First Quarter 2017

Management's Discussion and Analysis of Results of Operations and Financial Conditions

May 5, 2017

AIR CANADA

A STAR ALLIANCE MEMBER

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1. HIGHLIGHTS

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

	First Quarter		
(Canadian dollars in millions, except where indicated)	2017	2016	$ Change
Financial Performance Metrics			
Operating revenues	3,642	3,343	299
Operating income (loss)	(54)	154	(208)
Non-operating income (expense)	17	(53)	70
Net income (loss)	(37)	101	(138)
Adjusted net income (loss) (1)	(87)	85	(172)
Operating margin %	(1.5%)	4.6%	(6.1 pp)
EBITDAR (excluding special items) (1)	342	460	(118)
EBITDAR margin (excluding special items) % (1)	9.4%	13.8%	(4.4 pp)
Unrestricted liquidity (2)	4,073	3,229	844
Net cash flows from operating activities	1,027	974	53
Free cash flow (1)	470	(142)	612
Adjusted net debt (1)	6,702	6,308	394
Return on invested capital ("ROIC") % (1)	12.9%	17.4%	(4.5 pp)
Leverage ratio	2.5	2.5	-
Basic earnings (loss) per share	$ (0.14)	$ 0.36	$ (0.50)
Diluted earnings (loss) per share	$ (0.14)	$ 0.35	$ (0.49)
Adjusted earnings (loss) per share – diluted (1)	$ (0.32)	$ 0.30	$ (0.62)
Operating Statistics (3)			**% Change**
Revenue passenger miles ("RPM") (millions)	18,341	16,092	14.0
Available seat miles ("ASM") (millions)	22,894	19,833	15.4
Passenger load factor %	80.1%	81.1%	(1.0 pp)
Passenger revenue per RPM ("Yield") (cents)	16.5	17.4	(5.1)
Passenger revenue per ASM ("PRASM") (cents)	13.2	14.1	(6.3)
Operating revenue per ASM (cents)	15.9	16.9	(5.6)
Operating expense per ASM ("CASM") (cents)	16.1	16.1	0.4
Adjusted CASM (cents) (1)	11.6	12.3	(6.0)
Average number of full-time equivalent ("FTE") employees (thousands) (4)	26.9	25.4	5.7
Aircraft in operating fleet at period-end	384	374	2.7
Average fleet utilization (hours per day)	9.9	9.8	0.8
Seats dispatched (thousands)	14,280	13,177	8.4
Aircraft frequencies (thousands)	134.3	133.5	0.5
Average stage length (miles) (5)	1,603	1,505	6.5
Fuel cost per litre (cents)	63.2	48.1	31.4
Fuel litres (thousands)	1,193,732	1,061,600	12.4
Revenue passengers carried (thousands) (6)	10,924	9,957	9.7

(1) Adjusted net income (loss), EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent), EBITDAR margin, leverage ratio, free cash flow, ROIC and adjusted CASM are each non-GAAP financial measures and adjusted net debt is an additional GAAP measure. Refer to sections 6 and 14 of this MD&A for descriptions of Air Canada's non-GAAP financial measures and additional GAAP measures. As referenced in the table above, special items are excluded from Air Canada's reported EBITDAR calculations. Refer to section 4 of this MD&A for information on the special items.

(2) 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, 2017, unrestricted liquidity was comprised of cash and short-term investments of $3,624 million and undrawn lines of credit of $449 million. At March 31, 2016, unrestricted liquidity was comprised of cash and short-term investments of $2,947 million and undrawn lines of credit of $282 million.

(3) Except for the reference to average number of FTE employees, operating statistics in this table include third party carriers (such as Jazz Aviation LP ("Jazz"), Sky Regional Airlines Inc. ("Sky Regional"), Air Georgian Limited ("Air Georgian") and Exploits Valley Air Services Ltd. ("EVAS")) operating under capacity purchase agreements with Air Canada.

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

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

(6) Revenue passengers are counted on a flight number basis (rather than by journey/itinerary or by leg) 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 2017. 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 2017, Air Canada's 2016 annual audited consolidated financial statements and notes and Air Canada's 2016 MD&A dated February 17, 2017 ("Air Canada's 2016 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 15 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of May 4, 2017. Certain comparative figures have been reclassified to conform to the financial statement presentation adopted for the current year.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 17 "Risk Factors" of Air Canada's 2016 MD&A and section 12 of this MD&A. Air Canada issued a news release dated May 5, 2017 reporting on its results for the first quarter of 2017. This news release is available on Air Canada's website at **www.aircanada.com** and on SEDAR's website at **www.sedar.com**. For further information on Air Canada's public disclosures, including Air Canada's Annual Information Form, consult SEDAR at **www.sedar.com**.

CAUTION REGARDING FORWARD-LOOKING INFORMATION

Air Canada's public communications may include forward-looking statements within the meaning of applicable securities laws. Such forward-looking 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, our ability to successfully achieve or sustain positive net profitability or to realize our initiatives and objectives, currency exchange, industry, market, credit, economic and geopolitical conditions, energy prices, competition, our ability to successfully implement appropriate strategic initiatives or reduce operating costs, our dependence on technology, cybersecurity risks, our ability to pay our indebtedness and secure financing, war, terrorist acts, epidemic diseases, our dependence on key suppliers including regional carriers and Aimia Canada Inc., casualty losses, employee and labour relations and costs, our ability to preserve and grow our brand, pension issues, environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), limitations due to restrictive covenants, insurance issues and costs, our dependence on the Star Alliance, interruptions of service, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties and our ability to attract and retain required personnel, as well as the factors identified throughout Air Canada's public disclosure file available at **www.sedar.com** and, in particular, those identified in section 17 "Risk Factors" of Air Canada's 2016 MD&A and section 12 of this MD&A. The forward-looking statements contained or incorporated by reference in this MD&A represent Air Canada's expectations as of the date of this MD&A (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 relatively modest Canadian GDP growth for 2017 and 2018. Air Canada also expects that the Canadian dollar will trade, on average, at C$1.34 per U.S. dollar in the second quarter of 2017 and the full year 2017 and that the price of jet fuel (taking the impact of fuel hedging into account) will average 65 CAD cents per litre in the second quarter of 2017 and the full year 2017.

INTELLECTUAL PROPERTY

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3. OVERVIEW

On a GAAP basis, Air Canada reported a first quarter of 2017 operating loss of $54 million compared to operating income of $154 million in the first quarter of 2016. Air Canada recorded a net loss of $37 million or $0.14 per diluted share in the first quarter of 2017 versus net income of $101 million or $0.35 per diluted share in the same quarter in 2016.

In the first quarter of 2017, Air Canada reported EBITDAR of $342 million compared to EBITDAR of $460 million in the first quarter of 2016. The airline recorded a 2017 first quarter EBITDAR margin of 9.4% versus a 2016 first quarter EBITDAR margin of 13.8%, better than the approximate 50% margin reduction projected in Air Canada's February 17, 2017 news release. The better than expected EBITDAR margin performance was primarily driven by a first quarter revenue environment that was more robust than anticipated, lower than forecasted aircraft maintenance expense largely due to a deferral of maintenance activities, and lower than anticipated jet fuel prices. Air Canada recorded an adjusted net loss of $87 million or $0.32 per diluted share in the first quarter of 2017 versus adjusted net income of $85 million or $0.30 per diluted share in the first quarter of 2016. EBITDAR and adjusted net income are non-GAAP financial measures. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

Financial Summary

The following is an overview of Air Canada's results of operations and financial position for the first quarter of 2017 compared to the first quarter of 2016.

- Record operating revenues of $3,642 million in the first quarter of 2017, an increase of $299 million or 9% from the first quarter of 2016. On capacity growth of 15.4%, record passenger revenues of $3,095 million in the first quarter of 2017 increased $231 million or 8.1% from the first quarter of 2016.

- Operating expenses of $3,696 million in the first quarter of 2017, an increase of $507 million or 16% from the first quarter of 2016. A special item, described in section 4 of this MD&A, increased operating expenses by $30 million in the first quarter of 2017. CASM increased 0.4% from the first quarter of 2016. On an adjusted basis, CASM decreased 6.0% from the first quarter of 2016, better than the 3.25% to 4.75% decrease forecast in Air Canada's news release dated February 17, 2017. Air Canada's better than projected adjusted CASM performance was largely driven by lower than anticipated aircraft maintenance expense and other operating expense reductions. The lower than anticipated aircraft maintenance expense was due to a deferral of certain maintenance activities into the remainder of the year as well lower end of lease maintenance provisions on narrow-body aircraft lease extensions. Adjusted CASM is a non-GAAP financial measure. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

- Adjusted net debt of $6,702 million, a decrease of $388 million from December 31, 2016, reflecting the impact of higher cash and short-term investment balances partly offset by the impact of higher long-term debt and finance lease balances and a higher capitalized operating lease balance. Adjusted net debt is an additional GAAP measure. Refer to section 6.2 "Adjusted Net Debt" of this MD&A for additional information.

- The airline's leverage ratio (adjusted net debt to trailing 12-month EBITDAR) was 2.5 at March 31, 2017 versus a ratio of 2.6 at December 31, 2016. Leverage ratio is a non-GAAP financial measure. Refer to section 6.2 "Adjusted Net Debt" and section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

- Net cash flows from operating activities of $1,027 million in the first quarter of 2017, an improvement of $53 million from the first quarter of 2016. Free cash flow of $470 million in the first quarter of 2017 improved $612 million from the first quarter of 2016 due to a lower level of net capital expenditures year-over-year (additions to property, equipment and intangible assets of $926 million less proceeds from the sale and leaseback of aircraft of $369 million) and the impact of higher cash flows from operating activities versus the same quarter in 2016. Refer to section 6.4 "Consolidated Cash Flow Movements" of this MD&A for additional information. Free cash flow is a non-GAAP financial measure. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

- Return on invested capital ("ROIC") for the 12 months ended March 31, 2017 of 12.9% versus 17.4% for the 12 months ended March 31, 2016**.** ROIC is a non-GAAP financial measure. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

4. RESULTS OF OPERATIONS

The following table and discussion compares results of Air Canada for the first quarter of 2017 versus the first quarter of 2016.

	First Quarter		Change	
(Canadian dollars in millions, except per share figures)	**2017**	**2016**	**$**	**%**
Operating revenues				
Passenger	$ 3,095	$ 2,864	$ 231	8
Cargo	134	116	18	16
Other	413	363	50	14
Total revenues	**3,642**	**3,343**	**299**	**9**
Operating expenses				
Aircraft fuel	659	446	213	48
Regional airlines expense				
Aircraft fuel	95	64	31	48
Other	537	505	32	6
Wages, salaries and benefits	644	608	36	6
Airport and navigation fees	210	198	12	6
Aircraft maintenance	228	221	7	3
Depreciation, amortization and impairment	228	182	46	25
Sales and distribution costs	205	182	23	13
Ground package costs	256	231	25	11
Aircraft rent	122	112	10	9
Food, beverages and supplies	85	77	8	10
Communications and information technology	71	67	4	6
Special items	30	-	30	100
Other	326	296	30	10
Total operating expenses	**3,696**	**3,189**	**507**	**16**
Operating income (loss)	**(54)**	**154**	**(208)**	
Non-operating income (expense)				
Foreign exchange gain	70	50	20	
Interest income	12	10	2	
Interest expense	(79)	(96)	17	
Interest capitalized	9	23	(14)	
Net financing expense relating to employee benefits	(16)	(18)	2	
Loss on financial instruments recorded at fair value	-	(10)	10	
Gain on sale and leaseback of assets	26	-	26	
Loss on debt settlements	-	(6)	6	
Other	(5)	(6)	1	
Total non-operating income (expense)	**17**	**(53)**	**70**	
Income (loss) before income taxes	**(37)**	**101**	**(138)**	
Income taxes	-	-	-	
Net income (loss) for the period	**$ (37)**	**$ 101**	**$ (138)**	
Basic earnings (loss) per share	**$ (0.14)**	**$ 0.36**	**$ (0.50)**	
Diluted earnings (loss) per share	**$ (0.14)**	**$ 0.35**	**$ (0.49)**	
EBITDAR (1)	**$ 342**	**$ 460**	**$ (118)**	
Adjusted net income (loss) (1)	**$ (87)**	**$ 85**	**$ (172)**	
Adjusted earnings (loss) per share – diluted (1)	**$ (0.32)**	**$ 0.30**	**$ (0.62)**	

(1) EBITDAR, adjusted net income (loss) and adjusted earnings (loss) per share – diluted are non-GAAP financial measures. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

System passenger revenues increased 8.1% from the first quarter of 2016

In the first quarter of 2017, system passenger revenues of $3,095 million increased $231 million or 8.1% from the first quarter of 2016.

In the first quarter of 2017, business cabin system revenues increased $58 million or 10.0% from the first quarter of 2016 on a traffic increase of 12.0%, partly offset by a yield decline of 1.8%.

The table below provides passenger revenue by geographic region for the first quarter of 2017 and the first quarter of 2016.

Passenger Revenue (Canadian dollars in millions)	**First Quarter 2017**	**First Quarter 2016**	**$ Change**	**% Change**
Canada	$ 970	$ 954	$ 16	1.7
U.S. transborder	785	717	68	9.5
Atlantic	551	508	43	8.3
Pacific	448	398	50	12.5
Other	341	287	54	18.8
System	**$ 3,095**	**$ 2,864**	**$ 231**	**8.1**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the first quarter of 2017 versus the first quarter of 2016.

First Quarter 2017 versus First Quarter 2016	**Passenger Revenue % Change**	**Capacity (ASMs) % Change**	**Traffic (RPMs) % Change**	**Passenger Load Factor pp Change**	**Yield % Change**	**PRASM % Change**
Canada	1.7	3.2	3.6	0.3	(1.7)	(1.3)
U.S. transborder	9.5	9.6	12.0	1.8	(2.2)	-
Atlantic	8.3	19.7	14.4	(3.5)	(5.3)	(9.5)
Pacific	12.5	30.3	22.5	(5.1)	(8.1)	(13.6)
Other	18.8	20.1	22.8	1.9	(3.4)	(1.2)
System	**8.1**	**15.4**	**14.0**	**(1.0)**	**(5.1)**	**(6.3)**

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the first quarter of 2017 and each of the previous four quarters.

System	**Year-over-Year by Quarter (% Change)**				
	Q1'16	**Q2'16**	**Q3'16**	**Q4'16**	**Q1'17**
Passenger revenues	2.8	2.0	10.5	7.0	8.1
Capacity (ASMs)	8.2	11.0	20.9	17.1	15.4
Traffic (RPMs)	7.7	9.3	18.9	15.3	14.0
Passenger load factor (pp change)	(0.3)	(1.2)	(1.5)	(1.2)	(1.0)
Yield	(4.7)	(6.8)	(7.0)	(7.2)	(5.1)
PRASM	(5.1)	(8.2)	(8.6)	(8.6)	(6.3)

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

- The 14.0% traffic increase which reflected traffic growth in all markets. Consistent with the airline's objective of increasing global international-to-international connecting traffic through its major Canadian hubs (sixth freedom traffic), the traffic growth in the first quarter of 2017 reflected an increase in connecting traffic via Canada to international destinations.

- The 5.1% yield decrease which reflected:

  - an increase in average stage length of 6.5%, due to long-haul international expansion, which had the effect of reducing system yield by 3.6 percentage points;

  - an unfavourable currency impact of $31 million;

  - a reduction in carrier surcharges (fuel-related) in the Pacific market, the effect of launch pricing to support the introduction of new Pacific services and the impact of increased industry capacity and competitive pricing activities on certain Pacific services;

  - a higher proportion of seats into long-haul leisure markets led by an increase in lower-cost flights operated by Air Canada Rouge; and

  - a higher proportional growth of lower-yielding international and U.S. transborder passenger flows connecting to Air Canada's routes in the domestic market (sixth freedom traffic) in support of the airline's international expansion strategy.

Domestic passenger revenues increased 1.7% from the first quarter of 2016

In the first quarter of 2017, domestic passenger revenues of $970 million increased $16 million or 1.7% from the first quarter of 2016.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the first quarter of 2017 and each of the previous four quarters.

Canada	Year-over-Year by Quarter (% Change)				
	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17
Passenger revenues	(2.3)	(1.6)	4.8	2.5	1.7
Capacity (ASMs)	6.3	4.5	6.3	5.5	3.2
Traffic (RPMs)	4.1	4.2	8.2	5.7	3.6
Passenger load factor (pp change)	(1.7)	(0.2)	1.5	0.1	0.3
Yield	(6.5)	(5.8)	(3.1)	(3.1)	(1.7)
PRASM	(8.4)	(6.1)	(1.4)	(2.9)	(1.3)

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

- The 3.6% traffic increase which reflected traffic growth on all domestic services and included gains in business cabin traffic as well as incremental connecting traffic to U.S. and international destinations.

- The 1.7% yield decrease which reflected the impact of lower competitive fares, a 1.4% longer average stage length, which had the effect of reducing domestic yield by 0.8 percentage points in the first quarter of 2017, and higher proportional growth of lower-yielding international and U.S. transborder passenger flows connecting to Air Canada's routes in the domestic market in support of the airline's international expansion strategy.

U.S. transborder passenger revenues increased 9.5% from the first quarter of 2016

In the first quarter of 2017, U.S. transborder passenger revenues of $785 million increased $68 million or 9.5% from the first quarter of 2016.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the first quarter of 2017 and each of the previous four quarters.

U.S. transborder	Year-over-Year by Quarter (% Change)				
	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17
Passenger revenues	2.5	2.3	14.0	10.1	9.5
Capacity (ASMs)	10.2	12.3	19.3	14.1	9.6
Traffic (RPMs)	5.8	10.8	20.8	15.0	12.0
Passenger load factor (pp change)	(3.3)	(1.1)	1.0	0.6	1.8
Yield	(3.3)	(7.9)	(5.6)	(4.3)	(2.2)
PRASM	(7.1)	(9.1)	(4.5)	(3.6)	-

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

- The 12.0% traffic increase which reflected traffic growth on all major U.S. transborder services and included gains in business cabin traffic. The year-over-year increase in traffic was mainly due to strong passenger demand between Canada and the U.S. Growth of international-to-international connecting passenger flows from the U.S. in support of Air Canada's international expansion strategy was also a contributing factor.

- The 2.2% yield decline which reflected the impact of increased industry capacity on U.S. long-haul and short-haul routes, growth in lower-yielding international-to-international connecting traffic from and to the U.S. and an unfavourable currency impact of $6 million. Yield growth on Air Canada Rouge-operated sun routes was a partly offsetting factor.

Atlantic passenger revenues increased 8.3% from the first quarter of 2016

In the first quarter of 2017, Atlantic passenger revenues of $551 million increased $43 million or 8.3% from the first quarter of 2016.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the first quarter of 2017 and each of the previous four quarters.

Atlantic	Year-over-Year by Quarter (% Change)				
	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17
Passenger revenues	12.9	5.0	10.7	8.3	8.3
Capacity (ASMs)	13.6	16.6	28.1	21.5	19.7
Traffic (RPMs)	15.8	10.9	21.8	19.3	14.4
Passenger load factor (pp change)	1.5	(4.0)	(4.4)	(1.4)	(3.5)
Yield	(2.5)	(5.4)	(9.1)	(9.2)	(5.3)
PRASM	(0.6)	(9.9)	(13.6)	(10.9)	(9.5)

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

- The 14.4% traffic increase which reflected traffic growth on all major Atlantic services with the exception of services to the United Kingdom. Traffic increased in all cabins. The uncertainty following the United Kingdom's referendum vote to withdraw from the European Union continued to have a negative impact on traffic originating from the United Kingdom, however, this impact was partly offset by an increase in traffic to the United Kingdom from point-of-sale Canada. The overall traffic increase was led by strong growth on Air Canada's services to Delhi from Vancouver and Toronto.

- The 5.3% yield decline which reflected an unfavourable currency impact of $15 million and an increase in average stage length of 2.0%, which had the effect of reducing Atlantic yield by 1.2 percentage points. The impact of increased industry capacity to and from Canada and the U.S., resulting in a competitive pricing environment, and a higher proportion of seats offered into long-haul leisure markets, were also contributing factors.

Pacific passenger revenues increased 12.5% from the first quarter of 2016

In the first quarter of 2017, Pacific passenger revenues of $448 million increased $50 million or 12.5% from the first quarter of 2016.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the first quarter of 2017 and each of the previous four quarters.

Pacific	Year-over-Year by Quarter (% Change)				
	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17
Passenger revenues	7.7	8.8	19.2	12.1	12.5
Capacity (ASMs)	3.1	12.4	34.8	31.9	30.3
Traffic (RPMs)	6.3	13.7	29.0	23.7	22.5
Passenger load factor (pp change)	2.6	1.0	(3.9)	(5.3)	(5.1)
Yield	1.4	(4.2)	(7.6)	(9.3)	(8.1)
PRASM	4.6	(3.1)	(11.6)	(15.0)	(13.6)

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

- The 22.5% traffic increase which reflected traffic growth on all major Pacific services with the exception of services to Hong Kong where capacity remained consistent with last year's level. The traffic increase versus the same quarter in 2016 was largely driven by the June 2016 launch of services to Seoul from Toronto and to Brisbane from Vancouver as well as the February 2017 launch of services to Shanghai from Montreal.

- The 8.1% yield decline which reflected a reduction in carrier surcharges (fuel-related), the effect of launch pricing to support the introduction of new services and the impact of increased industry capacity and competitive pricing activities on certain Pacific services. Growth in lower-yielding international-to-international passenger flows and an unfavourable currency impact of $5 million were also contributing factors.

Other passenger revenues increased 18.8% from the first quarter of 2016

In the first quarter of 2017, Other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of $341 million increased $54 million or 18.8% from the first quarter of 2016.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the first quarter of 2017 and each of the previous four quarters.

Other	Year-over-Year by Quarter (% Change)				
	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17
Passenger revenues	(1.5)	(6.4)	8.3	7.3	18.8
Capacity (ASMs)	7.5	6.0	12.5	13.2	20.1
Traffic (RPMs)	8.1	6.5	15.1	15.7	22.8
Passenger load factor (pp change)	0.4	0.3	1.9	1.8	1.9
Yield	(9.2)	(12.4)	(6.0)	(7.6)	(3.4)
PRASM	(8.8)	(12.1)	(3.9)	(5.5)	(1.2)

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

- The 22.8% traffic increase which reflected traffic growth on all major services. Gains in business cabin traffic as well as incremental connecting traffic to and from South America via Canada were also contributing factors.

- The 3.4% yield decrease which reflected competitive pricing activities, driven by increased capacity, on routes to traditional sun destinations. Growth in lower-yielding international passenger flows also contributed to the yield decline. Yield growth on services to South America was a partly offsetting factor.

Cargo revenues increased 16% from the first quarter of 2016

In the first quarter of 2017, cargo revenues of $134 million increased $18 million or 16% from the first quarter of 2016 reflecting traffic growth of 32.7%, partly offset by a 12.6% reduction in yield. Traffic growth was recorded in all markets. The Pacific market reflected a particularly strong performance with growth in traffic and yield versus the same quarter in 2016.

The table below provides cargo revenue by geographic region for the first quarter of 2017 and the first quarter of 2016.

Cargo Revenue (Canadian dollars in millions)	First Quarter 2017	First Quarter 2016	$ Change	% Change
Canada	$ 16	$ 14	$ 2	17.6
U.S. transborder	8	7	1	7.3
Atlantic	46	47	(1)	(2.0)
Pacific	52	38	14	38.3
Other	12	10	2	21.0
System	**$ 134**	**$ 116**	**$ 18**	**16.0**

Other revenues increased 14% from the first quarter of 2016

In the first quarter of 2017, other revenues of $413 million increased $50 million or 14%, mainly due to higher ground package revenues at Air Canada Vacations which was primarily driven by growth in passenger volumes.

CASM increased 0.4% from the first quarter of 2016. Adjusted CASM decreased 6.0% from the first quarter of 2016

The following table compares Air Canada's CASM and Adjusted CASM for the first quarter of 2017 to the first quarter of 2016.

	First Quarter		Change	
(cents per ASM)	2017	2016	cents	%
Aircraft fuel	2.88	2.25	0.63	28.0
Regional airlines expense				
Aircraft fuel	0.42	0.32	0.10	31.3
Other	2.34	2.55	(0.21)	(8.2)
Wages and salaries	2.06	2.28	(0.22)	(9.6)
Benefits	0.75	0.79	(0.04)	(5.1)
Airport and navigation fees	0.92	1.00	(0.08)	(8.0)
Aircraft maintenance	1.00	1.11	(0.11)	(9.9)
Depreciation, amortization and impairment	1.00	0.92	0.08	8.7
Sales and distribution costs	0.90	0.92	(0.02)	(2.2)
Ground package costs	1.12	1.17	(0.05)	(4.3)
Aircraft rent	0.53	0.56	(0.03)	(5.4)
Food, beverages and supplies	0.37	0.39	(0.02)	(5.1)
Communications and information technology	0.31	0.34	(0.03)	(8.8)
Special items	0.13	-	0.13	100.0
Other	1.41	1.48	(0.07)	(4.7)
CASM	**16.14**	**16.08**	**0.06**	**0.4**
Remove:				
Aircraft fuel expense (1), ground package costs at Air Canada Vacations and special items	(4.54)	(3.74)	(0.80)	(21.4)
Adjusted CASM (2)	**11.60**	**12.34**	**(0.74)**	**(6.0)**

(1) Includes aircraft fuel expense related to regional airline operations.
(2) Adjusted CASM is a non-GAAP financial measure. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

Operating expenses increased 16% from the first quarter of 2016

In the first quarter of 2017, operating expenses of $3,696 million increased $507 million or 16% from the first quarter of 2016. This increase was mainly driven by the 15.4% capacity growth and higher jet fuel prices (before the impact of foreign exchange). These increases were partly offset by the favourable impact of a stronger Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) which decreased operating expenses by $81 million (comprised of $29 million relating to aircraft fuel expense and an aggregate of $52 million relating to non-fuel operating expenses).

Aircraft fuel expense increased 48% from the first quarter of 2016

In the first quarter of 2017, aircraft fuel expense (including fuel expense related to regional airline operations) amounted to $754 million, an increase of $244 million or 48% from the first quarter of 2016. This increase reflected higher jet fuel prices (before the impact of foreign exchange), which accounted for an increase of $216 million and a higher volume of fuel litres consumed, which accounted for an increase of $63 million. These increases were partly offset by a favourable currency impact of $29 million, fuel hedging gains of $4 million and lower cash premiums associated with fuel derivative contracts of $2 million.

Regional airlines expense increased 11% from the first quarter of 2016

In the first quarter of 2017, regional airlines expense of $632 million increased $63 million or 11% from the first quarter of 2016, reflecting the impact of higher base jet fuel prices year-over-year and increased flying, which was the result of fleet expansion initiatives in the Air Canada Express fleet operated by Jazz, Sky Regional and Air Georgian. These increases were partly offset by the impact of lower rates year-over-year (pursuant to capacity purchase agreements) and, to a lesser extent, a favourable currency impact.

Wages, salaries and benefits expense amounted to $644 million in the first quarter of 2017, an increase of $36 million or 6% from the first quarter of 2016

In the first quarter of 2017, wages and salaries expense of $472 million increased $21 million or 5% from the first quarter of 2016. This increase was mainly due to a higher number of full-time equivalent ("FTE") employees when compared to the same quarter in 2016 to support the airline's capacity growth. On the 15.4% capacity growth, the average number of FTE employees increased 5.7% year-over-year.

In the first quarter of 2017, employee benefits expense of $172 million increased $15 million or 10% from the first quarter in 2016, mainly due to the impact of lower discount rates which increased the current service cost of defined benefit pension plans.

Airport and navigation fees increased 6% from the first quarter of 2016

In the first quarter of 2017, airport and navigation fees of $210 million increased $12 million or 6% from the first quarter of 2016, largely due to growth in wide-body and international flying. The favourable impact of Air Canada's agreement with the Greater Toronto Airports Authority, which is allowing the airline to increase international connecting traffic at Toronto Pearson International Airport on a more cost effective basis, the 6% Nav Canada rate reduction, which was effective September 1, 2016, and a favourable currency impact were partly offsetting factors.

Aircraft maintenance expense increased 3% from the first quarter of 2016

In the first quarter of 2017, aircraft maintenance expense of $228 million increased $7 million or 3% from the first quarter of 2016, reflecting, in large part, the effect of having additional Boeing 777 and 787 aircraft in the fleet, which have engines under power-by-the-hour arrangements, partly offset by a favourable currency impact. The decrease in end of lease maintenance provisions was mainly due to more favourable terms on narrow-body aircraft lease extensions.

The following table provides a breakdown of the more significant items included in maintenance expense for the periods indicated:

	First Quarter		Change	
(Canadian dollars in millions)	**2017**	**2016**	**$**	**%**
Technical maintenance	$ 195	$ 181	$ 14	8
Maintenance provision [1]	27	32	(5)	(16)
Other	6	8	(2)	(25)
Total aircraft maintenance expense	**$ 228**	**$ 221**	**$ 7**	**3**

(1) Maintenance provisions relate to return conditions on aircraft leases which are recorded over the term of the lease.

Depreciation, amortization and impairment expense increased 25% from the first quarter of 2016

In the first quarter of 2017, depreciation, amortization and impairment expense of $228 million increased $46 million or 25% from the first quarter of 2016, mainly due to the addition of Boeing 787 and 777 aircraft to Air Canada's mainline fleet and to an increase in expenses related to aircraft refurbishment programs.

Sales and distribution costs increased 13% from the first quarter of 2016

In the first quarter of 2017, sales and distribution costs of $205 million increased $23 million or 13% from the first quarter of 2016, reflecting a higher volume of ticket sales and the impact of enhanced competitive incentive programs when compared to the same quarter in 2016. A higher proportion of sales through international points-of-sales, which generally results in higher transaction costs, and an increase in credit card expenses (in line with sales and revenue growth) were also contributing factors to the increase in sales and distribution costs versus the first quarter of 2016.

Ground package costs increased 11% from the first quarter of 2016

In the first quarter of 2017, the cost of ground packages at Air Canada Vacations amounted to $256 million, an increase of $25 million or 11% from the first quarter of 2016, reflecting higher passenger volumes year-over-year, partly offset by a lower cost of ground packages (before the impact of foreign exchange) and a favourable currency impact.

Aircraft rent increased 9% from the first quarter of 2016

In the first quarter of 2017, aircraft rent expense amounted to $122 million, an increase of $10 million or 9% from the first quarter of 2016, reflecting a greater number of leased aircraft, primarily Boeing 787 aircraft, and the reclassification of certain finance leases to operating leases, which occurred upon the renewal of the leases. A favourable currency impact and the effect of lower rates on certain lease renewals were partly offsetting factors.

Special items

In the first quarter of 2017, Air Canada recorded a provision of $30 million relating to a fine which was reinstated by a decision of the European Commission pertaining to cargo investigations. Refer to section 12 "Risk Factors" of this MD&A for additional information.

Other expenses increased 10% from the first quarter of 2016

In the first quarter of 2017, other expenses of $326 million increased $30 million or 10% from the first quarter of 2016, reflecting, in large part, the capacity growth.

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

	First Quarter		Change	
(Canadian dollars in millions)	**2017**	**2016**	**$**	**%**
Terminal handling	$ 68	$ 59	$ 9	15
Crew cycle	44	40	4	10
Building rent and maintenance	42	39	3	8
Miscellaneous fees and services	37	33	4	12
Remaining other expenses	135	125	10	8
Total other expenses	**$ 326**	**$ 296**	**$ 30**	**10**

Non-operating income amounted to $17 million in the first quarter of 2017 compared to non-operating expense of $53 million in the first quarter of 2016

Factors contributing to the $70 million year-over-year improvement in the first quarter non-operating income included:

- Gains on foreign exchange of $70 million compared to gains on foreign exchange of $50 million in the first quarter of 2016. In the first quarter of 2017, foreign exchange gains on U.S. denominated long-term debt amounted to $54 million and foreign currency derivatives amounted to $22 million. The gains in the first quarter of 2017 were also attributable to a stronger Canadian dollar at March 31, 2017 when compared to December 31, 2016. The March 31, 2017 closing exchange rate was US$1=C$1.3299 while the December 31, 2016 closing exchange rate was US$1=C$1.3427.

- A decrease in interest expense of $17 million, reflecting, in large part, the impact of the $1.25 billion refinancing transaction concluded in October 2016. Refer to section 9.8 of Air Canada's 2016 MD&A for additional information.

- A gain of $26 million on the sale and leaseback of two Boeing 787-9 aircraft.

5. FLEET

The following table provides the number of aircraft in Air Canada's operating fleet as at March 31, 2017 and December 31, 2016 as well as Air Canada's planned operating fleet, including aircraft operating and expected to be operated by Air Canada Rouge, as at December 31, 2017 and December 31, 2018.

	Actual			Planned			
Mainline	**December 31, 2016**	**First Quarter 2017 Fleet Changes**	**March 31, 2017**	**Remainder of 2017 Fleet Changes**	**December 31, 2017**	**2018 Fleet Changes**	**December 31, 2018**
Wide-body Aircraft							
Boeing 787-8	**8**	-	**8**	**-**	**8**	-	**8**
Boeing 787-9	**13**	4	**17**	5	**22**	5	**27**
Boeing 777-300ER	**19**	-	**19**	-	**19**	-	**19**
Boeing 777-200LR	**6**	-	**6**	-	**6**	-	**6**
Boeing 767-300ER	**14**	(2)	**12**	(4)	**8**	(3)	**5**
Airbus A330-300	**8**	-	**8**	-	**8**	-	**8**
Narrow-body Aircraft							
Boeing 737 MAX 8	**-**	-	**-**	2	**2**	16	**18**
Airbus A321	**15**	-	**15**	-	**15**	-	**15**
Airbus A320	**42**	-	**42**	-	**42**	-	**42**
Airbus A319	**18**	-	**18**	-	**18**	(8)	**10**
Embraer 190	**25**	-	**25**	-	**25**	-	**25**
Total Mainline	**168**	2	**170**	3	**173**	10	**183**
Air Canada Rouge							
Wide-body Aircraft							
Boeing 767-300ER	**20**	2	**22**	2	**24**	1	**25**
Narrow-body Aircraft							
Airbus A321	**5**	-	**5**	-	**5**	-	**5**
Airbus A319	**20**	-	**20**	-	**20**	-	**20**
Total Air Canada Rouge	**45**	2	**47**	2	**49**	1	**50**
Total wide-body Aircraft	**88**	4	**92**	3	**95**	3	**98**
Total narrow-body Aircraft	**125**	-	**125**	2	**127**	8	**135**
Total Mainline and Air Canada Rouge	**213**	4	**217**	5	**222**	11	**233**

In addition to the above-referenced five Boeing 787-9 aircraft that Air Canada plans to introduce into its operating fleet in 2018, Air Canada expects to introduce the remaining two of the 37 Boeing 787 aircraft on order in 2019. In addition to the above-referenced 16 Boeing 737 MAX aircraft the airline plans to introduce into its operating fleet in 2018, Air Canada expects to introduce the remaining 43 of the 61 Boeing 737 MAX aircraft on order between 2019 and 2021. These aircraft are replacing existing aircraft in Air Canada's mainline fleet.

In June 2016, Air Canada and Bombardier Inc. ("Bombardier") finalized a purchase agreement which includes a firm order for 45 Bombardier C-Series CS300 aircraft and options for an additional 30 Bombardier C-Series CS300 aircraft. Deliveries are scheduled to begin in late 2019 and extend to 2022. The first 25 aircraft on delivery are expected to replace Air Canada's existing mainline fleet of Embraer 190 aircraft, with incremental aircraft supporting Air Canada's hub and network growth.

Air Canada Express

The following table provides, as at March 31, 2017, 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, 2017			
	Jazz	Sky Regional	Other	Total
Embraer 175	-	22	-	22
Bombardier CRJ-100/200	13	-	14	27
Bombardier CRJ-705/900	16	-	-	16
Bombardier Dash 8-100	16	-	-	16
Bombardier Dash 8-300	26	-	-	26
Bombardier Dash 8-Q400	44	-	-	44
Total Air Canada Express	**115**	**22**	**14**	**151**

The following table provides the number of aircraft planned, as at December 31, 2017, 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, 2017			
	Jazz	Sky Regional	Other	Total
Embraer 175	-	25	-	25
Bombardier CRJ-100/200	10	-	14	24
Bombardier CRJ-705/900	21	-	-	21
Bombardier Dash 8-100	16	-	-	16
Bombardier Dash 8-300	26	-	-	26
Bombardier Dash 8-Q400	44	-	-	44
Total Air Canada Express	**117**	**25**	**14**	**156**

Other aircraft with CPA carriers

Air Georgian and EVAS also operate a total of 16 18-passenger Beech 1900 aircraft on behalf of Air Canada pursuant to their capacity purchase agreements with Air Canada.

6. FINANCIAL AND CAPITAL MANAGEMENT

6.1. Financial Position

The following table provides a condensed consolidated statement of financial position of Air Canada as at March 31, 2017 and as at December 31, 2016.

(Canadian dollars in millions)	March 31, 2017	December 31, 2016	$ Change
Assets			
Cash, cash equivalents and short-term investments	$ 3,624	$ 2,979	$ 645
Other current assets	1,297	1,368	(71)
Current assets	4,921	4,347	574
Property and equipment	8,845	8,520	325
Pension assets	1,007	1,153	(146)
Intangible assets	312	315	(3)
Goodwill	311	311	-
Deposits and other assets	468	468	-
Total assets	**$ 15,864**	**$ 15,114**	**$ 750**
Liabilities			
Current liabilities	$ 5,261	$ 4,424	$ 837
Long-term debt and finance leases	5,959	5,911	48
Pension and other benefit liabilities	2,559	2,436	123
Maintenance provisions	961	922	39
Other long-term liabilities	199	202	(3)
Total liabilities	**14,939**	**13,895**	**1,044**
Total shareholders' equity	**925**	**1,219**	**(294)**
Total liabilities and shareholders' equity	**$ 15,864**	**$ 15,114**	**$ 750**

Movements in current assets and current liabilities are described in section 6.3 "Working Capital" of this MD&A. Long-term debt and finance leases are discussed in sections 6.2 "Adjusted Net Debt" and 6.4 "Consolidated Cash Flow Movements" of this MD&A.

At March 31, 2017, property and equipment amounted to $8,845 million, an increase of $325 million from December 31, 2016. The increase in property and equipment was mainly due to additions to property and equipment of $922 million, partly offset by the sale of two Boeing 787 aircraft under sale and operating leaseback transactions and the impact of depreciation expense of $223 million. In the first quarter of 2017, the additions to property and equipment included four Boeing 787-9 aircraft (two of which were financed under sale and operating leaseback transactions), progress payments on future aircraft deliveries and capitalized maintenance costs.

The net long-term pension and other benefit liabilities of $1,552 million (comprised of pension and other benefit liabilities of $2,559 million net of pension assets of $1,007 million) increased $269 million from December 31, 2016. This increase was mainly due to the impact of a 20 basis point decrease in the discount rate used to value the liabilities, resulting in a net loss on remeasurements on employee benefit liabilities of $203 million recorded in other comprehensive income.

6.2. Adjusted Net Debt

The following table reflects Air Canada's adjusted net debt balances as at March 31, 2017 and as at December 31, 2016.

(Canadian dollars in millions, except where indicated)	March 31, 2017	December 31, 2016	$ Change
Total long-term debt and finance leases	$ 5,959	$ 5,911	$ 48
Current portion of long-term debt and finance leases	825	707	118
Total long-term debt and finance leases, including current portion	6,784	6,618	166
Less cash, cash equivalents and short-term investments	(3,624)	(2,979)	(645)
Net debt	**$ 3,160**	**$ 3,639**	**$ (479)**
Capitalized operating leases (1)	3,542	3,451	91
Adjusted net debt	**$ 6,702**	**$ 7,090**	**$ (388)**
EBITDAR (trailing 12 months)	**$ 2,650**	**$ 2,768**	**$ (118)**
Adjusted net debt to EBITDAR ratio (2)	**2.5**	**2.6**	**(0.1)**

(1) *Adjusted net debt is an additional GAAP financial measure and 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 (including aircraft rent expense related to regional airline operations) was $506 million for the 12 months ended March 31, 2017 and $493 million for the 12 months ended December 31, 2016.*

(2) *Adjusted net debt to trailing 12-month EBITDAR ratio (also referred to as "leverage ratio" in this MD&A) is a non-GAAP financial measure and is used by Air Canada as a means to measure financial leverage. Leverage ratio is calculated by dividing adjusted net debt by trailing 12-month EBITDAR. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.*

At March 31, 2017, total long-term debt and finance leases (including current portion) of $6,784 million increased $166 million from December 31, 2016. In the first quarter of 2017, new borrowings of $371 million were partly offset by debt repayments of $152 million and the favourable impact of a stronger Canadian dollar of $54 million, as at March 31, 2017 compared to December 31, 2016, on Air Canada's foreign currency denominated debt (mainly U.S. dollars).

Adjusted net debt amounted to $6,702 million at March 31, 2017, a decrease of $388 million from December 31, 2016, reflecting the impact of higher cash and short-term investment balances partly offset by the impact of higher long-term debt and finance lease balances and a higher capitalized operating lease balance.

At March 31, 2017, the adjusted net debt to EBITDAR ratio was 2.5 versus 2.6 as at December 31, 2016.

At March 31, 2017, Air Canada's weighted average cost of capital ("WACC"), on a pre-tax basis, was approximately 7.8% (compared to approximately 9.0% at March 31, 2016). WACC is based on an estimate by management and consists of an estimated cost of equity of 20.7% and an average cost of debt and finance leases of 4.57% (compared to an estimated cost of equity of 23.6% and an average cost of debt and finance leases of 5.25% at March 31, 2016).

6.3. Working Capital

The following table provides information on Air Canada's working capital balances as at March 31, 2017 and as at December 31, 2016.

(Canadian dollars in millions)	March 31, 2017	December 31, 2016	$ Change
Cash, cash equivalents and short-term investments	$ 3,624	$ 2,979	$ 645
Accounts receivable	785	707	78
Other current assets	512	661	(149)
Total current assets	**$ 4,921**	**$ 4,347**	**$ 574**
Accounts payable and accrued liabilities	1,753	1,644	109
Advance ticket sales	2,683	2,073	610
Current portion of long-term debt and finance leases	825	707	118
Total current liabilities	**$ 5,261**	**$ 4,424**	**$ 837**
Net working capital	**$ (340)**	**$ (77)**	**$ (263)**

The negative net working capital of $340 million at March 31, 2017 represented a decrease of $263 million from December 31, 2016. This decrease in net working capital was largely due to capital expenditures of $926 million, which resulted in a net cash outflow of $186 million (after deducting the financing drawn or sale-leaseback proceeds received relating to the delivery of four Boeing 787 aircraft). As expected, most working capital balances increased in the first quarter of 2017 as a result of the seasonal build-up of advance ticket sales and activity levels heading into the second and third quarters of 2017.

6.4. 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 2017	First Quarter 2016	First Quarter $ Change
Net cash flows from operating activities	**$ 1,027**	**$ 974**	**$ 53**
Proceeds from borrowings	371	616	(245)
Reduction of long-term debt and finance lease obligations	(152)	(230)	78
Shares purchased for cancellation	(33)	(34)	1
Distributions related to aircraft special purpose leasing entities	-	(32)	32
Issue of shares	1	-	1
Financing fees	(3)	(1)	(2)
Net cash flows from financing activities	**$ 184**	**$ 319**	**$ (135)**
Short-term investments	(162)	36	(198)
Additions to property, equipment and intangible assets	(926)	(1,116)	190
Proceeds from sale of assets	1	144	(143)
Proceeds from sale and leaseback of assets	369	-	369
Other	(6)	-	(6)
Net cash flows used in investing activities	**$ (724)**	**$ (936)**	**$ 212**
Effect of exchange rate changes on cash and cash equivalents	**$ (4)**	**$ (21)**	**$ 17**
Increase in cash and cash equivalents	**$ 483**	**$ 336**	**$ 147**

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

(Canadian dollars in millions)	First Quarter 2017	First Quarter 2016	First Quarter $ Change
Net cash flows from operating activities	**$ 1,027**	**$ 974**	**$ 53**
Additions to property, equipment and intangible assets, net of proceeds from sale-leaseback transactions	(557)	(1,116)	559
Free cash flow (1)	**$ 470**	**$ (142)**	**$ 612**

(1) Free cash flow is a non-GAAP financial measure used by Air Canada as an indicator of the financial strength and performance of its business, indicating how much cash it is able to generate from operations and after capital expenditures. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment and intangible assets, and is net of proceeds from sale and leaseback transactions. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

Free cash flow

In the first quarter of 2017, net cash flows from operating activities of $1,027 million improved $53 million when compared to the same quarter in 2016. This increase in net cash flows from operating activities was mainly due to the impact of higher cash inflows from working capital and the impact of lower pension past service funding payments, partly offset by lower operating results. The higher cash inflows from working capital was mainly due to the impact of the growth in advance ticket sales. In the first quarter of 2017, free cash flow of $470 million improved $612 million from the first quarter of 2016 due to a lower level of net capital expenditures year-over-year and the impact of higher cash flows from operating activities versus the same quarter in 2016.

Net cash flows from financing activities

Proceeds from borrowings amounted to $371 million in the first quarter of 2017 and reduction of long-term debt and finance lease obligations amounted to $152 million. Refer to sections 6.1 "Financial Position" and 6.2 "Adjusted Net Debt" of this MD&A for additional information.

6.5. Capital Expenditures and Related Financing Arrangements

Boeing 787 Aircraft

Air Canada has outstanding purchase commitments with The Boeing Company ("Boeing") for 12 Boeing 787 aircraft (five of which remain to be delivered in 2017, five in 2018 and two in 2019). Air Canada also has purchase options for 13 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on previously determined pricing and delivery positions), and purchase rights for 10 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on Boeing's then current pricing).

Subject to certain conditions, Air Canada has various financing or sale and leaseback commitments covering up to nine of the remaining 12 Boeing 787 firm aircraft orders, which are summarized as follows:

- For seven of the Boeing 787 aircraft, which are scheduled for delivery by 2019, the financing terms are for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments.
- Sale and leaseback transactions with third parties for two Boeing 787 aircraft scheduled for delivery in the second quarter of 2017.

Boeing 737 Aircraft

Air Canada has an agreement with Boeing for the purchase of Boeing 737 MAX aircraft which provides for:

- Firm orders for 61 737 MAX aircraft consisting of 737 MAX 8 and 737 MAX 9 aircraft with substitution rights between them as well as for the 737 MAX 7 aircraft.
- Purchase options for 18 Boeing 737 MAX aircraft.
- Certain rights to purchase an additional 30 Boeing 737 MAX aircraft.

In the first quarter of 2017, Air Canada elected to substitute 16 Boeing 737 MAX 9 aircraft for 16 Boeing 737 MAX 8 aircraft. Consequently, the firm order for the 737 MAX aircraft consists of 49 737 MAX 8 aircraft and 12 737 MAX 9 aircraft.

Deliveries of Boeing 737 MAX aircraft 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.

Bombardier C-Series CS300 Aircraft

In June 2016, Air Canada and Bombardier finalized a purchase agreement which includes a firm order for 45 Bombardier C-Series CS300 aircraft and options for an additional 30 Bombardier CS300 aircraft. Deliveries are scheduled to begin in late 2019 and extend to 2022.

Capital Commitments

As outlined in the table below, the estimated aggregate cost of the future firm Boeing 787, Boeing 737 MAX and Bombardier C-Series CS300 aircraft deliveries and other capital purchase commitments as at March 31, 2017 approximates $7,559 million.

(Canadian dollars in millions)	Remainder of 2017	2018	2019	2020	2021	Thereafter	Total
Projected committed expenditures	$ 1,324	$ 1,771	$ 1,394	$ 1,425	$ 1,048	$ 597	$ 7,559
Projected planned but uncommitted expenditures	133	249	408	375	439	Not available	Not available
Projected planned but uncommitted capitalized maintenance (1)	99	121	113	116	120	Not available	Not available
Total projected expenditures (2)	**$ 1,556**	**$ 2,141**	**$ 1,915**	**$ 1,916**	**$ 1,607**	**Not available**	**Not available**

(1) *Future capitalized maintenance amounts for 2020 and 2021 and beyond are not yet determinable, however estimates of $116 million and $120 million, respectively, have been made for 2020 and 2021.*

(2) *U.S. dollar amounts are converted using the March 31, 2017 closing exchange rate of US$1=C$1.3299. 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, 2017.*

6.6. Pension Funding Obligations

Based on recently finalized actuarial valuations, as at January 1, 2017, the aggregate solvency surplus in Air Canada's domestic registered pension plans was $1.9 billion. Based on the January 1, 2017 actuarial valuation results and applicable pension regulations, Air Canada is not permitted to and will not make current service cost payments for 2017 to any of its Canadian registered pension plans. For 2017, Air Canada will make contributions to international and supplemental plans, for total forecasted contributions, on a cash basis, of $90 million.

As at March 31, 2017, taking into account the effect of financial instrument risk management tools, approximately 75% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk. Air Canada may continue to increase the percentage of fixed income products matched to pension liabilities, subject to favourable market conditions.

For additional information on Air Canada's pension funding obligations, refer to section 9.7 "Pension Funding Obligations" of Air Canada's 2016 MD&A.

6.7. Contractual Obligations

The table below provides Air Canada's contractual obligations as at March 31, 2017, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and finance lease obligations, operating lease obligations and committed capital expenditures.

(Canadian dollars in millions)	Remainder of 2017	2018	2019	2020	2021	Thereafter	Total
Principal							
Long-term debt obligations	$ 577	$ 652	$ 534	$ 541	$ 888	$ 3,432	$ 6,624
Finance lease obligations	31	49	46	49	17	71	263
Total principal obligations	**$ 608**	**$ 701**	**$ 580**	**$ 590**	**$ 905**	**$ 3,503**	**$ 6,887**
Interest							
Long-term debt obligations	$ 204	230	214	185	140	364	1,337
Finance lease obligations	17	19	14	10	6	18	84
Total interest obligations	**$ 221**	**$ 249**	**$ 228**	**$ 195**	**$ 146**	**$ 382**	**$ 1,421**
Total long-term debt and finance lease obligations	**$ 829**	**$ 950**	**$ 808**	**$ 785**	**$ 1,051**	**$ 3,885**	**$ 8,308**
Operating lease obligations	**$ 452**	**$ 553**	**$ 464**	**$ 342**	**$ 245**	**$ 761**	**$ 2,817**
Committed capital expenditures	**$ 1,324**	**$ 1,771**	**$ 1,394**	**$ 1,425**	**$ 1,048**	**$ 597**	**$ 7,559**
Total contractual obligations (1)	**$ 2,605**	**$ 3,274**	**$ 2,666**	**$ 2,552**	**$ 2,344**	**$ 5,243**	**$ 18,684**

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

6.8. 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, 2017	December 31, 2016
Issued and outstanding shares		
Variable voting shares	88,533,320	86,657,994
Voting shares	182,511,144	186,554,808
Total issued and outstanding shares	**271,044,464**	**273,212,802**
Class A variable voting and Class B voting shares potentially issuable		
Stock options	8,757,600	8,985,958
Total shares potentially issuable	**8,757,600**	**8,985,958**
Total outstanding and potentially issuable shares	**279,802,064**	**282,198,760**

Issuer Bid

In May 2016, Air Canada received Toronto Stock Exchange ("TSX") approval and implemented a normal course issuer bid, authorizing, between May 30, 2016 and May 29, 2017, the purchase of up to 22,785,511 Class B voting shares and Class A voting shares (collectively the "Shares"), representing 10% of the public float as at May 16, 2016.

In the first quarter of 2017, Air Canada purchased, for cancellation, 2,397,200 Shares at an average cost of $13.62 per Share for aggregate consideration of $33 million. At March 31, 2017, a total of 15,935,911 Shares remained available for repurchase under this issuer bid.

7. QUARTERLY FINANCIAL DATA

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

(Canadian dollars in millions, except where indicated)	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2017 Q1
Passenger	$ 3,082	$ 3,716	$ 2,836	$ 2,864	$ 3,143	$ 4,106	$ 3,035	$ 3,095
Cargo	123	119	135	116	111	130	155	134
Other	209	188	211	363	204	215	235	413
Operating revenues	**3,414**	**4,023**	**3,182**	**3,343**	**3,458**	**4,451**	**3,425**	**3,642**
Aircraft fuel	648	697	527	446	527	708	598	659
Regional airlines expense								
Aircraft fuel	97	95	81	64	77	96	90	95
Other	497	489	468	505	501	543	532	537
Wages, salaries & benefits	568	598	590	608	611	658	633	644
Airport and navigation fees	201	223	193	198	211	247	203	210
Aircraft maintenance	195	198	210	221	243	230	200	228
Depreciation, amortization and impairment	177	165	160	182	202	220	212	228
Sales and distribution costs	152	157	145	182	170	179	172	205
Ground package costs	84	63	87	231	85	72	101	256
Aircraft rent	84	89	98	112	112	118	120	122
Food, beverages and supplies	80	91	81	77	86	104	82	85
Communications and IT	52	52	50	67	59	56	60	71
Special items	(23)	-	31	-	-	-	91	30
Other	279	291	303	296	297	324	313	326
Operating expenses	**3,091**	**3,208**	**3,024**	**3,189**	**3,181**	**3,555**	**3,407**	**3,696**
Operating income (loss)	**323**	**815**	**158**	**154**	**277**	**896**	**18**	**(54)**
Foreign exchange gain (loss)	56	(251)	(159)	50	(17)	(42)	(29)	70
Interest income	12	12	13	10	13	12	13	12
Interest expense	(94)	(106)	(99)	(96)	(98)	(97)	(83)	(79)
Interest capitalized	21	20	20	23	15	12	8	9
Net financing expense relating to employee benefits	(25)	(28)	(27)	(18)	(17)	(17)	(24)	(16)
Gain (loss) on financial instruments recorded at fair value	5	(20)	(3)	(10)	(1)	6	9	-
Gain on sale and leaseback of assets	-	-	-	-	19	-	-	26
Loss on debt settlements	-	-	(13)	(6)	(1)	-	(82)	-
Other	(2)	(5)	(6)	(6)	(4)	(2)	(8)	(5)
Total non-operating income (expense)	**(27)**	**(378)**	**(274)**	**(53)**	**(91)**	**(128)**	**(196)**	**17**
Income (loss) before income taxes	$ 296	$ 437	$ (116)	$ 101	$ 186	$ 768	$ (178)	$ (37)
Income taxes	-	-	-	-	-	-	(1)	-
Net income (loss)	**$ 296**	**$ 437**	**$ (116)**	**$ 101**	**$ 186**	**$ 768**	**$ (179)**	**$ (37)**
Diluted earnings (loss) per share	**$ 1.00**	**$ 1.48**	**$ (0.41)**	**$ 0.35**	**$ 0.66**	**$ 2.74**	**$ (0.66)**	**$ (0.14)**
EBITDAR (1)	**$ 568**	**$ 1,076**	**$ 456**	**$ 460**	**$ 605**	**$ 1,248**	**$ 455**	**$ 342**
Adjusted net income (loss) (1)	**$ 250**	**$ 734**	**$ 116**	**$ 85**	**$ 203**	**$ 821**	**$ 38**	**$ (87)**
Adjusted earnings (loss) per share – diluted (1)	**$ 0.85**	**$ 2.50**	**$ 0.40**	**$ 0.30**	**$ 0.72**	**$ 2.93**	**$ 0.14**	**$ (0.32)**

(1) EBITDAR, adjusted net income (loss) and adjusted earnings (loss) per share – diluted are non-GAAP financial measures. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

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

	2015			2016				2017
System	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**
Passenger PRASM (cents)	15.0	15.5	14.7	14.1	13.8	14.2	13.5	13.2
CASM (cents)	15.4	13.6	16.0	16.1	14.2	12.5	15.4	16.1
Adjusted CASM (cents) (1)	11.3	10.0	12.2	12.3	11.2	9.4	11.4	11.6
Economic fuel price per litre (cents) (2)	66.9	61.4	58.6	48.1	52.2	55.2	59.4	63.2

(1) *Adjusted CASM is a non-GAAP financial measure. Refer to section 14 "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.*

The following table provides Air Canada's revenue passenger miles (RPMs), available seat miles (ASMs) and passenger load factors, on a system-basis and by market, for the last eight quarters.

	2015			2016				2017
System	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**
RPMs (millions)	16,845	20,462	15,301	16,092	18,418	24,328	17,643	18,341
ASMs (millions)	20,132	23,535	18,869	19,833	22,344	28,458	22,091	22,894
Passenger load factor (%)	83.7%	86.9%	81.1%	81.1%	82.4%	85.5%	79.9%	80.1%
Domestic								
RPMs (millions)	4,525	5,606	4,291	3,960	4,717	6,068	4,534	4,101
ASMs (millions)	5,433	6,649	5,222	4,952	5,678	7,066	5,510	5,108
Passenger load factor (%)	83.3%	84.3%	82.2%	80.0%	83.1%	85.9%	82.3%	80.3%
U.S. transborder								
RPMs (millions)	2,804	2,992	2,768	3,376	3,107	3,613	3,182	3,782
ASMs (millions)	3,384	3,539	3,493	4,278	3,799	4,223	3,985	4,687
Passenger load factor (%)	82.9%	84.5%	79.2%	78.9%	81.8%	85.6%	79.9%	80.7%
Atlantic								
RPMs (millions)	4,864	6,792	3,719	3,401	5,394	8,270	4,437	3,891
ASMs (millions)	5,839	7,640	4,755	4,383	6,805	9,785	5,778	5,248
Passenger load factor (%)	83.3%	88.9%	78.2%	77.6%	79.3%	84.5%	76.8%	74.1%
Pacific								
RPMs (millions)	3,432	3,877	3,202	3,218	3,902	5,002	3,959	3,943
ASMs (millions)	4,000	4,318	3,773	3,732	4,496	5,821	4,977	4,862
Passenger load factor (%)	85.8%	89.8%	84.9%	86.2%	86.8%	85.9%	79.6%	81.1%
Other								
RPMs (millions)	1,220	1,195	1,322	2,137	1,298	1,375	1,531	2,624
ASMs (millions)	1,476	1,389	1,626	2,488	1,566	1,563	1,841	2,989
Passenger load factor (%)	82.6%	86.0%	81.3%	85.8%	82.9%	87.9%	83.1%	87.8%

8. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Air Canada's financial instruments and risk management practices are summarized in section 12 of Air Canada's 2016 MD&A. There have been no material changes to Air Canada's financial instruments and risk management practices from what was disclosed at that time. Additional information on Air Canada's risk management practices and financial instruments is discussed in Note 8 of Air Canada's first quarter 2017 interim unaudited condensed consolidated financial statements.

9. ACCOUNTING POLICIES

Air Canada's accounting policies are as disclosed in Note 2 to the 2016 annual consolidated financial statements. There have been no material changes to Air Canada's accounting policies from what was disclosed at that time.

As described in Note 2I to the 2016 annual consolidated financial statements, performance share units ("PSUs") and restricted share units ("RSUs") were accounted for as equity settled instruments. A prospective change in accounting was made in 2017 from equity settled to cash settled instruments based on settlement experience. In accounting for cash settled instruments, compensation expense is adjusted for subsequent changes in the fair value of the PSUs and RSUs taking into account forfeiture estimates. The liability related to cash settled PSUs and RSUs is recorded in Other long-term liabilities.

10. 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 2016 MD&A. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

11. RELATED PARTY TRANSACTIONS

At March 31, 2017, 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.

12. RISK FACTORS

For a description of risk factors associated with Air Canada and its business, refer to section 17 "Risk Factors" of Air Canada's 2016 MD&A, with the following update to the portion entitled *Investigations by competition authorities relating to Air Canada Cargo:*

In March 2017, the European Commission issued a new decision imposing the same fine of 21 million Euros ($30 million) initially levied against Air Canada in 2010. Air Canada will be paying the fine, as required, pending the outcome of its appeal. While Air Canada cannot predict with certainty the outcome of its appeal or any related proceedings, Air Canada believes it has reasonable grounds to challenge the European Commission's ruling.

13. 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 2016 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 2017 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, 2017 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

14. NON-GAAP FINANCIAL MEASURES

Below is a description of certain non-GAAP financial measures used by Air Canada in an effort to provide readers with additional information on its financial and operating performance. Such measures are not recognized measures for financial statement presentation under GAAP, do not have standardized meanings, may not be comparable to similar measures presented by other entities and should not be considered a substitute for or superior to GAAP results.

EBITDAR

EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is commonly used in the airline industry and is used by Air Canada as a means to view operating results before interest, taxes, depreciation, amortization, impairment and aircraft rent as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. Air Canada excludes special items from EBITDAR as such items would distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

EBITDAR is reconciled to operating income (loss) as follows:

	First Quarter		
(Canadian dollars in millions)	**2017**	**2016**	**$ Change**
Operating income (loss) – GAAP	**$ (54)**	**$ 154**	**$ (208)**
Add back (as reflected on Air Canada's consolidated statement of operations):			
Depreciation, amortization and impairment	228	182	46
Aircraft rent	122	112	10
Add back (included in Regional airlines expense):			
Depreciation, amortization and impairment	6	5	1
Aircraft rent	10	7	3
EBITDAR (including special items)	**$ 312**	**$ 460**	**$ (148)**
Remove effect of special items	**30**	**-**	**30**
EBITDAR (excluding special items)	**$ 342**	**$ 460**	**$ (118)**

Adjusted Net Debt to Trailing 12-Month EBITDAR (Leverage Ratio)

Adjusted net debt to trailing 12-month EBITDAR ratio (also referred to as "leverage ratio" in this MD&A) is commonly used in the airline industry and is used by Air Canada as a means to measure financial leverage. Leverage ratio is calculated by dividing adjusted net debt by trailing 12-month EBITDAR. Refer to section 6.2 "Adjusted Net Debt" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP. As mentioned above, Air Canada excludes special items from EBITDAR results (which are used to determine leverage ratio) as such items would distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

Free Cash Flow

Free cash flow is commonly used in the airline industry and is used by Air Canada as an indicator of the financial strength and performance of its business, indicating the amount of cash Air Canada is able to generate from operations and after capital expenditures. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment and intangible assets, and is net of proceeds from sale and leaseback transactions. Refer to section 6.4 "Consolidated Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

Adjusted CASM

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

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.

Excluding aircraft fuel expense, the cost of ground packages at Air Canada Vacations and special 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:

	First Quarter		
(Canadian dollars in millions, except where indicated)	**2017**	**2016**	**$ Change**
Operating expense – GAAP	**$ 3,696**	**$ 3,189**	**$ 507**
Adjusted for:			
Aircraft fuel expense (as reflected on Air Canada's consolidated statement of operations)	(659)	(446)	(213)
Aircraft fuel expense (included in Regional airlines expense)	(95)	(64)	(31)
Ground package costs	(256)	(231)	(25)
Special items	(30)	-	(30)
Operating expense, adjusted for the above-noted items	**$ 2,656**	**$ 2,448**	**$ 208**
ASMs (millions)	**22,894**	**19,833**	**15.4%**
Adjusted CASM (cents)	**¢ 11.60**	**¢ 12.34**	**(6.0%)**

Adjusted Net Income and Adjusted Earnings per Share – Diluted

Air Canada uses adjusted net income and adjusted earnings per share – diluted as a means to assess the overall financial performance of its business without the effects of foreign exchange, net financing income (expense) relating to employee benefits, mark-to-market adjustments on derivatives and other financial instruments recorded at fair value, gain on sale and leaseback of assets, loss on debt settlements and special items as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful. Air Canada also uses adjusted net income as a measure to determine its return on invested capital which is described below.

	First Quarter		
(Canadian dollars in millions, except per share values)	**2017**	**2016**	**$ Change**
Net income (loss) attributable to shareholders of Air Canada	**$ (37)**	**$ 101**	**$ (138)**
Adjusted for:			
Special items	30	-	30
Foreign exchange gain	(70)	(50)	(20)
Net financing expense relating to employee benefits	16	18	(2)
Loss on financial instruments recorded at fair value	-	10	(10)
Gain on sale and leaseback of assets	(26)	-	(26)
Loss on debt settlements	-	6	(6)
Adjusted net income (loss)	**$ (87)**	**$ 85**	**$ (172)**
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	273	287	(14)
Adjusted earnings (loss) per share – diluted	**$ (0.32)**	**$ 0.30**	**$ (0.62)**

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

	First Quarter	
(in millions)	**2017**	**2016**
Weighted average number of shares outstanding – basic	**273**	**282**
Effect of dilution	6	5
remove anti-dilutive impact	(6)	-
Weighted average number of shares outstanding – diluted	**273**	**287**

Return on Invested Capital

Air Canada uses return on invested capital ("ROIC") as a means 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 (excluding pension 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).

	12 Months ended		
(Canadian dollars in millions, except where indicated)	March 31, 2017	March 31, 2016	$ Change
Net income for the period attributable to shareholders of Air Canada	**$ 738**	**$ 714**	**$ 24**
Remove:			
Special items (1)	121	8	113
Impairment charges	-	14	(14)
Foreign exchange loss	18	304	(286)
Net financing expense relating to employee benefits	74	98	(24)
(Gain) loss on financial instruments recorded at fair value	(14)	28	(42)
Gain on sale and leaseback of assets (2)	(45)	-	(45)
Loss on debt settlements (3)	83	19	64
Adjusted net income	**$ 975**	**$ 1,185**	**$ (210)**
Adjusted for:			
Interest expense (4)	357	395	(38)
Implicit interest on operating leases (5)	248	196	52
Adjusted income before interest	**$ 1,580**	**$ 1,776**	**$ (196)**
Invested capital:			
Working capital excluding current portion of long-term debt and finance leases	343	331	12
Long-term assets, excluding pension assets	9,380	8,130	1,250
Maintenance provisions	(892)	(836)	(56)
Other operating long-term liabilities	(168)	(223)	55
Capitalized operating leases (6)	3,542	2,807	735
Invested capital	**$ 12,205**	**$ 10,209**	**$ 1,996**
Return on invested capital (%)	**12.9%**	**17.4%**	**(4.5 pp)**

(1) *Special items for the 12 months ended March 31, 2017 included a provision of $30 million related to cargo investigations and a past service cost expense of $91 million to reflect the estimated cost of defined benefit pension increases applicable to members of the Air Canada Pilots' Association. Special items for the 12 months ended March 31, 2016 included one-time payments totaling $26 million related to Air Canada's contract on collective agreement terms with CUPE, one-time payments totaling $36 million related to Air Canada's contract on collective agreement terms with the IAMAW, a $30 million recovery related to cargo investigations which was previously paid; and favourable tax-related provision adjustments of $23 million.*

(2) *In the 12 months ended March 31, 2017, Air Canada recorded a gain of $45 million on the sale and leaseback of four Boeing 787 aircraft.*

(3) *Loss on debt settlements for the 12 months ended March 31, 2017 of $83 million of which $82 million was related to a $1.25 billion refinancing transaction and $1 million was related to the prepayment of debt associated with the disposal of Embraer 190 aircraft.*

(4) *Interest expense excludes the loss on debt settlements related to the C$1.25 billion refinancing transaction and to the disposal of Embraer 190 aircraft.*

(5) *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.*

(6) *Capitalized operating leases are calculated by multiplying the trailing 12 months of aircraft rent by 7. Aircraft rent totaled $506 million for the 12 months ended March 31, 2017 and $401 million for the 12 months ended March 31, 2016 (includes aircraft rent related to regional operations).*

15. GLOSSARY

Adjusted CASM – Refers to operating expense per ASM adjusted to remove the effects of aircraft fuel expense, ground packages costs at Air Canada Vacations, and special items. Refer to section 14 "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 derivatives and other financial instruments recorded at fair value, gain on sale and leaseback of assets, loss on debt settlements and special items. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

Air Georgian – Refers to Air Georgian Limited.

Atlantic passenger and cargo revenues – Refer to revenues from flights that cross the Atlantic Ocean with origins and destinations principally in Europe, India, the United Arab Emirates and Morocco.

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.

Bombardier – Refers to Bombardier Inc.

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 14 "Non-GAAP Financial Measures" of this MD&A for additional information. Air Canada excludes special items from EBITDAR.

EVAS – Refers to Exploits Valley Air Services Ltd.

Free cash flow – Refers to net cash flows from operating activities minus additions to property, equipment and intangible assets, and is net of proceeds from sale and leaseback transactions. Free cash flow is a non-GAAP financial measure. Refer to sections 6.4 and 14 of this MD&A for additional information.

Jazz – Refers to Jazz Aviation LP.

Leverage ratio – Refers to adjusted net debt to trailing 12-month EBITDAR ratio (calculated by dividing adjusted net debt by trailing 12-month EBITDAR). Leverage ratio is a non-GAAP financial measure. Refer to sections 6.2 and 14 of this MD&A for additional information.

Loss on debt settlements – Refer to losses related to debt settlements that, in management's view, are to be separately disclosed by virtue of their size or incidence to enable a fuller understanding of the Corporation's financial performance.

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 14 "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 number 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.

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

Sky Regional – Refers to Sky Regional Airlines Inc.

Special items – Refer to those items that, in management's view, are to be separately disclosed by virtue of their significance to the financial statements, to enable a fuller understanding of the Corporation's financial performance.

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).