2018 ANNUAL REPORT

1. HIGHLIGHTS

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

(Canadian dollars in millions, except where indicated)	Fourth Quarter 2018	Fourth Quarter 2017 (1)	Fourth Quarter $ Change	Full Year 2018	Full Year 2017 (1)	Full Year $ Change
Financial Performance Metrics						
Operating revenues	4,246	3,820	426	18,065	16,252	1,813
Operating income	122	133	(11)	1,174	1,371	(197)
Income (loss) before income taxes	(216)	20	(236)	405	1,286	(881)
Net income (loss)	(231)	8	(239)	167	2,029	(1,862)
Adjusted pre-tax income (2)	68	77	(9)	952	1,165	(213)
Adjusted net income (2)	54	60	(6)	677	1,145	(468)
Operating margin %	2.9%	3.5%	(0.6) pp	6.5%	8.4%	(1.9) pp
EBITDAR (excluding special items) (2)	543	521	22	2,851	2,928	(77)
EBITDAR margin (excluding special items) % (2)	12.8%	13.6%	(0.8) pp	15.8%	18.0%	(2.2) pp
Unrestricted liquidity (3)	5,725	4,181	1,544	5,725	4,181	1,544
Net cash flows from operating activities	360	389	(29)	2,695	2,738	(43)
Free cash flow (2)	141	(43)	184	791	1,056	(265)
Adjusted net debt (2)	5,858	6,116	(258)	5,858	6,116	(258)
Return on invested capital ("ROIC") % (2)	12.6%	15.3%	(2.7) pp	12.6%	15.3%	(2.7) pp
Leverage ratio (2)	2.1	2.1	-	2.1	2.1	-
Diluted earnings per share	$ (0.85)	$ 0.02	$ (0.87)	$ 0.60	$ 7.31	$ (6.71)
Adjusted earnings per share – diluted (2)	$ 0.20	$ 0.22	$ (0.02)	$ 2.45	$ 4.11	$ (1.66)
Operating Statistics (4)			% Change			% Change
Revenue passenger miles ("RPM") (millions)	20,801	19,396	7.2	92,360	85,137	8.5
Available seat miles ("ASM") (millions)	25,598	24,191	5.8	110,866	103,492	7.1
Passenger load factor %	81.3%	80.2%	1.1 pp	83.3%	82.3%	1.0 pp
Passenger revenue per RPM ("Yield") (cents)	18.2	17.6	3.8	17.6	17.1	2.5
Passenger revenue per ASM ("PRASM") (cents)	14.8	14.1	5.2	14.6	14.1	3.8
Operating revenue per ASM (cents)	16.6	15.8	5.1	16.3	15.7	3.8
Operating expense per ASM ("CASM") (cents)	16.1	15.2	5.7	15.2	14.4	6.0
Adjusted CASM (cents) (2)	11.4	11.3	0.5	10.6	10.6	0.3
Average number of full-time equivalent ("FTE") employees (thousands) (5)	30.5	28.3	7.6	29.9	27.8	7.4
Aircraft in operating fleet at period-end	400	395	1.3	400	395	1.3
Average fleet utilization (hours per day)	9.7	9.7	(0.1)	10.4	10.4	0.1
Seats dispatched (thousands)	15,185	14,522	4.6	63,800	60,820	4.9
Aircraft frequencies (thousands)	137.7	138.4	(0.5)	578.9	569.6	1.6
Average stage length (miles) (6)	1,686	1,666	1.2	1,738	1,702	2.1
Fuel cost per litre (cents)	84.3	67.5	24.8	80.4	62.6	28.4
Fuel litres (thousands)	1,293,063	1,254,111	3.1	5,597,232	5,331,888	5.0
Revenue passengers carried (thousands) (7)	11,909	11,314	5.3	50,904	48,126	5.8

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

(2) Adjusted pre-tax income, adjusted net income, adjusted earnings per share – diluted, EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent), EBITDAR margin, leverage ratio, free cash flow, ROIC and adjusted CASM are each non-GAAP financial measures and adjusted net debt is an additional GAAP measure. Refer to sections 8 and 20 of Air Canada's 2018 MD&A for descriptions of Air Canada's non-GAAP financial measures and additional GAAP measures. As referenced in the table above, special items are excluded from Air Canada's reported EBITDAR calculations. Refer to section 6 of Air Canada's 2018 MD&A for information on the special items.

(3) Unrestricted liquidity refers to the sum of cash, cash equivalents and short-term investments and the amount of available credit under Air Canada's revolving credit facilities. At December 31, 2018, unrestricted liquidity was comprised of cash, cash equivalents and short-term investments of $4,707 million and undrawn lines of credit of $1,018 million. At December 31, 2017, unrestricted liquidity was comprised of cash, cash equivalents and short-term investments of $3,804 million and undrawn lines of credit of $377 million.

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

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

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

(7) Revenue passengers are counted on a flight number basis (rather than by journey/itinerary or by leg) which is consistent with the IATA definition of revenue passengers carried.

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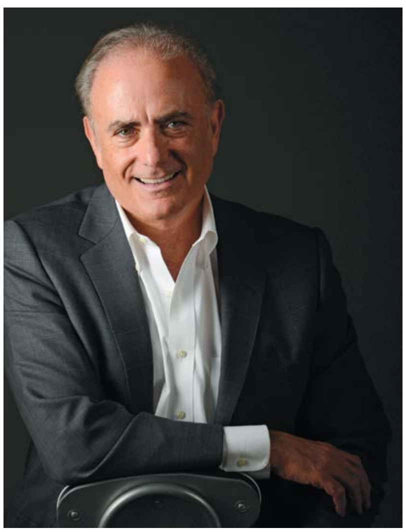
MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER


Calin Rovinescu

Air Canada's strong execution capabilities were on full display in 2018 given the many challenges faced during the year, including significantly higher fuel costs and economic and trade uncertainty. The results achieved, including a strengthened balance sheet and an expanded global franchise, demonstrated both resiliency and consistency. Air Canada shares outperformed industry peers as well as the TSX Composite Index, and they have now returned more than 4,000% since we first set about to transform ourselves a decade ago.

We generated record operating revenue of $18.065 billion in 2018 and ended the year with record unrestricted liquidity of $5.725 billion. Following on a record year in 2017, we reported a comparably solid performance on other key metrics, such as EBITDAR of $2.851 billion (including record fourth quarter EBITDAR of $543 million), operating income of $1.174 billion, net cash from operating activities of $2.695 billion and $791 million free cash flow.

Success in any given year depends on many things going right. In this regard, our 2018 record revenue reflected year-over-year increases in passenger revenue in all markets we serve. This underscores both the strength of our network and a highly efficient fleet deployment across that network.

To put this in perspective, we have achieved nine consecutive years of revenue growth. Our 2018 passenger revenue was $16.2 billion, an 11.2% increase over 2017.

This revenue growth was also accompanied by strict cost discipline within controllable cost categories. In 2018, Air Canada's unit costs, or cost per available seat mile (CASM), increased 6.0% compared to 2017, mostly attributable to an increase in fuel costs of almost $1.2 billion. Adjusted CASM, which excludes fuel expense, the cost of ground packages at Air Canada Vacations and special items, increased only 0.3%, in line with our projections.

Our free cash flow of $791 million in 2018 was significantly above guidance. Adjusted net debt of $5.858 billion was down $258 million from the prior year as an increase in long-term debt and finance leases was more than offset by an increase in cash, cash equivalents and short-term investments. The company's leverage ratio of 2.1 was unchanged from December 31, 2017. Our weighted average cost of capital stood at 7.2% at year-end, 540 basis points lower than our return on invested capital of 12.6%, resulting in continued value creation.

Another important record for the year was the number of customers carried. We flew 50.9 million passengers, an increase of 5.8% from 2017, with an average load factor of 83.3%. To contextualize these numbers, looking back into our past, it took us 30 years to fly our first 50 million customers.

More importantly, we carried our customers safely and did so with increased levels of customer care as the numerous awards we were privileged to receive in 2018 attest. For the second year in a row and the seventh time in nine years, Skytrax named us North America's Best Airline and we remain the only four-star international network carrier in North America. We achieved a five-star rating for our onboard

Air Canada shares outperformed industry peers as well as the TSX Composite Index, and they have now returned more than 4,000% since we first set about to transform ourselves a decade ago.

customer experience from the Airline Passenger Experience Association. As well, we continue to lead in the all-important, higher-yielding market segment of frequent business travellers, where Air Canada is the preferred airline for domestic travel for 92% of this population, according to the Ipsos Reid 2018 Canadian Business Traveller Survey.

Results such as these speak to the extent of the transformation Air Canada has undergone; one we are committed to pursue even more vigorously into the future, as we continue to adhere to the four corporate priorities that have brought us to this point.

The first of these is Revenue Enhancement and Cost Control. Not only have we successfully grown revenue, but the make-up of that revenue has also greatly improved. On a stage-length adjusted basis, in 2018, system yield increased 3.7% and PRASM improved 5% over 2017. We have done this by attracting a greater share of business and premium customers as well as through an effective ancillary fee strategy, which resulted in a 13% increase in such revenue over 2017.

As mentioned, the counterpart to revenue generation is cost control. Our ability to contain unit costs below our forecast is evidence of a cost discipline now engrained throughout our company. Today, on a local currency basis, we operate at the same adjusted CASM level on average as our much larger U.S. competitors, which should further reduce the valuation discount our company has long been subject to versus our U.S. peers.

We anticipate further cost reductions. Already, at year-end, we had achieved or identified $220 million of $250 million in annual savings targeted in a two-year Cost Transformation Program which began in 2018. Air Canada Rouge, with its 29% lower adjusted CASM compared to Air Canada mainline, continues to expand in leisure markets and domestically on routes where we face low-cost carrier competition.

Our fleet renewal has also been a key driver for CASM reductions. In 2018, we took delivery of five Boeing 787-9 and 16 Boeing 737 MAX 8 aircraft into the mainline fleet and added one Airbus A321, two Airbus A319s and one Boeing 767 aircraft to the Air Canada Rouge fleet. All of these new fleet types have been designed to produce significant CASM savings over the aircraft they will replace.

We have structured our fleet renewal program to strengthen our balance sheet. At present, 55 aircraft, or 23% of our combined mainline/Rouge fleet, are unencumbered, creating a pool of assets valued at US$2.6 billion that we can monetize if needed. This asset pool will increase as we expect to have close to 100 or almost 40% of our combined mainline/Rouge fleet unencumbered by the end of 2021.

Fleet renewal has also supported our second priority of International Expansion. During 2018, Air Canada and Air Canada Rouge launched 29 new routes, mostly international and transborder. With our wide-body fleet renewal largely completed, the pace of capacity growth will taper but we will continue to add new international routes where margins are higher and to further diversify and de-risk our network.

An equally important consideration is each new route's potential to draw incremental international-connecting traffic through our hubs. In support of this, we undertook several projects in 2018 to streamline airport connection processes, notably with new measures to save connecting and transiting customers significant time on customs and baggage retrieval. These efforts are bearing fruit, as over the last five years we have grown such connecting traffic by 142%.

We augment our network through close partnerships with other carriers, notably the 28-member Star Alliance. Beyond this, Air Canada belongs to two important joint ventures, one with United Airlines and the Lufthansa group of airlines and a second completed in 2018 with Air China. The latter is the first joint venture between a Chinese and North American carrier and it gives us a first mover advantage in the growing Chinese air transport market, which is expected to become the world's largest by 2022.

During the year, we continued to work on two major initiatives that will further spur customer engagement. One of these is the development of our new loyalty program, which took a quantum leap in 2018 when Air Canada reached an agreement to acquire Aeroplan and entered into co-branded credit card agreements with TD, CIBC, Visa and, after year-end, the Amex Bank of Canada.

Our modern fleet and expansive network are essential to our third priority of Customer Engagement. Along with investing in aircraft, we have devoted considerable resources to training, onboard amenities and the airport environment. A milestone achievement in 2018 was the launch of Air Canada Signature Service, providing superior curb-to-curb services for Premium customers travelling internationally and on select transcontinental itineraries. Other innovations included the expansion of onboard connectivity to international flights and the opening of three new Maple Leaf Lounges.

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A second major customer service initiative is the replacement of our decades-old reservation system by a new passenger service system. After it goes into service later in 2019, it will modernize our systems for reservations, inventory and departure control, and allow Air Canada to optimize its flight schedule by providing the ability to more easily manage inventory between any given origin and destination. For customers, one key benefit is that it will automate rebookings during flight disruptions, such as those caused by extreme weather.

The new reservation system, by giving employees superior tools to assist customers, will also significantly advance our fourth priority of Culture Change. While strong finances make our transformation possible, it is our employees who most immediately effect change and carry through Air Canada's transformation. It is their day-to-day interactions with our customers and their ability to take ever-better care of them that ultimately determines the success of our company.

The strength of Air Canada's culture is widely recognized through our unprecedented, long-term labour agreements that provide stability and common purpose for all employee groups. For the sixth year in a row, we have been ranked among Canada's Top 100 employers and during 2018 we received other awards, including One of Canada's Most Attractive Employers, One of the 50 Most Engaged Workplaces, and we were rated fifth in the Top 20 Employer Brands in Canada.

Another significant recognition from 2018 that we are proud of and bears on employee engagement is the Eco-Airline of the Year Award from *Air Transport World*. Studies show that, increasingly, people, particularly millennials, opt for careers with companies that act responsibly. This award helps further our recruitment, retention and engagement efforts, not to mention also appealing to customers who quite properly demand responsible behaviour and sustainability commitments from corporations.

It has been 10 years now since Air Canada first undertook to repair a badly broken business model with the aim of transforming itself into a global champion that would be sustainably profitable over the long-term. Our 2018 performance, following on record results of recent years, can leave no doubt that we are achieving these ambitious goals.

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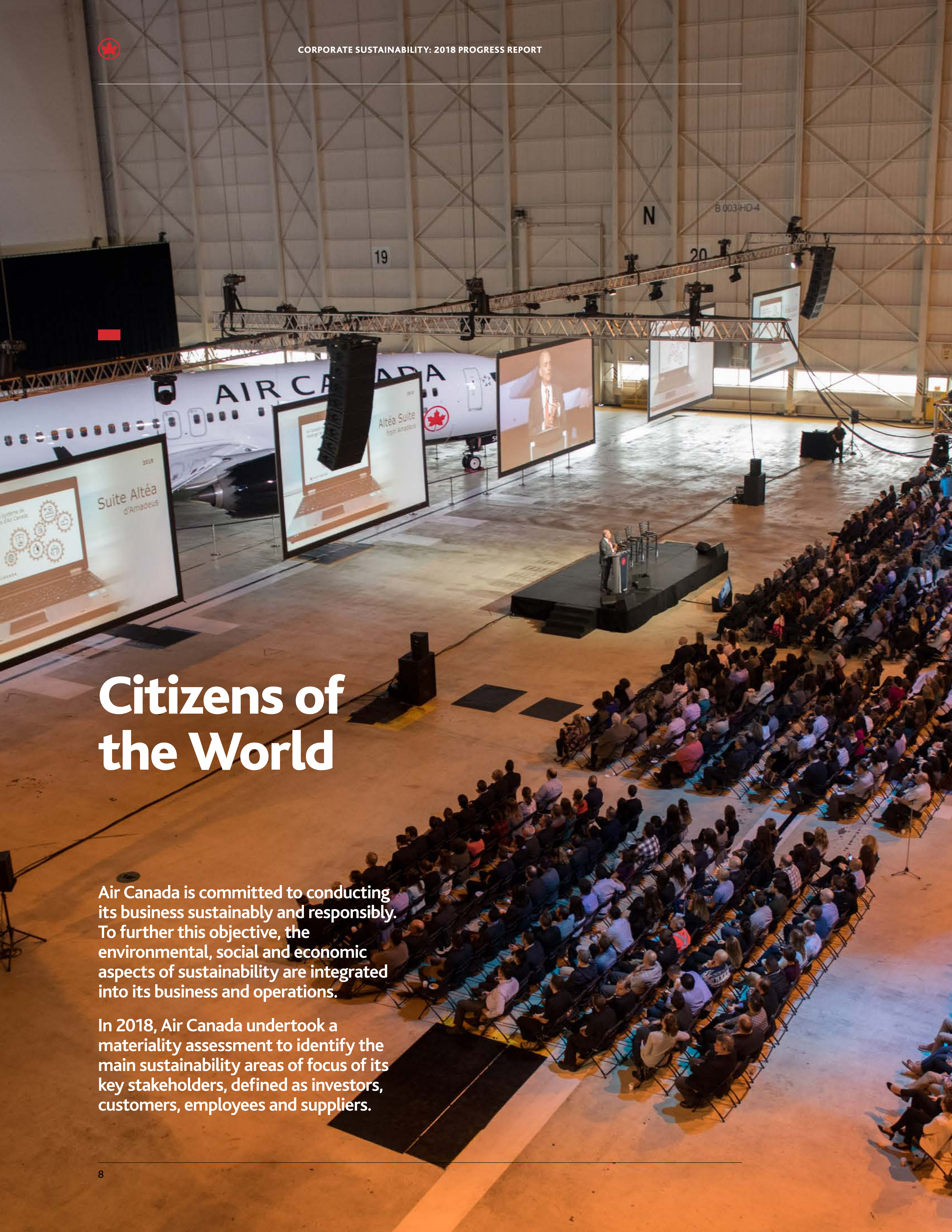
However, we are also cognizant that our industry continuously evolves and that our competition never rests, so we also view all we have achieved as a prelude to the next chapter. The resiliency of Air Canada, as shown by its 2018 results relative to its peers, and its now well-established track record of delivering on its commitments, gives us every confidence of continued success.

Backstopping this confidence is the unwavering support we have received from our Board of Directors and shareholders during every step of our journey. I am deeply appreciative of the guidance provided by our Board of Directors and the long-term commitment investors have made, as together we progress toward our ever-closer goal of an investment grade rating.

Finally, I also thank the 30,000 employees of Air Canada, who have so wholly embraced change in a rapidly evolving landscape that they now occupy a leadership role in the global industry. As well, I also thank our customers and assure them that all of us at Air Canada are fully committed to earning their loyalty every day by continuing to transport them safely with the utmost of care and class.

Calin Rovinescu
President and Chief Executive Officer

March 1, 2019



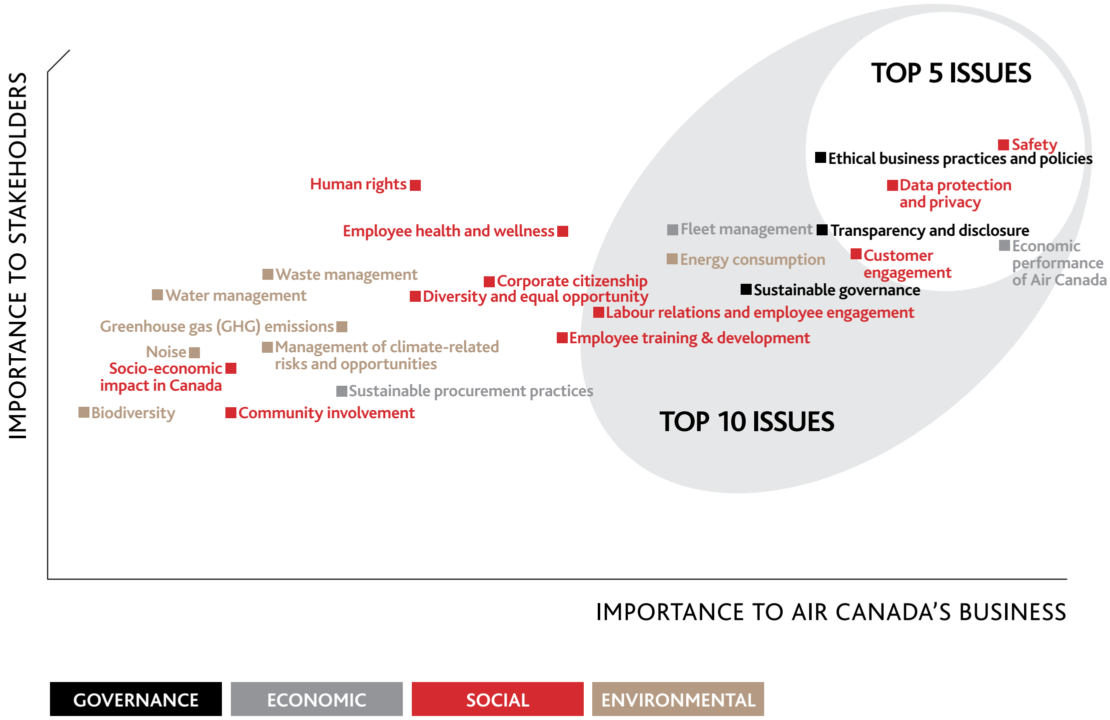
Citizens of the World

Air Canada is committed to conducting its business sustainably and responsibly. To further this objective, the environmental, social and economic aspects of sustainability are integrated into its business and operations.

In 2018, Air Canada undertook a materiality assessment to identify the main sustainability areas of focus of its key stakeholders, defined as investors, customers, employees and suppliers.

RESULTS OF STAKEHOLDER ANALYSIS CONDUCTED IN 2018

Air Canada's Materiality Matrix



1 Safety
2 Economic performance of Air Canada
3 Data protection and privacy
4 Ethical business practices and policies
5 Customer engagement
6 Transparency and disclosure
7 Fleet management
8 Sustainable governance
9 Energy consumption
10 Labour relations and employee engagement

In addition, a Corporate Sustainability Working Group tasked with the monitoring and coordinating of Air Canada's corporate sustainability initiatives was formed. The group is comprised of Air Canada senior management subject-matter experts from diverse functions, including Environmental Affairs, Health and Safety, Strategic Procurement, Legal, Communications and Community Partnerships, as well as Brand, Investor Relations and Risk Advisory. The Working Group reports on Air Canada's sustainability performance and makes recommendations to a Corporate Sustainability Steering Committee, which includes several Air Canada Executives.

A fulsome discussion of Air Canada's corporate sustainability performance, awards and goals will be available in the company's forthcoming Corporate Sustainability Report that will be available online at **aircanada.com**.

The report continues to be anchored on four pillars: (i) safety; (ii) environment; (iii) employees; and (iv) the communities.

The following is an overview of Air Canada's key social and environmental performance achievements in 2018:

SAFETY

- ✓ Provided employees with an updated Alcohol and Drug Policy to lend guidance and manage the risks associated with the legalization of cannabis.
- ✓ Successfully implemented a Multi-Factor Authenticator pilot program to better protect employee, customer and company data, reducing exposure to cyber-risk.
- ✓ Conducted a privacy maturity assessment to help drive its efforts in protecting employee and customer data.

ENVIRONMENT

- ✓ Recognized as the 2018 Eco-Airline of the Year by *Air Transport World*.
- ✓ Achieved IATA Environmental Assessment (IEnvA) Certification, Phase 1.
- ✓ Exceeded the collective fuel efficiency targets of 1.5% set for the airline industry.
- ✓ Continued to modernize its fleet towards improved fuel efficiency with the addition of 16 Boeing 737 MAX and five Boeing 787 aircraft.
- ✓ Contributed to saving 160 tonnes of carbon emissions on 22 domestic flights for Earth Day through Canada's Biojet Supply Chain Initiative (CBSCI), an innovative biojet fuel research project funded through the Green Aviation Research & Development Network (GARDN), developing experience-based knowledge with biojet integration in co-mingled fuelling systems at Canadian airports. As the only commercial airline partner, Air Canada sourced and integrated 230,000 litres of sustainable biojet fuel into Pearson International Airport's multi-user fuel supply system.
- ✓ Operated, in partnership with the Edmonton Airport Authority, a biofuel trade mission flight on May 2, 2018—Air Canada's eighth biofuel flight since 2012.
- ✓ Continued to advance its new livery deployment with a leading technology paint system known as base coat clear coat (BCCC) system. This livery system contains no chrome, lead or other heavy metals and requires less layers of paint, enabling operational efficiencies, reducing weight and reducing the overall carbon footprint.

EMPLOYEES

- ✓ Recognized as one of Canada's Top 100 Employers and Canada's Best Diversity employers, and named one of the top five most attractive company brands to work for in Canada and one of Montréal's Top Employers.
- ✓ Enhanced the Emerging Leaders Program, a corporate career development program for managers.
- ✓ Implemented Buy-Time to Retirement and Reduced Work Week programs for senior employees to transition to retirement, while enabling the transfer of expertise to their colleagues.
- ✓ Marked International Women's Day 2018 by operating two intercontinental flights with all-female staff, from ground handlers, to check-in, to pilots and flight attendants, and welcomed young women considering employment in aviation during Young Women in Aviation Day.
- ✓ Celebrated Pride, engaging in five memorable parades and other events for its employees and the community.

Canada's Top 100 Employers 2018

2018 CANADA'S BEST DIVERSITY EMPLOYERS

Montréal's Top Employers 2018

COMMUNITIES

- ✓ Established 150 community partnerships, such as those focused on the diversity of the LGBTQ2+ community in Canada, the Rendez-vous de la Francophonie, the Vimy Foundation, and the Indspire Awards—the latter designed to recognize the tremendous contributions that Indigenous People are making across the country.
- ✓ The Air Canada Foundation granted financial and in-kind support to 275 Canadian registered charities focused on the health and well-being of children and youth and provided assistance to over 450 fundraising initiatives.
- ✓ Raised a record 7,595,245 Aeroplan Miles in December 2018 through the Air Canada Foundation's Matching Miles campaign for children requiring medical care away from home.

In addition, the following business process improvements were made in 2018 in support of Air Canada's sustainability efforts:

- ✓ First airline to be certified for CEIV Live Animals by the International Air Transport Association.
- ✓ Launched a "Supplier portal" (available on aircanada.com) to collect key information on existing and prospective suppliers. In addition to continually improving its Supplier Code of Conduct, Air Canada's Strategic Procurement team amended its formal supplier risk assessment process for new strategic suppliers in order for Air Canada to monitor for possible reputational risk issues. The assessment focuses on multitude criteria, including environmental, health and safety, cyber-security, privacy compliance, criminal and other illegal activities.

As well, Air Canada made significant progress in its goal of becoming a sustainably profitable global champion. Its key accomplishments in this regard are further described in Air Canada's public disclosure file, including in its 2018 MD&A.

There are many upcoming programs to further secure Air Canada's long-term sustainable performance, including initiatives related to its loyalty business.

The following is an overview of Air Canada's corporate sustainability objectives for 2019:

SAFETY

- Rank in the top 3% of airlines included in the IATA Operational Safety Audit.
- Deploy the Multi-Factor Authenticator Program to its entire employee base.
- Pursue the Privacy Action Plan, focusing on six broad areas to improve its privacy maturity.

ENVIRONMENT

- Prepare for the first delivery of the new fuel-efficient Airbus A220 aircraft.
- Continue to act on the 2020 Corporate Waste Strategy with the following key activities for 2019:
  - Single-Use Plastics Reduction Program for both on board and within our workplaces.
  - Expansion of the collection and recycling process in the Maple Leaf Lounges.
  - Centralization of waste infrastructure at its Montréal headquarters.
  - Audit the Onboard Domestic Recycling Program as part of its continuous improvement focus for domestic flights.

EMPLOYEES

- Support the implementation of Amadeus Altéa Suite passenger service system by initiating training for more than 7,000 employees.
- Create a change management Centre of Excellence.
- Further develop its Emerging Leaders Program to focus more directly on succession plans in key areas of the business.

COMMUNITIES

- Develop community partnerships in support of regional network performance, talent acquisition and socio-economic development.
- Achieve a fundraising goal for the Air Canada Foundation of $2M (net) to support charitable organizations focusing on the health and wellness of children and youth.

2018

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

2. INTRODUCTION AND KEY ASSUMPTIONS

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), the "Corporation" refers, as the context may require, to Air Canada and/or one or more of Air Canada's subsidiaries, including its wholly-owned operating subsidiaries, Touram Limited Partnership, doing business as Air Canada Vacations® ("Air Canada Vacations") and Air Canada Rouge LP, doing business as Air Canada Rouge® ("Air Canada Rouge"). This MD&A provides the reader with a review and analysis, from the perspective of management, of Air Canada's financial results for the fourth quarter and full year of 2018. This MD&A should be read in conjunction with Air Canada's audited consolidated financial statements and notes for 2018. All financial information has been prepared in accordance with generally accepted accounting principles in Canada ("GAAP"), as set out in the CPA Canada Handbook – Accounting ("CPA Handbook"), which incorporates International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"), except for any non-GAAP measures and any financial information specifically denoted otherwise.

Except as otherwise noted, monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 21 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of February 14, 2019.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 18 "Risk Factors" of this MD&A. Air Canada issued a news release dated February 15, 2019 reporting on its results for the fourth quarter and the full year of 2018. This news release is available on Air Canada's website at **aircanada.com** and on SEDAR's website at **www.sedar.com**. For further information on Air Canada's public disclosures, including Air Canada's Annual Information Form, consult SEDAR at **www.sedar.com**.

CAUTION REGARDING FORWARD-LOOKING INFORMATION

Air Canada's public communications may include forward-looking statements within the meaning of applicable securities laws. Such forward-looking statements are included in this MD&A and may be included in other communications, including filings with regulatory authorities and securities regulators. Forward-looking statements may be based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to strategies, expectations, planned operations or future actions. Forward-looking statements are identified using 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, our ability to successfully achieve or sustain positive net profitability or to realize our initiatives and objectives, industry, market, credit, economic and geopolitical conditions, energy prices, currency exchange, competition, our dependence on technology, cybersecurity risks, our ability to successfully implement appropriate strategic initiatives or reduce operating costs, our ability to successfully integrate and operate the Aeroplan loyalty business following its acquisition from Aimia Inc. and to successfully launch our new loyalty program, our ability to preserve and grow our brand, airport user and related fees, high levels of fixed costs, our dependence on key suppliers including regional carriers, employee and labour relations and costs, our dependence on Star Alliance and joint ventures, interruptions of service, environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), our ability to pay our indebtedness and maintain liquidity, pension issues, limitations due to restrictive covenants, pending and future litigation and actions by third parties, our ability to attract and retain required personnel, war, terrorist acts, casualty losses, changes in laws, regulatory developments or proceedings, epidemic diseases, insurance issues and costs, as well as the factors identified in Air Canada's public disclosure file available at www.sedar.com and, in particular, those identified in section 18 "Risk Factors" of this MD&A. The forward-looking statements contained or incorporated by reference in this MD&A represent Air Canada's expectations as of the date of this MD&A (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 because of new information, future events or otherwise, except as required under applicable securities regulations.

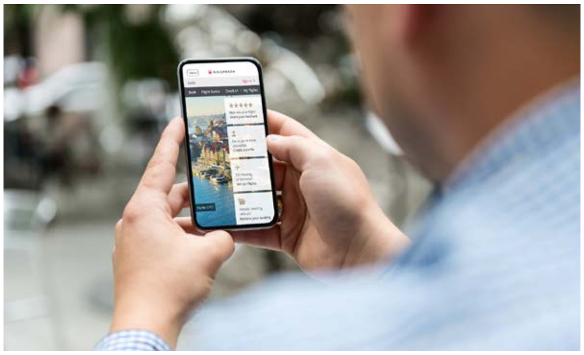
KEY ASSUMPTIONS

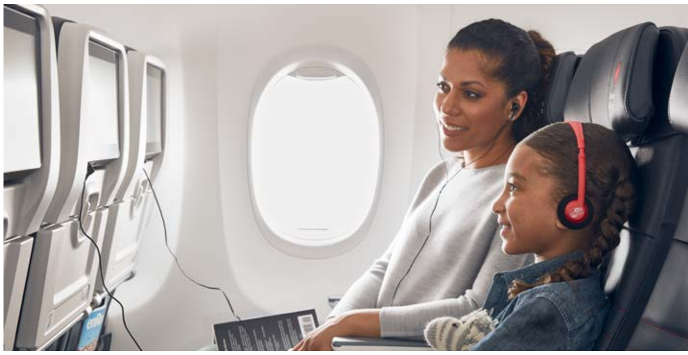
Assumptions were made by Air Canada in preparing and making forward-looking statements. As part of its assumptions, Air Canada assumes continued relatively modest Canadian GDP growth for the first quarter and full year 2019. Air Canada also expects that the Canadian dollar will trade, on average, at C$1.32 per U.S. dollar in the first quarter and for the full year 2019 and that the price of jet fuel will average 77 CAD cents per litre in the first quarter and 82 CAD cents per litre for the full year 2019.

INTELLECTUAL PROPERTY

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

This MD&A may also include trademarks, service marks or trade names of other parties. Air Canada's use or display of other parties' trademarks, service marks, trade names or products is not intended to, and does not imply a relationship with, or endorsement or sponsorship of Air Canada by, the trademark, service mark or trade name owners or licensees.





3. ABOUT AIR CANADA

Air Canada is 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 2018, Air Canada, together with Jazz Aviation LP ("Jazz"), Sky Regional Airlines Inc. ("Sky Regional") and other regional airlines operating flights on behalf of Air Canada under capacity purchase agreements, operated, on average, 1,613 daily scheduled flights to 222 direct destinations on six continents, comprised of 64 Canadian cities, 60 destinations in the United States and a total of 98 cities in Europe, Africa, the Middle East, Asia, Australia, the Caribbean, Mexico and South America. In 2018, Air Canada carried a record of 50.9 million passengers, an increase of 5.8% from 2017.

At December 31, 2018, Air Canada mainline operated a fleet of 184 aircraft, comprised of 91 Boeing and Airbus narrow-body aircraft, 74 Boeing and Airbus wide-body aircraft, and 19 Embraer 190 regional jets, while Air Canada Rouge operated a fleet of 53 aircraft, comprised of 22 Airbus A319 aircraft, six Airbus A321 aircraft and 25 Boeing 767-300 aircraft.

Air Canada enhances its domestic and transborder network through capacity purchase agreements ("CPAs") with regional airlines, namely Jazz, Sky Regional Airlines Inc. ("Sky Regional"), Air Georgian Limited ("Air Georgian") and Exploits Valley Air Services Limited ("EVAS"), each of which operates flights on behalf of Air Canada. These carriers form an integral part of the airline's international network strategy, providing valuable traffic feed to Air Canada and Air Canada Rouge routes. At December 31, 2018, the Air Canada Express fleet was comprised of 45 Bombardier regional jets, 84 Bombardier Dash-8 turboprop aircraft and 25 Embraer 175 aircraft for a total of 154 aircraft. Air Georgian and EVAS also operated a total of nine 18-passenger Beech 1900 aircraft on behalf of Air Canada.

Air Canada is a founding member of the Star Alliance® network. Through the 28-member airline network, Air Canada offers its customers access to 1,317 destinations in 193 countries, as well as reciprocal participation in frequent flyer programs and the use of airport lounges and other common airport facilities.

Air Canada is able to build customer loyalty through Air Canada Altitude®, its frequent flyer program and through the Aeroplan® loyalty program. Air Canada Altitude recognizes and rewards Aeroplan members with a range of premium travel privileges and benefits corresponding to their travel activity, such as priority check-in, complimentary checked baggage and upgrades to Business Class, as well as opportunities to earn Aeroplan Miles on Air Canada flights and those of the other 27 Star Alliance member airlines. Aeroplan members also have opportunities to redeem their Aeroplan Miles for travel with Star Alliance member airlines.

Air Canada has been pursuing a comprehensive strategy to improve profitability and competitiveness in leisure markets. This strategy leverages the strengths of Air Canada, Air Canada Rouge, the airline's lower-cost airline, and Air Canada Vacations. Through Air Canada Rouge, Air Canada is pursuing opportunities in leisure markets made viable by Air Canada Rouge's more competitive cost structure. Air Canada Vacations is a leading Canadian tour operator, developing, marketing and distributing vacation travel packages, operating in the outbound leisure travel market (Caribbean, Mexico, U.S., Europe, Central and South America, South Pacific, Australia and Asia), and the inbound leisure travel market to destinations within Canada, and also offering cruise packages in North America, Europe and the Caribbean.

Air Canada Cargo, Canada's largest provider of air cargo services as measured by cargo capacity, provides direct cargo services to over 150 Canadian, U.S. transborder and international destinations and has sales representation in over 50 countries. Air cargo services are provided across the Air Canada network.

4. STRATEGY

Air Canada's principal objective is to become a sustainably profitable global champion. In pursuing this goal, Air Canada seeks to continually improve customer experience and employee engagement and create value for shareholders by focusing on four core priorities:

1. **Identify and implement cost reduction and revenue enhancing initiatives;**
2. **Pursue profitable international growth opportunities and leverage its competitive attributes to expand margins, in large part by increasing connecting traffic through its strategic international gateways in Toronto, Vancouver and Montreal, and grow and compete effectively in both the business and leisure market to and from Canada;**
3. **Engage customers by continually enhancing their travel experience and by consistently achieving customer service excellence; and**
4. **Foster positive culture change. This includes making meaningful investments in training and other tools that promote improved collaboration to enable Air Canada and its employees to better work together in a supportive and enriching environment.**

1. Revenue Enhancement and Cost Transformation

Margin improvement through the implementation of sustainable cost transformation and profitable revenue-generating initiatives is a key priority at Air Canada. Air Canada continues to seek and implement measures to reduce unit costs and expand margins, including through fleet modernization and greater fleet productivity. Additionally, Air Canada seeks to improve its ability to generate incremental passenger and ancillary revenue, including through its expanded suite of branded fare products and investments in technology.

Key achievements in 2018

- Record operating revenue of $18,065 million, $1,813 million or 11% above 2017.
- Carried record 50.9 million passengers, an increase of 5.8% from 2017.
- EBITDAR margin of 15.8%, consistent with the 2018 EBITDAR margin of approximately 16% forecast in Air Canada's news release dated October 31, 2018. Operating income of $1,174 million in 2018 reflected a decrease of $197 million from 2017. EBITDAR is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.
- ROIC of 12.6%, consistent with the 2018 ROIC of approximately 12% forecast in Air Canada's news release dated October 31, 2018. ROIC is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Realized or identified savings of $220 million under the new Cost Transformation Program intended to secure $250 million in savings. Air Canada expects to achieve the remaining savings of $30 million by the end of 2019.
- Adjusted CASM increased 0.3% from 2017, in line with the range of no increase to an increase of 0.75% projected in Air Canada's news release dated October 31, 2018. CASM increased 6.0% from 2017. Adjusted CASM is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

- Added one Airbus A321, two Airbus A319 and one Boeing 767 aircraft to the Air Canada Rouge fleet and five Boeing 787-9 and 16 Boeing 737 MAX 8 aircraft to the mainline fleet.
- Sold and leased back 25 Embraer 190 aircraft, of which six were returned to the lessor in late 2018.
- Record unrestricted liquidity of $5,725 million.
- Finalized, in November 2018, definitive agreements to acquire Aimia Inc's Aeroplan loyalty business as well as commercial agreements related to and in support of this acquisition with TD, CIBC, and Visa. The acquisition was completed on January 10, 2019.

Air Canada is taking tangible steps to pursue its strategy for sustained value creation and profitability through the execution of new and on-going strategic initiatives. These include:

Air Canada Rouge

Since its first flight in July 2013, Air Canada Rouge, Air Canada's low-cost carrier, has been deployed to a growing number of Caribbean destinations and select leisure destinations in the U.S. and Canada, as well as in international leisure markets where demand is highly elastic and responds positively to competitively priced, non-stop capacity. At December 31, 2018, Air Canada Rouge operated 53 aircraft (25 Boeing 767, 22 Airbus A319 and six Airbus A321 aircraft). Air Canada plans to add 10 narrow-body aircraft to Air Canada Rouge's fleet in 2019. Refer to section 8 "Fleet" of this MD&A for additional information.

Air Canada Rouge provides Air Canada with the flexibility to shift capacity between markets as well as between seasons. It also provides Air Canada with the ability to compete against lower-cost carriers as well as emerging North American ultra-low-cost carriers. Air Canada Rouge offers competitive fares while leveraging the strengths of Air Canada mainline, including its powerful brand, award-winning products and services, extensive network with enhanced connection options, distribution capability and operational expertise.

Boeing 787 Aircraft

To date, Air Canada has taken delivery of 35 Boeing 787 Dreamliner aircraft of its firm order of 37 (comprised of 8 787-8 and 29 787-9 aircraft). Air Canada plans to take delivery of the remaining two Boeing 787-9 aircraft on firm order by the summer of 2019. The Boeing 787 Dreamliner is driving new opportunities for profitable growth by opening new international destinations made viable by its lower operating costs, mid-size capacity and longer range.

Narrow-body Fleet Renewal Program

To date, Air Canada has taken delivery of 20 Boeing 737 MAX 8 aircraft of its firm order of 61 737 MAX aircraft (comprised of 50 Boeing 737 MAX 8 and 11 Boeing 737 MAX 9 aircraft). The Boeing 737 MAX aircraft are replacing the Airbus narrow-body aircraft in Air Canada's mainline fleet. Air Canada plans to add 18 737 Max 8 aircraft to the mainline narrow-body fleet in 2019.

Air Canada estimates that the Boeing 737 MAX 8 aircraft is delivering an 11% lower CASM when compared to the mainline Airbus A320 aircraft, mainly driven by greater maintenance and fuel efficiencies. This aircraft also offers greater deployment opportunities in the domestic, U.S. transborder and certain Atlantic markets.

Air Canada has a firm order for 45 Airbus A220-300 aircraft, the first of which Air Canada plans to take delivery of in late 2019. The first 25 aircraft on delivery will replace the Embraer 190 aircraft in Air Canada's mainline fleet, with the incremental aircraft supporting Air Canada's hub and network growth. Air Canada estimates that the Airbus A220-300 aircraft will deliver a 12% lower CASM when compared to the Embraer 190 aircraft, mainly driven by greater maintenance and fuel efficiencies. This aircraft, with its longer range, will also offer greater deployment opportunities, enabling Air Canada to serve new markets not as well suited to Air Canada's larger Boeing 737 MAX or Airbus A321 aircraft. Refer to section 8 "Fleet" of this MD&A for additional information.

Improvements to Commercial Agreement with Jazz and Equity Investment in Chorus

In February 2019, Air Canada concluded an agreement to amend and extend its capacity purchase agreement ("CPA") with Jazz, a wholly-owned subsidiary of Chorus Aviation Inc. The amendments will provide long term stability for Chorus, reaffirming Jazz as Air Canada's most significant Air Canada Express carrier well into the future. The amendments will bolster the strength and competitiveness of the Air Canada Express brand and its coast-to-coast regional network, and provide significant CPA savings for Air Canada, while optimizing network and fleet flexibility when compared to the current agreement.

Highlights of the CPA amendments are as follows:

- An extension of the CPA term by 10 years from January 1, 2026 to December 31, 2035.
- Simplification and modernization of the Jazz fleet with growth through more, larger gauge aircraft. The amendments include various minimum levels of covered aircraft at different points in time, providing Air Canada the flexibility to optimize its fleet within its network strategy.
- The continuance of a fixed fee structure, including new terms mitigating risk and market-oriented compensation to make the CPA more competitive for Air Canada, given new competitors entering the market.
- In support of Air Canada's cost transformation program, projected annual savings to Air Canada of approximately $50 million in 2019 and 2020, and cumulative savings of approximately $53 million between 2021 and 2025, both as compared to the 2015 CPA frame-work (from both fixed fee and performance incentive reductions). Beyond 2025, the CPA provides for a market competitive fixed fee. These projected savings are in addition to the significant benefits expected from improved network efficiencies relating to this transaction.
- The continuation of a highly successful pilot mobility agreement that provides Air Canada Express pilots with access to pilot careers at Air Canada on a planned basis.
- The consolidation of more of Air Canada's overall regional capacity into Jazz' footprint, thereby lowering Air Canada's overall regional costs in the future.

The amendments became effective retroactively as at January 1, 2019.

Concurrent with the CPA amendments, Air Canada made a $97.26 million equity investment in Chorus, subscribing for 15,561,600 Class B voting shares in the capital of Chorus, representing, at time of issuance, approximately 9.99% of the issued and outstanding Class A variable voting shares and Class B voting shares of Chorus on a combined basis. Chorus shares were issued to Air Canada at a price of $6.25 per share, representing a 5% premium to their five-day volume weighted average price as of the close of trading on January 10, 2019. Concurrently with the closing of the equity investment, Air Canada and Chorus entered into an investor rights agreement under which, among other things, Air Canada will hold the investment shares for a period of at least 60 months, subject to certain limited exceptions. Deputy Chief Executive Officer and Chief Financial Officer of Air Canada, Michael Rousseau, was also appointed to the board of directors of Chorus.

Other Revenue Optimization and Cost Reduction Initiatives

Air Canada has created a culture of continuous cost transformation and revenue improvement across the organization, continually seeking productivity, process and other improvements. Initiatives may entail revising business and operational processes, including supply chain and maintenance operations, improving employee productivity and asset utilization, and promoting workplace policies to add revenue and lower costs.

Air Canada updated its suite of branded fare products to allow it to further segment its customer base and offer a variety of fare options and a customized on-board experience. These new re-bundled fares provide a wider range of choices and stimulate sales based on specific attributes, driving incremental revenue. Air Canada continues to increase its ancillary revenue from its "à la carte" services, such as those related to baggage, ticket changes, seat selection, preferred seating and upgrades, and from its onboard offerings, including food, beverage, duty-free shopping and onboard Wi-Fi Internet. Air Canada is also realizing incremental revenue through investments in web and mobile platforms and, in 2018, saw a significant acceleration in direct channel share and core ancillary revenue sales.

Investments in technology will also play an important role in enhancing margins, including the implementation of a new passenger service system ("PSS") in late 2019 which is further described below. This new system is expected to provide annual incremental benefits of over $100 million.

2. Leveraging International Network

Air Canada is focused on leveraging its international network and its competitive attributes to appropriately expand margins, in large part by increasing international connecting traffic through its strategic international gateways in Toronto, Vancouver and Montreal, and competing effectively in the leisure market to and from Canada. Air Canada also continues to develop commercial alliances with major international carriers to broaden its network offerings.

Key developments in 2018

- Introduced non-stop Air Canada mainline service from Vancouver to Paris and Zurich; from Montreal to Dublin and Tokyo-Narita; and from Toronto to Shannon.
- Launched non-stop Air Canada Rouge service from Montreal to Bucharest, Lisbon, Phoenix and Victoria; from Toronto to Bucharest, Kamloops, Nanaimo, Porto and Zagreb; and from Edmonton to Las Vegas.
- Started non-stop Air Canada Express service from Toronto to Omaha and Providence; from Montreal to Baltimore, London (ON), Pittsburgh, and Windsor; from Vancouver to Sacramento; from Edmonton to Kelowna, San Francisco and Victoria; and from Calgary to Comox.
- Converted Air Canada Rouge service between Montreal and Casablanca to mainline service using an Airbus A330 aircraft.
- Concluded a revenue-sharing joint venture agreement with Air China, the first joint venture agreement between a Chinese and North American airline. The agreement, which is in respect of all flights between mainland China and Canada, allows for cooperation in various commercial and operational areas, including network planning, revenue management, sales and distribution, and airport operations. The joint venture agreement provides customers more flight choices, seamless travel experiences, optimized flight schedules, harmonized fare products, as well as reciprocal participation in frequent flyer programs and use of airport lounges. Air Canada and Air China also enhanced their codeshare agreement to include Zhengzhou, Xiamen, Shenzhen and Nanjing in domestic China and Victoria, Kelowna, Saskatoon, and Regina in domestic Canada. Furthermore, the codeshare agreement now includes flights between Montreal and Havana, and Montreal and Shanghai.
- Expanded the codeshare agreement with Cathay Pacific, further widening the network by connecting Air Canada's services to Hong Kong to many Southeast Asian destinations, including the Philippines, Malaysia, Vietnam and Thailand. As a result, Air Canada now offers codeshare services to destinations such as Manila, Cebu, Kuala Lumpur, Ho Chi Minh City, Hanoi, Bangkok, Phuket and Chiang Mai.
- Implemented a new codeshare agreement with Adria Airways, connecting Air Canada's services to Germany and Belgium (Frankfurt, Munich and Brussels) to Ljubljana, Slovenia.
- Expanded the codeshare agreement with All Nippon Airways (ANA) with the addition of ANA's code on Air Canada's new Montreal–Narita service, providing customers with additional travel options to cities within Japan and other Asian destinations.
- Increased sixth freedom traffic (international-to-international, including U.S.) connecting through Air Canada's major Canadian hubs by 15% when compared to 2017.

Air Canada has competitive strengths which allows it to profitably pursue international route opportunities. It has the ability to appreciably increase international-to-international traffic through its strategic international gateways in Toronto, Vancouver and Montreal, and is broadening its network appeal through its membership in Star Alliance, its revenue-sharing joint venture with Air China on routes between Canada and China, and its A++ trans-Atlantic revenue-sharing joint venture with United Airlines and Deutsche Lufthansa AG, which the parties are focused on enhancing to increase competitiveness, create operating efficiencies and improve customer experience. Air Canada's network is also enhanced through numerous codeshare and interline agreements. Furthermore, Air Canada has access to Canada's wide portfolio of international route rights, and Canada's multi-ethnic demographic profile provides the airline with further opportunities to profitably capture demand for international travel. These attributes, combined with Air Canada's powerful brand and industry-leading products and services, allow it to leverage its network and benefit from the higher margins generally available in international markets.

Air Canada plans to continue to selectively and profitably expand its international services by leveraging its new aircraft and improved cost structure, and by exploiting the following competitive advantages:

- A widely recognized brand and a strong position in the market for trans-Atlantic and trans-Pacific travel to and from Canada and to and from North and South America via Canada.
- An extensive and expanding global network, enhanced by the airline's membership in Star Alliance and by numerous commercial arrangements.
- A flexible fleet mix, enabling the airline to redeploy or otherwise manage capacity to match changes in demand.
- Air Canada Altitude, Air Canada's frequent flyer 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 Aeroplan program, which allows all customers to earn and redeem Aeroplan Miles.
- Competitive products and services, including lie-flat suites in the Signature Class cabin, concierge services, Maple Leaf® lounges and, at its Toronto global hub, an exclusive Air Canada Signature Suite offering eligible Signature Class customers exclusive amenities, including "à la carte" meal service in the Suite's complimentary restaurant.
- Geographically well-positioned hubs (Toronto, Montreal and Vancouver) with efficient in-transit facilities, accentuating the advantages of flying Air Canada for customers travelling between the U.S. and Asia or Europe.
- Favourable slot times at busy airports, including Beijing, Shanghai, Hong Kong, Tokyo-Narita, Tokyo-Haneda, Paris-Charles de Gaulle, Frankfurt, London-Heathrow, New York-LaGuardia, and Washington-Ronald Reagan National Airport.

In 2019, Air Canada plans to launch additional international services, including non-stop Air Canada year-round flights from Toronto to Vienna. The flights to Austria's capital will be operated in cooperation with Star Alliance joint venture partner Austrian Airlines. Air Canada also plans to launch non-stop summer seasonal service from Montreal to Bordeaux and increase weekly frequencies from Vancouver to Delhi, Melbourne and Zurich.

Air Canada enhances its domestic and transborder network through capacity purchase agreements with Jazz, Sky Regional and other airlines (operating under the Air Canada Express banner). Air Canada Express provides a network of local traffic, as well as high volumes of feeder traffic that flow into Air Canada's long-haul network and support its strategy to grow international transit traffic to and from the U.S. In 2019, Air Canada plans to enhance services to North Carolina, including with the launch of a new, non-stop daily flight between Montreal and Raleigh. The airline will also deploy larger aircraft on flights between Toronto and Raleigh and Charlotte to increase capacity on these routes and introduce Business Class service.

Air Canada continues to increase sixth freedom traffic, particularly from the U.S., with its award-winning products and services, geographically well-positioned Canadian hubs, extensive network and other competitive advantages.

Lester B. Pearson International Airport ("Toronto Pearson") offers a strategic advantage due to its proximity to densely populated major U.S. markets and serves a large number of business and leisure travellers flying to and from Toronto, Canada's largest city. Air Canada's and its Star Alliance partners' operations are consolidated in one terminal at Toronto Pearson, which also has efficient in-transit facilities that allow passengers and their bags to move seamlessly between Canadian and U.S. Customs and Immigration. For several years, Air Canada has worked closely with the Greater Toronto Airports Authority ("GTAA") to transform Toronto Pearson into the leading North American airport and gain a greater share of the global sixth freedom market.

Air Canada has also been growing its Vancouver hub into a premier gateway to Asia-Pacific markets and developing Montreal into a complementary trans-Atlantic hub. With convenient connections between Vancouver and cities across North America, Air Canada offers some of the shortest elapsed travel time between continental North America and Pacific Asia, providing a better travel experience. The airline's Montreal hub not only links North America with key markets in France, but also positions Montreal as a premier gateway to the Atlantic. Given the improvements that are being made in Toronto, Vancouver and Montreal, the airline is able to build its network from the U.S. to provide increased connection flows to its international flights.

Since its inception in 1997, the Star Alliance network has grown to include the following 28 airlines: Adria Airways, Aegean Airlines, Air Canada, Air China, Air India, Air New Zealand, ANA, Asiana Airlines, Austrian Airlines, Avianca, Avianca Brasil, Brussels Airlines, Copa Airlines, Croatia Airlines, EGYPTAIR, Ethiopian Airlines, EVA Air, LOT Polish Airlines, Lufthansa, Scandinavian Airlines, Shenzhen Airlines, Singapore Airlines, South African Airways, Swiss International Air Lines AG, TAP Portugal, THAI, Turkish Airlines and United Airlines.

In addition to its membership in Star Alliance and its joint venture agreements, Air Canada's numerous codeshare and interline agreements allow it to achieve greater critical mass and network scope. Air Canada has 36 codeshare partners, of which 26 are Star Alliance members and 10 are non-members (Aer Lingus, Central Mountain Air, Etihad, Eurowings, GOL Linhas Aéreas Inteligentes, Jet Airways, Middle East Airlines, SriLankan Airlines, Cathay Pacific and Virgin Australia).

Air Canada continues to assess new strategic partnerships in support of its business plan and international growth strategy.

3. Customer Engagement

Providing a consistently high level of customer service and growing the airline's premium customer base are important aspects of Air Canada's business strategy. Air Canada continually strives to improve customer loyalty and generate positive referrals to attract new customers. The airline recognizes that its ongoing success is dependent on consistently delivering superior value and innovative products, providing the highest levels of customer service and anticipating the changing needs of customers.

Acquisition of Aimia's Aeroplan Loyalty Business

Air Canada Altitude is designed to recognize and reward its most frequent travellers with exclusive perks and privileges based on the number of miles or segments customers fly combined with their total spend. These privileges, including priority airport services, lounge access, and eUpgrade credits, are designed to enhance the Air Canada experience and encourage loyalty from frequent flyers. Altitude members also benefit from Air Canada's Aeroplan program, which provides a wide range of ways to earn and redeem Aeroplan Miles, including flights and upgrades to over 1,200 destinations worldwide.

On January 10, 2019, Air Canada completed the closing of its purchase of Aimia Canada Inc., owner and operator of the Aeroplan loyalty business, from Aimia Inc. The aggregate purchase price for the acquisition consisted of $450 million in cash plus $47 million in cash for pre-closing adjustments. The purchase price is subject to post-closing adjustments and the acquisition also includes the assumption of the Aeroplan Miles liability. Air Canada received payments from The Toronto-Dominion Bank ("TD") and Canadian Imperial Bank of Commerce ("CIBC") in the aggregate amount of $822 million. Visa Canada Corporation ("Visa") also made a payment to Air Canada and, assuming completion of the Amex Bank of Canada ("AMEX") agreement referred to below, AMEX will do likewise.

Concurrently with the conclusion of the Aeroplan purchase, Air Canada, TD, CIBC, and Visa finalized various commercial agreements relating to and in support of the acquisition, including credit card loyalty program and network agreements for future participation in Air Canada's new loyalty program. In addition, TD and CIBC made payments to Aimia Canada Inc., now Air Canada's subsidiary, in the aggregate amount of $400 million as prepayments to be applied towards future monthly payments in respect of Aeroplan Miles. Air Canada also has entered into an agreement in principle with AMEX, which also issues Aeroplan co-branded products, to secure its continued participation in Air Canada's loyalty program after 2020. Following the closing of the acquisition, Aimia Canada Inc. changed its name to Aeroplan Inc.

Consistent with its promise of continued investments in the customer experience, Air Canada plans to launch its new loyalty program in mid-2020. Air Canada believes that the new program will allow it to further strengthen customer relationships, offer members more flexible rewards, and deliver a more consistent end-to-end customer experience. The new program will offer broad earning and redemption opportunities, more personalized service and a better digital experience for Air Canada customers.

Passenger Service System

Air Canada concluded an agreement with Amadeus for the full Amadeus Altéa Suite passenger service system (PSS) including reservations, inventory and departure control solutions. The new reservation system, scheduled to be implemented in late 2019, will allow Air Canada to optimize its flight schedule by providing the ability to more easily manage inventory between any given origin and destination and automate rebookings during flight disruptions, such as those caused by extreme weather. It will also support Air Canada's international network through more seamless booking and customer handling with Star Alliance and interline partners.

Products and Services

Investing in products and services remains pivotal to Air Canada's commitment to customer engagement. To this end, the airline has partnered with leading brands and continues to invest in premium products that enhance the customer's journey.

In 2018, Air Canada launched Air Canada Signature Service, rebranding the lie-flat Business Class product available on most international mainline flights, as well as select key transcontinental markets. Air Canada Signature Service provides eligible customers with an end-to-end premium experience, including access to priority ground products, including select concierge services, as well an exclusive on-board experience in Air Canada Signature Class.

Air Canada Signature Class was also introduced in North America, replacing Business Class – Transcontinental, and for the first time showcasing a product specification aligned to international standards in North America. Air Canada Signature Class is available on select transcontinental routes, including daily overnight flights from Los Angeles, San Francisco and Vancouver to Toronto. Air Canada Signature Class is also available on flights between Toronto and Honolulu.

Air Canada provides concierge assistance at 47 airports globally. In 2019, the airline plans to expand this service to include Dubai and Vienna. The premium agent program, with specially-trained customer sales and service agents accredited specifically to work at Priority Check-in and inside the Maple Leaf Lounges, is now available at 10 Canadian airports, with plans to expand to key locations in the U.S. throughout 2019.

Throughout 2018, Air Canada also expanded the use of a fleet of BMW vehicles, operating as part of the Air Canada Valet Service at Toronto Pearson. At the end of 2018, Air Canada operated a fleet of 20 BMW 7-series limousines, providing select customers connecting from a domestic to an international Air Canada Signature Class with a personalized airside drive between the gate areas. By 2019, this will make Air Canada the first airline in North America to provide this type of service to Business Class customers, subject to certain restrictions.

The Maple Leaf Lounge portfolio has expanded to Saskatoon, with the opening of Air Canada's 23rd lounge worldwide. Air Canada also opened a new 7,400 square feet Maple Leaf Lounge located inside the new gate area at New York LaGuardia, as well as a new 3,600 square feet Maple Leaf Lounge at St. John's International Airport. The lounges at LaGuardia and St. John's International are each replacing existing facilities, providing a significantly improved ground product. In 2019, Air Canada expects to open a new Maple Leaf Lounge at San Francisco International Airport, as well as starting a comprehensive refurbishment program of existing facilities at key hubs.

The Air Canada Signature Suite, a premium "à la carte" dining facility available at Toronto Pearson open for select customers departing in Air Canada Signature Class, opened in late 2017 and has been well received by customers throughout 2018. Plans are underway to review and possibly expand the concept to Vancouver International Airport in 2019.

Seamless means of transiting through Air Canada's hubs at Toronto Pearson, Vancouver and Montreal Trudeau and enhancements to facilities and processes supporting Air Canada's sixth freedom traffic strategy now allow customers connecting from Japan to a domestic destination to not have to claim their bags at the connecting point, unless otherwise advised by customs. This is in addition to customers connecting from the U.S., Europe or Australia to a Canadian airport through these hubs. By summer 2019, Air Canada expects to have all international to domestic connections included in the International to Domestic program. Supporting new flights to Asia, during 2018, Air Canada also expanded the China Transit Program to include Montreal Trudeau, providing eligible citizens of the People's Republic of China the opportunity to connect through Montreal on select eligible flights without the need for a Canadian visa.

Starting with the Boeing 787 Dreamliner, and then followed by the Boeing 777, Air Canada has been progressively upgrading its wide-body aircraft with next generation cabin, and in-flight entertainment products. They have been enthusiastically received by customers and, in 2019, Air Canada will extend these improvements to its fleet of Airbus A330 aircraft. Air Canada also received its first 18 new Boeing 737 MAX (two in 2017 and 16 in 2018) and, in late 2019, will take its first delivery of the new Airbus A220 aircraft. These aircraft bring market-leading cabins and entertainment products to Air Canada's narrow-body fleet.

Air Canada and Air Canada Rouge have expanded Wi-Fi connectivity to additional aircraft and expect to have all aircraft connected by the end of 2019. Air Canada introduced complimentary global streaming Wi-Fi service as a reward option for Altitude Elite 75K and Super Elite 100K members, making Air Canada the first airline in North America to offer complimentary Wi-Fi to its most frequent flyers.

Air Canada received a number of awards recognizing its industry-leading products and services in 2018, including being named *Best Airline in North America* in the 2018 Skytrax World Airline Awards, as well as *Best Business Class in North America*. Skytrax also revalidated Air Canada's ranking as North America's only four-star International network carrier as part of a quality audit which assessed more than 1,000 touch-points on the ground and in the air. As part of the four-star re-certification, Air Canada was awarded high marks for the Air Canada Signature Class service on select North American transcontinental markets, the new Business Class seat offered on the Boeing 737 MAX aircraft, the state-of-the-art entertainment system on the Boeing fleet, as well as the service offered in Premium Economy Class, all reflective of the significant investment in product and service undertaken over the previous years. In addition, the Air Canada Signature Suite was considered amongst the best, if not the best in the world for business class pre-flight dining.

In late 2018, the Ipsos Reid 2018 Canadian Business Traveller Survey confirmed Air Canada as the preferred airline for domestic travel for 92% of frequent business travellers. The national study determined that Air Canada is the only Canadian airline to see a consistent increase in preference and in usage over the past five years. Additionally, readers of leading frequent business traveller magazine, *Business Traveler*, have named Air Canada *Best North American Airline for International Travel*, as well as *Best North American Airline for Inflight Experience*. Among other things, the survey of frequent business travellers found:

- Overall satisfaction with Air Canada's service continues to increase, contrasting that of domestic competitors, climbing six percentage points over 2017 for in-flight and four percentage points for airports. Air Canada's highest scores in the last five years were driven by satisfaction in its schedule, loyalty program, customer service and perception as a dynamic organization.
- Air Canada is the only Canadian airline that has seen an increase in its Net Promoter Score (NPS) for 2018.
- 96% intend to use Air Canada for domestic business travel in the coming year, significantly more than those who intended to use other Canadian carriers.
- Air Canada is the preferred airline for travel between Canada and the U.S., increasing by 11 percentage points over the last five years.
- Business travel increased the most internationally to Europe, Asia and other global destinations, growing by five percentage points over last year.

4. Culture Change

Air Canada continues to evolve its culture, transforming from a transportation company to a customer service excellence company which treats is employees and its customers with care and class. In 2018, Air Canada launched a new employee engagement survey which provided stronger analytics and a deeper understanding of where additional focus is required. With a 30% response rate, the survey yielded meaningful data to determine an employee net promoter score (eNPS). A total of 78% of employees surveyed were identified as "promoters" (the truly engaged) or "passives" (those leaning towards positive or are more easily influenced to become promoters with small incremental actions). Work environment, support and learning opportunities were identified as key takeaways. The survey also further reinforced the link between customer perceptions and employee behaviours, while providing meaningful direction for the development of 2018 and 2019 initiatives.

Air Canada also regularly validates the organizational pulse through focus groups and Yammer, its internal social media platform. The airline also connects with employees through weekly executive messages and multiple communications channels, including a daily newsletter. Over 5,000 employees participated in town halls held in hangars across the system which allowed for open Q&A sessions between employees and executives.

To equip managers to excel at critical face-to-face communications, Air Canada's management development programs focus on coaching for soft skills that include relationship building and making authentic connections. In 2019, Air Canada will focus on the evolution of manager 'soft skills' – an essential ingredient in leadership competency development.

It is expected that Millennials will make up 75% of Air Canada's workforce within the next 15 years. Air Canada's development programs are customized, taking into account different learning and engagement styles. The airline's succession strategy is now driven by a Talent Board comprised of executives working closely with Human Resources to identify and prepare new leadership – both young and seasoned.

Air Canada is also leveraging artificial intelligence and virtual interviews to enhance its hiring practices and ensure it is attracting the best candidates in the field.

The importance of diversity and inclusion at work is a direct reflection of Air Canada's broad customer base and a key element in Air Canada's hiring strategy. In 2019, a senior leader diversity counsel and company-wide employee business groups will identify programs and opportunities to promote diversity, including "Women in Aviation" learning events, scholarships and internships for under-represented groups, such as people with disability and spectrum limitations.

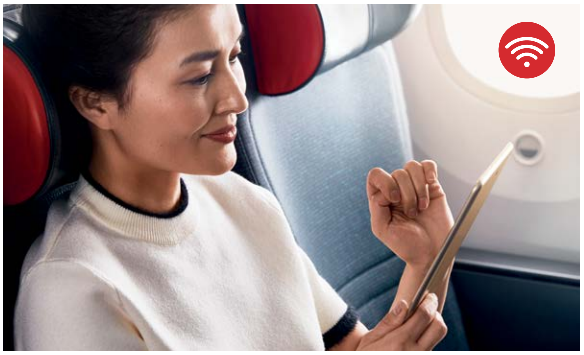
Air Canada's achievements can be measured in several ways, including through external recognition such as:

- One of Canada's Best Diversity Employers – 2018 – Mediacorp Canada
- One of Canada's Top 100 Employers – 2019 – Mediacorp Canada
- One of Montréal's Top Employers – 2019 – Mediacorp Canada
- One of Canada's Most Attractive Employers – 2018 – Universum Global
- One of 50 Most Engaged Workplaces™ – 2018 – Achievers
- One of 2018 North American Candidate Experience Awards winners – Talent Board
- Fifth in the Top 20 Employer Brands in Canada – 2018 – Randstad

Labour

Starting in 2014, Air Canada entered into multiple long-term labour agreements with unions representing its unionized workforce. These agreements provide additional stability and flexibility, as well as demonstrate a collaborative partnership supporting its transformation into a global champion. These agreements include the following:

- ACPA (Pilots) – In 2014, Air Canada and ACPA, representing pilots, ratified a new contract providing collective agreement terms for 10 years, ending September 29, 2024, subject to certain renegotiation provisions and benchmarks over this period. In 2017, Air Canada ratified amendments to its existing long-term labour agreement with ACPA. The amendments to the 10-year agreement provide additional commercial opportunities as well as increased operational flexibility.
- IAMAW (Maintenance, Operations and Baggage) – In 2016, Air Canada and the IAMAW, representing technical maintenance, operational support and airport baggage handlers, concluded a new contract providing collective agreement terms for 10 years, ending March 31, 2026, subject to certain renegotiation provisions over this period.
- CALDA (Dispatchers) – In 2016, Air Canada and CALDA, representing flight dispatchers, concluded a new contract providing collective agreement terms for 12 years, ending February 29, 2028, subject to certain renegotiation provisions over this period.
- CUPE (Flight Attendants) – In 2015, Air Canada and CUPE, representing flight attendants, concluded a new contract providing collective agreement terms for 10 years, ending March 31, 2025, subject to certain renegotiation provisions over this period.
- Unifor (Customer Service and Sales Agents) – In 2015, Air Canada and Unifor, representing the airline's customer service and sales agents concluded a new contract providing collective agreement terms for five years, ending February 28, 2020.



5. OVERVIEW

Full Year 2018 Financial Summary

The following is an overview of Air Canada's results of operations and financial position for the full year 2018 compared to the full year 2017.

- Record operating revenues of $18,065 million in 2018 compared to operating revenues of $16,252 million in 2017, an increase of $1,813 million or 11%. On capacity growth of 7.1%, record passenger revenues of $16,223 million increased $1,630 million or 11.2% from 2017.
- Operating expenses of $16,891 million in 2018 versus operating expenses of $14,881 million in 2017, an increase of $2,010 million or 14%. CASM increased 6.0% from 2017. Adjusted CASM increased 0.3% from 2017.
- Operating income of $1,174 million in 2018 compared to operating income of $1,371 million in 2017, a decrease of $197 million.
- EBITDAR of $2,851 million in 2018 compared to EBITDAR of $2,928 million in 2017, a decrease of $77 million. The airline reported a 2018 EBITDAR margin (EBITDAR as a percentage of operating revenue) of 15.8%. This compared to an EBITDAR margin of 18.0% in 2017. Special items are excluded from all of Air Canada's reported EBITDAR calculations. Refer to section 6 of this MD&A for information on special items.
- Net income of $167 million or $0.60 per diluted share in 2018 versus net income of $2,029 million or $7.31 per diluted share in 2017. In 2018, Air Canada recorded foreign exchange losses of $317 million and a loss on disposal of assets of $188 million. In 2017, Air Canada recorded a deferred income tax recovery of $759 million and foreign exchange gains of $120 million.
- Adjusted net income of $677 million or $2.45 per diluted share in 2018 versus adjusted net income of $1,145 million or $4.11 per diluted share in 2017. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Adjusted net debt of $5,858 million at December 31, 2018 versus adjusted net debt of $6,116 million at December 31, 2017, a decrease of $258 million. In 2018, increases in long-term debt and finance lease balances of $533 million and capitalized operating lease balances of $112 million were more than offset by an increase in cash, cash equivalents and short-term investment balances of $903 million. Adjusted net debt is an additional GAAP measure. Refer to section 9.3 "Adjusted Net Debt" of this MD&A for additional information.
- Air Canada's leverage ratio (adjusted net debt to trailing 12-month EBITDAR) was 2.1 at December 31, 2018, unchanged from December 31, 2017. Leverage ratio is a non-GAAP financial measure. Refer to section 9.3 "Adjusted Net Debt" of this MD&A for additional information.
- Net cash flows from operating activities of $2,695 million in 2018 versus net cash flows from operating activities of $2,738 million in 2017. In 2018, free cash flow of $791 million decreased $265 million from 2017 and exceeded the $500 million to $600 million range projected in Air Canada's news release dated October 31, 2018. The better than expected free cash flow can be attributed to a combination of lower than projected capital expenditures, better than expected cash from working capital and stronger than anticipated income from operations. Refer to section 9.5 "Consolidated Cash Flow Movements" of this MD&A for additional information.

- Return on invested capital ("ROIC") for the 12 months ended December 31, 2018 of 12.6%, in line with the ROIC of approximately 12% projected in Air Canada's news release dated October 31, 2018. This compared to ROIC of 15.3% for the 12 months ended December 31, 2017. The decrease in ROIC versus 2017 was mainly driven by lower adjusted net income, an increase in average shareholders' equity net of excess cash and an increase in aircraft rent expense year-over-year.

Fourth Quarter 2018 Financial Summary

The following is an overview of Air Canada's results of operations for the fourth quarter of 2018 compared to the fourth quarter of 2017.

- Record operating revenues of $4,246 million in the fourth quarter of 2018 compared to operating revenues of $3,820 million in the fourth quarter of 2017, an increase of $426 million or 11%. On capacity growth of 5.8%, record passenger revenues of $3,795 million increased $386 million or 11.3% from the fourth quarter of 2017.
- Operating expenses of $4,124 million in the fourth quarter of 2018 versus operating expenses of $3,687 million in the fourth quarter of 2017, an increase of $437 million or 12%. CASM increased 5.7% from the fourth quarter of 2017. Adjusted CASM increased 0.5% from the fourth quarter of 2017, better than the 1.5% to 2.5% increase projected in Air Canada's news release dated October 31, 2018. Air Canada's better than expected adjusted CASM performance was largely due to lower aircraft maintenance expense, driven by a favourable annual adjustment related to end-of-lease maintenance provisions, as well as the timing of certain engine maintenance events.
- Operating income of $122 million in the fourth quarter of 2018 compared to operating income of $133 million in the fourth quarter of 2017, a decrease of $11 million.
- Record EBITDAR of $543 million in the fourth quarter of 2018 compared to the previous record EBITDAR of $521 million in the fourth quarter of 2017, an increase of $22 million. The airline reported a fourth quarter 2018 EBITDAR margin of 12.8% compared to an EBITDAR margin of 13.6% in the fourth quarter of 2017.
- A net loss of $231 million or $0.85 per diluted share in the fourth quarter of 2018 versus net income of $8 million or $0.02 per diluted share in the fourth quarter of 2017.
- Adjusted net income of $54 million or $0.20 per diluted share in the fourth quarter of 2018 versus adjusted net income of $60 million or $0.22 per diluted share in the fourth quarter of 2017.
- Net cash flows from operating activities of $360 million in the fourth quarter of 2018 versus net cash flows from operating activities of $389 million in the fourth quarter of 2017. Free cash flow of $141 million in the fourth quarter of 2018 represented an improvement of $184 million from the fourth quarter of 2017.

6. RESULTS OF OPERATIONS – Full Year 2018 versus Full Year 2017

The following table and discussion provide and compare results of Air Canada for 2018 and 2017:

(Canadian dollars in millions, except per share figures)	Full Year 2018	2017 (1)	$ Change	% Change
Operating revenues				
Passenger	$ 16,223	$ 14,593	$ 1,630	11
Cargo	803	708	95	13
Other	1,039	951	88	9
Total revenues	**18,065**	**16,252**	**1,813**	**11**
Operating expenses				
Aircraft fuel	3,969	2,927	1,042	36
Regional airlines expense				
Aircraft fuel	531	412	119	29
Other	2,311	2,205	106	5
Wages, salaries and benefits	2,873	2,671	202	8
Airport and navigation fees	964	905	59	7
Aircraft maintenance	1,003	938	65	7
Depreciation, amortization and impairment	1,080	956	124	13
Sales and distribution costs	807	770	37	5
Ground package costs	602	538	64	12
Aircraft rent	518	503	15	3
Catering and onboard services	433	383	50	13
Communications and information technology	294	254	40	16
Special items	-	30	(30)	(100)
Other	1,506	1,389	117	8
Total operating expenses	**16,891**	**14,881**	**2,010**	**14**
Operating income	**1,174**	**1,371**	**(197)**	
Non-operating income (expense)				
Foreign exchange gain (loss)	(317)	120	(437)	
Interest income	108	60	48	
Interest expense	(331)	(311)	(20)	
Interest capitalized	35	36	(1)	
Net financing expense relating to employee benefits	(50)	(65)	15	
Gain (loss) on financial instruments recorded at fair value	(1)	23	(24)	
Gain on sale and leaseback of assets	-	52	(52)	
Gain on debt settlements and modifications	9	21	(12)	
Loss on disposal of assets	(188)	-	(188)	
Other	(34)	(21)	(13)	
Total non-operating expense	**(769)**	**(85)**	**(684)**	
Income before income taxes	**405**	**1,286**	**(881)**	
Income tax (expense) recovery	(238)	743	(981)	
Net income	**$ 167**	**$ 2,029**	**$ (1,862)**	
Diluted earnings (loss) per share	**$ 0.60**	**$ 7.31**	**$ (6.71)**	
EBITDAR (2)	**$ 2,851**	**$ 2,928**	**$ (77)**	
Adjusted pre-tax income (2)	**$ 952**	**$ 1,165**	**$ (213)**	
Adjusted net income (2)	**$ 677**	**$ 1,145**	**$ (468)**	
Adjusted earnings per share – diluted (2)	**$ 2.45**	**$ 4.11**	**$ (1.66)**	

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

(2) EBITDAR, adjusted pre-tax income, adjusted net income and adjusted earnings per share – diluted are non-GAAP financial measures. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

System Passenger Revenues

With the adoption of *IFRS 15 – Revenue from Contracts with Customer*s effective January 1, 2018, certain passenger and cargo related fees were reclassified from Other revenue to Passenger revenue and Cargo revenue on Air Canada's consolidated statement of operations, with restatement of 2017 amounts. This reclassification has no impact on total operating revenue. Concurrent with this change in presentation, Air Canada has revised the methodology used to calculate yield and PRASM. These measures are now based on total passenger revenues, with restatement of 2017 amounts on the same basis.

In 2018, system passenger revenues of $16,223 million increased $1,630 million or 11.2% from 2017 on traffic growth of 8.5% and a yield improvement of 2.5%. On a stage length adjusted basis, yield increased 3.7% when compared to 2017. Business cabin revenues, on a system-basis, increased $376 million or 13.2% from 2017 on traffic and yield growth of 9.4% and 3.5%, respectively.

The table below provides passenger revenue by geographic region for the full year 2018 and the full year 2017.

(Canadian dollars in millions)	Full Year			
Passenger Revenues	**2018**	2017 [1]	$ Change	% Change
Canada	$ 4,894	$ 4,637	$ 257	5.5
U.S. transborder	3,504	3,195	309	9.7
Atlantic	4,237	3,539	698	19.7
Pacific	2,430	2,195	235	10.7
Other	1,158	1,027	131	12.7
System	**$ 16,223**	**$ 14,593**	**$ 1,630**	**11.2**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the full year 2018 versus the full year 2017.

Full Year 2018 versus Full Year 2017 [1]	**Passenger Revenue** % Change	**Capacity (ASMs)** % Change	**Traffic (RPMs)** % Change	**Passenger Load Factor** pp Change	**Yield** % Change	**PRASM** % Change
Canada	5.5	3.2	2.7	(0.4)	2.7	2.3
U.S. transborder	9.7	6.9	7.1	0.1	2.4	2.6
Atlantic	19.7	10.4	14.7	3.1	4.4	8.4
Pacific	10.7	4.0	5.7	1.4	4.7	6.4
Other	12.7	14.7	12.8	(1.4)	-	(1.7)
System	**11.2**	**7.1**	**8.5**	**1.0**	**2.5**	**3.8**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts which are reflected in the table above.

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

- The 8.5% traffic increase which reflected traffic growth in all markets and included gains in the business and premium economy cabins. Consistent with the airline's objective of increasing global international-to-international connecting traffic through its major Canadian hubs (sixth freedom traffic), the traffic growth in 2018 reflected an increase in connecting traffic via Canada to international destinations.

- The 2.5% system yield increase which reflected:
  - increases in fares and carrier surcharges, growth in high-yielding local traffic and an improved overall fare mix;
  - greater proportional growth of high-yielding business and premium economy class passengers;
  - an increase in ancillary revenues, including through baggage fees, advance seat selection/preferred seating fees and airport paid upgrades; and
  - the introduction of an expanded suite of fare offerings on domestic, U.S. transborder and Atlantic services, resulting in growth in ancillary revenue and an improved fare mix.

  These factors were partly offset by an increase in average stage length of 2.1%, due to long-haul international expansion, which had the effect of reducing system yield by 1.2 percentage points.

Domestic Passenger Revenues

In 2018, domestic passenger revenues of $4,894 million increased $257 million or 5.5% from 2017.

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

- The 2.7% traffic increase which reflected traffic growth on all major domestic services as well as incremental connecting traffic within Canada to international destinations. The traffic growth in 2018 included gains in the business cabin.
- The 2.7% yield increase which reflected yield improvements on all major domestic services. The overall yield improvement versus 2017 reflected gains in the business cabin as well as the impact of new fare categories on domestic services, resulting in growth in ancillary revenue, including baggage fees, and an improved fare mix.

U.S. Transborder Passenger Revenues

In 2018, U.S. transborder passenger revenues of $3,504 million increased $309 million or 9.7% from 2017.

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

- The 7.1% traffic increase which reflected traffic growth on all major U.S. transborder services. The traffic increase in 2018 reflected strong passenger demand between Canada and the U.S., gains in the business cabin and growth in international-to-international connecting passenger flows from the U.S.
- The 2.4% yield increase which reflected yield growth on all major U.S. transborder services with the exception of U.S. short-haul routes. The launch of new fare categories on U.S. transborder services, resulting in growth in ancillary revenue and an improved fare mix, contributed to the overall yield improvement year-over-year. An unfavourable currency impact of $13 million was an offsetting factor.

Atlantic Passenger Revenues

In 2018, Atlantic passenger revenues of $4,237 million increased $698 million or 19.7% from 2017.

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

- The 14.7% traffic increase which reflected traffic growth on all major Atlantic services and included gains in all cabins. The 10.4% capacity growth year-over-year was mainly due to the launch of new services from Vancouver to France and Switzerland; from Toronto to Ireland, Portugal, Romania and Croatia; and from Montreal to Ireland, Romania and Portugal, as well as to increased frequencies on existing routes.
- The 4.4% yield increase which reflected yield improvements on all major Atlantic services and included an increase in carrier surcharges year-over-year and a favourable currency impact of $20 million. The launch of a new fare category on Atlantic services, resulting in growth in ancillary revenue, including baggage fees, and an improved fare mix, also contributed to the overall yield improvement year-over-year. An increase in average stage length of 1.5%, which had the effect of reducing Atlantic yield by 0.9 percentage points, was a partly offsetting factor.

Pacific Passenger Revenues

In 2018, Pacific passenger revenues of $2,430 million increased $235 million or 10.7% from 2017.

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

- The 5.7% traffic increase which reflected traffic growth on all major Pacific services with the exception of services to Hong Kong and Japan where capacity was reduced year-over-year. The traffic growth included gains in the business and premium economy cabins.
- The 4.7% yield increase which reflected yield growth on all major Pacific services with the exception of Australia which was slightly below 2017. The yield increase year-over-year included gains in the business and premium economy cabins. The lower yield on services to Australia reflected increased industry capacity when compared to 2017. The overall Pacific yield improvement versus 2017 included an increase in carrier surcharges year-over-year, particularly in Japan and Korea where surcharges are regulated.

Other Passenger Revenues

In 2018, Other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of $1,158 million increased $131 million or 12.7% from 2017.

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

- The 12.8% traffic increase which reflected traffic growth on services to South America and on routes to traditional sun destinations. The traffic growth in 2018 included gains in all cabins.
- No change in yield when compared to 2017 as yield growth on services to the Caribbean was offset by yield decreases on services to South America and Mexico. The yield decline on services to South America was mainly due to a significant increase in average stage length due to the removal of the short-haul tag between Santiago and Buenos Aires as Air Canada now serves both markets on a non-stop basis. The yield decline on services to Mexico was mainly driven by competitive pricing activities due to increased industry capacity. An increase in average stage length of 4.1% had the effect of reducing yield in the Other markets by 2.3 percentage points. On a stage length adjusted basis, yield increased 2.3% when compared to 2017.

Cargo Revenues

In 2018, cargo revenues of $803 million increased $95 million or 13.6% from 2017 on yield and traffic growth of 8.1% and 5.1%, respectively. In 2018, the Atlantic and Pacific markets experienced particularly strong performances.

The table below provides cargo revenue by geographic region for the full year 2018 and the full year 2017.

Cargo Revenues	Full Year			
(Canadian dollars in millions)	**2018**	2017 (1)	$ Change	% Change
Canada	$ 95	$ 84	$ 11	14.0
U.S. transborder	43	39	4	11.5
Atlantic	278	245	33	13.7
Pacific	325	280	45	16.0
Other	62	60	2	2.6
System	**$ 803**	**$ 708**	**$ 95**	**13.6**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

Other Revenues

In 2018, other revenues of $1,039 million increased $88 million or 9% when compared to 2017, mainly due to an increase in ground package revenue at Air Canada Vacations, driven by both higher passenger volumes and a higher price of ground packages when compared to 2017. An increase in passenger and airline-related fees versus 2017 was also a contributing factor.

CASM and Adjusted CASM

In 2018, CASM increased 6.0% and adjusted CASM increased 0.3% when compared to 2017.

The table below compares Air Canada's CASM and adjusted CASM for the full year 2018 to the full year 2017.

	Full Year			
(cents per ASM)	2018	2017 (1)	¢ Change	% Change
Aircraft fuel	¢ 3.58	¢ 2.83	¢ 0.75	26.6
Regional airlines expense				
Aircraft fuel	0.48	0.40	0.08	20.4
Other	2.08	2.13	(0.05)	(2.2)
Wages and salaries	1.96	1.99	(0.03)	(1.4)
Benefits	0.63	0.59	0.04	6.4
Airport and navigation fees	0.87	0.87	-	(0.6)
Aircraft maintenance	0.90	0.91	(0.01)	(0.3)
Depreciation, amortization and impairment	0.97	0.92	0.05	5.4
Sales and distribution costs	0.73	0.74	(0.01)	(2.2)
Ground package costs	0.54	0.52	0.02	4.4
Aircraft rent	0.47	0.49	(0.02)	(3.8)
Catering and onboard services	0.39	0.37	0.02	5.5
Communications and information technology	0.27	0.25	0.02	7.9
Special items	-	0.03	(0.03)	(100.0)
Other	1.37	1.34	0.03	1.3
CASM	**¢ 15.24**	**¢ 14.38**	**¢ 0.86**	**6.0**
Remove:				
Aircraft fuel expense (2), ground package costs at Air Canada Vacations and special items	(4.61)	(3.78)	(0.83)	21.9
Adjusted CASM (3)	**¢ 10.63**	**¢ 10.60**	**¢ 0.03**	**0.3**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.
(2) Includes aircraft fuel expense related to regional airline operations.
(3) Adjusted CASM is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Operating Expenses

In 2018, operating expenses of $16,891 million increased $2,010 million or 14% from 2017 on capacity growth of 7.1%.

The more notable components of the year-over-year change in operating expenses are described below.

Aircraft Fuel Expense

In 2018, aircraft fuel expense (including fuel expense related to regional airline operations) amounted to $4,500 million, an increase of $1,161 million or 35% from 2017. This increase reflected:

- higher jet fuel prices (before the impact of foreign exchange), which accounted for an increase of $918 million;
- a higher volume of fuel liters consumed, which accounted for an increase of $165 million;
- an unfavourable currency impact of $44 million; and
- fuel hedging losses/expenses of $36 million in 2018 versus fuel hedging losses/expenses of $2 million in 2017, an increase of $34 million.

Regional Airlines Expense

In 2018, regional airlines expense of $2,842 million increased $225 million or 9% when compared to 2017, reflecting, in large part, higher aircraft fuel expense year-over-year, as well as a growth in capacity purchase fees due to a higher volume of engine maintenance activity when compared to 2017. Higher CPA rates and the impact of increased flying were also contributing factors.

The table below provides a breakdown of regional airlines expense for the full year 2018 and the full year 2017.

	Full Year			
(Canadian dollars in millions)	**2018**	2017	$ Change	% Change
Capacity purchase fees	$ 1,333	$ 1,267	$ 66	5
Aircraft fuel	531	412	119	29
Airport and navigation fees	296	293	3	1
Sales and distribution costs	153	146	7	5
Depreciation, amortization and impairment	38	28	10	36
Aircraft rent	41	40	1	3
Other	450	431	19	4
Total regional airlines expense	**$ 2,842**	**$ 2,617**	**$ 225**	**9**

Wages, Salaries and Benefits Expense

In 2018, wages and salaries expense of $2,174 million increased $115 million or 6% from 2017, largely due to a higher number of full-time equivalent ("FTE") employees, mainly in support of the airline's capacity growth and international expansion strategy.

In 2018, employee benefits expense of $699 million increased $87 million or 14% from 2017, higher than the increase of $75 million projected in Air Canada's news release dated October 31, 2018. The increase in employee benefits expenses versus 2017 was mainly due to the higher level of FTE employees and the impact of lower discount rates which increased the current service cost of defined benefit pension plans.

Airport and Navigation Fees

In 2018, airport and navigation fees of $964 million increased $59 million or 7% from 2017, largely due to growth in wide-body and international flying. In addition, in 2017, Air Canada received a $15 million one-time refund from Nav Canada while no such refund was received in 2018. The favourable impact of Air Canada's agreement with the Greater Toronto Airports Authority, which is allowing the airline to increase international connecting traffic at Toronto Pearson International Airport on a more cost-effective basis, and a 3.9% Nav Canada rate reduction effective September 1, 2017 were offsetting factors.

Aircraft Maintenance Expense

In 2018, aircraft maintenance expense of $1,003 million increased $65 million or 7% from 2017, better than the increase of $95 million projected in Air Canada's news release dated October 31, 2018. This better than anticipated performance was largely due to an annual adjustment related to end-of-lease maintenance provisions and to timing of engine maintenance events. The increase in aircraft maintenance expense versus 2017 was mainly driven by an increase in engine and components maintenance activity and the impact of having additional Boeing 787 aircraft in the fleet in 2018, which have engines under power-by-the-hour arrangements. These increases were largely offset by the impact of having a greater number of aircraft leases being extended in 2018 and to more favourable end-of-lease conditions on aircraft lease extensions. The impact of a stronger Canadian dollar on U.S. denominated maintenance expenses was also an offsetting factor.

The table below provides a breakdown of the more significant items included in maintenance expense for the full year 2018 and the full year 2017.

	Full Year			
(Canadian dollars in millions)	**2018**	2017 [1]	$ Change	% Change
Technical maintenance	$ 923	$ 824	$ 99	12
Maintenance provisions [1]	51	100	(49)	(49)
Other	29	14	15	107
Total aircraft maintenance expense	**$ 1,003**	**$ 938**	**$ 65**	**7**

(1) Maintenance provisions relate to return conditions on aircraft leases which are recorded over the term of the lease.

Depreciation, Amortization and Impairment Expense

In 2018, depreciation, amortization and impairment expense of $1,080 increased $124 million or 13% from 2017, in line with the increase of $125 million projected in Air Canada's news release dated October 31, 2018. The increase in depreciation, amortization and impairment expense versus 2017 was largely due to the addition of Boeing 787 and 737 MAX aircraft into the mainline fleet. The sale of 25 Embraer 190 aircraft (which Air Canada leased back), in August 2018, was an offsetting factor.

Sales and Distribution Costs

In 2018, sales and distribution costs of $807 million increased $37 million or 5% from 2017, reflecting, in large part, the growth in passenger revenue. The favourable impact of new commission programs introduced in North America in April 2018 and growth in direct bookings when compared to 2017 were offsetting factors.

Ground Package Costs

In 2018, the cost of ground packages at Air Canada Vacations of $602 million increased $64 million or 12% when compared to 2017, mainly due to higher passenger volumes and a higher cost of ground packages (before the impact of foreign exchange) reflecting, in large part, a change in product mix. A favourable currency impact was an offsetting factor.

Aircraft Rent

In 2018, aircraft rent expense of $518 million increased $15 million or 3% from 2017, reflecting, in large part, the impact of a greater number of leased aircraft, including 25 Embraer 190 aircraft which Air Canada sold and leased back in August 2018, partly offset by the impact of lower rates on certain lease renewals.

Special Items

In the first quarter of 2017, Air Canada recorded a provision of $30 million relating to a fine which was reinstated by a decision of the European Commission pertaining to cargo investigations. Air Canada paid the fine in the second quarter of 2017. Air Canada has appealed the decision. While Air Canada cannot predict with certainty the outcome of its appeal or any related proceedings, Air Canada believes it has reasonable grounds to challenge the European Commission's ruling. Refer to "Current legal proceedings" under section 18 "Risk Factors" of this MD&A for additional information.

Other Expenses

In 2018, other expenses of $1,506 million increased $117 million or 8% from 2017, reflecting, in large part, the capacity growth and Air Canada's international expansion strategy, as well as an increase in customer service expense. The increase in customer service expense was partly due to the impact of operational disruptions caused by severe weather, particularly in the first half of 2018. In addition, the first quarter of 2018 included expenses of $26 million related to new uniforms.

The table below provides a breakdown of the more significant items included in other expenses for the full year 2018 and the full year 2017.

	Full Year			
(Canadian dollars in millions)	**2018**	2017 (1)	$ Change	% Change
Terminal handling	$ 327	$ 296	$ 31	10
Crew cycle	212	197	15	8
Building rent and maintenance	176	167	9	5
Miscellaneous fees and services	173	164	9	5
Remaining other expenses	618	565	53	9
Total other expenses	**$ 1,506**	**$ 1,389**	**$ 117**	**8**

Non-operating Income (Expense)

In 2018, non-operating expense amounted to $769 million versus non-operating expense of $85 million in 2017.

Components of the year-over-year change in non-operating expense included:

- In 2018, losses on foreign exchange amounted to $317 million compared to gains on foreign exchange of $120 million in 2017. The December 31, 2018 closing exchange rate was US$1=C$1.3637 while the December 31, 2017 closing exchange rate was US$1=C$1.2571. Foreign exchange losses on long-term debt of $501 million were partly offset by foreign exchange gains on foreign currency derivatives of $245 million.
- In 2017, Air Canada recorded a gain of $52 million on the sale and leaseback of four Boeing 787-9 aircraft. No such gains were recorded in 2018.
- In 2018, Air Canada recorded a gain of $9 million on debt modifications, which included a gain of $11 million related to the repricing of the airline's US$1.2 billion senior secured credit facility. This compared to a gain on debt modifications of $27 million in 2017, which was also related to the repricing of the senior secured credit facility.
- In 2018, Air Canada recorded a loss on disposal of assets of $188 million related to the sale of 25 Embraer 190 aircraft. No such loss was recorded in 2017. Air Canada realized net proceeds of $293 million from the sale of these aircraft in 2018.

7. RESULTS OF OPERATIONS – Fourth Quarter 2018 versus Fourth Quarter 2017

The following table and discussion provide and compare results of Air Canada for the fourth quarter of 2018 and the fourth quarter of 2017:

(Canadian dollars in millions, except per share figures)	Fourth Quarter 2018	2017 [1]	$ Change	% Change
Operating revenues				
Passenger	$ 3,795	$ 3,409	$ 386	11
Cargo	217	198	19	10
Other	234	213	21	10
Total revenues	**4,246**	**3,820**	**426**	**11**
Operating expenses				
Aircraft fuel	958	735	223	30
Regional airlines expense				
Aircraft fuel	133	112	21	19
Other	575	563	12	2
Wages, salaries and benefits	719	674	45	7
Airport and navigation fees	225	201	24	12
Aircraft maintenance	250	243	7	3
Depreciation, amortization and impairment	267	245	22	9
Sales and distribution costs	182	169	13	8
Ground package costs	126	106	20	19
Aircraft rent	133	126	7	6
Catering and onboard services	104	89	15	17
Communications and information technology	69	62	7	11
Other	383	362	21	6
Total operating expenses	**4,124**	**3,687**	**437**	**12**
Operating income	**122**	**133**	**(11)**	
Non-operating income (expense)				
Foreign exchange loss	(269)	(62)	(207)	
Interest income	32	18	14	
Interest expense	(84)	(79)	(5)	
Interest capitalized	8	9	(1)	
Net financing expense relating to employee benefits	(12)	(18)	6	
Loss on financial instruments recorded at fair value	(3)	(1)	(2)	
Gain on debt settlements and modifications	-	24	(24)	
Other	(10)	(4)	(6)	
Total non-operating expense	**(338)**	**(113)**	**(225)**	
Income (loss) before income taxes	**(216)**	**20**	**(236)**	
Income tax expense	(15)	(12)	(3)	
Net income	**$ (231)**	**$ 8**	**$ (239)**	
Diluted earnings (loss) per share	**$ (0.85)**	**$ 0.02**	**$ (0.87)**	
EBITDAR [2]	**$ 543**	**$ 521**	**$ 22**	
Adjusted pre-tax income [2]	**$ 68**	**$ 77**	**$ (9)**	
Adjusted net income [2]	**$ 54**	**$ 60**	**$ (6)**	
Adjusted earnings per share – diluted [2]	**$ 0.20**	**$ 0.22**	**$ (0.02)**	

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

(2) EBITDAR, adjusted pre-tax income, adjusted net income and adjusted earnings per share – diluted are non-GAAP financial measures. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

System Passenger Revenues

In the fourth quarter of 2018, system passenger revenues of $3,795 million increased $386 million or 11.3% from the fourth quarter of 2017 on traffic growth of 7.2% and a yield improvement of 3.8%. On a stage length adjusted basis, yield increased 4.5% when compared to the same quarter in 2017. Business cabin revenues, on a system-basis, increased $92 million or 12.5% from the fourth quarter of 2017 on traffic and yield growth of 9.3% and 2.9%, respectively.

The table below provides passenger revenue by geographic region for the fourth quarter of 2018 and the fourth quarter of 2017.

(Canadian dollars in millions)

	Fourth Quarter			
Passenger Revenues	**2018**	2017 (1)	$ Change	% Change
Canada	$ 1,216	$ 1,151	$ 65	5.6
U.S. transborder	846	746	100	13.4
Atlantic	899	763	136	18.0
Pacific	550	501	49	9.7
Other	284	248	36	14.5
System	**$ 3,795**	**$ 3,409**	**$ 386**	**11.3**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the fourth quarter of 2018 versus the fourth quarter of 2017.

Fourth Quarter 2018 versus Fourth Quarter 2017 (1)	**Passenger Revenue** % Change	**Capacity (ASMs)** % Change	**Traffic (RPMs)** % Change	**Passenger Load Factor** pp Change	**Yield** % Change	**PRASM** % Change
Canada	5.6	1.5	1.7	0.2	3.9	4.1
U.S. transborder	13.4	9.7	9.6	(0.1)	3.5	3.4
Atlantic	18.0	9.5	14.5	3.5	3.0	7.7
Pacific	9.7	(0.8)	0.3	0.9	9.3	10.6
Other	14.5	15.2	14.0	(0.9)	0.5	(0.6)
System	**11.3**	**5.8**	**7.2**	**1.1**	**3.8**	**5.2**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts which are reflected in the table above.

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the fourth quarter of 2018 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
System	Q4'17 (1)	Q1'18	Q2'18	Q3'18	**Q4'18**
Passenger revenues	11.4	11.8	10.4	11.2	**11.3**
Capacity (ASMs)	9.5	8.6	7.5	6.7	**5.8**
Traffic (RPMs)	9.9	11.4	8.2	7.5	**7.2**
Passenger load factor (pp change)	0.3	2.1	0.5	0.6	**1.1**
Yield	1.4	0.4	2.0	3.4	**3.8**
PRASM	1.8	3.0	2.7	4.2	**5.2**

(1) To provide a more meaningful comparison, the year-over-year percentage changes for the fourth quarter 2017 versus the fourth quarter of 2016 are based on previously reported 2016 and 2017 amounts as 2016 amounts have not been restated for the adoption of IFRS 15.

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

- The 7.2% traffic increase which reflected traffic growth in all markets and included gains in the business and premium economy cabins. Consistent with the airline's objective of increasing global international-to-international connecting traffic through its major Canadian hubs (sixth freedom traffic), the traffic growth in the fourth quarter of 2018 reflected an increase in connecting traffic via Canada to international destinations.
- The 3.8% system yield increase which reflected:
  - increases in fares and carrier surcharges, growth in high-yielding local traffic, and an improvement in the overall fare mix;
  - greater proportional growth of high-yielding business and premium economy class passengers;
  - an increase in ancillary revenues, including through baggage fees, advance seat selection/preferred seating fees and airport paid upgrades;
  - the introduction of an expanded suite of fare offerings on domestic, U.S. transborder and Atlantic services, resulting in growth in ancillary revenue and an improved fare mix; and
  - a favourable currency impact of $35 million when compared to the fourth quarter of 2017.

  These factors were partly offset by an increase in average stage length of 1.2%, due to long-haul international expansion, which had the effect of reducing system yield by 0.7 percentage points.

Domestic Passenger Revenues

In the fourth quarter of 2018, domestic passenger revenues of $1,216 million increased $65 million or 5.6% from the fourth quarter of 2017.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the fourth quarter of 2018 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Canada	Q4'17 (1)	Q1'18	Q2'18	Q3'18	**Q4'18**
Passenger revenues	5.4	5.9	6.6	4.3	**5.6**
Capacity (ASMs)	1.4	3.4	3.2	4.3	**1.5**
Traffic (RPMs)	1.6	3.0	2.6	3.4	**1.7**
Passenger load factor (pp change)	0.2	(0.3)	(0.5)	(0.7)	**0.2**
Yield	3.5	2.8	3.9	0.9	**3.9**
PRASM	3.8	2.5	3.2	-	**4.1**

(1) To provide a more meaningful comparison, the year-over-year percentage changes for the fourth quarter 2017 versus the fourth quarter of 2016 are based on previously reported 2016 and 2017 amounts as 2016 amounts have not been restated for the adoption of IFRS 15.

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

- The 1.7% traffic increase which reflected traffic growth on all major domestic services as well as incremental connecting traffic within Canada to international destinations. The traffic growth in the fourth quarter of 2018 included gains in the business cabin.
- The 3.9% yield increase which reflected yield improvements on all major domestic services. The overall yield improvement versus the fourth quarter of 2017 reflected gains in the business cabin as well as the impact of new fare categories on domestic services, resulting in growth in ancillary revenue and an improved fare mix.

U.S. Transborder Passenger Revenues

In the fourth quarter of 2018, U.S. transborder passenger revenues of $846 million increased $100 million or 13.4% from the fourth quarter of 2017.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the fourth quarter of 2018 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
U.S. transborder	Q4'17 (1)	Q1'18	Q2'18	Q3'18	**Q4'18**
Passenger revenues	6.3	6.9	8.9	9.7	**13.4**
Capacity (ASMs)	6.7	5.5	6.8	5.9	**9.7**
Traffic (RPMs)	7.1	6.7	6.6	5.6	**9.6**
Passenger load factor (pp change)	0.3	0.9	(0.1)	(0.3)	**(0.1)**
Yield	(0.7)	0.1	2.2	3.8	**3.5**
PRASM	(0.3)	1.3	2.0	3.5	**3.4**

(1) To provide a more meaningful comparison, the year-over-year percentage changes for the fourth quarter 2017 versus the fourth quarter of 2016 are based on previously reported 2016 and 2017 amounts as 2016 amounts have not been restated for the adoption of IFRS 15.

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

- The 9.6% traffic increase which reflected traffic growth on all major U.S. transborder services. The traffic increase in the fourth quarter of 2018 reflected strong passenger demand between Canada and the U.S., gains in the business cabin, and growth in international-to-international connecting passenger flows from the U.S.
- The 3.5% yield increase which reflected yield growth on all major U.S. transborder services. The launch of new fare categories on U.S. transborder services, resulting in growth in ancillary revenue and an improved fare mix, and a favourable currency impact of $10 million contributed to the overall yield improvement year-over-year. An increase in average stage length of 1.8%, which had the effect of reducing U.S. transborder yield by 1.0 percentage points, was a partly offsetting factor.

Atlantic Passenger Revenues

In the fourth quarter of 2018, Atlantic passenger revenues of $899 million increased $136 million or 18.0% from the fourth quarter of 2017.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the fourth quarter of 2018 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Atlantic	Q4'17 (1)	Q1'18	Q2'18	Q3'18	**Q4'18**
Passenger revenues	22.2	23.9	17.8	20.3	**18.0**
Capacity (ASMs)	13.9	9.6	11.9	10.3	**9.5**
Traffic (RPMs)	14.4	17.5	15.5	13.1	**14.5**
Passenger load factor (pp change)	0.3	5.4	2.6	2.2	**3.5**
Yield	6.8	5.4	1.9	6.4	**3.0**
PRASM	7.3	13.0	5.3	9.1	**7.7**

(1) To provide a more meaningful comparison, the year-over-year percentage changes for the fourth quarter 2017 versus the fourth quarter of 2016 are based on previously reported 2016 and 2017 amounts as 2016 amounts have not been restated for the adoption of IFRS 15.

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

- The 14.5% traffic increase which reflected traffic growth on all major Atlantic services and included gains in all cabins. The 9.5% capacity growth year-over-year was due to additional frequencies from Vancouver to India, an extension of seasonal mainline operations, including Toronto and Montreal to Italy and Montreal to Israel, and an extension of seasonal services on many markets operated by Air Canada Rouge.
- The 3.0% yield increase which reflected yield improvements on all major Atlantic services and included an increase in carrier surcharges year-over-year and a favourable currency impact of $12 million. The launch of a new fare category on Atlantic services, resulting in growth in ancillary revenue, including baggage fees, and an improved fare mix, also contributed to the overall yield improvement year-over-year.

Pacific Passenger Revenues

In the fourth quarter of 2018, Pacific passenger revenues of $550 million increased $49 million or 9.7% from the fourth quarter of 2017.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the fourth quarter of 2018 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Pacific	Q4'17 (1)	Q1'18	Q2'18	Q3'18	**Q4'18**
Passenger revenues	13.5	14.2	9.9	9.9	**9.7**
Capacity (ASMs)	12.2	12.0	5.2	1.1	**(0.8)**
Traffic (RPMs)	13.7	15.9	5.7	2.9	**0.3**
Passenger load factor (pp change)	1.0	2.8	0.4	1.5	**0.9**
Yield	(0.2)	(1.5)	4.0	6.8	**9.3**
PRASM	1.1	1.9	4.5	8.6	**10.6**

(1) To provide a more meaningful comparison, the year-over-year percentage changes for the fourth quarter 2017 versus the fourth quarter of 2016 are based on previously reported 2016 and 2017 amounts as 2016 amounts have not been restated for the adoption of IFRS 15.

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

- The 9.3% yield increase which reflected yield growth on all major Pacific services with the exception of Australia which was slightly below the fourth quarter of 2017. The lower yield on services to Australia reflected increased industry capacity when compared to the same quarter in 2017. The overall Pacific yield improvement versus the fourth quarter of 2017 included an increase in carrier surcharges year-over-year and a favourable currency impact of $6 million.
- The 0.3% traffic increase which reflected traffic growth on services to Australia, Korea and China, offset by traffic decreases on services to Hong Kong, Japan and Taiwan where capacity was reduced year-over-year. The traffic growth included gains in the business and premium economy cabins.

Other Passenger Revenues

In the fourth quarter of 2018, Other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of $284 million increased $36 million or 14.5% from the fourth quarter of 2017.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the fourth quarter of 2018 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Other	Q4'17 (1)	Q1'18	Q2'18	Q3'18	**Q4'18**
Passenger revenues	23.7	17.7	7.6	7.9	**14.5**
Capacity (ASMs)	18.7	15.0	11.7	16.8	**15.2**
Traffic (RPMs)	17.9	15.6	8.6	11.1	**14.0**
Passenger load factor (pp change)	(0.6)	0.4	(2.4)	(4.3)	**(0.9)**
Yield	4.8	1.9	(0.9)	(2.8)	**0.5**
PRASM	4.1	2.4	(3.7)	(7.6)	**(0.6)**

(1) To provide a more meaningful comparison, the year-over-year percentage changes for the fourth quarter 2017 versus the fourth quarter of 2016 are based on previously reported 2016 and 2017 amounts as 2016 amounts have not been restated for the adoption of IFRS 15.

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

- The 14.0% traffic increase which reflected traffic growth on services to South America and on routes to traditional sun destinations. The traffic growth in the fourth quarter of 2018 included gains in all cabins.
- The 0.5% yield increase which reflected yield growth on services to the Caribbean and Mexico, largely offset by a yield decrease on services to South America. The yield decline on services to South America was mainly due a significant increase in average stage length due to the removal of the short-haul tag between Santiago and Buenos Aires as Air Canada now serves both markets on a non-stop basis. An increase in average stage length of 6.1% had the effect of reducing yield in the Other markets by 3.4 percentage points. On a stage length adjusted basis, yield increased 3.9% when compared to the fourth quarter of 2017.

Cargo Revenues

In the fourth quarter of 2018, cargo revenues of $217 million increased $19 million or 10.0% from the same quarter in 2017 on yield and traffic growth of 6.8% and 2.9%, respectively. In the fourth quarter of 2018, the Atlantic and Pacific markets experienced particularly strong performances.

The table below provides cargo revenue by geographic region for the fourth quarter of 2018 and the fourth quarter of 2017.

Cargo Revenues

	Fourth Quarter			
(Canadian dollars in millions)	**2018**	2017 (1)	$ Change	% Change
Canada	$ 27	$ 23	$ 4	21.3
U.S. transborder	12	10	2	23.2
Atlantic	72	66	6	8.5
Pacific	88	81	7	9.2
Other	18	18	-	(2.5)
System	**$ 217**	**$ 198**	**$ 19**	**10.0**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

Other Revenues

In the fourth quarter of 2018, other revenues of $234 million increased $21 million or 10% when compared to the fourth quarter of 2017, mainly due to an increase in ground package revenue at Air Canada Vacations. This increase was driven by higher passenger volumes and, to a lesser extent, a higher price of ground packages when compared to the fourth quarter of 2017. An increase in passenger and airline-related fees versus the fourth quarter of 2017 was also a contributing factor to the increase in other revenue.

CASM and Adjusted CASM

In the fourth quarter of 2018, CASM increased 5.7% and adjusted CASM increased 0.5% when compared to the fourth quarter of 2017.

The table below compares Air Canada's CASM and adjusted CASM for the fourth quarter of 2018 to the fourth quarter of 2017.

	Full Year			
(cents per ASM)	2018	2017 [1]	¢ Change	% Change
Aircraft fuel	¢ 3.74	¢ 3.04	¢ 0.70	23.1
Regional airlines expense				
Aircraft fuel	0.52	0.46	0.06	12.0
Other	2.25	2.33	(0.08)	(3.3)
Wages and salaries	2.18	2.26	(0.08)	(3.4)
Benefits	0.63	0.53	0.10	18.4
Airport and navigation fees	0.88	0.83	0.05	5.5
Aircraft maintenance	0.98	1.01	(0.03)	(3.1)
Depreciation, amortization and impairment	1.04	1.01	0.03	2.8
Sales and distribution costs	0.71	0.70	0.01	1.3
Ground package costs	0.49	0.44	0.05	11.6
Aircraft rent	0.52	0.52	-	0.4
Catering and onboard services	0.41	0.37	0.04	11.0
Communications and information technology	0.27	0.26	0.01	4.4
Other	1.49	1.48	0.01	0.8
CASM	**¢ 16.11**	**¢ 15.24**	**¢ 0.87**	**5.7**
Remove:				
Aircraft fuel expense [2], ground package costs at Air Canada Vacations and special items	(4.75)	(3.94)	(0.81)	20.5
Adjusted CASM [3]	**¢ 11.36**	**¢ 11.30**	**¢ 0.06**	**0.5**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.
(2) Includes aircraft fuel expense related to regional airline operations.
(3) Adjusted CASM is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Operating Expenses

In the fourth quarter of 2018, operating expenses of $4,124 million increased $437 million or 12% from the fourth quarter of 2017 on capacity growth of 5.8%.

In the fourth quarter of 2018, the unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars), compared to the same quarter in 2017, increased operating expenses by $64 million (comprised of $37 million related to aircraft fuel expense and an aggregate of $27 million relating to non-fuel operating expenses).

The more notable components of the year-over-year change in operating expenses are described below.

Aircraft Fuel Expense

In the fourth quarter of 2018, aircraft fuel expense (including fuel expense related to regional airline operations) amounted to $1,091 million, an increase of $244 million or 29% from the fourth quarter of 2017. This increase reflected:

- higher jet fuel prices (before the impact of foreign exchange), which accounted for an increase of $151 million;
- an unfavourable currency impact of $37 million;
- a higher volume of fuel litres consumed, which accounted for an increase of $27 million; and
- fuel hedging losses/expenses of $26 million in the fourth quarter of 2018 versus fuel hedging gains (net of expenses) of $3 million in the fourth quarter of 2017, an increase of $29 million.

Regional Airlines Expense

In the fourth quarter of 2018, regional airlines expense of $708 million increased $33 million or 5% when compared to the fourth quarter of 2017, reflecting, in large part, higher aircraft fuel expense year-over-year, as well as a growth in capacity purchase fees due to higher CPA rates year-over-year.

The table below provides a breakdown of regional airlines expense for the fourth quarter of 2018 and the fourth quarter of 2017.

	Fourth Quarter			
(Canadian dollars in millions)	**2018**	2017	$ Change	% Change
Capacity purchase fees	$ 336	$ 330	$ 6	2
Aircraft fuel	133	112	21	19
Airport and navigation fees	73	71	2	3
Sales and distribution costs	34	35	(1)	(3)
Depreciation, amortization and impairment	11	7	4	57
Aircraft rent	10	10	-	-
Other	111	110	1	1
Total regional airlines expense	**$ 708**	**$ 675**	**$ 33**	**5**

Wages, Salaries and Benefits Expense

In the fourth quarter of 2018, wages and salaries expense of $557 million increased $11 million or 2% from the same quarter in 2017, largely due to a higher number of FTE employees mainly in support of the airline's capacity growth and international expansion strategy.

In the fourth quarter of 2018, employee benefits expense of $162 million increased $34 million or 27% from the fourth quarter of 2017, mainly due to the higher level of FTE employees and the impact of lower discount rates which increased the current service cost of defined benefit pension plans. In addition, the fourth quarter of 2017 reflected a favourable impact of $9 million related to an annual valuation pertaining to workers' compensation versus an unfavourable impact of $4 million in the fourth quarter of 2018.

Airport and Navigation Fees

In the fourth quarter of 2018, airport and navigation fees of $225 million increased $24 million or 12% from the fourth quarter of 2017, largely due to growth in wide-body and international flying. In addition, in the fourth quarter of 2017, Air Canada received a $15 million one-time refund from Nav Canada while no such refund was received in the fourth quarter of 2018. The favourable impact of Air Canada's agreement with the Greater Toronto Airports Authority, which is allowing the airline to increase international connecting traffic at Toronto Pearson International Airport on a more cost-effective basis, was an offsetting factor.

Aircraft Maintenance Expense

In the fourth quarter of 2018, aircraft maintenance expense of $250 million increased $7 million or 3% from the fourth quarter of 2017.

The table below provides a breakdown of the more significant items included in maintenance expense for the fourth quarter of 2018 and the fourth quarter of 2017.

	Fourth Quarter			
(Canadian dollars in millions)	**2018**	2017 (1)	$ Change	% Change
Technical maintenance	$ 222	$ 206	$ 16	8
Maintenance provisions (1)	17	31	(14)	(45)
Other	11	6	5	83
Total aircraft maintenance expense	**$ 250**	**$ 243**	**$ 7**	**3**

(1) Maintenance provisions relate to return conditions on aircraft leases which are recorded over the term of the lease.

Depreciation, Amortization and Impairment Expense

In the fourth quarter of 2018, depreciation, amortization and impairment expense of $267 million increased $22 million or 9% from the fourth quarter of 2017, largely due to the addition of Boeing 787 and 737 MAX aircraft into the mainline fleet. The sale of 25 Embraer 190 aircraft (which Air Canada leased back) in August 2018 was an offsetting factor.

Sales and Distribution Costs

In the fourth quarter of 2018, sales and distribution costs of $182 million increased $13 million or 8% from the same quarter in 2017, reflecting, in large part, the growth in passenger revenue. The favourable impact of new commission programs introduced in North America in April 2018 and growth in direct bookings when compared to the fourth quarter of 2017 were offsetting factors.

Ground Package Costs

In the fourth quarter of 2018, the cost of ground packages at Air Canada Vacations of $126 million increased $20 million or 19% when compared to the same quarter in 2017 due to a higher cost of ground packages (before the impact of foreign exchange) reflecting, in large part, a change in product mix, and higher passenger volumes year-over-year.

Aircraft Rent

In the fourth quarter of 2018, aircraft rent expense of $133 million increased $7 million or 6% from fourth quarter of 2017, reflecting, in large part, the impact of a greater number of leased aircraft, including 25 Embraer 190 aircraft which Air Canada sold and leased back in August 2018, and an unfavourable currency impact when compared to the fourth quarter of 2017. The impact of lower rates on certain lease renewals was an offsetting factor.

Other Expenses

In the fourth quarter of 2018, other expenses of $383 million increased $21 million or 6% from the same quarter in 2017, reflecting, in large part, the capacity growth and Air Canada's international expansion strategy.

The table below provides a breakdown of the more significant items included in other expenses for the fourth quarter of 2018 and the fourth quarter of 2017.

	Fourth Quarter			
(Canadian dollars in millions)	**2018**	2017	$ Change	% Change
Terminal handling	$ 77	$ 69	$ 8	12
Crew cycle	52	51	1	2
Building rent and maintenance	47	41	6	15
Miscellaneous fees and services	50	45	5	11
Remaining other expenses	157	156	1	1
Total other expenses	**$ 383**	**$ 362**	**$ 21**	**6**

Non-operating Income (Expense)

In the fourth quarter of 2018, non-operating expense amounted to $338 million versus non-operating expense of $113 million in the fourth quarter of 2017.

Components of the year-over-year change in non-operating expense included:

- In the fourth quarter of 2018, losses on foreign exchange amounted to $269 million compared to losses on foreign exchange of $62 million in the fourth quarter of 2017. The December 31, 2018 closing exchange rate was US$1=C$1.3637 while the September 30, 2018 closing exchange rate was US$1=C$1.2908. Foreign exchange losses on long-term debt of $333 million were partly offset by foreign exchange gains on foreign currency derivatives of $75 million.
- In the fourth quarter of 2017, Air Canada recorded a gain of $27 million on debt modifications related to the repricing of the airline's US$1.2 billion senior secured credit facility. No such gains were recorded in the fourth quarter of 2018.

8. FLEET

Mainline and Air Canada Rouge

The following table provides Air Canada's and Air Canada Rouge's operating fleet as at December 31, 2018. Refer to the Air Canada Express section below for information on the fleet of aircraft operated by regional airlines operating flights on behalf of Air Canada under capacity purchase agreements with Air Canada.

	Total Seats	Number of Operating Aircraft	Average Age	Owned	Finance Lease	Operating Lease
Mainline						
Wide-body aircraft						
Boeing 787-8	255	8	4.2	8	-	-
Boeing 787-9	298	27	2.1	21	-	6
Boeing 777-300ER	450/400	19	8.5	10	1	8
Boeing 777-200LR	300	6	11.1	4	-	2
Boeing 767-300ER	211	6	29.5	3	-	3
Airbus A330-300	292	8	18.2	8	-	-
Narrow-body aircraft						
Boeing 737 MAX 8	169	18	0.8	18	-	-
Airbus A321	190	15	15.7	5	-	10
Airbus A320	146	42	25.2	1	-	41
Airbus A319	120	16	21.2	5	-	11
Embraer 190	97	19	11.3	-	-	19
Total Mainline		**184**	**13.6**	**83**	**1**	**100**
Air Canada Rouge						
Wide-body aircraft						
Boeing 767-300ER (1)	282	25	21.6	3	2	20
Narrow-body aircraft						
Airbus A321	200	6	3.7	-	-	6
Airbus A319 (1)	136	22	20.2	17	-	5
Total Air Canada Rouge		**53**	**19.0**	**20**	**2**	**31**
Total Mainline and Air Canada Rouge		**237**	**14.8**	**103**	**3**	**131**

(1) The Boeing 767 aircraft and the Airbus A319 aircraft reflected as owned in the table above are owned by Air Canada and leased to Air Canada Rouge.

The table below provides the number of aircraft in Air Canada's operating fleet as at December 31, 2018 as well as Air Canada's planned operating fleet, including aircraft operating and expected to be operated by Air Canada Rouge, as at December 31, 2019 and December 31, 2020.

	Actual	Planned			
	December 31, 2018	2019 Fleet Changes	December 31, 2019	2020 Fleet Changes	December 31, 2020
Mainline					
Wide-body aircraft					
Boeing 787-8	8	-	8	-	8
Boeing 787-9	27	2	29	-	29
Boeing 777-300ER	19	-	19	-	19
Boeing 777-200LR	6	-	6	-	6
Boeing 767-300ER	6	(6)	-	-	-
Airbus A330-300	8	4	12	1	13
Narrow-body aircraft					
Boeing 737 MAX 8	18	18	36	14	50
Airbus A321	15	-	15	-	15
Airbus A320	42	(13)	29	(13)	16
Airbus A319	16	-	16	-	16
Airbus A220-300	-	1	1	14	15
Embraer 190	19	(5)	14	(14)	-
Total Mainline	**184**	**1**	**185**	**2**	**187**
Air Canada Rouge					
Wide-body aircraft					
Boeing 767-300ER	25	-	25	-	25
Narrow-body aircraft					
Airbus A321	6	4	10	-	10
Airbus A320	-	6	6	1	7
Airbus A319	22	-	22	-	22
Total Air Canada Rouge	**53**	**10**	**63**	**1**	**64**
Total wide-body aircraft	**99**	**-**	**99**	**1**	**100**
Total narrow-body aircraft	**138**	**11**	**149**	**2**	**151**
Total Mainline and Air Canada Rouge	**237**	**11**	**248**	**3**	**251**

Sale of Embraer 190 Aircraft

In August 2018, Air Canada finalized the sale and leaseback of 25 Embraer 190 aircraft. Six of these aircraft were returned to the lessor in 2018. Air Canada will continue to operate the remaining 19 until they gradually exit the fleet in 2019 and 2020.

Air Canada Express

The table below provides the number of aircraft operated, as at December 31, 2018, and planned, as at December 31, 2019 and December 31, 2020, on behalf of Air Canada, by Jazz, Sky Regional and other airlines operating flights under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada.

	Actual	Planned			
	December 31, 2018	2019 Fleet Changes	December 31, 2019	2020 Fleet Changes	December 31, 2020
Embraer 175	25	-	25	-	25
Bombardier CRJ-100/200	24	(2)	22	(7)	15
Bombardier CRJ-900	21	5	26	9	35
Bombardier Dash 8-100	15	(15)	-	-	-
Bombardier Dash 8-300	25	(2)	23	(4)	19
Bombardier Dash 8-Q400	44	-	44	(8)	36
Total Air Canada Express	**154**	**(14)**	**140**	**(10)**	**130**

Other Aircraft with CPA Carriers

A total of nine 18-passenger Beech 1900 aircraft are also operated by CPA carriers on behalf of Air Canada.

9. FINANCIAL AND CAPITAL MANAGEMENT

9.1. LIQUIDITY

Air Canada manages its liquidity needs through a variety of strategies, including by seeking to sustain and improve cash from operations and free cash flow, sourcing committed financing, as necessary, for new and existing aircraft, and through other financing activities.

Liquidity needs are primarily related to meeting obligations associated with financial liabilities, capital commitments, ongoing operations, contractual and other obligations, which are further discussed in sections 9.6, 9.7 and 9.8 of this MD&A. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available for use 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. At December 31, 2018, unrestricted liquidity amounted to $5,725 million (comprised of cash, cash equivalents and short-term investments of $4,707 million and undrawn lines of credit of $1,018 million. This compared to unrestricted liquidity of $4,181 million at December 31, 2017 (comprised of cash, cash equivalents and short-term investments of $3,804 million and undrawn lines of credit of $377 million). In addition, Air Canada monitors its financial leverage as measured by the adjusted net debt to EBITDAR ratio, as further described in section 9.3 of this MD&A.

9.2. FINANCIAL POSITION

The following table provides a condensed consolidated statement of financial position of Air Canada as at December 31, 2018 and as at December 31, 2017.

(Canadian dollars in millions)	**December 31, 2018**	December 31, 2017 (1)	$ Change
Assets			
Cash, cash equivalents and short-term investments	$ 4,707	$ 3,804	$ 903
Other current assets	1,594	1,593	1
Current assets	**$ 6,301**	**$ 5,397**	**$ 904**
Deposits and other assets	444	465	(21)
Property and equipment	9,729	9,252	477
Pension assets	1,969	1,583	386
Deferred income tax	39	456	(417)
Intangible assets	404	318	86
Goodwill	311	311	-
Total assets	**$ 19,197**	**$ 17,782**	**$ 1,415**
Liabilities			
Current liabilities	$ 5,099	$ 5,101	$ (2)
Long-term debt and finance leases	6,197	5,448	749
Pension and other benefit liabilities	2,547	2,592	(45)
Maintenance provisions	1,118	1,003	115
Other long-term liabilities	151	167	(16)
Deferred income tax	52	49	3
Total liabilities	**$ 15,164**	**$ 14,360**	**$ 804**
Total shareholders' equity	**$ 4,033**	**$ 3,422**	**$ 611**
Total liabilities and shareholders' equity	**$ 19,197**	**$ 17,782**	**$ 1,415**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

Movements in current assets and current liabilities are described in section 9.4 "Working Capital" of this MD&A. Long-term debt and finance leases are discussed in sections 9.3 "Adjusted Net Debt" and 9.5 "Consolidated Cash Flow Movements" of this MD&A.

At December 31, 2018, property and equipment amounted to $9,729 million, an increase of $477 million from December 31, 2017. This increase was mainly due to additions to property and equipment of $2,039 million, offset by the impact of depreciation expense of $1,066 million and the impact of the sale of 25 Embraer 190 aircraft in 2018.

In 2018, additions to property and equipment included five Boeing 787-9 aircraft and 16 Boeing 737 MAX 8 aircraft. Four Boeing 787 and nine Boeing 737 MAX aircraft were financed with proceeds from the sale of enhanced equipment trust certificates (EETCs) issued through a U.S. dollar private offering in 2017, one Boeing 787 and four Boeing 737 MAX aircraft were financed with proceeds from the sale of EETCs issued through a Canadian dollar private offering in 2018, and three Boeing 737 MAX aircraft were purchased with cash. Additional information on these EETC private offerings can be found in section 9.8 "Contractual Obligations" of this MD&A. In 2018, additions to property and equipment also included progress payments on future aircraft deliveries and capitalized maintenance costs.

The net long-term pension and other benefit liabilities of $578 million (comprised of pension and other benefit liabilities of $2,547 million net of pension assets of $1,969 million) decreased $431 million from December 31, 2017. This decrease was mainly due to a 21-basis point increase in the discount rate used to value the liabilities and the impact of revised demographic assumptions, resulting in a net gain on remeasurements on employee liabilities of $688 million for the year ended December 31, 2018 ($503 million, net of tax) recorded on Air Canada's consolidated statement of comprehensive income. The revised demographic assumptions relate mainly to updated actuarial assumptions regarding retirement rates, which resulted in a decrease to the actuarial liability of $277 million.

9.3. ADJUSTED NET DEBT

The following table reflects Air Canada's adjusted net debt balances as at December 31, 2018 and as at December 31, 2017.

(Canadian dollars in millions)	**December 31, 2018**	December 31, 2017	$ Change
Total long-term debt and finance leases	$ 6,197	$ 5,448	$ 749
Current portion of long-term debt and finance leases	455	671	(216)
Total long-term debt and finance leases (including current portion)	**$ 6,652**	**$ 6,119**	**$ 533**
Less cash, cash equivalents and short-term investments	(4,707)	(3,804)	(903)
Net debt	**$ 1,945**	**$ 2,315**	**$ (370)**
Capitalized operating leases (1)	3,913	3,801	112
Adjusted net debt (1)	**$ 5,858**	**$ 6,116**	**$ (258)**
EBITDAR (trailing 12 months)	**$ 2,851**	**$ 2,928**	**$ (77)**
Adjusted net debt to EBITDAR ratio (2)	**2.1**	**2.1**	**-**

(1) Adjusted net debt is an additional GAAP financial measure and a key component of the capital managed by Air Canada and provides management with a measure of its net indebtedness. Air Canada includes capitalized operating leases which is a measure commonly used in the industry to ascribe a value to obligations under operating leases. Common industry practice is to multiply annualized aircraft rent expense by 7. This definition of capitalized operating leases is used by Air Canada and may not be comparable to similar measures presented by other public companies. Aircraft rent (including aircraft rent expense related to regional airline operations) was $559 million for the 12 months ended December 31, 2018 and $543 million for the 12 months ended December 31, 2017.

(2) Adjusted net debt to trailing 12-month EBITDAR ratio (also referred to as "leverage ratio" in this MD&A) is a non-GAAP financial measure and is used by Air Canada as a means to measure financial leverage. Leverage ratio is calculated by dividing adjusted net debt by trailing 12-month EBITDAR. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

At December 31, 2018, total long-term debt and finance leases (including current portion) of $6,652 million increased $533 million from December 31, 2017. The unfavourable impact of a weaker Canadian dollar, as at December 31, 2018 compared to December 31, 2017, increased foreign currency denominated debt (mainly U.S. dollars) by $501 million. In 2018, new aircraft-related borrowings of $1,210 million were largely offset by debt repayments of $1,167 million.

At December 31, 2018, adjusted net debt of $5,858 million decreased $258 million from December 31, 2017 as increases in long-term debt and finance lease balances of $533 million and capitalized operating lease balances of $112 million were more than offset by an increase in cash, cash equivalents and short-term investment balances of $903 million. At December 31, 2018, Air Canada's leverage ratio (adjusted net debt to trailing 12-month EBITDAR ratio) was 2.1, unchanged from December 31, 2017.

At December 31, 2018, Air Canada's weighted average cost of capital ("WACC"), on a pre-tax basis, was 7.2% (compared to 7.6% at December 31, 2017). WACC is based on an estimate by management and consists of an estimated cost of equity of 20.0% and an average cost of debt and finance leases of 4.4% (compared to an estimated cost of equity of 20.0% and an average cost of debt and finance leases of 4.5% at December 31, 2017).

9.4. WORKING CAPITAL

The table below provides information on Air Canada's working capital balances as at December 31, 2018 and as at December 31, 2017.

(Canadian dollars in millions)	**December 31, 2018**	December 31, 2017	$ Change
Cash, cash equivalents and short-term investments	$ 4,707	$ 3,804	$ 903
Accounts receivable	796	814	(18)
Other current assets	798	779	19
Total current assets	**$ 6,301**	**$ 5,397**	**$ 904**
Accounts payable and accrued liabilities	1,927	1,961	(34)
Advance ticket sales	2,717	2,469	248
Current portion of long-term debt and finance leases	455	671	(216)
Total current liabilities	**$ 5,099**	**$ 5,101**	**$ (2)**
Net working capital	**$ 1,202**	**$ 296**	**$ 906**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

The net working capital of $1,202 million at December 31, 2018 represented an improvement of $906 million from December 31, 2017.

The net cash flow benefit of positive operating results in 2018 more than offset the impact of net capital expenditures. Net cash outflow relating to capital expenditures was $838 million (after deducting proceeds drawn on the delivery of five Boeing 787 and 13 Boeing 737 MAX aircraft of $1,210 million, and proceeds on the sale of 25 Embraer 190 aircraft of $293 million less the repayment of the associated debt of $144 million). In 2018, Air Canada also made an additional debt repayment of $268 million in conjunction with the amendment of the 2016 Credit Facility (refer to section 9.3 "Adjusted Net Debt" of this MD&A for additional information) and purchased three Boeing 737 MAX aircraft using cash.

9.5 CONSOLIDATED CASH FLOW MOVEMENTS

The table below provides the cash flow movements for Air Canada for the periods indicated.

	Fourth Quarter			Full Year		
(Canadian dollars in millions)	2018	2017	$ Change	2018	2017	$ Change
Net cash flows from operating activities	**$ 360**	**$ 389**	**$ (29)**	**$ 2,695**	**$ 2,738**	**$ (43)**
Proceeds from borrowings	-	-	-	1,210	733	477
Reduction of long-term debt and finance lease obligations	(361)	(240)	(121)	(1,170)	(814)	(356)
Shares purchased for cancellation	(50)	(35)	(15)	(73)	(71)	(2)
Issue of shares	-	2	(2)	5	9	(4)
Financing fees	(4)	(11)	7	(12)	(26)	14
Net cash flows used in financing activities	**$ (415)**	**$ (284)**	**$ (131)**	**$ (40)**	**$ (169)**	**$ 129**
Short-term investments	36	(167)	203	(848)	(998)	150
Additions to property, equipment and intangible assets	(219)	(432)	213	(2,197)	(2,422)	225
Proceeds from sale of assets	1	2	(1)	11	5	6
Proceeds from sale-leaseback of assets	-	-	-	293	740	(447)
Other	(1)	(24)	23	47	(16)	63
Net cash flows used in investing activities	**$ (183)**	**$ (621)**	**$ 438**	**$ (2,694)**	**$ (2,691)**	**$ (3)**
Effect of exchange rate changes on cash and cash equivalents	**$ 16**	**$ 12**	**$ 4**	**$ 27**	**$ (23)**	**$ 50**
Increase (decrease) in cash and cash equivalents	**$ (222)**	**$ (504)**	**$ 282**	**$ (12)**	**$ (145)**	**$ 133**

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

	Fourth Quarter			Full Year		
(Canadian dollars in millions)	2018	2017	$ Change	2018	2017	$ Change
Net cash flows from operating activities	**$ 360**	**$ 389**	**$ (29)**	**$ 2,695**	**$ 2,738**	**$ (43)**
Additions to property, equipment and intangible assets, net of proceeds from sale and leaseback transactions	(219)	(432)	213	(1,904)	(1,682)	(222)
Free cash flow (1)	**$ 141**	**$ (43)**	**$ 184**	**$ 791**	**$ 1,056**	**$ (265)**

(1) Free cash flow is a non-GAAP financial measure used by Air Canada as an indicator of the financial strength and performance of its business, indicating how much cash it is able to generate from operations and after capital expenditures. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment and intangible assets, and is net of proceeds from sale and leaseback transactions. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Free Cash Flow

In the fourth quarter of 2018, net cash flows from operating activities of $360 million decreased $29 million when compared to the same quarter in 2017. The cash flow benefit of an improvement in operating income quarter over quarter was more than offset by a decrease in cash from working capital. Free cash flow of $141 million increased $184 million from the fourth quarter of 2017 due to a lower level of capital expenditures.

In 2018, net cash flows from operating activities of $2,695 million decreased $43 million when compared to 2017. In 2018, free cash flow of $791 million decreased $265 million from 2017. In 2018, Air Canada received proceeds of $293 million from the sale and leaseback of 25 Embraer 190 aircraft. In 2017, Air Canada received proceeds of $740 million from the sale and leaseback of four Boeing 787 aircraft.

Net Cash Flows from (used in) Financing Activities

Reduction of long-term debt and finance lease obligations amounted to $361 million in the fourth quarter of 2018 and $1,170 million for the full year 2018 while proceeds from borrowings were nil in the fourth quarter of 2018 and totaled $1,210 million in 2018.

Refer to sections 9.4 "Working Capital", 9.2 "Financial Position" and 9.3 "Adjusted Net Debt" of this MD&A for additional information.

9.6. CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS

Boeing 787 Aircraft

As of the date of this MD&A, Air Canada has outstanding purchase commitments with The Boeing Company ("Boeing") for two Boeing 787 aircraft to be delivered in 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 positions), and purchase rights for 10 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on Boeing's then current pricing and available delivery positions).

Boeing 737 MAX Aircraft

Air Canada has an agreement with Boeing for the purchase of Boeing 737 MAX aircraft which provides for:

- Firm orders for 61 737 MAX aircraft, consisting of 50 737 MAX 8 and 11 737 MAX 9 aircraft with substitution rights between them as well as for the 737 MAX 7 aircraft.
- Purchase options for 18 Boeing 737 MAX aircraft.
- Certain rights to purchase an additional 30 Boeing 737 MAX aircraft.

As of the date of this MD&A, 18 Boeing 737 MAX 8 aircraft have been delivered, with the remaining 43 Boeing 737 MAX aircraft scheduled for delivery from 2019 to 2024.

In April 2018, Air Canada concluded an amendment to its Boeing 737 purchase agreement, pursuant to which certain aircraft delivery positions were accelerated and others deferred. The amendment accelerates the delivery of five 737 MAX aircraft by one year, to 2020, and defers the delivery of 11 737 MAX aircraft by up to 36 months.

Subject to certain conditions, Air Canada also has financing commitments covering 25 firm Boeing 737 MAX aircraft scheduled for delivery in 2020, 2023 and 2024. The financing terms are for 80% of the aircraft delivery price and the term to maturity is 10 years with mortgage-style repayments.

Airbus A220-300 Aircraft

In June 2016, Air Canada and Bombardier Inc. ("Bombardier") finalized a purchase agreement which includes a firm order for 45 Airbus A220-300 aircraft (formerly called Bombardier C-Series CS300 aircraft) and options for an additional 30 Airbus A220-300 aircraft. Deliveries are scheduled to begin in late 2019 and extend to 2022. The first 25 aircraft on delivery are expected to replace Air Canada's existing mainline fleet of Embraer 190 aircraft, with incremental aircraft supporting Air Canada's hub and network growth.

Reconfiguration of Airbus A330 Aircraft

In order to provide customers with a product that is consistent across its wide-body fleet, Air Canada plans on reconfiguring 12 Airbus A330 aircraft (eight of which are currently in service and four scheduled to be added in 2019) to the new Boeing 787 state-of-the-art standard. The reconfiguration of the Airbus A330 aircraft is expected to begin in late 2019 for completion in the first half of 2020. The capital expenditure related to this refurbishment program (which is included in the projected committed expenditures in the table below) is approximately $275 million.

Capital Commitments

As outlined in the table below, the estimated aggregate cost of the future firm Boeing 787, Boeing 737 MAX and Airbus A220-300 aircraft deliveries and other capital purchase commitments as at December 31, 2018 approximates $6,076 million. The table below also includes the impact of the amendment to the Boeing 737 purchase agreement discussed above.

(Canadian dollars in millions)	2019	2020	2021	2022	2023	Thereafter	Total
Projected committed expenditures	$ 2,382	$ 1,556	$ 815	$ 753	$ 375	$ 195	$ 6,076
Projected planned but uncommitted expenditures	324	441	440	228	186	Not available	Not available
Projected planned but uncommitted capitalized maintenance (1)	212	183	166	Not available	Not available	Not available	Not available
Total projected expenditures (2)	**$ 2,918**	**$ 2,180**	**$ 1,421**	**$ 981**	**$ 561**	**Not available**	**Not available**

(1) Future capitalized maintenance amounts for 2022 and 2023 and beyond are not yet determinable.
(2) U.S. dollar amounts are converted using the December 31, 2018 closing exchange rate of US$1=C$1.3637. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at December 31, 2018.

9.7. PENSION FUNDING OBLIGATIONS

Air Canada maintains several defined benefit pension plans, including domestic registered pension plans, supplemental pension plans and international pension plans. Air Canada also has several defined contribution pension plans as well as plans providing other retirement and post-employment benefits to its employees.

As at January 1, 2018, the aggregate solvency surplus in the domestic registered pension plans was $2.6 billion. Based on preliminary estimates, including actuarial assumptions, as at January 1, 2019, the aggregate solvency surplus in Air Canada's domestic registered pension plans is projected to be $2.4 billion. The final valuations to be made as at January 1, 2019 will be completed in the first half of 2019. Based on preliminary estimates, Air Canada does not expect to make any past service payments in 2019.

As permitted by applicable legislation and subject to applicable plan rules, amounts in excess of 105% on a solvency basis may be used to reduce current service contributions under the defined benefit component or to fund the employer contribution to a defined contribution component within the same pension plan.

On a cash basis, total employer pension funding contributions (including the international and supplemental plans) amounted to $94 million in 2018, as described in the table below.

(Canadian dollars in millions)	2018
Current service domestic registered plans	$ 1
Other pension arrangements (1)	93
Total employer pension funding contributions	**$ 94**

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

On a cash basis, total pension funding contributions (including the international and supplemental plans) are forecasted to be $93 million in 2019, as described in the table below.

(Canadian dollars in millions)	2019
Current service domestic registered plans	$ 2
Other pension arrangements (1)	91
Total projected employer pension funding contributions	**$ 93**

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

As at December 31, 2018, taking into account the effect of financial instrument risk management tools, approximately 81% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk. Air Canada may continue to increase the percentage of fixed income products matched to pension liabilities, subject to favourable market conditions.

9.8. CONTRACTUAL OBLIGATIONS

The table below provides Air Canada's contractual obligations as at December 31, 2018, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and finance lease obligations, operating lease obligations and committed capital expenditures.

(Canadian dollars in millions)	2019	2020	2021	2022	2023	Thereafter	Total
Principal							
Long-term debt obligations	$ 407	$ 640	$ 1,003	$ 342	$ 1,450	$ 2,731	$ 6,573
Finance lease obligations	48	50	17	15	16	41	187
Total principal obligations	**$ 455**	**$ 690**	**$ 1,020**	**$ 357**	**$ 1,466**	**$ 2,772**	**$ 6,760**
Interest							
Long-term debt obligations	273	258	214	176	151	346	1,418
Finance lease obligations	14	10	6	5	4	10	49
Total interest obligations	**$ 287**	**$ 268**	**$ 220**	**$ 181**	**$ 155**	**$ 356**	**$ 1,467**
Total long-term debt and finance lease obligations	**$ 742**	**$ 958**	**$ 1,240**	**$ 538**	**$ 1,621**	**$ 3,128**	**$ 8,227**
Operating lease obligations	**$ 679**	**$ 527**	**$ 383**	**$ 294**	**$ 230**	**$ 868**	**$ 2,981**
Committed capital expenditures	**$ 2,382**	**$ 1,556**	**$ 815**	**$ 753**	**$ 375**	**$ 195**	**$ 6,076**
Total contractual obligations (1)	**$ 3,803**	**$ 3,041**	**$ 2,438**	**$ 1,585**	**$ 2,226**	**$ 4,191**	**$ 17,284**

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

Covenants in Credit Card Agreements

Air Canada's principal credit card processing agreements for credit card processing services contain triggering events upon which Air Canada is required to provide the applicable credit card processor with cash deposits. The obligations 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, cash equivalents and short-term investments of Air Canada. In 2018, Air Canada made no cash deposits under these agreements (nil in 2017).

9.9. SHARE INFORMATION

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

	December 31, 2018	December 31, 2017
Issued and outstanding shares		
Variable voting shares	125,214,350	115,986,084
Voting shares	145,515,561	157,090,562
Total issued and outstanding shares	**270,729,911**	**273,076,646**
Class A variable voting and Class B voting shares potentially issuable		
Stock options	6,014,464	6,121,252
Total shares potentially issuable	**6,014,464**	**6,121,252**
Total outstanding and potentially issuable shares	**276,744,375**	**279,197,898**

Issuer Bid

In May 2018, Air Canada received approval from the Toronto Stock Exchange for the renewal of its normal course issuer bid for its Class A variable voting shares and Class B voting shares (collectively the "shares"), authorizing, between May 31, 2018 and May 30, 2019, the purchase of up to 24,040,243 shares, representing 10% of Air Canada's public float as at May 17, 2018. In 2018, Air Canada purchased, for cancellation 3,013,822 shares at an average cost of $24.11 per share for aggregate consideration of $73 million. At December 31, 2018, a total of 21,940,639 shares remained available for repurchase under the existing issuer bid.

10. QUARTERLY FINANCIAL DATA

The table below summarizes quarterly financial results for Air Canada for the last eight quarters.

(Canadian dollars in millions, except where indicated)	2017 (1)				2018			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Passenger	$ 3,120	$ 3,550	$ 4,514	$ 3,409	$ 3,489	$ 3,921	$ 5,018	$ 3,795
Cargo	148	168	194	198	168	200	218	217
Other	374	192	172	213	414	212	179	234
Operating revenues	**3,642**	**3,910**	**4,880**	**3,820**	**4,071**	**4,333**	**5,415**	**4,246**
Aircraft fuel	659	701	832	735	825	964	1,222	958
Regional airlines expense								
Aircraft fuel	95	96	109	112	114	135	149	133
Other	537	552	553	563	561	607	568	575
Wages, salaries & benefits	644	663	690	674	700	711	743	719
Airport and navigation fees	210	230	264	201	221	237	281	225
Aircraft maintenance	228	226	241	243	256	220	277	250
Depreciation, amortization and impairment	228	242	241	245	267	278	268	267
Sales and distribution costs	181	188	232	169	189	199	237	182
Ground package costs	256	103	73	106	276	114	86	126
Aircraft rent	122	130	125	126	125	123	137	133
Catering and onboard services	85	97	112	89	96	108	125	104
Communications and information technology	71	58	63	62	79	67	79	69
Special items	30	-	-	-	-	-	-	-
Other	326	332	369	362	376	344	403	383
Operating expenses	**3,672**	**3,618**	**3,904**	**3,687**	**4,085**	**4,107**	**4,575**	**4,124**
Operating income (loss)	**(30)**	**292**	**976**	**133**	**(14)**	**226**	**840**	**122**
Foreign exchange gain (loss)	70	68	44	(62)	(112)	(25)	89	(269)
Interest income	12	14	16	18	20	24	32	32
Interest expense	(79)	(80)	(73)	(79)	(83)	(84)	(80)	(84)
Interest capitalized	9	9	9	9	13	7	7	8
Net financing expense relating to employee benefits	(16)	(16)	(15)	(18)	(12)	(13)	(13)	(12)
Gain (loss) on financial instruments recorded at fair value	-	7	17	(1)	1	(9)	10	(3)
Gain on sale and leaseback of assets	26	26	-	-	-	-	-	-
Gain (loss) on debt settlements and modifications	-	-	(3)	24	11	(1)	(1)	-
Loss on disposal of assets	-	-	-	-	-	(186)	(2)	-
Other	(5)	(6)	(6)	(4)	(8)	(10)	(6)	(10)
Total non-operating income (expense)	**17**	**22**	**(11)**	**(113)**	**(170)**	**(297)**	**36**	**(338)**
Income (loss) before income taxes	**(13)**	**314**	**965**	**20**	**(184)**	**(71)**	**876**	**(216)**
Income tax (expense) recovery	-	(3)	758	(12)	14	(6)	(231)	(15)
Net income (loss)	**$ (13)**	**$ 311**	**$ 1,723**	**$ 8**	**$ (170)**	**$ (77)**	**$ 645**	**$ (231)**
Diluted earnings (loss) per share	**$ (0.05)**	**$ 1.13**	**$ 6.22**	**$ 0.02**	**$ (0.62)**	**$ (0.28)**	**$ 2.34**	**$ (0.85)**
EBITDAR (2)	**$ 366**	**$ 681**	**$ 1,360**	**$ 521**	**$ 397**	**$ 646**	**$ 1,265**	**$ 543**
Adjusted pre-tax income (loss) (2)	**$ (63)**	**$ 229**	**$ 922**	**$ 77**	**$ (72)**	**$ 163**	**$ 793**	**$ 68**
Adjusted net income (loss) (2)	**$ (63)**	**$ 226**	**$ 922**	**$ 60**	**$ (52)**	**$ 114**	**$ 561**	**$ 54**
Adjusted earnings (loss) per share – diluted (2)	**$ (0.23)**	**$ 0.82**	**$ 3.33**	**$ 0.22**	**$ (0.19)**	**$ 0.41**	**$ 2.03**	**$ 0.20**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.
(2) EBITDAR, adjusted pre-tax income (loss), adjusted net income (loss) and adjusted earnings (loss) per share – diluted are non-GAAP financial measures. Reconciliations of these measures to comparable GAAP measures can be found in section 20 "Non-GAAP Financial Measures" of this MD&A and in Air Canada's MD&A reports, available at aircanada.com.

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

(Canadian dollars in millions)	2017 Q1	2017 Q2	2017 Q3	2017 Q4	2018 Q1	2018 Q2	2018 Q3	2018 Q4
Capacity purchase fees	$ 308	$ 314	$ 315	$ 330	$ 319	$ 360	$ 318	$ 336
Aircraft fuel	95	96	109	112	114	135	149	133
Airport and navigation fees	69	73	80	71	69	76	78	73
Sales and distribution costs	37	40	34	35	34	41	44	34
Depreciation, amortization and impairment	6	7	8	7	9	9	9	11
Aircraft rent	10	10	10	10	10	10	11	10
Other	107	108	106	110	120	111	108	111
Total regional airlines expense	**$ 632**	**$ 648**	**$ 662**	**$ 675**	**$ 675**	**$ 742**	**$ 717**	**$ 708**

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

System	2017 (1) Q1	2017 (1) Q2	2017 (1) Q3	2017 (1) Q4	2018 Q1	2018 Q2	2018 Q3	2018 Q4
Passenger PRASM (cents)	13.6	14.0	14.5	14.1	14.0	14.4	15.1	14.8
CASM (cents)	16.0	14.3	12.6	15.2	16.4	15.1	13.8	16.1
Adjusted CASM (cents) (2)	11.5	10.7	9.3	11.3	11.5	10.6	9.4	11.4
Fuel cost per litre (cents) (3)	63.2	61.3	59.4	67.5	73.3	80.3	83.0	84.3

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.
(2) Adjusted CASM is a non-GAAP financial measure. A reconciliation of this measure to a comparable GAAP measure can be found in section 20 "Non-GAAP Financial Measures" of this MD&A and in Air Canada's MD&A reports, available at aircanada.com.
(3) Includes aircraft fuel expense related to regional airline operations. Includes fuel handling expenses.

The table below provides Air Canada's revenue passenger miles (RPMs), available seat miles (ASMs) and passenger load factors, on a system-basis and by market, for the last eight quarters.

	2017				2018			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
System								
RPMs (millions)	18,341	20,928	26,472	19,396	20,440	22,654	28,465	20,801
ASMs (millions)	22,894	25,357	31,050	24,191	24,862	27,269	33,137	25,598
Passenger load factor (%)	80.1	82.5	85.3	80.2	82.2	83.1	85.9	81.3%
Domestic								
RPMs (millions)	4,101	4,875	6,130	4,607	4,226	5,003	6,339	4,684
ASMs (millions)	5,108	5,837	7,173	5,584	5,280	6,026	7,482	5,667
Passenger load factor (%)	80.3	83.5	85.4	82.5	80.0	83.0	84.7	82.7%
U.S. transborder								
RPMs (millions)	3,782	3,609	3,951	3,408	4,037	3,848	4,172	3,734
ASMs (millions)	4,687	4,376	4,683	4,252	4,945	4,673	4,962	4,662
Passenger load factor (%)	80.7	82.5	84.4	80.1	81.6	82.3	84.1	80.1%
Atlantic								
RPMs (millions)	3,891	6,131	9,406	5,076	4,573	7,084	10,642	5,813
ASMs (millions)	5,248	7,661	11,087	6,582	5,753	8,571	12,231	7,206
Passenger load factor (%)	74.1	80.0	84.8	77.1	79.5	82.7	87.0	80.6%
Pacific								
RPMs (millions)	3,943	4,671	5,471	4,501	4,572	4,936	5,630	4,514
ASMs (millions)	4,862	5,540	6,412	5,586	5,447	5,829	6,484	5,541
Passenger load factor (%)	81.1	84.3	85.3	80.6	83.9	84.7	86.8	81.5%
Other								
RPMs (millions)	2,624	1,642	1,514	1,804	3,032	1,783	1,682	2,056
ASMs (millions)	2,989	1,943	1,695	2,187	3,437	2,170	1,978	2,522
Passenger load factor (%)	87.8	84.5	89.3	82.5	88.2	82.1	85.0	81.6%

11. SELECTED ANNUAL INFORMATION

The following table provides selected annual information for Air Canada for the years 2016 through 2018.

	Full Year		
(Canadian dollars in millions, except per share figures)	2018	2017 (1)	2016 (1)
Operating revenues	$ 18,065	$ 16,252	$ 14,677
Operating expenses (2)	16,891	14,881	13,332
Operating income	**1,174**	**1,371**	**1,345**
Income before income taxes	405	1,286	877
Recovery of (provision for) income taxes (3)	(238)	743	(1)
Net income	**$ 167**	**$ 2,029**	**$ 876**
EBITDAR (4)	**$ 2,851**	**$ 2,928**	**$ 2,768**
Adjusted pre-tax income (4)	**$ 952**	**$ 1,165**	**$ 1,148**
Adjusted net income (4)	**$ 677**	**$ 1,145**	**$ 1,147**
Basic earnings per share	**$ 0.61**	**$ 7.44**	**$ 3.16**
Diluted earnings per share	**$ 0.60**	**$ 7.31**	**$ 3.10**
Adjusted earnings per share – diluted (4)	**$ 2.45**	**$ 4.11**	**$ 4.06**
Cash, cash equivalents and short-term investments	**$ 4,707**	**$ 3,804**	**$ 2,979**
Total assets (5)	**$ 19,197**	**$ 17,782**	**$ 15,114**
Total long-term liabilities (6)	**$ 10,520**	**$ 9,930**	**$ 10,178**
Total liabilities	**$ 15,164**	**$ 14,360**	**$ 13,895**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts. 2016 amounts have not been restated for the adoption of this new accounting standard.
(2) In 2017, Air Canada recorded a provision of $30 million relating to a fine which was reinstated by a decision of the European Commission pertaining to cargo investigations. In 2016, Air Canada recorded a past service cost expense of $91 million to reflect the estimated cost of pension increases applicable to ACPA-represented pilots who participate in a defined benefit plan.
(3) In 2017, Air Canada recorded a tax recovery of $743 million (representing a deferred income tax recovery of $759 million and a current income tax expense of $16 million). This deferred income tax recovery was excluded from adjusted net income as it reflected a one-time recognition of previously unrecognized income tax assets.
(4) EBITDAR, adjusted pre-tax income, adjusted net income and adjusted earnings per share – diluted are non-GAAP financial measures. Reconciliations of these measures to comparable GAAP measures can be found in section 20 "Non-GAAP Financial Measures" of this MD&A and in Air Canada's MD&A reports, available at aircanada.com.
(5) In 2017, Air Canada recorded a deferred income tax asset of $456 million.
(6) Total long-term liabilities include long-term debt (including current portion) and finance leases, pension and other benefit liabilities, maintenance provisions and other long-term liabilities.

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

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

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

	Fourth Quarter		Full Year	
(Canadian dollars in millions)	**2018**	2017	**2018**	2017
Share forward contracts	$ (3)	$ -	$ -	$ 26
Fuel derivatives	-	(1)	(1)	(3)
Financial instruments recorded at fair value	**$ (3)**	**$ (1)**	**$ (1)**	**$ 23**

Risk Management

Under its risk management policy, Air Canada manages its fuel price risk, foreign exchange risk and interest rate risk through the use of various financial derivative instruments. Air Canada uses these instruments solely for risk management purposes and not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be an economic hedge and offset by changes in cash flows of the relevant risk being hedged.

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

Fuel Price Risk Management

Fuel price risk is the risk that future cash flows will fluctuate because of changes in jet fuel prices. In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries. Air Canada may use derivative contracts based on jet fuel, heating oil and crude-oil. Air Canada's policy permits hedging of up to 75% of the projected jet fuel purchases for the current calendar year, 50% of the projected jet fuel purchases for the next calendar year, and 25% of projected jet fuel purchases for any calendar year thereafter. These are maximum (but not mandated) limits. There is no minimum monthly hedging requirement. Air Canada performs regular reviews to assess market conditions and adjust its hedging strategy where management considers it warranted.

In 2018:

- Hedging losses on the settlement of fuel derivatives of $19 million and the associated premium costs of $17 million, for a hedging loss of $36 million were reclassified from other comprehensive income to aircraft fuel expense (net fuel hedging loss of $2 million was reclassified from other comprehensive income to aircraft fuel expense in 2017). No hedge ineffectiveness was recorded.
- Air Canada purchased crude-oil call options and swaps covering a portion of 2018 fuel exposure. The cash premium related to these contracts was $17 million ($18 million in 2017 for 2017 exposures).
- Fuel derivative contracts cash settled with a fair value of $19 million in favour of the counterparties ($26 million in favour of Air Canada in 2017).

There were no outstanding fuel derivatives as at December 31, 2018 and December 31, 2017.

Foreign Exchange Risk Management

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

Air Canada generates certain sales in U.S. dollars and in other foreign currencies which are converted to U.S. dollars under the Corporation's risk management program. In 2018, these net operating cash inflows totaled approximately US$4.2 billion and U.S. denominated operating costs amounted to approximately US$6.4 billion. Non-operating cash outflows in U.S. dollars, primarily related to interest payments on U.S. dollar denominated debt and net financing outflows, amounted to approximately US$1.9 billion. For 2018, this resulted in a U.S. dollar net cash flow exposure of approximately US$4.1 billion.

Air Canada has a target coverage of 70% on a rolling 18-month basis to manage the net U.S. dollar cash flow exposure described above utilizing the following risk management strategies:

- Holding U.S. dollar cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash and short-term investment balances as at December 31, 2018 amounted to $863 million (US$635 million) ($686 million (US$542 million) as at December 31, 2017). A portion of the cash and investment reserves are an economic hedge against long-term U.S. dollar debt while the remainder of the cash is operational cash and investment reserves which are applied against the rolling 18-month net U.S. dollar cash flow exposure. In 2018, a gain of $62 million (loss of $58 million in 2017) was recorded in foreign exchange gain (loss) reflecting the change in Canadian equivalent market value of the U.S. dollar cash, cash equivalents and short-term investment balances held.
- Locking in the foreign exchange rate through the use of a variety of foreign exchange derivatives which have maturity dates corresponding to the forecasted dates of U.S. dollar net outflows.

The level of foreign exchange derivatives entered into and their related maturity dates are dependent upon a number of factors, which include the amount of foreign revenue conversion available, U.S. dollar net cash outflows, as well as the amount attributed to aircraft and debt payments. Based on the notional amount of currency derivatives outstanding at December 31, 2018, as further described below, approximately 77% of net U.S. cash outflows are hedged for 2019 and 48% for 2020, resulting in derivative coverage of 68% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 75% coverage.

As at December 31, 2018, Air Canada had outstanding foreign currency options and swap agreements, settling in 2019 and 2020, to purchase at maturity $4,987 million (US$3,659 million) of U.S. dollars at a weighted average rate of $1.2645 per US$1.00 (2017 – $3,400 million (US$2,704 million) with settlements in 2018 and 2019 at a weighted average rate of $1.2703 per $1.00 U.S. dollar). Air Canada also has protection in place to sell a portion of its excess Euros, Sterling, YEN, and AUD (EUR €103 million, GBP £208 million, JPY ¥25,922 million, and AUD $105 million) which settle in 2019 and 2020 at weighted average rates of €1.1910, £1.3567, ¥0.0092, and AUD $0.7448 per $1.00 U.S. dollar, respectively (as at December 31, 2017 - EUR €101 million, GBP £105 million, JPY ¥8,623 million, CNY ¥41 million, and AUD $32 million with settlement in 2018 at weighted average rates of €1.1664, £1.3259, ¥0.0090, ¥0.1468 and AUD $0.7576 respectively per $1.00 U.S. dollar).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations and, based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at December 31, 2018 was $33 million in favour of the counterparties (2017 – $215 million in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. In 2018, a gain of $245 million was recorded in foreign exchange gain (loss) related to these derivatives (2017 – $274 million loss). In 2018, foreign exchange derivative contracts cash settled with a net fair value of $63 million in favour of Air Canada (2017 – $55 million in favour of the counterparties).

Interest Rate Risk Management

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Air Canada enters into both fixed and floating rate debt and leases certain assets where the rental amount fluctuates based on changes in short-term interest rates. Air Canada manages interest rate risk on a portfolio basis and seeks financing terms in individual arrangements that are most advantageous taking into account all relevant factors, including credit margin, term and basis. The risk management objective is to minimize the potential for changes in interest rates to cause adverse changes in cash flows to Air Canada. The cash, cash equivalents and short-term investment portfolio, which earns a floating rate of return, is an economic hedge for a portion of the floating rate debt.

The ratio of fixed to floating rate obligations outstanding is designed to maintain flexibility in Air Canada's capital structure and is based upon a long-term objective of 60% fixed and 40% floating but allows the flexibility to adjust to prevailing market conditions. The ratio at December 31, 2018, was 81% fixed and 19% floating (73% and 27%, respectively, as at December 31, 2017).

13. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Critical accounting estimates are those estimates of management that are most important to the portrayal of Air Canada's financial condition and results of operations. They require management's most difficult, subjective or complex Judgements, often because of the need to make estimates and Judgements about the effect of matters that are inherently uncertain. Actual results could differ from those estimates and Judgements under different assumptions or conditions.

Air Canada has identified the following areas that depend on critical accounting estimates utilized in the preparation of its consolidated financial statements.

Employee Future Benefits

Air Canada maintains several defined benefit plans providing pension, other retirement and post-employment benefits to its employees. The cost and related liabilities of Air Canada's pensions, other post-retirement and post-employment benefit programs are determined using actuarial valuations. The actuarial valuations involve assumptions, including discount rates, future salary increases, mortality rates and future benefit increases. Also, due to the long-term nature of these programs, such estimates are subject to significant uncertainty.

Assumptions

Management is required to make significant estimates about actuarial and financial assumptions to determine the cost and related liabilities of Air Canada's employee future benefits.

Financial Assumptions

Discount Rate

The discount rate used to determine the pension obligation was determined by reference to market interest rates on corporate bonds rated "AA" or better with cash flows that approximate the timing and amount of expected benefit payments.

Future increases in compensation are based upon the current compensation policies, labour and employment agreements and economic forecasts.

The significant weighted average assumptions used to determine Air Canada's accrued benefit obligations and cost are as follows:

	Pension Benefits		Other Employee Future Benefits	
	2018	2017	**2018**	2017
Discount rate used to determine:				
Net interest on the net benefit obligation for the year ended December 31	3.60%	3.90%	3.60%	3.90%
Service cost for the year ended December 31	3.70%	4.10%	3.70%	4.10%
Accrued benefit obligation as at December 31	3.81%	3.60%	3.81%	3.60%
Rate of future increases in compensation used to determine:				
Accrued benefit cost for the year ended December 31	2.50%	2.50%	Not applicable	Not applicable
Accrued benefit obligation as at December 31	2.50%	2.50%	Not applicable	Not applicable

Sensitivity Analysis

Sensitivity analysis is based on changing one assumption while holding all other assumptions constant. In practice, this may be unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to variations in significant actuarial assumptions, the same method (present value of the defined benefit obligation calculated with the projected unit credit method at the end of the reporting period) has been applied as that used for calculating the liability recognized in the consolidated statement of financial position.

Sensitivity analysis on 2018 pension expense and net financing expense relating to pension benefit liabilities, based on different actuarial assumptions with respect to discount rate is set out below. The effects on each pension plan of a change in an assumption are weighted proportionately to the total plan obligation to determine the total impact for each assumption presented.

	0.25 Percentage Point	
(Canadian dollars in millions)	Decrease	Increase
Discount rate on obligation assumption		
Pension expense	$ 22	$ (21)
Net financing expense relating to pension benefit liabilities	23	(21)
Total	**$ 45**	**$ (42)**
Increase (decrease) in pension obligation	**$ 703**	**$ (680)**

The increase (decrease) in the pension obligation for a 0.25 percentage point change in the discount rate relates to the gross amount of the pension liabilities and is before the impact of any change in plan assets. As at December 31, 2018, approximately 81% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk.

An increase of one-year life expectancy would increase the pension benefit obligation by $478 million.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 5.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2018 (2017 – 5.8%). The rate is assumed to decrease gradually to 5% by 2020 (2017 – assumed to decrease gradually to 5% by 2020). A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by $4 million and the obligation by $55 million. A one percentage point decrease in assumed health care trend rates would have decreased the total of current service and interest costs by $4 million and the obligation by $58 million.

A 0.25 percentage point decrease in discount rate for other employee future benefits would have increased the total of current and interest costs by less than $1 million and the obligation by $47 million. A 0.25 percentage point increase in discount rate would have decreased the total of current and interest costs by less than $1 million and the obligation by $44 million.

Depreciation and Amortization Period for Long-lived Assets

Air Canada makes estimates about the expected useful lives of long-lived assets and the expected residual value of the assets based on the estimated current and future fair values of the assets, Air Canada's fleet plans and the cash flows they generate. Changes to these estimates, which can be significant, could be caused by a variety of factors, including changes to maintenance programs, changes in jet fuel prices and other operating costs, changes in utilization of the aircraft, and changing market prices for new and used aircraft of the same or similar types. Estimates and assumptions are evaluated at least annually. Generally, these adjustments are accounted for on a prospective basis, through depreciation and amortization expense. For the purposes of sensitivity analysis on these estimates, a 50% reduction to residual values on aircraft with remaining useful lives greater than five years results in an increase of $14 million to annual depreciation expense. For aircraft with shorter remaining useful lives, the residual values are not expected to change significantly.

Impairment Considerations of Long-lived Assets

Long-lived assets include property and equipment, definite lived intangible assets, indefinite lived intangible assets and goodwill. Assets that have an indefinite useful life, including goodwill, are tested annually for impairment or when events or circumstances indicate that the carrying value may not be recoverable. Assets that are subject to depreciation or amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When required, an impairment test is performed by comparing the carrying amount of the asset or cash generating unit to their recoverable amount. Recoverable amount is calculated as the higher of an asset's or cash-generating unit's fair value less costs to dispose and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or CGUs). Management has determined that the appropriate level for assessing impairments is at the narrow-body and wide-body fleet levels for aircraft and related assets supporting the operating fleet. Parked aircraft not used in operations and aircraft leased or subleased to third parties are assessed for impairment at the individual asset level. Fair value less costs to dispose may be calculated based upon a discounted cash flow analysis, which requires management to make a number of significant market participant assumptions including assumptions relating to future operating plans, discount rates and future growth rates. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

Maintenance Provisions

The recording of maintenance provisions related to return conditions on aircraft leases requires management to make estimates of the future costs associated with the maintenance events required under the lease return condition and estimates of the expected future maintenance condition of the aircraft at the time of lease expiry. These estimates take into account current costs of these maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Any difference in the actual maintenance cost incurred and the amount of the provision is recorded in aircraft maintenance expense in the period. The effect of any changes in estimates, including changes in discount rates, inflation assumptions, cost estimates or lease expiries, is also recognized in maintenance expense in the period. Assuming the aggregate cost for return conditions increases by 5%, holding all other factors constant, there would be a cumulative balance sheet adjustment to increase the provision by $62 million at December 31, 2018 and an increase to aircraft maintenance expense in 2019 of approximately $6 million. Expected future cash flows to settle the obligation are discounted. If the discount rates were to increase by 1%, holding all other factors constant, there would be a cumulative balance sheet adjustment to decrease the provision by $21 million at December 31, 2018. An equivalent but opposite movement in the discount rate would result in a similar impact in the opposite direction.

Income Taxes

Income tax assets and liabilities are measured at the amount that is expected to be realized or incurred upon ultimate settlement with taxation authorities. Such assessments are based upon the applicable income tax legislation, regulations and interpretations, all of which may be subject to change and interpretation. Deferred income tax assets and liabilities are composed of the tax effect of temporary differences between the carrying amount and tax basis of assets and liabilities, as well as the income tax effect of undeducted income tax losses. The timing of the reversal of temporary differences is estimated and the income tax rate substantively enacted for the periods of reversal is applied to the temporary difference. The carrying amounts of assets and liabilities are subject to the accounting estimates that are inherent in those balances. Assumptions as to the timing of reversal of temporary differences include expectations about the future results of operations and future cash flows. Changes in tax laws, tax rates or expected timing of reversal may have a significant impact on the amounts recorded for deferred income tax assets and liabilities.

Income tax recorded on Air Canada's consolidated statement of operations is presented below.

	Fourth Quarter		Full Year	
(Canadian dollars in millions)	**2018**	2017	**2018**	2017
Current income tax	$ 3	$ -	$ (6)	$ (16)
Deferred income tax	(18)	(12)	(232)	759
Income tax (expense) recovery	**$ (15)**	**$ (12)**	**$ (238)**	**$ 743**

In the third quarter of 2017, Air Canada determined that it was probable that substantially all of the deferred income tax assets would be realized. Accordingly, Air Canada recorded a tax recovery of $774 million, which was revised to $755 million with $19 million related to share-based compensation reclassified to Retained earnings in the fourth quarter of 2017.

Income tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full year. Air Canada's effective tax rate for 2018 26.78% (26.60% for 2017). The income tax expense differs from the amounts computed by applying the statutory tax rate, principally due to the impact of unrecognized tax benefits on foreign exchange capital losses and the effect of non-deductible expenses.

14. ACCOUNTING POLICIES

IFRS 16 – Leases

IFRS 16 replaces IAS 17 Leases and related interpretations. The core principle is that a lessee recognizes assets and liabilities for all leases with a lease term of more than 12 months. A lessee is required to recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. Assets and liabilities arising from a lease are initially measured on a present value basis. The measurement of the lease liability includes non-cancellable lease payments (including inflation-linked payments), and also includes payments to be made in optional periods if the lessee is reasonably certain to exercise an option to extend the lease, or not to exercise an option to terminate the lease. Purchase options which are reasonably certain of being exercised are also included in the measurement of the lease liability. Lease payments will not include variable lease payments other than those that depend on an index or rate. The right-of-use asset will be derived from the calculation of the lease liability and will also include any provisions the lessee will owe for return conditions on leased assets.

The new standard is intended to provide an improved representation of leasing transactions, in particular those that do not currently require the lessee to recognize an asset and liability arising from an operating lease. IFRS 16 is effective for annual periods beginning on January 1, 2019. Entities have the option of adopting a full retrospective approach or a modified retrospective approach on transition to IFRS 16.

Air Canada will apply the standard effective January 1, 2019 and will transition with a full retrospective approach with restatement to each prior reporting period presented. Air Canada has elected the package of practical expedients to not reassess prior conclusions related to contracts containing leases and to apply the recognition exemption for short-term leases and contracts for which the underlying asset has a low value.

This standard will have a significant impact on Air Canada's consolidated balance sheet, along with a change to the recognition, measurement and presentation of lease expenses in the consolidated statement of operations.

Aircraft Leases

As of December 31, 2018, Air Canada had 126 aircraft under operating leases (111 aircraft as at December 31, 2017), and Air Canada will record such aircraft as right-of-use assets and lease liabilities of Air Canada in accordance with the requirements of the new standard. Additionally, the Corporation has identified that, under IFRS 16, Air Canada is the lessee in respect of aircraft used by regional carriers providing services under the respective capacity purchase agreements ("CPA"), and will record such aircraft as right-of-use assets and lease liabilities of Air Canada. As at December 31, 2018, there were 132 aircraft (134 aircraft as at December 31, 2017) operating under these arrangements on behalf of Air Canada.

Property Leases

Air Canada has leases related to airport terminal operations space and other real estate leases. For leases related to terminal operations space, there are generally effective substitution rights in the hands of the lessor and therefore these are not considered lease contracts under the standard. Leases with reciprocal termination rights with a notice period of less than 12 months would be considered short-term leases and therefore would be excluded from balance sheet recognition under the practical expedient. Finally, those airport terminal contracts with variable lease payments will also be excluded since variable lease payments, other than those based on an index or rate, are excluded from the measurement of the lease liability. This results in a portfolio of property leases that are expected to be recorded as right-of-use assets and lease liabilities under the standard which relate to dedicated space in Air Canada's hub locations of Toronto, Montreal and Vancouver, lease contracts on building space dedicated to Air Canada for offices, airport and maintenance operations, Maple Leaf Lounges and land leases.

Accounting for Leases and Right-of-Use Assets

Leases are recognized as a right-of-use asset and corresponding liability at the date of which the leased asset is available for use by the Corporation. Each lease payment is allocated between the liability and interest expense. The interest cost is charged to the consolidated statement of operations over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Right-of-use assets will be accounted for under IAS 16 Property, Plant and Equipment. Aircraft recorded as right-of-use assets will have the same accounting policies as directly owned aircraft, meaning the right-of-use assets will be componentized and depreciated over the lease term. Consistent with owned aircraft, any qualifying maintenance events will be capitalized and depreciated over the lesser of the lease term and expected maintenance life.

Maintenance provisions for end-of-lease return obligations will be recorded, as applicable, on aircraft leases as a maintenance expense over the term of the lease. Any changes to the provision for end-of-lease conditions will be recognized as an adjustment to the right-of-use asset and subsequently amortized to the income statement over the remaining term of the lease.

The application of IFRS 16 requires assumptions and estimates in order to determine the value of the right-of-use assets and the lease liabilities which mainly relate to the implicit interest rate for aircraft leases and the incremental borrowing rate at commencement date of the contract for property leases. Judgement must also be applied as to whether renewal options are reasonably certain of being exercised.

Income Statement Impacts

The impacts on the income statement will be an elimination of aircraft rent and building rent, which is recorded in other operating expenses, for those contracts which are recognized as leases, and instead will be replaced by an amortization of the right-of-use asset and interest costs on the lease liability. Maintenance expense is expected to decrease under the standard as qualifying maintenance events for the former operating leases will be capitalized as part of the right-of-use asset and depreciated over their expected maintenance life. This will be partially offset by higher maintenance provision expense recorded on all aircraft right-of-use assets which contain end of lease maintenance return conditions. Regional airlines expense is expected to decrease to the extent aircraft rent is removed and recorded in depreciation and interest expense outside of the regional airlines expense.

Since all the aircraft lease contracts are denominated in US dollars, there may be additional volatility in the foreign exchange recognized in the income statement due to the revaluation of the lease liabilities and maintenance provisions to the rate of exchange in effect at the date of the balance sheet.

Anticipated Impact to 2018 Results

Select adjusted financial statement information, which reflects the anticipated impact of adoption of IFRS 16 on January 1, 2018, is presented below. Line items that are not expected to be affected by the change in accounting policy have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided. In summary, the following adjustments are anticipated to be made to the amounts recognized in Air Canada's consolidated statement of financial position for the date of initial application on January 1, 2018.

(Canadian dollars in millions)	December 31, 2017 as Previously Reported	Air Canada Aircraft	Regional Aircraft	Property Leases	**Expected January 1, 2018 as Restated**
Accounts receivable	$ 814	$ (3)	$ -	$ -	$ 811
Deposits and other assets	465	(63)	-	-	402
Property and equipment	9,252	1,649	766	160	11,827
Deferred income tax	456	71	144	13	684
Total assets	**$ 17,782**	**$ 1,654**	**$ 910**	**$ 173**	**$ 20,519**
Accounts payable and accrued liabilities	1,961	(22)	(12)	-	1,927
Current portion of long-term debt and lease liabilities	671	357	146	12	1,186
Total current liabilities	5,101	335	134	12	5,582
Long-term debt and lease liabilities	5,448	1,452	1,092	198	8,190
Maintenance provisions	1,003	70	78	-	1,151
Other long-term liabilities	167	(8)	-	-	159
Total liabilities	**$ 14,360**	**$ 1,849**	**$ 1,304**	**$ 210**	**$ 17,723**
Retained earnings	2,554	(195)	(394)	(37)	1,928
Total shareholders' equity	**$ 3,422**	**$ (195)**	**$ (394)**	**$ (37)**	**$ 2,796**
Total liabilities and shareholders' equity	**$ 17,782**	**$ 1,654**	**$ 910**	**$ 173**	**$ 20,519**

The expected impact of the adoption of IFRS 16 on Air Canada's 2018 consolidated statement of operations is presented below.

(Canadian dollars in millions)	December 31, 2018 as Previously Reported	Air Canada Aircraft	Regional Aircraft	Property Leases	Expected December 31, 2018 as Restated
Operating revenues					
Passenger	$ 16,223	$ -	$ -	$ -	$ 16,223
Cargo	803	-	-	-	803
Other	1,039	-	-	-	1,039
Total revenues	**18,065**	**-**	**-**	**-**	**18,065**
Operating expenses					
Aircraft fuel	3,969	-	-	-	3,969
Regional airlines expense	2,842	-	(323)	-	2,519
Wages, salaries and benefits	2,873	-	-	-	2,873
Airport and navigation fees	964	-	-	-	964
Aircraft maintenance	1,003	(100)	-	-	903
Depreciation, amortization and impairment	1,080	424	197	16	1,717
Sales and distribution costs	807	-	-	-	807
Ground package costs	602	-	-	-	602
Aircraft rent	518	(512)	-	-	6
Catering and onboard services	433	-	-	-	433
Communications and information technology	294	-	-	-	294
Other	1,506	-	-	(27)	1,479
Total operating expenses	**16,891**	**(188)**	**(126)**	**(11)**	**16,566**
Operating income	**1,174**	**188**	**126**	**11**	**1,499**
Non-operating income (expense)					
Foreign exchange loss	(317)	(155)	(105)	(1)	(578)
Interest income	108	-	-	-	108
Interest expense	(331)	(131)	(91)	(14)	(567)
Interest capitalized	35	-	-	-	35
Net financing expense relating to employee benefits	(50)	-	-	-	(50)
Loss on financial instruments recorded at fair value	(1)	-	-	-	(1)
Gain on debt settlements and modifications	9	-	-	-	9
Loss on disposal of assets	(188)	-	-	-	(188)
Other	(34)	(2)	-	-	(36)
Total non-operating expense	**(769)**	**(288)**	**(196)**	**(15)**	**(1,268)**
Income before income taxes	**405**	**(100)**	**(70)**	**(4)**	**231**
Income tax expense	(238)	27	19	1	(191)
Net income	**$ 167**	**$ (73)**	**$ (51)**	**$ (3)**	**$ 40**
EBITDAR	**$ 2,851**	**$ 100**	**$ 244**	**$ 27**	**$ 3,222**

15. OFF-BALANCE SHEET ARRANGEMENTS

Guarantees

Guarantees in Fuel and De-icing Arrangements

Air Canada participates in fuel facility arrangements operated through eight Fuel Facility Corporations, and three aircraft de-icing service facilities, along with other airlines that contract for fuel and de-icing services at various major airports in Canada. These entities operate on a cost recovery basis. The aggregate debt of these entities that has not been consolidated by Air Canada under IFRS 10 Consolidated Financial Statements is approximately $571 million as at December 31, 2018 (December 31, 2017 - $529 million), which is Air Canada's maximum exposure to loss before taking into consideration the value of the assets that secure the obligations and any cost sharing that would occur amongst the other contracting airlines. Air Canada views this loss potential as remote. Each contracting airline participating in these entities shares pro rata, based on system usage, in the guarantee of this debt. The maturities of these debt arrangements vary but generally extend beyond five years.

Indemnification Agreements

In the ordinary course of Air Canada's business, Air Canada enters into a variety of agreements, such as real estate leases or operating agreements, aircraft financing or leasing agreements, technical service agreements, and director/officer contracts, and other commercial agreements, some of which may provide for indemnifications to counterparties that may require Air Canada to pay for costs and/or losses incurred by such counterparties. Air Canada cannot reasonably estimate the potential amount, if any, it could be required to pay under such indemnifications. Such amount would also depend on the outcome of future events and conditions, which cannot be predicted. While certain agreements specify a maximum potential exposure, certain others do not specify a maximum amount or a limited period. Historically, Air Canada has not made any significant payments under these indemnifications.

Air Canada expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities.

16. RELATED PARTY TRANSACTIONS

At December 31, 2018, Air Canada had no transactions with related parties as defined in the CPA Handbook, except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship agreements.

17. SENSITIVITY OF RESULTS

Air Canada's financial results are subject to many different internal and external factors which can have a significant impact on operating results. The following table describes, on an indicative basis, the financial impact that changes in fuel prices and the value of the Canadian dollar would generally have had on Air Canada's past operating results. An equivalent but opposite movement of the sensitivity factor in the table below would have generally resulted in a similar but opposite impact. These guidelines were derived from 2018 levels of activity and make use of management estimates. The impacts are not additive, do not reflect the interdependent relationship of the elements and may not be indicative of future trends or results which may vary significantly due to a wide range of factors many of which are beyond the control of Air Canada.

Key Variable (Canadian dollars in millions)	2018 Measure	Sensitivity Factor	Favourable/ (Unfavourable) Estimated Operating Income Impact
Fuel			
Fuel – Jet fuel price (US$/barrel) (1)	93.0	US$1/barrel increase	$ (46)
Fuel – Jet fuel price (CAD cents/litre) (1)	80.4	1% increase	$ (43)
Currency Exchange			
C$ to US$	C$1 = US$1.33	1 cent increase (i.e. $1.33 to $1.32 per US$)	
		Operating income (2)	**$ 19**
		Net interest expense	$ 2
		Revaluation of long-term debt, U.S. dollar cash, cash equivalents and short-term investments and other long-term monetary items, net	$ 44
		Remeasurement of outstanding currency derivatives	$ (37)
		Pre-tax Income Impact	**$ 28**

(1) Excludes the impact of fuel surcharges and fuel hedging. Refer to section 12 "Financial Instruments and Risk Management" of this MD&A for information on Air Canada's fuel derivative instruments.

(2) The operating income impact of currency exchange movements is before the impact of hedging activities, such as through the use of foreign currency derivatives and holding U.S. dollar cash reserves. The gains and losses related to these hedging activities are recorded in non-operating income (expense) on Air Canada's consolidated statement of operations.

18. RISK FACTORS

The risks described below should be read carefully when evaluating Air Canada's business and the forward-looking statements contained in this report and other statements Air Canada may make from time to time. Any of these risks could materially and adversely affect Air Canada's business, operating results, financial condition and the outcome of matters as to which forward-looking statements are made. In addition, these risks 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 not to be material may surface and have a material and adverse impact on Air Canada, its business, results from operations, financial condition and the outcome of matters as to which forward-looking statements are made.

Risks Relating to Air Canada

Operating results – Air Canada may sustain significant losses and not be able to successfully achieve and/or sustain positive net profitability or realize the objectives of any or all of its initiatives

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, Air Canada may not be able to successfully achieve and/or sustain positive net profitability or realize the objectives of any or all of its initiatives, including those which seek to increase revenues, decrease costs, improve margins, profitably deploy additional capacity, generate sufficient returns on its capital expenditures or offset or mitigate risks facing Air Canada, including those described in this "Risk Factors" section.

Economic and geopolitical conditions – Changes in economic and geopolitical conditions could have a material adverse effect on Air Canada, its business, results from operations and financial condition

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, operating revenues, costs and availability of fuel, foreign exchange costs, pension plan contributions, 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, changes to political or economic relationships within or between jurisdictions where Air Canada operates, or threatened or actual outbreaks of hostilities in or adjacent to regions Air Canada serves or over which it operates flights (or to regions it plans to operate), 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 is also impacted by economic conditions. Depressed economic conditions in areas served by Air Canada, geopolitical instability in various areas of the world and concerns about the environmental impacts of air travel and tendencies towards less environmentally impactful travel where customers may reduce or alter their travel activities, could each have the effect of reducing demand for air travel in Canada and abroad and could materially adversely impact Air Canada, its business, results of operations and financial condition.

Fuel costs – Significant fluctuations or increases in fuel prices could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Fuel costs constitute one of Air Canada's largest operating cost items. Fuel prices have and may continue to 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 the future price of fuel. 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. In addition, Air Canada may be unable to appropriately or sufficiently, or may not, hedge the risks associated with fluctuations in fuel prices. Furthermore, the impact of lower jet fuel prices could be offset by increased price competition, and a resulting decrease in revenues, for all air carriers. Significant fluctuations (including increases) in fuel prices could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Foreign exchange – A significant deterioration of the Canadian dollar relative to the U.S. dollar could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada's financial results are sensitive to the fluctuating value of the Canadian dollar. Air Canada incurs significant expenses in U.S. dollars for items such as fuel, aircraft purchases, aircraft leasing and maintenance, airport charges, ground package costs, sales and distribution costs, interest and debt servicing payments, while a substantial portion of its revenues are generated in Canadian dollars. Due to the competitive nature of the airline industry and customer sensitivity to travel costs, Air Canada may not be able to pass on increases in foreign exchange costs to its customers by increasing its fares. In addition, Air Canada may be unable to appropriately or sufficiently hedge the risks associated with fluctuations in exchange rates. A significant deterioration of the Canadian dollar relative to the U.S. dollar or other foreign currencies would increase the costs of Air Canada relative to its U.S. or other foreign competitors. Any of these factors could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Competition – Air Canada operates in a highly competitive environment and faces increasing competition in North America and internationally

Air Canada operates within a highly competitive industry and continuously encounters substantial price competition. Carriers, including low-cost, ultra-low-cost, domestic, U.S. and foreign carriers, have entered, announced their intention to enter or continue to enter or expand into markets Air Canada operates in or plans to operate in, including domestic, U.S. transborder, international and leisure-oriented markets.

Carriers against which Air Canada competes, including U.S. carriers, may also undergo (and some have undergone) substantial reorganizations (including by way of merger with or acquisition by another carrier), creating reduced levels of indebtedness, lower operating costs and other competitive advantages, and may therefore be able to more effectively compete against Air Canada. Consolidation within the airline industry and carriers increasingly entering into integrated commercial cooperation arrangements, such as joint ventures, which may be able to compete more effectively, could result in increased competition.

The proximity of several American airports in cities close to the Canadian border has also presented an additional challenge for Air Canada. Higher taxes, charges and fees for passengers departing from Canada has redirected appreciable passenger traffic away from Canadian airports to airports in the United States. Carriers operating from the United States have and may continue to increase their capacity at these airports and attract Canadian-originating, price-sensitive customers.

The prevalence of Internet travel websites and other travel product distribution channels has also resulted in a substantial increase in discounted and promotional fares initiated by Air Canada's competitors. Competitors also continue to pursue commissions/incentive actions and, in many cases, increase these payments.

Air Canada's ability to reduce its fares in order to effectively compete is dependent on Air Canada's ability to achieve acceptable operating margins and may be limited by applicable laws or government policies to encourage competition.

Increased competition, from existing, emerging or new competitors, including competitors entering into new or expanded joint ventures and other arrangements, or utilizing disruptive business models or technologies, and other competitive actions, or benefiting from foreign subsidies or other advantages not available to Air Canada, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Dependence on technology – Air Canada relies heavily on technology to operate its business and any technology systems failure or data breach could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada relies heavily on technology to operate its business, increase its revenues and reduce its costs. These systems include those relating to Air Canada's communications, websites, reservations, airport customer services and flight operations. Air Canada depends on the performance of its many suppliers, whose performance is in turn dependent upon their respective technologies.

As part of regular business operations, Air Canada collects, processes and stores sensitive data, including personal information of our passengers, employees and information of our business partners. The secure operation of the networks and systems on which this type of information is stored, processed and maintained is critical to our business.

Technology systems may be vulnerable to a variety of sources of failure, interruption or misuse, including by reason of human error, third party suppliers' acts or omissions, natural disasters, terrorist attacks, telecommunications failures, power failures, unauthorized or fraudulent users (including cyber-attacks, malware, ransomware, computer viruses and the like), and other operational and security issues.

It is generally viewed that cyber-attacks have increased and will continue to increase in both prevalence and sophistication. Air Canada invests in initiatives, including security initiatives and disaster recovery plans; however, these initiatives may not be successful or adequately address a highly dynamic and continually evolving threat landscape. Any technology systems failure, interruption or misuse, security breach or failure to comply with applicable data confidentiality, privacy, security or other related obligations, whether at Air Canada or a third party on whom Air Canada relies, could adversely affect Air Canada's reputation and expose Air Canada to litigation, claims for contract breach, fines, sanctions or otherwise materially and adversely affect Air Canada's operations, any of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Strategic, business, technology and other important initiatives – A delay or failure to identify and devise, invest in and implement certain important initiatives could have a material impact on Air Canada, its business, results from operations and financial condition

In order to operate its business, achieve its goals and remain competitive, Air Canada continually seeks to identify and devise, invest in, implement and pursue strategic, business, technology and other important initiatives, such as those relating to the implementation of Amadeus Altéa Suite to replace its existing passenger services system, the integration of the Aeroplan loyalty business following its acquisition in early 2019, the launch of Air Canada's new loyalty program, its aircraft fleet renewal program (including the planned re-fleeting of its narrow-body aircraft with Boeing 737 MAX aircraft and Airbus A220 (formerly Bombardier C-Series) aircraft and disposal of aircraft that are being replaced), participation in the leisure or lower cost market (including through Air Canada Rouge), joint venture arrangements, revenue enhancement initiatives, business processes, information technology, revenue management, cost transformation, improving premium passenger revenues, expansion of flying capacity (including in respect of new aircraft and 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 and personnel. A delay or failure to sufficiently and successfully identify and devise, invest in or implement any of 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.

Key supplies and suppliers – Air Canada's failure or inability to obtain certain goods and services from key suppliers on favourable terms could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada is dependent upon its ability to source, on favourable terms and costs, sufficient quantities of goods and services of desirable quality, in a timely manner, including those available at airports or from airport authorities, or otherwise required for Air Canada's business or operations, such as fuel, aircraft and related parts, airport services, aircraft maintenance services, and information technology systems and services. In certain cases, Air Canada may only be able to access goods and services from a limited number of suppliers (or from sole source suppliers) and the transition to new or alternative suppliers, which may be necessitated by reason of such suppliers increasing their rates or by their failure to perform, may not be possible or may take a significant amount of time or require significant resources. A failure, refusal or inability of a supplier may arise as a result of a wide range of causes, many of which are beyond Air Canada's control. Any failure or inability of Air Canada to successfully source goods and services, or to source goods and services of desirable quality 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 loyalty program – Loss of redemption partners, increased redemption rates of loyalty points, or disruptions or other interruptions of services affecting the Aeroplan loyalty program could have a material adverse effect on Air Canada, its business, results from operations and financial condition

In January 2019, Air Canada completed the acquisition of Aimia Canada Inc., owner and operator of the Aeroplan loyalty business and program. Through Aeroplan, Air Canada offers its customers who are Aeroplan members the opportunity to earn Aeroplan Miles, which management believes is a significant factor in many customers' decision to travel with Air Canada and contributes to building customer loyalty. The success of the Aeroplan program is dependent on maintaining sufficient accumulation and redemption partners. Increases in redemption rates for outstanding Aeroplan points may also have a material adverse effect. Difficulties integrating the Aeroplan business into Air Canada's business, any failures to adequately operate the Aeroplan program or interruptions or disruptions of Aeroplan program services, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Building on the Aeroplan program, Air Canada is working to implement a new loyalty program which involves significant investments as well as certain risks and uncertainties, including risks relating to attracting new and retaining current members, implementing the required information technology and loyalty management systems, successfully concluding strategic commercial arrangements, and transitioning from the Aeroplan program to the new loyalty program. Though Air Canada believes it would be able to mitigate and overcome risks and successfully create and launch its new loyalty program, the transition from the Aeroplan program and the launch and operation of Air Canada's new loyalty program entail risks which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Air Canada's brand – The failure to preserve or grow the value of Air Canada's brand could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada believes that its success is dependent on the value of its brand and on Air Canada's ability to preserve, grow and leverage that value. The Air Canada brand is recognized throughout the world, and Air Canada has received high ratings in external brand value studies, based in part on consumer perceptions on a variety of subjective qualities. Air Canada believes it has and continues to build an excellent reputation globally for the safety and quality of its services, and for the delivery of a consistently positive passenger experience. Air Canada's reputation and brand could also be damaged if exposed to significant adverse publicity through social media. Adverse publicity, whether justified or not, can rapidly spread through social or digital media. To the extent we are unable to respond timely and appropriately to adverse publicity, our brand and reputation may be damaged. Any failure to preserve or grow Air Canada's brand, including by reason of the conduct of Air Canada or any of its business partners or other external parties, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Airport user fees and air navigation fees – Increases in airport user fees and air navigation fees could have a material adverse effect on Air Canada, its business, results from operation and financial condition

Airport and air navigation authorities have or could significantly increase 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.

Leverage – Air Canada has a significant amount of indebtedness, and there can be no assurance that it will be able to satisfy its debt, lease and other obligations

Air Canada has a significant amount of indebtedness, including substantial fixed obligations under aircraft leases, aircraft purchases and other financings, and as a result of any challenging economic or other conditions affecting Air Canada, Air Canada may incur greater levels of indebtedness than currently exist or are planned. Although Air Canada has been focusing on reducing its level of indebtedness and improving its leverage ratios, the amount of indebtedness that Air Canada 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 balances or 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 changes in its business environment, including competitive pressures.

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 floating interest rates, to the extent these interest rates increase, its interest expense will increase. Moreover, Air Canada incurs a significant proportion of its indebtedness in foreign currencies, primarily in U.S. dollars, and as a result, future debt servicing repayments are subject to foreign exchange risk and the Canadian equivalent amount of indebtedness may increase. There can be no assurance that Air Canada will at all times be able to generate sufficient cash from its operations to satisfy its debts, lease and other 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.

High fixed costs and low margins – The airline industry may suffer from low profit margins and high fixed costs

The airline industry has historically been characterized by low profit margins and high fixed costs. The costs of operating a flight do not vary significantly with the number of passengers carried and, therefore, a relatively small change in the number of passengers, fare pricing or traffic mix could have a significant impact on Air Canada's operating and financial results. This condition may be exacerbated by aggressive pricing by competitors, which could have the effect of driving down fares in certain markets. Although Air Canada's margins have improved in recent years, a shortfall from expected revenue levels or profit margins could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Air Canada has focused on improving resiliency to weather downturns in its business; however, such efforts may not be successful. 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 within a timeframe required to sufficiently mitigate the effects of any downturns, and Air Canada may also be required to incur significant termination or other restructuring costs, any of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Regional carriers – The failure by regional carriers to fulfill their obligations to Air Canada could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada seeks to enhance its network through capacity purchase agreements with regional airlines such as Jazz, Sky Regional and other airlines operating flights on behalf of Air Canada. Pursuant to the terms of the Jazz CPA, Air Canada pays Jazz a number of fees, some of which are fixed and others which are determined based upon certain costs incurred by Jazz. Air Canada also reimburses Jazz for certain pass-through costs incurred by Jazz (or arranges to provide the related supplies to Jazz), such as fuel, navigation, landing and terminal fees. In addition, the Jazz CPA requires that Jazz maintain a minimum fleet size and contains a minimum average daily utilization guarantee which requires Air Canada to utilize Jazz for that amount of flying. Significant increases in Jazz's costs, the failure by Jazz to adequately fulfill its obligations under the Jazz CPA, factors which may reduce the utilization of the Jazz fleet, including economic or market downturns, and unexpected interruptions or cessation of Jazz's services could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

The failure by Air Canada's other regional carriers to fulfill their obligations under their respective agreements, or unexpected interruptions or disruptions of their services, as well as minimum guarantees in capacity purchase agreements which may limit Air Canada's ability to effectively manage regional capacity in response to economic downturns, market pressures or other external events, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Labour costs and labour relations – Air Canada may not be able to maintain labour costs at appropriate levels or secure labour agreements which permit it to successfully pursue its strategic initiatives. There can be no assurance that collective bargaining agreements will be further renewed without labour conflicts and/or disruptions

Labour costs constitute one of Air Canada's largest operating cost items. 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. Most of Air Canada's employees are unionized. While Air Canada has established long term arrangements with unions representing a significant portion of its unionized employees, 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 outcomes 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, or terms and conditions restricting or reducing, Air Canada's ability to sustain its business objectives or pursue its strategic initiatives, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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 execute on its business plans or operate its business, either of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition. In respect of the unions for Canadian-based employees, strikes or lock-outs may lawfully occur following the term and negotiations of the renewal of collective agreements once a number of pre-conditions prescribed by the *Canada Labour Code* have been satisfied.

Any labour disruption or work stoppage by any of the unionized work groups of Jazz, or other airlines operating flights on behalf of Air Canada, or other key suppliers, or of other parties with whom Air Canada conducts business or relies on 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 or involving the operations of key airports could result in lower demand for connecting traffic with Air Canada, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Star Alliance and Joint Ventures – Departure of a key member from Star Alliance or the failure by a key member to meet its obligations, including under joint ventures arrangements, could have a material adverse effect on Air Canada, its business, results from operations and financial condition

The strategic and commercial arrangements with Star Alliance members, including Air Canada's A++ joint venture counterparties, Lufthansa AG and United Airlines, 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 towards Air Canada, Air Canada, its business, results from operations and financial condition could be materially adversely affected.

Interruptions or disruptions in service – Interruptions or disruptions in service could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada's business is significantly dependent upon its ability to operate without interruption to or from a number of hub airports, including Toronto Pearson. Delays or disruptions in service, including those due to security, computer malfunctions or other incidents, weather conditions, labour conflicts with airport workers, baggage handlers, air traffic controllers, security personnel, 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, technology issues 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.

Need for capital and liquidity – Air Canada may not be able to obtain sufficient funds in a timely way and on acceptable terms to provide adequate liquidity and to finance necessary operating and capital expenditures

Air Canada's liquidity levels may be adversely impacted by risks identified in this MD&A, including economic conditions, foreign exchange rates, increased competition from domestic, international, and U.S. transborder carriers, including lower cost carriers, volatile fuel prices, labour issues, and contractual covenants (which require Air Canada to maintain minimum cash reserves and which could require Air Canada to deposit cash collateral with third parties). As part of Air Canada's efforts to manage such challenges and to support Air Canada's business strategy, significant liquidity and significant on-going operating and capital expenditures are required.

Although Air Canada's liquidity levels have significantly improved over the last several years, there can be no assurance that Air Canada will continue to maintain sufficient liquidity, whether from operations or by obtaining funds on terms acceptable to Air Canada, to finance the operating and capital expenditures necessary to manage any challenges and support its business strategy.

A major decline in the market price of Air Canada's securities may negatively impact Air Canada's ability to raise capital, issue debt, retain employees, make strategic acquisitions or enter into business arrangements. Differences between Air Canada's actual or anticipated financial results and the published expectations of financial analysts, as well as events affecting our business or operating environment, may contribute to volatility in Air Canada's securities. A major decline in the capital markets in general, or an adjustment in the market price or trading volumes of Air Canada's securities, may negatively affect our ability to raise capital, issue debt, retain senior executives and other key employees, make strategic acquisitions or enter into business arrangements.

Failure to maintain or generate required funds, whether from operations or financings, could require Air Canada to delay or abandon some or all of its anticipated expenditures or to modify its business strategy and this 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 or 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 maintain required liquidity levels. There can be no assurance as to Air Canada's credit ratings, and downgrades or improvements to credit ratings that do not materialize and that may otherwise be anticipated by the market, may adversely impact Air Canada's borrowing costs, its ability to attract capital, its liquidity and 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.

Pension plans – Failure or inability by Air Canada to make required cash contributions to its pension plans could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada maintains several defined benefit pension plans, including domestic registered pension plans, supplemental pension plans and international 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).

Air Canada's pension funding obligations (including projected funding obligations) may vary significantly based on a wide variety of factors, including pension plan solvency valuations, regulatory developments, plan demographics, changes to plan provisions, assumptions and methods used and changes in economic conditions (mainly the return on fund assets and changes in interest rates) and other factors, as well as the application of normal past service contribution rules which would generally require one fifth of any solvency deficit in a domestic registered plan, determined on the basis of an average over the previous three years, to be funded each year. Actual contributions that are determined on the basis of future valuation reports filed annually may vary significantly from projections. In addition, current service contributions in respect of a domestic registered plan are required unless they are funded (if permitted subject to applicable plan rules and legislation) through a sufficient surplus in such plan. Deteriorating economic conditions or a prolonged period of low or decreasing 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. Underfunded pension plans or a failure or inability by Air Canada to make required cash contributions to its pension plans could have a material adverse effect on Air Canada, its business, results from operations and financial condition. See section 9.7 "Pension Funding Obligations" of this MD&A for additional information.

Limitations due to restrictive covenants – Covenants contained in agreements to which Air Canada is a party may affect and, in some cases, significantly limit or prohibit the manner in which Air Canada operates its business

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, fixed charge coverage ratio) 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, make capital expenditures, and engage in acquisitions, mergers or restructurings or a change of control. Although Air Canada has, in the last few years, been able to negotiate more favourable and less restrictive covenants, there can be no assurance that it will be able to continue to do so. Future financing and other significant agreements may be subject to similar or stricter 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 section 9.8 "Contractual Obligations" of this MD&A for information on Air Canada's credit card processing agreements.

Current legal proceedings – Air Canada is involved in or may be subject to legal proceedings which could materially adversely impact Air Canada

Investigations by Competition Authorities Relating to Air Canada Cargo

The European Commission, the United States Department of Justice and the Competition Bureau in Canada, among others, investigated alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators. The investigations conducted by the U.S. Department of Justice and by the Competition Bureau in Canada concluded with no proceedings against Air Canada.

After having rendered a decision against a number of airlines, including Air Canada in 2010, which was overturned by the European General Court in December 2015, in March 2017, the European Commission rendered another decision finding that 12 air cargo carriers, including Air Canada, had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006, imposing a fine of 21 million Euros (approximately $29 million) on Air Canada. Air Canada paid the fine as required in the second quarter of 2017, pending the outcome of an appeal to the European General Court. While Air Canada cannot predict with certainty the outcome of its appeal or any related proceedings, Air Canada believes it has reasonable grounds to challenge the European Commission's ruling.

Air Canada is also named as a defendant or is otherwise involved in a number of class action lawsuits and other proceedings in Canada, Europe and the United States in connection with these allegations. The class action proceeding in the United States were settled by Air Canada in 2012, and certain third-party proceedings in the United Kingdom relating to the same allegations were settled in 2018.

As at December 31, 2018, Air Canada has a provision of $17 million ($17 million as at December 31, 2017) relating to outstanding claims in these matters, which is recorded in Accounts payable and accrued liabilities. This provision is an estimate based upon the status of 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 remaining proceedings and investigations. Based on the outcome of any developments regarding proceedings and investigations, Air Canada may adjust the provision in its results for subsequent periods as required.

Mandatory Retirement

Air Canada has been engaged in a number of proceedings involving challenges to the mandatory retirement provisions of certain of its collective agreements. The remaining cases relate to retirement which occurred pursuant to the previous Air Canada-Air Canada Pilots Association collective agreement, which originally incorporated provisions of the pension plan terms and conditions applicable to pilots requiring them to retire at age 60. Those provisions were later amended and since 2012 a variety of retirement rules have been in force. Some of those new rules, notably about benefit coverage for pilots entitled to an unreduced pension and Air Canada's duty to accommodate pilots over age 65 who wish to continue working, are being challenged. Air Canada has fully or partially prevailed in defending some of these complaints and is defending the remaining ones. 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, though any such financial liability, if imposed, would not be expected to be material.

Future legal proceedings

In the course of conducting their business, airlines are subject to various claims and litigation (including class action claims), including with respect to its contractual arrangements and current or new laws and regulations. Any future claims or litigation could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Key personnel – Air Canada is dependent on key employees and could be materially adversely affected by a shortfall or substantial turnover

Air Canada is dependent on the industry experience, qualifications and knowledge of a variety of employees, including its executive officers, managers, airline flight and operations personnel and other key employees to execute its business plan and operate its business. If Air Canada were to experience a shortfall or 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 – Terrorist attacks and related consequences could have a material adverse effect on Air Canada, its business, results from operations and financial condition

The potential for terrorist attacks and terrorist activity causes concern and uncertainty in the minds of the traveling public. The occurrence of a terrorist attack, an attempted attack or the perceived threat of one (whether or not involving Air Canada or another carrier, or involving Air Canada's destinations, or other destinations or regions), and 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, security and other costs, including higher operating costs to avoid flying over airspace near conflict zones. 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.

Casualty losses – Air Canada's business makes it subject to large liability claims for serious personal injury or death arising out of accidents or disasters

Due to the nature of its core 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 otherwise serviced by Air Canada or through third parties providing services to Air Canada, including claims for serious personal injury or death. Any such accident or disaster 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. 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.

Accidents and disasters may occur despite all appropriate measures being taken, and as a result of a variety of factors beyond Air Canada's control including acts of terrorism and sabotage, severe weather, lightning strikes and other natural phenomenon, bird strikes as well as the increasing prevalence of unmanned aerial vehicles.

Regulatory matters – Air Canada is subject to extensive and evolving domestic and foreign regulation in a wide range of matters

The airline industry is subject to extensive legal, regulatory and administrative controls and oversight, including in relation to taxes, airport fees and operations, route rights, security, passenger and consumer rights, flight crew and other labour rules, advertising, privacy, data security, licensing, competition, pensions, environment (including noise levels and carbon emissions), foreign exchange controls and, in some measure, pricing.

Compliance with current or future Canadian and international laws, regulations and administrative requirements, including potentially inconsistent or conflicting laws or regulations, or laws or regulations which disproportionally apply to Canadian airlines or Air Canada specifically (such as the *Air Canada Public Participation Act)*, may impose significant costs, impediments and/or competitive disadvantages, and there cannot be any assurance that current or future laws, regulations and administrative requirements will not adversely affect Air Canada, its business, results from operations and financial condition.

The ability of Air Canada to operate flights or otherwise offer air services on international routes between airports in Canada and other countries may be subject to change. Applicable arrangements between Canada and foreign governments, which govern many areas including traffic rights, may be amended from time to time, rules and policies with respect to airport operations may be revised, and the availability of appropriate slots or facilities may change. Air Canada currently operates a number of flights on international routes under government arrangements, regulations or policies that designate the number of carriers permitted to operate on such routes, the capacity of the carriers providing services on such routes, the airports at which carriers may operate international flights, or the number of carriers allowed access to particular airports. Any further limitations, additions or modifications to such arrangements, regulations or policies could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Additionally, if Canada were to adopt a more liberalized approach in relation to air services arrangements with foreign countries, such an approach could have a material adverse impact on Air Canada, its business, results from operations and financial condition and could result in the impairment of material amounts of related tangible and intangible assets.

Air Canada's current and future plans to enter into or expand revenue-sharing joint ventures and other alliance arrangements on various international routes are and may be subject to receipt of approvals from applicable Canadian and international authorities, to their not challenging them, and to satisfying the necessary applicable regulatory requirements. There can be no assurance that such conditions will be met or will continue in effect or that existing, or changes in, regulatory requirements or standards can be satisfied.

Many aspects of Air Canada's operations may also be subject to the proliferation of increasingly stringent laws and regulations relating to environmental reforms, such as in the area of climate change, and including the following:

The International Civil Aviation Organization ("ICAO") global market-based measure ("GMBM"), adopted in 2016, includes emissions from international flights. The GMBM is set to be implemented in phases, with the first two phases (occurring from 2021 to 2023, and 2024 to 2026, respectively) to be voluntary and with the third phase (from 2027 to 2035) to be mandatory. Canada voluntarily adopted the first phase. On the basis of the GMBM, the European Parliament and Council has continued exempting flights between Europe and third countries from the European Union ("EU") emissions trading system ("ETS").

In 2016, the Canadian Federal Government proposed a pan-Canadian benchmark for carbon pricing to be implemented in all Canadian jurisdictions by 2018, with pricing to be based on greenhouse gas emissions from all fossil fuels sources including jet fuel and other fuels used by Air Canada in ground operations and stationary combustion equipment. Canadian provinces may either apply an explicit price-based system, such as a carbon tax or levy, or a cap and trade system. Certain provinces, such as Alberta, British Columbia and Québec have implemented a carbon pricing system; others have had the federal carbon pricing backstop system applied. Since 2017, Air Canada and regional carriers operating flights on behalf of Air Canada have been subject to a carbon tax for flights operating in British Columbia and in Alberta.

Air Canada cannot predict whether, or the manner in which, these or other initiatives will ultimately be implemented or their impact on Air Canada; however, future developments in Canada and abroad could adversely impact Air Canada, including by increasing its costs. While Air Canada is continually focused on efficiency improvements, including carbon footprint reduction initiatives, the impact to Air Canada of climate change and other environmental initiatives may, in part, depend upon the extent to which the increased costs relating such initiatives, if any, could be recovered, including in the form of higher passenger fares and cargo rates.

Air Canada is also subject to domestic and foreign laws regarding privacy and security of passenger, employee and other data, including advance passenger information and access to airline reservation systems, which are not consistent in all countries which may assert jurisdiction over Air Canada, including in countries where Air Canada operates or conducts business. These laws and regulations are proliferating, are becoming increasingly stringent and may conflict with one another. The need to comply with these laws and regulatory regimes results in additional operating costs and complexities, and further regulation in this area or non-compliance, including in relation to data privacy and security requirements, could have a material adverse effect on Air Canada, its business (including by impacting Air Canada's goodwill and reputation), results from operations and financial condition.

Certain jurisdictions (including Canada, the United States, European Union countries and other jurisdictions where Air Canada operates or conducts business) have enacted and implemented, and they and domestic regulators may in the future enact and implement, consumer protection and passenger rights measures which are being increasingly adopted. Such measures may impose significant, unique, inconsistent or even conflicting obligations on Air Canada, which may result in increased liability and costs to Air Canada and which could adversely impact Air Canada, its business, results from operations and financial condition.

In 2018, the Federal Government proposed the *Air Passenger Protection Regulations* pursuant for adoption under the *Canada Transportation Act*, which are stated to govern flights to, from and within Canada, including connecting flights. The proposed regulations, which have been published for comments and are scheduled to be in force on July 1, 2019, specify requirements governing a carrier's obligations in the case of flight delay, cancellation or denial of boarding, as well as minimum standards of treatment, compensation and assistance in completing the planned itinerary. The regulations prescribe minimum compensation for lost or damaged baggage, obligations with respect to delays over three hours where an aircraft is on the tarmac, and a carrier's obligation to seat young children near a parent, guardian or tutor. The Minister of Transport is also authorized to order the Canadian Transportation Agency to make regulations respecting any of a carrier's other obligations towards passengers.

Epidemic diseases – Epidemic diseases could impact passenger demand for air travel

Outbreaks or the threat of outbreaks of viruses or other contagions or epidemic diseases, including influenza, SARS, Ebola, Zika, as well as any travel or other advisories relating to same, whether domestic or international or whether relating to Canadian cities or regions or other cities, regions or countries, could have a material adverse effect on demand for air travel and could result in a major negative impact on traffic on Air Canada's network. 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.

Availability of insurance coverage and increased insurance costs – Increases in insurance costs or reduction in insurance coverage could have a material adverse effect on Air Canada, its business, results from operations and financial condition

The aviation insurance industry has been continually re-evaluating the terrorism risks that it covers which may adversely affect some of Air Canada's existing insurance carriers or Air Canada's ability to obtain future insurance coverage (including war risk 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 could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

19. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures and Internal Controls over Financial Reporting

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

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

The Corporation will file certifications, signed by the Corporation's CEO and CFO, with the Canadian Securities Administrators ("CSA") upon filing of the Corporation's Annual Information Form. In those filings, the Corporation's CEO and CFO will certify, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design and effectiveness of the Corporation's disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting. The Corporation's CEO and CFO also certify the appropriateness of the financial disclosures in the Corporation's interim filings with securities regulators. In those interim filings, the Corporation's CEO and CFO also certify the design of the Corporation's disclosure controls and procedures and the design of internal controls over financial reporting.

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

Management's Report on Disclosure Controls and Procedures

Management, under the supervision of and with the participation of the Corporation's CEO and CFO, evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined under National Instrument 52-109) and concluded, as at December 31, 2018, that such disclosure controls and procedures were effective.

Management's Report on Internal Controls over Financial Reporting

Management, under the supervision of and with the participation of the Corporation's CEO and CFO, evaluated the effectiveness of the Corporation's internal controls over financial reporting (as defined under National Instrument 52-109). In making this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commissions ("COSO") in Internal Control - Integrated Framework (2013). Based on that evaluation, management and the CEO and CFO have concluded that, as at December 31, 2018, the Corporation's internal controls over financial reporting were effective. This evaluation took into consideration the Corporation's Corporate Disclosure Policy and the functioning of its Disclosure Policy Committee.

Changes in Internal Controls over Financial Reporting

There have been no changes to the Corporation's internal controls over financial reporting during the year ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

20. NON-GAAP FINANCIAL MEASURES

Below is a description of certain non-GAAP financial measures used by Air Canada to provide readers with additional information on its financial and operating performance. Such measures are not recognized measures for financial statement presentation under GAAP, do not have standardized meanings, may not be comparable to similar measures presented by other entities and should not be considered a substitute for or superior to GAAP results.

EBITDAR

EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is commonly used in the airline industry and is used by Air Canada as a means to view operating results before interest, taxes, depreciation, amortization, impairment and aircraft rent as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. Air Canada excludes special items from EBITDAR as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

EBITDAR is reconciled to operating income as follows:

	Fourth Quarter			Full Year		
(Canadian dollars in millions)	**2018**	2017 (1)	$ Change	**2018**	2017 (1)	$ Change
Operating income – GAAP	**$ 122**	**$ 133**	**$ (11)**	**$ 1,174**	**$ 1,371**	**$ (197)**
Add back (as reflected on Air Canada's consolidated statement of operations):						
Depreciation, amortization and impairment	267	245	22	1,080	956	124
Aircraft rent	133	126	7	518	503	15
Add back (included in Regional airlines expense):						
Depreciation, amortization and impairment	11	7	4	38	28	10
Aircraft rent	10	10	-	41	40	1
EBITDAR (including special items)	**$ 543**	**$ 521**	**$ 22**	**$ 2,851**	**$ 2,898**	**$ (47)**
Remove effect of special items (2)	-	-	-	-	30	(30)
EBITDAR (excluding special items)	**$ 543**	**$ 521**	**$ 22**	**$ 2,851**	**$ 2,928**	**$ (77)**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

(2) In the first quarter of 2017, Air Canada recorded a provision of $30 million relating to a fine which was reinstated by a decision of the European Commission pertaining to cargo investigations.

Adjusted CASM

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

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

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

Adjusted CASM is reconciled to GAAP operating expense as follows:

	Fourth Quarter			Full Year		
(Canadian dollars in millions, except where indicated)	**2018**	2017 [1]	$ Change	**2018**	2017 [1]	$ Change
Operating expense – GAAP	$ 4,124	$ 3,687	$ 437	$ 16,891	$ 14,881	$ 2,010
Adjusted for:						
Aircraft fuel expense (as reflected on Air Canada's consolidated statement of operations)	(958)	(735)	(223)	(3,969)	(2,927)	(1,042)
Aircraft fuel expense (included in Regional airlines expense)	(133)	(112)	(21)	(531)	(412)	(119)
Ground package costs	(126)	(106)	(20)	(602)	(538)	(64)
Special items [2]	-	-	-	-	(30)	30
Operating expense, adjusted for the above-noted items	$ 2,907	$ 2,734	$ 173	$ 11,789	$ 10,974	$ 815
ASMs (millions)	25,598	24,191	5.8%	110,866	103,492	7.1%
Adjusted CASM (cents)	¢ 11.36	¢ 11.30	0.5%	¢ 10.63	¢ 10.60	0.3%

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.
(2) In the first quarter of 2017, Air Canada recorded a provision of $30 million relating to a fine which was reinstated by a decision of the European Commission pertaining to cargo investigations.

Adjusted Pre-tax Income

Adjusted pre-tax income is used by Air Canada to assess the overall pre-tax financial performance of its business without the effects of foreign exchange gains or losses, net financing expense relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful. Air Canada uses adjusted pre-tax income before interest to determine return on invested capital.

Adjusted pre-tax income is reconciled to GAAP income (loss) before income taxes as follows:

	Fourth Quarter			Full Year		
(Canadian dollars in millions)	**2018**	2017 (1)	$ Change	**2018**	2017 (1)	$ Change
Income (loss) before income taxes	**$ (216)**	**$ 20**	**$ (236)**	**$ 405**	**$ 1,286**	**$ (881)**
Adjusted for:						
Special items (2)	-	-	-	-	30	(30)
Foreign exchange (gain) loss	269	62	207	317	(120)	437
Net financing expense relating to employee benefits	12	18	(6)	50	65	(15)
(Gain) loss on financial instruments recorded at fair value	3	1	2	1	(23)	24
Gain on sale and leaseback of assets	-	-	-	-	(52)	52
(Gain) loss on debt settlements and modifications	-	(24)	24	(9)	(21)	12
Loss on disposal of assets (3)	-	-	-	188	-	188
Adjusted pre-tax income	**$ 68**	**$ 77**	**$ (9)**	**$ 952**	**$ 1,165**	**$ (213)**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.
(2) In the first quarter of 2017, Air Canada recorded a provision of $30 million relating to a fine which was reinstated by a decision of the European Commission pertaining to cargo investigations.
(3) In 2018, Air Canada recorded a loss on disposal of assets of $188 million related to the sale of 25 Embraer 190 aircraft.

Adjusted Net Income (Loss) and Adjusted Earnings (Loss) per Share – Diluted

Air Canada uses adjusted net income (loss) and adjusted earnings (loss) per share – diluted as a means to assess the overall financial performance of its business without the after-tax effects of foreign exchange gains or losses, net financing expense relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful. Starting as of and including the fourth quarter of 2017, adjusted net income is determined net of tax. Accordingly, the 2018 and 2017 information in the table below is not directly comparable.

Adjusted net income is reconciled to GAAP net income (loss) as follows:

	Fourth Quarter			Full Year		
(Canadian dollars in millions, except per share figures)	2018	2017 (1)	$ Change	2018	2017 (1)	$ Change
Net income (loss)	**$ (231)**	**$ 8**	**$ (239)**	**$ 167**	**$ 2,029**	**$ (1,862)**
Adjusted for:						
Special items (2)	-	-	-	-	30	(30)
Recovery of deferred income taxes (one-time) (3)	-	-	-	-	(759)	759
Foreign exchange (gain) loss	273	57	216	339	(125)	464
Net financing expense relating to employee benefits	10	13	(3)	37	60	(23)
Gain on financial instruments recorded at fair value	3	-	3	1	(23)	24
Gain on sale and leaseback of assets	-	-	-	-	(52)	52
Loss on debt settlements and modifications	(5)	(18)	13	(4)	(15)	11
Loss on disposal of assets (4)	4	-	4	137	-	137
Adjusted net income	**$ 54**	**$ 60**	**$ (6)**	**$ 677**	**$ 1,145**	**$ (468)**
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	275	278	(3)	276	278	(2)
Adjusted earnings per share – diluted	**$ 0.20**	**$ 0.22**	**$ (0.02)**	**$ 2.45**	**$ 4.11**	**$ (1.66)**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

(2) In the first quarter of 2017, Air Canada recorded a provision of $30 million relating to a fine which was reinstated by a decision of the European Commission pertaining to cargo investigations

(3) In 2017, Air Canada recorded a tax recovery of $743 million (representing a deferred income tax recovery of $759 million and a current income tax expense of $16 million). This deferred income tax recovery was excluded from adjusted net income as it reflected a one-time recognition of previously unrecognized income tax assets.

(4) In 2018, Air Canada recorded a loss on disposal of assets of $188 million related to the sale of 25 Embraer 190 aircraft.

The following reflects the share amounts used in the computation of basic and diluted earnings per share on an adjusted-earnings per share basis:

	Fourth Quarter		Full Year	
(in millions)	2018	2017	2018	2017
Weighted average number of shares outstanding – basic	**271**	**274**	**272**	**273**
Effect of dilution	4	4	4	5
Weighted average number of shares outstanding – diluted	**275**	**278**	**276**	**278**

Return on Invested Capital

Air Canada uses return on invested capital ("ROIC") as a means to assess the efficiency with which it allocates its capital to generate returns. Return is based on adjusted pre-tax income (or loss, as applicable), excluding interest expense and implicit interest on operating leases. Invested capital includes (i) average year-over-year long-term debt, average year-over-year finance lease obligations, average year-over-year shareholders' equity and (ii) the value of capitalized operating leases (calculated by multiplying annualized aircraft rent by 7). Air Canada calculates invested capital based on a book value-based method of calculating ROIC, as described above. Following an increase in Air Canada's total cash, cash equivalents and short-term investments, Air Canada revised its methodology to reduce the average year-over-year book value of shareholders' equity by excess cash not required to run its core business operations. Air Canada uses average year-over-year advance ticket sales as a proxy for the minimum cash required for ongoing core business operations. This change results in invested capital more closely reflecting operating capital. Refer to the definition of adjusted pre-tax income (loss) for a discussion as to why Air Canada uses this measure to assess the overall pre-tax financial performance of its business.

Return on invested capital is reconciled to GAAP income before income taxes as follows:

(Canadian dollars in millions, except where indicated)	12 Months Ended December 31, 2018	12 Months Ended December 31, 2017 (1)	$ Change
Income before income taxes	**$ 405**	**$ 1,286**	**$ (881)**
Remove:			
Special items (2)	-	30	(30)
Foreign exchange loss (gain)	317	(120)	437
Net financing expense relating to employee benefits	50	65	(15)
Loss (gain) on financial instruments recorded at fair value	1	(23)	24
Gain on sale and leaseback of assets	-	(52)	52
Gain on debt settlements and modifications (3)	(9)	(21)	12
Loss on disposal of assets (4)	188	-	188
Adjusted pre-tax income	**$ 952**	**$ 1,165**	**$ (213)**
Adjusted for:			
Interest expense	331	311	20
Implicit interest on operating leases (5)	274	266	8
Adjusted pre-tax income before interest	**$ 1,557**	**$ 1,742**	**$ (185)**
Invested capital:			
Average long-term debt and finance lease obligations	6,386	6,369	17
Average shareholders' equity, net of excess cash	2,065	1,249	816
Capitalized operating leases (6)	3,913	3,801	112
Invested capital	**$ 12,364**	**$ 11,419**	**$ 945**
Return on invested capital (%)	**12.6**	**15.3**	**(2.7) pp**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

(2) Special items for the 12 months ended December 31, 2017 included a provision of $30 million related to cargo investigations.

(3) Gain on debt settlements and modifications for the 12 months ended December 31, 2018 of $9 million included a gain of $11 million related to the repricing of its US$1.1 billion senior secured credit facility and a loss of $2 million related to the prepayment of fixed rate debt.
Gain on debt settlements and modifications for the 12 months ended December 31, 2017 of $21 million included a gain of $27 million related to the repricing of its US$1.1 billion senior secured credit facility, a loss of $3 million related to the early exercise of a purchase option for an Airbus 330 aircraft and a loss of $2 million related to the prepayment of fixed rate debt on four Embraer 190 aircraft.

(4) In 2018, Air Canada disposed of 25 Embraer 190 aircraft resulting in a loss on disposal of $188 million.

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

(6) Capitalized operating leases are calculated by multiplying the trailing 12 months of aircraft rent by 7. Aircraft rent totaled $559 million for the 12 months ended December 31, 2018 and $543 million for the 12 months ended December 31, 2017 (includes aircraft rent related to regional operations).

Adjusted Net Debt to Trailing 12-Month EBITDAR (Leverage Ratio)

Adjusted net debt to trailing 12-month EBITDAR ratio (also referred to as "leverage ratio" in this MD&A) is commonly used in the airline industry and is used by Air Canada as a means to measure financial leverage. Leverage ratio is calculated by dividing adjusted net debt by trailing 12-month EBITDAR. As mentioned above, Air Canada excludes special items from EBITDAR results (which are used to determine leverage ratio) as such items would distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful. Refer to section 9.3 "Adjusted Net Debt" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

Free Cash Flow

Free cash flow is commonly used in the airline industry and is used by Air Canada as an indicator of the financial strength and performance of its business, indicating the amount of cash Air Canada is able to generate from operations and after capital expenditures. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment and intangible assets, and is net of proceeds from sale and leaseback transactions. Refer to section 9.5 "Consolidated Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

21. GLOSSARY

Adjusted CASM – Refers to operating expense per ASM adjusted to remove the effects of aircraft fuel expense, ground packages costs at Air Canada Vacations, and special items. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Adjusted net income (loss) – Refers to the consolidated net income (loss) of Air Canada adjusted to remove the after-tax effects of foreign exchange gains or losses, net financing income (expense) relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Adjusted pre-tax income (loss) – Refers to the consolidated income (loss) of Air Canada before income taxes and adjusted to remove the effects of foreign exchange gains or losses, net financing income (expense) relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Air Georgian – Refers to Air Georgian Limited.

Atlantic passenger and cargo revenues – Refer to revenues from flights that cross the Atlantic Ocean with origins and destinations principally in Europe, India, the Middle East and North Africa.

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

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

Boeing – Refers to The Boeing Company.

Bombardier – Refers to Bombardier Inc.

CALDA – Refers to the Canadian Airline Dispatchers Association.

CASM – Refers to operating expense per ASM.

CUPE – Refers to the Canadian Union of Public Employees.

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

EBITDAR – Refers to earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent. EBITDAR is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information. Air Canada excludes special items from EBITDAR.

EVAS – Refers to Exploits Valley Air Services Limited.

Free cash flow – Refers to net cash flows from operating activities minus additions to property, equipment and intangible assets, and is net of proceeds from sale and leaseback transactions. Free cash flow is a non-GAAP financial measure. Refer to sections 9.5 and 20 of this MD&A for additional information.

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

Jazz – Refers to Jazz Aviation LP.

Jazz CPA – Refers to the capacity purchase agreement between Air Canada and Jazz dated January 1, 2015 which became effective on January 1, 2015.

Leverage ratio – Refers to the ratio of adjusted net debt to trailing 12-month EBITDAR (calculated by dividing adjusted net debt by trailing 12-month EBITDAR). Leverage ratio is a non-GAAP financial measure. Refer to sections 9.3 and 20 of this MD&A for additional information.

Loss (gain) on debt settlements and modifications – Refer to gains or losses related to debt settlements and modifications that, in management's view, are to be separately disclosed by virtue of their size or incidence to enable a fuller understanding of the Corporation's financial performance.

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

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

Passenger load factor – Refers to a measure of passenger capacity utilization derived by expressing Revenue Passenger Miles as a percentage of Available Seat Miles.

Passenger revenue per available seat mile or PRASM – Refers to average passenger revenue per ASM.

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

Return on invested capital or ROIC – Refers to return on invested capital and is a measure used to assess the efficiency with which a company allocates its capital to generate returns. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Revenue passenger carried – Refers to the International Air Transport Association's (IATA) definition of passenger carried whereby passengers are counted on a flight number basis rather than by journey/itinerary or by leg.

Revenue passenger miles or RPMs – Refers to a measure of passenger traffic calculated by multiplying the total number of revenue passengers carried by the miles they are carried.

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

Sky Regional – Refers to Sky Regional Airlines Inc.

Special items – Refer to those items that, in management's view, are to be separately disclosed by virtue of their significance to the financial statements, to enable a fuller understanding of the Corporation's financial performance.

Toronto Pearson – refers to Lester B. Pearson International Airport.

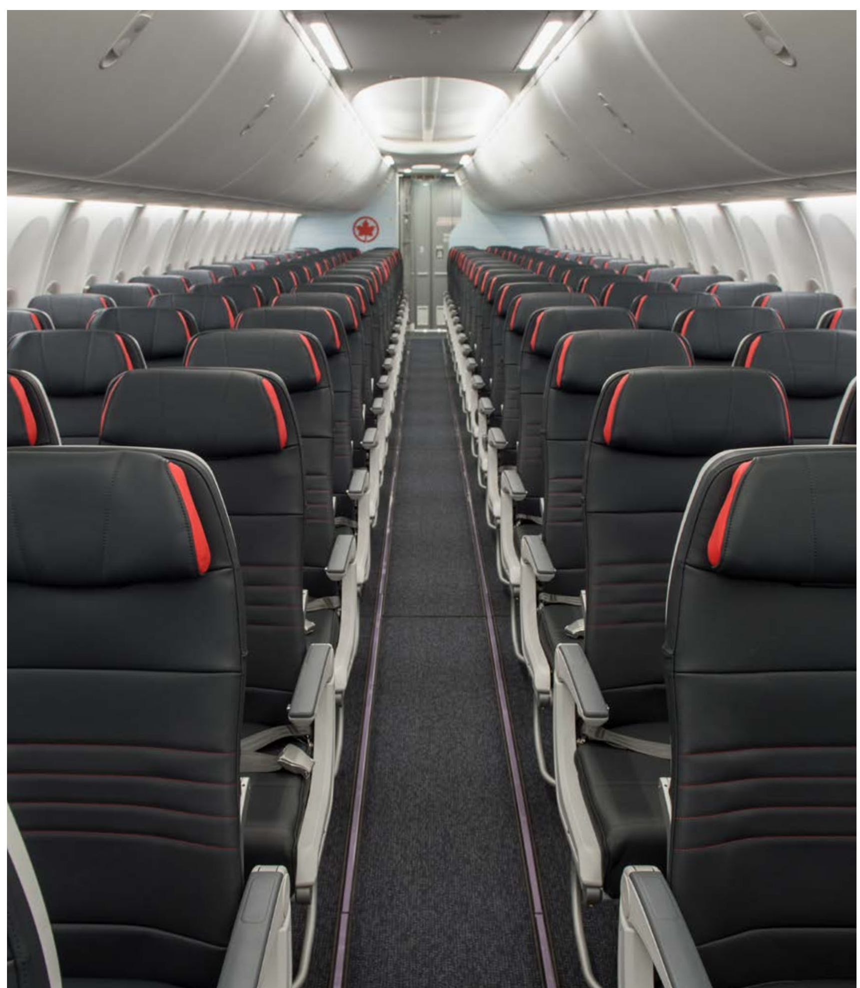
Unifor – Refers to the trade union in Canada, launched in 2013, as a merger of the Canadian Auto Workers and Communications, Energy and Paperworkers unions.

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

Yield – Refers to average passenger revenue per RPM.

2018

CONSOLIDATED FINANCIAL STATEMENTS AND NOTES



PHOTOS

EXTERIOR AIRBUS S.A.S 2019 – COMPUTER RENDERING BY FIXION.
PHOTO BY DREAMSTIME – MMS – 2019

INTERIOR OF AIR CANADA BOEING 737 MAX 8. PHOTO BY BRIAN LOSITO

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements have been prepared by management. Management is responsible for the fair presentation of the consolidated financial statements in conformity with generally accepted accounting principles in Canada which incorporates International Financial Reporting Standards, as issued by the International Accounting Standards Board. Management is responsible for the selection of accounting policies and making significant accounting judgements and estimates. Management is also responsible for all other financial information included in management's discussion and analysis and for ensuring that this information is consistent, where appropriate, with the information contained in the consolidated financial statements.

Management is responsible for establishing and maintaining adequate internal control over financial reporting which includes those policies and procedures that provide reasonable assurance over the safeguarding of assets and over the completeness, fairness and accuracy of the consolidated financial statements and other financial information.

The Audit, Finance and Risk Committee, which is comprised entirely of independent directors, reviews the quality and integrity of the Corporation's financial reporting and provides its recommendations, in respect of the approval of the financial statements, to the Board of Directors; oversees management's responsibilities as to the adequacy of the supporting systems of internal controls; provides oversight of the independence, qualifications and appointment of the external auditor; and, pre-approves audit, audit-related, and non-audit fees and expenses. The Board of Directors approves the Corporation's consolidated financial statements and management's discussion and analysis disclosures prior to their release. The Audit, Finance and Risk Committee meets with management, the internal auditors and external auditors at least four times each year to review and discuss financial reporting, disclosures, auditing and other matters.

The external auditors, PricewaterhouseCoopers LLP, conduct an independent audit of the consolidated financial statements in accordance with Canadian generally accepted auditing standards and express their opinion thereon. Those standards require that the audit is planned and performed to obtain reasonable assurance about whether the consolidated financial statements as a whole are free of material misstatement. The external auditors have unlimited access to the Audit, Finance and Risk Committee and meet with the Committee on a regular basis.

Calin Rovinescu
President and Chief Executive Officer

Michael Rousseau
Deputy Chief Executive Officer and
Chief Financial Officer

February 14, 2019

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Air Canada

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Air Canada and its subsidiaries (together, the Corporation) as at December 31, 2018 and 2017 and January 1, 2017, and its financial performance and its cash flows for the years ended December 31, 2018 and 2017 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

What we have audited

The Corporation's consolidated financial statements comprise:

- the consolidated statements of financial position as at December 31, 2018 and 2017 and January 1, 2017;
- the consolidated statements of operations for the years ended December 31, 2018 and 2017;
- the consolidated statements of comprehensive income for the years ended December 31, 2018 and 2017;
- the consolidated statements of changes in equity for the years ended December 31, 2018 and 2017;
- the consolidated statements of cash flow for the years ended December 31, 2018 and 2017; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Corporation in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis, which we obtained prior to the date of this auditor's report and the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, which is expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express an opinion or any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard. When we read the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Corporation's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Corporation or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Corporation's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional Judgement and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Corporation's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Corporation to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Corporation to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Michael Trudeau.

PricewaterhouseCoopers LLP[1]

Montreal, Quebec
February 14, 2019

[1]CPA auditor, Public accountancy permit NO. A113048

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Canadian dollars in millions)		December 31, 2018	December 31, 2017 Restated - Note 2	January 1, 2017 Restated - Note 2
Assets				
Current				
Cash and cash equivalents		$ 630	$ 642	$ 787
Short-term investments		4,077	3,162	2,192
Total cash, cash equivalents and short-term investments		4,707	3,804	2,979
Restricted cash	Note 2p	161	148	126
Accounts receivable	Note 18	796	814	707
Aircraft fuel inventory		109	91	79
Spare parts and supplies inventory	Note 2q	111	115	107
Prepaid expenses and other current assets	Note 18	417	425	447
Total current assets		6,301	5,397	4,445
Deposits and other assets		444	465	468
Property and equipment	Note 4	9,729	9,252	8,520
Pension assets	Note 8	1,969	1,583	1,153
Deferred income tax	Note 10	39	456	-
Intangible assets	Note 5	404	318	315
Goodwill	Note 6	311	311	311
Total assets		**$ 19,197**	**$ 17,782**	**$ 15,212**
Liabilities				
Current				
Accounts payable and accrued liabilities		$ 1,927	$ 1,961	$ 1,644
Advance ticket sales	Note 18	2,717	2,469	2,119
Current portion of long-term debt and finance leases	Note 7	455	671	707
Total current liabilities		5,099	5,101	4,470
Long-term debt and finance leases	Note 7	6,197	5,448	5,911
Pension and other benefit liabilities	Note 8	2,547	2,592	2,436
Maintenance provisions	Note 9	1,118	1,003	922
Other long-term liabilities		151	167	153
Deferred income tax	Note 10	52	49	49
Total liabilities		**$ 15,164**	**$ 14,360**	**$ 13,941**
Shareholders' Equity				
Share capital	Note 11	798	799	797
Contributed surplus		75	69	83
Hedging reserve		-	-	3
Retained earnings		3,160	2,554	388
Total shareholders' equity		4,033	3,422	1,271
Total liabilities and shareholders' equity		**$ 19,197**	**$ 17,782**	**$ 15,212**

The accompanying notes are an integral part of the consolidated financial statements.

On behalf of the Board of Directors:

Vagn Sørensen
Chairman

Christie J.B. Clark
Chair of the Audit, Finance and Risk Committee

CONSOLIDATED STATEMENTS OF OPERATIONS

For the year ended December 31 (Canadian dollars in millions except per share figures)		2018	2017 Restated - Note 2
Operating revenues			
Passenger	Note 18	$ 16,223	$ 14,593
Cargo	Note 18	803	708
Other		1,039	951
Total revenues		**18,065**	**16,252**
Operating expenses			
Aircraft fuel		3,969	2,927
Regional airlines expense	Note 19	2,842	2,617
Wages, salaries and benefits		2,873	2,671
Airport and navigation fees		964	905
Aircraft maintenance		1,003	938
Depreciation, amortization and impairment		1,080	956
Sales and distribution costs		807	770
Ground package costs		602	538
Aircraft rent		518	503
Catering and onboard services		433	383
Communications and information technology		294	254
Special items	Note 20	-	30
Other		1,506	1,389
Total operating expenses		**16,891**	**14,881**
Operating income		**1,174**	**1,371**
Non-operating income (expense)			
Foreign exchange gain (loss)		(317)	120
Interest income		108	60
Interest expense		(331)	(311)
Interest capitalized		35	36
Net financing expense relating to employee benefits	Note 8	(50)	(65)
Gain (loss) on financial instruments recorded at fair value	Note 15	(1)	23
Gain on sale and leaseback of assets	Note 21	-	52
Gain on debt settlements and modifications	Note 7	9	21
Loss on disposal of assets	Note 21	(188)	-
Other		(34)	(21)
Total non-operating expense		**(769)**	**(85)**
Income before income taxes		**405**	**1,286**
Income tax (expense) recovery	Note 10	(238)	743
Net income		**$ 167**	**$ 2,029**
Net income per share	Note 13		
Basic earnings per share		$ 0.61	$ 7.44
Diluted earnings per share		$ 0.60	$ 7.31

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the year ended December 31 (Canadian dollars in millions)		2018	2017 Restated - Note 2
Comprehensive income			
Net income		$ 167	$ 2,029
Other comprehensive income, net of tax expense:	Note 10		
Items that will not be reclassified to net income			
Remeasurements on employee benefit liabilities	Note 8	503	189
Items that will be reclassified to net income			
Fuel derivatives designated as cash flow hedges, net	Note 15	-	(3)
Total comprehensive income		**$ 670**	**$ 2,215**

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Canadian dollars in millions)	Share capital	Contributed surplus	Hedging reserve	Retained earnings	Total shareholders' equity
January 1, 2017 (1)	$ 797	$ 83	$ 3	$ 388	$ 1,271
Net income	-	-	-	2,029	2,029
Remeasurements on employee benefit liabilities	-	-	-	189	189
Fuel derivatives designated as cash flow hedges, net	-	-	(3)	-	(3)
Total comprehensive income	-	-	(3)	2,218	2,215
Share-based compensation	-	-	-	9	9
Shares issued (Note 11)	14	(5)	-	-	9
Shares purchased and cancelled under issuer bid (Note 11)	(12)	-	-	(59)	(71)
Reclassification of equity settled award to cash settled award (Note 2i)	-	(9)	-	(2)	(11)
December 31, 2017 (1)	$ 799	$ 69	$ -	$ 2,554	$ 3,422
Net income	-	-	-	167	167
Remeasurements on employee benefit liabilities	-	-	-	503	503
Fuel derivatives designated as cash flow hedges, net	-	-	-	-	-
Total comprehensive income	-	-	-	670	670
Share-based compensation	-	9	-	-	9
Shares issued (Note 11)	8	(3)	-	-	5
Shares purchased and cancelled under issuer bid (Note 11)	(9)	-	-	(64)	(73)
December 31, 2018	$ 798	$ 75	$ -	$ 3,160	$ 4,033

(1) Amounts for prior periods as restated – Refer to Note 2

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOW

For the year ended December 31 (Canadian dollars in millions except per share figures)		2018	2017 Restated - Note 2
Cash flows from (used for)			
Operating			
Net income		$ 167	$ 2,029
Adjustments to reconcile to net cash from operations			
Deferred income tax	Note 10	232	(759)
Depreciation, amortization and impairment		1,118	984
Foreign exchange (gain) loss	Note 15	328	(183)
Gain on sale and leaseback of assets	Note 21	-	(52)
Gain on debt settlements and modifications	Note 7	(9)	(21)
Loss on disposal of assets	Note 21	188	-
Employee benefit funding less than expense	Note 8	257	237
Financial instruments recorded at fair value	Note 15	14	(14)
Change in maintenance provisions		98	125
Changes in non-cash working capital balances		267	342
Other		35	50
Net cash flows from operating activities		**2,695**	**2,738**
Financing			
Proceeds from borrowings	Note 7	1,210	733
Reduction of long-term debt and finance lease obligations	Note 7	(1,170)	(814)
Shares purchased for cancellation	Note 11	(73)	(71)
Issue of shares		5	9
Financing fees	Note 7	(12)	(26)
Net cash flows used in financing activities		**(40)**	**(169)**
Investing			
Short-term investments		(848)	(998)
Additions to property, equipment and intangible assets		(2,197)	(2,422)
Proceeds from sale of assets		11	5
Proceeds from sale and leaseback of assets	Note 21	293	740
Other		47	(16)
Net cash flows used in investing activities		**(2,694)**	**(2,691)**
Effect of exchange rate changes on cash and cash equivalents		**27**	**(23)**
Decrease in cash and cash equivalents		**(12)**	**(145)**
Cash and cash equivalents, beginning of year		642	787
Cash and cash equivalents, end of year		**$ 630**	**$ 642**

The accompanying notes are an integral part of the consolidated financial statements.

For the years ended December 31, 2018 and 2017
(Canadian dollars in millions – except per share amounts)

1. GENERAL INFORMATION

The accompanying audited consolidated financial statements (the "financial statements") are of Air Canada (the "Corporation"). The term "Corporation" also refers to, as the context may require, Air Canada and/or one or more of its subsidiaries, including its principal wholly-owned operating subsidiaries, Touram Limited Partnership doing business under the brand name Air Canada Vacations® ("Air Canada Vacations") and Air Canada Rouge LP doing business under the brand name Air Canada Rouge® ("Air Canada Rouge").

Air Canada is incorporated and domiciled in Canada. The address of its registered office is 7373 Côte-Vertu Boulevard West, Saint-Laurent, Quebec.

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 as well as the international markets to and from Canada. Certain of the scheduled passenger services offered on domestic and Canada-U.S. transborder routes are operated under the brand name "Air Canada Express" and operated by third parties such as Jazz Aviation LP ("Jazz") and Sky Regional Airlines Inc. ("Sky Regional") through capacity purchase agreements (each a "CPA"). Air Canada also offers scheduled passenger services on domestic and Canada-U.S. transborder routes through capacity purchase agreements on other regional carriers, including those operating aircraft of 18 seats or less, some of which are referred to as Tier III carriers. Through Air Canada's global route network, virtually every major market throughout the world is served either directly or through the Star Alliance network. Air Canada also offers air cargo services on domestic and U.S. transborder routes as well as on international routes between Canada and major markets in Europe, Asia, South America and Australia.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation prepares its financial statements in accordance with generally accepted accounting principles in Canada ("GAAP") as set out in the CPA Canada Handbook – Accounting ("CPA Handbook") which incorporates International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

These financial statements were approved for issue by the Board of Directors of the Corporation on February 14, 2019.

These financial statements are based on the accounting policies as described below. These policies have been consistently applied to all the periods presented, except as otherwise stated.

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted for the current year.

a) Basis of measurement

These financial statements have been prepared under the historical cost convention, except for the revaluation of cash, cash equivalents, short-term investments, restricted cash and derivative instruments which are measured at fair value.

b) Principles of consolidation

These financial statements include the accounts of Air Canada and its subsidiaries. Subsidiaries are all entities (including structured entities) which Air Canada controls. For accounting purposes, control is established by an investor when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. All inter-company balances and transactions are eliminated.

c) Passenger and cargo revenues

The Corporation adopted IFRS 15 Revenue from Contracts with Customers on January 1, 2018 and applied it retrospectively to the previous periods. The impact of the new standard on the consolidated financial statements is summarized in Note 2bb.

Passenger and cargo revenues are recognized when the transportation is provided, except for revenue on unlimited flight passes which is recognized on a straight-line basis over the period during which the travel pass is valid. The Corporation has formed alliances with other airlines encompassing loyalty program participation, interline agreements and code sharing and coordination of services including reservations, baggage handling and flight schedules. Revenues are allocated based upon formulas specified in the agreements and are recognized as transportation is provided. Passenger revenue also includes certain fees and surcharges and revenues from passenger-related services such as seat selection and excess baggage which are recognized when the transportation is provided.

Airline passenger and cargo advance sales are deferred and included in Current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aimia Canada Inc. ("Aeroplan"), a corporation that provides loyalty program services to Air Canada and purchases seats from Air Canada pursuant to the Commercial Participation and Services Agreement between Aeroplan and Air Canada (the "CPSA"). Under the CPSA, Aeroplan purchases passenger tickets from Air Canada, which are accounted for as passenger revenues by Air Canada when transportation is provided. As further discussed in Note 23, Air Canada acquired Aimia Canada Inc., owner and operator of the Aeroplan loyalty business, from Aimia Inc. in January 2019.

d) Capacity purchase agreements

Air Canada has capacity purchase agreements with Jazz, Sky Regional and certain other regional carriers. Under these agreements, Air Canada markets, tickets and enters into other commercial arrangements relating to these flights and records the revenue it earns under Passenger revenue when transportation is provided. Operating expenses under capacity purchase agreements, which are aggregated in a separate line item in the consolidated statement of operations titled Regional airlines expense, include the capacity purchase fees, pass-through costs, which are direct costs incurred by the regional carrier and charged to the Corporation, and other costs incurred by the Corporation which are directly related to regional carrier operations.

e) Aeroplan loyalty program

Air Canada purchases Aeroplan Miles® from Aeroplan. Air Canada is an Aeroplan partner providing certain of Air Canada's customers, who are also members of Aeroplan, with Aeroplan Miles®, which they can redeem as Aeroplan members for air travel or other rewards offered by Aeroplan pursuant to its program.

The cost of purchasing Aeroplan Miles® from Aeroplan is accounted for as a sales incentive and charged against passenger revenues when the points are issued, which occurs upon the qualifying air travel being provided to the customer.

As further discussed in Note 23, Air Canada acquired Aimia Canada Inc., owner and operator of the Aeroplan loyalty business, from Aimia Inc. in January 2019.

f) Other revenues

Other revenue is primarily comprised of revenues from the sale of the ground portion of vacation packages, ground handling services, on-board sales, lounge pass sales and loyalty program marketing fees. Vacation package revenue is recognized as services are provided over the period of the vacation. Other airline related service revenues are recognized as the products are sold to passengers or the services are provided.

In certain subleases of aircraft to Jazz, for accounting purposes, the Corporation acts as an agent and accordingly reports the sublease revenues net against aircraft rent expense as the terms of the sublease match the terms of the Corporation's lease. The Corporation acts as lessee and sublessor in these matters.

g) Employee benefits

The cost of pensions, other post-retirement and post-employment benefits earned by employees is actuarially determined annually as at December 31. The cost is determined using the projected unit credit method and assumptions including market interest rates, salary escalation, retirement ages of employees, mortality rates, and health care costs.

Past service costs are recognized in the period of a plan amendment, irrespective of whether the benefits have vested. Gains and losses on curtailments or settlements are recognized in the period in which the curtailment or settlement occurs.

The current service cost and any past service cost, gains and losses on curtailments or settlements are recorded in Wages, salaries and benefits. The interest arising on the net benefit obligations are presented in Net financing expense relating to employee benefits. Net actuarial gains and losses, referred to as remeasurements, are recognized in Other comprehensive income and Retained earnings without subsequent reclassification to income.

The current service cost is estimated utilizing different discount rates derived from the yield curve used to measure the defined benefit obligation at the beginning of the year, reflecting the different timing of benefit payments for past service (the defined benefit obligation) and future service (the current service cost).

The liability in respect of minimum funding requirements, if any, is determined using the projected minimum funding requirements, based on management's best estimates of the actuarially determined funded status of the plan, market discount rates and salary escalation estimates. The liability in respect of the minimum funding requirement and any subsequent remeasurement of that liability are recognized immediately in Other comprehensive income and Retained earnings without subsequent reclassification to income.

Recognized pension assets are limited to the present value of any reductions in future contributions or any future refunds.

h) Employee profit sharing plans

The Corporation has employee profit sharing plans. Payments are calculated based on full calendar year results and an expense recorded throughout the year as a charge to Wages, salaries and benefits based on the estimated annual payments under the plans.

i) Share-based compensation plans

Certain employees of the Corporation participate in Air Canada's Long-Term Incentive Plan, which provides for the grant of stock options, performance share units ("PSUs") and restricted share units ("RSUs"), as further described in Note 12. PSUs and RSUs are notional share units which are exchangeable, on a one-to-one basis, as determined by the Board of Directors as described in Note 12, for Air Canada shares, or the cash equivalent.

Options are expensed using a graded vesting model over the vesting period. The Corporation recognizes compensation expense and a corresponding adjustment to Contributed surplus equal to the fair value of the equity instruments granted using the Black-Scholes option pricing model taking into consideration forfeiture estimates. Compensation expense is adjusted for subsequent changes in management's estimate of the number of options that are expected to vest.

A prospective change in accounting for PSUs and RSUs was made in 2017 from equity settled instruments to cash settled instruments based on settlement experience. In accounting for cash settled instruments, compensation expense is adjusted for subsequent changes in the fair value of the PSUs and RSUs taking into account forfeiture estimates. The liability related to cash settled PSUs and RSUs is recorded in Other long-term liabilities. Refer to Note 15 for a description of derivative instruments used by the Corporation to economically hedge the cash flow exposure to PSUs and RSUs.

Air Canada also maintains an employee share purchase plan. Under this plan, contributions by the Corporation's employees are matched to a specific percentage by the Corporation. Employees must remain with the Corporation and retain their shares until March 31 of the subsequent year for vesting of the Corporation's contributions. These contributions are expensed in Wages, salaries, and benefits expense over the vesting period.

j) Maintenance and repairs

Maintenance and repair costs for both leased and owned aircraft are charged to Aircraft maintenance as incurred, with the exception of maintenance and repair costs related to return conditions on aircraft under operating lease, which are accrued over the term of the lease, and major maintenance expenditures on owned and finance leased aircraft, which are capitalized as described below in Note 2r.

Maintenance and repair costs related to return conditions on aircraft leases are recorded over the term of the lease for the end of lease maintenance return condition obligations within the Corporation's operating leases, offset by a prepaid maintenance asset to the extent of any related power-by-the-hour maintenance service agreements or any recoveries under aircraft subleasing arrangements. The provision is recorded within Maintenance provisions using a discount rate taking into account the specific risks of the liability over the remaining term of the lease. Interest accretion on the provision is recorded in Other non-operating expense. Any changes in the maintenance cost estimate, discount rates, timing of settlement or difference in the actual maintenance cost incurred and the amount of the provision are recorded in Aircraft maintenance.

k) Other operating expenses

Included in Other operating expenses are expenses related to building rent and maintenance, airport terminal handling costs, professional fees and services, crew meals and hotels, advertising and promotion, insurance costs, and other expenses. Other operating expenses are recognized as incurred.

l) Financial instruments

Recognition

Financial assets and financial liabilities, including derivatives, are recognized on the consolidated statement of financial position when the Corporation becomes a party to the financial instrument or derivative contract.

Classification

The Corporation classifies its financial assets and financial liabilities in the following measurement categories i) those to be measured subsequently at fair value (either through other comprehensive income or through profit or loss) and ii) those to be measured at amortized cost. The classification of financial assets depends on the business model for managing the financial assets and the contractual terms of the cash flows. Financial liabilities are classified as those to be measured at amortized cost unless they are designated as those to be measured subsequently at fair value through profit or loss (irrevocable election at the time of recognition). For assets and liabilities measured at fair value, gains and losses are either recorded in profit or loss or other comprehensive income.

The Corporation reclassifies financial assets when and only when its business model for managing those assets changes. Financial liabilities are not reclassified.

The Corporation has implemented the following classifications:

- Cash and cash equivalents, Short-term investments, and Restricted cash are classified as assets at fair value through profit and loss and any period change in fair value is recorded through Interest income in the consolidated statement of operations, as applicable.
- Accounts receivable and Aircraft-related and other deposits are classified as assets at amortized cost and are measured using the effective interest rate method. Interest income is recorded in the consolidated statement of operations, as applicable.
- Accounts payable, credit facilities, and long-term debt are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method. Interest expense is recorded in the consolidated statement of operations, as applicable.

Measurement

All financial instruments are required to be measured at fair value on initial recognition, plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed in profit or loss. Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

Financial assets that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of the subsequent accounting periods. All other financial assets including equity investments are measured at their fair values at the end of subsequent accounting periods, with any changes taken through profit and loss or other comprehensive income (irrevocable election at the time of recognition).

Impairment

The Corporation assesses all information available, including, on a forward-looking basis, the expected credit losses associated with its assets carried at amortized cost. The impairment methodology applied depends on whether there has been a significant increase in credit risk. To assess whether there is a significant increase in credit risk, the Corporation compares the risk of a default occurring on the asset as at the reporting date with the risk of default as at the date of initial recognition based on all information available, and reasonable and supportive forward-looking information. For trade receivables only, the Corporation applies the simplified approach as permitted by IFRS 9 which requires expected lifetime losses to be recognized from initial recognition of receivables.

Derivatives and Hedge Accounting

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently re-measured to their fair value at the end of each reporting period. The accounting for subsequent changes in fair value depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged and the type of hedge relationship designated. The Corporation documents at the inception of the hedging transaction the economic relationship between hedging instruments and hedged items including whether the hedging instrument is expected to offset changes in cash flows of hedged items. The Corporation documents its risk management objective and strategy for undertaking various hedge transactions at the inception of each hedging relationship.

The Corporation applies hedge accounting for designated fuel derivatives. Crude oil prices, while not contractually specified in the Corporation's jet fuel purchase contracts, are economically related to jet fuel prices. The Corporation enters into option contracts on crude oil and designates the contracts in cash flow hedges of the crude oil component of its future jet fuel purchases. The Corporation has established a hedge ratio of 1:1 for its hedging relationships. Under hedge accounting, to the extent effective, the gain or loss on fuel hedging derivatives is recorded in other comprehensive income. Premiums paid for option contracts and the time value of the option contracts are deferred as a cost of the hedge in other comprehensive income. Amounts accumulated in other comprehensive income are presented as hedging reserve in equity and are reclassified to Aircraft fuel expense when the underlying hedged jet fuel is used. Any ineffective gain or loss on fuel hedging derivatives is recorded in non-operating expense in Gain on financial instruments recorded at fair value. Refer to Note 15 for the results from fuel hedge accounting.

When a hedging instrument expires, is sold or terminated, or when a hedge no longer meets the criteria for hedge accounting, any cumulative deferred gain or loss and deferred costs of hedging in equity at that time remains in equity until the forecast transaction occurs. When the forecast transaction is no longer expected to occur, the cumulative gain or loss and deferred costs of hedging that were reported in equity are immediately reclassified to profit or loss.

If the hedge ratio for risk management purposes is no longer optimal but the risk management objective remains unchanged and the hedge continues to qualify for hedge accounting, the hedge relationship will be rebalanced by adjusting either the volume of the hedged instrument or the volume of the hedged item so that the hedge ratio aligns with the ratio used for risk management purposes. Any hedge ineffectiveness is calculated and accounted for in profit or loss at the time of the hedge relationship rebalancing.

The Corporation enters into foreign currency, fuel derivatives and share forward contracts to manage the associated risks. Derivative instruments are recorded on the consolidated statement of financial position at fair value, including those derivatives that are embedded in financial or non-financial contracts that are required to be accounted for separately. Changes in the fair value of derivative instruments are recognized in Non-operating income (expense), except for effective changes for designated fuel derivatives under hedge accounting as described above. Derivative contracts are included in the consolidated statement of financial position at fair value in Prepaid expenses and other current assets, Deposits and other assets, and Accounts payable and accrued liabilities based on the terms of the contractual agreements. All cash flows associated with purchasing and selling derivatives are classified as operating cash flows in the consolidated statement of cash flow.

m) Foreign currency translation

The functional currency of Air Canada and its subsidiaries is the Canadian dollar. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the consolidated statement of financial position. Non-monetary assets and liabilities, revenues and expenses arising from transactions denominated in foreign currencies, are translated at the historical exchange rate or the average exchange rate during the period, as applicable. Adjustments to the Canadian dollar equivalent of foreign denominated monetary assets and liabilities due to the impact of exchange rate changes are recognized in Foreign exchange gain (loss).

n) Income taxes

The tax expense for the period comprises current and deferred income tax. Tax expense is recognized in the consolidated statement of operations, except to the extent that it relates to items recognized in other comprehensive income or directly in equity, in which case the tax is netted with such items.

The current income tax expense is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the jurisdictions where the Corporation and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulations are subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

o) Earnings per share

Basic earnings per share ("EPS") is calculated by dividing the net income for the period attributable to the shareholders of Air Canada by the weighted average number of shares outstanding during the period.

Diluted EPS is calculated by adjusting the weighted average number of shares outstanding for dilutive potential shares. The Corporation's potentially dilutive shares are comprised of stock options. The number of shares included with respect to time vesting options is computed using the treasury stock method unless they are anti-dilutive. Under this method, the proceeds from the exercise of such instruments are assumed to be used to purchase shares at the average market price for the period and the difference between the number of shares issued upon exercise and the number of shares assumed to be purchased is included in the calculation. The number of shares included with respect to performance-based employee share options is treated as contingently issuable shares because their issue is contingent upon satisfying specified conditions in addition to the passage of time. If the specified conditions are met, then the number of shares included is also computed using the treasury stock method unless they are anti-dilutive.

p) Restricted cash

The Corporation has recorded Restricted cash under Current assets representing funds held in trust by Air Canada Vacations in accordance with regulatory requirements governing advance ticket sales, as well as funds held in escrow accounts relating to Air Canada Vacations' credit card agreements for certain travel related activities.

Restricted cash with maturities greater than one year from the balance sheet date is recorded in Deposits and other assets. This restricted cash relates to funds on deposit with various financial institutions as collateral for letters of credit and other items.

q) Aircraft fuel inventory and spare parts and supplies inventory

Inventories of aircraft fuel, spare parts and supplies are measured at cost being determined using a weighted average formula, net of related obsolescence provision, as applicable.

The Corporation did not recognize any write-downs on inventories or reversals of any previous write-downs during the periods presented. Included in Aircraft maintenance is $57 related to spare parts and supplies consumed during the year (2017 – $54).

r) Property and equipment

Property and equipment is recognized using the cost model. Property under finance leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments.

The Corporation allocates the amount initially recognized in respect of an item of property and equipment to its significant components and depreciates separately each component. Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Aircraft and flight equipment are componentized into airframe, engine, and cabin interior equipment and modifications. Airframes and engines are depreciated over periods not exceeding 25 years, with residual values initially estimated at 10% of the original cost and updated for changes in estimates over time. Spare engines and related parts ("rotables") are depreciated over the average remaining useful life of the fleet to which they relate with residual values initially estimated at 10%. Cabin interior equipment and modifications are depreciated over the lesser of eight years or the remaining useful life of the aircraft. Cabin interior equipment and modifications to aircraft on operating leases are amortized over the lesser of eight years or the term of the lease. Major maintenance of airframes and engines, including replacement spares and parts, labour costs and/or third-party maintenance service costs, are capitalized and amortized over the average expected life between major maintenance events. Major maintenance events typically consist of more complex inspections and servicing of the aircraft. All power-by-the-hour fleet maintenance contract costs are charged to operating expenses in the income statement as incurred. Buildings are depreciated on a straight-line basis over their useful lives not exceeding 50 years or the term of any related lease, whichever is less. Leasehold improvements are amortized over the lesser of the lease term or 5 years. Ground and other equipment is depreciated over 3 to 25 years.

Residual values and useful lives are reviewed at least annually, and depreciation rates are adjusted accordingly on a prospective basis. Gains and losses on disposals of property and equipment are determined by comparing the proceeds with the carrying amount of the asset and are included as part of non-operating gains and losses in the consolidated statement of operations.

s) Interest capitalized

Borrowing costs are expensed as incurred. For borrowing costs attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use, the costs are capitalized as part of the cost of that asset. Capitalization of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and the activities to prepare the asset for its intended use are in progress. Borrowing costs are capitalized up to the date when the project is completed and the related asset is available for its intended use.

To the extent that funds are borrowed specifically for the purpose of obtaining such assets, the amount of borrowing costs eligible for capitalization is determined at the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings. To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the Corporation that are outstanding during the period. Borrowings made specifically for the purpose of obtaining a qualifying asset are excluded from this calculation until substantially all the activities necessary to prepare the asset for its intended use are complete.

t) Leases

Leases are classified as finance leases when the lease arrangement transfers substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Total aircraft operating lease rentals over the lease term are amortized to operating expense (Aircraft rent) on a straight-line basis. Included in Deposits and other assets and Other long-term liabilities are the differences between the straight-line aircraft rent expense and the payments as stipulated under the lease agreement.

u) Intangible assets

Intangible assets are initially recorded at cost. Indefinite life intangible assets are not amortized while assets with finite lives are amortized on a straight-line basis over their estimated useful lives.

	Estimated Useful Life	Remaining amortization period as at December 31, 2018
International route rights and slots	Indefinite	not applicable
Marketing based trade names	Indefinite	not applicable
Technology based (internally developed)	5 -10 years	1 to 10 years

Air Canada has international route rights and slots which enable the Corporation to provide services internationally. The value of the recorded intangible assets relates to the cost of route and slot rights at Tokyo's Narita International Airport, Washington's Reagan National Airport and London's Heathrow Airport. Air Canada expects to provide service to these international locations for an indefinite period.

Air Canada and certain of its subsidiaries have trade names, trademarks, and domain names (collectively, "Trade Names"). These items are marketing based intangible assets as they are primarily used in the sale and promotion of Air Canada's products and services. The Trade Names create brand recognition with customers and potential customers and are capable of contributing to cash flows for an indefinite period of time. Air Canada intends to continually re-invest in, and market, the Trade Names to support classification as indefinite life intangibles. If there were plans to cease using any of the Trade Names, the specific names would be classified as finite and amortized over the expected remaining useful life.

Development costs that are directly attributable to the design, development and testing of identifiable software products are recognized as technology based intangible assets if certain criteria are met, including technical feasibility and intent and ability to develop and use the technology to generate probable future economic benefits; otherwise they are expensed as incurred. Directly attributable costs that are capitalized as part of the technology based intangible assets include software-related, employee and third-party development costs and an appropriate portion of relevant overhead.

v) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Corporation's share of the net identifiable assets of the acquired business at the date of acquisition. Goodwill is tested at least annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. For the purpose of impairment testing, goodwill is tested for impairment at the lowest level within the entity at which the goodwill is monitored for internal management purposes, being the operating segment level (Note aa).

w) Impairment of long-lived assets

Long-lived assets include property and equipment, finite lived intangible assets, indefinite lived intangible assets and goodwill. Assets that have an indefinite useful life, including goodwill are tested at least annually for impairment or when events or circumstances indicate that the carrying value may not be recoverable. Assets that are subject to depreciation or amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment test is performed by comparing the carrying amount of the asset or group of assets to their recoverable amount. Recoverable amount is calculated as the higher of an asset's or cash-generating unit's fair value less costs to dispose and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units or CGUs). Management has determined that the appropriate level for assessing impairments is at the narrow-body and wide-body fleet levels for aircraft and related assets supporting the operating fleet. Parked aircraft not used in operations and aircraft leased or subleased to third parties are assessed for impairment at the individual asset level. An impairment loss is recognized for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount.

Long-lived assets, other than goodwill, that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date. Management assesses whether there is any indication that an impairment loss recognized in a prior period no longer exists or has decreased. In assessing whether there is a possible reversal of an impairment loss, management considers the indicators that gave rise to the impairment loss. If any such indicators exist that an impairment loss has reversed, management estimates the recoverable amount of the long-lived asset. An impairment loss recognized in prior periods for an asset other than goodwill shall be reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. The carrying amount of any individual asset in the CGU is not increased above the carrying value that would have been determined had the original impairment not occurred. A reversal of an impairment loss is recognized immediately in the consolidated statement of operations.

x) Non-current assets (or disposal groups) held for sale

Non-current assets (or disposal groups) are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction, such assets are available for immediate sale in present condition, and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to dispose.

y) Provisions

Provisions are recognized when there exists a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the obligation. If the effect is significant, the expected cash flows are discounted using a rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, interest accretion on the provision is recorded in Other non-operating expense.

z) Special items

Special items are those items that in management's view are to be separately disclosed by virtue of their size or incidence to enable a full understanding of the Corporation's financial performance.

aa) Segment reporting

Air Canada is managed as one operating segment based on how financial information is produced internally for the purposes of making operating decisions. The operating segment is reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of operations, has been identified as the Chief Executive Officer.

bb) Accounting standards adopted on January 1, 2018

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 replaces IAS 18 Revenue and related interpretations. The core principle of the new standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard is intended to enhance disclosures about revenue, provide more comprehensive guidance for transactions that were not previously addressed and improve guidance for multiple-element arrangements. IFRS 15 is effective for annual periods beginning on January 1, 2018.

The Corporation adopted the standard effective January 1, 2018 using the full retrospective method, which requires each prior reporting period presented to be restated. The main changes are explained below.

Accounting for costs to obtain a contract

Under IFRS 15, incremental costs of obtaining passenger revenues, such as credit card fees and global distribution system charges, are capitalized at time of sale and expensed at the time of passenger revenue recognition. Prior to adoption of IFRS 15, these costs were expensed as incurred at the time the flight ticket was sold. With this change in accounting policy for contract costs, the timing of expense recognition is impacted.

The impact on the consolidated statement of financial position as at January 1, 2017 is an increase to Prepaid expenses and other current assets of $58 and an equivalent increase to opening Retained earnings ($65 as at December 31, 2017). In addition, deferred commission costs in the amount of $40 as at January 1, 2017, previously recorded net against the Advance ticket sales liability, were reclassified to Prepaid expenses and other current assets ($35 as at December 31, 2017).

Accounting for change fees

Revenue arising from change fees which are collected by travel agents on Air Canada's behalf are deferred and recognized in passenger revenue at the time of the related flight, rather than at time of collection. The impact on the consolidated statement of financial position as at January 1, 2017 is an increase to Advance ticket sales of $6 and an equivalent decrease to opening Retained earnings ($6 as at December 31, 2017).

Presentation

Certain passenger and cargo related fees and surcharges were reclassified from Other to Passenger revenue and to Cargo revenue on the consolidated statement of operations to better reflect the nature and aggregation of similar revenue items. This reclassification has no impact on total operating revenues.

Impact to previously reported results

Selected adjusted financial statement information, which reflect the adoption of IFRS 15, is presented below. Line items that were not affected by the change in accounting policy have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided. In summary, the following adjustments were made to the amounts recognized in the consolidated statement of financial position for the date of initial application on January 1, 2017 and at the end of the comparative period, December 31, 2017.

(Canadian dollars in millions)	December 31, 2016 as previously reported	Reclassification	Remeasurements	January 1, 2017 as restated
Prepaid expenses and other current assets	$ 349	$ 40	$ 58	$ 447
Total assets	**$ 15,114**	**$ 40**	**$ 58**	**$ 15,212**
Advance ticket sales	2,073	40	6	2,119
Total current liabilities	**$ 4,424**	**$ 40**	**$ 6**	**$ 4,470**
Retained earnings	336	-	52	388
Total shareholders' equity	**$ 1,219**	**$ -**	**$ 52**	**$ 1,271**
Total liabilities and shareholders' equity	**$ 15,114**	**$ 40**	**$ 58**	**$ 15,212**

(Canadian dollars in millions)	December 31, 2017 as previously reported	Reclassification	Remeasurements	December 31, 2017 as restated
Prepaid expenses and other current assets	$ 325	$ 35	$ 65	$ 425
Deferred income tax	472	-	(16)	456
Total assets	**$ 17,698**	**$ 35**	**$ 49**	**$ 17,782**
Advance ticket sales	2,428	35	6	2,469
Total current liabilities	**$ 5,060**	**$ 35**	**$ 6**	**$ 5,101**
Retained earnings	2,511	-	43	2,554
Total shareholders' equity	**$ 3,379**	**$ -**	**$ 43**	**$ 3,422**
Total liabilities and shareholders' equity	**$ 17,698**	**$ 35**	**$ 49**	**$ 17,782**

No deferred income tax was recorded on the restatement as of January 1, 2017 due to deferred income tax assets not being recognized at that time. Starting in the third quarter of 2017, the adjustments include their corresponding income tax effect resulting in a $16 decrease of the tax recovery previously recorded in the consolidated statement of operations.

Adoption of the standard impacted the Corporation's previously reported consolidated statement of operations as follows.

(Canadian dollars in millions)	Year ended December 31, 2017 as previously reported	Reclassification	Remeasurements	Year ended December 31, 2017 as restated
Operating revenues				
Passenger	$ 14,471	$ 122	$ -	$ 14,593
Cargo	650	58	-	708
Other	1,131	(180)	-	951
Total revenues	**16,252**	**-**	**-**	**16,252**
Operating expenses				
Sales and distribution costs	777	-	(7)	770
Total operating expenses	**14,888**	**-**	**(7)**	**14,881**
Operating income	**1,364**	**-**	**7**	**1,371**
Income tax (expense) recovery	759	-	(16)	743
Net income	**$ 2,038**	**$ -**	**$ (9)**	**$ 2,029**
Basic earnings per share	$ 7.48	$ -	$ (0.04)	$ 7.44
Diluted earnings per share	$ 7.34	$ -	$ (0.03)	$ 7.31

Adoption of IFRS 15 did not have any net impact on the consolidated statement of cash flows.

cc) Accounting standards and amendments issued but not yet adopted

The following is an overview of accounting standard changes that the Corporation will be required to adopt in future years. The Corporation continues to evaluate the impact of these standards on its consolidated financial statements.

IFRS 16 – Leases

IFRS 16 replaces IAS 17 Leases and related interpretations. The core principle is that a lessee recognizes assets and liabilities for all leases with a lease term of more than 12 months. A lessee is required to recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. Assets and liabilities arising from a lease are initially measured on a present value basis. The measurement of the lease liability includes non-cancellable lease payments (including inflation-linked payments), and also includes payments to be made in optional periods if the lessee is reasonably certain to exercise an option to extend the lease, or not to exercise an option to terminate the lease. Purchase options which are reasonably certain of being exercised are also included in the measurement of the lease liability. Lease payments will not include variable lease payments other than those that depend on an index or rate. The right-of-use asset will be derived from the calculation of the lease liability and will also include any provisions the lessee will owe for return conditions on leased assets.

The new standard is intended to provide an improved representation of leasing transactions, in particular those that do not currently require the lessee to recognize an asset and liability arising from an operating lease. IFRS 16 is effective for annual periods beginning on January 1, 2019. Entities have the option of adopting a full retrospective approach or a modified retrospective approach on transition to IFRS 16.

The Corporation will apply the standard effective January 1, 2019 and will transition with a full retrospective approach with restatement to each prior reporting period presented. The Corporation has elected the package of practical expedients to not reassess prior conclusions related to contracts containing leases and to apply the recognition exemption for short term leases and contracts for which the underlying asset has a low value.

This standard will have a significant impact on the Corporation's consolidated balance sheet, along with a change to the recognition, measurement and presentation of lease expenses in the consolidated statement of operations.

Aircraft Leases

As of December 31, 2018 the Corporation had 126 aircraft under operating leases (111 aircraft as at December 31, 2017), and Air Canada will record such aircraft as right-of-use assets and lease liabilities of Air Canada in accordance with the requirements of the new standard. Additionally, the Corporation has identified that, under IFRS 16, Air Canada is the lessee in respect of aircraft used by regional carriers providing services under the respective capacity purchase agreements ("CPA"), and will record such aircraft as right-of-use assets and lease liabilities of Air Canada. As at December 31, 2018, there were 132 aircraft (134 aircraft as at December 31, 2017) operating under these arrangements on behalf of Air Canada.

Property Leases

The Corporation has leases related to airport terminal operations space and other real estate leases. For leases related to terminal operations space, there are generally effective substitution rights in the hands of the lessor and therefore these are not considered lease contracts under the standard. Leases with reciprocal termination rights with a notice period of less than 12 months would be considered short-term leases and therefore would be excluded from balance sheet recognition under the practical expedient. Finally, those airport terminal contracts with variable lease payments will also be excluded since variable lease payments, other than those based on an index or rate, are excluded from the measurement of the lease liability. This results in a portfolio of property leases that are expected to be recorded as right-of-use assets and lease liabilities under the standard which relate to dedicated space in Air Canada's hub locations of Toronto, Montreal and Vancouver, lease contracts on building space dedicated to Air Canada for offices, airport and maintenance operations, Maple Leaf Lounges and land leases.

Accounting for Leases and Right-of-Use Assets

Leases are recognized as a right-of-use asset and corresponding liability at the date of which the leased asset is available for use by the Corporation. Each lease payment is allocated between the liability and interest expense. The interest cost is charged to the consolidated statement of operations over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Right-of-use assets will be accounted for under IAS 16 Property, Plant and Equipment. Aircraft recorded as right-of-use assets will have the same accounting policies as directly owned aircraft, meaning the right-of-use assets will be componentized and depreciated over the lease term. Consistent with owned aircraft, any qualifying maintenance events will be capitalized and depreciated over the lesser of the lease term and expected maintenance life.

Maintenance provisions for end-of-lease return obligations will be recorded, as applicable, on aircraft leases as a maintenance expense over the term of the lease. Any changes to the provision for end-of-lease conditions will be recognized as an adjustment to the right-of-use asset and subsequently amortized to the income statement over the remaining term of the lease.

The application of IFRS 16 requires assumptions and estimates in order to determine the value of the right-of-use assets and the lease liabilities which mainly relate to the implicit interest rate for aircraft leases and the incremental borrowing rate at commencement date of the contract for property leases. Judgement must also be applied as to whether renewal options are reasonably certain of being exercised.

Income Statement Impacts

The impacts on the income statement will be an elimination of aircraft rent and building rent, which is recorded in other operating expenses, for those contracts which are recognized as leases, and instead will be replaced by an amortization of the right-of-use asset and interest costs on the lease liability. Maintenance expense is expected to decrease under the standard as qualifying maintenance events for the former operating leases will be capitalized as part of the right-of-use asset and depreciated over their expected maintenance life. This will be partially offset by higher maintenance provision expense recorded on all aircraft right-of-use assets which contain end of lease maintenance return conditions. Regional airlines expense is expected to decrease to the extent aircraft rent is removed and recorded in depreciation and interest expense outside of the Regionals airlines expense.

Since all the aircraft lease contracts are denominated in US dollars, there may be additional volatility in the foreign exchange recognized in the income statement due to the revaluation of the lease liabilities and maintenance provisions to the rate of exchange in effect at the date of the balance sheet.

Anticipated impact to 2018 results

Select adjusted financial statement information, which reflects the anticipated impact of adoption of IFRS 16 on January 1, 2018, is presented below. Line items that are not expected to be affected by the change in accounting policy have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided. In summary, the following adjustments are anticipated to be made to the amounts recognized in the consolidated statement of financial position for the date of initial application on January 1, 2018.

(Canadian dollars in millions)	December 31, 2017 as previously reported	Air Canada aircraft	Regional aircraft	Property leases	**Expected January 1, 2018 as restated**
Accounts receivable	$ 814	$ (3)	$ -	$ -	$ 811
Deposits and other assets	465	(63)	-	-	402
Property and equipment	9,252	1,649	766	160	11,827
Deferred income tax	456	71	144	13	684
Total assets	**$ 17,782**	**$ 1,654**	**$ 910**	**$ 173**	**$ 20,519**
Accounts payable and accrued liabilities	1,961	(22)	(12)	-	1,927
Current portion of long-term debt and lease liabilities	671	357	146	12	1,186
Total current liabilities	5,101	335	134	12	5,582
Long-term debt and lease liabilities	5,448	1,452	1,092	198	8,190
Maintenance provisions	1,003	70	78	-	1,151
Other long-term liabilities	167	(8)	-	-	159
Total liabilities	**$ 14,360**	**$ 1,849**	**$ 1,304**	**$ 210**	**$ 17,723**
Retained earnings	2,554	(195)	(394)	(37)	1,928
Total shareholders' equity	**$ 3,422**	**$ (195)**	**$ (394)**	**$ (37)**	**$ 2,796**
Total liabilities and shareholders' equity	**$ 17,782**	**$ 1,654**	**$ 910**	**$ 173**	**$ 20,519**

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in these financial statements and accompanying notes. These estimates and associated assumptions are based on historical experience, future operating plans and various other factors believed to be reasonable under the circumstances, and the results of such estimates form the basis of Judgements about carrying values of assets and liabilities. These underlying assumptions are reviewed on an ongoing basis. Actual results could differ materially from those estimates.

Significant estimates and judgements made in the preparation of these financial statements include, but are not limited to, the following areas, with further information contained in the applicable accounting policy or note:

- Employee future benefits
  - The cost and related liabilities of the Corporation's pensions, other post-retirement and post-employment benefit programs are determined using actuarial valuations. The actuarial valuations involve assumptions and estimates including discount rates, future salary increases, mortality rates and future benefit increases. Also, due to the long-term nature of these programs, such estimates are subject to significant uncertainty. Refer to Note 8 for additional information.
- Depreciation and amortization period for long-lived assets
  - The Corporation makes estimates about the expected useful lives of long-lived assets and the expected residual value of the assets based on the estimated current and future fair values of the assets, the Corporation's fleet plans and the cash flows they generate. Changes to these estimates, which can be significant, could be caused by a variety of factors, including changes to maintenance programs, changes in jet fuel prices and other operating costs, changes in utilization of the aircraft, and changing market prices for new and used aircraft of the same or similar types. Estimates and assumptions are evaluated at least annually. Generally, these adjustments are accounted for on a prospective basis, through depreciation and amortization expense. For the purposes of sensitivity analysis on these estimates, a 50% reduction to residual values on aircraft with remaining useful lives greater than five years results in an increase of $14 to annual depreciation expense. For aircraft with shorter remaining useful lives, the residual values are not expected to change significantly.
- Impairment considerations on long-lived assets
  - When required, an impairment test is performed by comparing the carrying amount of the asset or cash-generating unit to their recoverable amount, which is calculated as the higher of an asset's or cash-generating unit's fair value less costs to dispose and its value in use. Fair value less costs to dispose may be calculated based upon a discounted cash flow analysis, which requires management to make a number of significant market participant assumptions including assumptions relating to future operating plans, discount rates and future growth rates.
- Maintenance provisions
  - The recording of maintenance provisions related to return conditions on aircraft leases requires management to make estimates of the future costs associated with the maintenance events required under the lease return condition and estimates of the expected future maintenance condition of the aircraft at the time of lease expiry. These estimates take into account current costs of these maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Any difference in the actual maintenance cost incurred and the amount of the provision is recorded in Aircraft maintenance expense in the period. The effect of any changes in estimates, including changes in discount rates, inflation assumptions, cost estimates or lease expiries, is also recognized in Aircraft maintenance expense in the period. Refer to Note 9(a) for additional information.

- Income taxes
  - Income tax assets and liabilities are measured at the amount that is expected to be realized or incurred upon ultimate settlement with taxation authorities. Such assessments are based upon the applicable income tax legislation, regulations and interpretations, all of which may be subject to change and interpretation. Deferred income tax assets and liabilities are composed of the tax effect of temporary differences between the carrying amount and tax basis of assets and liabilities, as well as the income tax effect of undeducted income tax losses. The timing of the reversal of temporary differences is estimated and the income tax rate substantively enacted for the periods of reversal is applied to the temporary difference. The carrying amounts of assets and liabilities are subject to the accounting estimates that are inherent in those balances. Assumptions as to the timing of reversal of temporary differences include expectations about the future results of operations and future cash flows. Changes in tax laws, tax rates or expected timing of reversal may have a significant impact on the amounts recorded for deferred income tax assets and liabilities. Refer to Note 10 Income taxes for additional information.

4. PROPERTY AND EQUIPMENT

	Aircraft and flight equipment	Buildings and leasehold improvements	Ground and other equipment	Purchase deposits and assets under development	Total
Year ended December 31, 2017					
At January 1, 2017	$ 7,030	$ 409	$ 184	$ 897	$ 8,520
Additions	1,769	8	29	573	2,379
Reclassifications	309	62	36	(407)	-
Disposals	(713)	-	-	-	(713)
Depreciation	(852)	(41)	(41)	-	(934)
At December 31, 2017	$ 7,543	$ 438	$ 208	$ 1,063	$ 9,252
At December 31, 2017					
Cost	$ 11,320	$ 899	$ 545	$ 1,063	$ 13,827
Accumulated depreciation	(3,777)	(461)	(337)	-	(4,575)
	$ 7,543	$ 438	$ 208	$ 1,063	$ 9,252
Year ended December 31, 2018					
At January 1, 2018	$ 7,543	$ 438	$ 208	$ 1,063	$ 9,252
Additions	1,579	-	31	429	2,039
Reclassifications	517	42	-	(559)	-
Disposals	(496)	-	-	-	(496)
Depreciation	(980)	(44)	(42)	-	(1,066)
At December 31, 2018	$ 8,163	$ 436	$ 197	$ 933	$ 9,729
At December 31, 2018					
Cost	$ 12,123	$ 924	$ 567	$ 933	$ 14,547
Accumulated depreciation	(3,960)	(488)	(370)	-	(4,818)
	$ 8,163	**$ 436**	**$ 197**	**$ 933**	**$ 9,729**

As at December 31, 2018, property and equipment included finance leased assets including 8 aircraft (2017 – 9) with a net book value of $96 (2017 – $104) and facilities with a net book value of $32 (2017 – $34).

Included in aircraft and flight equipment are 21 aircraft and 16 spare engines (2017 – 21 aircraft and 14 spare engines) which are leased to CPA carriers with a cost of $395 (2017 – $387) less accumulated depreciation of $157 (2017 – $142) for a net book value of $238 (2017 – $245). Depreciation expense for 2018 for these aircraft and flight equipment amounted to $25 (2017 – $21).

As further described in Note 21, during 2018, the Corporation sold 25 Embraer 190 aircraft with a cost of $789 less accumulated depreciation of $308 for a net book value of $481.

Certain property and equipment are pledged as collateral as further described under the applicable debt instrument in Note 7. There are no impairments recorded as at December 31, 2018.

5. INTANGIBLE ASSETS

	International route rights and slots	Marketing based trade names	Technology based (internally developed)	Total
Year ended December 31, 2017				
At January 1, 2017	$ 97	$ 88	$ 130	$ 315
Additions	-	-	41	41
Amortization	-	-	(38)	(38)
At December 31, 2017	$ 97	$ 88	$ 133	$ 318
At December 31, 2017				
Cost	$ 97	$ 88	$ 458	$ 643
Accumulated amortization	-	-	(325)	(325)
	$ 97	$ 88	$ 133	$ 318
Year ended December 31, 2018				
At January 1, 2018	$ 97	$ 88	$ 133	$ 318
Additions	-	-	122	122
Amortization	-	-	(36)	(36)
At December 31, 2018	$ 97	$ 88	$ 219	$ 404
At December 31, 2018				
Cost	$ 97	$ 88	$ 579	$ 764
Accumulated amortization	-	-	(360)	(360)
	$ 97	**$ 88**	**$ 219**	**$ 404**

In 2018, technology-based assets with cost of $1 (2017 – $38) and accumulated amortization of $1 (2017 – $38) were retired.

Certain international route rights and slots are pledged as security for senior secured notes as described in Note 7.

An annual impairment review is conducted on all intangible assets that have an indefinite life. International route rights and slots and marketing based trade names are considered to have an indefinite life. The impairment review is carried out at the cash-generating unit level. On this basis, an impairment review was performed at the narrow-body and wide-body fleet levels for aircraft and related assets supporting the operating fleet. The allocation of the indefinite lived intangible assets to the cash-generating units was $138 to wide-body and $47 to narrow-body.

The recoverable amount of the cash-generating units has been measured based on the fair value less cost to dispose, using a discounted cash flow model. The discounted cash flow model would represent a level 3 fair value measurement within the IFRS 13 fair value hierarchy. Cash flow projections are based on the annual business plan approved by the Board of Directors of Air Canada. In addition, management-developed projections are made covering a five-year period. These cash flows are management's best estimate of future events taking into account past experience and future economic assumptions, such as the forward curves for crude-oil and the applicable exchange rates. Cash flows beyond the five-year period are projected to increase consistent with the long-term growth assumption of the airline industry considering various factors such as the Corporation's fleet plans and industry growth assumptions. The discount rate applied to the cash flow projections is derived from market participant assumptions regarding the Corporation's weighted average cost of capital adjusted for taxes and specific risks associated with the cash-generating unit being tested.

Due to the recoverable amount exceeding the carrying value of the cash generating units by a significant margin, the most recent calculation from the 2017 period was carried forward and used in the impairment test in the current period. Key assumptions used for the fair value less costs to dispose calculations in fiscal 2017 were as follows:

	2017
Discount rate	12.6%
Long-term growth rate	2.5%
Jet fuel price range per barrel	US$66 – US$79

The recoverable amount of both cash-generating units exceeded their respective carrying values by an aggregate amount of approximately $7,400. Reasonably possible changes in key assumptions would not cause the recoverable amount of each CGU to be less than the carrying value.

6. GOODWILL

Goodwill is tested at least annually for impairment. For the purpose of impairment testing, goodwill is tested for impairment using the fair value less cost to dispose model at the operating segment level. Air Canada is managed as one operating segment based on how financial information is produced internally for the purposes of making operating decisions, and it is the lowest level at which goodwill is monitored for internal management purposes.

In assessing the goodwill for impairment, the Corporation compares the aggregate recoverable amount consisting of the sum of its quoted equity market capitalization and the fair value of its debt to the carrying value of its net assets excluding long term debt. An impairment charge is recognized to the extent that the carrying value exceeds the recoverable amount. No impairment losses have been recorded against the value of goodwill since its acquisition.

No impairment charges have arisen as a result of the reviews performed as at December 31, 2018 and 2017. Reasonably possible changes in key assumptions would not cause the recoverable amount of goodwill to fall below the carrying value.

7. LONG-TERM DEBT AND FINANCE LEASES

	Final Maturity	Weighted Average Interest Rate (%)	2018	2017
Aircraft financing (a)				
Fixed rate U.S. dollar financing	2020 – 2030	3.84	$ 3,592	$ 2,828
Floating rate U.S. dollar financing	2020 – 2027	4.39	676	871
Fixed rate CDN dollar financing	2026 – 2030	3.76	287	-
Floating rate CDN dollar financing	2026 – 2027	2.89	298	332
Fixed rate Japanese yen financing	2027	1.84	146	131
Floating rate Japanese yen financing	2020 – 2027	0.88	42	61
Senior secured notes – CDN dollar (b)	2023	4.75	200	200
Senior unsecured notes – U.S. dollar (c)	2021	7.75	546	503
Other secured financing – U.S. dollar (b)	2023	4.52	786	1,073
Long-term debt		**4.22**	**6,573**	**5,999**
Finance lease obligations (d)	2020 - 2033	9.27	187	223
Total debt and finance leases		**4.36**	**6,760**	**6,222**
Unamortized debt issuance costs			(108)	(103)
Current portion			(455)	(671)
Long-term debt and finance leases			**$ 6,197**	**$ 5,448**

(a) Aircraft financing (US$3,130, C$585 and JPY ¥15,155) (2017 – US$2,943, C$332 and JPY ¥17,208) is secured primarily by specific aircraft with a carrying value of $5,575 (2017 – $5,230). For the majority of the financing, principal and interest is repayable quarterly until maturity and can be repaid at any time with the payment of applicable fees. US$222, C$298 and JPY ¥2,482 of the financing is supported by a loan guarantee by the Export-Import Bank of the United States ("EXIM").

In 2018, in connection with the financing of the acquisition of one new Boeing 787-9 aircraft and four new Boeing 737 MAX-8 aircraft, Air Canada entered into a certificate purchase agreement for a private offering of two tranches of enhanced equipment trust certificates with a combined aggregate face amount of $301 and a weighted average interest rate of 3.76% per annum, and a final expected maturity date of 2030. Proceeds from the offering were disbursed following delivery of the aircraft. These proceeds are included in fixed rate CDN dollar financing in the table above.

In 2017, in connection with the financing of four new Boeing 787-9 and nine new Boeing 737 MAX-8 aircraft, Air Canada completed the closing of a private offering of three tranches of enhanced equipment trust certificates ("EETC") with a combined aggregate face amount of US$719. The private offering was comprised of Class AA certificates, Class A certificates, and Class B certificates with final expected maturity dates between 2026 and 2030. The three tranches of certificates have a combined weighted average interest rate of 3.42%. Proceeds from the offering were disbursed during 2018 following delivery of the aircraft. The principal amount of US$719 is included in fixed rate U.S. dollar financing in the table above. Financing fees paid in conjunction with the offering in 2017 were $10 and are reported in Financing on the consolidated statement of cash flow.

In 2017, in connection with the acquisition of four Boeing 787-9 aircraft, the Corporation completed a financing, maturing in 2027 and comprised of a principal of US$439 subject to a floating rate, JPY ¥11,743 subject to a fixed rate and JPY ¥1,247 subject to a floating rate. These financings were secured using Japanese Operating Leases with a Call Option ("JOLCO") structures with the transactions recorded as loans and the aircraft as owned for accounting purposes in the Corporation's consolidated financial statements. Financing fees paid in 2017 in connection with the JOLCO structures were $13 and are reported in Financing on the consolidated statement of cash flow.

In connection with the sales transaction described in Note 21, long-term debt of $144 (US$109) related to the Embraer 190 aircraft was repaid in 2018. The loss recorded in Gain (loss) on debt settlements and modifications in respect of the prepayment of such debt was $2.

During 2018, principal of US$35 was prepaid relating to the financing of three Boeing 777 aircraft. The loss recorded in Gain (loss) on debt settlements and modifications in respect of the prepayment of such debt was less than $1.

During 2017, principal of US$27 was prepaid relating to the financing of one A330 aircraft and principal of US$25 relating to the financing of four Embraer 190 aircraft. A loss of $5 is included in Gain (loss) on debt settlements and modifications related to the prepayment of such fixed rate debt.

(b) In October 2016, as part of a refinancing transaction, Air Canada entered into a purchase agreement with a syndicate of initial purchasers relating to a private offering of $200 aggregate principal amount of 4.75% senior secured first lien notes due 2023 (the "2016 Senior Notes"), which were sold at par. Air Canada also received proceeds of a US$800 term loan, maturing in 2023, and entered into a new US$300 revolving credit facility expiring in 2021 (collectively with the term loan, the "2016 Credit Facility"). The revolving credit facility had an initial interest rate of 275 basis points over LIBOR (subject to a LIBOR floor of 75 basis points).

In June 2017, Air Canada completed a repricing of its US$1.1 billion 2016 Credit Facility, reducing the interest rate by 50 basis points, to an interest rate of 225 basis points over LIBOR (subject to a LIBOR floor of 75 basis points). The Corporation recorded a $27 Gain on debt settlements and modifications related to this transaction.

In February 2018, Air Canada completed a second repricing of its US$1.1 billion 2016 Credit Facility, reducing the interest rate by 25 basis points, to an interest rate of 200 basis points over LIBOR (subject to a LIBOR floor of 75 basis points). The Corporation recorded an $11 Gain on debt settlements and modifications related to this transaction.

In December 2018, Air Canada amended the 2016 Credit Facility. The amendment had the effect of increasing the revolving credit facility to US$600, reducing the outstanding term loan to US$600, concurrent with the additional repayment of US$192 of outstanding term loan, and extending the revolving loan commitment termination date to 2023. This repayment was made within the initial terms of the loan agreement.

In December 2018, Air Canada entered into a new $200 revolving credit facility. The facility is available until 2021 and, if drawn, would be secured by certain designated aircraft. No amounts have been drawn on the facility at December 31, 2018.

Air Canada may redeem some or all of the 2016 Senior Notes at any time on or after October 6, 2019 at certain established redemption prices, plus accrued and unpaid interest. At any time prior to October 6, 2019, Air Canada may redeem some or all of the 2016 Senior Notes at a price equal to 100% of their principal amount redeemed plus a "make-whole" premium and accrued and unpaid interest. At any time prior to October 6, 2019, Air Canada may redeem up to 35% of the aggregate principal amount of the 2016 Senior Notes with the proceeds of certain equity offerings, at established redemption prices, plus accrued and unpaid interest. In addition, at any time and from time to time prior to October 6, 2021, Air Canada may redeem, during any twelve-month period, up to 10% of the original aggregate principal amount of the 2016 Senior Notes at a redemption price of 103% of the principal amount, plus accrued and unpaid interest.

The 2016 Senior Notes and the Corporation's obligations under the 2016 Credit Facility are senior secured obligations of Air Canada, secured on a first lien basis, subject to certain permitted liens and exclusions, by certain real estate interests, ground service equipment, certain airport slots and gate leaseholds, and certain Pacific routes and the airport slots and gate leaseholds utilized in connection with those Pacific routes.

Other U.S. dollar secured financings are floating rate financings that are secured by certain assets including assets described above relating to the 2016 Credit Facility. As described above, during 2018, the Corporation prepaid US$192 of the outstanding term loan. As at December 31, 2018, the Corporation had not drawn on the revolving credit facility and the outstanding term loan principal was US$598 (2017 - US$798 principal).

(c) Private offering of US$400 of 7.75% senior unsecured notes due 2021, with interest payable semi-annually. Air Canada may at any time and from time to time redeem some or all of the senior unsecured notes at a redemption price equal to the greater of (i) 100% of the principal amount of the notes being redeemed and (ii) a "make-whole" amount, if any, plus, in either case accrued and unpaid interest.

(d) Finance leases, related to facilities and aircraft, total $187 ($61 and US$92) (2017 - $223 ($64 and US$126)). During 2018, the Corporation recorded interest expense on finance lease obligations of $19 (2017 – $23). The carrying value of aircraft and facilities under finance leases amounted to $96 and $32 respectively (2017 – $104 and $34).

Cash interest paid on Long-term debt and finance leases in 2018 by the Corporation was $281 (2017 – $287).

Maturity Analysis

Principal and interest repayment requirements as at December 31, 2018 on Long-term debt and finance lease obligations are as follows. U.S. dollar amounts are converted using the December 31, 2018 closing rate of C$1.3637.

	2019	2020	2021	2022	2023	Thereafter	Total
Principal							
Long-term debt obligations	$ 407	$ 640	$ 1,003	$ 342	$ 1,450	$ 2,731	$ 6,573
Finance lease obligations	48	50	17	15	16	41	187
	$ 455	**$ 690**	**$ 1,020**	**$ 357**	**$ 1,466**	**$ 2,772**	**$ 6,760**
Interest							
Long-term debt obligations	273	258	214	176	151	346	1,418
Finance lease obligations	14	10	6	5	4	10	49
	$ 287	**$ 268**	**$ 220**	**$ 181**	**$ 155**	**$ 356**	**$ 1,467**

Principal repayments in the table above exclude transaction costs of $108 which are offset against Long-term debt and finance leases in the consolidated statement of financial position.

Cash flows from financing activities

Information on the change in liabilities for which cash flows have been classified as financing activities in the statement of cash flows is presented below.

	Cash Flows				Non-Cash Changes			
	January 1, 2018	**Borrowings**	**Repayments**	**Financing Fees**	**Foreign exchange adjustments**	**Amortization of Financing Fees**	**Other Non-Cash Adjustments**	**December 31, 2018**
Long term debt	$ 5,999	$ 1,210	$ (1,122)	$ -	$ 492	$ -	$ (6)	$ 6,573
Lease liabilities	223	-	(45)	-	9	-	-	187
Unamortized debt issuance costs	(103)	-	-	(12)	-	20	(13)	(108)
Total liabilities from financing activities	**$ 6,119**	**$ 1,210**	**$ (1,167)**	**$ (12)**	**$ 501**	**$ 20**	**$ (19)**	**$ 6,652**

	Cash Flows				Non-Cash Changes			
	January 1, 2017	Borrowings	Repayments	Financing Fees	Foreign exchange adjustments	Amortization of Financing Fees	Other Non-Cash Adjustments	December 31, 2017
Long term debt	$ 6,447	$ 733	$ (766)	$ -	$ (392)	$ -	$ (23)	$ 5,999
Lease liabilities	275	-	(42)	-	(10)	-	-	223
Unamortized debt issuance costs	(104)	-	-	(16)	-	17	-	(103)
Total liabilities from financing activities	**$ 6,618**	**$ 733**	**$ (808)**	**$ (16)**	**$ (402)**	**$ 17**	**$ (23)**	**$ 6,119**

In 2017, financing fees of $10 paid in conjunction with the 2017 EETC offering were reported in Financing on the consolidated statement of cash flow but excluded from this table. These fees were recorded in Deposits and other assets until delivery of the aircraft and related recognition of long-term debt. Loss on debt settlements of $3 (2017 - $6) is included in Reduction of long-term debt and finance lease obligations on the consolidated statement of cash flow but excluded from this table.

8. PENSIONS AND OTHER BENEFIT LIABILITIES

The Corporation maintains several defined benefit and defined contribution plans providing pension, other post-retirement and post-employment benefits to its employees.

The Corporation is the administrator and sponsoring employer of eight Domestic Registered Plans ("Domestic Registered Plans") with defined benefit commitments registered under the Pension Benefits Standard Act, 1985 (Canada). The U.S. plan, UK plan and Japan plan are international plans covering members in those countries. In addition, the Corporation maintains a number of supplementary pension plans which are not registered. The defined benefit pension plans provide benefits upon retirement, termination or death based on the member's years of service and final average earnings for a specified period. Benefit payments are from trustee-administered funds, however there are also a number of unfunded plans where the Corporation meets the benefit payment obligation as it falls due. Plan assets held in trusts are governed by regulations. The governance of the plans, overseeing all aspects of the plans including investment decisions and contributions, lies primarily with the Corporation. The Human Resources and Compensation Committee, a committee of the Board of Directors, assists in the monitoring and oversight of the plans to ensure pension liabilities are appropriately funded, pension assets are prudently invested, risk is managed at an acceptable level and retirement benefits are administered in a proper and effective manner.

Other employee benefits include health, life and disability. These benefits consist of both post-employment and post-retirement benefits. The post-employment benefits relate to disability benefits available to eligible active employees, while the post-retirement benefits are comprised of health care and life insurance benefits available to eligible retired employees.

Pension Plan Cash Funding Obligations

Pension funding obligations (including projected funding obligations) may vary significantly based on a wide variety of factors, including the assumptions used in the most recently filed actuarial valuation reports (including the applicable discount rate used or assumed in the actuarial valuation), the plan demographics at the valuation date, the existing plan provisions, legislative and regulatory developments and changes in economic conditions (mainly the return on plan assets and changes in interest rates) and other factors. Actual contributions that are determined on the basis of future valuation reports may vary significantly from projections.

As at January 1, 2018, the aggregate solvency surplus in the domestic registered pension plans was $2.6 billion. The next required valuation to be made as at January 1, 2019 will be completed in the first half of 2019. With the Corporation's domestic registered pension plans in a solvency surplus position as at January 1, 2018, past service cost payments were not required in 2018. In addition, in accordance with legislation and applicable plan rules, the excess over 105% on a solvency basis can be used to reduce current service contributions under the defined benefit component or to fund the employer contribution to a defined contribution component within the same pension plan. Based on that, and including the international and supplemental plans, the total employer pension funding contributions during 2018 amounted to $83 ($94 employer contribution net of $11 used to fund employer contribution in defined contribution components of the same plans). Pension funding obligations for 2019 are expected to be $93.

Benefit Obligation and Plan Assets

These consolidated financial statements include all of the assets and liabilities of all Corporation-sponsored plans. The amounts recorded in the statement of financial position are as follows:

	Pension Benefits		Other Employee Future Benefits		Total	
	2018	2017	**2018**	2017	**2018**	2017
Non-current assets						
Pension assets	$ 1,969	$ 1,583	$ -	$ -	$ 1,969	$ 1,583
Current liabilities						
Accounts payable and accrued liabilities	-	-	60	61	60	61
Non-current liabilities						
Pension and other benefit liabilities	1,328	1,311	1,219	1,281	2,547	2,592
Net benefit obligation (asset)	**$ (641)**	**$ (272)**	**$ 1,279**	**$ 1,342**	**$ 638**	**$ 1,070**

The current portion of the net benefit obligation represents an estimate of other employee future benefits claims to be paid during 2019.

The following table presents financial information related to the changes in the pension and other post-employment benefits plans:

	Pension Benefits 2018	Pension Benefits 2017	Other Employee Future Benefits 2018	Other Employee Future Benefits 2017
Change in benefit obligation				
Benefit obligation at beginning of year	$ 20,260	$ 19,135	$ 1,342	$ 1,301
Current service cost	304	265	35	30
Past service cost	5	-	(8)	-
Interest cost	723	739	48	51
Employees' contributions	82	81	-	-
Benefits paid	(862)	(845)	(48)	(47)
Remeasurements:				
Experience loss (gain)	(11)	34	(28)	(45)
Loss (gain) from change in demographic assumptions	(262)	-	(14)	-
Loss (gain) from change in financial assumptions	(583)	855	(56)	64
Plan settlements	-	-	(6)	-
Foreign exchange loss (gain)	34	(4)	14	(12)
Total benefit obligation	19,690	20,260	1,279	1,342
Change in plan assets				
Fair value of plan assets at beginning of year	21,191	19,438	-	-
Return on plan assets, excluding amounts included in Net financing expense	(399)	1,708	-	-
Interest income	745	739	-	-
Employer contributions	83	81	51	47
Employees' contributions	82	81	-	-
Benefits paid	(862)	(845)	(48)	(47)
Settlements	-	-	(3)	-
Administrative expenses paid from plan assets	(12)	(12)	-	-
Foreign exchange gain (loss)	29	1	-	-
Total plan assets	20,857	21,191	-	-
(Surplus) deficit at end of year	**(1,167)**	**(931)**	**1,279**	**1,342**
Asset ceiling / additional minimum funding liability	526	659	-	-
Net benefit obligation (asset)	**$ (641)**	**$ (272)**	**$ 1,279**	**$ 1,342**

The actual return on plan assets was $346 (2017 – $2,447).

The pension benefit deficit of only those plans that are not fully funded is as follows:

	2018	2017
Domestic registered plans	$ 4	$ 3
International plans	85	78
Supplementary plans	1,239	1,230
	$ 1,328	**$ 1,311**

The weighted average duration of the defined benefit obligation is 14.2 years (2017 – 14.3 years).

Pension and Other Employee Future Benefit Expense

The Corporation has recorded net defined benefit pension and other employee future benefits expense as follows:

	Pension Benefits		Other Employee Future Benefits	
	2018	2017	**2018**	2017
Consolidated Statement of Operations				
Components of cost				
Current service cost	$ 304	$ 265	$ 35	$ 30
Past service cost	5	-	(8)	-
Plan settlements	-	-	(3)	-
Administrative and other expenses	12	12	-	-
Actuarial gains, including foreign exchange	-	-	(4)	(7)
Total cost recognized in Wages, salaries and benefits	**$ 321**	**$ 277**	**$ 20**	**$ 23**
Net financing expense relating to employee benefits	**$ 2**	**$ 14**	**$ 48**	**$ 51**
Total cost recognized in statement of operations	**$ 323**	**$ 291**	**$ 68**	**$ 74**
Consolidated Other Comprehensive (Income) Loss				
Remeasurements:				
Experience loss (gain), including foreign exchange	(6)	29	(10)	(50)
Loss (gain) from change in demographic assumptions	(262)	-	(14)	-
Loss (gain) from change in financial assumptions	(583)	855	(56)	64
Return on plan assets	399	(1,708)	-	-
Change in asset ceiling	(159)	299	-	-
Total cost (income) recognized in OCI	**$ (611)**	**$ (525)**	**$ (80)**	**$ 14**

In 2018, the Corporation offered a voluntary buyout program for retiree life and health benefits. The accepted offers were recognized as a plan amendment and settlement for a combined gain of $8.

Certain plan amendments made in conjunction with the 2014 ACPA collective agreement were or are conditional on meeting defined business plan targets tied to the number of operating aircraft in the fleet by 2020 and 2023. During the year ended December 31, 2018, actuarial losses of $43 (2017 - actuarial losses of $35) were recognized in other comprehensive income related to changes in assumptions associated with cost of pension increases applicable to affected members of ACPA.

The funding of employee benefits as compared to the expense recorded in the consolidated statement of operations is summarized in the table below.

	2018	2017
Net defined pension and other future employee benefits expense recorded in the consolidated statement of operations		
Wages, salaries and benefits	$ 341	$ 300
Net financing expense relating to employee benefit liabilities	50	65
	$ 391	**$ 365**
Employee benefit funding by Air Canada		
Pension benefits	$ 83	$ 81
Other employee benefits	51	47
	$ 134	**$ 128**
Employee benefit funding less than expense	**$ 257**	**$ 237**

Composition of Defined Benefit Pension Plan Assets

Domestic Registered Plans

The composition of the Domestic Registered Plan assets and the target allocation are the following:

	2018	2017	Target Allocation
Bonds	71%	70%	60%
Canadian equities	3%	3%	7%
Foreign equities	6%	7%	13%
Alternative investments	20%	20%	20%
	100%	**100%**	**100%**

For the Domestic Registered Plan assets, approximately 80% of assets as of December 31, 2018 have a quoted market price in an active market. Assets that do not have a quoted market price in an active market are mainly investments in privately held entities. The asset composition in the table represents the allocation of plan assets to each asset type.

Included in plan assets, for determining the net benefit obligation for accounting purposes, are 17,646,765 (2017 - 17,646,765) shares of Air Canada which were issued to a trust in 2009 in connection with pension funding agreements reached with all of the Corporation's Canadian-based unions. The trust arrangement provides that proceeds of any sale of the trust shares will be retained and applied to reduce future pension solvency deficits, if any should materialize. With the Corporation's domestic registered pension plans now in a surplus position on a solvency basis, the accounting rules prevent the recognition of the value of the shares held in trust as part of the pension assets. The shares held in trust have a fair value of $458 at December 31, 2018 (2017 - $457), however after giving effect to the asset ceiling, the recognized accounting value of the trust asset is nil.

For the Domestic Registered Plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Funds. As permitted under the investment policy, the actual asset mix may deviate from the target allocation from time to time. The deviations at December 31, 2018 are within the limits established in the investment policy. The investment return objective is to achieve a total annualized rate of return that exceeds by a minimum of 1.0% before investment fees on average over the long term (i.e. 10 years) the total annualized return that could have been earned by passively managing the Liability Replicating Portfolio. The Liability Replicating Portfolio, which is referenced to widely used Canadian fixed income indices (FTSE TMX Canada), closely matches the characteristics of the pension liabilities.

Recognizing the importance of surplus risk management, Air Canada manages the Domestic Registered Plans in an effort to mitigate surplus risk (defined as the difference between asset value and pension liability value), which is considered to be the key risk to be minimized and monitored. In addition, the objective of the investment strategy is to invest the plan assets in a prudent and diversified manner to mitigate the risk of price fluctuation of asset classes and individual investments within those asset classes and to combine those asset classes and individual investments in an effort to reduce overall risk.

In addition to the broad asset allocation, as summarized in the asset allocation section above, the following policies apply to individual asset classes invested within the pension funds:

- Equities are required to be diversified among regions, industries and economic sectors. Limitations are placed on the overall allocation to any individual security.
- Alternative investments are investments in non-publicly traded securities and in non-traditional asset classes. They may comprise, but are not limited to, investments in real estate, agriculture, timber, private equity, venture capital, infrastructure, emerging markets debt, high yield bonds and commodity futures. Alternative investments are required to be diversified by asset class, strategy, sector and geography.
- Canadian bonds are oriented toward long term investment grade securities rated “BBB” or higher. With the exception of Government of Canada securities or a province thereof or the U.S. Government, in which the plan may invest the entire fixed income allocation, these investments are required to be diversified among individual securities and sectors.

Derivatives are permitted provided that they are used for managing a particular risk (including interest rate risk related to pension liabilities) or to create exposures to given markets and currencies and that counterparties have a minimum credit rating of A. The Corporation manages interest rate risk related to its actuarial liabilities through a combination of financial instruments including, but not limited to, bonds, bond repurchase and reverse repurchase agreements, bond forwards, bond futures and interest rate swaps. As at December 31, 2018, taking into account the effect of such financial instrument risk management tools, approximately 81% of Air Canada’s pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk. Counterparty credit risk associated with such financial instruments is mitigated by receiving collateral from counterparties based on collateralization agreements, as well as by monitoring the counterparties’ credit ratings and ensuring compliance with the investment policy. The fair value of these derivative instruments is included in the Bonds in the asset composition table and is not a significant component of the aggregate bond fair values of the portfolio.

The trusts for the supplemental plans are invested 50% in indexed equity investments, in accordance with their investment policies, with the remaining 50% held by the Canada Revenue Agency as a refundable tax, in accordance with tax legislation.

Risks

Through its defined benefit pension plans, the Corporation is exposed to a number of risks, the most significant of which are detailed below:

Asset risk

Asset risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market price. Asset risk comprises currency risk, credit risk, and other price risk. Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. This risk is mitigated through implementation of hedging strategies. Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. This risk is mitigated by receiving collateral from counterparties based on collateralization agreements and by monitoring the issuers' credit risk. Other price risk is the risk the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. This risk is mitigated through proper diversification of plan assets.

Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. A decrease in corporate and/or government bond yields will increase plan liabilities, which will be partially offset by an increase in the value of the plans' bond holdings. As at December 31, 2018, approximately 81% of Air Canada's pension liabilities (including the effect of financial instrument risk management tools) were matched with fixed income products to mitigate a significant portion of the interest rate risk (discount rate risk).

Funding risk

Adverse changes in the value of plan assets or in interest rates, and therefore in the discount rate used to value liabilities, could have a significant impact on pension plan solvency valuations and future cash funding requirements.

Life expectancy

The majority of the plans' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the plans' liabilities.

Assumptions

Management is required to make significant estimates about actuarial and financial assumptions to determine the cost and related liabilities of the Corporation's employee future benefits.

Discount Rate

The discount rate used to determine the pension obligation was determined by reference to market interest rates on corporate bonds rated "AA" or better with cash flows that approximate the timing and amount of expected benefit payments.

Future Increases in Compensation

Estimates surrounding assumptions of future increases in compensation are based upon the current compensation policies, the Corporation's long range-plans, labour and employment agreements and economic forecasts.

The significant weighted average assumptions used to determine the Corporation's accrued benefit obligations and cost are as follows:

	Pension Benefits		Other Employee Future Benefits	
	2018	2017	**2018**	2017
Discount rate used to determine:				
Net interest on the net defined benefit obligation for the year ended December 31	3.60%	3.90%	3.60%	3.90%
Service cost for the year ended December 31	3.70%	4.10%	3.70%	4.10%
Accrued benefit obligation as at December 31	3.81%	3.60%	3.81%	3.60%
Rate of future increases in compensation used to determine:				
Accrued benefit cost and service cost for the year ended December 31	2.50%	2.50%	not applicable	not applicable
Accrued benefit obligation as at December 31	2.50%	2.50%	not applicable	not applicable

Sensitivity Analysis

Sensitivity analysis is based on changing one assumption while holding all other assumptions constant. In practice, this may be unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to variations in significant actuarial assumptions, the same method (present value of the defined benefit obligation calculated with the projected unit credit method at the end of the reporting period) has been applied as for calculating the liability recognized in the consolidated statement of financial position.

Sensitivity analysis on 2018 pension expense and net financing expense relating to pension benefit liabilities, based on different actuarial assumptions with respect to discount rate is set out below. The effects on each pension plan of a change in an assumption are weighted proportionately to the total plan obligation to determine the total impact for each assumption presented.

	0.25 Percentage Point	
	Decrease	Increase
Discount rate on obligation assumption		
Pension expense	$ 22	$ (21)
Net financing expense relating to pension benefit liabilities	23	(21)
	$ 45	**$ (42)**
Increase (decrease) in pension obligation	**$ 703**	**$ (680)**

The increase (decrease) in the pension obligation for a 0.25 percentage point change in the discount rate relates to the gross amount of the pension liabilities and is before the impact of any change in plan assets. As at December 31, 2018, approximately 81% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk.

An increase of one year in life expectancy would increase the pension benefit obligation by $478.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 5.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2018 (2017 – 5.8%). The rate is assumed to decrease gradually to 5% by 2020 (2017 – assumed to decrease gradually to 5% by 2020). A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by $4 and the obligation by $55. A one percentage point decrease in assumed health care trend rates would have decreased the total of current service and interest costs by $4 and the obligation by $58.

A 0.25 percentage point decrease in discount rate for other employee future benefits would have increased the total of current and interest costs by less than $1 and the obligation by $47. A 0.25 percentage point increase in discount rate would have decreased the total of current and interest costs by less than $1 and the obligation by $44.

Defined Contribution Pension Plans

Certain of the Corporation's management, administrative and unionized employees participate in a defined contribution pension plan, a defined contribution component of a plan which also includes a defined benefit component or a multi-employer plan which are accounted for as defined contribution plans. The Corporation contributes an amount expressed as a percentage of employees' contributions with such percentage varying by group and for some groups, based on the number of years of service. As permitted by legislation and applicable plan rules, surplus in the defined benefit component can be used to cover the employer contributions in the defined contribution component of such plan. As such, $11 of surplus in the defined benefit components of the domestic registered pension plans was used to cover the employer contributions in the defined contribution components during 2018 (2017 – $9).

The Corporation's expense for these pension plans amounted to $30 for the year ended December 31, 2018 (2017 – $21). Taking into account available surplus in the defined benefit components of applicable plans which may be expected to be used, expected total employer contributions for 2019 are $22.

9. PROVISIONS FOR OTHER LIABILITIES

The following table provides a continuity schedule of all recorded provisions. Refer to Note 16 for additional information on Litigation provisions. Current provisions are recorded in Accounts payable and accrued liabilities.

	Maintenance [(a)]	Asset retirement [(b)]	Litigation	Total provisions
At December 31, 2017				
Current	$ 68	$ -	$ 17	$ 85
Non-current	1,003	30	-	1,033
	$ 1,071	**$ 30**	**$ 17**	**$ 1,118**
Provisions arising during the year	$ 145	$ -	$ 2	$ 147
Amounts disbursed	-	-	(2)	(2)
Changes in estimated costs	(72)	-	-	(72)
Accretion expense	25	1	-	26
Foreign exchange loss	96	-	-	96
At December 31, 2018	**$ 1,265**	**$ 31**	**$ 17**	**$ 1,313**
Current	$ 147	$ -	$ 17	$ 164
Non-current	1,118	31	-	1,149
	$ 1,265	**$ 31**	**$ 17**	**$ 1,313**

(a) Maintenance provisions relate to the provision for the costs to meet the contractual return conditions on aircraft under operating leases. The provision relates to leases with expiry dates ranging from 2019 to 2029 with the average remaining lease term of approximately three years. The maintenance provisions take into account current costs of maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Assuming the aggregate cost for return conditions increases by 5%, holding all other factors constant, there would be a cumulative balance sheet adjustment to increase the provision by $62 at December 31, 2018 and an increase to maintenance expense in 2019 of approximately $6. Expected future cash flows to settle the obligation are discounted. If the discount rates were to increase by 1%, holding all other factors constant, there would be a cumulative balance sheet adjustment to decrease the provision by $21 at December 31, 2018. An equivalent but opposite movement in the discount rate would result in a similar impact in the opposite direction.

(b) Under the terms of certain land and facilities leases, the Corporation has an obligation to restore the land to vacant condition at the end of the lease and to rectify any environmental damage for which it is responsible. The related leases expire over terms ranging from 2019 to 2078. These provisions are based on numerous assumptions including the overall cost of decommissioning and remediation and the selection of alternative decommissioning and remediation approaches. The non-current provision is recorded in Other long-term liabilities.

10. INCOME TAXES

Income Tax Expense

Income tax recorded in the consolidated statement of operations is presented below.

	2018	2017 Restated - Note 2
Current income tax	$ (6)	$ (16)
Deferred income tax	(232)	759
Income tax (expense) recovery	**$ (238)**	**$ 743**

The income tax expense differs from the amount that would have resulted from applying the statutory income tax rate to income before income tax expense as follows:

	2018	2017 Restated - Note 2
Income before income taxes	$ 405	$ 1,286
Statutory income tax rate based on combined federal and provincial rates	26.78%	26.60%
Income tax expense based on statutory tax rates	**(108)**	**(342)**
Effects of:		
Non-taxable (non-deductible) portion of capital gains (losses)	(55)	52
Unrecognized deferred income tax assets on capital losses	(55)	-
Non-deductible expenses	(21)	(24)
Tax rate changes on deferred income taxes	2	(9)
Recognition of previously unrecognized deferred income tax assets	-	1,062
Other	(1)	4
Income tax (expense) recovery	**$ (238)**	**$ 743**

The applicable statutory tax rate is 26.78% (2017 – 26.60%). The Corporation's applicable tax rate is the Canadian combined rates applicable in the jurisdictions in which the Corporation operates. The increase to the statutory tax rate is mainly due to the net result of corporate income tax rate decreases in Quebec and the Yukon, and an increase in Saskatchewan, as well as changes in the level of activity by province.

Income tax recorded in the consolidated statement of comprehensive income is presented below.

	2018	2017
Remeasurements on employee benefit liabilities - deferred income tax	$ (188)	$ (322)
Income tax expense	**$ (188)**	**$ (322)**

The income tax expense differs from the amount that would have resulted from applying the statutory income tax rate to other comprehensive income before income tax expense as follows:

	2018	2017
Other comprehensive income before income taxes	$ 691	$ 508
Statutory income tax rate based on combined federal and provincial rates	26.78%	26.60%
Income tax expense based on statutory tax rates	**(185)**	**(135)**
Effects of:		
Recognition of previously unrecognized deferred income tax liability	-	(184)
Other	(3)	(3)
Income tax expense	**$ (188)**	**$ (322)**

Income tax recorded in shareholders' equity is presented below.

	2018	2017
Share-based compensation	$ -	$ 19
Income tax recovery	**$ -**	**$ 19**

Deferred Income Tax

Deferred income tax assets are recognized only to the extent that it is probable that future taxable income will be available to realize them. In making this assessment, consideration is given to available positive and negative evidence and relevant assumptions, including, historical financial results, and expectations relating to future taxable income, the overall business environment, and industry-wide trends.

During 2017, Air Canada determined that it was probable that substantially all of the deferred income tax assets, which include non-capital losses, would be realized.

Deferred tax assets and liabilities of $39 are recorded net as a noncurrent deferred income tax asset and deferred tax liabilities of $52 are recorded as a noncurrent deferred income tax liability on the consolidated statement of financial position. Certain intangible assets with nominal tax cost and a carrying value of $185 have indefinite lives and accordingly, the associated deferred income tax liability of $49 (2017 - $49) is not expected to reverse until the assets are disposed of, become impaired or amortizable and as a result is included as part of the noncurrent deferred income tax liability.

The significant components of deferred income tax assets and liabilities were as follows:

	2018	2017 Restated - Note 2
Deferred income tax assets		
Non-capital losses	$ 353	$ 649
Post-employment obligations	171	286
Accounting provisions not currently deductible for tax	67	61
Investment tax credits and recoverable taxes	37	31
Other	28	34
	656	1,061
Deferred income tax liabilities		
Property, equipment and technology-based intangibles	(555)	(554)
Indefinite-lived intangible assets	(49)	(49)
Other	(65)	(51)
	(669)	(654)
Net recognized deferred income tax assets (liabilities)	**(13)**	**407**
Balance sheet presentation		
Deferred income tax assets	39	456
Deferred income tax liabilities	(52)	(49)
Net recognized deferred income tax assets (liabilities)	**(13)**	**407**

The following table presents the variation of the components of deferred income tax balances:

	January 1, 2018 Restated - Note 2	2018 income statement movement	2018 OCI movement	December 31, 2018
Non-capital losses	$ 649	$ (296)	$ -	$ 353
Post-employment obligations	286	73	(188)	171
Accounting provisions not currently deductible for tax	61	6	-	67
Investment tax credits and recoverable taxes	31	6	-	37
Other deferred tax assets	34	(6)	-	28
Property, equipment and technology-based intangibles	(554)	(1)	-	(555)
Indefinite-lived intangible assets	(49)	-	-	(49)
Other deferred tax liabilities	(51)	(14)	-	(65)
Total recognized deferred income tax assets (liabilities)	**$ 407**	**$ (232)**	**$ (188)**	**$ (13)**

At December 31, 2018, the Corporation has deductible temporary differences of a capital nature for which no deferred income tax asset has been recognized at this time as the ability to utilize these tax attributes is limited to future taxable capital gains. Net capital losses do not have an expiry date.

The following are the temporary differences and tax loss carryforwards for which no deferred income tax assets could be recognized:

	2018	2017
Unrealized foreign exchange losses	$ 230	$ 62
Unrecognized net capital losses carryforwards	84	40
Total unrecognized net temporary differences	**$ 314**	**$ 102**
Deferred income tax rate based on combined federal and provincial rates	26.75%	26.79%
Total unrecognized net deferred income tax assets	**84**	**27**

The following are the Federal non-capital tax losses expiry dates:

	Tax Losses
2029	$ 36
2030	39
2031	6
2032	489
2033	403
2034	3
2035	244
2036	3
2037	2
2038	2
Non-capital losses carryforwards	**$ 1,227**

Cash income taxes paid in 2018 by the Corporation were $32 (2017 – $1).

11. SHARE CAPITAL

	Number of shares	Value
At January 1, 2017	**273,212,802**	**$ 797**
Shares issued on the exercise of stock options	3,906,662	14
Shares purchased and cancelled under issuer bid	(4,042,818)	(12)
At December 31, 2017	**273,076,646**	**$ 799**
Shares issued on the exercise of stock options	667,087	8
Shares purchased and cancelled under issuer bid	(3,013,822)	(9)
At December 31, 2018	**270,729,911**	**$ 798**

The issued and outstanding shares of Air Canada, along with the potential shares, were as follows:

		2018	2017
Issued and outstanding			
Class A variable voting shares		125,214,350	115,986,084
Class B voting shares		145,515,561	157,090,562
Total issued and outstanding		**270,729,911**	**273,076,646**
Potential shares			
Stock options	Note 12	6,014,464	6,121,252
Total outstanding and potentially issuable shares		**276,744,375**	**279,197,898**

Shares

As at December 31, 2018, the shares issuable by Air Canada consist of an unlimited number of Class A Variable Voting Shares ("Variable Voting Shares") and an unlimited number of Class B Voting Shares ("Voting Shares"). The two classes of shares have equivalent rights as shareholders except for voting rights. Holders of Variable Voting Shares are entitled to one vote per share unless (i) the number of Variable Voting Shares outstanding, as a percentage of the total number of voting shares of Air Canada exceeds 25% or (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting exceeds 25% 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% 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% of the votes that may be cast at such meeting.

Variable Voting Shares may only be held, beneficially owned or controlled, directly or indirectly, by persons who are not Canadians (within the meaning of the *Canada Transportation Act*). An issued and outstanding Variable Voting Share is converted into one Voting Share automatically and without any further act of Air Canada or the holder, if such Variable Voting Share becomes held, beneficially owned and controlled, directly or indirectly, otherwise than by way of security only, by a Canadian, as defined in the *Canada Transportation Act*.

Voting Shares may only be held, beneficially owned and controlled, directly or indirectly, by Canadians. An issued and outstanding Voting Share is 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 Canadian.

Shareholder Rights Plan

Under the terms of the shareholder rights plan agreement (the "Rights Plan"), effective until the day after Air Canada's 2020 annual meeting of shareholders, one right (a "Right") is issued with respect to each share of Air Canada issued and outstanding. These Rights would become exercisable only when a person, including any party related to it, acquires or announces its intention to acquire 20% or more of the outstanding shares of Air Canada calculated on a combined basis, without complying with the "Permitted Bid" provisions of the Rights Plan or, in certain cases, without the approval of the Board. Until such time, the Rights are not separable from the shares, are not exercisable and no separate rights certificates are issued. To qualify as a "Permitted Bid" under the Rights Plan, a bid must, among other things: (i) be made to all holders of shares, (ii) remain open for a period of not less than 105 days (or such shorter minimum period determined in accordance with National Instrument 62-104 - *Take-Over Bids and Issuer Bids* ("NI 62-104"), (iii) provide that no shares shall be taken up unless more than 50% of the then outstanding shares, other than the shares held by the person pursuing the acquisition and parties related to it, have been tendered and not withdrawn, and (iv) provide that if such 50% condition is satisfied, the bid will be extended for at least 10 days to allow other shareholders to tender.

Following the occurrence of an event which triggers the right to exercise the Rights and subject to the terms and conditions of the Rights Plan, each Right would entitle the holders thereof, other than the acquiring person or any related persons, to exercise their Rights and purchase from Air Canada two hundred dollars' worth of shares for one hundred dollars (i.e. at a 50% discount to the market price at that time). Upon such exercise, holders of rights beneficially owned and controlled by Qualified Canadians would receive Class B Voting Shares and holders of rights beneficially owned or controlled by persons who are not Qualified Canadians would receive Class A Variable Voting Shares.

Issuer Bid

In May 2017, Air Canada received approval from the Toronto Stock Exchange ("TSX") for the renewal of its normal course issuer bid, authorizing, between May 31, 2017 and May 30, 2018, the purchase of up to 22,364,183 shares, representing 10% of the public float as at May 17, 2017. The renewal followed the conclusion of the 2016 normal course issuer bid which expired on May 29, 2017.

In 2017, the Corporation purchased, for cancellation, 4,042,818 shares at an average cost of $17.49 per share for aggregate consideration of $71. The excess of the cost over the average book value of $59 was charged to Retained earnings.

In May 2018, Air Canada received approval from the TSX for the renewal of its normal course issuer bid, authorizing, between May 31, 2018 and May 30, 2019, the purchase of up to 24,040,243 shares, representing 10% of Air Canada's public float as at May 17, 2018. The renewal followed the conclusion of the 2017 normal course issuer bid which expired on May 30, 2018.

In 2018, the Corporation purchased, for cancellation, 3,013,822 shares at an average cost of $24.11 per share for aggregate consideration of $73. The excess of the cost over the average book value of $64 was charged to Retained earnings. At December 31, 2018, a total of 21,940,639 shares remain available for repurchase under the existing issuer bid.

12. SHARE-BASED COMPENSATION

Air Canada Long-Term Incentive Plan

Certain of the Corporation's employees participate in the Air Canada Long-term Incentive Plan (the "Long-term Incentive Plan"). The Long-term Incentive Plan provides for the grant of stock options, performance share units and restricted share units to senior management and officers of Air Canada. With respect to the stock options, 19,381,792 shares were initially authorized for issuance under the Long-term Incentive Plan of which 9,046,974 remain available for future issuance. The outstanding performance share units and restricted share units will not result in the issuance of new shares as these share units will be redeemed for shares purchased on the secondary market (and not issued from treasury) and/or equivalent cash, at the discretion of the Corporation.

Stock Options

The options to purchase shares granted under the Long-term Incentive Plan have a maximum term of seven years and an exercise price based on the fair market value of the shares at the time of the grant of the options. Fifty percent of options are time-based and vest over four years. The remaining options vest based upon performance conditions, which are based on operating margin (operating income over operating revenues) targets established by the Air Canada Board over the same time period. Each option entitles the employee to purchase one share at the stated exercise price. The Long-term Incentive Plan specifies that following retirement an employee may exercise options granted with the rights to exercise continuing for the three years after the retirement date.

The number of Air Canada stock options granted to employees, the related compensation expense recorded and the assumptions used to determine stock-based compensation expense, using the Black-Scholes option valuation model are as follows:

	2018		2017	
Compensation expense ($ millions)	$	9	$	6
Number of stock options granted to Air Canada employees		1,293,091		1,219,976
Weighted average fair value per option granted ($)	$	9.27	$	6.14
Aggregated fair value of options granted ($ millions)	$	12	$	7
Weighted average assumptions:				
Share price	$	26.28	$	14.85
Risk-free interest rate		1.95%-2.48%		0.86%-1.89%
Expected volatility		38.2%		39.6%-49.3%
Dividend yield		0%		0%
Expected option life (years)		5.25		5.25

Expected volatility was determined at the time of grant using the share price on a historical basis. It reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome.

A summary of the Long-term Incentive Plan option activity is as follows:

	2018		2017	
	Options	**Weighted Average Exercise Price/ Share**	Options	Weighted Average Exercise Price/ Share
Beginning of year	6,121,252	$ 8.46	8,985,958	$ 4.92
Granted	1,293,091	26.28	1,219,976	14.73
Exercised	(667,087)	7.90	(3,906,662)	2.30
Expired or cancelled	-	-	(35,148)	4.89
Forfeited	(732,792)	16.32	(142,872)	8.36
Outstanding options, end of year	**6,014,464**	**$ 11.40**	**6,121,252**	**$ 8.46**
Options exercisable, end of year	**2,800,327**	**$ 5.18**	**2,348,815**	**$ 4.29**

The weighted average share price on the date of exercise for options exercised in 2018 was $26.59 (2017 - $19.77).

		2018 Outstanding Options			**2018 Exercisable Options**	
Range of Exercise Prices	**Expiry Dates**	**Number of Options Outstanding**	**Weighted Average Remaining Life (Years)**	**Weighted Average Exercise Price/ Share**	**Number of Exercisable Options**	**Weighted Average Exercise Price/ Share**
$0.96	2019	22,952	1	$ 0.96	22,952	$ 0.96
$2.49 – $5.69	2020	1,603,605	2	2.88	1,603,605	2.88
$5.35 – $8.27	2021	578,680	3	5.39	578,680	5.39
$12.27 – $12.64	2022	583,830	4	12.64	193,481	12.64
$9.23 – $9.61	2023	1,186,834	5	9.26	283,691	9.26
$12.83 – $26.40	2024	954,568	6	14.39	117,919	14.26
$22.53 – $27.75	2025	1,083,995	7	26.49	-	-
		6,014,464		**$ 11.40**	**2,800,328**	**$ 5.18**

		2017 Outstanding Options			2017 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/ Share	Number of Exercisable Options	Weighted Average Exercise Price/ Share
$0.96	2019	40,604	2	$ 0.96	40,604	$ 0.96
$2.49 – $5.69	2020	1,711,049	3	2.89	1,711,049	2.89
$5.35 – $8.27	2021	818,126	4	5.43	257,165	5.44
$12.27 – $12.64	2022	852,965	5	12.56	157,649	12.64
$9.23 – $9.61	2023	1,481,246	6	9.27	182,348	9.27
$12.83 – $26.40	2024	1,217,262	7	14.74	-	-
		6,121,252		**$ 8.46**	**2,348,815**	**$ 4.29**

Performance and Restricted Share Units

The Long-term Incentive Plan also includes performance share units ("PSUs") and restricted share units ("RSUs"). The vesting of PSUs is based on the Corporation achieving its cumulative annual earnings target over a three-year period, while RSUs will vest after three years from their date of grant. The terms of the plan specify that upon the retirement of an employee, the number of units that vest are prorated based on the total number of completed months of active service during the vesting term. The PSUs and RSUs granted may only be redeemed for Air Canada shares purchased on the secondary market and/or equivalent cash at the discretion of the Board of Directors.

The compensation expense related to PSUs and RSUs in 2018 was $21 (2017 – $33).

A summary of the Long-term Incentive Plan share unit activity is as follows:

	2018	2017
Beginning of year	2,706,261	3,052,028
Granted	772,536	922,716
Settled	(694,111)	(1,098,067)
Forfeited	(283,922)	(170,416)
Outstanding share units, end of year	**2,500,764**	**2,706,261**

Refer to Note 15 for a description of derivative instruments used by the Corporation to mitigate the cash flow exposure to the PSUs and RSUs granted.

Employee Share Purchase Plan

Eligible employees can participate in the employee share purchase plan under which employees can invest between 2% and 10% of their base salary for the purchase of shares on the secondary market. For 2018 contributions, Air Canada will match 33.33% of the contributions made by employees. During 2018, the Corporation recorded compensation expense of $12 (2017 – $8) related to the Employee share Purchase Plan.

13. EARNINGS PER SHARE

The following table outlines the calculation of basic and diluted earnings per share:

(in millions, except per share amounts)	2018	2017 Restated - Note 2
Numerator:		
Numerator for basic and diluted earnings per share:		
Net income	$ 167	$ 2,029
Denominator:		
Weighted-average shares	272	273
Effect of potential dilutive securities:		
Stock options	4	5
Total potential dilutive securities	4	5
Adjusted denominator for diluted earnings per share	**276**	**278**
Basic earnings per share	**$ 0.61**	**$ 7.44**
Diluted earnings per share	**$ 0.60**	**$ 7.31**

The calculation of earnings per share is based on whole dollars and not on rounded millions. As a result, the above amounts may not be recalculated to the per share amount disclosed above.

Excluded from the 2018 calculation of diluted earnings per share were 749,000 (2017 – 101,000) outstanding options where the options' exercise prices were greater than the average market price of the shares for the year.

14. COMMITMENTS

Capital Commitments and Operating Leases

Capital commitments consist of the future firm aircraft deliveries and commitments related to the acquisition of other property and equipment. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at December 31, 2018. The Corporation has various operating lease agreements for aircraft, equipment and other property. U.S. dollar amounts are converted using the December 31, 2018 closing rate of CDN$1.3637. Minimum future commitments under these contractual arrangements are shown below.

	2019	2020	2021	2022	2023	Thereafter	Total
Capital commitments	$ 2,382	$ 1,556	$ 815	$ 753	$ 375	$ 195	**$ 6,076**
Operating leases							
Aircraft	561	435	316	243	194	625	**2,374**
Other property	118	92	67	51	36	243	**607**
Total	**$ 3,061**	**$ 2,083**	**$ 1,198**	**$ 1,047**	**$ 605**	**$ 1,063**	**$ 9,057**

The Corporation leases and subleases certain aircraft and spare engines to Jazz, Sky Regional and Air Georgian, which are charged back to Air Canada through their respective CPAs. These are reported net on the consolidated statement of operations. The leases and subleases relate to five Bombardier Q400 aircraft, 12 CRJ-200 aircraft, 25 Embraer 175 aircraft, and 16 spare engines. The lease and sublease revenue and expense related to these aircraft and engines each amount to $95 in 2018 (2017 – $92).

Flow-through Leases

For accounting purposes, the Corporation acts as an agent and subleases certain aircraft to Jazz on a flow-through basis, which are reported net on the consolidated statement of operations. The subleases with Jazz have the same terms and maturity as the Corporation's corresponding lease commitments to the lessors. These subleases relate to five Bombardier Q400 aircraft, ten Bombardier CRJ-200 aircraft, and fifteen Bombardier CRJ-705 aircraft which have final maturities ranging from 2021 to 2025. The sublease revenue and lease expense related to these aircraft each amounted to $77 in 2018 (2017 – $81). The operating lease commitments under these aircraft, which are recovered from Jazz, are not included in the aircraft operating lease commitments table above but are summarized, with U.S. dollar amounts converted using the December 31, 2018 closing rate of CDN$1.3637, as follows:

	2019	2020	2021	2022	2023	Thereafter	Total
Jazz flow-through leases	$ 81	$ 81	$ 72	$ 56	$ 47	$ 22	**$ 359**

Other Contractual Commitments

The future minimum non-cancellable commitment for the next 12 months under the Jazz CPA is approximately $1,218 and under the capacity purchase agreements with other regional carriers is $284. As further discussed in Note 23, the Corporation concluded an agreement to amend and extend its CPA with Jazz in February 2019.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Financial Instruments

	Carrying Amounts				
	December 31, 2018				December 31, 2017
	Financial instruments classification				
	Fair value through profit and loss	Assets at amortized cost	Liabilities at amortized cost	Total	
Financial Assets					
Cash and cash equivalents	$ 630	$ -	$ -	$ 630	$ 642
Short–term investments	4,077	-	-	4,077	3,162
Restricted cash	161	-	-	161	148
Accounts receivable	-	796	-	796	814
Prepaid expenses and other current assets					
Collateral on aircraft financing	-	-	-	-	24
Deposits and other assets					
Restricted cash	171	-	-	171	186
Aircraft related and other deposits	-	135	-	135	128
Derivative instruments					
Share forward contracts	43	-	-	43	54
Foreign exchange derivatives	24	-	-	24	-
	$ 5,106	**$ 931**	**$ -**	**$ 6,037**	**$ 5,158**
Financial Liabilities					
Accounts payable	$ -	$ -	$ 1,793	$ 1,793	$ 1,668
Foreign exchange derivatives	57	-	-	57	215
Current portion of long–term debt and finance leases	-	-	455	455	671
Long–term debt and finance leases	-	-	6,197	6,197	5,448
	$ 57	**$ -**	**$ 8,445**	**$ 8,502**	**$ 8,002**

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

	2018	2017
Share forward contracts	$ -	$ 26
Fuel derivatives	(1)	(3)
Gain (loss) on financial instruments recorded at fair value	**$ (1)**	**$ 23**

Risk Management

Under its risk management policy, the Corporation manages its market risk through the use of various financial derivative instruments. The Corporation uses these instruments solely for risk management purposes, not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be an economic hedge and offset by changes in cash flows of the relevant risk being hedged.

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

Market Risks

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk can be further divided into the following sub-classifications related to the Corporation: fuel price risk, foreign exchange risk, interest rate risk, and share-based compensation risk.

Fuel Price Risk

Fuel price risk is the risk that future cash flows will fluctuate because of changes in jet fuel prices. In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, the Corporation enters into derivative contracts with financial intermediaries. The Corporation may use derivative contracts based on jet fuel, heating oil and crude-oil based contracts. The Corporation's policy permits hedging of up to 75% of the projected jet fuel purchases for the current calendar year, 50% of the projected jet fuel purchases for the next calendar year, and 25% of projected jet fuel purchases for any calendar year thereafter. These are maximum (but not mandated) limits. There is no minimum monthly hedging requirement. There are regular reviews to adjust the strategy in light of market conditions.

During 2018:

- Hedging losses on the settlement of fuel derivatives of $19 and the associated premium costs of $17, for a hedging loss of $36 were reclassified from other comprehensive income to Aircraft fuel expense (net fuel hedging loss of $2 was reclassified from other comprehensive income to Aircraft fuel expense in 2017). No hedge ineffectiveness was recorded.
- The Corporation purchased crude-oil call options and swaps covering a portion of 2018 fuel exposure. The cash premium related to these contracts was $17 ($18 in 2017 for 2017 exposures).
- Fuel derivative contracts cash settled with a fair value of $19 in favour of the counterparties ($26 in favour of the Corporation in 2017).

There were no outstanding fuel derivatives as at December 31, 2018 and December 31, 2017.

Foreign Exchange Risk

The Corporation's financial results are reported in Canadian dollars, while a large portion of its expenses, debt obligations and capital commitments are in foreign currencies, primarily in U.S. dollars. Foreign exchange risk is the risk that fluctuations in foreign exchange rates may have on operating results and cash flows. The Corporation's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

Air Canada generates certain sales in U.S. dollars and in other foreign currencies which are converted to U.S. dollars under the Corporation's risk management program. In 2018, these net operating cash inflows totaled approximately US$4.2 billion and U.S. denominated operating costs amounted to approximately US$6.4 billion. Non-operating cash outflows in U.S. dollars, primarily related to interest payments on U.S. dollar denominated debt and net financing outflows, amounted to approximately US$1.9 billion. For 2018, this resulted in a U.S. dollar net cash flow exposure of approximately US$4.1 billion.

The Corporation has a target coverage of 70% on a rolling 18 month basis to manage the net U.S. dollar cash flow exposure described above utilizing the following risk management strategies:

- Holding U.S. dollar cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash and short-term investment balances as at December 31, 2018 amounted to $863 (US$635) ($686 (US$542) as at December 31, 2017). A portion of the cash and investment reserves are an economic hedge against long-term U.S. dollar debt while the remainder of the cash is operational cash and investment reserves which are applied against the rolling 18 month net U.S. dollar cash flow exposure. In 2018, a gain of $62 (loss of $58 in 2017) was recorded in Foreign exchange gain (loss) reflecting the change in Canadian equivalent market value of the U.S. dollar cash and short-term investment balances held.
- Locking in the foreign exchange rate through the use of a variety of foreign exchange derivatives which have maturity dates corresponding to the forecasted dates of U.S. dollar net outflows.

The level of foreign exchange derivatives entered into and their related maturity dates are dependent upon a number of factors, which include the amount of foreign revenue conversion available, U.S. dollar net cash outflows, as well as the amount attributed to aircraft and debt payments. Based on the notional amount of currency derivatives outstanding at December 31, 2018, as further described below, approximately 77% of net U.S. cash outflows are hedged for 2019 and 48% for 2020, resulting in derivative coverage of 68% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 75% coverage.

As at December 31, 2018, the Corporation had outstanding foreign currency options and swap agreements, settling in 2019 and 2020, to purchase at maturity $4,987 (US$3,659) of U.S. dollars at a weighted average rate of $1.2645 per US$1.00 (2017 – $3,400 (US$2,704) with settlements in 2018 and 2019 at a weighted average rate of $1.2703 per $1.00 U.S. dollar). The Corporation also has protection in place to sell a portion of its excess Euros, Sterling, YEN, and AUD (EUR €103, GBP £208, JPY ¥25,922, and AUD $105) which settle in 2019 and 2020 at weighted average rates of €1.1910, £1.3567, ¥0.0092, and AUD $0.7448 per $1.00 U.S. dollar, respectively (as at December 31, 2017 - EUR €101, GBP £105, JPY ¥8,623, CNY ¥41, and AUD $32 with settlement in 2018 at weighted average rates of €1.1664, £1.3259, ¥0.0090, ¥0.1468 and AUD $0.7576 respectively per $1.00 U.S. dollar).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations, and based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at December 31, 2018 was $33 in favour of the counterparties (2017 – $215 in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2018, a gain of $245 was recorded in Foreign exchange gain (loss) related to these derivatives (2017 – $274 loss). In 2018, foreign exchange derivative contracts cash settled with a net fair value of $63 in favour of the Corporation (2017 – $55 in favour of the counterparties).

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Corporation enters into both fixed and floating rate debt and also leases certain assets where the rental amount fluctuates based on changes in short term interest rates. The Corporation manages interest rate risk on a portfolio basis and seeks financing terms in individual arrangements that are most advantageous taking into account all relevant factors, including credit margin, term and basis. The risk management objective is to minimize the potential for changes in interest rates to cause adverse changes in cash flows to the Corporation. The cash and short-term investment portfolio which earns a floating rate of return is an economic hedge for a portion of the floating rate debt.

The ratio of fixed to floating rate obligations outstanding is designed to maintain flexibility in the Corporation's capital structure and is based upon a long term objective of 60% fixed and 40% floating but allows flexibility to adjust to prevailing market conditions. The ratio at December 31, 2018 is 81% fixed and 19% floating (73% and 27%, respectively as at December 31, 2017).

Share-based Compensation Risk

The Corporation issues RSUs and PSUs to certain of its employees, as described in Note 12, which entitles the employees to receive a payment in the form of one share, cash in the amount equal to market value of one share, or a combination thereof, at the discretion of the Board of Directors.

To hedge the share price exposure, the Corporation entered into share forward contracts to hedge PSUs and RSUs that may vest between 2019 and 2021, subject to the terms of vesting including realization of performance vesting criteria. The forward dates for the share forward contracts coincide with the vesting terms and planned settlement dates of 1,664,142 PSUs and RSUs from 2019 to 2021. These contracts were not designated as hedging instruments for accounting purposes. Accordingly, changes in the fair value of these contracts are recorded in Gain on financial instruments recorded at fair value in the period in which they arise. During 2018, a gain of less than $1 was recorded (2017 – gain of $26). Share forward contracts cash settled with a fair value of $17 in favour of the Corporation in 2018 (2017 – $12), with new contract purchases of $6 for 2021 hedges. As at December 31, 2018, the fair value of the share forward contracts is $43 in favour of the Corporation (2017 – $54 in favour of the Corporation), with those contracts maturing in 2019 valued at $26 recorded in Prepaid expenses and other current assets and the remainder of $17 recorded in Deposits and other assets.

Liquidity risk

The Corporation manages its liquidity needs through a variety of strategies including by seeking to sustain and improve cash from operations, sourcing committed financing for new and existing aircraft, and through other financing activities.

Liquidity needs are primarily related to meeting obligations associated with financial liabilities, capital commitments, ongoing operations, contractual and other obligations. The Corporation 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. At December 31, 2018, unrestricted liquidity was $5,725 comprised of Cash and cash equivalents and Short-term investments of $4,707 and undrawn lines of credit of $1,018. Another important aspect of managing liquidity risk relates to managing the Corporation's financial leverage. Refer to Note 17 Capital Disclosures for a discussion on financial leverage targets.

Cash and cash equivalents include $39 pertaining to investments with original maturities of three months or less at December 31, 2018 ($30 as at December 31, 2017).

A maturity analysis of the Corporation's principal and interest repayment requirements on long-term debt is set out in Note 7, and fixed operating commitments and capital commitments are set out in Note 14.

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. As at December 31, 2018, the Corporation's credit risk exposure consists mainly of the carrying amounts of Cash and cash equivalents, Short-term investments, Accounts receivable and derivative instruments. Cash and cash equivalents and Short-term investments are in place with major financial institutions, various levels of government in Canada, and major corporations. Accounts receivable are generally the result of sales of passenger tickets to individuals, largely through the use of major credit cards, through geographically dispersed travel agents, corporate outlets, or other airlines. Similarly, accounts receivable related to cargo revenues relate to accounts from a large number of geographically dispersed customers. Credit rating guidelines are used in determining derivative counterparties. In order to manage its exposure to credit risk and assess credit quality, the Corporation reviews counterparty credit ratings on a regular basis and sets credit limits when deemed necessary.

Sensitivity Analysis

The following table is a sensitivity analysis for each type of market risk relevant to the significant financial instruments recorded by the Corporation as at December 31, 2018. The sensitivity analysis is based on certain movements in the relevant risk factor. These assumptions may not be representative of actual movements in these risks and may not be relied upon. Given potential volatility in the financial and commodity markets, the actual movements and related percentage changes may differ significantly from those outlined below. Changes in income generally cannot be extrapolated because the relationship of the change in assumption to the change in income may not be linear. Each risk is contemplated independent of other risks; however, changes in one factor may result in changes in one or more several other factors, which may magnify or counteract the sensitivities.

The sensitivity analysis related to derivative contracts is based on the estimated fair value change applicable to the derivative as at December 31, 2018 considering a number of variables including the remaining term to maturity and does not consider the fair value change that would be applicable to the derivative assuming the market risk change was applicable to the maturity date of the derivative contract.

	Interest rate risk		**Foreign exchange rate risk (1)**		**Other price risk (2)**	
	Income		**Income**		**Income**	
	1% increase	1% decrease	5% increase	5% decrease	10% increase	10% decrease
Cash and cash equivalents	$ 6	$ (6)	$ (10)	$ 10	$ -	$ -
Short–term investments	$ 41	$ (41)	$ (33)	$ 33	$ -	$ -
Aircraft related deposits	$ -	$ -	$ (5)	$ 5	$ -	$ -
Long-term debt and finance leases	$ (18)	$ 18	$ 297	$ (297)	$ -	$ -
Share forward contracts	$ -	$ -	$ -	$ -	$ 4	$ (4)
Foreign exchange derivatives	$ -	$ -	$ (240)	$ 234	$ -	$ -

(1) Increase (decrease) in foreign exchange relates to a strengthening (weakening) of the Canadian dollar versus the U.S. dollar. The impact on long-term debt and finance leases includes $9 related to the Canadian dollar versus the Japanese yen. The impact of changes in other currencies is not significant to the Corporation's financial instruments.

(2) The sensitivity analysis for share forward contracts is based upon a 10% increase or decrease in the Air Canada share price.

Covenants in Credit Card Agreements

The Corporation's principal credit card processing agreements for credit card processing services contain triggering events upon which the Corporation is required to provide the applicable credit card processor with cash deposits. The obligations 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 the Corporation and the unrestricted cash and short-term investments of the Corporation. In 2018, the Corporation made no cash deposits under these agreements (nil in 2017).

Financial Instrument Fair Values in the Consolidated Statement of Financial Position

The carrying amounts reported in the consolidated statement of financial position for short term financial assets and liabilities, which includes Accounts receivable and Accounts payable and accrued liabilities, approximate fair values due to the immediate or short-term maturities of these financial instruments. Cash equivalents and Short-term investments are classified as held for trading and therefore are recorded at fair value.

The carrying amounts of derivatives are equal to fair value, which is based on the amount at which they could be settled based on estimated current market rates.

Management estimated the fair value of its long-term debt based on valuation techniques including discounted cash flows, taking into account market information and traded values where available, market rates of interest, the condition of any related collateral, the current conditions in credit markets and the current estimated credit margins applicable to the Corporation based on recent transactions. Based on significant unobservable inputs (Level 3 in the fair value hierarchy), the estimated fair value of debt and finance leases approximates its carrying value.

Following is a classification of fair value measurements recognized in the consolidated statement of financial position using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

	December 31, 2018	Fair value measurements at reporting date using:		
Recurring measurements		**Quoted prices in active markets for identical assets** (Level 1)	**Significant other observable inputs** (Level 2)	**Significant unobservable inputs** (Level 3)
Financial Assets				
Held–for–trading securities				
Cash equivalents	$ 39	$ -	$ 39	$ -
Short–term investments	4,077	-	4,077	-
Derivative instruments				
Share forward contracts	43	-	43	-
Foreign exchange derivatives	24	-	24	-
Total	**$ 4,183**	**$ -**	**$ 4,183**	**$ -**
Financial Liabilities				
Derivative instruments				
Foreign exchange derivatives	57	-	57	-
Total	**$ 57**	**$ -**	**$ 57**	**$ -**

Financial assets held by financial institutions in the form of cash and restricted cash have been excluded from the fair value measurement classification table above as they are not valued using a valuation technique.

The Corporation's policy is to recognize transfers into and transfers out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer. There were no transfers within the fair value hierarchy during 2018.

Offsetting of Financial Instruments in the Consolidated Statement of Financial Position

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position where the Corporation has a legally enforceable right to set-off the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously. In the normal course of business, the Corporation enters into various master netting arrangements or other similar arrangements that do not meet the criteria for offsetting in the consolidated statement of financial position but still allow for the related amounts to be set-off in certain circumstances, such as the termination of the contracts or in the event of bankruptcy or default of either party to the agreement.

Air Canada participates in industry clearing house arrangements whereby certain accounts receivable balances related to passenger, cargo and other billings are settled on a net basis with the counterparty through the clearing house. These billings are mainly the result of interline agreements with other airlines, which are commercial agreements that enable the sale and settlement of travel and related services between the carriers. Billed and work in process interline receivables are presented on a gross basis and amount to $70 as at December 31, 2018 ($75 as at December 31, 2017). These balances will be settled at a net value at a later date; however, such net settlement amount is unknown until the settlement date.

The following table presents the recognized financial instruments that are offset, or subject to enforceable master netting arrangements or other similar arrangements but not offset, as at December 31, 2018 and 2017, and shows in the Net column what the net impact would be on the consolidated statement of financial position if all set-off rights were exercised.

	Amounts offset			Amounts not offset	Net
Financial assets	Gross assets	Gross liabilities offset	Net amounts presented	Financial instruments	
December 31, 2018					
Derivative assets	$ 93	$ (69)	$ 24	$ 43	$ 67
Accounts receivable	113	(47)	66	-	66
	$ 206	**$ (116)**	**$ 90**	**$ 43**	**$ 133**
December 31, 2017					
Derivative assets	$ -	$ -	$ -	$ 54	$ 54
Accounts receivable	114	(48)	66	-	66
	$ 114	**$ (48)**	**$ 66**	**$ 54**	**$ 120**

	Amounts offset			Amounts not offset	Net
Financial liabilities	Gross liabilities	Gross assets offset	Net amounts presented	Financial instruments	
December 31, 2018					
Derivative liabilities	$ 317	$ (260)	$ 57	$ -	$ 57
	$ 317	**$ (260)**	**$ 57**	**$ -**	**$ 57**
December 31, 2017					
Derivative liabilities	$ 286	$ (71)	$ 215	$ -	$ 215
	$ 286	**$ (71)**	**$ 215**	**$ -**	**$ 215**

16. CONTINGENCIES, GUARANTEES AND INDEMNITIES

Contingencies and Litigation Provisions

Investigations by Competition Authorities Relating to Cargo

The European Commission, the United States Department of Justice and the Competition Bureau in Canada, among others investigated alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators. The investigations conducted by the U.S. Department of Justice and by the Competition Bureau in Canada concluded with no proceedings against Air Canada.

After having rendered a decision against a number of airlines, including Air Canada in 2010, which was overturned by the European General Court in December 2015, in March 2017, the European Commission rendered another decision finding that 12 air cargo carriers, including Air Canada, had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006, imposing a fine of 21 Euros (approximately $29) on Air Canada. Air Canada paid the fine as required in the second quarter of 2017, pending the outcome of an appeal to the European General Court. While Air Canada cannot predict with certainty the outcome of its appeal or any related proceedings, Air Canada believes it has reasonable grounds to challenge the European Commission's ruling.

Air Canada is also named as a defendant or is otherwise involved in a number of class action lawsuits and other proceedings in Canada, Europe and the United States in connection with these allegations. The class action proceeding in the United States were settled by Air Canada in 2012, and certain third-party proceedings in the United Kingdom relating to the same allegations were settled in 2018.

As at December 31, 2018, Air Canada has a provision of $17 ($17 as at December 31, 2017) relating to outstanding claims in these matters, which is recorded in Accounts payable and accrued liabilities. This provision is an estimate based upon the status of 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 remaining proceedings and investigations. Based on the outcome of any developments regarding proceedings and investigations, Air Canada may adjust the provision in its results for subsequent periods as required.

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 previous Air Canada-ACPA collective agreement, which incorporated 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, though any such financial liability, if imposed, would not be expected to be material.

Other Contingencies

Various other lawsuits and claims, including claims filed by various labour groups of Air Canada are pending by and against the Corporation and provisions have been recorded where appropriate. It is the opinion of management that final determination of these claims will not have a material adverse effect on the financial position or the results of the Corporation.

Guarantees

Guarantees in Fuel Facilities and De-Icing Arrangements

The Corporation participates in fuel facility arrangements operated through eight Fuel Facility Corporations, and three aircraft de-icing service facilities, along with other airlines that contract for fuel and de-icing services at various major airports in Canada. These entities operate on a cost recovery basis. The aggregate debt of these entities that has not been consolidated by the Corporation under IFRS 10 Consolidated Financial Statements is approximately $571 as at December 31, 2018 (December 31, 2017 - $529), which is the Corporation's maximum exposure to loss before taking into consideration the value of the assets that secure the obligations and any cost sharing that would occur amongst the other contracting airlines. The Corporation views this loss potential as remote. Each contracting airline participating in these entities shares pro rata, based on system usage, in the guarantee of this debt. The maturities of these debt arrangements vary but generally extend beyond five years.

Indemnification Agreements

In the ordinary course of the Corporation's business, the Corporation enters into a variety of agreements, such as real estate leases or operating agreements, aircraft financing or leasing agreements, technical service agreements, and director/officer contracts, and other commercial agreements, some of which may provide for indemnifications to counterparties that may require the Corporation to pay for costs and/or losses incurred by such counterparties. The Corporation cannot reasonably estimate the potential amount, if any, it could be required to pay under such indemnifications. Such amount would also depend on the outcome of future events and conditions, which cannot be predicted. While certain agreements specify a maximum potential exposure, certain others do not specify a maximum amount or a limited period. Historically, the Corporation has not made any significant payments under these indemnifications.

The Corporation expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities.

17. CAPITAL DISCLOSURES

The Corporation views capital as the sum of Long-term debt and finance leases, capitalized operating leases, and the book value of Shareholders' equity less excess cash not required to run its core business operations. The Corporation uses Advance ticket sales as a proxy for the minimum cash required for ongoing core business operations. Previously, the Corporation used the market value of its outstanding shares in the calculation of total capital. Following a significant increase in the book value of its equity, the Corporation decided to change its methodology to use book value. The Corporation includes capitalized operating leases, which is a measure commonly used in the industry ascribing a value to obligations under operating leases. The value is based on annualized aircraft rent expense, including aircraft rent expense related to regional carrier operations, multiplied by 7.0, which is a factor commonly used in the airline industry. The measure used may not necessarily reflect the fair value or net present value related to the future minimum lease payments as the measure is not based on the remaining contractual payments and the factor may not recognize discount rates implicit in the actual leases or current rates for similar obligations with similar terms and risks.

The Corporation also monitors its adjusted net debt and financial leverage ratio. Adjusted net debt is calculated as the sum of Long-term debt and finance lease obligations and capitalized operating leases less Cash and cash equivalents and Short-term investments. Financial leverage is calculated as adjusted net debt over 12 months trailing earnings before interest, taxes, depreciation, amortization and aircraft rent.

The Corporation's main objectives when managing capital are:

- To maintain financial leverage at or below targeted leverage ratios determined by management to be prudent;
- To ensure capital allocation decisions generate sufficient returns and to assess the efficiency with which the Corporation allocates its capital to generate returns.
- To structure repayment obligations in line with the expected life of the Corporation's principal revenue generating assets;
- To ensure the Corporation has access to capital to fund contractual obligations as they become due and to ensure adequate cash levels to withstand deteriorating economic conditions;
- To maintain an appropriate balance between debt supplied capital versus investor supplied capital; and
- To monitor the Corporation's credit ratings to facilitate access to capital markets at competitive interest rates.

In order to maintain or adjust the capital structure, the Corporation may adjust the type or amount of capital utilized, including purchase versus debt financing versus lease decisions, defer or cancel aircraft expenditures by not exercising available options or selling aircraft options, redeeming or issuing debt securities, issuing equity securities, and repurchasing outstanding shares, all subject to market conditions and the terms of the underlying agreements (or any consents required) or other legal restrictions.

The total capital and adjusted net debt as at December 31 is calculated as follows:

	2018	2017
Long-term debt and finance leases	$ 6,197	$ 5,448
Current portion of long-term debt and finance leases	455	671
	6,652	6,119
Capitalized operating leases	3,913	3,801
Adjusted debt	10,565	9,920
Shareholders' equity, net of excess cash	2,043	2,087
Total Capital	**$ 12,608**	**$ 12,007**
Adjusted debt	$ 10,565	$ 9,920
Less Cash and cash equivalents and Short-term investments	(4,707)	(3,804)
Adjusted net debt	**$ 5,858**	**$ 6,116**

18. REVENUE

Disaggregation of revenue

The Corporation disaggregates revenue from contracts with customers according to the nature of the air transportation services. The nature of services is presented as passenger, cargo and other revenue on its consolidated statement of operations. The Corporation further disaggregates air transportation service revenue according to geographic market segments.

A reconciliation of the total amounts reported by geographic region for Passenger revenues and Cargo revenues on the consolidated statement of operations is as follows:

Passenger Revenues	2018	2017 Restated - Note 2
Canada	$ 4,894	$ 4,637
U.S. Transborder	3,504	3,195
Atlantic	4,237	3,539
Pacific	2,430	2,195
Other	1,158	1,027
	$ 16,223	**$ 14,593**

Cargo Revenues	2018	2017 Restated - Note 2
Canada	$ 95	$ 84
U.S. Transborder	43	39
Atlantic	278	245
Pacific	325	280
Other	62	60
	$ 803	**$ 708**

Passenger and cargo revenues are based on the actual flown revenue for flights with an origin and destination in a specific country or region. Atlantic refers to flights that cross the Atlantic Ocean with origins and destinations principally in Europe, India, the Middle East and North Africa. Pacific refers to flights that cross the Pacific Ocean with origins and destinations principally in Asia and Australia. Other passenger and cargo revenues refer to flights with origins and destinations principally in Central and South America and the Caribbean and Mexico.

Other operating revenues are principally derived from customers located in Canada and consist primarily of revenues from the sale of the ground portion of vacation packages, buy on board and related passenger ancillary services and charges, and other airline-related services.

Contract balances

The following table provides information about receivables, contract assets, and contract liabilities from contracts with customers.

	December 31, 2018	December 31, 2017 Restated - Note 2	January 1, 2017 Restated - Note 2
Receivables, which are included in Accounts receivable	$ 575	$ 587	$ 540
Contract costs which are included in Prepaid expenses and other current assets	115	100	98
Contract liabilities – Advance ticket sales	2,717	2,469	2,119

Receivables include passenger, cargo and other receivables from contracts with customers. The Corporation sells passenger ticket and related ancillary services via cash, credit card or other card-based forms of payment with payment generally collected in advance of the performance of related transportation services. Passenger ticket and ancillary receivables are amounts due from other airlines for interline travel, travel agency payment processing intermediaries or credit card processors associated with sales for future travel and are included in Accounts receivable on the consolidated statement of financial position. Cargo and other accounts receivable relate to amounts owing from customers, including from freight forwarders and interline partners for cargo and other services provided.

Contract costs include credit card fees, commissions and global distribution system charges on passenger tickets. These costs are capitalized at time of sale and expensed at the time of passenger revenue recognition.

Airline passenger advance sales and the ground portion of vacation packages are deferred and included in Current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aeroplan. The deferred revenue is recognized when the related flight occurs or over the period of the vacation. The Corporation performs regular evaluations on the advance ticket sales liability. The Corporation records an estimate of breakage revenue for tickets that will expire unused. These estimates are based on historical experience.

Depending on the fare class, passengers may exchange their tickets up to the time of the flight or obtain a refund, generally in exchange for the payment of a fee. For non-refundable tickets that remain unused at the time of flight, the Corporation recognizes the full amount into revenue at time when transportation was to be provided. For refundable tickets that remain unused at the time of the flight, the Corporation recognizes the net revenue as they expire after any refund amount is issued to the passenger.

The practical expedient in IFRS 15 allows entities not to disclose the amount of the remaining transaction prices and its expected timing of recognition for performance obligations if the contract has an original expected duration of one year or less. The Corporation elects to use this practical expedient for the passenger travel performance obligation as passenger tickets expire within a year if unused.

19. REGIONAL AIRLINES EXPENSE

The Corporation has capacity purchase agreements with Jazz, Sky Regional and certain other regional carriers. Expenses associated with these arrangements are classified as regional airlines expense on the consolidated statement of operations. Regional airlines expense consists of the following:

	2018	2017
Capacity purchase fees	$ 1,333	$ 1,267
Aircraft fuel	531	412
Airport and navigation fees	296	293
Sales and distribution costs	153	146
Other operating expenses	529	499
Regional airlines expense	**$ 2,842**	**$ 2,617**

20. SPECIAL ITEMS

In 2017, the Corporation recorded $30 related to cargo investigations, as described in Note 16, and paid the fine to the European Commission as required, pending the outcome of its appeal.

21. SALE-LEASEBACK

In 2018, the Corporation entered into a sale and leaseback arrangement for 25 Embraer 190 aircraft for net proceeds of $293, which resulted in the recognition of a loss on disposal of $188. The aircraft will continue to be operated under leases entered into under such sale-leaseback agreement until they fully exit the fleet progressively through 2019 and 2020, in line with the Corporation's current fleet plans. The leases are accounted for as operating leases.

During 2017, the Corporation took delivery of four 787 aircraft that were financed under sale-leaseback transactions with proceeds of $740. The sales were at fair value and accordingly the resulting gain on sale of $52 was recognized in non-operating income. The leases are accounted for as operating leases with 12 year terms, paid monthly.

22. RELATED PARTY TRANSACTIONS

Compensation of Key Management

Key management includes Air Canada's Board of Directors, President and Chief Executive Officer, Deputy Chief Executive Officer and Chief Financial Officer, and Executive Vice-President and Chief Commercial Officer. The President, Passenger Airlines is also included in the 2017 period. Amounts reported are based upon the expense as reported in the consolidated financial statements. Compensation to key management is summarized as follows:

	2018	2017
Salaries and other benefits	$ 8	$ 11
Pension and post-employment benefits	1	5
Share-based compensation	10	18
	$ 19	**$ 34**

23. SUBSEQUENT EVENTS

Acquisition of Aimia's Aeroplan Loyalty Business

On January 10, 2019, Air Canada completed the closing of its purchase of Aimia Canada Inc., owner and operator of the Aeroplan loyalty business, from Aimia Inc. The aggregate purchase price for the acquisition consisted of $450 in cash plus $47 in cash for pre-closing adjustments. The purchase price is subject to post-closing adjustments and the acquisition also includes the assumption of the Aeroplan Miles liability. Air Canada received payments from The Toronto-Dominion Bank ("TD") and Canadian Imperial Bank of Commerce ("CIBC") in the aggregate amount of $822. Visa Canada Corporation ("Visa") also made a payment to Air Canada and assuming completion of the Amex Bank of Canada ("AMEX") agreement referred to below, AMEX will do likewise.

Concurrently with the conclusion of the Aeroplan purchase, Air Canada, TD, CIBC, and Visa finalized various commercial agreements relating to and in support of the acquisition, including credit card loyalty program and network agreements for future participation in Air Canada's new loyalty program. In addition, TD and CIBC made payments to Aimia Canada Inc., now Air Canada's subsidiary, in the aggregate amount of $400 as prepayments to be applied towards future monthly payments in respect of Aeroplan Miles. Air Canada also has entered into an agreement in principle with AMEX, which also issues Aeroplan co-branded products, to secure its continued participation in Air Canada's loyalty program after 2020. Following the closing of the acquisition, Aimia Canada Inc. changed its name to Aeroplan Inc.

Air Canada, as the acquirer, will perform business combination accounting as of the acquisition date, which generally requires that the acquirer measure the identifiable assets acquired and liabilities assumed at their fair values, subject to certain exceptions. The Corporation is evaluating the impact of the business combination accounting requirements, which results will be reported on in Air Canada's interim unaudited condensed consolidated financial statements and notes for the first quarter of 2019.

Capacity Purchase Agreement with Jazz and Equity Investment in Chorus

In February 2019, Air Canada concluded an agreement to amend and extend its capacity purchase agreement ("CPA") with Jazz, a wholly-owned subsidiary of Chorus Aviation Inc. The amendments provide an extension of the CPA term by ten years from January 1, 2026 to December 31, 2035. The amendments include various minimum levels of covered aircraft at different points in time, providing Air Canada the flexibility to optimize its fleet within its network strategy. The amendments became effective retroactively as at January 1, 2019.

Concurrently with the CPA amendments, Air Canada subscribed for 15,561,600 class B voting shares in the capital of Chorus, representing, at time of issuance, approximately 9.99% of the issued and outstanding class A variable voting shares and class B voting shares of Chorus on a combined basis. This represents an investment of $97 by Air Canada. The Chorus shares were issued to Air Canada at a price of $6.25 per share, representing a 5% premium to the five-day volume weighted average price of the shares as of the close of trading on January 10, 2019. Air Canada and Chorus entered into an investor rights agreement under which, among other things, Air Canada will hold the investment shares for a period of at least 60 months, subject to certain limited exceptions.

DIRECTORS

Christie J.B. Clark	Corporate Director, Toronto, Ontario
Gary A. Doer	Corporate Director, Winnipeg, Manitoba
Rob Fyfe	Corporate Director, Auckland, New Zealand
Michael M. Green	Chief Executive Officer and Managing Director, Tenex Capital Management, New York, New York
Jean Marc Huot	Partner, Stikeman Elliott LLP, Montreal, Quebec
Madeleine Paquin	President and Chief Executive Officer, Logistec Corporation, Montreal, Quebec
Calin Rovinescu	President and Chief Executive Officer, Air Canada, Montreal, Quebec
Vagn Sørensen	Corporate Director, London, United Kingdom
Kathleen Taylor	Corporate Director, Toronto, Ontario
Annette Verschuren	Chair and Chief Executive Officer, NRStor Inc., Toronto, Ontario
Michael M. Wilson	Corporate Director, Bragg Creek, Alberta

OFFICERS

Vagn Sørensen	Chairman of the Board
Calin Rovinescu	President and Chief Executive Officer
Michael Rousseau	Deputy Chief Executive Officer and Chief Financial Officer
Lucie Guillemette	Executive Vice President and Chief Commercial Officer
Craig Landry	Executive Vice President, Operations
Catherine Dyer	Senior Vice President and Chief Information Officer
Amos Kazzaz	Senior Vice President, Finance
Arielle Meloul-Wechsler	Senior Vice President, People, Culture and Communications
Ferio Pugliese	Senior Vice President, Government Relations and Air Canada Express
David J. Shapiro	Senior Vice President, International and Regulatory Affairs and Chief Legal Officer
Richard Steer	Senior Vice President, Operations
Duncan Bureau	President, Air Canada Rouge
Samuel Elfassy	Vice President, Safety
Mark Galardo	Vice President, Network Planning
Carolyn M. Hadrovic	Vice President and Corporate Secretary
Chris Isford	Vice President and Controller
John MacLeod	Vice President, Global Sales and Alliances
Mark Nasr	Vice President, Loyalty and eCommerce
Kevin O'Connor	Vice President, System Operations Control
Al Read	Vice President, Airports – North America
Renee Smith-Valade	Vice President, In-Flight Service
Tim Strauss	Vice President, Cargo
Murray Strom	Vice President, Flight Operations
Jon Turner	Vice President, Maintenance
Andrew Yiu	Vice President, Product

INVESTOR AND SHAREHOLDER INFORMATION

TSX price range and trading volume of Air Canada variable voting shares and voting shares (AC)

2018	High	Low	Volume traded
1st Quarter	$ 29.11	$ 22.05	83,265,443
2nd Quarter	$ 26.81	$ 20.33	68,206,296
3rd Quarter	$ 28.44	$ 20.63	71,010,035
4th Quarter	$ 29.39	$ 22.57	90,088,941
			312,570,715

Restrictions on voting securities

In 2018, the Canadian Government passed *An Act to amend the Canada Transportation Act and other Acts respecting transportation and to make related and consequential amendments to other Acts* (also known as the "Transportation Modernization Act"). This Act, among other things, amended the *Canada Transportation Act* ("CTA") by increasing, from 25% to 49%, the permitted level of foreign ownership of Canadian air carriers, while capping the voting rights of any single non-Canadian and of the aggregate of non-Canadian air carriers to 25%. Air Canada will seek shareholder approval at its 2019 annual and special meeting of shareholders to amend its articles of incorporation to increase the limits of foreign ownership and control of its voting shares to those permitted by these CTA amendments. The amendments to its articles is being undertaken by way of a court supervised and shareholder approved statutory plan of arrangement and will be subject to shareholder approval and approval of the Quebec Superior Court.

For further information

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Air Canada complies with the rules adopted by the Toronto Stock Exchange.

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English or French, it's the client's choice

Official Languages at Air Canada

For Air Canada, offering service in the language chosen by its customers is essential. Verbal exchanges with clients, public-address announcements at the airport and on board as well as briefing of passengers with special needs all constitute the very heart of customer service and call upon our employees' linguistic skills at all times. Our consideration to bilingualism not only makes good sense customerwise but also supports our legal obligations to serve the public in the two official languages of Canada.

Air Canada puts great efforts to better serve clients in the language of their choice. It is through reach-out activities with the minority language communities as well as ongoing employee awareness and training that we can face the daily challenges, whether it is the growing difficulty to recruit bilingual candidates outside the province of Quebec and the national capital region, or for our employees to maintain their language skills with very little opportunities to practice the acquired language in some regions of the country.

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AIR CANADA

Corporate profile

aircanada.com

Air Canada is Canada's largest domestic and international airline, serving more than 220 airports on six continents. Canada's flag carrier is among the 20 largest airlines in the world and in 2018 served nearly 51 million customers. In 2018, Air Canada, together with Jazz, Sky Regional and other regional airlines operating flights on behalf of Air Canada under capacity purchase agreements, operated, on average, 1,613 daily scheduled flights, comprised of 64 Canadian cities, 60 destinations in the United States and a total of 98 cities in Europe, Africa, the Middle East, Asia, Australia, the Caribbean, Mexico, and South America.

Air Canada is a founding member of the Star Alliance® network. Through the 28-member airline network, Air Canada offers its customers access to 1,317 destinations in 193 countries, as well as reciprocal participation in frequent flyer programs and the use of airport lounges and other common airport facilities.

Air Canada is the only international network carrier in North America to receive a Four-Star ranking according to independent U.K. research firm Skytrax, which also named Air Canada the Best Airline in North America for 2018.

Canada's Top 100 Employers 2018

2018 CANADA'S BEST DIVERSITY EMPLOYERS

WORLD AIRLINE SKYTRAX AWARDS 2018

Voted Best Airline in North America

A STAR ALLIANCE MEMBER