

ZIP, the Corporation's low-fare carrier, is based in Calgary with its own management and fleet. ZIP operates replacement flying on short-haul routes, with connections to and from the Corporation's worldwide network.

The Corporation holds a 100% interest in Touram Inc., which operates under the name Air Canada Vacations, a major Canadian tour operator.

Air Canada Technical Services, a division of Air Canada, provides maintenance, engineering and repair services to the Corporation's aircraft fleet and maintenance services to third parties. The major maintenance facilities of the Corporation are located in Toronto, Montreal, Vancouver, Calgary and Winnipeg.

The Corporation provides other airlines with ground handling and other contract services.

Filing for Protection Under CCAA

On April 1, 2003 Air Canada obtained an initial order from the Ontario Superior Court of Justice (the "Court") providing creditor protection under the *Companies Creditors Arrangement Act* ("CCAA"). The initial order was further amended by the Court throughout the CCAA proceedings based on motions from Air Canada, its creditors and other interested parties. On April 1, 2003, Air Canada, through Ernst & Young Inc., its Court-appointed monitor ("Monitor"), also made a concurrent petition for recognition and ancillary relief under Section 304 of the U.S. Bankruptcy Code. The CCAA and U.S. proceedings cover Air Canada and the following of its wholly-owned subsidiaries: Jazz Air Inc., ZIP Air Inc.,

3838722 Canada Inc., Air Canada Capital Ltd., Manoir International Finance Inc., Simco Leasing Ltd., and Wingco Leasing Inc. (collectively, the "Applicants"). Aeroplan, Touram Inc. and Destina.ca are not included in the CCAA filing. These three subsidiaries continue dealings with their creditors on a normal basis, unaffected by the CCAA and U.S. proceedings.

The initial order and U.S. proceedings has a general stay of proceedings against the Applicants. This stay generally precludes parties from taking any action against the Applicants for breach of contractual or other obligations. The Applicants have obtained extensions of the general stay of proceedings granted pursuant to the initial order to May 21, 2004; such period may, if necessary and at the discretion of the Court, be further extended. The purpose of the stay period order is to provide the Applicants with relief designed to stabilize their operations and business relationships with customers, vendors, employees and creditors and to allow the Corporation to develop a process for soliciting new equity or other post emergence financing. During the stay period, Air Canada has developed its revised business plan and negotiated new arrangements with creditors (including aircraft lessors) and labour unions with a view to having those arrangements completed prior to proposing a final plan of arrangement ("Plan of Arrangement").

The Applicants are continuing their operations with the consent and assistance of the Monitor and under the provisions of the Court orders. The Applicants are restructuring their capitalization, operations and cost structure and will propose a Plan of Arrangement, which will be submitted to the Court for confirmation after submission to the Applicants' creditors for approval.

The CCAA filing triggered defaults on substantially all of the Applicants' debt and lease obligations. The stay period order stays most actions against the Applicants, including employee group actions and most actions to collect pre-filing indebtedness or to exercise control over the Applicants' property. The order also grants the Applicants with the authority to, among other things, a) pay outstanding and future employee wages, salaries and employee benefits and other employee obligations; b) honour obligations related to airlines tickets and Aeroplan redemptions; and c) honour obligations related to the Applicants' interline, clearing house, Code-sharing and other similar agreements.

Progress in the Restructuring Process

The Applicants' restructuring plan consists mainly of (i) restructuring their capitalization and balance sheet through the compromise and settlement of the creditors' claims pursuant to the CCAA and the Plan of Arrangement, (ii) the restructuring of the operations through cost reduction initiatives, including the renegotiation of collective agreements, aircraft leases, real property leases and various commercial agreements, (iii) the reorientation of the product strategy to be effected mainly through a new product offering and the utilization of an appropriate fleet so as to effectively respond to prevailing industry conditions, and (iv) the completion of new financing for the overall exit financing needs, including a rights offering, financing from certain lenders and, possibly, an investment agreement with an equity sponsor.

The Applicants have made progress in their restructuring process since the date of filing, as described below.

DIP Financing

As of April 1, 2003, Air Canada obtained a secured revolving credit facility from GE Canada Finance Holding Company made up of a credit advance facility and a letter of credit facility with a maximum combined borrowing of up to U.S.\$700 million. The facility has a term that expires on the earlier of (i) the date of implementation of the Plan of Arrangement, and (ii) the prepayment in full by

Air Canada of all amounts outstanding under the facility and the termination of the lender's commitments under the facility. The terms of the credit facility were approved by the Court on April 1, 2003. As at March 31, 2004, the maximum amount available under the combined facilities was \$917 million of which \$300 million was drawn against the credit advance facility and letters of credit totalling \$19 million were issued against the letter of credit facility. The combined unused and accessible amount under the combined facilities was \$598 million at March 31, 2004.

CIBC Financing

Air Canada, for and on behalf of Aeroplan, and the Canadian Imperial Bank of Commerce ("CIBC") entered into a new co-branding credit card agreement which was approved by the Court on May 14, 2003, and is effective since June 11, 2003. Pursuant to the new co-branding credit card agreement, Aeroplan sells loyalty points to CIBC to be redeemed by customers for flights on Air Canada. The new agreement modifies the terms of the original co-branding credit card agreement between the parties by, among other things, increasing the amount paid to Aeroplan by CIBC for loyalty points and relaxing the exclusivity provisions.

CIBC also provided a commitment to Air Canada of up to \$350 million, pursuant to the terms and conditions of a credit agreement dated as of June 6, 2003 (the "CIBC Credit Agreement"). The obligations of Air Canada under the CIBC Credit Agreement were guaranteed by Aeroplan. The outstanding amount under the CIBC Credit Agreement was repaid in full, through the sale of loyalty points in the ordinary course, by April 30, 2004.

Amex Agreements

On December 22, 2003, Air Canada, Aeroplan and Amex Bank of Canada ("Amex") announced they had entered into a co-branding charge card agreement and a Membership Rewards agreement (collectively the "Amex Agreements"). The Amex Agreements provide Amex with the right to issue co-branded Aeroplan charge cards and to purchase from Aeroplan loyalty points to be allocated to users of the Amex charge cards and to be redeemed for flights on Air Canada. Amex will pay a price per loyalty point which is comparable to the price charged by Aeroplan under similar contracts. Under the terms of the Amex Agreements, Amex has also provided Air Canada with an \$80 million non-revolving credit facility to be repaid, at Amex's option, as loyalty points are purchased or as amounts are due to Air Canada and Aeroplan under the Amex Agreements. Any balance outstanding under the Amex facility is due on January 5, 2006.

Real Estate Facilities and Contracts Renegotiation and/or Repudiation

During the restructuring period, the Corporation has reviewed its real estate facilities with a view to eliminate unused or under-utilized facilities and to consolidate its operations to further reduce operating costs. As a result of this review, a total of 46 real property leases have been repudiated or assigned since April 1, 2003. In addition, the Corporation also evaluated all of its contracts for goods and services to identify opportunities to consolidate its supply base, to better leverage its buying power, and to take advantage of the opportunity to repudiate contracts that were unfavourable.

Equity Solicitation Process

On July 16, 2003, Air Canada commenced an equity investment solicitation process (the "Original Solicitation Process") to raise approximately \$700 million of its overall equity exit financing needs in connection with the Plan of Arrangement. The Original Solicitation Process, developed by Air Canada with the advice of its financial advisor, Seabury Securities LLC ("Seabury"), and in consultation with the

Monitor, was designed to investigate qualified investors' interest, to conduct due diligence sessions with interested investors and to solicit letters of intent to understand the investors' preliminary positions as to the value and general terms of the proposed investments.

During the process, qualified potential equity investors were invited to attend management presentations in connection with the overall restructuring plan and to conduct due diligence on the Corporation.

Following the receipt of letters of intent, the different proposals were analyzed by Air Canada, Seabury and the Monitor. Several qualified potential investors who had submitted letters of intent were invited to make presentations to the restructuring committee of the board of directors of Air Canada.

Given the favourable development of negotiations with Deutsche Bank Securities Inc. ("Deutsche Bank") on a possible rights offering whereby Deutsche Bank would act as standby purchaser, qualified potential investors who had submitted letters of intent had the opportunity to resubmit their letters of intent to reflect the scenario involving Deutsche Bank as standby purchaser under a rights offering.

On September 26, 2003, Air Canada announced the selection by the board of directors of two potential investors, Cerberus Capital Management L.P. ("Cerberus") and Trinity Time Investments Limited ("Trinity"), as candidates to advance to the final phase of the equity solicitation process and to negotiate a binding investment agreement with Air Canada. Final investment agreements were received from Cerberus and Trinity on November 7, 2003 and, after a thorough analysis, on November 8, 2003, the board of directors selected Trinity.

On November 20, 2003, an unsolicited offer was received by the Monitor whereby Cerberus supplemented its investment proposal submitted on November 7, 2003. On November 22, 2003, a further unsolicited supplement to the unsolicited offer from Cerberus was received by the Monitor.

Following a Court-supervised process which had the objective of bringing closure to the Original Solicitation Process, both Cerberus and Trinity were allowed by the Court to supplement their investment proposal. On December 21, 2003, the board of directors after receiving a comparative financial analysis from its financial advisors, Seabury and Merrill Lynch Canada Inc., and advice from its independent legal counsel, voted unanimously to reconfirm the selection of Trinity as equity investor. On January 16, 2004, the Court approved the supplemented investment proposal received from Trinity on December 19, 2003.

On April 2, 2004, Trinity announced that it was not to seek an extension of its investment agreement with Air Canada upon its expiry on April 30, 2004. Furthermore, it released Air Canada from its exclusivity obligations to Trinity, enabling Air Canada to open discussions with other prospective investors.

After having held numerous discussions with the Corporation's stakeholders, including labour unions, advisors to the unsecured creditors committee, General Electric Capital Corporation ("GECC") and GE Capital Aviation Services, the Monitor and the Corporation developed an equity process which consists of two major elements: (i) the expansion of the rights offering from \$450 million to \$850 million with the continued support of Deutsche Bank and (ii) the design of a private equity solicitation process to raise an additional \$250 million with a 45 day due diligence period and low conditionality provisions so as to mitigate closing risk. Also, pursuant to the private equity solicitation process, the Monitor has an expanded role whereby it supervises, facilitates and oversees the process. The Monitor will also provide its recommendation, if any, to the Corporation and the Court at the conclusion of the process.

In accordance with such equity process, Air Canada initiated intensive negotiations with Deutsche Bank in view of increasing the size of the rights offering. An amended and restated standby purchase agreement increasing the rights offering from \$450 million to \$850 million was entered into by Air Canada and Deutsche Bank as of April 29, 2004 and was approved by the Court on May 5, 2004. In accordance with the terms of an order of the Court dated May 4, 2004, which set out the terms of the private equity solicitation process, Air Canada initiated a new private equity solicitation process (the "New Solicitation Process") seeking an investment of approximately \$250 million so as to fulfill its overall equity exit financing needs of \$1.1 billion. Pursuant to the New Solicitation Process, potential investors must submit their investment agreements by June 18, 2004, the Court approval of the investment agreement selected by the Corporation and the Monitor, if any, is to be obtained by June 25, 2004 and the closing of the investment is to occur by September 30, 2004.

Standby Purchase Agreement

In the context of the Original Solicitation Process, informal expressions of interest were received from certain of Air Canada's financial creditors in connection with a possible rights offering. Extensive negotiations between Air Canada, its advisors and certain of the interested financial creditors resulted in the announcement, on October 24, 2003, that Air Canada had entered into a standby purchase agreement with Deutsche Bank in connection with the rights offering. Pursuant to the rights offering, creditors would have the right to subscribe for up to \$450 million of equity of a newly incorporated holding company under which the Corporation would be held.

On April 2, 2004, Trinity announced that it was not to seek an extension of the investment agreement with Air Canada upon its expiry on April 30, 2004. Consequently, Air Canada, with the substantial and direct involvement of the Monitor, commenced intensive negotiations with Deutsche Bank in connection with finalizing amendments to the original standby purchase agreement, that had already received approval of the Court, in view to increase the size of the rights offering. On April 29, 2004, an amended and restated standby purchase agreement, increasing the size of the rights offering from \$450 million to \$850 million was entered into between Air Canada and Deutsche Bank and was approved by the Court on May 5, 2004.

The amended and restated standby purchase agreement contains conditions, including those related to labour and pensions, which must be satisfied by May 15, 2004. The labour condition requires that the Corporation obtain \$200 in annual cost reductions to realize the labour cost savings agreed to by the various labour groups in 2003. In addition, the amended and restated standby purchase agreement requires that the labour groups provide assurances that all material disputes or claims will be compromised or waived upon emergence from the CCAA proceedings. The pension condition requires the Corporation to reach satisfactory arrangements with the Office of the Superintendent of Financial Institutions ("OSFI") to implement the February 18, 2004 agreement between the Corporation and its pension beneficiaries regarding funding over 10 years of the solvency deficit in the registered pension plans. The amendments do not require pension design changes as had previously been required by Trinity. In addition, the amended and restated standby purchase agreement requires satisfactory assurances from the Government of Canada that, upon emergence, the Corporation will be able to compete on a level playing field with all air carriers operating scheduled service in Canada in regards to the regulatory environment. The amended and restated standby purchase agreement requires the Corporation to emerge from CCAA protection no later than September 30, 2004.

Under the terms of the rights offering, creditors will have the right to subscribe for up to \$850 million of equity of a newly incorporated holding company under which the Corporation will be held. Pursuant to the amended and restated standby purchase agreement, Deutsche Bank will act as the exclusive standby purchaser and, in that capacity, will purchase all unsubscribed equity at a price equal to

the price paid by the creditors (which is based on a pre-money valuation of the newly incorporated holding company of \$925 million) plus a premium of 7.5%.

In consideration for the obligations incurred by Deutsche Bank in connection with the rights offering, Air Canada has agreed to pay to Deutsche Bank an amount of \$2 million as partial reimbursement of the costs and expenses previously incurred by Deutsche Bank in connection with the original standby purchase agreement entered into on October 29, 2003 and an amount of \$500,000 as of the first day of each month starting in May 2004, until the initial closing of the rights offering in respect of the costs and expenses incurred by Deutsche Bank in connection with the amended and restated standby purchase agreement. In addition, Air Canada has agreed to pay to Deutsche Bank an arrangement fee of \$12.75 million on the initial closing of the rights offering. Also, under specific circumstances, Deutsche Bank could be entitled to a break-up fee of \$25.5 million.

Negotiations with Aircraft Lessors

During the CCAA proceedings, Air Canada conducted extensive negotiations with its aircraft financiers to restructure its aircraft ownership costs. Through these efforts, the Corporation achieved: (i) reduced ownership costs consistent with current market conditions, (ii) modified lease expiry dates based on planned new aircraft acquisitions and scheduled heavy maintenance requirements, and (iii) satisfactory aircraft return conditions consistent with modified lease expiry dates. Pursuant to these negotiations, as of March 26, 2004, the Corporation eliminated 48 leased aircraft from its fleet and significantly reduced its future aircraft ownership costs. Additional fleet reductions are anticipated as the Corporation has early lease termination rights with respect to certain aircraft prior to December 31, 2005. In addition, Air Canada entered into a global restructuring agreement with GECC which covers approximately one-third of its fleet.

Global Restructuring Agreement

As of April 1, 2003, GECC leased, managed the leases of, or otherwise had an interest in, approximately one-third of Air Canada's fleet. After extensive negotiations and based on a tentative agreement reached on July 3, 2003, GECC and Air Canada entered into a global restructuring agreement on September 11, 2003 which was approved by the Court on January 16, 2004. The global restructuring agreement provides for, among other things: (i) the restructuring of leases for all GECC-owned and GECC-managed aircraft, (ii) exit financing in an amount of approximately U.S.\$585 million for use upon emergence from the CCAA proceedings, and (iii) financing in an amount of up to U.S.\$950 million to fund the acquisition of new regional jet aircraft. The global restructuring agreement also provides for the issuance to GECC of a convertible note and share purchase warrants which may entitle GECC to equity of Air Canada or its successors upon emergence from the CCAA proceedings. On April 29, 2004, the global restructuring agreement was extended to September 30, 2004 and is subject to the completion of certain conditions including the Corporation's exit from CCAA proceedings on or before September 30, 2004.

New Fleet

As part of its new strategy and further to a thorough evaluation of candidate aircraft, Air Canada reached, on December 18, 2003, agreements in principle with Bombardier and Embraer to purchase new aircraft. All aircraft purchases from Bombardier and Embraer are subject to a number of conditions, including financing on satisfactory commercial terms, negotiation of final documentation and receipt of all requisite approvals. Delivery of aircraft is planned to commence in September of 2004. The aggregate cost for these aircraft approximates U.S.\$2 billion.

On March 12, 2004, Air Canada received confirmation from Embraer that the aircraft manufacturer had secured financing on commercial terms satisfactory to Air Canada for an order of 45 firm 93-seat Embraer 190 aircraft. On March 24, 2004, Air Canada announced it had received confirmation from Bombardier that the aircraft manufacturer had secured financing on satisfactory commercial terms to Air Canada for the carrier's entire firm order of Bombardier aircraft.

On March 19, 2004, the Court approved an agreement between Air Canada and Airbus (AVSA S.A.R.L.) dated March 12, 2004 with respect to certain aircraft that had been ordered by Air Canada from Airbus prior to the date of filing. Prior to such date, Air Canada was committed to purchase from Airbus two Airbus A321 narrowbody aircraft and two Airbus A340-500 widebody aircraft in 2003 and three Airbus A340-600 widebody aircraft in 2004. Air Canada failed to take delivery of the Airbus A321 and Airbus A340-500 aircraft in 2003. On January 30, 2004, Air Canada repudiated its commitment to Airbus to purchase the Airbus A321 and the Airbus A340-500 aircraft. On March 12, 2004, Air Canada and Airbus reached an agreement which provided for the purchase by Air Canada of two Airbus A340-500 aircraft and their financing, with scheduled deliveries of the aircraft for June and July of 2004. The agreement also provided for the cancellation of the two Airbus A321 aircraft and the deferred delivery of the three Airbus A340-600 aircraft to 2010 with unilateral cancellation rights in favour of Air Canada. As part of the agreement, Airbus agreed to waive any claim against Air Canada during the CCAA process.

Settlement of Pilots' Arbitration Proceedings

In connection with the labour dispute settlement of May, 2003, it was agreed by Air Canada, Air Canada Jazz and the two pilots' unions, Air Canada's Pilot's Association ("ACPA") and Airline Pilot's Association ("ALPA"), that certain issues concerning the allocation of regional jet aircraft between ACPA and ALPA would be resolved in arbitration proceedings to be held on February 28 and 29, 2004. At the time of the arbitration hearing, the parties agreed to voluntary mediation proceedings instead of arbitration, at which ACPA, ALPA, Air Canada and Air Canada Jazz reached an agreement on the new regional jet aircraft to be purchased and the allocation between the two pilot groups. The mediated agreement was ratified by the members of ALPA and ACPA on March 19, 2004.

Arrangements with Unions

Since the date of filing and following extensive Court-supervised negotiations, the Corporation has achieved a restructuring of its labour force with the conclusion of new long-term collective agreements with all of its union groups. Pursuant to the new collective agreements, unconditional employment security provisions have been eliminated, permanent pay rate reductions have been accepted by seven of the ten union groups and modifications to work rules have been implemented and are expected to result in productivity increases and accrued flexibility for all union groups.

One of the conditions contained in the amended and restated standby purchase agreement is the achievement by the Corporation of labour cost reductions of \$200 million by May 15, 2004. As of May 19, 2004, the Corporation has reached tentative agreements, subject to ratification by the respective union membership, with all labour groups representing Canadian based employees with the exception of the Canadian Auto Workers ("CAW") which represents the Corporation's customer sales and service employees. On May 19, 2004, the Corporation announced that it has reached an impasse in its discussions with the CAW. Further, the Corporation announced that it intends to immediately commence discussions with Deutsche Bank and GECC to determine next steps. As a result, there is no assurance that the Corporation's restructuring will be successfully completed.

As part of its restructuring efforts, as of the end of February 2004, the Corporation had reduced employment levels since the date of filing by over 6100 employees measured on a full time equivalent basis.

Pension Plans

The deterioration of the solvency position of Air Canada's registered pension plans during 2002 triggered in March 2003 a direction by OSFI for Air Canada to file formal January 1, 2003 actuarial valuations of each defined benefit registered pension plan. As at January 1, 2004, Air Canada estimated that the overall Canadian defined benefit registered pension plan solvency deficit was approximately \$1.2 billion.

As part of the restructuring process, Air Canada has had extensive discussions with OSFI, its Canadian labour unions, its non-unionized employees and Court-appointed representatives of retirees, in order to address the funding of the solvency deficit in its registered pension plans. Following such discussions, Air Canada presented, on October 27, 2003, a detailed proposal for the funding over ten years of the solvency deficit in its registered pension plans. On February 18, 2004, Air Canada, and representatives of the pension beneficiaries agreed on a proposal for the funding of the solvency deficit over ten years commencing as at January 1, 2004, which has been presented to OSFI and the Government of Canada.

On May 14, 2004, Air Canada and OSFI reached an agreement in respect of pension funding relief. The agreement establishes a protocol under which OSFI will recommend to the Government of Canada the adoption of a regulation which would allow Air Canada to extend the payment of pension plan solvency deficiencies over a period of 10 years as opposed to the current maximum of 5 years. The protocol provides that the solvency deficiencies will be paid down in accordance with an agreed upon schedule of variable annual payments as opposed to the current regulatory requirement for equal annual payments. The protocol further provides that Air Canada request the approval of the Court to remit approximately \$34 million in special payments to certain pension plans immediately.

In consideration of OSFI proposing a regulation allowing for the elimination of any deemed trust which may have arisen as a result of required solvency deficit payments prior to the execution of the protocol, Air Canada and OSFI have agreed that upon Air Canada's emergence from the CCAA proceedings, the pension plan trustees will receive subordinated secured promissory notes in the aggregate amount of \$346.6 million with a second charge over the assets of Air Canada. The notes will be reduced as solvency payments are made in accordance with the agreed upon schedule. The terms of the notes should not materially affect the aircraft and exit financing to be made available to Air Canada pursuant to the global restructuring agreement with GECC and should not materially restrict any future secured or unsecured financings.

The implementation of the protocol is conditional upon (i) the emergence from the CCAA proceedings on or prior to December 31, 2004; (ii) the amended regulation coming into effect, and (iii) consent being obtained from plan beneficiaries through the unions and Court appointed representatives of non-unionized employees and retirees. The protocol represents a variation from the condition of the amended and restated standby purchase agreement with Deutsche Bank which Air Canada believes is not material. A request for confirmation and waiver from Deutsche Bank is pending.

Air Canada Jazz has resumed, since December 2003, remittance of all contributions to all of its defined contribution pension plans. Air Canada and Air Canada Jazz also remitted, in December 2003 and January 2004, an aggregate amount of approximately \$132 million representing the 2003 current service

costs under their defined benefit pension plans covering all of Air Canada's unionized and non-unionized employees and retirees in Canada and in the United Kingdom as well as a group of Air Canada Jazz pilots. Benefit payments for the Corporation's sponsored pension plans continue to be made in accordance with plan requirements. On April 27, 2004, the Court further amended its initial order to permit contributions by the Corporation into each of the Canadian defined benefit registered pension plan equal to the current service costs relating to the first quarter of 2004. Accordingly, on April 30, 2004, the Corporation made contributions totalling \$25 million.

Greater Toronto Airports Authority

On February 19, 2004, Air Canada applied to the Court seeking to have the Greater Toronto Airports Authority ("GTAA") honour its agreement with Air Canada regarding the relocation of Air Canada's domestic operations to Pearson's Terminal 1 New. Pursuant to the agreement in place between Air Canada and the GTAA, Air Canada was granted fixed preferential use of all 14 covered gates that will be available at the initial phase of Terminal 1 New.

The dispute arose when the GTAA declared that it would give Air Canada the fixed preferential use of only eight of the 14 gates, thus forcing Air Canada to share the remaining six gates with WestJet. On February 23, 2004, the Court ordered the GTAA to honour its agreements with Air Canada and to provide Air Canada with the fixed preferential use of all 14 covered gates. On March 19, 2004, the GTAA and WestJet were denied the right to appeal the Court's decision.

An issue also arose with the GTAA relating to the number of Pearson Terminal 2 gates to be vacated by Air Canada. On April 29, 2004, Air Canada and the GTAA concluded an agreement on a number of operational issues at Terminal 2. With respect to the three gates at Terminal 2 that were at issue, the agreement provides that they will become common use gates administered by the GTAA subject to some agreed grandfathered use by Air Canada. By letter dated April 30, 2004, Air Canada and the GTAA advised the Court of their commitment to continue to work together to enhance their relationship going forward.

Three-Year Summary: Evolution of Business

Integration of Canadian Airlines

In 1999, a take-over bid was launched to acquire the Corporation which take-over bid was subsequently determined to be illegal. The Corporation's proposal to acquire CAIL was successful and led to the financial restructuring of Canadian Airlines Corporation's and CAIL's \$3.5 billion of debt and lease obligations. Upon the closing of the restructuring plan, CAIL became a wholly-owned indirect subsidiary of Air Canada, effective July 5, 2000. The integration of the operations of the Corporation and CAIL was carried out in 2000 and the amalgamation of Air Canada and CAIL was completed on January 2, 2001. All regional operations were merged into Air Canada Regional Inc., now known as Air Canada Jazz.

On March 29, 2001, Transport Canada granted Air Canada an amended single Air Operator Certificate, allowing for the complete consolidation of CAIL's operations, maintenance and aircraft under the Air Canada operator certificate. The Corporation completed the intermingling of employees with the ratification of the contract with the Canadian Union of Public Employees on March 3, 2003.

Economic Environment

Commencing in the summer of 2000, Air Canada was faced with increasing competition from domestic low-cost airlines. Domestic low-cost airlines, together with growing consumer expectations for lower fares, have driven down yields. In addition, the bursting of the technology bubble in 2000 caused a substantial decline in the demand for premium business travel. The Corporation cut its planned 2001 capacity growth to zero, parked up to eight older widebody aircraft and reduced employment levels by 3,500 employees, primarily through voluntary separation packages and attrition. However, Air Canada was not fully able to respond to this new environment given the undertakings provided in connection with the acquisition of CAIL which notably prevented Air Canada from starting up a planned low-cost air carrier in Eastern Canada before September 2001 and also prevented Air Canada from significantly reducing labour costs.

Air Canada also experienced, in the past few years, a succession of negative events, each of which has had a dramatically greater impact on Air Canada than upon its domestic competitors given Air Canada's large transborder and international travel components. Recent years have been characterized by an overall recessionary economic environment which led to a general weakened demand for Air Canada's services and a substantial drop in demand in the premium corporate and business travel markets. The adverse consequences of a declining economy were compounded by the September 11, 2001 terrorist attacks and the 2003 SARS outbreak which led to a further reduction in consumer demand.

Given its limited ability to reduce labour costs and having effectively fixed aircraft fleet costs, Air Canada was unable to bring down its cost structure to a level necessary to respond to the decline in traffic and, generally, to the new landscape of the airline industry.

The September 11, 2001 terrorist attacks also triggered substantial increases in insurance and airport security costs. For 2002, Air Canada's annual aviation insurance costs increased by approximately \$71 million compared to insurance costs in effect prior to September 11, 2001. The \$24 Canadian government air traveller's security charge negatively impacted the Corporation's performance in 2002 on short haul routes. Effective March 1, 2003, the domestic air traveller's security charge was reduced to \$14 from \$24 for a round-trip ticket. On April 1, 2004, the charge was further reduced to \$12 for domestic travel, and \$20 for transborder and international travel. Following September 11, 2001, Air Canada also grounded many of its aircraft due to excess capacity. As most airlines were generally experiencing similar overcapacity problems, Air Canada's ability to dispose of such aircraft was severely restricted.

The geo-political instability that has characterized recent years, including the Iraqi crisis, brought uncertainty to the global economy and contributed to increased volatility in fuel prices. Fuel prices, an important factor for Air Canada, were at a near record level in the first quarter of 2003.

In this context, Air Canada experienced a worsening financial position exemplified by a net loss of \$1.315 billion for 2001 and a net loss of \$828 million for 2002, as well as the downgrading of its senior debt rating by Moody's (from Ba3 to B1) in January 2001 and by DBRS (from BB with a stable trend to BB (low)) in February 2001. The events of September 11, 2001, triggered another downgrade of Air Canada's debt rating by DBRS (from BB (low) to B (high)) and S&P (from BB- to B+) in September 2001 and by Moody's (from B1 to B3) in October 2001. As at December 31, 2002, Air Canada had total assets of book value of \$7.412 billion and total liabilities of \$9.700 billion.

In early 2003, Air Canada's revenues began to be severely impacted by: (i) the advent of the Iraq war; (ii) the SARS outbreak; and (iii) the rapid expansion of WestJet and other low-cost carriers. In combination, these factors caused Air Canada's passenger revenues to decline by over \$1.3 billion versus

2002. The operating losses of 2001 and 2002 had already significantly diminished the liquidity of Air Canada and alternative sources of funding were lost.

On March 21, 2003, OSFI issued directions requiring Air Canada to file new valuations of its main pension plan to retroactively make current service contributions in respect of 2002. The impact of these directions would have been to place a great burden on Air Canada's liquidity over the ensuing five years in order to fund the solvency deficit in the time required by existing regulations.

Consequently, with the advice of their financial and legal advisors, the Applicants elected to restructure their operations, debt and capitalization under CCAA protection. On April 1, 2003, the Applicants filed for and received protection under the CCAA in the form of a general stay of proceedings. The Court appointed the Monitor under the terms of the initial order. The Applicants, through the Monitor, also made a concurrent petition for recognition and ancillary relief under Section 304 of the U.S. Bankruptcy Code.

Further to Air Canada's announcement that it had filed for protection under the CCAA, DBRS and Moody's downgraded Air Canada's senior unsecured debt rating to C and S&P to D.

Regulatory Environment

For a description of the evolution of the regulatory environment of the Corporation over the last three years, please refer to the section entitled "Regulatory Environment".

Asset Sales

The Corporation started focusing on asset sales for purposes of raising liquidity in 2001, following the bursting of the technology bubble and the resulting economic slowdown and decline in business travel. These types of financing activities significantly increased following the terrorist attacks of September 2001. In 2002, the on-going economic slowdown, the threat of an Iraqi conflict and the general decline in travel contributed to further asset sales. The following amounts were raised by the Corporation through sale and leaseback transactions in 2001 and 2002:

- 2001: \$1,468 million – aircraft, spare engines and computer equipment; and
- 2002: \$284 million – aircraft, engines and real estate.

Business Process Re-engineering

As a result of the on-going economic slowdown, the Corporation continued its focus on cost reduction and revenue improvement initiatives. Several major undertakings were launched under the umbrella of the Securing Our Future ("SOF") re-engineering program, including the adoption of the Six Sigma methodology.

SOF is a program, which resulted from extensive management analysis and benchmarking and includes the following initiatives: the addition of more economy seating, 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 Computer Reservation System fees. A number of these initiatives were implemented and resulted in improved revenue and cost performance. An objective of SOF was to make business process re-engineering a permanent part of the Corporation's culture.

In May 2002, the Corporation introduced the Six Sigma methodology, a discipline to simplify processes, improve service and reduce waste and costs. Six Sigma is: (i) a rigorous and disciplined approach to managing business through data driven processes by providing a consistent analytical approach to project selection and solutions; (ii) an approach that provides a common business language that all employees share to discuss business improvements; and (iii) a measurement of variation, or defects, in an individual process.

A continuing area 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, the Corporation's Internet travel services portal. Regardless of the booking method, the use of electronic ticketing is now widespread. In terms of electronic check-in, the Corporation has made significant investments in Express self-service check-in kiosks available at major Canadian airports. At December 31, 2003, in excess of 82% of Air Canada's tickets were electronic tickets, representing 94% of all tickets issued where electronic ticketing is available. The Corporation became the first full service international airline to issue electronic tickets for its domestic network.

Fleet and Capacity Initiatives

In 2002, the Corporation continued to realign its capacity in order to address the slowdown in 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 the mainline fleet, many of the Corporation's oldest narrow-body aircraft were retired or sold, including several Boeing 767-200 and Boeing 737-200 aircraft and the entire DC-9 fleet. Furthermore, by year-end 2002, seven Boeing 737-200 aircraft were transferred to ZIP operations. During 2002, 16 new Airbus narrow-body aircraft were delivered, providing replacement capacity for some of the retired aircraft. In addition, the Corporation also took delivery of two Boeing B767-300 and three Airbus A321 aircraft on a Power By the Hour ("PBH") basis with aircraft rental payments based on the number of hours flown. As at December 31, 2002, the Corporation had a total of 10 PBH aircraft. In regards to wide-body aircraft, in 2002, four aircraft (three Airbus A340-300 and one Boeing 747-400) were returned to their lessors at the end of their leases.

At Air Canada Jazz, the Fokker F28 aircraft have all been retired.

To address the decline in business travel and support its drive to reduce unit costs, the Corporation continued its seat reconfiguration program in 2002, which has added economy class seating and reduced business class seating on Airbus A320, Airbus A319, Boeing 737 aircraft and added economy class seating only on Boeing 767 aircraft, while maintaining industry leading seat pitch standards.

During 2003, the Corporation continued the process of restructuring its fleet, including the elimination of unprofitable aircraft. For the period from April 1, 2003 to March 31, 2004, the Corporation eliminated 50 aircraft from its total fleet (48 leased aircraft and two owned aircraft). During this period, the Corporation also took delivery of three new Airbus narrow-body aircraft.

Subsidiaries and Divisions

Aeroplan

Aeroplan is Canada's largest loyalty program with six million members. In January 2002, Aeroplan was reorganized as a separate limited partnership. On January 27, 2003, Air Canada announced that it had entered into an agreement to sell a 35% interest in Aeroplan to Onex Corporation. Air Canada would retain the remaining 65% interest in Aeroplan. In conjunction with Air Canada's filing for protection under the CCAA, the parties terminated their original agreement and agreed to an exclusive negotiating period to restructure the transaction which ended on June 23, 2003. In connection with Air Canada's Original Solicitation Process which began in July 2003, it was decided that the exclusivity arrangement with Onex Corporation would not be extended.

ZIP

In September 2002, the Corporation launched a wholly-owned independently operated low-fare carrier, ZIP. ZIP is based in Calgary and operates primarily short-haul routes with connections to and from the Corporation's worldwide network. ZIP has agreements with the Corporation for the provisions of certain services, such as pilots, maintenance and ground handling, but operates independently of the Corporation, with its own Operating Certificate, fleet, flight attendants and management team.

Air Canada Jazz

In April 2002, Air Canada Jazz was launched as a new brand for Air Canada's regional operations. Air Canada Jazz forms an integral part of Air Canada's domestic and transborder market strategy and provides service throughout Canada and to certain destinations in the United States. In August 2002, Air Canada assumed commercial responsibility for Air Canada Jazz operations.

Destina.ca

In April 2002, Destina.ca, the Corporation's wholly-owned online travel site and a major partner of Aeroplan, was launched. Destina.ca offers customers one-stop reservation and destination information services with access to airlines, hotels and car rental agencies around the world.

Air Canada Technical Services

Air Canada Technical Services, a division of Air Canada, provides maintenance, engineering, repair for Air Canada's aircraft fleet and provides maintenance services to airline customers worldwide.

Tango by Air Canada

In November 2001, the Corporation launched Tango, a low fare "no frills" carrier, operated as a separately branded product. Given the success of the Tango brand, the Tango operation was integrated within Air Canada and Air Canada Jazz operations. Today, Tango is simply a fare available on-line at Air Canada's website and is offered on all domestic routes and most transborder routes (excluding Hawaii).

III DESCRIPTION OF THE BUSINESS OF THE CORPORATION

Passenger transportation is the principal business of the Corporation and, in 2003, represented 82% 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.

	2001	2002	2003
Domestic routes	\$3,743	\$3,688	\$3,059
International routes	4,958	5,087	4,318
Other operating revenues	910	1,051	991
Total.....	<u>\$9,611</u>	<u>\$9,826</u>	<u>\$8,368</u>

Passenger Operations and Route Networks

At December 31, 2003, the Corporation provided direct passenger air transportation to approximately 148 destinations. During 2003, the Corporation operated, on average, approximately 1,246 scheduled flights each day and carried approximately 28 million passengers. The Corporation operates significant domestic, transborder and international routes networks.

	2001	2002	2003
Domestic	\$3,582	\$3,535	\$2,919
Transborder	2,118	1,945	1,578
Other international.....	2,423	2,710	2,361
Total.....	<u>\$8,123</u>	<u>\$8,190</u>	<u>\$6,858</u>

The Corporation's primary hubs are located in Toronto, Montreal and Vancouver, which serve domestic, transborder and international markets, respectively. Toronto's Pearson is the Corporation's largest hub and, in 2003, its passengers accounted for approximately 56% of Pearson's passenger traffic. The Corporation is the principal tenant in Pearson's Terminal 1 New and Terminal 2.

The Corporation operates a hub at Montreal's Pierre-Elliott Trudeau International Airport and in 2003, its passengers accounted for approximately 52% of Montreal's passenger traffic. Montreal is a hub for domestic, transborder and international (primarily Trans-Atlantic) traffic. The Corporation also operates a hub at Vancouver's International Airport and in 2003, its passengers accounted for approximately 50% of Vancouver Airport's passenger traffic. Vancouver is a hub for domestic, transborder and international (primarily Trans-Pacific) traffic.

Air Canada has historically experienced greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters of the calendar year. This demand pattern is mainly a result of the high number of leisure travelers and their preference for travel during the spring and summer months. Seasonably low passenger demand results in significantly lower operating cash flow and margins in the first and fourth quarters for each calendar year, as compared to the second and third quarters.

Domestic

At December 31, 2003, the Corporation provided an extensive network and product offering across Canada with scheduled passenger service directly to 58 Canadian destinations. Domestic passenger revenues accounted for 42% of total passenger revenues in 2003. The most important Canadian routes in terms of operating revenues in 2003 were the transcontinental routes linking Toronto, Montreal 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. 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, Air Canada provides service between and within Central Canada, the Prairies and the Atlantic Provinces. In November 2001, Air Canada launched Tango, a low-fare "no frills" carrier, operated as a separately branded product. With significantly lower unit costs than Air Canada's full-service product, Tango operated lower replacement cost flying, point-to-point, mainly on long-haul routes. Given the success of the Tango brand, the Tango operation was integrated within Air Canada and Air Canada Jazz operations. Today, Tango is simply a fare available on-line at Air Canada's website (www.aircanada.com) and is offered on all domestic routes and most transborder routes (excluding Hawaii).

On September 22, 2002, ZIP was launched as a low-fare, high value airline to compete in the new market segment of low-cost airlines. ZIP is based in Calgary, with its own operating certificate, fleet, management team, and flight attendants. ZIP pilots are seconded from Air Canada. They have a reduced wage rate relative to Air Canada pilots, but they fly more hours. In terms of the ZIP flight attendants, their salaries and working conditions are comparable to other low-cost airlines. Several other functions, such as maintenance, dispatch and groundhandling, are contracted from Air Canada and Air Canada Jazz. ZIP currently operates a fleet of 12 Boeing B737-200 aircraft. This fleet will be replaced and expanded with 20 Airbus A319 aircraft starting in July 2004. With its lower cost base, ZIP allows Air Canada to compete effectively in the low-cost carrier environment. ZIP's schedule offers connections to and from Air Canada's network, provides Aeroplan points and, compared with other low-cost airlines, has more legroom and provides advanced seat selection.

Air Canada Jazz was launched in April 2002 as a new brand for Air Canada's regional operations. Air Canada Jazz forms an integral part of Air Canada's domestic and transborder market strategy and provides service throughout Canada and to certain destinations in the United States. A significant portion of Air Canada's passengers either originate from or are destined for small cities and communities. Air Canada linked its mainline and regional networks in order to serve connecting passengers more efficiently and to provide valuable traffic feed to Air Canada's mainline routes. Air Canada's mainline and regional operations coordinate marketing, flight schedules, ticketing and groundhandling in order to ensure convenient passenger connections. In August 2002, Air Canada assumed commercial responsibility for Air Canada Jazz operations.

Small independent domestic airline operators replace Air Canada Jazz operations in markets considered too small for Air Canada Jazz to serve directly. At December 31, 2003, these airlines operated flights under Air Canada's designator code and provided service to an additional 12 domestic destinations. Air Canada does not own any equity interests in these carriers.

Transborder (Canada — United States)

With the most non-stop destinations and flights to the United States, the Corporation carries more passengers between Canada and the United States than any other airline. At December 31, 2003, the Corporation directly served 75 routes to 44 transborder destinations with over 1,278 weekly flights. The Corporation's network reach was also increased by extensive connections to and Code-sharing with Star Alliance partner, United Airlines. In 2003, transborder passenger revenues represented 23% of total passenger revenues.

During 2003, Air Canada continued to adjust and optimize its capacity to the United States, while maintaining a competitive schedule on key markets. The difficult competitive environment continued as incremental non-stop services were offered by major US carriers. In 2003, Jetsgo was the first Canadian low-cost carrier to expand into the United States, with services to Florida and Newark. WestJet has also announced the introduction of transborder service in 2004 serving Florida, California, Las Vegas, Nevada and Arizona.

Overall capacity in 2003 to the United States (excluding sun markets) was reduced by 14.8% compared to 2002, reflecting the changing environment. Included in these reductions were the cancellation of service between Toronto-Charleston, Edmonton-Los Angeles, Winnipeg-Chicago, Montréal-Atlanta, Vancouver-Phoenix and Toronto-San Diego. Although the number of flights decreased overall by 10% from 2002, additional flights were added on a number of key markets in order to remain competitive with U.S. carrier growth.

International

Air Canada has a significant international network which is enhanced by strategic and commercial alliances with other Star Alliance members. At December 31, 2003, Air Canada provided scheduled service directly to 46 destinations in Europe, the Middle East, Latin America, the Caribbean and Asia. In 2003, international passenger revenues from the Atlantic and Pacific regions represented approximately 22% and 7% of total passenger revenues, respectively. In 2003, international passenger revenues represented approximately 34% of total passenger revenues.

During 2003, flights to Europe were negatively affected by the SARS outbreak, especially during the second quarter. Air Canada operated flights to the United Kingdom, France and Germany (with Lufthansa). In addition, Air Canada flew to Madrid, Copenhagen, Amsterdam, Zurich, Dublin, Rome and Tel Aviv. Service to Rome, Madrid and Dublin has been suspended. Air Canada commenced service to Manchester in cooperation with bmi in April 2004.

In the Asia-Pacific market, capacity was reduced significantly during the second quarter of 2003 due to the SARS outbreak. During the period from January to June 2003, Air Canada flew 31% fewer ASMs (66% fewer in June 2003 alone). As the SARS situation improved, demand picked up again and, as a result, Air Canada increased its capacity by the end of June 2003. Asia-Pacific services are now back to pre-SARS levels. The Vancouver-Taipei service is now offered through a Code-sharing agreement with EVA Air. Other new services were added with the introduction of the only non-stop service between Toronto and Delhi in October 2003 and a non-stop service from Hong Kong to Toronto in December

2003. In addition to targeting business travelers, these new services capitalize on the high volume "Visit Friends and Relatives" segment in these markets.

Air Canada also achieved growth in the Latin American and Caribbean markets. The introduction of scheduled service to Havana, Santiago, Bogota, Caracas, Lima and Buenos Aires and the growth of existing Caribbean leisure destinations, provided opportunities for the reallocation of underperforming aircraft, while capitalizing on the strength of Air Canada's network.

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 for regional jet aircraft and flights operated by Air Canada Jazz) and Hospitality Class. Executive First is Air Canada's redesigned international executive class service offering first class comfort and sophistication at business class fares. The Executive First service begins on the ground with exclusive check-in areas and airport concierge service, and continues in the air with more legroom and quality dining. Comfort and entertainment are enhanced with electronic sleeper seats, individual audio and video entertainment and satellite communication technology with global access to telephone 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, Montreal and Ottawa and high frequency services in Western Canada linking Vancouver, Calgary and Edmonton;
- a significant international network enhanced by the Corporation's Star Alliance membership;
- Maple Leaf Lounges, which provide members and Executive class passengers with state-of-the-art computer, entertainment, office and high speed internet equipment at most major Canadian airports, as well as in Los Angeles, London and Paris;
- arrival lounge in London Heathrow;
- in-flight entertainment on most flights longer than 45 minutes offering bilingual daily news and full-length feature movies on all flights over three and a half hours;
- personalized concierge service for Executive First and Aeroplan Super Elite customers at major Canadian, U.S. and international airports;
- electronic ticketing on all North American routes (and on many international routes);
- self-service airport check-in kiosks at major airports across Canada;
- onboard restaurant service on selected domestic and transborder routes; and
- on-line bookings.

Approximately 80% of Air Canada's passenger ticket sales were made by travel agents in 2003. Air Canada has strategic relationships with numerous travel agencies throughout the world. Air Canada is also expanding integrated systems for electronic commerce to enhance its product offerings. Electronic ticketing is available throughout Canada, in the United States and at many international service points for travel on Air Canada and selected Star Alliance partners. As at December 31, 2003, in excess of 82% of Air Canada's tickets sold worldwide were electronic tickets, representing 94% of all tickets issued where electronic ticketing is available. Effective January 13, 2003, Air Canada became the first full-service international airline in the world to issue 100% electronic tickets for its domestic network.

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 both airlines. This service was the first electronic ticketing initiative that bridged two different airline computer reservations systems. Furthermore, since 2001, this interline capability has been extended to the travel agency community. Plans are underway to have an interline ticketing service among all Star Alliance partners by mid-2005.

Air Canada's website, *www.aircanada.ca*, allows individual passengers to purchase tickets, access up-to-date schedule and corporate information and receive information on Air Canada's products and services as well as receive flight status notification through their wireless-enabled phones or trace cargo shipments. Air Canada also operates the following websites: *www.flytango.ca*; *www.destina.ca*; *www.aeroplan.com*, *www.flyjazz.ca* and *www.4321ZIP.com*.

Self-service airport check-in kiosks are located in Toronto, Montreal, Ottawa, Halifax, Winnipeg, Calgary, Vancouver and New York's LaGuardia Airport. Over 40,000 customers daily use this fast alternative for check-in where they can obtain boarding passes, confirm or select their seats, select the frequent flyer program for mileage accrual, stand by for earlier flights or request an upgrade. Over 150 kiosks are available to be used by customers traveling on Air Canada, Air Canada Jazz or ZIP flights.

Cargo Operations

Air Canada provides air cargo services on most of its scheduled domestic, transborder and international passenger flights. Air Canada is a major domestic air cargo carrier. Cargo services offered by Air Canada include guaranteed choice of flight airport-to-airport services for high priority shipments (AC Expedair and ACPriority), and air freight services (AC Air Freight), to Air Canada destinations worldwide. At December 31, 2003, Air Canada's cargo division provided direct air cargo service to approximately 225 Canadian and international destinations and had sales representation in over 50 countries. Cargo operations generated \$519 million in operating revenues in 2003 and accounted for 6% of Air Canada's total operating revenues.

The following table sets out the Corporation's cargo revenues from domestic and international operations for the periods indicated.

	Year ended December 31		
	(millions)		
	2001	2002	2003
Domestic	\$161	\$153	\$140
International.....	417	432	379
Total.....	<u>\$578</u>	<u>\$585</u>	<u>\$519</u>

In January 2002, the Corporation opened a new modern cargo terminal at Pearson. This new state-of-the-art cargo terminal is designed to meet the needs of customers and will make cargo handling more efficient than ever before. The cargo terminal is equipped with the new Inventory Control System which interfaces with all aspects of the cargo operation, making this facility one of the most technically advanced in the world. Air Canada is the largest supplier of air cargo services to Canada Post Corporation and in April 2002, Air Canada and Canada Post Corporation renewed their long standing cargo services contract. This contract for carriage of mail was extended until 2007 for domestic service and until 2005 for transborder and international service.

In June 2002, Air Canada Cargo launched a new freight management system AC Lynx, a Web-based process. AC Lynx offers the visibility and the tools needed to track cargo online from initial booking to delivery. Air Canada, jointly with United Airlines and Northwest Airlines, are the founding carriers of the new Cargo Portal Service in cooperation with Unisys. The new portal was launched on January 27, 2003. Endorsed by large freight forwarders and the Air Forwarders Association, this portal provides access to a suite of services from multiple airlines, enabling the forwarders to book shipments. The portal also enables its users to check schedules, capacity availability and shipment status, all from one site.

Other Operations

The Corporation also operates in the following related services:

	Year ended December 31		
	(millions)		
	2001	2002	2003
Other Revenues			
Aeroplan	\$230	\$309	\$307
Technical Services	224	239	169
Other	456	503	515
Total other revenues	\$910	\$1,051	\$991

Aeroplan

Aeroplan is Canada's premier loyalty program with six million members. Aeroplan members can earn Aeroplan points through an extensive network of over 100 partnerships with airline, hotel, car rental, financial, telecommunication, retail, services and entertainment partners. Aeroplan members can redeem their miles for reward travel to over 700 destinations in 128 countries served by Air Canada, Air Canada Jazz, ZIP, Air Canada's worldwide Star Alliance partner airlines and other Aeroplan partner airlines. Aeroplan members can also redeem their miles for a wide variety of over 120 exclusive and unique experiential rewards as well as car rentals, hotel stays, ski and Air Canada Vacations packages.

The Aeroplan frequent flyer program offers points accumulation as an incentive to Air Canada'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 points toward travel rewards worldwide on Air Canada, Star Alliance members and other partner airlines. Aeroplan also manages the tier membership programs for Air Canada'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.

In January 2002, Aeroplan was reorganized as a limited partnership. As one of its main strategies, Aeroplan accelerates the development of its technology base to leverage its core capabilities in database management, market segmentation, research, hosting and customer relationship management and continues to develop features to complement these capabilities. In May 2002, Aeroplan launched *aeroplan.com* enabling members to book online air travel rewards on Air Canada. During 2002, Aeroplan introduced several new ways to use Aeroplan points. Aeroplan has been voted the world's Best Frequent Flyer Program for the second consecutive year at the 2003 OAG (Official Airline Guide) Airline of the Year Awards in London, England.

On January 27, 2003, Air Canada announced that it had entered into an agreement to sell a 35% interest in Aeroplan to Onex Corporation. Air Canada would retain the remaining 65% interest in Aeroplan. In conjunction with Air Canada's filing for protection under the CCAA, the parties terminated their original agreement and agreed to an exclusive negotiating period to restructure the transaction which ended on June 23, 2003. In connection with Air Canada's Original Solicitation Process that began in July 2003, it was decided that the exclusivity arrangement with Onex Corporation would not be extended.

At December 31, 2003, Aeroplan had 176 managerial employees across its offices in Montreal, Toronto and Vancouver and a total of 1336 call centre agents at its call centres in Montreal and Vancouver.

Destina.ca

Destina.ca, launched in April 2002, is Air Canada's wholly-owned on-line travel site and a major partner of Aeroplan. Destina.ca offers customers one-stop reservation and destination information services with access to airlines, hotels and car rental agencies around the world.

In 2004 and beyond, Destina.ca will contribute to a major restructuring of Air Canada's on-line distribution channels and play a key role in the on-line operations and continued growth of the Air Canada commercial websites with a focus on the following initiatives:

- manage the Air Canada commercial websites that comprise Air Canada on-line (*aircanada.ca*, *aircanada.com*, *4321ZIP.com*, Agency Direct Bookings and *destina.ca* the on-line travel agency site);
- reduce Air Canada's distribution costs with the development and implementation of a common IT platform and booking engine to increase capacity and enhance functionality. The new web framework will facilitate a major expansion of on-line booking facilities and thus reduce distribution costs; and
- generate greater revenues from new business (hotels, cars, etc.).

Technical Services

Air Canada Technical Services ("ACTS") competes on a global basis as an aircraft maintenance, repair and overhaul service provider. ACTS is responsible for providing maintenance, engineering and repair for Air Canada's aircraft fleet and for providing maintenance services to airline customers worldwide. In 2003, third party operations generated \$169 million in operating revenues through the sale of maintenance and engineering services, aircraft materials and other services. In 2003, these technical

services were provided to over 70 customers including Airborne Express, Air Norterra, Atlantic Coast Airlines, Canadian Department of National Defence, Jet Blue Airways, Lufthansa, Pratt & Whitney and Skyservice Airlines. The major maintenance facilities for ACTS are located in Toronto, Montreal, Vancouver, Calgary and Winnipeg.

Other Revenues

Other revenues include, among others, revenues from Touram Inc. and passenger, cargo and groundhandling services to numerous airlines.

Air Canada's wholly-owned subsidiary, Touram, 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. As of December 31, 2003, Touram arranged travel for over 218,230 passengers. Currently, Air Canada Vacations offers vacation packages to Florida, Hawaii and Las Vegas.

Air Canada also provides passenger, cargo and groundhandling 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 and Other Alliances

Air Canada operates an extended global network in conjunction with its international partners. Air Canada was a founding member of Star Alliance in 1997, the world's largest airline alliance group.

Star Alliance has grown, since its inception, to include the following 17 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, bmi, Asiana Airlines, Spanair, LOT Polish Airlines and US Airways.

Through its strategic and commercial partnerships with Star Alliance members and several other airlines, Air Canada offers service to over 700 destinations in 132 countries across the globe, with reciprocal participation in frequent flyer programs and use of airport lounges. The Star Alliance facilitates Code-sharing and traveler connections and transfers by providing customers with a higher level of service between network connection points (which may include one stop check-in). The airlines have implemented initiatives such as common utilization of facilities and are focusing on capturing potential synergies in areas such as joint purchasing. Air Canada now Code-shares with all of the members.

In addition to Star Alliance, Air Canada has joint marketing, Code-sharing or commercial relationships with the following international airlines: El Al (Israel), Royal Jordanian (Jordan), EVA Air (Taiwan), and Air Jamaica (Jamaica).

As a member of the International Air Transportation Association, Air Canada 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.

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 1100 Code-share flights per day have been added, building high frequency services, which cater to the needs of the business traveler. Code-sharing with United Airlines and United Express carriers, Atlantic Coast and Air Wisconsin, allows the Corporation to indirectly serve over 75 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 re-submitted their alliance agreement for review in September 2002 and the U.S. Department of Transportation did not provide any comment or raise any issue.

Lufthansa

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

Fleet Overview

Air Canada's mainline total fleet and operating fleet, excluding Air Canada Jazz aircraft, at March 31, 2004, is as described below:

	<u>Total Number of Aircraft March 31, 2004</u>	<u>Number of Operating Aircraft March 31, 2004</u>
Widebody Aircraft		
Airbus A340-300	9	9
Airbus A330-300	8	8
Boeing B747-400	3	3
Boeing B747-200	3	0
Boeing B767-300	30	30
Boeing B767-200	20	13
Narrowbody Aircraft		
Airbus A321	13	13
Airbus A320	52	52
Airbus A319	48	48

	Total Number of Aircraft March 31, 2004	Number of Operating Aircraft March 31, 2004
Boeing B737-200 ⁽¹⁾	15	12
DC-9	18	0
CRJ-200	25	25
Total Aircraft	244	213

⁽¹⁾ ZIP operated with 12 B737-200 aircraft, which are included in the mainline fleet.

Air Canada Jazz's total fleet and operating fleet at March 31, 2004 is as described below:

	Total Number of Aircraft March 31, 2004	Number of Operating Aircraft March 31, 2004
CJR-200	10	10
BAE 146	10	10
Fokker F28	27	0
DHC-8-300	26	26
DHC-8-100	47	45
Total Aircraft	120	91

Widebody Aircraft

At March 31, 2004, Air Canada's operating widebody fleet was comprised of 63 aircraft, configured in two classes of service: Executive First or Executive Class, and Hospitality Class. The Airbus A340 is a four-engine 284-seat aircraft that serves Air Canada's trans-Pacific and trans-Atlantic routes. The Airbus A330 aircraft is a twin-engine variant of the Airbus A340 that Air Canada operates mainly on trans-Atlantic routes. The Boeing B747-400 aircraft, which is planned to be phased out in the short term, is a four-engine high capacity, long-range aircraft used primarily on trans-Atlantic and trans-Pacific routes. The Boeing B767-300 is a long-range aircraft used mainly on international routes. The Boeing B767-200 aircraft is used on domestic and international routes.

Narrowbody Aircraft (Air Canada and ZIP)

At March 31, 2004, Air Canada operated 150 narrowbody aircraft, including 113 Airbus narrowbody aircraft. These aircraft are configured in two classes of service, Executive Class and Hospitality Class, except for 25 regional jets (discussed below) and the ZIP aircraft, which are only configured in Hospitality Class. The Airbus A320 aircraft is a 140 to 154-seat, twin-engine aircraft. 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. The Airbus A321 is the largest narrowbody aircraft in the Airbus family with 166 seats. The 100-seat Boeing B737-200 aircraft, which is planned to be phased out by the end of 2004, is a twin engine aircraft. All of these narrowbody fleet types primarily serve Air Canada's domestic and transborder routes.

Regional Jet and Turboprop Aircraft (Air Canada and Air Canada Jazz)

At March 31, 2004, Air Canada operated 25 regional jet aircraft, and Air Canada Jazz operated an additional 20 regional jet aircraft. Air Canada Jazz also operated 71 turboprop aircraft. The Bombardier CRJ-200 is a 50-seat twin-engine regional jet aircraft used primarily to serve lower density markets on routes of less than 1,000 miles, as well as to serve larger markets at "off peak" times. These aircraft are also used in selected "point-to-point" markets, transborder markets, and to develop selected domestic markets. The BAE 146 aircraft, which is expected to be phased out by mid-2005, is a four engine regional jet aircraft used to serve lower density markets and larger markets at "off-peak" times. The de Havilland DHC-8 is a four engine turboprop aircraft used to serve smaller markets and to feed connecting traffic to Air Canada's hubs.

Fuel

Aircraft fuel is a major expense to Air Canada. Fuel prices fluctuate widely depending on international market conditions, political events, geopolitical conflicts, and exchange rates of foreign currencies. During 2003 and the first quarter of 2004, fuel prices remained at historically high levels and continue to remain high in the second quarter of 2004. Air Canada 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. At December 31, 2003, Air Canada had no hedges for its anticipated first and second quarter 2004 fuel consumption. Based on 2003 volumes, a U.S.\$1 per barrel movement in the average price of crude oil would have resulted in an approximate \$28 million change in 2003 fuel expense for Air Canada, net of fuel hedges, assuming flying capacity remained unchanged and that refining spreads between West Texas intermediate crude oil and jet fuel as well as foreign exchange rates remained constant.

Insurance

All airlines have experienced a dramatic increase in the cost of aviation insurance since September 11, 2001. The current environment indicates a return to stability with some cost reductions, as warranted, dependent upon the individual situation. Air Canada's 2003 insurance costs were \$73 million. Air Canada's 2004 insurance costs are expected to be approximately \$65 million (as compared to annual costs of approximately \$28 million prior to September 11, 2001). The Government of Canada is continuing its indemnity program for third party war risks in excess of U.S.\$50 million coverage as provided by current market aviation insurance policies post September 11, 2001. This Government of Canada indemnity program is applicable to the country's aviation industry. In accordance with its established risk management practices, Air Canada continues to maintain adequate levels of insurance to protect Air Canada's assets and operational exposures. Such insurance is comparable to insurance carried by other major international airlines.

Employees

As part of its restructuring activities, the Corporation concluded new long term collective agreements with all union groups which expire in 2009, except for two union groups located in the United Kingdom for which the collective agreements expire in 2006. These collective agreements provide that in 2006 (2004 for the two union groups located in the United Kingdom) union groups may re-negotiate wage provisions that would be in effect for the remainder of the collective agreements. Any unresolved differences in the re-negotiation of their wage provisions will be resolved, as necessary, through mediation and arbitration.

The implementation of the unionized workforce reduction plan emanating from the new collective agreements is expected to be completed by mid-2004. The implementation of the workforce reduction plan pertaining to the Corporation's non-unionized workforce began in May 2003 and is expected to continue until the end of 2004. A significant reduction of full-time equivalent ("FTE") employees has been achieved through the implementation of these workforce reduction plans. As of February 29, 2004, Air Canada had an average of 32,935 FTE employees. During the fourth quarter of 2003, Air Canada had an average of 33,124 FTE employees, a 17% decrease from the previous year, as shown in the table below.

Employee Group	Union⁽¹⁾	FTE Employees 4th Quarter 2003	FTE Employees 4th Quarter 2002⁽²⁾	Agreement(s) Expiry Date
Mainline-related				
Management & Administrative				
Support employees	N/A	3,614	4,723	N/A
Pilots	ACPA	2,830	3,100	2009 ⁽³⁾
Flight Attendants	CUPE	5,898	6,789	2009 ⁽³⁾
Customer Sales & Service Agents	CAW/IBT	4,899	6,303	2009 ⁽³⁾
Ramp & Cargo Employees				
	IAMAW	4,769	5,428	2009 ⁽³⁾
Technical Services Maintenance Employees	IAMAW/other	5,459	6,830	2009 ⁽³⁾
U.K. Unionized Employees	AMICUS/ TGWU	743	850	2006
Other Unionized Employees	Various	681	820	2006
Other	n/a	305	362	2009 ⁽³⁾
Total Mainline -related		29,198	35,205	
Air Canada Jazz and other subsidiaries	Various	<u>3,926</u>	<u>4,791</u>	
Total Consolidated		33,124	39,996	

⁽¹⁾ ACPA: Air Canada Pilots' Association; CUPE: Canadian Union of Public Employees; CAW: National Automobile, Aerospace, Transportation and General Workers Union of Canada; IBT: International Brotherhood of Teamsters; IAMAW: International Association of Machinists and Aerospace Workers.

⁽²⁾ Certain comparative figures have been reclassified to conform to the presentation adopted in the current year.

⁽³⁾ Although the collective agreements will only expire in 2009, wages may be the object of re-negotiations in 2006.

Properties and Facilities

The following describes principal properties owned or leased by Air Canada at May 12, 2004.

<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	197,000	Leased with options until 2005
Vancouver Technical Operations Centre	Offices, hangars, shops, simulator, test cell facilities	1,076,000	Owned facilities on leased land; lease and options until 2048
Vancouver South Hangar	Offices, hangars, shops, stores	250,000	Owned facilities on leased land lease until 2009 (plus an option to extend until 2019)
Vancouver Cargo Building	Cargo facility	92,000	Long-term lease expires 2019, with options to renew until 2039
Calgary International Airport	Hangar, Commissary, Ground Support Equipment ("GSE"), and Warehouse	234,000	Owned facility on leased land; lease and options until 2020
Winnipeg Air Canada Building	Offices and computer centre	392,000	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 New & 2 Facilities	Counters, offices, passenger and baggage handling facilities and commuter terminal	266,000	Lease expires in 2009 for Terminal 1 New and in 2005 for Terminal 2. Terminal 2 will be vacated in late 2005 when transborder flights also relocate to Terminal 1 New
Toronto - Pearson International Airport Maintenance Base	Offices, simulator building, hangars and workshops	1,540,000	Owned facilities on leased land; lease and options until 2012

Principal Properties	Description	Approx. Gross Internal Floor Area (Sq. Ft.)	Nature of Title
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
Toronto - Cargo Facility	Offices, Cargo & Equipment Maintenance Building ("EMB")	425,000	Lease facility from the Greater Toronto Airports Authority (GTAA). Term of the lease expires 2027.
Montreal Pierre-Elliott Trudeau International Airport - Terminal Facilities	Counters, offices, passenger and baggage handling facilities	129,000	Premises leased on a long term basis until 2014
Montreal Pierre-Elliott Trudeau International Airport Maintenance Base	Offices, computer centre, aircraft maintenance, hangars, workshops and training facilities	1,858,000	Owned facilities on leased land; lease and option until 2051
Montreal Air Canada Centre Air Canada Headquarters	Head office and training facilities	272,000	Owned facilities on leased land; lease and option until 2051
Montreal Office Building – Air Canada Call Centre	Offices, reservations and <i>Aeroplan</i> call centers	202,000	Owned facilities on owned land
Halifax Hangar Base	Offices, Hangar, and Cargo	90,000	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, Montreal, 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 Montreal. Major operational and overhaul facilities are maintained in Montreal, Winnipeg, Mississauga, Calgary and Vancouver.

IV MANAGEMENT DISCUSSION AND ANALYSIS OF RESULTS

The information that appears in the 2003 Management Discussion and Analysis of Results of Air Canada is incorporated herein by reference.

V SELECTED CONSOLIDATED FINANCIAL INFORMATION

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

	Year ended December 31		
	(millions)		
	2001⁽¹⁾⁽³⁾	2002	2003
Operating revenues:			
Passenger.....	\$8,123	\$8,190	6,858
Cargo	578	585	519
Other.....	910	1,051	991
Total operating revenues	\$9,611	\$9,826	\$8,368
Operating expenses:			
Salaries, wages and benefits.....	3,022	3,099	2,828
Aircraft fuel.....	1,593	1,288	1,253
Aircraft rent.....	959	1,109	1,009
Airport and navigation fees.....	738	772	743
Aircraft maintenance, materials and supplies.....	569	508	383
Communications and information technology....	479	459	388
Food, beverages and supplies	435	395	334
Depreciation, amortization and obsolescence.....	441	372	366
Commissions	476	369	272
Other.....	<u>1,630</u>	<u>1,647</u>	<u>1,476</u>
Total operating expenses.....	<u>\$10,342</u>	<u>10,018</u>	<u>9,052</u>
Operating loss before the undernoted items	<u>\$ (731)</u>	<u>\$ (192)</u>	<u>\$ (684)</u>
Reorganization and restructuring items	—	—	(1,050)
Non-recurring labour expenses	—	(26)	—
Non-operating income (expense):			
Net-interest expense	(275)	(221)	(86)
Other.....	41	55	(196)
Total non-operating expense	<u>\$ (234)</u>	<u>\$ (166)</u>	<u>\$ (282)</u>
Loss before foreign exchange on non-compromised long-term monetary items and income taxes.....	<u>\$ (965)</u>	<u>\$ (384)</u>	<u>(2,016)</u>
Foreign exchange on non-compromised long-term monetary items	<u>\$ (20)</u>	<u>\$ (60)</u>	<u>\$ 137</u>
Loss before income taxes.....	<u>\$ (985)</u>	<u>\$ (444)</u>	<u>\$ (1,879)</u>
Recovery of (provision for) income taxes.....	<u>(330)</u>	<u>(384)</u>	<u>12</u>
Loss for the year.....	<u><u>\$ (1,315)</u></u>	<u><u>\$ (828)</u></u>	<u><u>\$ (1,867)</u></u>
Loss per Share (2) -basic and diluted	\$(10.95)	\$ (6.89)	\$(15.53)
Cash Flow from Operations.....	\$(1,072)	\$ (95)	\$ 139
Total assets.....	\$ 8,744	\$ 7,412	\$6,910
Long-term debt and capital lease obligations (including current portion)	\$ 3,939	\$ 3,494	\$505
Subordinated perpetual debt	\$ 1,172	\$ 1,193	—
Liabilities subject to compromise	—	—	\$ 5,313

	Year ended December 31		
	(millions)		
	2001⁽¹⁾⁽³⁾	2002	2003
Shareholders' equity	\$(1,460)	\$(2,288)	\$(4,155)

- (1) Effective January 1, 2002, the Corporation retroactively adopted, with restatement of prior periods, the amendments to Canadian Institute of Chartered Accountants standard #1650 – Foreign Currency Translation ("CICA 1650"), which no longer permits the deferral and amortization of unrealized translation gains and losses on long-term foreign currency denominated assets and liabilities. The impact on loss for the year ended December 31, 2002 is unfavourable \$33 or \$0.28 per share, basic and diluted. The impact on loss for the year ended December 31, 2001 is unfavourable \$61 or \$0.52 per share, basic and diluted.
- (2) 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.
- (3) The results of 2001 include a full-year of the former Canadian Airlines.

VI MARKET FOR SECURITIES

The Common Shares of the Corporation and the Class A Non-Voting Common Shares of the Corporation are listed on The Toronto Stock Exchange, under the symbols "AC" and "AC.A", respectively.

VII DIVIDEND RECORD

The Corporation has not paid dividends on its Common Shares or Class A Non-Voting Common Shares in the last five years.

VIII DIRECTORS AND OFFICERS

Directors

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

Name and Municipality of Residence	Principal Occupation	Director Since	Common Shares
HON. W. DAVID ANGUS, Q.C. ⁽¹⁾⁽²⁾ Montreal, Québec	Senior Partner Stikeman Elliott LLP (Barristers & Solicitors)	March 1985	2,572
ROBERT E. BROWN ⁽⁵⁾⁽⁷⁾ Westmount, Québec	Chairman of the Board Air Canada	March 2003	-
J.V. RAYMOND CYR, O.C., LL.D. ⁽²⁾⁽³⁾⁽⁴⁾⁽⁷⁾ Montreal, Québec	Chairman of Polyvalor Inc. (research and telecommunications company)	April 1990	16,211

Name and Municipality of Residence	Principal Occupation	Director Since	Common Shares
JOHN F. FRASER, O.C. ⁽²⁾⁽⁵⁾⁽⁷⁾ Winnipeg, Manitoba	Corporate Director	April 1989	34,634
DAVID A. GANONG ⁽³⁾⁽⁴⁾ St. Stephen, New Brunswick	President Ganong Bros. Limited (chocolate and confectionery manufacturer)	August 1988	13,211
PIERRE MARC JOHNSON, B.A., LL.L, M.D., Ph.D. (hc), F.R.S.C. ⁽¹⁾⁽⁴⁾ Montreal, Québec	Senior Counsel Heenan Blaikie (Canadian law firm)	May 2000	9,245
FERNAND LALONDE, Q.C. ⁽¹⁾⁽²⁾ Westmount, Québec	Partner Pouliot Mercure (Barristers & Solicitors)	March 1988	12,211
HON. EDWARD C. LUMLEY, P.C., LL.D. ⁽³⁾⁽⁵⁾ South Lancaster, Ontario	Vice Chairman BMO Nesbitt Burns (investment banking)	April 1994	12,211
ROBERT A. MILTON ⁽⁴⁾ Westmount, Québec	President and Chief Executive Officer Air Canada	August 1999	-(⁶)
PAUL D. MITCHELL, LL.D. ⁽¹⁾⁽⁵⁾ Waterloo, Ontario	Chairman of the Board (Retired) McNeil Consumer Healthcare Canada (pharmaceuticals)	March 1985	12,211
RONALD W. OSBORNE ⁽⁴⁾⁽⁵⁾⁽⁷⁾ Toronto, Ontario	Corporate Director	May 1999	19,472
JOHN C. POPE ⁽¹⁾⁽³⁾⁽⁷⁾ Lake Forest, Illinois	Chairman of PFI Group (investment firm)	May 1999	11,284

(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

(6) Mr. Robert Milton sold his entire shareholding in the Corporation shortly after the Corporation's filing under the CCAA for purposes of avoiding any actual or perceived financial interest during the restructuring phase, while dealing with economic stakeholders. Proceeds of the disposal of shares were donated to Dreams Take Flight, an Air Canada employee-organized charity.

(7) Member of the Restructuring Committee.

Each of the directors has held the principal occupation listed above in the last five years except as follows: Mr. Robert E. Brown became Chairman of the Board on May 13, 2003. Prior to May 13, 2003, he was Vice Chairman of the Board since April 7, 2003. He is a Corporate Director since March 12, 2003. Prior to December 2002, Mr. Robert E. Brown was President and Chief Executive Officer of Bombardier. Prior to February 1999, Mr. Brown was President and Chief Operating Officer of Bombardier Aerospace (including Short Brothers of Northern Ireland). 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 November 1999, John C. Pope was Chairman of MotivePower Industries. Prior to December 2003, Ronald W. Osborne was President and Chief Executive Officer of Ontario Power Generation Inc.

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. No shareholders' meeting was held in 2003. 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	9
W.G. BREDT Hudson Heights, Québec	President & Chief Executive Officer, ZIP	30
M.R. BREWER Hudson, Québec	Executive Vice President, Commercial	23
P.E. BROTTTO Pointe-Claire, Québec	Executive Vice President, Planning & Cost Management	32
D. DEE Ottawa, Ontario	Senior Vice President, Corporate Affairs	6
R.J. DUCHESNE Montreal, Québec	President and Chief Executive Officer, Aeroplan	18
Y. DUFRESNE Montreal, Québec	Vice President, International, Alliances and Regulatory Affairs	19
L. FOURNEL Lachine, Québec	President and Chief Executive Officer, Destina.ca	25
K.C. HOWLETT Delta, British Columbia	Vice President, Labour Relations	31

Name and Municipality of Residence	Position held	Years of Airline Industry Experience
P. LÉTOURNEAU, Q.C. Saint-Laurent, Québec	Vice President and Corporate Secretary	24
N. MANGER Pointe-Claire, Québec	Vice President, Airports	32
R.A. MILTON Westmount, Québec	President & Chief Executive Officer	21
B. MOORE Kirkland, Québec	Vice President, Customer Service	9
C. MORIN Montreal, Québec	Vice President, Cargo	19
A. PATERSON Oakville, Ontario	President & Chief Operating Officer, Air Canada Vacations	17
M.R. PETERSON Beaconsfield, Québec	Executive Vice President & Chief Financial Officer	30
D. POUDRETTE Verdun, Québec	Vice President, Corporate Initiatives	19
R.F. REID Oakville, Ontario	Senior Vice President, Operations	27
M. ROSENBERG Toronto, Ontario	Vice President, Sales and Product Distribution	34
B.M. SMITH Toronto, Ontario	Vice President, Planning	14
S. SMITH Calgary, Alberta	Senior Vice President, Customer Experience	25
S. WELSCHEID Town of Mount Royal, Québec	Vice President, People	24

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 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 Ltd.; Allister Paterson who, prior to 2002, was Executive General Manager, Commercial at Air New Zealand Group; Stephen Smith who, prior to 2004,

was President of ZIP and, prior to 2000, was President and Chief Executive Officer of WestJet; Benjamin Smith who, prior to 2004, was Senior Director Network Planning and, prior to May 2003, was Managing Director, Tango and, prior to 2002, was President of ABW Travel Inc.; and Brad Moore who, prior to 2003, was Senior Director, In-Flight Service and, prior to 2001, managed Air Canada's performance strategy and, prior to 2000, was Director, Human Resources Uncle Toby's Foods (Australia).

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

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.

IX 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 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.

X 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 Corporation's annual filing for the financial year ended December 31, 2002 (form 28 under the *Securities Act* (Ontario)) filed with the Securities Commissions on July 2, 2003. Financial information, including consolidated comparative audited financial statements, are provided in the 2003 Management Discussion & Analysis of Results / 2003 Financial Statements and Notes of Air Canada.

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 2003 Management Discussion & Analysis of Results / 2003 Financial Statements and Notes 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 Corporation's annual filing for the financial year ended December 31, 2002 (form 28 under the *Securities Act* (Ontario)) filed with the Securities Commissions on July 2, 2003; 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.

Evaluation of Disclosure Controls and Procedures

The Chief Executive Officer and the Chief Financial Officer have reviewed Air Canada's disclosure controls and procedures as of the date of this Annual Information Form (the "Evaluation Date"). Based on that review, they have concluded that, as of the Evaluation Date, these controls and procedures were, in design and operation, effective to assure that the information required to be included in this report has been properly collected, processed and timely communicated to those responsible in order that it may be included in this report.