

AIR CANADA 

Third Quarter 2014

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

November 6, 2014



TABLE OF CONTENTS

1. Highlights	1
2. Introduction and Key Assumptions	3
3. Overview	5
4. Results of Operations – Third Quarter 2014 versus Third Quarter 2013	13
5. Results of Operations – First Nine Months 2014 versus First Nine Months 2013	26
6. Fleet	36
7. Financial and Capital Management	38
7.1. Liquidity	38
7.2. Financial Position	38
7.3. Adjusted Net Debt	39
7.4. Working Capital	40
7.5. Consolidated Cash Flow Movements	41
7.6. Capital Expenditures and Related Financing Arrangements	42
7.7. Pension Funding Obligations	43
7.8. Contractual Obligations	44
7.9. Share Information	45
8. Quarterly Financial Data	46
9. Financial Instruments and Risk Management	48
10. Critical Accounting Estimates	49
11. Accounting Policies	50
12. Off-Balance Sheet Arrangements	50
13. Related Party Transactions	50
14. Risk Factors	50
15. Controls and Procedures	50
16. Non-GAAP Financial Measures	52
17. Glossary	57

1. HIGHLIGHTS

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

(Canadian dollars in millions, except where indicated)	Third Quarter			First Nine Months		
	2014	2013	\$ Change	2014	2013	\$ Change
Financial Performance Metrics						
Operating revenues	3,798	3,479	319	10,168	9,488	680
Operating income	526	416	110	709	484	225
Non-operating expense ⁽¹⁾	(203)	(125)	(78)	(504)	(476)	(28)
Net income	323	299	24	205	16	189
Adjusted net income ⁽²⁾	457	365	92	464	337	127
Operating margin %	13.8%	12.0%	1.8 pp	7.0%	5.1%	1.9 pp
EBITDAR ⁽³⁾	749	626	123	1,352	1,156	196
EBITDAR margin % ⁽³⁾	19.7%	18.0%	1.7 pp	13.3%	12.2%	1.1 pp
Unrestricted liquidity ⁽⁴⁾	2,802	2,412	390	2,802	2,412	390
Free cash flow ⁽⁵⁾	(192)	(249)	57	(194)	45	(239)
Adjusted net debt ⁽⁶⁾	4,623	4,104	519	4,623	4,104	519
Return on invested capital ("ROIC") % ⁽⁷⁾	11.4%	10.2%	1.2 pp	11.4%	10.2%	1.2 pp
Net income per share – diluted	\$ 1.10	\$ 1.05	\$ 0.05	\$ 0.69	\$ 0.05	\$ 0.64
Adjusted net income per share – diluted ⁽²⁾	\$ 1.55	\$ 1.29	\$ 0.26	\$ 1.58	\$ 1.19	\$ 0.39
Operating Statistics ⁽⁸⁾			% Change			% Change
Revenue passenger miles (millions) ("RPM")	18,565	16,726	11.0	47,526	43,906	8.2
Available seat miles (millions) ("ASM")	21,299	19,404	9.8	56,486	52,540	7.5
Passenger load factor %	87.2%	86.2%	1.0 pp	84.1%	83.6%	0.6 pp
Passenger revenue per RPM ("Yield") (cents)	18.5	18.8	(1.3)	18.8	19.0	(1.1)
Passenger revenue per ASM ("PRASM") (cents)	16.1	16.2	(0.2)	15.8	15.9	(0.4)
Operating revenue per ASM (cents)	17.8	17.9	(0.5)	18.0	18.1	(0.3)
Operating expense per ASM ("CASM") (cents)	15.4	15.8	(2.6)	16.7	17.1	(2.3)
Adjusted CASM (cents) ⁽⁹⁾	10.1	10.4	(2.9)	11.1	11.5	(3.5)
Average number of full-time equivalent ("FTE") employees (thousands) ⁽¹⁰⁾	24.6	24.5	0.3	24.5	24.6	(0.4)
Aircraft in operating fleet at period-end	362	351	3.1	362	351	3.1
Average fleet utilization (hours per day)	10.8	10.8	0.3	10.2	10.3	(0.7)
Seats dispatched (thousands)	13,518	12,633	7.0	37,403	35,586	5.1
Aircraft frequencies (thousands)	150	146	3.0	420	417	0.9
Average stage length (miles) ⁽¹¹⁾	1,576	1,536	2.6	1,510	1,476	2.3
Economic fuel cost per litre (cents) ⁽¹²⁾	90.0	89.6	0.4	91.9	89.2	3.0
Fuel litres (millions)	1,200	1,111	8.0	3,221	3,050	5.6
Revenue passengers carried (thousands) ⁽¹³⁾	10,979	9,968	10.1	29,337	27,261	7.6

- (1) *In the third quarter of 2013, Air Canada recorded an interest charge of \$95 million related to the purchase of its senior secured notes due in 2015 and 2016.*
- (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.*
- (3) *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.*
- (4) *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 September 30, 2014, unrestricted liquidity was comprised of cash and short-term investments of \$2,528 million and undrawn lines of credit of \$274 million. At September 30, 2013, unrestricted liquidity was comprised of cash and short-term investments of \$2,309 million and undrawn lines of credit of \$103 million.*
- (5) *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.*
- (6) *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.*
- (7) *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.*
- (8) *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.*
- (9) *Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.*
- (10) *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.*
- (11) *Average stage length is calculated by dividing the total number of available seat miles by the total number of seats dispatched.*
- (12) *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.*
- (13) *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 third quarter 2014. This MD&A should be read in conjunction with Air Canada's interim unaudited condensed consolidated financial statements and notes for the third 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 November 5, 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 November 6, 2014 reporting on its results for the third 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 November 5, 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 annual Canadian GDP growth of 2.0% to 2.5% for 2014 and 2015. In addition, Air Canada expects that the Canadian dollar will trade, on average, at C\$1.12 per U.S. dollar in the fourth quarter of 2014 and C\$1.10 for the full year 2014 and that the price of jet fuel will average 82 cents per litre for the fourth quarter of 2014 and 90 cents per litre for the full year 2014. For the full year 2015, Air Canada expects that the Canadian dollar will trade, on average, at C\$1.11 per U.S. dollar and that the price of jet fuel will average 88 cents per litre.

3. OVERVIEW

On a GAAP basis, in the third quarter of 2014, Air Canada reported operating income of \$526 million compared to operating income of \$416 million in the third quarter of 2013, an increase of \$110 million, the highest for any quarter in Air Canada's history. The airline recorded net income of \$323 million or \$1.10 per diluted share in the third quarter of 2014 compared to net income of \$299 million or \$1.05 per diluted share in the third quarter of 2013, an improvement of \$24 million or \$0.05 per diluted share.

Air Canada recorded adjusted net income of \$457 million or \$1.55 per diluted share compared to adjusted net income of \$365 million or \$1.29 per diluted share in the third quarter of 2013, an improvement of \$92 million or \$0.26 per diluted share. Air Canada generated EBITDAR of \$749 million compared to EBITDAR of \$626 million in the third quarter of 2013, an improvement of \$123 million. The adjusted net income and EBITDAR results for the third quarter of 2014 are the highest for any quarter in Air Canada's history. Adjusted net income and EBITDAR are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

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 enhancement 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 business 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 unit costs, improve operating margins and increase the airline's 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. With over 12 months of data now available, Air Canada *rouge* Airbus A319 and Boeing 767 aircraft are delivering a 23% and 30% CASM reduction, respectively, versus the Airbus A319 and Boeing 767 aircraft in the airline's mainline fleet. These CASM improvements are mainly driven by increased seat density, lower wage rates and more competitive work rules, as well as 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. The new 458-seat Boeing 777 aircraft, with its higher seat density, is delivering a 20% lower CASM than the 349-seat Boeing 777 aircraft in the airline's mainline 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. Air Canada has estimated that the Boeing 787 aircraft will deliver a fuel and maintenance CASM reduction of 29% versus the Boeing 767 aircraft.
- Other ongoing cost reduction initiatives which are expected to deliver additional cost savings in excess of \$100 million per annum within the next four to 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 ("Toronto Pearson") and other Canadian hubs with the objective of increasing global connecting traffic via Canada.

In the first nine months of 2014, Air Canada continued to make progress in pursuing its strategic initiatives to reduce costs, enhance revenues and achieve sustainable profitability.

Revenue Enhancement and Cost Transformation

Margin improvement through sustainable cost reduction and revenue enhancements remains a key priority at Air Canada. Air Canada continues to take significant actions to reduce costs and generate incremental revenue. In the third quarter of 2014, Air Canada reported an operating margin of 13.8%, a 1.8 percentage point improvement from the same quarter in 2013. The airline reported record revenues of \$3,798 million in the third quarter of 2014, growth of 9% year-over-year while operating expenses increased 7%. For the first nine months of 2014, an operating margin of 7.0% was 1.9 percentage points higher than the first nine months of 2013.

Air Canada continues to make progress in lowering its unit cost through the execution of several strategic initiatives as further described above and through its continued focus on cost transformation. In the third quarter of 2014, adjusted CASM declined 2.9% from the same quarter in 2013 while adjusted CASM for the first nine months of 2014 decreased 3.5% year-over-year. The adjusted CASM improvements in 2014 were realized despite the impact of a much lower Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) when compared to the same periods in 2013. Had the value of the Canadian dollar remained at 2013 levels, adjusted CASM for the third quarter and the first nine months of 2014 would have reflected declines of 4.7% and 5.5%, respectively.

Air Canada has made an adjustment to its first checked bag policy for North American travel to align it with prevailing North American industry practice. The airline's fee for a first checked bag on U.S. transborder routes, in place since 2011, remains unchanged. As of September 18, 2014, customers purchasing Air Canada's lowest Economy Class Tango fare for travel on or after November 2, 2014 on domestic flights within Canada and to and from the Caribbean and Mexico will be charged \$25 for a first checked bag, in line with the baggage allowance policies of other North American carriers. The fee for a first checked bag does not apply to Economy Class tickets purchased using Flex and Latitude fares that offer additional flexibility, nor does it apply to Altitude Prestige, Elite and Super Elite members, Star Alliance Silver and Gold members and customers purchasing Air Canada Vacations packages.

In October 2013, the Greater Toronto Airports Authority ("GTAA") and Air Canada concluded an enhanced commercial relationship which is allowing Air Canada to grow its share of international connecting traffic at Toronto Pearson airport on a more cost effective basis.

Following receipt of exemptions under the Canadian Aviation Regulations allowing for a ratio of one flight attendant for every 50 passenger seats, Air Canada is aligning its operations to allow for this change on its narrow-body mainline and Air Canada *rouge* aircraft. When fully transitioned, these changes are expected to result in annual cost savings of \$28 million, on a run-rate basis. The savings associated with these changes began being realized in the third quarter of 2014.

On May 1, 2014, the airline outsourced its London ground handling operations to a third party provider which is expected to result in net annual savings of \$10 million, on a run-rate basis. The savings associated with this outsourcing began being realized in May 2014.

Air Canada is implementing a new passenger revenue management system aimed at optimizing its revenue performance on the basis of a passenger's full trip itinerary as opposed to managing its network routes on a leg basis. The implementation of this new system is progressing smoothly and the airline expects estimated incremental annual revenues in excess of \$100 million, on a run-rate basis, beginning in 2015.

In order to improve the economics of its standard configuration Boeing 777 long-haul fleet and to provide customers with a consistent product with its new Boeing 787 Dreamliners, the airline announced plans to convert 12 Boeing 777-300ER and six Boeing 777-200LR aircraft into a more competitive configuration, adding a premium economy cabin and refurbishing the International Business Class cabin to the new Boeing 787 state-of-the-art standards. The reconfiguration is designed to both lower unit costs and to allow the airline to compete more effectively and deliver a harmonized product offering across its flagship international fleet. The reconfiguration project is planned to start in late

2015 and is expected to be completed in the second half of 2016. The capital expenditures related to this program are approximately \$300 million with a payback period of less than three years.

International Expansion

International growth is one of the building blocks for making Air Canada stronger and more profitable. Air Canada's wide-body fleet is an important element of its strategy to develop its network internationally and further strengthen its position as a global player.

In addition to the five new higher-density Boeing 777-300ER aircraft currently deployed on select markets where there is high demand for economy travel, as of the date of this MD&A, Air Canada has introduced five Boeing 787-8 aircraft into the mainline fleet. The Boeing 787 aircraft are currently operating the airline's route from Toronto to Tokyo-Haneda, Toronto to Tel Aviv and Vancouver to Shanghai. The airline also plans to convert its Toronto-Paris, Vancouver-Tokyo-Narita, Vancouver-Beijing and Vancouver-Seoul services to Boeing 787 Dreamliner service over the 2014-2015 winter months and will make other adjustments to deployment as conditions warrant, including as new aircraft enter service. Air Canada will take delivery of a total of 37 Boeing 787 aircraft by the end of 2019 (with five scheduled deliveries for 2015), transforming its international wide-body fleet using the advancements in aviation technology for fuel efficiency and customer comfort. Air Canada's Dreamliner fleet plan provides for a total of 15 Boeing 787-8 aircraft and 22 of the larger capacity Boeing 787-9 aircraft. As Air Canada takes delivery of additional Boeing 787 aircraft, additional Boeing 767 aircraft will be moved from the mainline fleet to the Air Canada *rouge* fleet.

The expansion of Air Canada's leisure carrier, in tandem with Air Canada's mainline fleet renewal, is a key element of the airline's strategy for sustainable, profitable growth at both airlines. Through Air Canada *rouge*, Air Canada expects to continue to enhance margins on leisure routes previously operated by Air Canada mainline and to pursue opportunities in international leisure markets made viable by Air Canada *rouge*'s more competitive cost structure. Air Canada *rouge* is best suited to compete more cost effectively in markets where there is both a high leisure travel demand and low-cost competition. Since the launch of Air Canada *rouge* on July 1, 2013, Air Canada has deployed its leisure carrier to a growing number of Caribbean, European and select leisure destinations in the United States.

Air Canada recently announced that it is enhancing its international summer 2015 schedule, including:

- Year-round Air Canada service between Toronto Pearson and Amsterdam to be operated with a 211-seat, Boeing 767-300ER aircraft with 24 International Business Class pods, featuring fully lie-flat seats. Flights begin June 4, 2015 and will be operated up to six times weekly.
- Double-daily Air Canada service from both Toronto Pearson and Montreal to Paris-Charles de Gaulle. The additional flights will be offered from June to September 2015 operated using Boeing 767-300ER aircraft with 24 International Business Class pods featuring fully lie-flat seats.
- New non-stop Air Canada service from Toronto Pearson to Panama City. With the launch of the three-times weekly, year-round service, Air Canada will be the only Canadian network carrier operating between Canada and Panama. The service will be provided with an Airbus A319 aircraft with 120 seats. The flights will also be timed to offer convenient onward connections from Tocumen International Airport.
- New non-stop Air Canada service from Toronto Pearson to Rio de Janeiro for winter 2014-2015 which will continue to operate during the summer of 2015. These year-round flights will be operated with a Boeing 767-300ER aircraft and will complement Air Canada's existing daily non-stop service to Sao Paulo. Air Canada will become the only carrier offering non-stop flights between Canada and Rio de Janeiro.
- New Air Canada *rouge* twice weekly service between Montreal and Venice beginning May 14, 2015 and up to five flights per week between Vancouver and Osaka-Kansai beginning May 1, 2015.

- An increase to daily from five times a week on Air Canada *rouge* service from Toronto Pearson to Athens and Barcelona, and an increase to four times from three weekly on service from Toronto to Venice. From Montreal, Air Canada *rouge* service to Athens will double to four times weekly and service to Barcelona will increase to three-times weekly from twice weekly in summer 2014. Overall, Air Canada *rouge* service to Athens, Barcelona, Lisbon, Manchester and Nice will operate a longer season during the summer of 2015 compared to the summer 2014.
- Air Canada *rouge* year-round service between Toronto Pearson and Lima, Peru beginning May 2, 2015, subject to government approval, a route that is currently being operated by mainline.

By peak summer 2015, Air Canada, Air Canada *rouge* and its regional commercial partners flying under the Air Canada Express™ banner will operate on average approximately 11,295 flights per week to 185 destinations: 60 in Canada, 50 in the United States, 39 in the Caribbean and Mexico, 22 European gateways, and 14 across Asia, Australia and South America. Air Canada will continue to evaluate future market opportunities as new aircraft are introduced into its mainline fleet and existing aircraft are released for operation by Air Canada *rouge*. As of the date of this MD&A, the Air Canada *rouge* fleet was comprised of 20 Airbus A319 aircraft and 8 Boeing 767 aircraft. Air Canada *rouge* may operate up to 50 aircraft.

On September 24th, Air Canada and Air India announced a series of new codeshare routes that will improve air travel connectivity between Canada and India. Beginning in October 2014, Air Canada will place its AC code on Air India services from Delhi to London Heathrow, Milan, Paris-Charles de Gaulle, Hong Kong, Tokyo-Narita and Shanghai, and from Mumbai to London Heathrow. It will also place its code on Air India's domestic flights from Delhi and Mumbai to Amritsar, Ahmedabad, Bangalore, Kolkata, Hyderabad and Chennai.

As part of its international expansion strategy, Air Canada continues to grow global international-to-international transit traffic via Canada through its world-class hub in Toronto and its strong international gateways in Montreal, Vancouver and Calgary. Over the last several years, Air Canada has been successful in growing this so-called sixth freedom traffic, particularly from the U.S., by leveraging its award-winning products and services, its geographically well-positioned hubs in Canada, its extensive network and other competitive advantages. In the first nine months of 2014, international-to-international connecting traffic increased 26% when compared to the same period in 2013.

Customer Engagement

Air Canada continually seeks to enhance the travel experience and recognizes that its success is dependent on consistently delivering superior value and innovative products, continually striving to provide the highest levels of customer service, and anticipating the evolving needs of customers.

Air Canada recently launched an enhanced Preferred Seats program. The airline has reconfigured its narrow-body aircraft with more Preferred Seats, which provide up to an additional four inches (10.16 cm) of legroom, and is making it easier for customers to conveniently purchase these seats when booking or at any time prior to boarding, including through its website, its airport kiosks or mobile devices. Most Preferred Seats are located near the front of the aircraft, enabling customers to disembark more quickly at their destination.

Furthermore, Air Canada, the first Canadian carrier to offer customers in-flight Wi-Fi connectivity, began rolling out connectivity across its North American fleet in May 2014 under an agreement with Gogo®. Air Canada plans to outfit its Airbus A319, A320 and A321 and Embraer 190 aircraft, as well as its Air Canada Express CRJ-705 and Embraer 175 aircraft, with Air-To-Ground Wi-Fi connectivity. Installations began in May with the goal of equipping 29 aircraft in 2014 and a targeted completion date of December 2015 for the designated 130 narrow-body aircraft. The agreement with Gogo® also provides for future type-testing of Gogo® satellite solutions for Wi-Fi on international flights.

Over the last several years, Air Canada has been working closely with the GTAA to improve all aspects of customer and baggage processing include faster check-in lines and less wait times at U.S. pre-clearance.

In June 2014, Air Canada officially opened its latest International Maple Leaf Lounge® at London Heathrow Airport's new Terminal 2. Located at Star Alliance's largest airport hub, Air Canada's newest International Maple Leaf Lounge was created as an extension of the overall travel experience for its International Business customers. Air Canada's London

International Lounge is the airline's 21st Maple Leaf Lounge, and one of three lounges in Europe, along with departure lounges at Paris-Charles de Gaulle and Frankfurt. In the United States, Air Canada operates Maple Leaf Lounges at Los Angeles International Airport and at New York LaGuardia. In Canada, Air Canada has 15 Maple Leaf Lounges at airports across the country.

As of the date of this MD&A, in 2014, Air Canada received the following important industry awards which demonstrate its customers' appreciation of the airline's extensive network, alliance relationships and leading products and services, as well as their recognition of the dedication and professionalism of Air Canada employees.

- "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.
- "Canada's Favourite Airline for Business Travel" in the 2014 Ipsos Reid Canadian Business Traveller Study. Air Canada was the preferred airline of 83% of Canadian frequent business travellers surveyed for 2014, an improvement of 14 percentage points in Air Canada's ratings in the national survey over the past six years. The survey showed consistently strong ratings in customer preference for Air Canada's frequent flyer reward program, flight schedule, business class service, Maple Leaf Lounges and complimentary in-flight entertainment.
- "Best Long Haul Airline (Americas)" by the respected airline safety and product reviewing website, AirlineRatings.com. The results are based on ratings of 450 airlines globally by hundreds of thousands of passengers.
- "Favourite Scheduled Airline" by the Baxter Travel Media Agent's Choice Award for the fifth year in a row. Air Canada not only earned top spot in the national vote, but was also the favourite of agents in all four regions across Canada.
- "Best North American Airline", for the second consecutive year, by the readers of the various TTG Asia publications at the 25th annual TTG Asia Travel Awards 2014 honoring the best of the best of the Asia Pacific travel trade.

Culture Change

A cornerstone of Air Canada's business strategy is to transform its corporate culture to one that embraces leadership, accountability and entrepreneurship. Air Canada believes that a healthy and dynamic corporate culture provides a competitive advantage which can have a significant impact on its long-term performance. Air Canada continues to foster positive changes to its culture by promoting entrepreneurship, engagement, empowerment and earnings for performance. Air Canada seeks to foster a common sense of purpose, shared values and common goals among employees and continues to focus on effectively communicating the rationale behind its strategic initiatives and the importance of adapting to changing market conditions.

In a recent survey of its employees, the airline saw a significant improvement in employee engagement. Most notably, the survey suggested that most employees are familiar with Air Canada's key priorities and believe that the airline is on the right track towards stability. Generally, employees observed signs of increased and improved culture change occurring in the workplace and indicated their pride in working for Air Canada. Furthermore, the survey indicated employees sensed a heightened sense of community and teamwork.

Air Canada continues to be awarded many industry honours, proof that employees are participating in the airline's transformation and recognize that the airline's success depends on providing top customer care.

Air Canada is proud to be recognized, for a second year in a row, as one of "Canada's Top 100 Employers" in an annual survey by Mediacorp Canada Inc., confirming the airline's progress on culture change. The national competition selects top companies after conducting a detailed review of their operations and human resources practices, including a comparison to others in their industry and region. The annual competition evaluates and identifies the country's leading

companies and organizations for attracting and retaining employees. The competition focuses on eight key areas: physical workplace; work and social atmosphere; health, financial and family benefits; vacation and time off; employee communications; performance management; training and skills development and community involvement. In citing Air Canada, Mediacorp noted that Air Canada "recognizes and encourages employee volunteers through the Volunteer Involvement Program – donating airline tickets to charitable organizations where employees volunteer."

In August 2014, Air Canada released the 2013 edition of Citizens of the World, the airline's third corporate sustainability report. The document evaluates Air Canada's performance during 2013 in four key areas of sustainability: safety, the environment, the well-being of employees, and the company's community involvement. Communities are important to Air Canada because they are home to its customers and employees and connecting people and communities is the essence of the airline's business. For this reason, Air Canada ensures economic, environmental and social sustainability considerations are part of its decision-making and one way the airline does this is by reporting on its activities through Citizens of the World.

Agreement with the Air Canada Pilots Association

On October 31, 2014, Air Canada announced that a ten-year collective agreement reached with the Air Canada Pilots Association ("ACPA") was ratified by Air Canada's pilots. The new agreement, which is a tangible indication of the shift in culture underway at Air Canada, provides greater stability and long-term cost certainty. In addition, the agreement provides for increased flexibility with respect to regional airline capacity purchase agreements to help ensure cost competitiveness. It also facilitates the evolution of Air Canada *rouge* into a stronger leisure carrier with improved fleet renewal flexibility and terms. As well, the agreement provides additional codeshare and joint venture flexibility and scope. The agreement is subject to certain openers and benchmarks over the 10-year period.

Third Quarter 2014 Financial Summary

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

- Operating revenues of \$3,798 million, an increase of \$319 million or 9% from the third quarter of 2013.
- An ASM capacity increase of 9.8% from the third quarter of 2013, in line with the 9.0% to 10.0% capacity increase projected in Air Canada's news release dated August 7, 2014. The capacity growth in the third quarter of 2014 was primarily driven by increased seat density from Air Canada *rouge*, the five high-density Boeing 777-300ER aircraft brought into Air Canada's mainline fleet in the second half of 2013 and early 2014 and, to a lesser extent, the introduction of four Boeing 787 aircraft into the mainline fleet.
- Passenger revenues of \$3,476 million, an increase of \$299 million or 9.4% from the third quarter of 2013, on traffic growth of 11.0% partly offset by a yield decline of 1.3%. An increase in average stage length of 2.6% had the effect of reducing system yield by 1.5 percentage points. On a stage length adjusted basis, system yield improved 0.2% year-over-year.
- A PRASM decline of 0.2% from the third quarter of 2013, as the 1.3% decline in yield was almost fully offset by a passenger load factor improvement of 1.0 percentage points.
- An adjusted CASM reduction of 2.9% from the third quarter of 2013, less than the 3.5% to 4.5% adjusted CASM decrease projected in Air Canada's news release dated August 7, 2014. This was primarily due to higher than forecasted expenses related to employee profit sharing programs due to better than expected results and to higher than expected depreciation expense largely due to Air Canada having recorded a depreciation charge related to certain aircraft maintenance events in the third quarter of 2014. Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" for additional information.
- Operating income of \$526 million compared to operating income of \$416 million in the third quarter of 2013, an improvement of \$110 million. Operating margin of 13.8% improved 1.8 percentage points from the third quarter of 2013.
- Net income of \$323 million or \$1.10 per diluted share compared to a net income of \$299 million or \$1.05 per diluted share in the third quarter of 2013. The net income in the third quarter of 2014 included foreign exchange losses of \$71 million. The net income in the third quarter of 2013 included foreign exchange gains of \$49 million.
- EBITDAR of \$749 million compared to EBITDAR of \$626 million in the third quarter of 2013, an increase of \$123 million. EBITDAR is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" for additional information.
- Adjusted net income of \$457 million or \$1.55 per diluted share compared to adjusted net income of \$365 million or \$1.29 per diluted share in the third quarter of 2013, an improvement of \$92 million or \$0.26 per diluted share. Adjusted net-income is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" for additional information.
- Negative free cash flow of \$192 million, an improvement of \$57 million from the third quarter of 2013, on higher cash flows generated from operating activities, the result of stronger operating results. This improvement in cash from operating activities was largely offset by an increase in capital expenditures which included the acquisition of two Boeing 787 aircraft during the third 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 \$4,623 million at September 30, 2014, an increase of \$519 million from December 31, 2013. The airline's adjusted net debt to EBITDAR ratio was 2.8 at September 30, 2014, (2.9 at June 30, 2014 and 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 \$2,802 million at September 30, 2014 (September 30, 2013 – \$2,412 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 September 30, 2014, cash and short-term investments amounted to \$2,528 million and undrawn lines of credit amounted to \$274 million. At September 30, 2013, cash and short-term investments amounted to \$2,309 million and undrawn lines of credit amounted to \$103 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 September 30, 2014 was 11.4% (11.0% for the trailing 12 months ended June 30, 2014 and 10.5% for the trailing 12 months ended December 31, 2013). This compares to 10.2% for the 12 months ended September 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 – THIRD QUARTER 2014 VERSUS THIRD QUARTER 2013

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

(Canadian dollars in millions, except per share figures)	Third Quarter		Change	
	2014	2013	\$	%
Operating revenues				
Passenger	\$ 3,476	\$ 3,177	\$ 299	9
Cargo	128	120	8	7
Other	194	182	12	7
Total revenues	3,798	3,479	319	9
Operating expenses				
Aircraft fuel	1,076	1,002	74	7
Wages, salaries, and benefits	561	565	(4)	(1)
Capacity purchase agreements	312	295	17	6
Airport and navigation fees	281	274	7	3
Aircraft maintenance	166	131	35	27
Sales and distribution costs	173	159	14	9
Depreciation, amortization and impairment	146	130	16	12
Ground package costs	56	52	4	8
Aircraft rent	77	80	(3)	(4)
Food, beverages and supplies	88	80	8	10
Communications and information technology	50	49	1	2
Other	286	246	40	16
Total operating expenses	3,272	3,063	209	7
Operating income	526	416	110	
Non-operating income (expense)				
Foreign exchange gain (loss)	(71)	49	(120)	
Interest income	11	7	4	
Interest expense ⁽¹⁾	(81)	(174)	93	
Interest capitalized	6	15	(9)	
Net financing expense relating to employee benefits	(34)	(51)	17	
Fuel and other derivatives	(31)	30	(61)	
Other	(3)	(1)	(2)	
Total non-operating expense	(203)	(125)	(78)	
Income before income taxes	323	291	32	
Income taxes	-	8	(8)	
Net income	\$ 323	\$ 299	\$ 24	
Net income per share – basic	\$ 1.13	\$ 1.08	\$ 0.05	
Net income per share – diluted	\$ 1.10	\$ 1.05	\$ 0.05	
EBITDAR ⁽²⁾	\$ 749	\$ 626	\$ 123	
Adjusted net income ⁽³⁾	\$ 457	\$ 365	\$ 92	
Adjusted net income per share – diluted ⁽³⁾	\$ 1.55	\$ 1.29	\$ 0.26	

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

(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) 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 9.4% from the third quarter of 2013

In the third quarter of 2014, on capacity growth of 9.8%, system passenger revenues of \$3,476 million increased \$299 million or 9.4% from 2013 third quarter system passenger revenues of \$3,177 million. The increase in third quarter system passenger revenues was due to traffic growth of 11.0% partly offset by a yield decline of 1.3%. An increase in average stage length of 2.6% from the same quarter of 2013 had the effect of reducing system yield by 1.5 percentage points. On a stage length adjusted basis, system yield improved 0.2% year-over-year. The favourable impact of a weaker Canadian dollar on foreign currency denominated passenger revenues increased passenger revenues by \$67 million in the third quarter of 2014.

In the third quarter of 2014, system business cabin revenues increased \$31 million or 5.3% on yield growth of 5.3%. Business cabin PRASM improvements were recorded in all markets.

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

Passenger Revenue	Third Quarter 2014 \$ Million	Third Quarter 2013 \$ Million	Change \$ Million	% Change
Canada	1,246	1,170	76	6.5
U.S. transborder	591	531	60	11.2
Atlantic	941	819	122	14.9
Pacific	537	497	40	8.3
Other	161	160	1	0.5
System	3,476	3,177	299	9.4

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

Third Quarter 2014 Versus Third Quarter 2013	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	6.5	5.3	6.9	1.2	(0.7)	0.8
U.S. transborder	11.2	12.7	16.2	2.5	(3.7)	(0.7)
Atlantic	14.9	20.2	19.2	(0.8)	(3.5)	(4.4)
Pacific	8.3	1.6	3.6	1.7	4.9	7.0
Other	0.5	2.2	3.6	1.1	(2.4)	(1.1)
System	9.4	9.8	11.0	1.0	(1.3)	(0.2)

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

System	Year-over-Year by Quarter (% Change)				
	Q3'13	Q4'13	Q1'14	Q2'14	Q3'14
Passenger revenues	4.9	1.9	3.2	7.5	9.4
Capacity (ASMs)	3.0	3.5	3.8	8.5	9.8
Traffic (RPMs)	2.9	2.5	2.9	9.9	11.0
Passenger load factor (pp change)	(0.1)	(0.9)	(0.7)	1.1	1.0
Yield	2.0	(0.6)	0.4	(2.1)	(1.3)
PRASM	1.8	(1.7)	(0.5)	(0.8)	(0.2)

In the third quarter of 2014, Air Canada’s system capacity was 9.8% higher than in the third quarter of 2013, with capacity growth reflected in all markets.

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

- The 11.0% 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 third quarter of 2014 also reflected incremental connecting traffic to international destinations.
- The 1.3% yield decrease which was largely the result of the following:
 - o An increase in average stage length of 2.6% from the same quarter of 2013 which had the effect of reducing system yield by 1.5 percentage points.
 - o The domestic yield decrease of 0.7% which reflected higher proportional growth of lower-yielding international and U.S. transborder passenger flows, as well as declines on regional routes within Ontario and Quebec and on routes within Western Canada. These yield decreases were partly offset by yield growth on transcontinental services. Overall, domestic yield, excluding connecting traffic to U.S. and international destinations, was positive year-over-year.
 - o The U.S. transborder yield decline of 3.7% which reflected, in large part, a 3.8% longer average stage length, which had the effect of reducing U.S. transborder yield by 2.2 percentage points. In addition, the U.S. transborder market was impacted by a higher proportion of seats into long-haul markets, led by new and increased lower-cost leisure flying by Air Canada *rouge*. Additionally, the third quarter of 2014 experienced a significantly higher proportion of lower-yielding incremental international passenger flows in support of the airline’s international expansion strategy. A favourable currency impact of \$12 million partly offset the yield decrease.
 - o The Atlantic yield decline of 3.5% which reflected, in large part, the impact of a higher proportion of seats into long-haul markets, led by new and increased lower-cost leisure flying by Air Canada *rouge*. In addition, certain Atlantic services are being served with lower-cost Boeing 777 higher-density aircraft which have a larger economy cabin. A favourable currency impact of \$30 million partly offset the yield decrease.
 - o The 2.4% yield decline in the Other markets which reflected a yield decrease on routes to South America partly offset by yield growth on routes to Mexico and to traditional sun destinations. South American yields were impacted by the airline’s suspension of service to Venezuela, as well as the temporary use of higher-density wetleased Boeing 767 aircraft, which had no business cabin, on services to Lima and Bogota.

Partly offsetting these yield declines were:

- o The Pacific yield growth of 4.9% which was largely driven by strong passenger demand, reduced capacity on key routes, improvements in the airline’s business cabin revenue performance, an increase in premium economy traffic and a favourable currency impact of \$13 million.

System PRASM decreased 0.2% year-over-year as the impact of the lower yield was almost fully offset by a 1.0 percentage point improvement in passenger load factor.

Domestic passenger revenues increased 6.5% from the third quarter of 2013

In the third quarter of 2014, on capacity growth of 5.3%, domestic passenger revenues of \$1,246 million increased \$76 million or 6.5% from the third quarter of 2013. The increase in domestic passenger revenues was due to traffic growth of 6.9% partly offset by a yield decline of 0.7%.

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

Canada	Year-over-Year by Quarter (% Change)				
	Q3'13	Q4'13	Q1'14	Q2'14	Q3'14
Passenger revenues	2.1	(1.1)	(1.5)	2.2	6.5
Capacity (ASMs)	2.3	3.2	3.9	3.6	5.3
Traffic (RPMs)	1.7	2.6	1.7	5.3	6.9
Passenger load factor (pp change)	(0.5)	(0.4)	(1.8)	1.3	1.2
Yield	0.5	(3.6)	(3.5)	(3.3)	(0.7)
PRASM	-	(4.1)	(5.5)	(1.8)	0.8

In the third quarter of 2014, the 5.3% domestic capacity growth reflected capacity increases on all major domestic services.

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

- The 6.9% traffic increase which reflected traffic growth on all major domestic services. The traffic growth in the third quarter of 2014 reflected increases on services within Canada, as well as incremental connecting traffic to U.S. and international destinations.
- The 0.7% yield decrease which reflected higher proportional growth of lower-yielding international and U.S. transborder passenger flows, as well as declines on regional routes within Ontario and Quebec and on routes within Western Canada. These yield decreases were partly offset by yield growth on transcontinental services. Overall, domestic yield, excluding connecting traffic to U.S. and international destinations, improved year-over-year.

The domestic PRASM increase of 0.8% from the third quarter of 2013 was due to a 1.2 percentage point improvement in passenger load factor partly offset by the yield decrease.

U.S. transborder passenger revenues increased 11.2% from the third quarter of 2013

In the third quarter of 2014, on a capacity growth of 12.7%, U.S. transborder passenger revenues of \$591 million increased \$60 million or 11.2% from the third 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 3.7%.

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

U.S. transborder	Year-over-Year by Quarter (% Change)				
	Q3'13	Q4'13	Q1'14	Q2'14	Q3'14
Passenger revenues	4.7	8.1	5.7	11.5	11.2
Capacity (ASMs)	(1.6)	1.6	1.9	12.2	12.7
Traffic (RPMs)	0.5	4.0	5.7	16.2	16.2
Passenger load factor (pp change)	1.7	1.8	2.9	2.8	2.5
Yield	4.7	4.2	0.3	(3.3)	(3.7)
PRASM	7.0	6.6	4.0	0.1	(0.7)

In the third quarter of 2014, the 12.7% 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. Capacity on U.S. short-haul routes was unchanged when compared to the same quarter in 2013.

Components of the year-over-year change in third 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 capacity. Consistent with the airline’s objective of increasing global international-to-international connecting traffic through Toronto Pearson, the third quarter of 2014 experienced significantly higher proportional growth of lower-yielding international-to-international passenger flows from the U.S. relative to the third quarter of 2013, in addition to experiencing traffic growth between Canada and the U.S.
- The 3.7% yield decline which largely reflected a 3.8% longer average stage length, driven by route composition changes as long-haul (lower-yielding) capacity grew while short-haul (higher-yielding) capacity was unchanged when compared to the third quarter of 2013. This increase in average stage length had the effect of reducing U.S. transborder yield by 2.2 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, the third quarter of 2014 experienced a significantly higher proportion of lower-yielding incremental international-to-international passenger flows in support of the airline’s international expansion strategy. Partly offsetting these yield decreases were a favourable currency impact of \$12 million as well as improvements in Air Canada’s business cabin revenue performance as a result of pricing changes and a significant increase in higher-yielding short-haul traffic.

PRASM decreased 0.7% from the third quarter of 2013 as the lower yield was largely offset by a passenger load factor improvement of 2.5 percentage points.

Atlantic passenger revenues increased 14.9% from the third quarter of 2013

In the third quarter of 2014, on capacity growth of 20.2%, Atlantic passenger revenues of \$941 million increased \$122 million or 14.9% from the third quarter of 2013. The increase in Atlantic passenger revenues was due to traffic growth of 19.2% as yield declined 3.5%.

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

Atlantic	Year-over-Year by Quarter (% Change)				Q3'14
	Q3'13	Q4'13	Q1'14	Q2'14	
Passenger revenues	11.0	2.7	8.3	12.3	14.9
Capacity (ASMs)	2.1	5.9	7.6	16.2	20.2
Traffic (RPMs)	3.1	1.7	1.2	14.7	19.2
Passenger load factor (pp change)	0.8	(3.1)	(4.5)	(1.1)	(0.8)
Yield	7.6	0.7	7.1	(2.0)	(3.5)
PRASM	8.6	(3.2)	0.7	(3.3)	(4.4)

In the third quarter of 2014, the Atlantic capacity growth of 20.2% reflected capacity increases on all major Atlantic services.

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

- The 19.2% traffic increase which reflected traffic growth on all major Atlantic services, including traffic growth between the U.S. and Europe via the airline’s major Canadian hubs, in line with Air Canada’s international growth strategy.
- The 3.5% yield decline which reflected, in large part, a higher proportion of seats into long-haul leisure markets. This was driven by additional Atlantic services being served with lower-cost Boeing 777 higher-density aircraft which have a larger economy cabin, new and increased lower-cost leisure flying by Air Canada *rouge* which offers a Premium *rouge* product but has no international business cabin, and the temporary use of higher-density wetleased Boeing 767 aircraft, which had no business cabin, on certain routes. Increased industry capacity and a very competitive pricing environment, particularly in the economy cabin, were also factors to the yield decline. Partly offsetting these yield decreases were a favourable currency impact of \$30 million as well as improvements in Air Canada’s business cabin revenue performance and an increase in premium economy traffic which resulted in higher average fares.

The 4.4% PRASM decrease was due to the lower yield and a 0.8 percentage point decline in passenger load factor.

Pacific passenger revenues increased 8.3% from the third quarter of 2013

In the third quarter of 2014, on capacity growth of 1.6%, Pacific passenger revenues of \$537 million increased \$40 million or 8.3% from the third quarter of 2013. The increase in Pacific passenger revenues was due to yield and traffic growth of 4.9% and 3.6%, respectively.

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

Pacific	Year-over-Year by Quarter (% Change)				
	Q3'13	Q4'13	Q1'14	Q2'14	Q3'14
Passenger revenues	3.8	(3.2)	1.2	5.7	8.3
Capacity (ASMs)	12.1	4.4	4.6	1.8	1.6
Traffic (RPMs)	8.5	0.7	3.2	4.1	3.6
Passenger load factor (pp change)	(2.9)	(3.0)	(1.1)	1.9	1.7
Yield	(4.8)	(4.0)	(1.6)	1.8	4.9
PRASM	(7.9)	(7.4)	(2.8)	4.1	7.0

In the third quarter of 2014, the 1.6% Pacific capacity growth reflected capacity increases on services to Japan and Hong Kong largely offset by capacity decreases on services to Korea and China.

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

- The 3.6% traffic increase which reflected traffic growth on all major Pacific services with the exception of services to China and 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 on routes to Japan.
- The 4.9% yield improvement which reflected yield growth on all major Pacific services with the exception of Hong Kong where capacity was increased significantly. Yield on services to Japan was essentially at the 2013 level. 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 services to Korea, China and the South Pacific, driven mainly by strong passenger demand, reduced capacity on key routes, as well as improvements in Air Canada’s business cabin performance and an increase in premium economy traffic which resulted in higher average fares. A favourable currency impact of \$13 million was also a contributing factor to the yield growth year-over-year.

The 7.0% PRASM improvement was due to the yield growth and a passenger load factor improvement of 1.7 percentage points.

Other passenger revenues increased 0.5% from the third quarter of 2013

In the third quarter of 2014, on capacity growth of 2.2%, Other passenger revenues (comprised of routes to the Caribbean, Mexico and Central and South America) of \$161 million increased \$1 million or 0.5% from the third quarter of 2013. The increase in Other passenger revenues was due to traffic growth of 3.6% partly offset by a yield decline of 2.4%.

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

Other	Year-over-Year by Quarter (% Change)				
	Q3'13	Q4'13	Q1'14	Q2'14	Q3'14
Passenger revenues	0.6	11.5	11.0	17.7	0.5
Capacity (ASMs)	(3.9)	0.6	(1.0)	11.0	2.2
Traffic (RPMs)	(3.7)	5.0	3.1	15.7	3.6
Passenger load factor (pp change)	0.1	3.4	3.3	3.5	1.1
Yield	4.1	6.5	8.5	2.6	(2.4)
PRASM	4.2	11.1	12.9	7.0	(1.1)

In the third quarter of 2014, the 2.2% capacity growth reflected capacity increases on routes to Mexico and to traditional sun destinations largely offset by a capacity reduction on services to South America.

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

- The overall 3.6% traffic increase which reflected traffic growth on routes to Mexico and to traditional sun destinations largely offset by a traffic decrease on services to South America where capacity was reduced year-over-year. While the third quarter of 2014 experienced an increase in lower-cost leisure flying by Air Canada *rouge*, particularly on routes to the Caribbean, traffic grew in line with the capacity growth.
- The overall 2.4% yield decrease which reflected a decline on routes to South America partly offset by yield growth on routes to Mexico and to traditional sun destinations. South American yields were impacted by the airline’s suspension of service to Venezuela, as well as the temporary use of higher-density wetleased Boeing 767 aircraft, which had no business cabin, on services to Lima and Bogota.

The overall 1.1% PRASM decrease was due to the lower yield partly offset by a passenger load factor improvement of 1.1 percentage points.

Cargo revenues increased 6.5% from the third quarter of 2013

In the third quarter of 2014, cargo revenues of \$128 million increased \$8 million or 6.5% from the third quarter of 2013 due to traffic growth of 6.9% partly offset by a yield decline of 0.5% year-over-year.

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

Cargo Revenue	Third Quarter 2014 \$ Million	Third Quarter 2013 \$ Million	Change \$ Million
Canada	18	17	1
U.S. transborder	5	4	1
Atlantic	49	44	5
Pacific	50	48	2
Other	6	7	(1)
System	128	120	8

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

System	Year-over-Year by Quarter (% Change)				
	Q3'13	Q4'13	Q1'14	Q2'14	Q3'14
Cargo revenues	1.7	1.6	7.0	6.6	6.5
Capacity (ETMs)	1.2	3.5	4.1	8.2	9.6
Revenue per ETM	1.1	(2.2)	2.8	(1.5)	(3.0)
Traffic (RTMs)	2.9	4.3	6.4	11.3	6.9
Yield per RTM	(0.6)	(2.9)	0.5	(4.3)	(0.5)

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

Third Quarter 2014 Versus Third Quarter 2013	Cargo Revenue % Change	Capacity (ETMs) % Change	Rev / ETM % Change	Traffic (RTMs) % Change	Yield / RTM % Change
Canada	6.7	22.4	(12.8)	41.8	(24.7)
U.S. transborder	14.2	33.4	(14.4)	17.7	(3.0)
Atlantic	11.1	14.5	(2.9)	11.9	(0.7)
Pacific	4.5	(1.4)	5.9	-	4.5
Other	(15.3)	(6.5)	(9.4)	(12.7)	(3.0)
System	6.5	9.6	(3.0)	6.9	(0.5)

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

- The 6.9% traffic increase which reflected traffic growth in all markets with the exception of the Other markets where capacity was reduced year-over-year. The growth in traffic was mainly due to increased capacity, market share gains and strong demand from North America to Europe.
- The 0.5% yield decrease which reflected yield declines in all markets with the exception of the Pacific market. The overall yield decline was due to the impact of increased industry capacity and aggressive competitive pricing activities. In the domestic market, the use of larger aircraft on transcontinental routes put pressure on yields in the third quarter of 2014. The favourable impact of a weaker Canadian dollar on foreign currency denominated cargo revenues and strong demand out of Asia which enabled price increases were partly offsetting factors.

Other revenues increased 7% from the third 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 third quarter of 2014, Other revenues of \$194 million increased \$12 million or 7% from the third quarter of 2013 mainly due to growth in passenger-related fees and higher ground package revenues at Air Canada Vacations, the result of higher passenger volumes.

CASM decreased 2.6% from the third quarter of 2013. Adjusted CASM decreased 2.9% from the third quarter of 2013

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

(cents per ASM)	Third Quarter		Change	
	2014	2013	cents	%
Aircraft fuel	5.05	5.16	(0.11)	(2.1)
Wages and salaries	2.13	2.28	(0.15)	(6.6)
Benefits	0.50	0.63	(0.13)	(20.6)
Capacity purchase agreements	1.47	1.52	(0.05)	(3.3)
Airport and navigation fees	1.32	1.41	(0.09)	(6.4)
Aircraft maintenance	0.78	0.68	0.10	14.7
Sales and distribution costs	0.81	0.82	(0.01)	(1.2)
Depreciation, amortization and impairment	0.68	0.67	0.01	1.5
Ground package costs	0.26	0.27	(0.01)	(3.7)
Aircraft rent	0.36	0.41	(0.05)	(12.2)
Food, beverages and supplies	0.41	0.41	-	-
Communications and information technology	0.23	0.25	(0.02)	(8.0)
Other	1.37	1.27	0.10	7.9
CASM	15.37	15.78	(0.41)	(2.6)
Remove:				
Fuel expense, ground package costs at Air Canada Vacations and unusual items	(5.32)	(5.43)	0.11	(2.0)
Adjusted CASM ⁽¹⁾	10.05	10.35	(0.30)	(2.9)

(1) 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 7% from the third quarter of 2013

In the third quarter of 2014, operating expenses of \$3,272 million increased \$209 million or 7% from the third quarter of 2013. The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) in the third quarter of 2014, when compared to the third quarter of 2013, increased operating expenses by approximately \$68 million. Refer to section 9 "Financial Instruments and Risk Management" of this MD&A for information on Air Canada's foreign exchange risk management strategy.

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

Fuel expense increased 7% from the third quarter of 2013

In the third quarter of 2014, fuel expense of \$1,076 million increased \$74 million or 7% from the third quarter of 2013. The increase in fuel expense year-over-year was due to an increase in volume of fuel litres consumed, which accounted for an increase of \$80 million, and the unfavourable impact of a weaker Canadian dollar versus the U.S. dollar when

compared to the third quarter of 2013, which accounted for an increase of \$36 million. Partly offsetting these increases was the impact of a 4% decline in jet fuel prices year-over-year, which accounted for a decrease of \$42 million to fuel expenses in the third quarter of 2014. On a capacity increase of 9.8%, fuel efficiency improved 1.6% based on litres consumed per ASM.

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)	Third Quarter		Change	
	2014	2013	\$	%
Aircraft fuel expense – GAAP	\$ 1,076	\$ 1,002	\$ 74	7
Add: Net cash (receipts) payments on fuel derivatives ⁽¹⁾	4	(6)	10	(167)
Economic cost of fuel – Non-GAAP ⁽²⁾	\$ 1,080	\$ 996	\$ 84	8
Fuel consumption (thousands of litres)	1,200,017	1,110,964	89,053	8
Fuel cost per litre (cents) – GAAP	89.7	90.2	(0.5)	(0.6)
Economic fuel cost per litre (cents) – Non-GAAP ⁽²⁾	90.0	89.6	0.4	0.4

(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 \$561 million in the third quarter of 2014, a decrease of \$4 million or 1% from the third quarter of 2013

In the third quarter of 2014, wages and salaries expense of \$454 million increased \$12 million or 3% from the third quarter of 2013, mainly due to higher average salaries and the impact of higher staff levels driven by the growth of Air Canada *rouge* and by the airline's international expansion. These increases were partly offset by the favourable impact of Air Canada having outsourced its London ground handling operations to a third party provider.

In the third quarter of 2014, employee benefits expense of \$107 million decreased \$16 million or 13% from the third quarter of 2013, mainly due to the impact of higher discount rates which decreases the current service cost of defined benefit pension plans.

Capacity purchase costs increased 6% from the third quarter of 2013

In the third quarter of 2014, capacity purchase costs of \$312 million increased \$17 million or 6% from the third quarter of 2013, mainly due to a one-time cost associated with the temporary use of higher-density wetleased Boeing 767 aircraft on certain routes, higher rates under the capacity purchase agreement with Jazz Aviation LP ("Jazz CPA"), an increase in block hours flown by Sky Regional and, to a lesser extent, other third party carriers (other than Jazz) operating under capacity purchase agreements with Air Canada, and an unfavourable currency impact. These increases were partly offset by a decline in block hours flown by Jazz under the Jazz CPA.

Airport and navigation fees increased 3% from the third quarter of 2013

In the third quarter of 2014, airport and navigation fees of \$281 million increased \$7 million or 3% from the third quarter of 2013, largely due to the addition of five Boeing 777 and four Boeing 787 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 GTAA which is allowing the airline to grow its share of international connecting traffic at Toronto Pearson on a more cost effective basis.

Aircraft maintenance expense increased 27% from the third quarter of 2013

In the third quarter of 2014, aircraft maintenance expense of \$166 million increased \$35 million or 27% from the third quarter of 2013, largely due to an increase in expenses related to maintenance provisions. The increase in expenses

related to maintenance provisions was mainly due to a fewer number of aircraft lease extensions when compared to third 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. A higher volume of engine and component maintenance activity versus the third quarter of 2013 and an unfavourable currency impact of \$6 million were also contributing factors to the increase in maintenance expense year-over-year.

Sales and distribution costs increased 9% from the third quarter of 2013

In the third quarter of 2014, sales and distribution costs of \$173 million increased \$14 million or 9% from the third quarter of 2013 on passenger revenue growth of 9.4%. 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 to the increase in sales and distribution costs year-over-year.

Depreciation, amortization and impairment expense increased 12% from the third quarter of 2013

In the third quarter of 2014, depreciation, amortization and impairment expense of \$146 million increased \$16 million or 12% from the third quarter of 2013, in large part due to the addition of five Boeing 777 and four Boeing 787 aircraft to the airline’s fleet.

Ground package costs increased 8% from the third quarter of 2013

In the third quarter of 2014, the cost of ground packages at Air Canada Vacations amounted to \$56 million, an increase of \$4 million or 8% from the third quarter of 2013. The increase in ground package costs at Air Canada Vacations was mainly due to an increase in the price of ground packages, higher passenger volumes 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 third quarter of 2013

In the third quarter of 2014, aircraft rent expense of \$77 million decreased \$3 million or 4% from the third 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 \$3 million.

Other operating expenses increased 16% from the third quarter of 2013

In the third quarter of 2014, Other operating expenses of \$286 million increased \$40 million or 16% from the third quarter of 2013 mainly due to the 9.8% capacity growth, an increase in terminal handling expenses arising from Air Canada’s international expansion as well as Air Canada having outsourced its London ground handling operations to a third party provider (the savings associated with this initiative are included in other expense categories, such as wages and salaries expense, for a net overall cost reduction), and an unfavourable currency impact.

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

(Canadian dollars in millions)	Third Quarter		Change	
	2014	2013	\$	%
Terminal handling	\$ 66	\$ 54	\$ 12	22
Crew cycle	38	29	9	31
Building rent and maintenance	37	32	5	16
Miscellaneous fees and services	32	32	-	-
Remaining other expenses	113	99	14	14
Other operating expenses	\$ 286	\$ 246	\$ 40	16

Non-operating expense amounted to \$203 million in the third quarter of 2014 compared to non-operating expense of \$125 million in the third quarter of 2013

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

(Canadian dollars in millions)	Third Quarter		Change
	2014	2013	\$
Foreign exchange gain (loss)	\$ (71)	\$ 49	\$ (120)
Interest income	11	7	4
Interest expense	(81)	(174)	93
Interest capitalized	6	15	(9)
Net financing expense relating to employee benefits	(34)	(51)	17
Fuel and other derivatives	(31)	30	(61)
Other	(3)	(1)	(2)
Total non-operating expense	\$ (203)	\$ (125)	\$ (78)

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

- Losses on foreign exchange, mainly related to U.S. denominated long-term debt, which amounted to \$71 million in the third quarter of 2014 compared to gains of \$49 million in the third quarter of 2013. The losses in the third quarter of 2014 were mainly attributable to a weaker Canadian dollar at September 30, 2014 when compared to June 30, 2014. Partially offsetting these losses were gains of \$126 million on foreign currency derivatives. Refer to section 9 “Financial Instruments and Risk Management” of this MD&A for additional information. The September 30, 2014 closing exchange rate was US\$1 = C\$1.1200 while the June 30, 2014 closing exchange rate was US\$1 = C\$1.0670.
- In the third quarter of 2013, Air Canada recorded a charge of \$95 million in interest expense pertaining to the purchase of its senior secured notes due in 2015 and 2016, comprised of \$61 million related to premium costs paid, in respect of notes purchased, and \$34 million related to the write off of existing transaction costs and discounts. No such charge was recorded in the third quarter of 2014.
- A decrease in net financing expense relating to employee benefits of \$17 million which was mainly due to the impact of lower pension liabilities.
- Losses on fuel and other derivatives which amounted to \$31 million in the third quarter of 2014 versus gains of \$30 million in the third quarter of 2013. Refer to section 9 “Financial Instruments and Risk Management” of this MD&A for additional information.

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

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

(Canadian dollars in millions, except per share figures)	First Nine Months		Change	
	2014	2013	\$	%
Operating revenues				
Passenger	\$ 9,049	\$ 8,461	\$ 588	7
Cargo	369	346	23	7
Other	750	681	69	10
Total revenues	10,168	9,488	680	7
Operating expenses				
Aircraft fuel	2,956	2,703	253	9
Wages, salaries, and benefits	1,678	1,694	(16)	(1)
Capacity purchase agreements	887	843	44	5
Airport and navigation fees	784	751	33	4
Aircraft maintenance	527	474	53	11
Sales and distribution costs	519	475	44	9
Depreciation, amortization and impairment ⁽¹⁾	409	430	(21)	(5)
Ground package costs	303	261	42	16
Aircraft rent	234	242	(8)	(3)
Food, beverages and supplies	235	218	17	8
Communications and information technology	152	145	7	5
Other	775	768	7	1
Total operating expenses	9,459	9,004	455	5
Operating income	709	484	225	
Non-operating income (expense)				
Foreign exchange loss	(192)	(65)	(127)	
Interest income	29	22	7	
Interest expense ⁽²⁾	(239)	(324)	85	
Interest capitalized	21	36	(15)	
Net financing expense relating to employee benefits	(102)	(155)	53	
Fuel and other derivatives	(10)	15	(25)	
Other	(11)	(5)	(6)	
Total non-operating expense	(504)	(476)	(28)	
Income before income taxes	205	8	197	
Income taxes	-	8	(8)	
Net income	\$ 205	\$ 16	\$ 189	
Net income per share – basic	\$ 0.70	\$ 0.05	\$ 0.65	
Net income per share – diluted	\$ 0.69	\$ 0.05	\$ 0.64	
EBITDAR ⁽³⁾	\$ 1,352	\$ 1,156	\$ 196	
Adjusted net income ⁽⁴⁾	\$ 464	\$ 337	\$ 127	
Adjusted net income per share – diluted ⁽⁴⁾	\$ 1.58	\$ 1.19	\$ 0.39	

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

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

(4) 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 7.0% from the first nine months of 2013

In the first nine months of 2014, on capacity growth of 7.5%, system passenger revenues of \$9,049 million increased \$588 million or 7.0% from the first nine months of 2013. The increase in system passenger revenues was due to traffic growth of 8.2% partly offset by a yield decline of 1.1%. An increase in average stage length of 2.3% versus the first nine months of 2013 had the effect of reducing yield by 1.3 percentage points. On a stage length adjusted basis, system yield improved 0.2% year-over-year.

In the first nine months of 2014, system business cabin revenues increased \$81 million or 4.8% from the first nine months of 2013 due to a yield improvement of 4.4% and, to a much lesser extent, an increase in traffic of 0.4%.

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

Passenger Revenue	First Nine Months 2014 \$ Million	First Nine Months 2013 \$ Million	Change \$ Million	% Change
Canada	3,282	3,197	85	2.6
U.S. transborder	1,807	1,653	154	9.4
Atlantic	2,029	1,801	228	12.7
Pacific	1,333	1,265	68	5.4
Other	598	545	53	9.7
System	9,049	8,461	588	7.0

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

First Nine Months 2014 Versus First Nine Months 2013	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	2.6	4.4	4.9	0.4	(2.5)	(2.0)
U.S. transborder	9.4	8.5	12.3	2.8	(2.1)	1.3
Atlantic	12.7	15.8	13.8	(1.5)	(0.9)	(2.7)
Pacific	5.4	2.6	3.7	0.9	2.0	3.1
Other	9.7	3.1	6.6	2.8	3.7	7.2
System	7.0	7.5	8.2	0.6	(1.1)	(0.4)

In the first nine months of 2014, Air Canada's system capacity was 7.5% higher than in the first nine months of 2013, with capacity growth reflected in all markets.

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

- The 8.2% 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 first nine months of 2014 also reflected incremental connecting traffic to international destinations.
- The 1.1% system yield decrease which reflected yield declines in the domestic, U.S. transborder and Atlantic markets partly offset by yield growth in the Other and Pacific markets as well as by a favourable currency impact of \$175 million. An increase in average stage length of 2.3% versus the same period in 2013 had the effect of reducing system yield by 1.3 percentage points.

The 0.4% PRASM decrease was due to the lower yield partly offset by a passenger load factor improvement of 0.6 percentage points. PRASM improvements were recorded in all markets with the exception of the Atlantic and domestic 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 third quarter 2014 and each of the previous four quarters.

Domestic passenger revenues increased 2.6% from the first nine months of 2013

In the first nine months of 2014, on a capacity increase of 4.4%, domestic passenger revenues of \$3,282 million increased \$85 million or 2.6% from the first nine months of 2013 on traffic growth of 4.9% partly offset by a yield decline of 2.5%.

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

- The 4.9% traffic increase which reflected traffic growth on all major domestic services. The traffic growth in the first nine months of 2014 reflected increases on services within Canada, as well as incremental connecting traffic to international destinations.
- The yield decline of 2.5% 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 lower-yielding international and U.S. transborder passenger flows.

The 2.0% PRASM decrease was due to the yield decline.

U.S. transborder passenger revenues increased 9.4% from the first nine months of 2013

In the first nine months of 2014, on capacity growth of 8.5%, U.S. transborder passenger revenues of \$1,807 million increased \$154 million or 9.4% from the first nine months of 2013 mainly due to a traffic increase of 12.3% partly offset by a yield decrease of 2.1%.

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

- The traffic increase of 12.3% 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 nine months of 2014 also experienced higher proportional growth of international-to-international passenger flows from the U.S. relative to the first nine months of 2013.
- The 2.1% yield decrease which reflected an average stage length increase driven by route composition changes, increased Air Canada *rouge* flying on lower-yielding price sensitive leisure routes, as well as incremental lower-yielding international-to-international connecting traffic when compared to the first nine months of 2013. Partly offsetting these yield decreases were a favourable currency impact of \$38 million, as well as an improvement in the airline's business cabin revenue performance.

The 1.3% PRASM increase was due to a passenger load factor improvement of 2.8 percentage points partly offset by the yield decline.

Atlantic passenger revenues increased 12.7% from the first nine months of 2013

In the first nine months of 2014, on capacity growth of 15.8%, Atlantic passenger revenues of \$2,029 million increased \$228 million or 12.7% from the first nine months of 2013 due to traffic growth of 13.8% partly offset by a yield decrease of 0.9%.

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

- The 13.8% traffic increase which reflected traffic growth on all major Atlantic services with the exception of services from Eastern Canada to Germany and to Scandinavia where capacity was reduced year-over-year. While traffic decreased on services to Scandinavia, the decline was less than the capacity reduction.
- The 0.9% yield decline which reflected a higher proportion of seats into leisure-focused long-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 flying by Air Canada *rouge* which offers a Premium *rouge* product but has no international business cabin. Increased industry capacity and a very competitive pricing environment, particularly in the economy cabin, were also factors to the yield decline. Partly offsetting these yield decreases were a favourable currency impact of \$72 million, improvements in Air Canada's business cabin revenue performance and an increase in premium economy traffic which resulted in higher average fares.

The 2.7% PRASM decrease was due to a 1.5 percentage point decline in passenger load factor and the yield decrease.

Pacific passenger revenues increased 5.4% from the first nine months of 2013

In the first nine months of 2014, on capacity growth of 2.6%, Pacific passenger revenues of \$1,333 million increased \$68 million or 5.4% from the first nine months of 2013 due to traffic and yield growth of 3.7% and 2.0%, respectively.

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

- The 3.7% traffic increase which reflected traffic growth on services to Hong Kong and Japan, where capacity was increased year-over-year, partly offset by traffic decreases on services to Korea, Australia and China where capacity was reduced year-over-year.
- The 2.0% 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 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 services to Korea, China, Australia and, to a lesser extent, Japan. A favourable currency impact of \$30 million, improvements in the airline's business cabin revenue performance and an increase in premium economy traffic which resulted in higher average fares, were also contributing factors to the yield growth year-over-year.

The 3.1% PRASM increase was due to the higher yield and to a passenger load factor improvement of 0.9 percentage points.

Other passenger revenues increased 9.7% from the first nine months of 2013

In the first nine months of 2014, on a capacity increase of 3.1%, Other passenger revenues (comprised of routes to the Caribbean, Mexico and Central and South America) of \$598 million increased \$53 million or 9.7% from the first nine months of 2013 due to traffic and yield growth of 6.6% and 3.7%, respectively.

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

- The overall 6.6% traffic increase which reflected traffic growth on all major services in the Other markets with the exception of South America where capacity was reduced year-over-year.
- The overall 3.7% yield increase which reflected yield growth on the airline's routes to Mexico and to traditional sun destinations partly offset by a lower yield on services to South America, in large part due to the airline's suspension of service to Venezuela.

The 7.2% PRASM increase was due to the yield growth and a 2.8 percentage point improvement in passenger load factor.

Cargo revenues increased 6.6% from the first nine months of 2013

In the first nine months of 2014, cargo revenues of \$369 million increased \$23 million or 6.6% from the first nine months of 2013 due to traffic growth of 8.2% partly offset by a yield decline of 1.4%.

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

Cargo Revenue	First Nine Months 2014 \$ Million	First Nine Months 2013 \$ Million	Change \$ Million
Canada	49	47	2
U.S. transborder	15	13	2
Atlantic	143	125	18
Pacific	139	135	4
Other	23	26	(3)
System	369	346	23

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

First Nine Months 2014 Versus First Nine Months 2013	Cargo Revenue % Change	Capacity (ETMs) % Change	Rev / ETM % Change	Traffic (RTMs) % Change	Yield / RTM % Change
Canada	4.1	19.9	(13.2)	29.9	(19.9)
U.S. transborder	12.4	20.3	(6.5)	11.1	1.1
Atlantic	14.0	11.3	2.5	16.6	(2.2)
Pacific	3.3	(0.9)	4.2	1.1	2.1
Other	(9.9)	(2.7)	(7.4)	(10.9)	1.1
System	6.6	7.5	(0.8)	8.2	(1.4)

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

- The 8.2% traffic increase which reflected traffic growth in all markets with the exception of the Other markets where capacity was reduced year-over-year. The overall traffic growth reflected favourable economic conditions in the U.S. and Europe.
- The 1.4% 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 nine 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 third quarter of 2014 and each of the previous four quarters.

Other revenues increased 10% from the first nine months of 2013

In the first nine months of 2014, Other revenues of \$750 million increased \$69 million or 10% from the first nine 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 2.3% from the first nine months of 2013. Adjusted CASM decreased 3.5% from the first nine months of 2013.

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

(cents per ASM)	First Nine Months		Change	
	2014	2013	cents	%
Aircraft fuel	5.23	5.14	0.09	1.8
Wages and salaries	2.32	2.42	(0.10)	(4.1)
Benefits	0.65	0.80	(0.15)	(18.8)
Capacity purchase agreements	1.57	1.61	(0.04)	(2.5)
Airport and navigation fees	1.39	1.43	(0.04)	(2.8)
Aircraft maintenance	0.93	0.90	0.03	3.3
Sales and distribution costs	0.92	0.90	0.02	2.2
Depreciation, amortization and impairment	0.72	0.82	(0.10)	(12.2)
Ground package costs	0.54	0.50	0.04	8.0
Aircraft rent	0.41	0.46	(0.05)	(10.9)
Food, beverages and supplies	0.42	0.42	-	-
Communications and information technology	0.27	0.28	(0.01)	(3.6)
Other	1.38	1.46	(0.08)	(5.5)
CASM	16.75	17.14	(0.39)	(2.3)
Remove:				
Fuel expense, ground package costs at Air Canada Vacations and unusual items ⁽¹⁾⁽²⁾	(5.70)	(5.69)	(0.01)	0.2
Adjusted CASM ⁽³⁾	11.05	11.45	(0.40)	(3.5)

(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 5% from the first nine months of 2013

In the first nine months of 2014, operating expenses of \$9,459 million increased \$455 million or 5% from the first nine months of 2013. The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) in the first nine months of 2014, when compared to the first nine months of 2013, increased operating expenses by approximately \$308 million.

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

Fuel expense increased 9% from the first nine months of 2013

In the first nine months of 2014, fuel expense of \$2,956 million increased \$253 million or 9% from the first nine 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 nine months of 2013, which accounted for an increase of \$171 million, and a higher volume of fuel litres consumed, which accounted for an increase of \$151 million. Partly offsetting these increases was the impact of a 3% year-over-year decline in jet fuel prices, which accounted for a decrease of \$69 million to fuel expense in the first nine 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 Nine Months		Change	
	2014	2013	\$	%
Aircraft fuel expense – GAAP	\$ 2,956	\$ 2,703	\$ 253	9
Add: Net cash payments on fuel derivatives ⁽¹⁾	6	18	(12)	(67)
Economic cost of fuel – Non-GAAP ⁽²⁾	\$ 2,962	\$ 2,721	\$ 241	9
Fuel consumption (thousands of litres)	3,220,893	3,049,676	171,217	5.6
Fuel cost per litre (cents) – GAAP	91.8	88.6	3.1	3.5
Economic fuel cost per litre (cents) – Non-GAAP ⁽²⁾	91.9	89.2	2.7	3.0

(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 \$1,678 million in the first nine months of 2014, a decrease of \$16 million or 1% from the first nine months of 2013

In the first nine months of 2014, wages and salaries expense of \$1,309 million increased \$36 million or 3% from the first nine months of 2013, in large part due to higher average salaries as well as Air Canada having recorded a provision of \$12 million related to the outsourcing of its London operations to a third party provider.

In the first nine months of 2014, employee benefits expense of \$369 million decreased \$52 million or 12% from the first nine 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 nine months of 2013

In the first nine months of 2014, capacity purchase costs of \$887 million increased \$44 million or 5% from the first nine months of 2013, mainly due to an increase in block hours flown by Sky Regional and, to a lesser extent, other third party carriers (excluding Jazz) operating under capacity purchase agreements with Air Canada, higher rates under the Jazz CPA and an unfavourable currency impact. 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 first nine months of 2013

In the first nine months of 2014, airport and navigation fees of \$784 million increased \$33 million or 4% from the first nine months of 2013, largely due to the addition of five Boeing 777 and four Boeing 787 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 GTAA which is allowing the airline to grow its share of international connecting traffic at Toronto Pearson on a more cost effective basis.

Aircraft maintenance expense increased 11% from the first nine months of 2013

In the first nine months of 2014, aircraft maintenance expense of \$527 million increased \$53 million or 11% from the first nine months of 2013. This increase in aircraft maintenance expense was mainly due to a \$31 million unfavourable currency impact and an increase in expenses related to maintenance provisions. The increase in expenses related to maintenance provisions was due to more aircraft under operating leases in the third quarter of 2014, which was as a result of the reclassification of certain aircraft from finance leases to operating leases upon lease extension, as well as to a fewer number of aircraft lease extensions when compared to first nine 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. In addition, Air Canada recorded favourable accrual adjustments of \$15 million in the first nine months of 2013 while no such adjustments were recorded in the first nine months of 2014. These increases were largely offset by the impact of a lower volume of engine and airframe maintenance activity in the first and second quarters of 2014, 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 nine months of 2013

In the first nine months of 2014, sales and distribution costs of \$519 million increased \$44 million or 9% from the first nine months of 2013 on passenger revenue growth of 7.0%. 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 to the increase in sales and distribution costs year-over-year.

Depreciation, amortization and impairment expense decreased 5% from the first nine months of 2013

In the first nine months of 2014, depreciation, amortization and impairment expense of \$409 million decreased \$21 million or 5% from the first nine months of 2013.

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

The impact of the addition of five Boeing 777 and four Boeing 787 aircraft to the airline's operating fleet was largely 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 by a decrease in depreciation expense related to the airline's interior refurbishment programs.

Ground package costs increased 16% from the first nine months of 2013

In the first nine months of 2014, the cost of ground packages at Air Canada Vacations amounted to \$303 million, an increase of \$42 million or 16% from the first nine months of 2013. The increase in ground package costs at Air Canada Vacations was largely due to higher passenger volumes. An unfavourable currency impact also contributed to the increase in ground package costs year-over-year.

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

In the first nine months of 2014, aircraft rent expense of \$234 million decreased \$8 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 \$15 million.

Other operating expenses increased 1% from the first nine months of 2013

In the first nine months of 2014, other operating expenses of \$775 million increased \$7 million or 1% from the first nine months of 2013. The increase in Other expenses was driven by the 7.5% capacity growth, an increase in terminal handling expenses arising from Air Canada having outsourced its London ground handling operations to a third party provider (the savings associated with this initiative are included in other expense categories, such as wages and salaries expense, for a net overall cost reduction), and an unfavourable currency impact. Partly offsetting these increases was the impact of Air Canada having recorded favourable tax-related provision adjustments of \$41 million in the first nine months of 2014 while no such adjustments were recorded in the first nine 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 nine months of 2013 while no such charges were recorded in the first nine months of 2014.

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

(Canadian dollars in millions)	First Nine Months		Change	
	2014	2013	\$	%
Terminal handling	\$ 177	\$ 148	\$ 29	20
Building rent and maintenance	112	97	15	15
Crew cycle	105	90	15	17
Miscellaneous fees and services	92	100	(8)	(8)
Remaining other expenses	289	333	(44)	(13)
Other operating expenses	\$ 775	\$ 768	\$ 7	1

Non-operating expense amounted to \$504 million in the first nine months of 2014 compared to non-operating expense of \$476 million in the first nine months of 2013

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

(Canadian dollars in millions)	First Nine Months		Change
	2014	2013	\$
Foreign exchange loss	\$ (192)	\$ (65)	\$ (127)
Interest income	29	22	7
Interest expense	(239)	(324)	85
Interest capitalized	21	36	(15)
Net financing expense relating to employee benefits	(102)	(155)	53
Fuel and other derivatives	(10)	15	(25)
Other	(11)	(5)	(6)
Total non-operating expense	\$ (504)	\$ (476)	\$ (28)

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

- Losses on foreign exchange which amounted to \$192 million in the first nine months of 2014 compared to losses of \$65 million in the first nine months of 2013. These losses were mainly related to unrealized foreign exchange losses on the translation of U.S. dollar denominated debt. An unrealized revaluation gain of \$33 million related to foreign currency derivatives as well as a revaluation gain of \$16 million related to foreign-denominated cash reserves (mainly U.S. dollars) were recorded in the first nine months of 2014. Refer to section 9 "Financial Instruments and Risk Management" of this MD&A for additional information.
- In the first nine months of 2013, Air Canada recorded a charge of \$95 million in interest expense pertaining to the purchase of its senior secured notes due in 2015 and 2016, comprised of \$61 million related to premium costs paid, in respect of notes purchased, and \$34 million related to the write off of existing transaction costs and discounts. No such charge was recorded in the first nine months of 2014.
- A decrease in net financing expense relating to employee benefits of \$53 million which was mainly due to the impact of lower pension liabilities.

- Losses related to fuel and other derivatives which amounted to \$10 million in the first nine months of 2014 versus gains of \$15 million in the first nine 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 September 30, 2014 and December 31, 2013, as well as Air Canada's planned 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					
	December 31, 2013	First Nine Months 2014 Fleet Changes	September 30, 2014	Remainder of 2014 Fleet Changes	December 31, 2014	2015 Fleet Changes	December 31, 2015	2016 Fleet Changes	December 31, 2016
Mainline									
Boeing 787-8	-	4	4	2	6	2	8	-	8
Boeing 787-9	-	-	-	-	-	3	3	9	12
Boeing 777-300ER	16	1	17	-	17	-	17	2	19
Boeing 777-200LR	6	-	6	-	6	-	6	-	6
Boeing 767-300ER	27	(6)	21	-	21	(4)	17	(4)	13
Airbus A330-300	8	-	8	-	8	-	8	-	8
Airbus A321	10	-	10	-	10	3	13	-	13
Airbus A320	41	-	41	-	41	2	43	-	43
Airbus A319	30	(11)	19	(1)	18	-	18	(5)	13
EMBRAER 190	45	-	45	-	45	(8)	37	(12)	25
Total Mainline	183	(12)	171	1	172	(2)	170	(10)	160
Air Canada <i>rouge</i>									
Boeing 767-300ER	2	6	8	-	8	4	12	4	16
Airbus A319	8	11	19	1	20	-	20	5	25
Total Air Canada <i>rouge</i>	10	17	27	1	28	4	32	9	41
Total Mainline and Air Canada <i>rouge</i>	193	5	198	2	200	2	202	(1)	201

In the third quarter of 2014, Air Canada exercised purchase rights for two Boeing 777-300ER aircraft, with scheduled deliveries in the second quarter of 2016. The configuration of these aircraft will be high-density with a total of 450 seats in a three-cabin configuration, including a premium economy cabin and an International Business Class cabin that will offer Air Canada's new international product standard as introduced on the airline's Boeing 787 aircraft. Air Canada also recently announced that it plans on harmonizing the interior of its existing five higher-density Boeing 777-300 aircraft to Boeing 787 standards.

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 three Airbus A321 and two Airbus A320 aircraft (which have been leased from third parties) until the airline takes delivery of the Boeing 737 MAX aircraft. In addition, Air Canada expects to retain five Boeing 767 aircraft in 2016 which it had originally planned to return to lessors.

Air Canada Express

The following table provides, as at September 30, 2014, the number of aircraft operated on behalf of Air Canada 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 September 30, 2014 and December 31, 2014.

	As at September 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 September 30, 2014, unrestricted liquidity amounted to \$2,802 million (comprised of cash and short-term investments of \$2,528 million and undrawn lines of credit of \$274 million). This compared to unrestricted liquidity of \$2,412 million (comprised of cash and short-term investments of \$2,309 million and undrawn lines of credit of \$103 million) at September 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 September 30, 2014 and as at December 31, 2013.

(Canadian dollars in millions)	September 30, 2014	December 31, 2013	\$ Change
Assets			
Cash, cash equivalents and short-term investments	\$ 2,528	\$ 2,208	\$ 320
Other current assets	1,138	1,080	58
Current assets	3,666	3,288	378
Property and equipment	5,735	5,073	662
Intangible assets	301	304	(3)
Goodwill	311	311	-
Deposits and other assets	532	494	38
Total assets	\$ 10,545	\$ 9,470	\$ 1,075
Liabilities			
Current liabilities	\$ 3,502	\$ 3,190	312
Long-term debt and finance leases	4,557	3,959	598
Pension and other benefit liabilities	2,812	2,687	125
Maintenance provisions	757	656	101
Other long-term liabilities	317	375	(58)
Total liabilities	11,945	10,867	1,078
Total equity	(1,400)	(1,397)	(3)
Total liabilities and equity	\$ 10,545	\$ 9,470	\$ 1,075

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 September 30, 2014, Property and equipment amounted to \$5,735 million, an increase of \$662 million from December 31, 2013. The increase in Property and equipment was mainly due to additions to property and equipment of \$1,093 million in the first nine months of 2014, partially offset by the impact of depreciation expense of \$377 million. The additions to Property and equipment included flight equipment purchases of \$680 million, which included one Boeing 777-300ER aircraft delivered in February and four Boeing 787-8 delivered in May, June, July and September, respectively, progress payments on future aircraft deliveries of \$170 million, and capitalized maintenance costs of \$144 million.

At September 30, 2014, Pension and other benefit liabilities increased \$125 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 \$197 million in the first nine months of 2014. At September 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 \$306 million were made in the first nine 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 September 30, 2014 and as at December 31, 2013.

(Canadian dollars in millions, except where indicated)	September 30, 2014	December 31, 2013	\$ Change
Total long-term debt and finance leases	\$ 4,557	\$ 3,959	\$ 598
Current portion of long-term debt and finance leases	424	374	50
Total long-term debt and finance leases, including current portion	4,981	4,333	648
Less cash, cash equivalents and short-term investments	(2,528)	(2,208)	(320)
Net debt	\$ 2,453	\$ 2,125	\$ 328
Capitalized operating leases ⁽¹⁾	2,170	2,226	(56)
Adjusted net debt	\$ 4,623	\$ 4,351	\$ 272
EBITDAR (excluding benefit plan amendments) (trailing 12 months)	\$ 1,629	\$ 1,433	\$ 196
Adjusted net debt to EBITDAR ratio	2.8	3.0	(0.2)

(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. 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 \$310 million for the twelve months ended September 30, 2014 and \$318 million for the twelve months ended December 31, 2013.

At September 30, 2014, total long-term debt and finance leases, including current portion, amounted to \$4,981 million, an increase of \$648 million from December 31, 2013. This increase was due to new borrowings of \$978 million partly offset by debt repayments of \$556 million. In the first nine 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 four 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. In addition, in the third quarter of 2014, Air Canada disposed of its two Airbus 340-500 aircraft and repaid the financing related to these aircraft in the amount of \$90 million. No gain or loss was recorded on the disposition. The unfavourable impact of a weaker Canadian dollar as at September 30, 2014 compared to December

31, 2013 on Air Canada's foreign currency denominated debt (mainly U.S. dollars), which accounted for an increase of \$213 million, was also a contributing factor to the increase in long-term debt.

Adjusted net debt amounted to \$4,623 million at September 30, 2014, an increase of \$272 million from December 31, 2013, mainly due to the higher long-term debt and finance lease balances partly offset by higher cash balances.

At September 30, 2014, the adjusted net debt to EBITDAR ratio amounted to 2.8 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 September 30, 2014, Air Canada's weighted average cost of capital ("WACC") was approximately 9.2%. WACC is based on an estimate by management and consists of an estimated cost of equity of 20.1% and an average cost of debt and finance leases of 5.6%.

Unsecured Financing

In April 2014, Air Canada completed a private offering of US\$400 million of 7.75% senior unsecured notes due 2021. 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 September 30, 2014 and as at December 31, 2013.

(Canadian dollars in millions)	September 30, 2014	December 31, 2013	\$ Change
Cash, cash equivalents and short-term investments	\$ 2,528	\$ 2,208	\$ 320
Accounts receivable	703	589	114
Other current assets	435	491	(56)
Accounts payable and accrued liabilities	(1,269)	(1,129)	(140)
Advance ticket sales	(1,809)	(1,687)	(122)
Current portion of long-term debt and finance leases	(424)	(374)	(50)
Net working capital	\$ 164	\$ 98	\$ 66

The net working capital of \$164 million at September 30, 2014 represented an increase of \$66 million from December 31, 2013. This improvement in net working capital was largely due to the impact of strong operating results as well as the proceeds from the US\$400 million senior unsecured notes completed in the second quarter of 2014. Partly offsetting these increases were capital expenditures of \$1,115 million (or \$555 million net of the financing drawn upon the delivery of the fifth and final Boeing 777-300ER aircraft and the four Boeing 787-8 aircraft received in the first nine months of 2014) and pension funding payments of \$306 million.

7.5. Consolidated Cash Flow Movements

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

(Canadian dollars in millions)	Third Quarter			First Nine Months		
	2014	2013	\$ Change	2014	2013	\$ Change
Net cash flows from (used for) operating activities	\$ 191	\$ (9)	\$ 200	\$ 921	\$ 663	\$ 258
Proceeds from borrowings	194	1,554	(1,360)	978	1,716	(738)
Reduction of long-term debt and finance lease obligations	(166)	(1,140)	974	(556)	(1,455)	899
Other	1	6	(5)	1	(9)	10
Net cash flows from financing activities	29	420	(391)	423	252	171
Short-term investments	157	(191)	348	(137)	(269)	132
Additions to property, equipment and intangible assets	(383)	(240)	(143)	(1,115)	(618)	(497)
Proceeds from sale of assets	65	27	38	68	35	33
Other	(23)	15	(38)	(13)	(5)	(8)
Net cash flows used in investing activities	(184)	(389)	205	(1,197)	(857)	(340)
Increase in cash and cash equivalents	36	22	14	147	58	89
Cash and cash equivalents, beginning of period	861	790	71	750	754	(4)
Cash and cash equivalents, end of period	\$ 897	\$ 812	\$ 85	\$ 897	\$ 812	\$ 85

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

(Canadian dollars in millions)	Third Quarter			First Nine Months		
	2014	2013	\$ Change	2014	2013	\$ Change
Cash flows from (used for) operating activities	\$ 191	\$ (9)	\$ 200	\$ 921	\$ 663	\$ 258
Additions to property, equipment and intangible assets	(383)	(240)	(143)	(1,115)	(618)	(497)
Free cash flow ⁽¹⁾	\$ (192)	\$ (249)	\$ 57	\$ (194)	\$ 45	\$ (239)

(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 \$192 million in the third quarter of 2014 reflected an improvement of \$57 million from the third quarter of 2013, on higher cash flows from operating activities, the result of stronger operating results. This improvement in cash from operating activities was largely offset by an increase in capital expenditures of \$143 million in the third quarter of 2014. Capital expenditures included the acquisition of two Boeing 787 aircraft during the third quarter of 2014.

In the first nine months of 2014, free cash flow declined \$239 million compared to the first nine months of 2013. The decrease in free cash flow was due to an increase in capital expenditures of \$497 million, which was mainly related to the acquisition of one Boeing 777-300ER in the first quarter of 2014 and four Boeing 787 aircraft delivered in the first nine months of 2014. The impact of additional capital expenditures year-over-year was partly offset by an increase in cash flows from operating activities of \$258 million. The \$258 million increase in cash flows from operating activities was related to stronger operating results year-over-year.

Net cash flows used in financing activities

Proceeds from borrowings amounted to \$194 million in the third quarter of 2014 and \$978 million in the first nine months of 2014. In the third quarter and the first nine months of 2014, reduction of long-term debt and finance lease obligations amounted to \$166 million and \$556 million, respectively. Refer to section 7.3 "Adjusted Net Debt" of this MD&A for additional information on Air Canada's 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 September 30, 2014 (except where stated otherwise) and do not account for Air Canada's fifth firm order Boeing 787 aircraft delivered in October 2014 and financed with support from EXIM covering 85% of the aircraft delivery and, therefore, such discussion and presentation are provided as if that fifth firm order Boeing 787 aircraft had not been delivered or financed.

As at December 31, 2013, Air Canada had outstanding purchase commitments with Boeing for the acquisition of 37 Boeing 787 aircraft, with the first six deliveries scheduled for 2014, four of which were delivered by the end of the third quarter, and the remaining 31 scheduled for delivery 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).

Financing for the four Boeing 787 aircraft deliveries was provided with support from EXIM covering 85% of the aircraft delivery. The last of five Boeing 777 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.

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

The financing terms for the firm commitments (subject to conditions) for the remaining 24 of the 27 financing commitments for the Boeing 787 aircraft are as follows: For 23 of the 787 aircraft, the financing terms are for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments. For the other 787 aircraft, the financing under the commitment covers up to 90% of the capital expenditure and the term to maturity is 15 years with principal payments made on a mortgage-style basis resulting in equal installment payments of principal and interest over the term to maturity.

In the third quarter of 2014, Air Canada exercised purchase rights for two Boeing 777-300ER aircraft, with scheduled deliveries in the second quarter of 2016. Financing alternatives will be considered prior to the planned delivery dates of these aircraft. The capital expenditures related to this purchase are included in the table provided below. Air Canada has purchase rights for 11 Boeing 777 aircraft (entitling Air Canada to purchase aircraft based on previously determined pricing).

On March 31, 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.

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 with 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, Boeing 777 and Boeing 737 MAX aircraft deliveries and other capital purchase commitments as at September 30, 2014 approximates \$8,231 million.

(Canadian dollars in millions)	Remainder of 2014	2015	2016	2017	2018	Thereafter	Total
Projected committed expenditures	\$ 351	\$ 936	\$ 1,855	\$ 1,667	\$ 1,342	\$ 2,080	\$ 8,231
Projected planned but uncommitted expenditures	1	230	229	298	282	not available	not available
Projected planned but uncommitted capitalized maintenance ⁽¹⁾	48	151	159	109	109	not available	not available
Total projected expenditures ⁽²⁾	\$ 400	\$ 1,317	\$ 2,243	\$ 2,074	\$ 1,733	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 September 30, 2014 closing exchange rate of US\$1 = C\$1.1200. 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 September 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 Air Canada's contractual obligations as at September 30, 2014 including those relating to interest and principal repayment obligations on Air Canada's long-term debt and finance lease obligations, operating lease obligations and committed capital expenditures.

(Canadian dollars in millions)	Remainder of 2014	2015	2016	2017	2018	Thereafter	Total
<i>Principal</i>							
Long-term debt obligations	\$ 101	\$ 393	\$ 356	\$ 471	\$ 453	\$ 2,998	\$ 4,772
Finance lease obligations	16	64	27	28	31	127	293
Total principal obligations	\$ 117	\$ 457	\$ 383	\$ 499	\$ 484	\$ 3,125	\$ 5,065
<i>Interest</i>							
Long-term debt obligations	65	247	226	231	183	288	1,240
Finance lease obligations	7	24	19	17	14	37	118
Total interest obligations	\$ 72	\$ 271	\$ 245	\$ 248	\$ 197	\$ 325	\$ 1,358
Total long-term debt and finance lease obligations	\$ 189	\$ 728	\$ 628	\$ 747	\$ 681	\$ 3,450	\$ 6,423
Operating lease obligations	\$ 99	\$ 341	\$ 283	\$ 250	\$ 215	\$ 452	\$ 1,640
Committed capital expenditures	\$ 351	\$ 936	\$ 1,855	\$ 1,667	\$ 1,342	\$ 2,080	\$ 8,231
Total contractual obligations ^{(1) (2)}	\$ 639	\$ 2,005	\$ 2,766	\$ 2,664	\$ 2,238	\$ 5,982	\$ 16,294

(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.

Ratings

Air Canada's corporate credit and/or Air Canada's Senior Notes are rated by the following rating agencies:

- Moody's Investors Service, Inc. ("Moody's");
- Standard & Poor's Rating Services ("Standard & Poor's");
- Fitch Ratings, Inc. ("Fitch"); and
- DBRS Limited ("DBRS").

Ratings are described in section 9.8 of Air Canada's 2013 MD&A dated February 12, 2014, except for the updates described below.

Moody's Ratings

On September 17, 2014, Moody's upgraded the following ratings relating to Air Canada:

- Air Canada's corporate family rating to B2 from B3 and probability of default ratings to B2-PD from B3-PD.
- Senior First Lien Notes ratings to Ba3 from B1 and its Senior Second Lien Notes rating to B3 from Caa1.
- Air Canada's speculative grade liquidity rating was affirmed at SGL-2.
- The ratings on Air Canada's 2013-1 Class A, Class B and Class C enhanced equipment trust certificates were upgraded by one notch to Baa1, Ba2, and B1, respectively.
- The rating outlook for Air Canada and the enhanced equipment trust certificates was changed to stable from positive.

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		
	October 31, 2014	September 30, 2014	December 31, 2013
Issued and outstanding shares			
Class A variable voting shares	33,336,923	33,625,414	26,577,512
Class B voting shares	252,855,851	252,567,360	257,954,927
Total issued and outstanding shares	286,192,774	286,192,774	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	10,575,972	10,646,472	10,079,694
Total shares potentially issuable	10,575,972	10,646,472	11,417,071
Total outstanding and potentially issuable shares	296,768,746	296,839,246	295,949,510

Earnings per Share

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

(in millions)	Third Quarter		First Nine Months	
	2014	2013	2014	2013
Weighted average number of shares outstanding – basic	286	277	286	276
Effect of potential dilution	8	6	7	7
Weighted average number of shares outstanding – diluted	294	283	293	283

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	2013				2014		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Operating revenues	\$ 2,839	\$ 2,952	\$ 3,057	\$ 3,479	\$ 2,894	\$ 3,065	\$ 3,305	\$ 3,798
Aircraft fuel	821	870	831	1,002	831	918	962	1,076
Ownership (DAR) ⁽¹⁾⁽²⁾	236	251	211	210	224	209	211	223
Other operating expenses ⁽³⁾⁽⁴⁾	1,735	1,937	1,841	1,851	1,704	2,000	1,887	1,973
Operating expenses	2,792	3,058	2,883	3,063	2,759	3,127	3,060	3,272
Operating income (loss)	47	(106)	174	416	135	(62)	245	526
Total non-operating income (expense) ⁽⁵⁾	(107)	(154)	(197)	(125)	(141)	(279)	(22)	(203)
Income taxes	-	-	-	8	-	-	-	-
Net income (loss)	\$ (60)	\$ (260)	\$ (23)	\$ 299	\$ (6)	\$ (341)	\$ 223	\$ 323
Earnings (loss) per share – diluted	\$ (0.22)	\$ (0.95)	\$ (0.09)	\$ 1.05	\$ (0.02)	\$ (1.20)	\$ 0.75	\$ 1.10
EBITDAR, excluding benefit plan amendments ⁽³⁾⁽⁶⁾	\$ 283	\$ 145	\$ 385	\$ 626	\$ 277	\$ 147	\$ 456	\$ 749
EBITDAR ⁽⁶⁾	\$ 283	\$ 145	\$ 385	\$ 626	\$ 359	\$ 147	\$ 456	\$ 749
Adjusted net income (loss) ⁽⁷⁾	\$ (5)	\$ (143)	\$ 115	\$ 365	\$ 3	\$ (132)	\$ 139	\$ 457
Adjusted net income (loss) per diluted share ⁽⁷⁾	\$ (0.02)	\$ (0.52)	\$ 0.41	\$ 1.29	\$ 0.01	\$ (0.46)	\$ 0.47	\$ 1.55

(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.

(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		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Revenue passenger miles (millions)	12,574	13,087	14,093	16,726	12,882	13,466	15,495	18,565
Available seat miles (millions)	15,484	16,164	16,972	19,404	16,033	16,774	18,413	21,299
Passenger load factor (%)	81.2	81.0	83.0	86.2	80.3	80.3	84.2	87.2
Passenger PRASM (cents)	16.0	15.4	16.0	16.2	15.7	15.3	15.9	16.1
CASM, excluding benefit plan amendments (cents) ⁽¹⁾	18.0	18.9	17.0	15.8	17.7	18.6	16.6	15.4
Adjusted CASM (cents) ⁽²⁾	12.4	12.5	11.7	10.4	12.1	12.2	11.2	10.1
Economic fuel price per litre (cents) ⁽³⁾	88.1	92.4	85.7	89.6	88.4	94.7	91.6	90.0

(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.

(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:

(Canadian dollars in millions)	Third Quarter		First Nine Months	
	2014	2013	2014	2013
Fuel derivatives	\$ (24)	\$ 21	\$ (18)	\$ 3
Share forward contracts	(7)	9	7	13
Interest rate swaps	-	-	1	(1)
Fuel and other derivatives	\$ (31)	\$ 30	\$ (10)	\$ 15

Fuel Price Risk Management

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 third quarter of 2014:

- Air Canada recorded a loss of \$24 million on fuel derivatives (loss of \$18 million in the first nine months of 2014) (a gain of \$21 million and \$3 million, respectively, for the third quarter and first nine months of 2013).
- Air Canada purchased crude-oil and refined products-based call options and call spreads covering a portion of 2015 fuel exposure. The cash premium related to these contracts was \$11 million (\$31 million in the first nine months of 2014) (\$3 million and \$30 million, respectively, for the third quarter and first nine months of 2013).
- Fuel derivative contracts settled with a fair value of \$6 million in favour of Air Canada (\$24 million in favour of Air Canada in the first nine months of 2014) (\$20 million and \$21 million, respectively, in favour of Air Canada for the third quarter and first nine months of 2013).

As at September 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\$108 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 2,508,000 barrels. Air Canada had hedged approximately 10% of its 2015 anticipated jet fuel purchases with call options with notional volumes of 2,910,000 barrels at an average WTI equivalent capped price of US\$101 per barrel. The fair value of the fuel derivatives portfolio at September 30, 2014 was \$9 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 third quarter of 2014, Air Canada recorded a loss of \$7 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 2018, subject to the terms of vesting (gain of \$7 million in the first nine months of 2014). Air Canada entered into additional share forward contracts during the third quarter of 2014. These contracts were prepaid by Air Canada for \$5 million. Share forward contracts cash settled with a fair value of \$7 million in favour of Air Canada in the first nine months of

2014. As at September 30, 2014, the fair value of the share forward contracts was \$61 million in favour of Air Canada (December 31, 2013 - \$56 million in favour of Air Canada).

Foreign Exchange Risk Management

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

The weighted average foreign exchange rate of the derivative portfolio is favourable as compared to the closing exchange rate on September 30, 2014. In addition, the hedging structures put in place have various option pricing features, such as knock-out terms and multipliers, and based on the assumed volatility used in the fair value calculation, the fair value of these foreign currency contracts as at September 30, 2014 was \$17 million in favour of Air Canada (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 third quarter of 2014, a gain of \$126 million was recorded in Foreign exchange gain (loss) on Air Canada's consolidated statement of operations related to these derivatives (a gain of \$33 million for the first nine months of 2014) (a loss of \$15 million and a gain of \$29 million, respectively, for the third quarter and first nine months of 2013). In the third quarter of 2014, foreign exchange derivative contracts cash settled with a net fair value of \$3 million in favour of the counterparties (\$29 million in favour of Air Canada in the first nine months of 2014) (\$12 million and \$42 million, respectively, in favour of Air Canada for the third quarter and the first nine months of 2013).

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 September 30, 2014 amounted to \$919 million (US\$823 million) (\$791 million (US\$743 million) as at December 31, 2013). In the first nine months of 2014, an unrealized gain of \$34 million (unrealized gain of \$19 million in the first nine 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 third 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, and *IFRS 9 – Financial Instruments* which will become effective for periods beginning on January 1, 2018. Air Canada continues to evaluate the impact of these standards on its consolidated financial statements

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.

IFRS 9 – Financial Instruments

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

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 September 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 third 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 September 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:

(Canadian dollars in millions)	Third Quarter			First Nine Months		
	2014	2013	\$ Change	2014	2013	\$ Change
GAAP operating income	\$ 526	\$ 416	\$ 110	\$ 709	\$ 484	\$ 225
Add back:						
Aircraft rent	77	80	(3)	234	242	(8)
Depreciation, amortization and impairment	146	130	16	409	430	(21)
EBITDAR	\$ 749	\$ 626	\$ 123	\$ 1,352	\$ 1,156	\$ 196

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)	Third Quarter			First Nine Months		
	2014	2013	\$ Change	2014	2013	\$ Change
GAAP operating expense	\$ 3,272	\$ 3,063	\$ 209	\$ 9,459	\$ 9,004	\$ 455
Adjusted for:						
Aircraft fuel	(1,076)	(1,002)	(74)	(2,956)	(2,703)	(253)
Tax-related provision adjustments ⁽¹⁾	-	-	-	(41)	-	(41)
Ground packages costs at Air Canada Vacations	(56)	(52)	(4)	(303)	(261)	(42)
Impairment charge ⁽²⁾	-	-	-	-	(24)	24
Operating expense, adjusted for the above-noted items	\$ 2,140	\$ 2,009	\$ 131	\$ 6,159	\$ 6,016	\$ 143
ASMs (millions)	21,299	19,404	9.8%	56,486	52,540	7.5%
Adjusted CASM (cents)	¢ 10.05	¢ 10.35	(2.9%)	¢ 11.05	¢ 11.45	(3.5%)

(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 and Adjusted Net Income Per Share – Diluted

Air Canada uses adjusted net income and adjusted net income 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)	Third Quarter			First Nine Months		
	2014	2013	\$ Change	2014	2013	\$ Change
Net income for the period attributable to shareholders	\$ 321	\$ 298	\$ 23	\$ 201	\$ 13	\$ 188
Adjusted for:						
Tax-related provision adjustments ⁽¹⁾	-	-	-	(41)	-	(41)
Impairment charge ⁽²⁾	-	-	-	-	24	(24)
Foreign exchange (gain) loss	71	(49)	120	192	65	127
Interest charge ⁽³⁾	-	95	(95)	-	95	(95)
Net financing expense relating to employee benefits	34	51	(17)	102	155	(53)
(Gain) loss on fuel and other derivatives	31	(30)	61	10	(15)	25
Adjusted net income	\$ 457	\$ 365	\$ 92	\$ 464	\$ 337	\$ 127
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	294	283	11	293	283	10
Adjusted net income per share – diluted	\$ 1.55	\$ 1.29	\$ 0.26	\$ 1.58	\$ 1.19	\$ 0.39

(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.

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

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:

(in millions)	Third Quarter		First Nine Months	
	2014	2013	2014	2013
Weighted average number of shares outstanding – basic	286	277	286	276
Effect of potential dilution	8	6	7	7
Weighted average number of shares outstanding – diluted	294	283	293	283

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 September 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)	September 30, 2014	September 30, 2013	\$ Change
Net income for the period attributable to shareholders (trailing 12 months)	\$ 194	\$ (48)	\$ 242
Remove:			
Benefit plan amendments ⁽¹⁾	(82)	-	(82)
Tax-related provision adjustments ⁽²⁾	(41)	-	(41)
Impairment charge ⁽³⁾	6	24	(18)
Foreign exchange loss	247	56	191
Interest expense charge ⁽⁴⁾	-	95	(95)
Net financing expense relating to employee benefits	155	227	(72)
Gain on fuel and other derivatives	(12)	(22)	10
Adjusted net income (trailing 12 months)	\$ 467	\$ 332	\$ 135
Adjusted for:			
Interest expense ⁽⁵⁾	312	297	15
Implicit interest on operating leases ⁽⁶⁾	152	158	(6)
Adjusted income before interest (trailing 12 months)	\$ 931	\$ 787	\$ 144
Invested capital:			
Working capital, excluding current portion of long-term debt and finance leases	566	469	97
Long-term non-financial assets	6,447	5,951	496
Maintenance provisions	(694)	(608)	(86)
Other operating long-term liabilities	(304)	(361)	57
Capitalized operating leases ⁽⁷⁾	2,170	2,261	(91)
Invested capital	\$ 8,185	\$ 7,712	\$ 473
Return on invested capital (%)	11.4%	10.2%	1.2 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.

(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 \$310 million for the twelve months ended September 30, 2014 (for the twelve months ended September 30, 2013 - \$323 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).