AIR CANADA

Third Quarter 2014

INTERIM UNAUDITED

Condensed Consolidated Financial Statements and Notes

November 6, 2014

A STAR ALLIANCE MEMBER
MEMBRE DU RÉSEAU STAR ALLIANCE

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Unaudited (Canadian dollars in millions)		**September 30, 2014**	**December 31, 2013**
ASSETS			
Current			
Cash and cash equivalents		$ 897	$ 750
Short-term investments		1,631	1,458
Total cash, cash equivalents and short-term investments		2,528	2,208
Restricted cash		75	92
Accounts receivable		703	589
Aircraft fuel inventory		78	71
Spare parts and supplies inventory		83	65
Prepaid expenses and other current assets		199	263
Total current assets		3,666	3,288
Property and equipment		5,735	5,073
Intangible assets		301	304
Goodwill		311	311
Deposits and other assets		532	494
Total assets		**$ 10,545**	**$ 9,470**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		$ 1,269	$ 1,129
Advance ticket sales		1,809	1,687
Current portion of long-term debt and finance leases	Note 3	424	374
Total current liabilities		3,502	3,190
Long-term debt and finance leases	Note 3	4,557	3,959
Pension and other benefit liabilities	Note 4	2,812	2,687
Maintenance provisions		757	656
Other long-term liabilities		317	375
Total liabilities		**$ 11,945**	**$ 10,867**
EQUITY			
Shareholders' equity			
Share capital		834	827
Contributed surplus		75	80
Deficit		(2,376)	(2,367)
Total shareholders' equity		(1,467)	(1,460)
Non-controlling interests		67	63
Total equity		(1,400)	(1,397)
Total liabilities and equity		**$ 10,545**	**$ 9,470**

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

CONSOLIDATED STATEMENT OF OPERATIONS

Unaudited (Canadian dollars in millions except per share figures)		Three Months Ended September 30		Nine Months Ended September 30	
		2014	2013	2014	2013
Operating revenues					
Passenger		$ 3,476	$ 3,177	$ 9,049	$ 8,461
Cargo		128	120	369	346
Other		194	182	750	681
Total revenues		**3,798**	**3,479**	**10,168**	**9,488**
Operating expenses					
Aircraft fuel		1,076	1,002	2,956	2,703
Wages, salaries and benefits	Note 4	561	565	1,678	1,694
Capacity purchase agreements		312	295	887	843
Airport and navigation fees		281	274	784	751
Aircraft maintenance		166	131	527	474
Sales and distribution costs		173	159	519	475
Depreciation, amortization and impairment		146	130	409	430
Ground package costs		56	52	303	261
Aircraft rent		77	80	234	242
Food, beverages and supplies		88	80	235	218
Communications and information technology		50	49	152	145
Other		286	246	775	768
Total operating expenses		**3,272**	**3,063**	**9,459**	**9,004**
Operating income		**526**	**416**	**709**	**484**
Non-operating income (expense)					
Foreign exchange gain (loss)		(71)	49	(192)	(65)
Interest income		11	7	29	22
Interest expense	Note 3	(81)	(174)	(239)	(324)
Interest capitalized		6	15	21	36
Net financing expense relating to employee benefits	Note 4	(34)	(51)	(102)	(155)
Fuel and other derivatives	Note 7	(31)	30	(10)	15
Other		(3)	(1)	(11)	(5)
Total non-operating expense		(203)	(125)	(504)	(476)
Income before income taxes		**323**	**291**	**205**	**8**
Income taxes		-	8	-	8
Net income for the period		**$ 323**	**$ 299**	**$ 205**	**$ 16**
Net income attributable to:					
Shareholders of Air Canada		321	298	201	13
Non-controlling interests		2	1	4	3
Net income for the period		**$ 323**	**$ 299**	**$ 205**	**$ 16**
Net income per share attributable to shareholders of Air Canada	Note 5				
Basic earnings per share		$ 1.13	$ 1.08	$ 0.70	$ 0.05
Diluted earnings per share		$ 1.10	$ 1.05	$ 0.69	$ 0.05

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Unaudited (Canadian dollars in millions)		Three Months Ended September 30		Nine Months Ended September 30	
		2014	**2013**	**2014**	**2013**
Comprehensive income (loss)					
Net income for the period		$ 323	$ 299	$ 205	$ 16
Other comprehensive income, net of taxes of nil:					
Items that will not be reclassified to net income					
Remeasurements on employee benefit liabilities	Note 4	96	105	(197)	252
Total comprehensive income		**$ 419**	**$ 404**	**$ 8**	**$ 268**
Comprehensive income attributable to:					
Shareholders of Air Canada		$ 417	$ 403	$ 4	$ 265
Non-controlling interests		2	1	4	3
		$ 419	**$ 404**	**$ 8**	**$ 268**

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	–	–	13	13	3	16
Remeasurements on employee benefit liabilities	–	–	252	252	–	252
Total comprehensive income	–	–	265	265	3	268
Share-based compensation	–	17	–	17	–	17
Shares issued, net	6	–	–	6	–	6
September 30, 2013	$ 819	$ 79	$ (4,016)	$ (3,118)	$ 62	$ (3,056)
January 1, 2014	$ 827	$ 80	$ (2,367)	$ (1,460)	$ 63	$ (1,397)
Net income	–	–	201	201	4	205
Remeasurements on employee benefit liabilities	–	–	(197)	(197)	–	(197)
Total comprehensive income	–	–	4	4	4	8
Share-based compensation	–	(1)	(13)	(14)	–	(14)
Shares issued	1	–	–	1	–	1
Shares vested for employee recognition award	6	(4)	–	2	–	2
September 30, 2014	$ 834	$ 75	$ (2,376)	$ (1,467)	$ 67	$ (1,400)

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 September 30 2014	Three Months Ended September 30 2013	Nine Months Ended September 30 2014	Nine Months Ended September 30 2013
Cash flows from (used for)					
Operating					
Net income for the period		$ 323	$ 299	$ 205	$ 16
Adjustments to reconcile to net cash from operations					
Depreciation, amortization and impairment		146	130	409	430
Foreign exchange loss (gain)		73	(34)	201	125
Employee benefit funding (greater) less than expense	Note 4	(27)	(10)	(63)	7
Fuel and other derivatives	Note 7	23	(5)	7	(17)
Discontinued operations - Aveos		–	–	–	(27)
Change in maintenance provisions		32	10	64	35
Changes in non-cash working capital balances		(379)	(427)	129	60
Other		–	28	(31)	34
Net cash flows from (used in) operating activities		**191**	**(9)**	**921**	**663**
Financing					
Proceeds from borrowings	Note 3	194	1,554	978	1,716
Reduction of long-term debt and finance lease obligations	Note 3	(166)	(1,140)	(556)	(1,455)
Issue of common shares, net		1	6	1	6
Other		–	–	–	(15)
Net cash flows from financing activities		**29**	**420**	**423**	**252**
Investing					
Short-term investments		157	(191)	(137)	(269)
Additions to property, equipment and intangible assets		(383)	(240)	(1,115)	(618)
Proceeds from sale of assets	Note 3B	65	27	68	35
Other		(23)	15	(13)	(5)
Net cash flows used in investing activities		**(184)**	**(389)**	**(1,197)**	**(857)**
Increase in cash and cash equivalents		**36**	**22**	**147**	**58**
Cash and cash equivalents, beginning of period		861	790	750	754
Cash and cash equivalents, end of period		**$ 897**	**$ 812**	**$ 897**	**$ 812**

Cash payments of interest	**$ 33**	**$ 158**	**$ 172**	**$ 285**
Cash payments (recovery) of income taxes	**$ (1)**	**$ 1**	**$ (1)**	**$ 1**

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 November 5, 2014.

These financial statements are based on the accounting policies consistent with those disclosed in Note 2 to the 2013 annual consolidated financial statements, except for a change in the policy described in Note 2T Property and equipment. Previously, cabin interior equipment and modifications were depreciated over the lesser of 5 years or the remaining useful life of the aircraft. Effective April 1, 2014, cabin interior equipment and modifications are depreciated over the lesser of 8 years or the remaining useful life of the aircraft. The adjustment to their useful lives was made prospectively as a change in accounting estimate and reflects product developments, and is in line with fleet strategy. The impact of this change in accounting estimate is a decrease of $2 in depreciation expense in the third quarter of 2014 ($3 for the nine months ended September 30, 2014).

Refer to Note 2 to the 2013 annual consolidated financial statements for information on new accounting standards and amendments not yet effective. The following is an overview of the accounting standard changes since those disclosed at that time. The Corporation continues to evaluate the impact of these standards on its consolidated financial statements.

IFRS 9 – Financial Instruments

The final version of IFRS 9 was issued in July 2014 and includes (i) a third measurement category for financial assets – fair value through other comprehensive income; (ii) a single, forward-looking expected loss impairment model, and (iii) a mandatory effective date for IFRS 9 of annual periods beginning on or after January 1, 2018.

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 replaces IAS 18 Revenue and related interpretations. The core principle of the new standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard is intended to enhance disclosures about revenue, provide more comprehensive guidance for transactions that were not previously addressed and improve guidance for multiple-element arrangements. IFRS 15 is effective for annual periods beginning on January 1, 2017, with early adoption permitted.

3. LONG-TERM DEBT AND FINANCE LEASES

	Final Maturity	Weighted Average Interest Rate (%)	September 30 2014	December 31 2013
Aircraft financing				
Fixed rate US dollar financing (a)	2015 – 2025	6.34	$ 1,824	$ 1,706
Floating rate US dollar financing (b)	2015 – 2026	1.42	787	609
Floating rate CDN dollar financing (c)	2026	1.92	103	-
Floating rate Japanese yen financing	2020	0.26	103	116
Senior secured notes – US dollar	2019 – 2020	7.61	784	745
Senior unsecured notes – US dollar (d)	2021	7.75	448	-
Senior secured notes – CDN dollar	2019	7.63	300	300
Other secured financing – US dollar (e)	2015 – 2019	5.61	423	467
Other secured financing – CDN dollar	2016	-	-	126
Long-term debt		**5.66**	**4,772**	**4,069**
Finance lease obligations	2015 – 2033	10.09	293	328
Total debt and finance leases		**5.92**	**5,065**	**4,397**
Unamortized debt issuance costs			(84)	(64)
Current portion			(424)	(374)
Long-term debt and finance leases			**$ 4,557**	**$ 3,959**

The above table provides terms of instruments disclosed in Note 8 to the 2013 annual consolidated financial statements of the Corporation as well as terms of instruments concluded during the nine months ended September 30, 2014 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) Financing of US$184 associated with the delivery of two Boeing 787 aircraft was completed in the second quarter of 2014 and US$92 for an additional Boeing 787 aircraft in the third quarter of 2014. The financing is supported by a loan guarantee by the Export Import Bank of the United States ("EXIM"), with principal and interest repayable quarterly until maturity in 2026. During the third quarter, the Corporation disposed of two A340-500 aircraft and repaid the financing related to these aircraft in the amount of $90. No gain or loss was recorded on the sale.

(c) Financing of $103 associated with the delivery of one Boeing 787 aircraft was completed in the third quarter of 2014. The financing is supported by a loan guarantee by EXIM, with principal and interest repayable quarterly until maturity in 2026.

(d) 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 to be used for general corporate purposes.

(e) 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 September 30, 2014 was $84 (US$75).

In conjunction with the purchase of all of its outstanding 9.250% Senior Secured Notes due 2015, 10.125% Senior Secured Notes due 2015 and 12.000% Senior Second Lien Notes due 2016, the premium costs paid, in the amount of $61, as well as the write off of existing transaction costs and discounts related to the Notes, in the amount of $34, were recorded as an interest charge in the third quarter of 2013.

Refer to Note 6 for the Corporation's principal and interest repayment requirements as at September 30, 2014.

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 September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
Consolidated Statement of Operations				
Operating expenses				
Wages, salaries and benefits				
Pension benefits	$ 41	$ 69	$ 146	$ 205
Other employee benefits	7	5	27	36
	$ 48	**$ 74**	**$ 173**	**$ 241**
Non-operating income (expense)				
Net financing expense relating to employee benefit liabilities				
Pension benefits	$ (20)	$ (39)	$ (60)	$ (116)
Other employee benefits	(14)	(12)	(42)	(39)
	$ (34)	**$ (51)**	**$ (102)**	**$ (155)**
Consolidated Other Comprehensive Income (Loss)				
Remeasurements on employee benefit liabilities				
Pension benefits	$ 108	$ 92	$ (71)	$ 161
Other employee benefits	(12)	13	(126)	91
	$ 96	**$ 105**	**$ (197)**	**$ 252**

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 September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
Net defined pension and other future employee benefits expense recorded in the consolidated statement of operations				
Wages, salaries and benefits	$ 48	$ 74	$ 173	$ 241
Net financing expense relating to employee benefit liabilities	34	51	102	155
	$ 82	**$ 125**	**$ 275**	**$ 396**
Employee benefit funding by Air Canada				
Pension benefits	$ 100	$ 122	$ 306	$ 353
Other employee benefits	9	13	32	36
	$ 109	**$ 135**	**$ 338**	**$ 389**
Employee benefit funding (greater) less than expense	**$ (27)**	**$ (10)**	**$ (63)**	**$ 7**

The net benefit obligation of pension plans that report a deficit for accounting purposes is as follows:

	December 31, 2013
Domestic registered plans	$ 574
US, UK, and Japan	63
Supplementary plans	798
	$ 1,435

5. EARNINGS PER SHARE

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

	Three Months Ended September 30		Nine Months Ended September 30	
(in millions, except per share amounts)	**2014**	**2013**	**2014**	**2013**
Numerator for basic and diluted earnings per share:				
Net income attributable to shareholders of Air Canada	$321	$298	$201	$13
Denominator:				
Weighted-average number of shares outstanding – basic	286	277	286	276
Effect of potential dilutive securities:				
Stock options	8	4	7	3
Warrants	-	1	-	3
Shares held in Trust for employee share-based compensation award	-	1	-	1
Total potential dilutive securities	8	6	7	7
Adjusted denominator for diluted earnings per share	294	283	293	283
Basic earnings per share	**$1.13**	**$1.08**	**$0.70**	**$0.05**
Diluted earnings per share	**$1.10**	**$1.05**	**$0.69**	**$0.05**

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.

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 of the 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 and warrants where the exercise prices were greater than the average market price of the ordinary shares.

6. COMMITMENTS

Aircraft and Related Financing

The discussion and presentation related to Air Canada's aircraft and related financing and commitments are as at September 30, 2014 (except where stated otherwise) and do not account for the Corporation's fifth firm order Boeing 787 aircraft delivered in October 2014 and financed with support from EXIM covering 85% of the aircraft delivery and, therefore, such discussion and presentation are provided as if that fifth firm order Boeing 787 aircraft had not been delivered or financed.

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, four of which were delivered by the end of the third quarter. The last of five Boeing 777 aircraft recently acquired 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.

In addition, as described in Note 16 to the 2013 annual consolidated financial statements, the Corporation had purchase rights for Boeing 777 aircraft (entitling Air Canada to purchase aircraft based on previously determined pricing). In the third quarter of 2014, the Corporation exercised purchase rights for two Boeing 777 aircraft, with scheduled deliveries in the second quarter of 2016. Financing alternatives will be considered prior to the planned delivery dates of these aircraft. The capital expenditures related to this purchase are included in the table provided below. As at September 30, 2014, the Corporation has purchase rights for 11 Boeing 777.

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 27 of the remaining 33 Boeing 787 firm aircraft orders. This includes final commitments from EXIM, subject to documentation and other conditions, for one additional Boeing 787 aircraft which was delivered in October 2014, and preliminary commitments from EXIM for two other 787 aircraft scheduled for delivery in November 2014 and February 2015 (which became final commitments in October 2014).

The financing terms for the firm commitments (subject to conditions) for the remaining 24 of the 27 financing commitments for the Boeing 787 aircraft are as follows. For 23 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 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.

Certain of the financing commitments for the Boeing 787 aircraft and/or the Boeing 737 MAX aircraft will be reduced based on allocations to be determined by the Corporation, although the specifics of the reduction have not yet been determined. Taking the estimated financing reduction into consideration, the total committed financing on these aircraft, including commitments from EXIM, will be at least $4,400.

Capital Commitments

The estimated aggregate cost of the future firm Boeing 787, Boeing 777 and Boeing 737 MAX aircraft deliveries and other capital purchase commitments as at September 30, 2014 approximates $8,231. US dollar amounts are converted using the September 30, 2014 closing rate of CDN$1.12. 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 September 30, 2014.

	Remainder of 2014	2015	2016	2017	2018	Thereafter	Total
Capital commitments	$ 351	$ 936	$ 1,855	$ 1,667	$ 1,342	$ 2,080	**$ 8,231**

Maturity Analysis

Principal and interest repayment requirements as at September 30, 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	$ 101	$ 393	$ 356	$ 471	$ 453	$ 2,998	**$ 4,772**
Finance lease obligations	16	64	27	28	31	127	**293**
	$ 117	**$ 457**	**$ 383**	**$ 499**	**$ 484**	**$ 3,125**	**$ 5,065**

Interest	Remainder of 2014	2015	2016	2017	2018	Thereafter	Total
Long-term debt obligations	$ 65	$ 247	$ 226	$ 231	$ 183	$ 288	**$ 1,240**
Finance lease obligations	7	24	19	17	14	37	**118**
	$ 72	**$ 271**	**$ 245**	**$ 248**	**$ 197**	**$ 325**	**$ 1,358**

7. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Refer to Note 17 to the 2013 annual consolidated financial statements for information on the Corporation's risk management strategy. The following is a summary of fuel and other derivatives included in non-operating income (expense) on the consolidated statement of operations for the periods indicated:

Summary of gain (loss) on Fuel and other derivatives

	Three Months Ended September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
Fuel derivatives	$ (24)	$ 21	$ (18)	$ 3
Share forward contracts	(7)	9	7	13
Interest rate swaps	-	-	1	(1)
Fuel and other derivatives	**$ (31)**	**$ 30**	**$ (10)**	**$ 15**

Fuel Price Risk Management

During the third quarter of 2014, the Corporation recorded a loss of $24 in Fuel and other derivatives related to fuel derivatives ($18 loss for the nine months ended September 30, 2014; gain of $21 and $3, respectively, for the three and nine months period ended September 30, 2013). During the third quarter of 2014, the Corporation purchased crude-oil and refined products-based call options covering a portion of 2015 fuel exposure. The cash premium related to these contracts was $11 ($31 for the nine months ended September 30, 2014; $3 and $30, respectively, for the three and nine months ended September 30, 2013). Fuel derivative contracts settled with a net fair value of $6 in favour of the Corporation in the third quarter of 2014 ($24 in favour of the Corporation for the nine months ended September 30, 2014; $20 and $21, respectively, for the three and nine months period ended September 30, 2013).

As of September 30, 2014, approximately 40% 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$108 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 2,508,000 barrels. The Corporation has also hedged approximately 10% of its 2015 anticipated jet fuel purchases with call options with notional volumes of 2,910,000 barrels at an average WTI equivalent capped price of US$101 per barrel. The fair value of the fuel derivatives portfolio at September 30, 2014 is $9 in favour of the Corporation (December 31, 2013 – $20 in favour of the Corporation) and is recorded within Prepaid expenses and other current assets.

Share Forward Contracts

In the third quarter of 2014, the Corporation recorded a loss of $7 on share forward contracts which hedge share units granted under the Corporation's long-term incentive plan that may vest with settlement dates between 2015 and 2018, subject to the terms of vesting (gain of $7 for the nine months ended September 30, 2014). The Corporation entered into additional share forward contracts during the third quarter of 2014. These contracts were prepaid by the Corporation for $5. Share forward contracts cash settled with a fair value of $7 in favour of the Corporation in the nine months ended September 30, 2014. As at September 30, 2014, the fair value of the share forward contracts was $61 in favour of the Corporation (December 31, 2013 - $56 in favour of the Corporation).

Foreign Exchange Risk Management

As at September 30, 2014, the Corporation had outstanding foreign currency options and swap agreements, settling in 2014, 2015 and 2016, to purchase at maturity $2,805 of US dollars at a weighted average rate of $1.0493 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 September 30, 2014 as compared to December 31, 2013 reflects the increased capital expenditure program for 2014 and 2015 and an increase in target coverage from 50% to 60% of the net US dollar exposure on a rolling 18 month basis. As at September 30, 2014, based on the notional amount of currency derivatives outstanding at that time, approximately 66% of net US cash outflows were hedged for the remainder of 2014 and approximately 47% for 2015 and 10% for 2016.

The weighted average foreign exchange rate of the derivative portfolio is favourable as compared to the closing exchange rate on September 30, 2014. In addition, 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 September 30, 2014 was $17 in favour of the Corporation (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 third quarter of 2014, a gain of $126 was recorded in Foreign exchange gain (loss) related to these derivatives (a gain of $33 for the first nine months of 2014; loss of $15 and gain of $29, respectively, for the three and nine months ended September 30, 2013). During the third quarter of 2014, foreign exchange derivative contracts cash settled with a net fair value of $3 in favour of the counterparties ($29 for the first nine months of 2014 in favour of the Corporation; $12 and $42, respectively, for the three and nine months ended September 30, 2013 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 September 30, 2014 amounted to $919 (US$823) (December 31, 2013 – $791 (US$743)). During the first nine months of 2014, an unrealized gain of $34 (unrealized gain of $19 for the first nine months of 2013) 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.

Sensitivity Analysis

The Corporation's foreign exchange rate risk related to Long-term debt has been impacted with the issuance of the senior unsecured notes (US$400), additional aircraft related financings (US$420) for three Boeing 787 aircraft and one Boeing 777 aircraft, and repayments of debt. In relation to the total USD debt balances at September 30, 2014, a 5% strengthening or weakening in rates of the Canadian dollar versus the U.S. dollar would result in a $224 increase or decrease to pre-tax income, respectively. The sensitivity to total USD debt exposure is partially offset by US$887 held in cash and cash equivalents, short-term investments and deposits and other assets for operational activities as at September 30, 2014 for which a 5% strengthening or weakening in rates of the Canadian dollar would impact pre-tax income by approximately $50. This sensitivity analysis does not take into account the foreign exchange derivative contract portfolio outstanding at September 30, 2014.

The majority of the new debt has fixed interest rates and as a result, there is no significant impact to interest rate risk sensitivity analysis as compared to amounts disclosed at December 31, 2013. Refer to Note 17 to the 2013 annual consolidated financial statements of the Corporation for further information regarding interest rate risk and foreign exchange risk.

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 nine months ended September 30, 2014.

		Fair value measurements at reporting date using:		
	September 30, 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	$ 294	$ –	$ 294	$ –
Short–term investments	1,631	–	1,631	–
Deposits and other assets				
Prepayment option on senior secured notes	2	–	–	2
Derivative instruments				
Fuel derivatives	9	–	9	–
Share forward contracts	61	–	61	–
Foreign exchange derivatives	17	–	17	–
Interest rate swaps	8	–	8	–
Total	**$ 2,022**	**$ –**	**$ 2,020**	**$ 2**

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.