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EXPLANATORY NOTES

The information in this Annual Information Form ("AIF") is stated as at December 31, 2012, unless otherwise indicated.

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

Subsidiaries — References herein to the term "subsidiary" or "subsidiaries" refer, in relation to any entity, to any other entity, including a corporation or a limited partnership, which is controlled, directly or indirectly, by that entity.

Defined Terms — For an explanation of the capitalized terms and expressions and certain defined terms, refer to the section entitled "Glossary of Terms" at the end of this AIF.

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

Statistical Information — Market data and certain industry forecasts used throughout this AIF were obtained from internal surveys, market research, publicly available information and industry publications. Industry publications generally state that the information contained therein has been obtained from sources believed to be reliable, but that the accuracy and completeness of such information is not guaranteed. Similarly, internal surveys, industry forecasts, market research and other publicly available information, while believed to be reliable, have not been independently verified, and the Corporation does not make any representation as to the accuracy of such information.

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

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

Assumptions were made by Air Canada in preparing and making forward-looking statements. As part of these assumptions, Air Canada assumes Canadian GDP growth of 1.5% to 2.0% for 2013. In addition, Air Canada expects that the Canadian dollar will trade, on average, at C$1.01 per U.S. dollar in the first quarter of 2013 and $1.02 for the full year 2013 and that the price of jet fuel will average 91 cents per litre for the first quarter of 2013 and 90 cents per litre for the full year 2013.
CORPORATE STRUCTURE

Name, Address and Incorporation

Air Canada was continued under the Canada Business Corporations Act (“CBCA”) on August 25, 1988. Air Canada acquired Canadian Airlines International Ltd. (“Canadian Airlines”) on July 6, 2000 and completed a corporate amalgamation with Canadian Airlines effective January 1, 2001, with the amalgamated entity being known as Air Canada. Pursuant to a consolidated plan of reorganization, compromise and arrangement of Air Canada and certain of its subsidiaries made pursuant to the Companies Creditors Arrangement Act (“CCAA”) (referred to herein as the "Plan"), ACE Aviation Holdings Inc. (“ACE”) became the parent holding company of the reorganized Air Canada on September 30, 2004.

On November 24, 2006, ACE and Air Canada completed an initial public offering and secondary offering of an aggregate 25 million Class A variable voting shares of Air Canada (the “Variable Voting Shares”) and Class B voting shares of Air Canada (the “Voting Shares”, together with the Variable Voting Shares, the “Shares”) (the “Initial Public Offering”). The Shares trade on the Toronto Stock Exchange ("TSX") under the symbol AC.A for the Variable Voting Shares and the symbol AC.B for the Voting Shares. Through the Initial Public Offering, Air Canada sold an aggregate of 9,523,810 Variable Voting Shares and Voting Shares for gross proceeds of $200 million to be used for general corporate purposes, including the partial funding of its fleet renewal program. In the secondary offering, ACE reported selling an aggregate of 15,476,190 Variable Voting Shares and Voting Shares for gross proceeds of $325 million. As at November 24, 2006, ACE reported holding a 75% ownership interest in Air Canada.

On October 27, 2009, Air Canada completed a bought deal public offering pursuant to which it sold to an underwriting syndicate 160,500,000 units of Air Canada at a price of $1.62 per unit for aggregate gross proceeds to Air Canada of $260 million (net proceeds of $249 million after expenses and underwriter fees). Each unit was comprised of one Variable Voting Share or one Voting Share, of Air Canada, and one-half of one share purchase warrant (each whole warrant a "Warrant") entitling the holder thereof to acquire one Variable Voting Share or one Voting Share at an exercise price of $2.20 per Share, at any time prior to October 27, 2012. As a result of this public offering, and shares issued by Air Canada to a trust in conjunction with the adoption, in July 2009, of the Air Canada 2009 Pension Regulations and the completion of pension funding agreements with the Corporation’s Canadian-based unions (the “Pension MOUs”), which are identified in the "Pension Plan Arrangements" section of this AIF, ACE reported that its ownership interest in Air Canada, as at October 27, 2009, was reduced from 75% to 27%.

Effective December 1, 2009, the operations of AC Cargo Limited Partnership and ACGHS Limited Partnership, previously wholly-owned subsidiaries of Air Canada, were wound up into Air Canada and are now operated as divisions of Air Canada.

On December 23, 2010, ACE announced that it had concluded a public secondary offering on a bought deal basis of 44 million Class B voting shares of Air Canada for net proceeds to ACE of $156 million. Air Canada did not receive any of the proceeds from this offering. As at December 23, 2010, after giving effect to this offering, ACE reported its ownership interest in Air Canada as having been reduced from 27% to approximately 11%.

On February 10, 2012, ACE announced its intention to seek shareholder approval for its winding-up, the distribution of its remaining net assets and, ultimately, its dissolution in the future. On April 25, 2012, ACE announced that its shareholders had approved a special resolution providing for the voluntary liquidation of ACE. On June 28, 2012, ACE announced that the Quebec Superior Court – Commercial Division had appointed Ernst & Young Inc. as liquidator of ACE.

On October 27, 2012, 79,430,300 Warrants, which were issued in 2009 with an exercise price of $2.20, expired.

On November 14, 2012, ACE announced that it had sold to Cormark Securities Inc., an investment dealer, a total of 31 million shares of Air Canada and 2.5 million warrants to purchase Air Canada shares at exercise prices of $1.51 (1.25 million warrants) and $1.44 (1.25 million warrants) and that, as a result, ACE no longer held any shares or warrants in the capital of Air Canada.
The head office of Air Canada is located at 7373 Côte-Vertu Boulevard West, Saint-Laurent, Québec, H4S 1Z3. Air Canada's website address is aircanada.com. (For greater certainty, no information contained in Air Canada’s website is incorporated in this AIF by reference, unless expressly stated herein).

Additional information is provided in Air Canada’s consolidated financial statements for the year ended December 31, 2012 and Air Canada’s 2012 Management’s Discussion and Analysis of Results of Operations and Financial Condition (“MD&A”) dated February 7, 2013, both of which are available on Air Canada’s website at aircanada.com and on SEDAR at www.sedar.com.

INTERCORPORATE RELATIONSHIP

The following chart illustrates, on a simplified basis, the corporate structure of Air Canada (including jurisdiction of establishment/incorporation of the various entities) as at December 31, 2012.

(1) Air Canada directly and indirectly holds all of the issued and outstanding shares of certain subsidiaries, including 8165343 Canada Inc. (doing business as Air Canada rouge) which is incorporated under the laws of Canada, Air Canada Capital Ltd. and Simco Leasing Ltd., which are incorporated under the laws of the province of Alberta. Air Canada holds all the issued and outstanding limited partner units of Touram Limited Partnership (doing business as Air Canada Vacations), a limited partnership formed under the laws of the province of Quebec. Touram General Partner Inc., a corporation incorporated under the laws of Canada, is the general partner of, and holds a 0.00001% interest in Touram Limited Partnership. Air Canada holds a 100% interest in Touram General Partner Inc.

Certain subsidiaries, each of which represents not more than 10% of the consolidated assets and not more than 10% of the consolidated sales and operating revenues of the Corporation, and all of which, in the aggregate, represent not more than 20% of the total consolidated assets and the total consolidated sales and operating revenues of the Corporation at December 31, 2012, have been omitted.
REGULATORY ENVIRONMENT

In Canada, commercial air transportation, including policy, maintenance standards, operations standards, safety and ground and navigation facilities, falls wholly within the jurisdiction of the Government of Canada and is the responsibility of the Minister of Transport. The Canadian Transportation Agency, an independent administrative body of the Government of Canada, acts as a quasi-judicial tribunal to resolve a range of commercial and consumer transportation-related disputes and acts as an economic regulator, to make determinations and to issue authorities, licences and permits related to the air transportation industry. NAV Canada, a private sector, non-share capital corporation, is responsible for providing air navigation services in Canada. All major Canadian airports are operated by Canadian airport authorities that are not-for-profit corporations.

Domestic Services

On December 16, 2011, the Government of Canada announced that the Canadian Transportation Agency would proceed with developing regulations requiring, among other things, air carriers to include all fees, taxes and surcharges in their advertised prices, by bringing into force section 86.1 of the Canada Transportation Act (“CTA”). The regulations were published on January 2, 2013 and are in force.

Transborder Services

Transborder services between Canada and the United States were initially liberalized by the 1995 Canada–U.S. Air Services Agreement. This agreement provides Canadian air carriers unlimited route rights to provide “own aircraft” services between points in Canada and points in the United States. Under the 1995 Canada–U.S. Air Services Agreement, carriers of both countries are free to set their own prices for transborder services according to market forces. Prices may only be disallowed under special circumstances if the authorities of both countries agree, for example in response to predatory or monopolistic pricing behaviour on specific routes. In November 1997, Canada and the United States concluded an agreement that allows Canadian and U.S. carriers to code share to, from and via each other’s territory, with carriers from other countries provided the other country allows code sharing and the carriers hold the underlying rights to serve that country. Air Canada code shares with certain Star Alliance™ partners via Canada and the United States and some of these Star Alliance™ partners’ codes appear on some transborder flights operated by other airlines operating flights on behalf of Air Canada, including Jazz Aviation LP (“Jazz”), a subsidiary of Chorus Aviation Inc.

The Open Skies Agreement between Canada and the United States, which came into force in 2007, further liberalized air transportation services. The Open Skies Agreement allows air carriers of both countries (i) to pick up passenger and/or cargo traffic in the other country and carry that traffic to a third country as part of a service to or from the carrier’s home country, (ii) to operate stand-alone all-cargo services between the other country’s territory and third countries, and (iii) greater pricing flexibility for services between the other country and a third country. The carriage of local traffic between points within one country by carriers of the other country, commonly known as cabotage, continues to be prohibited.
International Services

Scheduled international air services are regulated by the Canadian and foreign governments involved. The Minister of Transport has the authority to designate which Canadian air carriers may serve scheduled international routes. International route rights are obtained through bilateral negotiations between Canada and foreign countries. Bilateral agreements provide for the rights which may be exercised over agreed routings and the conditions under which the carriers may operate, including, among others, the number of carriers which may operate, the capacity and/or flight frequencies that may be provided and the controls over tariffs to be charged. Most bilateral agreements to which Canada is a party provide for the designation of more than one Canadian carrier, while some provide for the designation of only one Canadian carrier.

In May 2002, the Minister of Transport introduced a liberalized multiple designation policy applicable to scheduled international air services by Canadian carriers (excluding services to the United States). Any Canadian carrier may apply to be designated to serve any foreign country regardless of the size of the air travel market. If the number of Canadian carriers permitted is restricted under existing bilateral agreements, the Government of Canada will pursue negotiations with the appropriate countries to seek the necessary rights for Canadian carriers. In addition, an incumbent carrier’s designation in a particular market will be subject to reallocation only in circumstances where the bilateral agreement limits designation and the carrier is not operating its own aircraft or code share services.

On November 27, 2006, the Minister of Transport released a new international air transportation policy called Blue Sky that includes a more liberalized approach to Canada’s bilateral air transportation negotiations. The Government of Canada indicated that, under the new policy, when in Canada’s overall interest, it would proactively pursue opportunities to negotiate more liberalized agreements for international scheduled air transportation that will provide maximum opportunity for passenger and all-cargo services to be added according to market conditions. On December 9, 2008, the Minister of Transport announced that Canada had successfully concluded negotiations with the European Union on a comprehensive air transport agreement. Such agreement includes, among other things, unrestricted direct air services between Canada and European Union member states, flexible pricing arrangements, increased flexibility on code sharing and improved flexibility on cargo services. Although not yet in force, these rights and others contained in this new air transport agreement are available, on a provisional basis, as of December 18, 2009.

Charter Services

Charter operations are generally not covered by bilateral agreements, although charter services are covered under the Open Skies Agreement. Canadian government policy permits Canadian carriers to operate charter services between Canada and any point in the world subject to prior approval of the Canadian and other appropriate regulatory authorities.

The policy governing international passenger charter air services does not contain restrictions relating to advance booking, minimum stay requirements or prohibitions on one-way travel, however it requires that the entire seating capacity of an aircraft is chartered and that charter carriers are prohibited from selling seats directly to the public.

Foreign Ownership Rules

The Government of Canada’s Bill C-10, the Budget Implementation Act 2009, contains provisions whereby the provisions relating to voting securities in the Air Canada Public Participation Act (“ACPPA”) would be repealed and the CTA would be amended to provide the Governor in Council with flexibility to increase the foreign ownership limit from the existing 25% level to a maximum of 49%. These provisions will come into force on a date to be fixed by order of the Governor in Council made on the recommendation of the Minister of Finance, in the case of the ACPPA, and on the recommendation of the Minister of Transport, in the case of the CTA. Management cannot predict if or when the provisions relating to foreign ownership limits will come into force.

Carbon Emissions

There continues to be heightened focus on carbon emissions emanating from the aviation industry and legislation in various jurisdictions is being considered or adopted. Legislative initiatives include, for example, market-based mechanisms such as emissions trading systems, designed to reduce the total amount of carbon emissions by all targeted industries through the setting of permissible emissions allowances for these industries. Individual operators within those industries are
generally allocated a certain number of free emission allowances and may purchase additional allowances from the pool of permissible emissions allowances. In certain circumstances, they may also purchase or sell permissible emissions allowances among operators across different industries and may obtain emissions credits by investing in certified carbon reduction projects or by taking certain early action in reducing their carbon footprint.

On November 19, 2008, the European Parliament adopted directive 2008/101/EC to add the aviation industry to the industries covered by the existing European Emission Trading Scheme ("EU ETS"). The EU ETS caps greenhouse gas ("GHG") emissions from covered industries while allowing trading of permissible GHG emissions allowances among the operators in the covered industry. Aviation emissions were incorporated in the EU ETS starting January 2012 to include flights operated between Canada and countries within the European Union. The EU ETS would require aircraft operators to monitor and report fuel consumption and carbon dioxide emissions data. While this legislation would be expected to result in increased costs to the aircraft operators, as it relates to the purchase of emissions allowances, the net financial impact depends, in part, upon the percentage of such cost that, if any, would be recoverable in the form of higher passenger and cargo fares.

In November 2012, the European Commission announced that it would defer the implementation of the EU ETS as it applies to extra-EU flights pending work being done by the International Civil Aviation Organization ("ICAO") on market-based measures and expected to be agreed on at the ICAO assembly in the fall of 2013. Flights between EU aerodromes ("intra-EU flights") operated in 2012 were still subject to carbon emission reporting and surrender of allowance to cover the emissions. The derogation suspends the application of the EU Emissions Trading Aviation Directive 2008/1001 in regards to the remittance of allowances and monitoring requirement for flights to and from third countries ("extra-EU flights") on both EU and non-EU airlines for the year 2012. The Directive will therefore not be enforced and payment will not be required by EU regulatory authorities in respect of extra-EU flights operated in 2012, however, as indicated above, intra-EU flights will remain covered. The suspension of compliance obligations is on the condition that aircraft operators return any free allowances that have already been allocated for 2012 in respect of their international flights. The final regulatory text for the derogation is expected to be adopted by the entire EU Parliament in April 2013 and the derogation is expected to be in effect by April 30, 2013.

Based on the deferring of implementation and current trading prices of European Union CO2 allowances (EUAs), Air Canada expects related operating costs to be insignificant in 2013. This expectation is subject to change based on the change in the market price of EUAs and other factors such as Air Canada’s ability to offset this cost through higher passenger fares, cargo rates and/or surcharges. At the present time, Air Canada has not implemented a specific ETS surcharge and is currently taking these costs under consideration in the context of its global fuel surcharge strategy.

On the domestic front, on October 19, 2006, the Government of Canada tabled the Clean Air Act with the intention to strengthen the legislative basis for taking action on reducing air pollution and GHG. Since then, a number of supporting regulations on a sector-by-sector basis have been developed, and a national target set in alignment with the United States. At this time, there are no specific targets for aviation emissions.

In 2010, Air Canada endorsed the new industry targets (as set out by the International Air Transport Association "IATA") to collectively achieve: (i) an average improvement of fuel efficiency of 1.5% per year from 2009 to 2020, (ii) carbon neutral growth from 2020 onwards, and (iii) a reduction in CO2 emissions of 50% by 2050, relative to 2005. Air Canada has achieved a cumulative fuel efficiency improvement of 1.95% between 2009 and 2011. Air Canada implemented a fuel efficiency program in mid-2006, which has contributed to the overall efficiency improvement.

In 2012, the Government of Canada and the Canadian aviation industry announced the development of Canada's Action Plan to Reduce Greenhouse Gas Emissions from Aviation, which is a voluntary action plan that sets an aspirational goal to improve fuel efficiency from a 2005 baseline by an average annual rate of at least 2 percent per year until 2020 (the "Voluntary Action Plan"). The three principle measures to achieve this target are fleet renewals and upgrades, more efficient air operations, and improved capabilities in air traffic management. The Voluntary Action Plan also supports the aspirational goal of carbon neutral growth from 2020 onwards and absolute GHG emission reductions by 2050. Further work is underway to establish monitoring and reporting standards under this plan.
Official Languages Act

Pursuant to the ACPPA, Air Canada is subject to the Official Languages Act (Canada) (the "OLA"). The OLA compels Air Canada to, among other things, ensure that any member of the traveling public can communicate with and obtain services in either official language, French and English, where there is significant demand for those services in that language (Part IV of the OLA) and to allow its direct employees to work in either official language (Part V of the OLA) where there is significant demand. The ACPPA also imposes on Air Canada the obligation to ensure any of its subsidiaries’ customers can communicate with the subsidiary in respect of air services and incidental services, and obtain those services, in either official language, where the number of customers warrants such services.

Pursuant to the OLA, where services are performed on behalf of Air Canada by another party, Air Canada has the duty to ensure that any member of the public can communicate with and obtain those services in either official language in any case where those services, if provided by Air Canada, would be required under the OLA to be provided in either official language.

On October 17, 2011, Bill C-17, An Act to amend the Air Canada Public Participation Act was tabled for first reading in the House of Commons. Such proposed legislation, if enacted without amendment, would (i) extend the application of Parts IV, IX and X of the Official Languages Act to designated air carriers under contract with Air Canada; and (ii) exempt Air Canada from the application of section 25 of the Official Languages Act with respect to air services provided or made available by air carriers with which it has only code-sharing arrangements. Management cannot predict if or when Parliament will proceed with such proposed legislation.

Security

Air Canada’s first priority is to ensure the safety and security of its customers, employees and aircraft by maintaining the highest safety and security standards.

Since the September 11, 2001, terrorist attacks in the United States, new air security measures have been and are being regularly introduced in Canada and elsewhere (such as increased passenger and baggage screening, enhanced security procedures at check-in gates and on board the aircraft, reinforced cockpit doors on aircraft, an expanded program of armed police on aircraft and a requirement for passengers to produce valid identification prior to boarding all flights). On April 1, 2002, the Government of Canada established the Canadian Air Transport Security Authority ("CATSA"). CATSA’s responsibilities fall into four major air security areas, namely, pre-board screening of passengers and their belongings, hold baggage screening, non-passenger screening of those entering airport restricted areas and restricted area identity card implementation and management.

An air traveler’s security charge was introduced on April 1, 2002, to cover the costs of CATSA. The charges have been revised in subsequent federal budgets. As of January 1, 2013, the maximum charge is $15 for domestic travel, $25 for transborder travel and $26 for international travel.

In October 2002, the Government of Canada implemented its Advance Passenger Information initiative to help identify potentially high risk individuals and address other border security issues. In March 2003, it also established a Passenger Name Record program. Canadian and foreign carriers are required by regulation to provide the Canada Border Services Agency ("CBSA") with specific personal information on all passengers and crew members on board international flights destined to Canada at the time of departure, as well as to provide access to passenger name records in the carriers’ internal reservation systems.
Foreign countries such as the United States, the United Kingdom, Australia, Mexico, South Korea, China and countries that are members of the Caribbean Community and Common Market ("CARICOM") have enacted similar information requirements with respect to flights operating into and/or from their territory. Air Canada also complies with the Secure Flight requirements imposed by the U.S. Transportation Security Administration ("TSA") which require the provision of basic passenger information prior to flight and more complete information at check-in to enable the TSA and U.S. Customs and Border Protection ("CBP") to perform their watch list and Electronic System for Travel Authorization ("ESTA") verifications prior to the issuance of the passenger’s boarding pass.

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

The Passenger Protect Program and Identity Screening Regulations came into effect in June 2007. Passengers aged 18 or over are required to have in their possession government-issued identification which includes their name, date of birth and gender. The identification may be required at check-in and must be presented at the boarding gate. The verification requirements were amended in 2010 to require a comparison of the passenger’s full face with the identification document. If a passenger refuses to remove facial coverings, Air Canada must deny carriage. All immigration documentation requirements still apply on international flights.

The failed terrorist attack in December 2009 on board a U.S. commercial carrier prompted the implementation of additional security measures for flights to the United States, including restrictions relating to carry-on baggage. The October 2010 attempted attacks on cargo aircraft bound from Yemen to the United States have resulted in regulations imposing stricter controls on cargo security.

Air Canada continues to work with the appropriate authorities to ensure full compliance with security requirements, including new programs that will affect the airline industry:

- Air Canada was the first carrier in Canada to provide Transport Canada with a security management system. The security management system uses threat/risk assessments in conjunction with government regulations to define appropriate security measures and then monitors compliance through audits and incident reporting;

- Air Canada has implemented the measures imposed by Transport Canada under the Passenger Protect Program as Air Canada already complies with similar requirements imposed by the TSA, a U.S. government agency for its Secure Flight program;

- Air Canada works with CATSA and other agencies to continuously improve security measures and to ensure that any innovation adopted by Air Canada maintains the highest degree of security; and

- More stringent cargo screening regulations requiring 100% screening took effect in various jurisdictions, including in Canada effective December 31, 2012. This has led to increased security related costs for screening equipment and security services providers. Complexities of screening various cargo commodities necessitate additional staff for validation, segregation procedures and record keeping. Participants may perform their own screening and be registered by the various jurisdictions to become secure supply chain participants. In 2013, the charges applied to supply chain participants who are not registered are expected to largely offset the expected increased costs to Air Canada.
Safety

In order to improve the safety performance of Canadian air operators and increase accountability in the aviation sector, Canadian Aviation Regulations require air operators to implement a safety management system in their organizations and appoint executives who are accountable for safety.

Air Canada has an approved safety management system in place in accordance with the Canadian Aviation Regulations. Air Canada's President and Chief Executive Officer has been appointed as the Accountable Executive ("AE") for Air Canada's Safety Management System and Air Canada's Senior Director, Corporate Safety, Environment and Quality, is responsible for the implementation of the Safety Management System on behalf of the AE.

Privacy

Air Canada is subject to applicable Canadian and foreign privacy laws regarding the collection, use, disclosure and protection of passenger and employee data. In Canada, Canada's federal private sector privacy legislation, the Personal Information Protection and Electronic Documents Act (Canada) (the "PIPEDA"), governs the collection, use and disclosure of personal information in the course of commercial activities by a federally-regulated business. In addition, the PIPEDA regulates the handling of employee personal information by federally-regulated employers. With certain exceptions, the PIPEDA also applies to the collection or disclosure of personal information across provincial or Canadian international borders and within provinces without substantially similar private sector privacy legislation. The PIPEDA requires informed implicit or explicit consent, as the case may be, by the individuals whose personal information is collected and used. The personal information may then only be used for the purposes for which it was originally collected or for other purposes specified in, or allowed by, the PIPEDA. Air Canada has a privacy policy which is designed to meet or exceed the requirements of such privacy legislation.
TRADEMARKS

Air Canada believes that its trademarks are important to its competitive position. Air Canada is Air Canada's trade name and trademark. Other trademarks include Air Canada Express™, Air Canada Jetz®, Air Canada Jazz®, Jazz®, Air Canada Vacations®, Vacances Air Canada®, Executive First®, Executive Class®, AC Priority™, AC Air Freight™, Rapidair®, Maple Leaf™, Feuille d'ébrâble™, Maple Leaf Lounge™, Air Canada Elite®, Air Canada Super Elite®, Air Canada rouge™, Air Canada Elite®, Altitude™, Altitude Prestige™, Altitude Elite™, Altitude Super Elite™ and related design marks such as the Air Canada Roundel®. Air Canada has granted Aimia Canada Inc. (formerly Aeroplan Canada Inc.) a license to use Air Canada® and Air Canada Roundel® trademarks around the world solely in association with the Aeroplan® program. Air Canada has granted Jazz a license to use Air Canada Jazz®, Jazz®, Air Canada®, Air Canada Design®, Air Canada and Design® and other trademarks in Canada and the United States in association with the provision of scheduled airline services in regions of Canada and across the Canada–United States border. Air Canada protects its proprietary information, including its trademarks and database, through trademark laws, contractual provisions, confidentiality procedures and other means. Employees, service providers, and other parties with whom Air Canada carries on business are, as appropriate, contractually bound to protect Air Canada's proprietary information in order to control access to and the distribution of any such information.
INDUSTRY OVERVIEW AND COMPETITIVE ENVIRONMENT

General

The airline industry has traditionally been dominated by large established network carriers. Network carriers generally benefit from brand name recognition and a long operating history. They offer scheduled flights to major domestic and international cities while also serving smaller cities. They generally concentrate most of their operations in a limited number of hub cities, serving most other destinations in their network by providing one-stop or connecting service through their hubs.

Over the past three decades, governments gradually reduced economic regulation of commercial aviation. This has resulted in a more open and competitive environment for domestic, transborder and international airline services, for both scheduled and leisure charter operations. This deregulation transformed the airline industry and allowed the emergence of low-cost carriers, which resulted in a rapid shift in the competitive environment. With their relatively low unit costs largely resulting from lower labour costs and a simplified operational model and product offering, low-cost carriers are able to operate profitably while generally achieving lower yields than network carriers. By offering lower fares, these carriers have expanded and succeeded in gaining market share from network carriers. While the majority of low-cost carriers offer predominately point-to-point services between designated cities, some utilize a similar "hub and spoke" strategy to the network carriers. WestJet Airlines Ltd. ("WestJet") is the largest low-cost carrier in Canada and, at December 31, 2012, offered scheduled service to 81 destinations in North America, Central America and the Caribbean with a fleet of 100 Boeing 737 aircraft. In 2012, WestJet announced that it would be launching a new regional airline, named WestJet Encore, in the second half of 2013, using a fleet of up to 45 Bombardier 78-seat Q400 turboprop aircraft (comprised of 20 committed and 25 optional aircraft), seven of which would be expected to be delivered in 2013. WestJet also announced that WestJet Encore, at maturity, would operate in both the domestic and transborder markets, including to new destinations not currently served by WestJet, on flights between existing destinations not currently flown by WestJet, and on some existing short-haul routes currently flown by WestJet's Boeing 737 aircraft.

Domestic Market

The Canadian domestic market is characterized by a large geographic territory with a limited number of high density markets accounting for the majority of passenger traffic and revenue. This leads to a concentration of routes in Canada around four major hubs: Toronto, Montreal, Vancouver and Calgary.

Air Canada is the largest provider of scheduled passenger services in the Canadian market. Based on Official Airline Guide ("OAG") data, during the period from January 1, 2012 to December 31, 2012, Air Canada, together with Jazz and other airlines operating flights on behalf of Air Canada under commercial agreements with Air Canada (which operate under the brand name "Air Canada Express" and which are referred to in this AIF as "Contracted Carriers"), led the Canadian airline industry's domestic scheduled capacity with an estimated market share of approximately 55% based on Available Seat Miles ("ASMs").

Air Canada is Canada's largest domestic airline. Jazz is the largest regional airline in Canada and operates regional services for Air Canada under a capacity purchase agreement (the "Jazz CPA"). Air Canada, together with its Contracted Carriers, carries more passengers, serves more non-stop destinations and provides more flights in the domestic market than any other airline.

Competition in the domestic market is primarily from WestJet. As at December 31, 2012, Air Canada, together with its Contracted Carriers, provided service to 59 domestic destinations within Canada, while WestJet provided service to 31 domestic destinations. WestJet announced that WestJet Encore, at maturity, would operate in eastern and western Canada.

Porter Airlines Inc. ("Porter") is a regional passenger carrier based at and operating from Billy Bishop Toronto City Airport primarily in the eastern triangle market to compete with Air Canada’s Rapidair services at Toronto Pearson International Airport ("Toronto Pearson Airport"). The airline serves primarily short-haul business markets such as Ottawa, Montreal, New York (Newark), Chicago (Midway) and Boston (Logan) from Toronto, operating with a fleet of 26 70-seat Bombardier Q400 aircraft.
On May 1, 2011, Sky Regional Airlines Inc. ("Sky Regional") commenced service between Toronto Island’s Billy Bishop Toronto City Airport and Montreal’s Trudeau Airport on behalf of Air Canada and pursuant to a capacity purchase agreement. Air Canada’s schedule provides up to 15 daily non-stop return flights between downtown Toronto and Montreal Pierre Elliott Trudeau International Airport ("Montreal Trudeau Airport").

Other airlines operating in the domestic market include Canadian North and First Air, based in Yellowknife and Iqaluit, respectively, and they operate services primarily within northern Canada and connecting northern Canada to the rest of the country.

The following chart illustrates the estimated share of the overall domestic scheduled capacity provided by Air Canada, together with its Contracted Carriers, as measured by ASMs.

Estimated Domestic Scheduled Capacity Market Share

<table>
<thead>
<tr>
<th>Estimate</th>
<th>Share</th>
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<tbody>
<tr>
<td>Air Canada</td>
<td>55%</td>
</tr>
<tr>
<td>Other Airlines</td>
<td>10%</td>
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<tr>
<td>WJA</td>
<td>35%</td>
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**U.S. Transborder Market**

In 2012, there were, on average, 1,152 daily scheduled transborder flights operated between Canada and the United States across the industry. Toronto Pearson Airport, Air Canada's largest hub, is the world’s largest originator of flights into the United States.

Air Canada is the largest provider of scheduled passenger services in the U.S. transborder market. Based on OAG data, during the period from January 1, 2012 to December 31, 2012, Air Canada, together with its Contracted Carriers, provided more U.S. transborder scheduled capacity than any other airline with an estimated market share of approximately 35% based on ASMs.

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(1) Source: OAG data, based on ASMs during the period from January 1, 2012 to December 31, 2012; represents the estimated share of the overall domestic scheduled capacity of Air Canada and its Contracted Carriers. The estimated share of the overall domestic scheduled capacity of the other carriers presented also includes the domestic scheduled capacity of their respective affiliated or contracted regional carrier(s), when applicable.

(2) WJA = WestJet Airlines.
Air Canada, together with its Contracted Carriers, carries more passengers, serves more non-stop destinations and provides more flights in the U.S. transborder market than any other airline. Competition in the U.S. transborder market is primarily from U.S. network carriers and their regional affiliates and from WestJet. The U.S. network carriers tend to operate flights between the United States and Canada into their hubs, connecting to flights to other U.S. destinations. U.S. network carriers with U.S. transborder operations include Alaska Airlines, American Airlines, United Airlines, Delta Airlines (including their subsidiary Northwest Airlines), and U.S. Airways. In 2012, Air Canada, together with its Contracted Carriers, provided service to 55 U.S. destinations from Canada, while U.S. carriers provided service to 26 U.S. destinations from Canada and WestJet provided service to 20 U.S. destinations. WestJet announced that, at maturity, WestJet Encore would operate in the transborder market.

As of the date of this AIF, in 2013, Air Canada has transferred two of 15 Embraer 175 aircraft from its mainline fleet to Sky Regional who will operate these aircraft on Air Canada’s behalf under an amended capacity purchase agreement. Subject to certain conditions, an additional 13 Embraer 175 aircraft are expected to be transferred to Sky Regional in the course of 2013. These aircraft will continue flying on U.S. short-haul routes, primarily from Toronto and Montreal to destinations in the Northeast U.S.

Canadian low-cost carriers also operate U.S. transborder services and have expressed an intention to further expand these operations in the future.

The following chart illustrates the estimated share of the overall U.S. transborder scheduled capacity of Air Canada, together with its Contracted Carriers, as measured by ASMs.

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1. Source: OAG data, based on ASMs during the period from January 1, 2012 to December 31, 2012; represents the estimated share of the overall transborder scheduled capacity of Air Canada and its Contracted Carriers. The estimated share of the overall transborder scheduled capacity of the other carriers presented also includes the transborder scheduled capacity of their respective affiliated or contracted regional carrier(s), when applicable.

2. AMR = American Airlines; WJA = WestJet Airlines; LCC = U.S. Airways; DAL = Delta Air Lines; UAL = United Airlines.
International Market

Air Canada principally services the international market from three strategically-positioned airports, which are further described below:

- Toronto Pearson Airport, Canada's largest airport, is located in Canada's largest city and offers regular non-stop flights to numerous destinations in Europe, Central America/Caribbean/South America and, more recently, to destinations to Asia. Toronto Pearson Airport offers, on average, approximately 539 daily departures, of which 14% are to international destinations.

- Montreal Trudeau Airport is located in Canada's second largest city, and offers regular non-stop service to several European destinations and certain Central American/Caribbean and South American destinations. Montreal Trudeau Airport offers, on average, approximately 261 daily departures, of which 11% are to international destinations.

- Vancouver International Airport, located in Canada's third largest city, is strategically positioned on Canada’s west coast and acts as a gateway to many Asian destinations. Vancouver International Airport offers, on average, approximately 311 daily departures, of which 8% are to international destinations.

Air Canada is Canada's largest provider of scheduled passenger services in the international market to and from Canada and has a broad portfolio of international route rights. Based on OAG data, during the period from January 1, 2012 to December 31, 2012, Air Canada provided more international scheduled capacity in the international market to and from Canada than any other airline with an estimated market share of approximately 37% based on ASMs. Air Canada is currently the only Canadian scheduled carrier with routes from Canada to Asia, although a number of Asian carriers service Canadian destinations. Air Canada is also the sole Canadian scheduled carrier offering flights to South America, and no South American scheduled network carrier currently provides non-stop service to Canada.

Canadian low-cost carriers as well as Canadian charter airlines and tour operators, such as Transat A.T. Inc. ("Transat") and Sunwing Airlines ("Sunwing"), also operate services to Mexico and the Caribbean and certain of them have expressed an intention to further expand these operations in the future. In 2012, WestJet, Sunwing and Transat provided service to 30, 21 and 14 destinations, respectively, to Mexico and the Caribbean. Air Canada rouge™, as described in the section entitled “Air Canada’s Business Strategy” of this AIF, will enable Air Canada to compete more effectively against these low-cost carriers serving international leisure destinations.

In late 2012, Air Canada unveiled its new leisure airline, Air Canada rouge™. For its inaugural 2013 season, Air Canada rouge™ will introduce new routes not currently operated by Air Canada to Venice, Italy, and Edinburgh, Scotland. In addition, Air Canada seasonal services from Toronto and Montreal to Athens, Greece will be transferred to the leisure carrier. Similarly, existing Air Canada flights operated in cooperation with Air Canada Vacations to Cuba, the Dominican Republic, Jamaica and Costa Rica will be operated by Air Canada rouge™ effective July 2013.

In the transatlantic and transpacific markets, Air Canada competes primarily with foreign network carriers and, to a lesser extent, with charter carriers on higher density routes during peak travel seasons. In addition, U.S. network carriers compete by flying Canadian passengers through their hubs to destinations in international markets.

The following chart illustrates the estimated share of the overall international scheduled capacity provided by Air Canada and other airlines as measured by ASMs.
Estimated International Scheduled Capacity Market Share

- Air Canada: 37%
- Other Airlines: 25%
- TRZ: 10%
- CATH: 6%
- BA: 4%
- LH: 3%
- KLM: 7%
- WJA: 4%
- SWG: 4%

(1) Source: OAG data, based on ASMs during the period from January 1, 2012 to December 31, 2012; represents the estimated share of the overall international scheduled capacity of Air Canada. The estimated share of the overall international scheduled capacity of the other carriers presented also includes the international scheduled capacity of their respective affiliated or contracted regional carrier(s), when applicable.

(2) KLM = Air France KLM; LH = Lufthansa; BA = British Airways; CATH = Cathay Pacific Airways; TRZ = Transat A.T. Inc.; WJA = Westjet Airlines; SWG = Sunwing Airlines
THE BUSINESS

Overview

Air Canada is Canada’s largest domestic, U.S. transborder and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-U.S. transborder market and in the international market to and from Canada. In 2012, Air Canada, together with Jazz and other regional airlines operating flights on behalf of Air Canada under capacity purchase agreements, operated, on average, 1,520 daily scheduled flights to 59 destinations in Canada, 55 destinations in the U.S. and a total of 64 destinations in the Canada-Europe, Canada-Pacific, Canada-Caribbean/Central America and Canada-South America markets. Domestic, U.S. transborder and international departures accounted for approximately 66%, 26% and 8%, respectively, of the 1,520 average daily departures. In 2012, Air Canada carried close to 35 million revenue passengers and provided passenger service to 178 direct destinations on five continents.

Air Canada enhances its domestic and transborder network through capacity purchase agreements with certain regional airlines that operate flights under the Air Canada Express brand name. These regional carriers include Jazz and Sky Regional, operating smaller jet and turboprop aircraft, and other Tier III carriers, operating aircraft of 19 seats or less. Under these capacity purchase agreements, regional carriers operate with smaller jet and turboprop aircraft that have lower trip costs than conventional large jet aircraft, allowing them to provide service to Air Canada’s customers in lower density markets as well as in higher density markets at off-peak times throughout Canada and the United States. Air Canada determines the routes, schedules and markets and purchases the greater part of these carriers’ fleet capacity, incurring capacity purchase fees and pass-through costs, all in accordance with the terms of each agreement.

As at December 31, 2012, Air Canada operated a mainline fleet of 205 aircraft comprised of 89 Airbus narrowbody aircraft, 56 Boeing and Airbus widebody aircraft and 60 Embraer regional jets. In addition, as at December 31, 2012, Jazz operated, on behalf of Air Canada, 124 aircraft comprised of 49 Bombardier regional jets and 75 Dash-8 turboprop aircraft, and other regional airlines operating flights on behalf of Air Canada operated an additional 22 aircraft.

In late 2012, Air Canada unveiled plans for a new travel leisure group, which comprises the activities of the airline’s tour operator business, Air Canada Vacations, and a new low-cost leisure airline which will operate under the brand name Air Canada rouge™. Air Canada rouge™, which will begin flight operations in July 2013, will leverage the strengths of Air Canada’s extensive network, operational expertise and frequent flyer reward program and will allow the airline to compete more effectively in the leisure market, with a goal of improving Air Canada’s earnings capabilities and strengthening its competitive position. Air Canada Vacations is a leading Canadian tour operator. Based in Montreal and Toronto, Air Canada Vacations operates its business in the outbound leisure travel market (Caribbean, Mexico, U.S., Europe, Central and South America, South Pacific and Asia) by developing, marketing and distributing vacation travel packages. Air Canada Vacations also offers cruise packages in North America, Europe and the Caribbean.

Air Canada is a founding member of the Star Alliance™ network. Through Star Alliance™ network’s 27 member airlines, Air Canada is able to offer its customers access to approximately 1,329 destinations in 194 countries, as well as reciprocal participation in frequent flyer programs and use of airport lounges and other common airport facilities.

Air Canada participates in a transatlantic joint venture with United Airlines and Deutsche Lufthansa AG through which the carriers provide customers with more choice and streamlined service on routings between North and Central America, and Africa, India, Europe and the Middle East. This transatlantic joint venture, including its revenue share structure, was implemented effective January 1, 2010.

In October 2010, Air Canada announced that it had concluded a memorandum of understanding with United Airlines setting out the principles for a comprehensive revenue-sharing joint venture on Canada-U.S. flights. In June 2011, Canada’s Commissioner of Competition filed a Notice of Application opposing the proposed joint venture as well as Air Canada’s and United Airline’s existing transborder cooperation arrangements, which Air Canada and United Airlines challenged. In October 2012, Air Canada announced that it, together with United Continental Holdings Inc., United Air Lines Inc. and Continental Airlines Inc. had reached an agreement with Canada’s Commissioner of Competition which settles the Notice of Application. The conclusion of this agreement preserves, subject to agreed conditions, the airlines’ existing commercial arrangements and their ability to create a transborder joint venture.
Through its long-term relationship with Aimia Canada Inc. (formerly Aeroplan Canada Inc. and referred to as "Aeroplan" in this AIF), Air Canada’s loyalty program provider, Air Canada is able to build customer loyalty by offering those customers who are Aeroplan® members the opportunity to earn Aeroplan® Miles when they fly with Air Canada and with the 27 Star Alliance™ member airlines. Aeroplan is also Air Canada’s single largest customer. The relationship with Aeroplan is designed to provide a stable and recurring source of revenue from the purchase of Air Canada seats by Aeroplan, which in turn are provided to Aeroplan® members who choose to redeem their Aeroplan® Miles for travel on Air Canada. Additionally, Aeroplan® members may also choose to redeem their Aeroplan® Miles for travel with the Star Alliance™ member airlines.

Air Canada also generates revenue from its Air Canada Cargo division, which provides direct cargo services to over 150 Canadian, U.S. transborder and international destinations and has sales representation in over 50 countries. Air Canada Cargo is Canada’s largest provider of air cargo services as measured by cargo capacity. Air cargo services are provided on domestic and U.S. transborder flights and on international flights on routes between Canada and major markets in Europe, Asia, South America and Australia.

Air Canada’s Business Strategy

In 2013, Air Canada will continue to build on its underlying fundamental strengths and its strategic plan priorities in its continued effort to improve its earnings generation capability, strengthen its competitive position and fulfill its strategic vision of building value for customers, shareholders, employees and other stakeholders.

Air Canada’s business strategy focuses on four key priorities:

- Pursuing revenue enhancements and transforming costs to enhance its competitiveness;
- Expanding internationally and increasing connecting traffic through its international gateways;
- Engaging with customers, with a particular emphasis on premium class passengers and products; and
- Fostering positive changes to its culture.

Air Canada’s key priorities, including successes realized in 2012, are outlined below.

Cost Transformation and Revenue Enhancement

Key achievements in 2012

- Concluded collective agreements with all its major Canadian unions, which include modifications to the defined benefit pension plans (some of which remain subject to regulatory approval);
- Concluded new agreements and is in the process of selecting and finalizing other agreements with aircraft maintenance service providers, on a cost-competitive basis;
- Entered into an agreement which, subject to conclusion of certain conditions, provides for the transfer of 15 Embraer 175 aircraft to Sky Regional, two of which have been transferred to Sky Regional as of the date of this AIF, who will operate these aircraft, under the Air Canada Express banner, at a lower cost; and
- Announced the launch of Air Canada rouge™, a new low-cost leisure airline.

Air Canada’s Business Transformation team leads the airline’s cost transformation and revenue enhancement priority. Its mandate is two-fold, namely, to pursue revenue generating and cost reduction opportunities and to transform the way the airline operates, including by changing business processes, implementing cross-functional improvement projects, improving employee productivity and investing in new technology. Over the last several years, Air Canada has successfully implemented, and continues to seek out and implement, many cost-saving and revenue-generating initiatives, including
through contract renegotiation and operating process improvements, all with a goal of improving the airline’s ability to meet its long-term financial objectives.

The collective agreements concluded in 2011 and 2012 with the airline’s main labour groups provide Air Canada with the flexibility to implement certain strategic initiatives, including Air Canada rouge™, that were not possible in the past. The implementation of such strategic initiatives will be designed to provide Air Canada with opportunities to increase its competitiveness, grow its revenues, lower its costs and ultimately enhance profitability.

For example, the new five-year collective agreement concluded with the Air Canada Pilots Association (“ACPA”), the union representing Air Canada’s pilots, permits the airline to better manage its fleet and productivity which, in turn, allows Air Canada to better compete in the current industry environment and to reduce costs. The new agreement improves Air Canada’s competitive position by allowing certain adjustments to its relationship with regional airlines and to the composition of the mainline fleet. In this regard, as of the date of this AIF, in 2013, Air Canada has transferred two of 15 Embraer 175 aircraft from its mainline fleet to Sky Regional who will operate these aircraft on Air Canada’s behalf under a amended capacity purchase agreement. Subject to certain conditions, an additional 13 Embraer 175 aircraft are expected to be transferred to Sky Regional in the course of 2013. These aircraft will continue flying on U.S. short-haul routes, primarily from Toronto and Montreal to destinations in the Northeast U.S. Air Canada will derive cost saving benefits from this initiative as Sky Regional’s costs to operate these aircraft will be lower.

The new collective agreement concluded with ACPA also provides Air Canada with the ability to operate a low-cost airline with up to 50 aircraft. As discussed in this AIF, Air Canada rouge™ will begin flight operations in 2013 under a more competitive cost structure and enable Air Canada to more effectively compete in the low-cost segment of the leisure market.

In 2012, Air Canada also created the Air Canada Leisure Group, which is comprised of Air Canada’s leisure tour operator, Air Canada Vacations, and Air Canada rouge™. The Air Canada Leisure Group will also be well positioned in the highly competitive, but growing, leisure segment in Canada, with a strong value proposition and competitive cost structure. Air Canada rouge™ will operate under the principle of maintaining a long-term cost structure consistent with that of its low-cost competitors. By delivering its leisure product at lower costs, the airline expects to improve its operating margins.

The collective agreements concluded with Air Canada’s main labour groups also contain amendments to the defined benefit plans. Based on the actuarial valuations as at January 1, 2012, Air Canada estimated that these changes, along with similar changes to management and other non-unionized employee pension plans, in the aggregate, would result in a decline of approximately $1.1 billion to the solvency deficit in its domestic registered pension plans, had these amendments been implemented on January 1, 2012. These changes remain subject to regulatory approvals by the Office of the Superintendent of Financial Institutions (“OSFI”). Except for new hires represented by the Canadian Auto Workers (“CAW”) and the Canadian Union of Public Employees (“CUPE”) (who will participate in a new pension plan with a defined benefit and defined contribution component), all new hires participate in defined contribution plans which, in the long-term, will reduce the volatility of Air Canada’s pension obligations. Since 2005, new non-unionized employee hires participate in defined contribution plans (rather than defined pension plans).

Following the filing by Aveos Fleet Performance Inc. (“Aveos”) under the CCAA and the termination of all maintenance agreements between Air Canada and Aveos, Air Canada has entered, or is in the process of entering, into new maintenance contracts with experienced and cost-competitive service providers. The new maintenance agreements, negotiated at market terms and rates, have resulted in meaningful unit cost savings and better aircraft turnaround times.

Through its Business Transformation team, Air Canada is also working towards lowering fuel consumption; bettering aircraft turnaround times; reducing credit card fees; improving productivity in its call centres; enhancing passenger revenues through product and service innovations and cargo revenues through the more effective use of aircraft space.

Air Canada is also leveraging its Aeroplan loyalty program and offering new tier levels in its rebranded frequent flyer status recognition program, Air Canada Altitude, to build loyalty and generate incremental revenues.

In late 2013, Air Canada expects to begin implementing a new revenue management system aimed at optimizing the airline’s network revenue performance on the basis of a passenger’s full trip itinerary. This new system will be implemented over a two-year period and will be designed to improve the manner in which Air Canada optimizes its passenger revenues.
Air Canada also expects to achieve further cost savings starting in 2014 when it is scheduled to begin introducing Boeing 787 aircraft into its fleet. The Boeing 787 aircraft will allow the airline to reduce operating expenses through fuel and maintenance savings.

Expanding internationally and Increasing Connecting Traffic through International Gateways

Key achievements in 2012

- Increased its sixth freedom traffic (international to international, including U.S.) connecting at Toronto Pearson Airport by over 20% from 2011;
- Announced plans for a major international expansion with a focus on key gateways to Asia;
- Announced the launch of Air Canada rouge™, which will operate routes not currently operated by Air Canada, including Venice, Italy, and Edinburgh, Scotland;
- Concluded a number of new codeshare agreements, including with Egyptair, South African Airways and Turkish Airlines; and
- Together with United Airlines, concluded an agreement with Canada's Commissioner of Competition which preserves, subject to agreed conditions, the airlines' existing commercial agreements and the ability to create a transborder joint venture.

In 2013, Air Canada plans on selectively and profitably expanding its international services and growing its market share, including through its numerous airline relationships. Air Canada believes it is well-positioned to grow international revenues by leveraging the following competitive advantages:

- A widely-recognized brand and a strong position in the market for transatlantic and transpacific travel to and from Canada and to and from South America via Canada;
- An extensive and expanding global network, which is enhanced by the airline's membership in Star Alliance, numerous codeshare agreements, and participation in revenue sharing joint ventures;
- A flexible fleet mix, which provides the airline with the ability to easily redeploy capacity when changes in demand occur;
- Air Canada Altitude, Air Canada's frequent flyer recognition program, which recognizes the airline's most frequent flyers by offering them a range of exclusive travel privileges, including the benefits derived from Air Canada's partnership with the Aeroplan program, and allows all customers to earn and redeem Aeroplan® Miles with Canada's leading coalition loyalty program;
- Competitive products and services, including lie-flat beds in the Executive First cabin, concierge services and Maple Leaf lounges; and
- Geographically well-positioned hubs (Toronto, Montreal, Vancouver and Calgary), which provide competitive advantages to serve customers travelling to or from the U.S. to Asia and Europe.

Over the last several years, Air Canada has been intensifying its focus on high growth economies, such as the Asian markets. In 2013, Air Canada plans on further expanding its capacity in these markets, including through the introduction of a new Toronto-Seoul service which will operate three times a week, creating a fifth Asian destination from Air Canada's Toronto Pearson Airport hub. Furthermore, Air Canada will add three weekly departures between Toronto and Beijing, bringing the total number of departures from Toronto to Beijing to ten per week, and will add four departures a week between Vancouver and Beijing, for a total of 11 weekly departures. Air Canada has also upgraded its Calgary-Tokyo Narita service to offer daily departures, up from five per week. Beginning in June 2013, Air Canada will also begin flying three-
times weekly, year-round, from Toronto to Istanbul, providing a gateway to other destinations in Turkey, Central Asia, the Middle East and Africa.

On February 7, 2013, Air Canada announced the introduction of a new International Premium Economy cabin for customers seeking enhanced comfort and service on international flights as it continues to modernize its widebody fleet with the addition of five new Boeing 777-300ER aircraft. Air Canada’s five new Boeing 777-300ER aircraft will be the first aircraft configured with the carrier’s new Premium Economy cabin prior to the arrival of Boeing 787 aircraft scheduled to begin delivery in 2014. The five Boeing 777-300ER aircraft will also offer a larger Economy cabin as Air Canada will strategically deploy these aircraft on select international markets with high volume demand for economy travel. Air Canada’s 37 Boeing 787 aircraft will feature a brand new, enhanced version of Air Canada’s award-winning Executive First lie-flat beds and product that has yet to be announced, in addition to Premium Economy and Economy options. The Boeing 787 fleet will be deployed on the carrier’s current and future high premium demand international routes.

In 2013, Air Canada plans to grow global connecting traffic via Canada through its world-class hub in Toronto and its strong international gateways in Montreal, Vancouver and Calgary.

While Toronto Pearson Airport costs are high relative to other North American airports, Toronto Pearson Airport has a strategic geographic advantage due to its proximity to major markets in the U.S. and can accommodate further growth in connecting passenger traffic.

Over the last several years, Air Canada has been working closely with the Greater Toronto Airport Authority ("GTAA") to transform Toronto Pearson Airport into a leading North American airport in order to gain a greater share of the global international-to-international connection market. Air Canada’s success in marketing its superior product offerings to U.S. customers combined with Toronto Pearson Airport’s efficient in-transit facilities, which allow passengers and their bags to move seamlessly between Canada and U.S. Customs and Immigration, have helped boost Air Canada’s international connecting traffic at Toronto Pearson Airport by over 20% since 2011. As well, with Air Canada’s growing International reach, Toronto is experiencing a significant increase in transfer traffic connecting between international points.

The further development of commercial alliances with major international carriers continues to be an important aspect of Air Canada’s business strategy. These commercial arrangements provide Air Canada with an effective way of leveraging expansion and broadening its network appeal. Air Canada is extending its global reach through its membership in Star Alliance, which allows the airline to offer its customers a choice of 1,329 airports in 194 countries. Air Canada is also strengthening its market presence in North and Central America, Europe, the Middle East, Africa and India through its participation in a transatlantic revenue sharing joint venture with United Airlines and Deutsche Lufthansa AG, referred to as A++, and has the ability to pursue a U.S. transborder joint venture with United Airlines. By coordinating pricing, scheduling and sales, Air Canada is better able to serve customers by offering more travel options, while reducing travel times. Air Canada is also achieving greater critical mass and network scope through numerous codeshare and interline agreements. For example, in anticipation of Air Canada’s new service to Istanbul, Air Canada and Turkish Airlines have agreed to reciprocal code-sharing which will ensure seamless connections on a single itinerary for customers travelling beyond Istanbul, throughout Turkey and to points in Central Asia, Africa and the Middle East.

For its inaugural 2013 season, Air Canada rouge™ is planning on introducing routes not currently operated by Air Canada, such as Venice, Italy, and Edinburgh, Scotland. In addition, Air Canada seasonal services from Toronto and Montreal to Athens, Greece are scheduled to be transferred to the leisure carrier. Similarly, existing Air Canada flights operated in cooperation with Air Canada Vacations to Cuba, the Dominican Republic, Jamaica and Costa Rica are scheduled to be operated by Air Canada rouge™ effective July 2013. Air Canada rouge™ flights to all destinations to be served in the carrier’s inaugural 2013 summer schedule will depart from Air Canada’s main hub at Toronto Pearson Airport offering customers seamless connections with Air Canada, Air Canada Express and its Star Alliance partner flights. Air Canada rouge™ customers will benefit from attractively priced through-fares from any point within Air Canada’s extensive network on a single ticket as well as baggage checked through to final destination and Aeroplan mileage accumulation and redemption.
The Air Canada rouge™ fleet will initially be comprised of two Boeing 767-300ER aircraft to operate transatlantic flights in a two-cabin configuration offering a selection of rouge™ seats, rouge™ Plus seats with additional legroom, and Premium rouge™ seats featuring additional seating comfort, space and enhanced meal and beverage service; and two Airbus A319 aircraft to operate North American flights in an all-economy configuration offering a selection of rouge™ seats and rouge™ Plus™ seats with additional legroom. Prior to the end of 2013, Air Canada plans to transfer an additional six Airbus A319 aircraft, for a total of eight Airbus A319 aircraft, from its mainline fleet to Air Canada rouge™. Air Canada rouge™ will expand to other leisure destinations as Air Canada starts to take delivery of new Boeing 787 Dreamliner aircraft, which is scheduled to commence in 2014, thereby freeing up aircraft for transfer to the Air Canada rouge™ fleet. As this occurs, and subject to commercial demand, Air Canada rouge™ may operate up to 20 Boeing 767-300ER aircraft and 30 Airbus A319 aircraft, for a total of 50 aircraft, to pursue opportunities in markets made viable by the lower operating cost structure of Air Canada rouge™.

Engaging with Customers with Particular Emphasis on Premium Passengers and Premium Products

Key achievements in 2012

In 2012, Air Canada received the following important industry awards which demonstrate its customers’ appreciation of the airline’s extensive network, alliance relationships and leading products and services, as well as their recognition of the dedication and professionalism of Air Canada’s employees in delivering its world class products and services.

- “Best In-flight Services in North America” and “Best North American Airline for International Travel” in Business Traveler’s “Best in Business Travel” award program, for a fifth consecutive year;
- “Best Flight Experience to Canada from Anywhere in the World” by readers of Executive Travel Magazine in their annual “Leading Edge Awards” readership survey of frequent international travelers, for a fifth consecutive year;
- “Best International Airline in North America” in a worldwide survey of more than 18 million air travelers conducted by independent U.K. research firm, Skytrax, for their 2012 World Airline Awards, for a third consecutive year;
- “Best Airline in North America” by Global Traveler magazine, for a fourth consecutive year; and

Air Canada was also recognized for its airport and onboard product and service improvements. The airline has become the only international network carrier in North America to receive a Four-Star ranking according to Skytrax. The much-coveted ranking is considered an airline industry benchmark and is based on detailed, independently conducted, quality analysis by Skytrax across more than 800 different areas of airport and onboard product and service delivery.

In addition, Air Canada was recognized as the preferred airline for more than 79% of frequent business travellers in Canada according to the 2012 Canadian Business Travel Survey by Ipsos Reid, which helps demonstrate that Air Canada’s efforts in promoting its premium class products and services are yielding positive results.

Increasing customer satisfaction levels and growing the airline’s premium customer base remain key elements of Air Canada’s business strategy. Air Canada recognizes that its success is dependent on consistently delivering superior value and innovative products, constantly striving to provide the highest levels of customer service, and continuing to evolve to anticipate the changing needs of customers. In 2013, Air Canada will continue to focus on understanding and anticipating customer preferences to ensure it adopts products and services appropriate to those preferences.

In 2013, Air Canada will also continue to focus on better managing its premium class cabin to maximize revenues and in seeking new opportunities to increase premium cabin revenues. Air Canada believes it maintains a revenue premium that more than offsets the higher costs associated with service to premium passengers.
Air Canada is one of the most recognized brands in Canada, and the airline plans to continue to leverage this strength to attract revenue, particularly on its international service. Air Canada's extensive and expanding global network, its modern fleet, industry-leading on-board products and services, lounges and airport facilities are among the advantages of flying Air Canada.

When surveyed, customers cite Air Canada's frequent flyer recognition program, which was renamed "Air Canada Altitude" in March 2013, as one of the key reasons they fly Air Canada. Specifically designed to recognize and reward Air Canada's most frequent flyers, Air Canada Altitude offers members a wide range of travel privileges, rewards and additional status levels, as well as recognition across Star Alliance. Improved benefits include enhanced priority travel services such as a complimentary checked baggage allowance, higher upgrade priority for higher status members, exclusive partner offers and new incentives such as tier status gifts, as well as a new dedicated website altitude.aircanada.com. Air Canada Altitude members will continue to benefit from Air Canada's partnership with the Aeroplan program, which provides a wide range of ways to earn and redeem valuable Aeroplan® Miles, including flights to over 1,200 destinations worldwide.

The "Air Canada Rewards for Small Business" program is allowing the airline to broaden its access to corporate customers and providing it with new business opportunities. Designed to bridge the gap between the average leisure traveler and occasional business traveler, and the large corporate accounts with numerous frequent flyers, the program caters to small and medium size businesses, allowing them to earn rewards and complimentary services, including discounts on Air Canada flights. The program also offers businesses the use of an exclusive online tool that manages travel expenses and tracks rewards simultaneously. Rewards can be shared among employees, in addition to the Aeroplan® Miles and Air Canada Status Miles that employees can earn by flying Air Canada. This is one example of how Air Canada is increasing its customer reach.

In May 2012, Air Canada doubled its in-flight movie programming and significantly increased its television content. In fact, Air Canada was among the world’s best airlines for in-flight entertainment, according to a list compiled by the Smarter Travel website. Frequent flyers also rate Air Canada’s lounges and its concierge service high on their list of reasons for choosing to fly Air Canada and the airline plans on building on these offerings in 2013, including with the addition of Maple Leaf Lounges and an additional concierge base in Europe.

Fostering Positive Culture Change

Air Canada believes that a healthy and dynamic corporate culture can have a significant impact on its long-term performance. The workforce's ability to respond and adapt to changing market conditions and customer expectations is a key ingredient to the airline’s continued success. Acknowledging the importance of aligning its corporate culture with its strategic plans, over the last several years, Air Canada has been seeking to foster a common sense of purpose, shared values and common goals among employees to promote the airline’s prosperity and growth. This important initiative is delivered in many forms, including through executive presentations, daily communiqués, monthly letters from senior executives, quarterly conference calls, and in many daily interactions.

While the difficult collective bargaining process in 2011 and 2012 presented challenges for the company to move culture change initiatives forward, the customer awards, referred to previously, show that Air Canada’s employees are engaged and motivated to deliver a superior customer service experience. To ensure that high levels of customer satisfaction are maintained, many of Air Canada’s training programs are being re-evaluated. In fact, Air Canada is currently implementing a three-year talent management plan which comprises several elements designed to ensure that the right talent is recruited and developed with a thorough understanding of the impact that each employee has on the quality of Air Canada’s products and services. The modular courses will focus on defining and subsequently developing key behaviors that all employees need to understand and exhibit.

In 2013, Air Canada plans to continue fostering positive changes to its culture by promoting:

- Entrepreneurship
- Engagement
- Empowerment
- Earnings for Performance
Air Canada believes that employees are more likely to embrace culture change if they take an active part in the transformation, and Air Canada will continue to encourage employee feedback and ideas as employees are often in a good position to identify improvements and changes for success.

In 2012, Air Canada celebrated its employees and its achievements throughout the past 75 years and will continue to host employee recognition events to celebrate its successes going forward.

To encourage the development of a corporate culture which is focused on transformation and performance, Air Canada has a profit sharing program in place which allows eligible employees to be recognized for their contributions and share in the financial success of the airline. In 2013, the airline will remain focused on raising employee awareness on the importance of Air Canada achieving its financial goals and will continue to promote the message that maintaining a strong financial position can provide stability and growth opportunities.

Financial Overview

Along with many airline carriers globally, Air Canada faced a number of significant challenges in 2009, including as a result of volatile fuel prices and foreign exchange, liquidity requirements and a downturn in demand for air travel. Air Canada undertook various initiatives and developed a plan to manage through the challenges brought on by the prevailing weak economic environment. These initiatives included adjusting capacity to better match passenger demand; launching a comprehensive company-wide cost transformation program (the “CTP”) to improve unit revenue and cost productivity; stabilizing its finances through a series of significant transactions; and reducing the risks associated with the expiry of its labour collective agreements in 2009 and the pension solvency deficit in its registered pension plans.

In 2010, Air Canada benefited from an improving economy and made significant progress on executing and delivering on its key priorities which allowed it to record operating income (before a net reduction of $46 million to a provision for cargo investigations) of $232 million. EBITDAR (before a net reduction of $46 million to a provision for cargo investigations) of $1,386 million in 2010 was the highest EBITDAR recorded in the airline’s history.

In 2011, operating income of $179 million decreased $53 million from 2010 while EBITDAR of $1,242 million declined $144 million from 2010 (both before a net reduction of $46 million to a provision for cargo investigations in 2010). Air Canada experienced revenue growth in 2011, driven by increased fares and fuel surcharges, however the revenue growth was more than offset by an increase in total operating expenses, the result of significantly higher jet fuel prices year-over-year. As discussed above, in 2009, Air Canada launched the CTP with the objective of achieving annualized revenue improvements and cost savings of $530 million by the end of 2011. By September 30, 2011, Air Canada had surpassed this CTP target.

In 2012, strong passenger demand, a disciplined approach to capacity management and ongoing focus on cost transformation and revenue enhancement, allowed Air Canada to record improvements in its financial performance. Adjusted Net Income of $53 million improved $175 million from 2011. EBITDAR, excluding the impact of benefit plan amendments, amounted to $1,327 million, an increase of $85 million from 2011. EBITDAR (including the impact of benefit plan amendments) of $1,451 million was $209 million higher than in 2011. Operating income of $437 million reflected an increase of $258 million from 2011. On a GAAP basis, net income amounted to $131 million compared to a net loss of $249 million in 2011, an improvement of $380 million.
The table below sets forth certain of Air Canada’s financial results for the years ended December 31, 2012 and December 31, 2011:

<table>
<thead>
<tr>
<th>(Canadian dollars in millions)</th>
<th>Year ended December 31, 2012</th>
<th>Year ended December 31, 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Passenger revenue</td>
<td>$ 10,737</td>
<td>$ 10,208</td>
</tr>
<tr>
<td>Cargo revenue</td>
<td>488</td>
<td>481</td>
</tr>
<tr>
<td>Other revenue (1)</td>
<td>895</td>
<td>923</td>
</tr>
<tr>
<td>Total operating revenues</td>
<td>12,120</td>
<td>11,612</td>
</tr>
<tr>
<td>Total operating expenses (2)</td>
<td>11,683</td>
<td>11,433</td>
</tr>
<tr>
<td>Operating income</td>
<td>437</td>
<td>179</td>
</tr>
<tr>
<td>Non-operating expense (3)</td>
<td>(250)</td>
<td>(429)</td>
</tr>
<tr>
<td>Income (loss) before income taxes and discontinued operations</td>
<td>187</td>
<td>(250)</td>
</tr>
<tr>
<td>Income taxes</td>
<td>(1)</td>
<td>1</td>
</tr>
<tr>
<td>Net income (loss) from continuing operations</td>
<td>186</td>
<td>(249)</td>
</tr>
<tr>
<td>Net loss from discontinued operations – Aveos (3)</td>
<td>(55)</td>
<td>-</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>$ 131</td>
<td>$ (249)</td>
</tr>
</tbody>
</table>

(1) Other revenues consist primarily of revenues from the sale of the ground portion of vacation packages, ground handling services and other airline-related services, as well as revenues related to the lease or sublease of aircraft to third parties.

(2) In the third quarter of 2012, Air Canada recorded an operating expense reduction of $124 million related to changes to the terms of the ACPA collective agreement pertaining to retirement age.

(3) In the first quarter of 2012, Air Canada recorded a loss on its investment in Aveos’ parent holding company as a result of Aveos’ filing for court protection pursuant to the CCAA and ceasing operations in March 2012. As a result, Air Canada reduced the carrying value of its investment in Aveos’ parent holding company as well as the carrying value of a long term note receivable from Aveos to nil, and recorded an aggregate loss on investments of $65 million in Non-operating expense. Air Canada also recorded a liability of $55 million, which was charged to Discontinued operations, related to Air Canada’s commitment under an employee separation program.

The table below sets forth the proportions of passenger revenues derived from domestic, transborder and international services of Air Canada for the years ended December 31, 2012 and December 31, 2011:

<table>
<thead>
<tr>
<th>(Passenger revenues, in percent)</th>
<th>Year ended December 31, 2012</th>
<th>Year ended December 31, 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic</td>
<td>39</td>
<td>39</td>
</tr>
<tr>
<td>Transborder</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>International</td>
<td>41</td>
<td>41</td>
</tr>
<tr>
<td>Total</td>
<td>100 %</td>
<td>100 %</td>
</tr>
</tbody>
</table>

For additional information on Air Canada’s financial results for 2012, refer to Air Canada’s consolidated financial statements for the year ended December 31, 2012, and Air Canada’s 2012 MD&A dated February 7, 2013, both of which are available on Air Canada’s website at aircanada.com or on SEDAR at www.sedar.com.

Refer to section 20 “Non-GAAP Financial Measures” of Air Canada’s 2012 MD&A dated February 7, 2013, which can be found on Air Canada’s website at aircanada.com or on SEDAR at www.sedar.com and which section is hereby incorporated by reference in this AIF, for a reconciliation of Adjusted Net Income (loss), and for a reconciliation of EBITDAR and EBITDAR, excluding the impact of benefit plan amendments, to operating income (loss).
Liquidity Risks

Liquidity needs are primarily related to meeting obligations associated with financial liabilities, capital commitments, ongoing operations, contractual and other obligations (including pension funding obligations), covenants in credit card and other agreements. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements.

Air Canada's principal objective in managing liquidity risk is to maintain a minimum unrestricted cash balance in excess of 15% of 12-month trailing operating revenues. As of December 31, 2012, cash, cash equivalents and short-term investments amounted to $2,026 million or 17% of annual operating revenues ($2,099 million or 18% of annual operating revenues as of December 31, 2011).

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

Significant Financing Transactions

Air Canada entered into the following significant transactions in the years 2010 through to 2012:

- In early 2010, Air Canada entered into arrangements with a new lender, comprised of a group of entities that are related to each other, to obtain a $100 million increase to the $600 million credit facility (the "Credit Facility") that Air Canada concluded in 2009. As noted below, this Credit Facility was repaid in full in 2010.

- In 2010, Air Canada completed a private offering of two series of senior secured notes, consisting of US$600 million senior secured first lien notes due 2015 (the "U.S. Dollar First Lien Notes") and $300 million senior secured first lien notes due 2015 (the "Canadian Dollar First Lien Notes" and, collectively with the U.S. Dollar First Lien Notes, the "First Lien Notes"). On August 3, 2010, Air Canada also completed a private offering of US$200 million senior secured second lien notes due 2016 (the "Second Lien Notes" and, together with the First Lien Notes, the "Notes"). Air Canada received net proceeds of $1,075 million after deduction of fees, expenses and discounts.

- In 2010, Air Canada used approximately $729 million of the net proceeds of the offerings to repay all of the outstanding debt under an existing credit facility, including $29 million for early payment fees.

- In 2010, Air Canada concluded a credit agreement with GE Japan Corporation, PK Airfinance Japan ("GE Japan") for a senior secured term loan facility in the amount of up to approximately US$171 million to refinance amounts due in 2011 and 2012 related to 16 aircraft currently operated by Air Canada and leased from special purpose leasing entities which are consolidated by Air Canada. In 2011, Air Canada received net financing proceeds of $125 million (US$128 million), after financing fees of $2 million, through draws on a secured term loan facility (the "Facility"). The draws on the Facility were utilized to refinance amounts related to eight Airbus A319 aircraft and four Boeing 767-300ER aircraft with refinanced terms of seven and four years, respectively. In early 2012, Air Canada drew upon the final amounts available of US$42 million to refinance four Airbus A319 aircraft, with refinanced terms of five years.

- In 2011, Air Canada entered into a revolving loan facility consisting of a Canadian dollar denominated revolving facility in the amount of $50 million and a U.S. dollar denominated revolving facility in the amount of $100 million. The agreement expires on January 31, 2015. As at December 31, 2012, an amount of approximately $103 million ($26 million and U.S. $77 million) was drawn under the facility.

- In 2012, the repayment date of a short-term loan of $78 million (US$75 million) entered into in 2008 was extended to March 2015.
Covenants in Credit Card Agreements

Air Canada has various agreements with companies that process customer credit card transactions. Approximately 85% of Air Canada’s sales are processed using credit cards, with remaining sales processed through cash based transactions. Air Canada receives payment for a credit card sale generally in advance of when the passenger transportation is provided.

In 2012, Air Canada transitioned its principal credit card processing agreements for credit card processing services in North America to a new service provider. The terms of the new agreements are for five years each and the agreements contain triggering events upon which Air Canada is required to provide the credit card processor with cash deposits. The obligation to provide cash deposits and the required amount of deposits are each based upon a matrix measuring, on a quarterly basis, both a fixed charge coverage ratio for Air Canada and the unrestricted cash and short-term investments of Air Canada. Air Canada made no cash deposits under these agreements in 2012.

Air Canada also has agreements with another processor for the provision of certain credit card processing services requirements for markets other than North America and for its cargo operations worldwide where such agreements contain deposit obligations similar to the obligations set forth above.

Refer to the section entitled “Risk Factors” of this AIF for additional information.

Ratings

This section describes the ratings that certain rating agencies have attributed to Air Canada and its Notes. These ratings provide investors with an independent view of credit quality. However, they are not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the rating organization. Each rating should be evaluated independently of any other credit rating.

Air Canada’s corporate credit and Air Canada’s Notes are rated (as of the dates indicated below) by the following rating agencies:

- Standard & Poor’s Rating Services (“Standard & Poor’s”);
- Moody’s Investors Service, Inc. (“Moody’s”); and
- DBRS Limited (“DBRS”).

Standard & Poor’s Ratings

On October 18, 2012, Standard & Poor’s assigned its long-term corporate credit rating on Air Canada as “B-” with a negative outlook. The rating was stated as reflecting Standard & Poor’s assessment that Air Canada has a highly-leveraged financial risk profile characterized by its substantial debt and lease burden; still-high adjusted debt to EBITDA and correspondingly weak cash flow protection measures; weak history of profitability; and modest (and highly volatile) cash flow to cover relatively high fixed costs. Standard & Poor’s stated that tempering factors included Air Canada’s strong market position in Canada as the provider of commercial airline services; broad route network; good brand recognition; industry-leading yields driven in part by Air Canada’s tiered-pricing model; medium-term opportunity to expand into profitable international and U.S. transborder markets; a desire to address the high cost structure to improve its competitiveness and Standard & Poor’s view that Air Canada’s liquidity was considered adequate as per their definitions.

Rating of Notes:

On October 18, 2012, Standard & Poor’s also assigned the following ratings in respect of Air Canada’s Notes:

- Corporate Credit Rating: B- with Negative Outlook (rank 16 out of 22).
- First Lien Notes: B+ (rank 14 out of 22),
- Recovery Rating: 1 (rank 2 out of 7), indicating a very high (90-100%) recovery in a default scenario.
Second Lien Notes: B- (rank 16 out of 22)

Recovery Rating: 4 (rank 5 out of 7), indicating an average (30-50%) recovery in a default scenario.

Standard & Poor’s long-term debt credit rating scale provides its assessment of the creditworthiness of a company in meeting a specific financial obligation, a specific class of financial obligations, or a specific financial program. It takes into consideration Standard & Poor’s view of the likelihood of payment, i.e. capacity and willingness of the company in meeting its financial commitment on an obligation according to the terms of the obligation, among other factors.

Moody’s Ratings

On April 3, 2012, Moody’s lowered Air Canada’s corporate family rating and probability of default ratings to Caa1 from B3 (rank 17 out of 21), its First Lien Notes senior secured rating to B2 from B1 (15 out of 21) and its Second Lien Notes senior secured rating to Caa2 from Caa1 (18 out of 21). Moody’s affirmed Air Canada’s speculative grade liquidity rating at SGL-2 (rank 2 out of 4), stating that this was indicative of good liquidity. Moody’s stated that Air Canada’s rating outlook was stable. Moody’s also stated that it had lowered Air Canada’s ratings because of its expectation that Air Canada’s adjusted leverage will remain in excess of eight times EBITDA through at least 2012, higher than Moody’s had previously expected. Moody’s also stated its concern with Air Canada’s ability to absorb higher capital expenditures for new aircraft and additional funding requirements for pension shortfalls beginning in 2014.

DBRS Ratings

Corporate Rating:

Corporate Family Rating: B (rank 15 out of 26)

On November 14, 2012, DBRS reaffirmed Air Canada’s Issuer Rating of “B” with a stable trend. DBRS stated that the rating reflects its view of Air Canada’s high business risk, operating in the very competitive and volatile global airline industry; its leveraged balance sheet; its high cost structure; and its relatively weak debt coverage ratios. DBRS stated it believes Air Canada’s overall business risk profile is near the industry average. DBRS also stated that it views Air Canada as having a strong position in the markets where it competes and is the largest airline in Canada.

The DBRS long-term debt rating scale provides DBRS’ opinion on the risk of default. That is, the risk that an issuer will fail to satisfy its financial obligations in accordance with the terms under which an obligation has been issued. Ratings are based on quantitative and qualitative considerations relevant to the borrowing entity.

Customary payments were made to credit rating organizations for the provision of rating services in respect of the Corporation’s ratings and in respect of the ratings for the First and Second Lien Notes.

Pension Plan Arrangements

Air Canada maintains several pension plans, including defined benefit and defined contribution pension plans and plans providing other retirement and post-employment benefits to its employees. Based on preliminary estimates as at January 1, 2013, the aggregate solvency deficit in Air Canada’s domestic registered pension plans is estimated to be $3.7 billion, whereas the aggregate solvency deficit in the domestic registered pension plans, as at January 1, 2012, was $4.2 billion. This estimated decrease to the aggregate solvency deficit of approximately $500 million versus the valuation as at January 1, 2012 was mainly due to a 14.0% return on plan assets (which was in excess of assumed returns) and to past service payments made in 2012, partly offset by a decrease of 0.3% in the solvency discount rate used in the calculation of the solvency liabilities (discount rate of 3.0% at January 1, 2013 versus 3.3% at January 1, 2012). The valuations to determine the actual solvency deficit as of January 1, 2013 will be completed in the first half of 2013, but as described below, they will not increase the 2013 pension past service cost funding obligations. For illustrative purposes only, based on the actuarial valuations as of January 1, 2012, an increase in the discount rate of 1% would result in a decrease of $1,840 million to the pension solvency liability, and a decrease in the discount rate of 1% would result in an increase of $2,348 million to the pension solvency liability.
In July 2009, the Government of Canada adopted the Air Canada 2009 Pension Regulations. The Air Canada 2009 Pension Regulations relieved Air Canada from making any past service contributions (i.e. special payments to amortize the plan solvency deficits) to its ten domestic defined benefit registered pension plans in respect of the period beginning April 1, 2009, and ending December 31, 2010. Thereafter, in respect of the period from January 1, 2011 to December 31, 2013, the aggregate annual past service contribution is the lesser of (i) $150 million, $175 million, and $225 million in 2011, 2012, and 2013, respectively, on an accrued basis, and (ii) the maximum past service contribution permitted under the Income Tax Act (Canada) and the regulations thereunder, as amended (the “Tax Act”). Current service contributions continue to be made in the normal course while the Air Canada 2009 Pension Regulations are in effect.

The Air Canada 2009 Pension Regulations were adopted during the third quarter of 2009 in coordination with the Pension MOUs. Pursuant to the Pension MOUs, on October 26, 2009, Air Canada issued to a trust, 17,647,059 Class B voting shares. This number of shares represented 15% of the shares of Air Canada issued and outstanding as at the date of the Pension MOUs and the date of issuance (in both cases after taking into account such issuance). All net proceeds of sale of such shares by the trust are to be contributed to the pension plans. For so long as the trust continues to hold at least 2% of the issued and outstanding shares of Air Canada, the trustee will have the right to designate one nominee (who shall not be a member or officer of any of Air Canada’s Canadian-based unions) to Air Canada’s board of directors, subject to completion of Air Canada’s usual governance process for selection and confirmation of director nominees. On February 9, 2010, Air Canada’s Board of Directors approved the appointment of the Honourable Roy Romanow to the Air Canada Board of Directors, following his nomination by Air Canada’s Canadian-based unions pursuant to the Pension MOUs.

After accounting for the effect of the Air Canada 2009 Pension Regulations, as outlined above, total employer pension funding contributions in 2012 amounted to $433 million.

<table>
<thead>
<tr>
<th>(Canadian dollars in millions)</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Past service domestic registered plans</td>
<td>173</td>
<td>138</td>
</tr>
<tr>
<td>Current service domestic registered plans</td>
<td>169</td>
<td>171</td>
</tr>
<tr>
<td>Other pension arrangements(1)</td>
<td>91</td>
<td>76</td>
</tr>
<tr>
<td><strong>Pension funding obligations</strong></td>
<td><strong>433</strong></td>
<td><strong>385</strong></td>
</tr>
</tbody>
</table>

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

Pension funding obligations are generally dependent on a number of factors, including the assumptions used in the most recently filed actuarial valuation reports for current service (including the applicable discount rate used or assumed in the actuarial valuation), the plan demographics at the valuation date, the existing plan provisions, existing pension legislation and changes in economic conditions (mainly the return on fund assets and changes in interest rates). Actual contributions that are determined on the basis of future valuation reports filed annually may vary significantly from projections. In addition to changes in plan demographics and experience, actuarial assumptions and methods may be changed from one valuation to the next, including due to changes in plan experience, financial markets, future expectations, and changes in legislation and other factors. Until the end of 2013, Air Canada’s past service pension funding obligations are limited by the Air Canada 2009 Pension Regulations.

As of 2014, the Air Canada 2009 Pension Regulations will cease to have effect. However, as announced on March 12, 2013, Air Canada and the Government of Canada have agreed to an extension of Air Canada’s pension funding arrangements to January 30, 2021.

According to the agreement reached with the Government of Canada, the Minister of Finance will propose new regulations under the Pension Benefits Standards Act in respect of special payments under Air Canada’s defined benefit plans applicable to the period between 2014 to 2020 inclusive, expiring January 30, 2021. According to the terms of the agreement, subject to the maximum past service contribution permitted under the Income Tax Act for the plan year, Air Canada will be required to make payments of at least $150 million annually with an average of $200 million per year over seven years, to contribute an aggregate minimum of $1.4 billion in solvency deficit payments, in addition to its pension current service payments.
Under the agreement, during the time the regulations are in force, Air Canada will be subject to a series of covenants and undertakings, including a prohibition on dividends and share repurchases, as well as certain limitations on executive compensation arrangements. As requested by the Government of Canada, Air Canada has also agreed to use reasonable efforts, during the negotiations of the next collective agreements with Air Canada’s Canadian-based unions, to seek to include in those collective agreements provisions which would have employees contribute fifty per cent of their pension plan normal costs, and has agreed not to implement pension plan benefit improvements without regulatory approval. The agreement permits Air Canada to elect to opt out of the regulations and have special payments for that plan year, in respect of all Air Canada pension plans, collectively, determined in accordance with the normal funding rules.

Air Canada’s Canadian-based unions had previously provided approval or support for Air Canada’s extension request and the arrangements are subject to successfully concluding a consultation process with Air Canada management and retiree beneficiaries. The new funding arrangements will become effective upon the execution of formal documentation and the subsequent adoption of new regulations under the Pension Benefits Standards Act, subject to Governor in Council approval.

Absent the adoption and implementation of the agreement upon expiry of the Air Canada 2009 Pension Regulations, under generally applicable regulations, Air Canada’s pension funding obligations would be determined by a wide variety of factors, including those described above as well as the application of normal past service contribution rules which would generally require one fifth of any solvency deficit, determined on the basis of an average over the previous three years, to be funded each year in addition to required current service contributions.

Air Canada’s projected pension funding obligations, on a cash basis, for 2013, are provided in the table below.

<table>
<thead>
<tr>
<th>(Canadian dollars in millions)</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Past service domestic registered plans</td>
<td>221</td>
</tr>
<tr>
<td>Current service domestic registered plans</td>
<td>170</td>
</tr>
<tr>
<td>Other pension arrangements(^{(1)})</td>
<td>80</td>
</tr>
<tr>
<td><strong>Projected pension funding obligations</strong></td>
<td><strong>471</strong></td>
</tr>
</tbody>
</table>

\(^{(1)}\) Includes retirement compensation arrangements, supplemental plans and international plans.

**Arrangements with Unions and Amendments to the Defined Benefit Pension Plans**

Most of Air Canada’s employees are unionized. In 2011, collective agreements were concluded and ratified and/or conclusively settled through arbitration with the CAW and with CUPE. The agreements include amendments to the defined benefit pension plans for CAW and CUPE represented plan members, which are subject to regulatory approval. In addition, a hybrid pension regime consisting of defined contribution and defined benefit components applies to new employees represented by the CAW and CUPE, hired after the date of ratification, for CAW, and the coming into force, for CUPE, of the new agreements.

As described below, collective agreements obtained through arbitration with the International Association of Machinists and Aerospace Workers ("IAMAW") and ACPA, and collective agreements concluded with the CAW in respect of crew schedulers and with the Canadian Airline Dispatchers Association ("CALDA") in 2012 also include amendments to the defined benefit pension plans for represented plan members. Based on the actuarial valuations of January 1, 2012, Air Canada has estimated that these changes, along with similar changes to management and other non-unionized employee pension plans, in the aggregate, would result in a decline of approximately $1.1 billion to the solvency deficit in its domestic registered pension plans, had these amendments been implemented on January 1, 2012. Such amendments, which remain subject to regulatory approval by OSFI, would take effect on January 1, 2014.

In June 2012, Air Canada and IAMAW received the decision of the arbitrator in the final offer selection arbitration conducted in accordance with the process legislated by the Government of Canada in the Protecting Air Service Act. The arbitrator’s final offer selection concludes a new five-year collective agreement with the IAMAW which is in effect until March 31, 2016. The new collective agreement preserves the defined benefit pension plans for current employees and introduces a new IAMAW multi-employer pension plan to which, subject to certain conditions, Air Canada will become a
party for new employees hired after the date of the decision. The collective agreement also includes amendments to the defined benefit pension plans of current IAMAW members which are subject to regulatory approval by OSFI.

On July 30, 2012, Air Canada and ACPA received the decision of the arbitrator in the final offer selection arbitration conducted in accordance with the Protecting Air Service Act. The arbitrator’s final offer selection concludes a new five-year collective agreement with ACPA which is in effect until April 1, 2016. This new collective agreement preserves defined benefit pension plans for current employees and introduces a defined contribution pension plan for new employees hired after July 30, 2012. As disclosed above, the collective agreement also includes amendments to the defined benefit pension plans of current ACPA members which are subject to regulatory approval by OSFI. In addition, the new ACPA collective agreement contemplates pilots working past age 60, which was the age of mandatory retirement in the previous collective agreement.

The new collective agreements concluded in 2012 in respect of CAW-represented crew schedulers and CALDA members also include amendments to the defined benefit pension plans of crew schedulers and CALDA members which are subject to regulatory approval. In addition, a hybrid pension regime consisting of a defined contribution and a defined benefit plan applies to new crew schedulers employees hired after the date of ratification of the new agreements. For CALDA employees, the new pension arrangement for new hires is a defined contribution plan.

In June 2012, Air Canada also concluded an agreement with Aimia Canada Inc. (formerly Aeroplan Canada Inc.) through which Air Canada will transfer to the Aeroplan defined benefit pension plan all the pension plan assets and obligations related to pension benefits accrued by CAW-represented employees who were Air Canada employees and who chose to transition to employment at Aeroplan in 2009. The transfer is subject to the approval of OSFI but the 2012 actuarial valuations assume that the transfer has been made. Based on the most recent actuarial valuation report, the solvency deficit and related compensation for transferred employees is not material.

Pension and Benefits Agreement with Aveos

On June 22, 2007, Air Canada and Aveos entered into a Pension and Benefits Agreement covering the transfer of certain pension and benefit assets and obligations to Aveos. On July 14, 2011, certain unionized employees of Air Canada elected to become employees of Aveos. The Pension and Benefits Agreement provided that, subject to regulatory approval by OSFI, where required, the assets and obligations under the pension, other post-retirement and post-employment benefits plans pertaining to the transferred unionized employees would be transferred to Aveos, with Air Canada providing compensation payments to be paid quarterly to Aveos over a period not exceeding five years once determined after the transfer. In 2012, OSFI ordered the termination of Aveos’ defined benefit pension plans and, as a result, the assets and liabilities, accruing prior to July 14, 2011 in respect of transferred employees will remain under Air Canada’s pension plans. In addition, obligations under the other post-retirement and post-employment benefits plans pertaining to the transferred unionized employees, for accounting purposes, continue to be included in Air Canada’s consolidated financial statements but their final determination may be subject to Aveos’ CCAA proceedings.

Air Canada’s Environmental Objectives

Air Canada is mindful of the impact that its use of energy and natural resources has on the environment. To minimize the generation of waste as well as the emission of carbon dioxide and other greenhouse gases, Air Canada has developed an environmental management system based on principles of the International Organization for Standardization standard ISO 14000. Providing a continual cycle of planning, implementation and review, Air Canada’s environmental management system is designed to ensure continuous improvement in its efforts towards meeting its environmental objectives.

Air Canada’s main environmental objectives are as follows:

- Optimize energy consumption and minimize emissions resulting from air and ground operations including aircraft maintenance;
- Ensure efficient use of resources, minimize waste generation and effectively manage waste disposal;
- Minimize noise from aircraft operations;
Seek opportunities to include in the supply chain suppliers that demonstrate a respect for the environment; and

Promote sound environmental management policies and practices throughout the Corporation.

Air Canada measures and discloses its greenhouse gas emissions and climate change strategies through annual reporting to the Carbon Disclosure Project ("CDP"). The CDP is an organization based in the United Kingdom which works with shareholders and corporations to disclose the greenhouse gas emissions of major corporations. Air Canada is also monitoring its CO2 emissions for flights to and from EU destinations in accordance with the EU ETS. Although the EU ETS compliance requirement to report on 2012 emissions has been suspended, Air Canada will continue to monitor its emissions generated in 2013 for flights to and from EU destinations.

Routes and Schedules

Air Canada

In 2012, Air Canada and its Contracted Carriers, operated, on average, 1,520 scheduled daily departures to 59 destinations in Canada, 55 destinations in the U.S. and 64 destinations in the Canada-Europe, Canada-Pacific, Canada-Caribbean/Central America and Canada-South America markets. Domestic, U.S. transborder and international departures accounted for approximately 66%, 26% and 8%, respectively, of the approximately 1,520 average daily departures. In addition, Air Canada provides certain passenger charter services under the brand name "AC Jetz".

In 2012, Air Canada, together with its Contracted Carriers, carried close to 35 million revenue passengers and provided passenger service to 178 direct destinations on five continents.

Air Canada's hubs are located in Toronto, Vancouver, Montreal and Calgary, each of which provides extensive access to domestic, transborder and the international markets. Toronto Pearson Airport is the largest hub in Canada and a significant airline origin and destination market in North America. Vancouver International Airport is the second largest hub in Canada and is Air Canada's gateway to the Pacific Rim. Montreal Trudeau Airport is the third most important hub in Air Canada's network and Calgary International Airport is Air Canada's fourth largest hub. For the year ended December 31, 2012, Air Canada, together with its Contracted Carriers, operated, on average:

- 331 daily departures from Toronto;
- 145 daily departures from Vancouver;
- 139 daily departures from Montreal, and
- 108 daily departures from Calgary.

Domestic Services

In 2012, Air Canada, together with its Contracted Carriers, provided the largest network and most extensive product offering in Canada, with scheduled direct passenger service to 59 Canadian destinations. The most important Canadian routes, in terms of operating revenues, are the transcontinental routes linking Toronto, Montreal and Ottawa with major western Canadian cities, including Vancouver, Calgary, Edmonton and Winnipeg. On a combined basis, Air Canada, together with its Contracted Carriers, operate a large number of short-haul routes, including Rapidair® routes, linking Toronto, Montreal and Ottawa. Air Canada, together with its Contracted Carriers, also offer frequent service linking major centres within western Canada, and operates numerous flights between Calgary, Edmonton and Vancouver. In addition to transcontinental and commuter routes, Air Canada, together with its Contracted Carriers, provide service between and within Central Canada, the Prairies and the Atlantic provinces.

In October 2012, Air Canada announced it was increasing capacity on regional routes across western Canada in the fall 2012 and the winter of 2013 to meet demand and that it would gradually be introducing Q400 aircraft operated by Jazz under the Air Canada Express banner on key markets beginning in 2013. In early February 2013, the airline announced that Q400 service had begun between Calgary and Fort McMurray, Calgary and Regina and between Calgary and Saskatoon. Air
Canada also announced it would continue to roll out Q400 aircraft on additional routes to British Columbia, Alberta and the Northwest Territories in the coming months and, in response to strong demand, it was also increasing capacity on key regional routes in Western Canada in the spring and summer of 2013 either through the use of larger aircraft or with additional frequencies.

Transborder Services

With the most non-stop destinations and flights from Canada to the United States, Air Canada, together with its Contracted Carriers, carry more passengers between Canada and the United States than any other airline. Air Canada, together with its Contracted Carriers, directly served 55 U.S. destinations in 2012. Air Canada’s network reach is also enhanced through its extensive connections to, and code sharing flights with United Airlines, its Star Alliance™ partner.

International Services

Air Canada is well positioned as Canada’s largest scheduled international airline. In 2012, Air Canada provided scheduled service directly to 64 destinations in Europe, the Middle East, Asia, Australia, the Caribbean, and Central and South America.

Air Canada offers transatlantic services to the United Kingdom, Germany, France, Switzerland, Israel, Ireland, Italy, Spain, Belgium, Denmark and Greece. Air Canada plans to introduce service to Istanbul, Turkey, on June 4, 2013.

Air Canada also offers services to the Asia-Pacific market via its Vancouver, Calgary and Toronto hubs. Air Canada operates non-stop flights to Japan (Vancouver, Calgary and Toronto to Tokyo), China (Vancouver and Toronto to Beijing, Shanghai and Hong Kong) and Korea (Vancouver to Seoul).

Air Canada has also expanded its services to South America, Australia and Central America/Caribbean. Air Canada currently provides service directly to six destinations in South America, one in Australia, nine in Central America and 29 in the Caribbean.

Jazz

Jazz is an integral part of Air Canada’s North American strategy. Jazz operates both domestic and transborder services for Air Canada under the Jazz CPA. Jazz operates scheduled passenger service on behalf of Air Canada with approximately 755 departures per day to 56 destinations in Canada and 28 destinations in the United States as at December 31, 2012. Approximately 40% of Jazz’s traffic connects to Air Canada’s mainline network. In 2012, Jazz contributed approximately 19% of Air Canada’s consolidated domestic ASM capacity and approximately 17% of Air Canada’s consolidated transborder ASM capacity.

Sky Regional

Sky Regional operates 15 daily non-stop return flights between downtown Toronto and Montreal Trudeau Airport for Air Canada under a capacity purchase agreement.

As of the date of this AIF, in 2013, Air Canada has transferred two of 15 Embraer 175 aircraft from its mainline fleet to Sky Regional who will operate these aircraft on Air Canada’s behalf under an amended capacity purchase agreement. Subject to certain conditions, an additional 13 Embraer 175 aircraft are expected to be transferred to Sky Regional in the course of 2013. These aircraft will continue flying on U.S. short-haul routes, primarily from Toronto and Montreal to destinations in the Northeast U.S.
Aircraft Fleet

The following table provides the number of aircraft in Air Canada’s operating fleet as at December 31, 2012, and December 31, 2011, as well as Air Canada’s expected operating fleet, including aircraft operated by Air Canada rouge™, as at December 31, 2013, 2014 and 2015.

<table>
<thead>
<tr>
<th></th>
<th>Actual (As at December 31, 2012)</th>
<th>Planned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boeing 787</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Boeing 777-300</td>
<td>12</td>
<td>-</td>
</tr>
<tr>
<td>Boeing 777-200</td>
<td>6</td>
<td>-</td>
</tr>
<tr>
<td>Boeing 767-300</td>
<td>30</td>
<td>-</td>
</tr>
<tr>
<td>Airbus A330-300</td>
<td>8</td>
<td>-</td>
</tr>
<tr>
<td>Airbus A321</td>
<td>10</td>
<td>-</td>
</tr>
<tr>
<td>Airbus A320</td>
<td>41</td>
<td>-</td>
</tr>
<tr>
<td>Airbus A319</td>
<td>38</td>
<td>-</td>
</tr>
<tr>
<td>EMBRAER 190</td>
<td>45</td>
<td>-</td>
</tr>
<tr>
<td>EMBRAER 175</td>
<td>15</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Mainline</strong></td>
<td>205</td>
<td>-</td>
</tr>
<tr>
<td><strong>Air Canada rouge™</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Boeing 767-300</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Airbus A319</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Air Canada rouge™</strong></td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Mainline and Air Canada rouge™</strong></td>
<td>205</td>
<td>-</td>
</tr>
</tbody>
</table>

On October 1, 2012 Air Canada announced the planned addition of two new Boeing 777-300ER aircraft, scheduled to be delivered in June and August 2013, respectively, in order to pursue strategic growth opportunities for its international network. Air Canada also plans on operating three additional Boeing 777 aircraft for which it has outstanding firm commitments. These three aircraft are scheduled to be delivered in November and December 2013 and February 2014, respectively.

In late 2012, Air Canada unveiled plans for a new leisure airline operating under the brand name Air Canada rouge™. The Air Canada rouge™ fleet will initially be comprised of two Boeing 767-300ER aircraft to operate transatlantic flights in a two-cabin configuration offering a selection of rouge™ seats, rouge™ Plus seats with additional legroom, and Premium rouge™ seats featuring additional seating comfort, space and enhanced meal and beverage service; and two Airbus A319 aircraft to operate North American flights in an all-economy configuration offering a selection of rouge™ seats and rouge Plus™ seats with additional legroom. Prior to the end of 2013, Air Canada plans to transfer an additional six Airbus A319
a total of eight Airbus A319 aircraft, from its mainline fleet to Air Canada rouge™. Air Canada rouge™ will expand to other leisure destinations as Air Canada starts to take delivery of new Boeing 787 Dreamliner aircraft, which is scheduled to commence in 2014, thereby freeing up aircraft for transfer to the Air Canada rouge™ fleet. As this occurs, and also subject to commercial demand and other factors, Air Canada rouge™ may operate up to 20 Boeing 767-300ER aircraft and 30 Airbus A319 aircraft, for a total of 50 aircraft, to pursue opportunities in markets made viable by the lower operating cost structure of Air Canada rouge™.

The average age of Air Canada’s operating fleet (excluding aircraft operated by Jazz and by other airlines operating flights on behalf of Air Canada) was 12.6 years at December 31, 2012.

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

<table>
<thead>
<tr>
<th></th>
<th>Jazz</th>
<th>Sky Regional</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>CRJ-100</td>
<td>8</td>
<td>–</td>
<td>–</td>
<td>8</td>
</tr>
<tr>
<td>CRJ-200</td>
<td>25</td>
<td>–</td>
<td>–</td>
<td>25</td>
</tr>
<tr>
<td>CRJ-705</td>
<td>16</td>
<td>–</td>
<td>–</td>
<td>16</td>
</tr>
<tr>
<td>Dash 8-100</td>
<td>34</td>
<td>–</td>
<td>–</td>
<td>34</td>
</tr>
<tr>
<td>Dash 8-300</td>
<td>26</td>
<td>–</td>
<td>–</td>
<td>26</td>
</tr>
<tr>
<td>Dash 8-400</td>
<td>15</td>
<td>5</td>
<td>–</td>
<td>20</td>
</tr>
<tr>
<td>Beech 1900</td>
<td>–</td>
<td>–</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>124</td>
<td>5</td>
<td>17</td>
<td>146</td>
</tr>
</tbody>
</table>

The following table provides the planned number of aircraft, as at December 31, 2013, which will be operated by Jazz and by other airlines operating flights on behalf of Air Canada under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada.

<table>
<thead>
<tr>
<th></th>
<th>Jazz</th>
<th>Sky Regional</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>EMBRAER 175</td>
<td>–</td>
<td>15</td>
<td>–</td>
<td>15</td>
</tr>
<tr>
<td>CRJ-200</td>
<td>25</td>
<td>–</td>
<td>–</td>
<td>25</td>
</tr>
<tr>
<td>CRJ-705</td>
<td>16</td>
<td>–</td>
<td>–</td>
<td>16</td>
</tr>
<tr>
<td>Dash 8-100</td>
<td>34</td>
<td>–</td>
<td>–</td>
<td>34</td>
</tr>
<tr>
<td>Dash 8-300</td>
<td>26</td>
<td>–</td>
<td>–</td>
<td>26</td>
</tr>
<tr>
<td>Dash 8-400</td>
<td>21</td>
<td>5</td>
<td>–</td>
<td>26</td>
</tr>
<tr>
<td>Beech 1900</td>
<td>–</td>
<td>–</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>122</td>
<td>20</td>
<td>17</td>
<td>159</td>
</tr>
</tbody>
</table>

The table above also reflects the transfer of 15 Embraer aircraft from the mainline fleet to Sky Regional which, subject to certain conditions, is expected to be completed in 2013. As of the date of this AIF, in 2013, two of the 15 Embraer aircraft have been transferred to Sky Regional. Subject to certain conditions, the remaining 13 Embraer aircraft are expected to be transferred to Sky Regional in the course of 2013.
On July 12, 2012, Chorus Aviation Inc. ("Chorus") announced that it had exercised six of 15 options it held to acquire additional Dash 8-400 ("Q400") aircraft to be operated by its subsidiary, Jazz, under the Air Canada Express banner. Chorus announced that the six optioned 74-seat Q400 aircraft are contracted to be delivered at a rate of two per month in February, March and April 2013, and will be placed in operation the subsequent month. At that time, Chorus also announced that a total of nine 50-seat CRJ-100 aircraft would be removed from the Jazz fleet, one of which was removed in December 2012 with the remaining eight planned for removal by May 2013. As a result, as of May 2013, the number of covered aircraft under the Jazz CPA will be reduced to 122 aircraft, with the overall seating capacity, operated under the Jazz CPA, being held relatively constant.

Widebody Aircraft Fleet

As at December 31, 2012, Air Canada's operating widebody fleet was comprised of 56 aircraft, each configured in two classes of service: Executive First or Executive Class, and Economy Class. The Airbus A330-300 aircraft is a 265-seat aircraft twin-engine aircraft that Air Canada operates mainly on transatlantic routes. The Boeing 777-300ER aircraft is a 349-seat twin-engine aircraft used mainly on international routes. The Boeing 777-200LR aircraft is a long-range 270-seat twin-engine aircraft used mainly on international routes. The Boeing 767-300ER aircraft is a long-range 191-213-seat aircraft used mainly on international routes.

The two Boeing 767-300ER in the Air Canada rouge™ fleet will have a two-cabin configuration offering a selection of rouge™ seats, rouge Plus™ seats and Premium rouge™ seats.

Boeing Orders and Financing Terms

Air Canada has outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of 37 Boeing 787 aircraft. The first seven deliveries are scheduled for 2014 and the remaining 30 between 2015 and 2019. Air Canada also has purchase options for 13 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on previously determined pricing and delivery position), and purchase rights for 10 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on Boeing’s then current pricing).

Air Canada has financing commitments from Boeing and the engine manufacturer covering 31 of the 37 Boeing 787 firm aircraft orders. The financing terms for 28 out of the 31 covered aircraft is for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments. For the remaining three out of the 31 covered aircraft, the financing under the commitment covers up to 90% of the capital expenditure and the term to maturity is 15 years with principal payments made on a mortgage style basis resulting in equal instalment payments of principal and interest over the term to maturity.

In addition, Air Canada has outstanding purchase commitments for the acquisition of five Boeing 777 aircraft, which are scheduled to be added to Air Canada’s mainline fleet in the second half of 2013 and the first half of 2014. Air Canada is evaluating financing alternatives in the approximate range of $550 million to $650 million, covering these aircraft. Air Canada also has purchase rights for 13 Boeing 777 (entitling Air Canada to purchase aircraft based on previously determined pricing).

Narrowbody and Regional Jet Aircraft Fleet

As at December 31, 2012, Air Canada operated 149 narrowbody aircraft, including 89 Airbus narrowbody aircraft. These aircraft are configured in two classes of service: Executive Class and Economy Class. The Airbus A320 aircraft is a 146-seat, twin-engine aircraft. The twin-engine Airbus A319 aircraft offers 120 seats and is essentially a shortened version of the Airbus A320 aircraft, with similar engines, operating systems and flight deck. The twin-engine Airbus A321 aircraft is the largest narrowbody aircraft in the Airbus family, with 174 seats. The Embraer 190 and Embraer 175 aircraft are 97-seat and 73-seat twin-engine aircraft, respectively. These small jets have lower trip operating costs than Air Canada’s Airbus narrowbody aircraft. All of these narrowbody aircraft types primarily serve Air Canada’s domestic, transborder and Caribbean routes.

The two Airbus A319 aircraft in the Air Canada rouge™ fleet will have an all-economy configuration offering a selection of rouge™ seats and rouge Plus™ seats.
Aircraft Fuel

Aircraft fuel is a major expense in the airline industry and the single largest expense to Air Canada, representing approximately 30% of Air Canada's 2012 total operating expenses. In 2012, the price of West Texas Intermediate ("WTI") crude oil per barrel averaged US$95. Based on 2012 volumes, management estimates that a US$1 per barrel movement in the average price of WTI crude oil would have resulted in an approximate $25 million change in 2012 fuel expense for Air Canada (excluding any impact of fuel surcharges, foreign exchange rates and fuel hedging), assuming flying capacity remained unchanged and that refining spreads between WTI crude oil and jet fuel as well as foreign exchange rates remained constant.

In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries. Air Canada uses derivative contracts on jet fuel, heating oil and crude oil-based contracts. Heating oil and crude oil derivatives are used due to the relative limited liquidity of jet fuel derivative instruments on a medium to long-term horizon since jet fuel is not traded on an organized futures exchange. 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. Air Canada performs regular reviews and, if necessary, adjusts the strategy in light of market conditions. Air Canada does not purchase or hold any derivative financial instrument for speculative purposes.

As of February 28, 2013, approximately 31% of Air Canada’s anticipated purchases of jet fuel for 2013 was hedged at an average WTI-equivalent capped price of US$100 per barrel. Air Canada’s contracts to hedge anticipated jet fuel purchases over the 2013 period are comprised of call options and call spreads.

For additional information on Air Canada's fuel derivatives, refer to Air Canada's consolidated financial statements for the year ended December 31, 2012, and Air Canada’s 2012 MD&A dated February 7, 2013, both of which are available on Air Canada’s website at aircanada.com or on SEDAR at www.sedar.com.

Star Alliance™

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

Since its inception in 1997, the Star Alliance™ network has grown to include the following 27 airlines: Adria Airways, Aegean Airlines, Air Canada, Air China, Air New Zealand, ANA, Asiana Airlines, Austrian, Avianca TACA Airlines, Brussels Airlines, Copa Airlines, Croatia Airlines, EGYPTAIR, Ethiopian Airlines, LOT Polish Airlines, Lufthansa, Scandinavian Airlines, Shenzhen Airlines, Singapore Airlines, South African Airways, SWISS, TAM Airlines, TAP Portugal, THAI, Turkish Airlines, United and US Airways.

Through Air Canada’s strategic and commercial arrangements with Star Alliance™ members and other airlines, Air Canada’s customers have access to over 1,329 destinations in 194 countries, with reciprocal participation in frequent flyer programs and use of airport lounges. The Star Alliance™ is an alliance that brings together networks, lounge access, check-in services, ticketing and dozens of other services to improve the travel experience for customers. The airlines have implemented initiatives, such as common utilization of facilities, and are focusing on capturing potential synergies in additional areas. Air Canada code shares with all Star Alliance™ members, except for Adria Airways, Aegean Airlines, Copa Airlines, Croatia Airlines, Ethiopian Airlines, Shenzhen Airlines and US Airways.
Other Services

Cargo Services

Air Canada Cargo provides direct cargo services to over 150 Canadian, U.S. transborder and international destinations and has sales representation in over 50 countries. The network is extended through interline agreements with other air carriers and through ground trucking services offered in selected markets.

Air Canada Cargo is Canada’s largest provider of air cargo services as measured by cargo capacity. Its primary customers are large freight forwarding companies and businesses whose products require the use of air services to expedite their time sensitive cargo shipments. With safety and customer service at the heart of the business, Air Canada Cargo offers customers a unique set of business solutions tailored to meet their needs efficiently and cost-effectively. There are services for high priority shipments (AC Priority1™) and a service for standard air freight services (AC Standard™). In addition there are seven solutions including one for high value secure items, one for dangerous goods and one for temperature sensitive cargo such as those shipped by the pharmaceutical industry.

Air Canada Cargo uses e-business to drive value in the supply chain. The company has shifted its strategic focus and efforts to include such offerings as e-freight and e-air waybills (which remove the need to carry paper documents) and is taking steps to assist customers in adapting to the positive changes supported by technology.

Air Canada Cargo is also actively involved in Cargo 2000 and several other industry initiatives to promote efficient cargo operations and improved service performance. This attention to quality raises their standing amongst their customers and maintains their competitiveness.

Air Canada Cargo’s freight management system, AC Lynx™, offers customers a number of services including on-line tracking of cargo shipments. In addition, Air Canada Cargo is a founding member of Cargo Portal Services which offers customers a web-based booking and an air cargo management tool that facilitates the movement and tracking of air cargo globally.

Air Canada Cargo continues to work with the various regulatory authorities worldwide and has shown its commitment to cargo security with recent implementation of state of the art equipment and training.

Air Canada Vacations

Air Canada Vacations is one of Canada’s leading tour operators offering a full range of leisure travel packages, including cruises, tours, car rentals and excursions. Based in Montreal and Toronto, Air Canada Vacations operates its business in the outbound leisure travel market (Caribbean, Mexico, U.S., Europe, North, Central and South America, South Pacific and Asia) by developing, marketing and distributing vacation travel packages.

As described in the section entitled “Air Canada’s Business Strategy” in this AIF, in late 2012, Air Canada unveiled plans to form a leisure group, which groups the activities of the airline’s tour operator business, Air Canada Vacations, with a new low-cost leisure airline – named Air Canada rouge™, with services commencing on July 1, 2013. Air Canada Vacations’ strong brand reputation will allow the airline to leverage the established marketing and distribution channels of both Air Canada Vacations and Air Canada.

Air Canada Vacations offers its products through its website (www.aircanadavacations.com) and a network of independent travel agencies across Canada.
Facilities

Air Canada owns or leases facilities in major airports consisting of offices, hangar space, aircraft maintenance and ground handling facilities. The following describes the principal properties owned or leased by Air Canada as at December 31, 2012:

<table>
<thead>
<tr>
<th>Principal Properties</th>
<th>Description</th>
<th>Square Footage</th>
<th>Nature of Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>Montreal – Air Canada Centre Air Canada Headquarters</td>
<td>Head office and training facilities</td>
<td>272,000</td>
<td>Owned facilities on leased land</td>
</tr>
<tr>
<td>Montreal Trudeau Airport – Maintenance Base</td>
<td>Offices, computer centre, aircraft maintenance, hangars, workshops and training facilities</td>
<td>1,326,664</td>
<td>Owned facilities on leased land</td>
</tr>
<tr>
<td>Toronto Pearson Airport – Terminal Building</td>
<td>Counters, offices, passenger and baggage handling facilities</td>
<td>191,000</td>
<td>Leased</td>
</tr>
<tr>
<td>Toronto Pearson Airport – Maintenance Base</td>
<td>Offices, hangars, shops and simulators</td>
<td>1,021,632</td>
<td>Owned facilities on leased land</td>
</tr>
<tr>
<td>Toronto Pearson Airport</td>
<td>Offices, shops, training and equipment storage</td>
<td>258,757</td>
<td>Leased</td>
</tr>
<tr>
<td>Toronto – Cargo Facility and Equipment Maintenance</td>
<td>Offices, cargo and equipment maintenance facilities</td>
<td>426,000</td>
<td>Leased</td>
</tr>
<tr>
<td>Vancouver – Technical Operations Centre</td>
<td>Offices, hangars, shops and simulators</td>
<td>1,087,985</td>
<td>Owned facilities on leased land</td>
</tr>
<tr>
<td>Vancouver – South Hangar</td>
<td>Offices, hangars, shops, stores</td>
<td>131,626</td>
<td>Owned facilities on leased land</td>
</tr>
<tr>
<td>Calgary International Airport</td>
<td>Hangar, commissary, ground support equipment and warehouse</td>
<td>267,891</td>
<td>Owned facilities on leased land</td>
</tr>
<tr>
<td>Winnipeg – Air Canada Building</td>
<td>Offices and computer centre</td>
<td>394,650</td>
<td>Owned land and facility</td>
</tr>
<tr>
<td>Winnipeg Airport – Maintenance Base</td>
<td>Offices, aircraft maintenance hangars and workshops</td>
<td>278,891</td>
<td>Owned facilities on leased land</td>
</tr>
</tbody>
</table>

Air Canada operates additional office, terminal, maintenance and/or cargo facilities under long-term leases at Toronto, Montreal, Vancouver, Calgary, London (England) and Los Angeles. A portion of the hangar space and aircraft maintenance facilities in Montreal and Toronto are leased or subleased by Air Canada to Jazz and other third parties. In February 2012, Air Canada repurchased the Air Canada Building in Winnipeg. A significant portion of the office space in the Air Canada Building in Winnipeg is subleased to third parties.

On March 18, 2012, Aveos announced that it had ceased operating its airframe maintenance facilities in Montreal, Winnipeg and Vancouver. On March 19, 2012, Aveos filed for court protection pursuant to the CCAA. As part of their restructuring, Aveos notified Air Canada that it was repudiating all leases from Air Canada of hangar space, effective September 30, 2012. Aveos has since vacated these premises.

Early in 2012, Air Canada also concluded the purchase of a parcel of land in Brampton, Ontario, to accommodate the construction of Air Canada’s new System Operations Centre (“SOC”), which is expected to be completed in the spring of 2014.
The following table provides a breakdown of Air Canada’s average full-time equivalent (“FTE”) employees for the years 2012 and 2011 together with the unions that represent them.

<table>
<thead>
<tr>
<th>Employee Group</th>
<th>Union</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management and Administrative Support</td>
<td>n/a</td>
<td>3,403</td>
<td>3,212</td>
</tr>
<tr>
<td>Pilots</td>
<td>ACPA</td>
<td>2,760</td>
<td>2,708</td>
</tr>
<tr>
<td>Flight Attendants</td>
<td>CUPE</td>
<td>5,840</td>
<td>5,992</td>
</tr>
<tr>
<td>Customer Sales and Service Agents</td>
<td>CAW/IBT</td>
<td>3,579</td>
<td>3,461</td>
</tr>
<tr>
<td>Technical Services, Ramp and Cargo</td>
<td>IAMAW</td>
<td>7,533</td>
<td>7,393</td>
</tr>
<tr>
<td>United Kingdom Unionized Employees</td>
<td>UNITE</td>
<td>579</td>
<td>577</td>
</tr>
<tr>
<td>Other Unionized</td>
<td>various</td>
<td>309</td>
<td>327</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>24,003</strong></td>
<td><strong>23,670</strong></td>
</tr>
</tbody>
</table>

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

(2) Certain administrative support employees are represented by IAMAW.
RISK FACTORS

The risks described herein may not be the only risks faced by Air Canada. Other risks of which Air Canada is not aware or which Air Canada currently deems to be immaterial may surface and have a material adverse impact on Air Canada, its business, results from operations and financial condition.

Risks Relating to Air Canada

Financial Results

Prior to emergence, on September 30, 2004, from its restructuring under the CCAA, Air Canada had sustained significant losses and Air Canada may sustain significant losses in the future. Since emergence from CCAA to December 31, 2012, Air Canada has accumulated a deficit of $3,406 million in Shareholders' Equity. A variety of factors, including economic conditions and other factors described in this Risk Factors section, may result in Air Canada incurring significant losses. Despite ongoing strategic and business initiatives, including efforts at securing cost reductions, revenue improvements as well as efforts relating to the launch of a low cost carrier, Air Canada may not be able to successfully achieve positive net profitability or realize the objectives of any or all of its initiatives, including those which seek to decrease costs, improve yield or offset or mitigate risks facing Air Canada, including those relating to economic conditions, labour issues, liquidity, pension funding, competition, and volatility in fuel costs and other expenses.

Leverage

Air Canada has, and is expected to continue to have and incur, a significant amount of indebtedness, including substantial fixed obligations under aircraft leases and other financings (including under the private offering of senior secured notes completed in 2010), and as a result of challenging economic or other conditions affecting Air Canada, Air Canada may incur greater levels of indebtedness than currently exist. The amount of indebtedness that Air Canada currently has and which it may incur in the future could have a material adverse effect on Air Canada, for example, by (i) limiting Air Canada’s ability to obtain additional financing, (ii) requiring Air Canada to dedicate a substantial portion of its cash flow from operations to payments on its indebtedness and fixed cost obligations, thereby reducing the funds available for other purposes, (iii) making Air Canada more vulnerable to economic downturns, and (iv) limiting Air Canada’s flexibility in planning for, or reacting to, competitive pressures or changes in its business environment.

The ability of Air Canada to make scheduled payments under its indebtedness will depend on, among other things, its future operating performance and its ability to refinance its indebtedness, if necessary. In addition, as Air Canada incurs indebtedness which bears interest at fluctuating interest rates, to the extent these interest rates increase, its interest expense will increase. There can be no assurance that Air Canada will be able to generate sufficient cash from its operations to pay its debts and lease obligations. Each of these factors is, to a large extent, subject to economic, financial, competitive, regulatory, operational and other factors, many of which are beyond Air Canada’s control.

Need for Additional Capital and Liquidity

Air Canada faces a number of challenges in its business, including in relation to economic conditions, pension plan funding, labour issues, volatile fuel prices, contractual covenants which require Air Canada to maintain minimum cash reserves and which could require Air Canada to deposit cash collateral with third parties, foreign exchange rates and increased competition from international, U.S. transborder and low-cost domestic carriers. Air Canada’s liquidity levels may be adversely impacted by these as well as by other factors and risks identified in this AIF. As part of Air Canada’s efforts to meet such challenges and to support Air Canada’s business strategy, significant liquidity and significant operating and capital expenditures are, and will in the future be, required. There can be no assurance that Air Canada will continue to be able to obtain on a timely basis sufficient funds on terms acceptable to Air Canada to provide adequate liquidity and to finance the operating and capital expenditures necessary to overcome challenges and support its business strategy if cash flows from operations and cash on hand are insufficient.
Failure to generate additional funds, whether from operations or additional debt or equity financings, could require Air Canada to delay or abandon some or all of its anticipated expenditures or to modify its business strategy and could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Furthermore, competitors with greater liquidity or the ability to raise money more easily and on less onerous terms could represent a competitive disadvantage to Air Canada.

Air Canada’s credit ratings influence its ability to access capital markets and improve its liquidity. There can be no assurance that Air Canada’s credit ratings will not be downgraded, which would add to Air Canada’s borrowing costs, hamper its ability to access capital, adversely impact its liquidity, and limit its ability to operate its business, all of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Economic and Geopolitical Conditions

Airline operating results are sensitive to economic and geopolitical conditions which can have a significant impact on Air Canada. For example, economic and geopolitical conditions may impact demand for air transportation in general or to or from certain destinations, and may also impact Air Canada’s operating costs, pension plan contributions, fuel costs, and costs and availability of capital and supplies required by Air Canada. Especially in light of Air Canada’s substantial fixed cost structure, any prolonged or significant impact arising from economic and geopolitical conditions, including weakness of the Canadian, U.S. or world economies could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Airline fares and passenger demand have fluctuated significantly in the past and may fluctuate significantly in the future. Air Canada is not able to predict with certainty market conditions and the fares that Air Canada may be able to charge. Customer expectations can change rapidly and the demand for lower fares may limit revenue opportunities. Travel, especially leisure travel, is a discretionary consumer expense. Demand for business and premium travel are also impacted by economic conditions. Depressed economic conditions in North America and other areas served by Air Canada, as well as geopolitical instability in various areas of the world, concerns about the environmental impacts of air travel and tendencies towards “green” travel initiatives where consumers reduce their travel activities, could have the effect of reducing demand for air travel in Canada and abroad and could materially adversely impact Air Canada’s profitability.

Pension Plans

Canadian federal pension legislation requires that the funded status of registered pension plans be determined periodically, on both a going concern basis (essentially assuming indefinite plan continuation) and a solvency basis (essentially assuming immediate plan termination).

Pension plan solvency valuations are influenced primarily by long-term interest rates and by the investment return on plan assets, which in turn may be dependent on a variety of factors, including economic conditions. The interest rate used to calculate benefit obligations for solvency purposes is a prescribed rate derived from the interest rates on long-term Government of Canada bonds. Deteriorating economic conditions or prolonged period of low interest rates may result in significant increases in Air Canada’s funding obligations, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Refer to the section entitled “Pension Plan Arrangements” in this AIF for additional information relating to Air Canada’s pension funding obligations. In particular, as of 2014, the Air Canada 2009 Pension Regulations will cease to have effect. As announced on March 12, 2013, Air Canada and the Government of Canada have agreed to an extension of Air Canada’s pension funding arrangements to January 30, 2021. Air Canada’s Canadian-based unions had previously provided approval or support for Air Canada’s extension request and the arrangements are subject to successfully concluding a consultation process with Air Canada management and retiree beneficiaries. The new funding arrangements will become effective upon the execution of formal documentation and the subsequent adoption of new regulations under the Pension Benefits Standards Act, subject to Governor in Council approval. Absent the adoption and implementation of the agreement, under generally applicable regulations, Air Canada’s pension funding obligations may vary significantly based on a wide variety of factors, including regulatory developments, assumptions and methods used and changes in the economic conditions (mainly the return on fund assets and changes in interest rates) as well as the application of normal past service contribution rules which would generally require one fifth of any solvency deficit, determined on the basis of an average over the previous three years, to be funded each year in addition to required current service contributions.
Underfunded pension plans or a failure or inability by Air Canada to make required cash contributions to its registered pension plans may have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Fuel Costs

Fuel costs constituted the largest percentage of the total operating costs of Air Canada in 2012. Fuel prices fluctuate widely depending on many factors including international market conditions, geopolitical events, jet fuel refining costs and the Canada/U.S. dollar exchange rate. Air Canada cannot accurately predict fuel prices. Since approximately 2007, fuel prices have significantly increased and fluctuated near or at historically high levels. Should fuel prices fluctuate significantly or increase significantly above current levels, fuel costs could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Due to the competitive nature of the airline industry, Air Canada may not be able to pass on increases in fuel prices to its customers by increasing its fares. Based on 2012 volumes, management estimates that a US$1 per barrel movement in the average price of WTI crude oil would have resulted in an approximate $25 million change in 2012 fuel expense for Air Canada (excluding any impact of fuel surcharges, foreign exchange rates and fuel hedging), assuming flying capacity remained unchanged and that refining spreads between WTI crude oil and jet fuel as well as foreign exchange rates remained constant.

Foreign Exchange

Air Canada's financial results are sensitive to the fluctuating value of the Canadian dollar. In particular, Air Canada has a significant annual net outflow of U.S. dollars and is affected by fluctuations in the U.S./Canada dollar exchange rate. Management estimates that during 2012, a $0.01 strengthening of the Canadian dollar versus the U.S. dollar (i.e., $1.01 to $1.00 per U.S. dollar) would have had an estimated $33 million favourable impact on operating income and a $54 million favourable impact on pre-tax income. Conversely, a corresponding opposite change in the exchange rate would have had the corresponding opposite effect. Air Canada incurs significant expenses in U.S. dollars for items such as fuel, aircraft rental and maintenance charges, interest payments, debt servicing and computerized reservations system fees, while a substantial portion of its revenues are generated in Canadian dollars. A significant deterioration of the Canadian dollar relative to the U.S. dollar would increase the costs of Air Canada relative to its U.S. competitors and could have a material adverse effect on Air Canada, its business, results from operations and financial condition. In addition, Air Canada may be unable to appropriately hedge the risks associated with fluctuations in exchange rates.

Competition

North America

Air Canada operates within a highly competitive industry. Over the past few years, several carriers have entered or announced their intention to enter or expand into the domestic (including regional), the U.S. transborder and international markets in which Air Canada operates.

Canadian low-cost and other carriers have entered and/or expanded or announced their intention to compete in many of Air Canada's key domestic (including regional) markets and, along with some U.S. carriers have also entered and/or expanded their operations in the U.S. transborder and leisure-oriented markets. Carriers against which Air Canada competes, including U.S. carriers, may undergo (and some have undergone) substantial reorganizations (including by way of merger with or acquisition by another carrier), creating reduced levels of indebtedness and lower operating costs and may therefore be in a position to more effectively compete with Air Canada.

The proximity of several American airports in cities close to the Canadian border (such as Plattsburgh, Buffalo and Bellingham) has also presented an additional challenge for Air Canada. Higher taxes, charges and fees for passengers departing from Canada travelling to the U.S. has redirected appreciable passenger traffic away from Canadian airports. Low-cost carriers based in the U.S. have and may continue to increase their capacity at these airports and attract Canadian-originating, price-sensitive, leisure customers.
International

Air Canada is also facing increasing competition in international markets as carriers increase their international capacity, both by expansion and by shifting existing domestic capacity to international operations to avoid low-cost domestic competition.

Given Canada's diverse, sustained immigration levels and multicultural population, Canadian gateways such as Toronto, Montreal, and Vancouver are deemed attractive by international carriers. In 2012, foreign carriers such as Air Algerie, Air China, British Airways, Egyptair, Korean Airlines, Lufthansa, Philippines Airlines, Saudi Arabian Airlines, and Turkish Airlines entered or announced their intention to enter or expand their operations into Canada.

Increased competition in the domestic, transborder or international markets could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Labour Costs and Labour Relations

Labour costs constituted one of Air Canada's largest operating cost items in 2012. There can be no assurance that Air Canada will be able to maintain such costs at levels that do not negatively affect its business, results from operations and financial condition. There can be no assurance that future agreements with employees' unions or the outcome of arbitrations will be on terms consistent with Air Canada's expectations or comparable to agreements entered into by Air Canada's competitors. Any future agreements or outcome of negotiations or arbitrations including in relation to wages or other labour costs or work rules may result in increased labour costs or other charges, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Most of Air Canada's employees are unionized. In 2011, tentative collective agreements with the CAW, the union representing Air Canada's customer service employees at airports and call centres, as well as with CUPE, the union representing Air Canada's flight attendants, were concluded and, respectively, ratified or conclusively settled through arbitration. The agreement with the CAW is in effect until February 28, 2015 and the agreement with CUPE is in effect until March 31, 2015. In 2011, Air Canada also entered into a collective agreement with UNITE, the union representing the airline's London Heathrow-based employees. In the first quarter of 2012, Air Canada concluded agreements with the CAW, in relation to in-flight crew schedulers and flight operations crew schedulers, and with CALDA, in relation to flight dispatchers. In June 2012, the decision of the arbitrator was issued in respect of the IAMAW final offer selection arbitration conducted in accordance with the process legislated by the Government of Canada in the Protecting Air Service Act. The arbitrator's final offer selection concluded a new five-year collective agreement between Air Canada and the IAMAW which is in effect until March 31, 2016. In July 2012, the decision of the arbitrator was issued in respect of the ACPA final offer selection arbitration conducted in accordance with the process legislated by the Government of Canada in the Protecting Air Service Act. The arbitrator's final offer selection concluded a new five-year collective agreement between Air Canada and the ACPA which is in effect until April 1, 2016.

ACPA and the IAMAW have, each, independently, instituted proceedings to contest the constitutional validity of the legislation which referred to arbitration the resolution of the issues that had not been resolved in bargaining. Air Canada is not a party to these proceedings. Air Canada expects that in both cases the legislation (and therefore the collective agreements concluded through the arbitration process) will be upheld.

No strikes or lock-outs may lawfully occur during the term of the collective agreements, nor during the negotiations of their renewal until a number of pre-conditions, in respect of the unions for Canadian-based employees, prescribed by the Canada Labour Code, have been satisfied. There can be no assurance that collective agreements will be further renewed without labour conflict or action or that there will not otherwise be any labour conflict or action that could also lead to a degradation, interruption or stoppage in Air Canada's service or otherwise adversely affect the ability of Air Canada to conduct its operations, any of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.
Any labour disruption or work stoppage by any of the unionized work groups of Jazz or other parties with whom Air Canada conducts business could have a material adverse effect on Air Canada, its business, results from operations and financial condition. In addition, labour conflicts at Star Alliance partners could result in lower demand for connecting traffic with Air Canada and, ultimately, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Revenue and Alliance Environment

Air Canada also encounters substantial price competition. The prevalence of low-cost carriers, along with the advent of Internet travel websites and other travel products distribution channels, has resulted in a substantial increase in discounted and promotional fares initiated by Air Canada's competitors. A decision to match competitors' fares to maintain passenger traffic results in reduced yields which, in turn, could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Furthermore, Air Canada's ability to reduce its fares in order to effectively compete with other carriers is dependent on Air Canada's ability to achieve acceptable operating margins and may also be limited by government policies to encourage competition. Likewise, competitors continue to pursue commissions/incentive actions and, in many cases, increase these payments. The decision to modify Air Canada's current programs in order to remain competitive and maintain passenger traffic could result in increased costs to Air Canada's business.

Furthermore, consolidation within the airline industry could result in increased competition as some airlines emerging from such consolidations and entering into integrated commercial cooperation arrangements, such as joint ventures, may be able to compete more effectively, which could have a material adverse effect on Air Canada.

Airline Industry Characterized by Low Gross Profit Margins and High Fixed Costs

The airline industry is characterized by low gross profit margins and high fixed costs. The costs of operating any particular flight do not vary significantly with the number of passengers carried and, therefore, a relatively small change in the number of passengers or in fare pricing or traffic mix would have a significant effect on Air Canada's operating and financial results. This condition has been exacerbated by aggressive pricing by low-cost carriers, which has had the effect of driving down fares in general. Accordingly, a shortfall from expected revenue levels could have a material adverse effect on Air Canada, its business, results from operations and financial condition. As a result of high fixed costs, should Air Canada be required to reduce its overall capacity or the number of flights operated, it may not be able to successfully reduce certain fixed costs in the short-term and may be required to incur important termination or other restructuring costs, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Limitations Due to Restrictive Covenants

Some of the financing and other major agreements to which Air Canada is a party contain, and in the future may contain, restrictive, financial (including in relation to asset valuations, liquidity, minimum EBITDAR results, fixed charge coverage ratio and debt coverage ratios) and other covenants which affect and, in some cases, significantly limit or prohibit, among other things, the manner in which Air Canada may structure or operate its business, including by reducing Air Canada's liquidity, limiting Air Canada's ability to incur indebtedness, create liens, sell assets, pay dividends, repurchase its shares, make capital expenditures, and engage in acquisitions, mergers or restructurings or a change of control. Future financing and other major agreements may also be subject to similar covenants which limit Air Canada's operating and financial flexibility, which could materially and adversely affect Air Canada's ability to operate its business and its profitability.

A failure by Air Canada to comply with its contractual obligations (including restrictive, financial and other covenants), or to pay its indebtedness and fixed costs could result in a variety of material adverse consequences, including the acceleration of its indebtedness, the withholding of credit card proceeds by the credit card service providers and the exercise of remedies by its creditors, lessors or other co-contracting parties, and such defaults could trigger additional defaults under other indebtedness or agreements. In such a situation, Air Canada may not be able to repay the accelerated indebtedness or fulfill its obligations under certain contracts, make required aircraft lease payments or otherwise cover its fixed costs. Also, the lenders under the financing arrangements could foreclose upon all or substantially all of the assets of Air Canada which secure Air Canada's obligations.
Refer to the section entitled “Covenants in Credit Card Agreements” in this AIF for additional information relating to Air Canada’s credit card processing agreements.

**Strategic, Business, Technology and Other Important Initiatives**

In order to operate its business, achieve its goals and remain competitive, Air Canada continuously seeks to identify and devise, invest in, implement and pursue strategic, business, technology and other important initiatives, such as those relating to participation in the low-cost market (including the planned launch of Air Canada rouge™ in the second half of 2013), the aircraft fleet restructuring (including the planned transfer of 15 Embraer 175 aircraft to Sky Regional), business processes, information technology, revenue management (including the planned implementation of Air Canada’s revenue management system), cost transformation, improving premium passenger revenues, expansion of flying capacity (including in respect of new routes), corporate culture transformation, initiatives seeking to ensure a consistently high quality customer service experience and others. These initiatives, including activities relating to their development and implementation, may be adversely impacted by a wide range of factors, many of which are beyond Air Canada’s control. Such factors include the need to seek legal or regulatory approvals, the performance of third parties, including suppliers, the implementation and integration of such initiatives into Air Canada’s other activities and processes as well as the adoption and acceptance of these initiatives by Air Canada’s customers, suppliers, unions and personnel. A delay or failure to sufficiently and successfully identify and devise, invest in or implement these initiatives could adversely affect Air Canada’s ability to operate its business, achieve its goals and remain competitive and could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

For instance, a key component of Air Canada’s business plan is the acquisition of new and more efficient Boeing 787 aircraft. A delay or failure in the completion of Air Canada’s fleet restructuring, including further delays by the manufacturers in the delivery of the widebody aircraft, or an inability to remove, as planned, certain aircraft from the fleet in coordination with the planned entry into service of new aircraft, could adversely affect the implementation of Air Canada’s business plan which may, in turn, have a material adverse effect on Air Canada, its business, results from operations and financial condition.

**Airport User Fees and Air Navigation Fees**

With the privatization of airports and air navigation authorities in Canada, airport and air navigation authorities have significantly increased their fees. Though certain authorities have implemented some fee reductions, if authorities in Canada or elsewhere were to significantly increase their fees, Air Canada, its business, results from operations and financial condition could be materially adversely affected.

**Dependence on Technology**

Air Canada relies heavily on technology, including computer and telecommunications equipment and software and internet-based systems, to operate its business, increase its revenues and reduce its costs. These systems include those relating to Air Canada’s telecommunications, websites, computerized airline reservations and airport customer services and flight operations.

These technology systems may be vulnerable to a variety of sources of failure, interruption or misuse, including by reason of third party suppliers’ acts or omissions, natural disasters, terrorist attacks, telecommunications failures, power failures, computer viruses, unauthorized or fraudulent users, and other operational and security issues. While Air Canada continues to invest in initiatives, including security initiatives and disaster recovery plans, these measures may not be adequate or implemented properly. Any such technology systems failure, interruption or misuse, whether at Air Canada or a third party on whom Air Canada relies, could materially and adversely affect Air Canada’s operations and could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

**Key Supplies and Suppliers**

Air Canada is dependent upon its ability to source, on favourable terms and costs, sufficient quantities of goods and services in a timely manner, including those available at airports or from airport authorities or otherwise required for Air Canada’s operations such as fuel, aircraft and related parts and aircraft maintenance services. In certain cases, Air Canada may only be able to access goods and services from a limited number of suppliers and transition to new suppliers (including
aircraft maintenance service providers to whom Air Canada transitioned following Aveos’ closure) may take a significant amount of time and require significant resources. A failure, refusal or inability of a supplier to provide goods or services may arise as a result of a wide range of causes, many of which are beyond Air Canada's control. In addition, there can be no assurance as to the continued viability of any of Air Canada’s suppliers. Any failure or inability of Air Canada to successfully source goods and services, including by reason of a failure, refusal or inability of a supplier, or to source goods and services on terms and pricing and within the timeframes acceptable to Air Canada, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

**Aeroplan®**

Through its commercial agreement with Aeroplan, Air Canada is able to offer its customers who are Aeroplan® members the opportunity to earn Aeroplan® Miles. Based on customer surveys, management believes that rewarding customers with Aeroplan® Miles is a significant factor in customers’ decision to travel with Air Canada and contributes to building customer loyalty. The failure by Aeroplan to adequately fulfill its obligations towards Air Canada under the Aeroplan Commercial Participation and Services Agreement and in connection with the Aeroplan program, or other unexpected interruptions or disruptions of Aeroplan services which are beyond Air Canada’s control, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

**Regional Carriers**

Air Canada seeks to enhance its network through capacity purchase agreements, including the Jazz CPA and other capacity purchase agreements with regional airlines, such as Sky Regional, operating flights on behalf of Air Canada.

Under the Jazz CPA, Jazz provides Air Canada’s customers service in lower density markets and higher density markets at off-peak times throughout Canada and to and from certain destinations in the United States and also provides valuable traffic feed to Air Canada’s mainline routes. Pursuant to the terms of the Jazz CPA, Air Canada pays Jazz a number of fees which are determined based upon certain costs incurred by Jazz. Air Canada also reimburses Jazz, without mark-up, for certain pass-through costs incurred directly by Jazz, such as fuel, navigation, landing and terminal fees and certain other costs. Significant increases in such pass-through costs, the failure by Jazz to adequately fulfill its obligations under the Jazz CPA, or other unexpected interruptions or cessation of Jazz’s services which are beyond Air Canada’s control could have a material adverse effect on Air Canada, its business, results from operations and financial condition. In addition, the Jazz CPA requires that Jazz maintain a minimum fleet size and contains a minimum average daily utilization guarantee which requires that Air Canada make certain minimum payments to Jazz regardless of the amount of flying done on its behalf by Jazz.

The failure by Air Canada’s other regional carriers to fulfill their obligations under their respective agreements, or other unexpected interruptions or disruptions of their services which are beyond Air Canada’s control could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

**Star Alliance™**

The strategic and commercial arrangements with Star Alliance members provide Air Canada with important benefits, including codesharing, efficient connections and transfers, reciprocal participation in frequent flyer programs and use of airport lounges from the other members. Should a key member leave Star Alliance or otherwise fail to meet its obligations thereunder, Air Canada, its business, results from operations and financial condition could be materially adversely affected.

**Interruptions or Disruptions in Service**

Air Canada’s business is significantly dependent upon its ability to operate without interruption at a number of hub airports, including Toronto Pearson Airport. Delays or disruptions in service, including those due to security or other incidents, weather conditions, labour conflicts with airport workers, baggage handlers, air traffic controllers and other workers not employed by Air Canada or other causes beyond the control of Air Canada could have a material adverse impact on Air Canada, its business, results from operations and financial condition.
Interruptions and disruptions in service may be caused by, and the demand and cost of air travel may be adversely impacted by, environmental conditions and factors in addition to those relating to the weather. Environmental conditions and factors, such as those arising from volcanic eruptions or other natural phenomena, as well as those arising from man-made sources, could cause interruptions and disruptions in service, increase Air Canada’s costs or adversely impact demand for air travel, any of which could have a material adverse impact on Air Canada, its business, results from operations and financial condition.

Current Legal Proceedings

Investigations by Competition Authorities Relating to Cargo

The European Commission and the United States Department of Justice investigated and the Competition Bureau in Canada is investigating alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including Air Canada. Competition authorities in several jurisdictions have sought or requested information from Air Canada as part of their investigations. Air Canada has been cooperating with these investigations, which are likely to lead, or have led, to proceedings against Air Canada and a number of airlines and other cargo operators in certain jurisdictions. Air Canada is also named as a defendant, and may otherwise become implicated, in a number of class action lawsuits and other proceedings that have been filed before the United States District Court, in Canada and Europe in connection with these allegations. In the United States, the investigation by the U.S. Department of Justice has concluded with no proceedings having been instituted against Air Canada and, in 2012, Air Canada entered into a settlement agreement relating to class action proceedings in the United States in connection with these allegations under which Air Canada made no admission of liability. Under the settlement agreement for which final court approval was obtained, a payment of $8 million was made by Air Canada in 2012.

In 2010, the European Commissions issued a decision finding that 12 air cargo carriers (including groups of related carriers) had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006. Air Canada was among the carriers subject to the decision and a fine of 21 million Euros (approximately C$29 million at an exchange rate of $1.3970) was imposed on Air Canada. Air Canada is appealing this decision and filed an application for appeal before the European General Court. In 2011, Air Canada paid the fine, as required, pending the outcome of its appeal.

As at December 31, 2012, Air Canada has a provision of $29 million relating to outstanding claims in this matter, which is recorded in accounts payable and accrued liabilities on Air Canada’s consolidated statement of financial position. This provision is an estimate based upon the status of the investigations and proceedings at this time and Air Canada’s assessment as to the potential outcome for certain of them. The provision does not address the proceedings and investigations in all jurisdictions, but only where there is sufficient information to do so. Air Canada has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings and investigations. As stated above, Air Canada is appealing the decision issued by the European Commission and, if and as appropriate, based on the outcome of any updates regarding this appeal as well as developments regarding proceedings and investigations in other jurisdictions, may record adjustments to the provision and/or its income in subsequent periods as required.

Billy Bishop Toronto City Airport

In February 2006, Jazz commenced proceedings before the Ontario Superior Court of Justice against Porter and other defendants (collectively the “Porter Defendants”) after Jazz became aware that it would be excluded from operating flights from Billy Bishop Toronto City Airport. On October 26, 2007, the Porter Defendants counter-claimed against Jazz and Air Canada alleging various violations of competition law, including that Jazz and Air Canada’s commercial relationship contravenes Canadian competition laws, and claiming $850 million in damages. On October 16, 2009, Jazz discontinued its suit in the Ontario Superior Court against Porter.

The counterclaim filed by Porter in the Ontario Superior Court of Justice against Jazz and Air Canada was stayed pending the outcome of a mirror counterclaim made by Porter in the Federal Court in relation to proceedings in the Federal Court that have been discontinued. On March 20, 2013, an agreement was concluded providing for the dismissal of the counterclaim against Air Canada and Jazz.
Pay Equity

CUPE, which represents Air Canada's flight attendants, filed a complaint in 1991 before the Canadian Human Rights Commission alleging gender-based wage discrimination. CUPE claims the predominantly female flight attendant group should be paid the same as the predominantly male pilot, mechanics, ramp and cargo groups because their work is of equal value. Litigation on a preliminary matter was pursued through the Supreme Court of Canada, and the Commission did not begin investigating the complaint on the merits until March 2007. The Commission concluded its investigation in 2011 and decided not to refer the complaint to the Canadian Human Rights Tribunal for inquiry. CUPE instituted proceedings before the Federal Court to challenge this decision, and the Federal Court upheld the Commission’s decision and dismissed CUPE’s challenge. Air Canada considers that any proceedings will show that it is complying with the equal pay provisions of the Canadian Human Rights Act, however, management has determined that it is not possible at this time to predict with any degree of certainty the final outcome of the proceedings.

Mandatory Retirement

Air Canada is engaged in a number of proceedings involving challenges to the mandatory retirement provisions of certain of its collective agreements, including the ACPA collective agreement which incorporate provisions of the pension plan terms and conditions applicable to pilots requiring them to retire at age 60. Air Canada has fully or partially resolved some of these complaints and is defending others. At this time, it is not possible to determine with any degree of certainty the extent of any financial liability that may arise from Air Canada being unsuccessful in its defence of these proceedings.

Future Legal Proceedings

Airlines are susceptible to various claims and litigation, including class action claims, in the course of operating their business or with respect to the interpretation of existing agreements. Any future claims or litigation could also have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Key Personnel

Air Canada is dependent on the experience and industry knowledge of its executive officers and other key employees to execute its business plan. If Air Canada were to experience a substantial turnover in its leadership or other key employees, Air Canada, its business, results from operations and financial condition could be materially adversely affected. Additionally, Air Canada may be unable to attract and retain additional qualified key personnel as needed in the future.

Risks Relating to the Airline Industry

Terrorist Attacks and Security Measures

The potential for terrorist attacks and terrorist activity causes uncertainty in the minds of the traveling public. The occurrence of a terrorist attack (or attempted attacks) (whether domestic or international and whether involving Air Canada or another carrier or no carrier at all) and increasingly restrictive security measures, such as those relating to the content of carry-on baggage, passenger identification document requirements, and passenger screening procedures could have a material adverse effect on passenger demand for air travel and on the number of passengers traveling on Air Canada’s flights. It could also lead to a substantial increase in insurance, airport security and other costs. Any resulting reduction in passenger revenues and/or increases in costs, including insurance, security or other costs could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Epidemic Diseases (Severe Acute Respiratory Syndrome (SARS), H1N1 Influenza or Other Epidemic Diseases)

The international outbreaks of Severe Acute Respiratory Syndrome (SARS) in 2003, and the resulting actions of the World Health Organization (the “WHO”), including a travel advisory against non-essential travel to Toronto, Canada, had a significant adverse effect on passenger demand for air travel in Air Canada’s markets and resulted in a major negative impact on traffic on the entire network. An outbreak of influenza, SARS, H1N1 influenza virus or of another epidemic
disease (whether domestic or international) or any WHO or similar travel advisories (whether relating to Canadian cities or regions or other cities, regions or countries) could have a material adverse effect on passenger demand for air travel. Any resulting reduction in traffic in the markets served by Air Canada could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Casualty Losses

Due to the nature of its core operating business, Air Canada may be subject to liability claims arising out of accidents or disasters involving aircraft on which Air Canada’s customers are traveling or involving aircraft of other carriers maintained or repaired by Air Canada, including claims for serious personal injury or death. There can be no assurance that Air Canada’s insurance coverage will be sufficient to cover one or more large claims and any shortfall may be material. Additionally, any accident or disaster involving an aircraft operated by or on behalf of Air Canada or an aircraft of another carrier receiving line maintenance services from Air Canada may significantly harm Air Canada’s reputation for safety, which would have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Seasonal Nature of the Business, Other Factors and Prior Performance

Air Canada has historically experienced considerably greater demand for its services in the second and third quarters of the calendar year and significantly lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the preference of a high number of leisure travelers to travel during the spring and summer months. Air Canada has substantial fixed costs that do not meaningfully fluctuate with passenger demand in the short-term.

As described elsewhere, demand for and cost of air travel is also affected by factors such as geopolitical and economic conditions, war or the threat of war or terrorist attacks, fare levels and weather conditions. Due to these and other factors, operating results for an interim period are not necessarily indicative of operating results for an entire year, and operating results for an historical period are not necessarily indicative of operating results for a future period.

Regulatory Matters

The airline industry is subject to extensive Canadian and foreign government regulations relating to, among other things, security, safety, consumer rights, privacy, licensing, competition, environment (including noise levels and carbon emissions) and, in some measure, pricing. For example, new and proposed legislation have been considered or adopted concerning carbon emissions emanating from the aviation industry. Such legislative initiatives include, for example, market-based mechanisms called emissions trading systems, which are being proposed and implemented to reduce the amount of carbon emissions through the setting of emissions allowances and charging aircraft operators for a certain percentage of these allowances. The implementation of additional regulations or decisions, including those relating to carbon emissions, and others, whether by Transport Canada, the Competition Bureau and/or the Competition Tribunal, the Canadian Transportation Agency or other domestic or foreign governmental entities, may have a material adverse effect on Air Canada, its business, results from operations and financial condition.

The European Union passed legislation for an Emissions Trading System, which will include carbon emissions from aviation commencing in January 2012, including for flights operated between Canada and countries within the European Union. The legislation requires aircraft operators to monitor and report on fuel use and emissions data. While this legislation is expected to result in increased costs relating to the purchase of emissions allowances, the net financial impact will, in part, depend upon how much of such cost, if any, will be recovered, including in the form of higher passenger fares and cargo rates. In November 2012, the European Commission announced that it would defer their Emissions Trading System for international aviation by approximately eleven months pending an anticipated agreement on a multilateral global alternative program being agreed by the ICAO Assembly in the fall of 2013.

The availability of international routes to Canadian air carriers is regulated by agreements between Canada and foreign governments. Changes in Canadian or foreign government aviation policy could result in the alteration or termination of these agreements and could adversely affect Air Canada and its international operations.
Air Canada is subject to domestic and foreign laws regarding privacy of passenger and employee data, including advance passenger information and access to airline reservation systems, which are not consistent in all countries in which Air Canada operates. The need to comply with these regulatory regimes results in additional operating costs and further regulation in this area could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

There can be no assurances that new laws, regulations or revisions to same, or decisions, will not be adopted or rendered, from time to time, and these could impose additional requirements or restrictions, which may adversely impact Air Canada, its business, results from operations and financial condition.

**Availability of Insurance Coverage and Increased Insurance Costs**

The aviation insurance industry has been continually re-evaluating the terrorism risks that it covers, and this activity may adversely affect some of Air Canada’s existing insurance carriers or Air Canada’s ability to obtain future insurance coverage. To the extent that Air Canada’s existing insurance carriers are unable or unwilling to provide it with insurance coverage, and in the absence of measures by the Government of Canada to provide the required coverage, Air Canada’s insurance costs may increase further and may result in Air Canada being in breach of regulatory requirements or contractual arrangements requiring that specific insurance be maintained, which may have a material adverse effect on Air Canada, its business, results from operations and financial condition.

**Third Party War Risk Insurance**

There is a risk that the Government of Canada may not continue to provide an indemnity for third party war risk liability coverage, which it currently provides to Air Canada and certain other carriers in Canada until December 31, 2013. In the event that the Government of Canada does not continue to provide such indemnity or amends such indemnity, Air Canada and other industry participants would have to turn to the commercial insurance market to seek such coverage. Air Canada estimates that such coverage would cost Air Canada approximately US$3 million per year. Alternative solutions, such as those envisioned by ICAO and IATA, have not developed as planned, due to actions taken by other countries and the recent availability of supplemental insurance products. ICAO and IATA are continuing their efforts in this area; however, the achievement of a global solution is not likely in the immediate or near future. The U.S. federal government has set up its own facility to provide war risk coverage to U.S. carriers, thus removing itself as a key component of any global plan.
MARKET FOR SECURITIES

The Variable Voting Shares and the Voting Shares are traded on the TSX under the trading symbols "AC.A" and "AC.B", respectively. The Warrants traded on the TSX under the trading symbol "AC.WT" and, as a result of their expiration, were delisted after close of market on October 29, 2012. The following table sets forth the price range and trading volume of the Variable Voting Shares, the Voting Shares and the Warrants as reported by the TSX for the months of January to, and including, December 2012, as applicable.

<table>
<thead>
<tr>
<th></th>
<th>Variable Voting Shares (AC.A)</th>
<th>Voting Shares (AC.B)</th>
<th>Warrants (AC.WT) (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High</td>
<td>Low</td>
<td>Average Daily Trading Volume</td>
</tr>
<tr>
<td>January</td>
<td>1.17</td>
<td>0.97</td>
<td>33,625</td>
</tr>
<tr>
<td>February</td>
<td>1.44</td>
<td>0.96</td>
<td>88,329</td>
</tr>
<tr>
<td>March</td>
<td>1.02</td>
<td>0.77</td>
<td>165,753</td>
</tr>
<tr>
<td>April</td>
<td>1.00</td>
<td>0.83</td>
<td>39,288</td>
</tr>
<tr>
<td>May</td>
<td>1.00</td>
<td>0.82</td>
<td>25,511</td>
</tr>
<tr>
<td>June</td>
<td>1.06</td>
<td>0.86</td>
<td>60,181</td>
</tr>
<tr>
<td>July</td>
<td>1.19</td>
<td>0.97</td>
<td>40,301</td>
</tr>
<tr>
<td>August</td>
<td>1.23</td>
<td>1.02</td>
<td>78,046</td>
</tr>
<tr>
<td>September</td>
<td>1.34</td>
<td>1.05</td>
<td>579,209</td>
</tr>
<tr>
<td>October</td>
<td>1.95</td>
<td>1.23</td>
<td>127,928</td>
</tr>
<tr>
<td>November</td>
<td>2.00</td>
<td>1.73</td>
<td>35,292</td>
</tr>
<tr>
<td>December</td>
<td>1.87</td>
<td>1.50</td>
<td>29,401</td>
</tr>
</tbody>
</table>

(1) These warrants expired on October 27, 2012 and were delisted from the TSX after close of market on October 29, 2012.

TRANSFER AGENT AND REGISTRAR

The transfer agent and registrar for the Variable Voting Shares and Voting Shares of Air Canada is Canadian Stock Transfer Company Inc. as administrative agent for CIBC Mellon Trust Company with its principal offices in Montreal, Toronto, Vancouver, Calgary and Halifax.
DIVIDEND RECORD

The Corporation has not declared or paid dividends on its Voting Shares and Variable Voting Shares for the financial years ended December 31, 2012, 2011 and 2010.

Air Canada's current policy is to reinvest earnings in order to finance the growth and development of its business. As a result, Air Canada does not expect to pay dividends in the foreseeable future. Any future determination to pay cash dividends is at the discretion of Air Canada's board of directors and will depend on Air Canada's financial condition, results of operations, capital requirements, restrictive covenants in contracts and such other factors as Air Canada's board of directors deems relevant. Agreements entered into in relation to the Notes described in the section entitled “Significant Transactions” in this AIF, the Pension MOUs and the agreement with the Government of Canada to extend Air Canada's pension funding arrangements to January 30, 2021, both of which are described in the section entitled "Pension Plan Arrangements" in this AIF, and certain other agreements of Air Canada include restrictions with respect to Air Canada's ability to declare and pay dividends.

DESCRIPTION OF CAPITAL STRUCTURE

The authorized share capital of Air Canada is comprised of an unlimited number of Variable Voting Shares and Voting Shares. As of March 21, 2013, 31,279,502 Class A Variable Voting Shares and 244,694,234 Class B Voting Shares were issued and outstanding. The following summary describes the rights, privileges, restrictions and conditions that are attached to the Variable Voting Shares and the Voting Shares. This summary does not purport to be complete and is subject to, and is qualified in its entirety by, reference to the terms of Air Canada’s articles of amalgamation, as amended.

Variable Voting Shares

Voting

The holders of the Variable Voting Shares shall be entitled to receive notice of, and to attend and vote at, all meetings of the shareholders of Air Canada, except where the holders of a specified class are entitled to vote separately as a class as provided in the CBCA.

The Variable Voting Shares may only be held, beneficially owned or controlled, directly or indirectly, by persons who are not Canadians, as such term is defined in the CTA (“Qualified Canadians”) and are entitled to one vote per Variable Voting Share unless (i) the number of Variable Voting Shares outstanding, as a percentage of the total number of votes attaching to all issued and outstanding voting shares, exceeds 25% (or any higher percentage that the Governor in Council may by regulation specify) or (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting exceeds 25% (or any higher percentage that the Governor in Council may by regulation specify) of the total number of votes that may be cast at such meeting. If either of the above noted thresholds would otherwise be surpassed at any time, the vote attached to each Variable Voting Share will decrease proportionately such that (i) the Variable Voting Shares as a class do not carry more than 25% (or any higher percentage that the Governor in Council may by regulation specify) of the aggregate votes attached to all issued and outstanding voting shares of Air Canada and (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting do not exceed 25% (or any higher percentage that the Governor in Council may by regulation specify) of the votes that may be cast at such meeting.

The Government of Canada’s Bill C-10, the Budget Implementation Act 2009, contains provisions whereby the provisions relating to voting securities in the ACPPA would be repealed and the CTA would be amended to provide the Governor in Council with flexibility to increase the foreign ownership limit from the existing 25% level to a maximum of 49%. These provisions will come into force on a date to be fixed by order of the Governor in Council made on the recommendation of the Minister of Finance, in the case of the ACPPA, and on the recommendation of the Minister of Transport, in the case of the CTA.
**Dividends**

Subject to the rights, privileges, restrictions and conditions attached to the shares of Air Canada of any other class ranking senior to the Variable Voting Shares, the holders of the Variable Voting Shares shall, at the discretion of the directors, be entitled to receive, out of monies, assets or property of Air Canada properly applicable to the payment of dividends, any dividends declared and payable by Air Canada on the Variable Voting Shares and the Variable Voting Shares shall rank equally as to dividends on a share-for-share basis with the Voting Shares participating on an as-converted basis. All dividends declared in any fiscal year of Air Canada shall be declared in equal or equivalent amounts per share on all Variable Voting Shares, and Voting Shares participating on an as-converted basis at the time outstanding, without preference or distinction.

**Subdivision or Consolidation**

No subdivision or consolidation of the Variable Voting Shares or the Voting Shares shall occur unless, simultaneously, the shares of the other class are subdivided or consolidated in the same manner, so as to maintain and preserve the relative rights of the holders of the shares of each of the said classes.

**Rights upon Liquidation, Dissolution or Winding Up**

Subject to the rights, privileges, restrictions and conditions attaching to the shares of Air Canada ranking prior to the Variable Voting Shares, upon liquidation, dissolution or winding up of Air Canada or other distribution of Air Canada's assets among its shareholders for the purpose of winding up its affairs, the holders of the Variable Voting Shares and Voting Shares shall be entitled to receive the remaining property of Air Canada and shall be entitled to share equally, share for share, in all distributions of such assets.

**Conversion**

Each issued and outstanding Variable Voting Share shall be converted into one Voting Share, automatically and without any further act of Air Canada or of the holder, if (i) such Variable Voting Share becomes held, beneficially owned and controlled, directly or indirectly, otherwise than by way of security only, by a Qualified Canadian; or (ii) the provisions contained in the CTA relating to foreign ownership restrictions are repealed and not replaced with other similar provisions.

In the event that an offer is made to purchase Voting Shares and the offer is one which must, pursuant to applicable securities legislation or the rules of a stock exchange on which the Voting Shares are then listed, be made to all or substantially all the holders of the Voting Shares in a province of Canada to which the requirement applies, each Variable Voting Share shall become convertible at the option of the holder into one Voting Share that shall be subject to the offer at any time while the offer is in effect and until one day after the time prescribed by applicable securities legislation for the offeror to take up and pay for such shares as are to be acquired pursuant to the offer. The conversion right may only be exercised in respect of Variable Voting Shares for the purpose of depositing the resulting Voting Shares in response to the offer and the transfer agent shall deposit the resulting Voting Shares on behalf of the shareholder.

If the Voting Shares resulting from the conversion and deposited pursuant to the offer are withdrawn by the shareholder or are not taken up by the offeror or the offer is abandoned or withdrawn, the Voting Shares resulting from the conversion shall be reconverted automatically and without further act from Air Canada or the holder, into Variable Voting Shares.

There shall be no right to convert the Variable Voting Shares into Voting Shares or to convert Voting Shares into Variable Voting Shares, except in accordance with the conversion procedure set forth in the Air Canada articles of amalgamation.
Constraints on Ownership of Shares

The Variable Voting Shares may only be held, beneficially owned or controlled, directly or indirectly, by persons who are not Qualified Canadians.

Voting Shares

Voting

The holders of the Voting Shares shall be entitled to receive notice of, and to attend and vote at, all meetings of the shareholders of Air Canada (except where the holders of a specified class are entitled to vote separately as a class as provided in the CBCA), and each Voting Share shall confer the right to one vote in person or by proxy at all meetings of shareholders of Air Canada.

Dividends

Subject to the rights, privileges, restrictions and conditions attaching to the shares of Air Canada of any other class ranking senior to the Voting Shares, the holders of the Voting Shares shall, at the discretion of the directors, be entitled to receive, out of monies, assets or property of Air Canada properly applicable to the payment of dividends, any dividends declared and payable by Air Canada on the Voting Shares and the Voting Shares shall rank equally as to dividends on a share-for-share basis with the Variable Voting Shares participating on an as-converted basis and all dividends declared in any fiscal year of Air Canada shall be declared in equal or equivalent amounts per share on all Voting Shares and Variable Voting Shares on an as-converted basis at the time outstanding, without preference or distinction.

Subdivision or Consolidation

No subdivision or consolidation of the Voting Shares or the Variable Voting Shares shall occur unless, simultaneously, the shares of the other class are subdivided or consolidated in the same manner, so as to maintain and preserve the relative rights of the holders of the shares of each of the said classes.

Rights upon Liquidation, Dissolution or Winding Up

Subject to the rights, privileges, restrictions and conditions attaching to the shares of Air Canada ranking senior to the Voting Shares, upon liquidation, dissolution or winding up of Air Canada or other distribution of Air Canada’s assets among its shareholders for the purpose of winding up its affairs, the holders of the Voting Shares and Variable Voting Shares shall be entitled to receive the remaining property of Air Canada and shall be entitled to share equally, share for share, in all distributions of such assets.

Conversion

Unless the foreign ownership restrictions of the CTA are repealed and not replaced with other similar restrictions, an issued and outstanding Voting Share shall be converted into one Variable Voting Share, automatically and without any further act of Air Canada or the holder, if such Voting Share becomes held, beneficially owned or controlled, directly or indirectly, otherwise than by way of security only, by a person who is not a Qualified Canadian.
In the event that an offer is made to purchase Variable Voting Shares and the offer is one which must, pursuant to applicable securities legislation or the rules of a stock exchange on which the Variable Voting Shares are then listed, be made to all or substantially all the holders of the Variable Voting Shares, each Voting Share shall become convertible at the option of the holder into one Variable Voting Share that shall be subject to the offer at any time while the offer is in effect and until one day after the time prescribed by applicable securities legislation for the offeror to take up and pay for such shares as are to be acquired pursuant to the offer. The conversion right may only be exercised in respect of Voting Shares for the purpose of depositing the resulting Variable Voting Shares in response to the offer and the transfer agent shall deposit the resulting Variable Voting Shares on behalf of the shareholder.

If the Variable Voting Shares resulting from the conversion and deposited pursuant to the offer are withdrawn by the shareholder or are not taken up by the offeror or the offer is abandoned or withdrawn, the Variable Voting Shares resulting from the conversion shall be reconverted automatically and without further act from Air Canada or the holder, into Voting Shares.

There shall be no right to convert the Variable Voting Shares into Voting Shares or to convert Voting Shares into Variable Voting Shares, except in accordance with the conversion procedure set forth in the Air Canada articles of amalgamation.

**Constraints on Ownership of Shares**

The Voting Shares may only be held, beneficially owned and controlled, directly or indirectly, by Qualified Canadians.

**Declaration as to Canadian Status**

Air Canada's articles of amalgamation, as amended, provide that: (i) the Voting Shares may only be held, beneficially owned and controlled, directly or indirectly, by persons who are Qualified Canadians; and (ii) the Variable Voting Shares may only be held, beneficially owned or controlled, directly or indirectly, by persons who are not Qualified Canadians.

**Repurchase of Shares**

On December 7, 2011, Air Canada announced that it had received approval from the TSX to implement a normal course issuer bid to purchase, for cancellation, up to 24,737,753 Variable Voting Shares and/or Voting Shares, representing 10% of the total public float of the Shares calculated in accordance with the rules of the TSX. The repurchase program, which commenced on December 12, 2011 and ended December 11, 2012, was conducted through the facilities of the TSX. In 2012, Air Canada purchased for cash and cancelled 3,019,600 shares at an average cost of $1.67 per Voting Share. In 2011, Air Canada purchased for cash and cancelled 239,524 shares at an average cost of $1.08 per share.

Air Canada may be allowed, from time to time, to purchase shares for cancellation in accordance with applicable securities legislation and the rules prescribed under applicable stock exchange or regulatory policies. Any such repurchase would constitute an “issuer bid” under Canadian provincial securities legislation and would be conducted in accordance with the applicable requirements thereof. Any future decision to purchase shares for cancellation will depend on Air Canada’s financial condition, results of operations, capital requirements, restrictive covenants in contracts and such other factors as Air Canada’s board of directors deems relevant. Agreements entered into in relation to the Notes described in the section entitled "Significant Transactions" in this AIF and the agreement with the Government of Canada to extend Air Canada’s pension funding arrangements to January 30, 2021 described in the section entitled "Pension Plan Arrangements" in this AIF include restrictions with respect to Air Canada’s ability to purchase shares for cancellation.

**Information and Reports**

Air Canada or its transfer agent will furnish to shareholders, in accordance with applicable securities laws, all financial statements of Air Canada (including quarterly and annual financial statements) and other reports as are from time to time required by applicable law, including prescribed forms needed for the completion of shareholders’ tax returns under the Tax Act and equivalent provincial legislation.
Prior to each meeting of shareholders, the Board of Directors of Air Canada will provide to the shareholders (along with notice of the meeting) a form of proxy and all information as is required by applicable law and the rules of the TSX to be provided to shareholders.

The directors and officers of Air Canada are required to file insider reports and comply with insider trading provisions under applicable Canadian securities legislation in respect of trades made by such persons in securities of Air Canada.

**Air Canada Shareholder Rights Plan**

The Board of Directors of Air Canada approved a shareholder rights plan on March 30, 2011 (the “Rights Plan”). The Rights Plan was designed to foster fair treatment of all shareholders of Air Canada in connection with any take-over bid for Air Canada. The plan was approved by the shareholders of Air Canada at the annual and special shareholder meeting held on May 5, 2011.

The Rights Plan creates one right in respect of each Variable Voting Share and Voting Share of Air Canada outstanding as at March 30, 2011 or subsequently issued. The Rights Plan is scheduled to expire at the close of business on the date immediately following the date of Air Canada’s annual meeting of shareholders to be held in 2014, unless terminated earlier in accordance with the terms of the Rights Plan approved on March 30, 2011. Until the separation time, which typically occurs at the time of an unsolicited take-over bid, whereby an Acquiring Person (as defined in the Rights Plan) acquires or attempts to acquire 20% or more of Air Canada’s Variable Voting Shares or 20% or more of Air Canada’s Voting Shares, the rights are not separable from the shares, are not exercisable and no separate rights certificates are issued.

Under the Rights Plan approved on March 30, 2011, each right, other than those held by an Acquiring Person and certain of its related parties, entitles the holder in certain circumstances following the acquisition by an Acquiring Person of 20% or more of the Variable Voting Shares or 20% or more of the Voting Shares of Air Canada (otherwise than through the “Permitted Bid” requirements of the Rights Plan) to purchase from Air Canada $200 worth of Variable Voting Shares or Voting Shares for $100 (i.e. at a 50% discount). Upon such exercise, holders of rights beneficially owned and controlled by Qualified Canadians would receive Voting Shares and holders of rights beneficially owned or controlled by persons who are not Qualified Canadians would receive Variable Voting Shares.

In 2012, the shareholders of Air Canada approved amendments to the Rights Plan. Subject to certain exceptions identified in the Rights Plan, the Rights Plan, as currently amended, would be triggered in the event of an offer to acquire 20% or more of the outstanding Class A variable voting shares and Class B voting shares of Air Canada calculated on a combined basis, instead of 20% or more of the outstanding Class A variable voting shares or Class B voting shares calculated on a per class basis as was the case under the Rights Plan prior to the amendments that came into effect in 2012.

The amendments to the Rights Plan were proposed in order to render effective a decision issued by Canadian securities regulatory authorities (pursuant to an application of Air Canada) that effectively treats Air Canada's Class A variable voting shares and Class B voting shares as a single class for the purposes of applicable take-over bid requirements and early warning reporting requirements contained under Canadian securities laws. A copy of the decision is available under Air Canada’s profile at www.sedar.com.

The Rights Plan, originally approved at Air Canada’s 2011 annual and special shareholder meeting, is designed to provide Air Canada’s shareholders and the Board of Directors additional time to assess an unsolicited take-over bid for the company and, where appropriate, to give the Board of Directors additional time to pursue alternatives for maximizing shareholder value. It also encourages fair treatment of all shareholders by providing them with an equal opportunity to participate in a take-over bid.

The Rights Plan is scheduled to expire at the close of business on the date immediately following the date of Air Canada’s annual meeting of shareholders to be held in 2014, unless terminated earlier in accordance with the terms of the Rights Plan.
**DIRECTORS AND OFFICERS**

**Directors**

The name, municipality of residence and principal occupation of each of the directors are, as of the date hereof, as set forth below. Such individuals have served as directors of Air Canada since the dates set forth opposite their respective names.

<table>
<thead>
<tr>
<th>Name and Municipality of Residence</th>
<th>Principal Occupation</th>
<th>Director Since</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bernard Attali (1)(2) Paris, France</td>
<td>Senior Advisor, TPG Capital, a private investment firm</td>
<td>November 15, 2006</td>
</tr>
<tr>
<td>Thomas Birks (3)(4) Montreal, Québec</td>
<td>President, Birinco Inc.</td>
<td>February 7, 2013</td>
</tr>
<tr>
<td>Michael M. Green (2)(3)(4)(5) Radnor, Pennsylvania</td>
<td>Chief Executive Officer and Managing Director Tenex Capital Management, a private investment firm</td>
<td>March 30, 2009</td>
</tr>
<tr>
<td>Jean Marc Huot (1)(4) Montreal, Québec</td>
<td>Partner, Stikeman Elliott LLP</td>
<td>May 8, 2009</td>
</tr>
<tr>
<td>Pierre Marc Johnson (1)(2)(4)(6) Montreal, Québec</td>
<td>Counsel, Heenan Blaikie LLP</td>
<td>November 15, 2006</td>
</tr>
<tr>
<td>David I. Richardson (3)(7) Grafton, Ontario</td>
<td>Corporate Director</td>
<td>September 30, 2004</td>
</tr>
<tr>
<td>Roy J. Romanow (1)(3) Saskatoon, Saskatchewan</td>
<td>Senior Fellow, Public Policy University of Saskatchewan</td>
<td>February 9, 2010</td>
</tr>
<tr>
<td>Calin Rovinescu Montreal, Québec</td>
<td>President and Chief Executive Officer Air Canada</td>
<td>April 1, 2009</td>
</tr>
<tr>
<td>Vagn Sørensen (2)(3)(4)(5) Holte, Denmark</td>
<td>Corporate Director</td>
<td>November 15, 2006</td>
</tr>
<tr>
<td>Annette Verschuren (2)(3) Toronto, Ontario</td>
<td>Chair and Chief Executive Officer NRstor Inc.</td>
<td>November 12, 2012</td>
</tr>
</tbody>
</table>

(1) Member of the Governance and Corporate Matters Committee.
(2) Member of the Human Resources and Compensation Committee.
(3) Member of the Audit, Finance and Risk Committee.
(4) Member of the Pension Committee.
(5) Member of the Nominating Committee.
(6) Mr. Johnson was also a director of Air Canada from May 2000 to September 2004.
(7) Mr. Richardson has been a director of Air Canada since September 2004 and became Chairman of the Board of Air Canada on January 1, 2008.
Unless otherwise indicated below, each of the directors has held the occupation listed above for more than five years. Mr. Green was Managing Director at Cerberus Capital Management, L.P. from 2004 to 2009. Mr. Leonard was Interim Chief Executive Officer of Walter Energy, Inc. from 2010 to 2011 and Chairman of AirTran Holdings, Inc. from 1999 to 2008 and also Chief Executive Officer from 1999 to 2007. Mr. Rovinescu was Co-founder and Senior Principal of Genuity Capital Markets from 2004 to 2009. Ms. Verschuren was the President of The Home Depot Canada from 1996 to 2011.

Officers

The board of directors of Air Canada may from time to time appoint one or more officers of Air Canada. A majority of the officers of Air Canada shall be residents of Canada within the meaning of the Tax Act and Canadians within the meaning of the CTA.

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

<table>
<thead>
<tr>
<th>Name and Municipality of Residence</th>
<th>Position with Air Canada</th>
<th>Principal Occupation</th>
<th>Officer since</th>
</tr>
</thead>
<tbody>
<tr>
<td>David I. Richardson (1) Grafton, Ontario</td>
<td>Chairman of the Board</td>
<td>Corporate Director</td>
<td>January 1, 2008</td>
</tr>
<tr>
<td>Calin Rovinescu (2) Montreal, Québec</td>
<td>President and Chief Executive Officer</td>
<td>President and Chief Executive Officer, Air Canada</td>
<td>April 1, 2009</td>
</tr>
<tr>
<td>Klaus Goersch Mississauga, Ontario</td>
<td>Executive Vice President and Chief Operating Officer</td>
<td>Executive Vice President and Chief Operating Officer, Air Canada</td>
<td>October 1, 2012</td>
</tr>
<tr>
<td>Michael Rousseau St. Lambert, Quebec</td>
<td>Executive Vice President and Chief Financial Officer</td>
<td>Executive Vice President and Chief Financial Officer, Air Canada</td>
<td>October 22, 2007</td>
</tr>
<tr>
<td>Benjamin M. Smith Toronto, Ontario</td>
<td>Executive Vice President and Chief Commercial Officer</td>
<td>Executive Vice President and Chief Commercial Officer, Air Canada</td>
<td>April 26, 2004</td>
</tr>
<tr>
<td>Lise Fournel Beaconsfield, Québec</td>
<td>Senior Vice President and Chief Information Officer</td>
<td>Senior Vice President and Chief Information Officer, Air Canada</td>
<td>April 10, 1995</td>
</tr>
<tr>
<td>Kevin C. Howlett Delta, British Columbia</td>
<td>Senior Vice President, Employee Relations</td>
<td>Senior Vice President, Employee Relations, Air Canada</td>
<td>March 18, 2002</td>
</tr>
<tr>
<td>Susan Welscheid Mont Royal, Québec</td>
<td>Senior Vice President, Customer Service</td>
<td>Senior Vice President, Customer Service, Air Canada</td>
<td>December 13, 1999</td>
</tr>
<tr>
<td>Alan D. Butterfield Beaconsfield, Québec</td>
<td>Vice President, Air Canada Maintenance and Engineering</td>
<td>Vice President, Air Canada Maintenance and Engineering, Air Canada</td>
<td>February 19, 2007</td>
</tr>
<tr>
<td>Nick Careen Candiac, Québec</td>
<td>Vice President, Airports</td>
<td>Vice President, Airports, Air Canada</td>
<td>June 1, 2009</td>
</tr>
<tr>
<td>Yves Dufresne Montreal, Québec</td>
<td>Vice President, Alliances and Regulatory Affairs</td>
<td>Vice President, Alliances and Regulatory Affairs, Air Canada</td>
<td>April 26, 2004</td>
</tr>
<tr>
<td>Marcel Forget Montreal, Québec</td>
<td>Vice President, Network Planning</td>
<td>Vice President, Network Planning, Air Canada</td>
<td>April 8, 2009</td>
</tr>
<tr>
<td>Name and Municipality of Residence</td>
<td>Position with Air Canada</td>
<td>Principal Occupation</td>
<td>Officer since</td>
</tr>
<tr>
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<td>--------------------------</td>
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</tr>
<tr>
<td>Zeina Gedeon Dollard des Ormeaux, Québec</td>
<td>Vice President, E-Commerce, Product Distribution and Sales Development</td>
<td>Vice President, E-Commerce, Product Distribution and Sales Development, Air Canada</td>
<td>March 1, 2012</td>
</tr>
<tr>
<td>Lucie Guillemette Beaconsfield, Québec</td>
<td>Vice President, Revenue Management</td>
<td>Vice President, Revenue Management, Air Canada</td>
<td>February 6, 2008</td>
</tr>
<tr>
<td>Carolyn M. Hadrovic Beaconsfield, Québec</td>
<td>Corporate Secretary</td>
<td>Corporate Secretary, Air Canada</td>
<td>February 16, 2006</td>
</tr>
<tr>
<td>Chris Isford Winnipeg, Manitoba</td>
<td>Vice President and Controller</td>
<td>Vice President and Controller, Air Canada</td>
<td>November 1, 2006</td>
</tr>
<tr>
<td>Amos Kazzaz, Saint-Laurent, Québec</td>
<td>Vice President, Financial Planning and Analysis</td>
<td>Vice President, Financial Planning and Analysis, Air Canada</td>
<td>May 3, 2010</td>
</tr>
<tr>
<td>Craig Landry Montreal, Québec</td>
<td>Vice President, Marketing</td>
<td>Vice President, Marketing, Air Canada</td>
<td>August 1, 2010</td>
</tr>
<tr>
<td>Priscille LeBlanc Toronto, Ontario</td>
<td>Vice President, Corporate Communications</td>
<td>Vice President, Corporate Communications, Air Canada</td>
<td>November 8, 2007</td>
</tr>
<tr>
<td>Scott Morey Georgetown, Ontario</td>
<td>Vice President, Labour Relations</td>
<td>Vice President, Labour Relations, Air Canada</td>
<td>January 15, 2007</td>
</tr>
<tr>
<td>Claude Morin Montreal, Québec</td>
<td>Vice President, Global Sales Management</td>
<td>Vice President, Global Sales Management, Air Canada</td>
<td>March 2, 2000</td>
</tr>
<tr>
<td>David J. Shapiro Hampstead, Québec</td>
<td>Vice President and General Counsel</td>
<td>Vice President and General Counsel, Air Canada</td>
<td>November 12, 2004</td>
</tr>
<tr>
<td>Lise-Marie Turpin Pointe-Claire, Québec</td>
<td>Vice President, Cargo</td>
<td>Vice President, Cargo</td>
<td>March 1, 2012</td>
</tr>
<tr>
<td>Derek Vanstone Toronto, Ontario</td>
<td>Vice President, Corporate Strategy, Industry and Government Affairs</td>
<td>Vice President, Corporate Strategy, Industry and Government Affairs, Air Canada</td>
<td>September 10, 2012</td>
</tr>
<tr>
<td>Michael Friisdahl Toronto, Ontario</td>
<td>President and Chief Executive Officer, Leisure Group</td>
<td>President and Chief Executive Officer, Leisure Group, Air Canada</td>
<td>October 1, 2012</td>
</tr>
</tbody>
</table>

(1) Mr. Richardson is a non-executive officer of Air Canada.
(2) Mr. Rovinescu was also an executive officer of Air Canada from 2000 to 2004.

Unless otherwise indicated below, each of the officers has held a position with Air Canada similar to that listed above for more than five years. Mr. Rovinescu was Co-founder and Senior Principal of Genuity Capital Markets from 2004 to 2009. Mr. Goersch was Executive Vice President, Operations and Customer Service of AirTran Airways from 2010 to 2012 and Senior Vice President, Operations of AirTran Airways from 2008 to 2010. Mr. Careen was Senior Vice President, Operations of Air Canada Jazz from 2008 to 2009 and Vice President, Airports and SOC of Air Canada Jazz from 2007 to 2008. Mr. Forget was a consultant from 2007 to 2009. Ms. Gedeon was President and Chief Executive Officer of Air Canada.
Vacations from 2007 to 2012. Mr. Kazzaz was Chief Operating Officer of ZAPI from 2007 to 2010. Mr. Landry was Senior Vice President, Commercial of Aeroplan Canada from 2009 to 2010, Senior Vice President, Corporate Development of Groupe Aeroplan from 2008 to 2009 and Vice President, Marketing and Rewards of Aeroplan Canada from 2006 to 2008. Mr. Morin was President and Chief Executive Officer of Air Canada Cargo from 2004 to 2008. Ms. Turpin was Managing Director of Air Canada Cargo from 2008 to 2012 and Senior Director, Operations - The Americas of Air Canada Cargo from 2002 to 2008. Mr. Vanstone was Deputy Chief of Staff to the Prime Minister of Canada from 2010 to 2012 and Chief of Staff to the Minister of Finance from 2007 to 2010. Mr. Friisdahl was Chief Executive Officer of Thomas Cook North America from 2003 to 2012.

As at March 21, 2013, the directors and officers mentioned above, as a group, owned, or had control or direction over, directly or indirectly, 1,451,301 Class B Voting Shares representing approximately 0.59% of the outstanding Class B Voting Shares and 157,759 Class A Variable Voting Shares representing approximately 0.50% of the outstanding Class A Variable Voting Shares.

**Cease Trade Orders, Bankruptcies, Penalties or Sanctions**

To the knowledge of Air Canada, no director or executive officer of Air Canada is, as at the date of this AIF, or was, within 10 years before the date of this AIF, a director, chief executive officer or chief financial officer of any company that, (a) was subject to a cease trade order, an order similar to a cease trade order or an order that denied the relevant company access to any exemption under securities legislation, that was in effect for a period of more than 30 consecutive days (an "Order") that was issued while the director or executive officer of Air Canada was acting in the capacity as director, chief executive officer or chief financial officer, or (b) was subject to an Order that was issued after the director or executive officer of Air Canada ceased to be a director, chief executive officer or chief financial officer and which resulted from an event that occurred while that person was acting in the capacity as director, chief executive officer or chief financial officer.

To the knowledge of Air Canada, no director or executive officer of Air Canada, or a shareholder holding a sufficient number of securities of Air Canada to affect materially the control of Air Canada, (a) is, as at the date of this AIF, or has been within the 10 years before the date of this AIF, a director or executive officer of any company that, while that person was acting in that capacity, or within a year of that person ceasing to act in that capacity, became bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver, receiver manager or trustee appointed to hold its assets; or (b) has, within the 10 years before the date of the AIF, become bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency, or become subject to or instituted any proceedings, arrangement or compromise with creditors, or had a receiver, receiver manager or trustee appointed to hold the assets of the director, executive officer or shareholder of Air Canada, except for:
(i) Michael M. Green was a director of Anchor Glass Container Corporation when it filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code in August 2005;

(ii) Pierre Marc Johnson was a director of Air Canada when it filed for protection under the CCAA on April 1, 2003;

(iii) Calin Rovinescu was an executive officer of Air Canada when it filed for protection under the CCAA on April 1, 2003;

(iv) Lise Fournel was an executive officer of Air Canada when it filed for protection under the CCAA on April 1, 2003;

(v) Kevin Howlett was an executive officer of Air Canada when it filed for protection under the CCAA on April 1, 2003;

(vi) Susan Welscheid was an executive officer of Air Canada when it filed for protection under the CCAA on April 1, 2003;

(vii) Alan D. Butterfield was appointed Vice President, Line and Airframe Maintenance at United Airlines in March 2004 while United Airlines and its parent company, UAL Corp. were operating under bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code;

(viii) Amos Kazzaz was Vice President, Corporate Real Estate at United Airlines when its parent company, UAL Corp. filed for protection under Chapter 11 of the U.S. Bankruptcy Code in December 2002; and

(ix) Claude Morin was an executive officer of Air Canada when it filed for protection under the CCAA on April 1, 2003.

To the knowledge of Air Canada, no director or executive officer of Air Canada or a shareholder holding a sufficient number of securities of Air Canada to affect materially the control of Air Canada, (i) has been subject to any penalties or sanctions imposed by a court relating to securities legislation or by a securities regulatory authority or has entered into a settlement agreement with a securities regulatory authority or (ii) has been subject to any other penalties or sanctions imposed by a court or regulatory body that would likely be considered important to a reasonable investor in making an investment decision.
AUDIT, FINANCE AND RISK COMMITTEE

Audit Committee Charter

The charter of the Audit, Finance and Risk Committee ("Audit Committee") is attached as Appendix A to this AIF.

Composition of Audit Committee

As of the date hereof, the Audit Committee of Air Canada consists of Michael M. Green (chair), Thomas Birks, Joseph B. Leonard, Roy J. Romanow, Vagn Sørensen and Annette Verschuren. Each member of the Audit Committee is independent and financially literate as defined under National Instrument 52-110 – Audit Committees.

Relevant Education and Experience of Audit Committee Members

In addition to each member’s general business experience, the education and experience of each Audit Committee member that is relevant to the performance of his responsibilities as an Audit Committee member is as follows:

(i) Michael M. Green is the Chief Executive Officer and Managing Director of Tenex Capital Management, a private investment firm. Mr. Green has a multi-industry investment and operations background in aerospace, transportation, telecommunications and software systems. Mr. Green was Managing Director of Cerberus Capital Management, L.P. from 2004 to 2009. From 1999 to 2004, Mr. Green was Managing Partner of TenX Capital Partners, and joined Cerberus in 2004 when Cerberus acquired certain portfolio companies from TenX. Previously, Mr. Green was Chief Executive Officer of Trispam Solutions and Naviant Technology. Mr. Green began his career at General Electric Company where he worked in several operating departments and held positions in engineering, manufacturing, sales, marketing and general management. Mr. Green holds a dual Bachelor of Science degree in Electrical Engineering and Physics from State University of New York, Buffalo and a Master of Science degree in Electrical Engineering from Villanova University.

(ii) Thomas Birks is the President of Birinco Inc., a merchant bank with investment portfolios ranging from private equity to passive investments. From 1985 to 1989, Mr. Birks served as President of Henry Birks and Sons Ltd. Mr. Birks has extensive global experience having worked in various countries including Australia, Japan and South Africa for Coles-Myer, Mitsubishi Bank, and Van Zwam, Vladykin and Douglas, respectively. He previously served as Chair of Viterra Inc., as well as Chair and board member of numerous corporations, educational institutions, hospitals and foundations. Mr. Birks graduated from McGill University with a Bachelor of Arts degree and holds a Master of Business Administration degree from the Harvard Business School. He has also studied at the University of Lausanne, the University of Fribourg and the University of Paris.

(iii) Joseph B. Leonard is a corporate director. Mr. Leonard is a director of Mueller Water Products, Inc. and Walter Energy, Inc. Mr. Leonard was Interim Chief Executive Officer of Walter Energy, Inc. from 2010 to 2011 and Chairman of AirTran Holdings, Inc. from 1999 to 2008 and Chief Executive Officer from 1999 to 2007. Mr. Leonard was also President and Chief Executive Officer of AlliedSignal’s Aerospace marketing, sales and service organization and previously held various senior management positions with Northwest Airlines, Eastern Airlines and American Airlines. Mr. Leonard holds a Bachelor of Science degree in Aerospace Engineering from Auburn University Montgomery.

(iv) Roy J. Romanow is a Senior Fellow in Public Policy at the University of Saskatchewan. During his career in public office, Mr. Romanow served as Premier of Saskatchewan from 1991 until 2001. Mr. Romanow was previously Deputy Premier, Attorney General and Minister of Intergovernmental Affairs. From 2001 to 2002, Mr. Romanow led the Royal Commission on the Future of Health Care in Canada, and from 2003 to 2008, he served on Canada’s Security Intelligence Review Committee. Mr. Romanow holds a Bachelor of Arts degree and a Bachelor of Law degree from the University of Saskatchewan.
Vagn Sørensen is a corporate director. Mr. Sørensen is the Chairman of FL Smidth & Co. A/S, Scandic Hotels AB, Select Service Partner Plc U.K., TDC A/S and UC4 Software GmbH, and Vice Chairman of DFDS A/S. Mr. Sørensen is a director of Braganza AS, Lufthansa Cargo AG, Nordic Aviation Capital A/S and Royal Caribbean Cruises Ltd. Mr. Sørensen is also a Senior Industrial Advisor with EQT Partners, a private equity fund. Mr. Sørensen was previously President and Chief Executive Officer of Austrian Airlines Group from 2001 to 2006, and held various senior commercial positions and served as Deputy Chief Executive Officer with SAS Scandinavian Airlines System. Mr. Sørensen has served as Chairman of the Association of European Airlines, member of the Board of Governors of the International Air Transport Association and member of the Board of Vienna Stock Exchange. Mr. Sørensen holds a Master of Economics degree from Aarhus Business School in Denmark.

Annette Verschuren is the Chair and Chief Executive Officer of NRstor Inc., a new venture focused on commercializing energy storage technologies. From 1996 to 2011, Ms. Verschuren was the President of The Home Depot Canada and prior to joining The Home Depot Canada, Ms. Verschuren was the President and co-owner of Michaels of Canada. Previously, Ms. Verschuren was the Vice President, Corporate Development of Imasco Ltd. and the Executive Vice President of Canada Development Investment Corporation. Ms. Verschuren is a board member of Liberty Mutual Insurance Group and the North West Company. She also serves as Chancellor of Cape Breton University and is a board member of numerous non-profit organizations including the CAMH Foundation, the Conference Board of Canada and Habitat for Humanity’s national leadership council. Ms. Verschuren holds honorary doctorate degrees from Mount Saint Vincent University, Dalhousie University and St. Francis Xavier University where she also earned a Bachelor of Business Administration degree.

Pre-approval Policies and Procedures

The Audit Committee reviews and approves the nature of all non-audit services, as permitted by securities legislation and regulations, to be provided by the Corporation’s external auditor prior to the commencement of such work. In this regard, the Audit Committee will prepare a report for presentation to the shareholders of the Corporation quarterly or annually, as required, regarding the Audit Committee’s approval of such non-audit services in the period.

The Audit Committee will also require and review a report from the external auditor that in the external auditor’s professional judgment it is independent of the Corporation and discuss this report with the external auditor in order to evaluate the objectivity and independence of the external auditor. The Audit Committee will also review steps taken by the external auditor to address any findings in the foregoing review.

Auditors’ Fees

PricewaterhouseCoopers LLP has served as the Corporation’s auditing firm since April 26, 1990. Fees payable for the years ended December 31, 2012 and December 31, 2011 to PricewaterhouseCoopers LLP and its affiliates are $2,725,564 and $2,789,161, respectively, as detailed below.

<table>
<thead>
<tr>
<th></th>
<th>Year ended December 31, 2012</th>
<th>Year ended December 31, 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit fees</td>
<td>$1,769,465</td>
<td>$1,734,574</td>
</tr>
<tr>
<td>Audit-related fees</td>
<td>612,639</td>
<td>779,484</td>
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<td>Tax fees</td>
<td>131,558</td>
<td>103,271</td>
</tr>
<tr>
<td>All other fees</td>
<td>211,902</td>
<td>171,832</td>
</tr>
<tr>
<td></td>
<td>$2,725,564</td>
<td>$2,789,161</td>
</tr>
</tbody>
</table>
The nature of each category of fees is described below:

Audit fees

Audit fees were paid for professional services rendered for the audit of the Corporation’s annual consolidated financial statements and for services that are normally provided in connection with statutory and regulatory filings or engagements related to the annual consolidated financial statements, including review engagements performed on the interim consolidated financial statements of the Corporation.

Audit-related fees

Audit-related fees were paid for professional services related to the audit of the non-consolidated financial statements of Air Canada, pension plan audits, audits of subsidiary companies, where required, specified procedures reports and other audit engagements not related to the consolidated financial statements of the Corporation.

Tax fees

Tax fees were paid for professional services rendered with respect to income taxes.

All other fees

Other fees were paid for translation services, advisory services and fees related to the auditors’ involvement with offering documents, if any.

INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

Other than as described elsewhere in this AIF, none of the (i) directors or executive officers of Air Canada, (ii) shareholders of Air Canada, that, to the knowledge of Air Canada, beneficially own, or control, directly or indirectly, more than 10% of any class of shares of Air Canada, or (iii) any associate or affiliate of the persons referred to in (i) and (ii), has or has had any material interest, direct or indirect, in any transaction during the three most recently completed financial years or the current financial year that has materially affected or is reasonably expected to materially affect Air Canada or any of its subsidiaries.

LEGAL PROCEEDINGS

A description of certain legal proceedings to which Air Canada is a party appears under the heading “Current Legal Proceedings” in the section entitled “Risk Factors” in this AIF.

MATERIAL CONTRACTS

The contracts that are material to the Corporation and that were entered into within the year ended December 31, 2012, or before such year but which are still in effect, and which are required to be filed with Canadian securities regulatory authorities in accordance with section 12.2 of National Instrument 51-102 — Continuous Disclosure Obligations, are as follows:

(i) the Indentures dated August 2010 governing the First Lien Notes and the Second Lien Notes, and the Collateral Trust Agreement dated August 2010 governing the holding of collateral securing the First Lien Notes and the Second Lien Notes;

(ii) the Jazz CPA; and

(iii) the Aircraft General Terms Agreement AGTA-ACN and related agreements between Boeing and Air Canada dated November 4, 2005.
EXPERTS

The Corporation’s independent auditors are PricewaterhouseCoopers LLP, Chartered Accountants, who have issued an auditor’s report dated February 6, 2013, in respect of the Corporation’s consolidated statement of financial position as at December 31, 2012 and December 31, 2011, and the consolidated statement of operations, consolidated statement of comprehensive income (loss), consolidated statement of changes in equity, and consolidated statement of cash flow for the years ended December 31, 2012 and December 31, 2011. PricewaterhouseCoopers LLP has advised that they are independent with respect to the Corporation within the meaning of the Code of Ethics of the Ordre des comptables agréés du Québec.

ADDITIONAL INFORMATION

Additional information, including directors’ and officers’ remuneration and indebtedness, principal holders of Air Canada’s securities and securities authorized for issuance under equity compensation plans are contained in Air Canada’s management proxy circular for its 2012 annual and special meeting of shareholders held on June 4, 2012 and will be contained in Air Canada’s management proxy circular for its 2013 annual meeting of shareholders. Additional financial information is provided in Air Canada’s consolidated financial statements for the year ended December 31, 2012 and Air Canada’s 2012 MD&A dated February 7, 2013. The above documents and additional information relating to Air Canada are available on Air Canada’s website at aircanada.com or on SEDAR at www.sedar.com.

The following documents can be obtained by sending your request to the Corporate Secretary of Air Canada, at Air Canada Centre, P.O. Box 14000, Station Airport, Dorval, Québec, H4Y 1H4:

(i) this AIF, together with any document incorporated herein by reference;

(ii) the Consolidated Financial Statements of Air Canada as at and for the year ended December 31, 2012, including the auditor’s report and notes related thereto, Air Canada’s MD&A for the year ended December 31, 2012, and any interim financial statements filed after the audited financial statements for Air Canada’s most recently completed financial year; and

(iii) any other documents that are incorporated by reference into a short form prospectus pursuant to which securities of Air Canada are in the course of a distribution.

Except when securities of Air Canada are in the course of distribution pursuant to a short form prospectus, Air Canada may require the payment of a reasonable charge from persons, other than securityholders of Air Canada, requesting copies of these documents.
"ACE" means ACE Aviation Holdings Inc., a corporation incorporated under the CBCA;

"ACPA" means the Air Canada Pilots Association;

"ACPPA" means the Air Canada Public Participation Act, as amended;

"Adjusted Net Income" means the consolidated net income (loss) of the Corporation attributable to shareholders of Air Canada adjusted to remove the effects of (to the extent included in consolidated net income (loss)) foreign exchange, net financing income (expense) relating to employee benefits, mark-to-market adjustments on derivatives and other financial instruments recorded at fair value, and unusual items;

"AE" means Accountable Executive;

"Aeroplan" means Aimia Canada Inc. ;

"Air Canada Cargo" means the cargo services division of Air Canada;

"Air Canada Vacations" means Touram Limited Partnership (doing business as Air Canada Vacations), a limited partnership established under the laws of the Province of Québec;

"Air Canada rougeTM" means 8165343 Canada Inc. (doing business as Air Canada rougeTM), which is incorporated under the laws of Canada;

"Available Seat Miles or ASMs" means the total number of seats available for passengers multiplied by the miles flown;

"Audit Committee" means the Audit, Finance and Risk Committee of Air Canada;

"Aveos" means Aveos Fleet Performance Inc.;

"Boeing" means The Boeing Company;

"CAIL" means Canadian Airlines International Ltd.;

"CALDA" means the Canadian Airline Dispatchers Association;

"CARICOM" means the Caribbean Community and Common Market;

"CATSA" means the Canadian Air Transport Security Agency;

"CAW" means the Canadian Auto Workers;

"CBCA" means the Canada Business Corporations Act, as amended;
"CBP" means the U.S. Customers and Border Protection;

"CBSA" means the Canada Border Services Agency;

"CCAA" means the Companies’ Creditors Arrangement Act, as amended;

"CDP" means the Carbon Disclosure Project;

"Corporation" shall have the meaning ascribed thereto under “Explanatory Notes”;

"CTA" means the Canada Transportation Act, as amended;

"CTP" means Air Canada’s cost transformation program which was launched in mid-2009;

"CUPE" means the Canadian Union of Public Employees;

"DBRS" means DBRS Limited;

"EBITDA" means earnings before interest, taxes, depreciation, amortization and impairment;

"EBITDAR" means earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent;

"Embraer" means EMBRAER – Empresa Brasileira de Aeronautica S.A.;

"ESTA" means Electronic System for Travel Authorization;

"EU ETS" means European Emission Trading Scheme;

"FTE" shall have the meaning ascribed thereto under employees;

"GAAP" means generally accepted accounting principles in Canada;

"GTAA" means the Greater Toronto Airport Authority;

"IAMAW" means the International Association of Machinists and Aerospace Workers;

"IATA" means the International Air Transport Association;

"IBT" means the International Brotherhood of Teamsters;

"ICAO" means the International Civil Aviation Organization;

"Independent" means independent as defined in National Policy 58-201 — Corporate Governance Guidelines;
"Initial Public Offering" shall have the meaning ascribed thereto under "Corporate Structure – Name, Address and Incorporation";

"Jazz" means Jazz Aviation LP;

"Jazz CPA" means the Amended and Restated Capacity Purchase Agreement between Air Canada and Jazz dated January 1, 2006, as amended;

"Management" means management of Air Canada;

"Montreal Trudeau Airport" means Montreal's Pierre Elliott Trudeau International Airport;

"Moody's" means Moody's Investors service, Inc.

"OAG" means Official Airline Guide;

"OLA" means the Official Languages Act (Canada), as amended;

"Open Skies Agreement" means the agreement negotiated between the governments of Canada and the United States which came into force on March 12, 2007;

"OSFI" means the Office of the Superintendent of Financial Institutions;

"PIPEDA" means the Personal Information Protection and Electronic Documents Act (Canada);

"Plan" means the consolidated plan of reorganization, compromise and arrangement of Air Canada and certain of its subsidiaries pursuant to which ACE became the parent holding company of the reorganized Air Canada and its subsidiaries;

"Porter" means Porter Airlines Inc.;

"Shares" means both Variable Voting Shares and Voting Shares;

"SOC" means System Operations Centre;

"SARS" means Severe Acute Respiratory Syndrome;

"Sky Regional" means Sky Regional Airlines Inc.;

"Standard & Poor's" means Standard & Poor's Rating Services;

"Subsidiary" has the meaning attributed to such term in the CBCA, provided that, notwithstanding the reference to a body corporate in the CBCA, a subsidiary may refer to a limited partnership or trust;

"Sunwing" means Sunwing Airlines;
"Tax Act" means the *Income Tax Act (Canada)* and the regulations thereunder, as amended;

"Toronto Pearson Airport" means Toronto Pearson International Airport;

"Transat" means Transat A.T. Inc.;

"TSA" means the Transportation Security Administration;

"TSX" means the Toronto Stock Exchange;

"United Airlines" means United Air Lines, Inc.;

"Variable Voting Shares" means Class A variable voting shares in the capital of Air Canada;

"Voting Shares" means Class B voting shares in the capital of Air Canada;

"WestJet" means WestJet Airlines Ltd.;

"WHO" means the World Health Organization;

"WTI" means West Texas Intermediate; and

"Yield" means average passenger revenue per Revenue Passenger Mile.
SCHEDULE A

CHARTER OF THE

AUDIT, FINANCE AND RISK COMMITTEE
(the "Audit Committee")

OF THE BOARD OF DIRECTORS

OF AIR CANADA
(the "Corporation")

1. PURPOSE

The purpose of the Audit Committee is as follows:

(i) To assist the Board in the discharge of its responsibility to monitor the component parts of the Corporation's financial reporting and audit process.

(ii) To maintain and enhance the quality, credibility and objectivity of the Corporation's financial reporting and to satisfy itself and oversee management's responsibility as to the adequacy of the supporting systems of internal financial and accounting controls.

(iii) To assist the Board of Directors in its oversight of the independence, qualifications and appointment of the external auditor.

(iv) To monitor the performance of the internal financial and accounting controls and of the internal and external auditors.

(v) To provide independent communication among the Board, the internal auditor and the external auditor.

(vi) To facilitate in-depth and candid discussions among the Audit Committee, management and the external auditor regarding significant issues involving judgment and impacting quality of controls and reporting.

2. COMPOSITION AND QUALIFICATION

(a) The Audit Committee of the Corporation shall be composed of not less than three directors, all of whom shall meet the independence, experience and other membership requirements under applicable laws, rules and regulations as determined by the Board of Directors. The members of the Audit Committee shall have no relationships with management, the Corporation and its related entities that in the opinion of the Board may interfere with their independence from management and from the Corporation. In addition, an Audit Committee member shall not receive, other than for service on the Board or the Audit Committee or other committees of the Board, any consulting, advisory, or other compensatory fee from the Corporation or any of its related entities, parties or subsidiaries. The members of the Audit Committee shall possess the mix of characteristics, experiences and skills to provide an appropriate balance for the performance of the duties of the Audit Committee and in particular each member of the Audit Committee shall be "financially literate" and at least one member shall be a "financial expert" as defined by relevant securities legislation or regulations.
The members of the Audit Committee shall be appointed by the Board to hold office from the time of their appointment until the next annual general meeting of the shareholders or until their successors are appointed. Unless a Chair and a Secretary are appointed by the Board, the members of the Audit Committee may designate a Chair and a Secretary by a majority vote of all the Audit Committee members.

The Audit Committee may invite, from time to time, such person as it may see fit to attend its meeting and to take part in discussion and consideration of the affairs of the Audit Committee. However, any such persons invited may not vote at any meeting of the Audit Committee.

The Board, may, at any time, remove any member of the Audit Committee at its discretion and may accept the resignation of any member of the Audit Committee. Vacancies at any time occurring on the Audit Committee shall be filled by the Board.

3. MEETINGS AND PROCEDURE

(i) The Audit Committee shall meet at least four times annually, or more frequently as circumstances dictate. Such meetings shall be held by telephone or by any other mean which enables all participants to communicate with each other simultaneously.

(ii) The Audit Committee may fix its own procedure at meetings and for the calling of meetings except as may be otherwise provided by the Board.

(iii) A quorum for the transaction of business at an Audit Committee meeting shall be a majority of the Audit Committee members. All decisions and recommendations made by the Audit Committee shall be made by a majority vote of the members present at the meeting.

(iv) An "in-camera" session of the members of the Audit Committee shall be held as part of each meeting of the Audit Committee.

(v) Notice of meetings shall be given by letter, facsimile, email or telephone not less than 24 hours before the time fixed for the meeting. Notice of meetings shall state the date, the place and the hour at which such meetings shall be held. Members may waive notice of any meeting.

(vi) The minutes of the Audit Committee meetings shall accurately record the significant discussions of, and decisions made by, the Audit Committee, including all recommendations to be made by the Audit Committee to the Board and shall be distributed to Audit Committee members as well as to all the directors of the Corporation, with copies to the Chief Executive Officer of the Corporation.

(vii) The Audit Committee shall report to the Board on all proceedings and deliberations of the Audit Committee at the first subsequent meeting of the Board, and at such other times and in such manner as the Board may require or as the Audit Committee in its discretion may consider advisable.
4. RESPONSIBILITIES AND DUTIES

To achieve its objectives, the Audit Committee shall:

(a) Monitor and review the quality and integrity of the Corporation's accounting and financial reporting process through discussions with management, the external auditor and the internal auditor. This will include a review of the annual and quarterly financial statements and Management's Discussion and Analyses ("MD&As") to be filed with regulatory authorities and provided to shareholders, and financial statements and other financial disclosure included in prospectuses, earnings press releases and other similar documents. The Audit Committee shall also review the Corporation's annual information form and other similar documents. These reviews will include:

(i) discussions with management and the external auditor and a consideration of the report by the external auditor to the Audit Committee of matters related to the conduct of an audit;

(ii) discussions with the external auditor respecting the auditor's judgment regarding both the acceptability and quality of the financial statements including the critical accounting policies and practices used by management in their preparation, alternative treatments and disclosures of financial information within generally accepted accounting principles that have been considered by management and their ramifications, the selection of changes in significant accounting policies, the method used to account for significant unusual transactions, the effect of significant accounting policies in controversial or emerging areas, the degree of aggressiveness or conservatism, as the case may be, of the accounting policies adopted by the Corporation, the process used by management in formulating particularly significant accounting estimates and the basis for the external auditor's conclusions regarding the reasonableness of those estimates;

(iii) a review of significant adjustments arising from an audit;

(iv) a review of disagreements with management over the application of accounting policies as well as any disclosure in the financial statements. The Audit Committee is responsible for the resolution of disagreements between management and the external auditor regarding financial reporting;

(v) a review of all material off-balance sheet transactions and other relationships with non-consolidated entities that may have a material current or future effect on the financial condition of the Corporation including their disclosure or lack thereof in the applicable quarterly or annual financial statements;

(vi) a review of the external auditor's suggestions for improvements to the Corporation's operations and internal controls;

(vii) a review of the nature and size of unadjusted errors of a non-trivial amount;

(viii) a review to ascertain that various covenants are complied with; and

(ix) the selection of, and changes in, accounting policies and consideration of the appropriateness of such selections and changes.

(b) Determine, based on its review and discussion, whether to recommend the approval by the Board of the annual and quarterly financial statements and related MD&A, and the financial disclosure in any such annual information forms, earnings press releases, prospectuses and other similar documents.

(c) Review with management, the external auditor and legal counsel, the Corporation's procedures to be satisfied that it complies with applicable laws and regulations, and any significant litigation, claim or other contingency, including tax assessments, that would have a material effect upon the financial position or operating results of the Corporation and the disclosure or impact on the results of these matters in the quarterly and annual financial statements. The Audit Committee should be satisfied that adequate procedures are in place for the review of the Corporation's public disclosure of financial information extracted or derived from the Corporation's financial statements, and must periodically assess the adequacy of those procedures.
Meet with the Corporation's external auditor to review and approve their audit plan with particular emphasis on risk factors which could lead to a material misstatement of the financial statements, the scope and timing of the audit, the assumptions and decisions that have been made in developing the plan and co-ordination of work between the external auditor and the internal audit department. The Audit Committee is responsible for overseeing the work of the external auditor engaged for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the Corporation.

Review and approve estimated audit and audit-related fees and expenses for the current year. Pre-approve any significant additional audit and audit-related fees over the estimated amount. Review and approve audit and audit-related fees and expenses for the prior year. The authority for the determination and payment of fees to the external auditor rests solely and exclusively with the Audit Committee. The Corporation shall ensure that funding is available to the Audit Committee for payment of compensation to the external auditor.

Review and approve, or delegate to a member of the Audit Committee the responsibility to review and approve, the nature of all non-audit services, as permitted by securities legislation and regulations, to be provided by the Corporations' external auditor prior to the commencement of such work. In this regard the Audit Committee will prepare a report for presentation to the shareholders of the Corporation quarterly or annually, as required, regarding the Audit Committee's approval of such non-audit services in the period. The pre-approval of non-audit services by a member of the Audit Committee to whom such authority is delegated must be presented to the Audit Committee at its first scheduled meeting following such pre-approval;

and implement from time to time a process in connection with non-audit services performed by the external auditor.

Review a report from the external auditor that in the external auditor's professional judgment it is independent of the Corporation and discuss this report with the external auditor in order to evaluate the objectivity and independence of the external auditor. The Audit Committee should specifically require the external auditor to confirm that it is a registered public accounting firm as prescribed by various applicable securities regulations and to confirm that it is not the subject of any other inquiry or investigation by governmental or professional authority relating to any audit conducted by the firm.

Receive reports on any consultations between management and other public accountants respecting accounting principles to be applied in preparing the quarterly or annual financial statements, and on any incidents involving fraud or illegal acts of which management, the internal audit department or the external auditor become aware. In this regard, review the relevant control procedures with management to satisfy itself that such matters are adequately guarded against.

At least once each year:

Meet privately with management to assess the performance of the external auditor.

Meet privately with the external auditor, amongst other things, to understand any restrictions placed on them or other difficulties encountered in the course of the audit, including instructions on the scope of their work and access to requested information and the level of co-operation received from management during the performance of their work and their evaluation of the Corporation's financial, accounting and audit personnel and systems.

Evaluate the performance of the external auditor, and if so determined, recommend that the Board either take steps to replace the external auditor or provide for the reappointment of the external auditor by the shareholders.

Regarding the services provided by the internal audit department, the Audit Committee will:
(i) meet privately with internal audit, amongst other things, to understand any restrictions placed on them or other difficulties encountered in the course of their audits, including instructions on the scope of their work and access to requested information and the level of co-operation received from management during the performance of their work;

(ii) periodically review and approve the mandate, reporting relationships and resources of the internal audit group;

(iii) review the objectivity, qualifications, adequacy and experience of the internal audit staff and approve the appointment, dismissal or replacement of the head of the internal audit department;

(iv) review and approve annually the planned scope for the internal audit program, its objectives, and the resources required to attain these objectives;

(v) periodically throughout each year review the reports of the internal audit department which describe the activities of the internal audit department for the preceding period; and

(vi) review the working relationship between the internal audit department and the external auditor, and between the internal audit department and management.

(l) Obtain from both the internal audit department and the Corporation’s external auditor the major audit findings and internal control recommendations reported during the period under review, the response of management to those recommendations, and review the follow-up performed by management and the internal audit department in order to monitor whether management has implemented an effective system of internal accounting control.

(m) Review significant emerging accounting and reporting issues, including recent professional and regulatory pronouncements, and assess their impact on the Corporation’s financial statements.

(n) Establish policies and procedures for the receipt, retention and treatment of complaints received by the Corporation from employees, shareholders and other stakeholders regarding accounting issues and financial reporting, internal accounting controls and internal or external auditing matters. The Audit Committee should be satisfied that sufficient controls are in place with the objective that all such complaints can be received anonymously and with an appropriate degree of confidentiality and that potential employee informants are aware of the process that is in place. The Audit Committee should also be satisfied that processes are in place with the objective that all such complaints, regardless of significance, are presented to the Audit Committee.

(o) Review policies for approval of senior management expenses.

(p) Review the process relative to the periodic certifications by the Chief Executive Officer and the Chief Financial Officer of the Corporation in respect of financial disclosures, the existence of any significant deficiencies in the design or operation of internal controls which could adversely affect the Corporation’s ability to record, process, summarize and report financial data and any significant changes in internal controls or changes to the environment in which the internal controls operate, including corrections of material deficiencies and weaknesses.

(q) Review with management the Corporation’s computer systems, including procedures to keep the systems secure and contingency plans developed to deal with possible computer failures.

(r) Review and approve all related party transactions as such term is defined from time to time in Regulation 61-101 respecting Protection of Minority Security Holders in Special Transactions of the Autorité des marchés financiers and Multilateral Instrument 61-101 issued by the Ontario Securities Commission, as may be amended from time to time.

(s) Review risk management systems and controls, especially in relation to derivatives, foreign currency exposure, hedging and insurance.
Whenever it may be appropriate to do so, retain and receive advice from experts, including independent legal counsel and independent public accountants, and conduct or authorize the conduct of investigations into any matters within the scope of the responsibility of the Audit Committee as the Audit Committee may consider appropriate. The Corporation shall ensure that funding is available to the Audit Committee in respect of the aforementioned activities.

Report regularly to the Board on the activities, findings and conclusions of the Audit Committee.

Review this Charter on an annual basis and recommend to the Board any changes to it that the Audit Committee considers advisable.

Complete a self-assessment annually to determine how effectively the Audit Committee is meeting its responsibilities.

Perform such other functions as may be delegated from time to time by the Board.

Review the process for the rotation of the lead audit partner, the concurring partner and any other audit engagement team partner of the external auditor of the Corporation.

Review and approve the Corporation’s hiring policies regarding partners, employees and former partners and employees of the present and former external auditors of the Corporation.

OTHER

(a) **Public Disclosure**

The Audit Committee shall:

(i) Review and approve the Corporation’s Public Disclosure Policy and any changes related thereto and satisfy itself that such policy is consistent with current developments and best practices;

(ii) Where practicable, management will review with the Audit Committee or the Chairman of the Audit Committee draft news releases to be disseminated to the public related to earnings warnings or financial results forecasting by the Corporation which are expected by management to be material in relation to the market price of any of the Corporation’s securities.

(b) **Risk Identification and Management**

The Audit Committee shall make all reasonable efforts to identify and address material financial and other risks to the business and affairs of the Corporation and its subsidiaries and make recommendations in that regard to the Board of Directors of the Corporation. The Audit Committee shall review and discuss with management, the internal audit department and the external auditor all major financial risk exposures and the steps management has taken to monitor/control those exposures. The Audit Committee shall be entitled, from time to time, to retain experts and consultants to assist the Audit Committee with the discharge of such mandate. The Audit Committee shall have the discretion in the discharge of these duties to address risks to the Corporation’s and its subsidiaries’ revenues and costs, as well as potentially corrupt or other practices that may lead to loss or depreciation of business reputation.

(c) **Contingent Liabilities**

The Audit Committee shall monitor contingent liabilities of the Corporation and its subsidiaries. In the discharge of this duty, the Audit Committee shall have the discretion to retain experts and consultants and to review, without limitation, workplace safety, environmental issues and any other matters, whether of a financial nature or otherwise, that can give rise to a contingent liability. The Audit Committee shall make recommendations, from time to time, to the Board of Directors of the Corporation on these matters.
(d) **Corporate Authorizations Policies**

The Audit Committee shall:

(iii) Periodically review and approve policies relative to the financial control, conduct, regulation and administration of subsidiary companies;

(iv) Periodically review any administrative resolutions adopted from time to time pursuant to the Corporation’s By-laws pertaining to the establishment of procedures relative to commitment and transaction authorizations, the determination of the officers or other persons by whom any instrument in writing or document is to be executed and the manner of execution thereof;

(v) Review, monitor and approve the Corporate Donations Policy and any changes thereto and the annual Corporate Donations Budget; and

(vi) Review, monitor and approve any other financial expenditure policies that would affect the Corporation’s and its subsidiaries’ financial condition or reputation.

(e) **Performance to Budget**

The Audit Committee shall review actual financial performance compared to budget.

(f) **Responsibilities**

Nothing contained in the above mandate is intended to assign to the Audit Committee the Board of Directors’ responsibility regarding the Corporation’s compliance with applicable laws or regulations or to expand applicable standards of liability under statutory or regulatory requirements for the directors or the members of the Audit Committee. Even though the Audit Committee has a specific mandate and its members have financial experience and expertise, it is not the duty of the Audit Committee to plan or conduct audits, or to determine that the Corporation’s financial statements are complete and accurate and are in accordance with generally accepted accounting principles. Such matters are the responsibility of management, the internal auditor and the external auditor.

Members of the Audit Committee are entitled to rely, absent knowledge to the contrary, on (i) the integrity of the persons and organizations from whom they receive information, (ii) the accuracy and completeness of the information provided, and (iii) representations made by management as to the non-audit services provided to the Corporation by the external auditor.

November 7, 2012