AIR CANADA

First Quarter 2012

Management's Discussion and Analysis of Results of Operations and Financial Condition

May 4, 2012

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1. HIGHLIGHTS

The financial and operating highlights for Air Canada for the periods indicated are as follows.

(Canadian dollars in millions, except where indicated)	First Quarter 2012	First Quarter 2011	Change $
Financial Performance Metrics			
Operating revenues	2,962	2,753	209
Operating loss	(93)	(66)	(27)
Non-operating income (expense)	(62)	47	(109)
Loss before income taxes	(155)	(19)	(136)
Net loss from continuing operations	(155)	(19)	(136)
Net loss from discontinued operations - Aveos	(55)	-	(55)
Net loss	(210)	(19)	(191)
Operating margin %	(3.1%)	(2.4%)	(0.7) pp
EBITDAR (1)	175	207	(32)
EBITDAR margin % (1)	5.9%	7.5%	(1.6) pp
Cash, cash equivalents and short-term investments	2,249	2,114	135
Free cash flow (2)	129	190	(61)
Adjusted net debt (3)	4,375	4,643	(268)
Net loss per share – Basic and diluted	$ (0.76)	$ (0.07)	$ (0.69)
Adjusted net loss per share – Basic and diluted (4)	$ (0.64)	$ (0.45)	$ (0.19)
Operating Statistics			**Change %**
Revenue passenger miles (millions) (RPM)	12,946	12,355	4.8
Available seat miles (millions) (ASM)	16,344	15,859	3.1
Passenger load factor %	79.2%	77.9%	1.3 pp
Passenger revenue per RPM ("Yield") (cents)	19.2	18.6	3.3
Passenger revenue per ASM ("RASM") (cents)	15.2	14.5	5.0
Operating revenue per ASM (cents)	18.1	17.4	4.4
Operating expense per ASM ("CASM") (cents)	18.7	17.8	5.2
CASM, excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations (cents) (5)	12.3	12.2	1.0
Average number of full-time equivalent (FTE) employees (thousands) (6)	24.0	23.6	1.5
Aircraft in operating fleet at period end (7)	330	328	0.6
Average fleet utilization (hours per day) (8)	10.1	10.1	-
Revenue frequencies (thousands)	135	132	2.4
Average aircraft flight length (miles) (8)	892	890	0.2
Economic fuel price per litre (cents) (9)	91.6	78.2	17.1
Fuel litres (millions)	970	938	3.4

(1) *EBITDAR (earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent) is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for a reconciliation of EBITDAR to operating income (loss).*
(2) *Free cash flow (cash flows from operating activities less additions to property, equipment and intangible assets) is a non-GAAP financial measure. Refer to section 6.5 of this MD&A for additional information.*
(3) *Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is a non-GAAP financial measure. Refer to section 6.3 of this MD&A for additional information.*
(4) *Adjusted net income (loss) per share (diluted) is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.*
(5) *Operating expense, excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations, is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.*
(6) *Reflects FTE employees at Air Canada. Excludes FTE employees at third party carriers (such as at Jazz Aviation LP ("Jazz")) operating under capacity purchase agreements with Air Canada.*
(7) *Includes Jazz aircraft covered under a capacity purchase agreement with Jazz (the "Jazz CPA"). Excludes aircraft operated by other third party carriers pursuant to capacity purchase agreements with Air Canada. Refer to section 5 of this MD&A for additional information.*
(8) *Excludes charter operations. Also excludes third party carriers operating under capacity purchase arrangements, other than Jazz aircraft covered under the Jazz CPA.*
(9) *Excludes third party carriers, other than Jazz, operating under capacity purchase agreements. Includes fuel handling. Economic fuel price per litre is a non-GAAP financial measure. Refer to section 4 of this MD&A for additional information.*

2. INTRODUCTION

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), the "Corporation" refers to, as the context may require, Air Canada and/or one or more of Air Canada's subsidiaries. This MD&A provides the reader with a review and analysis, from the perspective of management, of Air Canada's financial results for the first quarter of 2012. This MD&A should be read in conjunction with Air Canada's interim unaudited condensed consolidated financial statements and notes for the first quarter of 2012 and Air Canada's annual audited consolidated financial statements and notes and its annual MD&A for 2011 dated February 9, 2012. All financial information has been prepared in accordance with generally accepted accounting principles in Canada ("GAAP"), as set out in the Handbook of the Canadian Institute of Chartered Accountants – Part 1 ("CICA Handbook"), which incorporates International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), except for any financial information specifically denoted otherwise.

Except as otherwise noted, monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 16 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of May 3, 2012. Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 18 "Risk Factors" of Air Canada's annual MD&A for 2011 dated February 9, 2012 and section 13 "Risk Factors" of this MD&A.

Air Canada issued a news release dated May 4, 2012 reporting on its results for the first quarter of 2012. This news release is available on Air Canada's website at **aircanada.com** and on SEDAR's website at **www.sedar.com**. For further information on Air Canada's public disclosures, including Air Canada's Annual Information Form, consult SEDAR at **www.sedar.com**.

CAUTION REGARDING FORWARD-LOOKING INFORMATION

Air Canada's public communications may include written or oral forward-looking statements within the meaning of applicable securities laws. Such statements are included in this MD&A and may be included in other communications, including filings with regulatory authorities and securities regulators. Forward-looking statements may be based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to strategies, expectations, planned operations or future actions. Forward-looking statements are identified by the use of terms and phrases such as "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "predict", "project", "will", "would", and similar terms and phrases, including references to assumptions.

Forward-looking statements, by their nature, are based on assumptions, including those described herein and are subject to important risks and uncertainties. Forward-looking statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including without limitation, industry, market, credit and economic conditions, the ability to reduce operating costs and secure financing, pension issues, energy prices, employee and labour relations, currency exchange and interest rates, competition, war, terrorist acts, epidemic diseases, environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), insurance issues and costs, changes in demand due to the seasonal nature of the business, supply issues, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in section 18 "Risk Factors" of Air Canada's annual MD&A for 2011 dated February 9, 2012 and section 13 "Risk Factors" of this MD&A. The forward-looking statements contained in this MD&A represent Air Canada's expectations as of May 3, 2012 (or as of the date they are otherwise stated to be made), and are subject to change after such date. However, Air Canada disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

Assumptions were made by Air Canada in preparing and making forward-looking statements. Air Canada assumes that the Canadian economy will continue to recover and assumes Canadian GDP growth of 1.5% to 2.0% in 2012. In addition, Air Canada expects that the Canadian dollar will trade, on average, at C$0.99 per U.S. dollar in the second quarter of 2012 and C$1.00 per U.S. dollar for the full year 2012 and that the price of jet fuel will average 91 cents per litre for the second quarter of 2012 and for the full year 2012.

3. OVERVIEW

Air Canada is Canada's largest domestic, U.S. transborder and international airline and the largest provider of scheduled passenger services in the Canadian market, in the Canada-U.S. transborder market and in the international market to and from Canada. Air Canada's results of operations for the first quarter of 2012 compared to the first quarter of 2011 are as follows:

- In the first quarter of 2012, Air Canada reported operating revenues of $2,962 million, an increase of $209 million or 8% from the first quarter of 2011. Passenger revenues increased $213 million or 9% on a 4.8% growth in system passenger traffic and a 3.3% improvement in system yield. Overall capacity was 3.1% higher than in the first quarter of 2011 and reflected ASM capacity growth in all markets. This system capacity growth was in line with the 2.5% to 3.5% first quarter 2012 ASM capacity increase projected in Air Canada's news release dated February 9, 2012. System RASM increased 5.0% year-over-year on both the yield growth and a passenger load factor improvement of 1.3 percentage points.

- In the first quarter of 2012, Air Canada reported operating expenses of $3,055 million, an increase of $236 million or 8% from the first quarter of 2011, of which $147 million was due to higher fuel expense year-over-year. Excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations, CASM increased 1.0% from the first quarter of 2011.

- In the first quarter of 2012, Air Canada reported an operating loss of $93 million compared to an operating loss of $66 million in the first quarter of 2011. EBITDAR of $175 million decreased $32 million from the same quarter in 2011. Air Canada's EBITDAR of $175 million in the first quarter of 2012 was in line with the range of $170 million to $180 million projected in Air Canada's news release dated April 26, 2012.

- In the first quarter of 2012, Air Canada reported a net loss of $210 million or $0.76 per diluted share compared to a net loss of $19 million or $0.07 per diluted share in the first quarter of 2011. As a result of Aveos filing for court protection under the Companies Creditors Arrangements Act ("CCAA") on March 19, 2012, Air Canada recorded a loss on investments of $65 million in the first quarter of 2012 as well as a liability and corresponding loss from discontinued operations - Aveos of $55 million related to Air Canada's commitment under a separation program, for total charges of $120 million, as projected in Air Canada's news release dated April 26, 2012. Refer to section 4 of this MD&A for additional information on the separation program. In the first quarter of 2012, adjusted net loss per diluted share was $0.64 compared to an adjusted net loss per diluted share of $0.45 in the first quarter of 2011. Refer to section 15 "Non-GAAP Financial Measures" for additional information.

- Free cash flow amounted to $129 million in the first quarter of 2012, a decrease of $61 million from the first quarter of 2011. This decrease in free cash flow was largely due to an increase in capital expenditures of $87 million, a significant portion of which was related to the exercise of purchase rights on three Boeing 777 aircraft in the first quarter of 2012. In the first quarter of 2012, cash flows from operating activities amounted to $278 million, an improvement of $26 million from the first quarter of 2011, mainly due to improvements in cash from working capital.

- At March 31, 2012, adjusted net debt of $4,375 million decreased $201 million from December 31, 2011, reflecting lower debt balances, as well as the impact of an increase in cash, cash equivalents and short-term investments of $150 million. This increase in unrestricted cash was mainly due to positive free cash flow of $129 million recorded in the first quarter of 2012.

- Cash, cash equivalents and short-term investments totaled $2,249 million as at March 31, 2012, an increase of $135 million from March 31, 2011, and represented 19% of 12-month trailing operating revenues. Air Canada's total cash, cash equivalents and short-term investments of $2,249 million as at March 31, 2012 was in line with the cash levels projected in Air Canada's news release dated April 26, 2012.

4. RESULTS OF OPERATIONS – FIRST QUARTER 2012 VERSUS FIRST QUARTER 2011

The following table and discussion compares the results of Air Canada for the first quarter of 2012 versus the first quarter of 2011.

	First Quarter		Change	
(Canadian dollars in millions, except per share figures)	2012	2011	$	%
Operating revenues				
Passenger	$ 2,524	$ 2,311	$ 213	9
Cargo	122	116	6	5
Other	316	326	(10)	(3)
Total revenues	**2,962**	**2,753**	**209**	**8**
Operating expenses				
Aircraft fuel	889	742	147	20
Wages, salaries, and benefits	536	506	30	6
Airport and navigation fees	242	234	8	3
Capacity purchase agreements	256	242	14	6
Depreciation, amortization and impairment	180	185	(5)	(3)
Aircraft maintenance	182	166	16	10
Sales and distribution costs	166	166	-	-
Food, beverages and supplies	69	68	1	1
Communications and information technology	49	50	(1)	(2)
Aircraft rent	88	88	-	-
Other	398	372	26	7
Total operating expenses	**3,055**	**2,819**	**236**	**8**
Operating loss	**(93)**	**(66)**	**(27)**	
Non-operating income (expense)				
Foreign exchange gain	87	104	(17)	
Interest income	9	9	-	
Interest expense	(80)	(84)	4	
Net financing expense relating to employee benefits	(7)	(4)	(3)	
Gain (loss) on financial instruments recorded at fair value	(7)	27	(34)	
Loss on investments in Aveos	(65)	-	(65)	
Other	1	(5)	6	
Total non-operating income (expense)	**(62)**	**47**	**(109)**	
Loss before income taxes	**(155)**	**(19)**	**(136)**	
Recovery of income taxes	-	-	-	
Net loss for the period from continuing operations	**$ (155)**	**$ (19)**	**$ (136)**	
Net loss for the period from discontinued operations - Aveos	**$ (55)**	**$ -**	**$ (55)**	
Net loss for the period	**$ (210)**	**$ (19)**	**$ (191)**	
EBITDAR[(1)]	**$ 175**	**$ 207**	**$ (32)**	
Net loss per share – Basic and diluted	**$ (0.76)**	**$ (0.07)**	**$ (0.69)**	

(1) EBITDAR (earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent) is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for a reconciliation of EBITDAR to operating income (loss).

System passenger revenues increased 9.2% from the first quarter of 2011

System passenger revenues of $2,524 million in the first quarter of 2012 increased $213 million or 9.2% from 2011 first quarter passenger revenues of $2,311 million, due to a 4.8% growth in traffic and a 3.3% improvement in yield. Premium cabin revenues increased $54 million or 10.8% from the first quarter of 2011 due to traffic growth of 11.8% as premium cabin yield declined 1.0%. Traffic growth in the premium cabin was driven by two key factors: (i) the introduction of more attractive leisure business class fares on select North American routes, subject to business class seat availability, which generated buy-up from the lower-yielding economy class cabin, and (ii) increased usage of Air Canada's electronic upgrade product. The decline in premium cabin yield was mainly due to downward pressure on Air Canada's Atlantic business class fares as a result of increased competitive activities and weak economic conditions in Europe.

The table below provides passenger revenue by geographic region for the first quarter of 2012 and the first quarter of 2011.

Passenger Revenue	First Quarter 2012 $ Million	First Quarter 2011 $ Million	$ Change	% Change
Canada	944	898	46	5.0
U.S. transborder	604	533	71	13.5
Atlantic	368	347	21	6.0
Pacific	283	241	42	17.8
Other	325	292	33	11.1
System	**2,524**	**2,311**	**213**	**9.2**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the first quarter of 2012 versus the first quarter of 2011.

First Quarter 2012 Versus First Quarter 2011	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	5.0	2.0	3.8	1.4	0.7	2.6
U.S. transborder	13.5	6.2	7.3	0.8	3.9	4.9
Atlantic	6.0	3.3	5.9	1.8	(0.8)	1.7
Pacific	17.8	2.3	3.5	1.0	12.8	14.1
Other	11.1	1.7	3.7	1.6	6.3	8.4
System	**9.2**	**3.1**	**4.8**	**1.3**	**3.3**	**5.0**

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the first quarter 2012 and each of the previous four quarters.

System	Year-over-Year by Quarter (% Change)				
	Q1'11	Q2'11	Q3'11	Q4'11	Q1'12
Passenger Revenues	10.3	11.7	7.9	5.2	9.2
Capacity (ASMs)	7.7	6.4	2.6	2.5	3.1
Traffic (RPMs)	5.7	6.1	3.8	2.6	4.8
Passenger Load Factor (pp Change)	(1.5)	(0.2)	1.1	0.1	1.3
Yield	4.2	5.2	3.8	1.9	3.3
RASM	2.2	4.9	5.1	2.0	5.0

In the first quarter of 2012, Air Canada's overall capacity was 3.1% higher than the first quarter of 2011, with capacity growth reflected in all markets.

Components of the year-over-year change in first quarter system passenger revenues included:

- The system traffic increase which reflected growth in all markets. The traffic gains exceeded the capacity growth, resulting in a higher passenger load factor.
- The system yield growth which reflected growth in all markets with the exception of the Atlantic. The overall yield improvement was due to increased fares and higher fuel surcharges to partly offset higher fuel prices.

The RASM improvement was due to the higher yield and passenger load factor.

Domestic passenger revenues increased 5.0% from the first quarter of 2011

Domestic passenger revenues of $944 million in the first quarter of 2012 increased $46 million or 5.0% from the first quarter of 2011 due to traffic growth and, to a lesser extent, a yield improvement.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the first quarter 2012 and each of the previous four quarters.

Canada	Year-over-Year by Quarter (% Change)				
	Q1'11	Q2'11	Q3'11	Q4'11	Q1'12
Passenger Revenues	8.4	7.9	4.7	3.2	5.0
Capacity (ASMs)	(0.9)	(0.2)	0.3	2.1	2.0
Traffic (RPMs)	(0.5)	(0.6)	2.1	2.1	3.8
Passenger Load Factor (pp Change)	0.4	(0.3)	1.5	-	1.4
Yield	8.7	8.4	2.4	0.4	0.7
RASM	9.2	8.0	4.3	0.4	2.6

On May 1, 2011, Sky Regional, on behalf of Air Canada, began operating 15 daily flights from Toronto Island's Billy Bishop Airport to Montreal's Pierre Elliott Trudeau International Airport ("Montreal Trudeau Airport"). The domestic capacity growth in the first quarter of 2012 was mainly due to this new service and to capacity increases on regional routes. Components of the year-over-year change in first quarter domestic passenger revenues included:

- The traffic increase which reflected growth on all major domestic services. The traffic gains exceeded the capacity growth, resulting in a higher passenger load factor.
- The yield improvement which reflected growth on all major domestic services with the exception of routes linking Toronto and Montreal and on regional routes in Ontario. The overall yield improvement in the domestic market was due to fuel-related fare increases to partly offset higher fuel prices, as well as gains in premium cabin traffic. Yields on routes linking Toronto and Montreal and on regional routes in Ontario were negatively impacted by increased competitive pricing activities and the fact that higher-yielding premium cabin services are not offered on Air Canada's service from Toronto Island's Billy Bishop Airport.

The overall RASM improvement was due to the higher passenger load factor and the yield growth.

U.S. transborder passenger revenues increased 13.5% from the first quarter of 2011

U.S. transborder passenger revenues of $604 million in the first quarter of 2012 increased $71 million or 13.5% from the first quarter of 2011 due to traffic and yield growth.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the first quarter 2012 and each of the previous four quarters.

U.S. Transborder	Year-over-Year by Quarter (% Change)				
	Q1'11	Q2'11	Q3'11	Q4'11	Q1'12
Passenger Revenues	14.5	20.2	13.2	11.6	13.5
Capacity (ASMs)	10.8	7.8	4.7	3.2	6.2
Traffic (RPMs)	11.5	12.9	9.3	5.3	7.3
Passenger Load Factor (pp Change)	0.4	3.5	3.4	1.4	0.8
Yield	2.5	6.4	3.4	5.4	3.9
RASM	3.1	11.4	8.0	7.4	4.9

In the first quarter of 2012, the U.S. transborder capacity growth was largely due to increases in frequencies on routes to Florida and Hawaii. Components of the year-over-year change in first quarter U.S. transborder passenger revenues included:

- The traffic increase which reflected growth on all major U.S. transborder services and was in part due to sixth freedom traffic flows from the U.S. (meaning U.S. originating traffic carried through points in Canada to other international destinations) as the airline continues to leverage the strengths of its international network. The traffic gains exceeded the capacity growth, resulting in a higher passenger load factor.

- The yield improvement which reflected growth on all major U.S. transborder services. The yield improvement was due to fuel-related fare increases to partly offset higher fuel prices, as well as gains in premium cabin traffic.

The RASM improvement was due to the improvement in yield and, to a lesser extent, the higher passenger load factor.

Atlantic passenger revenues increased 6.0% from the first quarter of 2011

Atlantic passenger revenues of $368 million in the first quarter of 2012 increased $21 million or 6.0% from the first quarter of 2011 due to traffic growth.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the first quarter 2012 and each of the previous four quarters.

Atlantic	Year-over-Year by Quarter (% Change)				
	Q1'11	Q2'11	Q3'11	Q4'11	Q1'12
Passenger Revenues	0.8	11.6	8.2	(1.0)	6.0
Capacity (ASMs)	6.2	12.3	3.6	2.2	3.3
Traffic (RPMs)	(0.8)	8.4	4.1	1.2	5.9
Passenger Load Factor (pp Change)	(5.0)	(3.0)	0.5	(0.8)	1.8
Yield	1.3	2.7	3.8	(3.1)	(0.8)
RASM	(5.4)	(0.8)	4.3	(4.0)	1.7

In the first quarter of 2012, the Atlantic capacity growth was mainly driven by additional frequencies on Toronto – Montreal – Brussels, Toronto – Montreal – Geneva, Toronto – Zurich, Halifax – London, and the use of a larger aircraft on Calgary – Frankfurt.

Components of the year-over-year change in first quarter Atlantic passenger revenues included:

- The traffic increase which reflected growth on all major Atlantic services. The overall traffic gains, with particular strength in the premium cabin, exceeded the capacity growth resulting in a higher passenger load factor.

- The yield decline which was due in part to the impact of increased competitive activities and weak economic conditions in Europe. Approximately 30% of Air Canada's Atlantic revenues are generated from point of sale Europe.

The increase in RASM was due to the higher passenger load factor.

Pacific passenger revenues increased 17.8% from the first quarter of 2011

Pacific passenger revenues of $283 million in the first quarter of 2012 increased $42 million or 17.8% from the first quarter of 2011 due to a yield improvement and, to a lesser extent, traffic growth.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the first quarter 2012 and each of the previous four quarters.

Pacific	Year-over-Year by Quarter (% Change)				
	Q1'11	Q2'11	Q3'11	Q4'11	Q1'12
Passenger Revenues	17.0	6.4	5.8	6.9	17.8
Capacity (ASMs)	21.5	7.2	2.0	1.4	2.3
Traffic (RPMs)	16.0	5.9	1.5	1.6	3.5
Passenger Load Factor (pp Change)	(4.0)	(1.1)	(0.5)	0.1	1.0
Yield	0.7	0.4	4.2	4.7	12.8
RASM	(3.9)	(0.8)	3.6	4.9	14.1

In the first quarter of 2012, the Pacific capacity growth was mainly attributable to the use of a higher capacity Boeing 777 aircraft on Air Canada's Toronto – Narita route. All Pacific routes reflected capacity increases with the exception of Hong Kong. Traffic in the first quarter of 2011 was negatively impacted by the March 11th earthquake in Japan and its aftermath, which management estimated had adversely impacted first quarter 2011 Pacific passenger revenues by $3 million.

Components of the year-over-year change in first quarter Pacific passenger revenues included:

- The traffic increase which reflected growth on all major routes with the exception of Hong Kong. The overall traffic gains exceeded the capacity growth, resulting in a higher passenger load factor.

- The yield increase which reflected growth on all major Pacific services. The yield improvement was due to higher fuel surcharges to partly offset higher fuel prices, fare increases, as well as gains in premium cabin traffic. In addition, Air Canada introduced Tango fares on China and Hong Kong flights, with reduced Aeroplan miles offered, which, in turn, produced strong buy-up to higher-yielding Tango Plus fares.

The RASM improvement was due to the yield growth and, to a lesser extent, the higher passenger load factor.

Other passenger revenues increased 11.1% from the first quarter of 2011

Other passenger revenues (comprised of routes to Australia, the Caribbean, Mexico, Central and South America) of $325 million in the first quarter of 2012 increased $33 million or 11.1% from the first quarter of 2011 due to yield and traffic growth.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the first quarter 2012 and each of the previous four quarters.

Other	Year-over-Year by Quarter (% Change)				
	Q1'11	Q2'11	Q3'11	Q4'11	Q1'12
Passenger Revenues	16.4	20.7	16.9	11.1	11.1
Capacity (ASMs)	9.1	8.6	5.3	4.6	1.7
Traffic (RPMs)	7.7	10.9	5.8	4.9	3.7
Passenger Load Factor (pp Change)	(1.1)	1.7	0.4	0.2	1.6
Yield	8.1	9.0	10.4	5.7	6.3
RASM	6.7	11.4	11.0	5.9	8.4

In the first quarter of 2012, the capacity growth was mainly due to capacity increases on routes to South America and, to a lesser extent, to the Caribbean. Components of the year-over-year change in first quarter Other passenger revenues included:

- The overall traffic increase which reflected growth on all major services. The overall traffic increase exceeded the capacity growth, resulting in a higher passenger load factor.
- The overall yield improvement which was due to increased fares and higher fuel surcharges to partly offset higher fuel prices, as well as to gains in premium cabin traffic. Routes to South America and Australia recorded significant yield improvements year-over-year, on stronger passenger demand.

The overall RASM improvement was due to the yield growth and higher passenger load factor.

Cargo revenues increased 5.0% from the first quarter of 2011

Cargo revenues of $122 million in the first quarter of 2012 increased $6 million or 5.0% from the first quarter of 2011 due to traffic and yield growth.

The table below provides cargo revenue by geographic region for the first quarter of 2012 and the first quarter of 2011.

Cargo Revenue	First Quarter 2012 $ Million	First Quarter 2011 $ Million	$ Change	% Change
Canada	15	14	1	6.4
U.S. transborder	5	4	1	14.9
Atlantic	46	48	(2)	(3.9)
Pacific	39	34	5	16.6
Other	17	16	1	10.3
System	**122**	**116**	**6**	**5.0**

The table below provides year-over-year percentage changes in system cargo revenues and operating statistics for the first quarter 2012 and each of the previous four quarters.

System	Year-over-Year by Quarter (% Change)				
	Q1'11	Q2'11	Q3'11	Q4'11	Q1'12
Cargo Revenues	12.0	3.8	(1.7)	1.2	5.0
Capacity (ETMs)	7.4	7.0	1.9	2.5	3.1
Revenue per ETM	3.3	(3.1)	(3.5)	(1.3)	2.8
Traffic (RTMs)	5.8	(2.4)	(7.7)	(0.4)	5.0
Yield per RTM	4.9	6.3	6.5	1.6	1.3

The table below provides year-over-year percentage changes in cargo revenues and operating statistics for the first quarter of 2012 versus the first quarter of 2011.

First Quarter 2012 Versus First Quarter 2011	Cargo Revenue % Change	Capacity (ETMs) % Change	Rev / ETM % Change	Traffic (RTMs) % Change	Yield / RTM % Change
Canada	6.4	0.6	5.8	7.5	(1.0)
U.S. transborder	14.9	9.3	5.1	15.7	(0.7)
Atlantic	(3.9)	3.3	(6.9)	(8.3)	4.8
Pacific	16.6	2.3	13.9	19.2	(2.2)
Other	10.3	2.8	7.3	7.3	2.8
System	**5.0**	**3.1**	**2.8**	**5.0**	**1.3**

Components of the year-over-year change in first quarter cargo revenues included:

- The overall yield improvement which was mainly due to higher fuel surcharges year-over-year to offset higher fuel prices. This improvement was partly offset by the impact of increased competitive pricing activities, particularly in the North American and Atlantic markets.
- The traffic increase which reflected growth in all markets with the exception of the Atlantic market. The Pacific market experienced strong demand on reduced industry capacity while the Atlantic market continued to be negatively impacted by weak economic conditions in Europe.

Other revenues decreased 3% from the first quarter of 2011

Other revenues of $316 million in the first quarter of 2012 decreased $10 million or 3% from the first quarter of 2011 due to a decrease in third party ground package revenues at Air Canada Vacations, as well as a reduction in aircraft lease revenues. The decrease in third party ground package revenues at Air Canada Vacations was largely driven by lower passenger volumes. The decrease in aircraft lease revenues year-over-year was mainly due to fewer aircraft being subleased to third parties when compared to the first quarter of 2011.

CASM increased 5.2% from the first quarter of 2011. Excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations, CASM increased 1.0% from the first quarter of 2011

The following table compares Air Canada's CASM for the first quarter of 2012 to Air Canada's CASM for the corresponding period in 2011.

	First Quarter		Change	
(cents per ASM)	**2012**	**2011**	**cents**	**%**
Wages and salaries	2.48	2.36	0.12	5.1
Benefits	0.80	0.83	(0.03)	(3.6)
Aircraft fuel	5.44	4.68	0.76	16.2
Airport and navigation fees	1.48	1.47	0.01	0.7
Capacity purchase agreements	1.56	1.52	0.04	2.6
Ownership (DAR)[(1)]	1.64	1.72	(0.08)	(4.7)
Aircraft maintenance	1.11	1.04	0.07	6.7
Sales and distribution costs	1.01	1.04	(0.03)	(2.9)
Food, beverages and supplies	0.42	0.42	-	-
Communications and information technology	0.30	0.31	(0.01)	(3.2)
Other	2.45	2.38	0.07	2.9
Total operating expense	**18.69**	**17.77**	**0.92**	**5.2**
Remove:				
Cost of fuel expense and cost of ground packages at Air Canada Vacations	(6.38)	(5.58)	(0.80)	14.3
Operating expense, excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations[(2)]	**12.31**	**12.19**	**0.12**	**1.0**

(1) DAR refers to the combination of depreciation, amortization and impairment, and aircraft rent expenses.

(2) Operating expense, excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations, is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

The 1.0% increase in CASM, excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations, was better than the 4.0% to 5.0% increase projected in Air Canada's news release dated February 9, 2012. The better than expected performance was mainly due to lower than projected aircraft maintenance expense, largely due to timing of maintenance events, as well as lower sales and distribution costs versus what Air Canada had previously anticipated.

Operating expenses increased 8% from the first quarter of 2011

Air Canada recorded operating expenses of $3,055 million, an increase of $236 million or 8% from the operating expenses of $2,819 million recorded in the first quarter of 2011. The more significant variances are discussed below.

Fuel expense increased 20% from the first quarter of 2011

In the first quarter of 2012, fuel expense of $889 million increased $147 million or 20% from the first quarter of 2011. This increase was mainly due to higher base fuel prices year-over-year, which accounted for an increase of $108 million, a greater volume of fuel litres consumed, which accounted for an increase of $24 million, and the unfavourable impact of a weaker Canadian dollar in the first quarter of 2012 when compared to the first quarter of 2011, which accounted for an increase of $11 million.

The table below provides Air Canada's fuel cost per litre and economic fuel costs per litre for the periods indicated.

(Canadian dollars in millions, except where indicated)	First Quarter 2012	First Quarter 2011	Change $	Change %
Aircraft fuel expense – GAAP(1)	$ 882	$ 738	$ 144	20
Add: Net cash (receipts) payments on fuel derivatives(2)	7	(4)	11	275
Economic cost of fuel – Non-GAAP(3)	**$ 889**	**$ 734**	**$ 155**	**21**
Fuel consumption (thousands of litres)	969,554	938,206	31,348	3
Fuel costs per litre (cents) – GAAP	90.9	78.7	12.2	16
Economic fuel costs per litre (cents) – Non-GAAP	91.6	78.2	13.4	17

(1) Excludes fuel expense related to third party carriers, other than Jazz, operating under capacity purchase agreements.

(2) Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives.

(3) The economic cost of fuel is a non-GAAP measure used by Air Canada and may not be comparable to measures presented by other public companies. Air Canada uses this measure to calculate its cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period and premium costs associated with those derivatives.

Wages, salaries and benefits expense amounted to $536 million in the first quarter of 2012, an increase of $30 million or 6% from the first quarter of 2011

In the first quarter of 2012, wages and salaries expense of $405 million increased $31 million or 8% from the first quarter of 2011, mainly due to the impact of higher average salaries year-over-year and a 1.5% increase in the average number of full-time equivalent ("FTE") employees. In addition, in the first quarter of 2012, Air Canada recorded a liability of $18 million related to employee profit sharing payments. This liability is an estimate based upon a number of assumptions and may be subject to adjustment in the future. Employee benefits expense amounted to $131 million in the first quarter of 2012, a decrease of $1 million or 1% from the first quarter of 2011.

Airport and navigation fees increased 3% from the first quarter of 2011

In the first quarter of 2012, airport and navigation fees of $242 million increased $8 million or 3% from the first quarter of 2011, mainly due to a 2.4% increase in aircraft departures, including as a result of Sky Regional's commencement, on May 1, 2011, of services on behalf of Air Canada between Billy Bishop Toronto City Airport and Montreal Trudeau Airport. The growth in frequencies was in part due to this new service. The impact of changes in schedule and aircraft types being operated to certain destinations was also a factor in the increase in airport and navigations fees year-over-year.

Capacity purchase costs increased 6% from the first quarter of 2011

In the first quarter of 2012, capacity purchase costs of $256 million increased $14 million or 6% from the first quarter of 2011, mainly due to Sky Regional's commencement, on May 1, 2011, of services on behalf of Air Canada between Billy Bishop Toronto City Airport and Montreal Trudeau Airport, as well as higher Jazz CPA rates.

Ownership costs decreased 2% from the first quarter of 2011

In the first quarter of 2012, ownership costs (which are comprised of depreciation, amortization and impairment, and aircraft rent expenses) of $268 million declined $5 million or 2% from the first quarter of 2011, mainly due to a decrease in depreciation expense related to the airline's interior refurbishment programs.

Aircraft maintenance expense increased 10% from the first quarter of 2011

In the first quarter of 2012, aircraft maintenance expense of $182 million increased $16 million or 10% from the first quarter of 2011. This increase was mainly due to growth in engine and components maintenance activity, higher power-by-the-hour rates related to Air Canada's Boeing 777 aircraft, as well as an increase of $5 million pertaining to end of lease maintenance return provisions. These increases were partly offset by a decrease in airframe maintenance activity as well as lower deicing expenses resulting from more favourable weather conditions when compared to the first quarter of 2011.

Sales and distribution costs were unchanged from the first quarter of 2011

In the first quarter of 2012, sales and distribution costs of $166 million were unchanged from the first quarter of 2011 on passenger revenue growth of 9.2%. This increase was mainly due to an increase in transaction fees paid to Global Distribution Services ("GDS") providers, which was due to rate increases, and growth in credit card fees, which was driven by higher passenger sales. These increases were offset by lower commission expense at Air Canada, in part due to program changes, and by a decrease in sales and distribution costs at Air Canada Vacations resulting from lower passenger volumes.

Food, beverages and supplies expense increased 1% from the first quarter of 2011

In the first quarter of 2012, food, beverages and supplies expense of $69 million increased $1 million or 1% from the first quarter of 2011. The impact of a 4.8% growth in passenger traffic was largely offset by the favourable impact of contract and process improvements.

Other operating expenses increased 7% from the first quarter of 2011

In the first quarter of 2012, other operating expenses amounted to $398 million increased $26 million or 7% from the first quarter of 2011.

The following table provides a breakdown of the more significant items included in other expenses:

	First Quarter		Change	
(Canadian dollars in millions)	**2012**	**2011**	**$**	**%**
Air Canada Vacations' land costs	$ 153	$ 143	$ 10	7
Terminal handling	47	47	-	-
Building rent and maintenance	32	33	(1)	(3)
Crew cycle	28	29	(1)	(3)
Miscellaneous fees and services	33	23	10	43
Remaining other expenses	105	97	8	8
Other operating expenses	**$ 398**	**$ 372**	**$ 26**	**7**

Factors contributing to the year-over-year change in first quarter Other expenses included:

- The 3.1% growth in capacity.
- An increase of $10 million or 7% in expenses related to ground packages at Air Canada Vacations which was due to a higher cost of ground packages. Higher hotel costs in the Caribbean, driven by strong industry demand as well as a rebound in the U.S. economy, were the main contributing factors.
- An increase of $10 million or 43% in miscellaneous fees and services incurred in relation to various corporate initiatives.

Non-operating expense amounted to $62 million in the first quarter of 2012 compared to non-operating income of $47 million in the first quarter of 2011

The following table provides a breakdown of non-operating income (expense) for the periods indicated:

(Canadian dollars in millions)	First Quarter 2012	First Quarter 2011	Change $
Foreign exchange gain	$ 87	$ 104	$ (17)
Interest income	9	9	-
Interest expense	(80)	(84)	4
Net financing expense relating to employee benefits	(7)	(4)	(3)
Gain (loss) on financial instruments recorded at fair value	(7)	27	(34)
Loss on investments in Aveos	(65)	-	(65)
Other	1	(5)	6
Total non-operating income (expense)	**$ (62)**	**$ 47**	**$ (109)**

Factors contributing to the year-over-year change in first quarter non-operating income (expense) included:

- Gains on foreign exchange (mainly related to U.S. currency denominated long-term debt) which amounted to $87 million in the first quarter of 2012 compared to gains of $104 million in the first quarter of 2011. The gains in the first quarter of 2012 were mainly attributable to a stronger Canadian dollar at March 31, 2012 when compared to December 31, 2011. The March 31, 2012 closing exchange rate was US$1 = C$0.9975 while the December 31, 2011 closing exchange rate was US$1 = C$1.017.

- A decrease in interest expense which was largely due to the impact of net debt repayments made in the last twelve months.

- An increase in net financing expense relating to employee benefits which was due to a decrease in the expected return on pension plan assets for 2012. The net financing expense is comprised of interest cost on the employee benefit liabilities and expected returns on pension plan assets.

- Losses related to fair value adjustments on derivative instruments which amounted to $7 million in the first quarter of 2012 versus gains of $27 million in the first quarter of 2011. Refer to section 8 of this MD&A for additional information.

- A loss, in the first quarter of 2012, on Air Canada's investments in Aveos' parent holding company which is further described below.

INVESTMENT IN AVEOS

On March 18, 2012, Aveos Fleet Performance Inc. ("Aveos") announced that it had ceased operating its airframe maintenance facilities in Montreal, Winnipeg and Vancouver. On March 19, 2012, Aveos filed for court protection pursuant to the Companies' Creditors Arrangements Act ("CCAA") and, on March 20, 2012, issued a notice of termination to all of its employees.

As a result of the above, Air Canada has reduced the carrying value of its investment in Aveos Holding Company, Aveos' parent company, as well as the carrying value of a long term note receivable from Aveos to nil and has recorded an aggregate loss on investments of $65 million in the first quarter of 2012. In addition, Air Canada has recorded a liability of $55 million, which is charged to Discontinued operations, related to Air Canada's commitment under a separation program.

Operating amounts owing between Air Canada and Aveos, including disputed invoices, may be subject to Aveos' CCAA proceedings and are being reported on a net basis. The ultimate settlement of such amounts may be dependent on the resolution by the court process. As such, certain balances recorded are based on a number of estimates and assumptions and it is not possible to predict the outcome of the claims between the parties. Uncertainty exists as to the ultimate resolution and, as such, additional provisions or charges may be required.

Discontinued Operations

On January 31, 2011, the Canada Industrial Relations Board issued an order (the "Order") determining that the sale of Air Canada's former aircraft, engine and component maintenance and repair business had occurred within the meaning of the Canada Labour Code, and establishing Aveos as a distinct employer, bound by separate collective agreements. The issuance of the order triggered the commencement of the process by which certain employees transitioned from Air Canada to employment with Aveos effective July 14, 2011.

Pursuant to the Order and a related separation program, Air Canada has a commitment to provide up to a maximum of 1,500 separation packages to IAMAW-represented Aveos employees employed as of the date of the Order (with each package including up to a maximum of 52 weeks of pay), in the event that employees are permanently laid off or terminated as a direct result of Aveos ceasing to be the exclusive provider of airframe maintenance services to Air Canada prior to June 30, 2015. These packages will also be made available at any time up to June 30, 2013, in the event of an insolvency, liquidation or bankruptcy involving Aveos resulting in the cancellation of Air Canada-Aveos contracts and in the termination or permanent layoff of IAMAW-represented employees.

As a result of Aveos' CCAA filing, a liability of $55 million related to the total cost that Air Canada may incur in relation to these separation packages has been recorded in Accounts payable and accrued liabilities and charged to Discontinued operations in the first quarter of 2012. There is no impact to cash flows relating to Discontinued operations in the first quarter of 2012.

Investments in Aveos

In 2010, Aveos reached an agreement with its lenders and equity holders on the terms of a consensual restructuring plan to recapitalize the company. As part of this recapitalization, Air Canada and Aveos entered into agreements to settle certain issues and modify the terms of certain contractual arrangements in exchange for Air Canada receiving a minority equity interest in Aveos and a Term Note with a face value of $22 million. As a result of these agreements, Air Canada's equity investment in Aveos was recorded at $49 million, based upon its estimated fair value, and $2 million for legal fees. A Term Note of $22 million was recorded at its estimated fair value of $11 million, based on the present value of expected cash flows on a discounted basis. Prior to Aveos filing for CCAA, the carrying value of the Term Note was $14 million.

As a result of Aveos' CCAA filing, the share investment and Term Note have been adjusted to their estimated fair value of nil as at March 31, 2012 with an aggregate charge of $65 million recorded in Non-operating expense on Air Canada's consolidated statement of operations.

Refer to section 6.8 "Pension Funding Obligations" of this MD&A for additional information on a Pension and Benefits Agreement between Air Canada and Aveos.

5. FLEET

The following table provides the number of aircraft in Air Canada's operating fleet as at March 31, 2012 and December 31, 2011, as well as Air Canada's expected operating fleet as at December 31, 2012 and as at December 31, 2013 (excluding aircraft which are leased or subleased to third parties and excluding aircraft operated by Jazz under the Jazz CPA and by other regional airlines operating flights under the Air Canada Express banner on behalf of Air Canada pursuant to commercial agreements with Air Canada).

	Actual (As at March 31, 2012)			Planned (As at March 31, 2012)			
	December 31, 2011	First Quarter 2012 Fleet Changes	March 31, 2012	Remainder of 2012 Fleet Changes	December 31, 2012	2013 Fleet Changes	December 31, 2013
Boeing 777-300	12	–	12	–	12	–	12
Boeing 777-200	6	–	6	–	6	–	6
Boeing 767-300	30	–	30	–	30	–	30
Airbus A330-300	8	–	8	–	8	–	8
Airbus A321	10	–	10	–	10	–	10
Airbus A320	41	–	41	–	41	–	41
Airbus A319	38	–	38	–	38	–	38
EMBRAER 190	45	–	45	–	45	–	45
EMBRAER 175	15	–	15	–	15	–	15
Total	**205**	–	**205**	–	**205**	–	**205**
Average age (years)	**11.6**		**11.9**		**12.6**		**13.6**

The following table provides, as at March 31, 2012, the number of aircraft operated by Jazz under the Jazz CPA and by other airlines operating flights under the Air Canada Express banner on behalf of Air Canada pursuant to commercial agreements with Air Canada.

	As at March 31, 2012			
	Jazz	Sky Regional	Other	Total
CRJ-100	14	–	–	**14**
CRJ-200	25	–	–	**25**
CRJ-705	16	–	–	**16**
Dash 8-100	34	–	–	**34**
Dash 8-300	26	–	–	**26**
Dash 8-400	10	5	–	**15**
Beech 1900	–	–	17	**17**
Total	**125**	**5**	**17**	**147**

6. FINANCIAL AND CAPITAL MANAGEMENT

6.1. Liquidity

Air Canada manages its liquidity needs through a variety of strategies which include seeking to achieve positive cash from operations, sourcing committed financing for new and existing aircraft, and through other financing activities.

Liquidity needs are primarily related to meeting obligations associated with financial liabilities, capital commitments, ongoing operations, contractual and other obligations (including pension funding obligations), and covenants in credit card and other agreements. Refer to sections 6.6, 6.7 and 6.8 of this MD&A for information on Air Canada's contractual obligations, capital commitments and pension funding obligations. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. Air Canada's principal objective in managing liquidity risk is to maintain a minimum unrestricted cash balance in excess of a target liquidity level of 15% of 12-month trailing operating revenues.

At March 31, 2012, cash, cash equivalents and short-term investments amounted to $2,249 million, or 19% of 12-month trailing operating revenues (December 31, 2011 – $2,099 million, or 18% of 2011 operating revenues), exceeding Air Canada's minimum target liquidity level of 15% of 12-month trailing operating revenues.

6.2. Financial Position

The following table provides a condensed statement of financial position of Air Canada as at March 31, 2012 and as at December 31, 2011.

(Canadian dollars in millions)	March 31, 2012	December 31, 2011	Change $
Assets			
Cash, cash equivalents and short-term investments	$ 2,249	$ 2,099	$ 150
Other current assets	1,091	1,228	(137)
Current assets	3,340	3,327	13
Property and equipment	5,064	5,088	(24)
Intangible assets	326	312	14
Goodwill	311	311	-
Deposits and other assets	515	595	(80)
Total assets	**$ 9,556**	**$ 9,633**	**$ (77)**
Liabilities			
Current liabilities	$ 3,382	$ 3,153	$ 229
Long-term debt and finance leases	3,883	3,906	(23)
Pension and other benefit liabilities	5,459	5,563	(104)
Maintenance provisions	557	548	9
Other long-term liabilities	440	469	(29)
Total liabilities	**13,721**	**13,639**	**82**
Total equity	**(4,165)**	**(4,006)**	**(159)**
Total liabilities and equity	**$ 9,556**	**$ 9,633**	**$ (77)**

Movements in current assets and current liabilities are described in section 6.4 of this MD&A. Long-term debt and finance leases are discussed in sections 6.3 and 6.5 of this MD&A.

At March 31, 2012, Deposits and other assets declined by $80 million from December 31, 2011, reflecting the write-off of Air Canada's investments in Aveos' parent company as further described in section 4 of this MD&A. Property and equipment amounted to $5,064 million at March 31, 2012, a reduction of $24 million from December 31, 2011. This reduction in Property and equipment was mainly due to the impact of depreciation expense of $169 million in the first quarter of 2012, partly offset by additions to property and equipment of $142 million. The additions to property and equipment included deposits and progress payments on future aircraft deliveries of $63 million, facility purchases of $45 million, and flight equipment of $28 million.

Pension and other benefit liabilities decreased $104 million from December 31, 2011, mainly due to Air Canada having made pension funding payments of $100 million in the first quarter of 2012. Refer to section 6.8 for additional information on Air Canada's pension funding obligations.

6.3. Adjusted Net Debt

The following table reflects Air Canada's adjusted net debt balances as at March 31, 2012 and as at December 31, 2011.

(Canadian dollars in millions)	March 31, 2012	December 31, 2011	Change $
Total long-term debt and finance leases	$ 3,883	$ 3,906	$ (23)
Current portion of long-term debt and finance leases	396	424	(28)
Total long-term debt and finance leases, including current portion	4,279	4,330	(51)
Less cash, cash equivalents and short-term investments	(2,249)	(2,099)	(150)
Net debt	**$ 2,030**	**$ 2,231**	**$ (201)**
Capitalized operating leases(1)	2,345	2,345	-
Adjusted net debt	**$ 4,375**	**$ 4,576**	**$ (201)**

(1) Adjusted net debt is a non-GAAP financial measure used by Air Canada and may not be comparable to measures presented by other public companies. Adjusted net debt is a key component of the capital managed by Air Canada and provides a measure of its net indebtedness. Air Canada includes capitalized operating leases which is a measure commonly used in the industry to ascribe a value to obligations under operating leases. Common industry practice is to multiply annualized aircraft rent expense by 7.0. This definition of capitalized operating leases is used by Air Canada and may not be comparable to similar measures presented by other public companies. Aircraft rent was $335 million for the twelve months ended March 31, 2012 and $335 million for the twelve months ended December 31, 2011.

Total debt and finance leases, including current portion, amounted to $4,279 million at March 31, 2012, a decrease of $51 million from December 31, 2011. The reduction in long-term debt and finance leases from December 31, 2011 was mainly due to the favourable impact of a stronger Canadian dollar at March 31, 2012 compared to December 31, 2011 on Air Canada's foreign currency denominated debt (mainly U.S. dollars), which accounted for a decrease of $85 million. Proceeds from borrowings of $149 million were largely offset by debt repayments of $125 million.

At March 31, 2012, adjusted net debt decreased $201 million from December 31, 2011. This reduction in adjusted net debt included the impact of lower debt balances, as described above, and the impact of an increase in cash, cash equivalents and short-term investments of $150 million, which was mainly due to positive free cash flow of $129 million recorded in the first quarter of 2012.

Credit Ratings

On April 24, 2012, Standard & Poor's Ratings Services ("Standard & Poor's") affirmed its ratings on Air Canada, including Air Canada's "B-" long-term corporate credit rating. At the same time, Standard & Poor's removed all ratings from CreditWatch with negative implications, where they had been placed on March 23, 2012. The outlook is negative, reflecting Standard & Poor's stated expectations of weak cash flow generation in 2012 due to operational disruptions caused by labour disputes, which Standard & Poor's has stated could lead to a leverage ratio of 9 times EBITDA (earnings before interest, taxes, depreciation and amortization) in 2012.

On April 3, 2012, Moody's Investors Service, Inc. ("Moody's") lowered Air Canada's corporate family rating and probability of default ratings to Caa1 from B3, its 1st lien senior secured rating to B2 from B1 and its 2nd lien senior secured rating to Caa2 from Caa1. Moody's affirmed Air Canada's speculative grade liquidity rating at SGL-2, stating that this was indicative of good liquidity. Moody's stated that Air Canada's rating outlook was stable. Moody's also stated that it had lowered Air Canada's ratings because of its expectation that Air Canada's adjusted leverage will remain in excess of 8 times EBITDA through at least 2012, higher than Moody's had previously expected. Moody's also stated its concern with Air Canada's ability to absorb higher capital expenditures for new aircraft and additional funding requirements for pension shortfalls beginning in 2014.

6.4. Working Capital

The following table provides information on Air Canada's working capital balances at March 31, 2012 and at December 31, 2011.

(Canadian dollars in millions)	March 31, 2012	December 31, 2011	Change $
Cash and short-term investments	$ 2,249	$ 2,099	$ 150
Accounts receivable	682	712	(30)
Other current assets	409	516	(107)
Accounts payable and accrued liabilities	(1,229)	(1,175)	(54)
Advance ticket sales	(1,757)	(1,554)	(203)
Current portion of long-term debt and finance leases	(396)	(424)	28
Net working capital	**$ (42)**	**$ 174**	**$ (216)**

The net negative working capital of $42 million at March 31, 2012 represented a deterioration of $216 million from December 31, 2011. This decline was largely due to the impact of capital expenditures of $149 million and a liability of $55 million recorded in Accounts payable and accrued liabilities related to the separation program for Aveos employees as further described in section 4 of this MD&A. The decrease in Other current assets of $107 million was largely due to the seasonal decline in restricted cash and prepaid vacation deposits in the Air Canada Vacations' business, whereas the growth in advance ticket sales was consistent with the seasonal growth of demand leading into the second and third quarters at Air Canada.

6.5. Consolidated Cash Flow Movements

The following table provides the cash flow movements for Air Canada for the periods indicated:

	First Quarter		
(Canadian dollars in millions)	2012	2011	Change $
Net cash flows from (used for) operating activities, before the undernoted items	$ (118)	$ 30	$ (148)
Net cash flows used for fuel hedge settlements and premiums	(14)	(7)	(7)
Excess of employee benefit funding over expense	(35)	(21)	(14)
Loss on investments in Aveos	65	-	65
Discontinued operations - Aveos	55	-	55
Change in maintenance provisions	7	19	(12)
Changes in non-cash working capital balances	326	260	66
Provision for cargo investigations	(8)	(29)	21
Net cash flows from operating activities	278	252	26
Additions to property, equipment and intangible assets	(149)	(62)	(87)
Free cash flow(1)	**129**	**190**	**(61)**
Short-term investments	(224)	90	(314)
Other	13	(33)	46
Net cash flows from (used for) investing activities (excluding additions to property, equipment and intangible assets)	**(211)**	**57**	**(268)**
Proceeds from borrowings	149	63	86
Reduction of long-term debt and finance lease obligations	(125)	(267)	142
Distributions related to aircraft special purpose leasing entities	(16)	(31)	15
Net cash flows from (used for) financing activities	**8**	**(235)**	**243**
Net increase (decrease) in cash and cash equivalents	(74)	12	(86)
Net increase (decrease) in short-term investments	224	(90)	314
Net increase (decrease) in cash, cash equivalents and short-term investments	**$ 150**	**$ (78)**	**$ 228**

(1) Free cash flow is a non-GAAP financial measure used by Air Canada and may not be comparable to measures presented by other public companies. Air Canada considers free cash flow to be an indicator of the financial strength and performance of its business because it shows how much cash is available, including repaying debt, meeting ongoing financial obligations and reinvesting in Air Canada.

Free cash flow amounted to $129 million in the first quarter of 2012 compared to free cash flow of $190 million in the first quarter of 2011, a decrease of $61 million. This decrease in free cash flow was largely due to an increase in capital expenditures of $87 million, a significant portion of which was due to the exercise of purchase rights on three Boeing 777 aircraft in the first quarter of 2012.

In the first quarter of 2012, cash flows from operating activities amounted to $278 million, an increase of $26 million from the first quarter of 2011, mainly due to improvements in net working capital.

In the first quarter of 2012, proceeds from borrowings amounted to $149 million, which included net financing proceeds of $41 million under a credit agreement to refinance amounts related to four Airbus A319 aircraft, with refinanced terms of five years and additional draws of $106 million under a revolving loan facility. In the first quarter of 2012, debt repayments amounted to $125 million and included payments of $48 million for the refinancing of amounts related to the four Airbus A319 aircraft referred to above.

6.6. Contractual Obligations

Information on Air Canada's contractual obligations is described in section 9.7 of Air Canada's 2011 MD&A dated February 9, 2012. Except for projected increases to capital expenditures disclosed in section 6.7 "Capital Expenditures and Related Financing Arrangements" of this MD&A, there have been no significant changes to Air Canada's contractual obligations from those disclosed at that time.

Air Canada also provides an update on the section entitled "Covenants in Credit Card Agreements" as follows:

Covenants in Credit Card Agreements

As described in section 9.7 of Air Canada's 2011 MD&A dated February 9, 2012, Air Canada has various agreements with companies that process customer credit card transactions. The expiry of Air Canada's principal credit card processing agreements for credit card processing services in North America has been extended to August 31, 2012. In addition, Air Canada is in the final stages of negotiating longer-term arrangements.

6.7. Capital Expenditures and Related Financing Arrangements

Boeing

In the first quarter of 2012, Air Canada exercised purchase rights for three Boeing 777 aircraft with scheduled deliveries towards the end of 2013 and the first half of 2014. Following the exercise of these purchase rights, as at March 31, 2012, Air Canada had outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of 37 Boeing 787 aircraft and five Boeing 777 aircraft. Air Canada is currently reviewing operating and financing alternatives for these five Boeing 777 aircraft which may include subleasing and, as a result, these five aircraft have not been included in the fleet table provided in section 5 of this MD&A.

Capital Commitments

As at March 31, 2012, the estimated aggregate cost of the future firm Boeing 787 aircraft deliveries and other capital purchase commitments approximates $5,559 million (of which $3,051 million is subject to committed financing, subject to the fulfillment of certain terms and conditions). Other capital purchase commitments relate principally to building and leasehold improvement projects.

The table below provides updated information on Air Canada's current projected, planned and committed capital expenditures for 2012, for the next four years and after 2016.

(Canadian dollars in millions)	Remainder of 2012	2013	2014	2015	2016	Thereafter	Total
Projected committed expenditures	$ 218	$ 467	$ 986	$ 566	$ 999	$ 2,323	$ 5,559
Projected planned but uncommitted expenditures	36	120	120	120	120	not available	not available
Projected planned but uncommitted capitalized maintenance	27	34	34	34	34	not available	not available
Total projected expenditures(1)	281	621	1,140	720	1,153	not available	not available
Projected financing on committed expenditures	-	-	(592)	(453)	(799)	(1,207)	(3,051)
Total projected expenditures, net of financing	**$ 281**	**$ 621**	**$ 548**	**$ 267**	**$ 354**	**not available**	**not available**

1) *U.S. dollar amounts are converted using the March 31, 2012 closing exchange rate of US$1 = C$0.9975. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day LIBOR rate at March 31, 2012.*

6.8. Pension Funding Obligations

Air Canada maintains several pension plans, including defined benefit and defined contribution pension plans and plans providing other retirement and post-employment benefits to its employees. Based on preliminary estimates as at January 1, 2012, the aggregate solvency deficit in Air Canada's domestic registered pension plans is estimated to be $4.4 billion. This estimated increase to the aggregate solvency deficit of approximately $2.2 billion versus the valuation as of January 1, 2011 was mainly due to a decrease in the solvency discount rate partly offset by a 6.8% return on plan assets. The valuations as of January 1, 2012 will be completed in the first half of 2012 but, as described in section 9.8 of Air Canada's 2011 MD&A dated February 9, 2012, valuations will not increase pension past service cost funding obligations required prior to 2014. Pension funding obligations for 2014 would be determined based on actuarial valuations completed in mid-2014.

As described in section 9.8 of Air Canada's 2011 MD&A dated February 9, 2012, the collective agreements concluded with the CAW and CUPE include amendments to the defined benefit pension plans of CAW and CUPE members which remain subject to regulatory approval. Air Canada will seek to conclude collective agreements with its other union groups containing similar amendments to the defined benefit pensions for employees represented by such groups. Should Air Canada successfully conclude and obtain regulatory approval for all such amendments, Air Canada estimates that the solvency deficit in its domestic registered pension plans would decline by approximately $1.1 billion.

Pension and Benefits Agreement with Aveos

On June 22, 2007, Air Canada and Aveos entered into a Pension and Benefits Agreement covering the transfer of certain pension and benefit assets and obligations to Aveos. On July 14, 2011 (the "Certification Date"), certain unionized employees of Air Canada elected to become employees of Aveos. The Pension and Benefits Agreement provides that, subject to regulatory approval by the Office of the Superintendent of Financial Institutions ("OSFI"), where required, the assets and obligations under the pension, other post-retirement and post-employment benefits plans pertaining to the transferred unionized employees are to be transferred to Aveos.

As of the date of this MD&A, in light of the uncertainty relating to Aveos' CCAA filing, no determination as to the impact of Aveos' CCAA filing on final transfers and compensation amounts between Air Canada and Aveos has been made.

6.9. Share Information

The issued and outstanding shares of Air Canada, along with shares potentially issuable, are, as of the dates indicated below, as follows:

	Number of Shares at	
	April 30, 2012	December 31, 2011
Issued and outstanding shares		
Class A variable voting shares	37,838,068	42,204,645
Class B voting shares	239,567,875	235,166,848
Total issued and outstanding shares	**277,405,943**	**277,371,493**
Class A variable voting and Class B voting shares potentially issuable		
Warrants	89,430,300	89,430,300
Shares held in trust	1,502,542	1,536,992
Stock options	8,790,536	6,581,242
Total shares potentially issuable	**99,723,378**	**97,548,534**
Total outstanding and potentially issuable shares	**377,129,321**	**374,920,027**

7. QUARTERLY FINANCIAL DATA

The following tables summarize quarterly financial results and major operating statistics for Air Canada for the last eight quarters.

(Canadian dollars in millions)	2010			2011				2012
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Operating revenues	**$ 2,625**	**$ 3,026**	**$ 2,616**	**$ 2,753**	**$ 2,918**	**$ 3,242**	**$ 2,699**	**$ 2,962**
Aircraft fuel	660	733	640	742	882	943	808	889
Ownership (DAR)(1)	281	274	313	273	265	265	260	268
Other operating expenses	1,637	1,713	1,648	1,804	1,698	1,764	1,729	1,898
Operating expenses	**2,578**	**2,720**	**2,601**	**2,819**	**2,845**	**2,972**	**2,797**	**3,055**
Operating income (loss) before undernoted item	**47**	**306**	**15**	**(66)**	**73**	**270**	**(98)**	**(93)**
Provision adjustment for cargo investigations, net(2)	–	–	46	–	–	–	–	–
Operating income (loss)	**47**	**306**	**61**	**(66)**	**73**	**270**	**(98)**	**(93)**
Total non-operating income (expense)	**(365)**	**11**	**28**	**47**	**(120)**	**(394)**	**38**	**(62)**
Recovery of (provision for) income taxes	–	–	–	–	1	–	–	–
Discontinued operations - Aveos	–	–	–	–	–	–	–	(55)
Net income (loss)	**$ (318)**	**$ 317**	**$ 89**	**$ (19)**	**$ (46)**	**$ (124)**	**$ (60)**	**$ (210)**

(1) DAR refers to the combination of depreciation, amortization and impairment, and aircraft rent expense.

(2) In the first quarter of 2008, Air Canada recorded a provision for cargo investigations of $125 million. In the fourth quarter of 2010, Air Canada recorded a net reduction of $46 million to this provision.

(Canadian dollars in millions, except where indicated)	2010			2011				2012
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Revenue passenger miles (millions)	12,896	15,531	11,756	12,355	13,677	16,126	12,065	**12,946**
Available seat miles (millions)	15,523	18,328	14,918	15,859	16,512	18,799	15,290	**16,344**
Passenger load factor (%)	83.1	84.7	78.8	77.9	82.8	85.8	78.9	**79.2**
RASM (cents)(1)	14.8	14.8	15.1	14.5	15.6	15.5	15.4	**15.2**
CASM (cents)	16.6	14.8	17.4	17.8	17.2	15.8	18.3	**18.7**
CASM, excluding fuel expense (cents)	12.3	10.8	13.2	13.1	11.9	10.8	13.0	**13.2**
CASM, excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations (cents)(2)	12.0	10.6	12.8	12.2	11.5	10.6	12.6	**12.3**
Economic fuel price per litre (cents)(3)	66.8	64.6	67.5	78.2	87.9	85.8	88.6	**91.6**
EBITDAR before the provision adjustment for cargo investigations, net(4)(5)	**$ 328**	**$ 580**	**$ 328**	**$ 207**	**$ 338**	**$ 535**	**$ 162**	**$ 175**
EBITDAR(4)(5)	**$ 328**	**$ 580**	**$ 374**	**$ 207**	**$ 338**	**$ 535**	**$ 162**	**$ 175**
Net income (loss) per share								
– Basic	**$ (1.14)**	**$ 1.13**	**$ 0.31**	**$ (0.07)**	**$ (0.17)**	**$ (0.45)**	**$ (0.22)**	**$ (0.76)**
– Diluted	**$ (1.14)**	**$ 1.10**	**$ 0.27**	**$ (0.07)**	**$ (0.17)**	**$ (0.45)**	**$ (0.22)**	**$ (0.76)**

(1) System RASM excludes the impact of a $40 million favourable adjustment recorded in the fourth quarter of 2010.

(2) Operating expense, excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations, is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

(3) Includes fuel handling and is net of fuel hedging results.

(4) In the first quarter of 2008, Air Canada recorded a provision for cargo investigations of $125 million. In the fourth quarter of 2010, Air Canada recorded a net reduction of $46 million to this provision.

(5) EBITDAR (earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent) is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for a reconciliation of EBITDAR to operating income (loss).

8. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of "Gain (Loss) on Financial Instruments Recorded at Fair Value"

The following is a summary of "gain (loss) on financial instruments recorded at fair value" included in non-operating income (expense) on Air Canada's consolidated statement of operations for the periods indicated:

	First Quarter	
(Canadian dollars in millions)	2012	2011
Fuel derivatives	$ (8)	$ 36
Interest rate swaps	-	(3)
Share forward contracts	-	(3)
Other	1	(3)
Gain (loss) on financial instruments recorded at fair value	**$ (7)**	**$ 27**

Fuel Price Risk

Fuel price risk is the risk that future cash flows relating to jet fuel purchases will fluctuate because of changes in jet fuel prices. In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries.

In the first quarter of 2012, Air Canada recorded a loss of $8 million in Loss on financial instruments recorded at fair value related to fuel derivatives ($36 million gain in the first quarter of 2011). In the first quarter of 2012, Air Canada purchased crude-oil and refined products-based call options covering a portion of 2012 fuel exposure. The cash premium related to these contracts was $15 million.

As of March 31, 2012, approximately 33% of Air Canada's anticipated purchases of jet fuel for the remainder of 2012 is hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US$116 per barrel. Air Canada's contracts to hedge anticipated jet fuel purchases over the 2012 period are comprised of call options and call spreads. The fair value of the fuel derivatives portfolio at March 31, 2012 was $18 million in favour of Air Canada ($11 million in favour of Air Canada as at December 31, 2011) and was recorded within Prepaid expenses and other current assets on Air Canada's consolidated statement of financial position.

The following table outlines the notional volumes per barrel along with the WTI weighted average floor and capped price for each year currently hedged by type of derivative instruments as at March 31, 2012. Air Canada is expected to generate fuel hedging gains if oil prices increase above the average capped price, with call spreads subject to an average maximum price protection of US$143 per barrel.

Derivative Instruments	Term	Volume (bbls)	WTI Equivalent Weighted Average Capped Price (US$/bbl)
Call options	2012	6,076,341	$116
Call spreads	2012	120,000	$116

9. CRITICAL ACCOUNTING ESTIMATES

Information on Air Canada's critical accounting estimates is disclosed in section 13 "Critical Accounting Estimates" of Air Canada's 2011 MD&A dated February 9, 2012. There have been no material changes to Air Canada's critical accounting estimates from what was disclosed at that time.

10. ACCOUNTING POLICIES

Refer to section 14 "Accounting Policies" of Air Canada's 2011 MD&A dated February 9, 2012 for information on new accounting standards and amendments not yet effective.

Carbon Emissions Accounting Policy

The European Union passed legislation for an Emissions Trading System ("ETS") which includes carbon emissions from aviation commencing January 2012, including for flights operated between Canada and countries within the European Union. The legislation requires aircraft operators to monitor and report on fuel use and emissions data. Air Canada began accounting for the terms of the ETS in January 2012. A cost of settlement accounting model is adopted whereby emission allowances granted by the European Union are recorded in Intangible assets on Air Canada's consolidated statement of financial position and are measured at fair value at the date of initial recognition with an offset to deferred income as a government grant. Purchased emission allowances are recorded at cost and also recognized in Intangible assets. The intangible assets are subsequently measured using the cost model in IAS 38, Intangible assets and will be de-recognized at the end of each emission compliance period as an offset to Air Canada's provision for emissions obligations. The intangible assets are subject to Air Canada's impairment of long-lived assets accounting policy. The government grant, measured based on the fair value of emission allowances at the date of initial recognition, is amortized as an offset to Other operating expenses over the emission compliance period based on volume of emissions generated during the period compared to the expected volume of emissions during the emission compliance period. A provision to deliver emission allowances is recognized, with an offset to Other operating expense, as carbon emissions are made using a weighted average cost model per unit of emission expected to be incurred for the emission compliance period as a whole. The emission allowances, net of the provision to deliver emission allowances, at March 31, 2012, was $17 million and was recorded within Intangible assets on Air Canada's consolidated statement of financial position. The deferred credit related to the government grant was $17 million and was recorded within Accounts payable and accrued liabilities on Air Canada's consolidated statement of financial position.

11. OFF-BALANCE SHEET ARRANGEMENTS

Information on Air Canada's off-balance sheet arrangements is disclosed in section 15 "Off-Balance Sheet Arrangements" of Air Canada's 2011 MD&A dated February 9, 2012. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

12. RELATED PARTY TRANSACTIONS

At March 31, 2012, Air Canada had no transactions with related parties as defined in the CICA Handbook – Part 1, except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship agreements.

13. RISK FACTORS

For a detailed description of risk factors associated with Air Canada, refer to section 18 "Risk Factors" of Air Canada's 2011 MD&A dated February 9, 2012. Air Canada is not aware of any significant changes to its risk factors from those disclosed at that time. Air Canada, however, provides the following updates:

The risk factors in Air Canada's 2011 MD&A dated February 9, 2012 related to Investigations by Competition Authorities relating to Cargo under *Current Legal Proceedings* are updated to account for the fact that, in the first quarter of 2012, Air Canada entered into a settlement agreement relating to class action proceedings in the United States. This settlement was made without any admission of liability and remains subject to final court approval. As a result of the settlement agreement, a payment of $8 million was made in the first quarter of 2012 to settle the class action proceedings in the United States.

The status of matters relating to Air Canada's collective agreements with its principal union groups and discussed in the risk factors relating to Labour Costs and Labour Relations is updated as follows:

In 2011, tentative collective agreements with the CAW, the unions representing Air Canada's customer service employees at airports and call centres, as well as with CUPE, the union representing its flight attendants, were, concluded and, respectively, ratified or conclusively settled through arbitration. Also in 2011, Air Canada entered into a collective agreement with UNITE, the union representing the airline's London Heathrow-based employees. In the first quarter of 2012, Air Canada concluded agreements with the CAW, in relation to in-flight crew schedulers and flight operations crew schedulers, and with CALDA, in relation to flight dispatchers.

On February 9, 2012, Air Canada and the IAMAW reached a tentative agreement regarding the technical, maintenance and operational support employees it represents, though on February 22, 2012, the IAMAW advised that these employees had rejected the agreement. On March 7, 2012, Air Canada announced that the IAMAW had provided notice of its intent to strike as of March 12, 2012. Meanwhile, negotiations between Air Canada and ACPA, representing its pilots, continued into March 2012. On March 8, 2012, Air Canada issued a notice of lock-out pertaining to the bargaining unit represented by ACPA, effective March 12, 2012. Also on March 8, 2012, Canada's Minister of Labour, the Honourable Lisa Raitt, issued a referral pursuant to the Canada Labour Code, which effectively barred Air Canada from proceeding with the lock-out of its pilots and the IAMAW from commencing a strike.

On March 15, 2012, Bill C-33 received Royal Assent, referring Air Canada and both the IAMAW and ACPA to binding arbitration under arbitrators appointed by the Minister of Labour to resolve the outstanding collective bargaining issues and prohibiting strikes or lock-outs for the duration of the arbitration process. Bill C-33 also provides that the parties remain free to enter into new collective agreements before a decision is rendered by the respective arbitrators, and if they enter such a new collective agreement, the respective arbitrator's duties under the legislation cease.

On April 19, 2012, Air Canada announced that it would enter into a 10-day negotiation period with ACPA to begin following the appointment of an arbitrator by the Minister of Labour in accordance with the provisions of the Protecting Air Service Act. Air Canada and ACPA will ask that the arbitrator facilitate the negotiations process.

On April 27, 2012, Air Canada announced a similar agreement for a 10-day negotiation period with the IAMAW representing the airline's mechanics, baggage handlers and cargo agents.

On May 2, 2012, Air Canada announced that it had been advised by the Federal Minister of Labour, the Honourable Lisa Raitt, of the appointment of arbitrators in accordance with Bill C-33, Protecting Air Service Act.

Air Canada and the IAMAW, the union representing certain finance and clerical employees, have not yet reached a tentative agreement.

14. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures and Internal Controls over Financial Reporting

Disclosure controls and procedures within the Corporation have been designed to provide reasonable assurance that all relevant information is identified to its President and Chief Executive Officer ("CEO"), its Executive Vice President and Chief Financial Officer ("CFO") and its Disclosure Policy Committee to ensure appropriate and timely decisions are made regarding public disclosure.

Internal controls over financial reporting have been designed by management, under the supervision of, and with the participation of the Corporation's CEO and CFO, to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and its preparation of financial statements for external purposes in accordance with GAAP.

In the Corporation's 2011 filings, the Corporation's CEO and CFO certified, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design and effectiveness of the Corporation's disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting.

In the Corporation's first quarter 2012 filings, the Corporation's CEO and CFO certify, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design of the Corporation's disclosure controls and procedures and the design of internal controls over financial reporting.

The Corporation's Audit, Finance and Risk Committee reviewed this MD&A and the interim unaudited condensed consolidated financial statements and notes, and the Corporation's Board of Directors approved these documents prior to their release.

Changes in Internal Controls over Financial Reporting

There have been no changes to Air Canada's internal controls over financial reporting during the first quarter of 2012 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

15. NON-GAAP FINANCIAL MEASURES

EBITDAR

EBITDAR (earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before depreciation, amortization and impairment, and aircraft rent as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. EBITDAR is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, and therefore may not be comparable to similar measures presented by other public companies.

EBITDAR is reconciled to operating income (loss) as follows:

	First Quarter		
(Canadian dollars in millions)	2012	2011	Change $
GAAP operating income (loss)	$ (93)	$ (66)	$ (27)
Add back:			
Aircraft rent	88	88	-
Depreciation, amortization and impairment	180	185	(5)
EBITDAR	**$ 175**	**$ 207**	**$ (32)**

Operating Expense, Excluding Fuel Expense and Excluding the Cost of Ground Packages at Air Canada Vacations

Air Canada uses operating expense, excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations, to assess the operating performance of its ongoing airline business as such expenses may distort the analysis of certain business trends and render comparative analyses to other airlines less meaningful. Fuel expense fluctuates widely depending on many factors, including international market conditions, geopolitical events, jet fuel refining costs, the Canada/U.S. currency exchange rate, and excluding this expense from GAAP expense results, allows Air Canada to more effectively compare its operating performance. Air Canada incurs expenses related to ground packages at Air Canada Vacations, which some airlines that may not have extensive tour operator businesses generally would not incur, and excluding these expenses from GAAP results, allows its operating expense performance to be more comparable to those of other airlines. In addition, these costs do not generate ASMs and therefore excluding these costs from GAAP expense results, provides for a more meaningful comparison across periods when ground package costs are changing. Operating expense, excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations, is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning and therefore may not be comparable to similar measures presented by other public companies.

Operating expense, excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations, is reconciled to operating expense as follows:

	First Quarter		
(Canadian dollars in millions)	2012	2011	Change $
GAAP operating expense	$ 3,055	$ 2,819	$ 236
Remove:			
Aircraft fuel expense	(889)	(742)	(147)
Operating expense, excluding fuel expense	**$ 2,166**	**$ 2,077**	**$ 89**
Remove:			
Cost of ground packages at Air Canada Vacations	(153)	(143)	(10)
Operating expense, excluding fuel expense and excluding the cost of ground packages at Air Canada Vacations	**$ 2,013**	**$ 1,934**	**$ 79**

Adjusted Net Income (Loss) Per Share – Diluted

Air Canada uses adjusted net income (loss) per share – diluted to assess the performance of its business without the effects of foreign exchange and other unusual items. Such measure is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning and therefore may not be comparable to similar measures presented by other public companies.

	First Quarter		
(Canadian dollars in millions)	2012	2011	Change $
Net loss for the period attributable to shareholders of Air Canada	$ (211)	$ (21)	$ (190)
Remove:			
Foreign exchange (gain) loss	(87)	(104)	17
Loss on investments in Aveos	65	-	65
Discontinued operations - Aveos	55	-	55
Adjusted net loss	**$ (178)**	**$ (125)**	**$ (53)**
Weighted average number of outstanding shares used in computing diluted loss per share (in millions)	277	278	(1)
Adjusted net loss per share – diluted	**$ (0.64)**	**$ (0.45)**	**$ (0.19)**

16. GLOSSARY

ACPA – Refers to the Air Canada Pilots Association.

Atlantic passenger and cargo revenues – Refers to revenues from flights that cross the Atlantic Ocean with origins and destinations principally in Europe.

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.

CALDA – Refers to the Canadian Airline Dispatchers Association.

CASM – Operating expense per ASM.

CAW – Refers to the Canadian Auto Workers.

CUPE – Refers to the Canadian Union of Public Employees.

EBITDAR – EBITDAR is earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent and is a non-GAAP financial measure commonly used in the airline industry to view operating results before depreciation, amortization and impairment, and aircraft rent as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. Refer to section 15 of this MD&A for additional information.

Effective Ton Miles or ETMs – Refers to the mathematical product of tonnage capacity times distance hauled.

IAMAW – Refers to the International Association of Machinists and Aerospace Workers.

Other passenger and cargo revenues – Refers to revenues from flights with origins and destinations principally in Central and South America, Australia, the Caribbean and Mexico.

Pacific passenger and cargo revenues – Refers to revenues from flights that cross the Pacific Ocean with origins and destinations principally in Asia.

Passenger Load Factor – A measure of passenger capacity utilization derived by expressing Revenue Passenger Miles as a percentage of Available Seat Miles.

Passenger Revenue per Available Seat Mile or RASM – Average passenger revenue per ASM.

Percentage point (pp) – A measure for the arithmetic difference of two percentages.

Revenue Passenger Miles or RPMs – A measure of passenger traffic calculated by multiplying the total number of revenue passengers carried by the miles they are carried.

Revenue Ton Miles or RTMs – Refers to the mathematical product of weight in tons of a shipment being transported by the number of miles that it is transported.

Yield – Average passenger revenue per RPM.