



## **Second Quarter 2017**

**Management's Discussion and Analysis  
of Results of Operations and Financial  
Condition**

**August 1, 2017**

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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)	Second quarter			First six months		
	2017	2016	\$ Change	2017	2016	\$ Change
<b>Financial Performance Metrics</b>						
Operating revenues	3,910	3,458	452	7,552	6,801	751
Operating income	281	277	4	227	431	(204)
Non-operating income (expense)	22	(91)	113	39	(144)	183
Net income	300	186	114	263	287	(24)
Adjusted net income <sup>(1)</sup>	215	203	12	128	288	(160)
Operating margin %	7.2%	8.0%	(0.8 pp)	3.0%	6.3%	(3.3 pp)
EBITDAR (excluding special items) <sup>(1)</sup>	670	605	65	1,012	1,065	(53)
EBITDAR margin (excluding special items) % <sup>(1)</sup>	17.1%	17.5%	(0.4 pp)	13.4%	15.7%	(2.3 pp)
Unrestricted liquidity <sup>(2)</sup>	4,493	3,449	1,044	4,493	3,449	1,044
Net cash flows from operating activities	829	658	171	1,856	1,632	224
Free cash flow <sup>(1)</sup>	305	(443)	748	775	(585)	1,360
Adjusted net debt <sup>(1)</sup>	6,393	6,840	(447)	6,393	6,840	(447)
Return on invested capital ("ROIC") % <sup>(1)</sup>	12.3%	16.2%	(3.9 pp)	12.3%	16.2%	(3.9 pp)
Leverage ratio <sup>(1)</sup>	2.4	2.6	(0.2)	2.4	2.6	(0.2)
Diluted earnings per share	\$ 1.08	\$ 0.66	\$ 0.42	\$ 0.95	\$ 1.01	\$ (0.06)
Adjusted earnings per share – diluted <sup>(1)</sup>	\$ 0.78	\$ 0.72	\$ 0.06	\$ 0.46	\$ 1.01	\$ (0.55)
<b>Operating Statistics <sup>(3)</sup></b>			<b>% Change</b>			<b>% Change</b>
Revenue passenger miles ("RPM") (millions)	20,928	18,418	13.6	39,269	34,510	13.8
Available seat miles ("ASM") (millions)	25,357	22,344	13.5	48,251	42,177	14.4
Passenger load factor %	82.5%	82.4%	0.1 pp	81.4%	81.8%	(0.4 pp)
Passenger revenue per RPM ("Yield") (cents)	16.5	16.7	(1.4)	16.5	17.0	(3.2)
Passenger revenue per ASM ("PRASM") (cents)	13.6	13.8	(1.2)	13.4	13.9	(3.7)
Operating revenue per ASM (cents)	15.4	15.5	(0.4)	15.7	16.1	(2.9)
Operating expense per ASM ("CASM") (cents)	14.3	14.2	0.5	15.2	15.1	0.5
Adjusted CASM (cents) <sup>(1)</sup>	10.8	11.2	(3.5)	11.2	11.7	(4.7)
Average number of full-time equivalent ("FTE") employees (thousands) <sup>(4)</sup>	27.8	26.1	6.6	27.3	25.8	6.2
Aircraft in operating fleet at period-end	393	380	3.4	393	380	3.4
Average fleet utilization (hours per day)	10.3	10.1	2.8	10.1	9.9	1.8
Seats dispatched (thousands)	14,962	13,840	8.1	29,242	27,017	8.2
Aircraft frequencies (thousands)	141.2	139.9	1.0	275.5	273.4	0.8
Average stage length (miles) <sup>(5)</sup>	1,695	1,614	5.0	1,650	1,561	5.7
Fuel cost per litre (cents)	61.3	52.2	17.4	62.2	50.2	23.8
Fuel litres (thousands)	1,300,061	1,157,371	12.3	2,493,793	2,219,031	12.4
Revenue passengers carried (thousands) <sup>(6)</sup>	11,895	10,846	9.7	22,819	20,803	9.7

- (1) *Adjusted net income, adjusted earnings per share – diluted, 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 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 June 30, 2017, unrestricted liquidity was comprised of cash and short-term investments of \$4,054 million and undrawn lines of credit of \$439 million. At June 30, 2016, unrestricted liquidity was comprised of cash and short-term investments of \$3,148 million and undrawn lines of credit of \$301 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 carried 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 second 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 second 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 July 31, 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 August 1, 2017 reporting on its results for the second quarter of 2017. 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 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](http://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\$1.29 per U.S. dollar in the third quarter of 2017 and at C\$1.31 per U.S. dollar for the full year 2017 and that the price of jet fuel (taking the impact of fuel hedging into account) will average 59 CAD cents per litre in the third quarter of 2017 and 61 CAD cents per litre for the full year 2017.

### **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 also 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 TM symbols, but Air Canada reserves all rights to 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.

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### 3. OVERVIEW

On a GAAP basis, Air Canada reported second quarter 2017 operating income of \$281 million compared to second quarter 2016 operating income of \$277 million. Air Canada recorded net income of \$300 million or \$1.08 per diluted share in the second quarter of 2017 versus net income of \$186 million or \$0.66 per diluted share in the same quarter in 2016.

In the second quarter of 2017, Air Canada reported record EBITDAR of \$670 million compared to EBITDAR of \$605 million in the second quarter of 2016 and consistent with the forecast in Air Canada's July 6, 2017 news release. The airline recorded a second quarter 2017 EBITDAR margin of 17.1% versus a second quarter 2016 EBITDAR margin of 17.5%. Air Canada recorded adjusted net income of \$215 million or \$0.78 per diluted share in the second quarter of 2017 versus adjusted net income of \$203 million or \$0.72 per diluted share in the second quarter of 2016. EBITDAR, adjusted net income and adjusted earnings per share 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 second quarter of 2017 compared to the second quarter of 2016.

- Record operating revenues of \$3,910 million in the second quarter of 2017, an increase of \$452 million or 13% from the second quarter of 2016. On capacity growth of 13.5%, record passenger revenues of \$3,517 million in the second quarter of 2017 increased \$374 million or 11.9% from the second quarter of 2016.
- Operating expenses of \$3,629 million in the second quarter of 2017, an increase of \$448 million or 14% from the second quarter of 2016. CASM increased 0.5% from the second quarter of 2016. On an adjusted basis, CASM decreased 3.5% from the second quarter of 2016, better than the 1.5% to 2.5% decrease forecasted in Air Canada's news release dated May 5, 2017. Air Canada's better than projected adjusted CASM performance was largely driven by lower than anticipated aircraft maintenance expense. The lower than anticipated aircraft maintenance expense was mainly attributable to the deferral of certain maintenance activities into the remainder of 2017 and to lower end of lease maintenance provisions due to more favourable terms on wide-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 \$6,393 million, a decrease of \$697 million from December 31, 2016, reflecting the impact of higher cash and short-term investment balances partly offset by the impact of a higher capitalized operating lease balance and higher long-term debt and finance lease balances. 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 2.4 at June 30, 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.
- Record net cash flows from operating activities of \$829 million in the second quarter of 2017, an improvement of \$171 million from the second quarter of 2016. Record free cash flow of \$305 million in the second quarter of 2017 improved \$748 million from the second 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. 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 June 30, 2017 of 12.3% versus 16.2% for the 12 months ended June 30, 2016. The decrease in ROIC was largely due to an increase Air Canada's invested capital, in support of the airline's international expansion strategy. 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 provides and compares results of Air Canada for the periods indicated:

(Canadian dollars in millions, except per share figures)	Second quarter				First six months			
	2017	2016	Change		2017	2016	Change	
			\$	%			\$	%
<b>Operating revenues</b>								
Passenger	\$ 3,517	\$ 3,143	\$ 374	12	\$ 6,612	\$ 6,007	\$ 605	10
Cargo	154	111	43	39	288	227	61	27
Other	239	204	35	17	652	567	85	15
<b>Total revenues</b>	<b>3,910</b>	<b>3,458</b>	<b>452</b>	<b>13</b>	<b>7,552</b>	<b>6,801</b>	<b>751</b>	<b>11</b>
<b>Operating expenses</b>								
Aircraft fuel	701	527	174	33	1,360	973	387	40
Regional airlines expense								
Aircraft fuel	96	77	19	25	191	141	50	35
Other	552	501	51	10	1,089	1,006	83	8
Wages, salaries and benefits	663	611	52	9	1,307	1,219	88	7
Airport and navigation fees	230	211	19	9	440	409	31	8
Aircraft maintenance	226	243	(17)	(7)	454	464	(10)	(2)
Depreciation, amortization and impairment	242	202	40	20	470	384	86	22
Sales and distribution costs	199	170	29	17	404	352	52	15
Ground package costs	103	85	18	21	359	316	43	14
Aircraft rent	130	112	18	16	252	224	28	13
Food, beverages and supplies	97	86	11	13	182	163	19	12
Communications and IT	58	59	(1)	(2)	129	126	3	2
Special items	-	-	-	-	30	-	30	100
Other	332	297	35	12	658	593	65	11
<b>Total operating expenses</b>	<b>3,629</b>	<b>3,181</b>	<b>448</b>	<b>14</b>	<b>7,325</b>	<b>6,370</b>	<b>955</b>	<b>15</b>
<b>Operating income</b>	<b>281</b>	<b>277</b>	<b>4</b>		<b>227</b>	<b>431</b>	<b>(204)</b>	
<b>Non-operating income (expense)</b>								
Foreign exchange gain (loss)	68	(17)	85		138	33	105	
Interest income	14	13	1		26	23	3	
Interest expense	(80)	(98)	18		(159)	(194)	35	
Interest capitalized	9	15	(6)		18	38	(20)	
Net financing expense relating to employee benefits	(16)	(17)	1		(32)	(35)	3	
Gain (loss) on financial instruments recorded at fair value	7	(1)	8		7	(11)	18	
Gain on sale and leaseback of assets	26	19	7		52	19	33	
Loss on debt settlements	-	(1)	1		-	(7)	7	
Other	(6)	(4)	(2)		(11)	(10)	(1)	
<b>Total non-operating income (expense)</b>	<b>22</b>	<b>(91)</b>	<b>113</b>		<b>39</b>	<b>(144)</b>	<b>183</b>	
<b>Income before income taxes</b>	<b>303</b>	<b>186</b>	<b>117</b>		<b>266</b>	<b>287</b>	<b>(21)</b>	
Income tax expense	(3)	-	(3)		(3)	-	(3)	
<b>Net income</b>	<b>\$ 300</b>	<b>\$ 186</b>	<b>\$ 114</b>		<b>\$ 263</b>	<b>\$ 287</b>	<b>\$ (24)</b>	
<b>Diluted earnings per share</b>	<b>\$ 1.08</b>	<b>\$ 0.66</b>	<b>\$ 0.42</b>		<b>\$ 0.95</b>	<b>\$ 1.01</b>	<b>\$ (0.06)</b>	
<b>EBITDAR <sup>(1)</sup></b>	<b>\$ 670</b>	<b>\$ 605</b>	<b>\$ 65</b>		<b>\$ 1,012</b>	<b>\$ 1,065</b>	<b>\$ (53)</b>	
<b>Adjusted net income <sup>(1)</sup></b>	<b>\$ 215</b>	<b>\$ 203</b>	<b>\$ 12</b>		<b>\$ 128</b>	<b>\$ 288</b>	<b>\$ (160)</b>	
<b>Adjusted earnings per share – diluted <sup>(1)</sup></b>	<b>\$ 0.78</b>	<b>\$ 0.72</b>	<b>\$ 0.06</b>		<b>\$ 0.46</b>	<b>\$ 1.01</b>	<b>\$ (0.55)</b>	

(1) EBITDAR, adjusted net income and adjusted earnings 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

In the second quarter of 2017, system passenger revenues of \$3,517 million increased \$374 million or 11.9% from the second quarter of 2016 on traffic growth of 13.6% partly offset by a yield decline of 1.4%. On a stage-length adjusted basis, yield improved 1.4% when compared to the same quarter in 2016.

In the second quarter of 2017, business cabin system revenues increased \$90 million or 14.6% from the second quarter of 2016 on traffic and yield growth of 11.2% and 3.0%, respectively.

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

Passenger revenue (Canadian dollars in millions)	Second quarter 2017	Second quarter 2016	\$ Change	% Change
Canada	\$ 1,122	\$ 1,079	\$ 43	4.0
U.S. transborder	785	674	111	16.3
Atlantic	871	763	108	14.3
Pacific	527	469	58	12.5
Other	212	158	54	34.7
<b>System</b>	<b>\$ 3,517</b>	<b>\$ 3,143</b>	<b>\$ 374</b>	<b>11.9</b>

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

Second quarter 2017 versus Second quarter 2016	Passenger revenue % change	Capacity (ASMs) % change	Traffic (RPMs) % change	Passenger load factor pp change	Yield % change	PRASM % change
Canada	4.0	2.8	3.3	0.5	0.8	1.4
U.S. transborder	16.3	15.2	16.2	0.7	0.3	1.2
Atlantic	14.3	12.6	13.7	0.8	0.6	1.5
Pacific	12.5	23.2	19.7	(2.5)	(6.0)	(8.7)
Other	34.7	24.1	26.4	1.5	6.5	8.4
<b>System</b>	<b>11.9</b>	<b>13.5</b>	<b>13.6</b>	<b>0.1</b>	<b>(1.4)</b>	<b>(1.2)</b>

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

System	Year-over-year by quarter (% change)				
	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17
Passenger revenues	2.0	10.5	7.0	8.1	11.9
Capacity (ASMs)	11.0	20.9	17.1	15.4	13.5
Traffic (RPMs)	9.3	18.9	15.3	14.0	13.6
Passenger load factor (pp change)	(1.2)	(1.5)	(1.2)	(1.0)	0.1
Yield	(6.8)	(7.0)	(7.2)	(5.1)	(1.4)
PRASM	(8.2)	(8.6)	(8.6)	(6.3)	(1.2)

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

- The 13.6% traffic increase which reflected traffic growth in all markets. The traffic increase included gains in the business and premium economy cabins. Air Canada launched 16 international and U.S. transborder routes in the second quarter of 2017, including services from Vancouver to Nagoya, Taipei, London Gatwick and Frankfurt; from Toronto to Berlin and Reykjavik; and from Montreal to Marseille, Tel Aviv and Reykjavik. 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 second quarter of 2017 reflected an increase in connecting traffic via Canada to international destinations.
- The 1.4% system yield decrease which reflected:
  - an increase in average stage length of 5.0%, due to long-haul international expansion, which had the effect of reducing system yield by 2.8 percentage points;
  - the impact of launch pricing to support the introduction of new Pacific services and 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 sixth freedom traffic in support of the airline's international expansion strategy.

These factors were largely offset by the following:

- Yield increases in the domestic, U.S. transborder, Atlantic and Other markets, in large part due to:
  - greater proportional growth of higher-yielding business and premium economy passengers;
  - yield growth in both the business and premium economy cabins;
  - growth in higher-yielding local traffic and an improvement in the overall fare mix;
  - the introduction of seat selection fees on certain international markets; and
  - an increase in airport paid upgrade revenues.

In the first six months of 2017, system passenger revenues of \$6,612 million increased \$605 million or 10.1% from the first six months of 2016.

The table below provides passenger revenue by geographic region for the first six months of 2017 versus the first six months of 2016.

Passenger revenue (Canadian dollars in millions)	First six months 2017	First six months 2016	\$ Change	% Change
Canada	\$ 2,092	\$ 2,033	\$ 59	2.9
U.S. transborder	1,570	1,391	179	12.8
Atlantic	1,422	1,271	151	11.9
Pacific	975	867	108	12.5
Other	553	445	108	24.4
<b>System</b>	<b>\$ 6,612</b>	<b>\$ 6,007</b>	<b>\$ 605</b>	<b>10.1</b>

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

<b>First six months 2017 versus First six months 2016</b>	<b>Passenger revenue % change</b>	<b>Capacity (ASMs) % change</b>	<b>Traffic (RPMs) % change</b>	<b>Passenger load factor pp change</b>	<b>Yield % change</b>	<b>PRASM % change</b>
Canada	2.9	3.0	3.4	0.4	(0.4)	0.1
U.S. transborder	12.8	12.2	14.0	1.3	(0.9)	0.7
Atlantic	11.9	15.4	14.0	(1.0)	(1.8)	(3.0)
Pacific	12.5	26.4	21.0	(3.7)	(7.0)	(11.0)
Other	24.4	21.7	24.2	1.8	0.1	2.2
<b>System</b>	<b>10.1</b>	<b>14.4</b>	<b>13.8</b>	<b>(0.4)</b>	<b>(3.2)</b>	<b>(3.7)</b>

Components of the year-over-year change in system passenger revenues in the first six months of 2017 versus the first six months of 2016 included:

- The 13.8% traffic increase which reflected traffic growth in all markets. The traffic increase included gains in the business and premium economy cabins as well as incremental connecting traffic via Canada to international destinations.
- The 3.2% yield decrease which reflected:
  - an increase in average stage length of 5.7% (which had the effect of reducing system yield by 3.2 percentage points);
  - an unfavourable currency impact of \$34 million, mainly attributable to the first quarter of 2017;
  - 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 reduction in carrier surcharges (fuel-related) in the Pacific market, particularly in the first quarter of 2017;
  - a higher proportion of seats into long-haul leisure markets; and
  - a higher proportional growth of lower-yielding sixth freedom traffic in support of the airline's international expansion strategy.

These factors were partly offset by the following:

- volume and yield growth in higher-yielding business and premium economy passengers;
- growth in higher-yielding local traffic and improvements to the overall fare mix; and
- an increase in preferred seat/advance seat selection and airport paid upgrade revenues.

### **Domestic passenger revenues**

In the second quarter of 2017, domestic passenger revenues of \$1,122 million increased \$43 million or 4.0% from the second quarter of 2016.

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

Canada	Year-over-year by quarter (% change)				
	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17
Passenger revenues	(1.6)	4.8	2.5	1.7	4.0
Capacity (ASMs)	4.5	6.3	5.5	3.2	2.8
Traffic (RPMs)	4.2	8.2	5.7	3.6	3.3
Passenger load factor (pp change)	(0.2)	1.5	0.1	0.3	0.5
Yield	(5.8)	(3.1)	(3.1)	(1.7)	0.8
PRASM	(6.1)	(1.4)	(2.9)	(1.3)	1.4

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

- The 3.3% traffic increase which reflected traffic growth on all domestic services. The traffic increase included gains in the business cabin. The year-over-year increase in traffic was due to strong passenger demand on services within Canada as well as incremental connecting traffic to U.S. and international destinations.
- The 0.8% yield increase which reflected yield improvements on short-haul routes and on connecting traffic. The yield increase included gains in the business cabin.

In the first six months of 2017, domestic passenger revenues of \$2,092 million increased \$59 million or 2.9% from the first six months of 2016 on traffic growth of 3.4% partly offset by a yield decline of 0.4%.

### U.S. transborder passenger revenues

In the second quarter of 2017, U.S. transborder passenger revenues of \$785 million increased \$111 million or 16.3% from the second quarter of 2016.

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

U.S. transborder	Year-over-year by quarter (% change)				
	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17
Passenger revenues	2.3	14.0	10.1	9.5	16.3
Capacity (ASMs)	12.3	19.3	14.1	9.6	15.2
Traffic (RPMs)	10.8	20.8	15.0	12.0	16.2
Passenger load factor (pp change)	(1.1)	1.0	0.6	1.8	0.7
Yield	(7.9)	(5.6)	(4.3)	(2.2)	0.3
PRASM	(9.1)	(4.5)	(3.6)	-	1.2

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

- The 16.2% traffic increase which reflected traffic growth on all major U.S. transborder services. The traffic increase included gains in the business cabin. The year-over-year increase in traffic was mainly due to strong passenger demand between Canada and the U.S. followed by growth of international-to-international connecting passenger flows from the U.S. in support of Air Canada's international expansion strategy.
- The 0.3% yield increase which reflected yield improvements on Air Canada Rouge-operated sun routes partly offset by the impact of increased industry capacity on U.S. long-haul and short-haul routes and by growth in lower-yielding international-to-international connecting traffic from and to the U.S.

In the first six months of 2017, U.S. transborder passenger revenues of \$1,570 million increased \$179 million or 12.8% from the first six months of 2016 on traffic growth of 14.0% partly offset by a yield decline of 0.9%.

### Atlantic passenger revenues

In the second quarter of 2017, Atlantic passenger revenues of \$871 million increased \$108 million or 14.3% from the second quarter of 2016.

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

Atlantic	Year-over-year by quarter (% change)				
	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17
Passenger revenues	5.0	10.7	8.3	8.3	14.3
Capacity (ASMs)	16.6	28.1	21.5	19.7	12.6
Traffic (RPMs)	10.9	21.8	19.3	14.4	13.7
Passenger load factor (pp change)	(4.0)	(4.4)	(1.4)	(3.5)	0.8
Yield	(5.4)	(9.1)	(9.2)	(5.3)	0.6
PRASM	(9.9)	(13.6)	(10.9)	(9.5)	1.5

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

- The 13.7% traffic increase which reflected traffic growth on all Atlantic services. The traffic increase included gains in the business and premium economy cabins.
- The 0.6% yield increase which reflected yield improvements on most major Atlantic services, led by gains in the business and premium economy cabins.

In the first six months of 2017, Atlantic passenger revenues of \$1,422 million increased \$151 million or 11.9% from the first six months of 2016 on traffic growth of 14.0% partly offset by a yield decline of 1.8%.

### Pacific passenger revenues

In the second quarter of 2017, Pacific passenger revenues of \$527 million increased \$58 million or 12.5% from the second quarter of 2016.

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

Pacific	Year-over-year by quarter (% change)				
	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17
Passenger revenues	8.8	19.2	12.1	12.5	12.5
Capacity (ASMs)	12.4	34.8	31.9	30.3	23.2
Traffic (RPMs)	13.7	29.0	23.7	22.5	19.7
Passenger load factor (pp change)	1.0	(3.9)	(5.3)	(5.1)	(2.5)
Yield	(4.2)	(7.6)	(9.3)	(8.1)	(6.0)
PRASM	(3.1)	(11.6)	(15.0)	(13.6)	(8.7)

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

- The 19.7% traffic increase which reflected traffic growth on all major Pacific services. The traffic increase was mainly driven by the June 2016 launch of services to Seoul from Toronto and to Brisbane from Vancouver; the February 2017 launch of services to Shanghai from Montreal; and the June 2017 launch of services to Nagoya from Vancouver and to Taipei from Vancouver.
- The 6.0% yield decline which reflected 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 (mainly between Asia and the U.S/Latin America) was also contributing factor.

In the first six months of 2017, Pacific passenger revenues of \$975 million increased \$108 million or 12.5% from the first six months of 2016 on traffic growth of 21.0% partly offset by a yield decline of 7.0%.

### Other passenger revenues

In the second quarter of 2017, Other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of \$212 million increased \$54 million or 34.7% from the second quarter of 2016.

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

Other	Year-over-year by quarter (% change)				
	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17
Passenger revenues	(6.4)	8.3	7.3	18.8	34.7
Capacity (ASMs)	6.0	12.5	13.2	20.1	24.1
Traffic (RPMs)	6.5	15.1	15.7	22.8	26.4
Passenger load factor (pp change)	0.3	1.9	1.8	1.9	1.5
Yield	(12.4)	(6.0)	(7.6)	(3.4)	6.5
PRASM	(12.1)	(3.9)	(5.5)	(1.2)	8.4

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

- The 26.4% traffic increase which reflected traffic growth on all major services and included gains in the business and premium economy cabins on services to South America.
- The 6.5% yield increase which reflected yield improvements on all major services and included gains in the business and premium economy cabins on services to South America.

In the first six months of 2017, Other passenger revenues of \$553 million increased \$108 million or 24.4% from the first six months of 2016 mainly on traffic growth of 24.2%.

### Cargo revenues

In the second quarter of 2017, cargo revenues of \$154 million increased \$43 million or 38.7% from the second quarter of 2016 on traffic and yield growth of 34.7% and 3.0%, respectively. Traffic increases were recorded in all markets. The Pacific market reflected a particularly strong performance with growth in both traffic and yield versus the same quarter in 2016.

In the first six months of 2017, cargo revenues of \$288 million increased \$61 million or 27.1% from the second quarter of 2016 on traffic growth of 33.7% partly offset by a yield decline of 5.0%. Capacity

growth of 19.1% reflected increases in all markets. A capacity increase of 26.0% in the Pacific market reflected the introduction of new services as well as increased frequencies on existing services. Air freight demand in the Pacific market was strong which resulted in traffic growth significantly surpassing capacity growth in the first six months of 2017.

The table below provides cargo revenue by geographic region for the periods indicated.

Cargo revenue (Canadian dollars in millions)	Second quarter				First six months			
	2017	2016	Change		2017	2016	Change	
			\$	%			\$	%
Canada	\$ 18	\$ 15	\$ 3	19.3	\$ 34	\$ 29	\$ 5	18.5
U.S. transborder	8	6	2	43.6	16	13	3	23.8
Atlantic	50	41	9	21.2	96	88	8	8.7
Pacific	65	41	24	55.9	117	79	38	47.6
Other	13	8	5	72.5	25	18	7	42.8
<b>System</b>	<b>\$ 154</b>	<b>\$ 111</b>	<b>\$ 43</b>	<b>38.7</b>	<b>\$ 288</b>	<b>\$ 227</b>	<b>\$ 61</b>	<b>27.1</b>

### Other revenues

Other revenues of \$239 million in the second quarter of 2017 and \$652 million in the first six months of 2017 increased \$35 million or 17% and \$85 million or 15%, respectively, from the same periods in 2016, reflecting an increase in ground package revenues at Air Canada Vacations, primarily the result of higher passenger volumes.



**CASM and adjusted CASM**

The following table compares Air Canada's CASM and Adjusted CASM for the periods indicated.

(cents per ASM)	Second quarter				First six months			
	2017	2016	Change		2017	2016	Change	
			¢	%			¢	%
Aircraft fuel	2.77	2.36	0.41	17.4	2.82	2.31	0.51	22.1
Regional airlines expense								
Aircraft fuel	0.38	0.35	0.03	8.6	0.40	0.33	0.07	21.2
Other	2.17	2.24	(0.07)	(3.1)	2.25	2.39	(0.14)	(5.9)
Wages and salaries	1.99	2.13	(0.14)	(6.6)	2.02	2.20	(0.18)	(8.2)
Benefits	0.62	0.61	0.01	1.6	0.68	0.69	(0.01)	(1.4)
Airport and navigation fees	0.91	0.94	(0.03)	(3.2)	0.91	0.97	(0.06)	(6.2)
Aircraft maintenance	0.89	1.09	(0.20)	(18.3)	0.94	1.10	(0.16)	(14.5)
Depreciation, amortization and impairment	0.95	0.91	0.04	4.4	0.97	0.91	0.06	6.6
Sales and distribution costs	0.78	0.76	0.02	2.6	0.84	0.83	0.01	1.2
Ground package costs	0.40	0.38	0.02	5.3	0.74	0.75	(0.01)	(1.3)
Aircraft rent	0.51	0.50	0.01	2.0	0.52	0.53	(0.01)	(1.9)
Food, beverages and supplies	0.38	0.39	(0.01)	(2.6)	0.38	0.39	(0.01)	(2.6)
Communications and IT	0.23	0.26	(0.03)	(11.5)	0.27	0.30	(0.03)	(10.0)
Special items	-	-	-	-	0.06	-	0.06	100.0
Other	1.33	1.32	0.01	0.8	1.38	1.40	(0.02)	-
<b>CASM</b>	<b>14.31</b>	<b>14.24</b>	<b>0.07</b>	<b>0.5</b>	<b>15.18</b>	<b>15.10</b>	<b>0.08</b>	<b>0.5</b>
<b>Remove:</b>								
Aircraft fuel expense <sup>(1)</sup> , ground package costs at Air Canada	(3.54)	(3.08)	(0.46)	14.9	(4.02)	(3.39)	(0.63)	(18.6)
Vacations and special items								
<b>Adjusted CASM <sup>(2)</sup></b>	<b>10.77</b>	<b>11.16</b>	<b>(0.39)</b>	<b>(3.5)</b>	<b>11.16</b>	<b>11.71</b>	<b>(0.55)</b>	<b>(4.7)</b>

(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**

In the second quarter of 2017, operating expenses of \$3,629 million increased \$448 million or 14% from the second quarter of 2016. This increase was mainly driven by the 13.5% capacity growth and higher jet fuel prices. In the second quarter of 2017, the unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars), when compared to the second quarter of 2016, increased operating expenses by \$43 million (comprised of \$17 million relating to aircraft fuel expense and an aggregate of \$26 million relating to non-fuel operating expenses).

In the first six months of 2017, operating expenses of \$7,325 million increased \$955 million or 15% from the first six months of 2016. This increase was mainly driven by the 14.4% capacity growth and higher jet fuel prices. In the first six months of 2017, the favourable impact of a stronger Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars), when compared to the first six months of 2016, decreased operating expenses by \$38 million (comprised of \$12 million relating to aircraft fuel expense and an aggregate of \$26 million relating to non-fuel operating expenses).

### Aircraft fuel expense

In the second quarter of 2017, aircraft fuel expense (including fuel expense related to regional airline operations) amounted to \$797 million, an increase of \$193 million or 32% from the second quarter of 2016. This increase mainly reflected higher jet fuel prices (before the impact of foreign exchange), which accounted for an increase of \$100 million, a higher volume of fuel litres consumed, which accounted for an increase of \$73 million, and an unfavourable currency impact of \$17 million.

In the first six months of 2017, aircraft fuel expense (including fuel expense related to regional airline operations) amounted to \$1,551 million, an increase of \$437 million or 39% from the first six months of 2016. This increase reflected higher jet fuel prices (before the impact of foreign exchange), which accounted for an increase of \$316 million and a higher volume of fuel litres consumed, which accounted for an increase of \$136 million. These increases were partly offset by a favourable currency impact of \$12 million.

### Regional airlines expense

Regional airlines expense of \$648 million in the second quarter of 2017 and \$1,280 million in the first six months of 2017 increased \$70 million or 12% and \$133 million or 12%, respectively, from the same periods in 2016. These increases reflected 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. The increase in capacity purchase fees was also due to engine maintenance timing versus the same periods in 2016.

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

(Canadian dollars in millions)	Second quarter				First six months			
	2017	2016	Change		2017	2016	Change	
			\$	%			\$	%
Capacity purchase fees	\$ 314	\$ 289	\$ 25	9	\$ 622	\$ 582	\$ 40	7
Aircraft fuel	96	77	19	25	191	141	50	35
Airport and navigation	73	71	2	3	142	139	3	2
Sales and distribution costs	40	35	5	14	77	70	7	10
Depreciation, amortization and impairment	7	6	1	17	13	11	2	18
Aircraft rent	10	8	2	25	20	15	5	33
Other operating expenses	108	92	16	17	215	189	26	14
<b>Total regional airlines expense</b>	<b>\$ 648</b>	<b>\$ 578</b>	<b>\$ 70</b>	<b>12</b>	<b>\$ 1,280</b>	<b>\$ 1,147</b>	<b>\$ 133</b>	<b>12</b>

### Wages, salaries and benefits expense

Wages and salaries expense of \$505 million in the second quarter of 2017 and \$977 million in the first six months of 2017 increased \$30 million or 6% and \$51 million or 6%, respectively, from the same periods in 2016. These increases were mainly due to a higher number of full-time equivalent ("FTE") employees to support the airline's international growth.

Employee benefits expense of \$158 million in the second quarter of 2017 and \$330 million in the first six months of 2017 increased \$22 million or 16% and \$37 million or 13%, respectively, from the same periods in 2016, mainly due to the impact of lower discount rates which increased the current service cost of defined benefit pension plans. In the second quarter of 2016, Air Canada recorded a gain on post-employment liabilities which reduced employee benefits expense by \$10 million.

### Airport and navigation fees

Airport and navigation fees of \$230 million in the second quarter of 2017 and \$440 million in the first six months of 2017 increased \$19 million or 9% and \$31 million or 8%, respectively, from the same periods in 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, and a 6% Nav Canada rate reduction effective September 1, 2016 were partly offsetting factors.

### Aircraft maintenance expense

Aircraft maintenance expense of \$226 million in the second quarter of 2017 and \$454 million in the first six months of 2017 decreased \$17 million or 7% and \$10 million or 2%, respectively, from the same periods in 2016. The decrease was largely due to a greater number of aircraft leases being extended in 2017 (which has the effect of deferring maintenance provisions) and to more favourable end-of-lease conditions on aircraft lease extensions (which has the effect of reducing maintenance provisions). The effect of having additional Boeing 787 aircraft in the fleet, which have engines under power-by-the-hour arrangements, was a partly offsetting factor.

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

(Canadian dollars in millions)	Second quarter				First six months			
	2017	2016	Change		2017	2016	Change	
			\$	%			\$	%
Technical maintenance	\$ 220	\$ 211	\$ 9	4	\$ 415	\$ 392	\$ 23	6
Maintenance provisions <sup>(1)</sup>	7	32	(25)	(78)	34	64	(30)	(47)
Other	(1)	-	(1)	(100)	5	8	(3)	(38)
<b>Total aircraft maintenance expense</b>	<b>\$ 226</b>	<b>\$ 243</b>	<b>\$ (17)</b>	<b>(7)</b>	<b>\$ 454</b>	<b>\$ 464</b>	<b>\$ (10)</b>	<b>(2)</b>

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

### Depreciation, amortization and impairment expense

Depreciation, amortization and impairment expense of \$242 million in the second quarter of 2017 and \$470 million in the first six months of 2017 increased \$40 million or 20% and \$86 million or 22%, respectively, from the same periods in 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

Sales and distribution costs of \$199 million in the second quarter of 2017 and \$404 million in the first six months of 2017 increased \$29 million or 17% and \$52 million or 15%, respectively, from the same periods in 2016, reflecting a higher volume of ticket sales and the impact of enhanced competitive incentive programs when compared to the same periods 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 same periods in 2016.

### Ground package costs

The cost of ground packages at Air Canada Vacations of \$103 million in the second quarter of 2017 and \$359 million in the first six months of 2017 increased \$18 million or 21% and \$43 million or 14%, respectively, from the same periods in 2016, mainly reflecting higher passenger volumes year-over-year.

### Aircraft rent expense

Aircraft rent expense of \$130 million in the second quarter of 2017 and \$252 million in the first six months of 2017 increased \$18 million or 16% and \$28 million or 13%, respectively, from the same periods in 2016, reflecting a greater number of leased aircraft, primarily Boeing 787 aircraft.

### 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 (\$30 million in the first six months of 2017). Air Canada paid the fine in the second quarter of 2017. Air Canada has appealed the decision. Refer to section 12 "Risk Factors" of this MD&A for additional information. No special items were recorded in the first six months of 2016.

### Other expenses

Other expenses of \$332 million in the second quarter of 2017 and \$658 million in the first six months of 2017 increased \$35 million or 12% and \$65 million or 11%, respectively, from the same periods in 2016, reflecting, in large part, the capacity growth and the impact of Air Canada's international expansion strategy.

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

(Canadian dollars in millions)	Second quarter				First six months			
	2017	2016	Change		2017	2016	Change	
			\$	%			\$	%
Terminal handling	\$ 73	\$ 59	\$ 14	24	\$ 141	\$ 118	\$ 23	19
Crew cycle	47	41	6	15	91	81	10	12
Building rent and maintenance	43	37	6	16	85	76	9	12
Miscellaneous fees and services	37	34	3	9	74	67	7	10
Remaining other expenses	132	126	6	5	267	251	16	6
<b>Total other expenses</b>	<b>\$ 332</b>	<b>\$ 297</b>	<b>\$ 35</b>	<b>12</b>	<b>\$ 658</b>	<b>\$ 593</b>	<b>\$ 65</b>	<b>11</b>

### Non-operating income

Non-operating income of \$22 million in the second quarter of 2017 improved \$113 million from the second quarter of 2016. In the first six months of 2017, non-operating income of \$39 million improved \$183 million from the same period in 2016.

Factors contributing to the year-over-year improvement in non-operating income included:

- In the second quarter of 2017, gains on foreign exchange amounted to \$68 million compared to losses on foreign exchange of \$17 million in the second quarter of 2016. Foreign exchange gains on long-term debt of \$158 million were largely offset by foreign exchange losses on foreign currency derivatives of \$96 million. The gains in the second quarter of 2017 were attributable to the impact of a stronger Canadian dollar at June 30, 2017 when compared to March 31, 2017 on long-term debt and other net monetary liabilities. The June 30, 2017 closing exchange rate was US\$1=C\$1.2964 while the March 31, 2017 closing exchange rate was US\$1=C\$1.3299. In the first six months of 2017, gains on foreign exchange amounted to \$138 million compared to gains on foreign exchange of \$33 million in the first six months of 2016. Foreign exchange gains on long-term debt of \$212 million were largely offset by foreign exchange losses on foreign currency derivatives of \$74 million. The gains in the first six months of 2017 were attributable to a stronger Canadian dollar at June 30, 2017 when compared to December 31, 2016. The December 31, 2016 closing exchange rate was US\$1=C\$1.3427.

- A decrease in interest expense of \$18 million in the second quarter of 2017 and \$35 million in the first six months of 2017, 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 in the second quarter of 2017 (\$52 million in the first six months of 2017 on the sale and leaseback of four Boeing 787-9 aircraft). In the second quarter of 2016, Air Canada recorded a gain of \$19 million on the sale and leaseback of two Boeing 787-9 aircraft (\$19 million in the first six months of 2016).

**5. FLEET**

The following table provides the number of aircraft in Air Canada's operating fleet as at June 30, 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			
	December 31, 2016	First six months 2017 fleet changes	June 30, 2017	Remainder of 2017 fleet changes	December 31, 2017	2018 fleet changes	December 31, 2018
<b>Mainline</b>							
<b><u>Wide-body aircraft</u></b>							
Boeing 787-8	8	-	8	-	8	-	8
Boeing 787-9	13	8	21	1	22	5	27
Boeing 777-300ER	19	-	19	-	19	-	19
Boeing 777-200LR	6	-	6	-	6	-	6
Boeing 767-300ER	14	(4)	10	(2)	8	(3)	5
Airbus A330-300	8	-	8	-	8	-	8
<b><u>Narrow-body aircraft</u></b>							
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
<b>Total Mainline</b>	<b>168</b>	<b>4</b>	<b>172</b>	<b>1</b>	<b>173</b>	<b>10</b>	<b>183</b>
<b>Air Canada Rouge</b>							
<b><u>Wide-body aircraft</u></b>							
Boeing 767-300ER	20	4	24	-	24	1	25
<b><u>Narrow-body aircraft</u></b>							
Airbus A321	5	-	5	-	5	-	5
Airbus A319	20	-	20	-	20	-	20
<b>Total Air Canada Rouge</b>	<b>45</b>	<b>4</b>	<b>49</b>	<b>-</b>	<b>49</b>	<b>1</b>	<b>50</b>
<b>Total wide-body aircraft</b>	<b>88</b>	<b>8</b>	<b>96</b>	<b>(1)</b>	<b>95</b>	<b>3</b>	<b>98</b>
<b>Total narrow-body aircraft</b>	<b>125</b>	<b>-</b>	<b>125</b>	<b>2</b>	<b>127</b>	<b>8</b>	<b>135</b>
<b>Total Mainline and Air Canada Rouge</b>	<b>213</b>	<b>8</b>	<b>221</b>	<b>1</b>	<b>222</b>	<b>11</b>	<b>233</b>

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 June 30, 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 June 30, 2017			
	Jazz	Sky Regional	Other	Total
Embraer 175	-	25	-	25
Bombardier CRJ-100/200	11	-	14	25
Bombardier CRJ-705/900	21	-	-	21
Bombardier Dash 8-100	16	-	-	16
Bombardier Dash 8-300	26	-	-	26
Bombardier Dash 8-Q400	44	-	-	44
<b>Total Air Canada Express</b>	<b>118</b>	<b>25</b>	<b>14</b>	<b>157</b>

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
<b>Total Air Canada Express</b>	<b>117</b>	<b>25</b>	<b>14</b>	<b>156</b>

### Other aircraft with CPA carriers

Air Georgian and EVAS also operate a total of 15 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 June 30, 2017 and as at December 31, 2016.

(Canadian dollars in millions)	June 30, 2017	December 31, 2016	\$ Change
<b>Assets</b>			
Cash, cash equivalents and short-term investments	\$ 4,054	\$ 2,979	\$ 1,075
Other current assets	1,326	1,368	(42)
<b>Current assets</b>	<b>5,380</b>	<b>4,347</b>	<b>1,033</b>
Property and equipment	9,133	8,520	613
Pension assets	1,069	1,153	(84)
Intangible assets	309	315	(6)
Goodwill	311	311	-
Deposits and other assets	456	468	(12)
<b>Total assets</b>	<b>\$ 16,658</b>	<b>\$ 15,114</b>	<b>\$ 1,544</b>
<b>Liabilities</b>			
Current liabilities	\$ 5,684	\$ 4,424	\$ 1,260
Long-term debt and finance leases	5,894	5,911	(17)
Pension and other benefit liabilities	2,697	2,436	261
Maintenance provisions	992	922	70
Other long-term liabilities	194	202	(8)
<b>Total liabilities</b>	<b>15,461</b>	<b>13,895</b>	<b>1,566</b>
<b>Total shareholders' equity</b>	<b>1,197</b>	<b>1,219</b>	<b>(22)</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 16,658</b>	<b>\$ 15,114</b>	<b>\$ 1,544</b>

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 June 30, 2017, property and equipment amounted to \$9,133 million, an increase of \$613 million from December 31, 2016. The increase in property and equipment was mainly due to additions to property and equipment of \$1,810 million, largely offset by the sale of four Boeing 787 aircraft under sale and operating leaseback transactions and the impact of depreciation expense of \$459 million. In the first six months of 2017, the additions to property and equipment included eight Boeing 787-9 aircraft (four 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 \$1,628 million (comprised of pension and other benefit liabilities of \$2,697 million net of pension assets of \$1,069 million) increased \$345 million from December 31, 2016. This increase was mainly due to the impact of a 40 basis point decrease in the discount rate used to value the liabilities, resulting in a net loss on remeasurements on employee benefit liabilities of \$226 million recorded in other comprehensive income on Air Canada's consolidated statement of operations. In the second quarter of 2017, strong investment returns on pension plan assets more than offset the 20 basis point decline in the discount rate occurring within the period.



## 6.2. Adjusted net debt

The following table reflects Air Canada's adjusted net debt balances as at June 30, 2017 and as at December 31, 2016.

(Canadian dollars in millions, except where indicated)	June 30, 2017	December 31, 2016	\$ Change
Total long-term debt and finance leases	\$ 5,894	\$ 5,911	\$ (17)
Current portion of long-term debt and finance leases	871	707	164
Total long-term debt and finance leases, including current portion	6,765	6,618	147
Less cash, cash equivalents and short-term investments	(4,054)	(2,979)	(1,075)
<b>Net debt</b>	<b>\$ 2,711</b>	<b>\$ 3,639</b>	<b>\$ (928)</b>
Capitalized operating leases <sup>(1)</sup>	3,682	3,451	231
<b>Adjusted net debt</b>	<b>\$ 6,393</b>	<b>\$ 7,090</b>	<b>\$ (697)</b>
<b>EBITDAR (trailing 12 months)</b>	<b>\$ 2,715</b>	<b>\$ 2,768</b>	<b>\$ (53)</b>
<b>Adjusted net debt to EBITDAR ratio <sup>(2)</sup></b>	<b>2.4</b>	<b>2.6</b>	<b>(0.2)</b>

(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 \$526 million for the 12 months ended June 30, 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 June 30, 2017, total long-term debt and finance leases (including current portion) of \$6,765 million increased \$147 million from December 31, 2016. In the first six months of 2017, new borrowings of \$733 million were largely offset by debt repayments of \$371 million and the favourable impact of a stronger Canadian dollar of \$212 million, as at June 30, 2017 compared to December 31, 2016, on Air Canada's foreign currency denominated debt (mainly U.S. dollars).

Adjusted net debt amounted to \$6,393 million at June 30, 2017, a decrease of \$697 million from December 31, 2016, reflecting the impact of higher cash and short-term investment balances partly offset by the impact of a higher capitalized operating lease balance and higher long-term debt and finance lease balances.

At June 30, 2017, the adjusted net debt to EBITDAR ratio was 2.4 versus 2.6 as at December 31, 2016.

At June 30, 2017, Air Canada's weighted average cost of capital ("WACC"), on a pre-tax basis, was approximately 7.6% (compared to approximately 9.4% at June 30, 2016). WACC is based on an estimate by management and consists of an estimated cost of equity of 20.0% and an average cost of debt and finance leases of 4.45% (compared to an estimated cost of equity of 27.5% and an average cost of debt and finance leases of 5.1% at June 30, 2016).

### 6.3. Working capital

The following table provides information on Air Canada's working capital balances as at June 30, 2017 and as at December 31, 2016.

(Canadian dollars in millions)	June 30, 2017	December 31, 2016	\$ Change
Cash, cash equivalents and short-term investments	\$ 4,054	\$ 2,979	\$ 1,075
Accounts receivable	871	707	164
Other current assets	455	661	(206)
<b>Total current assets</b>	<b>\$ 5,380</b>	<b>\$ 4,347</b>	<b>\$ 1,033</b>
Accounts payable and accrued liabilities	1,675	1,644	31
Advance ticket sales	3,138	2,073	1,065
Current portion of long-term debt and finance leases	871	707	164
<b>Total current liabilities</b>	<b>\$ 5,684</b>	<b>\$ 4,424</b>	<b>\$ 1,260</b>
<b>Net working capital</b>	<b>\$ (304)</b>	<b>\$ (77)</b>	<b>\$ (227)</b>

The negative net working capital of \$304 million at June 30, 2017 represented a decrease of \$227 million from December 31, 2016. This decrease in net working capital was largely due to capital expenditures of \$1,821 million, which resulted in a net cash outflow of \$348 million (after deducting the financing drawn or sale-leaseback proceeds received relating to the delivery of eight Boeing 787 aircraft). In addition, in the second quarter of 2017, Air Canada exercised purchase options and repaid outstanding amounts on three financed A330 aircraft, increasing the number of owned and unencumbered aircraft. The net cash outflows related to these aircraft were largely offset by positive cash operating results.

As expected, most working capital balances increased in the first six months of 2017 as a result of the seasonal build-up of advance ticket sales and activity levels heading into the third quarter 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)	Second quarter			First six months		
	2017	2016	\$ Change	2017	2016	\$ Change
<b>Net cash flows from operating activities</b>	<b>\$ 829</b>	<b>\$ 658</b>	<b>\$ 171</b>	<b>\$ 1,856</b>	<b>\$ 1,632</b>	<b>\$ 224</b>
Proceeds from borrowings	362	692	(330)	733	1,308	(575)
Reduction of long-term debt and finance lease obligations	(219)	(158)	(61)	(371)	(388)	17
Shares purchased for cancellation	(3)	(24)	21	(36)	(58)	22
Distributions related to aircraft special purpose leasing entities	-	-	-	-	(32)	32
Issue of shares	2	-	2	3	-	3
Financing fees	(9)	(1)	(8)	(12)	(2)	(10)
<b>Net cash flows from financing activities</b>	<b>\$ 133</b>	<b>\$ 509</b>	<b>\$ (376)</b>	<b>\$ 317</b>	<b>\$ 828</b>	<b>\$ (511)</b>
Short-term investments	(413)	(229)	(184)	(575)	(193)	(382)
Additions to property, equipment and intangible assets	(895)	(1,452)	557	(1,821)	(2,568)	747
Proceeds from sale of assets	1	150	(149)	2	294	(292)
Proceeds from sale-leaseback of assets	371	351	20	740	351	389
Other	5	(8)	13	(1)	(8)	7
<b>Net cash flows used in investing activities</b>	<b>\$ (931)</b>	<b>\$ (1,188)</b>	<b>\$ 257</b>	<b>\$ (1,655)</b>	<b>\$ (2,124)</b>	<b>\$ 469</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>\$ (2)</b>	<b>\$ (5)</b>	<b>\$ 3</b>	<b>\$ (6)</b>	<b>\$ (26)</b>	<b>\$ 20</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>\$ 29</b>	<b>\$ (26)</b>	<b>\$ 55</b>	<b>\$ 512</b>	<b>\$ 310</b>	<b>\$ 202</b>

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

(Canadian dollars in millions)	Second quarter			First six months		
	2017	2016	\$ Change	2017	2016	\$ Change
<b>Net cash flows from operating activities</b>	<b>\$ 829</b>	<b>\$ 658</b>	<b>\$ 171</b>	<b>\$ 1,856</b>	<b>\$ 1,632</b>	<b>\$ 224</b>
Additions to property, equipment and intangible assets, net of proceeds from sale-leaseback transactions	(524)	(1,101)	577	(1,081)	(2,217)	1,136
<b>Free cash flow <sup>(1)</sup></b>	<b>\$ 305</b>	<b>\$ (443)</b>	<b>\$ 748</b>	<b>\$ 775</b>	<b>\$ (585)</b>	<b>\$ 1,360</b>

(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 second quarter of 2017, net cash flows from operating activities of \$829 million increased \$171 million when compared to the same quarter in 2016. This increase was mainly due to the impact of stronger cash operating results and, to a lesser extent, the impact of higher cash inflows from working

capital. The higher cash inflows from working capital was mainly due to the impact of the growth in advance ticket sales. In the second quarter of 2017, free cash flow of \$305 million improved \$748 million from the second 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.

In the first six months of 2017, net cash flows from operating activities of \$1,856 million increased \$224 million when compared to the same period 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 funding payments. The higher cash inflows from working capital was mainly due to the impact of the growth in advance ticket sales. In the first six months of 2017, free cash flow of \$775 million improved \$1,360 million from the first six months 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 period in 2016.

### **Net cash flows from financing activities**

In the second quarter of 2017, proceeds from borrowings amounted to \$362 million and reduction of long-term debt and finance lease obligations amounted to \$219 million.

In the first six months of 2017, proceeds from borrowings amounted to \$733 million and reduction of long-term debt and finance lease obligations amounted to \$371 million.

Refer to sections 6.3 "Working Capital", 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 eight Boeing 787 aircraft (one of which remains 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 financing commitments covering up to six of the remaining 8 Boeing 787 firm aircraft orders, 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.

### 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 June 30, 2017 approximates \$6,582 million.

(Canadian dollars in millions)	Remainder of 2017	2018	2019	2020	2021	Thereafter	Total
Projected committed expenditures	\$ 450	\$ 1,727	\$ 1,393	\$ 1,380	\$ 1,050	\$ 582	\$ 6,582
Projected planned but uncommitted expenditures	102	349	487	285	342	Not available	Not available
Projected planned but uncommitted capitalized maintenance <sup>(1)</sup>	58	93	129	130	51	Not available	Not available
<b>Total projected expenditures <sup>(2)</sup></b>	<b>\$ 610</b>	<b>\$ 2,169</b>	<b>\$ 2,009</b>	<b>\$ 1,795</b>	<b>\$ 1,443</b>	<b>Not available</b>	<b>Not available</b>

(1) Future capitalized maintenance amounts for 2021 and beyond are not yet determinable, however an estimate of \$51 million, has been made for 2021.

(2) U.S. dollar amounts are converted using the June 30, 2017 closing exchange rate of US\$1=C\$1.2964. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at June 30, 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 June 30, 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 June 30, 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
<i>Principal</i>							
Long-term debt obligations	\$ 364	\$ 656	\$ 541	\$ 551	\$ 890	\$ 3,622	\$ 6,624
Finance lease obligations	20	48	45	48	17	70	248
<b>Total principal obligations</b>	<b>\$ 384</b>	<b>\$ 704</b>	<b>\$ 586</b>	<b>\$ 599</b>	<b>\$ 907</b>	<b>\$ 3,692</b>	<b>\$ 6,872</b>
<i>Interest</i>							
Long-term debt obligations	\$ 133	\$ 233	\$ 216	\$ 187	\$ 143	\$ 391	\$ 1,303
Finance lease obligations	11	19	14	10	6	18	78
<b>Total interest obligations</b>	<b>\$ 144</b>	<b>\$ 252</b>	<b>\$ 230</b>	<b>\$ 197</b>	<b>\$ 149</b>	<b>\$ 409</b>	<b>\$ 1,381</b>
<b>Total long-term debt and finance lease obligations</b>	<b>\$ 528</b>	<b>\$ 956</b>	<b>\$ 816</b>	<b>\$ 796</b>	<b>\$ 1,056</b>	<b>\$ 4,101</b>	<b>\$ 8,253</b>
<b>Operating lease obligations</b>	<b>\$ 318</b>	<b>\$ 599</b>	<b>\$ 514</b>	<b>\$ 396</b>	<b>\$ 296</b>	<b>\$ 1,060</b>	<b>\$ 3,183</b>
<b>Committed capital expenditures</b>	<b>\$ 450</b>	<b>\$ 1,727</b>	<b>\$ 1,393</b>	<b>\$ 1,380</b>	<b>\$ 1,050</b>	<b>\$ 582</b>	<b>\$ 6,582</b>
<b>Total contractual obligations <sup>(1)</sup></b>	<b>\$ 1,296</b>	<b>\$ 3,282</b>	<b>\$ 2,723</b>	<b>\$ 2,572</b>	<b>\$ 2,402</b>	<b>\$ 5,743</b>	<b>\$18,018</b>

(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:

	June 30, 2017	December 31, 2016
<b>Issued and outstanding shares</b>		
Variable voting shares	84,969,158	86,657,994
Voting shares	186,641,217	186,554,808
<b>Total issued and outstanding shares</b>	<b>271,610,375</b>	<b>273,212,802</b>
<b>Class A variable voting and Class B voting shares potentially issuable</b>		
Stock options	9,009,855	8,985,958
<b>Total shares potentially issuable</b>	<b>9,009,855</b>	<b>8,985,958</b>
<b>Total outstanding and potentially issuable shares</b>	<b>280,620,230</b>	<b>282,198,760</b>

Issuer Bid

In May 2017, Air Canada received approval from the Toronto Stock Exchange ("TSX") for the renewal of its normal course issuer bid for its Class A variable voting shares and Class B voting shares (collectively the "Shares"), authorizing, between May 31, 2017 and May 30, 2018, the purchase of up to 22,364,183 Shares, representing 10% of the public float as at May 17, 2017. The renewal followed the conclusion of the 2016 normal course issuer bid which expired on May 29, 2017.

In the second quarter of 2017, Air Canada purchased, for cancellation, 200,000 Shares at an average cost of \$17.00 per Share for aggregate consideration of \$3 million (2,597,200 Shares at an average cost of \$13.88 per Share for aggregate consideration of \$36 million for the six months ended June 30, 2017). The excess of the cost over the average book value of \$2 million (\$28 million for the six months ended June 30, 2017) was charged to retained earnings. At June 30, 2017, a total of 22,164,183 Shares remain available for repurchase under the existing 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		2016				2017	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Passenger	\$ 3,716	\$ 2,836	\$ 2,864	\$ 3,143	\$ 4,106	\$ 3,035	\$ 3,095	\$ 3,517
Cargo	119	135	116	111	130	155	134	154
Other	188	211	363	204	215	235	413	239
<b>Operating revenues</b>	<b>4,023</b>	<b>3,182</b>	<b>3,343</b>	<b>3,458</b>	<b>4,451</b>	<b>3,425</b>	<b>3,642</b>	<b>3,910</b>
Aircraft fuel	697	527	446	527	708	598	659	701
Regional airlines expense								
Aircraft fuel	95	81	64	77	96	90	95	96
Other	489	468	505	501	543	532	537	552
Wages, salaries & benefits	598	590	608	611	658	633	644	663
Airport and navigation fees	223	193	198	211	247	203	210	230
Aircraft maintenance	198	210	221	243	230	200	228	226
Depreciation, amortization and impairment	165	160	182	202	220	212	228	242
Sales and distribution costs	157	145	182	170	179	172	205	199
Ground package costs	63	87	231	85	72	101	256	103
Aircraft rent	89	98	112	112	118	120	122	130
Food, beverages and supplies	91	81	77	86	104	82	85	97
Communications and IT	52	50	67	59	56	60	71	58
Special items	-	31	-	-	-	91	30	-
Other	291	303	296	297	324	313	326	332
<b>Operating expenses</b>	<b>3,208</b>	<b>3,024</b>	<b>3,189</b>	<b>3,181</b>	<b>3,555</b>	<b>3,407</b>	<b>3,696</b>	<b>3,629</b>
<b>Operating income (loss)</b>	<b>815</b>	<b>158</b>	<b>154</b>	<b>277</b>	<b>896</b>	<b>18</b>	<b>(54)</b>	<b>281</b>
Foreign exchange gain (loss)	(251)	(159)	50	(17)	(42)	(29)	70	68
Interest income	12	13	10	13	12	13	12	14
Interest expense	(106)	(99)	(96)	(98)	(97)	(83)	(79)	(80)
Interest capitalized	20	20	23	15	12	8	9	9
Net financing expense relating to employee benefits	(28)	(27)	(18)	(17)	(17)	(24)	(16)	(16)
Gain (loss) on financial instruments recorded at fair value	(20)	(3)	(10)	(1)	6	9	-	7
Gain on sale and leaseback of assets	-	-	-	19	-	-	26	26
Loss on debt settlements	-	(13)	(6)	(1)	-	(82)	-	-
Other	(5)	(6)	(6)	(4)	(2)	(8)	(5)	(6)
<b>Total non-operating income (expense)</b>	<b>(378)</b>	<b>(274)</b>	<b>(53)</b>	<b>(91)</b>	<b>(128)</b>	<b>(196)</b>	<b>17</b>	<b>22</b>
Income (loss) before income taxes	\$ 437	\$ (116)	\$ 101	\$ 186	\$ 768	\$ (178)	\$ (37)	\$ 303
Income tax expense	-	-	-	-	-	(1)	-	(3)
<b>Net income (loss)</b>	<b>\$ 437</b>	<b>\$ (116)</b>	<b>\$ 101</b>	<b>\$ 186</b>	<b>\$ 768</b>	<b>\$ (179)</b>	<b>\$ (37)</b>	<b>\$ 300</b>
<b>Diluted earnings (loss) per share</b>	<b>\$ 1.48</b>	<b>\$ (0.41)</b>	<b>\$ 0.35</b>	<b>\$ 0.66</b>	<b>\$ 2.74</b>	<b>\$ (0.66)</b>	<b>\$ (0.14)</b>	<b>\$ 1.08</b>
<b>EBITDAR <sup>(1)</sup></b>	<b>\$ 1,076</b>	<b>\$ 456</b>	<b>\$ 460</b>	<b>\$ 605</b>	<b>\$ 1,248</b>	<b>\$ 455</b>	<b>\$ 342</b>	<b>\$ 670</b>
<b>Adjusted net income (loss) <sup>(1)</sup></b>	<b>\$ 734</b>	<b>\$ 116</b>	<b>\$ 85</b>	<b>\$ 203</b>	<b>\$ 821</b>	<b>\$ 38</b>	<b>\$ (87)</b>	<b>\$ 215</b>
<b>Adjusted earnings (loss) per share – diluted <sup>(1)</sup></b>	<b>\$ 2.50</b>	<b>\$ 0.40</b>	<b>\$ 0.30</b>	<b>\$ 0.72</b>	<b>\$ 2.93</b>	<b>\$ 0.14</b>	<b>\$ (0.32)</b>	<b>\$ 0.78</b>

(1) EBITDAR, adjusted net income (loss) and adjusted earnings (loss) per share – diluted are non-GAAP financial measures. Reconciliations of these measures to comparable GAAP measures can be found in "Non-GAAP Financial Measures" of this MD&A and in Air Canada's MD&A reports, available at [aircanada.com](http://aircanada.com).



The following table provides a breakdown of the most significant items included in regional airlines expense for the last eight quarters.

(Canadian dollars in millions, except where indicated)	2015		2016				2017	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Capacity purchase fees	\$ 298	\$ 282	\$ 293	\$ 289	\$ 313	\$ 304	\$ 308	\$ 314
Aircraft fuel	95	81	64	77	96	90	95	96
Airport and navigation	74	69	68	71	79	72	69	73
Sales and distribution costs	32	28	35	35	36	36	37	40
Depreciation, amortization and impairment	4	4	5	6	6	6	6	7
Aircraft rent	3	5	7	8	8	8	10	10
Other operating expenses	78	80	97	92	101	106	107	108
<b>Total regional airlines expense</b>	<b>\$ 584</b>	<b>\$ 549</b>	<b>\$ 569</b>	<b>\$ 578</b>	<b>\$ 639</b>	<b>\$ 622</b>	<b>\$ 632</b>	<b>\$ 648</b>

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

System	2015		2016				2017	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Passenger PRASM (cents)	15.5	14.7	14.1	13.8	14.2	13.5	13.2	13.6
CASM (cents)	13.6	16.0	16.1	14.2	12.5	15.4	16.1	14.3
Adjusted CASM (cents) <sup>(1)</sup>	10.0	12.2	12.3	11.2	9.4	11.4	11.6	10.8
Fuel price per litre (cents) <sup>(2)</sup>	61.4	58.6	48.1	52.2	55.2	59.4	63.2	61.3

(1) Adjusted CASM is a non-GAAP financial measure. A reconciliation of this measure to a comparable GAAP measure can be found in "Non-GAAP Financial Measures" of this MD&A and in Air Canada's MD&A reports, available at [aircanada.com](http://aircanada.com).

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

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.

System	2015		2016				2017	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
RPMs (millions)	20,462	15,301	16,092	18,418	24,328	17,643	18,341	20,928
ASMs (millions)	23,535	18,869	19,833	22,344	28,458	22,091	22,894	25,357
Passenger load factor (%)	86.9%	81.1%	81.1%	82.4%	85.5%	79.9%	80.1%	82.5%
<b>Domestic</b>								
RPMs (millions)	5,606	4,291	3,960	4,717	6,068	4,534	4,101	4,875
ASMs (millions)	6,649	5,222	4,952	5,678	7,066	5,510	5,108	5,837
Passenger load factor (%)	84.3%	82.2%	80.0%	83.1%	85.9%	82.3%	80.3%	83.5%
<b>U.S. transborder</b>								
RPMs (millions)	2,992	2,768	3,376	3,107	3,613	3,182	3,782	3,609
ASMs (millions)	3,539	3,493	4,278	3,799	4,223	3,985	4,687	4,376
Passenger load factor (%)	84.5%	79.2%	78.9%	81.8%	85.6%	79.9%	80.7%	82.5%
<b>Atlantic</b>								
RPMs (millions)	6,792	3,719	3,401	5,394	8,270	4,437	3,891	6,131
ASMs (millions)	7,640	4,755	4,383	6,805	9,785	5,778	5,248	7,661
Passenger load factor (%)	88.9%	78.2%	77.6%	79.3%	84.5%	76.8%	74.1%	80.0%
<b>Pacific</b>								
RPMs (millions)	3,877	3,202	3,218	3,902	5,002	3,959	3,943	4,671
ASMs (millions)	4,318	3,773	3,732	4,496	5,821	4,977	4,862	5,540
Passenger load factor (%)	89.8%	84.9%	86.2%	86.8%	85.9%	79.6%	81.1%	84.5%
<b>Other</b>								
RPMs (millions)	1,195	1,322	2,137	1,298	1,375	1,531	2,624	1,642
ASMs (millions)	1,389	1,626	2,488	1,566	1,563	1,841	2,989	1,943
Passenger load factor (%)	86.0%	81.3%	85.8%	82.9%	87.9%	83.1%	87.8%	84.5%

## 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 second quarter 2017 interim unaudited condensed consolidated financial statements.

## 9. ACCOUNTING POLICIES

Air Canada's accounting policies are as disclosed in Note 2 of Air Canada's 2016 annual audited 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 21 of Air Canada's 2016 annual audited 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 on Air Canada's consolidated statement of financial position.

### **Critical Accounting Estimates and Judgments**

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect certain of the amounts reported in these financial statements and accompanying notes. The underlying assumptions are reviewed on an ongoing basis. Actual results could differ materially from those estimates. As described in Note 10 of Air Canada's 2016 annual audited consolidated financial statements, Air Canada has temporary differences and tax loss carryforwards for which no deferred income tax assets have been recognized. Deferred income tax assets are recognized only to the extent that it is probable that future taxable income will be available to realize them. In making this assessment, consideration is given to available positive and negative evidence and relevant assumptions. Consideration is given to, among other things, future projections of taxable income, overall business environment, historical financial results, and industry-wide trends and outlook. Based on these factors described, no deferred income tax assets have been recorded as of June 30, 2017. However, if the profitability trend continues and projections for future financial performance is both sustained and significant enough to provide sufficient positive evidence, there may be recognition of deferred income tax assets in 2017.

### **IFRS 15 – Revenue from contracts with customers**

As described in Note 2BB of Air Canada's 2016 annual consolidated financial statements, Air Canada will apply IFRS 15 effective January 1, 2018. The standard will be applied retrospectively with adjustment to the opening consolidated statement of financial position as at January 1, 2017. Under IFRS 15, incremental costs of obtaining passenger revenues, such as credit card fees and global distribution system charges, will be capitalized at the time the flight is sold and expensed at the time of passenger revenue recognition. Currently, these costs are expensed as incurred at the time the flight ticket is sold. The anticipated impact on the consolidated statement of financial position as at January 1, 2017 is an increase to Prepaid expenses and other current assets of \$61 million and an equivalent increase to opening retained earnings. The amount of the deferred contract cost asset will fluctuate on a quarterly basis in line with changes in the advance ticket sales liability.

Air Canada continues to evaluate other possible impacts of this standard on its consolidated financial statements, including the impact of changes to the disclosure requirements, however no further financial statement impacts are expected at this time.

## 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 June 30, 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 has appealed the decision. Air Canada recorded the charge as a special item in the first quarter of 2017 and paid the fine, as required, in the second quarter of 2017, 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 second 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 June 30, 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 as follows:

(Canadian dollars in millions, except where indicated)	Second quarter			First six months		
	2017	2016	\$ Change	2017	2016	\$ Change
<b>Operating income – GAAP</b>	<b>\$ 281</b>	<b>\$ 277</b>	<b>\$ 4</b>	<b>\$ 227</b>	<b>\$ 431</b>	<b>\$ (204)</b>
<b>Add back (as reflected on Air Canada's consolidated statement of operations):</b>						
Depreciation, amortization and impairment	242	202	40	470	384	86
Aircraft rent	130	112	18	252	224	28
<b>Add back (included in Regional airlines expense):</b>						
Depreciation, amortization and impairment	7	6	1	13	11	2
Aircraft rent	10	8	2	20	15	5
<b>EBITDAR (including special items)</b>	<b>\$ 670</b>	<b>\$ 605</b>	<b>\$ 65</b>	<b>\$ 982</b>	<b>\$ 1,065</b>	<b>\$ (83)</b>
Remove effect of special items	-	-	-	30	-	30
<b>EBITDAR (excluding special items)</b>	<b>\$ 670</b>	<b>\$ 605</b>	<b>\$ 65</b>	<b>\$ 1,012</b>	<b>\$ 1,065</b>	<b>\$ (53)</b>

### 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:

(Canadian dollars in millions, except where indicated)	Second quarter			First six months		
	2017	2016	\$ Change	2017	2016	\$ Change
<b>Operating expense – GAAP</b>	<b>\$ 3,629</b>	<b>\$ 3,181</b>	<b>\$ 448</b>	<b>\$ 7,325</b>	<b>\$ 6,370</b>	<b>\$ 955</b>
<b>Adjusted for:</b>						
Aircraft fuel expense (as reflected on Air Canada's consolidated statement of operations)	(701)	(527)	(174)	(1,360)	(973)	(387)
Aircraft fuel expense (included in Regional airlines expense)	(96)	(77)	(19)	(191)	(141)	(50)
Ground package costs	(103)	(85)	(18)	(359)	(316)	(43)
Special items	-	-	-	(30)	-	(30)
<b>Operating expense, adjusted for the above-noted items</b>	<b>\$ 2,729</b>	<b>\$ 2,492</b>	<b>\$ 237</b>	<b>\$ 5,385</b>	<b>\$ 4,940</b>	<b>\$ 445</b>
<b>ASMs (millions)</b>	<b>25,357</b>	<b>22,344</b>	<b>13.5%</b>	<b>48,251</b>	<b>42,177</b>	<b>14.4%</b>
<b>Adjusted CASM (cents)</b>	<b>¢ 10.77</b>	<b>¢ 11.16</b>	<b>(3.5%)</b>	<b>¢ 11.16</b>	<b>¢ 11.71</b>	<b>(4.7%)</b>

**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.

(Canadian dollars in millions, except where indicated)	Second quarter			First six months		
	2017	2016	\$ Change	2017	2016	\$ Change
<b>Net income</b>	\$ 300	\$ 186	\$ 114	\$ 263	\$ 287	\$ (24)
<b>Adjusted for:</b>						
Special items	-	-	-	30	-	30
Foreign exchange (gain) loss	(68)	17	(85)	(138)	(33)	(105)
Net financing expense relating to employee benefits	16	17	(1)	32	35	(3)
Loss (gain) on financial instruments recorded at fair value	(7)	1	(8)	(7)	11	(18)
Gain on sale and leaseback of assets	(26)	(19)	(7)	(52)	(19)	(33)
Loss on debt settlements	-	1	(1)	-	7	(7)
<b>Adjusted net income</b>	\$ 215	\$ 203	\$ 12	\$ 128	\$ 288	\$ (160)
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	277	283	(6)	278	284	(6)
<b>Adjusted earnings per share – diluted</b>	\$ 0.78	\$ 0.72	\$ 0.06	\$ 0.46	\$ 1.01	\$ (0.55)

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

(in millions)	Second quarter		First six months	
	2017	2016	2017	2016
<b>Weighted average number of shares outstanding – basic</b>	271	278	272	279
Effect of dilution	6	5	6	5
<b>Weighted average number of shares outstanding – diluted</b>	277	283	278	284



## 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).

(Canadian dollars in millions, except where indicated)	12 Months ended		
	June 30, 2017	June 30, 2016	\$ Change
<b>Net income for the period</b>	<b>\$ 852</b>	<b>\$ 605</b>	<b>\$ 247</b>
<b>Remove:</b>			
Special items <sup>(1)</sup>	121	31	90
Impairment charges	-	-	-
Foreign exchange (gain) loss	(67)	377	(444)
Net financing expense relating to employee benefits	73	90	(17)
(Gain) loss on financial instruments recorded at fair value	(22)	34	(56)
Gain on sale and leaseback of assets	(52)	(19)	(33)
Loss on debt settlements <sup>(2)</sup>	82	20	62
<b>Adjusted net income</b>	<b>\$ 987</b>	<b>\$ 1,138</b>	<b>\$ (151)</b>
<b>Adjusted for:</b>			
Interest expense <sup>(3)</sup>	339	399	(60)
Implicit interest on operating leases <sup>(4)</sup>	258	213	45
<b>Adjusted income before interest</b>	<b>\$ 1,584</b>	<b>\$ 1,750</b>	<b>\$ (166)</b>
<b>Invested capital:</b>			
Working capital excluding current portion of long-term debt and finance leases	310	264	46
Long-term assets, excluding pension assets	9,946	8,571	1,375
Maintenance provisions	(919)	(838)	(81)
Other operating long-term liabilities	(158)	(202)	44
Capitalized operating leases <sup>(5)</sup>	3,682	3,038	644
<b>Invested capital</b>	<b>\$ 12,861</b>	<b>\$ 10,833</b>	<b>\$ 2,028</b>
<b>Return on invested capital (%)</b>	<b>12.3%</b>	<b>16.2%</b>	<b>(3.9 pp)</b>

(1) Special items for the 12 months ended June 30, 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 June 30, 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, and a \$30 million recovery related to cargo investigations which was previously paid.

(2) Loss on debt settlements for the 12 months ended June 30, 2017 of \$82 million was related to a \$1.25 billion refinancing transaction.

(3) Interest expense excludes the loss on debt settlements related to the C\$1.25 billion refinancing transaction.

(4) 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.

(5) Capitalized operating leases are calculated by multiplying the trailing 12 months of aircraft rent by 7. Aircraft rent totaled \$526 million for the 12 months ended June 30, 2017 and \$434 million for the 12 months ended June 30, 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 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 Middle East and North Africa.

**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).