AIR CANADA

First Quarter 2014

Interim Unaudited

Condensed Consolidated Financial Statements and Notes

May 15, 2014

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Unaudited (Canadian dollars in millions)		**March 31, 2014**	**December 31, 2013**
ASSETS			
Current			
Cash and cash equivalents		$ 875	$ 750
Short-term investments		1,515	1,458
Total cash, cash equivalents and short-term investments		2,390	2,208
Restricted cash		68	92
Accounts receivable		756	589
Aircraft fuel inventory		78	71
Spare parts and supplies inventory		73	65
Prepaid expenses and other current assets		226	263
Total current assets		3,591	3,288
Property and equipment		5,264	5,073
Intangible assets		302	304
Goodwill		311	311
Deposits and other assets		496	494
Total assets		**$ 9,964**	**$ 9,470**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		$ 1,239	$ 1,129
Advance ticket sales		2,124	1,687
Current portion of long-term debt and finance leases	Note 3	413	374
Total current liabilities		3,776	3,190
Long-term debt and finance leases	Note 3	4,191	3,959
Pension and other benefit liabilities	Note 4	2,877	2,687
Maintenance provisions		693	656
Other long-term liabilities		374	375
Total liabilities		**$ 11,911**	**$ 10,867**
EQUITY			
Shareholders' equity			
Share capital		833	827
Contributed surplus		74	80
Deficit		(2,918)	(2,367)
Total shareholders' equity		(2,011)	(1,460)
Non-controlling interests		64	63
Total equity		(1,947)	(1,397)
Total liabilities and equity		**$ 9,964**	**$ 9,470**

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

CONSOLIDATED STATEMENT OF OPERATIONS

Unaudited		Three months ended March 31	
(Canadian dollars in millions except per share figures)		2014	2013
Operating revenues			
Passenger		$ 2,608	$ 2,527
Cargo		119	111
Other		338	314
Total revenues		**3,065**	**2,952**
Operating expenses			
Aircraft fuel		918	870
Wages, salaries and benefits	Note 4	569	564
Capacity purchase agreements		281	272
Airport and navigation fees		247	232
Aircraft maintenance		181	175
Sales and distribution costs		175	164
Depreciation, amortization and impairment		130	170
Aircraft rent		79	81
Food, beverages and supplies		70	66
Communications and information technology		53	49
Other		424	415
Total operating expenses		**3,127**	**3,058**
Operating loss		**(62)**	**(106)**
Non-operating income (expense)			
Foreign exchange loss		(161)	(40)
Interest income		9	7
Interest expense		(77)	(73)
Interest capitalized		5	8
Net financing expense relating to employee benefits	Note 4	(34)	(52)
Loss on financial instruments recorded at fair value	Note 7	(15)	(2)
Other		(6)	(2)
Total non-operating expense		(279)	(154)
Loss before income taxes		**(341)**	**(260)**
Income taxes		-	-
Net loss for the period		**$ (341)**	**$ (260)**
Net income (loss) attributable to:			
Shareholders of Air Canada		(342)	(261)
Non-controlling interests		1	1
		$ (341)	**$ (260)**
Net loss per share attributable to shareholders of Air Canada			
Basic and diluted loss per share	Note 5	$ (1.20)	$ (0.95)

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

Unaudited		Three months ended March 31	
(Canadian dollars in millions)		**2014**	**2013**
Comprehensive income (loss)			
Net loss for the period		$ (341)	$ (260)
Other comprehensive income (loss), net of taxes of nil:			
Items that will not be reclassified to net income			
Remeasurements on employee benefit liabilities	Note 4	(203)	116
Total comprehensive loss		**$ (544)**	**$ (144)**
Comprehensive income (loss) attributable to:			
Shareholders of Air Canada		$ (545)	$ (145)
Non-controlling interests		1	1
		$ (544)	**$ (144)**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Unaudited (Canadian dollars in millions)	Share capital	Contributed surplus	Deficit	Total shareholders' equity	Non-controlling interests	Total equity
January 1, 2013	$ 813	$ 62	$ (4,281)	$ (3,406)	$ 59	$ (3,347)
Net income (loss)	–	–	(261)	(261)	1	(260)
Remeasurements on employee benefit liabilities	–	–	116	116	–	116
Total comprehensive income (loss)	–	–	(145)	(145)	1	(144)
Share-based compensation	–	1	–	1	–	1
March 31, 2013	$ 813	$ 63	$ (4,426)	$ (3,550)	$ 60	$ (3,490)
January 1, 2014	$ 827	$ 80	$ (2,367)	$ (1,460)	$ 63	$ (1,397)
Net income (loss)	–	–	(342)	(342)	1	(341)
Remeasurements on employee benefit liabilities	–	–	(203)	(203)	–	(203)
Total comprehensive income (loss)	–	–	(545)	(545)	1	(544)
Share-based compensation	–	(2)	(6)	(8)	–	(8)
Shares vested for employee recognition award	6	(4)	–	2	–	2
March 31, 2014	$ 833	$ 74	$ (2,918)	$ (2,011)	$ 64	$ (1,947)

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

CONSOLIDATED STATEMENT OF CASH FLOW

Unaudited (Canadian dollars in millions)		Three months ended March 31 2014	2013
Cash flows from (used for)			
Operating			
Net loss for the period		$ (341)	$ (260)
Adjustments to reconcile to net cash from operations			
Depreciation, amortization and impairment		130	170
Foreign exchange loss		178	53
Employee benefit funding (greater) less than expense	Note 4	(13)	13
Fuel and other derivatives	Note 7	14	(9)
Discontinued operations - Aveos		-	(22)
Change in maintenance provisions		11	14
Changes in non-cash working capital balances		367	300
Other		(2)	2
Net cash flows from operating activities		**344**	**261**
Financing			
Proceeds from borrowings		197	13
Reduction of long-term debt and finance lease obligations		(81)	(96)
Net cash flows from (used in) financing activities		**116**	**(83)**
Investing			
Short-term investments		(30)	17
Additions to property, equipment and intangible assets		(310)	(114)
Proceeds from sale of assets		2	4
Other		3	10
Net cash flows used in investing activities		**(335)**	**(83)**
Increase in cash and cash equivalents		**125**	**95**
Cash and cash equivalents, beginning of period		750	754
Cash and cash equivalents, end of period		**$ 875**	**$ 849**

Cash payments of interest	**$ 42**	**$ 92**
Cash payments of income taxes	**$ -**	**$ -**

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

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(CANADIAN DOLLARS IN MILLIONS – EXCEPT PER SHARE AMOUNTS)

1. GENERAL INFORMATION

The accompanying unaudited interim condensed consolidated financial statements (the "financial statements") are of Air Canada (the "Corporation"). The term "Corporation" also refers to, as the context may require, Air Canada and/or one or more of its subsidiaries, including its principal wholly-owned operating subsidiaries, Touram Limited Partnership ("Air Canada Vacations") and Air Canada *rouge* LP doing business under the brand name Air Canada *rouge*™ ("Air Canada *rouge*"). These financial statements also include certain aircraft leasing entities, which are consolidated under IFRS 10 Consolidated Financial Statements.

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

The Corporation historically experiences greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the spring and summer months. The Corporation has substantial fixed costs in its cost structure that do not meaningfully fluctuate with passenger demand in the short term.

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 have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 "Interim Financial Reporting". In accordance with GAAP, these financial statements do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the Corporation's annual consolidated financial statements for the year ended December 31, 2013. In management's opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim period presented.

These financial statements were approved for issue by the Board of Directors of the Corporation on May 14, 2014.

These financial statements are based on the accounting policies consistent with those disclosed in Note 2 to the 2013 annual consolidated financial statements. Refer to Note 2 to the 2013 annual consolidated financial statements for information on new accounting standards and amendments not yet effective.

3. LONG-TERM DEBT AND FINANCE LEASES

	Final Maturity	Weighted Average Interest Rate (%)	March 31 2014	December 31 2013
Aircraft financing				
Fixed rate US dollar financing (a)	2014 – 2025	6.37	$ 1,907	$ 1,706
Floating rate US dollar financing (b)	2015 – 2021	2.36	610	609
Floating rate Japanese yen financing	2020	0.28	118	116
Senior secured notes – US dollar	2019 – 2020	7.61	774	745
Senior secured notes – CDN dollar	2019	7.63	300	300
Other secured financing – US dollar	2015 – 2019	6.27	519	467
Other secured financing – CDN dollar	2016	9.15	122	126
Long-term debt		**6.02**	**4,350**	**4,069**
Finance lease obligations	2014 – 2033	10.12	321	328
Total debt and finance leases		**6.30**	**4,671**	**4,397**
Unamortized debt issuance costs			(67)	(64)
Current portion			(413)	(374)
Long-term debt and finance leases			**$ 4,191**	**$ 3,959**

The terms and conditions of the instruments referred to in the above table are disclosed in Note 8 to the 2013 annual consolidated financial statements of the Corporation except for events during the three months ended March 31, 2014 and the offering of unsecured notes completed in April 2014 which are described below.

(a) Financing associated with one Boeing 777 aircraft was drawn during the first quarter of 2014 upon delivery of the aircraft, representing the final draw on proceeds under the private offering of enhanced equipment trust certificates which was completed in 2013.

(b) In the first quarter of 2014, the maturity date of a term loan due 2015 was extended to January 2018. The carrying value of the debt as at March 31, 2014 was $83 (US$75).

Refer to Note 6 for the Corporation's principal and interest repayment requirements as at March 31, 2014.

Unsecured Notes Offering

In April 2014, the Corporation completed a private offering of US$400 of 7.75% senior unsecured notes due 2021, with interest payable semi-annually. The Corporation received net proceeds of approximately $432 from the sale and will use the proceeds for general corporate purposes.

4. PENSIONS AND OTHER BENEFIT LIABILITIES

Pension and Other Employee Future Benefit Expense

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

	Three Months Ended March 31	
	2014	2013
Consolidated Statement of Operations		
Operating expenses		
Wages, salaries and benefits		
Pension benefits	$ 60	$ 68
Other employee benefits	11	15
	$ 71	**$ 83**
Non-operating income (expense)		
Net financing expense relating to employee benefit liabilities		
Pension benefits	$ (20)	$ (39)
Other employee benefits	(14)	(13)
	$ (34)	**$ (52)**
Consolidated Other Comprehensive Income (Loss)		
Remeasurements on employee benefit liabilities		
Pension benefits	$ (138)	$ 124
Other employee benefits	(65)	(8)
	$ (203)	**$ 116**

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

	Three Months Ended March 31	
	2014	2013
Net defined pension and other future employee benefits expense recorded in the consolidated statement of operations		
Wages, salaries and benefits	$ 71	$ 83
Net financing expense relating to employee benefit liabilities	34	52
	$ 105	**$ 135**
Employee benefit funding by Air Canada		
Pension benefits	$ 107	$ 113
Other employee benefits	11	9
	$ 118	**$ 122**
Employee benefit funding (greater) less than expense	**$ (13)**	**$ 13**

5. EARNINGS PER SHARE

The following table outlines the share amounts used in the calculation of basic and diluted earnings per share.

	Three months ended March 31	
(in millions)	**2014**	**2013**
Weighted-average number of shares outstanding – basic	285	274
Effect of potential dilutive securities:		
Warrants	-	4
Stock options	7	3
Shares held in Trust for employee share-based compensation award	1	1
	8	8
Add back anti-dilutive impact	(8)	(8)
Adjusted denominator for diluted earnings per share	**285**	**274**

Basic EPS is calculated based on the weighted average number of ordinary shares in issue after deducting shares held in trust for the purposes of the Employee Recognition Award. All remaining shares held in trust for the Employee Recognition Award vested in the first quarter of 2014.

Excluded from the calculation of diluted earnings per share were outstanding options where the exercise prices were greater than the average market price of the ordinary shares for the period.

6. COMMITMENTS

Aircraft and Related Financing

As described in Note 16 to the 2013 annual consolidated financial statements, the Corporation has outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of 37 Boeing 787 aircraft with the first six deliveries scheduled for 2014. The last of five Boeing 777-300ER aircraft purchased by the Corporation was delivered in February 2014, and financed through proceeds from the private offering of enhanced equipment trust certificates as described in Note 3 Long-term Debt and Finance Leases.

On March 31, 2014, the Corporation concluded an agreement with Boeing for the purchase of Boeing 737 MAX aircraft. The agreement includes firm orders for 33 737 MAX 8 and 28 737 MAX 9 aircraft, with substitution rights between them as well as for the 737 MAX 7 aircraft. It also provides for options for 18 aircraft and certain rights to purchase an additional 30 aircraft. Deliveries are scheduled to begin in 2017 with two aircraft, and the remaining deliveries between 2018 and 2021, subject to certain deferral and acceleration rights.

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

Subject to certain conditions, the Corporation also has financing commitments covering up to 31 of the 37 Boeing 787 firm aircraft orders. This includes final commitments from Export-Import Bank of the United States ("EXIM"), subject to documentation and other conditions, for five Boeing 787 aircraft scheduled for delivery in 2014, and preliminary commitments from EXIM for two 787 aircraft scheduled for delivery in 2015.

The financing terms for the remaining 24 of the 31 financing commitments for the Boeing 787 aircraft are as follows. For 22 of the 787 aircraft, the financing terms are for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments. For the other two of the 787 aircraft, the financing under the commitment covers up to 90% of the capital expenditure and the term to maturity is 15 years with principal payments made on a mortgage-style basis resulting in equal installment payments of principal and interest over the term to maturity.

As a result of certain agreements finalized in the first quarter of 2014, certain of the financing commitments for the Boeing 787 aircraft and/or the Boeing 737 MAX aircraft will be reduced, although the specifics of the reduction have not yet been determined. Taking the financing reduction into consideration, the total committed financing on these aircraft will be at least $4,800.

Capital Commitments

The estimated aggregate cost of the future firm Boeing 787 and Boeing 737 MAX aircraft deliveries and other capital purchase commitments as at March 31, 2014 approximates $8,474. US dollar amounts are converted using the March 31, 2014 closing rate of CDN$1.1055. 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 US LIBOR rate at March 31, 2014.

	Remainder of 2014	2015	2016	2017	2018	Thereafter	Total
Capital commitments	$ 884	$ 985	$ 1,353	$ 1,704	$ 1,431	$ 2,117	**$ 8,474**

Maturity Analysis

Principal and interest repayment requirements as at March 31, 2014 on Long-term debt and finance lease obligations are as follows.

Principal	Remainder of 2014	2015	2016	2017	2018	Thereafter	Total
Long-term debt obligations	$ 266	$ 375	$ 558	$ 452	$ 436	$ 2,263	**$ 4,350**
Finance lease obligations	48	63	27	28	30	125	**321**
	$ 314	**$ 438**	**$ 585**	**$ 480**	**$ 466**	**$ 2,388**	**$ 4,671**

Interest	Remainder of 2014	2015	2016	2017	2018	Thereafter	Total
Long-term debt obligations	$ 184	$ 230	$ 189	$ 196	$ 146	$ 200	**$ 1,145**
Finance lease obligations	23	24	19	17	14	37	**134**
	$ 207	**$ 254**	**$ 208**	**$ 213**	**$ 160**	**$ 237**	**$ 1,279**

7. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

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

	Three months ended March 31	
	2014	2013
Fuel derivatives	$ (2)	$ (11)
Share forward contracts	(14)	9
Interest rate swaps	1	–
Loss on financial instruments recorded at fair value	**$ (15)**	**$ (2)**

Fuel Price Risk Management

During the first quarter of 2014, the Corporation recorded a loss of $2 in Loss on financial instruments recorded at fair value related to fuel derivatives ($11 loss in 2013). During the first quarter of 2014, the Corporation purchased crude-oil and refined products-based call options covering a portion of 2014 fuel exposure. The cash premium related to these contracts was $10. During the first quarter of 2014, fuel derivative contracts cash settled with a net fair value of $7 in favour of the Corporation.

As of March 31, 2014, approximately 27% of the Corporation's anticipated purchases of jet fuel for the remainder of 2014 are hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US$103 per barrel. The Corporation's contracts to hedge anticipated jet fuel purchases over the 2014 period are comprised of call options with notional volumes of 5,562,000 barrels. The fair value of the fuel derivatives portfolio at March 31, 2014 is $21 in favour of the Corporation ($20 in favour of the Corporation as at December 31, 2013) and is recorded within Prepaid expenses and other current assets.

Foreign Exchange Risk Management

As at March 31, 2014, the Corporation had outstanding foreign currency options and swap agreements, settling in 2014 and 2015, to purchase at maturity $3,094 of US dollars at a weighted average rate of $1.0551 per US$1.00. The Corporation also has protection in place to sell a portion of its excess Euros and Sterling against US dollars. The increase in level of foreign exchange derivatives outstanding at March 31, 2014 reflects the significant capital expenditure program for 2014 and an increase in target coverage from 50% to 60% of the net US dollar exposure on a rolling 15 month basis. As at March 31, 2014, based on the notional amount of currency derivatives outstanding at that time, approximately 75% of net US cash outflows were hedged for the remainder of 2014 and approximately 53% for 2015.

While the weighted average foreign exchange rate of the derivative portfolio is favourable as compared to the closing exchange rate on March 31, 2014, the hedging structures put in place have various option pricing features, such as knock-out terms and multipliers, and based on the assumed volatility used in the fair value calculation, the fair value of these foreign currency contracts as at March 31, 2014 was $14 in favour of the counterparties (December 31, 2013 – $13 in favour of the Corporation). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During the first three months of 2014, an unrealized loss of $4 was recorded in Foreign exchange gain (loss) related to these derivatives (2013 – $23 gain). During the first three months of 2014, foreign exchange derivative contracts cash settled with a net fair value of $23 in favour of the Corporation (2013 - $12 in favour of the Corporation).

The Corporation also holds US cash reserves as an economic hedge against changes in the value of the US dollar. US dollar cash and short-term investment balances as at March 31, 2014 amounted to $803 (US$726) ($791 (US$743) as at December 31, 2013). During the first three months of 2014, an unrealized gain of $29 (2013 – unrealized gain of $12) was recorded in Foreign exchange gain (loss) reflecting the change in Canadian equivalent market value of the US dollar cash and short-term investment balances held.

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. Based on significant observable inputs (Level 2 in the fair value hierarchy), the estimated fair value of debt approximates its carrying value.

Following is a classification of fair value measurements recognized in the Consolidated Statement of Financial Position using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. There are no changes in classifications or methods of measuring fair value from those disclosed in Note 17 to the 2013 annual consolidated financial statements. There were no transfers within the fair value hierarchy or change in the fair value of Level 3 assets during the three months ended March 31, 2014.

		Fair value measurements at reporting date using:		
	March 31, 2014	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	$ 223	$ –	$ 223	$ –
Short–term investments	1,515	–	1,515	–
Deposits and other assets				
Prepayment option on senior secured notes	2	–	–	2
Derivative instruments				
Fuel derivatives	21	–	21	–
Share forward contracts	42	–	42	–
Interest rate swaps	9	–	9	–
Total	**1,812**	–	**1,810**	**2**
Financial Liabilities				
Derivative instruments				
Foreign exchange derivatives	14	–	14	–
Total	**$ 14**	**$ –**	**$ 14**	**$ –**

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.