AIR CANADA

Second Quarter 2015

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

August 12, 2015

A STAR ALLIANCE MEMBER
MEMBRE DU RÉSEAU STAR ALLIANCE

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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)	Second Quarter			First Six Months		
	2015	2014	$ Change	2015	2014	$ Change
Financial Performance Metrics						
Operating revenues	3,414	3,305	109	6,663	6,370	293
Operating income	323	245	78	523	183	340
Non-operating expense	(27)	(22)	(5)	(536)	(301)	(235)
Net income (loss)	296	223	73	(13)	(118)	105
Adjusted net income (1)	250	139	111	372	7	365
Operating margin %	9.5%	7.4%	2.1 pp	7.8%	2.9%	4.9 pp
EBITDAR (2)	591	456	135	1,033	603	430
EBITDAR margin % (2)	17.3%	13.8%	3.5 pp	15.5%	9.5%	6.0 pp
Unrestricted liquidity (3)	3,283	2,954	329	3,283	2,954	329
Net cash flows from operating activities	509	386	123	1,317	730	587
Free cash flow (4)	299	(36)	335	682	(2)	684
Adjusted net debt (5)	4,896	4,309	587	4,896	4,309	587
Return on invested capital ("ROIC") % (6)	16.2%	11.0%	5.2 pp	16.2%	11.0%	5.2 pp
Net income (loss) per share – diluted	$ 1.00	$ 0.75	$ 0.25	$ (0.06)	$ (0.42)	$ 0.36
Adjusted net income per share – diluted (1)	$ 0.85	$ 0.47	$ 0.38	$ 1.26	$ 0.02	$ 1.24
Operating Statistics (7)			**% Change**			**% Change**
Revenue passenger miles (millions) ("RPM")	16,845	15,495	8.7	31,782	28,961	9.7
Available seat miles (millions) ("ASM")	20,132	18,413	9.3	38,467	35,187	9.3
Passenger load factor %	83.7%	84.2%	(0.5) pp	82.6%	82.3%	0.3 pp
Passenger revenue per RPM ("Yield") (cents)	18.0	18.9	(5.0)	18.1	19.0	(4.6)
Passenger revenue per ASM ("PRASM") (cents)	15.0	15.9	(5.5)	15.0	15.6	(4.2)
Operating revenue per ASM (cents)	17.0	17.9	(5.5)	17.3	18.1	(4.3)
Operating expense per ASM ("CASM") (cents)	15.4	16.6	(7.6)	16.0	17.6	(9.2)
Adjusted CASM (cents) (8)	11.3	11.2	0.7	11.6	11.7	(0.5)
Average number of full-time equivalent ("FTE") employees (thousands) (9)	24.8	24.5	1.2	24.7	24.4	1.0
Aircraft in operating fleet at period-end	372	360	3.3	372	360	3.3
Average fleet utilization (hours per day)	10.0	9.9	1.1	9.9	9.9	-
Seats dispatched (thousands)	12,992	12,288	5.7	25,329	23,885	6.0
Aircraft frequencies (thousands)	143	139	2.5	277	270	2.3
Average stage length (miles) (10)	1,550	1,498	3.4	1,519	1,473	3.1
Fuel cost per litre (cents)	66.9	91.8	(27.1)	66.1	93.0	(29.0)
Fuel litres (millions)	1,114	1,048	6.3	2,153	2,021	6.5
Revenue passengers carried (thousands) (11)	10,229	9,620	6.3	19,716	18,358	7.4

(1) Adjusted net income (loss) and adjusted net income (loss) per share – diluted are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

(2) EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

(3) Unrestricted liquidity refers to the sum of cash, cash equivalents, short-term investments and the amount of available credit under Air Canada's revolving credit facilities. At June 30, 2015, unrestricted liquidity was comprised of cash and short-term investments of $3,021 million and undrawn lines of credit of $262 million. At June 30, 2014, unrestricted liquidity was comprised of cash and short-term investments of $2,615 million and undrawn lines of credit of $339 million.

(4) 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 7.5 "Consolidated Cash Flow Movements" of this MD&A for additional information.

(5) Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is an additional GAAP financial measure. Refer to section 7.3 "Adjusted Net Debt" of this MD&A for additional information.

(6) Return on invested capital ("ROIC") is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

(7) Except for the reference to average number of FTE employees, operating statistics in this table include third party carriers (such as Jazz Aviation LP ("Jazz") and Sky Regional Airlines Inc. ("Sky Regional")) operating under capacity purchase agreements with Air Canada.

(8) Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

(9) Reflects FTE employees at Air Canada. Excludes FTE employees at third party carriers (such as Jazz and Sky Regional) operating under capacity purchase agreements with Air Canada.

(10) Average stage length is calculated by dividing the total number of available seat miles by the total number of seats dispatched.

(11) Revenue passengers are counted on a flight number basis which is consistent with the IATA definition of revenue passengers carried.

2. INTRODUCTION AND KEY ASSUMPTIONS

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), the "Corporation" refers, as the context may require, to Air Canada and/or one or more of Air Canada's subsidiaries, including its wholly-owned operating subsidiaries, Touram Limited Partnership, doing business as Air Canada Vacations® ("Air Canada Vacations") and Air Canada *rouge* LP, doing business as Air Canada *rouge*® ("Air Canada *rouge*"). This MD&A provides the reader with a review and analysis, from the perspective of management, of Air Canada's financial results for the second quarter of 2015. This MD&A should be read in conjunction with Air Canada's interim unaudited condensed consolidated financial statements and notes for the second quarter of 2015, Air Canada's 2014 annual audited consolidated financial statements and notes and Air Canada's 2014 MD&A dated February 11, 2015 ("Air Canada's 2014 MD&A"). All financial information has been prepared in accordance with generally accepted accounting principles in Canada ("GAAP"), as set out in the CPA Canada Handbook – Accounting ("CPA 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 17 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of August 11, 2015.

Air Canada has capacity purchase agreements with Jazz, Sky Regional and certain other regional carriers. As of 2015, Air Canada changed the presentation of the expenses related to capacity purchase agreements on its consolidated statement of operations. This change in presentation was adopted to provide an improved presentation of the economic costs associated with regional carrier operations. Prior period amounts were reclassified to conform to the current period presentation. For additional information, refer to Note 2 of Air Canada's interim unaudited consolidated financial statements for the second quarter of 2015.

Effective January 1, 2015, Air Canada and Jazz amended the terms of their capacity purchase agreement and extended its term through to December 31, 2025. As a result of the amendments, certain costs that were previously capacity purchase agreement fees are now pass-through costs. Other costs that were pass-through costs are now costs directly incurred by Air Canada.

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 2014 MD&A dated February 11, 2015. Air Canada issued a news release dated August 12, 2015 reporting on its results for the second quarter of 2015. This news release is available on Air Canada's website at **www.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, economic and geopolitical conditions, currency exchange, the ability to reduce operating costs and secure financing, energy prices, interest rates, competition, employee and labour relations, pension issues, 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 2014 MD&A. The forward-looking statements contained in this MD&A represent Air Canada's expectations as of August 11, 2015 (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.

KEY ASSUMPTIONS

Assumptions were made by Air Canada in preparing and making forward-looking statements. As part of its assumptions, Air Canada assumes relatively low Canadian GDP growth for 2015. Air Canada also expects that the Canadian dollar will trade, on average, at C$1.30 per U.S. dollar in the third quarter of 2015 and at C$1.27 for the full year 2015 and that the price of jet fuel will average 62 cents per litre for the third quarter of 2015 and 64 cents per litre for the full year 2015.

INTELLECTUAL PROPERTY

Air Canada owns or has rights to trademarks, service marks or trade names used in connection with the operation of its business. In addition, Air Canada's names, logos and website names and addresses are owned or licensed by Air Canada. Air Canada also owns or has the rights to copyrights that protect the content of its products and/or services. Solely for convenience, the trademarks, service marks, trade names and copyrights referred to in this MD&A may be listed without the ©, ® and ™ symbols, but Air Canada will assert, to the fullest extent under applicable law, its rights or the rights of the applicable licensors to these trademarks, service marks, trade names and copyrights.

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3. OVERVIEW

In the second quarter of 2015, Air Canada generated adjusted net income of $250 million, an improvement of $111 million from the second quarter of 2014. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information. On a GAAP basis, Air Canada reported operating income of $323 million compared to operating income of $245 million in the second quarter of 2014, an improvement of $78 million. Net income of $296 million in the second quarter of 2015 increased $73 million from the same quarter in 2014.

Strategy

Air Canada's goal is to fully develop as a leading global airline, to be among those with the highest levels of customer experience, employee engagement and value creation for shareholders and other stakeholders. This is being pursued through the following four key strategies, which are further discussed in Air Canada's 2014 MD&A:

- Continually identifying and implementing cost reduction and revenue generating initiatives;
- Expanding internationally and increasing connecting traffic through international gateways, on a sustainable and profitable basis, and competing effectively in the leisure market to and from Canada;
- Engaging customers by continually enhancing the travel experience and providing a consistently high level of customer experience, with additional emphasis on premium and business passengers and products; and
- Fostering positive culture change through employee engagement programs designed to promote an understanding of how the airline and its employees can work together to deliver on the customer promise and investing in the tools and training required to provide a culture of top customer care.

Pension Update

On May 26, 2015, Air Canada elected to opt out of the *Air Canada Pension Plan Funding Regulations, 2014* (the "2014 Regulations"), effective at that time. The 2014 Regulations became effective on January 1, 2014 and under their terms, Air Canada was required to make solvency deficit payments of $200 million per year, on average, over a seven-year period. An agreement with the Government of Canada entered into in connection with these regulations contained several restrictions, including a prohibition on dividends and share repurchases, however, the agreement allowed Air Canada to opt out at any time. Refer to section 7.7 of this MD&A for additional information on Air Canada's pension funding obligations.

Labour Update

In June 2015, Air Canada concluded a collective agreement with Unifor, the union representing the airline's approximately 4,000 customer service and sales agents. The new agreement is in effect until February 28, 2020.

In April 2015, Air Canada concluded a collective agreement with the International Brotherhood of Teamsters ("IBT") representing the airline's U.S.-based unionized workforce. The new agreement is in effect until June 30, 2019.

In February 2015, Air Canada concluded a collective agreement with Unite representing Air Canada's U.K.-based unionized workforce. The new agreement is in effect until December 31, 2019.

Second Quarter 2015 Financial Summary

The following is an overview of Air Canada's results of operations and financial position for the second quarter of 2015 compared to the second quarter of 2014.

- Operating revenues of $3,414 million, an increase of $109 million or 3% from the second quarter of 2014.

- An ASM capacity increase of 9.3% from the second quarter of 2014, in line with the 8.75% to 9.75% capacity increase projected in Air Canada's news release dated May 12, 2015. The capacity growth in the second quarter of 2015 was primarily driven by increased seat density from Air Canada *rouge,* the airline's lower-cost leisure carrier*,* and through the introduction of Boeing 787 aircraft into the mainline fleet. The Boeing 787 Dreamliner is driving new opportunities for profitable growth at Air Canada. In addition to replacing Boeing 767 aircraft on existing routes, these aircraft are also serving new international destinations made viable by the Boeing 787 aircraft's lower operating costs, mid-size capacity and longer range. As new Boeing 787 aircraft are introduced in the mainline fleet, the Boeing 767 aircraft are being transferred to Air Canada *rouge* to pursue opportunities in international leisure markets made viable by Air Canada *rouge*'s lower cost structure.

- Passenger revenues of $3,082 million, an increase of $117 million or 3.9% from the second quarter of 2014. PRASM declined 5.5% from the second quarter of 2014 on a 5.0% decline in yield (which is consistent with the anticipated yield impact stemming from the implementation of the airline's strategic plan) and, to a much lesser extent, a passenger load factor decline of 0.5 percentage points. The favourable impact of a weaker Canadian dollar on foreign currency denominated passenger revenues increased passenger revenues by approximately $61 million in the second quarter of 2015.

- Operating expenses of $3,091 million, an increase of $31 million or 1% from the second quarter of 2014. This increase was mainly due to the 9.3% capacity growth, the unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses which increased operating expenses by approximately $134 million in the second quarter of 2015, impairment charges of $14 million related to the planned disposal of two Airbus A340-300 aircraft in the second quarter of 2015 versus nil in the second quarter of 2014, and favourable tax-related provision adjustments of $23 million in the second quarter of 2015 versus favourable tax-related provision adjustments of $41 million in the second quarter of 2014. These increases were largely offset by the impact of lower fuel prices which decreased operating expenses by $351 million in the second quarter of 2015. The impairment charges (recorded in depreciation, amortization and impairment expense) are included in Air Canada's GAAP operating income and net income results and in its CASM results but are excluded from its adjusted net income and adjusted CASM results. The favourable tax-related provision adjustments (recorded within other expenses) are included in Air Canada's GAAP operating income and net income results and in its EBITDAR and CASM results but are excluded from its adjusted net income and adjusted CASM results.

- A CASM reduction of 7.6% from the second quarter of 2014. On an adjusted basis, CASM increased 0.7% from the second quarter of 2014, in line with the 0.25% to 1.25% increase projected in Air Canada's news release dated May 12, 2015. Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

- EBITDAR of $591 million compared to EBITDAR of $456 million in the second quarter of 2014, an increase of $135 million. In the second quarters of 2015 and 2014, Air Canada recorded favourable tax-related provision adjustments of $23 million and $41 million, respectively. Air Canada recorded an EBITDAR margin of 17.3% compared to an EBITDAR margin of 13.8% in the second quarter of 2014, an improvement of 3.5 percentage points. EBITDAR is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

- Net income of $296 million or $1.00 per diluted share compared to net income of $223 million or $0.75 per diluted share in the second quarter of 2014, an increase of $73 million or $0.25 per diluted share.

- Adjusted net income of $250 million or $0.85 per diluted share compared to adjusted net income of $139 million or $0.47 per diluted share in the second quarter of 2014, an increase of $111 million or $0.38 per diluted share. Adjusted net-income is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

- Net cash flows from operating activities of $509 million, an improvement of $123 million. Free cash flow of $299 million was $335 million higher than in the second quarter of 2014, reflecting a decrease in capital expenditures of $212 million and the higher net cash flows from operating activities. Free cash flow (net cash flows from operating activities less additions to property, equipment and intangible assets) is a non-GAAP financial measure. Refer to section 7.5 "Consolidated Cash Flow Movements" of this MD&A for additional information.

- Adjusted net debt amounted to $4,896 million at June 30, 2015, a decrease of $236 million from December 31, 2014 as higher cash and short-term investments balances more than offset an increase in long-term debt and finance lease balances (including current portion). The airline's adjusted net debt to EBITDAR ratio was 2.3 at June 30, 2015 versus a ratio of 3.1 at December 31, 2014. Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is an additional GAAP financial measure. Refer to section 7.3 "Adjusted Net Debt" of this MD&A for additional information.

- Unrestricted liquidity (cash, short-term investments and undrawn lines of credit) of $3,283 million at June 30, 2015 (June 30, 2014 – $2,954 million). Unrestricted liquidity refers to the sum of cash, cash equivalents, short-term investments and the amount of available credit under Air Canada's revolving credit facilities. At June 30, 2015, cash and short-term investments amounted to $3,021 million and undrawn lines of credit amounted to $262 million. At June 30, 2014, cash and short-term investments amounted to $2,615 million and undrawn lines of credit amounted to $339 million.

- Return on invested capital ("ROIC") for the 12 months ended June 30, 2015 of 16.2% versus 11.0% for the 12 months ended June 30, 2014. ROIC is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

4. RESULTS OF OPERATIONS – SECOND QUARTER 2015 VERSUS SECOND QUARTER 2014

The following table and discussion compares results of Air Canada for the second quarter 2015 versus the second quarter of 2014.

(Canadian dollars in millions, except per share figures)	Second Quarter 2015	Second Quarter 2014	Change $	Change %
Operating revenues				
Passenger	$ 3,082	$ 2,965	$ 117	4
Cargo	123	122	1	1
Other	209	218	(9)	(4)
Total revenues	**3,414**	**3,305**	**109**	**3**
Operating expenses				
Aircraft fuel	648	835	(187)	(22)
Regional airlines expense				
Aircraft fuel	97	127	(30)	(24)
Other	497	451	46	10
Wages, salaries and benefits	568	535	33	6
Airport and navigation fees	201	186	15	8
Aircraft maintenance	190	171	19	11
Sales and distribution costs	152	143	9	6
Depreciation, amortization and impairment	177	128	49	38
Ground package costs	84	77	7	9
Aircraft rent	84	76	8	11
Food, beverages and supplies	80	74	6	8
Communications and information technology	52	47	5	11
Other	261	210	51	24
Total operating expenses	**3,091**	**3,060**	**31**	**1**
Operating income	**323**	**245**	**78**	
Non-operating income (expense)				
Foreign exchange gain	56	40	16	
Interest income	12	9	3	
Interest expense	(94)	(81)	(13)	
Interest capitalized	21	10	11	
Net financing expense relating to employee benefits	(25)	(34)	9	
Fuel and other derivatives	5	36	(31)	
Other	(2)	(2)	-	
Total non-operating expense	**(27)**	**(22)**	**(5)**	
Income before income taxes	**296**	**223**	**73**	
Income taxes	-	-	-	
Net income	**$ 296**	**$ 223**	**$ 73**	
Net income per share – basic	**$ 1.03**	**$ 0.77**	**$ 0.26**	
Net income per share – diluted	**$ 1.00**	**$ 0.75**	**$ 0.25**	
EBITDAR (1)	**$ 591**	**$ 456**	**$ 135**	
Adjusted net income (1)	**$ 250**	**$ 139**	**$ 111**	
Adjusted net income per share – diluted (1)	**$ 0.85**	**$ 0.47**	**$ 0.38**	

(1) EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent), adjusted net income (loss) and adjusted net income (loss) per share – diluted are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

System passenger revenues increased 3.9% from the second quarter of 2014

In the second quarter of 2015, on capacity growth of 9.3%, system passenger revenues of $3,082 million increased $117 million or 3.9% from the second quarter of 2014.

In the second quarter of 2015, system business cabin revenues increased $1 million or 0.1% from the second quarter of 2014 as a yield improvement of 0.8% was mostly offset by a traffic decrease of 0.7%.

The table below provides passenger revenue by geographic region for the second quarter of 2015 and the second quarter of 2014.

Passenger Revenue	Second Quarter 2015 $ Million	Second Quarter 2014 $ Million	Change $ Million	% Change
Canada	1,097	1,093	4	0.4
U.S. transborder	660	595	65	10.9
Atlantic	726	682	44	6.5
Pacific	431	425	6	1.4
Other	168	170	(2)	(1.3)
System	**3,082**	**2,965**	**117**	**3.9**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the second quarter of 2015 versus the second quarter of 2014.

Second Quarter 2015 versus Second Quarter 2014	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	0.4	2.6	3.1	0.3	(4.1)	(3.7)
U.S. transborder	10.9	12.4	12.9	0.4	(1.9)	(1.5)
Atlantic	6.5	11.2	11.0	(0.2)	(4.0)	(4.2)
Pacific	1.4	13.6	10.4	(2.5)	(8.1)	(10.7)
Other	(1.3)	10.3	7.9	(1.9)	(9.0)	(11.0)
System	**3.9**	**9.3**	**8.7**	**(0.5)**	**(5.0)**	**(5.5)**

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the second quarter of 2015 and each of the previous four quarters.

System	Year-over-Year by Quarter (% Change)				
	Q2'14	Q3'14	Q4'14	Q1'15	Q2'15
Passenger revenues	7.5	9.4	7.6	6.9	3.9
Capacity (ASMs)	8.5	9.8	8.5	9.3	9.3
Traffic (RPMs)	9.9	11.0	9.4	10.9	8.7
Passenger load factor (pp change)	1.1	1.0	0.6	1.2	(0.5)
Yield	(2.1)	(1.3)	(1.9)	(4.2)	(5.0)
PRASM	(0.8)	(0.2)	(1.2)	(2.7)	(5.5)

In the second quarter of 2015, Air Canada's system capacity was 9.3% higher than in the second quarter of 2014, with capacity growth reflected in all markets.

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

- The 8.7% traffic increase which reflected traffic growth in all markets. Consistent with the airline's objective of increasing global international-to-international connecting traffic through its major Canadian hubs, the traffic growth in the second quarter of 2015 also reflected lower-yielding incremental connecting traffic to international destinations.

- The 5.0% yield decrease which is consistent with the anticipated yield impact stemming from the implementation of the airline's strategic plan and which reflected:

    - an increase in average stage length of 3.4%, which had the effect of reducing system yield by 1.9 percentage points;

    - a higher proportional growth of lower-yielding international-to-international passenger flows in support of the airline's international expansion strategy;

    - a higher proportion of seats into long-haul leisure markets; and

    - a reduction in carrier surcharges relating to lower fuel prices, particularly where carrier surcharges are regulated such as Japan, Hong Kong, Korea and Brazil.

  Partly offsetting this yield decline was a favourable currency impact of $61 million.

System PRASM decreased 5.5% due to the lower yield and, to a much lesser extent, a passenger load factor decline of 0.5 percentage points.

Domestic passenger revenues increased 0.4% from the second quarter of 2014

In the second quarter of 2015, on capacity growth of 2.6%, domestic passenger revenues of $1,097 million increased $4 million or 0.4% from the second quarter of 2014.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the second quarter of 2015 and each of the previous four quarters.

Canada	Year-over-Year by Quarter (% Change)				
	Q2'14	Q3'14	Q4'14	Q1'15	Q2'15
Passenger revenues	2.2	6.5	5.7	3.4	0.4
Capacity (ASMs)	3.6	5.3	6.1	2.1	2.6
Traffic (RPMs)	5.3	6.9	6.6	3.9	3.1
Passenger load factor (pp change)	1.3	1.2	0.4	1.4	0.3
Yield	(3.3)	(0.7)	(1.8)	(1.8)	(4.1)
PRASM	(1.8)	0.8	(1.3)	-	(3.7)

In the second quarter of 2015, the 2.6% domestic capacity growth reflected capacity increases on all major domestic services with the exception of services to the Maritimes where capacity was reduced year-over-year. A 3.0% growth in capacity on routes within western Canada reflected, in large part, the use of larger aircraft on Calgary–Vancouver and Vancouver–Edmonton to facilitate connectivity in support of the airline's international expansion strategy.

Components of the year-over-year change in second quarter domestic passenger revenues included:

- The 3.1% traffic increase which reflected traffic growth on all domestic services with the exception of services to the Maritimes where capacity was reduced year-over-year. The traffic growth in the second quarter of 2015 reflected increases on services within Canada, as well as incremental connecting traffic to U.S. and international destinations. Partly offsetting the traffic growth in the second quarter of 2015 was the impact of lower passenger demand in oil-related markets.

- An increase in baggage fee revenues following an adjustment to the airline's first checked bag policy which became effective for travel as of November 2, 2014. Baggage fee revenues are not included in Air Canada's yield and PRASM results.

- The 4.1% yield decrease which reflected the impact of increased industry capacity and competitive pricing activities, higher proportional growth of lower-yielding international and U.S. transborder passenger flows in support of the international expansion strategy, a higher proportion of economy cabin traffic, as well as a decline in corporate oil market-related traffic. Partly offsetting this yield decline was a favourable currency impact of $8 million.

Domestic PRASM decreased 3.7% on the lower yield as passenger load factor improved 0.3 percentage points.

U.S. transborder passenger revenues increased 10.9% from the second quarter of 2014

In the second quarter of 2015, on a capacity growth of 12.4%, U.S. transborder passenger revenues of $660 million increased $65 million or 10.9% from the second quarter of 2014.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the second quarter of 2015 and each of the previous four quarters.

U.S. transborder	Year-over-Year by Quarter (% Change)				
	Q2'14	Q3'14	Q4'14	Q1'15	Q2'15
Passenger revenues	11.5	11.2	9.5	12.6	10.9
Capacity (ASMs)	12.2	12.7	14.0	17.3	12.4
Traffic (RPMs)	16.2	16.2	15.5	17.7	12.9
Passenger load factor (pp change)	2.8	2.5	1.1	0.3	0.4
Yield	(3.3)	(3.7)	(5.0)	(4.3)	(1.9)
PRASM	0.1	(0.7)	(3.7)	(4.0)	(1.5)

In the second quarter of 2015, the 12.4% U.S. transborder capacity growth reflected capacity increases on all major U.S. transborder services with the exception of certain long-haul routes from western Canada to the U.S. and certain long-haul routes from eastern Canada to the U.S.

Components of the year-over-year change in second quarter U.S. transborder passenger revenues included:

- The 12.9% traffic increase which reflected traffic growth on all major U.S. transborder services with the exception of certain long-haul routes from eastern Canada to the U.S. The year-over-year increase in traffic was largely due to strong passenger demand between Canada and the U.S. as well as growth of international-to-international passenger flows from the U.S. in support of Air Canada's international expansion strategy. Passenger demand was particularly strong on U.S. sun routes, on services from eastern Canada to California, and on services from western Canada to the western U.S.

- The 1.9% yield decline which reflected a 2.2% longer average stage length, which had the effect of reducing U.S. transborder yield by 1.2 percentage points, as well as an increase in long-haul leisure flying led by lower-cost Air Canada *rouge*, which is allowing Air Canada to effectively compete on lower-yielding leisure routes. Partly offsetting this yield decrease was a favourable currency impact of $23 million.

U.S. transborder PRASM decreased 1.5% on the lower yield as passenger load factor improved 0.4 percentage points.

Atlantic passenger revenues increased 6.5% from the second quarter of 2014

In the second quarter of 2015, on capacity growth of 11.2%, Atlantic passenger revenues of $726 million increased $44 million or 6.5% from the second quarter of 2014.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the second quarter of 2015 and each of the previous four quarters.

Atlantic	Year-over-Year by Quarter (% Change)				
	Q2'14	Q3'14	Q4'14	Q1'15	Q2'15
Passenger revenues	12.3	14.9	13.6	11.0	6.5
Capacity (ASMs)	16.2	20.2	8.7	10.7	11.2
Traffic (RPMs)	14.7	19.2	12.8	17.2	11.0
Passenger load factor (pp change)	(1.1)	(0.8)	2.9	4.2	(0.2)
Yield	(2.0)	(3.5)	0.8	(5.1)	(4.0)
PRASM	(3.3)	(4.4)	4.7	0.4	(4.2)

In the second quarter of 2015, the 11.2% Atlantic capacity growth reflected capacity increases on all major Atlantic services with the exception of services to Germany where capacity was reduced year-over-year.

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

- The 11.0% traffic increase which reflected traffic growth on all major Atlantic services with the exception of services to Germany where capacity was reduced year-over-year. The traffic growth in the second quarter of 2015 reflected incremental traffic between the U.S. and Europe via the airline's major Canadian hubs, in line with Air Canada's international growth strategy.

- The 4.0% yield decline which reflected:

  - the impact of increased industry capacity and competitive pricing activities on all major Atlantic services; and

  - the impact of having a higher proportion of seats in long-haul (lower-yielding) leisure markets.

These yield decreases were partly offset by a favourable currency impact of $11 million.

Atlantic PRASM decreased 4.2% mainly on the lower yield.

Pacific passenger revenues increased 1.4% from the second quarter of 2014

In the second quarter of 2015, on capacity growth of 13.6%, Pacific passenger revenues of $431 million increased $6 million or 1.4% from the second quarter of 2014.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the second quarter of 2015 and each of the previous four quarters.

Pacific	Year-over-Year by Quarter (% Change)				
	Q2'14	Q3'14	Q4'14	Q1'15	Q2'15
Passenger revenues	5.7	8.3	6.5	(0.5)	1.4
Capacity (ASMs)	1.8	1.6	9.5	7.6	13.6
Traffic (RPMs)	4.1	3.6	7.6	6.5	10.4
Passenger load factor (pp change)	1.9	1.7	(1.4)	(0.8)	(2.5)
Yield	1.8	4.9	(0.8)	(6.5)	(8.1)
PRASM	4.1	7.0	(2.5)	(7.4)	(10.7)

In the second quarter of 2015, the 13.6% Pacific capacity growth reflected capacity increases on all major Pacific services with the exception of services to Hong Kong and Australia where capacity was reduced year-over-year.

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

- The 10.4% traffic increase which reflected traffic growth on all major Pacific services with exception of services to Australia where capacity was reduced year-over-year. Despite the capacity reduction on services to Hong Kong, traffic increased on these services when compared to the same quarter in 2014. Traffic on services to Japan increased 30% on a 42% growth in capacity with the introduction of Air Canada's new service to Osaka and an additional frequency from Toronto to Tokyo, both effective May 1, 2015. Air Canada's performance on services to Japan was also impacted by a weaker Japanese economy. The other major services in the airline's Pacific network performed in line with last year.

- The 8.1% yield decline which mainly reflected a significant reduction in carrier surcharges relating to lower fuel prices, particularly where carrier surcharges are regulated, such as Japan, Hong Kong and Korea, as well as competitive pressures from Canada and the U.S., both in terms of added capacity and pricing. The competitive pressures impacted both local, U.S. sixth freedom and beyond traffic. Partly offsetting this yield decrease was a favourable currency impact of $14 million.

Pacific PRASM decreased 10.7% on the lower yield and, to lesser extent, a passenger load factor decline of 2.5 percentage points.

Other passenger revenues decreased 1.3% from the second quarter of 2014

In the second quarter of 2015, on capacity growth of 10.3%, Other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of $168 million decreased $2 million or 1.3% from the second quarter of 2014.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the second quarter of 2015 and each of the previous four quarters.

Other	Year-over-Year by Quarter (% Change)				
	Q2'14	Q3'14	Q4'14	Q1'15	Q2'15
Passenger revenues	17.7	0.5	0.4	9.5	(1.3)
Capacity (ASMs)	11.0	2.2	3.9	12.9	10.3
Traffic (RPMs)	15.7	3.6	3.0	13.4	7.9
Passenger load factor (pp change)	3.5	1.1	(0.6)	0.3	(1.9)
Yield	2.6	(2.4)	(2.7)	(3.7)	(9.0)
PRASM	7.0	(1.1)	(3.4)	(3.3)	(11.0)

In the second quarter of 2015, the 10.3% capacity growth reflected capacity increases on all major services in the Other markets. Incremental capacity in the form of higher seat density on capacity to Lima, and the introduction of services to Rio de Janeiro in December 2014 were the main contributors to the capacity increase year-over-year. Traffic on services to South America increased almost 19% when compared to same quarter in 2014.

Components of the year-over-year change in second quarter Other passenger revenues included:

- The overall 7.9% traffic increase which reflected traffic growth on all major services in the Other markets. Consistent with Air Canada's strategy of increasing international-to-international traffic through its Canadian hubs, the traffic growth on services to South America in the second quarter of 2015 also reflected incremental lower-yielding connecting traffic from the U.S. in support of Air Canada's international expansion strategy.

- The overall 9.0% yield decrease which reflected a 4.3% increase in average stage length, which had the effect of reducing yield by 2.4 percentage points, competitive pricing activities and a reduction in carrier surcharges relating to lower fuel prices. In addition, in the second quarter of 2014, yields were favourably impacted by the FIFA World Cup tournament in Brazil. Partly offsetting this yield decline was a favourable currency impact of $5 million.

Overall PRASM decreased 11.0% on the lower yield and, to a lesser extent, a passenger load factor decline of 1.9 percentage points.

Cargo revenues increased 1.3% from the second quarter of 2014

In the second quarter of 2015, cargo revenues of $123 million increased $1 million or 1.3% from the second quarter of 2014.

The table below provides cargo revenue by geographic region for the second quarter of 2015 and the second quarter of 2014.

Cargo Revenue	Second Quarter 2015 $ Million	Second Quarter 2014 $ Million	Change $ Million
Canada	17	17	-
U.S. transborder	6	5	1
Atlantic	45	47	(2)
Pacific	47	46	1
Other	8	7	1
System	**123**	**122**	**1**

The table below provides year-over-year percentage changes in system cargo revenues and operating statistics for the second quarter of 2015 and each of the previous four quarters.

System	Year-over-Year by Quarter (% Change)				
	Q2'14	Q3'14	Q4'14	Q1'15	Q2'15
Cargo revenues	6.6	6.5	3.9	7.9	1.3
Capacity (ETMs)	8.2	9.6	11.6	12.9	11.9
Revenue per ETM	(1.5)	(3.0)	(6.9)	(4.5)	(9.5)
Traffic (RTMs)	11.3	6.9	7.5	3.5	(1.9)
Yield per RTM	(4.3)	(0.5)	(3.3)	4.2	3.2

The table below provides year-over-year percentage changes in cargo revenues and operating statistics for the second quarter of 2015 versus the second quarter of 2014.

Second Quarter 2015 versus Second Quarter 2014	Cargo Revenue % Change	Capacity (ETMs) % Change	Rev / ETM % Change	Traffic (RTMs) % Change	Yield / RTM % Change
Canada	1.9	1.8	0.2	10.7	(7.9)
U.S. transborder	10.6	40.1	(21.1)	39.5	(20.7)
Atlantic	(2.5)	9.7	(11.1)	(0.3)	(2.2)
Pacific	2.8	12.3	(8.4)	(8.8)	12.7
Other	7.5	19.2	(9.8)	8.2	(0.6)
System	**1.3**	**11.9**	**(9.5)**	**(1.9)**	**3.2**

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

- The 3.2% yield increase which was largely driven by a favourable currency impact in the Pacific market. Partly offsetting this yield growth were yield declines in the domestic, U.S. transborder, Atlantic and Other markets, the result of increased industry capacity and competitive pricing activities.

- The 1.9% traffic decrease which was mainly driven by an overall reduction in volumes and the impact of increased industry capacity in the Pacific market. Partly offsetting this traffic decline were traffic increases in the domestic, U.S. transborder and Other markets, primarily reflecting the airline's use of larger aircraft on certain routes.

Other revenues decreased 4% from the second quarter of 2014

In the second quarter of 2015, other revenues of $209 million decreased $9 million or 4% from the second quarter of 2014, mainly due to the impact of the new Jazz CPA, effective January 1, 2015, whereby certain costs, such as ground handling services performed by Air Canada, are no longer recovered from Jazz and passed through to Air Canada under the Jazz CPA as capacity purchase fees, thereby reducing both other revenues and capacity purchase fees. A reduction in aircraft sublease revenues was also a contributing factor to the decrease in other revenues year-over-year. These decreases were largely offset by growth in passenger-related fees.

CASM decreased 7.6% from the second quarter of 2014. Adjusted CASM increased 0.7% from the second quarter of 2014

The following table compares Air Canada's CASM and Adjusted CASM for the second quarter of 2015 to the second quarter 2014.

	Second Quarter		Change	
(cents per ASM)	**2015**	**2014**	**cents**	**%**
Aircraft fuel	3.22	4.53	(1.31)	(28.9)
Regional airlines expense				
Aircraft fuel	0.48	0.69	(0.21)	(30.4)
Other	2.47	2.45	0.02	0.8
Wages and salaries	2.22	2.29	(0.07)	(3.1)
Benefits	0.60	0.62	(0.02)	(3.2)
Airport and navigation fees	1.00	1.01	(0.01)	(1.0)
Aircraft maintenance	0.95	0.93	0.02	2.2
Sales and distribution costs	0.75	0.78	(0.03)	(3.8)
Depreciation, amortization and impairment	0.88	0.70	0.18	25.7
Ground package costs	0.42	0.42	-	-
Aircraft rent	0.42	0.41	0.01	2.4
Food, beverages and supplies	0.39	0.40	(0.01)	(2.5)
Communications and information technology	0.26	0.26	-	-
Other	1.29	1.13	0.16	14.2
CASM	**15.35**	**16.62**	**(1.27)**	**(7.6)**
Remove:				
Aircraft fuel expense (1), ground package costs at Air Canada Vacations, and unusual items (2)(3)	(4.07)	(5.42)	1.35	24.9
Adjusted CASM (4)	**11.28**	**11.20**	**0.08**	**0.7**

(1) Includes aircraft fuel expense related to regional airline operations.

(2) In the second quarter of 2015, Air Canada recorded impairment charges of $14 million related to the planned disposal of two Airbus A340-300 aircraft in the second half of 2015 (neither of which was operated by Air Canada).

(3) In the second quarter of 2015, Air Canada recorded favourable tax-related provision adjustments of $23 million. In the second quarter of 2014, Air Canada recorded favourable tax-related provision adjustments of $41 million.

(4) Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Operating expenses increased 1% from the second quarter of 2014

In the second quarter of 2015, on capacity growth of 9.3%, operating expenses of $3,091 million increased $31 million or 1% from the second quarter of 2014.

Components of the year-over-year change in second quarter operating expenses included:

- The impact of the 9.3% capacity growth.

- The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) which increased operating expenses by approximately $134 million (comprised of $73 million in aircraft fuel expense and an aggregate of $61 million in non-fuel operating expenses). Refer to section 9 "Financial Instruments and Risk Management" of this MD&A for information on Air Canada's foreign exchange risk management strategy.

- Impairment charges of $14 million related to the planned disposal of two Airbus A340-300 aircraft (neither of which was operated by Air Canada) while no such charges were recorded in the second quarter of 2014.

- Favourable tax-related provision adjustments of $23 million versus favourable tax-related provision adjustments of $41 million in the second quarter of 2014.

Largely offsetting these increases was:

- The impact of lower fuel prices which accounted for a decrease of $351 million to aircraft fuel expense.

Aircraft fuel expense decreased 22% from the second quarter of 2014

In the second quarter of 2015, aircraft fuel expense of $648 million decreased $187 million or 22% from the second quarter of 2014.

Aircraft fuel expense, including fuel expense related to regional airline operations, amounted to $745 million in the second quarter of 2015, a decrease of $217 million or 23% from the second quarter of 2014. The decrease in aircraft fuel expense in the second quarter of 2015 was due to a significant decline in jet fuel prices year-over-year, which accounted for a decrease of $351 million to aircraft fuel expense. These decreases were partly offset by the unfavourable impact of a weaker Canadian dollar versus the U.S. dollar when compared to the second quarter of 2014, which accounted for an increase of $73 million, as well as a higher volume of fuel litres consumed, which accounted for an increase of $61 million.

The table below provides Air Canada's fuel cost per litre and economic fuel cost per litre (including aircraft fuel expense related to regional airline operations) for the periods indicated.

(Canadian dollars in millions, except where indicated)	Second Quarter 2015	Second Quarter 2014	Change $	Change %
Aircraft fuel expense – GAAP	**$ 648**	**$ 835**	**$ (187)**	**(22)**
Add: Aircraft fuel expense related to regional airline operations	97	127	(30)	(24)
Total Aircraft fuel expense	**$ 745**	**$ 962**	**$ (217)**	**(23)**
Add: Net cash payments (receipts) on fuel derivatives (1)	11	(2)	13	(650)
Economic cost of fuel – Non-GAAP (2)	**$ 756**	**$ 960**	**$ (204)**	**(21)**
Fuel consumption (thousands of litres)	**1,113,576**	**1,047,855**	**65,721**	**6.3**
Fuel cost per litre (cents) – GAAP	**66.9**	**91.8**	**(24.9)**	**(27.1)**
Economic fuel cost per litre (cents) – Non-GAAP (2)	**67.9**	**91.6**	**(23.7)**	**(25.9)**

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

(2) *The economic cost of fuel is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, and may not be comparable to similar 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.*

Regional airlines expense increased 3% from the second quarter of 2014

Air Canada has capacity purchase agreements with Jazz, Sky Regional and certain other regional carriers. Under these arrangements, Air Canada markets, tickets and enters into other commercial arrangements relating to these flights and records the revenue it earns under Passenger revenues. As of 2015, expenses incurred related to capacity purchase agreements are presented in a separate line item on Air Canada's consolidated statement of operations titled Regional airlines expense which reflects the inclusion of all expenses related to the third-party contract carrier arrangements, including capacity purchase fees, pass-through costs and other costs.

Effective January 1, 2015, Air Canada and Jazz amended the terms of their capacity purchase agreement ("Jazz CPA"). Following such amendments and in order to better reflect costs under the Jazz CPA and Air Canada's other regional capacity purchase agreements, certain costs that were previously capacity purchase fees are now pass-through costs. Other costs that were pass-through costs are now costs directly incurred by Air Canada. As a result, the line categories within regional airlines expense are not directly comparable year-over-year.

In the second quarter of 2015, regional airlines expense of $594 million increased $16 million or 3% from the second quarter of 2014, mainly due to higher rates year-over-year and, to a lesser extent, an unfavourable currency impact. These increases were largely offset by a decrease in aircraft fuel expense.

The following table provides a breakdown of Regional airlines expense for the periods indicated:

	Second Quarter		Change	
(Canadian dollars in millions)	**2015**	**2014**	**$**	**%**
Capacity purchase fees	$ 302	$ 294	$ 8	3
Aircraft fuel	97	127	(30)	(24)
Airport and navigation	70	70	-	-
Sales and distribution costs	33	28	5	18
Other operating expenses	92	59	33	56
Total regional airlines expense	**$ 594**	**578**	**$ 16**	**3**

Wages, salaries and benefits expense amounted to $568 million in the second quarter of 2015, an increase of $33 million or 6% from the second quarter of 2014

In the second quarter of 2015, wages and salaries expense of $447 million increased $26 million or 6% from the second quarter of 2014, mainly due to an increase in expense accruals related to the annual employee profit sharing programs and a lump sum payment of $9 million made to the airline's approximately 4,000 customer service and sales agents, represented by Unifor, reflecting their annual wage increase. Higher average salaries, mainly due to contractual increases, was also a contributing factor in the increase in wages and salaries expense year-over-year.

In the second quarter of 2015, employee benefits expense of $121 million increased $7 million or 6% from the second quarter of 2014, mainly due to the impact of lower discount rates which increased the current service cost of defined benefit pension plans, largely offset by a favourable impact of benefit plan amendments of $19 million relating to U.S. post-retirement health plans.

Airport and navigation fees increased 8% from the second quarter of 2014

In the second quarter of 2015, airport and navigation fees of $201 million increased $15 million or 8% from the second quarter of 2014, mainly due to an increase in aircraft departures of 2.5% and an unfavourable currency impact. These increases were partly offset by the impact of the terms of an agreement with the Greater Toronto Airports Authority which is allowing Air Canada to grow its share of international passengers connecting at Toronto Pearson International Airport on a more cost effective basis.

Aircraft maintenance expense increased 11% from the second quarter of 2014

In the second quarter of 2015, aircraft maintenance expense of $190 million increased $19 million or 11% from the second quarter of 2014, mainly due to an unfavourable currency impact of $23 million and the timing of scheduled airframe and components maintenance activity versus the second quarter of 2014. These increases were largely offset by timing of engine maintenance activity versus the second quarter of 2014 as well as the impact of Air Canada having extended a greater number of aircraft leases, and of certain favourable lease return condition provision adjustments which, together, resulted in a decrease of $17 million to aircraft maintenance expense in the second quarter of 2015. Lease term extensions postpone the expected timing of the end of lease costs and lengthen the period over which expenses are recorded and result in a cumulative adjustment to reflect the revised provision required as at the balance sheet date, thus reducing maintenance expense in the period.

Sales and distribution costs increased 6% from the second quarter of 2014

In the second quarter of 2015, sales and distribution costs of $152 million increased $9 million or 6% from the second quarter of 2014 on passenger revenue growth of 3.9%. This growth in sales and distribution costs was mainly due to the impact of a higher volume of tickets sales generated through Global Distribution System ("GDS") providers, an unfavourable currency impact and higher credit card fees, in line with sales and revenue growth. These increases were partly offset by the impact of more favourable distribution rates negotiated in 2015.

Depreciation, amortization and impairment expense increased 38% from the second quarter of 2014

In the second quarter of 2015, depreciation, amortization and impairment expense of $177 million increased $49 million or 38% from the second quarter of 2014, largely due to the introduction of new Boeing 787 aircraft to Air Canada's mainline fleet. In addition, in the second quarter of 2015, Air Canada recorded impairment charges of $14 million related to the planned disposal of two Airbus A340-300 aircraft in the second half of 2015 (neither of which was operated by Air Canada) while no such charges were recorded in the second quarter of 2014.

Ground package costs increased 9% from the second quarter of 2014

In the second quarter of 2015, the cost of ground packages at Air Canada Vacations amounted to $84 million, an increase of $7 million or 9% from the second quarter of 2014, largely due to an unfavourable currency impact and a higher cost of ground packages partly offset by the impact of lower passenger volumes.

Aircraft rent increased 11% from the second quarter of 2014

In the second quarter of 2015, aircraft rent expense amounted to $84 million, an increase of $8 million or 11% from the second quarter of 2014, mainly due to an unfavourable currency impact and an increase in the number of leased aircraft in anticipation of the replacement of 20 of the airline's Embraer 190 aircraft in late 2015 and the first half of 2016. These increases were partly offset by the favourable impact of lower rates on lease renewals.

Other expenses increased 24% from the second quarter of 2014

In the second quarter of 2015, other expenses of $261 million increased $51 million or 24% from the second quarter of 2014, reflecting the 9.3% capacity growth, an increase in advertising and promotion expense, largely driven by the airline's international network expansion, an increase in customer inconvenience costs proportional to the higher passenger volumes, and an unfavourable currency impact. In addition, in the second quarter of 2015, Air Canada recorded favourable tax-related provision adjustments of $23 million versus $41 million in the second quarter of 2014 (reflected in remaining other expenses). An increase in terminal handling expense was mainly due to Air Canada's international expansion strategy.

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

	Second Quarter		Change	
(Canadian dollars in millions)	**2015**	**2014**	**$**	**%**
Terminal handling	$ 59	$ 47	$ 12	26
Building rent and maintenance	36	36	-	-
Crew cycle	36	35	1	3
Miscellaneous fees and services	35	33	2	6
Remaining other expenses	95	59	36	61
Total other expenses	**$ 261**	**$ 210**	**$ 51**	**24**

Non-operating expense amounted to $27 million in the second quarter of 2015 compared to non-operating expense of $22 million in the second quarter of 2014

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

(Canadian dollars in millions)	Second Quarter 2015	Second Quarter 2014	Change $
Foreign exchange gain	$ 56	$ 40	$ 16
Interest income	12	9	3
Interest expense	(94)	(81)	(13)
Interest capitalized	21	10	11
Net financing expense relating to employee benefits	(25)	(34)	9
Fuel and other derivatives	5	36	(31)
Other	(2)	(2)	-
Total non-operating expense	**$ (27)**	**$ (22)**	**$ (5)**

Factors contributing to the year-over-year change in second quarter non-operating expense included:

- Gains on foreign exchange, mainly related to U.S. denominated long-term debt, which amounted to $56 million in the second quarter of 2015 compared to gains on foreign exchange of $40 million in the second quarter of 2014. The gains in the second quarter of 2015 were mostly attributable to a stronger Canadian dollar at June 30, 2015 when compared to March 31, 2015. The June 30, 2015 closing exchange rate was US$1 = C$1.2490 while the March 31, 2015 closing exchange rate was US$1 = C$1.2666. Partially offsetting these gains were losses of $13 million on foreign currency derivatives and $12 million on cash and short-term investments balances.

- An increase in interest expense of $13 million was mainly due to new borrowings, a standby charge related to the financing, by way of Enhanced Equipment Trust Certificates ("EETCs"), of aircraft which remain to be delivered, and to the impact of a weaker Canadian dollar on U.S. denominated borrowings. This increase was mostly offset by an increase in capitalized interest of $11 million which largely reflected the above-noted standby charge.

- A decrease in net financing expense relating to employee benefits of $9 million which was mainly due to the impact of the lower net defined pension benefit obligation.

- Gains on fuel and other derivatives which amounted to $5 million in the second quarter of 2015 versus gains on fuel and other derivatives of $36 million in the second quarter of 2014. Refer to section 9 "Financial Instruments and Risk Management" of this MD&A for additional information.

5. RESULTS OF OPERATIONS – FIRST SIX MONTHS 2015 VERSUS FIRST SIX MONTHS 2014

The following table and discussion compares results of Air Canada for the first six months of 2015 versus the first six months of 2014.

	First Six Months		Change	
(Canadian dollars in millions, except per share figures)	**2015**	**2014**	**$**	**%**
Operating revenues				
Passenger	$ 5,868	$ 5,573	$ 295	5
Cargo	252	241	11	5
Other	543	556	(13)	(2)
Total revenues	**6,663**	**6,370**	**293**	**5**
Operating expenses				
Aircraft fuel	1,240	1,628	(388)	(24)
Regional airlines expense				
Aircraft fuel	183	252	(69)	(27)
Other	963	893	70	8
Wages, salaries and benefits	1,136	1,092	44	4
Airport and navigation fees	386	369	17	5
Aircraft maintenance	378	333	45	14
Sales and distribution costs	306	291	15	5
Depreciation, amortization and impairment	330	254	76	30
Ground package costs	265	247	18	7
Aircraft rent	166	152	14	9
Food, beverages and supplies	142	140	2	1
Communications and information technology	109	99	10	10
Other	536	437	99	23
Total operating expenses	**6,140**	**6,187**	**(47)**	**(1)**
Operating income	**523**	**183**	**340**	
Non-operating income (expense)				
Foreign exchange loss	(352)	(121)	(231)	
Interest income	21	18	3	
Interest expense	(184)	(158)	(26)	
Interest capitalized	30	15	15	
Net financing expense relating to employee benefits	(50)	(68)	18	
Fuel and other derivatives	6	21	(15)	
Other	(7)	(8)	1	
Total non-operating expense	**(536)**	**(301)**	**(235)**	
Loss before income taxes	**(13)**	**(118)**	**105**	
Income taxes	-	-	-	
Net loss	**$ (13)**	**$ (118)**	**$ 105**	
Net loss per share – basic and diluted	**$ (0.06)**	**$ (0.42)**	**$ 0.36**	
EBITDAR (1)	**$ 1,033**	**$ 603**	**$ 430**	
Adjusted net income (1)	**$ 372**	**$ 7**	**$ 365**	
Adjusted net income per share – diluted (1)	**$ 1.26**	**$ 0.02**	**$ 1.24**	

(1) EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent), adjusted net income (loss) and adjusted net income (loss) per share – diluted are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

System passenger revenues increased 5.3% from the first six months of 2014

In the first six months of 2015, on capacity growth of 9.3%, system passenger revenues of $5,868 million increased $295 million or 5.3% from the first six months of 2014.

In the first six months of 2015, system business cabin revenues increased $7 million or 0.6% from the first six months of 2014 due to a yield improvement of 1.3% partly offset by a traffic decrease of 0.7%.

The table below provides passenger revenue by geographic region for the first six months of 2015 and the first six months of 2014.

Passenger Revenue	First Six Months 2015 $ Million	First Six Months 2014 $ Million	Change $ Million	% Change
Canada	2,073	2,036	37	1.8
U.S. transborder	1,359	1,216	143	11.8
Atlantic	1,176	1,088	88	8.2
Pacific	800	796	4	0.5
Other	460	437	23	5.3
System	**5,868**	**5,573**	**295**	**5.3**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the first six months of 2015 versus the first six months of 2014.

First Six Months 2015 versus First Six Months 2014	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	1.8	2.4	3.4	0.8	(3.0)	(2.0)
U.S. transborder	11.8	14.9	15.4	0.4	(3.2)	(2.8)
Atlantic	8.2	11.0	13.2	1.6	(4.4)	(2.5)
Pacific	0.5	10.7	8.5	(1.7)	(7.3)	(9.1)
Other	5.3	11.9	11.2	(0.5)	(5.7)	(6.3)
System	**5.3**	**9.3**	**9.7**	**0.3**	**(4.6)**	**(4.2)**

In the first six months of 2015, Air Canada's system capacity was 9.3% higher than in the first six months of 2014, with capacity growth reflected in all markets.

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

- The 9.7% traffic increase which reflected traffic growth in all markets. Consistent with the airline's objective of increasing global international-to-international connecting traffic through its major Canadian hubs, the traffic growth in the first six months of 2015 also reflected lower-yielding incremental connecting traffic to international destinations.

- The 4.6% yield decrease which reflected:

  - an increase in average stage length of 3.1%, which had the effect of reducing system yield by 1.8 percentage points;

- a higher proportional growth of lower-yielding international-to-international passenger flows in support of the airline's international expansion strategy;

- a higher proportion of seats into long-haul leisure markets led by lower-cost Air Canada *rouge* flying;

- the use of lower-cost Boeing 777 high-density aircraft which have a larger economy cabin. The use of this lower-cost aircraft on high-volume routes is allowing the airline to access traditionally lower-yielding traffic while improving profitability; and

- a reduction in carrier surcharges relating to lower fuel prices, particularly where carrier surcharges are regulated such as Japan, Hong Kong, Korea and Brazil.

Partly offsetting this yield decline was a favourable currency impact of $99 million.

System PRASM decreased 4.2% mainly on the lower yield.

Domestic passenger revenues increased 1.8% from the first six months of 2014

In the first six months of 2015, on capacity growth of 3.4%, domestic passenger revenues of $2,073 million increased $37 million or 1.8% from the first six months of 2014.

In the first six months of 2015, the 3.4% domestic capacity growth reflected capacity increases on all major domestic services with the exception of services to the Maritimes where capacity was reduced year-over-year. The reduction in capacity on services to the Maritimes was partly due to weather-related issues in the first quarter of 2015.

Components of the year-over-year change in domestic passenger revenues in the first six months included:

- The 3.4% traffic increase which reflected traffic growth on all domestic services. The traffic growth in the first six months of 2015 reflected increases on all major domestic services with the exception of services to the Maritimes where capacity was reduced year-over-year. Although there was a reduction in traffic on services to the Maritimes, the traffic decrease was less than the capacity reduction. The first six months of 2015 also reflected incremental connecting traffic to U.S. and international destinations. Partly offsetting the traffic growth was a traffic decline in oil-related markets.

- An increase in baggage fee revenues following an adjustment to the airline's first checked bag policy which became effective for travel as of November 2, 2014. Baggage fee revenues are not included in Air Canada's yield and PRASM results.

- The 3.0% yield decrease which reflected the impact of increased industry capacity and competitive pricing activities, higher proportional growth of lower-yielding international and U.S. transborder passenger flows in support of the international expansion strategy, a higher proportion of economy cabin traffic, as well as a decline in corporate oil market-related traffic. Partly offsetting this yield decline was a favourable currency impact of $14 million.

Domestic PRASM decreased 2.0% on the lower yield as passenger load factor improved 0.8 percentage points.

U.S. transborder passenger revenues increased 11.8% from the first six months of 2014

In the first six months of 2015, on a capacity growth of 14.9%, U.S. transborder passenger revenues of $1,359 million increased $143 million or 11.8% from the first six months of 2014.

In the first six months of 2015, the 11.8% U.S. transborder capacity growth reflected capacity increases on all major U.S. transborder services with the exception of certain long-haul routes from western Canada to the U.S. and certain routes from eastern Canada to the U.S.

Components of the year-over-year change in U.S. transborder passenger revenues in the first six months included:

- The 15.4% traffic increase which reflected traffic growth on all major U.S. transborder services with the exception of certain routes from eastern Canada to the U.S. The year-over-year increase in traffic was due to strong passenger demand between Canada and the U.S. as well as growth of international-to-international passenger flows from the U.S. in support of Air Canada's international expansion strategy.

- The 3.2% yield decline which reflected a 2.9% longer average stage length, which had the effect of reducing U.S. transborder yield by 1.6 percentage points, as well as an increase in long-haul leisure flying led by lower-cost Air Canada *rouge* flying, which is allowing Air Canada to effectively compete on lower-yielding leisure routes. Partly offsetting this yield decrease was a favourable currency impact of $37 million.

U.S. transborder PRASM decreased 2.8% on the lower yield as passenger load factor improved 0.4 percentage points.

Atlantic passenger revenues increased 8.2% from the first six months of 2014

In the first six months of 2015, on capacity growth of 11.0%, Atlantic passenger revenues of $1,176 million increased $88 million or 8.2% from the first six months of 2014.

In the first six months of 2015, the 11.0% Atlantic capacity growth reflected capacity increases on all major Atlantic services with the exception of services to Germany.

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

- The 13.2% traffic increase which reflected traffic growth on all major Atlantic services with the exception of services to Germany where capacity was reduced year-over-year. The traffic increase in the first six months of 2015 included traffic growth between the U.S. and Europe via the airline's major Canadian hubs, in line with Air Canada's international growth strategy.

- The 4.4% yield decline which reflected:

    - the impact of increased industry capacity and competitive pricing activities on all major Atlantic services; and

    - the impact of having a higher proportion of seats in long-haul (lower-yielding) leisure markets.

  Partly offsetting this yield decrease was a favourable currency impact of $17 million.

Atlantic PRASM decreased 2.5% on the lower yield as passenger load factor improved 1.6 percentage points.

Pacific passenger revenues increased 0.5% from the first six months of 2014

In the first six months of 2015, on capacity growth of 10.7%, Pacific passenger revenues of $800 million increased $4 million or 0.5% from the first six months of 2014.

In the first six months of 2015, the 10.7% Pacific capacity growth reflected capacity increases on all major Pacific services.

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

- The 10.7% traffic increase which reflected traffic growth on all major Pacific services.

- The 7.3% yield decline which mainly reflected a significant reduction in carrier surcharges relating to lower fuel prices, particularly where carrier surcharges are regulated such as Japan, Hong Kong and Korea, as well as competitive pressures from Canada and the U.S., both in terms of added capacity and pricing. The competitive pressures impacted both local, U.S. sixth freedom and beyond traffic. Partly offsetting this yield decrease was a favourable currency impact of $22 million.

Pacific PRASM decreased 9.1% due to the lower yield and, to a lesser extent, a passenger load factor decline of 1.7 percentage points.

Other passenger revenues increased 5.3% from the first six months of 2014

In the first six months of 2015, on capacity growth of 11.9%, Other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of $460 million increased $23 million or 5.3% from the first six months of 2014.

In the first six months of 2015, the 11.9% capacity growth reflected capacity increases on all major services in the Other markets.

Components of the year-over-year change in Other passenger revenues in the first six months included:

- The overall 11.2% traffic increase which reflected traffic growth on all major services in the Other markets. Consistent with Air Canada's strategy of increasing international-to-international traffic through its Canadian hubs, the traffic growth on services to South America in the first six months of 2015 also reflected incremental lower-yielding connecting traffic from the U.S. in support of Air Canada's international expansion strategy.

- The overall 5.7% yield decrease which reflected competitive pricing activities, a reduction in carrier surcharges relating to lower fuel prices, and a higher proportional growth of lower-yielding U.S. transborder passenger flows to South America. In addition, South American yields were impacted by the airline's suspension of service to Venezuela in 2014. Partly offsetting this yield decline was a favourable currency impact of $9 million.

Overall PRASM decreased 6.3% on the lower yield and, to a much lesser extent, a passenger load factor decline of 0.5 percentage points.

Cargo revenues increased 4.5% from the first six months of 2014

In the first six months of 2015, cargo revenues of $252 million increased $11 million or 4.5% from the first six months of 2014.

The table below provides cargo revenue by geographic region for the first six months of 2015 and the first six months of 2014.

Cargo Revenue	First Six Months 2015 $ Million	First Six Months 2014 $ Million	Change $ Million
Canada	34	31	3
U.S. transborder	12	10	2
Atlantic	95	94	1
Pacific	93	89	4
Other	18	17	1
System	**252**	**241**	**11**

The table below provides year-over-year percentage changes in cargo revenues and operating statistics for the first six months of 2015 versus the first six months of 2014.

First Six Months 2015 versus First Six Months 2014	Cargo Revenue % Change	Capacity (ETMs) % Change	Rev / ETM % Change	Traffic (RTMs) % Change	Yield / RTM % Change
Canada	10.2	6.5	3.5	23.3	(10.6)
U.S. transborder	18.8	37.7	(13.8)	40.6	(15.5)
Atlantic	1.8	9.6	(7.1)	5.5	(3.5)
Pacific	4.1	9.5	(5.0)	(9.2)	14.6
Other	3.5	23.8	(16.3)	(3.1)	6.8
System	**4.5**	**12.4**	**(7.0)**	**0.7**	**3.8**

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

- The 3.8% yield increase which reflected yield growth in the Pacific and Other markets partly offset by yield declines in the domestic, U.S. transborder and Atlantic markets. A favourable currency impact and strong demand out of Asia, particularly in the first four months of 2015, were the main factors to the yield growth year-over-year. This yield growth was largely offset by the impact of increased industry capacity and competitive pricing activities in the domestic, U.S. transborder and Atlantic markets.

- The 0.7% traffic increase which reflected traffic growth in the domestic, U.S. transborder and Atlantic markets partly offset by traffic decreases in the Pacific and Other markets. The overall growth in traffic was mainly due to increased capacity and some market share gains within North America and between North America and Europe. The Pacific market was impacted by load restrictions on certain key routes such as Sydney and Hong Kong, while South America was impacted by lower cargo demand.

Other revenues decreased 2% from the first six months of 2014

In the first six months of 2015, other revenues of $543 million decreased $13 million or 2% from the first six months of 2014, mainly due to the impact of the new Jazz CPA, effective January 1, 2015, whereby certain costs, such as ground handling services performed by Air Canada, are no longer recovered from Jazz and passed through to Air Canada under the Jazz CPA as capacity purchase fees, thereby reducing both other revenues and capacity purchase fees. A reduction in aircraft sublease revenues was also a contributing factor to the decrease in other revenues year-over-year. These decreases were mostly offset by an increase in ground package revenues at Air Canada Vacations, largely the result of higher passenger volumes, and by growth in passenger-related fees.

CASM decreased 9.2% from the first six months of 2014. Adjusted CASM decreased 0.5% from the first six months of 2014

The following table compares Air Canada's CASM and Adjusted CASM for the first six months of 2015 to the first six months of 2014.

	First Six Months		Change	
(cents per ASM)	**2015**	**2014**	**cents**	**%**
Aircraft fuel	3.22	4.63	(1.41)	(30.5)
Regional airlines expense				
Aircraft fuel	0.48	0.71	(0.23)	(32.4)
Other	2.50	2.54	(0.04)	(1.6)
Wages and salaries	2.25	2.36	(0.11)	(4.7)
Benefits	0.71	0.74	(0.03)	(4.1)
Airport and navigation fees	1.00	1.05	(0.05)	(4.8)
Aircraft maintenance	0.98	0.95	0.03	3.2
Sales and distribution costs	0.80	0.83	(0.03)	(3.6)
Depreciation, amortization and impairment	0.86	0.72	0.14	19.4
Ground package costs	0.69	0.70	(0.01)	(1.4)
Aircraft rent	0.43	0.43	-	-
Food, beverages and supplies	0.37	0.40	(0.03)	(7.5)
Communications and information technology	0.28	0.28	-	-
Other	1.39	1.24	0.15	12.1
CASM	**15.96**	**17.58**	**(1.62)**	**(9.2)**
Remove:				
Aircraft fuel expense (1), ground package costs at Air Canada Vacations, and unusual items (2)(3)	(4.36)	(5.92)	1.56	26.4
Adjusted CASM (4)	**11.60**	**11.66**	**(0.06)**	**(0.5)**

(1) Includes aircraft fuel expense related to regional airline operations.

(2) In the second quarter of 2015, Air Canada recorded impairment charges of $14 million related to the planned disposal of two Airbus A340-300 aircraft in the second half of 2015 (neither of which was operated by Air Canada).

(3) In the second quarter of 2015, Air Canada recorded favourable tax-related provision adjustments of $23 million. In the second quarter of 2014, Air Canada recorded favourable tax-related provision adjustments of $41 million.

(4) Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Operating expenses decreased 1% from the first six months of 2014

In the first six months of 2015, on capacity growth of 9.3%, operating expenses of $6,140 million decreased $47 million or 1% from the first six months of 2014.

Components of the year-over-year change in operating expenses in the first six months included:

- The impact of lower fuel prices which accounted for a decrease of $726 million to aircraft fuel expense.

Largely offsetting this decline were:

- The impact of the 9.3% capacity growth.

- The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) which increased operating expenses by approximately $269 million (comprised of $145 million in aircraft fuel expense and an aggregate of $124 million in non-fuel operating expenses).

- Impairment charges of $14 million related to the planned disposal of two Airbus A340-300 aircraft (neither of which was operated by Air Canada) while no such charges were recorded in the first six months of 2014.

- Favourable tax-related provision adjustments of $23 million versus favourable tax-related provision adjustments of $41 million in the first six months of 2014.

Aircraft fuel expense decreased 24% from the first six months of 2014

In the first six months of 2015, aircraft fuel expense of $1,240 million decreased $388 million or 24% from the first six months of 2014.

Aircraft fuel expense, including fuel expense related to regional airline operations, amounted to $1,423 million in the first six months of 2015, a decrease of $457 million or 24% from the first six months of 2014. The decrease in aircraft fuel expense in the first six months of 2015 was due a significant decline in jet fuel prices year-over-year, which accounted for a decrease of $726 million to aircraft fuel expense. These decreases were partly offset by the unfavourable impact of a weaker Canadian dollar versus the U.S. dollar when compared to the first six months of 2014, which accounted for an increase of $145 million, as well as a higher volume of fuel litres consumed, which accounted for an increase of $124 million.

The table below provides Air Canada's fuel cost per litre and economic fuel cost per litre (including aircraft fuel expense related to regional airline operations) for the periods indicated.

(Canadian dollars in millions, except where indicated)	First Six Months 2015	First Six Months 2014	Change $	Change %
Aircraft fuel expense – GAAP	**$ 1,240**	**$ 1,628**	**$ (388)**	**(24)**
Add: Aircraft fuel expense related to regional airline operations	183	252	(69)	(27)
Total Aircraft fuel expense	**$ 1,423**	**$ 1,880**	**$ (457)**	**(24)**
Add: Net cash payments on fuel derivatives (1)	22	1	21	2,100
Economic cost of fuel – Non-GAAP (2)	**$ 1,445**	**$ 1,881**	**$ (436)**	**(23)**
Fuel consumption (thousands of litres)	**2,152,997**	**2,020,876**	**132,121**	**6.5**
Fuel cost per litre (cents) – GAAP	**66.1**	**93.0**	**(26.9)**	**(29.0)**
Economic fuel cost per litre (cents) – Non-GAAP (2)	**67.1**	**93.1**	**(26.0)**	**(27.9)**

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

(2) The economic cost of fuel is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, and may not be comparable to similar 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.

Regional airlines expense increased $1 million from the first six months of 2014

In the first six months of 2015, regional airlines expense of $1,146 million increased $1 million from the first six months of 2014. This increase was mainly due to higher rates year-over-year and, to a lesser extent, an unfavourable currency impact. These increases were mostly offset by a decrease in aircraft fuel expense.

The following table provides a breakdown of Regional airlines expense for the periods indicated:

(Canadian dollars in millions)	First Six Months 2015	First Six Months 2014	Change $	Change %
Capacity purchase fees	$ 576	$ 575	$ 1	-
Aircraft fuel	183	252	(69)	(27)
Airport and navigation	135	134	1	1
Sales and distribution costs	66	55	11	20
Other operating expenses	186	129	57	44
Total regional airlines expense	**$ 1,146**	**$ 1,145**	**$ 1**	**-**

Wages, salaries and benefits expense amounted to $1,136 million in the first six months of 2015, an increase of $44 million or 4% from the first six months of 2014

In the first six months of 2015, wages and salaries expense of $864 million increased $34 million or 4% from the first six months of 2014, mainly due to an increase in expense accruals related to the annual employee profit sharing programs, higher average salaries, and a lump sum payment of $9 million made to the airline's approximately 4,000 customer service and sales agents, represented by Unifor, reflecting their annual wage increase.

In the first six months of 2015, employee benefits expense of $272 million increased $10 million or 4% from the first six months of 2014, mainly due to the impact of lower discount rates which increased the current service cost of defined benefit pension plans, largely offset by a favourable impact of benefit plan amendments of $19 million relating to U.S. post-retirement health plans.

Airport and navigation fees increased 5% from the first six months of 2014

In the first six months of 2015, airport and navigation fees of $386 million increased $17 million or 5% from the first six months of 2014, mainly due to an increase in aircraft departures of 2.3% and an unfavourable currency impact. These increases were partly offset by the impact of the terms of an agreement with the Greater Toronto Airports Authority which is allowing Air Canada to grow its share of international passengers connecting at Toronto Pearson International Airport on a more cost effective basis, as well as by other factors.

Aircraft maintenance expense increased 14% from the first six months of 2014

In the first six months of 2015, aircraft maintenance expense of $378 million increased $45 million or 14% from the first six months of 2014, mainly due to an unfavourable currency impact of $45 million and the timing of scheduled airframe and components maintenance activity versus the first six months of 2014. These increases were largely offset by Air Canada having extended a greater number of aircraft leases, and of certain favourable lease return condition provision adjustments which, together, resulted in a decrease of $39 million to aircraft maintenance expense in the first six months of 2015. Lease term extensions postpone the expected timing of the end of lease costs and lengthen the period over which expenses are recorded and result in a cumulative adjustment to reflect the revised provision required as at the balance sheet date, thus reducing maintenance expense in the period. The timing of engine maintenance activity was also a partly offsetting factor to the increase in maintenance expense year-over-year.

Sales and distribution costs increased 5% from the first six months of 2014

In the first six months of 2015, sales and distribution costs of $306 million increased $15 million or 5% from the first six months of 2014 on passenger revenue growth of 5.3%. This growth in sales and distribution costs was mainly due to the impact of a higher volume of tickets sales generated through GDS providers, an unfavourable currency impact and higher credit card fees, in line with sales and revenue growth. These increases were partly offset by the impact of more favourable distribution rates negotiated in 2015.

Depreciation, amortization and impairment expense increased 30% from the first six months of 2014

In the first six months of 2015, depreciation, amortization and impairment expense of $330 million increased $76 million or 30% from the first six months of 2014, largely due to the introduction of new Boeing 787 aircraft to Air Canada's mainline fleet. In addition, in the first six months of 2015, Air Canada recorded impairment charges of $14 million related to the planned disposal of two Airbus A340-300 aircraft in the second half of 2015 (neither of which was operated by Air Canada) while no such charges were recorded in the first six months of 2014.

Ground package costs increased 7% from the first six months of 2014

In the first six months of 2015, the cost of ground packages at Air Canada Vacations amounted to $265 million, an increase of $18 million or 7% from the first six months of 2014, largely due to an unfavourable currency impact and the impact of higher passenger volumes in the first quarter of 2015.

Aircraft rent increased 9% from the first six months of 2014

In the first six months of 2015, aircraft rent expense amounted to $166 million, an increase of $14 million or 9% from the first six months of 2014, largely due to a unfavourable currency impact and, to a lesser extent, a higher number of aircraft leases in anticipation of the replacement of 20 of the airline's Embraer 190 aircraft in late 2015 and the first half of 2016. These increases were partly offset by the favourable impact of lower rates on lease renewals.

Other expenses increased 23% from the first six months of 2014

In the first six months of 2015, other expenses of $536 million increased $99 million or 23% from the first six months of 2014, reflecting the 9.3% capacity growth, an increase in advertising and promotion expense, largely driven by the airline's international network expansion, an increase in customer inconvenience costs proportional to the higher passenger volumes, and an unfavourable currency impact. In addition, in the first six months of 2015, Air Canada recorded favourable tax-related provision adjustments of $23 million versus $41 million in the first six months of 2014 (reflected in remaining other expenses). An increase in terminal handling expense was mainly due to Air Canada's international expansion strategy and the outsourcing of London ground handling operations, in the first half of 2014, to a third party provider (the savings associated with this initiative are included in other expense categories, such as wages and salaries expense, for a net reduction overall).

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

	First Six Months		Change	
(Canadian dollars in millions)	**2015**	**2014**	**$**	**%**
Terminal handling	$ 109	$ 89	$ 20	22
Building rent and maintenance	72	72	-	-
Crew cycle	71	67	4	6
Miscellaneous fees and services	66	58	8	14
Remaining other expenses	218	151	67	44
Total other expenses	**$ 536**	**$ 437**	**$ 99**	**23**

Non-operating expense amounted to $536 million in the first six months of 2015 compared to non-operating expense of $301 million in the first six months of 2014

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

	First Six Months		Change
(Canadian dollars in millions)	2015	2014	$
Foreign exchange loss	$ (352)	$ (121)	$ (231)
Interest income	21	18	3
Interest expense	(184)	(158)	(26)
Interest capitalized	30	15	15
Net financing expense relating to employee benefits	(50)	(68)	18
Fuel and other derivatives	6	21	(15)
Other	(7)	(8)	1
Total non-operating expense	**$ (536)**	**$ (301)**	**$ (235)**

Factors contributing to the year-over-year change in non-operating expense in the first six months included:

- Losses on foreign exchange, mainly related to U.S. denominated long-term debt, which amounted to $352 million in the first six months of 2015 compared to losses on foreign exchange of $121 million in the first six months of 2014. The losses in the first six months of 2015 were mostly attributable to a weaker Canadian dollar at June 30, 2015 when compared to December 31, 2014. The June 30, 2015 closing exchange rate was US$1 = C$1.2490 while the December 31, 2014 closing exchange rate was US$1 = C$1.1601. Partially offsetting these losses were gains of $41 million on foreign currency derivatives and $59 million on cash and short-term investments balances. The losses on foreign exchange in the first six months of 2015 included a loss of $24 million related to funds held in Venezuela due to the impact of a new foreign exchange mechanism announced in the first quarter of 2015. As at June 30, 2015, the Canadian equivalent of funds held in Venezuela was nominal.

- An increase in interest expense of $26 million was mainly due to new borrowings, a standby charge related to the financing, by way of EETCs, of aircraft which remain to be delivered, and to the impact of a weaker Canadian dollar on U.S. denominated borrowings. This increase was mostly offset by an increase in capitalized interest of $15 million which largely reflected the above-noted standby charge.

- A decrease in net financing expense relating to employee benefits of $18 million which was mainly due to the impact of the lower net defined benefit obligation for pension.

- Gains on fuel and other derivatives which amounted to $6 million in the first six months of 2015 versus gains on fuel and other derivatives of $21 million in the first six months of 2014. Refer to section 9 "Financial Instruments and Risk Management" of this MD&A for additional information.

6. FLEET

Mainline and Air Canada *rouge*

The following table provides the number of aircraft in Air Canada's operating fleet as at June 30, 2015 and December 31, 2014, as well as Air Canada's planned operating fleet, including aircraft currently operating and expected to be operated by Air Canada *rouge*, as at December 31, 2015, December 31, 2016 and December 31, 2017.

	Actual			Planned					
Mainline	**December 31, 2014**	**First Six Months 2015 Fleet Changes**	**June 30, 2015**	**Remainder of 2015 Fleet Changes**	**December 31, 2015**	**2016 Fleet Changes**	**December 31, 2016**	**2017 Fleet Changes**	**December 31, 2017**
Wide-body Aircraft									
Boeing 787-8	6	2	8	-	8	-	8	-	8
Boeing 787-9	-	-	-	3	3	10	13	9	22
Boeing 777-300ER	17	-	17	-	17	2	19	-	19
Boeing 777-200LR	6	-	6	-	6	-	6	-	6
Boeing 767-300ER	21	(4)	17	-	17	(2)	15	(5)	10
Airbus A330-300	8	-	8	-	8	-	8	-	8
Narrow-body Aircraft									
Boeing 737 MAX	-	-	-	-	-	-	-	2	2
Airbus A321	10	3	13	1	14	1	15	-	15
Airbus A320	41	1	42	-	42	-	42	-	42
Airbus A319	18	-	18	-	18	-	18	-	18
Embraer 190	45	-	45	(13)	32	(7)	25	-	25
Total Mainline	172	2	174	(9)	165	4	169	6	175
Air Canada *rouge*									
Wide-body Aircraft									
Boeing 767-300ER	8	6	14	1	15	4	19	6	25
Narrow-body Aircraft									
Airbus A321	-	-	-	4	4	1	5	-	5
Airbus A319	20	-	20	-	20	-	20	-	20
Total Air Canada *rouge*	28	6	34	5	39	5	44	6	50
Total wide-body Aircraft	66	4	70	4	74	14	88	10	98
Total narrow-body Aircraft	134	4	138	(8)	130	(5)	125	2	127
Total Mainline and Air Canada *rouge*	200	8	208	(4)	204	9	213	12	225

Air Canada Express

The following table provides, as at June 30, 2015, the number of aircraft operated, on behalf of Air Canada, by Jazz, Sky Regional and other airlines operating flights under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada.

	As at June 30, 2015			
	Jazz	Sky Regional	Other	Total
Embraer 175	-	15	-	15
Bombardier CRJ-100/200	24	-	6	30
Bombardier CRJ-705	16	-	-	16
Bombardier Dash 8-100	33	-	-	33
Bombardier Dash 8-300	26	-	-	26
Bombardier Dash 8-Q400	21	5	-	26
Beech 1900	-	-	17	17
Total Air Canada Express	**120**	**20**	**23**	**163**

The following table provides, as at December 31, 2015, the number of aircraft planned to be operated, on behalf of Air Canada, by Jazz, Sky Regional and other airlines operating flights under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada.

	As at December 31, 2015			
	Jazz	Sky Regional	Other	Total
Embraer 175	-	15	-	15
Bombardier CRJ-100/200	18	-	6	24
Bombardier CRJ-705	16	-	-	16
Bombardier Dash 8-100	28	-	-	28
Bombardier Dash 8-300	26	-	-	26
Bombardier Dash 8-Q400	26	5	-	31
Beech 1900	-	-	17	17
Total Air Canada Express	**114**	**20**	**23**	**157**

In support of Air Canada's international expansion strategy, Air Canada entered into lease agreements for five Embraer 175 aircraft. The aircraft are expected to be introduced into the Air Canada Express operating fleet in the second quarter of 2016.

7. FINANCIAL AND CAPITAL MANAGEMENT

7.1. Liquidity

Air Canada manages its liquidity needs through a variety of strategies including by seeking to sustain and improve 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, which are further discussed in sections 7.6, 7.7 and 7.8 of this MD&A. 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. As part of its liquidity risk management strategy, Air Canada seeks to maintain unrestricted liquidity of at least $1.7 billion. This minimum liquidity level was determined in conjunction with Air Canada's liquidity risk management strategy. At June 30, 2015, unrestricted liquidity amounted to $3,283 million (comprised of cash and short-term investments of $3,021 million and undrawn lines of credit of $262 million). This compared to unrestricted liquidity of $2,954 million (comprised of cash and short-term investments of $2,615 million and undrawn lines of credit of $339 million) at June 30, 2014.

7.2. Financial Position

The following table provides a condensed consolidated statement of financial position of Air Canada as at June 30, 2015 and as at December 31, 2014.

(Canadian dollars in millions)	June 30, 2015	December 31, 2014	$ Change
Assets			
Cash, cash equivalents and short-term investments	$ 3,021	$ 2,275	$ 746
Other current assets	1,272	1,203	69
Current assets	4,293	3,478	815
Property and equipment	6,277	5,998	279
Pension	623	-	623
Intangible assets	308	305	3
Goodwill	311	311	-
Deposits and other assets	562	556	6
Total assets	**$ 12,374**	**$ 10,648**	**$ 1,726**
Liabilities			
Current liabilities	$ 4,346	$ 3,537	$ 809
Long-term debt and finance leases	5,093	4,732	361
Pension and other benefit liabilities	2,209	2,403	(194)
Maintenance provisions	831	796	35
Other long-term liabilities	283	313	(30)
Total liabilities	**12,762**	**11,781**	**981**
Total equity	**(388)**	**(1,133)**	**745**
Total liabilities and equity	**$ 12,374**	**$ 10,648**	**$ 1,726**

Movements in current assets and current liabilities are described in section 7.4 "Working Capital" of this MD&A. Long-term debt and finance leases are discussed in sections 7.3 "Adjusted Net Debt" and 7.5 "Consolidated Cash Flow Movements" of this MD&A.

At June 30, 2015, Property and equipment amounted to $6,277 million, an increase of $279 million from December 31, 2014. The increase in Property and equipment was mainly due to additions to Property and equipment of $598 million in the first six months of 2015, offset by the impact of depreciation expense of $319 million. The additions to Property and equipment included flight equipment purchases of $303 million, which included two Boeing 787-8 aircraft delivered in the first six months of 2015, progress payments on future aircraft deliveries of $139 million, and capitalized maintenance costs of $98 million.

Certain pension plans are now in net asset positions and, as a result, those plans are required to be reported as pension assets on Air Canada's consolidated statement of financial position. At June 30, 2015, the net pension and other benefit liabilities amounted to $1,586 million (comprised of pension and other benefit liabilities of $2,209 million net of pension assets of $623 million), a decrease of $817 million from December 31, 2014, mainly due to strong investment returns and the impact of higher prescribed pension plan discount rates as at June 30, 2015 versus December 31, 2014. Pension funding payments of $174 million were made in the first six months of 2015. Refer to section 7.7 "Pension Funding Obligations" of this MD&A for additional information.

7.3. Adjusted Net Debt

The following table reflects Air Canada's adjusted net debt balances as at June 30, 2015 and as at December 31, 2014.

(Canadian dollars in millions, except where indicated)	June 30, 2015	December 31, 2014	$ Change
Total long-term debt and finance leases	$ 5,093	$ 4,732	$ 361
Current portion of long-term debt and finance leases	528	484	44
Total long-term debt and finance leases, including current portion	5,621	5,216	405
Less cash, cash equivalents and short-term investments	(3,021)	(2,275)	(746)
Net debt	**$ 2,600**	**$ 2,941**	**$ (341)**
Capitalized operating leases (1)	2,296	2,191	105
Adjusted net debt	**$ 4,896**	**$ 5,132**	**$ (236)**
EBITDAR (trailing 12 months)	**$ 2,101**	**$ 1,671**	**$ 430**
Adjusted net debt to EBITDAR ratio	**2.3**	**3.1**	**(0.8) pp**

(1) Adjusted net debt is an additional 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 management with 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. 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 $328 million for the twelve months ended June 30, 2015 and $313 million for the twelve months ended December 31, 2014 (includes aircraft rent expense related to regional airline operations).

At June 30, 2015, total long-term debt and finance leases, including current portion, amounted to $5,621 million, an increase of $405 million from December 31, 2014. This increase was mainly due to the unfavourable impact of a weaker Canadian dollar as at June 30, 2015 compared to December 31, 2014 on Air Canada's foreign currency denominated debt (mainly U.S. dollars), which accounted for an increase of $344 million. In the first six months of 2015, new borrowings amounted to $289 million and debt repayments amounted to $262 million. Air Canada took delivery of two Boeing 787-8 aircraft in the first six months of 2015. One aircraft was, following its acquisition and delivery in the first quarter of 2015, included in the enhanced equipment trust certificates financing transaction, as described in section 7.8 "Contractual Obligations" of this MD&A, and the other delivery was financed with Export-Import Bank of the United States ("EXIM") financing support.

Adjusted net debt amounted to $4,896 million at June 30, 2015, a decrease of $236 million from December 31, 2014, as higher cash and short-term investments balances more than offset the higher long-term debt and finance lease balances.

At June 30, 2015, the adjusted net debt to EBITDAR ratio amounted to 2.3 versus a ratio of 3.1 at December 31, 2014. The improvement of 0.8 percentage points to the ratio was due to both a $430 million increase in EBITDAR year-over-year and the decrease in adjusted net debt of $236 million as discussed above.

At June 30, 2015, Air Canada's weighted average cost of capital ("WACC"), on a pre-tax basis, was approximately 10.8%. WACC is based on an estimate by management and consists of an estimated cost of equity of 22.4% and an average cost of debt and finance leases of 5.5%.

7.4. Working Capital

The following table provides information on Air Canada's working capital balances as at June 30, 2015 and as at December 31, 2014.

(Canadian dollars in millions)	June 30, 2015		December 31, 2014		$ Change	
Cash, cash equivalents and short-term investments	$	3,021	$	2,275	$	746
Accounts receivable		822		656		166
Other current assets		450		547		(97)
Total current assets	**$**	**4,293**	**$**	**3,478**	**$**	**815**
Accounts payable and accrued liabilities		1,423		1,259		164
Advance ticket sales		2,395		1,794		601
Current portion of long-term debt and finance leases		528		484		44
Total current liabilities	**$**	**4,346**	**$**	**3,537**	**$**	**809**
Net working capital	**$**	**(53)**	**$**	**(59)**	**$**	**6**

The net negative working capital of $53 million at June 30, 2015 represented a slight improvement of $6 million from December 31, 2014. This improvement was mainly driven by the cash flow benefit of positive operating results in the first six months of 2015, mostly offset by capital expenditures of $635 million (or $396 million net of the financing drawn upon the delivery of two Boeing 787-8 aircraft) and pension funding payments of $174 million. The increase in accounts receivable and advance ticket sales is related to the seasonal growth in demand leading into the third quarter. Most working capital balances usually increase in the first six months of the year as a result of the seasonal build-up of advance ticket sales and activity levels heading into the third quarter. The increase in accounts payable and accrued liabilities includes the impact of seasonal growth in operating costs.

7.5. Consolidated Cash Flow Movements

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

(Canadian dollars in millions)	Second Quarter 2015	Second Quarter 2014	Second Quarter $ Change	First Six Months 2015	First Six Months 2014	First Six Months $ Change
Net cash flows from operating activities	**$ 509**	**$ 386**	**$ 123**	**$ 1,317**	**$ 730**	**$ 587**
Proceeds from borrowings	7	626	(619)	289	784	(495)
Reduction of long-term debt and finance lease obligations	(147)	(348)	201	(262)	(390)	128
Distributions related to aircraft special purpose leasing entities	-	-	-	(9)	-	(9)
Issue of common shares	2	-	2	3	-	3
Financing fees	(7)	-	(7)	(22)	-	(22)
Other	(1)	-	(1)	(1)	-	(1)
Net cash flows from (used in) financing activities	**(146)**	**278**	**(424)**	**(2)**	**394**	**(396)**
Short-term investments	(139)	(264)	125	(290)	(294)	4
Additions to property, equipment and intangible assets	(210)	(422)	212	(635)	(732)	97
Proceeds from sale of assets	9	1	8	10	3	7
Other	19	7	12	16	10	6
Net cash flows used in investing activities	**(321)**	**(678)**	**357**	**(899)**	**(1,013)**	**114**
Increase (decrease) in cash and cash equivalents	**42**	**(14)**	**56**	**416**	**111**	**305**
Cash and cash equivalents, beginning of period	1,035	875	160	661	750	(89)
Cash and cash equivalents, end of period	**$ 1,077**	**$ 861**	**$ 216**	**$ 1,077**	**$ 861**	**$ 216**

The following table provides the consolidated calculation of free cash flow for Air Canada for the periods indicated:

(Canadian dollars in millions)	Second Quarter 2015	Second Quarter 2014	Second Quarter $ Change	First Six Months 2015	First Six Months 2014	First Six Months $ Change
Net cash flows from operating activities	**$ 509**	**$ 386**	**$ 123**	**$ 1,317**	**$ 730**	**$ 587**
Additions to property, equipment and intangible assets	(210)	(422)	212	(635)	(732)	97
Free cash flow (1)	**$ 299**	**$ (36)**	**$ 335**	**$ 682**	**$ (2)**	**$ 684**

(1) Free cash flow is not a recognized measure for financial presentation under GAAP, does not have a standardized meaning and is not 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 generated from the business after investing in capital assets, which is available to meet ongoing financial obligations, including repaying debt, and reinvesting in Air Canada.

Free cash flow

Net cash flows from operating activities of $509 million for the second quarter of 2015 improved $123 million compared to the second quarter of 2014. This increase in net cash flows from operating activities was mainly due to the improvement in operating income. Free cash flow improved $335 million in the second quarter of 2015 from the same period in 2014, reflecting the impact of higher operating income and lower capital expenditures when compared to the second quarter of 2014.

In the first six months, net cash flows from operating activities of $1,317 million improved $587 million from the first six months of 2014, mainly due to the improvement in operating income and the impact of higher cash inflows from working capital. The higher cash inflows from working capital was due to the impact of the timing of certain payments, the impact of lower fuel prices and the growth in advance ticket sales. Free cash flow improved $684 million in the first six months of 2015 from the same period in 2014.

Net cash flows used in financing activities

Proceeds from borrowings amounted to $7 million in the second quarter of 2015 and $289 million in the first six months of 2015. In the second quarter and first six months of 2015, reduction of long-term debt and finance lease obligations amounted to $147 million and $262 million, respectively. Refer to section 7.3 "Adjusted Net Debt" of this MD&A and section 7.6 "Capital Expenditures and Related Financing Arrangements" below for additional information on Air Canada's financing activities.

7.6. Capital Expenditures and Related Financing Arrangements

Aircraft and Related Financing

Private Offering of Enhanced Equipment Trust Certificates

In March 2015, in connection with the financing of one Boeing 787-8 delivered in January 2015 and eight new Boeing 787-9 aircraft which are currently scheduled for delivery from July 2015 to March 2016, Air Canada announced the closing of a private offering of three tranches of enhanced equipment trust certificates with a combined aggregate face amount of approximately US$1.031 billion. Refer to section 7.8 "Contractual Obligations" of this MD&A for additional information.

Boeing

As at June 30, 2015, Air Canada had outstanding purchase commitments with The Boeing Company ("Boeing") for 29 Boeing 787 aircraft. Air Canada also has purchase options for 13 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on previously determined pricing and delivery positions), and purchase rights for 10 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on Boeing's then current pricing).

Subject to certain conditions, Air Canada has various financing or sale and leaseback commitments covering up to 24 of the remaining 29 Boeing 787 firm aircraft orders, which are summarized as follows:

- For eight Boeing 787-9 aircraft, which are currently scheduled for delivery from July 2015 to March 2016, Air Canada announced the closing of a private offering of enhanced equipment trust certificates.
- For 14 of the 787 aircraft, the financing terms are for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments.
- A sale and leaseback transaction with a third party for two Boeing 787 firm aircraft.

In the first quarter of 2015, Air Canada and Boeing concluded an amendment to the Boeing 787 purchase agreement which substitutes the remaining seven Boeing 787-8 with seven Boeing 787-9 aircraft. Air Canada's Boeing 787 fleet is planned to be comprised of eight Boeing 787-8 aircraft, all of which were in Air Canada's operating fleet as at June 30, 2015, and 29 Boeing 787-9 aircraft, which are scheduled for delivery between 2015 and 2019.

Air Canada has outstanding purchase commitments with Boeing for the purchase of Boeing 737 MAX aircraft. This agreement includes firm orders for 33 737 MAX 8 and 28 737 MAX 9 aircraft with substitution rights between them as well as for the 737 MAX 7 aircraft. It also provides for purchase options for 18 Boeing 737 aircraft and certain rights to purchase an additional 30 Boeing 737 aircraft. Deliveries are scheduled to begin in 2017 with two aircraft, with the remaining deliveries between 2018 and 2021, subject to deferral and acceleration rights.

Air Canada has financing commitments, subject to certain conditions, covering all 61 of the Boeing 737 MAX firm aircraft orders. The financing terms are for 80% of the aircraft delivery price and the term to maturity is 10 years with mortgage-style repayments.

In 2014, Air Canada exercised purchase rights for two Boeing 777 aircraft, with scheduled deliveries in the second quarter of 2016. Financing alternatives will be considered prior to the planned delivery dates of these aircraft. As at June 30, 2015, Air Canada had purchase rights for 11 Boeing 777 (entitling Air Canada to purchase aircraft based on previously determined pricing).

As described in section 9.6 "Capital Expenditures and Related Financing Arrangements" of Air Canada's 2014 MD&A, certain of the financing commitments for the Boeing 787 and/or the Boeing 737 MAX aircraft would be reduced based on the allocation of the commitments between aircraft types to be determined by Air Canada. Following the closing of the private offering of enhanced equipment trust certificates, Air Canada completed the allocation of the commitments between aircraft types. The total committed financing on these Boeing 787 aircraft and/or the Boeing 737 MAX aircraft, including commitments from the private offering of enhanced equipment trust certificates and the sale and leaseback transaction with a third party, will be at least $6,155 million.

Capital Commitments

As outlined in the table below, the estimated aggregate cost of the future firm Boeing 787, Boeing 777 and Boeing 737 MAX aircraft deliveries and other capital purchase commitments as at June 30, 2015 approximates $8,551 million.

(Canadian dollars in millions)	**Remainder of 2015**	**2016**	**2017**	**2018**	**2019**	**Thereafter**	**Total**
Projected committed expenditures	$ 752	$ 2,316	$ 1,755	$ 1,523	$ 1,147	$ 1,058	$ 8,551
Projected planned but uncommitted expenditures	91	280	323	306	343	not available	not available
Projected planned but uncommitted capitalized maintenance (1)	137	215	130	129	129	not available	not available
Total projected expenditures (2)	**$ 980**	**$ 2,811**	**$ 2,208**	**$ 1,958**	**$ 1,619**	**not available**	**not available**

(1) Future capitalized maintenance amounts for 2018 and beyond are not yet determinable however an estimate of $129 million has been made for 2018 and 2019.

(2) U.S. dollar amounts are converted using the June 30, 2015 closing exchange rate of US$1 = C$1.2490. 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 U.S. LIBOR rate at June 30, 2015.

7.7. 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 actuarial valuations completed in the second quarter of 2015, the aggregate solvency surplus in Air Canada's domestic registered pension plans as at January 1, 2015 was $660 million.

In the second quarter of 2015, Air Canada elected to opt out of the *Air Canada Pension Plan Funding Regulations, 2014* (the "2014 Regulations"), effective at that time. As described in section 9.7 "Pension Funding Obligations" of Air Canada's 2014 MD&A, the 2014 Regulations became effective on January 1, 2014 and under their terms, Air Canada was required to make solvency deficit payments of $200 million per year, on average, over a seven-year period. The agreement with the Government of Canada entered into in connection with these regulations contained several restrictions, including a prohibition on dividends and share repurchases, however, the agreement allowed Air Canada to opt out at any time.

Total employer contributions to defined benefit pension plans for 2015 are expected to be $322 million, which includes solvency deficit payments of approximately $96 million versus the $200 million that would have been required under the 2014 Regulations.

As at June 30, 2015, approximately 75% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk. Air Canada may continue to increase the percentage of pension liabilities being matched with fixed income products, subject to favourable market conditions.

Assuming that Air Canada's domestic registered pension plans are in a solvency surplus position as at January 1, 2016, Air Canada's projected pension funding obligations, on a cash basis, for the years 2015 to 2019 are as follows:

(Canadian dollars in millions)	**2015**	**2016**	**2017**	**2018**	**2019**
Past service domestic registered plans	$ 96	$ 7	$ -	$ -	$ -
Current service domestic registered plans	145	144	143	141	139
Other pension arrangements (1)	81	84	88	89	89
Total projected pension funding obligations	**$ 322**	**$ 235**	**$ 231**	**$ 230**	**$ 228**

(1) Includes retirement compensation arrangements, supplemental plans and international plans.

7.8. Contractual Obligations

<u>Private Offering of Enhanced Equipment Trust Certificates</u>

In March 2015, in connection with the financing of one Boeing 787-8 delivered in January 2015 and eight new Boeing 787-9 aircraft, which are currently scheduled for delivery from July 2015 to March 2016, Air Canada announced the closing of a private offering of three tranches of enhanced equipment trust certificates with a combined aggregate face amount of approximately US$1.031 billion.

The private offering is comprised of Class A certificates, Class B certificates and Class C certificates.

- The Class A certificates, with a US$667 million face amount, have an interest rate of 3.600% per annum and a final expected distribution date of March 15, 2027.

- The Class B certificates, with a US$182 million face amount, have an interest rate of 3.875% per annum and a final expected distribution date of March 15, 2023.

- The Class C certificates, with US$182 million face amount, have an interest rate of 5.000% per annum and a final expected distribution date of March 15, 2020.

The certificates have a combined weighted average interest rate of 3.81% per annum.

The table below provides Air Canada's contractual obligations as at June 30, 2015, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and finance lease obligations, operating lease obligations and committed capital expenditures. The table below also includes the impact of the financing associated with eight Boeing 787-9 aircraft as described above, the proceeds of which are held in escrow and will be drawn upon the delivery of these aircraft (which are currently scheduled for delivery between July 2015 and March 2016).

(Canadian dollars in millions)	Remainder of 2015	2016	2017	2018	2019	Thereafter	Total
Principal							
Long-term debt obligations	$ 223	$ 426	$ 561	$ 583	$ 1,587	$ 2,045	$ 5,425
Finance lease obligations	38	34	35	42	39	103	291
Total principal obligations	**$ 261**	**$ 460**	**$ 596**	**$ 625**	**$ 1,626**	**$ 2,148**	**$ 5,716**
Interest							
Long-term debt obligations	$ 138	$ 260	$ 260	$ 207	$ 178	$ 184	$ 1,227
Finance lease obligations	13	23	19	16	12	29	112
Total interest obligations	**$ 151**	**$ 283**	**$ 279**	**$ 223**	**$ 190**	**$ 213**	**$ 1,339**
Total long-term debt and finance lease obligations	**$ 412**	**$ 743**	**$ 875**	**$ 848**	**$ 1,816**	**$ 2,361**	**$ 7,055**
Operating lease obligations	**$ 216**	**$ 395**	**$ 352**	**$ 307**	**$ 244**	**$ 372**	**$ 1,886**
Committed capital expenditures	**$ 752**	**$ 2,316**	**$ 1,755**	**$ 1,523**	**$ 1,147**	**$ 1,058**	**$ 8,551**
Total contractual obligations (1)(2)	**$ 1,380**	**$ 3,454**	**$ 2,982**	**$ 2,678**	**$ 3,207**	**$ 3,791**	**$ 17,492**
EETC financing related to eight Boeing 787 aircraft (principal and interest)	**$ 24**	**$ 99**	**$ 106**	**$ 104**	**$ 102**	**$ 1,233**	**$ 1,668**
Total obligations, including the impact of the EETC financing related to eight Boeing 787 aircraft	**$ 1,404**	**$ 3,553**	**$ 3,088**	**$ 2,782**	**$ 3,309**	**$ 5,024**	**$ 19,160**

(1) Total contractual obligations exclude commitments for goods and services required in the ordinary course of business. Also excluded are long-term liabilities other than long-term debt in finance lease obligations due to reasons of uncertainty of timing of cash flows and items that are non-cash in nature.

(2) The table above excludes the future minimum non-cancelable commitments under CPA arrangements which, for the year 2015, amounted to approximately $856 million with Jazz and $115 million for the other regional carriers. In February 2015, Air Canada and Jazz concluded an amendment to the Jazz CPA, effective as of January 1, 2015.

7.9. Share Information

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

	June 30, 2015	December 31, 2014
Issued and outstanding shares		
Variable voting shares	87,633,948	69,232,535
Voting shares	199,589,756	217,256,759
Total issued and outstanding shares	**287,223,704**	**286,489,294**
Class A variable voting and Class B voting shares potentially issuable		
Stock options	9,931,386	10,002,975
Total shares potentially issuable	**9,931,386**	**10,002,975**
Total outstanding and potentially issuable shares	**297,165,090**	**296,492,269**

Issuer Bid

In May 2015, Air Canada announced that it had received approval from the Toronto Stock Exchange ("TSX") to implement a normal course issuer bid to purchase, for cancellation, up to 10,000,000 Class A variable voting shares and/or Class B voting shares (the "Shares") representing, at that time, 3.49% of the total issued and outstanding shares. The repurchase program, which is authorized for the period from May 29, 2015 to May 28, 2016, will be conducted through the facilities of the TSX. Prior to the end of the second quarter of 2015, Air Canada purchased and cancelled 100,000 shares for cash at an average cost of $13.80 per Share.

8. QUARTERLY FINANCIAL DATA

The following table summarizes quarterly financial results for Air Canada for the last eight quarters. As of 2015, expenses incurred related to capacity purchase agreements are now presented in a separate line item on Air Canada's consolidated statement of operations titled Regional airlines expense. Prior period amounts have been reclassified to conform to the current period presentation.

	2013		2014				2015	
(Canadian dollars in millions, except where indicated)	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Passenger	3,177	2,560	2,608	2,965	3,476	2,755	2,786	3,082
Cargo	120	128	119	122	128	133	129	123
Other	182	206	338	218	194	216	334	209
Operating revenues	**$ 3,479**	**$ 2,894**	**$ 3,065**	**$ 3,305**	**$ 3,798**	**$ 3,104**	**$ 3,249**	**$ 3,414**
Aircraft fuel	877	713	793	835	939	680	592	648
Regional airlines expense								
Aircraft fuel	125	118	125	127	137	111	86	97
Other	452	433	442	451	471	460	466	497
Wages, salaries & benefits (1)	554	540	557	535	549	590	568	568
Benefit plan amendments	-	(82)	-	-	-	-	-	-
Airport and navigation fees	204	167	183	186	208	178	185	201
Aircraft maintenance	120	141	162	171	158	187	188	190
Sales and distribution costs	130	114	148	143	146	123	154	152
Depreciation, amortization and impairment (2)	124	144	126	128	142	130	153	177
Ground package costs	52	66	170	77	56	74	181	84
Aircraft rent	78	73	76	76	74	76	82	84
Food, beverages and supplies	76	67	66	74	84	70	62	80
Communications and information technology	48	44	52	47	49	51	57	52
Other (3)	223	221	227	210	259	268	275	261
Operating expenses	**3,063**	**2,759**	**3,127**	**3,060**	**3,272**	**2,998**	**3,049**	**3,091**
Operating income (loss)	**416**	**135**	**(62)**	**245**	**526**	**106**	**200**	**323**
Foreign exchange gain (loss)	49	(55)	(161)	40	(71)	(115)	(408)	56
Interest income	7	10	9	9	11	10	9	12
Interest expense (4)	(174)	(73)	(77)	(81)	(81)	(83)	(90)	(94)
Interest capitalized	15	10	5	10	6	9	9	21
Net financing expense relating to employee benefits	(51)	(53)	(34)	(34)	(34)	(32)	(25)	(25)
Fuel and other derivatives	30	22	(15)	36	(31)	9	1	5
Other	(1)	(2)	(6)	(2)	(3)	(4)	(5)	(2)
Total non-operating income (expense)	**(125)**	**(141)**	**(279)**	**(22)**	**(203)**	**(206)**	**(509)**	**(27)**
Income taxes	8	-	-	-	-	-	-	-
Net income (loss)	**$ 299**	**$ (6)**	**$ (341)**	**$ 223**	**$ 323**	**$ (100)**	**$ (309)**	**$ 296**
Net income (loss) per share – diluted	**$ 1.05**	**$ (0.02)**	**$ (1.20)**	**$ 0.75**	**$ 1.10**	**$ (0.35)**	**$ (1.08)**	**$ 1.00**
EBITDAR, excluding benefit plan amendments (5)	**$ 626**	**$ 277**	**$ 147**	**$ 456**	**$ 749**	**$ 319**	**$ 442**	**$ 591**
EBITDAR (5)	**$ 626**	**$ 359**	**$ 147**	**$ 456**	**$ 749**	**$ 319**	**$ 442**	**$ 591**
Adjusted net income (loss) (6)	**$ 365**	**$ 3**	**$ (132)**	**$ 139**	**$ 457**	**$ 67**	**$ 122**	**$ 250**
Adjusted net income (loss) per share – diluted (6)	**$ 1.29**	**$ 0.01**	**$ (0.46)**	**$ 0.47**	**$ 1.55**	**$ 0.23**	**$ 0.41**	**$ 0.85**

(1) *In the fourth quarter of 2014, one-time payments totaling $30 million were made to ACPA members under a collective agreement concluded in October 2014.*

(2) *In the second quarter of 2015, Air Canada recorded impairment charges of $14 million related to the planned disposal of two Airbus A340-300 aircraft in the second half of 2015 (neither of which was operated by Air Canada).*

(3) *In the second quarter of 2015, Air Canada recorded favourable tax-related provision adjustments of $23 million. In the second quarter of 2014, Air Canada recorded favourable tax-related provision adjustments of $41 million.*

(4) *In the third quarter of 2013, Air Canada recorded an interest charge of $95 million related to the purchase of its senior secured notes which were to become due in 2015 and 2016.*

(5) *EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.*

(6) *Adjusted net income (loss) and adjusted net income (loss) per diluted share are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.*

The following table provides a breakdown of the most significant items included in other expenses for the last eight quarters:

	2013		2014				2015	
(Canadian dollars in millions)	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Terminal handling	45	39	42	47	54	47	50	59
Building rent and maintenance	31	33	36	36	35	31	36	36
Crew cycle	28	31	32	35	38	36	35	36
Miscellaneous fees and services	32	27	25	33	31	30	31	35
Remaining other expenses	87	91	92	59	101	124	123	95
Total other expenses	**$ 223**	**$ 221**	**$ 227**	**$ 210**	**$ 259**	**$ 268**	**$ 275**	**$ 261**

The following table provides a breakdown of the most significant items included in regional airlines expense for the last eight quarters:

	2013		2014				2015	
(Canadian dollars in millions)	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Capacity purchase fees	295	280	281	294	312	295	274	302
Aircraft fuel	125	118	125	127	137	111	86	97
Airport and navigation fees	70	65	64	70	73	69	65	70
Sales and distribution costs	29	24	27	28	27	30	33	33
Depreciation, amortization and impairment	5	5	4	4	4	4	4	4
Aircraft rent	3	2	3	3	3	3	3	3
Other operating expenses	50	57	63	52	52	59	87	85
Total regional airlines expense	**$ 577**	**$ 551**	**$ 567**	**$ 578**	**$ 608**	**$ 571**	**$ 552**	**$ 594**

The following table provides major quarterly operating statistics for Air Canada for the last eight quarters.

	2013		2014				2015	
	Q3	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Revenue passenger miles (millions)	16,726	12,882	13,466	15,495	18,565	14,090	14,937	16,845
Available seat miles (millions)	19,404	16,033	16,774	18,413	21,299	17,403	18,335	20,132
Passenger load factor (%)	86.2	80.3	80.3	84.2	87.2	81.0	81.5	83.7
Passenger PRASM (cents)	16.2	15.7	15.3	15.9	16.1	15.6	14.9	15.0
CASM, excluding benefit plan amendments (cents)	15.8	17.7	18.6	16.6	15.4	17.2	16.6	15.4
Adjusted CASM (cents) (1)	10.4	12.1	12.2	11.2	10.1	12.1	11.9	11.3
Economic fuel price per litre (cents) (2)	89.6	88.4	94.7	91.6	90.0	80.7	66.3	66.9

(1) Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

(2) Includes aircraft fuel expense related to regional airline operations. Includes fuel handling expenses. Economic fuel price per litre is a non-GAAP financial measure. Refer to section 4 "Results of Operations" of this MD&A for additional information.

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Fuel and Other Derivatives

The following is a summary of fuel and other derivatives included in non-operating income (expense) on Air Canada's consolidated statement of operations for the periods indicated:

	Second Quarter		First Six Months	
(Canadian dollars in millions)	**2015**	**2014**	**2015**	**2014**
Fuel derivatives	$ -	$ 8	$ (4)	$ 6
Share forward contracts	5	28	9	14
Interest rate swaps	-	-	1	1
Total fuel and other derivatives	**$** 5	**$ 36**	**$** 6	**$ 21**

Risk Management

Under its risk management policy, Air Canada manages its interest rate risk, foreign exchange risk, share-based compensation risk and market risk through the use of various derivative financial instruments. Air Canada uses derivative financial instruments only for risk management purposes, not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be offset by changes in cash flows related to the risk being hedged.

Air Canada engages in derivative hedging in an effort to mitigate various risks. The derivative fair values represent the amount of the consideration that could be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. Fair value of these derivatives is determined using active markets, where available. When no such market is available, valuation techniques are applied such as discounted cash flow analysis. Where practical, the valuation technique incorporates all factors that would be considered in setting a price, including Air Canada's own credit risk and the credit risk of the counterparty.

Fuel Price Risk Management

Fuel price risk is the risk that future cash flows 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 crude oil-based derivative contracts with financial intermediaries. Air Canada's policy permits hedging of up to 75% of the projected jet fuel purchases for the next 12 months, 50% for the next 13 to 24 months and 25% for the next 25 to 36 months. These are maximum (but not mandated) limits. There is no minimum monthly hedging requirement. There are regular reviews to adjust the strategy in light of market conditions.

In the second quarter of 2015:

- Air Canada recorded a loss of less than $1 million in fuel and other derivatives related to fuel derivatives (a loss of $4 million in the first six months of 2015; gains of $8 million and $6 million in the second quarter of 2014 and in the first six months of 2014, respectively). These derivatives were not designated as hedges for accounting purposes.

- Air Canada purchased crude-oil call options covering a portion of 2015 fuel exposures. The cash premium related to these contracts was $9 million ($17 million in the first six months of 2015; $10 million and $20 million in the second quarter of 2014 and in the first six months of 2014, respectively, for 2014 exposures).

- Fuel derivative contracts cash settled with a net fair value of $1 million in favour of Air Canada ($1 million in favour of Air Canada in the first six months of 2015; $11 million and $18 million in favour of Air Canada in the second quarter of 2014 and in the first six months of 2014, respectively).

Air Canada applies fuel hedge accounting for certain designated fuel derivatives prospectively from April 1, 2015. In the second quarter of 2015, premiums paid for option contracts and the time value of the option contracts of $1 million were deferred as a cost of the hedge in other comprehensive income and will be reclassified to aircraft fuel expense when the underlying hedged jet fuel is used.

A summary of amounts related to fuel derivatives designated as hedging instruments at June 30, 2015 is presented below.

	Carrying amount of the hedging instrument				
	Nominal amount of the hedging instrument (in barrels)	Assets	Liabilities	Consolidated statement of financial position classification	Changes in fair value used for calculating hedge ineffectiveness
Cash flow hedge					
Fuel price risk – option contracts	2,580,000	$ 8	$ -	Prepaid expenses and other current assets	$ -

As of June 30, 2015, and based on the derivate structures in place as of that date, approximately 40% of Air Canada's anticipated purchases of jet fuel for the remainder of 2015 is hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US$66 per barrel for WTI prices up to US$71 per barrel and an average equivalent capped price of US$72 per barrel for WTI prices above US$77 per barrel. Air Canada's contracts to hedge anticipated jet fuel purchases over the remainder of 2015 are comprised of call options with notional volumes of 5,790,000 barrels. The fair value of the fuel derivatives portfolio at June 30, 2015 was $16 million in favour of Air Canada (as at December 31, 2014 – $4 million in favour of Air Canada) and is recorded within prepaid expenses and other current assets on Air Canada's consolidated statement of financial condition.

Foreign Exchange Risk Management

Air Canada's financial results are reported in Canadian dollars, while a large portion of its expenses, debt obligations and capital commitments are in foreign currencies, primarily in U.S. dollars. Foreign exchange risk is the risk that fluctuations in foreign exchange rates may have on operating results and cash flows.

In order to manage exposure to the U.S dollar and other foreign exchange exposures, Air Canada holds U.S. dollar cash reserves and enters into currency derivative contracts. These derivatives and U.S. dollar cash reserves serve to mitigate the cash flow exposure from adverse currency movements. The result of these hedging activities is recorded as a Foreign exchange gain or loss in non-operating expense on Air Canada's consolidated statement of operations (not within operating income).

Air Canada's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

The level of foreign exchange derivatives entered into and their related maturity dates are dependent upon a number of factors, which include the amount of foreign revenue conversion available, U.S. dollar net cash flows, as well as the amount attributed to aircraft and debt payments. For the net U.S. dollar shortfall, the Corporation has increased its target coverage from 60% to 70% on a rolling 18-month basis. Based on the notional amount of currency derivatives outstanding at June 30, 2015, as further described below, approximately 72% of net U.S. cash outflows is hedged for the remainder of 2015 and 46% for 2016, resulting in derivative coverage of 55% over the next 18 months. U.S. dollar cash and investment reserves combined with derivative coverage results in 67% target coverage.

As at June 30, 2015, Air Canada had outstanding foreign currency options and swap agreements, settling in 2015 and 2016, to purchase at maturity $2,642 million (US$2,116 million) of U.S. dollars at a weighted average rate of $1.1980 per US$1.00 (as at December 31, 2014 – $2,658 million (US$2,292 million) with settlements in 2015 and 2016 at a weighted average rate of $1.0884 per $1.00 U.S. dollar). Air Canada also has protection in place to sell a portion of its excess Euros, Sterling and Yen (EUR $19 million, GBP $15 million, JPY $1,069 million) which settle in 2015 at weighted average rates of $1.1850, $1.5667, and $0.0084 per $1.00 U.S. dollar, respectively (as at December 31, 2014 - EUR $35 million, GBP $27 million with settlement in 2015 at weighted average rates of $1.2806 and $1.6217, respectively, per $1.00 U.S. dollar).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations, and based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at June 30, 2015 was $11 million in favour of Air Canada (as at December 31, 2014 – $30 million in favour of Air Canada). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. In the second quarter of 2015, a loss of $13 million was recorded in foreign exchange gain (loss) related to these derivatives (a gain of $41 million in the first six months of 2015; losses of $89 million and $93 million, respectively, in the second quarter of 2014 and in first six months of 2014). In the second quarter of 2015, foreign exchange derivative contracts cash settled with a net fair value of $9 million in favour of Air Canada ($60 million in favour of Air Canada in the first six months of 2015, $9 million and $32 million in favour of Air Canada,in the second quarter of 2014 and in the first six months of 2014, respectively).

Air Canada also holds U.S. cash and investment reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash and short-term investment balances as at June 30, 2015 amounted to $920 million or US$737 million ($717 million or US$620 million as at December 31, 2014). In the second quarter of 2015, an unrealized loss of $12 million was recorded in Foreign exchange gain (loss) reflecting the change in Canadian equivalent market value of the U.S. dollar cash and short-term investment balances held ($59 million in favour of Air Canada in the first six months of 2015; unrealized losses of $37 million and $8 million in the second quarter of 2014 and in the first six months of 2014, respectively).

Update on Foreign Exchange Sensitivity

Information on Air Canada's sensitivity of results to various economic assumptions is disclosed in section 17 "Sensitivity of Results" of Air Canada's 2014 MD&A. Given the decrease in the price of jet fuel, Air Canada's net exposure to the U.S. dollar has also declined. As a result, the annual pre-tax income impact of a one cent change in the Canadian dollar versus the U.S. dollar has decreased from $45 million to approximately $34 million.

10. CRITICAL ACCOUNTING ESTIMATES

Information on Air Canada's critical accounting estimates is disclosed in section 13 "Critical Accounting Estimates" of Air Canada's 2014 MD&A. There have been no material changes to Air Canada's critical accounting estimates from what was disclosed at that time.

11. ACCOUNTING POLICIES

Air Canada's accounting policies are as disclosed in Air Canada's audited consolidated financial statements and notes for 2014. There have been no material changes to Air Canada's accounting policies from what was disclosed at that time with the exception that Air Canada has early adopted the new accounting standard *IFRS 9 – Financial Instruments* with a date of initial application of January 1, 2015. The adoption of this standard has no impact on Air Canada's consolidated financial statements on date of adoption or for comparative periods. Air Canada has begun to apply hedge accounting for certain designated fuel derivatives prospectively from April 1, 2015. Crude oil prices, while not contractually specified in Air Canada's jet fuel purchase contracts, are economically related to jet fuel prices. Air Canada enters into option contracts on crude oil and designates the contracts in cash flow hedges of the crude oil component of its future jet fuel purchases. Air Canada has established a hedge ratio of 1:1 for its hedging relationships. Under hedge accounting, the effective gain or loss on fuel hedging derivatives is recorded in other comprehensive income and reclassified to aircraft fuel expense when the underlying jet fuel being hedged is used. Premiums paid for option contracts and the time value of the option contracts are deferred as a cost of the hedge in other comprehensive income and reclassified to aircraft fuel expense when the underlying hedged jet fuel is used. Any ineffective gain or loss on fuel hedging derivatives is recorded in non-operating expense in fuel and other derivatives on Air Canada's consolidated statement of operations.

Accounting Standards and Amendments Issued but Not Yet Adopted

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 replaces IAS 18 Revenue and related interpretations. The core principle of the new standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the Corporation expects to be entitled in exchange for those goods or services. In July, 2015, the International Accounting Standards Board confirmed a deferral of the effective date by one year to January 1, 2018, with earlier application permitted. Air Canada continues to evaluate the impact that the adoption of this standard may have on its consolidated financial statements.

12. 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 2014 MD&A. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

13. RELATED PARTY TRANSACTIONS

At June 30, 2015, Air Canada had no transactions with related parties as defined in the CPA Handbook, except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship agreements.

14. RISK FACTORS

For a detailed description of risk factors associated with Air Canada and its business, refer to section 18 "Risk Factors" of Air Canada's 2014 MD&A. Air Canada is not aware of any significant changes to its risk factors from those disclosed at that time.

15. 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 2014 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 second quarter 2015 filings, the Corporation's CEO and CFO certified, 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 the Corporation's internal controls over financial reporting during the quarter ended June 30, 2015 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

16. 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 may not be comparable to similar measures presented by other public companies.

EBITDAR is reconciled to operating income as follows:

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2015**	**2014**	**$ Change**	**2015**	**2014**	**$ Change**
Operating income – GAAP	**$ 323**	**$ 245**	**$ 78**	**$ 523**	**$ 183**	**$ 340**
Add back (as reflected on Air Canada's consolidated statement of operations):						
Depreciation, amortization and impairment	177	128	49	330	254	76
Aircraft rent	84	76	8	166	152	14
Add back (included in Regional airlines expense):						
Depreciation, amortization and impairment	4	5	(1)	8	9	(1)
Aircraft rent	3	2	1	6	5	1
EBITDAR	**$ 591**	**$ 456**	**$ 135**	**$ 1,033**	**$ 603**	**$ 430**

Adjusted CASM

Air Canada uses adjusted CASM to assess the operating and cost performance of its ongoing airline business without the effects of aircraft fuel expense, the cost of ground packages at Air Canada Vacations, and unusual items as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

Adjusted CASM is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning and may not be comparable to similar measures presented by other public companies.

Aircraft fuel expense is excluded from operating expense results as it fluctuates widely depending on many factors, including international market conditions, geopolitical events, jet fuel refining costs and Canada/U.S. currency exchange rates. Air Canada also incurs expenses related to ground packages at Air Canada Vacations which some airlines, without comparable tour operator businesses, may not incur. In addition, these costs do not generate ASMs and therefore excluding these costs from operating expense results provides for a more meaningful comparison across periods when such costs may vary.

Therefore, excluding aircraft fuel expense, the cost of ground packages at Air Canada Vacations, and unusual items from operating expenses generally allows for more meaningful analysis of Air Canada's operating expense performance and a more meaningful comparison to those of other airlines.

Adjusted CASM is reconciled to GAAP operating expense as follows:

(Canadian dollars in millions, except where indicated)	Second Quarter 2015	Second Quarter 2014	Second Quarter $ Change	First Six Months 2015	First Six Months 2014	First Six Months $ Change
Operating expense – GAAP	**$ 3,091**	**$ 3,060**	**$ 31**	**$ 6,140**	**$ 6,187**	**$ (47)**
Adjusted for:						
Aircraft fuel expense (as reflected on Air Canada's consolidated statement of operations)	(648)	(835)	187	(1,240)	(1,628)	388
Aircraft fuel expense (included in Regional airlines expense)	(97)	(127)	30	(183)	(252)	69
Tax-related provision adjustments	23	41	(18)	23	41	(18)
Impairment charges	(14)	-	(14)	(14)	-	(14)
Ground packages costs at Air Canada Vacations	(84)	(77)	(7)	(265)	(247)	(18)
Operating expense, adjusted for the above-noted items	**$ 2,271**	**$ 2,062**	**$ 209**	**$ 4,461**	**$ 4,101**	**$ 360**
ASMs (millions)	**20,132**	**18,413**	**9.3%**	**38,467**	**35,187**	**9.3%**
Adjusted CASM (cents)	**¢ 11.3**	**¢ 11.2**	**0.7%**	**¢ 11.6**	**¢ 11.7**	**(0.5)%**

Adjusted Net Income and Adjusted Net Income per Share – Diluted

Air Canada uses adjusted net income and adjusted net income per share – diluted to assess the overall financial performance of its business without the effects of foreign exchange, net financing income (expense) relating to employee benefits, mark-to-market adjustments on fuel and other derivatives and unusual items as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful. Air Canada also uses adjusted net income as a measure to determine return on invested capital which is further described below. These measures are not recognized measures for financial statement presentation under GAAP, do not have a standardized meaning and may not be comparable to similar measures presented by other public companies.

(Canadian dollars in millions, except per share values)	Second Quarter 2015	Second Quarter 2014	Second Quarter $ Change	First Six Months 2015	First Six Months 2014	First Six Months $ Change
Net income (loss) attributable to shareholders of Air Canada	**$ 295**	**$ 222**	**$ 73**	**$ (15)**	**$ (120)**	**$ 105**
Adjusted for:						
Tax-related provision adjustments	(23)	(41)	18	(23)	(41)	18
Impairment charges	14	-	14	14	-	14
Foreign exchange (gain) loss	(56)	(40)	(16)	352	121	231
Net financing expense relating to employee benefits	25	34	(9)	50	68	(18)
Gain on fuel and other derivatives	(5)	(36)	31	(6)	(21)	15
Adjusted net income	**$ 250**	**$ 139**	**$ 111**	**$ 372**	**$ 7**	**$ 365**
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	295	293	2	295	293	2
Adjusted net income per share – diluted	**$ 0.85**	**$ 0.47**	**$ 0.38**	**$ 1.26**	**$ 0.02**	**$ 1.24**

The following reflects the share amounts used in the computation of basic and diluted earnings per share on an adjusted net income (loss) per share basis:

(in millions)	Second Quarter 2015	Second Quarter 2014	First Six Months 2015	First Six Months 2014
Weighted average number of shares outstanding – basic	**287**	**286**	**287**	**286**
Effect of dilution	8	7	8	7
add back anti-dilutive impact	-	-	-	-
Weighted average number of shares outstanding – diluted	**295**	**293**	**295**	**293**

Return on Invested Capital

Air Canada uses return on invested capital ("ROIC") to assess the efficiency with which it allocates its capital to generate returns. Return is based on adjusted net income (loss), excluding interest expense and implicit interest on operating leases. Invested capital includes (i) average year-over-year total assets, net of average year-over-year non-interest-bearing operating liabilities, and (ii) the value of capitalized operating leases (calculated by multiplying annualized aircraft rent by 7). This measure is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning and may not be comparable to similar measures presented by other public companies.

(Canadian dollars in millions, except where indicated)	June 30, 2015	June 30, 2014	$ Change
Net income for the period attributable to shareholders of Air Canada (trailing 12 months)	**$ 205**	**$ 171**	**$ 34**
Remove:			
One-time payments – ACPA	30	-	30
Benefit plan amendments	-	(82)	82
Tax-related provision adjustments	(23)	(41)	18
Impairment charges	14	6	8
Foreign exchange loss	538	127	411
Interest expense charge	-	95	(95)
Net financing expense relating to employee benefits	116	172	(56)
(Gain) loss on financial instruments recorded at fair value	16	(73)	89
Adjusted net income (trailing 12 months)	**$ 896**	**$ 375**	**$ 521**
Adjusted for:			
Interest expense (1)	348	310	38
Implicit interest on operating leases (2)	161	153	8
Adjusted income before interest (trailing 12 months)	**$ 1,405**	**$ 838**	**$ 567**
Invested capital:			
Working capital excluding current portion of long-term debt and finance leases	329	60	269
Long-term assets, excluding pension assets	7,081	6,335	746
Maintenance provisions	(760)	(661)	(99)
Other operating long-term liabilities	(263)	(321)	58
Capitalized operating leases (3)	2,296	2,191	105
Invested capital	**$ 8,683**	**$ 7,604**	**$ 1,079**
Return on invested capital (%)	**16.2%**	**11.0%**	**5.2 pp**

(1) *Interest expense excludes the non-recurring interest expense charge on the repayment of the senior secured notes recognized in 2013.*

(2) *Interest implicit on operating leases is equal to 7.0% of 7 times the trailing 12 months of aircraft rent. 7.0% is a proxy and does not necessarily represent the actual implicit interest on operating leases for any given period.*

(3) *Capitalized operating leases are calculated by multiplying the trailing 12 months of aircraft rent by 7. Aircraft rent totaled $328 million for the twelve months ended June 30, 2015 and $313 million for the twelve months ended June 30, 2014 (includes aircraft rent related to regional operations).*

17. GLOSSARY

2014 Regulations – Refers to the *Air Canada Pension Plan Funding Regulations, 2014*

ACPA – Refers to the Air Canada Pilots Association.

Adjusted CASM – Refers to operating expense per ASM adjusted to remove the effects of aircraft fuel expense, ground packages costs, and unusual items. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Adjusted net income (loss) – Refers to the consolidated net income (loss) of Air Canada attributable to the shareholders of Air Canada adjusted to remove the effects of (to the extent included in consolidated net income (loss)) foreign exchange gains or losses, net financing income (expense) relating to employee benefits, mark-to-market adjustments on fuel and other derivatives and unusual items. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Air Canada's 2014 MD&A – Refers to Air Canada's 2014 Management's Discussion and Analysis of Results of Operations and Financial Condition dated February 11, 2015.

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

Available Seat Miles or ASMs – Refers to a measure of passenger capacity calculated by multiplying the total number of seats available for passengers by the miles flown.

Average stage length – Refers to the average mile per departure seat and is calculated by dividing total ASMs by total seats dispatched.

Boeing – Refers to The Boeing Company.

CASM – Refers to operating expense per ASM.

Domestic passenger and cargo revenues – Refer to revenues from flights within Canada.

EBITDAR – Refers to earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent. EBITDAR is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

EETCs – Refers to Enhanced Equipment Trust Certificates issued in connection with the financing of aircraft.

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

GDS – Refers to Global Distribution System which is generally a network that enables automated transactions between third parties and booking agents in order to provide travel-related services to customers.

IBT – Refers to the International Brotherhood of Teamsters.

Jazz – Refers to Jazz Aviation LP.

Jazz CPA – Refers to the capacity purchase agreement between Air Canada and Jazz.

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

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

Passenger Load Factor – Refers to 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 PRASM – Refers to average passenger revenue per ASM (baggage fee revenues, which are included in passenger revenues, are removed for the purposes of calculating PRASM).

Percentage point (pp) – Refers to a measure for the arithmetic difference of two percentages.

Return on invested capital or ROIC – Refers to return on invested capital and is a measure used to assess the efficiency with which a company allocates its capital to generate returns. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Revenue Passenger Carried – Refers to IATA's definition of passenger carried whereby passengers are counted on a flight no. basis rather than by journey/itinerary or by leg.

Revenue Passenger Miles or RPMs – Refers to 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.

Seats dispatched – Refers to the number of seats on non-stop flights. A non-stop flight refers to a single take-off and landing.

Sky Regional – Refers to Sky Regional Airlines Inc.

Unifor – Refers to a trade union in Canada, launched in 2013, as a merger of the Canadian Auto Workers and Communications, Energy and Paperworkers unions.

Unite – Refers to the union which represents Air Canada's U.K.-based unionized workforce.

Weighted average cost of capital or WACC – Refers to management's estimate of its cost of capital, in which each category of capital is proportionately weighted.

Yield – Refers to average passenger revenue per RPM (baggage fee revenues, which are included in passenger revenues, are removed for the purposes of calculating yield).