

**AIR CANADA** 

First Quarter 2015

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

May 12, 2015



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## 1. HIGHLIGHTS

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

(Canadian dollars in millions, except where indicated)	First Quarter		
	2015	2014	\$ Change
<b>Financial Performance Metrics</b>			
Operating revenues	3,249	3,065	184
Operating income (loss)	200	(62)	262
Non-operating expense	(509)	(279)	(230)
Net loss	(309)	(341)	32
Adjusted net income (loss) <sup>(1)</sup>	122	(132)	254
Operating margin %	6.2%	(2.0)%	8.2 pp
EBITDAR <sup>(2)</sup>	442	147	295
EBITDAR margin % <sup>(2)</sup>	13.6%	4.8%	8.8 pp
Unrestricted liquidity <sup>(3)</sup>	3,123	2,515	608
Free cash flow <sup>(4)</sup>	383	34	349
Adjusted net debt <sup>(5)</sup>	5,190	4,426	764
Return on invested capital ("ROIC") % <sup>(6)</sup>	15.2%	10.9%	4.3 pp
Net loss per share – basic and diluted	\$ (1.08)	\$ (1.20)	\$ 0.12
Adjusted net income (loss) per share – diluted <sup>(1)</sup>	\$ 0.41	\$ (0.46)	\$ 0.87
<b>Operating Statistics <sup>(7)</sup></b>			<b>% Change</b>
Revenue passenger miles (millions) ("RPM")	14,937	13,466	10.9
Available seat miles (millions) ("ASM")	18,335	16,774	9.3
Passenger load factor %	81.5%	80.3%	1.2 pp
Passenger revenue per RPM ("Yield") (cents)	18.3	19.1	(4.2)
Passenger revenue per ASM ("PRASM") (cents)	14.9	15.3	(2.7)
Operating revenue per ASM (cents)	17.7	18.3	(3.0)
Operating expense per ASM ("CASM") (cents)	16.6	18.6	(10.8)
Adjusted CASM (cents) <sup>(8)</sup>	11.9	12.2	(1.8)
Average number of full-time equivalent ("FTE") employees (thousands) <sup>(9)</sup>	24.5	24.3	0.9
Aircraft in operating fleet at period-end	369	353	4.5
Average fleet utilization (hours per day)	9.7	9.8	(1.0)
Seats dispatched (thousands)	12,337	11,597	6.4
Aircraft frequencies (thousands)	134	131	2.3
Average stage length (miles) <sup>(10)</sup>	1,486	1,446	2.7
Economic fuel cost per litre (cents) <sup>(11)</sup>	66.3	94.7	(30.0)
Fuel litres (millions)	1,039	973	6.8
Revenue passengers carried (thousands) <sup>(12)</sup>	9,487	8,749	8.4

- (1) *Adjusted net income (loss) and adjusted net income (loss) per share – diluted are non-GAAP financial measures. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.*
- (2) *EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.*
- (3) *Unrestricted liquidity refers to the sum of cash, cash equivalents, short-term investments and the amount of available credit under Air Canada's revolving credit facilities. At March 31, 2015, unrestricted liquidity was comprised of cash and short-term investments of \$2,850 million and undrawn lines of credit of \$273 million. At March 31, 2014, unrestricted liquidity was comprised of cash and short-term investments of \$2,390 million and undrawn lines of credit of \$125 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 6.5 "Consolidated Cash Flow Movements" of this MD&A for additional information.*
- (5) *Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is a non-GAAP financial measure. Refer to section 6.3 "Adjusted Net Debt" of this MD&A for additional information.*
- (6) *Return on invested capital ("ROIC") is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.*
- (7) *Operating statistics (except for average number of FTE employees) include third party carriers (such as Jazz Aviation LP ("Jazz") and Sky Regional Airlines Inc. ("Sky Regional")) operating under capacity purchase agreements with Air Canada.*
- (8) *Adjusted CASM is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.*
- (9) *Reflects FTE employees at Air Canada. Excludes FTE employees at third party carriers (such as Jazz and Sky Regional) operating under capacity purchase agreements with Air Canada.*
- (10) *Average stage length is calculated by dividing the total number of available seat miles by the total number of seats dispatched.*
- (11) *Includes aircraft fuel expense related to regional airline operations. 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.*
- (12) *Revenue passengers are counted on a flight number basis which is consistent with the IATA definition of revenue passengers carried.*

## 2. INTRODUCTION AND KEY ASSUMPTIONS

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), the "Corporation" refers, as the context may require, to Air Canada and/or one or more of Air Canada's subsidiaries, including its wholly-owned operating subsidiaries, Touram Limited Partnership, doing business as Air Canada Vacations® ("Air Canada Vacations") and Air Canada *rouge* LP, doing business as Air Canada *rouge*® ("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 first quarter of 2015. This MD&A should be read in conjunction with Air Canada's interim unaudited condensed consolidated financial statements and notes for the first quarter of 2015, Air Canada's 2014 annual audited consolidated financial statements and notes and Air Canada's 2014 MD&A dated February 11, 2015 ("Air Canada's 2014 MD&A"). 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 for any financial information specifically denoted otherwise.

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 16 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of May 11, 2015.

Air Canada has capacity purchase agreements with Jazz Aviation LP ("Jazz"), Sky Regional Airlines Inc. ("Sky Regional") and certain other regional carriers. As of 2015, Air Canada has changed the presentation of the expenses related to capacity purchase agreements on its consolidated statement of operations. This change in presentation has been adopted to provide an improved presentation of the economic costs associated with regional carrier operations. Prior period amounts have been reclassified to conform to the current period presentation. For additional information, refer to Note 2 of Air Canada's interim unaudited consolidated financial statements for the first quarter of 2015.

Effective January 1, 2015, Air Canada and Jazz amended the terms of their capacity purchase agreement and extended its term through to December 31, 2025. As a result of the amendments, certain costs that were previously capacity purchase agreement fees are now pass-through costs. Other costs that were pass-through costs are now costs directly incurred by Air Canada.

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 2014 MD&A dated February 11, 2015. Air Canada issued a news release dated May 12, 2015 reporting on its results for the first quarter of 2015. This news release is available on Air Canada's website at [www.aircanada.com](http://www.aircanada.com) and on SEDAR's website at [www.sedar.com](http://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](http://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 2014 MD&A. The forward-looking statements contained in this MD&A represent Air Canada's expectations as of May 11, 2015 (or as of the date they are otherwise stated to be made), and are subject to change after such date. However, Air Canada disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

## **KEY ASSUMPTIONS**

Assumptions were made by Air Canada in preparing and making forward-looking statements. As part of its assumptions, Air Canada assumes Canadian GDP growth of 1.75% to 2.25% for 2015. In addition, Air Canada expects that the Canadian dollar will trade, on average, at C\$1.22 per U.S. dollar in the second quarter of 2015 and for the full year 2015 and that the price of jet fuel will average 69 cents per litre for the second quarter of 2015 and 70 cents per litre for the full year 2015.

## **INTELLECTUAL PROPERTY**

Air Canada owns or has rights to trademarks, service marks or trade names used in connection with the operation of its business. In addition, Air Canada's names, logos and website names and addresses are owned or licensed by Air Canada. Air Canada also owns or has the rights to copyrights that protect the content of its products and/or services. Solely for convenience, the trademarks, service marks, trade names and copyrights referred to in this MD&A may be listed without the ©, ® and ™ symbols, but Air Canada will assert, to the fullest extent under applicable law, its rights or the rights of the applicable licensors to these trademarks, service marks, trade names and copyrights.

This MD&A may include trademarks, service marks or trade names of other parties. Air Canada's use or display of other parties' trademarks, service marks, trade names or products is not intended to, and does not imply a relationship with, or endorsement or sponsorship of Air Canada by, the trademark, service mark or trade name owners or licensees.

### 3. OVERVIEW

In the first quarter of 2015, Air Canada generated adjusted net income of \$122 million, an improvement of \$254 million from the first quarter of 2014. Refer to section 15 “Non-GAAP Financial Measures” of this MD&A for additional information. On a GAAP basis, Air Canada reported operating income of \$200 million compared to an operating loss of \$62 million in the first quarter of 2014, an improvement of \$262 million.

#### **Strategy**

Air Canada’s goal is to fully develop as a leading global airline, to be among those with the highest levels of customer experience, employee engagement and value creation for shareholders and other stakeholders. This is being pursued through the following four key strategies, which are further discussed in Air Canada’s 2014 MD&A:

- Continually identifying and implementing cost reduction and revenue generating initiatives;
- Expanding internationally and increasing connecting traffic through international gateways, on a sustainable and profitable basis, and competing effectively in the leisure market to and from Canada;
- Engaging customers by continually enhancing the travel experience and providing a consistently high level of customer experience, with additional emphasis on premium and business passengers and products; and
- Fostering positive culture change through employee engagement programs designed to promote an understanding of how the airline and its employees can work together to deliver on the customer promise and investing in the tools and training required to provide a culture of top customer care.

#### **First Quarter 2015 Financial Summary**

The following is an overview of Air Canada’s results of operations and financial position for the first quarter of 2015 compared to the first quarter of 2014.

- Operating revenues of \$3,249 million, an increase of \$184 million or 6% from the first quarter of 2014.
- An ASM capacity increase of 9.3% from the first quarter of 2014, in line with the 8.5% to 9.5% capacity increase projected in Air Canada’s news release dated February 11, 2015. The capacity growth in the first quarter of 2015 was primarily driven by increased seat density from Air Canada *rouge* and, through the introduction of Boeing 787 aircraft into the mainline fleet.
- Passenger revenues of \$2,786 million, an increase of \$178 million or 6.9% from the first quarter of 2014 on traffic growth of 10.9% partly offset by a yield decline of 4.2%. The yield decline was driven by an increase in average stage length of 2.7% which had the effect of reducing system yield by 1.6 percentage points, a higher proportional growth of lower-yielding international-to-international passenger flows, a higher proportion of seats into long-haul leisure markets, and the use of lower-cost Boeing 777 high-density aircraft which have a larger economy cabin.
- A PRASM decline of 2.7% from the first quarter of 2014 as the 4.2% decline in yield was partly offset by a passenger load factor improvement of 1.2 percentage points.
- The favourable impact of a weaker Canadian dollar on foreign currency denominated passenger revenues increased passenger revenues by approximately \$38 million in the first quarter of 2015. The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S.) increased operating expenses by approximately \$135 million (comprised of \$72 million in Aircraft fuel expense and an aggregate of \$63 million in non-fuel operating expenses) in the first quarter of 2015.
- An adjusted CASM decrease of 1.8% from the first quarter of 2014, better than the 0.5% to 1.5% increase projected in Air Canada’s news release dated February 11, 2015. The better than expected adjusted CASM performance was largely due to:

- Lower than anticipated aircraft maintenance expenses, primarily driven by the acceleration of aircraft lease extensions and certain favourable lease return condition provision adjustments, reducing maintenance expenses by \$22 million in the first quarter of 2015;
- The impact of the new Jazz CPA, effective January 1, 2015, whereby certain costs, such as ground handling services performed by Air Canada, are no longer recovered from Jazz and passed through to Air Canada under the Jazz CPA as capacity purchase fees, thereby reducing both other revenues and capacity purchase fees; and
- Lower than expected employee benefits expense due to lower benefit payments and improved plan experience.

Adjusted CASM is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

- Operating income of \$200 million compared to an operating loss of \$62 million in the first quarter of 2014, an improvement of \$262 million. Air Canada reported an operating margin of 6.2% compared to a negative operating margin of 2.0% in the first quarter of 2014, an improvement of 8.2 percentage points.
- A net loss of \$309 million or \$1.08 per diluted share compared to a net loss of \$341 million or \$1.20 per diluted share in the first quarter of 2014. The net loss in the first quarter of 2015 included foreign exchange losses of \$408 million while the net loss in the first quarter of 2014 included foreign exchange losses of \$161 million.
- EBITDAR of \$442 million compared to EBITDAR of \$147 million in the first quarter of 2014, an increase of \$295 million. EBITDAR is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Adjusted net income of \$122 million or \$0.41 per diluted share compared to an adjusted net loss of \$132 million or \$0.46 per diluted share in the first quarter of 2014, an improvement of \$254 million or \$0.87 per diluted share. Adjusted net-income is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Free cash flow of \$383 million, \$349 million higher than the first quarter of 2014, reflecting higher cash flows from operating activities partly offset by an increase in capital expenditures which included the acquisition of two Boeing 787-8 aircraft in the first quarter of 2015. 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 6.5 "Consolidated Cash Flow Movements" of this MD&A for additional information.
- Adjusted net debt amounted to \$5,190 million at March 31, 2015, an increase of \$58 million from December 31, 2014 as higher long-term debt and finance lease balances were largely offset by higher cash and short-term investments balances. The airline's adjusted net debt to EBITDAR ratio was 2.6 at March 31, 2015 versus a ratio of 3.1 at December 31, 2014. 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 6.3 "Adjusted Net Debt" of this MD&A for additional information.
- Unrestricted liquidity (cash, short-term investments and undrawn lines of credit) of \$3,123 million at March 31, 2015 (March 31, 2014 – \$2,515 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 March 31, 2015, cash and short-term investments amounted to \$2,850 million and undrawn lines of credit amounted to \$273 million. At March 31, 2014, cash and short-term investments amounted to \$2,390 million and undrawn lines of credit amounted to \$125 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") at March 31, 2015 of 15.2% versus 10.9% at March 31, 2014. Air Canada's goal is to maintain a sustainable ROIC of 10% to 13%. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.



#### 4. RESULTS OF OPERATIONS – FIRST QUARTER 2015 VERSUS FIRST QUARTER 2014

The following table and discussion compares results of Air Canada for the first quarter 2015 versus the first quarter of 2014.

(Canadian dollars in millions, except per share figures)	First Quarter		Change	
	2015	2014	\$	%
<b>Operating revenues</b>				
Passenger	\$ 2,786	\$ 2,608	\$ 178	7
Cargo	129	119	10	8
Other	334	338	(4)	(1)
<b>Total revenues</b>	<b>3,249</b>	<b>3,065</b>	<b>184</b>	<b>6</b>
<b>Operating expenses</b>				
Aircraft fuel	592	793	(201)	(25)
Regional airlines expense	552	567	(15)	(3)
Wages, salaries and benefits	568	557	11	2
Airport and navigation fees	185	183	2	1
Aircraft maintenance	188	162	26	16
Sales and distribution costs	154	148	6	4
Depreciation, amortization and impairment	153	126	27	21
Ground package costs	181	170	11	6
Aircraft rent	82	76	6	8
Food, beverages and supplies	62	66	(4)	(6)
Communications and information technology	57	52	5	10
Other	275	227	48	21
<b>Total operating expenses</b>	<b>3,049</b>	<b>3,127</b>	<b>(78)</b>	<b>(2)</b>
<b>Operating income (loss)</b>	<b>200</b>	<b>(62)</b>	<b>262</b>	
<b>Non-operating income (expense)</b>				
Foreign exchange loss	(408)	(161)	(247)	
Interest income	9	9	-	
Interest expense	(90)	(77)	(13)	
Interest capitalized	9	5	4	
Net financing expense relating to employee benefits	(25)	(34)	9	
Fuel and other derivatives	1	(15)	16	
Other	(5)	(6)	1	
<b>Total non-operating expense</b>	<b>(509)</b>	<b>(279)</b>	<b>(230)</b>	
<b>Loss before income taxes</b>	<b>(309)</b>	<b>(341)</b>	<b>32</b>	
Income taxes	-	-	-	
<b>Net loss</b>	<b>\$ (309)</b>	<b>\$ (341)</b>	<b>\$ 32</b>	
<b>Net loss per share – basic and diluted</b>	<b>\$ (1.08)</b>	<b>\$ (1.20)</b>	<b>\$ 0.12</b>	
<b>EBITDAR <sup>(1)</sup></b>	<b>\$ 442</b>	<b>\$ 147</b>	<b>\$ 295</b>	
<b>Adjusted net income (loss) <sup>(2)</sup></b>	<b>\$ 122</b>	<b>\$ (132)</b>	<b>\$ 254</b>	
<b>Adjusted net income (loss) per share – diluted <sup>(2)</sup></b>	<b>\$ 0.41</b>	<b>\$ (0.46)</b>	<b>\$ 0.87</b>	

(1) EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

(2) Adjusted net income (loss) and adjusted net income (loss) per share – diluted are non-GAAP financial measures. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

### System passenger revenues increased 6.9% from the first quarter of 2014

In the first quarter of 2015, on capacity growth of 9.3%, system passenger revenues of \$2,786 million increased \$178 million or 6.9% from the first quarter of 2014. The increase in system passenger revenues was due to traffic growth of 10.9% partly offset by a yield decline of 4.2%. Modest yield declines are an anticipated and natural consequence of the successful implementation of Air Canada's business strategy to profitably increase long-haul international and leisure flying.

In the first quarter of 2015, system business cabin revenues increased \$7 million or 1.2% from the first quarter of 2014 due to a yield improvement of 1.8% partly offset by a traffic decrease of 0.6%.

The table below provides passenger revenue by geographic region for the first quarter of 2015 and the first quarter of 2014.

Passenger Revenue	First Quarter 2015 \$ Million	First Quarter 2014 \$ Million	Change \$ Million	% Change
Canada	976	943	33	3.4
U.S. transborder	699	621	78	12.6
Atlantic	450	406	44	11.0
Pacific	369	371	(2)	(0.5)
Other	292	267	25	9.5
<b>System</b>	<b>2,786</b>	<b>2,608</b>	<b>178</b>	<b>6.9</b>

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the first quarter of 2015 versus the first quarter of 2014.

First Quarter 2015 Versus First Quarter 2014	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	3.4	2.1	3.9	1.4	(1.8)	-
U.S. transborder	12.6	17.3	17.7	0.3	(4.3)	(4.0)
Atlantic	11.0	10.7	17.2	4.2	(5.1)	0.4
Pacific	(0.5)	7.6	6.5	(0.8)	(6.5)	(7.4)
Other	9.5	12.9	13.4	0.3	(3.7)	(3.3)
<b>System</b>	<b>6.9</b>	<b>9.3</b>	<b>10.9</b>	<b>1.2</b>	<b>(4.2)</b>	<b>(2.7)</b>

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the first quarter of 2015 and each of the previous four quarters.

System	Year-over-Year by Quarter (% Change)				
	Q1'14	Q2'14	Q3'14	Q4'14	Q1'15
Passenger revenues	3.2	7.5	9.4	7.6	6.9
Capacity (ASMs)	3.8	8.5	9.8	8.5	9.3
Traffic (RPMs)	2.9	9.9	11.0	9.4	10.9
Passenger load factor (pp change)	(0.7)	1.1	1.0	0.6	1.2
Yield	0.4	(2.1)	(1.3)	(1.9)	(4.2)
PRASM	(0.5)	(0.8)	(0.2)	(1.2)	(2.7)

In the first quarter of 2015, Air Canada's system capacity was 9.3% higher than in the first quarter of 2014, with capacity growth reflected in all markets.

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

- The 10.9% traffic increase which reflected traffic growth in all markets. Consistent with the airline's objective of increasing global international-to-international connecting traffic through its major Canadian hubs, the traffic growth in the first quarter of 2015 also reflected lower-yielding incremental connecting traffic to international destinations.
- The 4.2% yield decrease which reflected:
  - o an increase in average stage length of 2.7%, which had the effect of reducing system yield by 1.6 percentage points;
  - o a higher proportional growth of lower-yielding international-to-international passenger flows in support of the airline's international expansion strategy;
  - o a higher proportion of seats into long-haul leisure markets; and
  - o the use of lower-cost Boeing 777 high-density aircraft which have a larger economy cabin. The use of this lower-cost aircraft on high-volume routes is allowing the airline to access traditionally lower-yielding traffic while improving profitability.

These decreases were largely offset by a favourable currency impact of \$38 million and improvements in Air Canada's business cabin performance.

System PRASM decreased 2.7% due to the lower yield partly offset by a passenger load factor improvement of 1.2 percentage points.

#### Domestic passenger revenues increased 3.4% from the first quarter of 2014

In the first quarter of 2015, on capacity growth of 2.1%, domestic passenger revenues of \$976 million increased \$33 million or 3.4% from the first quarter of 2014. The increase in domestic passenger revenues was due to traffic growth of 3.9% and an increase in baggage fee revenues. These increases were partly offset by a yield decline of 1.8%.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the first quarter of 2015 and each of the previous four quarters.

Canada	Year-over-Year by Quarter (% Change)				
	Q1'14	Q2'14	Q3'14	Q4'14	Q1'15
Passenger revenues	(1.5)	2.2	6.5	5.7	3.4
Capacity (ASMs)	3.9	3.6	5.3	6.1	2.1
Traffic (RPMs)	1.7	5.3	6.9	6.6	3.9
Passenger load factor (pp change)	(1.8)	1.3	1.2	0.4	1.4
Yield	(3.5)	(3.3)	(0.7)	(1.8)	(1.8)
PRASM	(5.5)	(1.8)	0.8	(1.3)	-

In the first quarter of 2015, the 2.1% domestic capacity growth reflected capacity increases on all major domestic services with the exception of services to the Maritimes where capacity was reduced year-over-year. The reduction in capacity on services to the Maritimes was partly due to weather-related issues.

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

- The 3.9% traffic increase which reflected traffic growth on all domestic services. The traffic growth in the first quarter of 2015 reflected increases on services within Canada, as well as incremental connecting traffic to U.S. and international destinations. While traffic to oil-related markets decreased year-over-year, the traffic decline in these markets was offset by traffic growth on other domestic services, particularly on transcontinental services and services linking Toronto, Montreal and Ottawa.
- An increase in baggage fee revenues following an adjustment to the airline's first checked bag policy which became effective for travel as of November 2, 2014. Baggage fee revenues are not included in Air Canada's yield and PRASM results.
- The 1.8% yield decrease which reflected the impact of increased industry capacity and aggressive pricing activities on regional routes within Ontario and Quebec and on routes within Western Canada. In addition, a higher proportional growth of lower-yielding international and U.S. transborder passenger flows in support of the airline's international expansion strategy was also a factor in the yield decline year-over-year. These yield decreases were partly offset by a favourable currency impact of \$6 million.

Domestic PRASM was unchanged from the first quarter of 2014 as the yield decline was offset by a passenger load factor improvement of 1.4 percentage points.

#### U.S. transborder passenger revenues increased 12.6% from the first quarter of 2014

In the first quarter of 2015, on a capacity growth of 17.3%, U.S. transborder passenger revenues of \$699 million increased \$78 million or 12.6% from the first quarter of 2014. The increase in U.S. transborder passenger revenues was due to traffic growth of 17.7% partly offset by a yield decline of 4.3%.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the first quarter of 2015 and each of the previous four quarters.

U.S. transborder	Year-over-Year by Quarter (% Change)				
	Q1'14	Q2'14	Q3'14	Q4'14	Q1'15
Passenger revenues	5.7	11.5	11.2	9.5	12.6
Capacity (ASMs)	1.9	12.2	12.7	14.0	17.3
Traffic (RPMs)	5.7	16.2	16.2	15.5	17.7
Passenger load factor (pp change)	2.9	2.8	2.5	1.1	0.3
Yield	0.3	(3.3)	(3.7)	(5.0)	(4.3)
PRASM	4.0	0.1	(0.7)	(3.7)	(4.0)

In the first quarter of 2015, the 17.3% U.S. transborder capacity growth reflected capacity increases on all major U.S. transborder services.

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

- The 17.7% traffic increase which reflected traffic growth on all major U.S. transborder services with the exception of services from Montreal to Colorado where capacity was reduced year-over-year. In the first quarter of 2015, passenger demand on U.S. sun routes and from western Canada to the western U.S. was particularly strong. The traffic growth was achieved through additional long-haul capacity and improved load factors on short-haul flying. The year-over-year increase in traffic was largely due to significantly higher proportional growth of lower-yielding international-to-international passenger flows from the U.S. in support of Air Canada's international expansion strategy, as well as strong passenger demand on services between Canada and the U.S.

- The 4.3% yield decline which reflected:
  - o a 3.4% longer average stage length, which had the effect of reducing U.S. transborder yield by 1.9 percentage points;
  - o the impact of having a higher proportion of seats in long-haul (lower-yielding) leisure markets; and
  - o a higher proportion of lower-yielding incremental international-to-international passenger flows in support of the airline's international expansion strategy. The increase in long-haul leisure flying was led by lower-cost Air Canada *rouge* flying, allowing Air Canada to effectively compete on lower-yielding leisure routes.

These yield decreases were partly offset by a favourable currency impact of \$14 million.

U.S. transborder PRASM decreased 4.0% on the lower yield as passenger load factor improved 0.3 percentage points.

### Atlantic passenger revenues increased 11.0% from the first quarter of 2014

In the first quarter of 2015, on capacity growth of 10.7%, Atlantic passenger revenues of \$450 million increased \$44 million or 11.0% from the first quarter of 2014. The increase in Atlantic passenger revenues was due to traffic growth of 17.2% partly offset by a yield decline of 5.1%.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the first quarter of 2015 and each of the previous four quarters.

Atlantic	Year-over-Year by Quarter (% Change)				
	Q1'14	Q2'14	Q3'14	Q4'14	Q1'15
Passenger revenues	8.3	12.3	14.9	13.6	11.0
Capacity (ASMs)	7.6	16.2	20.2	8.7	10.7
Traffic (RPMs)	1.2	14.7	19.2	12.8	17.2
Passenger load factor (pp change)	(4.5)	(1.1)	(0.8)	2.9	4.2
Yield	7.1	(2.0)	(3.5)	0.8	(5.1)
PRASM	0.7	(3.3)	(4.4)	4.7	0.4

In the first quarter of 2015, the 10.7% Atlantic capacity growth reflected capacity increases on all major Atlantic services with the exception of services to Germany.

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

- The 17.2% 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 5.1% yield decline which reflected:
  - o the impact of offering a higher proportion of seats in long-haul (lower-yielding) leisure markets, particularly in this lower demand travel period of the year. The first quarter is traditionally highly competitive from a pricing perspective as carriers seek to capture additional traffic.
  - o a 1.0% longer average stage length, which had the effect of reducing Atlantic yield by 0.6 percentage points; and

- o an increase in long-haul leisure flying was led by additional Atlantic services being served with lower-cost Boeing 777 higher-density aircraft which have a larger economy cabin. The use of this lower-cost aircraft on high-volume routes is allowing the airline to access traditionally lower-yielding traffic while improving profitability.

These yield decreases were partly offset by a favourable currency impact of \$6 million.

Atlantic PRASM increased 0.4% as the yield decline was more than offset by a passenger load factor improvement of 4.2 percentage points.

### Pacific passenger revenues decreased 0.5% from the first quarter of 2014

In the first quarter of 2014, on capacity growth of 7.6%, Pacific passenger revenues of \$369 million decreased \$2 million or 0.5% from the first quarter of 2014. The decrease in Pacific passenger revenue was due to a yield decrease of 6.5% mostly offset by traffic growth of 6.5%.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the first quarter of 2015 and each of the previous four quarters.

Pacific	Year-over-Year by Quarter (% Change)				
	Q1'14	Q2'14	Q3'14	Q4'14	Q1'15
Passenger revenues	1.2	5.7	8.3	6.5	(0.5)
Capacity (ASMs)	4.6	1.8	1.6	9.5	7.6
Traffic (RPMs)	3.2	4.1	3.6	7.6	6.5
Passenger load factor (pp change)	(1.1)	1.9	1.7	(1.4)	(0.8)
Yield	(1.6)	1.8	4.9	(0.8)	(6.5)
PRASM	(2.8)	4.1	7.0	(2.5)	(7.4)

In the first quarter of 2015, the 7.6% Pacific capacity growth reflected capacity increases on all major Pacific services with the exception of services to Japan.

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

- The 6.5% traffic increase which reflected traffic growth on all major Pacific services with the exception of services to Japan where capacity was reduced year-over-year.
- The 6.5% yield decline which reflected competitive pressures from Canada and the U.S., both in terms of added capacity and pricing. The competitive pressures impacted both local, U.S. sixth freedom and beyond traffic. A reduction in carrier surcharges in countries where carrier surcharges are regulated, such as Japan, Hong Kong and Korea, was also a contributing factor in the yield decline year-over-year. These yield decreases were partly offset by a favourable currency impact of \$8 million.

Pacific PRASM decreased 7.4% due to the lower yield and, to a much lesser extent, a passenger load factor decline of 0.8 percentage points.

### Other passenger revenues increased 9.5% from the first quarter of 2014

In the first quarter of 2015, on capacity growth of 12.9%, Other passenger revenues (comprised of routes to the Caribbean, Mexico and Central and South America) of \$292 million increased \$25 million or 9.5% from the first quarter of 2014. The increase in Other passenger revenues was due to traffic growth of 13.4% partly offset by a yield decline of 3.7%.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the first quarter of 2015 and each of the previous four quarters.

Other	Year-over-Year by Quarter (% Change)				
	Q1'14	Q2'14	Q3'14	Q4'14	Q1'15
Passenger revenues	11.0	17.7	0.5	0.4	9.5
Capacity (ASMs)	(1.0)	11.0	2.2	3.9	12.9
Traffic (RPMs)	3.1	15.7	3.6	3.0	13.4
Passenger load factor (pp change)	3.3	3.5	1.1	(0.6)	0.3
Yield	8.5	2.6	(2.4)	(2.7)	(3.7)
PRASM	12.9	7.0	(1.1)	(3.4)	(3.3)

In the first quarter of 2015, the 12.9% capacity growth reflected capacity increases on routes to Mexico and to traditional sun destinations and on services to South America.

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

- The overall 13.4% traffic increase which reflected traffic growth on routes to Mexico and to traditional sun destinations and on services to South America. Consistent with Air Canada's strategy of increasing international-to-international traffic through its Canadian hubs, the traffic growth on services to South America in the first quarter of 2015 also reflected incremental lower-yielding connecting traffic from the U.S. in support of Air Canada's international expansion strategy.
- The overall 3.7% yield decrease which reflected a decline on routes to South America and to traditional sun destinations. South American yields were impacted by the airline's suspension of service to Venezuela while routes to traditional sun destinations were affected by increased industry capacity and aggressive pricing activities. In addition, a higher proportional growth of lower-yielding U.S. transborder passenger flows to South America was also a factor in the yield decline year-over-year. These yield decreases were partly offset by a favourable currency impact of \$4 million.

The overall 3.3% PRASM decrease was due to the lower yield as passenger load factor improved 0.3 percentage points.

#### Cargo revenues increased 7.9% from the first quarter of 2014

In the first quarter of 2015, cargo revenues of \$129 million increased \$10 million or 7.9% from the first quarter of 2014 due to yield and traffic growth of 4.2% and 3.5%, respectively.

The table below provides cargo revenue by geographic region for the first quarter of 2015 and the first quarter of 2014.

Cargo Revenue	First Quarter 2015 \$ Million	First Quarter 2014 \$ Million	Change \$ Million
Canada	17	14	3
U.S. transborder	6	5	1
Atlantic	50	47	3
Pacific	46	43	3
Other	10	10	-
<b>System</b>	<b>129</b>	<b>119</b>	<b>10</b>

The table below provides year-over-year percentage changes in system cargo revenues and operating statistics for the first quarter of 2015 and each of the previous four quarters.

System	Year-over-Year by Quarter (% Change)				
	Q1'14	Q2'14	Q3'14	Q4'14	Q1'15
Cargo revenues	7.0	6.6	6.5	3.9	7.9
Capacity (ETMs)	4.1	8.2	9.6	11.6	12.9
Revenue per ETM	2.8	(1.5)	(3.0)	(6.9)	(4.5)
Traffic (RTMs)	6.4	11.3	6.9	7.5	3.5
Yield per RTM	0.5	(4.3)	(0.5)	(3.3)	4.2

The table below provides year-over-year percentage changes in cargo revenues and operating statistics for the first quarter of 2015 versus the first quarter of 2014.

First Quarter 2014 Versus First Quarter 2013	Cargo Revenue % Change	Capacity (ETMs) % Change	Rev / ETM % Change	Traffic (RTMs) % Change	Yield / RTM % Change
Canada	20.0	11.6	7.5	38.5	(13.4)
U.S. transborder	27.0	36.0	(6.6)	41.6	(10.3)
Atlantic	6.1	9.4	(3.0)	11.8	(5.1)
Pacific	5.4	6.6	(1.1)	(9.7)	16.7
Other	0.8	26.7	(20.5)	(10.0)	12.0
<b>System</b>	<b>7.9</b>	<b>12.9</b>	<b>(4.5)</b>	<b>3.5</b>	<b>4.2</b>

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

- The 3.5% traffic increase which reflected traffic growth in all markets with the exception of the Pacific and Other markets. The Pacific market was impacted by load restrictions on certain key routes such as Sydney and Hong Kong while the Other market was impacted by lower cargo demand. The overall growth in traffic was mainly due to increased capacity, market share gains and strong demand from North America to Europe.
- The 4.2% yield increase which reflected yield growth in the Pacific and Other markets. A favourable currency impact due to a weaker Canadian dollar on foreign currency denominated cargo revenues and strong demand out of Asia were the main factors to the yield growth year-over-year.

#### Other revenues decreased 1% from the first quarter of 2014

In the first quarter of 2015, Other revenues of \$334 million decreased \$4 million or 1% from the first quarter of 2014, mainly due to the impact of the new Jazz CPA, effective January 1, 2015, whereby certain costs, such as ground handling services performed by Air Canada, are no longer recovered from Jazz and passed through to Air Canada under the Jazz CPA as capacity purchase fees, thereby reducing both other revenues and capacity purchase fees. A reduction in aircraft sublease revenues was also a contributing factor to the decrease in Other revenues year-over-year. These decreases were mostly offset by an increase in ground package revenues at Air Canada Vacations, largely the result of higher passenger volumes, and by growth in passenger-related fees.



**CASM decreased 10.8% from the first quarter of 2014. Adjusted CASM decreased 1.8% from the first quarter of 2014**

The following table compares Air Canada's first quarter 2015 and first quarter 2014 CASM.

(cents per ASM)	First Quarter		Change	
	2015	2014	cents	%
Aircraft fuel	3.23	4.73	(1.50)	(31.7)
Regional airlines expense	3.01	3.38	(0.37)	(10.9)
Wages and salaries	2.27	2.44	(0.17)	(7.0)
Benefits	0.83	0.88	(0.05)	(5.7)
Airport and navigation fees	1.01	1.09	(0.08)	(7.3)
Aircraft maintenance	1.02	0.97	0.05	5.2
Sales and distribution costs	0.84	0.88	(0.04)	(4.5)
Depreciation, amortization and impairment	0.84	0.75	0.09	12.0
Ground package costs	0.99	1.01	(0.02)	(2.0)
Aircraft rent	0.45	0.45	-	-
Food, beverages and supplies	0.34	0.40	(0.06)	(15.0)
Communications and information technology	0.31	0.31	-	-
Other	1.49	1.35	0.14	10.4
<b>CASM</b>	<b>16.63</b>	<b>18.64</b>	<b>(2.01)</b>	<b>(10.8)</b>
<b>Remove:</b>				
Aircraft fuel expense <sup>(1)</sup> , ground package costs at Air Canada Vacations, and unusual items	(4.69)	(6.48)	1.79	(27.6)
<b>Adjusted CASM <sup>(2)</sup></b>	<b>11.94</b>	<b>12.16</b>	<b>(0.22)</b>	<b>(1.8)</b>

(1) Includes aircraft fuel expense related to regional airline operations.

(2) Adjusted CASM is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

**Operating expenses decreased 2% from the first quarter of 2014**

In the first quarter of 2015, on capacity growth of 9.3%, operating expenses of \$3,049 million decreased \$78 million or 2% from the first quarter of 2014. The decline in operating expenses reflected the impact of lower jet fuel prices largely offset by the impact of the weaker Canadian dollar and capacity-related cost increases. The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) in the first quarter of 2015, when compared to the first quarter of 2014, increased operating expenses by approximately \$135 million (comprised of \$72 million in Aircraft fuel expense and an aggregate of \$63 million non-fuel operating expenses). Refer to section 8 "Financial Instruments and Risk Management" of this MD&A for information on Air Canada's foreign exchange risk management strategy.

**Aircraft fuel expense decreased 25% from the first quarter of 2014**

In the first quarter of 2015, aircraft fuel expense of \$592 million decreased \$201 million or 25% from the first quarter of 2014.

Aircraft fuel expense, including fuel expense related to regional airline operations, amounted to \$678 million in the first quarter of 2015, a decrease of \$240 million or 26% from the first quarter of 2014. The decrease in aircraft fuel expense in the first quarter of 2015 was due to the impact of a significant decline in jet fuel prices year-over-year, which accounted for a decrease of \$375 million to aircraft fuel expense. These decreases were largely offset by the unfavourable impact of a weaker Canadian dollar versus the U.S. dollar when compared to the first quarter of 2014, which accounted for an increase of \$72 million, as well as a higher volume of fuel litres consumed, which accounted for an increase of \$63 million.

The table below provides Air Canada's fuel cost per litre and economic fuel cost per litre (including aircraft fuel expense related to regional airline operations) for the periods indicated.

(Canadian dollars in millions, except where indicated)	First Quarter		Change	
	2015	2014	\$	%
<b>Aircraft fuel expense – GAAP</b>	\$ 592	\$ 793	\$ (201)	(25)
<b>Add:</b> Aircraft fuel expense related to regional airline operations	86	125	(39)	(31)
<b>Total Aircraft fuel expense</b>	\$ 678	\$ 918	\$ (240)	(26)
<b>Add:</b> Net cash payments on fuel derivatives <sup>(1)</sup>	11	3	8	267
<b>Economic cost of fuel – Non-GAAP <sup>(2)</sup></b>	\$ 689	\$ 921	\$ (232)	(25)
<b>Fuel consumption (thousands of litres)</b>	1,039,421	973,021	66,400	6.8
<b>Fuel cost per litre (cents) – GAAP</b>	65.2	94.3	(29.1)	(30.9)
<b>Economic fuel cost per litre (cents) – Non-GAAP <sup>(2)</sup></b>	66.3	94.7	(28.4)	(30.0)

(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.

### Regional airlines expense decreased 3% from the first quarter of 2014

Air Canada has capacity purchase agreements with Jazz, Sky Regional and certain other regional carriers. Under these arrangements, Air Canada markets, tickets and enters into other commercial arrangements relating to these flights and records the revenue it earns under Passenger revenues. Operating expenses under capacity purchase agreements include the capacity purchase fees, pass-through costs and other costs incurred by Air Canada which are directly related to regional carrier operations. Pass-through costs are costs charged to Air Canada without a mark-up and include fuel, airport and user fees and other costs. Prior to 2015, these costs were recorded in the applicable category within Operating expenses with capacity purchase fees presented as a separate line item. As of 2015, expenses incurred related to capacity purchase agreements are now presented in a separate line item on Air Canada's consolidated statement of operations titled Regional airlines expense which reflects the inclusion of all expenses related to the third-party contract carrier arrangements, including capacity purchase fees, pass-through costs and other costs. This change in presentation has been adopted to provide an improved presentation of the economic costs associated with regional carrier operations. Prior period amounts have been reclassified to conform to the current period presentation.

Effective January 1, 2015, Air Canada and Jazz amended the terms of their capacity purchase agreement, including extending its term through to December 31, 2025. As a result of the amendments, certain costs that were previously capacity purchase agreement fees are now pass-through costs. Other costs that were pass-through costs are now costs directly incurred by Air Canada.

The following table provides a breakdown of Regional airlines expense for the periods indicated:

(Canadian dollars in millions)	First Quarter		Change	
	2015	2014	\$	%
Capacity purchase fees	\$ 274	\$ 281	\$ (7)	(2)
Aircraft fuel	86	125	(39)	(31)
Airport and navigation	65	64	1	2
Sales and distribution costs	33	27	6	22
Other operating expenses	94	70	24	34
<b>Total Regional airlines expense</b>	<b>\$ 552</b>	<b>\$ 567</b>	<b>\$ (15)</b>	<b>(3)</b>

**Wages, salaries and benefits expense amounted to \$568 million in the first quarter of 2015, an increase of \$11 million or 2% from the first quarter of 2014**

In the first quarter of 2015, wages and salaries expense of \$417 million increased \$8 million or 2% from the first quarter of 2014, mainly due to an increase in expense accruals related to the annual employee profit sharing programs and to higher average salaries. Partly offsetting these increases was the impact of Air Canada having recorded a provision of \$11 million related the outsourcing of its London Heathrow ground handling operations in the first quarter of 2014 while no such provision was recorded in the first quarter of 2015.

In the first quarter of 2015, employee benefits expense of \$151 million increased \$3 million or 2% from the first quarter of 2014 largely due to the impact of lower discount rates which increased the current service cost of defined benefit pension plans.

**Airport and navigation fees increased 1% from the first quarter of 2014**

In the first quarter of 2015, airport and navigation fees of \$185 million increased \$2 million or 1% from the first quarter of 2014, mainly due to an increase in aircraft departures of 2.3% and an unfavourable currency impact. These increases were largely offset by the impact of the terms of an agreement with the Greater Toronto Airports Authority which is allowing Air Canada to grow its share of international passengers connecting at Toronto Pearson International Airport on a more cost effective basis, as well as by other factors.

**Aircraft maintenance expense increased 16% from the first quarter of 2014**

In the first quarter of 2015, aircraft maintenance expense of \$188 million increased \$26 million or 16% from the first quarter of 2014, mainly due to an unfavourable currency impact of \$22 million and the timing of scheduled airframe and components maintenance activity versus the first quarter of 2014. These increases were largely offset by the impact of Air Canada having extended a greater number of aircraft leases, and to certain favourable lease return condition provision adjustments which, together, resulted in a decrease of \$22 million to aircraft maintenance expense in the first quarter of 2015. Lease term extensions postpone the expected timing of the end of lease costs and lengthen the period over which expenses are recorded and result in a cumulative adjustment to reflect the revised provision required as at the balance sheet date, thus reducing maintenance expense in the period.

**Sales and distribution costs increased 4% from the first quarter of 2014**

In the first quarter of 2015, sales and distribution costs of \$154 million increased \$6 million or 4% from the first quarter of 2014 on passenger revenue growth of 6.9%. The revenue growth in the first quarter of 2015 outpaced sales and distribution costs, reflecting Air Canada's continued focus on margin improvement. The year-over-year increase was mainly driven by an unfavourable currency impact and the impact of a higher volume of tickets sold. An increase in credit card fees was in line with sales and revenue growth.

### Depreciation, amortization and impairment expense increased 21% from the first quarter of 2014

In the first quarter of 2015, depreciation, amortization and impairment expense of \$153 million increased \$27 million or 21% from the first quarter of 2014, largely due to the introduction of new Boeing 787 aircraft to Air Canada's mainline fleet.

### Ground package costs increased 6% from the first quarter of 2014

In the first quarter of 2015, the cost of ground packages at Air Canada Vacations amounted to \$181 million, an increase of \$11 million or 6% from the first quarter of 2014, largely due to higher passenger volumes and an unfavourable currency impact. These increases were partly offset by the favourable impact of lower hotel rates negotiated by Air Canada Vacations.

### Aircraft rent increased 8% from the first quarter of 2014

In the first quarter of 2015, aircraft rent expense amounted to \$82 million, an increase of \$6 million or 8% from the first quarter of 2014, largely due to a unfavourable currency impact partly offset by the favourable impact of lower rates on lease renewals.

### Other operating expenses increased 21% from the first quarter of 2014

In the first quarter of 2015, Other operating expenses of \$275 million increased \$48 million or 21% from the first quarter of 2014, largely due to the 9.3% capacity growth. An unfavourable currency impact was also a contributing factor. An increase in Remaining other expenses of \$31 million or 34% included the impact of growth in advertising and promotion expense due to additional promotional programs, largely driven by the airline's international network expansion, as well as an increase in customer inconvenience costs, largely due to higher passenger volumes. An increase in terminal handling expense was mainly due to Air Canada's international expansion strategy and the outsourcing of London ground handling operations, in the first half of 2014, 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 reduction overall).

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

(Canadian dollars in millions)	First Quarter		Change	
	2015	2014	\$	%
Terminal handling	\$ 50	\$ 42	\$ 8	19
Building rent and maintenance	36	36	-	-
Crew cycle	35	32	3	9
Miscellaneous fees and services	31	25	6	24
Remaining other expenses	123	92	31	34
<b>Total Other expenses</b>	<b>\$ 275</b>	<b>\$ 227</b>	<b>\$ 48</b>	<b>21</b>

**Non-operating expense amounted to \$509 million in the first quarter of 2015 compared to non-operating expense of \$279 million in the first quarter of 2014**

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

(Canadian dollars in millions)	First Quarter		Change
	2015	2014	\$
Foreign exchange loss	\$ (408)	\$ (161)	\$ (247)
Interest income	9	9	-
Interest expense	(90)	(77)	(13)
Interest capitalized	9	5	4
Net financing expense relating to employee benefits	(25)	(34)	9
Fuel and other derivatives	1	(15)	16
Other	(5)	(6)	1
<b>Total Non-operating expense</b>	<b>\$ (509)</b>	<b>\$ (279)</b>	<b>\$ (230)</b>

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

- Losses on foreign exchange, mainly related to U.S. denominated long-term debt, which amounted to \$408 million in the first quarter of 2015 compared to foreign exchange losses of \$161 million in the first quarter of 2014. The losses in the first quarter of 2015 were mostly attributable to a weaker Canadian dollar at March 31, 2015 when compared to December 31, 2014. The March 31, 2015 closing exchange rate was US\$1 = C\$1.2666 while the December 31, 2014 closing exchange rate was US\$1 = C\$1.1601. Partially offsetting these losses were gains of \$54 million on foreign currency derivatives and \$71 million on cash and short-term investments balances. The loss on foreign exchange in the first quarter of 2015 included a loss of \$24 million related to funds held in Venezuela due to the impact of a new foreign exchange mechanism announced during the period. As at March 31, 2015, the Canadian equivalent of funds held in Venezuela was nominal.
- An increase in interest expense of \$13 million which was mainly due to new borrowings and the impact of a weaker Canadian dollar on U.S. denominated interest expense.
- A decrease in net financing expense relating to employee benefits of \$9 million which was mainly due to the impact of the lower net defined benefit obligation for pension.
- Gains on fuel and other derivatives which amounted to \$1 million in the first quarter of 2015 versus losses on fuel and other derivatives of \$15 million in the first quarter of 2014. Refer to section 8 "Financial Instruments and Risk Management" of this MD&A for additional information.

## 5. FLEET

### Mainline and Air Canada *rouge*

The following table provides the number of aircraft in Air Canada's operating fleet as at March 31, 2015 and December 31, 2014, 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, 2015, December 31, 2016 and December 31, 2017.

	Actual				Planned				
	December 31, 2014	First Quarter 2015 Fleet Changes	March 31, 2015	Remainder of 2015 Fleet Changes	December 31, 2015	2016 Fleet Changes	December 31, 2016	2017 Fleet Changes	December 31, 2017
<b>Mainline</b>									
<b>Wide-body Aircraft</b>									
Boeing 787-8	6	2	8	-	8	-	8	-	8
Boeing 787-9	-	-	-	3	3	10	13	9	22
Boeing 777-300ER	17	-	17	-	17	2	19	-	19
Boeing 777-200LR	6	-	6	-	6	-	6	-	6
Boeing 767-300ER	21	(2)	19	(2)	17	(2)	15	(5)	10
Airbus A330-300	8	-	8	-	8	-	8	-	8
<b>Narrow-body Aircraft</b>									
Boeing 737 MAX	-	-	-	-	-	-	-	2	2
Airbus A321	10	1	11	2	13	2	15	-	15
Airbus A320	41	2	43	-	43	-	43	-	43
Airbus A319	18	-	18	-	18	-	18	-	18
Embraer 190	45	-	45	(13)	32	(7)	25	-	25
<b>Total Mainline</b>	<b>172</b>	<b>3</b>	<b>175</b>	<b>(10)</b>	<b>165</b>	<b>5</b>	<b>170</b>	<b>6</b>	<b>176</b>
<b>Air Canada <i>rouge</i></b>									
<b>Wide-body Aircraft</b>									
Boeing 767-300ER	8	2	10	4	14	4	18	7	25
<b>Narrow-body Aircraft</b>									
Airbus A321	-	-	-	4	4	1	5	-	5
Airbus A319	20	-	20	-	20	-	20	-	20
<b>Total Air Canada <i>rouge</i></b>	<b>28</b>	<b>2</b>	<b>30</b>	<b>8</b>	<b>38</b>	<b>5</b>	<b>43</b>	<b>7</b>	<b>50</b>
<b>Total wide-body Aircraft</b>	<b>66</b>	<b>2</b>	<b>68</b>	<b>5</b>	<b>73</b>	<b>14</b>	<b>87</b>	<b>11</b>	<b>98</b>
<b>Total narrow-body Aircraft</b>	<b>134</b>	<b>3</b>	<b>137</b>	<b>(7)</b>	<b>130</b>	<b>(4)</b>	<b>126</b>	<b>2</b>	<b>128</b>
<b>Total Mainline and Air Canada <i>rouge</i></b>	<b>200</b>	<b>5</b>	<b>205</b>	<b>(2)</b>	<b>203</b>	<b>10</b>	<b>213</b>	<b>13</b>	<b>226</b>

## Air Canada Express

The following table provides, as at March 31, 2015, the number of aircraft operated on behalf of Air Canada by Jazz, Sky Regional and other airlines operating flights under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada.

	As at March 31, 2015			
	Jazz	Sky Regional	Other	Total
Embraer 175	-	15	-	15
Bombardier CRJ-100	-	-	5	5
Bombardier CRJ-200	25	-	-	25
Bombardier CRJ-705	16	-	-	16
Bombardier Dash 8-100	34	-	-	34
Bombardier Dash 8-300	26	-	-	26
Bombardier Dash 8-Q400	21	5	-	26
Beech 1900	-	-	17	17
<b>Total Air Canada Express</b>	<b>122</b>	<b>20</b>	<b>22</b>	<b>164</b>

The following table provides, as at December 31, 2015, the number of aircraft planned to be operated on behalf of Air Canada by Jazz, Sky Regional and other airlines operating flights under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada.

	As at December 31, 2015			
	Jazz	Sky Regional	Other	Total
Embraer 175	-	15	-	15
Bombardier CRJ-100	-	-	2	2
Bombardier CRJ-200	18	-	4	22
Bombardier CRJ-705	16	-	-	16
Bombardier Dash 8-100	28	-	-	28
Bombardier Dash 8-300	26	-	-	26
Bombardier Dash 8-Q400	26	5	-	31
Beech 1900	-	-	17	17
<b>Total Air Canada Express</b>	<b>114</b>	<b>20</b>	<b>23</b>	<b>157</b>

## 6. FINANCIAL AND CAPITAL MANAGEMENT

### 6.1. Liquidity

Air Canada manages its liquidity needs through a variety of strategies including by seeking to sustain and 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, which are further discussed in sections 6.6, 6.7 and 6.8 of this MD&A. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. As part of its liquidity risk management strategy, Air Canada seeks to maintain unrestricted liquidity of at least \$1.7 billion. This minimum target level was determined in conjunction with Air Canada's liquidity risk management strategy. At March 31, 2015, unrestricted liquidity amounted to \$3,123 million (comprised of cash and short-term investments of \$2,850 million and undrawn lines of credit of \$273 million). This compared to unrestricted liquidity of \$2,515 million (comprised of cash and short-term investments of \$2,390 million and undrawn lines of credit of \$125 million) at March 31, 2014.

### 6.2. Financial Position

The following table provides a condensed consolidated statement of financial position of Air Canada as at March 31, 2015 and as at December 31, 2014.

(Canadian dollars in millions)	March 31, 2015	December 31, 2014	\$ Change
<b>Assets</b>			
Cash, cash equivalents and short-term investments	\$ 2,850	\$ 2,275	\$ 575
Other current assets	1,295	1,203	92
<b>Current assets</b>	<b>4,145</b>	<b>3,478</b>	<b>667</b>
Property and equipment	6,241	5,998	243
Intangible assets	305	305	-
Goodwill	311	311	-
Deposits and other assets	579	556	23
<b>Total assets</b>	<b>\$ 11,581</b>	<b>\$ 10,648</b>	<b>\$ 933</b>
<b>Liabilities</b>			
Current liabilities	\$ 4,240	\$ 3,537	\$ 703
Long-term debt and finance leases	5,252	4,732	520
Pension and other benefit liabilities	2,145	2,403	(258)
Maintenance provisions	849	796	53
Other long-term liabilities	308	313	(5)
<b>Total liabilities</b>	<b>12,794</b>	<b>11,781</b>	<b>1,013</b>
<b>Total equity</b>	<b>(1,213)</b>	<b>(1,133)</b>	<b>(80)</b>
<b>Total liabilities and equity</b>	<b>\$ 11,581</b>	<b>\$ 10,648</b>	<b>\$ 933</b>



Movements in current assets and current liabilities are described in section 6.4 “Working Capital” of this MD&A. Long-term debt and finance leases are discussed in sections 6.3 “Adjusted Net Debt” and 6.5 “Consolidated Cash Flow Movements” of this MD&A.

At March 31, 2015, Property and equipment amounted to \$6,241 million, an increase of \$243 million from December 31, 2014. The increase in Property and equipment was mainly due to additions to Property and equipment of \$392 million in the first quarter of 2015, offset by the impact of depreciation expense of \$149 million. The additions to Property and equipment included flight equipment purchases of \$263 million, which included two Boeing 787-8 aircraft delivered in the first quarter of 2015, progress payments on future aircraft deliveries of \$83 million, and capitalized maintenance costs of \$31 million.

At March 31, 2015, Pension and other benefit liabilities decreased \$258 million from December 31, 2014, mainly due to strong investment returns on pension plan assets partly offset by the impact of lower prescribed pension plan discount rates as at March 31, 2015 versus December 31, 2014. Pension funding payments of \$93 million were made in the first quarter of 2015. Refer to section 6.7 “Pension Funding Obligations” of this MD&A for additional information.

### 6.3. Adjusted Net Debt

The following table reflects Air Canada’s adjusted net debt balances as at March 31, 2015 and as at December 31, 2014.

(Canadian dollars in millions, except where indicated)	March 31, 2015	December 31, 2014	\$ Change
Total long-term debt and finance leases	\$ 5,252	\$ 4,732	\$ 520
Current portion of long-term debt and finance leases	555	484	71
Total long-term debt and finance leases, including current portion	5,807	5,216	591
Less cash, cash equivalents and short-term investments	(2,850)	(2,275)	(575)
<b>Net debt</b>	<b>\$ 2,957</b>	<b>\$ 2,941</b>	<b>\$ 16</b>
Capitalized operating leases <sup>(1)</sup>	2,233	2,191	42
<b>Adjusted net debt</b>	<b>\$ 5,190</b>	<b>\$ 5,132</b>	<b>\$ 58</b>
<b>EBITDAR (trailing 12 months)</b>	<b>\$ 1,966</b>	<b>\$ 1,671</b>	<b>\$ 295</b>
<b>Adjusted net debt to EBITDAR ratio</b>	<b>2.6</b>	<b>3.1</b>	<b>(0.5) pp</b>

(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 \$319 million for the twelve months ended March 31, 2015 and \$313 million for the twelve months ended December 31, 2014.

At March 31, 2015, total long-term debt and finance leases, including current portion, amounted to \$5,807 million, an increase of \$591 million from December 31, 2014. This increase was mainly due to the unfavourable impact of a weaker Canadian dollar as at March 31, 2015 compared to December 31, 2014 on Air Canada’s foreign currency denominated debt (mainly U.S. dollars), which accounted for an increase of \$419 million. In the first quarter of 2015, new borrowings amounted to \$282 million and debt repayments amounted to \$115 million. Air Canada took delivery of two Boeing 787-8 aircraft in the first quarter of 2015. One aircraft was, following its acquisition and delivery in the first quarter of 2015, included in the enhanced equipment trust certificates financing transaction, as described in section 6.8 “Contractual Obligations” of this MD&A, and the other delivery was financed with Export-Import Bank of the United States (“EXIM”) financing support.

Adjusted net debt amounted to \$5,190 million at March 31, 2015, an increase of \$58 million from December 31, 2014, as higher long-term debt and finance lease balances were largely offset by higher cash and short-term investments balances

At March 31, 2015, the adjusted net debt to EBITDAR ratio amounted to 2.6 versus a ratio of 3.1 at December 31, 2014. The improvement to the ratio was due to a \$295 million increase in EBITDAR year-over-year. Air Canada uses this ratio to manage its financial leverage risk and has an objective to maintain the ratio below 3.5.

At March 31, 2015, Air Canada's weighted average cost of capital ("WACC"), on a pre-tax basis, was approximately 11.0%. WACC is based on an estimate by management and consists of an estimated cost of equity of 24.1% and an average cost of debt and finance leases of 5.5%.

#### 6.4. Working Capital

The following table provides information on Air Canada's working capital balances as at March 31, 2015 and as at December 31, 2014.

(Canadian dollars in millions)	March 31, 2015	December 31, 2014	\$ Change
Cash, cash equivalents and short-term investments	\$ 2,850	\$ 2,275	\$ 575
Accounts receivable	776	656	120
Other current assets	519	547	(28)
Accounts payable and accrued liabilities	(1,472)	(1,259)	(213)
Advance ticket sales	(2,213)	(1,794)	(419)
Current portion of long-term debt and finance leases	(555)	(484)	(71)
<b>Net working capital</b>	<b>\$ (95)</b>	<b>\$ (59)</b>	<b>\$ (36)</b>

The net negative working capital of \$95 million at March 31, 2015 represented an increase of \$36 million from December 31, 2014. This increase was largely due to capital expenditures of \$425 million (or \$186 million net of the financing drawn upon the delivery of two Boeing 787-8 aircraft) and pension funding payments of \$93 million, largely offset by the cash flow benefit of positive operating results in the first quarter of 2015. As expected, most working capital balances increased in the first quarter of 2015 as a result of the seasonal build-up of advance ticket sales and activity levels heading into the second and third quarters.

## 6.5. Consolidated Cash Flow Movements

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

(Canadian dollars in millions)	First Quarter		
	2015	2014	\$ Change
<b>Net cash flows from operating activities</b>	<b>\$ 808</b>	<b>\$ 344</b>	<b>\$ 464</b>
Proceeds from borrowings	282	197	85
Reduction of long-term debt and finance lease obligations	(115)	(81)	(34)
Distributions related to aircraft special purpose leasing entities	(9)	-	(9)
Issue of common shares	1	-	1
Financing fees	(15)	-	(15)
<b>Net cash flows from financing activities</b>	<b>144</b>	<b>116</b>	<b>28</b>
Short-term investments	(151)	(30)	(121)
Additions to property, equipment and intangible assets	(425)	(310)	(115)
Proceeds from sale of assets	1	2	(1)
Other	(3)	3	(6)
<b>Net cash flows used in investing activities</b>	<b>(578)</b>	<b>(335)</b>	<b>(243)</b>
<b>Increase in cash and cash equivalents</b>	<b>374</b>	<b>125</b>	<b>249</b>
Cash and cash equivalents, beginning of period	661	750	(89)
<b>Cash and cash equivalents, end of period</b>	<b>\$ 1,035</b>	<b>\$ 875</b>	<b>\$ 160</b>

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

(Canadian dollars in millions)	First Quarter		
	2015	2014	\$ Change
<b>Net cash flows from operating activities</b>	<b>\$ 808</b>	<b>\$ 344</b>	<b>\$ 464</b>
Additions to property, equipment and intangible assets	(425)	(310)	(115)
<b>Free cash flow <sup>(1)</sup></b>	<b>\$ 383</b>	<b>\$ 34</b>	<b>\$ 349</b>

(1) Free cash flow is not a recognized measure for financial presentation under GAAP, does not have a standardized meaning and is not 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

Cash from operations of \$808 million for the first quarter of 2015 improved \$464 million compared to the first quarter of 2014. This increase in cash from operations was mainly due to the improvement in operating income and the impact of higher cash inflows from working capital. The higher cash inflows from working capital was due to the impact of the timing of certain payments, the impact of lower fuel prices and the growth in advance ticket sales. Free cash flow improved \$349 million in the first quarter of 2015 from the same period in 2014. Free cash flow was negatively impacted by an increase in capital expenditures which included the acquisition of two Boeing 787-8 aircraft in the first quarter of 2015.

### Net cash flows used in financing activities

In the first quarter of 2015, proceeds from borrowings amounted to \$282 million and reduction of long-term debt and finance lease obligations amounted to \$115 million. Refer to section 6.3 "Adjusted Net Debt" of this MD&A and section 6.6 "Capital Expenditures and Related Financing Arrangements" below for additional information on Air Canada's financing activities.

## 6.6. Capital Expenditures and Related Financing Arrangements

### Aircraft and Related Financing

#### Private Offering of Enhanced Equipment Trust Certificates

In March 2015, in connection with the financing of one Boeing 787-8 delivered in January 2015 and eight new Boeing 787-9 aircraft which are currently scheduled for delivery from July 2015 to March 2016, Air Canada announced the closing of a private offering of three tranches of enhanced equipment trust certificates with a combined aggregate face amount of approximately US\$1.031 billion. Refer to section 6.8 "Contractual Obligations" of this MD&A for additional information.

#### Boeing

As at March 31, 2015, Air Canada had outstanding purchase commitments with The Boeing Company ("Boeing") for 29 Boeing 787 aircraft. 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).

Subject to certain conditions, Air Canada has various financing or sale and leaseback commitments covering up to 24 of the remaining 29 Boeing 787 firm aircraft orders, which such commitments are summarized as follows:

- For eight Boeing 787-9 aircraft, which are currently scheduled for delivery from July 2015 to March 2016, Air Canada announced the closing of a private offering of enhanced equipment trust certificates.
- For 14 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.
- A sale and leaseback transaction with a third party for two Boeing 787 firm aircraft.

In the first quarter of 2015, Air Canada and Boeing concluded an amendment to the Boeing 787 purchase agreement which substitutes the remaining seven Boeing 787-8 with seven Boeing 787-9 aircraft. Air Canada's Boeing 787 fleet is planned to be comprised of eight Boeing 787-8 aircraft, all of which were in Air Canada's operating fleet as at March 31, 2015, and 29 Boeing 787-9 aircraft, which are scheduled for delivery between 2015 and 2019.

Air Canada has outstanding purchase commitments with Boeing for the purchase of Boeing 737 MAX aircraft. This 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 purchase options for 18 Boeing 737 aircraft and certain rights to purchase an additional 30 Boeing 737 aircraft. Deliveries are scheduled to begin in 2017 with two aircraft, with the remaining deliveries between 2018 and 2021, subject to deferral and acceleration rights.

Air Canada has financing commitments, subject to certain conditions, covering all 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.

In 2014, Air Canada exercised purchase rights for two Boeing 777 aircraft, with scheduled deliveries in the second quarter of 2016. Financing alternatives will be considered prior to the planned delivery dates of these aircraft. As at March 31, 2015, Air Canada has purchase rights for 11 Boeing 777 (entitling Air Canada to purchase aircraft based on previously determined pricing).

As described in section 9.6 "Capital Expenditures and Related Financing Arrangements" of Air Canada's 2014 MD&A, certain of the financing commitments for the Boeing 787 and/or the Boeing 737 MAX aircraft would be reduced based on the allocation of the commitments between aircraft types to be determined by Air Canada. Following the closing of the private offering of enhanced equipment trust certificates, Air Canada completed the allocation of the commitments between aircraft types. The total committed financing on these Boeing 787 aircraft and/or the Boeing 737 MAX aircraft, including commitments from the private offering of enhanced equipment trust certificates and the sale and leaseback transaction with a third party, will be at least \$6,242 million.

## 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 March 31, 2015 approximates \$9,012 million.

(Canadian dollars in millions)	Remainder of 2015	2016	2017	2018	2019	Thereafter	Total
Projected committed expenditures	\$ 886	\$ 2,385	\$ 1,799	\$ 1,598	\$ 1,208	\$ 1,136	\$ 9,012
Projected planned but uncommitted expenditures	89	299	327	297	346	not available	not available
Projected planned but uncommitted capitalized maintenance <sup>(1)</sup>	165	159	109	109	109	not available	not available
<b>Total projected expenditures <sup>(2)</sup></b>	<b>\$ 1,140</b>	<b>\$ 2,843</b>	<b>\$ 2,235</b>	<b>\$ 2,004</b>	<b>\$ 1,663</b>	<b>not available</b>	<b>not available</b>

(1) Future capitalized maintenance amounts for 2018 and beyond are not yet determinable however an estimate of \$109 million has been made for 2018 and 2019.

(2) U.S. dollar amounts are converted using the March 31, 2015 closing exchange rate of US\$1 = C\$1.2666. 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 March 31, 2015.

## 6.7. Pension Funding Obligations

Based on updated preliminary estimates, including actuarial assumptions, as at January 1, 2015, the aggregate solvency surplus in Air Canada's domestic registered pension plans is projected to be \$660 million as compared to the initial preliminary estimate of \$780 million provided in Air Canada's 2014 MD&A, largely the result of updated actuarial assumptions and plan experience.

Air Canada is permitted to opt out of the 2014 Regulations, as described in section 9.7 "Pension Funding Obligations" of Air Canada's 2014 MD&A, and have past service payments in respect of all Air Canada pension plans, collectively, determined in accordance with normal funding rules.

Air Canada would consider opting out of the 2014 Regulations when the annual solvency deficit payments under normal funding rules, which are determined using deficit levels over three years, would be less than \$200 million and when there would be a strong basis for confidence that the airline's de-risking strategy in respect of its pension funding obligations would make a future significant deficit unlikely to re-occur. At March 31, 2015, approximately 75% of the pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk.

In the event that Air Canada opts out of the 2014 Regulations, based on the normal funding rules and subject to the finalization of the revised preliminary estimate of the pension solvency surplus of \$660 million at January 1, 2015, Air Canada's past service payments to the domestic registered plans would be approximately \$90 million in 2015.

In the event that Air Canada does not opt out and continues funding its domestic registered pension plans under the 2014 Regulations, Air Canada's projected pension funding obligations, on a cash basis, for the years 2015 to 2019 would be as follows:

(Canadian dollars in millions)	2015	2016	2017	2018	2019
Past service domestic registered plans	\$ 200	\$ 200	\$ 200	\$ 200	\$ 200
Current service domestic registered plans	143	142	141	139	137
Other pension arrangements <sup>(1)</sup>	81	84	88	89	89
<b>Total projected pension funding obligations</b>	<b>\$ 424</b>	<b>\$ 426</b>	<b>\$ 429</b>	<b>\$ 428</b>	<b>\$ 426</b>

(1) Includes retirement compensation arrangements, supplemental plans and international plans.

Additional information on Air Canada's pension funding obligations is disclosed in section 9.7 "Pension Funding Obligations" of Air Canada's 2014 MD&A.

## 6.8. Contractual Obligations

### Private Offering of Enhanced Equipment Trust Certificates

In March 2015, in connection with the financing of one Boeing 787-8 delivered in January 2015 and eight new Boeing 787-9 aircraft, which are currently scheduled for delivery from July 2015 to March 2016, Air Canada announced the closing of a private offering of three tranches of enhanced equipment trust certificates with a combined aggregate face amount of approximately US\$1.031 billion.

The private offering is comprised of Class A certificates, Class B certificates and Class C certificates.

- The Class A certificates, with a US\$667 million face amount, have an interest rate of 3.600% per annum and a final expected distribution date of March 15, 2027.
- The Class B certificates, with a US\$182 million face amount, have an interest rate of 3.875% per annum and a final expected distribution date of March 15, 2023.
- The Class C certificates, with US\$182 million face amount, have an interest rate of 5.000% per annum and a final expected distribution date of March 15, 2020.

The certificates have a combined weighted average interest rate of 3.81% per annum.

The table below provides Air Canada's contractual obligations as at March 31, 2015, 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. The table below also includes the impact of the financing associated with eight Boeing 787 aircraft as described above, the proceeds of which are held in escrow and will be drawn upon the delivery of these aircraft (which are currently scheduled for delivery between July 2015 and March 2016).

(Canadian dollars in millions)	Remainder of 2015	2016	2017	2018	2019	Thereafter	Total
<i>Principal</i>							
Long-term debt obligations	\$ 358	\$ 432	\$ 567	\$ 584	\$ 1,605	\$ 2,071	\$ 5,617
Finance lease obligations	54	30	31	34	38	97	284
<b>Total principal obligations</b>	<b>\$ 412</b>	<b>\$ 462</b>	<b>\$ 598</b>	<b>\$ 618</b>	<b>\$ 1,643</b>	<b>\$ 2,168</b>	<b>\$ 5,901</b>
<i>Interest</i>							
Long-term debt obligations	\$ 218	\$ 270	\$ 270	\$ 216	\$ 186	\$ 187	\$ 1,347
Finance lease obligations	19	21	18	15	11	27	111
<b>Total interest obligations</b>	<b>\$ 237</b>	<b>\$ 291</b>	<b>\$ 288</b>	<b>\$ 231</b>	<b>\$ 197</b>	<b>\$ 214</b>	<b>\$ 1,458</b>
<b>Total long-term debt and finance lease obligations</b>	<b>\$ 649</b>	<b>\$ 753</b>	<b>\$ 886</b>	<b>\$ 849</b>	<b>\$ 1,840</b>	<b>\$ 2,382</b>	<b>\$ 7,359</b>
<b>Operating lease obligations</b>	<b>\$ 304</b>	<b>\$ 356</b>	<b>\$ 320</b>	<b>\$ 276</b>	<b>\$ 225</b>	<b>\$ 332</b>	<b>\$ 1,813</b>
<b>Committed capital expenditures</b>	<b>\$ 886</b>	<b>\$ 2,285</b>	<b>\$ 1,799</b>	<b>\$ 1,598</b>	<b>\$ 1,208</b>	<b>\$ 1,136</b>	<b>\$ 9,012</b>
<b>Total contractual obligations <sup>(1)(2)</sup></b>	<b>\$ 1,839</b>	<b>\$ 3,494</b>	<b>\$ 3,005</b>	<b>\$ 2,723</b>	<b>\$ 3,273</b>	<b>\$ 3,850</b>	<b>\$ 18,184</b>
<b>EETC financing related to eight Boeing 787 aircraft (principal and interest)</b>	<b>\$ 24</b>	<b>\$ 100</b>	<b>\$ 108</b>	<b>\$ 105</b>	<b>\$ 103</b>	<b>\$ 1,251</b>	<b>\$ 1,691</b>
<b>Total obligations, including the impact of the EETC financing related to eight Boeing 787 aircraft</b>	<b>\$ 1,863</b>	<b>\$ 3,594</b>	<b>\$ 3,113</b>	<b>\$ 2,828</b>	<b>\$ 3,376</b>	<b>\$ 5,101</b>	<b>\$ 19,875</b>

(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 commitments under CPA arrangements which, for the year 2015, amounted to approximately \$856 million with Jazz and \$115 million for the other regional carriers. In February 2015, Air Canada and Jazz concluded an amendment to the Jazz CPA, effective as of January 1, 2015.

## 6.9. Share Information

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

	March 31, 2015	December 31, 2014
<b>Issued and outstanding shares</b>		
Variable voting shares	76,626,185	69,232,535
Voting shares	210,190,063	217,256,759
<b>Total issued and outstanding shares</b>	<b>286,816,248</b>	<b>286,489,294</b>
<b>Class A variable voting and Class B voting shares potentially issuable</b>		
Stock options	9,635,301	10,002,975
<b>Total shares potentially issuable</b>	<b>9,635,301</b>	<b>10,002,975</b>
<b>Total outstanding and potentially issuable shares</b>	<b>296,451,549</b>	<b>296,492,269</b>



## 7. QUARTERLY FINANCIAL DATA

The following table summarizes quarterly financial results for Air Canada for the last nine quarters. As of 2015, expenses incurred related to capacity purchase agreements are now presented in a separate line item on Air Canada's consolidated statement of operations titled Regional airlines expense. Prior period amounts have been reclassified to conform to the current period presentation.

(Canadian dollars in millions, except where indicated)	2013				2014				2015
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Passenger	2,527	2,757	3,177	2,560	2,608	2,965	3,476	2,755	2,786
Cargo	111	115	120	128	119	122	128	133	129
Other	314	185	182	206	338	218	194	216	334
<b>Operating revenues</b>	<b>\$ 2,952</b>	<b>\$ 3,057</b>	<b>\$ 3,479</b>	<b>\$ 2,894</b>	<b>\$ 3,065</b>	<b>\$ 3,305</b>	<b>\$ 3,798</b>	<b>\$ 3,104</b>	<b>\$ 3,249</b>
Aircraft fuel	764	727	877	713	793	835	939	680	592
Regional airlines expense	507	514	577	551	567	578	608	571	552
Wages, salaries & benefits <sup>(1)</sup>	553	554	554	540	557	535	549	590	568
Benefit plan amendments	-	-	-	(82)	-	-	-	-	-
Airport and navigation fees	175	181	204	167	183	186	208	178	185
Aircraft maintenance	160	159	120	141	162	171	158	187	188
Sales and distribution costs	144	132	130	114	148	143	146	123	154
Depreciation, amortization and impairment	162	126	124	144	126	128	142	130	153
Ground package costs	150	59	52	66	170	77	56	74	181
Aircraft rent	79	78	78	73	76	76	74	76	82
Food, beverages and supplies	65	70	76	67	66	74	84	70	62
Communications and information technology	48	45	48	44	52	47	49	51	57
Other <sup>(2)</sup>	251	238	223	221	227	210	259	268	275
<b>Operating expenses</b>	<b>3,058</b>	<b>2,883</b>	<b>3,063</b>	<b>2,759</b>	<b>3,127</b>	<b>3,060</b>	<b>3,272</b>	<b>2,998</b>	<b>3,049</b>
<b>Operating income (loss)</b>	<b>(106)</b>	<b>174</b>	<b>416</b>	<b>135</b>	<b>(62)</b>	<b>245</b>	<b>526</b>	<b>106</b>	<b>200</b>
Foreign exchange gain (loss)	(40)	(74)	49	(55)	(161)	40	(71)	(115)	(408)
Interest income	7	8	7	10	9	9	11	10	9
Interest expense <sup>(3)</sup>	(73)	(77)	(174)	(73)	(77)	(81)	(81)	(83)	(90)
Interest capitalized	8	13	15	10	5	10	6	9	9
Net financing expense relating to employee benefits	(52)	(52)	(51)	(53)	(34)	(34)	(34)	(32)	(25)
Fuel and other derivatives	(2)	(13)	30	22	(15)	36	(31)	9	1
Other	(2)	(2)	(1)	(2)	(6)	(2)	(3)	(4)	(5)
<b>Total non-operating income (expense)</b>	<b>(154)</b>	<b>(197)</b>	<b>(125)</b>	<b>(141)</b>	<b>(279)</b>	<b>(22)</b>	<b>(203)</b>	<b>(206)</b>	<b>(509)</b>
Income taxes	-	-	8	-	-	-	-	-	-
<b>Net income (loss)</b>	<b>\$ (260)</b>	<b>\$ (23)</b>	<b>\$ 299</b>	<b>\$ (6)</b>	<b>\$ (341)</b>	<b>\$ 223</b>	<b>\$ 323</b>	<b>\$ (100)</b>	<b>\$ (309)</b>
<b>Net income (loss) per share – diluted</b>	<b>\$ (0.95)</b>	<b>\$ (0.09)</b>	<b>\$ 1.05</b>	<b>\$ (0.02)</b>	<b>\$ (1.20)</b>	<b>\$ 0.75</b>	<b>\$ 1.10</b>	<b>\$ (0.35)</b>	<b>\$ (1.08)</b>
<b>EBITDAR, excluding benefit plan amendments <sup>(4)</sup></b>	<b>\$ 145</b>	<b>\$ 385</b>	<b>\$ 626</b>	<b>\$ 277</b>	<b>\$ 147</b>	<b>\$ 456</b>	<b>\$ 749</b>	<b>\$ 319</b>	<b>\$ 442</b>
<b>EBITDAR <sup>(4)</sup></b>	<b>\$ 145</b>	<b>\$ 385</b>	<b>\$ 626</b>	<b>\$ 359</b>	<b>\$ 147</b>	<b>\$ 456</b>	<b>\$ 749</b>	<b>\$ 319</b>	<b>\$ 442</b>
<b>Adjusted net income (loss) <sup>(5)</sup></b>	<b>\$ (143)</b>	<b>\$ 115</b>	<b>\$ 365</b>	<b>\$ 3</b>	<b>\$ (132)</b>	<b>\$ 139</b>	<b>\$ 457</b>	<b>\$ 67</b>	<b>\$ 122</b>
<b>Adjusted net income (loss) per share – diluted <sup>(5)</sup></b>	<b>\$ (0.52)</b>	<b>\$ 0.41</b>	<b>\$ 1.29</b>	<b>\$ 0.01</b>	<b>\$ (0.46)</b>	<b>\$ 0.47</b>	<b>\$ 1.55</b>	<b>\$ 0.23</b>	<b>\$ 0.41</b>

- (1) In the fourth quarter of 2014, one-time payments totaling \$30 million were made to ACPA members under a collective agreement concluded in October 2014.
- (2) In the second quarter of 2014, Air Canada recorded favourable tax-related provision adjustments of \$41 million.
- (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 which were to become due in 2015 and 2016.
- (4) EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.
- (5) Adjusted net income (loss) and adjusted net income (loss) per diluted share are non-GAAP financial measures. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

The following table provides a breakdown of Regional airlines expense for the last nine quarters:

(Canadian dollars in millions)	2013				2014				2015
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Capacity purchase fees	272	276	295	280	281	294	312	295	274
Aircraft fuel	106	104	125	118	125	127	137	111	86
Airport and navigation fees	57	64	70	65	64	70	73	69	65
Sales and distribution costs	20	20	29	24	27	28	27	30	33
Ownership (DAR) <sup>(1)</sup>	10	7	8	7	7	7	7	7	7
Other operating expenses	42	43	50	57	63	52	52	59	87
<b>Total Regional airlines expense</b>	<b>\$ 507</b>	<b>\$ 514</b>	<b>\$ 577</b>	<b>\$ 551</b>	<b>\$ 567</b>	<b>\$ 578</b>	<b>\$ 608</b>	<b>\$ 571</b>	<b>\$ 552</b>

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

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

	2013				2014				2015
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Revenue passenger miles (millions)	13,087	14,093	16,726	12,882	13,466	15,495	18,565	14,090	14,937
Available seat miles (millions)	16,164	16,972	19,404	16,033	16,774	18,413	21,299	17,403	18,335
Passenger load factor (%)	81.0	83.0	86.2	80.3	80.3	84.2	87.2	81.0	81.5
Passenger PRASM (cents)	15.4	16.0	16.2	15.7	15.3	15.9	16.1	15.6	14.9
CASM, excluding benefit plan amendments (cents)	18.9	17.0	15.8	17.7	18.6	16.6	15.4	17.2	16.6
Adjusted CASM (cents) <sup>(1)</sup>	12.5	11.7	10.4	12.1	12.2	11.2	10.1	12.1	11.9
Economic fuel price per litre (cents) <sup>(2)</sup>	92.4	85.7	89.6	88.4	94.7	91.6	90.0	80.7	66.3

(1) Adjusted CASM is a non-GAAP financial measure. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

(2) Includes aircraft fuel expense related to regional airline operations. 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.

## 8. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

### 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)	First Quarter	
	2015	2014
Fuel derivatives	\$ (4)	\$ (2)
Share forward contracts	4	(14)
Interest rate swaps	1	1
<b>Total Fuel and other derivatives</b>	<b>\$ 1</b>	<b>\$ (15)</b>

### Risk Management

Under its risk management policy, Air Canada manages its interest rate risk, foreign exchange risk, share-based compensation risk and market risk through the use of various derivative financial instruments. Air Canada uses derivative financial instruments only for risk management purposes, not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be offset by changes in cash flows related to the risk being hedged.

Air Canada engages in derivative hedging in an effort to mitigate various risks. The derivative fair values represent the amount of the consideration that could be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. Fair value of these derivatives is determined using active markets, where available. When no such market is available, valuation techniques are applied such as discounted cash flow analysis. Where practical, the valuation technique incorporates all factors that would be considered in setting a price, including Air Canada's own credit risk and the credit risk of the counterparty.

### 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 crude oil-based derivative contracts with financial intermediaries. Air Canada's policy permits hedging of up to 75% of the projected jet fuel purchases for the next 12 months, 50% for the next 13 to 24 months and 25% for the next 25 to 36 months. These are maximum (but not mandated) limits. There is no minimum monthly hedging requirement. There are regular reviews to adjust the strategy in light of market conditions.

In the first quarter of 2015:

- Air Canada recorded a loss of \$4 million in Fuel and other derivatives on Air Canada's consolidated statement of operations related to fuel derivatives (loss of \$2 million in the first quarter of 2014).
- Air Canada purchased crude oil-based call options covering a portion of 2015 fuel exposures. The cash premium related to these contracts was \$8 million (\$10 million in the first quarter of 2014 for 2014 exposures).
- Fuel derivative contracts cash settled at nil value (\$7 million in favour of Air Canada in the first quarter of 2014).

As of March 31, 2015, and based on the derivative structures in place as of that date, approximately 28% of Air Canada's anticipated purchases of jet fuel for the remainder of 2015 is hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US\$72 per barrel for WTI prices up to US\$82 per barrel and an average equivalent capped price of US\$83 per barrel for WTI prices above US\$94 per barrel. Air Canada's contracts to hedge anticipated jet fuel purchases over the remainder of 2015 period are comprised of call options with notional volumes of 5,946,000 barrels. The fair value of the fuel derivatives portfolio at March 31, 2015 was \$8 million in favour of Air Canada (\$4 million in

favour of Air Canada in December 31, 2014) and is recorded within Prepaid expenses and other current assets on Air Canada's consolidated statement of financial condition.

### **Foreign Exchange Risk Management**

Air Canada's financial results are reported in Canadian dollars, while a large portion of its expenses, debt obligations and capital commitments are in foreign currencies, primarily in U.S. dollars. Foreign exchange risk is the risk that fluctuations in foreign exchange rates may have on operating results and cash flows.

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).

Air Canada's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

The level of foreign exchange derivatives entered into and their related maturity dates are dependent upon a number of factors, which include the amount of foreign revenue conversion available, U.S. dollar net cash flows, as well as the amount attributed to aircraft and debt payments. For the net U.S. dollar shortfall, Air Canada has increased its target coverage from 60% to 65% on a rolling 18-month basis. Based on the notional amount of currency derivatives outstanding at March 31, 2015, as further described below, approximately 75% of net U.S. cash outflows is hedged for the remainder of 2015 and 39% for 2016, resulting in derivative coverage of 58% over the next 18 months. U.S. dollar cash and investment reserves combined with derivative coverage results in a 65% target coverage.

As at March 31, 2015, Air Canada had outstanding foreign currency options and swap agreements, settling in 2015 and 2016, to purchase at maturity \$2,785 million (US\$2,200 million) of U.S. dollars at a weighted average rate of \$1.1784 per \$1.00 U.S. dollar (as at December 31, 2014 – \$2,658 million (US\$2,292 million) with settlements in 2015 and 2016 at a weighted average rate of \$1.0884 per \$1.00 US dollar). Air Canada also has protection in place to sell a portion of its excess Euros, Sterling and Yen (EUR \$32 million, GBP \$26 million, JPY \$1,832 million) which settle in 2015 at weighted average rates of \$1.1850, \$1.5167 and \$0.0087 per \$1.00 U.S. dollar respectively (as at December 31, 2014 - EUR \$35 million, GBP \$27 million with settlement in 2015 at weighted average rates of \$1.2806 and \$1.6217 respectively per \$1.00 U.S. dollar).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations and, based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at March 31, 2015 was \$33 million in favour of Air Canada (as at December 31, 2014 – \$30 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 first quarter of 2015, a gain of \$54 million was recorded in Foreign exchange gain (loss) on Air Canada's consolidated statement of operations related to these derivatives (2014 – \$4 million loss). In the first quarter of 2015, foreign exchange derivative contracts cash settled with a net fair value of \$51 million in favour of Air Canada (\$23 million in the first quarter of 2014 in favour of Air Canada).

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 investments balances as at March 31, 2015 amounted to \$899 million (US\$711 million) (\$717 million (US\$620 million) as at December 31, 2014). During the first three months of 2015, an unrealized gain of \$71 million (2014 – unrealized gain of \$29 million) 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 investments balances held.

## **9. CRITICAL ACCOUNTING ESTIMATES**

Information on Air Canada's critical accounting estimates is disclosed in section 13 "Critical Accounting Estimates" of Air Canada's 2014 MD&A. There have been no material changes to Air Canada's critical accounting estimates from what was disclosed at that time.

## 10. ACCOUNTING POLICIES

Air Canada's accounting policies are as disclosed in Air Canada's audited consolidated financial statements and notes for 2014. There have been no material changes to Air Canada's accounting policies from what was disclosed at that time with the exception that Air Canada has early adopted the new accounting standard *IFRS 9 – Financial Instruments* with a date of initial application of January 1, 2015. The adoption of this standard has no impact on Air Canada's consolidated financial statements on date of adoption or for comparative periods. Air Canada will apply hedge accounting for certain designated fuel derivatives prospectively from April 1, 2015. Under hedge accounting, the effective gain or loss on fuel hedging derivatives will be recorded in Other comprehensive income and reclassified to Aircraft fuel expense when the underlying jet fuel being hedged is used. Premiums paid for option contracts and the time value of the option contracts is deferred as a cost of the hedge in Other comprehensive income and reclassified to Aircraft fuel expense when the underlying hedged jet fuel is used. Any ineffective gain or loss on fuel hedging derivatives will be recorded in Non-operating expense in Fuel and other derivatives on Air Canada's consolidated statement of operations. Refer to Note 2 to Air Canada's interim unaudited condensed consolidated statements for the first quarter of 2015 for additional information.

### **Accounting Standards and Amendments Issued but Not Yet Adopted**

#### 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 Corporation expects to be entitled in exchange for those goods or services. On April 28, 2015, the International Accounting Standards Board proposed deferring the effective date by one year to January 1, 2018, with earlier application permitted. Air Canada continues to evaluate the impact that the adoption of this standard may have on its consolidated financial statements.

## 11. 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 2014 MD&A. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

## 12. RELATED PARTY TRANSACTIONS

At March 31, 2015, 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.

## 13. 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 2014 MD&A. Air Canada is not aware of any significant changes to its risk factors from those disclosed at that time.

## 14. 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 2014 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 first quarter 2015 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 March 31, 2015 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

## 15. 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 (loss) as follows:

(Canadian dollars in millions)	First Quarter		
	2015	2014	\$ Change
<b>Operating income (loss) – GAAP</b>	\$ 200	\$ (62)	\$ 262
<b>Add back (as reflected on Air Canada's consolidated statement of operations):</b>			
Depreciation, amortization and impairment	153	126	27
Aircraft rent	82	76	6
<b>Add back (included in Regional airlines expense):</b>			
Depreciation, amortization and impairment	4	4	-
Aircraft rent	3	3	-
<b>EBITDAR</b>	\$ 442	\$ 147	\$ 295

### Adjusted CASM

Air Canada uses adjusted CASM to assess the operating performance of its ongoing airline business without the effects of aircraft 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.

Aircraft 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 aircraft 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)	First Quarter		
	2015	2014	\$ Change
<b>Operating expense – GAAP</b>	\$ 3,049	\$ 3,127	\$ (78)
<b>Adjusted for:</b>			
Aircraft fuel expense (as reflected on Air Canada's consolidated statement of operations)	(592)	(793)	201
Aircraft fuel expense (included in Regional airlines expense)	(86)	(125)	39
Cost of ground packages at Air Canada Vacations	(181)	(170)	(11)
<b>Operating expense, adjusted for the above-noted items</b>	\$ 2,190	\$ 2,039	\$ 151
<b>ASMs (millions)</b>	<b>18,335</b>	<b>16,774</b>	<b>9.3%</b>
<b>Adjusted CASM (cents)</b>	<b>¢ 11.9</b>	<b>¢ 12.2</b>	<b>(1.8)%</b>

### Adjusted Net Income and Adjusted Net Income (loss) per Share – Diluted

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

(Canadian dollars in millions, except where indicated)	First Quarter		
	2015	2014	\$ Change
<b>Net loss for the period attributable to shareholders</b>	\$ (310)	\$ (342)	\$ 32
<b>Adjusted for:</b>			
Foreign exchange loss	408	161	247
Net financing expense relating to employee benefits	25	34	(9)
(Gain) loss on financial instruments recorded at fair value	(1)	15	(16)
<b>Adjusted net income (loss)</b>	\$ 122	\$ (132)	\$ 254
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	294	285	9
<b>Adjusted net income (loss) per share – diluted</b>	\$ 0.41	\$ (0.46)	\$ 0.87

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

(in millions)	First Quarter	
	2015	2014
<b>Weighted average number of shares outstanding – basic</b>	<b>287</b>	<b>285</b>
Effect of dilution	7	8
add back anti-dilutive impact	-	(8)
<b>Weighted average number of shares outstanding – diluted</b>	<b>294</b>	<b>285</b>



## 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), 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.

(Canadian dollars in millions, except where indicated)	March 31, 2015	March 31, 2014	\$ Change
<b>Net income (loss) for the period attributable to shareholders of Air Canada (trailing 12 months)</b>	<b>\$ 132</b>	<b>\$ (75)</b>	<b>\$ 207</b>
<b>Remove:</b>			
One-time payments – ACPA <sup>(1)</sup>	30	-	30
Benefit plan amendments <sup>(2)</sup>	-	(82)	82
Tax-related provision adjustments <sup>(3)</sup>	(41)	-	(41)
Impairment charge	-	6	(6)
Foreign exchange loss	554	241	313
Interest expense charge <sup>(4)</sup>	-	95	(95)
Net financing expense relating to employee benefits	125	190	(65)
Loss on financial instruments recorded at fair value	(15)	(24)	9
<b>Adjusted net income (trailing 12 months)</b>	<b>\$ 785</b>	<b>\$ 351</b>	<b>\$ 434</b>
<b>Adjusted for:</b>			
Interest expense <sup>(5)</sup>	335	306	29
Implicit interest on operating leases <sup>(6)</sup>	156	155	1
<b>Adjusted income before interest (trailing 12 months)</b>	<b>\$ 1,276</b>	<b>\$ 812</b>	<b>\$ 464</b>
<b>Invested capital:</b>			
Working capital excluding current portion of long-term debt and finance leases	344	133	211
Long-term non-financial assets	6,905	6,088	817
Maintenance provisions	(771)	(646)	(125)
Other operating long-term liabilities	(292)	(342)	50
Capitalized operating leases <sup>(7)</sup>	2,233	2,212	21
<b>Invested capital</b>	<b>\$ 8,419</b>	<b>\$ 7,445</b>	<b>\$ 974</b>
<b>Return on invested capital (%)</b>	<b>15.2%</b>	<b>10.9%</b>	<b>4.3 pp</b>

(1) In the fourth quarter of 2014, one-time payments totaling \$30 million were made to ACPA members under a collective agreement concluded in October 2014.

(2) 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.

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

(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 \$319 million for the twelve months ended March 31, 2014 (for the twelve months ended March 31, 2014 - \$316 million).

## 16. GLOSSARY

**ACPA** – Refers to the Air Canada Pilots Association.

**Adjusted CASM** – Refers to operating expense per ASM adjusted to remove the effects of aircraft fuel expense, ground packages costs, and unusual items. Refer to section 15 “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 15 “Non-GAAP Financial Measures” of this MD&A for additional information.

**Air Canada’s 2014 MD&A** – Refers to Air Canada’s 2014 Management’s Discussion and Analysis of Results of Operations and Financial Condition dated February 11, 2015.

**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 15 “Non-GAAP Financial Measures” of this MD&A for additional information.

**EETCs** – Refers to Enhanced Equipment Trust Certificates issued in connection with the financing of aircraft.

**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 15 “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.

**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).