

# News Release

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## Air Canada Reports Record Second Quarter 2014 Results

### Adjusted net income increased 21 per cent to \$139 million

MONTRÉAL, August 7, 2014 – Air Canada today reported second quarter adjusted net income <sup>(1)</sup> of \$139 million or \$0.47 per diluted share compared to adjusted net income of \$115 million or \$0.41 per diluted share in the second quarter of 2013, an improvement of \$24 million or 21 per cent. EBITDAR <sup>(1)</sup> (earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent) amounted to \$456 million compared to EBITDAR of \$385 million in the second quarter of 2013. On a GAAP basis, Air Canada reported net income of \$223 million or \$0.75 per diluted share in the second quarter of 2014 compared to a net loss of \$23 million or \$0.09 per diluted share in the second quarter of 2013. Air Canada's second quarter 2014 EBITDAR and GAAP net income results included favourable tax-related provision adjustments of \$41 million. These provisions are excluded from Air Canada's adjusted (net income and CASM) results.

"I am pleased to report that Air Canada delivered its best second quarter financial performance in the Corporation's history, surpassing last year's records in all three measures of operating income, adjusted net income and EBITDAR," said Calin Rovinescu, President and Chief Executive Officer. These results underline the significant incremental progress being achieved through our various value-enhancing strategies, as they continue to be implemented.

"In addition to seeing good year-over-year revenue growth in all of our five markets, we have also seen a marked increase in the number of international and U.S.-originating customers choosing Air Canada for their global travel plans. Investments by Air Canada and our industry partners to provide a seamless transfer experience at Canada's major hubs are starting to show results. The performance of Air Canada rouge™ has exceeded expectations and allows Air Canada to now compete more effectively in leisure markets on a more cost effective basis. Combined with Air Canada's other cost transformation strategies, adjusted CASM decreased 4.7 per cent from the previous year's quarter.

"During the quarter, Air Canada took delivery of the first two of 37 firm orders for the Boeing Dreamliner 787 aircraft and a third since, in July. The renewal of our international fleet with these next-generation aircraft will provide us with significant improvements in fuel efficiency and allow us to offer customers superior comfort and amenities. We look forward to realizing the full benefits of our international fleet renewal as new aircraft enter the mainline fleet.

“I am especially pleased that once again international air travellers surveyed by the independent UK-based research firm, Skytrax, selected Air Canada as Best Airline in North America for the fifth year in a row. This honour recognizes the professionalism of our employees and their commitment to taking care of our customers, as well as our investment in providing an award-winning product on board our aircraft and on the ground.

“Looking ahead, we remain focused on maintaining the momentum to transform Air Canada into an increasingly profitable company for our shareholders and employees, and executing on our four core priorities: cost transformation, international growth, customer engagement and culture change,” concluded Mr. Rovinescu.

### **Second Quarter Income Statement Highlights**

System passenger revenues amounted to \$2,965 million, an increase of \$208 million or 7.5 per cent from the second quarter of 2013, on a 9.9 per cent growth in traffic as yield declined 2.1 per cent year-over-year. Average stage length, on a system-basis, increased 2.5 percent from the same quarter of 2013 and had the effect of reducing yield by 1.5 percentage points. Passenger revenue per available seat mile (PRASM) decreased 0.8 per cent from the same quarter in 2013 on the lower yield as passenger load factor improved 1.1 percentage points. In the second quarter of 2014, system premium cabin revenues increased \$14 million or 2.4 per cent on yield growth of 3.6 per cent partly offset by a traffic decline of 1.2 per cent.

Operating expenses amounted to \$3,060 million, an increase of \$177 million or 6 per cent from the second quarter of 2013 on an 8.5 per cent increase in capacity. Included in Other operating expenses in the second quarter of 2014 were favourable tax-related provision adjustments of \$41 million. The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars), when compared to same quarter in 2013, increased operating expenses by \$110 million. This unfavourable currency impact on operating expenses was partially offset by a favourable currency impact on passenger revenues of \$70 million.

Air Canada’s adjusted cost per available seat mile (adjusted CASM<sup>(1)</sup>), which excludes fuel expense, the cost of ground packages at Air Canada Vacations<sup>TM</sup> and unusual items, decreased 4.7 per cent compared to the second quarter of 2013. The 4.7 per cent reduction in adjusted CASM surpassed the adjusted CASM decrease of 3.5 to 4.5 per cent projected in Air Canada’s news release dated May 15, 2014, largely the result of ASM capacity coming at the top end of the expected range and a slight improvement in the value of the Canadian dollar versus what Air Canada assumed in its May 15, 2014 projections.

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

## **Financial and Capital Management Highlights**

At June 30, 2014, unrestricted liquidity (cash, short-term investments and undrawn lines of credit) amounted to \$2,954 million (June 30, 2013 – \$2,139 million). Air Canada's principal objective in managing liquidity risk is to maintain a minimum unrestricted liquidity level of \$1.7 billion.

In April 2014, Air Canada completed a private offering of US\$400 million of 7.75 per cent senior unsecured notes due 2021 and received net proceeds of approximately \$432 million.

At June 30, 2014, adjusted net debt <sup>(1)</sup> amounted to \$4,309 million, a decrease of \$42 million from December 31, 2013. The airline's adjusted net debt to EBITDAR ratio was 2.9 at June 30, 2014 versus a ratio 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.

In the second quarter of 2014, free cash flow <sup>(1)</sup> reflected a decline of \$183 million from the second quarter of 2013, reflecting primarily the acquisition of two Boeing 787 aircraft.

For the 12 months ended June 30, 2014, return on invested capital (ROIC <sup>(1)</sup>) was 11.0 per cent versus 8.8 per cent for the 12 months ended June 30, 2013. Air Canada's goal is to achieve a sustainable ROIC of 10 to 13 per cent by 2015.

## **Pension Highlights**

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 per cent 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 per cent to calculate its future pension obligations. 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.

## **Current Outlook**

For the third quarter of 2014, Air Canada expects its system ASM capacity, as measured by available seat miles (ASMs), to increase in the range of 9.0 to 10.0 per cent when compared to the third quarter of 2013.

Air Canada now expects its full year 2014 system ASM capacity to increase in the range of 7.0 to 8.0 per cent (as opposed to the 6.5 to 8.0 per cent growth projected in Air Canada's news release dated May 15, 2014) and its full year domestic ASM capacity to increase in the range of 4.0 to 5.0 per cent when compared to 2013 (as opposed to 3.0 to 4.0 per cent growth projected in Air Canada's news release dated May 15, 2014). The projected system capacity increase is expected to be achieved at a unit cost which is below historical levels. The change in projected domestic ASM capacity is primarily driven by the use of larger aircraft on transcontinental routes in support of the airline's international expansion strategy.

Air Canada expects the ASM capacity growth to be comprised of an increase in the total number of seats dispatched (system) in the third quarter and full year 2014 in the range of 6.5 to 7.5 per cent and 5.0 to 6.0 per cent, respectively, when compared to same periods in 2013.

For the third quarter of 2014, Air Canada expects adjusted CASM to decrease in the range of 3.5 to 4.5 per cent when compared to the third quarter of 2013.

Taking into account Air Canada's adjusted CASM performance in the second quarter of 2014, for the full year 2014, Air Canada now expects adjusted CASM to decrease in the range of 3.2 to 4.2 per cent from the full year 2013 (as opposed to the 3.0 to 4.0 per cent decrease projected in Air Canada's news release dated May 15, 2014).

Air Canada's outlook assumes Canadian GDP growth of 2.0 to 2.5 per cent for 2014. Air Canada also expects that the Canadian dollar will trade, on average, at C\$1.08 per U.S. dollar in the third quarter of 2014 and C\$1.09 for the full year 2014 and that the price of jet fuel will average 90 cents per litre for the third quarter of 2014 and 91 cents per litre for the full year 2014.

The following table summarizes Air Canada's above-mentioned outlook for the third quarter and full year 2014 and related major assumptions:

	<b>Third Quarter 2014 versus Third Quarter 2013</b>	<b>Full Year 2014 versus Full Year 2013</b>
<b><u>Current Outlook</u></b>		
Available seat miles (System)	Increase 9.0% to 10.0%	Increase 7.0% to 8.0%
Available seat miles (Canada)		Increase 4.0% to 5.0%
Seats dispatched (System)	Increase 6.5% to 7.5%	Increase 5.0% to 6.0%
Adjusted CASM <sup>*</sup>	Decrease 3.5% to 4.5%	Decrease 3.2% to 4.2%

*\*Excludes fuel expense, the cost of ground packages at Air Canada Vacations and unusual items*

	<b>Major Assumptions – Third Quarter 2014</b>	<b>Major Assumptions – Full Year 2014</b>
<b><u>Major Assumptions</u></b>		
Canadian dollar per U.S. dollar	1.08	1.09
Jet fuel price – CAD cents per litre	90 cents	91 cents
Canadian economy	2014 Annualized Canadian GDP growth of 2.0% to 2.5%	Canadian GDP growth of 2.0% to 2.5%

For the full year 2014, Air Canada also expects:

- Depreciation, amortization and impairment expense to decrease by \$45 million from the full year 2013.
- Employee benefits expense to decrease by \$35 million from the full year 2013 (as opposed to the \$25 million decrease projected in Air Canada's news release dated May 15, 2014). This improvement is driven by actuarial gains recorded to date in 2014.
- Aircraft maintenance expense to increase \$65 million (approximately \$40 million of which is expected to be due to the weaker Canadian dollar when compared to the U.S. dollar) from the full year 2013 (as opposed to the \$90 million increase projected in Air Canada news release dated May 15, 2014). This improvement is driven by aircraft lease extensions, which have the effect of reducing the present value of end of lease maintenance obligations, as well as cost reduction initiatives, including savings obtained through contract negotiations.
- Net financing expense relating to employee benefits (in non-operating expense on Air Canada's statement of operations) to decrease by \$75 million from the full year 2013.

The following table summarizes the above-mentioned projections for the full year 2014:

	<b>Full Year 2014 versus Full Year 2013</b>
Depreciation, amortization and impairment expense	Decrease \$45 million
Employee benefits expense	Decrease \$35 million
Aircraft maintenance expense	Increase \$65 million
Net financing expense relating to employee benefits (in non-operating expense)	Decrease of \$75 million

The outlook provided constitutes forward-looking statements within the meaning of applicable securities laws and is based on a number of additional assumptions and subject to a number of risks. Please see section below entitled "Caution Regarding Forward-Looking Information."

<sup>(1)</sup> **Non-GAAP Measures**

Below is a description of certain non-GAAP measures used by Air Canada to provide additional information on its financial and operating performance. Such measures are not recognized measures for financial statement presentation under Canadian GAAP and do not have standardized meanings and may not be comparable to similar measures presented by other public companies. Refer to Air Canada's Second Quarter 2014 MD&A for reconciliation of non-GAAP financial measures.

- Adjusted net income (loss) and adjusted net income (loss) per diluted share are used by Air Canada to assess its performance without the effects of foreign exchange, net financing expense on employee benefits, mark-to-market adjustments on fuel and other derivatives and unusual items, such as the tax-related provision adjustments recorded in the second quarter of 2014.
- EBITDAR is commonly used in the airline industry and is used by Air Canada to assess earnings before interest, taxes, depreciation, amortization, 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.
- Adjusted CASM is used by Air Canada 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, such as the tax-related provision adjustments recorded in the second quarter of 2014 and impairment charges, as such expenses may distort the analysis of certain business trends and render comparative analyses to other airlines less meaningful.
- Free cash flow is used by Air Canada as an indicator of the financial strength and performance of its business because it shows how much cash is available for such purposes as repaying debt, meeting ongoing financial obligations and reinvesting in Air Canada.
- Adjusted net debt is a key component of the capital managed by Air Canada and provides a measure of the airline's net indebtedness. Adjusted net debt is calculated as the sum of total long-term debt and finance lease obligations and capitalized operating leases less cash and cash equivalents and short-term investments.
- Return on invested capital (ROIC) is used by Air Canada to assess the efficiency with which it allocates its capital to generate returns. Return is based on Adjusted net income (loss) (as discussed in the section above), excluding interest expense and implicit interest on operating leases. Invested capital includes average year-over-year total assets, net of average year-over-year non-interest-bearing operating liabilities, and the value of capitalized operating leases (calculated by multiplying annualized aircraft rent by 7). 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.

Air Canada's Second Quarter 2014 Interim Consolidated Financial Statements and Notes and its Second Quarter 2014 Management's Discussion and Analysis are available on Air Canada's website at [aircanada.com](http://aircanada.com), and will be filed on SEDAR at [www.sedar.com](http://www.sedar.com).

For further information on Air Canada's public disclosure file, including Air Canada's Annual Information Form dated March 28, 2014, consult SEDAR at [www.sedar.com](http://www.sedar.com).

## **Analyst Conference Call Advisory**

Air Canada will host its quarterly analysts' call today, August 7, 2014 at 09:00 ET. Calin Rovinescu, President and Chief Executive Officer, Michael Rousseau, Executive Vice President and Chief Financial Officer, and Ben Smith, Executive Vice President and Chief Commercial Officer will be available for analysts' questions. Immediately following the analysts' Q&A session, Michael Rousseau, Executive Vice President and Chief Financial Officer, and Pierre Houle, Treasurer, will be available to answer questions from holders of Air Canada's bonds and term loan B lenders. Media and the public may access this call on a listen-in basis. Details are as follows:

Dial 416-340-2218 or 1-866-225-0198

Live audio webcast: <http://www.media-server.com/m/p/ma35vhsp>

### **CAUTION REGARDING FORWARD-LOOKING INFORMATION**

*This news release includes forward-looking statements within the meaning of applicable securities laws. Forward-looking statements relate to analyses and other information that are 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 preliminary results, guidance, strategies, expectations, planned operations or future actions. Forward-looking statements are identified by the use of terms and phrases such as "preliminary", "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 news release and 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 news release represent Air Canada's expectations as of the date of this news release (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.*

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## **INFORMATION**

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## HIGHLIGHTS

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

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

- (1) *Adjusted net income (loss) and adjusted net income (loss) per share – diluted are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of Air Canada's Second Quarter 2014 MD&A for additional information.*
- (2) *EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of Air Canada's Second Quarter 2014 MD&A for additional information.*
- (3) *Unrestricted liquidity refers to the sum of cash, cash equivalents, short-term investments and the amount of available credit under Air Canada's revolving credit facilities. At June 30, 2014, unrestricted liquidity was comprised of cash and short-term investments of \$2,615 million and undrawn lines of credit of \$339 million. At June 30, 2013, unrestricted liquidity was comprised of cash and short-term investments of \$2,107 million and undrawn lines of credit of \$32 million.*
- (4) *Free cash flow (cash flows from operating activities less additions to property, equipment and intangible assets) is a non-GAAP financial measure. Refer to section 7.5 "Consolidated Cash Flow Movements" of Air Canada's Second Quarter 2014 MD&A for additional information.*
- (5) *Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is a non-GAAP financial measure. Refer to section 7.3 "Adjusted Net Debt" of Air Canada's Second Quarter 2014 MD&A for additional information.*
- (6) *Return on invested capital ("ROIC") is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of Air Canada's Second Quarter 2014 MD&A for additional information.*
- (7) *Operating statistics (except for average number of FTE employees) include third party carriers (such as Jazz Aviation LP ("Jazz") and Sky Regional Airlines Inc. ("Sky Regional")) operating under capacity purchase agreements with Air Canada.*
- (8) *Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of Air Canada's Second Quarter 2014 MD&A for additional information.*
- (9) *Reflects FTE employees at Air Canada. Excludes FTE employees at third party carriers (such as Jazz and Sky Regional) operating under capacity purchase agreements with Air Canada.*
- (10) *Average stage length is calculated by dividing the total number of available seat miles by the total number of seats dispatched.*
- (11) *Includes fuel handling expenses. Economic fuel price per litre is a non-GAAP financial measure. Refer to sections 4 and 5 "Results of Operations" of Air Canada's Second Quarter 2014 MD&A for additional information.*
- (12) *Revenue passengers are counted on a flight number basis which is consistent with the IATA definition of revenue passengers carried.*