2019

ANNUAL REPORT

AIR CANADA

A STAR ALLIANCE MEMBER

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			FULL YEAR		
	2019 (1)	2018	$ CHANGE	2019 (1)	2018	$ CHANGE
FINANCIAL PERFORMANCE METRICS						
Operating revenues	4,429	4,227	202	19,131	18,003	1,128
Operating income	145	179	(34)	1,650	1,496	154
Income (loss) before income taxes	172	(391)	563	1,775	228	1,547
Net income (loss)	152	(360)	512	1,476	37	1,439
Adjusted pre-tax income (2)	66	68	(2)	1,273	1,036	237
Adjusted net income (2)	47	55	(8)	917	738	179
Operating margin %	3.3%	4.2%	(0.9) pp	8.6%	8.3%	0.3 pp
EBITDA (2)	665	619	46	3,636	3,213	423
EBITDA margin % (2)	15.0%	14.6%	0.4 pp	19.0%	17.8%	1.2 pp
Unrestricted liquidity (3)	7,380	5,725	1,655	7,380	5,725	1,655
Net cash flows from operating activities	677	548	129	5,712	3,470	2,242
Free cash flow (2)	426	288	138	2,075	1,327	748
Net debt (2)	2,841	5,214	(2,373)	2,841	5,214	(2,373)
Return on invested capital ("ROIC") % (2)	15.5%	13.5%	2.0 pp	15.5%	13.5%	2.0 pp
Leverage ratio (2)	0.8	1.6	(0.8)	0.8	1.6	(0.8)
Diluted earnings (loss) per share	$ 0.56	$ (1.33)	$ 1.89	$ 5.44	$ 0.13	$ 5.31
Adjusted earnings per share – diluted (2)	$ 0.17	$ 0.20	$ (0.03)	$ 3.37	$ 2.67	$ 0.70
OPERATING STATISTICS (4)			% CHANGE			% CHANGE
Revenue passenger miles ("RPM") (millions)	21,403	20,801	2.9	94,113	92,360	1.9
Available seat miles ("ASM") (millions)	26,431	25,597	3.3	112,814	110,866	1.8
Passenger load factor %	81.0%	81.3%	(0.3) pp	83.4%	83.3%	0.1 pp
Passenger revenue per RPM ("Yield") (cents)	18.6	18.2	2.3	18.3	17.5	4.6
Passenger revenue per ASM ("PRASM") (cents)	15.0	14.7	2.0	15.3	14.6	4.8
Operating revenue per ASM (cents)	16.8	16.5	1.5	17.0	16.2	4.4
Operating expense per ASM ("CASM") (cents)	16.2	15.8	2.5	15.5	14.9	4.1
Adjusted CASM (cents) (2)	11.7	11.1	5.5	10.9	10.3	6.1
Average number of full-time equivalent ("FTE") employees (thousands) (5)	33.3	30.5	9.2	32.9	29.9	10.1
Aircraft in operating fleet at period-end (6)	403	400	0.8	403	400	0.8
Average fleet utilization (hours per day)	10.1	9.7	3.8	10.6	10.4	2.1
Seats dispatched (thousands)	15,506	15,184	2.1	64,653	63,800	1.3
Aircraft frequencies (thousands)	130.3	137.7	(5.4)	548.5	578.9	(5.3)
Average stage length (miles) (7)	1,705	1,686	1.1	1,745	1,738	0.4
Fuel cost per litre (cents)	75.0	84.3	(11.0)	76.1	80.4	(5.4)
Fuel litres (thousands)	1,349,573	1,293,063	4.4	5,713,924	5,597,232	2.1
Revenue passengers carried (thousands) (8)	12,048	11,909	1.2	51,543	50,904	1.3

(1) Air Canada began consolidating Aeroplan Inc.'s (formerly, Aimia Canada Inc, "Aeroplan") financial results on January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 14 "Accounting Policies" and section 15 "Critical Accounting Estimates and Judgments" of Air Canada's MD&A for additional information.

(2) Adjusted pre-tax income (loss), adjusted net income (loss), EBITDA (earnings before interest, taxes, depreciation and amortization), EBITDA margin, free cash flow, ROIC, leverage ratio, adjusted earnings (loss) per share–diluted and adjusted CASM are each non-GAAP financial measures and net debt is an additional GAAP measure. Refer to section 22 of Air Canada's MD&A for descriptions of Air Canada's non-GAAP financial measures and additional GAAP measures.

(3) Unrestricted liquidity refers to the sum of cash, cash equivalents and short and long-term investments, and the amount of available credit under Air Canada's revolving credit facilities. At December 31, 2019, unrestricted liquidity was comprised of cash, cash equivalents and short-term investments of $5,889 million, long-term investments of $512 million and undrawn lines of credit of $979 million. 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.

(4) Except for the reference to average number of FTE employees, operating statistics in this table include third party carriers operating under capacity purchase agreements with Air Canada.

(5) Reflects FTE employees at Air Canada and its subsidiaries. Excludes FTE employees at third party carriers operating under capacity purchase agreements with Air Canada.

(6) At December 31, 2019, the number of aircraft in Air Canada's operating fleet included 24 Boeing 737 MAX aircraft which are grounded and excluded aircraft under wet lease arrangements. Refer to section 9 "Fleet" of Air Canada's MD&A for additional information.

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

(8) 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.

MESSAGE FROM
THE PRESIDENT AND CHIEF
EXECUTIVE OFFICER

CALIN ROVINESCU

We were put to a significant test in 2019 – nearly 10 years to the day after we first undertook to transform Air Canada into a global champion. Despite the worldwide grounding of the Boeing 737 MAX, which deprived us of about 25% of our narrow-body fleet for most of the year, we still produced strong and, for some metrics, record results in 2019. Our performance in the face of such prolonged adversity is proof of the success of our transformation, the nimbleness of our organization and the consistency of our earnings.

During the year, we generated record operating revenue of $19.131 billion and ended 2019 with record unrestricted liquidity of $7.380 billion. We performed well on other key metrics too, with EBITDA [(1)] of $3.636 billion, an increase of $423 million or 13%, and operating income of $1.650 billion, an increase of $154 million or 10%, when compared to 2018.

On a capacity increase of 1.8%, record system passenger revenues of $17.232 billion increased $1.071 billion or 6.6% from 2018. It was our 10th consecutive year of revenue growth, and our efforts were rewarded by an 87% return on our shares in 2019. According to the Bloomberg World Airlines index, Air Canada was the best performing airline stock of 2019 and one of the best performers on the TSX. Moreover, it was the top performing stock from all industries on the TSX over the entire decade from January 1, 2010 to December 31, 2019 with a 3,575% return.

Complementing our strong revenue performance was laser-focused and disciplined cost control in the face of challenging circumstances. In 2019, operating expenses of $17.481 billion increased $974 million or 6% from 2018. Air Canada's cost per available seat mile (CASM) increased 4.1% from 2018. The airline's adjusted CASM [(1)] increased 6.1% from 2018. These unit cost increases arose, in large part, from the fact that our system ASMs only increased by 1.8% versus planned growth of approximately 4.8% due to the absence of the Boeing 737 MAX in our fleet for most of the year. There were also unplanned incremental higher costs incurred in relation to the Boeing 737 MAX grounding associated with replacement aircraft, wet leases and ongoing operating expenses, including depreciation and unproductive pilot wages.

In 2019, net cash flows from operating activities of $5.712 billion increased $2.242 billion from 2018. Free cash flow [(1)] of $2.075 billion increased $748 million from 2018 on higher cash flows from operating activities and a lower level of capital expenditures year-over-year, in large part due to the deferral of previously scheduled Boeing 737 MAX aircraft deliveries into subsequent years.

We ended the year with net debt [1] of $2.841 billion, a decrease of $2.373 billion from December 31, 2018, attributable to an increase in cash, cash equivalents and short- and long-term investment balances of $1.694 billion, and a decrease in long-term debt and lease liabilities (including current portion) of $679 million. At year-end, Air Canada's leverage ratio [1] was 0.8 compared to a leverage ratio of 1.6 at December 31, 2018, a significant improvement and at an "investment grade" level.

For the 12 months ended December 31, 2019, return on invested capital (ROIC) [1] was 15.5%. Air Canada's ROIC at December 31, 2019 was significantly higher than its weighted average cost of capital of 7.0%.

During 2019, we carried 51.5 million customers, a record for our company. While safety is paramount when transporting our customers, we are also very proud of our consistent delivery of excellent customer service. For the third year in a row and the eighth time in 10 years, Air Canada was voted Best Airline in North America at the Skytrax World Airline Awards, based on a survey of more than 21 million global travellers. We remain the only Skytrax four-star network carrier in North America.

For investors, consistency of results is almost as important as their quality. This provides certainty and assurance that a company can manage through cycles that all industries face and which the airline industry has historically experienced more than other industries. Consistency of results and meeting guidance to investors have been a key focus and integral to our transformation.

To achieve our objectives, we identified four core priorities that have remained constant and have guided us for nearly a decade.

The first of these, Revenue Generation and Cost Control, has been foundational to our success. Not only have we grown revenue consistently, but the quality of that revenue has also improved.

In 2019, the increase in system passenger revenue was driven by a yield improvement of 4.6% and traffic growth of 1.9%. The yield improvement, particularly in North America, was due to capacity constraints brought on by the Boeing 737 MAX grounding as well as a generally improved pricing environment. The yield improvement also reflected additional revenue from Aeroplan flight redemptions and other revenue subsequent to the Aeroplan acquisition on January 10, 2019 [2].

CONSISTENCY OF RESULTS AND MEETING GUIDANCE TO INVESTORS HAVE BEEN A KEY FOCUS AND INTEGRAL TO OUR **TRANSFORMATION.**

(1) EBITDA, adjusted CASM, free cash flow, ROIC and leverage ratio are each non-GAAP financial measures and net debt is an additional GAAP measure. Non-GAAP financial measures do not have any standardized meaning under GAAP and therefore may not be comparable to similar measures presented by other issuers. Refer to section 22 of Air Canada's 2019 MD&A for descriptions of Air Canada's non-GAAP financial measures and additional GAAP measures.

(2) Air Canada began consolidating Aeroplan's financial results on the date of the acquisition of Aeroplan, January 10, 2019.

To leverage our revenue performance, we constantly strive to manage and reduce costs. In 2019, this included the completion of a two-year $250 million Cost Transformation Program, a renewed Capacity Purchase Agreement with Jazz that we estimate will save $50 million annually, and the continued renewal of our narrow-body fleet, with the introduction of our Airbus A220 aircraft that are much more efficient on a unit cost basis than the aircraft they replace.

Due to these and other measures, passenger revenue growth exceeded operating expense growth during the year. We achieved this despite the increased costs associated with the Boeing 737 MAX grounding, which we estimate accounted for 3.6 percentage points of the 6.1 percentage point increase in adjusted CASM over 2018.

Our second priority remains Global Expansion. Since we first began our expansion a decade ago, we have grown capacity by over 90%, with most of that coming from new international services. Our international routes are supported by our partners in Star Alliance and through our joint ventures with United Airlines and the Lufthansa Group on the transatlantic and with Air China on the transpacific. Diversifying our network is key to our resiliency when facing changing market conditions. In 2019, we continued our international drive with the launch of new services, including to Auckland, Quito and Bordeaux, and we announced new services to Bogotá and Toulouse for 2020.

Key to our international growth has been our ability to attract international-to-international connecting traffic from the U.S., with our share of the U.S.-to-international market quadrupling from 2013 to 2019. To do this, we have established three powerful hubs in Toronto, Montréal and Vancouver, where we continue to enhance the connection process. We also continue to enhance our transborder network, including offering service between new city pairs and flying efficient aircraft. In 2019, we took another step to strengthen this initiative with the arrival into our fleet of the Airbus A220 (formerly the Bombardier C-Series), whose range and economics will enable us to open more U.S. routes. We have already announced new transborder services for 2020 using the A220 between Montréal and Seattle and Toronto and San Jose, California. In its short time in our fleet, the state-of-the-art Airbus A220 aircraft has earned rave reviews from customers.

KEY TO OUR INTERNATIONAL GROWTH HAS BEEN OUR ABILITY TO ATTRACT **INTERNATIONAL-TO-INTERNATIONAL CONNECTING TRAFFIC** FROM THE U.S.

This feeds into another priority, Customer Engagement. As mentioned, Air Canada again won the Skytrax award for Best Airline in North America. In addition, Skytrax recognized our Toronto Signature Suite as the World's Best Business Class Lounge Dining Experience, and we were also named the Best Business Class in North America.

In 2019, we made substantial progress on two long-term initiatives to significantly improve our business over the long term. One is the implementation of a new reservation system that will greatly enhance our customer service capability, including through better handling of irregular operations and an increased ability to work with our Star Alliance partners to enrich the travel options we can offer customers. This was a major program entailing 700,000 hours of development work and we implemented the first phase involving our reservations, inventory and ticketing functions. The second phase, transitioning airports to the new system, will be completed in the first half of 2020.

A second transformational customer initiative is our new loyalty program. At the beginning of 2019, Air Canada completed its purchase of the Aeroplan program. While the acquisition has already contributed positively to our 2019 results, we will truly begin to reap the benefits when we relaunch Aeroplan later this year. Our goal is to have the best loyalty program in Canada and one of the best airline loyalty programs in the world.

Our final priority, Culture Change, is foundational to everything we do at Air Canada and encompasses the passion, dedication and teamwork of our people that enable us to succeed. The culture we built over the last decade was on full display in 2019, as the grounding of the Boeing 737 MAX tested and brought out the best of our 37,000 people. Everyone throughout the organization worked hand in hand to deliver 97% of our planned schedule for the year, under most challenging circumstances.

Our culture at Air Canada has been repeatedly recognized, including by Air Canada being named one of Canada's Top 100 Employers, one of Montréal's Top Employers, and one of the 50 Most Engaged Workplaces. As a global carrier, a great strength of our culture is diversity, which we have cultivated. Today visible minorities represent 26% of the Air Canada team and we have 60 spoken languages in our workplaces. As well, close to 45% of our workforce are women. We have been consistently recognized as one of Canada's Best Diversity Employers.

WE WILL TRULY BEGIN TO REAP THE BENEFITS WHEN WE RELAUNCH AEROPLAN LATER THIS YEAR. **OUR GOAL IS TO HAVE THE BEST LOYALTY PROGRAM IN CANADA AND ONE OF THE BEST AIRLINE LOYALTY PROGRAMS IN THE WORLD.**

This emphasis on diversity also speaks to a broader focus on corporate sustainability and social responsibility. In this year's annual report, we have included a discussion on some of our environment, social and governance initiatives. These include participating in industry emissions reduction targets, reducing waste and promoting recycling, supporting alternative fuel development, equipping employees with tools, resources and advice to help manage mental health, financial and overall wellbeing, and growing the professional development of employees.

Beyond being the right thing to do, we recognize that sustainability and social responsibility are increasingly a key criterion for investor decisions. Moreover, corporate sustainability reinforces and binds all our core priorities. Fuel efficiency saves money, participating in sectoral climate plans facilitates global expansion from a regulatory and reputational perspective, our customers expect us to conduct business responsibly and employees take pride in working for an ethical company.

After a decade of transformation, we have discovered it is habit-forming and therefore there is no intention to relent. For 2020 and beyond, we have a number of projects underway, most notably our proposed acquisition of Transat A.T. Inc. Others will drive our core priorities, including opening a new Air Canada Signature Suite in Vancouver, launching more market-specific chef partnerships and improvements to onboard service, expanding the use of Artificial Intelligence, and continuing deliveries of Airbus A220 aircraft.

Now, along with the rest of our industry, and many other industries globally, we are facing a new challenge with the Coronavirus, or COVID-19. However, our strong balance sheet, extensive and diversified network, brand strength and talented and nimble people will allow us to respond effectively to this challenge.

On a personal note, in 2019, I marked my tenth anniversary as President and Chief Executive Officer of Air Canada. Throughout this time, I have enjoyed and am deeply appreciative of the unwavering support shown by our very talented leadership team, by our highly engaged Board of Directors and our long-term shareholders, who have stuck with us through numerous challenges over the years.

I especially want to thank our 37,000 people and our 34,000 retired employees, who have been at the core of our success. Change is never easy and by embracing wholeheartedly such an all-encompassing and open-ended program of transformation, they have proven their deep commitment to our company and to everyday delivery of customer service excellence. As well, I thank our customers and assure them that all of us at Air Canada will continue to work hard to earn and retain their loyalty.

Calin Rovinescu
President and Chief Executive Officer
March 2, 2020

CITIZENS OF THE WORLD

Being a sustainable global champion involves doing what is right for the longer-term interest of one's shareholders, employees, customers, communities and other stakeholders. Air Canada aims to create long-term stakeholder value through the implementation of initiatives that focus on ethical, social, environmental, cultural and economic dimensions of doing business.

Air Canada's achievements in this regard are reported through its Corporate Sustainability Report *Citizens of the World* (using the Global Reporting Initiative standards) and the Carbon Disclosure Project ("CDP") report. Certain indicators, including Scope 1 and 2 emissions, are verified by an external party, following internationally recognized standards.

In 2019, Air Canada was proud to have been the first Canadian airline to confirm its commitment to achieving the Sustainable Development Goals and join the UN Global Compact that encourages all businesses to adopt sustainable, socially responsible practices.

Following is a brief discussion of Air Canada's progress on its corporate sustainability objectives identified for 2019.

ACHIEVED

– Rank in the top 3% of airlines included in the IATA Operational Safety Audit.

– Manage the safety risk and hazards associated with the introduction of the Airbus A220 aircraft, new routes and new initiatives or projects.

IN PROGRESS

– Implement all necessary training and other measures required to effectively reintroduce the Boeing 737 MAX in operations when appropriate.

– Deploy the Multi-Factor Authenticator Program to our entire employee base.

– Pursue the privacy action plan.

SAFETY

IN PROGRESS

– Continue to act on the 2020 Corporate Waste Strategy through the following:
  - Single-Use Plastics Reduction Program
  - Expansion of the collection and recycling process in certain Maple Leaf Lounges
  - Centralization of waste infrastructure at our Montréal headquarters
  - Continuous improvement audits to the Onboard Domestic Recycling Program.

– Advocacy with federal and provincial governments on effective climate policy development for the aviation sector in Canada.

ENVIRONMENT

ACHIEVED

- Support the implementation of the Amadeus Altéa Suite passenger service system by initiating training for more than 10,000 employees.
- Create a change management Centre of Excellence.
- Further develop the Emerging Leaders Program.

EMPLOYEES

ACHIEVED

- 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 $2 million (net).

COMMUNITIES

2019

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 under the brand name Air Canada Vacations® ("Air Canada Vacations"), Air Canada Rouge LP, doing business under the brand name Air Canada Rouge® ("Air Canada Rouge") and, effective January 10, 2019, Aeroplan Inc. ("Aeroplan"). 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 2019. This MD&A should be read in conjunction with Air Canada's audited consolidated financial statements and notes for 2019. 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.

In September 2019, the IFRS Interpretations Committee finalized its decision that an entity should account for its obligations to compensate passengers for delayed or cancelled flights as variable consideration under IFRS 15 – Revenue from Contracts with Customers. Air Canada adopted this accounting treatment in the fourth quarter on a retrospective basis, with 2018 restated. Previously, Air Canada recognized passenger compensation costs by applying IAS 37 Provisions, Contingent Liabilities and Contingent Assets. While there is no impact to the amount of passenger compensation recognized, presentation within Air Canada's consolidated statement of operations is impacted as the compensation is reclassified against passenger revenue. Refer to section 14 "Accounting Policies" of this MD&A for additional information.

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 23 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of February 17, 2020.

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 20 "Risk Factors" of this MD&A. Air Canada issued a news release dated February 18, 2020, reporting on its results for the fourth quarter and the full year of 2019. 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 guidance, 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, economic and geopolitical conditions, the timing and conditions of the return to service of Boeing 737 MAX aircraft in our fleet (including the introduction of those on order and the management of our fleet and operations until their return to service or introduction), industry and market conditions and the demand environment, competition, energy prices, our dependence on technology, our ability to successfully implement appropriate strategic and other important initiatives (including our ability to reduce operating costs), cybersecurity risks, war, terrorist acts, epidemic diseases, our dependence on key suppliers, casualty losses, changes in laws, regulatory developments or proceedings, our ability to successfully launch and operate our new loyalty program, climate change and environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), interruptions of service, our dependence on regional and other carriers, our ability to preserve and grow our brand, employee and labour relations and costs, our dependence on Star Alliance® and joint ventures, limitations due to restrictive covenants, our ability to pay our indebtedness and maintain liquidity, pending and future litigation and actions by third parties, currency exchange, pension plans, our ability to attract and retain required personnel, 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 20 "Risk Factors" of this MD&A. Furthermore, the acquisition of Transat A.T. Inc. is subject to regulatory approvals and certain customary conditions, and there are no assurances that the acquisition will be completed as described in this MD&A or at all. 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.

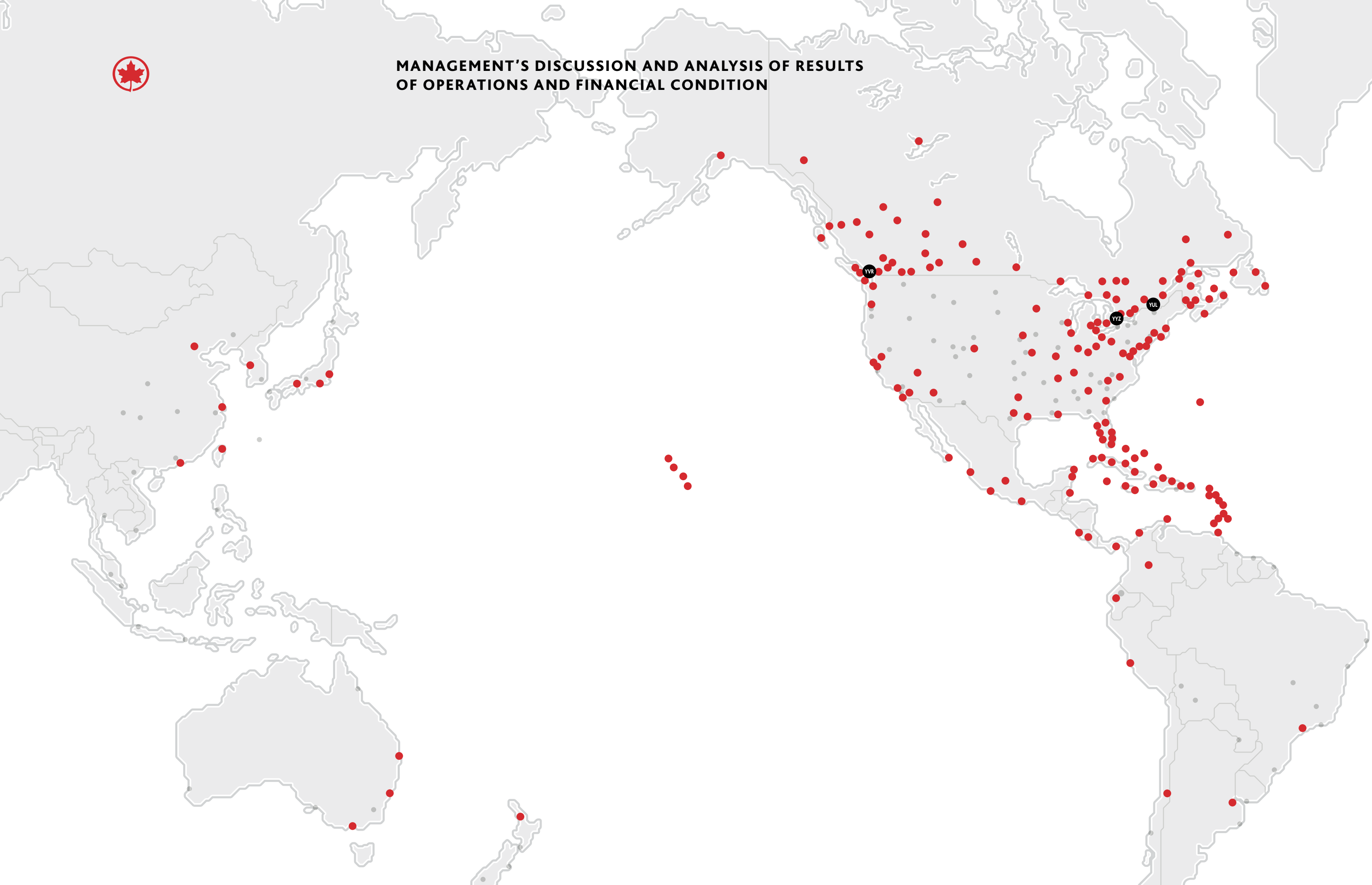
KEY ASSUMPTIONS

Assumptions were made by Air Canada in preparing and making forward-looking statements. As part of its assumptions, Air Canada assumes relatively modest Canadian GDP growth for the first quarter and full year 2020. Air Canada also expects that the Canadian dollar will trade, on average, at C$1.33 per U.S. dollar in the first quarter and the full year 2020. Air Canada also assumes that the price of jet fuel will average 71 CAD cents per litre in the first quarter and 74 CAD cents per litre for the full year 2020. Air Canada also assumes that the return to service of the Boeing 737 MAX aircraft will gradually commence late in the third quarter of 2020. It is premature to assess what the impact of Air Canada's planned acquisition of Transat A.T. Inc. would be, and it is therefore not factored into Air Canada's forward-looking statements.

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 ™ 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 the international market to and from Canada. Its mission is connecting Canada and the world.

In 2019, 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, 1,531 daily scheduled flights to 217 direct destinations on six continents. Those destinations were comprised of 62 Canadian destinations, 56 destinations in the United States and a total of 99 cities in Europe, Africa, the Middle East, Asia, Oceania, the Caribbean, Mexico and South America.

At December 31, 2019, Air Canada mainline had an operating fleet of 188 aircraft, comprised of 94 Boeing and Airbus narrow-body aircraft (including 24 Boeing 737 MAX aircraft which were grounded in March 2019 – refer to section 9 "Fleet" of this MD&A for additional information), 80 Boeing and Airbus wide-body aircraft, and 14 Embraer 190 regional jets. Air Canada Rouge operated a fleet of 64 aircraft, comprised of 22 Airbus A319 aircraft, 14 Airbus A321 aircraft, three Airbus A320 aircraft and 25 Boeing 767-300ER aircraft.

Air Canada enhances its domestic and transborder network through capacity purchase agreements ("CPAs") with regional airlines operating flights on behalf of Air Canada. These regional carriers, operating under the banner of Air Canada Express, 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, 2019, the Air Canada Express fleet was comprised of 48 Bombardier regional jets, 73 Bombardier Dash-8 turboprop aircraft and 25 Embraer 175 aircraft, for a total of 146 aircraft. At December 31, 2019, a total of five 18-passenger Beech 1900 aircraft were also operated by regional airlines on behalf of Air Canada.

Air Canada is a founding member of the Star Alliance® network. Through the 26-member airline network, Air Canada offers its customers access to more than 1,300 destinations in 195 countries, as well as reciprocal participation in frequent flyer programs and the use of airport lounges and other common airport facilities.

Air Canada builds customer loyalty through the Aeroplan® loyalty program. Aeroplan members can earn Aeroplan Miles with over 100 partners and redeem them for Flight Rewards with Air Canada and over 30 partner airlines, as well as for a wide range of non-air rewards. Air Canada Altitude offers eligible Aeroplan members 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.

Air Canada has 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. It operates 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. It also offers cruise packages in North America, Europe and the Caribbean.

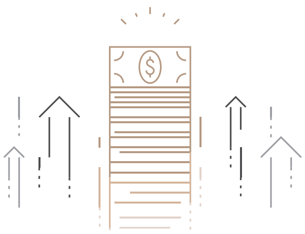
Air Canada Cargo, Canada's largest provider of air cargo services, as measured by cargo capacity, provides direct cargo services to over 150 Canadian, U.S. transborder and international destinations and has sales representation in over 50 countries. Air cargo services are provided across the Air Canada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

4. STRATEGY

Air Canada's principal objective is to be 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. Air Canada works towards its global champion goal by focusing on the following four core priorities:

1

REVENUE ENHANCEMENT AND COST TRANSFORMATION



Identifying and implementing cost reduction and revenue enhancing initiatives.

2

LEVERAGING INTERNATIONAL NETWORK

Pursuing profitable international growth opportunities and leveraging its competitive attributes to expand margins, in large part by increasing connecting traffic through its strategic international gateways in Toronto, Vancouver and Montréal, while continuing to grow and compete effectively in both the business and leisure markets to and from Canada.

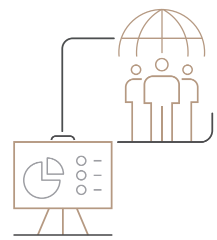
3

CUSTOMER ENGAGEMENT

Engaging customers by continually enhancing their travel experience and by consistently achieving customer service excellence.

4

CULTURE CHANGE



Fostering positive culture change, which includes making meaningful investments in training and other tools that support delivering exceptional customer experiences and 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 savings and 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 2019

- ✓ Record operating revenue of $19,131 million, an increase of $1,128 million or 6.3% from 2018.
- ✓ Record 51.5 million passengers carried, an increase of 1.3% from 2018.
- ✓ EBITDA margin of 19.0%, consistent with the 2019 EBITDA margin of approximately 19% forecast in Air Canada's news release dated October 29, 2019 (versus an EBITDA margin of 17.8% in 2018). Operating income of $1,650 million in 2019 reflected an increase of $154 million from 2018. EBITDA is a non-GAAP financial measure. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.
- ✓ ROIC of 15.5%, within the range of the 2019 ROIC of approximately 15.5% to 16.0% forecast in Air Canada's news release dated October 29, 2019 (versus a ROIC of 13.5% in 2018). ROIC is a non-GAAP financial measure. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.
- ✓ Record unrestricted liquidity of $7,380 million.
- ✓ Successfully completed a two-year $250 million Cost Transformation Program to December 31, 2019, achieving annual savings in excess of $250 million.
- ✓ Adjusted CASM increased 6.1% from 2018. CASM increased 4.1% from 2018. Air Canada estimated that, had it operated the 36 Boeing MAX aircraft as originally planned during 2019, adjusted CASM would have reflected an increase of approximately 2.5% when compared to 2018. Adjusted CASM is a non-GAAP financial measure. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

Air Canada continues to pursue value creation and profitability through a number of strategies, including those discussed below.

AIR CANADA ROUGE

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. 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.

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 were designed to provide long-term stability for Chorus, reaffirming Jazz as Air Canada's most significant Air Canada Express carrier well into the future. The amendments also 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.

BRANDED FARES

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 onboard 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 optimize 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 saw a significant acceleration in direct channel share in 2019.

INVESTMENTS IN TECHNOLOGY

Air Canada has a number of major initiatives already under way as the company moves forward with modernizing its passenger reservation system, transforming its loyalty program, and transforming core operational processes.

In 2017, in partnership with Amadeus, the world's largest provider of passenger services systems, Air Canada concluded an agreement for the full Amadeus Altéa Suite passenger service system including reservations, inventory and departure control solutions. In November 2019, Air Canada completed the first phase of the cutover from the previous reservation system, which had been in place for over 25 years to the new reservation system, which will enable Air Canada to make significant progress on all four of its strategic priorities. The final stage of the program will be completed in 2020, allowing Air Canada to begin to realize the full benefits of the system.

Altéa, as a shared infrastructure solution, will enable simplification and lower costs in Air Canada's technology environments and improve operational efficiency, including by automating functions. The new system also enables revenue enhancements and growth opportunities. Once fully implemented, Altéa 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 re-bookings during flight disruptions, such as those caused by extreme weather. The system also improves Air Canada's ability to personalize its products and services, which can provide tailored offerings to customers and improve ancillary revenues. It also supports Air Canada's international network through more seamless booking and customer handling with Star Alliance® and interline partners.

Once fully implemented, Altéa will also support significant customer service improvements. The system will enable Air Canada to serve its customers using a single passenger name record (PNR). Data will be available in real time to ensure the customer moves through their journey seamlessly and will contain a history and full audit trail of all changes made. Agents at Air Canada's contact centres, airports, travel agencies and 130+ airlines using Altéa will have a single view of the customer. Altéa will facilitate the recognition of top-tier customers, allowing Air Canada to better deliver on service promises, and will support the goal of building loyalty.

In parallel with the Altéa Suite agreement, Air Canada renewed its multi-year distribution agreement supporting its focus on delivering a consistent brand and customer experience across all channels. Amadeus users worldwide can access Air Canada's industry-leading customizable fare products and availability via the Amadeus Global Distribution System, as well as the carrier's ancillary offerings.

This new system is expected to provide annual incremental benefits of over $100 million once fully implemented.

Furthermore, leveraging artificial intelligence ("AI") has become a key part of Air Canada's strategy as it moves forward on a series of initiatives that will help shape its future. As a starting point, Air Canada has formed an AI Centre of Expertise, comprised of business leaders, data scientists and data engineers who collaborate closely with universities and researchers, and has delivered tangible benefits as an outcome of the application of AI in the business.

FLEET RENEWAL PROGRAM

Air Canada is generating fuel and maintenance cost savings with its younger fleet of Boeing 787 aircraft. The Dreamliner continues to drive profitable growth by opening opportunities to serve new international destinations made viable by its lower operating costs, mid-size capacity and longer range.

Air Canada took delivery of its first Airbus A220 aircraft (of a firm order of 45) in December 2019. The Airbus A220 aircraft are replacing the Embraer 190 aircraft in Air Canada's mainline fleet and support Air Canada's hub and network growth. With its longer range and efficiency, this aircraft offers 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. Air Canada also estimates that the Airbus A220 aircraft will deliver a 12% lower CASM when compared to the Embraer 190 aircraft, mainly driven by greater maintenance and fuel efficiencies.

Air Canada has taken delivery of 24 Boeing 737 MAX 8 aircraft. Refer to section 9 "Fleet" of this MD&A for additional information. The Boeing 737 MAX aircraft are expected to replace the ageing Airbus narrow-body aircraft in Air Canada's mainline fleet. Air Canada estimates that the Boeing 737 MAX aircraft will deliver an 11% lower CASM when compared to the mainline Airbus A320 aircraft, mainly driven by greater maintenance and fuel efficiencies.

2 LEVERAGING INTERNATIONAL NETWORK

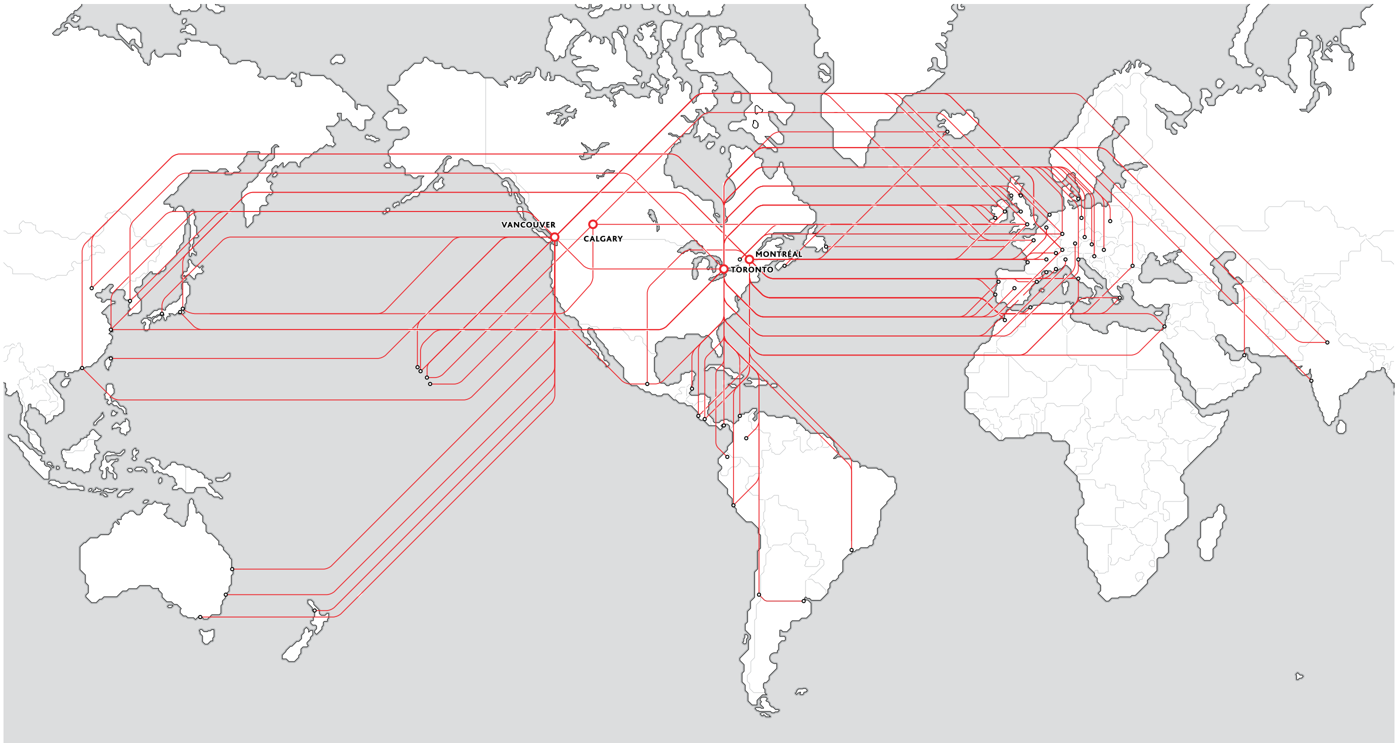
Air Canada is focused on leveraging its international network and its competitive attributes to appropriately expand margins.

Air Canada has competitive strengths which allow 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 Montréal. It 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.

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.

Lester B. Pearson International Airport ("Toronto Pearson") provides 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 and most of its Star Alliance® partners' operations are consolidated in Terminal One 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. In addition, Air Canada, in conjunction with the Canada Border Services Agency, the GTAA, the Vancouver International Airport Authority and the Montréal Airport Authority, have introduced a seamless connection process for those passengers that are arriving from an international origin and are transferring to another outbound international departure (other than the U.S.).

Air Canada has also been growing its Vancouver hub into a premier gateway to Asia-Pacific markets and has been developing Montréal into a 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 Asia-Pacific, providing a better travel experience. The airline's Montréal hub not only links North America with key markets in France, but also positions Montréal as a premier gateway to the Atlantic. Given the improvements that are being made at the Toronto, Vancouver and Montréal airports, the airline is able to build its network from the U.S. to provide increased connection flows to its international flights.



KEY DEVELOPMENTS IN 2019

- ✓ Successfully implemented a contingency plan following the grounding of 24 Boeing 737 MAX aircraft and the suspension of 12 Boeing 737 MAX aircraft deliveries scheduled for 2019, which resulted in Air Canada covering 97% of its scheduled 2019 ASM capacity despite the grounding.
- ✓ Meaningfully mitigated geopolitical headwinds, particularly in China and Hong Kong, by strategically redeploying capacity within the network.
- ✓ Introduced non-stop mainline service from Toronto to Vienna through a route-swap agreement with Austrian Airlines.
- ✓ Launched new non-stop winter seasonal services from Montréal to São Paulo, Vancouver to Auckland (mainline), and Toronto to Quito (Air Canada Rouge) as part of a broader strategy to optimize seasonality and reduce dependency on the third quarter.
- ✓ Announced two new daily summer services from Montréal to Nashville and from Calgary to Boston (mainline), both beginning in June 2020.
- ✓ Converted Air Canada Rouge service between Vancouver and Osaka/Kansai to mainline service using a Boeing 787-8 aircraft.
- ✓ Grew the feeder network with the introduction of non-stop Air Canada Express services such as Montréal to Raleigh/Durham and Sydney (Nova Scotia).
- ✓ Optimized and enhanced codeshare offerings with the Lufthansa Group and SAS through codeshare agreement updates.
- ✓ Added United Airlines and Lufthansa Group code on new Montréal-Bordeaux and Toronto-Vienna services.
- ✓ Expanded the codeshare agreement with Air New Zealand over the Tasman to further support Air Canada's international expansion strategy.
- ✓ Implemented the main components of the Air Canada–Air China revenue-sharing joint venture.
- ✓ Added six cities to codeshare points with Air China to maximize Canada–China flying, with a plan to further expand beyond Shanghai in 2020.
- ✓ Secured commitments to expand codeshare partnerships with GOL and Avianca to support Air Canada's new Montréal-São Paulo/Bogotá and Toronto-Quito services.

In 2020, Air Canada plans to continue to selectively and profitably expand its international services by leveraging 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.
- Competitive products and services, including lie-flat seats 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 a restaurant-style "à la carte" meal service, and the Air Canada Café, providing eligible customers with a premium coffee shop experience, a first in North America.
- Geographically well-positioned hubs (Toronto, Montréal and Vancouver) with efficient in-transit facilities, accentuating the advantages of flying Air Canada for customers travelling between the U.S., Asia, Europe and South America.
- 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 2020, Air Canada also plans to:

- Gradually re-introduce the Boeing 737 MAX aircraft into service, starting in the third quarter of 2020. Final decisions on returning the Boeing 737 MAX aircraft to service will be based on Air Canada's safety assessment following the lifting of government safety notices and approval by international regulatory authorities. Refer to section 9 "Fleet" of this MD&A for additional information.
- Introduce the Airbus A220 into the mainline narrow-body fleet and leverage its meaningfully improved economics to launch new services and expand the North America feeder network. The first two new routes to be operated with this new aircraft type include non-stop service between Montréal and Seattle and between Toronto and San Jose, California, both beginning in spring 2020.
- Continue to strengthen the A++ and Air China revenue-sharing joint ventures and further expand cooperation across all functional areas to enhance the overall customer experience.
- Continue to assess new strategic partnerships in support of its business plan and international growth strategy.

DEFINITIVE ARRANGEMENT AGREEMENT FOR THE ACQUISITION OF TRANSAT A.T. INC.

On August 23, 2019, Air Canada and Transat A.T. Inc. announced that nearly 95% of Transat shareholders had approved the Arrangement Agreement for Air Canada's acquisition of all issued and outstanding shares of Transat for $18 per share. The value of the all-cash transaction is approximately $720 million. The acquisition of Transat remains subject to regulatory approvals and other closing conditions usual in this type of transaction. If such approvals are obtained and conditions are met, the transaction is expected to be completed in mid-2020.

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.

ACQUISITION OF AEROPLAN

On January 10, 2019, Air Canada completed its purchase from Aimia Inc. ("Aimia") of Aeroplan, owner and operator of the Aeroplan loyalty business. The aggregate purchase price for the acquisition consisted of $450 million in cash plus $67 million in cash for closing adjustments (total purchase consideration of $517 million). The acquisition also included the assumption of the Aeroplan Miles liability.

Concurrently with the conclusion of the Aeroplan purchase, Air Canada, Aeroplan, The Toronto-Dominion Bank ("TD Bank"), Canadian Imperial Bank of Commerce ("CIBC") and Visa Canada Corporation ("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 the Aeroplan program. Similarly, in the first quarter of 2019, Air Canada, Aeroplan and Amex Bank of Canada ("AMEX") concluded agreements enabling AMEX's continued participation in the Aeroplan program. Air Canada received payments from TD Bank, CIBC, Visa and AMEX in the aggregate amount of $1,212 million.

In addition, TD Bank and CIBC made payments to Air Canada in the aggregate amount of $400 million as prepayments to be applied towards future monthly payments in respect of Aeroplan Miles.

Air Canada began consolidating Aeroplan's financial results on January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 14 "Accounting Policies" and section 15 "Critical Accounting Estimates and Judgments" of this MD&A for additional information.

Consistent with its commitment of continued investments in its loyalty program, Air Canada plans to launch an enhanced Aeroplan Program in the third quarter of 2020. Air Canada believes that the new program will enable the airline to further strengthen customer relationships, to offer members more flexible rewards with better value, and to deliver a more consistent end-to-end customer experience. The new program will offer a wide range of earning and redemption opportunities, more personalized service and a better digital experience for Aeroplan members.

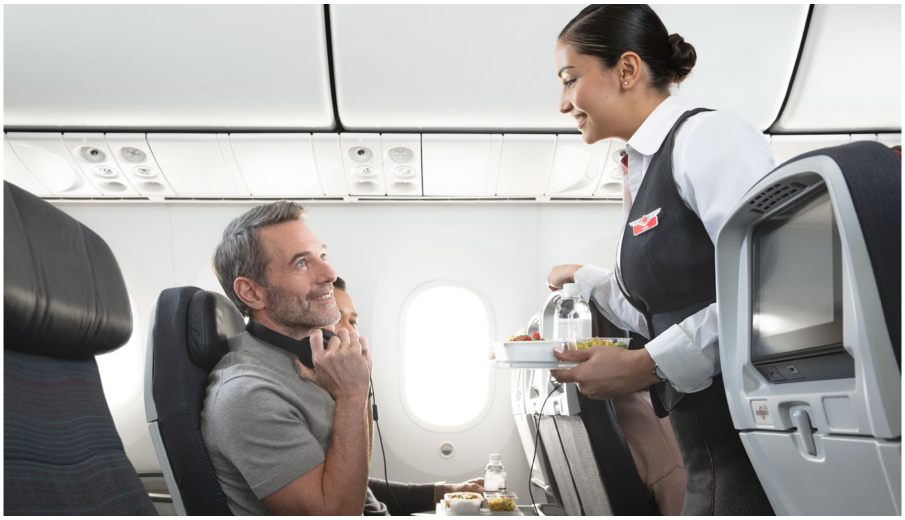
PRODUCTS AND SERVICES

Investing in products and services remains pivotal to Air Canada's commitment to customer engagement. Air Canada continues to partner with leading brands and invests in premium products that enhance the customer's journey.

Starting with the Boeing 787 Dreamliner, and then followed by the Boeing 777, Air Canada has been progressively upgrading its wide-body aircraft with enhanced cabin and in-flight entertainment products. They have been enthusiastically received by customers and, in 2019, Air Canada began extending these improvements to its fleet of Airbus A330 aircraft. In late 2019, Air Canada also took delivery of its first new Airbus A220 aircraft. These aircraft and when reintroduced, Air Canada's Boeing 737 MAX aircraft, bring market-leading cabins and entertainment products to Air Canada's narrow-body fleet and come equipped with satellite-based Wi-Fi.

In December 2019, Air Canada announced completion of installation of Wi-Fi high-speed satellite connectivity across the entire Air Canada Rouge fleet. As well as increasing services available to customers, this initiative allows Air Canada to provide a more consistent customer experience across its entire fleet. In addition to the full Air Canada Rouge fleet, satellite-based Wi-Fi is available on all Air Canada Boeing 777 aircraft, and most Boeing 787 and Airbus A330 aircraft, with the remainder to be completed in early 2020. Air Canada Wi-Fi connectivity is also available across the carrier's entire mainline narrow-body fleet and the Air Canada Express Embraer 175 and Bombardier CRJ-900 fleets.

Air Canada Signature Class, the lie-flat product offered on most international and transcontinental wide-body flights, was further enhanced in 2019 with the introduction of David Hawksworth-inspired breakfast dishes. In the summer of 2019, Air Canada announced that popular Montréal-based Chef Antonio Park had joined its culinary team. Since that time, his dishes have been launched in Air Canada Signature Class, Premium Economy and Economy Class on flights to Japan from Montréal, Toronto, and Vancouver. Most recently,



a meal tailored to the route was also launched in Air Canada Signature Class on flights to São Paulo from both Montréal and Toronto. Air Canada looks forward to expanding the Chef Park-inspired menu on other mainline routes to Asia and South America in 2020. Air Canada will also be introducing new meal concepts and other enhancements to the International Economy Class cabin across both mainline and Air Canada Rouge in 2020. Air Canada culinary guidance for onboard meals is complemented by world-renowned sommelier Véronique Rivest, who continues to provide guidance on the wine program offered in Signature Class and Business Class.

Air Canada provides concierge assistance at 49 airports globally. During 2019, the service was expanded to include Dubai and Vienna, and is now available for eligible customers at all airports where Signature Class is offered, except for Casablanca. A new concierge office was also opened at Calgary International Airport, providing personalized assistance in an upscale environment. In 2020, the airline plans to expand concierge service to include Toulouse once the route has started as well as open new concierge offices at New York-LaGuardia and Ottawa.

Throughout 2019, Air Canada also expanded the BMW Chauffeur Service at Toronto Pearson. Select customers connecting from a domestic to an international Air Canada Signature Class flight are now provided with a personalized airside drive between the gate areas. Air Canada is the first airline in North America to provide this type of service to Business Class customers.

In September 2019, Air Canada opened its first Air Canada Café at Toronto Pearson. Located inside the domestic gate area, in close proximity to the departure gates usually used for flights departing to Montréal-Trudeau and Ottawa, this 5,400 square foot, 109-seat facility is the first of its kind in North America, and provides eligible customers with a complimentary premium coffee shop experience.

The Maple Leaf Lounge portfolio has expanded to include an additional facility at Toronto Pearson with the opening of Air Canada's 24th lounge worldwide, the Maple Leaf Lounge Express. The 1,300 square-foot lounge provides seating for 50, and is located at the commuter gate area, serving select markets in the U.S. The Maple Leaf Lounge Express solidifies Air Canada's commitment to provide a seamless connection experience for customers transiting to the United States at Toronto Pearson. In 2020, Air Canada will continue a comprehensive refurbishment program of existing facilities at key hubs, a project which started in 2019 with a focus on the domestic Maple Leaf Lounge at Montréal-Trudeau.

The Air Canada Signature Suite, a premium "à la carte" dining facility available at Toronto Pearson for select customers departing in Air Canada Signature Class, won "World's Best Business Class Lounge Dining" at the 2019 Skytrax World Airline Awards at the Paris Airshow. Air Canada is expanding on this initiative, bringing it to the Vancouver International Airport in early 2020.

Air Canada received a number of additional awards recognizing its industry-leading products and services in 2019, including being named Best Airline in North America at the 2019 Skytrax World Airline Awards, as well as Best Business Class in North America, Best Airline Staff in Canada and Best Airline Cabin Cleanliness in North America. Air Canada also remains North America's only Skytrax four-star International network carrier. In addition, Air Canada was named as 2019 Airline of the Year at the 2019 *Global Traveler* Awards, as recognized by the leading magazine for luxury business and leisure travellers. In addition, the airline was recognized as offering the Best Premium Economy Class and Best Onboard Entertainment at the Global Traveller 2019 Leisure Lifestyle Awards which took place in the spring of 2019.

In late 2019, the Ipsos Reid 2019 Canadian Business Traveller Survey confirmed Air Canada as the preferred airline for domestic travel for 90% of frequent business travellers. The national study determined that Air Canada remains by far the preferred choice for business travel, with high overall satisfaction and intend-to-travel scores.

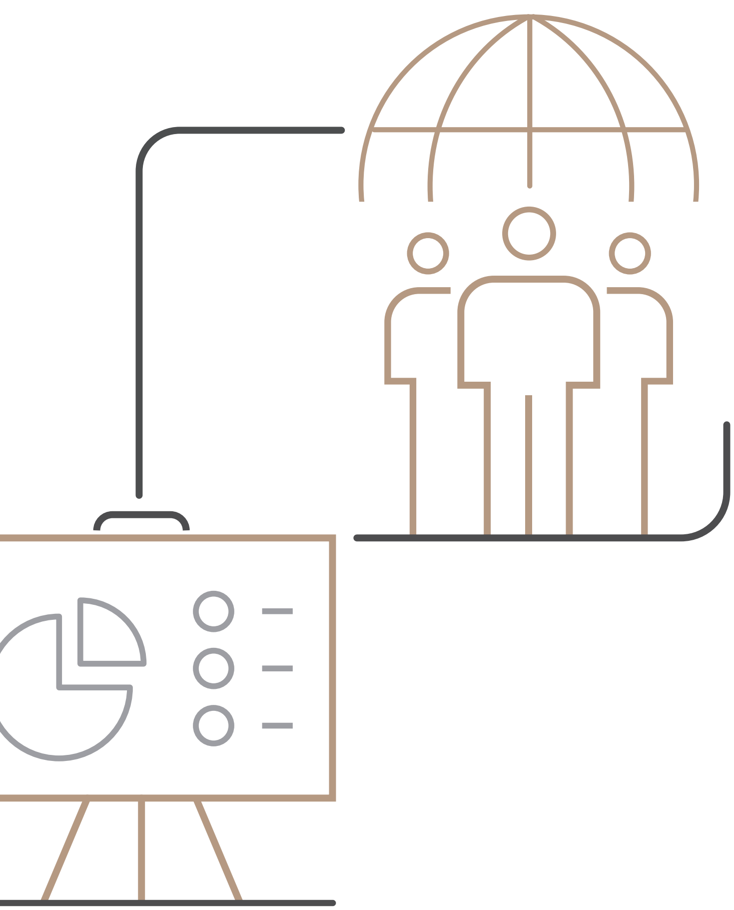
Voted Best Airline in North America

4

CULTURE CHANGE

Air Canada's positive corporate culture plays a key role in its organizational success, which was evidenced in 2019 by the company receiving the following recognitions:

- ✓ One of Canada's Top 100 Employers, One of Canada's Best Diversity Employers and One of Montréal's Top Employers – Mediacorp
- ✓ One of 50 Most Engaged Workplaces™ in North America – Achievers
- ✓ One of North America's Candidate (hiring) Experience Award winners – Talent Board
- ✓ Women's Executive Network Top 100 Most Powerful Women – KPMG, HSBC
- ✓ Four-Star ranking – Skytrax
- ✓ CEO / Strategist of the Year – Globe and Mail



The year 2019 proved to be extraordinary for Air Canada as the company embraced change and rallied together to see material evidence of how it succeeds and flourishes in times of unprecedented complexity. During 2019, examples of major challenges included a complete transformation of the company's passenger reservation system (after approximately 700,000 hours of development and completing 400,000 hours in training 10,000 employees) and the sudden grounding of the entire fleet of Boeing 737 MAX aircraft and suspension of further deliveries, which resulted in serious disruptions to operations. In addition, with the purchase of Aeroplan, the airline successfully integrated nearly 700 employees and then moved into the mode of building a new data-driven loyalty platform.

The implementation of Altéa was one of the largest cultural transformations and change management initiatives for Human Resources and Air Canada as a company. The new system, which manages reservation ticketing, inventory and customer management, required several partnerships and successful change management coordination among many internal and external teams.

The *Air Passenger Protection Regulations*, the first phase of which took effect on July 15, 2019, and the second phase on December 15, 2019, required a significant investment in planning and effort to make required changes to the company's policies, processes and procedures. Teams across the organization worked together to ensure that Air Canada remained aligned with IATA delay coding standards while adapting its communications and website to properly align with the new regulations.

Air Canada exceeded expectations with its 2019 employee engagement survey results, in both participation levels and overall employee net promoter score.

Air Canada regularly validates the organizational pulse through many vehicles and channels, including 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 and monthly 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.

5. SUSTAINABILITY AND SOCIAL IMPACT

Being a global champion involves doing what is right for the longer-term interest of the company's shareholders, employees, customers, communities and other stakeholders; it includes supporting research and development of innovative ways to reduce its environmental footprint and governing its business responsibly, safely, and ethically. Air Canada's social and environmental achievements are reported through its Corporate Sustainability Report "Citizens of the World" (using the Global Reporting Initiative Standards) and the Carbon Disclosure Project ("CDP") report. Certain indicators, including Scope 1 and 2 emissions, are verified by an external party in accordance with internationally recognized standards. In 2019, Air Canada was proud to have been the first Canadian airline to confirm its commitment to achieving the Sustainable Development Goals and to joining the UN Global Compact, which encourages all businesses to adopt sustainable, socially responsible practices.

Below is a brief discussion of Air Canada's approach to certain environmental, social and governance matters.

SAFETY

Air Canada has an extensive health and safety program to prevent accidents and injury occurring during the course of employment. A critical element of the health and safety program is the Hazard Prevention Program, which allows health and safety committees to identify and assess workplace hazards, and to determine appropriate controls to mitigate risks. These committees cover all employee groups at Air Canada. The Corporate Safety branch, through its Corporate Safety and Emergency Management department, is responsible for ensuring that employee safety programs are documented, implemented, effective and continuously improving. Among other things, it monitors compliance with applicable laws and regulations while tracking employee safety-related incidents.

Investing in employees' health not only helps ensure compliance with regulations but also demonstrates that employees are valuable and vital members of the team. Bi-annual, voluntary confidential safety culture surveys are conducted as an opportunity to get a sense of Air Canada employees' safety voice. In 2018, 81% of those surveyed responded positively, up 3 percentage points from the previous survey held in 2016.

With respect to mental health, employee groups benefit from the Employee and Family Assistance Program (or other similar programs). Upgrade to a Better You, a wellbeing platform and unique program that equips employees with tools, resources and advice to help manage health, finances and overall wellbeing, is also available to employees.

Air Canada continues to maintain exemplary IATA Operational Safety Audit results.

In 2019, Air Canada continued to implement its cybersecurity and privacy action plan focused on progressing its privacy maturity and managing risk through various means, including improvements to infrastructure, compliance programs and governance. As part of its efforts, Air Canada implemented Multi-Factor Authentication programs for employee- and customer-facing applications.

ENVIRONMENT

Increasingly, today's society is championing the importance of environmental issues, and the aviation industry has a role in addressing them. Air Canada is proud of its accomplishments to date, such as being named Eco Airline of the Year in 2018, partnering in Canada's Biojet Supply Chain Initiative to demonstrate the feasibility of a Canadian biofuel supply chain, and improving its fuel efficiency significantly over the last 30 years and more recently, since 2009, by 19%.

Air Canada monitors its greenhouse gas ("GHG") emissions closely and is committed to mitigating its environmental footprint. As 99% of the airline's CO_2 emissions are generated from aircraft engine combustion, there is a strong positive correlation between meeting its environmental targets and reducing fuel burn, emissions and operating costs. Air Canada's fleet modernization program offers substantive fuel efficiency improvements and meaningfully contributes to its environmental impact and emissions reduction efforts. The introduction of the Airbus A220 will reduce CO_2 emissions by up to 20% per seat compared to other narrow-body aircraft in its category. In addition, this aircraft reduces nitrogen oxides ("NOx") emissions to 50% below CAEP/6 standards, significantly mitigating the impact on air quality in the vicinity of airports where it will be operated. The Airbus A220 aircraft is one part of Air Canada's multi-billion-dollar wide-body and narrow-body fleet renewal program, which includes the very efficient Boeing 787 Dreamliner, which is 20% more energy efficient than the planes they replaced.

Air Canada was one of the first airlines in North America to adopt an Environmental Management System (EMS) based on ISO 14001. In 2017, it chose to pursue a certified Environmental Management System through the IATA IEnvA system. The IEnvA system is specific for airlines and demonstrates equivalency to the new ISO 14001: 2015 EMS standard. In 2018, Air Canada achieved Stage 1 certification and is currently in the process of preparing for Stage 2 certification.

Air Canada has endorsed the aviation industry's climate action targets and recognizes the ongoing work to be done in collaboration with the industry to cap the emissions growth of international aviation at 2020 levels. The Government of Canada has adopted the voluntary phase of ICAO's Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA), applicable to certain Air Canada international flights. CORSIA is designed to complement the basket of mitigation measures that the air transport industry is already pursuing to reduce its CO_2 emissions and will be the first global sector carbon offset scheme for a single industry. Emissions monitoring throughout 2019–2020 will form the 2020 baseline, with CORSIA offsets to begin January 1, 2021.

Air Canada is also a signatory, through the National Airlines Council of Canada ("NACC"), to the Canadian Action Plan to Reduce Greenhouse Gas Emissions from Aviation which is a multiparty action plan between aviation industry stakeholders and the federal government outlining how the parties intend to reduce greenhouse gas emissions from aviation activities. Action plan targets include average annual improvements in fuel efficiency of at least 2% per year until the end of 2020, from a 2005 baseline.

Air Canada has been engaged in the advocacy and development of sustainable aviation fuel for the past seven years, engaging fully with the applicable levels of government on policy mechanisms needed to support a Canadian biofuel supply chain. In addition to specific initiatives, such as participation in the Natural Resources Canada ("NRCan") "Sky's the Limit Challenge" and the "Civil Aviation Alternate Fuel Contrail and Emissions Research" project, Air Canada has operated eight biofuel flights since 2012. Air Canada is also working to lower its emissions within its ground operations and, to date, has moved to electrification of over 33% of its ground support equipment.

Air Canada also looks to reduce its waste. Among other initiatives (such as recycling and waste reduction programs), in 2018 Air Canada began a multi-year program to reduce and/or minimize its use of single-use plastics, with the first action being the removal of 35 million plastic items from service. Demonstrating its desire to engage employees and communities it operates in, Air Canada worked with an ocean clean-up organization, 4ocean, to host two public shoreline clean-ups in Clearwater, Florida, and Vancouver, B.C.

TALENT ACQUISITION, DEVELOPMENT AND DIVERSITY

Air Canada's employer brand remains very strong as the airline receives, on average, over 160 applications for every job posting. The company focuses on hiring exceptional talent and growing the professional development of employees by assisting them in determining career path options, with multiple opportunities to stay and grow within the organization.

Air Canada recognizes that employee professional development and competencies are not acquired through training alone and continues to look for ways in which experiential learning will help employees drive performance, innovation and organizational success. Emerging Leaders programs such as Managing the AC Way Leading the AC Way, mentoring, coaching, and others like Human Resource fundamentals, and the new Directors in Development series, all offer experiential learning opportunities.

Air Canada continues to emphasize the importance of organizational diversity, as proven by the company's engagement survey scores for diversity ranking among the top benchmarked scores. In August 2014, its Board established as its target that women represent at least 25% of the directors of Air Canada by 2017. This target was achieved in 2016, following the election of directors at the annual meeting of shareholders held on May 10, 2016. In October 2017, the Board established a new target that women represent at least 30% of the directors by 2020. Furthermore, as part of its continuing commitment to diversity, Air Canada is a member of the 30% Club and a signatory to the Catalyst Accord 2022, whose objective is to increase the average percentage of women on boards and in executive positions in corporate Canada to 30% or greater by 2022. Currently, three out of the 11 directors (28%) are women.

Air Canada pursues a comprehensive diversity management strategy with the goal of ensuring an inclusive and diverse workplace based on respect where all employees can utilize their talents.

Air Canada established a target of women representing at least 30% of senior management by 2020 and has exceeded it. In addition, one-third of Air Canada's Executive Committee is comprised of women.

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 early 2020, Air Canada and Unifor, representing the airline's customer service and sales agents, concluded a tentative agreement for collective agreement terms for six years, ending February 26, 2026. This tentative agreement remains subject to ratification. In 2019, Air Canada concluded an agreement with Unifor representing agents working in the Aeroplan customer service function.

THE AIR CANADA FOUNDATION

Air Canada believes that an airline truly thrives when it fully participates in the communities it serves. In 2019, the Air Canada Foundation achieved its target to raise more than $2 million, a record-breaking number. These funds were to be distributed, along with other in-kind donations, to charitable organizations dedicated to the health and wellbeing of children and youth in Canada. The Aeroplan Mile Matching Week for the Air Canada Foundation also brought in over 6.8 million Aeroplan Miles for the Hospital Transportation Program, which connects sick children to the medical care they need away from home. In 2019, over 200 children in need benefited from this program.

6. OVERVIEW

FULL YEAR 2019 FINANCIAL SUMMARY

The following is an overview of Air Canada's results of operations and financial position for the full year 2019 compared to the full year 2018.

- Record operating revenues of $19,131 million in 2019 compared to operating revenues of $18,003 million in 2018, an increase of $1,128 million or 6% on a yield improvement of 4.6% and traffic increase of 1.9%. The yield improvement year-over-year included additional revenue from Aeroplan flight redemptions and other revenues subsequent to the Aeroplan acquisition on January 10, 2019.
- Operating expenses of $17,481 million in 2019 versus operating expenses of $16,507 million in 2018, an increase of $974 million or 6%. CASM and adjusted CASM increased 4.1% and 6.1%, respectively, from 2018. These increases reflected, in large part, the impact of the Boeing 737 MAX aircraft grounding. Given that the Aeroplan loyalty business was not consolidated in Air Canada's financial results in 2018, for a more meaningful comparison of the cost performance of the ongoing airline business, Air Canada's adjusted CASM for 2019 excludes the operating expenses of Aeroplan. Adjusted CASM is a non-GAAP financial measure. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Operating income of $1,650 million in 2019 compared to operating income of $1,496 million in 2018, an increase of $154 million.
- EBITDA of $3,636 million in 2019 compared to EBITDA of $3,213 million in 2018, an increase of $423 million or 13%. The airline reported a 2019 EBITDA margin (EBITDA as a percentage of operating revenue) of 19.0%, in line with the 2019 EBITDA margin of approximately 19% projected in Air Canada's news release dated October 29, 2019. This compared to an EBITDA margin of 17.8% in 2018. EBITDA is a non-GAAP financial measure. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Record income before income taxes of $1,775 million in 2019 versus income before income taxes of $228 million in 2018.
- Record adjusted pre-tax income of $1,273 million in 2019 versus adjusted pre-tax income of $1,036 million in 2018. Adjusted pre-tax income is a non-GAAP financial measure. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Net income of $1,476 million or $5.44 per diluted share in 2019 versus net income of $37 million or $0.13 per diluted share in 2018.
- Adjusted net income of $917 million or $3.37 per diluted share in 2019 versus adjusted net income of $738 million or $2.67 per diluted share in 2018. Adjusted net income is a non-GAAP financial measure. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Net debt of $2,841 million at December 31, 2019, versus net debt of $5,214 million at December 31, 2018, a decrease of $2,373 million, reflecting an increase in cash, cash equivalents and short and long-term investment balances of $1,694 million and a decrease in long-term debt and lease liabilities (including current portion) of $679 million. Net debt is an additional GAAP measure. Refer to section 10.3 "Net Debt" of this MD&A for additional information. Air Canada's leverage ratio (net debt to trailing 12-month EBITDA) was 0.8 at December 31, 2019, in line with a leverage ratio not exceeding 1.0 projected in Air Canada's news release dated October 29, 2019. This compared to a leverage ratio of 1.6 at December 31, 2018. Leverage ratio is a non-GAAP financial measure. Refer to sections 10.3 "Net Debt" and 22 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Net cash flows from operating activities of $5,712 million in 2019 versus net cash flows from operating activities of $3,470 million in 2018. In 2019, free cash flow of $2,075 million increased $748 million from 2018 and was higher than the free cash flow of between $1.3 billion and $1.5 billion projected in Air Canada's news release dated October 29, 2019. The higher than expected free cash flow was due to a combination of factors, including higher cash from operations, a lower than projected level of capital expenditures due to certain projects being deferred to 2020, and to an initial settlement payment from

Boeing. Free cash flow is a non-GAAP financial measure. Refer to section 10.5 "Consolidated Cash Flow Movements" of this MD&A for additional information. Excess cash amounted to $2,732 million at December 31, 2019. Refer to section 10.1 "Liquidity" for additional information on excess cash.

- ROIC of 15.5% for the 12 months ended December 31, 2019, in line with a ROIC of between 15.5% and 16.0% projected in Air Canada's news release dated October 29, 2019. This compared to a ROIC of 13.5% at December 31, 2018. ROIC is a non-GAAP financial measure. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

FOURTH QUARTER 2019 FINANCIAL SUMMARY

The following is an overview of Air Canada's results of operations and financial position for the fourth quarter 2019 compared to the fourth quarter 2018.

- Record fourth quarter operating revenues of $4,429 million compared to record fourth quarter operating revenues of $4,227 million in 2018, an increase of $202 million or 5%. On a capacity increase of 3.3%, record fourth quarter passenger revenues of $3,975 million increased $199 million or 5.3% from the fourth quarter of 2018 on a yield improvement of 2.3% and traffic increase of 2.9%. The yield improvement year-over-year resulted in part from additional revenue from Aeroplan flight redemptions and other revenues subsequent to the Aeroplan acquisition on January 10, 2019.
- Operating expenses of $4,284 million in the fourth quarter of 2019 versus operating expenses of $4,048 million in the fourth quarter of 2018, an increase of $236 million or 6%. CASM and adjusted CASM increased 2.5% and 5.5%, respectively, from the fourth quarter of 2018. These increases reflected, in large part, the impact of the Boeing 737 MAX aircraft grounding.
- Operating income of $145 million in the fourth quarter of 2019 compared to operating income of $179 million in the fourth quarter of 2018, a decrease of $34 million.
- EBITDA of $665 million in the fourth quarter of 2019 compared to EBITDA of $619 million in the fourth quarter of 2019, an increase of $46 million or 7%. The airline reported a fourth quarter 2019 EBITDA margin (EBITDA as a percentage of operating revenue) of 15.0% compared to an EBITDA margin of 14.6% in the fourth quarter of 2018.
- Record income before income taxes of $172 million in the fourth quarter of 2019 versus a loss before income taxes of $391 million in the fourth quarter of 2018.
- Adjusted pre-tax income of $66 million in the fourth quarter of 2019 versus adjusted pre-tax income of $68 million in the fourth quarter of 2018.
- Record net income of $152 million or $0.56 per diluted share in the fourth quarter of 2019 versus a net loss of $360 million or $1.33 per diluted share in the fourth quarter of 2018.
- Adjusted net income of $47 million or $0.17 per diluted share in the fourth quarter of 2019 versus adjusted net income of $55 million or $0.20 per diluted share in the fourth quarter of 2018.
- Net cash flows from operating activities of $677 million in the fourth quarter of 2019 versus net cash flows from operating activities of $548 million in the fourth quarter of 2018. In the fourth quarter of 2019, free cash flow of $426 million increased $138 million from the fourth quarter of 2018.

7. RESULTS OF OPERATIONS – FULL YEAR 2019 VERSUS FULL YEAR 2018

The following table and discussion provide and compare results of Air Canada for 2019 and 2018:

(Canadian dollars in millions, except per share figures)	FULL YEAR			
	2019	2018	$ CHANGE	% CHANGE
OPERATING REVENUES				
Passenger	$ 17,232	$ 16,161	$ 1,071	7
Cargo	717	803	(86)	(11)
Other	1,182	1,039	143	14
Total revenues	**19,131**	**18,003**	**1,128**	**6**
OPERATING EXPENSES				
Aircraft fuel	3,862	3,969	(107)	(3)
Wages, salaries and benefits	3,184	2,873	311	11
Regional airlines expense				
Aircraft fuel	485	531	(46)	(9)
Other	1,956	1,977	(21)	(1)
Depreciation and amortization	1,986	1,717	269	16
Aircraft maintenance	1,004	903	101	11
Airport and navigation fees	990	964	26	3
Sales and distribution costs	874	807	67	8
Ground package costs	627	602	25	4
Catering and onboard services	445	433	12	3
Communications and information technology	397	294	103	35
Other	1,671	1,437	234	16
Total operating expenses	**17,481**	**16,507**	**974**	**6**
Operating income	**1,650**	**1,496**	**154**	
NON-OPERATING INCOME (EXPENSE)				
Foreign exchange gain (loss)	499	(578)	1,077	
Interest income	164	108	56	
Interest expense	(515)	(567)	52	
Interest capitalized	35	35	-	
Net financing expense relating to employee benefits	(39)	(50)	11	
Gain (loss) on financial instruments recorded at fair value	23	(1)	24	
Gain on debt settlements and modifications	6	9	(3)	
Gain (loss) on disposal of assets	13	(188)	201	
Other	(61)	(36)	(25)	
Total non-operating income (expense)	**125**	**(1,268)**	**1,393**	
Income before income taxes	**1,775**	**228**	**1,547**	
Income tax expense	(299)	(191)	(108)	
Net income	**$ 1,476**	**$ 37**	**$ 1,439**	
Diluted earnings per share	**$ 5.44**	**$ 0.13**	**$ 5.31**	
EBITDA (1)	**$ 3,636**	**$ 3,213**	**$ 423**	
Adjusted pre-tax income (1)	**$ 1,273**	**$ 1,036**	**$ 237**	
Adjusted net income (1)	**$ 917**	**$ 738**	**$ 179**	
Adjusted earnings per share – diluted (1)	**$ 3.37**	**$ 2.67**	**$ 0.70**	

(1) EBITDA, adjusted pre-tax income (loss), adjusted net income (loss) and adjusted earnings (loss) per share – diluted are non-GAAP financial measures. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

SYSTEM PASSENGER REVENUES

In the fourth quarter of 2019, Air Canada adopted a new accounting treatment for compensation to passengers for delayed and cancelled flights. All prior periods in 2018 and 2019 were restated to reflect this accounting change. Refer to section 14 "Accounting Policies" for additional information.

In 2019, passenger revenues of $17,232 million increased $1,071 million or 6.6% from 2018 on a yield improvement of 4.6% and traffic growth of 1.9%. As a result of the impact of the Boeing 737 MAX aircraft grounding, system ASMs increased 1.8% in 2019 versus planned system ASM growth of approximately 4.8%. In 2019, the yield improvement, particularly in North America, was due to the constrained capacity resulting from the grounding of the Boeing 737 MAX aircraft in mid-March, as well as a generally improved pricing environment. The yield increases also reflected additional revenue from Aeroplan flight redemptions and other revenues subsequent to the Aeroplan acquisition on January 10, 2019.

In 2019, business cabin revenues, on a system basis, increased $237 million or 7.4% from 2018 on yield growth of 4.2% and a traffic increase of 3.0%.

The table below provides passenger revenue by geographic region for the full year 2019 and the full year 2018.

(Canadian dollars in millions)	FULL YEAR			
	2019	2018	$ CHANGE	% CHANGE
PASSENGER REVENUE				
Canada	$ 5,233	$ 4,880	$ 353	7.2
U.S. transborder	3,795	3,492	303	8.7
Atlantic	4,468	4,207	261	6.2
Pacific	2,449	2,427	22	0.9
Other	1,287	1,155	132	11.4
System	**$ 17,232**	**$ 16,161**	**$ 1,071**	**6.6**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the full year 2019 versus the full year 2018.

FULL YEAR 2019 VERSUS FULL YEAR 2018	PASSENGER REVENUE % CHANGE	CAPACITY (ASMs) % CHANGE	TRAFFIC (RPMs) % CHANGE	PASSENGER LOAD FACTOR PP CHANGE	YIELD % CHANGE	PRASM % CHANGE
Canada	7.2	0.9	0.4	(0.4)	6.8	6.3
U.S. transborder	8.7	1.3	0.4	(0.8)	8.3	7.3
Atlantic	6.2	3.2	4.2	0.8	2.0	2.9
Pacific	0.9	(1.2)	(1.2)	0.1	2.1	2.2
Other	11.4	6.8	7.9	0.8	3.3	4.3
System	**6.6**	**1.8**	**1.9**	**0.1**	**4.6**	**4.8**

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

- The 4.6% system yield growth which reflected yield increases in all markets. The yield growth reflected increases in fares and an improvement in the overall fare mix. An increase in carrier surcharges, additional yield earned on Aeroplan redemption revenues and growth in higher-yielding local traffic were also contributing factors to the yield growth year-over-year. A favourable currency impact of $66 million was also a contributing factor to the yield growth year-over-year.
- The 1.9% traffic increase which reflected traffic growth in all markets with the exception of the Pacific market where capacity was reduced year-over-year.

Compared to 2018, PRASM increased 4.8% in 2019, mainly on the higher yield.

DOMESTIC PASSENGER REVENUES

In 2019, on capacity growth of 0.9%, domestic passenger revenues of $5,233 million increased $353 million or 7.2% from 2018.

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

- The 6.8% domestic yield increase which reflected yield growth on all major domestic services. The yield increase reflected the impact of fare increases, an improved traffic mix from capacity constraints as a result of the grounding of Boeing 737 MAX aircraft and from the optimization of fare categories, growth in higher-yielding local traffic, and additional yield earned on Aeroplan redemptions.
- The 0.4% traffic increase which reflected traffic growth on most major domestic services. This increase was largely offset by the impact of fewer connecting passengers as a result of the capacity reduction due to the grounding of Boeing 737 MAX aircraft.

Compared to 2018, domestic PRASM increased 6.3% in 2019, mainly on the higher yield.

U.S. TRANSBORDER PASSENGER REVENUES

In 2019, on capacity growth of 1.3%, U.S. transborder passenger revenues of $3,795 million increased $303 million or 8.7% from 2018.

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

- The 8.3% yield increase which reflected yield growth on all major U.S. transborder services. The overall yield improvement included the impact of an improved traffic mix in part due to capacity constraints as a result of the grounding of Boeing 737 MAX aircraft, additional yield earned on Aeroplan redemption revenues, growth in higher-yielding local traffic, and gains in the higher yielding business class revenues. A favourable currency impact of $33 million was also a contributing factor to the yield growth year-over-year.
- The 0.4% traffic increase which reflected, in large part, growth on services from Western Canada to the U.S. west coast, mostly offset by the impact of reduced capacity on U.S. leisure routes, such as Hawaii and Las Vegas, and on certain long-haul services, such as Eastern Canada to California, primarily due to the grounding of the Boeing 737 MAX aircraft.

Compared to 2018, U.S. transborder PRASM increased 7.3% in 2019, mainly on the higher yield.

ATLANTIC PASSENGER REVENUES

In 2019, on capacity growth of 3.2%, Atlantic passenger revenues of $4,468 million increased $261 million or 6.2% from 2018. In 2019, to help offset the impact of the Canada-China geopolitical situation, Air Canada reallocated capacity from the Pacific to the Atlantic market.

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

- The 4.2% traffic increase which reflected traffic growth on all major Atlantic services with the exception of services from Halifax and St. John's to London Heathrow, which were suspended as a result of the grounding of Boeing 737 MAX aircraft in mid-March 2019, and the suspension of services from Toronto to Delhi, in June 2019, due to the closure of Pakistani airspace. The airspace was re-opened on July 18, 2019, and Air Canada resumed operations in October 2019.
- The 2.0% yield increase which included additional yield earned on Aeroplan redemption revenues, increase in carrier surcharges year-over-year, the launch of new fare categories on Atlantic services (resulting in growth in ancillary revenue and an improved fare mix) gains in the higher yielding business class revenues, and a favourable currency impact of $10 million. The impact of aggressive pricing activities resulting from increased industry capacity was a partly offsetting factor.

Compared to 2018, Atlantic PRASM increased 2.9% in 2019 on the higher yield and a 0.8 percentage point improvement in passenger load factor.

PACIFIC PASSENGER REVENUES

In 2019, on a capacity decrease of 0.2%, Pacific passenger revenues of $2,449 million increased $22 million or 0.9% from 2018.

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

- The 2.1% yield increase which reflected yield growth on services to Hong Kong, Japan and Taiwan, partly offset by yield declines on services to Australia and Korea.
- The 1.2% traffic decrease which reflected traffic declines on services to China, Hong Kong and Taiwan, partly offset by traffic growth on services to Japan, Australia and Korea. The geopolitical situation between Canada and China continued to negatively impact travel demand in 2019, particularly business-related traffic between Canada-China/Hong Kong.

Compared to 2018, Pacific PRASM increased 2.2% in 2019, mainly on the higher yield.

OTHER PASSENGER REVENUES

In 2019, on capacity growth of 6.8%, other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of $1,287 million increased $132 million or 11.4% from 2018.

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

- The 7.9% traffic increase which reflected traffic growth on routes to traditional sun destinations and on services to South America.
- The 3.3% yield increase which reflected yield growth on routes to traditional sun destinations and on services to South America. The favourable impact of Air Canada having reverted back to one-stop service to Buenos Aires with a connection in Santiago on April 1, 2019 was also a contributing factor to the yield improvement year-over-year.

Compared to 2018, PRASM in the Other markets segment increased 4.3% in 2019 on the higher yield and a 0.8 percentage point improvement in passenger load factor.

CARGO REVENUES

In 2019, cargo revenues of $717 million decreased $86 million or 10.7% from 2018 on cargo yield and traffic declines of 6.2% and 4.8%, respectively. Demand for air cargo decreased industry-wide, particularly in the Atlantic and Pacific markets, causing reductions in volumes and putting downward pressure on yields, reflecting the impact of external factors, such as ongoing international trade challenges and reduced economic activities.

The table below provides cargo revenue by geographic region for the full year 2019 and the full year 2018.

(Canadian dollars in millions)	FULL YEAR			
	2019	2018	$ CHANGE	% CHANGE
CARGO REVENUE				
Canada	$ 113	$ 95	$ 18	18.5
U.S. transborder	48	43	5	11.0
Atlantic	242	278	(36)	(13.1)
Pacific	257	325	(68)	(21.0)
Other	57	62	(5)	(6.2)
System	**$ 717**	**$ 803**	**$ (86)**	**(10.7)**

OTHER REVENUES

In 2019, other revenues of $1,182 million increased $143 million or 14% when compared to 2018, mainly due to the net margin recorded on the redemption and delivery of non-air goods and services related to the Aeroplan program since its acquisition in January 2019. An increase in ground package revenue at Air Canada Vacations was also a contributing factor to the growth in other revenues. The increase in ground package revenue at Air Canada Vacations was driven by a higher price of ground packages and higher passenger volumes year-over-year.

CASM AND ADJUSTED CASM

In the fourth quarter of 2019, Air Canada adopted a new accounting treatment for compensation to passengers for delayed and cancelled flights. All prior periods in 2018 and 2019 were restated to reflect this accounting change. Refer to section 14 "Accounting Policies" for additional information.

In 2019, CASM increased 4.1% and adjusted CASM increased 6.1% compared to 2018. This increase reflected, in large part, the impact of the Boeing 737 MAX aircraft grounding, which resulted in a system ASM increase of 1.8% in 2019 rather than the planned system ASM growth of approximately 4.8%. It also resulted in significant higher costs associated with replacement aircraft and in higher ongoing operating expenses, including as a result of depreciation, aircraft maintenance and pilot wages that continued to be incurred in relation to the Boeing 737 MAX aircraft despite their grounding.

The table below compares Air Canada's CASM and adjusted CASM for 2019 versus 2018. Given that the Aeroplan loyalty business was not consolidated in Air Canada's financial results in 2018, for a more meaningful comparison of the cost performance of the ongoing airline business, Air Canada's adjusted CASM for the full year excludes the operating expenses of Aeroplan.

(cents per ASM)	FULL YEAR			
	2019 (1)	2018	¢ CHANGE	% CHANGE
CASM	**¢ 15.50**	**¢ 14.89**	**¢ 0.61**	**4.1**
Remove:				
Aircraft fuel expense (1), ground package costs at Air Canada Vacations, and the operating expenses of Aeroplan	(4.59)	(4.60)	0.01	-
Adjusted CASM (2)	**¢ 10.91**	**¢ 10.29**	**¢ 0.62**	**6.1**

(1) Includes aircraft fuel expense related to regional airline operations.
(2) Adjusted CASM is a non-GAAP financial measure. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

OPERATING EXPENSES

In 2019, on a capacity increase of 1.8%, operating expenses of $17,481 million increased $974 million or 6% from 2018. In 2019, the unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars), compared to 2018, increased operating expenses by $144 million (comprised of $85 million related to aircraft fuel expense and $59 million related to non-fuel operating expenses).

Aeroplan-related operating expenses amounted to $200 million in 2019. These expenses mainly impact wages, salaries and benefits, depreciation and amortization, communications and information technology and other expenses.

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

AIRCRAFT FUEL EXPENSE

In 2019, aircraft fuel expense (including fuel expense related to regional airline operations) amounted to $4,347 million, a decrease of $153 million or 3% from 2018. This decrease reflected the impact of lower jet fuel prices (before the impact of foreign exchange), accounting for a decrease of $306 million, and other factors, including lower fuel hedging expenses, accounting for a decrease of $22 million. These decreases were partly offset by a higher volume of fuel litres consumed, accounting for an increase of $90 million, and an unfavourable currency impact of $85 million. In 2019, Air Canada's fuel consumption was adversely impacted by the grounding of the Boeing 737 MAX fleet, which required the use of less fuel-efficient replacement aircraft.

WAGES, SALARIES AND BENEFITS EXPENSE

In 2019, wages and salaries expense of $2,464 million increased $290 million or 13% from 2018, largely due to a 10.1% increase in the number of full-time equivalent employees ("FTEs"), which included the impact of the acquisition of Aeroplan on January 10, 2019, and incremental personnel to support Air Canada's technology projects, including the insourcing of certain functions previously outsourced to third parties. The increase also reflected an increase in expenses related to employee profit sharing programs and higher stock-based compensation expense, which was due to the increase in Air Canada's share price during the period. Although Air Canada's Boeing 737 MAX fleet was grounded in early 2019, pilot wages related to these aircraft continue to be incurred as Air Canada awaits their return to service. Refer to section 9 "Fleet" for additional information.

In 2019, employee benefits expense of $720 million increased $21 million or 3% from 2018 mainly due to the higher level of FTE employees. This increase was partly offset by the favourable impact of higher discount rates related to pension and post-employment benefits.

REGIONAL AIRLINES EXPENSE

In 2019, regional airlines expense of $2,441 million decreased $67 million or 3% compared to 2018 on lower aircraft fuel expense, the impact of Air Canada's extended and amended capacity purchase agreement with Jazz (which became effective on January 1, 2019) and less flying by regional carriers when compared to 2018.

The table below provides a breakdown of regional airlines expense for the fourth quarter of 2019 and the fourth quarter of 2018.

(Canadian dollars in millions)	FULL YEAR			
	2019	2018	$ CHANGE	% CHANGE
Capacity purchase fees [(1)]	$ 1,042	$ 1,067	$ (25)	(2)
Aircraft fuel	485	531	(46)	(9)
Airport and navigation	292	296	(4)	(1)
Sales and distribution costs	158	153	5	3
Other operating expenses	464	461	3	3
Total regional airlines expense	**$ 2,441**	**$ 2,508**	**$ (67)**	**(3)**

(1) Capacity purchase fees exclude the component of fees related to aircraft costs which are accounted for as lease liabilities in accordance with IFRS 16 – Leases.

DEPRECIATION AND AMORTIZATION EXPENSE

In 2019, depreciation and amortization expense of $1,986 million increased $269 million or 16% from 2018. This increase was largely due to a higher volume of engine maintenance events on leased aircraft, the addition of Boeing 737 MAX and Boeing 787 aircraft into the mainline fleet, and the amortization of intangible assets recorded on the acquisition of Aeroplan on January 10, 2019.

AIRCRAFT MAINTENANCE EXPENSE

In 2019, aircraft maintenance expense of $1,004 million increased $101 million or 11% from 2018, reflecting, in large part, a higher volume of maintenance activity compared to 2018 and an unfavourable currency impact. In order to mitigate the impact of the Boeing 737 MAX grounding, Air Canada extended leases for Airbus A320 and Embraer 190 aircraft, resulting in a higher volume of maintenance activity than originally planned.

The table below provides a breakdown of the more significant items included in maintenance expense for the full year 2019 and the full year 2018.

(Canadian dollars in millions)	FULL YEAR			
	2019	2018	$ CHANGE	% CHANGE
Technical maintenance	$ 875	$ 769	$ 106	14
Maintenance provisions [(1)]	102	127	(25)	(20)
Other	27	7	20	286
Total aircraft maintenance expense	**$ 1,004**	**$ 903**	**$ 101**	**11**

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

AIRPORT AND NAVIGATION FEES

In 2019, airport and navigation fees of $990 million increased $26 million or 3% from 2018, reflecting the use of larger aircraft due to the grounding of the Boeing 737 MAX aircraft and Air Canada's international expansion strategy. 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 a partly offsetting factor.

SALES AND DISTRIBUTION COSTS

In 2019, sales and distribution costs of $874 million increased $67 million or 8% from 2018, reflecting, in large part, the increase in passenger revenues. Growth in direct bookings partly offset increases in transaction fees paid to global distribution service providers.

GROUND PACKAGE COSTS

In 2019, the cost of ground packages at Air Canada Vacations of $627 million increased $25 million or 4% from 2018 due to higher passenger volumes year-over-year and an unfavourable currency impact, partly offset by a lower cost of ground packages due to changes in product mix.

COMMUNICATION AND INFORMATION TECHNOLOGY EXPENSE

In 2019, communication and information technology expense of $397 million increased $103 million or 35% from 2018. This increase reflected additional information technology projects year-over-year, including those related to security, data platforms and systems resiliency and modernization. This increase also includes the impact of the acquisition of Aeroplan on January 10, 2019, as well as transitional costs associated with the insourcing of certain functions previously outsourced to third parties.

OTHER EXPENSES

In 2019, other expenses of $1,671 million increased $234 million or 16% from 2018. This increase reflected the cost of short-term aircraft leases, including for additional capacity related to the grounding of the Boeing 737 MAX aircraft, and higher project fees, including those related to the acquisition of Transat. This increase also includes the impact of the acquisition of Aeroplan on January 10, 2019.

The table below provides a breakdown of the more significant items included in other expenses for the full year 2019 and the full year 2018.

(Canadian dollars in millions)	FULL YEAR			
	2019	2018	$ CHANGE	% CHANGE
Terminal handling	$ 351	$ 327	$ 24	7
Crew cycle	228	212	16	8
Building rent and maintenance	178	149	29	19
Miscellaneous fees and services	213	173	40	23
Remaining other expenses	701	576	125	22
Total other expense	**$ 1,671**	**$ 1,437**	**$ 234**	**16**

NON-OPERATING INCOME (EXPENSE)

In 2019, non-operating income amounted to $125 million versus non-operating expenses of $1,268 million in 2018. Components of the year-over-year change in non-operating income included:

- In 2019, gains on foreign exchange amounted to $499 million compared to losses on foreign exchange of $578 million in 2018. The December 31, 2019 closing exchange rate was US$1=C$1.299, while the December 31, 2018 closing exchange rate was US$1=C$1.3637. The gains on foreign exchange in 2019 included gains on long-term debt and lease liabilities of $417 million and gains on foreign currency derivatives of $92 million.
- In 2018, Air Canada recorded a gain on debt settlements and modifications of $9 million, comprised of 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.
- In 2019, Air Canada recorded a gain of $13 million on the sale of aircraft, spare engines and a flight simulator, while no such gain was recorded in 2018.
- In 2018, Air Canada recorded a loss of $188 million on the sale of 25 Embraer 190 aircraft in 2018, while no such loss was recorded in 2019.

INCOME TAXES

In 2019, Air Canada recorded income tax expense of $299 million ($191 million in 2018). The table below provides a breakdown of what is included in income tax expense for the full year 2019 and the full year 2018.

(Canadian dollars in millions)	**2019**	2018
Current income tax	$ (72)	$ (6)
Deferred income tax	(227)	(185)
Income tax expense	**$ (299)**	**$ (191)**

8. RESULTS OF OPERATIONS – FOURTH QUARTER 2019 VERSUS FOURTH QUARTER 2018

The following table and discussion provide and compare results of Air Canada for the fourth quarter of 2019 and the fourth quarter of 2018:

(Canadian dollars in millions, except per share figures)	FOURTH QUARTER			
	2019	2018	$ CHANGE	% CHANGE
OPERATING REVENUES				
Passenger	$ 3,975	$ 3,776	$ 199	5
Cargo	186	217	(31)	(14)
Other	268	234	34	15
Total revenues	**4,429**	**4,227**	**202**	**5**
OPERATING EXPENSES				
Aircraft fuel	897	958	(61)	(6)
Wages, salaries and benefits	816	719	97	13
Regional airlines expense				
Aircraft fuel	116	133	(17)	(13)
Other	505	487	18	4
Depreciation and amortization	520	440	80	18
Aircraft maintenance	250	245	5	2
Airport and navigation fees	230	225	5	2
Sales and distribution costs	194	182	12	7
Ground package costs	131	126	5	4
Catering and onboard services	105	104	1	1
Communications and information technology	109	69	40	58
Other	411	360	51	14
Total operating expenses	**4,284**	**4,048**	**236**	**6**
Operating income	**145**	**179**	**(34)**	
NON-OPERATING INCOME (EXPENSE)				
Foreign exchange gain (loss)	92	(444)	536	
Interest income	41	32	9	
Interest expense	(122)	(142)	20	
Interest capitalized	9	8	1	
Net financing expense relating to employee benefits	(10)	(12)	2	
Gain (loss) on financial instruments recorded at fair value	5	(3)	8	
Gain on debt settlements and modifications	6	-	6	
Gain on disposal of assets	13	-	13	
Other	(7)	(9)	2	
Total non-operating income (expense)	**27**	**(570)**	**597**	
Income (loss) before income taxes	**172**	**(391)**	**563**	
Income tax (expense) recovery	(20)	31	(51)	
Net income (loss)	**$ 152**	**$ (360)**	**$ 512**	
Diluted earnings (loss) per share	**$ 0.56**	**$ (1.33)**	**$ 1.89**	
EBITDA (1)	**$ 665**	**$ 619**	**$ 46**	
Adjusted pre-tax income (1)	**$ 66**	**$ 68**	**$ (2)**	
Adjusted net income (1)	**$ 47**	**$ 55**	**$ (8)**	
Adjusted earnings per share – diluted (1)	**$ 0.17**	**$ 0.20**	**$ (0.03)**	

(1) EBITDA, adjusted pre-tax income (loss), adjusted net income (loss) and adjusted earnings (loss) per share – diluted are non-GAAP financial measures. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

SYSTEM PASSENGER REVENUES

In the fourth quarter of 2019, passenger revenues of $3,975 million increased $199 million or 5.3% from the fourth quarter of 2018 on traffic growth of 2.9% and a yield improvement of 2.3%. The impact of the Boeing 737 MAX aircraft grounding resulted in system ASM growth of 3.3% in the fourth quarter of 2019 versus planned system ASM growth of approximately 4.6%. In the fourth quarter of 2019, the yield improvement, particularly in North America, was due to the constrained capacity resulting from the grounding of the Boeing 737 MAX aircraft. The yield increases also reflected additional revenue from Aeroplan flight redemptions and other revenues subsequent to the Aeroplan acquisition on January 10, 2019.

In the fourth quarter of 2019, business cabin revenues, on a system basis, increased $31 million or 3.7% from the fourth quarter of 2018 on yield growth of 4.1%.

The table below provides passenger revenues by geographic region for the fourth quarter of 2019 and the fourth quarter of 2018.

(Canadian dollars in millions)	FOURTH QUARTER			
	2019	2018	$ CHANGE	% CHANGE
PASSENGER REVENUE				
Canada	$ 1,258	$ 1,212	$ 46	3.8
U.S. transborder	903	842	61	7.2
Atlantic	942	890	52	5.9
Pacific	555	549	6	1.2
Other	317	283	34	12.1
System	**$ 3,975**	**$ 3,776**	**$ 199**	**5.3**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics by geographic region for the fourth quarter of 2019 versus the fourth quarter of 2018.

FOURTH QUARTER 2019 VERSUS FOURTH QUARTER 2018	PASSENGER REVENUE % CHANGE	CAPACITY (ASMs) % CHANGE	TRAFFIC (RPMs) % CHANGE	PASSENGER LOAD FACTOR PP CHANGE	YIELD % CHANGE	PRASM % CHANGE
Canada	3.8	3.4	(0.1)	(2.8)	3.8	0.3
U.S. transborder	7.2	0.8	(1.0)	(1.5)	8.3	6.3
Atlantic	5.9	7.0	7.8	0.6	(1.8)	(1.0)
Pacific	1.2	(1.5)	(0.2)	1.1	1.4	2.8
Other	12.1	7.3	9.8	1.9	2.2	4.5
System	**5.3**	**3.3**	**2.9**	**(0.3)**	**2.3**	**2.0**

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the fourth quarter of 2019 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'18	Q1'19	Q2'19	Q3'19	Q4'19
SYSTEM					
Passenger revenues	11.3	9.3	10.4	2.8	5.3
Capacity (ASMs)	5.8	4.6	2.3	(2.1)	3.3
Traffic (RPMs)	7.2	4.2	3.6	(1.8)	2.9
Passenger load factor (pp change)	1.1	(0.4)	1.0	0.2	(0.3)
Yield	3.8	4.9	6.6	4.7	2.3
PRASM	5.2	4.4	7.9	5.0	2.0

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

- The 2.3% system yield growth which reflected yield increases in all markets with the exception of the Atlantic. The yield growth reflected increases in fares and an improvement in the overall fare mix. Additional yield earned on Aeroplan redemption revenues and growth in higher-yielding local traffic were also contributing factors to the yield growth year-over-year. These increases were partly offset by the impact of a longer average stage length year-over-year.
- The 2.9% traffic increase which reflected traffic growth in the Atlantic and Other markets. Traffic in the fourth quarter of 2019 was impacted by a slightly weaker western Canada market, a transitional impact arising from Air Canada's move to a new reservation system in mid-November, as well as fewer connecting passengers as a result of the grounding of the Boeing 737 MAX aircraft.

Compared to the fourth quarter of 2018, in the fourth quarter of 2019, PRASM increased 2.0% on the higher yield.

DOMESTIC PASSENGER REVENUES

In the fourth quarter of 2019, on capacity growth of 3.4%, domestic passenger revenues of $1,258 million increased $46 million or 3.8% from the fourth quarter of 2018.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the fourth quarter of 2019 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'18	**Q1'19**	**Q2'19**	**Q3'19**	**Q4'19**
CANADA					
Passenger revenues	5.6	5.8	10.4	8.5	3.8
Capacity (ASMs)	1.5	(0.1)	0.7	(0.1)	3.4
Traffic (RPMs)	1.7	0.6	1.9	(0.6)	(0.1)
Passenger load factor (pp change)	0.2	0.6	1.0	(0.4)	(2.8)
Yield	3.9	5.2	8.4	9.2	3.8
PRASM	4.1	6.0	9.6	8.6	0.3

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

- The 3.8% yield increase which reflected yield growth on all major domestic services. The yield increase reflected the impact of fare increases, an improved traffic mix from capacity constraints as a result of the grounding of Boeing 737 MAX aircraft and from the optimization of fare categories, growth in higher-yielding local traffic, and additional yield earned on Aeroplan redemptions.
- The 0.1% traffic decrease which reflected a slightly weaker western Canada market, a transitional impact arising from Air Canada's move to a new reservation system in mid-November, as well as fewer connecting passengers as a result of the capacity reduction due to the Boeing 737 MAX grounding.

Compared to the fourth quarter of 2018, domestic PRASM increased 0.3% in the fourth quarter of 2019 on the higher yield.

U.S. TRANSBORDER PASSENGER REVENUES

In the fourth quarter of 2019, on capacity growth of 0.8%, U.S. transborder passenger revenues of $903 million increased $61 million or 7.2% from the fourth quarter of 2018.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the fourth quarter of 2019 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'18	Q1'19	Q2'19	Q3'19	Q4'19
U.S. TRANSBORDER					
Passenger revenues	13.4	11.5	10.8	5.5	7.2
Capacity (ASMs)	9.7	8.0	0.3	(4.0)	0.8
Traffic (RPMs)	9.6	6.4	(0.1)	(3.9)	(1.0)
Passenger load factor (pp change)	(0.1)	(1.2)	(0.3)	0.1	(1.5)
Yield	3.5	4.7	10.9	9.8	8.3
PRASM	3.4	3.2	10.5	9.9	6.3

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

- The 8.3% yield increase which reflected yield growth on all major U.S. transborder services. The overall yield improvement included the impact of an improved traffic mix due to capacity constraints as a result of the grounding of Boeing 737 MAX aircraft, gains in the business cabin and additional yield earned on Aeroplan redemption revenues.
- The 1.0% traffic decrease which reflected, in large part, reduced capacity on services to Hawaii and on certain long-haul services, such as Eastern Canada to California, and fewer connecting passengers as a result of the grounding of the Boeing 737 MAX aircraft.

Compared to the fourth quarter of 2018, U.S. transborder PRASM increased 6.3% in the fourth quarter of 2019 on the higher yield.

ATLANTIC PASSENGER REVENUES

In the fourth quarter of 2019, on capacity growth of 7.0%, Atlantic passenger revenues of $942 million increased $52 million or 5.9% from the fourth quarter of 2018.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the fourth quarter of 2019 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'18	Q1'19	Q2'19	Q3'19	Q4'19
ATLANTIC					
Passenger revenues	18.0	11.9	11.7	0.4	5.9
Capacity (ASMs)	9.5	7.4	3.6	(1.3)	7.0
Traffic (RPMs)	14.5	8.1	5.8	(0.6)	7.8
Passenger load factor (pp change)	3.5	0.5	1.7	0.7	0.6
Yield	3.0	3.6	5.5	1.0	(1.8)
PRASM	7.7	4.2	7.8	1.8	(1.0)

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

- The 7.8% traffic increase which reflected traffic growth in all major Atlantic services with the exception of services from Halifax and St. John's to London Heathrow, which were suspended as a result of the grounding of the Boeing 737 MAX aircraft in mid-March 2019.
- The 1.8% yield decrease which reflected yield declines on most Atlantic services, reflecting the impact of increased industry capacity, which resulted in competitive pricing activities, as well as a longer average stage length year-over-year.

Compared to the fourth quarter of 2018, Atlantic PRASM decreased 1.0% in the fourth quarter of 2019 on the lower yield.

PACIFIC PASSENGER REVENUES

In the fourth quarter of 2019, on a capacity reduction of 1.5%, Pacific passenger revenues of $555 million increased $6 million or 1.2% from the fourth quarter of 2018.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the fourth quarter of 2019 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'18	Q1'19	Q2'19	Q3'19	Q4'19
PACIFIC					
Passenger revenues	9.7	4.7	6.7	(5.9)	1.2
Capacity (ASMs)	(0.8)	(1.5)	2.4	(4.1)	(1.5)
Traffic (RPMs)	0.3	(1.9)	2.7	(4.7)	(0.2)
Passenger load factor (pp change)	0.9	(0.4)	0.3	(0.5)	1.1
Yield	9.3	6.7	3.8	(1.2)	1.4
PRASM	10.6	6.2	4.1	(1.9)	2.8

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

- The 1.4% yield increase which reflected yield growth on services to China, Japan and Taiwan, partly offset by yield declines on services to Hong Kong and Korea.
- The 0.2% traffic decrease which reflected traffic declines on services to China and Taiwan, mostly offset by traffic increases on services to Japan, Korea and Australia. The geopolitical situation between Canada and China and the civil unrest in Hong Kong continued to negatively impact travel demand in the quarter, particularly business-related traffic demand between Canada and China/Hong Kong.

Compared to the fourth quarter of 2018, Pacific PRASM increased 2.8% in the fourth quarter of 2019 on the higher yield and a 1.1 percentage point improvement in passenger load factor.

OTHER PASSENGER REVENUES

In the fourth quarter of 2019, on capacity growth of 7.3%, Other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of $317 million increased $34 million or 12.1% from the fourth quarter of 2018.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the fourth quarter of 2019 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'18	Q1'19	Q2'19	Q3'19	Q4'19
OTHER					
Passenger revenues	14.5	14.6	13.3	3.4	12.1
Capacity (ASMs)	15.2	12.2	6.1	(2.2)	7.3
Traffic (RPMs)	14.0	9.4	9.6	1.2	9.8
Passenger load factor (pp change)	(0.9)	(2.2)	2.7	3.0	1.9
Yield	0.5	4.8	3.4	2.1	2.2
PRASM	(0.6)	2.2	6.8	5.8	4.5

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

- The 9.8% traffic increase which reflected traffic growth on services to South America and on routes to traditional sun destinations.
- The 2.2% yield increase which reflected yield growth on services to South America and Mexico, partly offset by yield decreases on routes to traditional sun destinations. Additional yield earned on Aeroplan redemption revenues and the favourable impact of Air Canada having reverted back to one-stop service to Buenos Aires with a connection in Santiago on April 1, 2019 were contributing factors to the yield improvement year-over-year. Gains from the premium economy cabin also contributed to the yield growth versus 2018.

Compared to the fourth quarter of 2018, PRASM in the Other markets increased 4.5% in the fourth quarter of 2019 on the higher yield and a 1.9 percentage improvement in passenger load factor.

CARGO REVENUES

In the fourth quarter of 2019, cargo revenues of $186 million decreased $31 million or 14.2% from the same period in 2018 on yield and traffic decreases of 8.7% and 6.0%, respectively. Demand for air cargo decreased industry-wide, particularly in the Atlantic and Pacific markets, causing reductions in volumes and putting downward pressure on yields, reflecting the impact of external factors, such as ongoing international trade challenges and reduced economic activities.

The table below provides cargo revenue by geographic region for the fourth quarter of 2019 and the fourth quarter of 2018.

(Canadian dollars in millions)	FOURTH QUARTER			
	2019	2018	$ CHANGE	% CHANGE
CARGO REVENUE				
Canada	$ 27	$ 27	$ -	-
U.S. transborder	11	12	(1)	(12.8)
Atlantic	63	72	(9)	(12.3)
Pacific	70	88	(18)	(20.9)
Other	15	18	(3)	(11.2)
System	**$ 186**	**$ 217**	**$ (31)**	**(14.2)**

OTHER REVENUES

In the fourth quarter of 2019, other revenues of $268 million increased $34 million or 15% when compared to the fourth quarter of 2018, mainly due to the net margin recorded on the redemption and delivery of non-air goods and services related to the Aeroplan program since its acquisition in January 2019. An increase in ground package revenue at Air Canada Vacations was also a contributing factor to the growth in other revenues year-over-year. The increase in ground package revenue at Air Canada Vacations was driven by higher passenger volumes and, to a lesser extent, a higher price of ground packages year-over-year.

CASM AND ADJUSTED CASM

In the fourth quarter of 2019, CASM increased 2.5% and adjusted CASM increased 5.5% compared to the fourth quarter of 2018. This increase reflected, in large part, the impact of the Boeing 737 MAX aircraft grounding, which resulted in a system ASM increase of 3.3% in the fourth quarter of 2019 rather than the planned system ASM growth of approximately 4.6%. It also resulted in significant higher costs associated with replacement aircraft and in higher ongoing operating expenses, including as a result of depreciation, aircraft maintenance and pilot wages that continued to be incurred in relation to the Boeing 737 MAX aircraft despite their grounding.

The table below compares Air Canada's CASM and adjusted CASM for the fourth quarter of 2019 to the fourth quarter of 2018. Given that the Aeroplan loyalty business was not consolidated in Air Canada's financial results in 2018, for a more meaningful comparison of the cost performance of the ongoing airline business, Air Canada's adjusted CASM for the fourth quarter excludes the operating expenses of Aeroplan.

(cents per ASM)	FOURTH QUARTER			
	2019 [1]	2018	¢ CHANGE	% CHANGE
CASM	**¢ 16.21**	**¢ 15.81**	**¢ 0.40**	**2.5**
Remove:				
Aircraft fuel expense [1], ground package costs at Air Canada Vacations, and the operating expenses of Aeroplan	(4.54)	(4.75)	0.21	4.4
Adjusted CASM [2]	**¢ 11.67**	**¢ 11.06**	**¢ 0.61**	**5.5**

(1) Includes aircraft fuel expense related to regional airline operations.
(2) Adjusted CASM is a non-GAAP financial measure. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

OPERATING EXPENSES

In the fourth quarter of 2019, on a capacity increase of 3.3%, operating expenses of $4,284 million increased $236 million or 6% from the fourth quarter of 2018.

Aeroplan-related operating expenses amounted to $58 million in the fourth quarter of 2019. These expenses mainly impact wages, salaries and benefits, depreciation and amortization, communications and information technology and other 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 2019, aircraft fuel expense (including fuel expense related to regional airline operations) amounted to $1,013 million, a decrease of $78 million or 7% from the fourth quarter of 2018. This decrease reflected the impact of lower jet fuel prices (before the impact of foreign exchange), accounting for a decrease of $102 million and other factors, including lower fuel hedging expenses, accounting for a decrease of $25 million. These decreases were partly offset by a higher volume of fuel litres consumed, accounting for an increase of $45 million, and an unfavourable currency impact of $4 million.

WAGES, SALARIES AND BENEFITS EXPENSE

In the fourth quarter of 2019, wages and salaries expense of $650 million increased $93 million or 17% from the same period in 2018. This increase was largely due to a 9.2% increase in the number of FTEs, which included the impact of the acquisition of Aeroplan on January 10, 2019 and incremental personnel to support Air Canada's technology projects, including the insourcing of certain functions previously outsourced to third parties. The increase also reflected higher stock-based compensation expense, which was due to the increase in Air Canada's share price during the period, and an increase in expenses related to employee profit sharing programs. Although Air Canada's Boeing 737 MAX fleet was grounded in early 2019, pilot wages related to these aircraft continue to be incurred as Air Canada awaits their return to service.

In the fourth quarter of 2019, employee benefits expense of $166 million increased $4 million from the same quarter in 2018 mainly due to the higher level of FTE employees. This increase was partly offset by the favourable impact of higher discount rates related to pension and post-employment benefits.

REGIONAL AIRLINES EXPENSE

In the fourth quarter of 2019, regional airlines expense of $621 million increased $1 million from the same quarter in 2018. The impact of lower aircraft fuel expense and less flying by regional carriers year-over-year was offset by higher capacity purchase fees due to timing of expenses when compared to the fourth quarter of 2018.

The table below provides a breakdown of regional airlines expense for the fourth quarter of 2019 and the fourth quarter of 2018.

(Canadian dollars in millions)	FOURTH QUARTER			
	2019 (1)	2018	$ CHANGE	% CHANGE
Capacity purchase fees (1)	$ 277	$ 264	$ 13	5
Aircraft fuel	116	133	(17)	(13)
Airport and navigation	71	73	(2)	(3)
Sales and distribution costs	38	34	4	12
Other operating expenses	119	116	3	3
Total regional airlines expense	**$ 621**	**$ 620**	**$ 1**	**-**

(1) Capacity purchase fees exclude the component of fees related to aircraft costs which are accounted for as lease liabilities in accordance with IFRS 16 – Leases.

DEPRECIATION AND AMORTIZATION EXPENSE

In the fourth quarter of 2019, depreciation and amortization expense of $520 million increased $80 million or 18% from the same period in 2018. This increase was largely due to a higher volume of engine maintenance events on leased aircraft, the addition of Boeing 737 MAX and Boeing 787 aircraft into the mainline fleet, and the amortization of intangible assets recorded on the acquisition of Aeroplan on January 10, 2019.

AIRCRAFT MAINTENANCE EXPENSE

In the fourth quarter of 2019, aircraft maintenance expense of $250 million increased $5 million or 2% from the same period in 2018.

The table below provides a breakdown of the more significant items included in maintenance expense for the fourth quarter of 2019 and the fourth quarter of 2018.

(Canadian dollars in millions)	FOURTH QUARTER			
	2019 (1)	2018	$ CHANGE	% CHANGE
Technical maintenance	$ 218	$ 211	$ 7	3
Maintenance provisions (1)	24	31	(7)	(23)
Other	8	3	5	167
Total aircraft maintenance expense	**$ 250**	**$ 245**	**$ 5**	**2**

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

COMMUNICATION AND INFORMATION TECHNOLOGY EXPENSE

In the fourth quarter of 2019, communication and information technology expense of $109 million increased $40 million or 58% from the same period in 2018. This increase reflected additional information technology projects year-over-year, including those related to security, data platforms and systems resiliency and modernization. This increase also includes the impact of the acquisition of Aeroplan on January 10, 2019, transitional costs associated with the insourcing of certain functions previously outsourced to third parties, as well as transaction fees related to Air Canada's new reservation system, launched in mid-November 2019.

OTHER EXPENSES

In the fourth quarter of 2019, other expenses of $411 million increased $51 million or 14% from the same period in 2018. This increase reflected the cost of short-term aircraft leases, including for additional capacity related to the grounding of the Boeing 737 MAX aircraft and higher project fees, including those related to the acquisition of Transat. This increase also includes the impact of the acquisition of Aeroplan on January 10, 2019.

The table below provides a breakdown of the more significant items included in other expenses for the fourth quarter of 2019 and the fourth quarter of 2018.

(Canadian dollars in millions)	FOURTH QUARTER			
	2019	2018	$ CHANGE	% CHANGE
Terminal handling	$ 82	$ 77	$ 5	6
Crew cycle	55	52	3	6
Building rent and maintenance	46	40	6	15
Miscellaneous fees and services	51	50	1	2
Remaining other expenses	177	141	36	26
Total other expense	**$ 411**	**$ 360**	**$ 51**	**14**

NON-OPERATING INCOME (EXPENSE)

In the fourth quarter of 2019, non-operating income amounted to $27 million versus non-operating expense of $570 million in the fourth quarter of 2018.

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

- In the fourth quarter of 2019, gains on foreign exchange amounted to $92 million compared to losses on foreign exchange of $444 million in the fourth quarter of 2018. The December 31, 2019 closing exchange rate was US$1=C$1.299, while the September 30, 2019 closing exchange rate was US$1=C$1.3241. The gains on foreign exchange in the fourth quarter of 2019 included foreign exchange gains on long-term debt and lease liabilities of $159 million and foreign exchange losses on foreign currency derivatives of $70 million.
- In the fourth quarter of 2019, Air Canada recorded a gain on debt settlements and modifications of $6 million related to the repricing of its US$1.1 billion senior secured credit facility, while no such gain was recorded in the fourth quarter of 2018.
- In the fourth quarter of 2019, Air Canada recorded a gain on disposal of assets of $13 million related to the sale of an aircraft, spare engines and a flight simulator, while no such gain was recorded in the fourth quarter of 2018.

9. FLEET

MAINLINE AND AIR CANADA ROUGE

The following table provides Air Canada's and Air Canada Rouge's operating fleet as at December 31, 2019. 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 (2)	AVERAGE AGE	OWNED	LEASED
MAINLINE					
Wide-body aircraft					
Boeing 787-8	255	8	5.3	8	-
Boeing 787-9	298	29	3.0	23	6
Boeing 777-300ER	400/450	19	9.5	10	9
Boeing 777-200LR	300	6	12.2	4	2
Boeing 767-300ER	211	5	30.1	4	1
Airbus A330-300	289	13	15.9	8	5
Narrow-body aircraft					
Boeing 737 MAX 8 (1)	169	24	1.6	24	-
Airbus A321	190	15	16.7	5	10
Airbus A320	147	38	25.0	7	31
Airbus A319	108	16	22.2	5	11
Airbus A220-300	137	1	0	1	-
Embraer 190	97	14	12.2	-	14
Total Mainline		**188**	**13.3**	**99**	**89**
AIR CANADA ROUGE					
Wide-body aircraft					
Boeing 767-300ER (2)	282	25	22.6	3	22
Narrow-body aircraft					
Airbus A321	199	14	4.2	4	10
Airbus A320	146	3	12.5	-	3
Airbus A319 (2)	136	22	21.2	17	5
Total Air Canada Rouge		**64**	**17.7**	**24**	**40**
Total Mainline and Air Canada Rouge (3)		**252**	**14.4**	**123**	**129**

(1) The Boeing 737 MAX fleet is grounded. Refer to "Grounding of Boeing737 MAX Aircraft" below for additional information.
(2) 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.
(3) Air Canada has contracted with other airlines to provide capacity under wet lease agreements as a result of the grounding of its Boeing 737 MAX fleet. The aircraft under these arrangements are excluded from the table above.

The tables below provide the number of aircraft in Air Canada's operating fleet as at December 31, 2019, 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, 2020 and December 31, 2021. Given the continued grounding of the Boeing 737 MAX aircraft, as described below, Air Canada assumes, in the table below, that six of 12 undelivered Boeing 737 MAX aircraft originally scheduled for delivery in 2019 will be delivered in 2020 and the remaining six will be delivered in 2021. Air Canada also assumes that 14 undelivered Boeing 737 MAX aircraft originally scheduled for delivery in 2020 will be delivered in 2021.

	ACTUAL	PLANNED			
	DEC. 31, 2019	2020 FLEET CHANGES	DEC. 31, 2020	2021 FLEET CHANGES	DEC. 31, 2021
MAINLINE					
Wide-body aircraft					
Boeing 787-8	8	-	8	-	8
Boeing 787-9	29	-	29	-	29
Boeing 777-300ER	19	-	19	-	19
Boeing 777-200LR	6	-	6	-	6
Boeing 767-300ER	5	-	5	(5)	-
Airbus A330-300	13	4	17	-	17
Narrow-body aircraft					
Boeing 737 MAX 8 (1)	24	6	30	20	50
Airbus A321	15	-	15	-	15
Airbus A320	38	(22)	16	(6)	10
Airbus A319	16	-	16	(7)	9
Airbus A220-300	1	17	18	16	34
Embraer 190	14	(14)	-	-	-
Total Mainline	**188**	**(9)**	**179**	**18**	**197**
AIR CANADA ROUGE					
Wide-body aircraft					
Boeing 767-300ER	25	(2)	23	-	23
Narrow-body aircraft					
Airbus A321	14	-	14	-	14
Airbus A320	3	2	5	-	5
Airbus A319	22	-	22	-	22
Total Air Canada Rouge	**64**	**-**	**64**	**-**	**64**
Total wide-body aircraft	**105**	**2**	**107**	**(5)**	**102**
Total narrow-body aircraft	**147**	**(11)**	**136**	**23**	**159**
Total Mainline and Air Canada Rouge	**252**	**(9)**	**243**	**18**	**261**

(1) Grounding of Boeing 737 MAX Aircraft

GROUNDING OF BOEING 737 MAX AIRCRAFT

On March 12, 2019, the European Aviation Safety Agency ("EASA") issued an Emergency Directive suspending the operation of the Boeing 737 MAX within, to and from the European skies (including outside territories). On March 13, 2019, Transport Canada issued a safety notice closing Canadian airspace to Boeing 737 MAX aircraft until further notice, followed by the Federal Aviation Administration's issuing of a temporary grounding order for the Boeing 737 MAX aircraft. On March 14, 2019, Boeing advised it was suspending Boeing 737 MAX deliveries to airline customers. Air Canada has been expecting to receive another 12 aircraft, for a total fleet of 36 Boeing 737 MAX aircraft by July 2019. Because the timeline for the return to service of the Boeing 737 MAX aircraft remains uncertain, for planning purposes, Air Canada is removing Boeing 737 MAX flying from its schedule until the end of June 2020. The table above may change once the duration and related impact of the grounding, or Boeing's decision to suspend deliveries, of the Boeing 737 MAX aircraft are known. Final decisions on returning the Boeing 737 MAX aircraft to service will be based on Air Canada's safety assessment following the lifting of government safety notices and approval by international regulatory authorities.

Measures taken by Air Canada to mitigate the impact of the Boeing 737 MAX grounding include:

- Substituting different aircraft on Boeing 737 MAX routes, maintaining certain owned or leased aircraft (including Boeing 767, Airbus A320 and Embraer 190 aircraft) in the operating fleet longer than originally planned, and accelerating the intake of up to eight Airbus A321 aircraft from WOW Air into its fleet.
- Contracting other carriers to provide additional capacity.
- Implementing several route changes, either changing operating times or substituting larger aircraft with fewer frequencies on routes operated more frequently by smaller aircraft.
- In some cases, deploying Air Canada Rouge aircraft to serve mainline routes and, in a small number of cases, suspending service on certain Boeing 737 MAX routes where alternative capacity is not yet available. Air Canada remains committed to these routes and will resume service as soon as possible. In addition, some seasonal route launches, such as Montréal-Bordeaux and Vancouver-Boston, were delayed.
- Maintaining Boeing 737 MAX aircraft training and flying requirements of pilots assigned to the Boeing 737 MAX aircraft.

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 and five were returned to the lessor in 2019, with the remaining 14 aircraft planned to exit the fleet in 2020.

AIR CANADA EXPRESS

The table below provides the number of aircraft operated, as at December 31, 2019, and planned, as at December 31, 2020 and December 31, 2021, 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			
	DEC. 31, 2019	2020 FLEET CHANGES	DEC. 31, 2020	2021 FLEET CHANGES	DEC. 31, 2021
Embraer 175	25	-	25	-	25
Bombardier CRJ-100/200	22	(7)	15	-	15
Bombardier CRJ-900	26	7	33	2	35
Bombardier Dash 8-100	6	(6)	-	-	-
Bombardier Dash 8-300	23	(4)	19	-	19
Bombardier Dash 8-Q400	44	(4)	40	(4)	36
Total Air Canada Express	**146**	**(14)**	**132**	**(2)**	**130**

OTHER AIRCRAFT WITH CPA CARRIERS

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

10. FINANCIAL AND CAPITAL MANAGEMENT

10.1. 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 10.6, 10.7 and 10.8 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, 2019, unrestricted liquidity amounted to $7,380 million (comprised of cash, cash equivalents and short-term investments of $5,889 million, long-term investments of $512 million and undrawn lines of credit of $979 million). This compared to unrestricted liquidity of $5,725 million at December 31, 2018 (comprised of cash, cash equivalents and short-term investments of $4,707 million and undrawn lines of credit of $1,018 million). After further review of Air Canada's liquidity management practices, in 2019 Air Canada updated its unrestricted liquidity definition to include long-term investments. Long-term investments are comprised of government bonds and other investment instruments that meet certain credit rating guidelines. Air Canada's long-term investments of $512 million at December 31, 2019 can be used to meet long-term financial commitments or converted to cash, if needed.

Air Canada defines excess cash as total cash and investments in excess of the minimum cash required to support operations. This measure of liquidity includes cash, cash equivalents, short-term investments, short-term restricted cash and long-term investments. Air Canada uses 20% of trailing 12-month operating revenue as its estimate of the minimum cash required to support ongoing business operations. This estimate of minimum cash provides adequate coverage for advance ticket sales and to meet Air Canada's liquidity needs, as described above. Excess cash amounted to $2,732 million at December 31, 2019. Excess cash is applied against shareholders' equity in the calculation of return on invested capital. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

In addition, Air Canada monitors its financial leverage as measured by the net debt to EBITDA ratio, as further described in section 10.3 of this MD&A.

10.2. FINANCIAL POSITION

The table below provides a condensed consolidated statement of financial position of Air Canada as at December 31, 2019 and as at December 31, 2018.

(Canadian dollars in millions)	**DEC. 31, 2019**	DEC. 31, 2018	$ CHANGE
ASSETS			
Cash, cash equivalents and short-term investments	$ 5,889	$ 4,707	$ 1,182
Other current assets	1,627	1,594	33
Current assets	**$ 7,516**	**$ 6,301**	**$ 1,215**
Investments, deposits and other assets	936	401	535
Property and equipment	12,834	12,183	651
Pension assets	2,064	1,969	95
Deferred income tax	134	314	(180)
Intangible assets	1,002	404	598
Goodwill	3,273	311	2,962
Total assets	**$ 27,759**	**$ 21,883**	**$ 5,876**
LIABILITIES			
Current liabilities	$ 7,775	$ 5,676	$ 2,099
Long-term debt and lease liabilities	8,024	8,873	(849)
Aeroplan and other deferred revenue	3,136	-	3,136
Pension and other benefit liabilities	2,930	2,547	383
Maintenance provisions	1,240	1,307	(67)
Other long-term liabilities	181	151	30
Deferred income tax	73	52	21
Total liabilities	**$ 23,359**	**$ 18,606**	**$ 4,753**
Total shareholders' equity	**$ 4,400**	**$ 3,277**	**$ 1,123**
Total liabilities and shareholders' equity	**$ 27,759**	**$ 21,883**	**$ 5,876**

Movements in current assets and current liabilities are described in section 10.4 "Working Capital" of this MD&A. Long-term debt and lease liabilities are discussed in sections 10.3 "Net Debt" and 10.5 "Consolidated Cash Flow Movements" of this MD&A.

Investments, deposits and other assets amounted to $936 million as at December 31, 2019, an increase of $535 million from December 31, 2018. The reasons for the increase include Air Canada's equity investment in Chorus, as described below, and the cash amounts placed in long-term investment accounts, as described in section 10.3 "Net Debt" of this MD&A.

At December 31, 2019, property and equipment amounted to $12,834 million, an increase of $651 million from December 31, 2018. This increase was due to additions to property and equipment of $2,552 million, including the non-cash impact of the Jazz CPA extension as described below, offset by the impact of depreciation expense of $1,872 million.

In 2019, additions to property and equipment included two new Boeing 787 aircraft, six new Boeing 737 MAX aircraft, one new Airbus A220 aircraft and four used Airbus A321 aircraft. These aircraft were purchased with cash. In 2019, additions to property and equipment also included progress payments on future aircraft deliveries and capitalized maintenance costs.

At December 31, 2019, net long-term pension and other benefit liabilities of $866 million (comprised of pension and other benefit liabilities of $2,930 million net of pension assets of $2,064 million) increased $288 million from December 31, 2018. The increase was mainly due to total costs recognized of $354 million during 2019. The increase also included the impact of a 68-basis point decrease in the discount rate used to value the liabilities, largely offset by a strong return on plan assets, resulting in a net loss on remeasurements on employee liabilities of $32 million ($22 million, net of tax) recorded on Air Canada's consolidated statement of comprehensive income.

ACQUISITION OF AEROPLAN

In January 2019, Air Canada completed the acquisition of Aeroplan, as further described in section 6 "Overview" of this MD&A. In addition to the commercial agreement consideration of $1,212 million and the $400 million prepayment of Aeroplan Miles (both of which are recorded within Aeroplan and other deferred revenue), the table below summarizes the additions to Air Canada's consolidated statement of financial position on the acquisition date.

(Canadian dollars in millions)

FAIR VALUE OF ASSETS ACQUIRED	
Cash	$ -
Accounts receivable	188
Prepaid expenses and other current assets	8
Property and equipment	55
Deferred income tax	44
Intangible assets – Technology-based	38
Intangible assets – Contract-based	225
Intangible assets – Trade name	90
	$ 648
FAIR VALUE OF LIABILITIES ASSUMED	
Accounts payable and accrued liabilities	210
Deferred revenue (current and long-term)	2,779
Long-term debt (lease liabilities)	41
Pension and other benefit liabilities	39
Deferred income tax	24
	$ 3,093
Fair value of net assets acquired	**(2,445)**
Goodwill	**2,962**
Total purchase consideration	**$ 517**

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 ("Jazz CPA") with Jazz, a wholly-owned subsidiary of Chorus Aviation Inc. The amendments provide an extension of the CPA term by 10 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 the fleet within its network strategy. The amendments became effective retroactively as at January 1, 2019. With the extension of the Jazz CPA term, increases of $95 million to the right-of-use asset and $104 million to the lease liability and a decrease of $9 million to the maintenance provision were recorded in the first quarter of 2019. The increases to the right-of-use asset and lease liability relate only to those aircraft that are specifically identified to be extended at this time. As additional aircraft are confirmed for extension during the term of the contract, additional right-of-use assets and lease liabilities will be recorded.

Concurrently with the Jazz 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 million 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 from February 2019, subject to certain limited exceptions. The equity investment in Chorus is accounted for at fair value, with all changes in fair value recorded through other comprehensive income. The fair value of the investment at December 31, 2019 was $126 million and is recorded in investments, deposits and other assets on Air Canada's consolidated statement of financial position. The change in fair value recorded through other comprehensive income for the year ended December 31, 2019 was $25 million, comprised of a gain of $29 million less deferred income tax expense of $4 million.

10.3. NET DEBT

The table below reflects Air Canada's net debt balances as at December 31, 2019 and as at December 31, 2018.

(Canadian dollars in millions, except where indicated)	**DEC. 31, 2019**	DEC. 31, 2018	$ CHANGE
Total long-term debt and lease liabilities	$ 8,024	$ 8,873	$ (849)
Current portion of long-term debt and lease liabilities	1,218	1,048	170
Total long-term debt and lease liabilities (including current portion)	**$ 9,242**	**$ 9,921**	**$ (679)**
Less cash, cash equivalents and short and long-term investments	(6,401)	(4,707)	(1,694)
Net debt (1)	**$ 2,841**	**$ 5,214**	**$ (2,373)**
EBITDA (trailing 12-month)	**$ 3,636**	**$ 3,213**	**$ 423**
Net debt to EBITDA ratio (2)	**0.8**	**1.6**	**(0.8)**

(1) 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.
(2) Net debt to trailing 12-month EBITDA ratio (also referred to as "leverage ratio" in this MD&A) is a non-GAAP financial measure and is used by Air Canada to measure financial leverage. Leverage ratio is calculated by dividing net debt by trailing 12-month EBITDA. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

At December 31, 2019, total long-term debt and lease liabilities (including current portion) of $9,242 million decreased $679 million from December 31, 2018. The favourable impact of a stronger Canadian dollar, as at December 31, 2019 compared to December 31, 2018, decreased foreign currency denominated debt (mainly U.S. dollars) by $417 million. Partially offsetting this decrease was the impact of the Jazz CPA extension, as described in section 10.2 "Financial Position" of this MD&A, which increased lease liabilities by $104 million.

At December 31, 2019, net debt of $2,841 million decreased $2,373 million from December 31, 2018, reflecting an increase in cash, cash equivalents and short and long-term investment balances of $1,694 million and a decrease in long-term debt and lease liabilities (including current portion) of $679 million. At December 31, 2019, Air Canada's leverage ratio (net debt to trailing 12-month EBITDA ratio) was 0.8 versus a leverage ratio of 1.6 at December 31, 2018.

In 2019, Air Canada began placing a portion of its cash in long-term investment accounts in order to improve investment returns while taking into account Air Canada's short-term cash flow needs. As at December 31, 2019, these long-term investments amounted to $512 million. These investments can be used to meet longer-term financial commitments or converted to cash, if needed. As such, Air Canada updated its definition of net debt to include these long-term investments (as a deduction) to arrive at net debt.

At December 31, 2019, Air Canada's weighted average cost of capital ("WACC"), on a pre-tax basis, was 7.0%. WACC is based on an estimate by management and consists of an estimated cost of equity of 15.0% and a blended average cost of debt and lease liabilities of 5.0% (comprised of an average cost of debt of 4.1% and an average cost of lease liabilities of 6.5%). This compared to WACC, on a pre-tax basis, of 8.0% at December 31, 2018, which consisted of an estimated cost of equity of 18.2% and a blended average cost of debt and lease liabilities of 5.4% (comprised of an average cost of debt of 4.2% and an average cost of lease liabilities of 7.6%).

10.4. WORKING CAPITAL

The table below provides information on Air Canada's working capital balances as at December 31, 2019 and as at December 31, 2018.

(Canadian dollars in millions)	DEC. 31, 2019	DEC. 31, 2018	$ CHANGE
Cash, cash equivalents and short-term investments	$ 5,889	$ 4,707	$ 1,182
Accounts receivable	926	796	130
Other current assets	701	798	(97)
Total current assets	**$ 7,516**	**$ 6,301**	**$ 1,215**
Accounts payable and accrued liabilities	2,456	1,911	545
Advance ticket sales	2,939	2,717	222
Aeroplan and other deferred revenue	1,162	-	1,162
Current portion of long-term debt and lease liabilities	1,218	1,048	170
Total current liabilities	**$ 7,775**	**$ 5,676**	**$ 2,099**
Net working capital	**$ (259)**	**$ 625**	**$ (884)**

The net negative working capital of $259 million at December 31, 2019 represented a decrease of $884 million from December 31, 2018. Cash used in investing and financing activities related to aircraft acquisitions, the investment in Chorus, the placing of cash in long-term investment accounts (as described in section 10.3 "Net Debt" above), and share repurchases were the main drivers of the decrease in net working capital in 2019.

Accounts payable and accrued liabilities of $2,456 million at December 31, 2019 increased $545 million from December 31, 2018, mostly due to an increase in current income tax payable, the addition of accounts payable from the acquisition of Aeroplan and the impact of growth in the business.

The net cash impact of the Aeroplan acquisition and related agreements amounted to an increase in cash of $1,115 million as at the acquisition date, representing the commercial agreement consideration of $1,212 million and the $400 million prepayment of Aeroplan Miles, which are reported as operating cash inflows, less the share purchase price of $517 million, which is reported as an investing outflow. On a working capital basis, this cash impact was largely offset with the current portion of Aeroplan and other deferred revenue.

10.5. CONSOLIDATED CASH FLOW MOVEMENTS

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

(Canadian dollars in millions)	FOURTH QUARTER			FULL YEAR		
	2019	2018	$ CHANGE	2019	2018	$ CHANGE
Net cash flows from operating activities	**$ 677**	**$ 548**	**$ 129**	**$ 5,712**	**$ 3,470**	**$ 2,242**
Proceeds from borrowings	-	-	-	-	1,210	(1,210)
Reduction of long-term debt and lease liabilities	(276)	(508)	232	(1,084)	(1,706)	622
Shares purchased for cancellation	(125)	(50)	(75)	(373)	(73)	(300)
Issue of shares	1	-	1	9	5	4
Financing fees	(1)	(4)	3	(1)	(12)	11
Net cash flows used in financing activities	**$ (401)**	**$ (562)**	**$ 161**	**$ (1,449)**	**$ (576)**	**$ (873)**
Investments, short-term and long-term	67	36	31	(255)	(848)	593
Additions to property, equipment and intangible assets	(251)	(260)	9	(2,025)	(2,436)	411
Proceeds from sale of assets	18	1	17	24	11	13
Proceeds from sale and leaseback of assets	-	-	-	-	293	(293)
Acquisition of Aeroplan	-	-	-	(517)	-	(517)
Investment in Chorus	-	-	-	(97)	-	(97)
Other	13	(1)	14	75	47	28
Net cash flows used in investing activities	**$ (153)**	**$ (224)**	**$ 71**	**$ (2,795)**	**$ (2,933)**	**$ 138**
Effect of exchange rate changes on cash and cash equivalents	**$ (9)**	**$ 16**	**$ (25)**	**$ (8)**	**$ 27**	**$ (35)**
Increase (decrease) in cash and cash equivalents	**$ 114**	**$ (222)**	**$ 336**	**$ 1,460**	**$ (12)**	**$ 1,472**

NET CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES

In the fourth quarter of 2019, net cash flows from operating activities of $677 million increased $129 million from the same quarter in 2018 on both an improvement in operating income and an increase in cash from working capital.

In 2019, net cash flows from operating activities of $5,712 million increased $2,242 million compared to 2018. As discussed in section 10.4 "Working Capital" of this MD&A, operating cash inflows related to the acquisition of Aeroplan amounted to $1,612 million. An improvement in operating income year-over-year and gross billings of Aeroplan Miles to program partners since the date of acquisition were also contributing factors that contributed to the improvement in net cash flows from operating activities in 2019.

NET CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES

In the fourth quarter of 2019, net cash outflows used in investing activities of $153 million decreased $71 million in the fourth quarter of 2019.

In 2019, net cash flows used in investing activities of $2,795 million decreased $138 million from 2018. A lower level of capital expenditures year-over-year was mainly due to fewer additions to property and equipment and included the impact of an initial settlement payment from Boeing, which is further discussed in section 10.6 "Capital Expenditures" of this MD&A. This was partly offset by the impact of Air Canada's ongoing investments in its new reservation and loyalty systems.

NET CASH FLOWS USED IN FINANCING ACTIVITIES

Reduction of long-term debt and lease liabilities amounted to $276 million in the fourth quarter of 2019 and $1,084 million for the full year 2019.

Refer to sections 10.4 "Working Capital", 10.2 "Financial Position", and 10.3 "Net Debt" and 10.9 "Share Information" of this MD&A for additional information.

FREE CASH FLOW

In conjunction with Air Canada's acquisition of Aeroplan, Air Canada received payments from TD Bank, CIBC, Visa and AMEX in the aggregate amount of $1,212 million. In addition, TD Bank and CIBC made payments to Air Canada in the aggregate amount of $400 million as prepayments to be applied towards future monthly payments in respect of Aeroplan Miles. Air Canada has excluded these one-time proceeds in its calculation of free cash flow.

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

(Canadian dollars in millions)	FOURTH QUARTER			FULL YEAR		
	2019	2018	$ CHANGE	2019	2018	$ CHANGE
Net cash flows from operating activities	**$ 677**	**$ 548**	**$ 129**	**$ 5,712**	**$ 3,470**	**$ 2,242**
Additions to property, equipment and intangible assets, net of proceeds from sale and leaseback transactions	(251)	(260)	9	(2,025)	(2,143)	118
One-time proceeds related to the acquisition of Aeroplan (as described above)	-	-	-	(1,612)	-	(1,612)
Free cash flow (1)	**$ 426**	**$ 288**	**$ 138**	**$ 2,075**	**$ 1,327**	**$ 748**

(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 can generate from operations after capital expenditures and after one-time proceeds related to the acquisition of Aeroplan. 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. The one-time proceeds related to the acquisition of Aeroplan in 2019 were also excluded from Air Canada's calculation of free cash flow. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

Free cash flow of $426 million increased $138 million from the fourth quarter of 2018. Excluding the one-time proceeds related to the Aeroplan acquisition, free cash flow of $2,075 million in 2019 increased $748 million from 2018 due to the higher cash flows from operating activities and a lower level of capital expenditures year-over-year, in large part due to the deferral of Boeing 737 MAX aircraft deliveries.

10.6. CAPITAL EXPENDITURES

BOEING 787

Air Canada took delivery of the last of 37 Boeing 787 aircraft it had on order at the end of April 2019. Air Canada's order with The Boeing Company ("Boeing") included 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).

737 MAX AIRCRAFT

Air Canada's agreement with Boeing for the purchase of Boeing 737 MAX aircraft provided for:

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

Twenty-four Boeing 737 MAX 8 aircraft have been delivered, and Air Canada's order contemplated the delivery of the remaining 37 Boeing 737 MAX aircraft from 2019 to 2024. Given the grounding of the Boeing 737 MAX aircraft and the uncertainty surrounding their return to service, Air Canada assumes, in the capital commitments table below, that six of 12 undelivered Boeing 737 MAX aircraft originally scheduled for delivery in 2019 will be delivered in 2020 and the remaining six will be delivered in 2021. Air Canada also assumes that 14 undelivered Boeing 737 MAX aircraft originally scheduled for delivery in 2020 will be delivered in 2021. This projected delivery schedule is subject to change given the grounding of the Boeing 737 MAX aircraft and the uncertainty surrounding their return to service.

Air Canada has been in discussions with Boeing and is seeking to settle the terms of an arrangement in relation to grounding of the Boeing 737 MAX aircraft. Until such time as an arrangement is finalized, information regarding the outstanding purchase commitments for aircraft is subject to change. An initial settlement payment contemplated by the arrangement was made to Air Canada during the fourth quarter of 2019, with any further amounts subject to finalization of the arrangement. The compensation is accounted for as an adjustment to the purchase price of current and future deliveries and will flow through Air Canada's consolidated statement of operations as reduced depreciation expense over the life of the aircraft, and as a reduction to additions to property and equipment on the consolidated statement of cash flow.

AIRBUS A220-300 AIRCRAFT

Under a purchase agreement concluded by Air Canada and Bombardier Inc. ("Bombardier") in June 2016, Air Canada has 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. The first Airbus A220 was delivered in late 2019, with the remaining deliveries to 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.

CAPITAL COMMITMENTS

As outlined in the table below, the estimated aggregate cost of all aircraft expected to be delivered and other capital purchase commitments as at December 31, 2019 is approximately $4,238 million. As mentioned above, Air Canada assumes, in the table below, that six of 12 undelivered Boeing 737 MAX aircraft originally scheduled for delivery in 2019 will be delivered in 2020 and the remaining six will be delivered in 2021. Air Canada also assumes that 14 undelivered Boeing 737 MAX aircraft originally scheduled for delivery in 2020 will be delivered in 2021. The capital commitments in the table below may change once matters relating to the Boeing 737 MAX aircraft's grounding have been resolved.

As described above in the "Capital Expenditures" section, Air Canada has been in discussions with Boeing and is seeking to settle the terms of an arrangement in relation to grounding of the Boeing 737 MAX aircraft. Until such time as such arrangement is finalized, information regarding the outstanding purchase commitments for aircraft is subject to change.

(Canadian dollars in millions)	2020	2021	2022	2023	2024	THEREAFTER	TOTAL
Projected committed expenditures	$ 1,635	$ 1,532	$ 898	$ 173	$ -	$ -	$ 4,238
Projected planned but uncommitted expenditures	484	633	572	686	677	Not available	Not available
Projected planned but uncommitted capitalized maintenance (1)	317	456	407	401	401	Not available	Not available
Total projected expenditures (2)	**$ 2,436**	**$ 2,621**	**$ 1,877**	**$ 1,260**	**$ 1,078**	**Not available**	**Not available**

(1) Future capitalized maintenance amounts for 2023 and beyond are not yet determinable; however, an estimate of $401 million has been made for 2023 and 2024.
(2) U.S. dollar amounts are converted using the December 31, 2019 closing exchange rate of US$1=C$1.2990. 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, 2019.

10.7. PENSION FUNDING OBLIGATIONS

Air Canada maintains several defined benefit pension plans, including domestic registered pension plans, supplemental pension plans and pension plans for foreign employees. 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, 2019, the aggregate solvency surplus in Air Canada's domestic registered pension plans was $2.5 billion. The next valuations to be made as at January 1, 2020 will be completed in the first half of 2020. 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.

Total employer defined benefit pension funding contributions (including the international and supplemental plans and the Aeroplan pension plan) were $109 million in 2019, as described in the table below.

(Canadian dollars in millions)	2019
Domestic registered plans	$ 9
Other pension arrangements (1)	100
Total employer defined benefit pension funding contributions	**$ 109**

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

Total employer defined benefit pension funding contributions (including the international and supplemental plans) are forecasted to be $100 million in 2020, as described in the table below.

(Canadian dollars in millions)	2020
Domestic registered plans	$ 3
Other pension arrangements (1)	97
Total projected employer defined benefit pension funding contributions	**$ 100**

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

As at December 31, 2019, approximately 87.5% of Air Canada's pension assets were invested in fixed income instruments 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.

10.8. CONTRACTUAL OBLIGATIONS

The table below provides Air Canada's contractual obligations as at December 31, 2019, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and lease liabilities and committed capital expenditures. The committed capital expenditures in the table below may change once the duration and related impact of the grounding, or Boeing's decision to suspend deliveries, of the Boeing 737 MAX aircraft is known.

(Canadian dollars in millions)	2020	2021	2022	2023	2024	THEREAFTER	TOTAL
PRINCIPAL							
Long-term debt	$ 587	$ 953	$ 327	$ 1,392	$ 292	$ 2,322	$ 5,873
Lease liabilities	631	483	408	400	364	1,173	3,459
Total principal obligations	**$ 1,218**	**$ 1,436**	**$ 735**	**$ 1,792**	**$ 656**	**$ 3,495**	**$ 9,332**
INTEREST							
Long-term debt	229	195	160	139	87	240	1,050
Lease liabilities	196	156	126	101	78	335	992
Total interest	**$ 425**	**$ 351**	**$ 286**	**$ 240**	**$ 165**	**$ 575**	**$ 2,042**
Total long-term debt and lease liabilities	**$ 1,643**	**$ 1,787**	**$ 1,021**	**$ 2,032**	**$ 821**	**$ 4,070**	**$ 11,374**
Committed capital expenditures	**$ 1,635**	**$ 1,532**	**$ 898**	**$ 173**	**$ -**	**$ -**	**$ 4,238**
Total contractual obligations (1)	**$ 3,278**	**$ 3,319**	**$ 1,919**	**$ 2,205**	**$ 821**	**$ 4,070**	**$ 15,612**

(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 lease liabilities due to reasons of uncertainty of timing of cash flows and items that are non-cash in nature.

10.9. 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, 2019	DECEMBER 31, 2018
ISSUED AND OUTSTANDING SHARES		
Variable voting shares	126,664,740	125,214,350
Voting shares	137,151,838	145,515,561
Total issued and outstanding shares	**263,816,578**	**270,729,911**
CLASS A VARIABLE VOTING AND CLASS B VOTING SHARES POTENTIALLY ISSUABLE		
Stock options	4,890,095	6,014,464
Total shares potentially issuable	**4,890,095**	**6,014,464**
Total outstanding and potentially issuable shares	**268,706,673**	**276,744,375**

NORMAL COURSE ISSUER BID

In May 2019, 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, 2019 and May 30, 2020, the purchase of up to 24,130,551 shares, representing 10% of Air Canada's public float of 241,305,518 shares as at May 17, 2019. The renewal followed the conclusion of the 2018 normal course issuer bid which expired on May 30, 2019.

In connection with the renewal of its issuer bid, Air Canada renewed its automatic share purchase plan (the "Plan") with its designated broker to facilitate the purchase of shares under the issuer bid at times when Air Canada would ordinarily not be permitted to purchase its shares due to regulatory restrictions or self-imposed blackout periods. Air Canada self-imposes regular blackouts during the period commencing 15 days prior to the end of each fiscal quarter to, and including, two trading days after the public announcement of Air Canada's quarterly or annual financial results. Pursuant to the Plan, before entering a blackout period, Air Canada may, but is not required to, instruct the designated broker to make purchases under the issuer bid based on parameters established by Air Canada. Such purchases will be determined by the designated broker based on Air Canada's parameters in accordance with the rules of the TSX, applicable securities laws and the terms of the Plan. The Plan was implemented effective May 31, 2019.

In 2019, Air Canada purchased, for cancellation, a total of 9,082,487 shares at an average cost of $41.64 per share for aggregate consideration of $378 million. At December 31, 2019, a total of 17,877,551 shares remained available for repurchase under Air Canada's issuer bid.

11. 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)	2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Operating revenues	$ 4,057	$ 4,324	$ 5,395	$ 4,227	$ 4,434	$ 4,739	$ 5,529	$ 4,429
Operating expenses	3,971	4,016	4,472	4,048	4,307	4,317	4,573	4,284
Operating income	**86**	**308**	**923**	**179**	**127**	**422**	**956**	**145**
Non-operating income (expense)	**(315)**	**(414)**	**31**	**(570)**	**158**	**18**	**(78)**	**27**
Income (loss) before income taxes	**(229)**	**(106)**	**954**	**(391)**	**285**	**440**	**878**	**172**
Income tax (expense) recovery	26	4	(252)	31	60	(97)	(242)	(20)
Net income (loss)	**$ (203)**	**$ (102)**	**$ 702**	**$ (360)**	**$ 345**	**$ 343**	**$ 636**	**$ 152**
Diluted earnings (loss) per share	**$ (0.74)**	**$ (0.37)**	**$ 2.55**	**$ (1.33)**	**$ 1.26**	**$ 1.26**	**$ 2.35**	**$ 0.56**
Adjusted pre-tax income (loss) (1)	**$ (32)**	**$ 185**	**$ 815**	**$ 68**	**$ 24**	**$ 326**	**$ 857**	**$ 66**
Adjusted net income (loss) (1)	**$ (26)**	**$ 129**	**$ 580**	**$ 55**	**$ 17**	**$ 240**	**$ 613**	**$ 47**
Adjusted earnings (loss) per share – diluted (1)	**$ (0.10)**	**$ 0.47**	**$ 2.10**	**$ 0.20**	**$ 0.06**	**$ 0.88**	**$ 2.27**	**$ 0.17**

(1) Adjusted pre-tax income (loss), adjusted net income (loss) and adjusted earnings (loss) per share – diluted are non-GAAP financial measures. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

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

(Canadian dollars in millions)	2018		2019			
	Q3	Q4	Q1	Q2	Q3	Q4
Capacity purchase fees (1)	$ 265	$ 264	$ 252	$ 247	$ 266	$ 277
Aircraft fuel	149	133	116	126	127	116
Airport and navigation	78	73	69	74	78	71
Sales and distribution costs	44	34	36	41	43	38
Other	109	116	118	113	114	119
Total regional airlines expense	**$ 645**	**$ 620**	**$ 591**	**$ 601**	**$ 628**	**$ 621**

(1) Capacity purchase fees exclude the component of fees related to aircraft costs which are accounted for as lease liabilities in accordance with IFRS 16 – Leases.

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

	2018		2019			
	Q3	Q4	Q1	Q2	Q3	Q4
SYSTEM						
Passenger PRASM (cents)	15.1	14.7	14.6	15.5	15.8	15.0
CASM (cents)	13.5	15.8	16.6	15.5	14.1	16.2
Adjusted CASM (cents) (1)	9.1	11.1	11.4	10.9	9.9	11.7
Fuel cost per litre (cents) (2)	83.0	84.3	75.5	79.2	74.7	75.0

(1) Adjusted CASM is a non-GAAP financial measure. A reconciliation of this measure to a comparable GAAP measure can be found in section 22 "Non-GAAP Financial Measures" of this MD&A and in Air Canada's MD&A reports, available at aircanada.com.
(2) Includes aircraft fuel expense related to regional airline operations and 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.

	2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
SYSTEM								
RPMs (millions)	20,440	22,654	28,465	20,801	21,293	23,463	27,954	21,403
ASMs (millions)	24,862	27,269	33,137	25,598	26,016	27,910	32,457	26,431
Passenger load factor (%)	82.2	83.1	85.9	81.3	81.8	84.1	86.1	81.0
DOMESTIC								
RPMs (millions)	4,226	5,003	6,339	4,684	4,251	5,097	6,298	4,682
ASMs (millions)	5,280	6,026	7,482	5,667	5,274	6,068	7,474	5,861
Passenger load factor (%)	80.0	83.0	84.7	82.7	80.6	84.0	84.3	79.9
U.S. TRANSBORDER								
RPMs (millions)	4,037	3,848	4,172	3,734	4,296	3,845	4,010	3,695
ASMs (millions)	4,945	4,673	4,962	4,662	5,341	4,686	4,764	4,700
Passenger load factor (%)	81.6	82.3	84.1	80.1	80.4	82.0	84.2	78.6
ATLANTIC								
RPMs (millions)	4,573	7,084	10,642	5,813	4,943	7,496	10,580	6,265
ASMs (millions)	5,753	8,571	12,231	7,206	6,177	8,882	12,068	7,710
Passenger load factor (%)	79.5	82.7	87.0	80.6	80.0	84.4	87.7	81.3
PACIFIC								
RPMs (millions)	4,572	4,936	5,630	4,514	4,486	5,072	5,364	4,504
ASMs (millions)	5,447	5,829	6,484	5,541	5,367	5,971	6,217	5,456
Passenger load factor (%)	83.9	84.7	86.8	81.5	83.6	84.9	86.3	82.6
OTHER								
RPMs (millions)	3,032	1,783	1,682	2,056	3,317	1,953	1,702	2,257
ASMs (millions)	3,437	2,170	1,978	2,522	3,857	2,303	1,934	2,704
Passenger load factor (%)	88.2	82.1	85.0	81.6	86.0	84.8	88.0	83.5

12. SELECTED ANNUAL INFORMATION

The following table provides selected annual information for Air Canada for the years 2017 through 2019.

(Canadian dollars in millions, except per share figures)	FULL YEAR		
	2019 (1)	2018	2017 (2)
Operating revenues	$ 19,131	$ 18,003	$ 16,252
Operating expenses (3)	17,481	16,507	14,881
Operating income	**1,650**	**1,496**	**1,371**
Income before income taxes	1,775	228	1,286
Income tax (expense) recovery (4)	(299)	(191)	743
Net income	**$ 1,476**	**$ 37**	**$ 2,029**
Adjusted pre-tax income (5)	**$ 1,273**	**$ 1,036**	**$ 1,165**
Adjusted net income (5)	**$ 917**	**$ 738**	**$ 1,145**
Basic earnings per share	**$ 5.51**	**$ 0.14**	**$ 7.44**
Diluted earnings per share	**$ 5.44**	**$ 0.13**	**$ 7.31**
Adjusted earnings per share – diluted (5)	**$ 3.37**	**$ 2.67**	**$ 4.11**
Cash, cash equivalents and short-term investments	**$ 5,889**	**$ 4,707**	**$ 3,804**
Total assets	**$ 27,759**	**$ 21,883**	**$ 17,782**
Total long-term liabilities	**$ 15,584**	**$ 12,930**	**$ 9,259**
Total liabilities	**$ 23,359**	**$ 18,606**	**$ 14,360**

(1) Air Canada began consolidating Aeroplan's financial results on January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 14 "Accounting Policies" and section 15 "Critical Accounting Estimates and Judgments" of this MD&A for additional information.
(2) 2017 has not been restated for certain accounting standards, as further described in section 14 "Accounting Policies." Accordingly, comparisons to 2018 and 2019 are not meaningful.
(3) 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.
(4) 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.
(5) EBITDA, 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 22 "Non-GAAP Financial Measures" of this MD&A and in Air Canada's MD&A reports, available at aircanada.com.

13. 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.

(Canadian dollars in millions)	FOURTH QUARTER		FULL YEAR	
	2019	2018	2019	2018
Share forward contracts	$ 5	$ (3)	$ 23	$ -
Fuel derivatives	-	-	-	(1)
Financial instruments recorded at fair value	**$ 5**	**$ (3)**	**$ 23**	**$ (1)**

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 can elect to enter 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 2019, Air Canada purchased crude oil call options covering a portion of 2019 fuel exposure. The cash premium related to these contracts was $14 million ($17 million in 2018 for 2018 exposures). Fuel derivative contracts cash settled with no fair value ($19 million in favour of the counterparties in 2018).

Associated premium costs and any hedging gains and losses are reclassified from other comprehensive income to aircraft fuel expense on settlement of the derivatives. A loss of $14 million was reclassified from other comprehensive income to aircraft fuel expense in 2019 (net fuel hedging loss of $36 million in 2018). No hedge ineffectiveness was recorded during 2019 and 2018.

There were no outstanding fuel derivatives as at December 31, 2019 and December 31, 2018.

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 2019, these net operating cash inflows totalled approximately US$3.7 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$2.3 billion. For 2019, this resulted in a U.S. dollar net cash flow exposure of approximately US$5.0 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, 2019 amounted to $1,123 million (US$862 million) ($863 million (US$635 million) as at December 31, 2018). 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 2019, a loss of $36 million (gain of $62 million in 2018) 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, 2019, as further described below, approximately 73% of net U.S. cash outflows are hedged for 2020 and 50% for 2021, resulting in derivative coverage of 66% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 73% coverage.

As at December 31, 2019, Air Canada had outstanding foreign currency options and swap agreements, settling in 2020 and 2021, to purchase at maturity $6,599 million (US$5,080 million) of U.S. dollars at a weighted average rate of $1.2775 per US$1.00 (2018 – $4,987 million (US$3,659 million) with settlements in 2019 and 2020 at a weighted average rate of $1.2645 per US$1.00). Air Canada also has protection in place to sell a portion of its excess Euros, Sterling, YEN, YUAN, and AUD (EUR €335 million, GBP £202 million, JPY ¥46,655 million, CNH ¥286 million and AUD $209 million) which settle in 2020 and 2021 at weighted average rates of €1.1577, £1.3238, ¥0.0096, ¥0.1469, and AUD $0.7092 per US$1.00, respectively (as at December 31, 2018 - EUR €103 million, GBP £208 million, JPY ¥25,922 million, and AUD $105 million with settlements in 2019 and 2020 at weighted average rates of €1.1910, £1.3567, ¥0.0092, and AUD $0.7448 respectively per US$1.00).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations. Based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at December 31, 2019 was $114 million in favour of the counterparties (2018 – $33 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 2019, a gain of $92 million was recorded in foreign exchange gain (loss) related to these derivatives (2018 – $245 million gain). In 2019, foreign exchange derivative contracts cash settled with a net fair value of $173 million in favour of Air Canada (2018 – $63 million in favour of Air Canada).

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 it 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, 2019 was 83% fixed and 17% floating (81% and 19%, respectively, as at December 31, 2018).

14. ACCOUNTING POLICIES

Air Canada adopted IFRS 16 – Leases on January 1, 2019. Additional information is available in Note 2 of Air Canada's audited consolidated financial statements and notes for 2019.

ACQUISITION OF AEROPLAN – ACCOUNTING POLICY IMPACTS

The following are updates to Air Canada's accounting policies applicable prospectively following the acquisition of Aeroplan on January 10, 2019. Refer to section 15 "Critical Accounting Estimates and Judgments" for additional information.

Passenger Revenues – Update from Aeroplan Acquisition

Prior to the acquisition of Aeroplan, advance ticket sales included the proceeds from the sale of flight tickets to Aeroplan, a corporation that provides loyalty program services to Air Canada that provided seats from Air Canada pursuant to the Commercial Participation and Services Agreement between Aeroplan and Air Canada (the "CPSA"). Under the CPSA, Aeroplan purchased passenger tickets from Air Canada, which are accounted for as passenger revenues by Air Canada when transportation is provided.

Subsequent to the acquisition of Aeroplan on January 10, 2019, advance ticket sales continue to include the value of Aeroplan Mile redemptions for flight tickets issued by Air Canada post-acquisition. For Aeroplan Miles issued after the acquisition date, the value of Aeroplan deferred revenue related to Aeroplan Miles issued but not yet redeemed is determined with reference to their Equivalent Ticket Value ("ETV") for Miles issued from qualifying air travel, or with reference to the consideration received for Aeroplan Miles sold to third party Aeroplan program partners. ETV is determined based on the value a passenger receives by redeeming Aeroplan Miles for a ticket rather than paying cash. On the acquisition date, the outstanding Aeroplan Miles were recorded at fair value as Aeroplan deferred revenue.

Breakage represents the estimated Aeroplan Miles that are not expected to be redeemed by Aeroplan members. The amount of revenue recognized related to breakage is based on the number of Aeroplan Miles redeemed in a period in relation to the total number of Aeroplan Miles expected to be redeemed. The number of Aeroplan Miles redeemed in a period also factors into any revised estimate for breakage. Changes in breakage are accounted for as follows: in the period of change, the deferred revenue balance is adjusted as if the revised estimate had been used in prior periods with the offsetting amount recorded as an adjustment to passenger revenue; for subsequent periods, the revised estimate is used.

Intangible Assets

Contract-based, marketing-based and technology-based intangible assets, with an acquisition fair value of $225 million, $90 million and $38 million, respectively, were recorded upon the acquisition of Aeroplan on January 10, 2019. The contract-based intangible assets have an estimated useful life of 11.5 years, being the term of the primary commercial agreements with program partners, which expire in 2030. The marketing-based trade name is considered an indefinite life intangible asset.

IFRIC 23 – UNCERTAINTY OVER INCOME TAX TREATMENTS

IFRIC 23 is effective for years beginning on or after January 1, 2019. IFRIC 23 provides a framework to consider, recognize and measure the accounting impact of tax uncertainties and provides specific guidance in several areas where previously IAS 12 Income Taxes was silent. The Corporation has adopted the interpretation of IFRIC 23 and concluded that it has no impact on previously reported results.

IFRS 15 – REVENUE FROM CONTRACTS WITH CUSTOMERS

In September 2019, the IFRS Interpretations Committee finalized its decision that an entity should account for its obligations to compensate passengers for delayed and cancelled flights as variable consideration under IFRS 15. Air Canada adopted this accounting treatment in the fourth quarter on a retrospective basis, with 2018 restated. Previously, Air Canada recognized passenger compensation costs by applying IAS 37 Provisions, Contingent Liabilities and Contingent Assets. While there is no impact to the amount of passenger compensation recognized, presentation within Air Canada's consolidated statement of operations is impacted as the compensation is reclassified against passenger revenue.

The impact on Air Canada's consolidated statement of operations was a decrease of $74 million from other operating expenses, a decrease of $13 million from regional airlines expense, and a decrease to passenger revenues of $87 million in 2019 (decrease of $51 million from other operating expenses, decrease of $11 million from regional airlines expense, and a decrease to passenger revenues of $62 million in 2018).

15. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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 judgments, often because of the need to make estimates and judgments about the effect of matters that are inherently uncertain. Actual results could differ from those estimates and judgments 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 and 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	
	2019	2018	**2019**	2018
Discount rate used to determine:				
Net interest on the net benefit obligation for the year ended December 31	3.81%	3.60%	3.81%	3.60%
Service cost for the year ended December 31	3.93%	3.70%	3.93%	3.70%
Accrued benefit obligation as at December 31	3.13%	3.81%	3.13%	3.81%
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 2019 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.

(Canadian dollars in millions)	0.25 PERCENTAGE POINT	
	DECREASE	INCREASE
Discount rate on obligation assumption		
Pension expense	$ 19	$ (19)
Net financing expense relating to pension benefit liabilities	24	(20)
Total	**$ 43**	**$ (39)**
Increase (decrease) in pension obligation	**$ 816**	**$ (787)**

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, 2019, approximately 87.5% 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 $516 million.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 5.25% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2019 (2018 – 5.5%). The rate is assumed to decrease gradually to 5% by 2021 (2018 – assumed to decrease gradually to 5% by 2021). A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by $5 million and the obligation by $80 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 $78 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 $59 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 $56 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 $16 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 including aircraft that are parked but are expected to be so temporarily and returned to service) 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 at the end of the lease 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 recognized as an adjustment to the right-of-use asset. 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 $70 million at December 31, 2019 and an increase to aircraft maintenance expense in 2020 of approximately $8 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 $20 million at December 31, 2019. An equivalent but opposite movement in the discount rate would result in a similar impact in the opposite direction.

BUSINESS COMBINATIONS

Air Canada's business acquisition of Aeroplan was accounted for using the acquisition method of accounting. Under the acquisition method, the estimated fair values of the acquired company's assets and assumed liabilities are added to the consolidated statement of financial position as at the acquisition date. There were various assumptions made when determining the fair values of Aeroplan's assets and assumed liabilities. The most significant assumptions and those requiring the most judgment involve the estimated fair values of intangible assets and the estimated fair values of deferred revenues related to the outstanding Aeroplan Miles obligation ("Aeroplan deferred revenue").

The intangible assets recognized on the acquisition of Aeroplan include technology-based, contract-based and marketing-based (trade name) intangible assets. To determine the fair value of technology-based intangible assets, Air Canada applied a depreciated replacement cost methodology. For contract-based intangible assets, Air Canada used the multi-period excess earnings method. This valuation technique values the intangible assets based on the capitalization of the excess earnings, which are calculated to be in excess of what a reasonable amount of earnings would be on the tangible assets used to generate the earnings. Significant assumptions include the determination of projected revenues, cash flows, customer retention rates, discount rates and anticipated average income tax rates. To determine the fair value of the trade name, Air Canada used the relief from royalty method. This valuation technique values the intangible assets based on the present value of the expected after-tax royalty cash flow stream using a hypothetical licensing arrangement. Significant assumptions include the determination of projected revenues, royalty rate, discount rates and anticipated average income tax rates.

The deferred revenues recognized on the acquisition of Aeroplan relate to the estimated fair value of outstanding Aeroplan Miles. The liability assumed was recorded based on the estimated fair value to service the Miles outstanding that are expected to be redeemed.

AEROPLAN LOYALTY PROGRAM

Loyalty program accounting requires management to make several estimates, including about the ETV of Aeroplan Miles issued and the breakage on Aeroplan Miles. The ETV of Aeroplan Miles issued is determined based on the value a passenger receives by redeeming Miles for a ticket rather than paying cash. This ETV is estimated with reference to historical Aeroplan redemptions as compared to equivalent ticket purchases after considering similar fare conditions, advance booking periods and other relevant factors including the selling price of Miles to third parties. ETV estimates and assumptions are considered for updates at least annually. A change in the ETV rate is accounted for prospectively on future Miles issued.

Breakage represents the estimated Miles that are not expected to be redeemed. Breakage is estimated by management based on the terms and conditions of membership and historical accumulation and redemption patterns, as adjusted for changes to any terms and conditions or other circumstances that may affect future redemptions. Management uses statistical and simulation models to estimate breakage.

Changes in breakage are accounted for as follows: in the period of change, the deferred revenue balance is adjusted as if the revised estimate had been used in prior periods with the offsetting amount recorded as an adjustment to passenger revenue; for subsequent periods, the revised estimate is used. A change in assumptions as to the number of Miles expected to be redeemed could have a material impact on revenue in the year in which the change occurs.

As at December 31, 2019, the Aeroplan Miles deferred revenue balance was $2,825 million. For illustrative purposes, a hypothetical 1% change in the number of outstanding Miles estimated to be redeemed would result in an approximate impact of $28 million on revenue with a corresponding adjustment to Aeroplan deferred revenue.

16. 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 $643 million as at December 31, 2019 (December 31, 2018 – $571 million). This 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, 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.

17. RELATED PARTY TRANSACTIONS

At December 31, 2019, Air Canada had no transactions with related parties as defined under GAAP, except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship agreements.

18. 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 2019 levels of activity and are based on 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.

(Canadian dollars in millions)

KEY VARIABLE	2019 MEASURE	SENSITIVITY FACTOR	FAVOURABLE/ (UNFAVOURABLE)
FUEL			ESTIMATED OPERATING INCOME IMPACT
Fuel – Jet fuel price (US$/barrel) (1)	86.1	US$1/barrel increase	$ (48)
Fuel – Jet fuel price (CAD cents/litre) (1)	76.1	1% increase	$ (41)
CURRENCY EXCHANGE		*1 cent increase (i.e. $1.31 to $1.30 per US$)*	ESTIMATED OPERATING INCOME AND PRE-TAX INCOME IMPACTS
C$ to US$	**US$1 = C$1.31**	Operating income (2)	$ 26
		Net interest expense	4
		Revaluation of long-term debt and lease liabilities, U.S. dollar cash, cash equivalents and short-term investments, and other long-term monetary items, net	63
		Remeasurement of outstanding currency derivatives	(51)
		Pre-tax income impact	**$ 42**

(1) Excludes the impact of carrier surcharges and fuel hedging.
(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.

19. ENTERPRISE RISK MANAGEMENT AND GOVERNANCE

OVERVIEW

The management of opportunities and risks is an integral part of Air Canada's business processes. Strategic decisions are made by the executive team with consideration of risk implications for the business and its stakeholders. Risks which may be material to Air Canada are identified and monitored on an ongoing basis through Air Canada's Enterprise Risk Management (ERM) program, which provides insight on a regular basis to the Board of Directors through the Board's Audit, Finance and Risk Committee.

BOARD OVERSIGHT

Risk management is part of Air Canada's corporate governance. The Board of Directors has established board committees (Audit, Finance and Risk Committee; Safety, Health, Environment and Security Committee; Governance and Nominating Committee; and Human Resources and Compensation Committee) to assist in the oversight responsibilities.

Risk information is reviewed by the Board or the relevant Board committee on a quarterly basis. In addition, Board committees review and discuss with management on a regular basis all key enterprise risk exposures based on their respective terms of reference set out in committee charters and the steps taken to monitor/control and mitigate those exposures to satisfy themselves that individual risks are being managed effectively. These processes seek to mitigate rather than eliminate risk.

The Audit, Finance and Risk Committee is responsible for oversight of the ERM program and the work carried out by the Corporate Audit and Advisory department, as stated in its committee charter.

ERM risk reporting is maintained by the Corporate Audit and Advisory department, which provides an independent update as to the state of each enterprise risk on a quarterly basis.

RISK MANAGEMENT FRAMEWORK AND STRUCTURE

Air Canada's enterprise risk management framework has been developed to support governance and oversight over the company's most important strategic risks and is aligned with the ISO 31000 standard and COSO ERM 2017 framework.

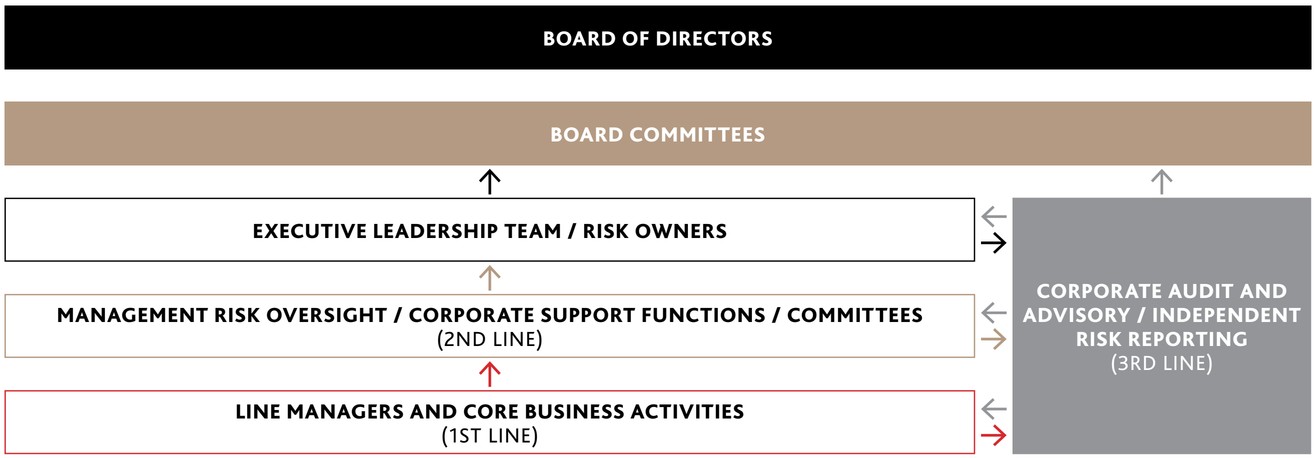
Formal policies and management committees are in place to manage specific risks such as safety, security, fraud, information security, privacy, environment and fuel price.

Sound business practices and ethical behaviour are also fundamental to Air Canada's risk governance culture. Air Canada has in place (and updates, as required) a Corporate Policy and Guidelines on Business Conduct ("Code of Conduct"), which sets out guiding principles and ethical standards that apply to all of Air Canada's corporate activities. A confidential, anonymous reporting process and ethics committee are also in place to oversee adherence to the Code of Conduct.

Air Canada's risk management structure is aligned with the "Three Lines of Defence" approach to risk management:

- 1st line - Business functions are expected to integrate risk management when performing their day-to-day core commercial and operational activities.
- 2nd line - Support functions establish policies, provide guidance and expertise, and provide risk oversight (e.g. Safety, Security, Legal and Compliance, Finance/Treasury/Tax, Sourcing and Procurement, Government Affairs, People, Environment, IT Operations and IT Security).
- 3rd line - Corporate Audit and Advisory department provides an independent and objective perspective on Air Canada's governance and its risk management practices and controls.

Air Canada's ERM and governance structure is as follows:



Although the risk management framework described in this section is aligned with industry best practices, there can be no assurance that it will be sufficient to prevent the occurrence of events that could have a material adverse effect on our financial position, financial performance, cash flows, business or reputation.

20. RISK FACTORS

The risks described below should be considered 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, individually or in combination, could materially and adversely affect Air Canada's business, operating results or financial condition and the outcome of matters as to which forward-looking statements are made. Should a risk materialize, circumstances at the time may also cause that risk to have a different impact than that which might otherwise have been expected. 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 or financial condition and the outcome of matters as to which forward-looking statements are made.

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. The airline industry has historically been characterized by low profit margins and high fixed costs, and the costs of operating a flight do not vary significantly with the number of passengers carried. Therefore, a relatively small change in the number of passengers, fare pricing or traffic mix, or increased costs, could have a significant impact on Air Canada's operating and financial results. Due to the competitive nature of the airline industry and customer sensitivity to travel costs, Air Canada may not be able to pass on cost increases to its customers. Despite a focus on improving resiliency to downturns in its business as well as ongoing and planned strategic and business initiatives, Air Canada may not be able to successfully achieve and/or sustain positive net profitability or realize all of its objectives, 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 MD&A.

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

Air Canada's operating results, like those of other airlines, are sensitive to and may be significantly impacted by economic and geopolitical conditions, which may impact demand for air transportation in general or to or from certain destinations, operating costs, operating revenues, costs and availability of fuel, foreign exchange costs, and costs and availability of capital and supplies. Any prolonged or significant impact arising from economic and geopolitical conditions, including weakness of the Canadian, U.S. or world economies, changes to political, economic, or trade relationships within or between jurisdictions where Air Canada operates flights or does business, or threatened or actual outbreaks of hostilities in or adjacent to regions Air Canada serves or over which it operates flights or does business could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Boeing 737 MAX Aircraft – The grounding of the Boeing 737 MAX aircraft could materially adversely impact Air Canada, its business, results of operations and financial condition

On March 12, 2019, the European Aviation Safety Agency ("EASA") issued an Emergency Directive suspending operation of the Boeing 737 MAX within, to and from the European skies (including outside territories). On March 13, 2019, Transport Canada issued a safety notice closing Canadian airspace to Boeing 737 MAX aircraft until further notice, followed by the Federal Aviation Administration issuing a temporary grounding order for the Boeing 737 MAX aircraft. On March 14, 2019, Boeing announced it would suspend Boeing 737 MAX deliveries to airline customers. At that time, Air Canada had 24 Boeing 737 MAX aircraft in its operating fleet, with additional Boeing 737 MAX aircraft scheduled for delivery from 2019 through to 2024. The duration and ongoing impact of this action are uncertain and could further negatively affect operations and future network plans, reduce revenues and increase costs, based on a number of factors. The latter include the period of time the aircraft remain unavailable, the availability and cost of appropriate replacement aircraft, passengers' perceptions in relation to the Boeing 737 MAX aircraft and the circumstances of any reintroduction of the aircraft to service. Any of those factors could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Fares and market demand – Fluctuations in fares and demand for air travel could materially adversely impact Air Canada, its business, results of operations and financial condition

Air Canada fares and passenger demand, like those of other airlines, have fluctuated significantly in the past and may fluctuate significantly in the future. Air Canada is not able to predict with certainty market conditions or the fares that Air Canada may be able to charge. Customer expectations and perception can change rapidly, and the demand for lower fares or alternative modes of transportation may impact revenues. Travel, especially leisure travel, is a discretionary consumer expense. Demand for business and premium travel is also impacted by economic conditions. Depressed economic conditions, geopolitical instability, security, health and concerns about the environmental impacts of air travel, trends towards less environmentally impactful travel could cause customers to reduce or alter their travel activities, potentially reducing demand for air travel and having a materially adverse impact on Air Canada, its business, results of 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 other 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. and Canadian carriers, may also undergo substantial reorganizations (including by way of merger with or acquisition by another carrier or entity), and this has already been the case for some of them. The result is greater access to capital, reduced levels of indebtedness, lower operating costs and other competitive advantages, potentially enabling them to more effectively compete against Air Canada. Consolidation within the airline industry and the increase in the number of carriers entering into integrated commercial cooperation arrangements may also strengthen the ability of carriers to compete. Such intensified competition could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

The prevalence of Internet travel websites and other travel product distribution channels has also resulted in a substantial increase in new routings and 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 its ability to achieve acceptable operating margins and may be limited by applicable laws or government policies intended to encourage competition.

Increased competition from existing, emerging or new competitors, including competitors entering into new or expanded joint ventures and other arrangements, 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.

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 fluctuated 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, and it may not be able to sufficiently, or may not, hedge the risk associated with fluctuations in fuel prices. 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. Furthermore, the impact of lower jet fuel prices could trigger increased competition, resulting in a decrease in revenues for all 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.

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, including to increase its revenues and reduce its costs. Systems include those relating to Air Canada's websites, reservations, airport customer services, flight operations and communications. Air Canada began implementing a new passenger services system, the Amadeus Altéa Suite, which is hosted and maintained by a third party. The reservations, inventory and ticketing (commercial functions) migration was partially completed in 2019.

Air Canada's passenger services system, website and other technology systems must efficiently accommodate a high volume of traffic and must securely and accurately deliver flight information and process information critical to Air Canada's business and operations. Air Canada also depends on the performance of its many suppliers, which 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 Air Canada's 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.

Technology systems are at risk of cybersecurity incidents, and it is generally viewed that cyber-attacks have increased and will continue to increase in both prevalence and sophistication. Air Canada invests in security initiatives and disaster recovery plans, for example these initiatives may not be successful or adequately address a highly dynamic and continually evolving threat landscape. Any technology system failure, degradation, interruption or misuse, security breach, inefficient of migration to a new system, or failure to comply with applicable data confidentiality, privacy, security or other related obligations, whether at Air Canada or at a third party on whom Air Canada relies, could adversely affect Air Canada's reputation. It could also expose Air Canada to litigation, claims for contract breach, fines, sanctions or remediation costs or otherwise materially and adversely affect Air Canada's operations. Any of the foregoing 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. The latter include those relating to the implementation of Amadeus Altéa Suite to replace its existing passenger services system, 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 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) and corporate culture transformation initiatives seeking to ensure a consistently high-quality customer service experience. 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 and reliability of third parties (including suppliers), their services and their products, 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.

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 travelling 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 travelling 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 could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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 the COVID-19 outbreak in China, 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.

Key supplies and suppliers – Air Canada's failure or inability to source 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 or within planned timeframes, 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 source 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, refusal or inability to deliver or perform, may not be possible or may take a significant amount of time or require significant resources. A failure, refusal, delay 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.

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 travelling 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, equipment failures, human error, severe weather, lightning strikes and other natural phenomena, 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, accessibility of transportation, flight crew and other labour rules, privacy, data security, advertising, 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, may impose significant costs, impediments and/or competitive disadvantages. 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 airport 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 or to consummate acquisitions or other transactions may be challenged by applicable Canadian and international authorities or third parties, and are and may be subject to conditions or receipt of approvals from applicable Canadian and international authorities and to satisfying the applicable regulatory requirements. There can be no assurance that such conditions will be met or will continue in effect or that existing or amended regulatory requirements or standards can be met.

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 known as the Carbon Offsetting and Reduction Scheme for International Aviation ("CORSIA"), adopted in 2016, includes emissions from applicable international flights. CORSIA 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 has voluntarily adopted the first phase. On the basis of the CORSIA, 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 Government of Canada proposed a pan-Canadian benchmark for carbon pricing to be implemented in all Canadian jurisdictions by 2018, with pricing 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 British Columbia and Quebec have implemented a carbon pricing system; others have had the federal carbon pricing backstop system applied. Air Canada and regional carriers operating flights on behalf of Air Canada have been subject to a carbon tax for flights operating on an intra-provincial basis.

Air Canada cannot predict whether, or the manner in which, these or other initiatives will ultimately be implemented or their impact on Air Canada, and 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 to 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 that may assert jurisdiction over Air Canada, including in countries where Air Canada operates, conducts business or processes or stores data. 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 complexities, operating costs and potential exposure to fines and penalties. 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 and accessibility measures. 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 2019, the *Air Passenger Protection Regulations* were adopted under the *Canada Transportation Act* and are stated to govern flights to, from and within Canada, including connecting flights. They also specify requirements governing a carrier's obligations, including in the case of flight delay, cancellation, denial of boarding, lost baggage, providing in certain cases minimum standards of treatment, compensation and other obligations. The Minister of Transport is also authorized to order the Canadian Transportation Agency to make regulations in respect of any of a carrier's other obligations towards passengers.

Aeroplan loyalty program – Loss of redemption partners, changes to accrual or redemption settlement rates, 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 Aeroplan Inc. (formerly Aimia Canada Inc.), owner and operator of the Aeroplan loyalty business and program. 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 Miles, 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.

Air Canada is working to implement a new, redesigned Aeroplan 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, and transitioning from the current 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 current 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.

Climate Change – Changes in environmental conditions, environmental regulations and public opinion regarding air travel could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada, like other airlines, is subject to climate change-related risks, including in relation to other factors described in this MD&A. The airline industry is a source of carbon dioxide and other greenhouse gases and faces extensive related laws and regulations, including those described in this MD&A. Climate change may increase the frequency and intensity of severe weather on the ground and at altitude (including turbulence events). Severe weather events at airports or destinations served by Air Canada may impact the viability or cost of flying to such destinations. Concern about climate change and the impact of carbon emissions from flights may result in reduced demand for air travel and adversely impact public perception of Air Canada and its brand. Climate change as well as a failure to adapt to and address evolving related regulations or changes in public opinion, failure to implement technologies which adequately reduce climate or environmental impacts, improve sustainability of its operations or otherwise respond to climate change-related challenges, in a timely manner, could have a material adverse effect on Air Canada, its brand, its business, results from operations and financial condition.

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, including those identified in this MD&A. Environmental conditions and factors, such as those arising from volcanic eruptions or other natural phenomena, those arising from man-made sources, and those arising from increases in the frequency, strength and duration of severe weather events, including as a result of climate change, 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.

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 certain airlines and regional airlines such as Jazz and Sky Regional 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, as well as similar circumstances relating to other airlines from whom Air Canada sources capacity, 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 built 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 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 promptly 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.

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 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. 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. 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. There can be no assurance that Air Canada will at all times be able to generate sufficient cash from its operations to satisfy its debt, 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.

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. The latter 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.

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, more recently, 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 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 10.8 "Contractual Obligations" of this MD&A for information on Air Canada's credit card processing agreements.

Need for capital and liquidity – Air Canada may not be able to obtain sufficient funds in a timely manner 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, 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 ongoing 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, including a major decline in capital markets in general, a downgrade in Air Canada's credit ratings, 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 negatively impact Air Canada's ability to raise capital, issue debt, borrow on acceptable terms, attract and/or retain key employees, make strategic acquisitions, enter into business arrangements or operate its business, and such factors may contribute to volatility in Air Canada's securities.

Legal proceedings – Air Canada may be subject to legal proceedings which could have a material adverse impact

In the course of conducting its business, Air Canada is 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.

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 is generated in Canadian dollars. In addition, Air Canada may not be able to sufficiently, or may not, hedge the risk 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.

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). In addition, current service contributions in respect of a domestic registered plan are required except to the extent they are funded (and if permitted subject to applicable plan rules and legislation) through a sufficient surplus in such plan. 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, changes to pension asset investment strategies, assumptions and methods used and changes in economic conditions (mainly the return on fund assets and changes in interest rates) and other factors. 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. See section 10.7 "Pension Funding Obligations" of this MD&A for additional information.

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.

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. This 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.

21. 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, 2019, 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, 2019, 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 changes to the Corporation's internal controls over financial reporting during the quarter ended December 31, 2019 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

In November 2019, the Corporation transitioned to a new reservation system, which results in significant changes and enhancements to the airline's reservation, ticketing and sales processes. This transition included migrating open ticket reservations into the new system. As a result of the system change, internal controls, documentation and procedures were updated and tested during the fourth quarter of 2019.

In addition, during the first quarter of 2019 and as previously reported, Air Canada adopted new internal control procedures related to the adoption of IFRS 16 – Leases and the consolidation of the Aeroplan loyalty program.

As a result of the adoption of IFRS 16 – Leases, new internal controls were implemented in the first quarter of 2019 to track and record additional lease liabilities and right-of-use assets, including new processes to record changes and other modifications related to those lease contracts. In addition, new processes have been implemented to provide the disclosures required by the new standard.

As described in section 14 "Accounting Policies" and section 15 "Critical Accounting Estimates and Judgments", there are a number of new accounting estimates and policies applied with related to the accounting for Aeroplan deferred revenue, including estimates related to Equivalent Ticket Value and breakage. New internal controls have been implemented as a result of the Aeroplan acquisition.

22. 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.

EBITDA

EBITDA (earnings before interest, taxes, depreciation and amortization) is commonly used in the airline industry and is used by Air Canada as a means to view operating results before interest, taxes, depreciation and amortization 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 EBITDA as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

EBITDA is reconciled to GAAP operating income as follows:

(Canadian dollars in millions)	FOURTH QUARTER			FULL YEAR		
	2019	2018	$ CHANGE	2019	2018	$ CHANGE
Operating income – GAAP	**$ 145**	**$ 179**	**$ (34)**	**$ 1,650**	**$ 1,496**	**$ 154**
Add back:						
Depreciation and amortization	520	440	80	1,986	1,717	269
EBITDA	**$ 665**	**$ 619**	**$ 46**	**$ 3,636**	**$ 3,213**	**$ 423**

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, the operating costs of Aeroplan during its initial year of acquisition, 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 a more meaningful analysis of Air Canada's operating expense performance and a more meaningful comparison to that of other airlines.

Following the completion of Air Canada's acquisition of Aeroplan on January 10, 2019, Air Canada began consolidating Aeroplan's results. Given that the Aeroplan loyalty business was not consolidated in Air Canada's financial results in 2018, for a more meaningful comparison of the cost performance of the ongoing airline business, Air Canada's adjusted CASM for 2019 excludes the operating expenses of Aeroplan.

Adjusted CASM is reconciled to GAAP operating expense as follows:

(Canadian dollars in millions, except where indicated)	FOURTH QUARTER			FULL YEAR		
	2019	2018	$ CHANGE	2019	2018	$ CHANGE
Operating expense – GAAP	**$ 4,284**	**$ 4,048**	**$ 236**	**$ 17,481**	**$ 16,507**	**$ 974**
Adjusted for:						
Aircraft fuel expense	(1,013)	(1,091)	78	(4,347)	(4,500)	153
Ground package costs	(131)	(126)	(5)	(627)	(602)	(25)
Operating expenses of Aeroplan	(58)	-	(58)	(200)	-	(200)
Operating expense, adjusted for the above-noted items	**$ 3,082**	**$ 2,831**	**$ 251**	**$ 12,307**	**$ 11,405**	**$ 902**
ASMs (millions)	**26,431**	**25,597**	**3.3%**	**112,814**	**110,866**	**1.8%**
Adjusted CASM (cents)	**¢ 11.67**	**¢ 11.06**	**5.5%**	**¢ 10.91**	**¢ 10.29**	**6.1%**

ADJUSTED PRE-TAX INCOME (LOSS)

Adjusted pre-tax income (loss) 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 (loss) before interest to determine return on invested capital.

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

(Canadian dollars in millions)	FOURTH QUARTER			FULL YEAR		
	2019	2018	$ CHANGE	2019	2018	$ CHANGE
Income (loss) before income taxes – GAAP	$ 172	$ (391)	$ 563	$ 1,775	$ 228	$ 1,547
Adjusted for:						
Foreign exchange (gain) loss	(92)	444	(536)	(499)	578	(1,077)
Net financing expense relating to employee benefits	10	12	(2)	39	50	(11)
(Gain) loss on financial instruments recorded at fair value	(5)	3	(8)	(23)	1	(24)
Gain on debt settlements and modifications	(6)	-	(6)	(6)	(9)	3
(Gain) loss on disposal of assets [1]	(13)	-	(13)	(13)	188	(201)
Adjusted pre-tax income	**$ 66**	**$ 68**	**$ (2)**	**$ 1,273**	**$ 1,036**	**$ 237**

(1) 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.

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

(Canadian dollars in millions)	FOURTH QUARTER			FULL YEAR		
	2019	2018	$ CHANGE	2019	2018	$ CHANGE
Net income (loss) – GAAP	**$ 152**	**$ (360)**	**$ 512**	**$ 1,476**	**$ 37**	**$ 1,439**
Adjusted for:						
Foreign exchange (gain) loss	(94)	403	(497)	(430)	530	(960)
Net financing expense relating to employee benefits	7	10	(3)	28	37	(9)
(Gain) loss on financial instruments recorded at fair value	(4)	3	(7)	(17)	1	(18)
Gain on debt settlements and modifications	(4)	(5)	1	(4)	(4)	-
(Gain) loss on disposal of assets (1)	(10)	4	(14)	(10)	137	(147)
Special net income tax recovery (2)	-	-	-	(126)	-	(126)
Adjusted net income	**$ 47**	**$ 55**	**$ (8)**	**$ 917**	**$ 738**	**$ 179**
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	269	275	(6)	272	276	(4)
Adjusted earnings per share – diluted	**$ 0.17**	**$ 0.20**	**$ (0.03)**	**$ 3.37**	**$ 2.67**	**$ 0.70**

(1) In 2018, Air Canada recorded a loss on disposal of assets of $188 million related to the sale of 25 Embraer 190 aircraft.
(2) Air Canada recorded special net income tax items in 2019 mainly related to Air Canada's acquisition of Aeroplan on January 10, 2019.

The table below reflects the share amounts used in the computation of basic and diluted earnings per share on an adjusted earnings per share basis.

(in millions)	FOURTH QUARTER		FULL YEAR	
	2019	2018	2019	2018
Weighted average number of shares outstanding – basic	**266**	**271**	**268**	**272**
Effect of dilution	3	4	4	4
Weighted average number of shares outstanding – diluted	**269**	**275**	**272**	**276**

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. ROIC is based on adjusted pre-tax income (loss), excluding interest expense. Invested capital includes average year-over-year long-term debt, average year-over-year lease obligations and average year-over-year shareholders' equity, net of excess cash. Air Canada defines excess cash as total cash and investments in excess of the minimum cash required to support operations. This measure of liquidity includes cash, cash equivalents, short-term investments, short-term restricted cash and long-term investments. Air Canada uses 20% of trailing 12-month operating revenue as its estimate of the minimum cash required to support ongoing business operations. This estimate of minimum cash provides adequate coverage for advance ticket sales and to meet Air Canada's liquidity needs, as described in section 10.1 "Liquidity" of this MD&A. Air Canada calculates invested capital based on a book value-based method of calculating ROIC, as described above. Refer to the definition of adjusted pre-tax income (loss) for a discussion as to why Air Canada uses adjusted pre-tax income (loss) 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, 2019	DECEMBER 31, 2018
Income before income taxes - GAAP	**$ 1,775**	**$ 228**
Remove:		
Foreign exchange (gain) loss	(499)	578
Net financing expense relating to employee benefits	39	50
(Gain) loss on financial instruments recorded at fair value	(23)	1
Gain on debt settlements and modifications (1)	(6)	(9)
(Gain) loss on disposal of assets (2)	(13)	188
Adjusted pre-tax income	**$ 1,273**	**$ 1,036**
Adjusted for:		
Interest expense	515	567
Adjusted pre-tax income before interest	**$ 1,788**	**$ 1,603**
Invested capital:		
Average long-term debt and lease liabilities	9,582	9,649
Average shareholders' equity, net of excess cash	1,951	2,227
Invested capital	**$ 11,533**	**$ 11,876**
Return on invested capital (%)	**15.5%**	**13.5%**

(1) In 2019, Air Canada recorded a gain on debt settlements and modifications of $6 million related to the repricing of its US$1.1 billion senior secured credit facility.
In 2018, Air Canada recorded a gain on debt settlements and modifications of $9 million comprised of 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.

(2) In 2019, Air Canada recorded a gain on disposal of assets of $13 million related to the sale of an aircraft, spare engines and a flight simulator.
In 2018, Air Canada recorded a loss on disposal of assets of $188 million related to the sale of 25 Embraer aircraft.

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. Free cash flow in 2019 also excludes the one-time proceeds related to the Aeroplan acquisition. Refer to section 10.5 "Consolidated Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

NET DEBT TO TRAILING 12-MONTH EBITDA (LEVERAGE RATIO)

Net debt to trailing 12-month EBITDA 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 net debt by trailing 12-month EBITDA (excluding special items). As mentioned above, Air Canada excludes special items from EBITDA results (which are used to determine leverage ratio) as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful. Refer to section 10.3 "Net Debt" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

23. 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, the operating expenses of Aeroplan, and special items. Adjusted CASM is a non-GAAP financial measure. Refer to section 22 "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 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. Adjusted net income (loss) is a non-GAAP financial measure. Refer to section 22 "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 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. Adjusted pre-tax income (loss) is a non-GAAP financial measure. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

Aeroplan – Refers to Aeroplan Inc., formerly known as Aimia Canada Inc.

Atlantic passenger and cargo revenues – Refers 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.

CASM – Refers to operating expense (cost) per ASM.

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

EBITDA – Refers to earnings before interest, taxes, depreciation and amortization. EBITDA is a non-GAAP financial measure. Refer to section 22 "Non-GAAP Financial Measures" of this MD&A for additional information. Air Canada excludes special items from EBITDA.

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 in 2019 also excludes the one-time proceeds related to the Aeroplan acquisition. Free cash flow is a non-GAAP financial measure. Refer to sections 10.5 "Consolidated Cash Flow Movements" and 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

Jazz – Refers to Jazz Aviation LP.

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

Leverage ratio – Refers to the ratio of net debt to trailing 12-month EBITDA (calculated by dividing net debt by trailing 12-month EBITDA). Leverage ratio is a non-GAAP financial measure. Refer to sections 10.3 "Net Debt" and 22 "Non-GAAP Financial Measures" of this MD&A for additional information.

Loss (gain) on debt settlements and modifications – Refers 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 – Refers to revenues from flights with origins and destinations principally in Central and South America, the Caribbean and Mexico.

Pacific passenger and cargo revenues – Refers to revenues from flights that cross the Pacific Ocean with origins and destinations principally in Asia 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. ROIC is a non-GAAP financial measure. Refer to section 22 "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 – Refers 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.

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.

2019

CONSOLIDATED FINANCIAL STATEMENTS AND NOTES

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 judgments 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 17, 2020

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, 2019 and 2018 and January 1, 2018, and its financial performance and its cash flows for the years ended December 31, 2019 and 2018 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, 2019 and 2018 and January 1, 2018;
- the consolidated statements of operations for the years ended December 31, 2019 and 2018;
- the consolidated statements of comprehensive income for the years ended December 31, 2019 and 2018;
- the consolidated statements of changes in equity for the years ended December 31, 2019 and 2018;
- the consolidated statements of cash flow for the years ended December 31, 2019 and 2018; 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.

EMPHASIS OF MATTER – ADOPTION OF NEW ACCOUNTING STANDARD

We draw attention to Note 2BB to the consolidated financial statements, which describes the adoption of IFRS 16 - Leases. Our opinion is not modified in respect of this matter.

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 judgment 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]

Montréal, Quebec
February 17, 2020

[1] CPA auditor, CA, public accountancy permit No. A113048

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Canadian dollars in millions)		**DECEMBER 31, 2019**	DECEMBER 31, 2018 RESTATED - NOTE 2	JANUARY 1, 2018 RESTATED - NOTE 2
ASSETS				
Current				
Cash and cash equivalents		$ 2,090	$ 630	$ 642
Short-term investments		3,799	4,077	3,162
Total cash, cash equivalents and short-term investments		5,889	4,707	3,804
Restricted cash	Note 2P	157	161	148
Accounts receivable	Note 21	926	796	811
Aircraft fuel inventory		102	109	91
Spare parts and supplies inventory	Note 2Q	110	111	115
Prepaid expenses and other current assets	Note 21	332	417	425
Total current assets		7,516	6,301	5,394
Investments, deposits and other assets	Note 6	936	401	402
Property and equipment	Note 7	12,834	12,183	11,827
Pension assets	Note 11	2,064	1,969	1,583
Deferred income tax	Note 13	134	314	684
Intangible assets	Note 8	1,002	404	318
Goodwill	Note 9	3,273	311	311
Total assets		**$ 27,759**	**$ 21,883**	**$ 20,519**
LIABILITIES				
Current				
Accounts payable and accrued liabilities		$ 2,456	$ 1,911	$ 1,927
Advance ticket sales	Note 21	2,939	2,717	2,469
Aeroplan and other deferred revenue	Notes 4 & 21	1,162	-	-
Current portion of long-term debt and lease liabilities	Note 10	1,218	1,048	1,186
Total current liabilities		7,775	5,676	5,582
Long-term debt and lease liabilities	Note 10	8,024	8,873	8,190
Aeroplan and other deferred revenue	Notes 4 & 21	3,136	-	-
Pension and other benefit liabilities	Note 11	2,930	2,547	2,592
Maintenance provisions	Note 12	1,240	1,307	1,151
Other long-term liabilities		181	151	159
Deferred income tax	Note 13	73	52	49
Total liabilities		**$ 23,359**	**$ 18,606**	**$ 17,723**
SHAREHOLDERS' EQUITY				
Share capital	Note 14	785	798	799
Contributed surplus		83	75	69
Hedging reserve		-	-	-
Accumulated other comprehensive income	Note 5	25	-	-
Retained earnings		3,507	2,404	1,928
Total shareholders' equity		4,400	3,277	2,796
Total liabilities and shareholders' equity		**$ 27,759**	**$ 21,883**	**$ 20,519**

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)		2019	2018 RESTATED - NOTE 2
OPERATING REVENUES			
Passenger	Note 21	$ 17,232	$ 16,161
Cargo	Note 21	717	803
Other		1,182	1,039
Total revenues		**19,131**	**18,003**
OPERATING EXPENSES			
Aircraft fuel		3,862	3,969
Wages, salaries and benefits		3,184	2,873
Regional airlines expense	Note 22	2,441	2,508
Depreciation and amortization		1,986	1,717
Aircraft maintenance		1,004	903
Airport and navigation fees		990	964
Sales and distribution costs		874	807
Ground package costs		627	602
Catering and onboard services		445	433
Communications and information technology		397	294
Other		1,671	1,437
Total operating expenses		**17,481**	**16,507**
Operating income		**1,650**	**1,496**
NON-OPERATING INCOME (EXPENSE)			
Foreign exchange gain (loss)		499	(578)
Interest income		164	108
Interest expense		(515)	(567)
Interest capitalized		35	35
Net financing expense relating to employee benefits	Note 11	(39)	(50)
Gain (loss) on financial instruments recorded at fair value	Note 18	23	(1)
Gain on debt settlements and modifications	Note 10	6	9
Gain (loss) on disposal of assets	Notes 7 & 23	13	(188)
Other		(61)	(36)
Total non-operating income (expense)		**125**	**(1,268)**
Income before income taxes		**1,775**	**228**
Income tax expense	Note 13	(299)	(191)
Net income		**$ 1,476**	**$ 37**
NET INCOME PER SHARE	Note 16		
Basic earnings per share		$ 5.51	$ 0.14
Diluted earnings per share		$ 5.44	$ 0.13

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)		2019	2018 RESTATED - NOTE 2
COMPREHENSIVE INCOME			
Net income		$ 1,476	$ 37
Other comprehensive income, net of tax expense:	Note 13		
Items that will not be reclassified to net income			
Remeasurements on employee benefit liabilities	Note 11	(22)	503
Remeasurements on equity investments	Note 5	25	-
Total comprehensive income		**$ 1,479**	**$ 540**

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Canadian dollars in millions)	SHARE CAPITAL	CONTRIBUTED SURPLUS	HEDGING RESERVE	ACCUMULATED OCI	RETAINED EARNINGS	TOTAL SHAREHOLDERS' EQUITY
January 1, 2018 [(1)]	$ 799	$ 69	$ –	$ –	$ 1,928	$ 2,796
Net income [(1)]	–	–	–	–	37	37
Remeasurements on employee benefit liabilities	–	–	–	–	503	503
Total comprehensive income	–	–	–	–	540	540
Share-based compensation	–	9	–	–	–	9
Shares issued	8	(3)	–	–	–	5
Shares purchased and cancelled under issuer bid	(9)	–	–	–	(64)	(73)
December 31, 2018 [(1)]	$ 798	$ 75	$ –	$ –	$ 2,404	$ 3,277
Net income	–	–	–	–	1,476	1,476
Remeasurements on employee benefit liabilities	–	–	–	–	(22)	(22)
Remeasurements on equity investments	–	–	–	25	–	25
Total comprehensive income	–	–	–	25	1,454	1,479
Share-based compensation	–	13	–	–	–	13
Shares issued	14	(5)	–	–	–	9
Shares purchased and cancelled under issuer bid	(27)	–	–	–	(351)	(378)
December 31, 2019	$ 785	$ 83	$ –	$ 25	$ 3,507	$ 4,400

(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)		2019	2018 RESTATED - NOTE 2
CASH FLOWS FROM (USED FOR)			
Operating			
Net income		$ 1,476	$ 37
Adjustments to reconcile to net cash from operations			
Deferred income tax	Note 13	227	185
Depreciation and amortization	Note 7	1,986	1,717
Foreign exchange (gain) loss	Note 18	(361)	589
Card agreement proceeds	Note 4	1,212	-
Aeroplan Miles prepayment proceeds	Note 4	400	-
Gain on debt settlements and modifications	Note 10	(6)	(9)
Loss (gain) on disposal of assets	Notes 7 & 23	(13)	188
Employee benefit funding less than expense	Note 11	210	257
Financial instruments recorded at fair value	Note 18	(37)	14
Change in maintenance provisions		49	168
Changes in non-cash working capital balances		566	286
Other		3	38
Net cash flows from operating activities		**5,712**	**3,470**
FINANCING			
Proceeds from borrowings	Note 10	-	1,210
Reduction of long-term debt and lease liabilities	Note 10	(1,084)	(1,706)
Shares purchased for cancellation	Note 14	(373)	(73)
Issue of shares		9	5
Financing fees	Note 10	(1)	(12)
Net cash flows used in financing activities		**(1,449)**	**(576)**
INVESTING			
Investments, short-term and long-term		(255)	(848)
Additions to property, equipment and intangible assets		(2,025)	(2,436)
Proceeds from sale of assets		24	11
Proceeds from sale and leaseback of assets	Note 23	-	293
Acquisition of Aeroplan	Note 4	(517)	-
Investment in Chorus	Note 5	(97)	-
Other		75	47
Net cash flows used in investing activities		**(2,795)**	**(2,933)**
Effect of exchange rate changes on cash and cash equivalents		**(8)**	**27**
Increase (decrease) in cash and cash equivalents		**1,460**	**(12)**
Cash and cash equivalents, beginning of year		630	642
Cash and cash equivalents, end of year		**$ 2,090**	**$ 630**

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

FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

(Canadian dollars except where otherwise indicated)

1. GENERAL INFORMATION

The accompanying audited consolidated financial statements (the "financial statements") are of Air Canada (the "Corporation"). The term "Corporation" also refers, as the context may require, to 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"), Air Canada Rouge LP doing business under the brand name Air Canada Rouge® ("Air Canada Rouge") and, effective January 10, 2019, Aeroplan Inc. ("Aeroplan"). Refer to Note 4 for information on the Aeroplan acquisition.

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 17, 2020.

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, long-term investments, 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

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. Passenger revenues are also reduced for the amount of any passenger compensation paid directly to a customer (refer to Note 2BB for additional information on this accounting change adopted in 2019).

Airline passenger and cargo advance sales are deferred and included in Current liabilities. As further discussed in Note 4, Air Canada acquired Aimia Canada Inc. (now Aeroplan Inc.), owner and operator of the Aeroplan loyalty business, from Aimia Inc. on January 10, 2019. Prior to the acquisition of Aeroplan, advance ticket sales included the proceeds from the sale of flight tickets to Aeroplan (formerly Aimia Canada Inc.), a corporation that provided loyalty program services to Air Canada and purchased seats from Air Canada pursuant to the Commercial Participation and Services Agreement between Aeroplan and Air Canada.

For Aeroplan Miles issued after the acquisition date, the value of Aeroplan deferred revenue related to Aeroplan Miles issued but not yet redeemed is determined with reference to their Equivalent Ticket Value ("ETV") for Miles issued from qualifying air travel, or with reference to the consideration received for Aeroplan Miles sold to third party Aeroplan program partners. ETV is determined based on the value a passenger receives by redeeming Aeroplan Miles for a ticket rather than paying cash.

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

As further discussed in Note 4, Air Canada acquired the Aeroplan loyalty business from Aimia Inc. on January 10, 2019. The Aeroplan loyalty program generates customer loyalty by rewarding customers to travel with Air Canada. This program allows program members to earn Aeroplan Miles by flying on Air Canada, Star Alliance partners and other airlines that participate in the Aeroplan loyalty program. When travelling, program members earn redeemable Aeroplan Miles based on a number of factors, including the passenger's loyalty program status, distance travelled, booking class and travel fare paid. Members can also earn Aeroplan Miles through participating Aeroplan program partners such as credit card companies, hotels, car rental agencies and other program partners. Aeroplan Miles are redeemable by members for air travel on Air Canada and other participating airlines, and for other program awards, such as hotel, car rentals, gift cards, merchandise and other non-air rewards.

Aeroplan members can earn Aeroplan Miles (1) through travel and (2) based on spending with program partners.

Miles Earned with Travel

Passenger ticket sales earning Aeroplan Miles under the Aeroplan loyalty program provide members with (1) air transportation and (2) Aeroplan Miles. As a revenue arrangement with multiple performance obligations, each performance obligation is valued on a relative standalone fair value basis. The value of Aeroplan Miles issued is determined based on the value a passenger receives by redeeming Miles for a ticket rather than paying cash, which is referred to as ETV. The ETV is adjusted for Miles that are not expected to be redeemed ("breakage"). The consideration allocated to the ETV for Miles earned with travel is recorded in Aeroplan deferred revenue.

Miles Sold to Program Partners

Aeroplan members can earn Aeroplan Miles based on their spending with participating Aeroplan partners such as credit card companies, hotels and car rental agencies and other program partners. Aeroplan Miles issued under program partner agreements are accounted for as a single performance obligation being the future delivery of a redemption reward to the Aeroplan member. The consideration received for Aeroplan Miles issued to Aeroplan members under these agreements is recorded as Aeroplan deferred revenue.

Prior to the acquisition of Aeroplan, Air Canada purchased Aeroplan Miles® from Aeroplan. The cost of purchasing Aeroplan Miles® from Aeroplan was accounted for as a sales incentive and charged against passenger revenues when the points were issued, which occurred upon the qualifying air travel being provided to the customer.

Breakage represents the estimated Aeroplan Miles that are not expected to be redeemed by Aeroplan members. The amount of revenue recognized related to breakage is based on the number of Aeroplan Miles redeemed in a period in relation to the total number of Aeroplan Miles expected to be redeemed. The number of Aeroplan Miles redeemed in a period also factors into any revised estimate for breakage. Changes in breakage are accounted for as follows: in the period of change, the deferred revenue balance is adjusted as if the revised estimate had been used in prior periods with the offsetting amount recorded as an adjustment to passenger revenue; and for subsequent periods, the revised estimate is used.

F) OTHER REVENUES

Other revenue is primarily comprised of revenues from the sale of the ground portion of vacation packages, ground handling services, onboard 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.

Following the acquisition of Aeroplan on January 10, 2019, redemption of Aeroplan Miles for non-air goods and services is recorded in other revenue. For non-air redemptions, the Corporation has determined that, for accounting purposes, it is not the principal in the transaction between the member and the ultimate supplier of the goods or service. When Miles are redeemed for non-air goods and services, the net margin is recorded in other revenue when the performance obligation is satisfied.

In certain subleases of aircraft to Jazz, for accounting purposes, the Corporation acts as an agent and accordingly reports the sublease revenues net against regional airlines expense. 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 15. PSUs and RSUs are notional share units which are exchangeable on a one-to-one basis for Air Canada shares or the cash equivalent, as determined by the Board of Directors.

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.

PSUs and RSUs are accounted for as 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 18 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 lease, which are accrued over the term of the lease, and major maintenance expenditures on owned and 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 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. Maintenance provisions for end-of-lease return obligations are recorded, as applicable, on aircraft leases as a maintenance expense over the term of the lease, 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 to the provision for end-of-lease conditions are recognized as an adjustment to the right-of-use asset and subsequently amortized to the income statement over the remaining term of the lease. Any 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, Restricted cash, and Long-term investments 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.
- The equity investment in Chorus is classified as an asset at fair value through other comprehensive income, and any period change in fair value is recorded through other comprehensive income in the consolidated statement of comprehensive income, 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

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 below. Derivative instruments are recorded 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.

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 18 for the results from fuel hedge accounting.

When a hedging instrument expires, is sold or is 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.

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 Investments, 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 $72 million related to spare parts and supplies consumed during the year (2018 – $57 million).

R) PROPERTY AND EQUIPMENT

Property and equipment is recognized using the cost model. Property under leases, recognized as right-of-use assets, 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 lease 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

The Corporation adopted IFRS 16 Leases on January 1, 2019, and applied it retrospectively to the previous periods. The impact of the new standard on previously reported results is summarized in Note 2BB.

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 do not include variable lease payments other than those that depend on an index or rate. The right-of-use asset is derived from the calculation of the lease liability.

Aircraft Leases

As at December 31, 2019, the Corporation had 127 aircraft under right-of-use leases (129 aircraft and 115 aircraft as at December 31, 2018 and December 31, 2017, respectively), and Air Canada recorded 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 had 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 recorded such aircraft as right-of-use assets and lease liabilities of Air Canada. As at December 31, 2019, there were 131 aircraft (137 aircraft and 139 aircraft as at December 31, 2018 and December 31, 2017, respectively) 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 are considered short-term leases and therefore excluded from balance sheet recognition under the practical expedient. Finally, those airport terminal contracts with entirely variable lease payments are also 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 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, Montréal and Vancouver, lease contracts on building space dedicated to the Corporation 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 rate of interest on the remaining balance of the liability for each period.

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

Maintenance provisions for end-of-lease return obligations are 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 are recognized as an adjustment to the right-of-use asset and subsequently amortized to the income statement over the remaining term of the lease.

Refer to Note 3 Critical Accounting Estimates – Leases for information on the most significant estimates and judgments applicable to the measurement of right-of-use assets and lease liabilities.

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, 2019
International route rights and slots	Indefinite	not applicable
Marketing-based trade names	Indefinite	not applicable
Technology-based (internally developed)	5 to 15 years	1 to 15 years
Contract-based (Aeroplan commercial agreements)	11.5 years	10.5 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, implementation, 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.

Contract-based and marketing-based trade name intangible assets were recorded upon the acquisition of Aeroplan. The contract-based intangible assets have an estimated useful life of 11.5 years, being the term of the primary commercial agreements with program partners, which expire in 2030. The marketing-based trade name is considered an indefinite life intangible asset.

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 2AA).

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 including aircraft that are parked but are expected to be so, temporarily, and returned to service) 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, 2019

IFRS 16 – Leases

The Corporation adopted the standard effective January 1, 2019 using the full retrospective approach, which requires each prior reporting period presented to be restated. The Corporation has elected to use 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. The main changes of IFRS 16 are explained below.

Income Statement Impacts

The impacts on the income statement are an elimination of aircraft rent and building rent, which were recorded in other operating expenses, for those contracts which are recognized as leases and instead are replaced by an amortization of the right-of-use asset and interest costs on the lease liability. Qualifying maintenance events for the former operating leases are capitalized as part of the right-of-use asset and depreciated over their expected maintenance life. This is 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 decreases 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 U.S. dollars, the foreign exchange recognized in the income statement includes the revaluation of the lease liabilities and maintenance provisions to the rate of exchange in effect at the date of the balance sheet.

Presentation

Rent on aircraft operated by regional carriers was previously included in Regional airlines expense. With the adoption of IFRS 16 and the elimination of aircraft rent, the depreciation on right-of-use assets associated with aircraft operated by regional carriers is presented within Depreciation and amortization on the consolidated statement of operations. Maintenance provisions for end-of-lease obligations related to regional carriers remain in the Regional airlines expense. Expenses related to short-term leases of less than 12 months, which are not recorded as leases under IFRS 16, are recorded in Other operating expenses.

Impact to Previously Reported Results

Select adjusted financial statement information which reflects the adoption of IFRS 16 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, 2018 and at the end of the comparative period, December 31, 2018.

(Canadian dollars in millions)	DEC. 31, 2017 AS PREVIOUSLY REPORTED	AIR CANADA AIRCRAFT	REGIONAL AIRCRAFT	PROPERTY LEASES	**JAN. 1, 2018 AS RESTATED**
Accounts receivable	$ 814	$ (3)	$ -	$ -	$ 811
Investments, 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**

(Canadian dollars in millions)	DEC. 31, 2018 AS PREVIOUSLY REPORTED	AIR CANADA AIRCRAFT	REGIONAL AIRCRAFT	PROPERTY LEASES	**DEC. 31, 2018 AS RESTATED**
Investments, deposits and other assets	$ 444	$ (43)	$ -	$ -	$ 401
Property and equipment	9,729	1,599	673	182	12,183
Deferred income tax	39	98	163	14	314
Total assets	**$ 19,197**	**$ 1,654**	**$ 836**	**$ 196**	**$ 21,883**
Accounts payable and accrued liabilities	1,927	(13)	(3)	-	1,911
Current portion of long-term debt and lease liabilities	455	403	179	11	1,048
Total current liabilities	5,099	390	176	11	5,676
Long-term debt and lease liabilities	6,197	1,446	1,005	225	8,873
Maintenance provisions	1,118	89	100	-	1,307
Other long-term liabilities	151	-	-	-	151
Total liabilities	**$ 15,164**	**$ 1,925**	**$ 1,281**	**$ 236**	**$ 18,606**
Retained earnings	3,160	(271)	(445)	(40)	2,404
Total shareholders' equity	**$ 4,033**	**$ (271)**	**$ (445)**	**$ (40)**	**$ 3,277**
Total liabilities and shareholders' equity	**$ 19,197**	**$ 1,654**	**$ 836**	**$ 196**	**$ 21,883**

Adoption of the standard impacted the Corporation's previously reported consolidated statement of operations as follows. The table below excludes the impact of the change in presentation for passenger compensation, the impact of which is separately described under IFRS 15 Revenue from Contracts with Customers.

(Canadian dollars in millions)	TWELVE MONTHS ENDED DEC. 31, 2018 AS PREVIOUSLY REPORTED	AIR CANADA AIRCRAFT	REGIONAL AIRCRAFT	PROPERTY LEASES	**TWELVE MONTHS ENDED DEC. 31, 2018 AS RESTATED**
Total revenues	**$ 18,065**	**$ -**	**$ -**	**$ -**	**$ 18,065**
OPERATING EXPENSES					
Regional airlines expense	2,842	-	(323)	-	2,519
Aircraft maintenance	1,003	(100)	-	-	903
Depreciation, amortization and impairment	1,080	424	197	16	1,717
Aircraft rent	518	(518)	-	-	-
Other	1,506	9	-	(27)	1,488
Total operating expenses	**16,891**	**(185)**	**(126)**	**(11)**	**16,569**
Operating income	**1,174**	**185**	**126**	**11**	**1,496**
Foreign exchange gain (loss)	(317)	(155)	(105)	(1)	(578)
Interest expense	(331)	(131)	(91)	(14)	(567)
Other	(34)	(2)	-	-	(36)
Total non-operating expense	(769)	(288)	(196)	(15)	(1,268)
Income (loss) before income taxes	405	(103)	(70)	(4)	228
Income tax (expense) recovery	(238)	27	19	1	(191)
Net income (loss) for the period	**$ 167**	**$ (76)**	**$ (51)**	**$ (3)**	**$ 37**
Basic earnings (loss) per share	$ 0.61	$ (0.28)	$ (0.18)	$ (0.01)	$ 0.14
Diluted earnings (loss) per share	$ 0.60	$ (0.28)	$ (0.18)	$ (0.01)	$ 0.13

The impact on the consolidated statement of cash flows is provided below. The interest portion of lease payments is classified under operating activities, while principal repayments on the lease liabilities are included within financing activities.

(Canadian dollars in millions)	TWELVE MONTHS ENDED DEC. 31, 2018 AS PREVIOUSLY REPORTED	AIR CANADA AIRCRAFT	REGIONAL AIRCRAFT	PROPERTY LEASES	**TWELVE MONTHS ENDED DEC. 31, 2018 AS RESTATED**
CASH FLOWS FROM (USED FOR)					
OPERATING					
Net income (loss) for the period	$ 167	$ (76)	$ (51)	$ (3)	$ 37
Deferred income tax	232	(27)	(19)	(1)	185
Depreciation, amortization and impairment	1,118	424	159	16	1,717
Foreign exchange (gain) loss	328	155	105	1	589
Change in maintenance provisions	98	51	19	-	168
Changes in non-cash working capital balances	267	10	9	-	286
Other	35	3	-	-	38
Net cash flows from operating activities	**2,695**	**540**	**222**	**13**	**3,470**
FINANCING					
Reduction of long-term debt and lease obligations	(1,170)	(373)	(150)	(13)	(1,706)
Net cash flows from (used in) financing activities	**(40)**	**(373)**	**(150)**	**(13)**	**(576)**
INVESTING					
Additions to property, equipment and intangible assets	(2,197)	(167)	(72)	-	(2,436)
Net cash flows used in investing activities	**(2,694)**	**(167)**	**(72)**	**-**	**(2,933)**
Effect of exchange rate on cash and cash equivalents	**27**	**-**	**-**	**-**	**27**
Cash and cash equivalents, beginning of period	**642**	**-**	**-**	**-**	**642**
Cash and cash equivalents, end of period	**$ 630**	**$ -**	**$ -**	**$ -**	**$ 630**

IFRIC 23 – Uncertainty over Income Tax Treatments

IFRIC 23 is effective for years beginning on or after January 1, 2019. IFRIC 23 provides a framework to consider, recognize and measure the accounting impact of tax uncertainties and provides specific guidance in several areas where previously IAS 12 Income Taxes was silent. The Corporation has adopted the interpretation of IFRIC 23 and concluded that it has no impact on previously reported results.

IFRS 15 Revenue from Contracts with Customers

In September 2019, the IFRS Interpretations Committee finalized its decision that an entity should account for its obligations to compensate passengers for delayed and cancelled flights as variable consideration under IFRS 15. The Corporation adopted this accounting treatment in the fourth quarter on a retrospective basis, with 2018 restated. Previously, the Corporation recognized passenger compensation costs by applying IAS 37 Provisions, Contingent Liabilities and Contingent Assets. While there is no impact to the amount of passenger compensation recognized, presentation within the consolidated statement of operations is impacted as the compensation is reclassified against passenger revenue.

The Corporation adopted this accounting treatment in the fourth quarter on a retrospective basis, with 2018 restated. The impact on the consolidated statement of operations was a decrease of $74 million from Other operating expenses, a decrease of $13 million from Regional airlines expense, and a decrease to Passenger revenues of $87 million in 2019 (decrease of $51 million from Other operating expenses, decrease of $11 million from Regional airlines expense, and a decrease to Passenger revenues of $62 million in 2018).

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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 judgments 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 judgments 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:

LEASES

The application of IFRS 16 Leases 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 and incremental rates of borrowing, as applicable. Judgment must also be applied as to whether renewal options are reasonably certain of being exercised.

BUSINESS COMBINATIONS

The Corporation's acquisition of Aeroplan was accounted for using the acquisition method of accounting. Under the acquisition method, the estimated fair values of the acquired company's assets and assumed liabilities are added to the consolidated statement of financial position as at the acquisition date. There were various assumptions made when determining the fair values of Aeroplan's assets and assumed liabilities. The most significant assumptions and those requiring the most judgment involve the estimated fair values of intangible assets and the estimated fair values of deferred revenues related to the outstanding Aeroplan Miles obligation ("Aeroplan deferred revenue").

The intangible assets recognized on the acquisition of Aeroplan include technology-based, contract-based and marketing-based (trade name) intangible assets. To determine the fair value of technology-based intangible assets, the Corporation applied a depreciated replacement cost methodology. For contract-based intangible assets, the Corporation used the multi-period excess earnings method. This valuation technique values the intangible assets based on the capitalization of the excess earnings, which are calculated to be in excess of what a reasonable amount of earnings would be on the tangible assets used to generate the earnings. Significant assumptions include, among others, the determination of projected revenues, cash flows, customer retention rates, discount rates and anticipated average income tax rates. To determine the fair value of the trade name, the Corporation used the relief from royalty method. This valuation technique values the intangible assets based on the present value of the expected after-tax royalty cash flow stream using a hypothetical licensing arrangement. Significant assumptions include, among others, the determination of projected revenues, royalty rate, discount rates and anticipated average income tax rates.

The deferred revenues recognized on the acquisition of Aeroplan relate to the estimated fair value of outstanding Aeroplan Miles. The liability assumed was recorded based on the estimated fair value to service the Miles outstanding that are expected to be redeemed.

AEROPLAN LOYALTY PROGRAM

Loyalty program accounting requires management to make several estimates including about the ETV of Aeroplan Miles issued and the breakage on Aeroplan Miles. The ETV of Aeroplan Miles issued is determined based on the value a passenger receives by redeeming Miles for a ticket rather than paying cash. This ETV is estimated with reference to historical Aeroplan redemptions as compared to equivalent ticket purchases after considering similar fare conditions, advance booking periods and other relevant factors including the selling price of Miles to third parties. ETV estimates and assumptions are considered for updates at least annually. A change in the ETV rate is accounted for prospectively on future Miles issued.

Breakage represents the estimated Miles that are not expected to be redeemed. Breakage is estimated by management based on the terms and conditions of membership and historical accumulation and redemption patterns, as adjusted for changes to any terms and conditions or other circumstances that may affect future redemptions. Management uses statistical and simulation models to estimate breakage.

Changes in breakage are accounted for as follows: in the period of change, the deferred revenue balance is adjusted as if the revised estimate had been used in prior periods with the offsetting amount recorded as an adjustment to passenger revenue; and for subsequent periods, the revised estimate is used. A change in assumptions as to the number of Miles expected to be redeemed could have a material impact on revenue in the year in which the change occurs.

As at December 31, 2019, the Aeroplan Miles deferred revenue balance was $2,825 million. For illustrative purposes, a hypothetical 1% change in the number of outstanding Miles estimated to be redeemed would result in an approximate impact of $28 million on revenue with a corresponding adjustment to Aeroplan deferred revenue.

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 11 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 $16 million 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 at the end of the lease 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 recognized as an adjustment to the right-of-use asset. Refer to Note 12(a) for additional information.

4. ACQUISITION OF AEROPLAN

On January 10, 2019, Air Canada completed its purchase, from Aimia Inc. ("Aimia"), of Aeroplan. The aggregate purchase price for the acquisition consisted of $450 million in cash plus $67 million in cash for closing adjustments (total purchase consideration of $517 million). The acquisition also included the assumption of the Aeroplan Miles liability.

Concurrently with the conclusion of the Aeroplan purchase, Air Canada, Aeroplan, The Toronto-Dominion Bank ("TD Bank"), Canadian Imperial Bank of Commerce ("CIBC"), and Visa Canada Corporation ("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 the Aeroplan program. Similarly, in the first quarter of 2019, Air Canada, Aeroplan, and AMEX Bank of Canada ("AMEX") concluded agreements enabling AMEX's continued participation in the Aeroplan program. Air Canada received payments from TD Bank, CIBC, Visa, and AMEX in the aggregate amount of $1,212 million. This consideration has been accounted for as deferred revenue and will be amortized into passenger revenue over the terms of the related agreements.

In addition, TD Bank and CIBC made payments to the Corporation in the aggregate amount of $400 million as prepayments to be applied towards future monthly payments in respect of Aeroplan Miles. This consideration is accounted for as a contract liability within Aeroplan and other deferred revenue.

Following the closing of the acquisition, Aimia Canada Inc. changed its name to Aeroplan Inc.

Air Canada, as the acquirer, performed 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 allocation of the purchase price to the fair value of assets and liabilities has been finalized and is summarized as follows:

(Canadian dollars in millions)

FAIR VALUE OF ASSETS ACQUIRED	
Cash	$ -
Accounts receivable	188
Prepaid expenses and other current assets	8
Property and equipment	55
Deferred income tax	44
Intangible assets – Technology-based	38
Intangible assets – Contract-based	225
Intangible assets – Trade name	90
	$ 648
FAIR VALUE OF LIABILITIES ASSUMED	
Accounts payable and accrued liabilities	210
Deferred revenue (current and long-term)	2,779
Long-term debt (lease liabilities)	41
Pension and other benefit liabilities	39
Deferred income tax	24
	$ 3,093
Fair value of net assets acquired	**(2,445)**
Goodwill	**2,962**
Total purchase consideration	**$ 517**

Refer to the Critical Accounting Estimates – Business Combinations section of Note 3 for the most significant estimates used in determining the acquisition date fair values.

The contract-based intangible asset is subject to amortization over the term of the related commercial agreements with program partners, while the trade name is considered to have an indefinite life. The goodwill is attributable to synergies with Air Canada related to the servicing of the deferred revenue liabilities, the skilled workforce, expansion capabilities into other geographies and the profitability of the acquired business.

As the acquisition was completed on January 10, 2019, the net earnings for the stub period from January 1 to January 9, 2019 were not significant for the purpose of disclosing the combined results of operations had the acquisition been completed at the beginning of the period.

INDEMNITY

The share purchase agreement with Aimia provides for customary indemnities between Aimia and Air Canada including in the event of misrepresentations and breaches of covenants. With respect to Aimia's general indemnification obligation, Aimia has no obligation to indemnify Air Canada unless and until the aggregate amount of the indemnifiable losses incurred exceeds $2.25 million, in which case all losses above $2.25 million are indemnifiable. Aimia's liability for such indemnity claims shall not exceed $55 million in all cases except with respect to (i) Aimia's fundamental representations, where its liability shall not exceed the purchase price, (ii) tax claims for pre-closing tax periods, where Aimia's liability is uncapped, and (iii) noncompliance with certain other provisions such as privacy and consumer protection laws, where Aimia's liability is uncapped. The agreement also provides for certain indemnities in respect of class action proceedings that existed at the closing of the acquisition, which are described below under "Litigation provisions".

With regard to Aimia's indemnification obligations, $2.25 million of the purchase price proceeds has been deposited with a third party escrow agent to cover any potential valid general indemnity claims that may be made by Air Canada against Aimia under the agreement until July 20, 2020, and $100 million of the purchase price proceeds was deposited in a separate account jointly controlled by Aimia and Air Canada pending the final determination related to an Aeroplan income tax audit conducted by the Canada Revenue Agency ("CRA") for the taxation year 2013 as well as all correlative adjustments. As a result of assessment notices from the CRA, the jointly controlled account was reduced by $27 million, with the balance of $73 million in that account remaining subject to the terms of the share purchase agreement with Aimia and the final resolution of these tax matters.

LITIGATION PROVISIONS – CLASS ACTIONS RELATED TO CERTAIN PASSENGER CHARGES

On the January 10, 2019 acquisition date, Aimia Canada Inc. (as it was then called) had, amongst other proceedings, three class action proceedings outstanding related to claims by Aeroplan members residing in Quebec for 1) fuel surcharges paid by them since December 12, 2011 when redeeming Miles for flights operated by or on behalf of Air Canada within North America, 2) airport improvement fees for a number of Canadian airports paid by them since December 15, 2011 when redeeming Miles for affected flights, and 3) passenger charges paid by them for a number of airports in Europe and Japan since June 9, 2012 when redeeming Miles for Air Canada flight tickets. Under the share purchase agreement with Aimia, Aimia will bear 50% of the liability and costs, if any, associated with these class action proceedings against Aimia Canada, up to a cap of $25 million for Aimia, after which Air Canada is solely responsible. The net liability to Air Canada in these actions, if any, is not expected to be material.

5. 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. With the extension of the CPA term, an increase of $95 million to the right-of-use asset and $104 million to the lease liability and a decrease of $9 million to the maintenance provision were recorded in the first quarter of 2019. The increases to the right-of-use asset and lease liability relate only to those aircraft that are specifically identified to be extended at this time. As additional aircraft are confirmed for extension during the term of the contract, additional right-of-use assets and lease liabilities will be recorded.

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 million 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. The equity investment in Chorus is accounted for at fair value, with all changes in fair value recorded through other comprehensive income. The fair value of the investment at December 31, 2019 was $126 million and is recorded in Investments, deposits and other assets. The change in fair value recorded through other comprehensive income for the year ended December 31, 2019 was $25 million, comprised of a gain of $29 million less deferred income tax expense of $4 million.

6. INVESTMENTS, DEPOSITS AND OTHER ASSETS

(Canadian dollars in millions)		**2019**	2018
Long-term investments		$ 512	$ -
Investment in Chorus	Note 5	126	-
Restricted cash	Note 2P	102	171
Aircraft-related deposit		98	111
Prepayments under maintenance agreements		56	74
Share forward contracts	Note 18	27	17
Other deposits		15	28
		$ 936	**$ 401**

7. PROPERTY AND EQUIPMENT

(Canadian dollars in millions)	DECEMBER 31, 2019 COST	DECEMBER 31, 2019 ACCUMULATED DEPRECIATION	DECEMBER 31, 2019 NET BOOK VALUE	DECEMBER 31, 2018 RESTATED - NOTE 2 COST	DECEMBER 31, 2018 RESTATED - NOTE 2 ACCUMULATED DEPRECIATION	DECEMBER 31, 2018 RESTATED - NOTE 2 NET BOOK VALUE
OWNED TANGIBLE ASSETS						
Aircraft and flight equipment	$ 12,920	$ 4,616	$ 8,304	$ 11,934	$ 3,825	$ 8,109
Buildings and leasehold improvements	923	501	422	858	454	404
Ground and other equipment	640	395	245	567	370	197
Purchase deposits and assets under development	1,041	-	1,041	933	-	933
Owned tangible assets	**$ 15,524**	**$ 5,512**	**$ 10,012**	**$ 14,292**	**$ 4,649**	**$ 9,643**
Air Canada aircraft	$ 5,055	$ 3,282	$ 1,773	$ 4,739	$ 3,119	$ 1,620
Regional aircraft	1,893	1,135	758	1,679	972	707
Land and buildings	447	156	291	372	159	213
Right-of-use assets	**$ 7,395**	**$ 4,573**	**$ 2,822**	**$ 6,790**	**$ 4,250**	**$ 2,540**
Property and equipment	**$ 22,919**	**$ 10,085**	**$ 12,834**	**$ 21,082**	**$ 8,899**	**$ 12,183**

Additions to owned aircraft in 2019 include six new Boeing 737 MAX-8, two new Boeing 787-9, one new Airbus A220 and four used Airbus A321 aircraft. One Boeing 767 aircraft was sold in 2019.

Included in aircraft and flight equipment are 16 aircraft and 15 spare engines (2018 – 16 aircraft and 16 spare engines) which are leased to CPA carriers with a cost of $353 million (2018 – $340 million) less accumulated depreciation of $154 million (2018 – $136 million) for a net book value of $199 million (2018 – $204 million). Depreciation expense for 2019 for these aircraft and flight equipment amounted to $21 million (2018 – $18 million).

As further described in Note 23, during 2018, the Corporation sold 25 Embraer 190 aircraft with a cost of $789 million less accumulated depreciation of $308 million for a net book value of $481 million.

Certain property and equipment are pledged as collateral as further described under the applicable debt instruments in Note 10. There are no impairments recorded as at December 31, 2019.

(Canadian dollars in millions)	JAN. 1, 2019	ADDITIONS	RECLASSIFI-CATIONS	DISPOSALS	DEPRECIATION	DEC. 31, 2019
OWNED TANGIBLE ASSETS						
Aircraft and flight equipment	$ 8,109	$ 893	$ 355	$ (14)	$ (1,039)	$ 8,304
Buildings and leasehold improvements	404	26	41	-	(49)	422
Ground and other equipment	197	66	21	(1)	(38)	245
Purchase deposits and assets under development	933	525	(417)	-	-	1,041
Owned tangible assets	**$ 9,643**	**$ 1,510**	**$ -**	**$ (15)**	**$ (1,126)**	**$ 10,012**
RIGHT-OF-USE ASSETS						
Air Canada aircraft	$ 1,620	$ 704	$ -	$ (7)	$ (544)	$ 1,773
Regional aircraft	707	234	-	(7)	(176)	758
Land and buildings	213	104	-	-	(26)	291
Right-of-use assets	**$ 2,540**	**$ 1,042**	**$ -**	**$ (14)**	**$ (746)**	**$ 2,822**
Property and equipment	**$ 12,183**	**$ 2,552**	**$ -**	**$ (29)**	**$ (1,872)**	**$ 12,834**

(Canadian dollars in millions)	JAN. 1, 2018	ADDITIONS	RECLASSIFICA-TIONS	DISPOSALS	DEPRECIATION	DEC. 31, 2018
OWNED TANGIBLE ASSETS						
Aircraft and flight equipment	$ 7,464	$ 1,583	$ 518	$ (495)	$ (961)	$ 8,109
Buildings and leasehold improvements	405	-	41	-	(42)	404
Ground and other equipment	208	31	-	-	(42)	197
Purchase deposits and assets under development	1,063	429	(559)	-	-	933
Owned tangible assets	**$ 9,140**	**$ 2,043**	**$ -**	**$ (495)**	**$ (1,045)**	**$ 9,643**
RIGHT-OF-USE ASSETS						
Air Canada aircraft	$ 1,686	$ 369	$ -	$ -	$ (435)	$ 1,620
Regional aircraft	806	68	-	(1)	(166)	707
Land and buildings	195	37	-	-	(19)	213
Right-of-use assets	**$ 2,687**	**$ 474**	**$ -**	**$ (1)**	**$ (620)**	**$ 2,540**
Property and equipment	**$ 11,827**	**$ 2,517**	**$ -**	**$ (496)**	**$ (1,665)**	**$ 12,183**

Depreciation and amortization recorded in the consolidated statement of operations is detailed as follows.

(Canadian dollars in millions)	2019	2018
Aircraft and flight equipment	$ 1,039	$ 961
Buildings and leasehold improvements	49	42
Ground and other equipment	38	42
Owned tangible assets	**1,126**	**1,045**
Air Canada aircraft	544	435
Regional aircraft	176	166
Land and buildings	26	19
Right-of-use assets	**746**	**620**
Property and equipment	**1,872**	**1,665**
Spare part and supplies inventory	19	16
Intangible assets	95	36
Depreciation and amortization	**$ 1,986**	**$ 1,717**

8. INTANGIBLE ASSETS

(Canadian dollars in millions)	INTERNATIONAL ROUTE RIGHTS AND SLOTS	CONTRACT-BASED	MARKETING-BASED TRADE NAMES	TECHNOLOGY BASED (INTERNALLY DEVELOPED)	TOTAL
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
YEAR ENDED DECEMBER 31, 2019					
At January 1, 2019	$ 97	$ -	$ 88	$ 219	$ 404
Additions	-	225	90	378	693
Amortization	-	(19)	-	(76)	(95)
At December 31, 2019	$ 97	$ 206	$ 178	$ 521	$ 1,002
AT DECEMBER 31, 2019					
Cost	$ 97	$ 225	$ 178	$ 928	$ 1,428
Accumulated amortization	-	(19)	-	(407)	(426)
	$ 97	**$ 206**	**$ 178**	**$ 521**	**$ 1,002**

In 2019, technology-based assets with a cost of $29 million (2018 – $1 million) and accumulated amortization of $29 million (2018 – $1 million) were retired.

Certain international route rights and slots are pledged as security for senior secured notes, as described in Note 10.

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 million to wide-body and $47 million to narrow-body. In connection with the 2019 Aeroplan acquisition, the Corporation acquired the Aeroplan trade name at fair value. This indefinite lived intangible asset has been allocated as $27 million to wide-body and $63 million to narrow-body cash generating units.

The recoverable amount of the cash-generating units has been measured based on 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 million. Reasonably possible changes in key assumptions would not cause the recoverable amount of each CGU to be less than the carrying value.

9. 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, 2019 and 2018. Reasonably possible changes in key assumptions would not cause the recoverable amount of goodwill to fall below the carrying value.

(Canadian dollars in millions)		2019
Goodwill, beginning of year		$ 311
Goodwill arising from Aeroplan acquisition	Note 4	2,962
Goodwill, end of year		$ 3,273

10. LONG-TERM DEBT AND LEASE LIABILITIES

	FINAL MATURITY	WEIGHTED AVERAGE INTEREST RATE (%)	**DECEMBER 31, 2019** (Canadian dollars in millions)	DECEMBER 31, 2018 RESTATED - NOTE 2 (Canadian dollars in millions)
Aircraft financing (a)				
Fixed rate U.S. dollar financing	2020 – 2030	3.84	$ 3,200	$ 3,592
Floating rate U.S. dollar financing	2026 – 2027	3.85	544	676
Fixed rate CDN dollar financing	2026 – 2030	3.78	259	287
Floating rate CDN dollar financing	2026 – 2027	2.64	264	298
Fixed rate Japanese yen financing	2027	1.84	141	146
Floating rate Japanese yen financing	2027	3.04	8	42
Senior secured notes – CDN dollar (b)	2023	4.75	200	200
Senior unsecured notes – U.S. dollar (c)	2021	7.75	520	546
Other secured financing – U.S. dollar (b)	2023	3.51	737	786
Long-term debt		**4.07**	**5,873**	**6,573**
Lease liabilities				
Air Canada aircraft	2020 – 2029	6.31	1,924	1,926
Regional aircraft	2020 – 2035	7.06	1,149	1,233
Land and buildings	2020 – 2078	6.07	386	297
Lease liabilities (d)		**6.53**	**3,459**	**3,456**
Total debt and lease liabilities		**4.98**	**9,332**	**10,029**
Unamortized debt issuance costs			(90)	(108)
Current portion – Long-term debt			(587)	(408)
Current portion – Air Canada aircraft			(418)	(438)
Current portion – Regional aircraft			(185)	(187)
Current portion – Land and buildings			(28)	(15)
Long-term debt and lease liabilities			**$ 8,024**	**$ 8,873**

(a) Aircraft financing (US$2,882 million, CDN $523 million and JPY ¥12,425 million) (2018 – US$3,130 million, CDN $585 million and JPY ¥15,155 million) is secured primarily by specific aircraft with a carrying value of $4,777 million (2018 – $5,575 million). 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$161 million and CDN $264 million 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 million 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 connection with the sales transaction described in Note 23, long-term debt of $144 million (US$109 million) related to the Embraer 190 aircraft was repaid in 2018. The loss recorded in Gain on debt settlements and modifications in respect of the prepayment of such debt was $2 million.

During 2019, principal of US$27 million and JPY ¥2032 million was prepaid relating to the financing of 4 Boeing 777 aircraft. The loss on debt settlements and modifications in respect of the prepayment of such debt was less than $1 million.

During 2018, principal of US$35 million 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 million.

(b) The senior secured notes consist of a private offering of $200 million aggregate principal amount of 4.75% senior secured first lien notes due 2023 (the "2016 Senior Notes"), which were sold at par. In December 2018, Air Canada entered into a new $200 million revolving credit facility, which it amended in November 2019. The facility is available until 2022 and, if drawn, would be secured by certain designated aircraft. No amounts have been drawn on the facility at December 31, 2019.

Other secured financing consists of a US$600 million term loan, maturing in 2023, and a US$600 million revolving credit facility expiring in 2023 (collectively with the term loan, the "2016 Credit Facility").

In November 2019, Air Canada completed a repricing of its 2016 Credit Facility, reducing the interest rate by 25 basis points, to an interest rate of 175 basis points over LIBOR. The Corporation recorded a $6 million Gain on debt settlements and modifications related to this transaction. In February 2018, Air Canada completed a repricing, reducing the interest rate by 25 points, to an interest rate of 200 basis points over LIBOR. The Corporation recorded an $11 million Gain on debt settlements and modifications related to this transaction.

Air Canada may redeem at any time and from time to time prior to October 6, 2021, during any 12-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 at December 31, 2019, the Corporation had not drawn on the revolving credit facility and the outstanding term loan principal was US$590 million (2018 - US$598 million principal).

(c) Private offering of US$400 million 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) Lease liabilities, related to facilities and aircraft, total $3,459 million ($346 million, US$2,369 million and GBP £15 million) (2018 - $3,456 million ($281 million, US$2,321 million and GBP £3 million)). The carrying value of aircraft and facilities under lease liabilities amounted to $2,532 million and $291 million respectively (2018 – $2,326 million and $213 million).

Cash interest paid on Long-term debt and lease liabilities in 2019 by the Corporation was $493 million (2018 – $519 million).

The Corporation has recorded Interest expense as follows:

(Canadian dollars in millions)	**2019**	2018
Interest on debt	$ 284	$ 311
Interest on lease liabilities	231	256
Interest expense	**$ 515**	**$ 567**

The consolidated statement of operations includes the following amounts related to leases which have not been recorded as right-of-use assets and lease liabilities.

(Canadian dollars in millions)	**2019**	2018
EXPENSE RELATED TO LEASES (INCLUDED IN OTHER OPERATING EXPENSES)		
Short-term leases	$ 83	$ 30
Variable lease payments not included in lease liabilities	31	35
	$ 114	**$ 65**

The value of low-value assets that are not short-term leases is not significant.

Total cash outflows for payments on lease liabilities was $882 million for the year ended December 31, 2019 (2018 – $837 million), of which $651 million was for principal repayments (2018 – $581 million).

MATURITY ANALYSIS

Principal and interest repayment requirements as at December 31, 2019 on Long-term debt and lease liabilities are as follows. U.S. dollar amounts are converted using the December 31, 2019 closing rate of CDN$1.2990.

(Canadian dollars in millions)	2020	2021	2022	2023	2024	THEREAFTER	TOTAL
PRINCIPAL							
Long-term debt obligations	$ 587	$ 953	$ 327	$ 1,392	$ 292	$ 2,322	$ 5,873
Air Canada aircraft	418	293	222	214	205	572	1,924
Regional aircraft	185	167	163	164	137	333	1,149
Land and buildings	28	23	23	22	22	268	386
Lease liabilities	631	483	408	400	364	1,173	3,459
Total long-term debt and lease liabilities	**$ 1,218**	**$ 1,436**	**$ 735**	**$ 1,792**	**$ 656**	**$ 3,495**	**$ 9,332**

(Canadian dollars in millions)	2020	2021	2022	2023	2024	THEREAFTER	TOTAL
INTEREST							
Long-term debt obligations	$ 229	$ 195	$ 160	$ 139	$ 87	$ 240	$ 1,050
Air Canada aircraft	102	75	59	47	36	54	373
Regional aircraft	72	60	48	36	25	71	312
Land and buildings	22	21	19	18	17	210	307
Lease liabilities	196	156	126	101	78	335	992
Total long-term debt and lease liabilities	**$ 425**	**$ 351**	**$ 286**	**$ 240**	**$ 165**	**$ 575**	**$ 2,042**

Principal repayments in the table above exclude transaction costs of $90 million which are offset against Long-term debt and lease liabilities in the consolidated statement of financial position.

The Corporation is committed to additional aircraft and property leases which have yet to commence. The total commitment is approximately $113 million based on estimates regarding timing of deliveries and rent. The aircraft lease terms to maturity range from 8 to 9 years and the properties are 20-year leases.

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.

(Canadian dollars in millions)	JAN. 1, 2019	CASH FLOWS			NON-CASH CHANGES			DEC. 31, 2019
		BORROWINGS	REPAYMENTS	FINANCING FEES	FOREIGN EXCHANGE ADJUSTMENTS	AMORTIZATION OF FINANCING FEES AND OTHER ADJUSTMENTS	NEW LEASE LIABILITIES (NEW AND RENEWED CONTRACTS)	
Long-term debt	$ 6,573	$ -	$ (433)	$ -	$ (266)	$ (1)	$ -	$ 5,873
Lease liabilities	3,456	-	(651)	-	(151)	-	805	3,459
Unamortized debt issuance costs	(108)	-	-	(1)	-	19	-	(90)
Total liabilities from financing activities	**$ 9,921**	**$ -**	**$ (1,084)**	**$ (1)**	**$ (417)**	**$ 18**	**$ 805**	**$ 9,242**

(Canadian dollars in millions)	JAN. 1, 2018	CASH FLOWS			NON-CASH CHANGES			DEC. 31, 2018
		BORROWINGS	REPAYMENTS	FINANCING FEES	FOREIGN EXCHANGE ADJUSTMENTS	AMORTIZATION OF FINANCING FEES AND OTHER ADJUSTMENTS	NEW LEASE LIABILITIES (NEW AND RENEWED CONTRACTS)	
Long-term debt	$ 5,999	$ 1,210	$ (1,122)	$ -	$ 492	$ (6)	$ -	$ 6,573
Lease liabilities	3,480	-	(581)	-	257	-	300	3,456
Unamortized debt issuance costs	(103)	-	-	(12)	-	7	-	(108)
Total liabilities from financing activities	**$ 9,376**	**$ 1,210**	**$ (1,703)**	**$ (12)**	**$ 749**	**$ 1**	**$ 300**	**$ 9,921**

Loss on debt settlements of nil (2018 - $3 million) is included in Reduction of long-term debt and lease liabilities on the consolidated statement of cash flow but excluded from this table.

11. PENSIONS AND OTHER BENEFIT LIABILITIES

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

The Corporation is the administrator and sponsoring employer of nine 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, 2019, the aggregate solvency surplus in the domestic registered pension plans was $2.5 billion. The next required valuation to be made as at January 1, 2020 will be completed in the first half of 2020. With the Corporation's domestic registered pension plans in a solvency surplus position as at January 1, 2019, past service cost payments were not required in 2019. 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 2019 amounted to $96 million ($109 million employer contribution net of $13 million used to fund employer contribution in defined contribution components of the same plans). Pension funding obligations for 2020 are expected to be $100 million.

BENEFIT OBLIGATION AND PLAN ASSETS

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

(Canadian dollars in millions)	PENSION BENEFITS		OTHER EMPLOYEE FUTURE BENEFITS		TOTAL	
	2019	2018	**2019**	2018	**2019**	2018
NON-CURRENT ASSETS						
Pension assets	$ 2,064	$ 1,969	$ -	$ -	$ 2,064	$ 1,969
CURRENT LIABILITIES						
Accounts payable and accrued liabilities	-	-	65	60	65	60
NON-CURRENT LIABILITIES						
Pension and other benefit liabilities	1,477	1,328	1,453	1,219	2,930	2,547
Net benefit obligation (asset)	**$ (587)**	**$ (641)**	**$ 1,518**	**$ 1,279**	**$ 931**	**$ 638**

The current portion of the net benefit obligation represents an estimate of other employee future benefits claims to be paid during 2020.

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

(Canadian dollars in millions)	PENSION BENEFITS		OTHER EMPLOYEE FUTURE BENEFITS	
	2019	2018	2019	2018
CHANGE IN BENEFIT OBLIGATION				
Benefit obligation at beginning of year	$ 19,690	$ 20,260	$ 1,279	$ 1,342
Acquisition of Aeroplan	181	-	19	-
Current service cost	271	304	35	35
Past service cost	-	5	(1)	(8)
Interest cost	751	723	51	48
Employees' contributions	81	82	-	-
Benefits paid	(880)	(862)	(48)	(48)
Remeasurements:				
Experience loss (gain)	17	(11)	29	(28)
Loss (gain) from change in demographic assumptions	(189)	(262)	5	(14)
Loss (gain) from change in financial assumptions	2,027	(583)	159	(56)
Plan settlements	-	-	-	(6)
Foreign exchange loss (gain)	(18)	34	(10)	14
Total benefit obligation	21,931	19,690	1,518	1,279
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	20,857	21,191	-	-
Acquisition of Aeroplan	161	-	-	-
Return on plan assets, excluding amounts included in Net financing expense	2,350	(399)	-	-
Interest income	782	745	-	-
Employer contributions	96	83	48	51
Employees' contributions	81	82	-	-
Benefits paid	(880)	(862)	(48)	(48)
Settlements	-	-	-	(3)
Administrative expenses paid from plan assets	(9)	(12)	-	-
Foreign exchange gain (loss)	(14)	29	-	-
Total plan assets	23,424	20,857	-	-
(Surplus) deficit at end of year	**(1,493)**	**(1,167)**	**1,518**	**1,279**
Asset ceiling / additional minimum funding liability	906	526	-	-
Net benefit obligation (asset)	**$ (587)**	**$ (641)**	**$ 1,518**	**$ 1,279**

The actual return on plan assets was $3,132 million (2018 – $346 million).

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

(Canadian dollars in millions)	2019	2018
Domestic registered plans	$ 44	$ 4
International plans	86	85
Supplementary plans	1,347	1,239
	$ 1,477	**$ 1,328**

The weighted average duration of the defined benefit obligation is 14.9 years (2018 – 14.2 years).

PENSION AND OTHER EMPLOYEE FUTURE BENEFIT EXPENSE

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

(Canadian dollars in millions)	PENSION BENEFITS		OTHER EMPLOYEE FUTURE BENEFITS	
	2019	2018	2019	2018
CONSOLIDATED STATEMENT OF OPERATIONS				
Components of cost				
Current service cost	$ 271	$ 304	$ 35	$ 35
Past service cost	-	5	(1)	(8)
Plan settlements	-	-	-	(3)
Administrative and other expenses	9	12	-	-
Actuarial losses (gains), including foreign exchange	-	-	1	(4)
Total cost recognized in Wages, salaries and benefits	**$ 280**	**$ 321**	**$ 35**	**$ 20**
Net financing expense relating to employee benefits	**$ (12)**	**$ 2**	**$ 51**	**$ 48**
Total cost recognized in statement of operations	**$ 268**	**$ 323**	**$ 86**	**$ 68**
CONSOLIDATED OTHER COMPREHENSIVE (INCOME) LOSS				
Remeasurements:				
Experience loss (gain), including foreign exchange	13	(6)	19	(10)
Loss (gain) from change in demographic assumptions	(189)	(262)	5	(14)
Loss (gain) from change in financial assumptions	2,027	(583)	159	(56)
Return on plan assets	(2,363)	399	-	-
Change in asset ceiling	361	(159)	-	-
Total cost (income) recognized in OCI	**$ (151)**	**$ (611)**	**$ 183**	**$ (80)**

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 million.

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, 2019, actuarial losses of $9 million (2018 - actuarial losses of $43 million) 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.

(Canadian dollars in millions)	2019	2018
Net defined pension and other future employee benefits expense recorded in the consolidated statement of operations		
Wages, salaries and benefits	$ 315	$ 341
Net financing expense relating to employee benefit liabilities	39	50
	$ 354	**$ 391**
Employee benefit funding by Air Canada		
Pension benefits	$ 96	$ 83
Other employee benefits	48	51
	$ 144	**$ 134**
Employee benefit funding less than expense	**210**	**257**

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:

	2019	2018	TARGET ALLOCATION
Bonds	71%	71%	70%
Canadian equities	3%	3%	3%
Foreign equities	7%	6%	7%
Alternative investments	19%	20%	20%
	100%	**100%**	**100%**

For the Domestic Registered Plan assets, approximately 81% of assets as of December 31, 2019 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 (2018 - 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 $856 million at December 31, 2019 (2018 - $458 million). 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, 2019 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, 2019, approximately 87.5% of Air Canada's pension assets were invested in fixed income instruments 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, 2019, approximately 87.5% of Air Canada's pension assets were invested in fixed income instruments 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	
	2019	2018	**2019**	2018
Discount rate used to determine:				
Net interest on the net defined benefit obligation for the year ended December 31	3.81%	3.60%	3.81%	3.60%
Service cost for the year ended December 31	3.93%	3.70%	3.93%	3.70%
Accrued benefit obligation as at December 31	3.13%	3.81%	3.13%	3.81%
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 2019 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.

(Canadian dollars in millions)	0.25 PERCENTAGE POINT	
	DECREASE	INCREASE
Discount rate on obligation assumption		
Pension expense	$ 19	$ (19)
Net financing expense relating to pension benefit liabilities	24	(20)
	$ 43	**$ (39)**
Increase (decrease) in pension obligation	**$ 816**	**$ (787)**

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, 2019, approximately 87.5% of Air Canada's pension assets were invested in fixed income instruments 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 $516 million.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 5.25% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2019 (2018 – 5.5%). The rate is assumed to decrease gradually to 5% by 2020 (2018 – 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 $5 million and the obligation by $80 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 $78 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 $59 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 $56 million.

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, $13 million 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 2019 (2018 – $11 million).

The Corporation's expense for these pension plans amounted to $40 million for the year ended December 31, 2019 (2018 – $30 million). 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 2020 are $33 million.

12. PROVISIONS FOR OTHER LIABILITIES

The following table provides a continuity schedule of all recorded provisions. Refer to Note 19 for additional information on Litigation provisions. Current provisions are recorded in Accounts payable and accrued liabilities.

(Canadian dollars in millions)	MAINTENANCE (a)	ASSET RETIREMENT (b)	LITIGATION	TOTAL PROVISIONS
At December 31, 2018				
Current	$ 147	$ -	$ 17	$ 164
Non-current	1,307	31	-	1,338
	$ 1,454	**$ 31**	**$ 17**	**$ 1,502**
Provisions arising during the year	$ 148	$ -	$ 22	$ 170
Amounts utilized	(162)	-	(5)	(167)
Changes in estimated costs	(9)	1	-	(8)
Accretion expense	41	1	-	42
Foreign exchange gain	(70)	-	-	(70)
At December 31, 2019	**$ 1,402**	**$ 33**	**$ 34**	**$ 1,469**
Current	$ 162	$ -	$ 34	$ 196
Non-current	1,240	33	-	1,273
	$ 1,402	**$ 33**	**$ 34**	**$ 1,469**

(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 2020 to 2035, with an 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 $70 million at December 31, 2019 and an increase to maintenance expense in 2020 of approximately $8 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 $20 million at December 31, 2019. 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 2020 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.

13. INCOME TAXES

INCOME TAX EXPENSE

Income tax recorded in the consolidated statement of operations is presented below.

(Canadian dollars in millions)	2019	2018 RESTATED - NOTE 2
Current income tax	$ (72)	$ (6)
Deferred income tax	(227)	(185)
Income tax expense	**$ (299)**	**$ (191)**

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:

(Canadian dollars in millions)	2019	2018 RESTATED - NOTE 2
Income before income taxes	$ 1,775	$ 228
Statutory income tax rate based on combined federal and provincial rates	26.73%	26.78%
Income tax expense based on statutory tax rates	**(474)**	**(61)**
Effects of:		
Non-taxable (non-deductible) portion of capital gains (losses)	32	(55)
Recognition of (unrecognized) deferred income tax assets on capital losses	37	(55)
Non-deductible expenses	(24)	(21)
Tax rate changes on deferred income taxes	(5)	2
Unrecognized deferred income tax liability on outside basis difference	126	-
Other	9	(1)
Income tax expense	**$ (299)**	**$ (191)**

The applicable statutory tax rate is 26.73% (2018 – 26.78%). The Corporation's applicable tax rate is the Canadian combined rates applicable in the jurisdictions in which the Corporation operates. The decrease to the statutory tax rate is mainly due to the net result of corporate income tax rate decrease in Alberta, as well as changes in the level of activity by province.

Income tax recorded in the consolidated statement of comprehensive income is presented below.

(Canadian dollars in millions)	2019	2018
Remeasurements on employee benefit liabilities - deferred income tax	$ 10	$ (188)
Remeasurements on equity investments - deferred income tax	(4)	-
Income tax (expense) recovery	**$ 6**	**$ (188)**

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:

(Canadian dollars in millions)	2019	2018
Other comprehensive income (loss) before income taxes	$ (3)	$ 691
Statutory income tax rate based on combined federal and provincial rates	26.73%	26.78%
Income tax (expense) recovery based on statutory tax rates	**1**	**(185)**
Effects of:		
Tax rate changes on deferred income taxes	5	-
Other	-	(3)
Income tax (expense) recovery	**$ 6**	**$ (188)**

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.

Deferred tax assets and liabilities of $134 million are recorded net as a non-current deferred income tax asset, and deferred tax liabilities of $73 million are recorded as a non-current deferred income tax liability on the consolidated statement of financial position. Certain intangible assets with nominal tax cost and a carrying value of $275 million have indefinite lives and, accordingly, the associated deferred income tax liability of $73 million (2018 - $49 million) 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 non-current deferred income tax liability.

The significant components of deferred income tax assets and liabilities were as follows:

(Canadian dollars in millions)	2019	2018 RESTATED - NOTE 2
DEFERRED INCOME TAX ASSETS		
Non-capital losses	$ 48	$ 353
Post-employment obligations	248	171
Accounting provisions not currently deductible for tax	85	67
Investment tax credits and recoverable taxes	22	37
Lease liabilities	1,092	1,125
Maintenance provisions	372	386
Other	197	-
	2,064	2,139
DEFERRED INCOME TAX LIABILITIES		
Property, equipment, technology-based and other intangible assets	(1,930)	(1,791)
Indefinite-lived intangible assets	(73)	(49)
Other	-	(37)
	(2,003)	(1,877)
Net recognized deferred income tax assets	**61**	**262**
BALANCE SHEET PRESENTATION		
Deferred income tax assets	134	314
Deferred income tax liabilities	(73)	(52)
Net recognized deferred income tax assets	**61**	**262**

The following table presents the variation of the components of deferred income tax balances:

(Canadian dollars in millions)	JANUARY 1, 2019 RESTATED - NOTE 2	2019 INCOME STATEMENT MOVEMENT	2019 OCI MOVEMENT	AEROPLAN ACQUISITION	DEC. 31, 2019
Non-capital losses	$ 353	$ (305)	$ -	$ -	$ 48
Post-employment obligations	171	57	10	10	248
Accounting provisions not currently deductible for tax	67	12	-	6	85
Investment tax credits and recoverable taxes	37	(15)	-	-	22
Lease liabilities	1,125	(42)	-	9	1,092
Maintenance provisions	386	(14)	-	-	372
Other deferred tax assets	-	228	(4)	(27)	197
Property, equipment, technology-based and other intangible assets	(1,791)	(185)	-	46	(1,930)
Indefinite-lived intangible assets	(49)	-	-	(24)	(73)
Other deferred tax liabilities	(37)	37	-	-	-
Total recognized deferred income tax assets (liabilities)	**$ 262**	**$ (227)**	**$ 6**	**$ 20**	**$ 61**

(Canadian dollars in millions)	JANUARY 1, 2018 RESTATED - NOTE 2	2018 INCOME STATEMENT MOVEMENT	2018 OCI MOVEMENT	DEC. 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
Lease liabilities	1,127	(2)	-	1,125
Maintenance provisions	321	65	-	386
Other deferred tax assets	-	-	-	-
Property, equipment, technology-based and other intangible assets	(1,771)	(20)	-	(1,791)
Indefinite-lived intangible assets	(49)	-	-	(49)
Other deferred tax liabilities	(20)	(17)	-	(37)
Total recognized deferred income tax assets (liabilities)	**$ 635**	**$ (185)**	**$ (188)**	**$ 262**

At December 31, 2019, 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:

(Canadian dollars in millions)	2019	2018
Unrealized net capital gain on investment	$ (14)	$ -
Unrealized foreign exchange losses	101	230
Unrecognized net capital losses carryforwards	91	84
Total unrecognized net temporary differences	**$ 178**	**$ 314**
Deferred income tax rate based on combined federal and provincial rates	26.54%	26.75%
Total unrecognized net deferred income tax assets	**47**	**84**

The following are the federal non-capital tax losses expiry dates:

(Canadian dollars in millions)	TAX LOSSES
2030	$ 11
2031	6
2032	2
2033	1
2034	3
2036	3
2037	2
2038	2
Non-capital losses carryforwards	**$ 30**

Cash income taxes paid in 2019 by the Corporation were $62 million (2018 – $32 million).

14. SHARE CAPITAL

(Canadian dollars in millions)	NUMBER OF SHARES	VALUE
At January 1, 2018	**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**
Shares issued on the exercise of stock options	2,069,354	14
Shares purchased and cancelled under issuer bid	(8,982,687)	(27)
At December 31, 2019	**263,816,578**	**$ 785**

The issued and outstanding shares of Air Canada, along with the potential shares, were as follows:

		2019	2018
ISSUED AND OUTSTANDING			
Class A variable voting shares		126,664,740	125,214,350
Class B voting shares		137,151,838	145,515,561
Total issued and outstanding		263,816,578	270,729,911
POTENTIAL SHARES			
Stock options	Note 15	4,890,095	6,014,464
Total outstanding and potentially issuable shares		**268,706,673**	**276,744,375**

SHARES

As at December 31, 2019, 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.

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.

Following approval by Air Canada's shareholders at Air Canada's annual and special meeting of shareholders held in 2019, Air Canada amended its articles to align the restrictions on the level of non-Canadian ownership and control with those prescribed by the definition of "Canadian" in the *Canada Transportation Act*.

Further to such amendments, Air Canada's articles provide that 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 49% or (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting exceeds 49% 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 49% 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 49% of the votes that may be cast at such meeting. Air Canada's articles also provide for the automatic reduction of the voting rights attached to Variable Voting Shares in the event any of the following limits are exceeded. In such event, the votes attributable to Variable Voting Shares will be affected as follows:

- *first*, if required, a reduction of the voting rights of any single non-Canadian holder (including a single non-Canadian holder authorized to provide an air service) carrying more than 25% of the votes to ensure that such non-Canadian holder never carries more than 25% of the votes which holders of Voting Shares cast at any meeting of shareholders;
- *second*, if required, and after giving effect to the first proration set out above, a further proportional reduction of the voting rights of all non-Canadian holders authorized to provide an air service to ensure that such non-Canadian holders authorized to provide an air service, in the aggregate, never carry more than 25% of the votes which holders of Voting Shares cast at any meeting of shareholders; and
- *third*, if required, and after giving effect to the first two prorations set out above, a proportional reduction of the voting rights for all non-Canadian holders as a class to ensure that non-Canadians never carry, in aggregate, more than 49% of the votes which holders of Voting Shares cast at any meeting of shareholders.

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 and 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 2018, Air Canada received approval from the Toronto Stock Exchange ("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 million. The excess of the cost over the average book value of $64 million was charged to Retained earnings.

In May 2019, Air Canada received approval from the TSX for the renewal of its normal course issuer bid, authorizing, between May 31, 2019 and May 30, 2020, the purchase of up to 24,130,551 shares, representing 10% of Air Canada's public float as at May 17, 2019. The renewal followed the conclusion of the 2018 normal course issuer bid which expired on May 30, 2019.

In 2019, the Corporation purchased, for cancellation, 9,082,487 shares at an average cost of $41.64 per share for aggregate consideration of $378 million. The excess of the cost over the average book value of $351 million was charged to Retained earnings. At December 31, 2019, a total of 17,877,551 shares remain available for repurchase under the existing issuer bid.

15. 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 8,101,989 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 up to ten 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 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:

	2019	2018
Compensation expense ($ millions)	$ 13	$ 9
Number of stock options granted to Air Canada employees	1,075,182	1,293,091
Weighted average fair value per option granted ($)	$ 10.75	$ 9.27
Aggregated fair value of options granted ($ millions)	$ 12	$ 12
Weighted average assumptions:		
Share price	$ 33.29	$ 26.28
Risk-free interest rate	1.36%-1.71%	1.95%-2.48%
Expected volatility	35.0%	38.2%
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:

	2019		2018	
	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE/SHARE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE/ SHARE
Beginning of year	6,014,464	$ 11.40	6,121,252	$ 8.46
Granted	1,075,182	33.29	1,293,091	26.28
Exercised	(2,069,354)	4.60	(667,087)	7.90
Expired or cancelled	-	-	-	-
Forfeited	(130,197)	22.48	(732,792)	16.32
Outstanding options, end of year	**4,890,095**	**$ 18.80**	6,014,464	$ 11.40
Options exercisable, end of year	**1,550,930**	**$ 11.02**	2,800,328	$ 5.18

The weighted average share price on the date of exercise for options exercised in 2019 was $43.51 (2018 - $26.59).

RANGE OF EXERCISE PRICES	EXPIRY DATES	2019 OUTSTANDING OPTIONS			2019 EXERCISABLE OPTIONS	
		NUMBER OF OPTIONS OUTSTANDING	WEIGHTED AVERAGE REMAINING LIFE (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE / SHARE	NUMBER OF EXERCISABLE OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE/ SHARE
$3.02 – $3.04	2020	67,035	1	$ 3.04	67,035	$ 3.04
$5.35 – $5.39	2021	368,705	2	5.39	368,705	5.39
$12.64	2022	404,843	3	12.64	404,843	12.64
$9.23 – $9.61	2023	1,096,332	4	9.26	370,897	9.26
$12.83 – $26.40	2027	893,788	8	14.38	214,285	14.38
$22.53 – $27.75	2028	1,016,939	9	26.47	125,165	26.47
$33.11 – $43.22	2029	1,042,453	10	33.29	-	-
		4,890,095		**$ 18.80**	**1,550,930**	**$ 11.02**

RANGE OF EXERCISE PRICES	EXPIRY DATES	2018 OUTSTANDING OPTIONS			2018 EXERCISABLE OPTIONS	
		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 – $5.39	2021	578,680	3	5.39	578,680	5.39
$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	2027	954,568	9	14.39	117,919	14.26
$22.53 – $27.75	2028	1,083,995	10	26.49	-	-
		6,014,464		**$ 11.40**	**2,800,328**	**$ 5.18**

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 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 2019 was $50 million (2018 – $21 million). The increase from 2018 reflected the increase in share price during 2019.

A summary of the Long-term Incentive Plan share unit activity is as follows:

	2019	2018
Beginning of year	2,500,764	2,706,261
Granted	643,186	772,536
Settled	(984,087)	(694,111)
Forfeited	(74,052)	(283,922)
Outstanding share units, end of year	**2,085,811**	**2,500,764**

Refer to Note 18 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 2019 contributions, Air Canada will match 33.33% of the contributions made by employees. During 2019, the Corporation recorded compensation expense of $13 million (2018 – $12 million) related to the Employee Share Purchase Plan.

16. EARNINGS PER SHARE

The following table outlines the calculation of basic and diluted earnings per share:

(in millions, except per share amounts)	2019	2018 RESTATED - NOTE 2
NUMERATOR:		
Numerator for basic and diluted earnings per share:		
Net income	$ 1,476	$ 37
DENOMINATOR:		
Weighted-average shares	268	272
Effect of potential dilutive securities:		
Stock options	4	4
Total potential dilutive securities	4	4
Adjusted denominator for diluted earnings per share	**272**	**276**
Basic earnings per share	**$ 5.51**	**$ 0.14**
Diluted earnings per share	**$ 5.44**	**$ 0.13**

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 2019 calculation of diluted earnings per share were 178,000 (2018 – 749,000) outstanding options where the options' exercise prices were greater than the average market price of the shares for the year.

17. COMMITMENTS

CAPITAL COMMITMENTS AND LEASES

Capital commitments consist of the future firm aircraft deliveries and commitments related to 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, 2019. U.S. dollar amounts are converted using the December 31, 2019 closing rate of CDN$1.2990. Minimum future commitments under these contractual arrangements are shown below.

(Canadian dollars in millions)	2020	2021	2022	2023	2024	THEREAFTER	**TOTAL**
Capital commitments	$ 1,635	$ 1,532	$ 898	$ 173	$ -	$ -	**$ 4,238**

On March 24, 2019, Boeing advised it would suspend 737 MAX aircraft deliveries. Given the grounding of the Boeing 737 MAX aircraft and the uncertainty surrounding their return to service, the Corporation assumes, in the table above, that of the 12 Boeing 737 MAX aircraft originally scheduled for delivery in 2019 and the 14 Boeing 737 MAX aircraft originally scheduled for delivery in 2020, 6 will be delivered in 2020 and the remainder delivered in 2021, for a total of 50 aircraft in Air Canada's Boeing 737 MAX fleet by the end of 2021. This projected delivery schedule is subject to change given the grounding of the Boeing 737 MAX aircraft and the uncertainty surrounding their return to service. The Corporation has been in discussions with Boeing and is seeking to settle the terms of an arrangement in relation to grounding of the Boeing 737 MAX aircraft. Until such time as such arrangement is finalized, information regarding the outstanding purchase commitments for aircraft is subject to change.

The Corporation leases and subleases certain aircraft and spare engines to its regional carriers 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 ten Bombardier Q400 aircraft, 22 CRJ-200 aircraft, 20 CRJ-705/900 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 $181 million in 2019 (2018 – $172 million).

OTHER CONTRACTUAL COMMITMENTS

The future minimum non-cancellable commitment for the next 12 months under the Jazz CPA is approximately $1,051 million and under the capacity purchase agreements with other regional carriers is $253 million.

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

SUMMARY OF FINANCIAL INSTRUMENTS

	CARRYING AMOUNTS					
	DECEMBER 31, 2019					DECEMBER 31, 2018 RESTATED - NOTE 2
	FINANCIAL INSTRUMENTS CLASSIFICATION					
(Canadian dollars in millions)	FAIR VALUE THROUGH PROFIT AND LOSS	FAIR VALUE THROUGH OCI	ASSETS AT AMORTIZED COST	LIABILITIES AT AMORTIZED COST	TOTAL	
FINANCIAL ASSETS						
Cash and cash equivalents	$ 2,090	$ -	$ -	$ -	**$ 2,090**	$ 630
Short-term investments	3,799	-	-	-	**3,799**	4,077
Restricted cash	157	-	-	-	**157**	161
Accounts receivable	-	-	926	-	**926**	796
Investments, deposits and other assets						
Long-term investments	512	-	-	-	**512**	-
Equity investment in Chorus	-	126	-	-	**126**	-
Restricted cash	102	-	-	-	**102**	171
Aircraft-related and other deposits	-	-	113	-	**113**	139
Derivative instruments						
Share forward contracts	45	-	-	-	**45**	43
Foreign exchange derivatives	3	-	-	-	**3**	24
	$ 6,708	**$ 126**	**$ 1,039**	**$ -**	**$ 7,873**	**$ 6,041**
FINANCIAL LIABILITIES						
Accounts payable	$ -	$ -	$ -	$ 2,240	**$ 2,240**	$ 1,777
Foreign exchange derivatives	117	-	-	-	**117**	57
Current portion of long-term debt and lease liabilities	-	-	-	1,218	**1,218**	1,048
Long-term debt and lease liabilities	-	-	-	8,024	**8,024**	8,873
	$ 117	**$ -**	**$ -**	**$ 11,482**	**$ 11,599**	**$ 11,755**

SUMMARY OF GAIN (LOSS) ON FINANCIAL INSTRUMENTS RECORDED AT FAIR VALUE

(Canadian dollars in millions)	**2019**	2018
Share forward contracts	$ 23	$ -
Fuel derivatives	-	(1)
Gain (loss) on financial instruments recorded at fair value	**$ 23**	**$ (1)**

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 can elect to enter 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 2019, the Corporation purchased crude oil call options covering a portion of 2019 fuel exposure. The cash premium related to these contracts was $14 million ($17 million in 2018 for 2018 exposures). Fuel derivative contracts cash settled with no fair value ($19 million in favour of the counterparties in 2018).

Associated premium costs and any hedging gains and losses are reclassified from other comprehensive income to Aircraft fuel expense on settlement of the derivatives. A loss of $14 million was reclassified from other comprehensive income to Aircraft fuel expense in 2019 (net fuel hedging loss of $36 million in 2018). No hedge ineffectiveness was recorded during 2019 or 2018.

There were no outstanding fuel derivatives as at December 31, 2019 and December 31, 2018.

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 2019, these net operating cash inflows totalled approximately US$3.7 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$2.3 billion. For 2019, this resulted in a U.S. dollar net cash flow exposure of approximately US$5.0 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, short and long-term investment balances as at December 31, 2019 amounted to $1,123 million (US$862 million) ($863 million (US$635 million) as at December 31, 2018). 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 2019, a loss of $36 million (gain of $62 million in 2018) 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, 2019, as further described below, approximately 73% of net U.S. cash outflows are hedged for 2020 and 50% for 2021, resulting in derivative coverage of 66% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 73% coverage.

As at December 31, 2019, the Corporation had outstanding foreign currency options and swap agreements, settling in 2020 and 2021, to purchase at maturity $6,599 million (US$5,080 million) of U.S. dollars at a weighted average rate of $1.2775 per US$1.00 (2018 – $4,987 million (US$3,659 million) with settlements in 2019 and 2020 at a weighted average rate of $1.2645 per $1.00 U.S. dollar). The Corporation also has protection in place to sell a portion of its excess Euros, Sterling, YEN, YUAN, and AUD (EUR €335 million, GBP £202 million, JPY ¥46,655 million, CNH ¥286 million and AUD $209 million) which settle in 2020 and 2021 at weighted average rates of €1.1577, £1.3238, ¥0.0096, ¥0.1469, and AUD $0.7092 per $1.00 U.S. dollar, respectively (as at December 31, 2018 - EUR €103 million, GBP £208 million, JPY ¥25,922 million, and AUD $105 million with settlements in 2019 and 2020 at weighted average rates of €1.1910, £1.3567, ¥0.0092, and AUD $0.7448 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, 2019 was $114 million in favour of the counterparties (2018 – $33 million in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2019, a gain of $92 million was recorded in Foreign exchange gain (loss) related to these derivatives (2018 – $245 million gain). In 2019, foreign exchange derivative contracts cash settled with a net fair value of $173 million in favour of the Corporation (2018 – $63 million in favour of the Corporation).

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, 2019 is 83% fixed and 17% floating (81% and 19%, respectively, as at December 31, 2018).

Share-based Compensation Risk

The Corporation issues RSUs and PSUs to certain of its employees, as described in Note 15, 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 2020 and 2022, 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 921,621 PSUs and RSUs from 2020 to 2022. These contracts were not designated as hedging instruments for accounting purposes. Accordingly, changes in the fair value of these contracts are recorded in Gain (loss) on financial instruments recorded at fair value in the period in which they arise. During 2019, a gain of $23 million was recorded (2018 – gain of less than $1 million). Share forward contracts cash settled with a fair value of $30 million in favour of the Corporation in 2019 (2018 – $17 million), with new contract purchases of $9 million for 2020 hedges. As at December 31, 2019, the fair value of the share forward contracts is $45 million in favour of the Corporation (2018 – $43 million in favour of the Corporation), with those contracts maturing in 2020 valued at $18 million recorded in Prepaid expenses and other current assets and the remainder of $27 million 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, 2019, unrestricted liquidity was $7,380 million comprised of Cash and cash equivalents, Short-term investments, and Long-term investments of $6,401 million and undrawn lines of credit of $979 million. Another important aspect of managing liquidity risk relates to managing the Corporation's financial leverage. Refer to Note 20 Capital Disclosures for a discussion on financial leverage targets.

Cash and cash equivalents include $381 million pertaining to investments with original maturities of three months or less at December 31, 2019 ($39 million as at December 31, 2018).

A maturity analysis of the Corporation's principal and interest repayment requirements on long-term debt and lease liabilities is set out in Note 10, and fixed operating commitments and capital commitments are set out in Note 17.

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. As at December 31, 2019, the Corporation's credit risk exposure consists mainly of the carrying amounts of Cash and cash equivalents, Short-term investments, Accounts receivable, Long-term investments and derivative instruments. Cash and cash equivalents and Short and Long-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. Accounts receivable related to the sale of Aeroplan Miles are mainly with major financial institutions, and any exposure associated with these customers is mitigated by the relative size and nature of business carried on by such partners. 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, 2019. 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. For purposes of presentation, each risk is contemplated independent of other risks; however, in reality, changes in one factor may result in changes in one or more 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, 2019 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	
(Canadian dollars in millions)	1% INCREASE	1% DECREASE	5% INCREASE	5% DECREASE	10% INCREASE	10% DECREASE
Cash and cash equivalents	$ 21	$ (21)	$ (37)	$ 37	$ -	$ -
Short-term investments	$ 38	$ (38)	$ (16)	$ 16	$ -	$ -
Long-term investments	$ 5	$ (5)	$ (2)	$ 2	$ -	$ -
Aircraft-related deposits	$ -	$ -	$ (5)	$ 5	$ -	$ -
Long-term debt and lease liabilities	$ (16)	$ 16	$ 413	$ (413)	$ -	$ -
Share forward contracts	$ -	$ -	$ -	$ -	$ 4	$ (4)
Foreign exchange derivatives	$ -	$ -	$ (195)	$ 522	$ -	$ -

(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 lease liabilities includes $7 million 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 2019, the Corporation made no cash deposits under these agreements (nil in 2018).

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 and Long-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 is $6,009 million compared to its carrying value of $5,873 million.

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.

RECURRING MEASUREMENTS (Canadian dollars in millions)	DECEMBER 31, 2019	FAIR VALUE MEASUREMENTS AT REPORTING DATE USING: 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	$ 381	$ -	$ 381	$ -
Short-term investments	3,799	-	3,799	-
Long-term investments	512	-	512	-
Equity investment in Chorus	126	126	-	-
Derivative instruments				
Share forward contracts	45	-	45	-
Foreign exchange derivatives	3	-	3	-
Total	**$ 4,866**	**$ 126**	**$ 4,740**	**$ -**
Financial Liabilities				
Derivative instruments				
Foreign exchange derivatives	117	-	117	-
Total	**$ 117**	**$ -**	**$ 117**	**$ -**

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 2019.

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 $86 million as at December 31, 2019 ($70 million as at December 31, 2018). 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, 2019 and 2018, 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.

FINANCIAL ASSETS	AMOUNTS OFFSET			AMOUNTS NOT OFFSET	NET
(Canadian dollars in millions)	GROSS ASSETS	GROSS LIABILITIES OFFSET	NET AMOUNTS PRESENTED	FINANCIAL INSTRUMENTS	
December 31, 2019					
Derivative assets	$ 11	$ (8)	$ 3	$ 45	$ 48
	$ 11	**$ (8)**	**$ 3**	**$ 45**	**$ 48**
December 31, 2018					
Derivative assets	$ 93	$ (69)	$ 24	$ 43	$ 67
Accounts receivable	113	(47)	66	-	66
	$ 206	**$ (116)**	**$ 90**	**$ 43**	**$ 133**

FINANCIAL LIABILITIES	AMOUNTS OFFSET			AMOUNTS NOT OFFSET	NET
(Canadian dollars in millions)	GROSS LIABILITIES	GROSS ASSETS OFFSET	NET AMOUNTS PRESENTED	FINANCIAL INSTRUMENTS	
December 31, 2019					
Derivative liabilities	$ 876	$ (759)	$ 117	$ -	$ 117
	$ 876	**$ (759)**	**$ 117**	**$ -**	**$ 117**
December 31, 2018					
Derivative liabilities	$ 317	$ (260)	$ 57	$ -	$ 57
	$ 317	**$ (260)**	**$ 57**	**$ -**	**$ 57**

19. CONTINGENCIES, GUARANTEES AND INDEMNITIES

CONTINGENCIES AND LITIGATION PROVISIONS

Various 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 $643 million as at December 31, 2019 (December 31, 2018 - $571 million), 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.

20. CAPITAL DISCLOSURES

The Corporation views capital as the sum of Long-term debt and lease liabilities and the book value of Shareholders' equity less excess cash. The Corporation defines excess cash as total cash and investments in excess of the minimum cash required to support operations. This measure of liquidity includes cash, cash equivalents, short-term investments, short-term restricted cash and long-term investments. The Corporation uses 20% of trailing 12-month operating revenue as its estimate of the minimum cash required to support ongoing business operations. This estimate of minimum cash provides adequate coverage for advance ticket sales and to meet Air Canada's liquidity needs.

The Corporation also monitors its net debt and financial leverage ratio. Net debt is calculated as the sum of Long-term debt and lease liabilities less Cash and cash equivalents, Short-term investments, and Long-term investments. Financial leverage is calculated as net debt over 12-month trailing earnings before interest, taxes, depreciation, and amortization.

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:

(Canadian dollars in millions)	**DEC. 31, 2019**	DEC. 31, 2018 RESTATED - NOTE 2
Long-term debt and lease liabilities	$ 8,024	$ 8,873
Current portion of long-term debt and lease liabilities	1,218	1,048
Total long-term debt and lease liabilities	9,242	9,921
Shareholders' equity, net of excess cash	1,668	2,010
Total Capital	**$ 10,910**	**$ 11,931**
Total long-term debt and lease liabilities	9,242	9,921
Less Cash and cash equivalents, Short-term investments, and Long-term investments	(6,401)	(4,707)
Net debt	**$ 2,841**	**$ 5,214**

21. 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:

(Canadian dollars in millions)	2019	2018 RESTATED - NOTE 2
PASSENGER REVENUES		
Canada	$ 5,233	$ 4,880
U.S. Transborder	3,795	3,492
Atlantic	4,468	4,207
Pacific	2,449	2,427
Other	1,287	1,155
	$ 17,232	**$ 16,161**

(Canadian dollars in millions)	2019	2018
CARGO REVENUES		
Canada	$ 113	$ 95
U.S. Transborder	48	43
Atlantic	242	278
Pacific	257	325
Other	57	62
	$ 717	**$ 803**

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, redemption of Aeroplan Miles for non-air goods and services, 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.

(Canadian dollars in millions)	DEC. 31, 2019	DEC. 31, 2018
Receivables, which are included in Accounts receivable	$ 578	$ 575
Contract costs which are included in Prepaid expenses and other current assets	124	115
Contract liabilities – Advance ticket sales	2,939	2,717
Contract liabilities – Aeroplan deferred revenue (current and long-term)	2,825	-
Contract liabilities – Other deferred revenue (current and long-term)	1,473	-

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. Aeroplan Miles are sold to program partners based on member accumulations and which billings are generally settled on a monthly basis. 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 sales and the ground portion of vacation packages are deferred and included in Current liabilities. A portion of the passenger sale related to the equivalent ticket value of any Aeroplan Miles issued is separated and deferred in Aeroplan deferred revenue. The Advance ticket sales liability is recognized in revenue 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 the 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.

A reconciliation of the Aeroplan deferred revenue is as follows.

(Canadian dollars in millions)			2019
Fair value as at January 10, 2019 acquisition	Note 4	$	2,779
Proceeds from Aeroplan Miles issued to program partners			953
Equivalent ticket value of Aeroplan Miles issued			201
Aeroplan Miles redeemed			(1,108)
Aeroplan deferred revenue, end of year		**$**	**2,825**

Proceeds from miles issued to Aeroplan program partners and the equivalent ticket value of Miles issued through travel are deferred until the Miles are redeemed and the reward is provided to the member. The Corporation expects the majority of the Miles outstanding will be redeemed within three years.

In connection with new commercial agreements signed in 2019, Air Canada received payments from TD Bank, CIBC, Visa, and AMEX in the aggregate amount of $1,212 million. Additionally, TD Bank and CIBC made payments to the Corporation in the aggregate amount of $400 million as prepayments to be applied towards future monthly payments in respect of Aeroplan Miles. These considerations are accounted for as a contract liability within Aeroplan and other deferred revenue.

22. 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:

(Canadian dollars in millions)	**2019**	2018 RESTATED - NOTE 2
Capacity purchase fees	$ 1,042	$ 1,067
Aircraft fuel	485	531
Airport and navigation fees	292	296
Sales and distribution costs	158	153
Other operating expenses	464	461
Regional airlines expense	**$ 2,441**	**$ 2,508**

23. SALE-LEASEBACK

In 2018, the Corporation entered into a sale and leaseback arrangement for 25 Embraer 190 aircraft for net proceeds of $293 million, which resulted in the recognition of a loss on disposal of $188 million. The aircraft will continue to be operated under leases entered into under such sale-leaseback agreement until they fully exit the fleet progressively through 2020.

24. 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, Executive Vice President and Chief Commercial Officer, and Executive Vice President of Operations. The Executive Vice President of Operations was not included in the 2018 period as the position was vacant at that time. Amounts reported are based upon the expense as reported in the consolidated financial statements. Compensation to key management is summarized as follows:

(Canadian dollars in millions)	**2019**	2018
Salaries and other benefits	$ 7	$ 8
Pension and post-employment benefits	5	1
Share-based compensation	36	10
	$ 48	**$ 19**

25. DEFINITIVE ARRANGEMENT AGREEMENT FOR THE ACQUISITION OF TRANSAT

On June 27, 2019, Air Canada and Transat A.T. Inc. ("Transat") announced a definitive arrangement agreement that provides for Air Canada's acquisition of all issued and outstanding shares of Transat. Under the terms of the agreement, Air Canada would have acquired all outstanding shares of Transat for $13 per share. The value of the all-cash transaction was, at that time, approximately $520 million.

On August 11, 2019, Air Canada and Transat announced that Air Canada had agreed to increase the purchase price for the acquisition of all issued and outstanding shares of Transat, from $13 to $18 per share and had amended the Arrangement Agreement dated June 27, 2019 accordingly. Based on the increased consideration, the value of the all-cash transaction is approximately $720 million.

On August 23, 2019, Air Canada and Transat announced that a majority of nearly 95% of Transat shareholders had approved the Arrangement Agreement mentioned above.

The acquisition of Transat remains subject to regulatory approvals and other closing conditions usual in this type of transaction. If such approvals are obtained and conditions are met, the transaction is expected to be completed in mid-2020.

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, Montréal, Quebec
Madeleine Paquin	President and Chief Executive Officer, Logistec Corporation, Montréal, Quebec
Calin Rovinescu	President and Chief Executive Officer, Air Canada, Montréal, 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

EXECUTIVE OFFICERS (1)

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
Arielle Meloul-Wechsler	Executive Vice President, Chief Human Resources and Communications Officer
David J. Shapiro	Executive Vice President, International and Regulatory Affairs and Chief Legal Officer
Amos Kazzaz	Senior Vice President, Finance
Catherine Luelo	Senior Vice President and Chief Information Officer
Ferio Pugliese	Senior Vice President, Air Canada Express and Government Relations
Richard Steer	Senior Vice President, Operations
Carolyn M. Hadrovic	Vice President and Corporate Secretary

(1) Executive officers include the Chief Executive Officer, the Chief Financial Officer, the Corporate Secretary and all Executive Vice Presidents and Senior Vice Presidents.

FSC
www.fsc.org
MIX
Paper from responsible sources
FSC® C095263

30%

RAINFOREST ALLIANCE CERTIFIED

ECF

BIO GAS ENERGY

PERMANENT

INVESTOR AND SHAREHOLDER INFORMATION

TSX price range and trading volume of Air Canada variable voting shares and voting shares (AC)

2019	HIGH	LOW	VOLUME TRADED
1st Quarter	$ 35.50	$ 24.75	77,956,990
2nd Quarter	$ 41.47	$ 31.29	67,120,023
3rd Quarter	$ 47.43	$ 39.45	83,773,975
4th Quarter	$ 51.07	$ 41.80	59,429,473
			288,280,461

Restrictions on voting securities

In 2018, the Government of Canada passed 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%. At its 2019 annual and special meeting of shareholders, Air Canada received approval for a plan of arrangement under section 192 of the *Canada Business Corporations Act* to effect amendments to Air Canada's restated articles of incorporation to align the restrictions on the level of non-Canadian ownership and voting control with those prescribed by the definition of "Canadian" in section 55(1) of the recently amended CTA. The Québec Superior Court subsequently issued a final order approving this plan of arrangement, and Air Canada's amended articles became effective on May 8, 2019.

FOR FURTHER INFORMATION

SHAREHOLDER RELATIONS
Telephone: 514-422-6644
Facsimile: 514-422-0296
shareholders.actionnaires@aircanada.ca

INVESTOR RELATIONS
Telephone: 514-422-7849
Facsimile: 514-422-7877
investors.investisseurs@aircanada.ca

HEAD OFFICE
Air Canada Centre
7373 Côte-Vertu Boulevard West
Saint-Laurent, Quebec H4S 1Z3

Internet: aircanada.com

Air Canada complies with the rules adopted by the Toronto Stock Exchange.

TRANSFER AGENT AND REGISTRAR
AST Trust Company (Canada)
2001 Robert-Bourassa Boulevard, Suite 1600
Montréal, Quebec H3A 2A6

Telephone: 1-800-387-0825 (Canada and United States)
416-682-3860 (other countries)

Inquiries may also be submitted by email to: inquiries@astfinancial.com

Ce rapport annuel est publié dans les deux langues officielles du Canada. Pour en recevoir un exemplaire en français, veuillez communiquer avec les Relations avec les actionnaires.

English or French, it's the client's choice

OFFICIAL LANGUAGES AT AIR CANADA

For Air Canada, offering service in the language chosen by our 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 are all central elements of customer service and call up on our employees' linguistic skills at all times. Our commitment to bilingualism not only makes good sense from a customer service standpoint but also supports our legal obligations to serve the public in Canada's two official languages.

Air Canada puts great efforts to better serve clients in the language of their choice. Outreach activities with minority language communities as well as ongoing employee awareness and training help us face the daily challenges, which include the growing difficulty of recruiting bilingual candidates outside the province of Quebec and the National Capital Region and supporting our employees' ability to maintain their language skills with very little opportunity to practice in some regions of the country.

PRODUCED IN-HOUSE BY: AIR CANADA MULTIMEDIA COMMUNICATIONS

CORPORATE PROFILE

Air Canada is Canada's largest domestic and international airline and served 217 airports on six continents in 2019. Canada's flag carrier is among the 20 largest airlines in the world and, in 2019, served more than 51 million customers. In 2019, 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, 1,531 daily scheduled flights, comprised of 62 Canadian cities, 56 destinations in the United States and a total of 99 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 26-member airline network, Air Canada offers its customers access to more than 1,300 destinations in 195 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 2019.

Voted Best Airline in North America