AIR CANADA

Second Quarter 2014

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

August 7, 2014

TABLE OF CONTENTS

1. HIGHLIGHTS

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

(Canadian dollars in millions, except where indicated)	Second Quarter			First Six Months		
	2014	2013	$ Change	2014	2013	$ Change
Financial Performance Metrics						
Operating revenues	3,305	3,057	248	6,370	6,009	361
Operating income	245	174	71	183	68	115
Non-operating expense	(22)	(197)	175	(301)	(351)	50
Net income (loss)	223	(23)	246	(118)	(283)	165
Adjusted net income (1)	139	115	24	7	(28)	35
Operating margin %	7.4%	5.7%	1.7 pp	2.9%	1.1%	1.8 pp
EBITDAR (2)	456	385	71	603	530	73
EBITDAR margin % (2)	13.8%	12.6%	1.2 pp	9.5%	8.8%	0.7 pp
Unrestricted liquidity (3)	2,954	2,139	815	2,954	2,139	815
Free cash flow (4)	(36)	147	(183)	(2)	294	(296)
Adjusted net debt (5)	4,309	3,975	334	4,309	3,975	334
Return on invested capital ("ROIC") % (6)	11.0%	8.8%	2.2 pp	11.0%	8.8%	2.2 pp
Net income (loss) per share – diluted	$ 0.75	$ (0.09)	$ 0.84	$ (0.42)	$ (1.04)	$ 0.62
Adjusted net income per share – diluted (1)	$ 0.47	$ 0.41	$ 0.06	$ 0.02	$ (0.10)	$ 0.12
Operating Statistics (7)			**% Change**			**% Change**
Revenue passenger miles (millions) ("RPM")	15,495	14,093	9.9	28,961	27,180	6.6
Available seat miles (millions) ("ASM")	18,413	16,972	8.5	35,187	33,136	6.2
Passenger load factor %	84.2%	83.0%	1.1 pp	82.3%	82.0%	0.3 pp
Passenger revenue per RPM ("Yield") (cents)	18.9	19.3	(2.1)	19.0	19.2	(0.9)
Passenger revenue per ASM ("PRASM") (cents)	15.9	16.0	(0.8)	15.6	15.7	(0.6)
Operating revenue per ASM (cents)	17.9	18.0	(0.4)	18.1	18.1	(0.2)
Operating expense per ASM ("CASM") (cents)	16.6	17.0	(2.2)	17.6	17.9	(2.0)
Adjusted CASM (cents) (8)	11.2	11.7	(4.7)	11.7	12.1	(3.6)
Average number of full-time equivalent ("FTE") employees (thousands) (9)	24.5	24.7	(0.8)	24.4	24.6	(0.8)
Aircraft in operating fleet at period end	360	349	3.2	360	349	3.2
Average fleet utilization (hours per day)	9.9	9.9	(0.4)	9.9	10.0	(1.2)
Seats dispatched (thousands)	12,288	11,610	5.8	23,885	22,953	4.1
Aircraft frequencies (thousands)	139	137	1.6	270	271	(0.2)
Average stage length (miles) (10)	1,498	1,462	2.5	1,473	1,444	2.0
Economic fuel cost per litre (cents) (11)	91.6	85.7	6.9	93.1	89.0	4.6
Fuel litres (millions)	1,048	985	6.3	2,021	1,939	4.2
Revenue passengers carried (thousands) (12)	9,620	8,823	9.0	18,358	17,294	6.2

(1) Adjusted net income (loss) and adjusted net income (loss) per share – diluted are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

(2) EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

(3) Unrestricted liquidity refers to the sum of cash, cash equivalents, short-term investments and the amount of available credit under Air Canada's revolving credit facilities. At June 30, 2014, unrestricted liquidity was comprised of cash and short-term investments of $2,615 million and undrawn lines of credit of $339 million. At June 30, 2013, unrestricted liquidity was comprised of cash and short-term investments of $2,107 million and undrawn lines of credit of $32 million.

(4) Free cash flow (cash flows from operating activities less additions to property, equipment and intangible assets) is a non-GAAP financial measure. Refer to section 7.5 "Consolidated Cash Flow Movements" of this MD&A for additional information.

(5) Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is a non-GAAP financial measure. Refer to section 7.3 "Adjusted Net Debt" of this MD&A for additional information.

(6) Return on invested capital ("ROIC") is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information

(7) Operating statistics (except for average number of FTE employees) include third party carriers (such as Jazz Aviation LP ("Jazz") and Sky Regional Airlines Inc. ("Sky Regional") operating under capacity purchase agreements with Air Canada.

(8) Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

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

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

(11) Includes fuel handling expenses. Economic fuel price per litre is a non-GAAP financial measure. Refer to sections 4 and 5 "Results of Operations" of this MD&A for additional information.

(12) Revenue passengers are counted on a flight number basis which is consistent with the IATA definition of revenue passengers carried.

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 ("Air Canada Vacations") and Air Canada *rouge* LP ("Air Canada *rouge*"). This MD&A provides the reader with a review and analysis, from the perspective of management, of Air Canada's financial results for the second quarter 2014. This MD&A should be read in conjunction with Air Canada's interim unaudited condensed consolidated financial statements and notes for the second quarter of 2014, Air Canada's annual audited consolidated financial statements and notes and its annual MD&A for 2013 dated February 12, 2014. Except as otherwise noted, 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 as otherwise noted, monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 17 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of August 6, 2014. Certain comparative figures have been reclassified to conform to the financial statement presentation adopted for the current year. Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 18 "Risk Factors" of Air Canada's 2013 MD&A dated February 12, 2014. Air Canada issued a news release dated August 7, 2014 reporting on its results for the second quarter 2014. This news release is available on Air Canada's website at **www.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 written or oral forward-looking statements within the meaning of applicable securities laws. Such statements are included in this MD&A and may be included in other communications, including filings with regulatory authorities and securities regulators. Forward-looking statements may be based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to strategies, expectations, planned operations or future actions. Forward-looking statements are identified by the use of terms and phrases such as "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "predict", "project", "will", "would", and similar terms and phrases, including references to assumptions.

Forward-looking statements, by their nature, are based on assumptions, including those described herein and are subject to important risks and uncertainties. Forward-looking statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including without limitation, industry, market, credit and economic conditions, the ability to reduce operating costs and secure financing, energy prices, currency exchange and interest rates, competition, employee and labour relations, pension issues, war, terrorist acts, epidemic diseases, environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), insurance issues and costs, changes in demand due to the seasonal nature of the business, supply issues, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in section 18 "Risk Factors" of Air Canada's 2013 MD&A dated February 12, 2014. The forward-looking statements contained in this MD&A represent Air Canada's expectations as of August 6, 2014 (or as of the date they are otherwise stated to be made), and are subject to change after such date. However, Air Canada disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

KEY ASSUMPTIONS

Assumptions were made by Air Canada in preparing and making forward-looking statements. As part of its assumptions, Air Canada assumes Canadian GDP growth of 2.0% to 2.5% for 2014. In addition, Air Canada expects that the Canadian dollar will trade, on average, at C$1.08 per U.S. dollar in the third quarter of 2014 and C$1.09 for the full year 2014 and that the price of jet fuel will average 90 cents per litre for the third quarter of 2014 and 91 cents per litre for the full year 2014.

3. OVERVIEW

In the second quarter of 2014, Air Canada recorded adjusted net income of $139 million or $0.47 per diluted share, an improvement of $24 million or $0.06 per diluted share when compared to the same quarter in 2013. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

On a GAAP basis, Air Canada reported net income of $223 million or $0.75 per diluted share compared to a net loss of $23 million or $0.09 per diluted share in the second quarter of 2013, an improvement of $246 million or $0.84 per diluted share. Air Canada generated EBITDAR of $456 million, an improvement of $71 million from to the EBITDAR of $385 million reported in the second quarter of 2013. In the second quarter of 2014, Air Canada recorded favourable tax-related provision adjustments of $41 million in Other operating expenses on Air Canada's consolidated statement of operations whereas no such provision adjustments were recorded in the second quarter of 2013. These provision adjustments are included in Air Canada's GAAP results however they are excluded from Air Canada's adjusted results.

Strategy

Air Canada continues to make progress in pursuing its strategic initiatives to improve revenues and reduce costs in order to achieve sustainable profitability. Air Canada's business strategy and key priorities focus on the following:

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

Air Canada is taking tangible steps to improve its earnings through the execution of strategic initiatives designed to lower its overall cost structure and increase its competitiveness. These include:

- The growth of Air Canada *rouge* to enhance margins in leisure markets and to pursue opportunities in international leisure markets made viable by Air Canada *rouge*'s lower cost structure. Air Canada has estimated that the Airbus A319 and the Boeing 767 aircraft in Air Canada *rouge*'s operating fleet has a 21% and 29% lower CASM, respectively, than the mainline-operated Airbus A319 and Boeing 767 aircraft. This lower cost structure level is driven by increased seat density of Air Canada *rouge*-operated aircraft, lower wage rates and more competitive work rules in labour agreements, and by reduced overhead costs.
- The introduction of five new high-density Boeing 777 aircraft configured for high volume, leisure-oriented international routes. In 2013 and early 2014, Air Canada took delivery of five high-density Boeing 777-300ER aircraft. Air Canada has estimated that the new Boeing 777 aircraft, with its higher seat density configuration (458 seats), has a 21% lower CASM than the 349-seat Boeing 777 aircraft in Air Canada's current operating fleet.
- The introduction of Boeing 787 aircraft to operate existing Boeing 767 routes in a more efficient manner and to pursue international growth opportunities made viable by this aircraft's lower operating costs. The introduction of these aircraft into the mainline fleet allowing the airline to reduce operating expenses through fuel and maintenance savings. Air Canada has estimated that the fuel and maintenance efficiencies associated with the Dreamliner, combined with a greater number of seats, will allow for a much better unit cost performance – 29% below that of the Boeing 767 aircraft it will replace.
- Other ongoing cost reduction initiatives which are expected to deliver additional cost savings in excess of $100 million per annum within the next five years.

Air Canada continues to focus on expanding internationally, gaining a greater share of the global international-to-international connection market and strengthening the airline's market presence through commercial partnerships and other initiatives. Air Canada believes that Canada's multi-ethnic demographic profile provides the airline opportunities to benefit from a growing demand for international travel. Combined with a powerful brand franchise and industry-leading products and services, Air Canada is leveraging its network in order to benefit from the higher margins generally available in international markets. The airline is also leveraging its world class hub at Toronto Pearson International Airport and other Canadian hubs with the objective of increasing global connecting traffic via Canada.

Increasing customer satisfaction levels and growing the airline's premium customer base remain key elements of Air Canada's business strategy. Air Canada remains focused on promoting its premium class cabin to maximize revenues. The airline believes it maintains a revenue premium that more than offsets the higher costs associated with service to premium passengers. Air Canada was recently named Best Airline in North America in the Skytrax 2014 World Airline Awards, the fifth consecutive year Air Canada has been recognized as the best airline in North America. The annual poll, based on surveys of nearly 19 million global passengers, is regarded as a key benchmarking tool for product excellence and customer satisfaction by the global airline industry. This is a demonstration of the airline's customers' appreciation of the airline's extensive network, alliance relationships and leading products and services, as well as the dedication and professionalism of its employees.

Additional information on Air Canada's business strategy can be found in Air Canada's 2013 MD&A dated February 12, 2014.

Second Quarter 2014 Financial Summary

The following is an overview of Air Canada's results of operations and financial position for the second quarter of 2014 compared to the second quarter of 2013.

- Operating revenues of $3,305 million, an increase of $248 million or 8% from the second quarter of 2013.

- An ASM capacity increase of 8.5% from the second quarter of 2013, in line with the 7.5% to 8.5% capacity increase projected in Air Canada's news release dated May 15, 2014. The capacity growth in the second quarter of 2014 was primarily driven by increased seat density from Air Canada *rouge* and the five high-density Boeing 777-300ER aircraft brought into Air Canada's mainline fleet in 2013 and early 2014.

- Passenger revenues of $2,965 million, an increase of $208 million or 7.5% from the second quarter of 2013, on traffic growth of 9.9%. A yield decline of 2.1% reflected, in large part, the impact of a higher proportion of seats into leisure-focused longer-haul markets, led by new and increased lower-cost flying by Air Canada *rouge*, expanded seasonal flying by Air Canada mainline, as well as additional Atlantic and Pacific services being served with lower-cost Boeing 777 higher-density aircraft which have a larger economy cabin. Average stage length, on a system-basis, increased 2.5% from the same quarter of 2013 and had the effect of reducing yield by 1.5 percentage points.

- A PRASM decline of 0.8% from the second quarter of 2013, reflecting the 2.1% decline in yield partly offset by a passenger load factor improvement of 1.1 percentage points.

- An adjusted CASM reduction of 4.7% from the second quarter of 2013, which is slightly better than the 3.5% to 4.5% adjusted CASM decrease projected in Air Canada's news release dated May 15, 2014. Refer to section 16 "Non-GAAP Financial Measures" for additional information. The better than projected adjusted CASM performance was largely due to ASM capacity coming in at the top end of the expected range and an approximate 1 cent improvement in the U.S./CDN exchange rate versus what Air Canada assumed in its May 15, 2014 projections.

- Operating income of $245 million compared to operating income of $174 million in the second quarter of 2013, an improvement of $71 million. In the second quarter of 2014, Air Canada recorded favourable tax-related provision adjustments of $41 million.

- Net income of $223 million or $0.75 per diluted share compared to a net loss of $23 million or $0.09 per diluted share in the second quarter of 2013. The net income in the second quarter of 2014 included foreign exchange gains of $40 million. The net loss in the second quarter of 2013 included foreign exchange losses of $74 million.

- EBITDAR of $456 million compared to EBITDAR of $385 million in the second quarter of 2013, an increase of $71 million. EBITDAR in the second quarter of 2014 included the favourable tax-related provision adjustments discussed above. Refer to section 16 "Non-GAAP Financial Measures" for additional information.

- Adjusted net income of $139 million or $0.47 per diluted share compared to adjusted net income of $115 million or $0.41 per diluted share in the second quarter of 2013, an improvement of $24 million or $0.06 per diluted share. Refer to section 16 "Non-GAAP Financial Measures" for additional information.

- Negative free cash flow of $36 million, a deterioration of $183 million from the second quarter of 2013, reflecting the addition of two Boeing 787 aircraft in the second quarter of 2014. Free cash flow (cash flows from operating activities less additions to property, equipment and intangible assets) is a non-GAAP financial measure. Refer to section 7.5 "Consolidated Cash Flow Movements" of this MD&A for additional information.

- Adjusted net debt amounted to $4,309 million at June 30, 2014, a decrease $42 million from December 31, 2013. The airline's adjusted net debt to EBITDAR ratio was 2.9 at June 30, 2014 versus a ratio of 3.0 at December 31, 2013. Air Canada uses this ratio to manage its financial leverage risk and its objective is to maintain the ratio below 3.5. Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is a non-GAAP financial measure. Refer to section 7.3 "Adjusted Net Debt" of this MD&A for additional information.

- Unrestricted liquidity of $2,954 million at June 30, 2014 (June 30, 2013 – $2,139 million). Unrestricted liquidity refers to the sum of cash, cash equivalents, short-term investments and the amount of available credit under Air Canada's revolving credit facilities. At June 30, 2014, cash and short-term investments amounted to $2,615 million and undrawn lines of credit amounted to $339 million. At June 30, 2013, cash and short-term investments amounted to $2,107 million and undrawn lines of credit amounted to $32 million. Air Canada's principal objective in managing liquidity risk is to maintain a minimum unrestricted liquidity level of $1.7 billion.

- Return on invested capital ("ROIC") for the trailing 12 months ended June 30, 2014 was 11.0%. This compares to 8.8% for the 12 months ended June 30, 2013. Air Canada's goal is to achieve a sustainable ROIC of 10 to 13% by 2015. Refer to section 16 "Non-GAAP Financial Measures" for additional information.

4. RESULTS OF OPERATIONS – SECOND QUARTER 2014 VERSUS SECOND QUARTER 2013

The following table and discussion compares results of Air Canada for the second quarter 2014 versus the second quarter of 2013.

	Second Quarter		Change	
(Canadian dollars in millions, except per share figures)	**2014**	**2013**	**$**	**%**
Operating revenues				
Passenger	$ 2,965	$ 2,757	$ 208	8
Cargo	122	115	7	6
Other	218	185	33	18
Total revenues	**3,305**	**3,057**	**248**	**8**
Operating expenses				
Aircraft fuel	962	831	131	16
Wages, salaries, and benefits	548	565	(17)	(3)
Capacity purchase agreements	294	276	18	7
Airport and navigation fees	256	245	11	4
Aircraft maintenance	180	168	12	7
Sales and distribution costs	171	152	19	13
Depreciation, amortization and impairment	133	130	3	2
Ground package costs	77	59	18	31
Aircraft rent	78	81	(3)	(4)
Food, beverages and supplies	77	72	5	7
Communications and information technology	49	47	2	4
Other	235	257	(22)	(9)
Total operating expenses	**3,060**	**2,883**	**177**	**6**
Operating income	**245**	**174**	**71**	
Non-operating income (expense)				
Foreign exchange gain (loss)	40	(74)	114	
Interest income	9	8	1	
Interest expense	(81)	(77)	(4)	
Interest capitalized	10	13	(3)	
Net financing expense relating to employee benefits	(34)	(52)	18	
Fuel and other derivatives	36	(13)	49	
Other	(2)	(2)	-	
Total non-operating expense	**(22)**	**(197)**	**175**	
Income (loss) before income taxes	**223**	**(23)**	**246**	
Income taxes	-	-	-	
Net income (loss)	**$ 223**	**$ (23)**	**$ 246**	
Net income (loss) per share – basic	**$ 0.77**	**$ (0.09)**	**$ 0.86**	
Net income (loss) per share – diluted	**$ 0.75**	**$ (0.09)**	**$ 0.84**	
EBITDAR (1)	**$ 456**	**$ 385**	**$ 71**	
Adjusted net income (2)	**$ 139**	**$ 115**	**$ 24**	
Adjusted net income per share – diluted (2)	**$ 0.47**	**$ 0.41**	**$ 0.06**	

(1) EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

(2) Adjusted net income (loss) and adjusted net income (loss) per share – diluted are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

System passenger revenues increased 7.5% from the second quarter of 2013

In the second quarter of 2014, on capacity growth of 8.5%, system passenger revenues of $2,965 million increased $208 million or 7.5% from 2013 second quarter system passenger revenues of $2,757 million. The increase in second quarter system passenger revenues was due to traffic growth of 9.9% partly offset by a yield decline of 2.1%. Average stage length increased 2.5% from the same quarter of 2013 and had the effect of reducing system yield by 1.5 percentage points.

In the second quarter of 2014, system premium cabin revenues increased $14 million or 2.4% on yield growth of 3.6%. Premium cabin traffic declined 1.2% when compared to the second quarter of 2013.

The table below provides passenger revenue by geographic region for the second quarter of 2014 and the second quarter of 2013.

Passenger Revenue	Second Quarter 2014 $ Million	Second Quarter 2013 $ Million	Change $ Million	% Change
Canada	1,093	1,069	24	2.2
U.S. transborder	595	534	61	11.5
Atlantic	682	607	75	12.3
Pacific	425	402	23	5.7
Other	170	145	25	17.7
System	**2,965**	**2,757**	**208**	**7.5**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the second quarter of 2014 versus the second quarter of 2013.

Second Quarter 2014 Versus Second Quarter 2013	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	2.2	3.6	5.3	1.3	(3.3)	(1.8)
U.S. transborder	11.5	12.2	16.2	2.8	(3.3)	0.1
Atlantic	12.3	16.2	14.7	(1.1)	(2.0)	(3.3)
Pacific	5.7	1.8	4.1	1.9	1.8	4.1
Other	17.7	11.0	15.7	3.5	2.6	7.0
System	**7.5**	**8.5**	**9.9**	**1.1**	**(2.1)**	**(0.8)**

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the second quarter of 2014 and each of the previous four quarters.

System	Year-over-Year by Quarter (% Change)				
	Q2'13	Q3'13	Q4'13	Q1'14	Q2'14
Passenger revenues	3.2	4.9	1.9	3.2	7.5
Capacity (ASMs)	2.2	3.0	3.5	3.8	8.5
Traffic (RPMs)	1.6	2.9	2.5	2.9	9.9
Passenger load factor (pp change)	(0.5)	(0.1)	(0.9)	(0.7)	1.1
Yield	1.5	2.0	(0.6)	0.4	(2.1)
PRASM	0.9	1.8	(1.7)	(0.5)	(0.8)

In the second quarter of 2014, Air Canada's system capacity was 8.5% higher than in the second quarter of 2013, with capacity growth reflected in all markets.

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

- The 9.9% traffic increase which reflected traffic growth in all markets. Consistent with the airline's objective of increasing global international to international connecting traffic through its major Canadian hubs, the traffic growth in the second quarter of 2014 also reflected incremental connecting traffic to international destinations.

- The 2.1% yield decrease which reflected yield declines in the Canada, U.S. transborder and Atlantic markets. The yield declines in the U.S. transborder and Atlantic markets reflected, in large part, the impact of a higher proportion of seats into longer-haul markets, led by new and increased lower-cost leisure flying by Air Canada *rouge*, expanded seasonal flying by Air Canada mainline, as well as additional Atlantic and Pacific services being served with lower-cost Boeing 777 higher-density aircraft which have a larger economy cabin. The yield in the domestic market was impacted by increased industry capacity and aggressive competitive pricing activities when compared to the second quarter of 2013. Yield growth in the Pacific and Other markets and a favourable currency impact of $70 million were partly offsetting factors.

The 0.8% PRASM decrease was due to the lower yield as passenger load factor improved 1.1 percentage points.

Domestic passenger revenues increased 2.2% from the second quarter of 2013

In the second quarter of 2014, on capacity growth of 3.6%, domestic passenger revenues of $1,093 million increased $24 million or 2.2% from the second quarter of 2013. The increase in domestic passenger revenues was due to traffic growth of 5.3% partly offset by a yield decline of 3.3%.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the second quarter of 2014 and each of the previous four quarters.

Canada	Year-over-Year by Quarter (% Change)				
	Q2'13	Q3'13	Q4'13	Q1'14	Q2'14
Passenger revenues	3.1	2.1	(1.1)	(1.5)	2.2
Capacity (ASMs)	3.1	2.3	3.2	3.9	3.6
Traffic (RPMs)	3.0	1.7	2.6	1.7	5.3
Passenger load factor (pp change)	-	(0.5)	(0.4)	(1.8)	1.3
Yield	0.1	0.5	(3.6)	(3.5)	(3.3)
PRASM	-	-	(4.1)	(5.5)	(1.8)

In the second quarter of 2014, the 3.6% domestic capacity growth reflected capacity increases on all major domestic services.

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

- The 5.3% traffic increase which reflected traffic growth on all major domestic services. The traffic growth in the second quarter of 2014 reflected increases on services within Canada, as well as incremental connecting traffic to international destinations.

- The 3.3% yield decrease which reflected marginal yield variances on most major domestic services, with the exception of regional routes within Ontario and Quebec and routes within Western Canada, all of which were impacted by increased industry capacity and competitive pricing activities. In addition, consistent with Air Canada's objective of increasing global international to international connecting traffic, the second quarter of 2014 experienced higher proportional growth of international and U.S. transborder passenger flows.

The domestic PRASM decrease of 1.8% from the second quarter of 2013 was due to the lower yield as passenger load factor improved 1.3 percentage points.

U.S. transborder passenger revenues increased 11.5% from the second quarter of 2013

In the second quarter of 2014, on a capacity growth of 12.2%, U.S. transborder passenger revenues of $595 million increased $61 million or 11.5% from the second quarter of 2013. The increase in U.S. transborder passenger revenues was due to traffic growth of 16.2% partly offset by a yield decline of 3.3%.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the second quarter of 2014 and each of the previous four quarters.

U.S. transborder	Year-over-Year by Quarter (% Change)				
	Q2'13	Q3'13	Q4'13	Q1'14	Q2'14
Passenger revenues	(0.3)	4.7	8.1	5.7	11.5
Capacity (ASMs)	(0.8)	(1.6)	1.6	1.9	12.2
Traffic (RPMs)	1.6	0.5	4.0	5.7	16.2
Passenger load factor (pp change)	1.9	1.7	1.8	2.9	2.8
Yield	(1.7)	4.7	4.2	0.3	(3.3)
PRASM	0.7	7.0	6.6	4.0	0.1

In the second quarter of 2014, the 12.2% U.S. transborder capacity growth reflected capacity increases on certain U.S. long-haul routes, such as San Francisco and Los Angeles, and on services to Florida and Las Vegas. This capacity growth was partly offset by capacity reductions on certain long-haul routes such as Hawaii, while capacity on U.S. short-haul routes remained essentially flat year-over-year.

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

- The 16.2% traffic increase which reflected traffic growth on all major U.S. transborder services. This growth was achieved through improved utilization of existing and incremental capacity. Consistent with the airline's objective of increasing global international to international connecting traffic through Toronto Pearson International Airport, the second quarter of 2014 experienced higher proportional growth of international to international passenger flows from the U.S. relative to the second quarter of 2013, in addition to experiencing traffic growth between Canada and the U.S.

- The 3.3% yield decline which reflected a 4.7% longer average stage length, driven by route composition changes as long-haul (lower yield) capacity grew while short-haul (higher yield) capacity was slightly down. This increase in average stage length had the effect of reducing U.S. transborder yield by 2.6 percentage points. Long-haul growth was led by lower-cost Air Canada *rouge* flying allowing Air Canada to effectively compete on lower-yielding, price sensitive leisure routes. Additionally, consistent with Air Canada's objective of increasing global international to international connecting traffic, a higher proportion of capacity was more effectively utilized to support the airline's international growth strategy. Offsetting the yield declines were improvements in Air Canada's premium cabin as a result of pricing changes, a significant increase in higher-yielding short-haul traffic that outpaced the capacity changes, as well as a favourable currency impact of $16 million.

PRASM was slightly above the second quarter of 2013 as a passenger load factor improvement of 2.8 percentage points offset the yield decline.

Atlantic passenger revenues increased 12.3% from the second quarter of 2013

In the second quarter of 2014, on capacity growth of 16.2%, Atlantic passenger revenues of $682 million increased $75 million or 12.3% from the second quarter of 2013. The increase in Atlantic passenger revenues was due to traffic growth of 14.7% as yield declined 2.0%.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the second quarter of 2014 and each of the previous four quarters.

Atlantic	Year-over-Year by Quarter (% Change)				
	Q2'13	Q3'13	Q4'13	Q1'14	Q2'14
Passenger revenues	8.8	11.0	2.7	8.3	12.3
Capacity (ASMs)	2.5	2.1	5.9	7.6	16.2
Traffic (RPMs)	0.9	3.1	1.7	1.2	14.7
Passenger load factor (pp change)	(1.3)	0.8	(3.1)	(4.5)	(1.1)
Yield	7.7	7.6	0.7	7.1	(2.0)
PRASM	6.0	8.6	(3.2)	0.7	(3.3)

In the second quarter of 2014, the Atlantic capacity growth of 16.2% reflected capacity increases on all major Atlantic services with the exception of services to Scandinavia.

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

- The 14.7% traffic increase which reflected traffic growth on all major Atlantic services.
- The 2.0% yield decline which reflected, in large part, a higher proportion of seats into longer-haul markets. This was driven by an increase in seasonal flying by Air Canada mainline, additional Atlantic services being served with lower-cost Boeing 777 higher-density aircraft which have a larger economy cabin, as well as new and increased lower-cost leisure flying by Air Canada *rouge*, which offers a Premium *rouge* product, but has no international business class cabin. A favourable currency impact of $28 million partly offset the yield decrease.

The 3.3% PRASM decrease was due to the lower yield and a 1.1 percentage point decline in passenger load factor.

Pacific passenger revenues increased 5.7% from the second quarter of 2013

In the second quarter of 2014, on capacity growth of 1.8%, Pacific passenger revenues of $425 million increased $23 million or 5.7% from the second quarter of 2013. The increase in Pacific passenger revenues was due to traffic growth of 4.1% and a yield improvement of 1.8%.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the second quarter of 2014 and each of the previous four quarters.

Pacific	Year-over-Year by Quarter (% Change)				
	Q2'13	Q3'13	Q4'13	Q1'14	Q2'14
Passenger revenues	3.7	3.8	(3.2)	1.2	5.7
Capacity (ASMs)	5.7	12.1	4.4	4.6	1.8
Traffic (RPMs)	2.3	8.5	0.7	3.2	4.1
Passenger load factor (pp change)	(2.9)	(2.9)	(3.0)	(1.1)	1.9
Yield	1.1	(4.8)	(4.0)	(1.6)	1.8
PRASM	(2.3)	(7.9)	(7.4)	(2.8)	4.1

In the second quarter of 2014, the 1.8% Pacific capacity growth reflected capacity increases on services to Hong Kong largely offset by capacity decreases on services to China, Japan and Korea.

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

- The 4.1% traffic increase which reflected traffic growth on all major Pacific services with the exception of services to Korea, where capacity was reduced year-over-year. The majority of the traffic growth was on the airline's services from Vancouver to Hong Kong and included a higher proportion of international to international passenger flows relative to the second quarter of 2013. On services to China and Japan, while capacity decreased year-over-year, traffic increased from the second quarter of 2013.

- The 1.8% yield improvement which reflected yield growth on all major Pacific services with the exception of Hong Kong where capacity was increased significantly. Air Canada operates a lower-cost Boeing 777 higher-density aircraft on its Vancouver-Hong Kong service which has a larger economy cabin. The use of this lower-cost aircraft on high volume routes, such as Vancouver-Hong Kong, is allowing the airline to access traditionally lower-yielding traffic while improving profitability. The yield reduction on services to Hong Kong was more than offset by a strong yield performance on all other Pacific services, driven mainly by strong passenger demand which resulted in higher average fares. A favourable currency impact of $12 million was also a contributing factor in the yield growth year-over-year.

The 4.1% PRASM improvement was due to the yield growth and a passenger load factor improvement of 1.9 percentage points. PRASM improvements were recorded on all major Pacific services with the exception of Hong Kong.

Other passenger revenues increased 17.7% from the second quarter of 2013

In the second quarter of 2014, on capacity growth of 11.0%, Other passenger revenues (comprised of routes to the Caribbean, Mexico and Central and South America) of $170 million increased $25 million or 17.7% from the second quarter of 2013. The increase in Other passenger revenues was due traffic growth of 15.7% and a yield improvement of 2.6%.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the second quarter of 2014 and each of the previous four quarters.

Other	Year-over-Year by Quarter (% Change)				
	Q2'13	Q3'13	Q4'13	Q1'14	Q2'14
Passenger revenues	(5.1)	0.6	11.5	11.0	17.7
Capacity (ASMs)	(4.8)	(3.9)	0.6	(1.0)	11.0
Traffic (RPMs)	(3.2)	(3.7)	5.0	3.1	15.7
Passenger load factor (pp change)	1.3	0.1	3.4	3.3	3.5
Yield	(2.6)	4.1	6.5	8.5	2.6
PRASM	(1.0)	4.2	11.1	12.9	7.0

In the second quarter of 2014, the 11.0% capacity growth reflected capacity increases on all major services in the Other markets.

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

- The overall 15.7% traffic increase which reflected traffic growth on all major services in the Other markets.
- The overall 2.6% yield improvement which reflected higher fares on routes to sun destinations. An overall favourable currency impact of $4 million also contributed to the yield improvement year-over-year.

The overall 7.0% PRASM increase was due to the yield growth and a passenger load factor improvement of 3.5 percentage points. PRASM improvements were recorded on all major services in the Other markets.

Cargo revenues increased 6.6% from the second quarter of 2013

In the second quarter of 2014, cargo revenues of $122 million increased $7 million or 6.6% from the second quarter of 2013 due to traffic growth of 11.3% as yield declined 4.3% year-over-year.

The table below provides cargo revenue by geographic region for the second quarter of 2014 and the second quarter of 2013.

Cargo Revenue	Second Quarter 2014 $ Million	Second Quarter 2013 $ Million	Change $ Million
Canada	17	16	1
U.S. transborder	5	5	-
Atlantic	47	40	7
Pacific	46	46	-
Other	7	8	(1)
System	**122**	**115**	**7**

The table below provides year-over-year percentage changes in system cargo revenues and operating statistics for the second quarter of 2014 and each of the previous four quarters.

System	Year-over-Year by Quarter (% Change)				
	Q2'13	Q3'13	Q4'13	Q1'14	Q2'14
Cargo revenues	(6.5)	1.7	1.6	7.0	6.6
Capacity (ETMs)	3.5	1.2	3.5	4.1	8.2
Revenue per ETM	(9.7)	1.1	(2.2)	2.8	(1.5)
Traffic (RTMs)	(0.2)	2.9	4.3	6.4	11.3
Yield per RTM	(6.3)	(0.6)	(2.9)	0.5	(4.3)

The table below provides year-over-year percentage changes in cargo revenues and operating statistics for the second quarter of 2014 versus the second quarter of 2013.

Second Quarter 2014 Versus Second Quarter 2013	Cargo Revenue % Change	Capacity (ETMs) % Change	Rev / ETM % Change	Traffic (RTMs) % Change	Yield / RTM % Change
Canada	5.9	20.5	(12.1)	33.2	(20.5)
U.S. transborder	13.6	25.9	(9.8)	8.5	4.7
Atlantic	18.0	10.6	6.6	22.3	(3.6)
Pacific	(1.2)	(1.3)	0.1	1.7	(2.8)
Other	(8.0)	8.3	(15.1)	(4.7)	(3.5)
System	**6.6**	**8.2**	**(1.5)**	**11.3**	**(4.3)**

Components of the year-over-year change in second quarter cargo revenues included:

- The 11.3% traffic increase which reflected traffic growth in all markets with the exception of the Other markets. The growth in traffic was mainly due to increased capacity, market share gains and strong demand from North America to the Atlantic.

- The 4.3% yield decrease which reflected yield declines in all markets with the exception of the U.S. transborder market. The overall yield decline was due to the impact of increased industry capacity. The favourable impact of a weaker Canadian dollar on foreign currency denominated cargo revenues was a partly offsetting factor.

Other revenues increased 18% from the second quarter of 2013

Other revenues consist primarily of revenues from the sale of the ground portion of vacation packages, ground handling services, and other airline-related services, as well as revenues related to the lease or sublease of aircraft to third parties. In the second quarter of 2014, Other revenues of $218 million increased $33 million or 18% from the second quarter of 2013 due to higher ground package revenues at Air Canada Vacations, the result of higher passenger volumes, and, to a lesser extent, growth in passenger-related fees.

CASM decreased 2.2% from the second quarter of 2013. Adjusted CASM decreased 4.7% from the second quarter of 2013

The following table compares Air Canada's second quarter 2014 and second quarter 2013 CASM.

	Second Quarter		Change	
(cents per ASM)	**2014**	**2013**	**cents**	**%**
Aircraft fuel	5.23	4.90	0.33	6.7
Wages and salaries	2.35	2.48	(0.13)	(5.2)
Benefits	0.62	0.85	(0.23)	(27.1)
Capacity purchase agreements	1.60	1.63	(0.03)	(1.8)
Airport and navigation fees	1.39	1.44	(0.05)	(3.5)
Aircraft maintenance	0.98	0.99	(0.01)	(1.0)
Sales and distribution costs	0.93	0.89	0.04	4.5
Depreciation, amortization and impairment	0.72	0.77	(0.05)	(6.5)
Ground package costs	0.42	0.35	0.07	20.0
Aircraft rent	0.43	0.48	(0.05)	(10.4)
Food, beverages and supplies	0.42	0.43	(0.01)	(2.3)
Communications and information technology	0.27	0.28	(0.01)	(3.6)
Other	1.26	1.50	(0.24)	(16.0)
CASM	**16.62**	**16.99**	**(0.37)**	**(2.2)**
Remove:				
Fuel expense, ground package costs at Air Canada Vacations and unusual items [(1)]	(5.43)	(5.25)	(0.18)	3.4
Adjusted CASM [(2)]	**11.19**	**11.74**	**(0.55)**	**(4.7)**

(1) *In the second quarter of 2014, Air Canada recorded favourable tax-related provision adjustments of $41 million.*

(2) *Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.*

Operating expenses increased 6% from the second quarter of 2013

In the second quarter of 2014, operating expenses of $3,060 million increased $177 million or 6% from the second quarter of 2013. The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) in the second quarter of 2014, when compared to the second quarter of 2013, increased operating expenses by approximately $110 million. Refer to section 9 "Financial Instruments and Risk Management" for information on Air Canada's foreign exchange risk management strategy.

The following summarizes the main factors in the year-over-year change in operating expenses:

Fuel expense increased 16% from the second quarter of 2013

In the second quarter of 2014, fuel expense of $962 million increased $131 million or 16% from the second quarter of 2013. The increase in fuel expense year-over-year was due to:

- The unfavourable impact of a weaker Canadian dollar versus the U.S. dollar when compared to the second quarter of 2013, which accounted for an increase of $64 million;
- A $53 million increase due to a higher volume of fuel litres consumed, reflecting, in large part, the 8.5% growth in capacity; and
- A 2% increase in jet fuel prices, which accounted for an increase of $14 million

The table below provides Air Canada's fuel cost per litre and economic fuel cost per litre for the periods indicated.

(Canadian dollars in millions, except where indicated)	Second Quarter 2014	Second Quarter 2013	Change $	Change %
Aircraft fuel expense – GAAP	**$ 962**	**$ 831**	**$ 131**	**16**
Add: Net cash (receipts) payments on fuel derivatives (1)	(2)	13	(15)	(115)
Economic cost of fuel – Non-GAAP (2)	**$ 960**	**$ 844**	**$ 116**	**14**
Fuel consumption (thousands of litres)	1,047,855	985,430	62,425	6.3
Fuel cost per litre (cents) – GAAP	91.8	84.4	7.4	8.8
Economic fuel cost per litre (cents) – Non-GAAP (2)	91.6	85.7	5.9	6.9

(1) Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives.

(2) The economic cost of fuel is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, and may not be comparable to similar measures presented by other public companies. Air Canada uses this measure to calculate its cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period and premium costs associated with those derivatives.

Wages, salaries and benefits expense amounted to $548 million in the second quarter of 2014, a decrease of $17 million or 3% from the second quarter of 2013

In the second quarter of 2014, wages and salaries expense of $434 million increased $13 million or 3% from the second quarter of 2013, mainly due to higher average salaries and an increase in expenses relating to employee profit sharing programs. These increases were partly offset by a 0.8% decrease in the number of full-time equivalent (FTE) employees when compared to the second quarter of 2013.

In the second quarter of 2014, employee benefits expense of $114 million decreased $30 million or 21% from the second quarter of 2013, reflecting actuarial gains on disability plans, a reduction in foreign pension plan liabilities, and the impact of higher discount rates which decreases the current service cost of defined benefit pension plans.

Capacity purchase costs increased 7% from the second quarter of 2013

In the second quarter of 2014, capacity purchase costs of $294 million increased $18 million or 7% from the second quarter of 2013, mainly due to an increase in block hours flown by Sky Regional under its capacity purchase agreement with Air Canada, an unfavourable currency impact and higher rates under the Jazz CPA. These increases were partly offset by a decline in block hours flown by Jazz under the Jazz CPA.

Airport and navigation fees increased 4% from the second quarter of 2013

In the second quarter of 2014, airport and navigation fees of $256 million increased $11 million or 4% from the second quarter of 2013, largely due to the addition of five Boeing 777 aircraft to Air Canada's operating fleet, an unfavourable currency impact and rate increases in certain stations. These increases were partly offset by the impact of the terms of an agreement, concluded in October 2013, with the Greater Toronto Airports Authority ("GTAA") which is allowing the airline to grow its share of international connecting traffic at Toronto Pearson International Airport on a more cost effective basis.

Aircraft maintenance expense increased 7% from the second quarter of 2013

In the second quarter of 2014, aircraft maintenance expense of $180 million increased $12 million or 7% from the second quarter of 2013, mainly due to a $12 million unfavourable currency impact and an increase in expenses related to maintenance provisions due to the reclassification of certain aircraft from finance leases to operating leases. In addition, in the second quarter of 2014, a fewer number of aircraft leases were extended when compared to second quarter of 2013. Lease term extensions postpone the expected timing of the end of lease costs and lengthen the period over which expenses are recorded, thus reducing maintenance expense in the period. These increases were largely offset by the impact of a lower volume of components and airframe maintenance activity, mainly driven by timing in the maintenance cycle when compared to the same quarter in 2013.

Sales and distribution costs increased 13% from the second quarter of 2013

In the second quarter of 2014, sales and distribution costs of $171 million increased $19 million or 13% from the second quarter of 2013 on passenger revenue growth of 7.5%. This growth in sales and distribution costs was mainly due to the impact of a higher volume of transactions with global distribution service providers and increases in commission and credit card expenses, which were in line with sales and revenue growth. An unfavourable currency impact was also a contributing factor.

Depreciation, amortization and impairment expense increased 2% from the second quarter of 2013

In the second quarter of 2014, depreciation, amortization and impairment expense of $133 million increased $3 million or 2% from the second quarter of 2013, in large part due to the addition of five Boeing 777 and two Boeing 787 aircraft. This increase was largely offset by the disposal of Airbus A340-300 aircraft (none of which were being operated by Air Canada), and by a decrease in depreciation expense related to the airline's interior refurbishment programs.

Ground package costs increased 31% from the second quarter of 2013

In the second quarter of 2014, the cost of ground packages at Air Canada Vacations amounted to $77 million, an increase of $18 million or 31% from the second quarter of 2013. The increase in ground package costs at Air Canada Vacations was mainly due to higher passenger volumes when compared to the second quarter of 2013 and, to a lesser extent, an unfavourable currency impact. Revenues from ground packages at Air Canada Vacations are included in "Other" revenues on Air Canada's consolidated statement of operations.

Aircraft rent expense decreased 4% from the second quarter of 2013

In the second quarter of 2014, aircraft rent expense of $78 million decreased $3 million or 4% from the second quarter of 2013. A decrease in aircraft rent expense due to more favourable rates on lease renewals was largely offset by an unfavourable currency impact of $5 million.

Other operating expenses decreased 9% from the second quarter of 2013

In the second quarter of 2014, Other operating expenses of $235 million decreased $22 million or 9% from the second quarter of 2013, mainly due to Air Canada having recorded favourable tax-related provision adjustments of $41 million in the second quarter of 2014 while no such adjustments were recorded in the second quarter of 2013. Partly offsetting this decrease was an increase in terminal handling expenses arising from Air Canada having outsourced its London operations to a third party provider, increased international flying and an unfavourable currency impact. While the expenses related to the airline's London outsourcing initiative are included in terminal handling, the savings associated with this initiative are included in other expense categories, such as wages and salaries expense, for a net overall cost reduction.

The following table provides a breakdown of the more significant items included in Other expenses:

	Second Quarter		Change	
(Canadian dollars in millions)	**2014**	**2013**	**$**	**%**
Terminal handling	$ 59	$ 48	$ 11	23
Building rent and maintenance	37	32	5	16
Crew cycle	35	31	4	13
Miscellaneous fees and services	34	34	-	-
Remaining other expenses	70	112	(42)	(38)
Other operating expenses	**$ 235**	**$ 257**	**$ (22)**	**(9)**

Non-operating expense amounted to $22 million in the second quarter of 2014 compared to non-operating expense of $197 million in the second quarter of 2013

The following table provides a breakdown of Non-operating expense for the periods indicated:

	Second Quarter		Change
(Canadian dollars in millions)	**2014**	**2013**	**$**
Foreign exchange gain (loss)	$ 40	$ (74)	$ 114
Interest income	9	8	1
Interest expense	(81)	(77)	(4)
Interest capitalized	10	13	(3)
Net financing expense relating to employee benefits	(34)	(52)	18
Fuel and other derivatives	36	(13)	49
Other	(2)	(2)	-
Total non-operating expense	**$ (22)**	**$ (197)**	**$ 175**

Factors contributing to the year-over-year change in second quarter non-operating expense included:

- Gains on foreign exchange, mainly related to U.S. denominated long-term debt, which amounted to $40 million in the second quarter of 2014 compared to losses of $74 million in the second quarter of 2013. The gains in the second quarter of 2014 were mainly attributable to a stronger Canadian dollar at June 30, 2014 when compared to March 31, 2014. Partially offsetting these gains were losses of $89 million on foreign currency derivatives. Refer to section 9 "Financial Instruments and Risk Management" of this MD&A for additional information. The June 30, 2014 closing exchange rate was US$1 = C$1.0670 while the March 31, 2014 closing exchange rate was US$1 = C$1.1055.

- A decrease in net financing expense relating to employee benefits of $18 million which was mainly due to the impact of lower pension liabilities.

- Gains on fuel and other derivatives which amounted to $36 million in the second quarter of 2014 versus losses of $13 million in the second quarter of 2013. Refer to section 9 "Financial Instruments and Risk Management" of this MD&A for additional information.

5. RESULTS OF OPERATIONS – FIRST SIX MONTHS 2014 VERSUS FIRST SIX MONTHS 2013

The following table and discussion compares results of Air Canada for the first six months of 2014 versus the first six months of 2013.

	First Six Months		Change	
(Canadian dollars in millions, except per share figures)	**2014**	**2013**	**$**	**%**
Operating revenues				
Passenger	$ 5,573	$ 5,284	$ 289	5
Cargo	241	226	15	7
Other	556	499	57	11
Total revenues	**6,370**	**6,009**	**361**	**6**
Operating expenses				
Aircraft fuel	1,880	1,701	179	11
Wages, salaries, and benefits	1,117	1,129	(12)	(1)
Capacity purchase agreements	575	548	27	5
Airport and navigation fees	503	477	26	5
Aircraft maintenance	361	343	18	5
Sales and distribution costs	346	316	30	9
Depreciation, amortization and impairment	263	300	(37)	(12)
Ground package costs	247	209	38	18
Aircraft rent	157	162	(5)	(3)
Food, beverages and supplies	147	138	9	7
Communications and information technology	102	96	6	6
Other	489	522	(33)	(6)
Total operating expenses	**6,187**	**5,941**	**246**	**4**
Operating income	**183**	**68**	**115**	
Non-operating income (expense)				
Foreign exchange loss	(121)	(114)	(7)	
Interest income	18	15	3	
Interest expense	(158)	(150)	(8)	
Interest capitalized	15	21	(6)	
Net financing expense relating to employee benefits	(68)	(104)	36	
Fuel and other derivatives	21	(15)	36	
Other	(8)	(4)	(4)	
Total non-operating expense	**(301)**	**(351)**	**50**	
Loss before income taxes	**(118)**	**(283)**	**165**	
Income taxes	-	-	-	
Net loss	**$ (118)**	**$ (283)**	**$ 165**	
Net loss per share – basic and diluted	**$ (0.42)**	**$ (1.04)**	**$ 0.62**	
EBITDAR (1)	**$ 603**	**$ 530**	**$ 73**	
Adjusted net income (loss) (2)	**$ 7**	**$ (28)**	**$ 35**	
Adjusted net income (loss) per share – diluted (2)	**$ 0.02**	**$ (0.10)**	**$ 0.12**	

(1) EBITDAR is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

(2) Adjusted net income (loss) and adjusted net income (loss) per share – diluted are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

System passenger revenues increased 5.5% from the first six months of 2013

In the first six months of 2014, on capacity growth of 6.2%, system passenger revenues of $5,573 million increased $289 million or 5.5% from 2013 first six months system passenger revenues of $5,284 million. The increase in system passenger revenues was due to traffic growth of 6.6% partly offset by a yield decline of 0.9%.

Premium cabin revenues increased $51 million or 4.5% from the first six months of 2013 due to a yield improvement of 3.9% and, to a lesser extent, traffic growth of 0.6%. This was comprised of a year-over-year premium cabin revenue increase of $37 million or 7.0% on a yield improvement of 4.5% and traffic growth of 2.4% in the first quarter of 2014, and a year-over-year premium cabin revenue increase of $14 million or 2.4% on a yield improvement of 3.6% partly offset by a traffic decrease of 1.2% in the second quarter of 2014.

The table below provides passenger revenue by geographic region for the first six months of 2014 and the first six months of 2013.

Passenger Revenue	First Six Months 2014 $ Million	First Six Months 2013 $ Million	Change $ Million	% Change
Canada	2,036	2,027	9	0.4
U.S. transborder	1,216	1,121	95	8.5
Atlantic	1,088	982	106	10.8
Pacific	796	769	27	3.5
Other	437	385	52	13.5
System	**5,573**	**5,284**	**289**	**5.5**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the first six months of 2014 versus the first six months of 2013.

First Six Months 2014 Versus First Six Months 2013	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	0.4	3.8	3.6	(0.1)	(3.4)	(3.6)
U.S. transborder	8.5	6.6	10.5	2.9	(1.3)	2.3
Atlantic	10.8	12.6	9.4	(2.3)	1.3	(1.6)
Pacific	3.5	3.2	3.7	0.4	0.2	0.7
Other	13.5	3.4	7.7	3.4	6.2	10.6
System	**5.5**	**6.2**	**6.6**	**0.3**	**(0.9)**	**(0.6)**

In the first six months of 2014, Air Canada's system capacity was 6.2% higher than in the first six months of 2013, with capacity growth reflected in all markets.

Components of the year-over-year change in first six months system passenger revenues included:

- The 6.6% traffic increase which reflected traffic growth in all markets. Consistent with the airline's objective of increasing global international to international connecting traffic through its major Canadian hubs, the traffic growth in first six months of 2014 also reflected incremental connecting traffic to international destinations.

- The 0.9% system yield decrease which mainly reflected declines in the domestic and U.S. transborder markets partly offset by yield growth in the Atlantic and Other markets as well as a favourable currency impact of $108 million.

The 0.6% PRASM decrease was due to the lower yield partly offset by a passenger load factor improvement of 0.3 percentage points. PRASM improvements were recorded in all markets with the exception of the domestic and Atlantic markets.

Refer to section 4 "Results of Operations" of this MD&A for year-over-year percentage changes in passenger revenues, capacity, traffic, passenger load factor, yield and PRASM by quarter for the second quarter 2014 and each of the previous four quarters.

Domestic passenger revenues increased 0.4% from the first six months of 2013

In the first six months of 2014, on a capacity increase of 3.8%, domestic passenger revenues of $2,036 million increased $9 million or 0.4% from the first six months of 2013 as traffic growth of 3.6% was almost fully offset by a yield decline of 3.4%.

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

- The 3.6% traffic increase which reflected traffic growth on all major domestic services. The traffic growth in the first six months of 2014 reflected increases on services within Canada, as well as incremental connecting traffic to international destinations.

- The yield decline of 3.4% which reflected yield declines on all major domestic services, the result of increased industry capacity, significant competitive pricing activities, commercial initiatives in the market place related to channels of distribution, particularly in the first quarter of 2014, as well as higher proportional growth of international to international passenger flows.

The 3.6% PRASM decrease was primarily due to the yield decline.

U.S. transborder passenger revenues increased 8.5% from the first six months of 2013

In the first six months of 2014, on capacity growth of 6.6%, U.S. transborder passenger revenues of $1,216 million increased $95 million or 8.5% from the first six months of 2013 mainly due to a traffic increase of 10.5% partly offset by a yield decrease of 1.3%.

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

- The traffic increase of 10.5% which reflected traffic growth on all major U.S. transborder services with the exception of services to Hawaii where capacity was reduced year-over-year. The traffic growth was achieved through improved utilization of capacity. The first six months of 2014 also experienced higher proportional growth of international to international passenger flows from the U.S. relative to the first six months of 2013.

- The 1.3% yield decrease which reflected an average stage length increase driven by route composition changes, as well as incremental lower-yielding international to international connecting traffic when compared to the first six months of 2013. A favourable currency impact of $26 million as well as strong premium revenue performance partly offset the yield decrease.

The 2.3% PRASM increase was due to a passenger load factor improvement of 2.9 percentage points partly offset by the yield decline.

Atlantic passenger revenues increased 10.8% from the first six months of 2013

In the first six months of 2014, on capacity growth of 12.6%, Atlantic passenger revenues of $1,088 million increased $106 million or 10.8% from the first six months of 2013 due to traffic growth of 9.4% and a yield improvement of 1.3%.

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

- The 9.4% traffic increase which reflected traffic growth on all major Atlantic services with the exception of Scandinavia where capacity was reduced year-over-year.

- The 1.3% yield improvement which reflected a higher proportion of higher-yielding traffic in all cabins, particularly in the first quarter of 2014, as well as a favourable currency impact of $42 million. Partly offsetting these increases was the impact of having a higher proportion of seats into leisure-focused long-haul markets, particularly in the second quarter of 2014. This was driven by an increase in seasonal flying by Air Canada mainline, additional Atlantic services being served with lower-cost Boeing 777 higher-density aircraft which have a larger economy cabin, as well as new and increased lower-cost flying by Air Canada *rouge*, which offers a Premium *rouge* product, but has no international business class cabin.

The 1.6% PRASM decrease was due to a 2.3 percentage point decline in passenger load factor partly offset by the yield increase.

Pacific passenger revenues increased 3.5% from the first six months of 2013

In the first six months of 2014, on capacity growth of 3.2%, Pacific passenger revenues of $796 million increased $27 million or 3.5% from the first six months of 2013 mainly due to traffic growth of 3.7%.

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

- The 3.7% traffic increase which reflected traffic growth on all major Pacific services with the exception of Korea and Australia where capacity was reduced year-over-year. The majority of the traffic growth was on the airline's services from Vancouver to Hong Kong and included a higher proportion of international to international passenger flows relative to the first six months of 2013. On services to Japan, while capacity decreased year-over-year, traffic increased from the first six months of 2013.

- The 0.2% yield increase which reflected yield growth on all Pacific services with the exception of Hong Kong. Air Canada operates a lower-cost Boeing 777 higher-density aircraft on its Vancouver-Hong Kong service which has a larger economy cabin. The traffic growth was mainly lower-yielding flow traffic which is consistent with Air Canada's objective of increasing global international to international connecting traffic through the use of lower-cost aircraft. A favourable currency impact of $17 million was also a contributing factor to the yield growth year-over-year.

The 0.7% PRASM increase was due to a passenger load factor improvement of 0.4 percentage points and the yield growth.

Other passenger revenues increased 13.5% from the first six months of 2013

In the first six months of 2014, on a capacity increase of 3.4%, Other passenger revenues (comprised of routes to the Caribbean, Mexico and Central and South America) of $437 million increased $52 million or 13.5% from the first six months of 2013 due to traffic growth of 7.7% and a yield increase of 6.2%.

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

- The overall 7.7% traffic increase which reflected traffic growth on major services in the Other markets with the exception of South America where capacity was reduced year-over-year.

- The overall 6.2% yield increase which reflected yield growth on all major services in the Other markets.

The 10.6% PRASM increase was due to the yield growth and a 3.4 percentage point improvement in passenger load factor. PRASM improvements were recorded on all major services in the Other markets.

Cargo revenues increased 6.8% from the first six months of 2013

In the first six months of 2014, cargo revenues of $241 million increased $15 million or 6.8% from the first six months of 2013 due to traffic growth of 8.9% as yield declined 1.9% year-over-year.

The table below provides cargo revenue by geographic region for the first six months of 2014 and the first six months of 2013.

Cargo Revenue	First Six Months 2014 $ Million	First Six Months 2013 $ Million	Change $ Million
Canada	31	30	1
U.S. transborder	10	9	1
Atlantic	94	81	13
Pacific	89	87	2
Other	17	19	(2)
System	**241**	**226**	**15**

The table below provides year-over-year percentage changes in cargo revenues and operating statistics for the first six months of 2014 and the first six months of 2013.

First Six Months 2014 Versus First Six Months 2013	Cargo Revenue % Change	Capacity (ETMs) % Change	Rev / ETM % Change	Traffic (RTMs) % Change	Yield / RTM % Change
Canada	2.6	18.5	(13.4)	23.4	(16.8)
U.S. transborder	11.6	15.6	(3.5)	8.4	2.9
Atlantic	15.6	9.0	6.1	19.2	(3.0)
Pacific	2.6	(0.7)	3.3	1.8	0.9
Other	(7.8)	(1.3)	(6.6)	(10.2)	2.8
System	**6.8**	**6.2**	**0.5**	**8.9**	**(1.9)**

Components of the year-over-year change in first six months cargo revenues included:

- The 8.9% traffic increase which reflected traffic growth in all markets with the exception of the Other markets where capacity was reduced year-over-year.
- The 1.9% yield decrease which reflected yield declines in the domestic and Atlantic markets. The domestic and Atlantic markets were impacted by increased industry capacity and aggressive competitive pricing activities when compared to the first six months of 2013. A favourable currency impact and yield growth in the U.S. transborder, Pacific and Other markets partly offset the yield decreases.

Refer to section 4 "Results of Operations" of this MD&A for year-over-year percentage changes in cargo revenues, capacity, traffic, passenger load factor, yield and PRASM by quarter for the second quarter of 2014 and each of the previous four quarters.

Other revenues increased 11% from the first six months of 2013

In the first six months of 2014, Other revenues of $556 million increased $57 million or 11% from the first six months of 2013. The increase in Other revenues was mainly due to higher ground package revenues at Air Canada Vacations, the result of higher passenger volumes, and growth in passenger-related fees. These increases were partly offset by a reduction in aircraft sublease revenues, in part due to the expiry of certain Airbus A340 subleases.

CASM decreased 2.0% from the first six months of 2013. Adjusted CASM decreased 3.6% from the first six months of 2013.

The following table compares Air Canada's CASM for the first six months of 2014 versus the first six months of 2013.

	First Six Months		Change	
(cents per ASM)	**2014**	**2013**	**cents**	**%**
Aircraft fuel	5.34	5.13	0.21	4.1
Wages and salaries	2.43	2.51	(0.08)	(3.2)
Benefits	0.74	0.90	(0.16)	(17.8)
Capacity purchase agreements	1.63	1.65	(0.02)	(1.2)
Airport and navigation fees	1.43	1.44	(0.01)	(0.7)
Aircraft maintenance	1.03	1.03	-	-
Sales and distribution costs	0.98	0.95	0.03	3.2
Depreciation, amortization and impairment	0.75	0.90	(0.15)	(16.7)
Ground package costs	0.70	0.63	0.07	11.1
Aircraft rent	0.45	0.49	(0.04)	(8.2)
Food, beverages and supplies	0.42	0.42	-	-
Communications and information technology	0.29	0.29	-	-
Other	1.39	1.59	(0.20)	(12.6)
CASM	**17.58**	**17.93**	**(0.35)**	**(2.0)**
Remove:				
Fuel expense, ground package costs at Air Canada Vacations and unusual items (1)(2)	(5.92)	(5.83)	(0.09)	1.5
Adjusted CASM (3)	**11.66**	**12.10**	**(0.44)**	**(3.6)**

(1) *In the first quarter of 2013, Air Canada recorded an impairment charge of $24 million related to Airbus A340-300 aircraft.*

(2) *In the second quarter of 2014, Air Canada recorded favourable tax-related provision adjustments of $41 million.*

(3) *Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.*

Operating expenses increased 4% from the first six months of 2013

In the first six months of 2014, operating expenses of $6,187 million increased $246 million or 4% from the first six months of 2013. The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) in the first six months of 2014, when compared to the first six months of 2013, increased operating expenses by approximately $240 million.

The following summarizes the main factors in the year-over-year change in operating expenses:

Fuel expense increased 11% from the first six months of 2013

In the first six months of 2014, fuel expense of $1,880 million increased $179 million or 11% from the first six months of 2013. The increase in fuel expense year-over-year was due to the unfavourable impact of a weaker Canadian dollar versus the U.S. dollar when compared to the first six months of 2013, which accounted for an increase of $135 million, and a higher volume of fuel litres consumed, which accounted for an increase of $71 million. Partly offsetting these increases was the impact of a 2% year-over-year decline in jet fuel prices, which accounted for a decrease of $27 million to fuel expense in the first six months of 2014.

The table below provides Air Canada's fuel cost per litre and economic fuel cost per litre for the periods indicated.

(Canadian dollars in millions, except where indicated)	First Six Months 2014	First Six Months 2013	Change $	Change %
Aircraft fuel expense – GAAP	**$ 1,880**	**$ 1,701**	**$ 179**	**11**
Add: Net cash payments on fuel derivatives (1)	1	24	(23)	(96)
Economic cost of fuel – Non-GAAP (2)	**$ 1,881**	**$ 1,725**	**$ 156**	**9**
Fuel consumption (thousands of litres)	2,020,876	1,938,712	82,164	4.2
Fuel cost per litre (cents) – GAAP	93.0	87.7	5.3	6.0
Economic fuel cost per litre (cents) – Non-GAAP (2)	93.1	89.0	4.1	4.6

(1) Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives.

(2) The economic cost of fuel is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, and may not be comparable to similar measures presented by other public companies. Air Canada uses this measure to calculate its cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period and premium costs associated with those derivatives.

Wages, salaries and benefits expense amounted to $1,117 million in the first six months of 2014, a decrease of $12 million or 1% from the first six months of 2013

In the first six months of 2014, wages and salaries expense of $855 million increased $24 million or 3% from the first six months of 2013, in large part due to higher average salaries and an increase in expenses relating to employee profit sharing programs. These increases were partly offset by a 0.8% decrease in the number of full-time equivalent (FTE) employees when compared to the first six months of 2013.

In the first six months of 2014, employee benefits expense of $262 million decreased $36 million or 12% from the first six months of 2013, reflecting actuarial gains on disability plans, a reduction in foreign pension plan liabilities, and the impact of higher discount rates which decreases the current service cost of defined benefit pension plans.

Capacity purchase costs increased 5% from the first six months of 2013

In the first six months of 2014, capacity purchase costs of $575 million increased $27 million or 5% from the first six months of 2013, mainly due to an increase in block hours flown by Sky Regional under its capacity purchase agreement with Air Canada, an unfavourable currency impact and higher rates under the Jazz CPA. These increases were partly offset by a decline in block hours flown by Jazz under the Jazz CPA.

Airport and navigation fees increased 5% from the first six months of 2013

In the first six months of 2014, airport and navigation fees of $503 million increased $26 million or 5% from the first six months of 2013, largely due to the addition of five Boeing 777 aircraft to Air Canada's operating fleet, an unfavourable currency impact and rate increases in certain stations. These increases were partly offset by the impact of the terms of an agreement, concluded in October 2013, with the Greater Toronto Airports Authority ("GTAA") which is allowing the airline to grow its share of international connecting traffic at Toronto Pearson International Airport on a more cost effective basis.

Aircraft maintenance expense increased 5% from the first six months of 2013

In the first six months of 2014, aircraft maintenance expense of $361 million increased $18 million or 5% from the first six months of 2013. This increase in aircraft maintenance expense was mainly due to the impact of Air Canada having recorded favourable accrual adjustments of $15 million in 2013 while no such adjustments were recorded in the first six months of 2014. A $25 million unfavourable currency impact and an increase in expenses related to maintenance provisions due to the reclassification of certain aircraft from finance leases to operating leases. In addition, in the first six months of 2014, a fewer number of aircraft leases were extended when compared to first six months of 2013. Lease term extensions postpone the expected timing of the end of lease costs and lengthen the period over which expenses are recorded, thus reducing maintenance expense in the period. These increases were largely offset by the impact of a lower volume of engine and airframe maintenance activity, mainly driven by timing in the maintenance cycle when compared to the same period in 2013.

Sales and distribution costs increased 9% from the first six months of 2013

In the first six months of 2014, sales and distribution costs of $346 million increased $30 million or 9% from the first six months of 2013 on passenger revenue growth of 5.5%. This growth in sales and distribution costs was mainly due to the impact of a higher volume of transactions with global distribution service providers and an increase in credit card expenses, which were in line with sales and revenue growth. An unfavourable currency impact was also a contributing factor.

Depreciation, amortization and impairment expense decreased 12% from the first six months of 2013

In the first six months of 2014, depreciation, amortization and impairment expense of $263 million decreased $37 million or 12% from the first six months of 2013.

In the first six months of 2013, Air Canada recorded an impairment charge of $24 million related to certain A340-300 aircraft (none of which are operated by Air Canada) while no such charge was recorded in the first half of 2014.

The impact of the addition of five Boeing 777 and two Boeing 787 to the airline's operating fleet was more than offset by the impact of certain engine and airframe maintenance events becoming fully amortized, the disposal of Airbus A340-300 aircraft (none of which were being operated by Air Canada) and of CRJ-100 aircraft (previously leased to and operated by Jazz), and by a decrease in depreciation expense related to the airline's interior refurbishment programs.

Ground package costs increased 18% from the first six months of 2013

In the first six months of 2014, the cost of ground packages at Air Canada Vacations amounted to $247 million, an increase of $38 million or 18% from the first six months of 2013. The increase in ground package costs at Air Canada Vacations was mainly due to higher passenger volumes. An unfavourable currency impact also contributed to the increase year-over-year.

Aircraft rent expense decreased 3% from the first six months of 2013

In the first six months of 2014, aircraft rent expense of $157 million decreased $5 million or 3% from the same period in 2013. A decrease in aircraft rent expense due to more favourable rates on lease renewals was largely offset by an unfavourable currency impact of $12 million.

Other operating expenses decreased 6% from the first six months of 2013

In the first six months of 2014, other operating expenses of $489 million decreased $33 million or 6% from the first six months of 2013, mainly due to Air Canada having recorded favourable tax-related provision adjustments of $41 million in the first six months of 2014 while no such adjustments were recorded in the first six months of 2013. In addition, one-time start-up expenses related to the transfer of Embraer 175 aircraft from the mainline fleet to Sky Regional were incurred in the first six months of 2013 while no such charges were recorded in the first six months of 2014. Partly offsetting this decrease was an increase in terminal handling expenses arising from Air Canada having outsourced its London operations to a third party provider, increased international flying and an unfavourable currency impact. While the expenses related to the airline's London outsourcing initiative are included in terminal handling, the savings associated with this initiative are included in other expense categories, such as wages and salaries expense, for a net overall cost reduction.

The following table provides a breakdown of the more significant items included in other expenses:

	First Six Months		Change	
(Canadian dollars in millions)	**2014**	**2013**	**$**	**%**
Terminal handling	$ 111	$ 94	$ 17	18
Building rent and maintenance	75	65	10	15
Crew cycle	67	61	6	10
Miscellaneous fees and services	60	68	(8)	(12)
Remaining other expenses	176	234	(58)	(25)
Other operating expenses	**$ 489**	**$ 522**	**$ (33)**	**(6)**

Non-operating expense amounted to $301 million in the first six months of 2014 compared to non-operating expense of $351 million in the first six months of 2013

The following table provides a breakdown of non-operating expense for the periods indicated:

	First Six Months		Change
(Canadian dollars in millions)	**2014**	**2013**	**$**
Foreign exchange loss	$ (121)	$ (114)	$ (7)
Interest income	18	15	3
Interest expense	(158)	(150)	(8)
Interest capitalized	15	21	(6)
Net financing expense relating to employee benefits	(68)	(104)	36
Fuel and other derivatives	21	(15)	36
Other	(8)	(4)	(4)
Total non-operating expense	**$ (301)**	**$ (351)**	**$ 50**

Factors contributing to the year-over-year change in first six months non-operating expense included:

- Losses on foreign exchange which amounted to $121 million in the first six months of 2014 compared to losses of $114 million in the first six months of 2013. An unrealized revaluation loss of $93 million related to foreign currency derivatives as well as a revaluation loss of $25 million related to U.S. dollar cash reserves were recorded in the first six months of 2014. Refer to section 9 "Financial Instruments and Risk Management" of this MD&A for additional information.

- A decrease in net financing expense relating to employee benefits of $36 million which was mainly due to the impact of lower pension liabilities partly offset by the impact of a decrease in the discount rate.

- Gains related to fuel and other derivatives which amounted to $21 million in the first six months of 2014 versus losses of $15 million in the first six months of 2013. Refer to section 9 "Financial Instruments and Risk Management" of this MD&A for additional information.

6. FLEET

Mainline and Air Canada *rouge*

The following table provides the number of aircraft in Air Canada's operating fleet as at June 30, 2014 and December 31, 2013, as well as Air Canada's expected operating fleet, including aircraft currently operating and expected to be operated by Air Canada *rouge*, as at December 31, 2014, December 31, 2015 and December 31, 2016.

	Actual			Planned					
Mainline	December 31, 2013	First Six Months 2014 Fleet Changes	June 30, 2014	Remainder of 2014 Fleet Changes	December 31, 2014	2015 Fleet Changes	December 31, 2015	2016 Fleet Changes	December 31, 2016
Boeing 787-8	–	2	2	4	6	2	8	1	9
Boeing 787-9	–	–	–	–	–	3	3	8	11
Boeing 777-300	16	1	17	–	17	–	17	–	17
Boeing 777-200	6	–	6	–	6	–	6	–	6
Boeing 767-300	27	(6)	21	–	21	(4)	17	(4)	13
Airbus A330-300	8	–	8	–	8	–	8	–	8
Airbus A321 (1)	10	–	10	–	10	–	10	5	15
Airbus A320 (1)	41	–	41	–	41	5	46	–	46
Airbus A319	30	(11)	19	(1)	18	–	18	(5)	13
EMBRAER 190	45	–	45	–	45	(10)	35	(10)	25
Total Mainline	183	(14)	169	3	172	(4)	168	(5)	163
Air Canada *rouge*									
Boeing 767-300	2	6	8	–	8	4	12	4	16
Airbus A319	8	11	19	1	20	–	20	5	25
Total Air Canada rouge	10	17	27	1	28	4	32	9	41
Total Mainline and Air Canada *rouge*	193	3	196	4	200	–	200	4	204

(1) Air Canada plans to replace 20 Embraer 190 aircraft with 10 larger narrow-body leased aircraft. As of the date of this MD&A, the type of replacement aircraft has not yet been determined; solely for illustrative purposes, Air Canada has assumed these to be five Airbus A320 and five Airbus A321 aircraft.

On March 31, 2014, Air Canada concluded an agreement with The Boeing Company ("Boeing") for the purchase of Boeing 737 MAX aircraft to replace the airline's narrow-body aircraft. Refer to section 7.6 "Capital Expenditures and Related Financing Arrangements" of this MD&A for additional information. The renewal of its narrow-body fleet with more fuel efficient aircraft is a key element of Air Canada's on-going cost transformation program. As part of the Boeing 737 MAX order, Boeing will be purchasing 20 of the 45 Embraer 190 aircraft currently in the airline's fleet. The Embraer 190 aircraft exiting the fleet will initially be replaced by a reduced number of larger leased narrow-body aircraft until the airline takes delivery of the Boeing 737 MAX aircraft. Air Canada has also been reviewing its options regarding its remaining 25 Embraer 190 aircraft and, after a comprehensive analysis, the airline has decided to continue to operate these aircraft as part of its mainline narrow-body fleet.

Air Canada Express

The following table provides, as at June 30, 2014, the number of aircraft operated by Jazz, Sky Regional and other airlines operating flights on behalf of Air Canada under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada. No changes are expected to the Air Canada Express fleet between June 30, 2014 and December 31, 2014.

	As at June 30, 2014			
	Jazz	Sky Regional	Other	Total
EMBRAER 175	–	15	–	**15**
CRJ-100	–	–	5	**5**
CRJ-200	25	–	–	**25**
CRJ-705	16	–	–	**16**
Dash 8-100	34	–	–	**34**
Dash 8-300	26	–	–	**26**
Dash 8-400	21	5	–	**26**
Beech 1900	–	–	17	**17**
Total Air Canada Express	**122**	**20**	**22**	**164**

7. FINANCIAL AND CAPITAL MANAGEMENT

7.1. Liquidity

Air Canada manages its liquidity needs through a variety of strategies including by seeking to 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 (including pension funding obligations), and covenants in credit card and other agreements. Refer to sections 7.6, 7.7 and 7.8 of this MD&A for information on Air Canada's capital commitments, pension funding obligations and contractual obligations. At June 30, 2014, unrestricted liquidity amounted to $2,954 million (comprised of cash and short-term investments of $2,615 million and undrawn lines of credit of $339 million). This compared to unrestricted liquidity of $2,139 million (comprised of cash and short-term investments of $2,107 million and undrawn lines of credit of $32 million at June 30, 2013). Air Canada's principal objective in managing liquidity risk is to maintain a minimum unrestricted liquidity level of $1.7 billion.

7.2. Financial Position

The following table provides a condensed consolidated statement of financial position of Air Canada as at June 30, 2014 and as at December 31, 2013.

(Canadian dollars in millions)	June 30, 2014	December 31, 2013	$ Change
Assets			
Cash, cash equivalents and short-term investments	$ 2,615	$ 2,208	$ 407
Other current assets	1,204	1,080	124
Current assets	3,819	3,288	531
Property and equipment	5,584	5,073	511
Intangible assets	303	304	(1)
Goodwill	311	311	-
Deposits and other assets	505	494	11
Total assets	**$ 10,522**	**$ 9,470**	**$ 1,052**
Liabilities			
Current liabilities	$ 4,045	$ 3,190	855
Long-term debt and finance leases	4,324	3,959	365
Pension and other benefit liabilities	2,944	2,687	257
Maintenance provisions	689	656	33
Other long-term liabilities	342	375	(33)
Total liabilities	**12,344**	**10,867**	**1,477**
Total equity	**(1,822)**	**(1,397)**	**(425)**
Total liabilities and equity	**$ 10,522**	**$ 9,470**	**$ 1,052**

Movements in current assets and current liabilities are described in section 7.4 "Working Capital" of this MD&A. Long-term debt and finance leases are discussed in sections 7.3, 7.5 and 7.8 of this MD&A.

At June 30, 2014, Property and equipment amounted to $5,584 million, an increase of $511 million from December 31, 2013. The increase in Property and equipment was mainly due to additions to property and equipment of $715 million in the first six months of 2014, partially offset by the impact of depreciation expense of $241 million. The additions to Property and equipment included flight equipment purchases of $420 million, which included one Boeing 777-300ER and two Boeing 787-8 aircraft delivered in February, May and June 2014, respectively, purchase deposits and assets under development of $181 million, and capitalized maintenance costs of $69 million.

At June 30, 2014, Pension and other benefit liabilities increased $257 million from December 31, 2013, mainly due to the impact of a decrease in the discount rate used to value the liabilities, largely offset by actuarial gains on the market value of plan assets, resulting in a net loss in Other comprehensive income of $293 million in the first six months of 2014. At June 30, 2014, 70% of the pension liabilities are matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk. Pension funding payments of $206 million were made in the first six months of 2014. Refer to section 9.7 "Pension Funding Obligations" of Air Canada's 2013 MD&A dated February 12, 2014 for additional information on Air Canada's pension funding obligations.

7.3. Adjusted Net Debt

The following table reflects Air Canada's adjusted net debt balances as at June 30, 2014 and as at December 31, 2013.

(Canadian dollars in millions, except where indicated)	June 30, 2014	December 31, 2013	$ Change
Total long-term debt and finance leases	$ 4,324	$ 3,959	$ 365
Current portion of long-term debt and finance leases	409	374	35
Total long-term debt and finance leases, including current portion	4,733	4,333	400
Less cash, cash equivalents and short-term investments	(2,615)	(2,208)	(407)
Net debt	**$ 2,118**	**$ 2,125**	**$ (7)**
Capitalized operating leases [1]	2,191	2,226	(35)
Adjusted net debt	**$ 4,309**	**$ 4,351**	**$ (42)**
EBITDAR (excluding benefit plan amendments) (trailing 12 months)	**$ 1,506**	**$ 1,433**	**$ 73**
Adjusted net debt to EBITDAR ratio	**2.9**	**3.0**	**(0.1)**

(1) Adjusted net debt is a non-GAAP financial measure used by Air Canada and may not be comparable to measures presented by other public companies. Adjusted net debt is a key component of the capital managed by Air Canada and provides management with a measure of its net indebtedness. Air Canada includes capitalized operating leases which is a measure commonly used in the industry to ascribe a value to obligations under operating leases. Common industry practice is to multiply annualized aircraft rent expense by 7.0. This definition of capitalized operating leases is used by Air Canada and may not be comparable to similar measures presented by other public companies. Aircraft rent was $ 313 million for the twelve months ended June 30, 2014 and $318 million for the twelve months ended December 31, 2013.

At June 30, 2014, total long-term debt and finance leases, including current portion, amounted to $4,733 million, an increase of $400 million from December 31, 2013. This increase was due to new borrowings of $784 million offset by debt repayments of $390 million. In the first six months of 2014, Air Canada completed a private offering of US$400 million of 7.75% senior unsecured notes due 2021 which is further described below. In addition, Air Canada took delivery of the fifth and final Boeing 777-300ER aircraft, which was financed under the private offering of enhanced equipment trust certificates (as further described in Air Canada's 2013 MD&A dated February 12, 2014), as well as the first two of 37 Boeing 787 aircraft, which were financed with support from the Export-Import Bank of the United States ("EXIM"). Refer to section 7.6 "Capital Expenditures and Related Financing Arrangements" of this MD&A for additional information. Debt repayments included an optional repayment of $182 million to eliminate the outstanding balance under a revolving loan facility. The facility remains available for use with an available credit of $232 million.

Adjusted net debt amounted to $4,309 million at June 30, 2014, a decrease of $42 million from December 31, 2013, mainly due to higher cash balances largely offset by the higher long-term debt and finance lease balances.

At June 30, 2014, the adjusted net debt to EBITDAR ratio amounted to 2.9 versus a ratio of 3.0 at December 31, 2013. Air Canada uses this ratio to manage its financial leverage risk and has an objective to maintain the ratio below 3.5.

At June 30, 2014, Air Canada's weighted average cost of capital ("WACC") was approximately 9.7%. WACC is based on an estimate by management and consists of an estimated cost of equity of 20% and an average cost of debt and finance leases of 5.8%.

Unsecured Financing

In April 2014, Air Canada completed a private offering of US$400 million of 7.75% senior unsecured notes due 2021 (the "Notes"). Air Canada received net proceeds of approximately $432 million from the sale of the Notes. The Notes were sold at par and provide for interest payable semi-annually. The Notes are senior unsecured obligations of Air Canada, and are guaranteed on a senior unsecured basis by one of Air Canada's subsidiaries.

7.4. Working Capital

The following table provides information on Air Canada's working capital balances as at June 30, 2014 and as at December 31, 2013.

(Canadian dollars in millions)	June 30, 2014	December 31, 2013	$ Change
Cash, cash equivalents and short-term investments	$ 2,615	$ 2,208	$ 407
Accounts receivable	761	589	172
Other current assets	443	491	(48)
Accounts payable and accrued liabilities	(1,353)	(1,129)	(224)
Advance ticket sales	(2,283)	(1,687)	(596)
Current portion of long-term debt and finance leases	(409)	(374)	(35)
Net working capital	**$ (226)**	**$ 98**	**$ (324)**

Unrestricted cash of $2,615 million increased $407 million as at June 30, 2014, largely due to the impact of proceeds from the US$400 million senior unsecured notes completed during the second quarter of 2014. The net negative working capital of $226 million at June 30, 2014 represented a deterioration of $324 million from December 31, 2013. This deterioration in net working capital was largely due to the impact of capital expenditures of $732 million (or $374 million net of the financing drawn upon the delivery of the fifth and final Boeing 777-300ER aircraft and the two Boeing 787-8 aircraft received during the first six months of 2014), pension funding payments of $206 million, partially offset by the impact of cash provided by operations in the first six months of 2014.

The increase in Accounts receivable and Advance ticket sales is related to the seasonal growth in demand leading into the third quarter at Air Canada. The growth in Accounts payable includes the impact of the seasonal growth in operating costs and a mark-to-market liability of $112 million related to foreign exchange derivatives as further described in section 9 "Financial Instruments and Risk Management" of this MD&A.

7.5. Consolidated Cash Flow Movements

The following table provides the cash flow movements for Air Canada for the periods indicated:

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2014**	**2013**	**$ Change**	**2014**	**2013**	**$ Change**
Net cash flows from operating activities	**$ 386**	**$ 411**	**$ (25)**	**$ 730**	**$ 672**	**$ 58**
Proceeds from borrowings	626	149	477	784	162	622
Reduction of long-term debt and finance lease obligations	(348)	(219)	(129)	(390)	(315)	(75)
Other	-	(15)	15	-	(15)	15
Net cash flows from (used in) financing activities	**278**	**(85)**	**363**	**394**	**(168)**	**562**
Short-term investments	(264)	(95)	(169)	(294)	(78)	(216)
Additions to property, equipment and intangible assets	(422)	(264)	(158)	(732)	(378)	(354)
Proceeds from sale of assets	1	4	(3)	3	8	(5)
Other	7	(30)	37	10	(20)	30
Net cash flows used in investing activities	**(678)**	**(385)**	**(293)**	**(1,013)**	**(468)**	**(545)**
Increase (decrease) in cash and cash equivalents	(14)	(59)	45	111	36	75
Cash and cash equivalents, beginning of period	875	849	26	750	754	(4)
Cash and cash equivalents, end of period	**$ 861**	**$ 790**	**$ 71**	**$ 861**	**$ 790**	**$ 71**

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

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2014**	**2013**	**$ Change**	**2014**	**2013**	**$ Change**
Cash flows from operating activities	**$ 386**	**$ 411**	**$ (25)**	**$ 730**	**$ 672**	**$ 58**
Additions to property, equipment and intangible assets	(422)	(264)	(158)	(732)	(378)	(354)
Free cash flow (1)	**$ (36)**	**$ 147**	**$ (183)**	**$ (2)**	**$ 294**	**$ (296)**

(1) Free cash flow is a non-GAAP financial measure used by Air Canada and may not be comparable to measures presented by other public companies. Air Canada considers free cash flow to be an indicator of the financial strength and performance of its business because it shows how much cash is generated from the business after investing in capital assets, which is available to meet ongoing financial obligations, including repaying debt, and reinvesting in Air Canada.

Free cash flow

Negative free cash flow of $36 million in the second quarter of 2014 reflected a deterioration of $183 million from the second quarter of 2013. Capital expenditures increased $158 million in the second quarter of 2014 and included the acquisition of two Boeing 787 aircraft. In addition, cash flows from operating activities declined $25 million. This decline in cash flows from operating activities was largely due to lower cash provided by working capital of $46 million, which was mainly due to the timing of aircraft fuel payments when compared to the same quarter in 2013.

In the first six months of 2014, free cash flow declined $296 million compared to the first six months of 2013. The decrease in free cash flow was due to an increase in capital expenditures of $354 million, which was mainly related to the acquisition of one Boeing 777-300ER in the first quarter of 2014 and two Boeing 787 aircraft delivered in the second quarter of 2014. The impact of additional capital expenditures year-over-year was partly offset by an increase in cash flows from operating activities of $58 million. The $58 million increase in cash flows from operating activities was related to the growth in adjusted net income as well as an increase in advance ticket sales year-over-year.

Net cash flows used in financing activities

Proceeds from borrowings amounted to $626 million in the second quarter of 2014 and $784 million in the first six months of 2014. In the second quarter and the first six months of 2014, reduction of long-term debt and finance lease obligations amounted to $348 million and $390 million, respectively. Refer to section 7.3 "Adjusted Net Debt" of this MD&A for additional information on financing activities.

7.6. Capital Expenditures and Related Financing Arrangements

Aircraft and Related Financing

The discussion and presentation related to Air Canada's aircraft and related financing and commitments are as at June 30, 2014 and do not account for Air Canada's third firm order Boeing 787 aircraft delivered in July 2014 and financed with support from EXIM covering 85% of the aircraft delivery and, therefore, such discussion and presentation are provided as if that third firm order Boeing 787 aircraft had not been delivered or financed.

As at December 31, 2013, Air Canada had outstanding purchase commitments with Boeing for the acquisition of 37 Boeing 787 aircraft. The first six deliveries are scheduled for 2014, two of which occurred in the second quarter, and the remaining 31 between 2015 and 2019. Air Canada also has purchase options for 13 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on previously determined pricing and delivery positions) and purchase rights for 10 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on Boeing's then current pricing). In addition, Air Canada has purchase rights for 13 Boeing 777 aircraft (entitling Air Canada to purchase aircraft based on previously determined pricing). Two of the 37 Boeing 787 aircraft were delivered in May and June 2014. Financing for the second quarter deliveries was provided with support from EXIM covering 85% of the aircraft delivery. The last of five Boeing 777-300ER aircraft acquired by Air Canada was delivered in February 2014, and financed through proceeds from the private offering of enhanced equipment trust certificates, which is further described in section 7.6 of Air Canada's 2013 MD&A dated February 12, 2014.

In the first quarter of 2014, Air Canada 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.

Air Canada 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, Air Canada also has financing commitments covering up to 29 of the remaining 35 Boeing 787 firm aircraft orders. This includes final commitments from EXIM, subject to documentation and other conditions, for three additional Boeing 787 aircraft scheduled for delivery in 2014, and preliminary commitments from EXIM for two other 787 aircraft.

The financing terms for the firm commitments (subject to conditions) for the remaining 24 of the 29 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 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 Air Canada, 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 $4.4 billion.

In order to improve the economics of the airline's existing Boeing 777 long-haul fleet and to provide customers with a consistent product to its new Boeing 787 Dreamliners, Air Canada is planning on converting 12 Boeing 777-300ER and six Boeing 777-200LR aircraft into a higher density configuration, including the addition of a premium economy cabin and refurbishing the International Business Class cabin to bring it to Boeing 787 standards. The reconfiguration is designed to both lower unit costs and to allow Air Canada to compete more effectively with a harmonized product offering across its international wide-body Boeing 777 fleet. The reconfiguration project is planned to start in late 2015 and be completed in the second half of 2016. The capital expenditures related to this reconfiguration program have been included in the table below.

Capital Commitments

As outlined in the table below, the estimated aggregate cost of the future firm Boeing 787 and Boeing 737 MAX aircraft deliveries and other capital purchase commitments as at June 30, 2014 approximates $7,844 million.

(Canadian dollars in millions)	Remainder of 2014	2015	2016	2017	2018	Thereafter	Total
Projected committed expenditures	$ 561	$ 957	$ 1,305	$ 1,621	$ 1,376	$ 2,024	$ 7,844
Projected planned but uncommitted expenditures	6	234	211	269	288	not available	not available
Projected planned but uncommitted capitalized maintenance (1)	81	151	159	109	109	not available	not available
Total projected expenditures (2)	**$ 648**	**$ 1,342**	**$ 1,675**	**$ 1,999**	**$ 1,773**	**not available**	**not available**

(1) *The table above includes certain maintenance events which are capitalized under IFRS. Future capitalized maintenance amounts for 2018 and beyond are not yet determinable however an estimate of $109 million has been made for 2018.*

(2) *U.S. dollar amounts are converted using the June 30, 2014 closing exchange rate of US$1 = C$1.0670. 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 June 30, 2014.*

7.7. Pension Funding Obligations

Based on actuarial valuations completed in the second quarter of 2014, the aggregate solvency surplus in Air Canada's domestic registered pension plans as at January 1, 2014 was $89 million whereas the solvency deficit at January 1, 2013 was $3.7 billion. The elimination of the $3.7 billion deficit and the surplus generated were largely the result of the following factors: (i) a 13.8% return on investments during 2013, (ii) the implementation of pension benefit amendments which decreased the solvency deficit by approximately $970 million, (iii) contributions made by Air Canada in respect of 2013 of $225 million in respect of the solvency deficit and (iv) the application of a prescribed discount rate of 3.9% to calculate its future pension obligations.

For additional information on Air Canada's pension funding obligations, refer to section 9.7 "Pension Funding Obligations" of Air Canada's 2013 MD&A dated February 12, 2014.

7.8. Contractual Obligations

The table below provides interest and principal repayment obligations on Air Canada's long-term debt and finance lease obligations as at June 30, 2014. The table includes the long-term debt and interest obligations associated with the private offering of US$400 million of 7.75% Notes due 2021, as further described in section 7.3 "Adjusted Net Debt" of this MD&A.

(Canadian dollars in millions)	Remainder of 2014	2015	2016	2017	2018	Thereafter	Total
Principal							
Long-term debt obligations	$ 155	$ 377	$ 341	$ 453	$ 436	$ 2,751	$ 4,513
Finance lease obligations	31	61	26	27	30	123	298
Total principal obligations	**$ 186**	**$ 438**	**$ 367**	**$ 480**	**$ 466**	**$ 2,874**	**$ 4,811**
Interest							
Long-term debt obligations	126	240	221	226	178	280	1,271
Finance lease obligations	14	23	19	16	13	37	122
Total interest obligations	**$ 140**	**$ 263**	**$ 240**	**$ 242**	**$ 191**	**$ 317**	**$ 1,393**
Total long-term debt and finance lease obligations	**$ 326**	**$ 701**	**$ 607**	**$ 722**	**$ 657**	**$ 3,191**	**$ 6,204**
Operating lease obligations	**$ 189**	**$ 320**	**$ 268**	**$ 239**	**$ 206**	**$ 437**	**$ 1,659**
Committed capital expenditures	**$ 561**	**$ 957**	**$ 1,305**	**$ 1,621**	**$ 1,376**	**$ 2,024**	**$ 7,844**
Total contractual obligations(1) (2)	**$ 1,076**	**$ 1,978**	**$ 2,180**	**$ 2,582**	**$ 2,239**	**$ 5,652**	**$ 15,707**

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

(2) The table above excludes the future minimum non-cancelable commitment under the Jazz CPA of $801 million for the full year 2014, the future minimum non-cancelable commitment under capacity purchase agreements with other regional carriers of $109 million for the full year 2014 and the minimum annual commitment to purchase Aeroplan® Miles from Aeroplan of $218 million for the full year 2014. Future commitments for 2015 and beyond are not yet determinable.

7.9. Share Information

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

	Number of Shares at		
	July 31, 2014	June 30, 2014	December 31, 2013
Issued and outstanding shares			
Class A variable voting shares	42,280,221	41,805,365	26,577,512
Class B voting shares	243,840,767	244,294,844	257,954,927
Total issued and outstanding shares	**286,120,988**	**286,100,209**	**284,532,439**
Class A variable voting and Class B voting shares potentially issuable			
Shares held in trust for employee recognition award	-	-	1,337,377
Stock options	10,802,500	10,823,279	10,079,694
Total shares potentially issuable	**10,802,500**	**10,823,279**	**11,417,071**
Total outstanding and potentially issuable shares	**296,923,488**	**296,923,488**	**295,949,510**

Earnings per Share

The following reflects the share amounts used in the computation of basic and diluted earnings per share:

	Second Quarter		First Six Months	
(in millions)	2014	2013	2014	2013
Weighted average number of shares outstanding – basic	**286**	**275**	**286**	**275**
Effect of potential dilution	7	8	7	8
Exclude anti-dilutive impact	-	(8)	(7)	(8)
Weighted average number of shares outstanding – diluted	**293**	**275**	**286**	**275**

8. QUARTERLY FINANCIAL DATA

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

(Canadian dollars in millions, except where indicated)	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2
Operating revenues	$ 3,326	$ 2,839	$ 2,952	$ 3,057	$ 3,479	$ 2,894	$ 3,065	$ 3,305
Aircraft fuel	963	821	870	831	1,002	831	918	962
Ownership (DAR) (1)(2)	255	236	251	211	210	224	209	211
Other operating expenses (3)(4)	1,685	1,735	1,937	1,841	1,851	1,704	2,000	1,887
Operating expenses	2,903	2,792	3,058	2,883	3,063	2,759	3,127	3,060
Operating income (loss)	423	47	(106)	174	416	135	(62)	245
Total non-operating income (expense) (5)	(64)	(107)	(154)	(197)	(125)	(141)	(279)	(22)
Income taxes	-	-	-	-	8	-	-	-
Net income (loss)	$ 359	$ (60)	$ (260)	$ (23)	$ 299	$ (6)	$ (341)	$ 223
Diluted earnings (loss) per share	$ 1.28	$ (0.22)	$ (0.95)	$ (0.09)	$ 1.05	$ (0.02)	$ (1.20)	$ 0.75
EBITDAR, excluding benefit plan amendments (3)(6)	$ 551	$ 283	$ 145	$ 385	$ 626	$ 277	$ 147	$ 456
EBITDAR (6)	$ 678	$ 283	$ 145	$ 385	$ 626	$ 359	$ 147	$ 456
Adjusted net income (loss) (7)	$ 229	$ (5)	$ (143)	$ 115	$ 365	$ 3	$ (132)	$ 139
Adjusted net income (loss) per diluted share (7)	$ 0.82	$ (0.02)	$ (0.52)	$ 0.41	$ 1.29	$ 0.01	$ (0.46)	$ 0.47

(1) *DAR refers to the combination of depreciation, amortization and impairment, and aircraft rent expense.*

(2) *In the first quarter of 2013, Air Canada recorded an impairment charge of $24 million related to Airbus A340-300 aircraft.*

(3) *In the fourth quarter of 2013, Air Canada recorded an operating expense reduction of $82 million related to changes to early retirement provisions in Air Canada's defined benefit pension plans. In the third quarter of 2012, Air Canada recorded an operating expense reduction of $127 million related to changes to the terms of the ACPA collective agreement pertaining to retirement age.*

(4) *In the second quarter of 2014, Air Canada recorded favourable tax-related provision adjustments of $41 million.*

(5) *In the third quarter of 2013, Air Canada recorded an interest charge of $95 million related to the purchase of its senior secured notes which were to become due in 2015 and 2016.*

(6) *EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.*

(7) *Adjusted net income (loss) and adjusted net income (loss) per diluted share are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.*

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

	2012		2013				2014	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Revenue passenger miles (millions)	16,258	12,574	13,087	14,093	16,726	12,882	13,466	15,495
Available seat miles (millions)	18,835	15,484	16,164	16,972	19,404	16,033	16,774	18,413
Passenger load factor (%)	86.3	81.2	81.0	83.0	86.2	80.3	80.3	84.2
Passenger PRASM (cents)	15.9	16.0	15.4	16.0	16.2	15.7	15.3	15.9
CASM, excluding benefit plan amendments (cents) (1)	16.1	18.0	18.9	17.0	15.8	17.7	18.6	16.6
Adjusted CASM (cents) (2)	10.7	12.4	12.5	11.7	10.4	12.1	12.2	11.2
Economic fuel price per litre (cents) (3)	87.7	88.1	92.4	85.7	89.6	88.4	94.7	91.6

(1) In the fourth quarter of 2013, Air Canada recorded an operating expense reduction of $82 million related to changes to early retirement provisions in Air Canada's defined benefit pension plans. In the third quarter of 2012, Air Canada recorded an operating expense reduction of $127 million related to changes to the terms of the ACPA collective agreement pertaining to retirement age.

(2) Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

(3) Includes fuel handling expenses. Economic fuel price per litre is a non-GAAP financial measure. Refer to section 4 "Results of Operations" of this MD&A for additional information.

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Refer to section 12 "Financial Instruments and Risk Management" of Air Canada's 2013 MD&A dated February 12, 2014 for information on Air Canada's risk management strategy. The following is a summary of fuel and other derivatives included in Non-operating income (expense) on Air Canada's consolidated statement of operations for the periods indicated:

Summary of Fuel and Other Derivatives

The following is a summary of fuel and other derivatives included in non-operating income (expense) on Air Canada's consolidated statement of operations for the periods indicated:

	Second Quarter		First Six Months	
(Canadian dollars in millions)	**2014**	**2013**	**2014**	**2013**
Fuel derivatives	$ 8	$ (7)	$ 6	$ (18)
Share forward contracts	28	(5)	14	4
Interest rate swaps	-	(1)	1	(1)
Fuel and other derivatives	**$ 36**	**$ (13)**	**$ 21**	**$ (15)**

Fuel Price Risk Management

Fuel price risk is the risk that future cash flows will fluctuate because of changes in jet fuel prices. In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries.

In the second quarter of 2014:

- Air Canada recorded a gain of $8 million on fuel derivatives (gain of $6 million in the first six months of 2014) (a loss of $7 million and $18 million, respectively, for the second quarter and first six months of 2013).
- Air Canada purchased crude-oil and refined products-based call options and call spreads covering a portion of 2014 fuel exposure. The cash premium related to these contracts was $10 million ($20 million in the first six months of 2014) ($16 million and $27 million, respectively, for the second quarter and first six months of 2013).
- Fuel derivative contracts settled with a fair value of $11 million in favour of Air Canada ($18 million in favour of Air Canada in the first six months of 2014) (nil and $1 million, respectively, for the second quarter and first six months of 2013).

As at June 30, 2014, approximately 40% of Air Canada's anticipated purchases of jet fuel for the remainder of 2014 is hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US$106 per barrel. Air Canada's contracts to hedge anticipated jet fuel purchases over the 2014 period are comprised of call options with notional volumes of 5,418,000 barrels. The fair value of the fuel derivatives portfolio at June 30, 2014 was $28 million in favour of Air Canada ($20 million in favour of Air Canada as at December 31, 2013) and is recorded within Prepaid expenses and other current assets on Air Canada's consolidated statement of financial position.

Share Forward Contracts

In the second quarter of 2014, Air Canada recorded a gain of $28 million on share forward contracts which hedge share units granted under Air Canada's long-term incentive plan that may vest with settlement dates between 2015 and 2017, subject to the terms of vesting (gain of $14 million in the first six months of 2014). Share forward contracts cash settled with a fair value of $7 million in favour of Air Canada in the second quarter of 2014. As at June 30, 2014, the fair value of the share forward contracts was $63 million in favour of Air Canada (December 31, 2013 - $56 million in favour of Air Canada).

Foreign Exchange Risk

In order to manage exposure to the U.S dollar and other foreign exchange exposures, Air Canada holds U.S. dollar cash reserves and enters into currency derivative contracts. These derivatives and U.S. dollar cash reserves serve to mitigate the cash flow exposure from adverse currency movements. The result of these hedging activities is recorded as a foreign exchange gain or loss in Non-operating expense on Air Canada's consolidated statement of operations (not within operating income).

As at June 30, 2014, Air Canada had outstanding foreign currency options and swap agreements, settling in 2014 and 2015, to purchase at maturity $3,001 million of U.S. dollars at a weighted average rate at maturity of $1.0727 per US$1.00. Air Canada also has protection in place to sell a portion of its excess Euros and Sterling against U.S. dollars. The increase in level of foreign exchange derivatives outstanding at June 30, 2014 as compared to December 31, 2013 reflects the significant capital expenditure program for 2014 and an increase in target coverage from 50% to 60% of the net U.S. dollar exposure on a rolling 18-month basis. As at June 30, 2014, based on the notional amount of currency derivatives outstanding at that time, approximately 89% of net U.S. cash outflows were hedged for the remainder of 2014 and approximately 47% for 2015.

The weighted average foreign exchange rate of the derivative portfolio is unfavourable as compared to the closing exchange rate on June 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 June 30, 2014 was $112 million in favour of the counterparties (December 31, 2013 – $13 million in favour of Air Canada). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. In the second quarter of 2014, a loss of $89 million was recorded in Foreign exchange gain (loss) on Air Canada's consolidated statement of operations related to these derivatives (a loss of $93 million for the first six months of 2014) (a gain of $21 million and $44 million, respectively, for the second quarter and first six months of 2013). In the second quarter of 2014, foreign exchange derivative contracts cash settled with a net fair value of $9 million in favour of Air Canada ($32 million in favour of Air Canada in the first six months of 2014) ($18 million and $30 million, respectively, in favour of Air Canada for the second quarter and first six months of 2013).

As a result of a weakening Canadian dollar and a lower notional value of derivatives outstanding, as at July 31, 2014, the fair value in favour of the counterparties was reduced to $10 million.

Air Canada also holds U.S. 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 June 30, 2014 amounted to $967 million (US$905 million) ($791 million (US$743 million) as at December 31, 2013). In the first six months of 2014, an unrealized loss of $8 million (unrealized gain of $39 million in the first six months of 2013) was recorded in Foreign exchange gain (loss) on Air Canada's consolidated statement of operations reflecting the change in Canadian equivalent market value of the U.S. dollar cash and short-term investment balances held.

10. CRITICAL ACCOUNTING ESTIMATES

Information on Air Canada's critical accounting estimates is disclosed in section 13 "Critical Accounting Estimates" of Air Canada's 2013 MD&A dated February 12, 2014. There have been no material changes to Air Canada's critical accounting estimates from what was disclosed at that time with the exception of a change to the depreciation period for cabin interior equipment and modifications from five years to eight years, or the remaining useful life of the aircraft, whichever is less. This change is effective prospectively from April 1, 2014. Refer to Note 2 of Air Canada's interim unaudited condensed consolidated financial statements for the second quarter of 2014 for additional information on this change in accounting estimate.

11. ACCOUNTING POLICIES

Air Canada's accounting policies are as disclosed in Air Canada's audited consolidated financial statements and notes for 2013. There have been no material changes to Air Canada's accounting policies from what was disclosed at that time with the exception of the addition of a new accounting standard *IFRS 15 – Revenue from Contracts with Customers* which will become effective for periods beginning on January 1, 2017, with early adoption permitted.

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. Air Canada continues to evaluate the impact of this standard on its consolidated financial statements.

12. OFF-BALANCE SHEET ARRANGEMENTS

Information on Air Canada's off-balance sheet arrangements is disclosed in section 15 "Off-Balance Sheet Arrangements" of Air Canada's 2013 MD&A dated February 12, 2014. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

13. RELATED PARTY TRANSACTIONS

At June 30, 2014, Air Canada had no transactions with related parties as defined in the CPA Handbook, except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship agreements.

14. RISK FACTORS

For a detailed description of risk factors associated with Air Canada and its business, refer to section 18 "Risk Factors" of Air Canada's 2013 MD&A dated February 12, 2014. Air Canada is not aware of any significant changes to its risk factors from those disclosed at that time.

15. 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 Executive Vice President 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.

In the Corporation's 2013 filings, the Corporation's CEO and CFO certified, 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.

In the Corporation's second quarter 2014 filings, the Corporation's CEO and CFO, certified, as required by National Instrument 52-109, the appropriateness of the financial disclosure, 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 interim unaudited condensed consolidated financial statements and notes, and the Corporation's Board of Directors approved these documents prior to their release.

Changes in Internal Controls over Financial Reporting

There have been no changes to the Corporation's internal controls over financial reporting during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

16. NON-GAAP FINANCIAL MEASURES

EBITDAR

EBITDAR (earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before depreciation, amortization and impairment, and aircraft rent as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. EBITDAR is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, and may not be comparable to similar measures presented by other public companies.

EBITDAR is reconciled to operating income as follows:

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2014**	**2013**	**$ Change**	**2014**	**2013**	**$ Change**
GAAP operating income	**$ 245**	**$ 174**	**$ 71**	**$ 183**	**$ 68**	**$ 115**
Add back:						
Aircraft rent	78	81	(3)	157	162	(5)
Depreciation, amortization and impairment	133	130	3	263	300	(37)
EBITDAR	**$ 456**	**$ 385**	**$ 71**	**$ 603**	**$ 530**	**$ 73**

Adjusted CASM

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

Adjusted CASM is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning and may not be comparable to similar measures presented by other public companies.

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.

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

Adjusted CASM is reconciled to GAAP operating expense as follows:

(Canadian dollars in millions, except where indicated)	Second Quarter 2014	Second Quarter 2013	Second Quarter $ Change	First Six Months 2014	First Six Months 2013	First Six Months $ Change
GAAP operating expense	$ 3,060	$ 2,883	$ 177	$ 6,187	$ 5,941	$ 246
Adjusted for::						
Aircraft fuel	(962)	(831)	(131)	(1,880)	(1,701)	(179)
Tax-related provision adjustments (1)	41	-	41	41	-	41
Ground packages costs at Air Canada Vacations	(77)	(59)	(18)	(247)	(209)	(38)
Impairment charge (2)	-	-	-	-	(24)	24
Operating expense, adjusted for the above-noted items	**$ 2,062**	**$ 1,993**	**$ 69**	**$ 4,101**	**$ 4,007**	**$ 94**
ASMs (millions)	**18,413**	**16,972**	**8.5%**	**35,187**	**33,136**	**6.2%**
Adjusted CASM (cents)	**¢ 11.2**	**¢ 11.7**	**(4.7%)**	**¢ 11.7**	**¢ 12.1**	**(3.6%)**

(1) *In the second quarter of 2014, Air Canada recorded favourable tax-related provision adjustments of $41 million.*

(2) *In the first quarter of 2013, Air Canada recorded an impairment charge of $24 million related to Airbus A340-300 aircraft.*

Adjusted Net Income (Loss) and Adjusted Net Income (Loss) Per Share – Diluted

Air Canada uses adjusted net income (loss) and adjusted net income (loss) per share – diluted to assess the performance of its business without the effects of foreign exchange, net financing income (expense) relating to employee benefits, mark-to-market adjustments on fuel and other derivatives and unusual items. These measures are not recognized measures for financial statement presentation under GAAP, do not have a standardized meaning and may not be comparable to similar measures presented by other public companies.

(Canadian dollars in millions, except per share values)	Second Quarter 2014	Second Quarter 2013	Second Quarter $ Change	First Six Months 2014	First Six Months 2013	First Six Months $ Change
Net income (loss) for the period attributable to shareholders	**$ 222**	**$ (24)**	**$ 246**	**$ (120)**	**$ (285)**	**$ 165**
Adjusted for:						
Tax-related provision adjustments (1)	(41)	-	(41)	(41)	-	(41)
Impairment charge (2)	-	-	-	-	24	(24)
Foreign exchange (gain) loss	(40)	74	(114)	121	114	7
Net financing expense relating to employee benefits	34	52	18)	68	104	(36)
(Gain) loss on fuel and other derivatives	36)	13	(49)	(21)	15	(36)
Adjusted net income (loss)	**$ 139**	**$ 115**	**$ 24**	**$ 7**	**$ (28)**	**$ 35**
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	293	283	10	293	275	18
Adjusted net income (loss) per share – diluted	**$ 0.47**	**$ 0.41**	**$ 0.06**	**$ 0.02**	**$ (0.10)**	**$ 0.12**

(1) *In the second quarter of 2014, Air Canada recorded favourable tax-related provision adjustments of $41 million.*

(2) *In first quarter of 2013, Air Canada recorded an impairment charge of $24 million related to Airbus A340-300 aircraft.*

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

	Second Quarter		First Six Months	
(in millions)	**2014**	**2013**	**2014**	**2013**
Weighted average number of shares outstanding – basic	**286**	**275**	**286**	**275**
Effect of dilution	7	8	7	8
Exclude anti-dilutive impact	-	-	-	(8)
Weighted average number of shares outstanding – diluted	**293**	**283**	**293**	**275**

Return on Invested Capital

Air Canada uses Return on invested capital (or ROIC) to assess the efficiency with which it allocates its capital to generate returns. Return is based on Adjusted net income (loss) (as defined above), excluding interest expense and implicit interest on operating leases. Invested capital includes (i) average year-over-year total assets, net of average year-over-year non-interest-bearing operating liabilities, and (ii) the value of capitalized operating leases (calculated by multiplying annualized aircraft rent by 7). This measure is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning and may not be comparable to similar measures presented by other public companies.

In the second quarter of 2014, Air Canada changed its approach in calculating invested capital from a financing method to an investing method. Management believes this change provides more relevant information as the return is based on the book value of invested capital used for operations and is not subject to changes in the market price of Air Canada's outstanding shares. For comparative purposes, the information as at June 30, 2013 provided below reflects this new methodology.

The following table provides Air Canada's return on invested capital for the periods indicated:

(Canadian dollars in millions, except where indicated)	June 30, 2014	June 30, 2013	$ Change
Net income for the period attributable to shareholders of Air Canada (trailing 12 months)	**$ 171**	**$ 12**	**$ 159**
Remove:			
Benefit plan amendments (1)	(82)	(127)	45
Tax-related provision adjustments (2)	(41)	-	(41)
Impairment charge (3)	6	24	(18)
Foreign exchange loss	127	34	93
Interest expense charge (4)	95	-	95
Net financing expense relating to employee benefits	172	248	(76)
(Gain) loss on fuel and other derivatives	(73)	5	(78)
Adjusted net income (trailing 12 months)	**$ 375**	**$ 196**	**$ 179**
Adjusted for:			
Interest expense (5)	310	294	16
Implicit interest on operating leases (6)	153	161	(8)
Adjusted income before interest (trailing 12 months)	**$ 838**	**$ 651**	**$ 187**
Invested capital:			
Working capital, excluding current portion of long-term debt and finance leases	60	77	(17)
Long-term non-financial assets	6,335	5,986	349
Maintenance provisions	(661)	(611)	(50)
Other operating long-term liabilities	(321)	(367)	46
Capitalized operating leases (7)	2,191	2,296	(105)
Invested capital	**$ 7,604**	**$ 7,381**	**$ 223**
Return on invested capital (%)	**11.0%**	**8.8%**	**2.2 pp**

(1) In the fourth quarter of 2013, Air Canada recorded an operating expense reduction of $82 million related to changes to early retirement provisions in Air Canada's defined benefit pension plans. In the third quarter of 2012, Air Canada recorded an operating expense reduction of $127 million related to changes to the terms of the ACPA collective agreement pertaining to retirement age.

(2) In the second quarter of 2014, Air Canada recorded favourable tax-related provisions adjustments of $41 million.

(3) In the first quarter of 2013, Air Canada recorded an impairment charge of $24 million related to Airbus A340-300 aircraft.

(4) In the third quarter of 2013, Air Canada recorded an interest charge of $95 million related to the purchase of its senior secured notes which were to become due in 2015 and 2016.

(5) Interest expense excludes the non-recurring interest expense charge on the repayment of the senior secured notes recognized in 2013 as described in (4) above.

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

(7) Capitalized operating leases are calculated by multiplying the trailing 12 months of aircraft rent by 7. Aircraft rent totaled $313 million for the twelve months ended June 30, 2014 (for the twelve months ended June 30, 2013 - $328 million).

17. GLOSSARY

Adjusted CASM – Refers to operating expense per ASM adjusted to remove the effects of fuel expense, ground packages costs and unusual items. Refer to section 16 "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 attributable to the shareholders of Air Canada adjusted to remove the effects of (to the extent included in consolidated net income (loss)) foreign exchange gains or losses, net financing income (expense) relating to employee benefits, mark-to-market adjustments on fuel and other derivatives and unusual items. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Atlantic passenger and cargo revenues – Refer to revenues from flights that cross the Atlantic Ocean with origins and destinations principally in Europe.

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.

CASM – Refers to operating expense per ASM.

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

EBITDAR – Refers to earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent. EBITDAR is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Effective Ton Miles or ETMs – Refers to the mathematical product of tonnage capacity times distance hauled.

EXIM – Refers to Export-Import Bank of the United States.

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

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

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

Passenger Revenue per Available Seat Mile or PRASM – Refers to average passenger revenue per ASM (baggage fee revenues, which are included in passenger revenues, are removed for the purposes of calculating PRASM).

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

Return on invested capital or ROIC – Refers to return on invested capital and is a measure used to assess the efficiency with which a company allocates its capital to generate returns. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Revenue Passenger Carried – Refers to IATA's definition of passenger carried whereby passengers are counted on a flight no. 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.

Revenue Ton Miles or RTMs – Refers to the mathematical product of weight in tons of a shipment being transported by the number of miles that it is transported.

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

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, and consists of an estimated cost of equity of 20% and an average cost of debt and finance leases of 6%.

Yield – Refers to average passenger revenue per RPM (baggage fee revenues, which are included in passenger revenues, are removed for the purposes of calculating yield).