



First Quarter 2018
INTERIM UNAUDITED
Condensed Consolidated
Financial Statements and Notes
April 30, 2018



A STAR ALLIANCE MEMBER 

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

| Unaudited (Canadian dollars in millions) | March 31, 2018 | December 31, 2017 Restated - note 2 | January 1, 2017 Restated - note 2 |
|--|---------------------------|--|--|
| ASSETS | | | |
| Current | | | |
| Cash and cash equivalents | \$ 1,197 | \$ 642 | \$ 787 |
| Short-term investments | 3,299 | 3,162 | 2,192 |
| Total cash, cash equivalents and short-term investments | 4,496 | 3,804 | 2,979 |
| Restricted cash | 92 | 148 | 126 |
| Accounts receivable | 891 | 814 | 707 |
| Aircraft fuel inventory | 75 | 91 | 79 |
| Spare parts and supplies inventory | 117 | 115 | 107 |
| Prepaid expenses and other current assets Note 3 | 307 | 425 | 447 |
| Total current assets | 5,978 | 5,397 | 4,445 |
| Deposits and other assets | 474 | 465 | 468 |
| Property and equipment | 9,852 | 9,252 | 8,520 |
| Pension assets Note 5 | 1,571 | 1,583 | 1,153 |
| Deferred income tax | 451 | 456 | - |
| Intangible assets | 333 | 318 | 315 |
| Goodwill | 311 | 311 | 311 |
| Total assets | \$ 18,970 | \$ 17,782 | \$ 15,212 |
| LIABILITIES | | | |
| Current | | | |
| Accounts payable and accrued liabilities Note 3 | \$ 2,055 | \$ 1,961 | \$ 1,644 |
| Advance ticket sales Note 3 | 3,041 | 2,469 | 2,119 |
| Current portion of long-term debt and finance leases Note 4 | 620 | 671 | 707 |
| Total current liabilities | 5,716 | 5,101 | 4,470 |
| Long-term debt and finance leases Note 4 | 6,117 | 5,448 | 5,911 |
| Pension and other benefit liabilities Note 5 | 2,575 | 2,592 | 2,436 |
| Maintenance provisions | 1,051 | 1,003 | 922 |
| Other long-term liabilities | 204 | 216 | 202 |
| Total liabilities | \$ 15,663 | \$ 14,360 | \$ 13,941 |
| SHAREHOLDERS' EQUITY | | | |
| Share capital | 801 | 799 | 797 |
| Contributed surplus | 69 | 69 | 83 |
| Hedging reserve | - | - | 3 |
| Retained earnings | 2,437 | 2,554 | 388 |
| Total shareholders' equity | 3,307 | 3,422 | 1,271 |
| Total liabilities and shareholders' equity | \$ 18,970 | \$ 17,782 | \$ 15,212 |

The accompanying notes are an integral part of the condensed consolidated financial statements.

CONSOLIDATED STATEMENT OF OPERATIONS

| Unaudited (Canadian dollars in millions except per share figures) | | Three months ended March 31 | |
|--|---------|------------------------------------|---|
| | | 2018 | 2017 Restated - note 2 |
| Operating revenues | | | |
| Passenger | Note 12 | \$ 3,489 | \$ 3,120 |
| Cargo | Note 12 | 168 | 148 |
| Other | | 414 | 374 |
| Total revenues | | 4,071 | 3,642 |
| Operating expenses | | | |
| Aircraft fuel | | 825 | 659 |
| Regional airlines expense | | 675 | 632 |
| Wages, salaries and benefits | Note 5 | 700 | 644 |
| Airport and navigation fees | | 221 | 210 |
| Aircraft maintenance | | 256 | 228 |
| Depreciation, amortization and impairment | | 267 | 228 |
| Sales and distribution costs | | 189 | 181 |
| Ground package costs | | 276 | 256 |
| Aircraft rent | | 125 | 122 |
| Food, beverages and supplies | | 96 | 85 |
| Communications and information technology | | 79 | 71 |
| Special items | Note 11 | - | 30 |
| Other | | 376 | 326 |
| Total operating expenses | | 4,085 | 3,672 |
| Operating loss | | (14) | (30) |
| Non-operating income (expense) | | | |
| Foreign exchange gain (loss) | | (112) | 70 |
| Interest income | | 20 | 12 |
| Interest expense | | (83) | (79) |
| Interest capitalized | | 13 | 9 |
| Net financing expense relating to employee benefits | Note 5 | (12) | (16) |
| Gain on financial instruments recorded at fair value | Note 10 | 1 | - |
| Gain on sale and leaseback of assets | Note 13 | - | 26 |
| Gain on debt settlements and modifications | Note 4 | 11 | - |
| Other | | (8) | (5) |
| Total non-operating income (expense) | | (170) | 17 |
| Loss before income taxes | | (184) | (13) |
| Recovery of income taxes | Note 6 | 14 | - |
| Net loss for the period | | \$ (170) | \$ (13) |
| Net loss per share | | | |
| Basic and diluted loss per share | Note 8 | \$ (0.62) | \$ (0.05) |

The accompanying notes are an integral part of the condensed consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

| Unaudited (Canadian dollars in millions) | Three months ended March 31 | |
|--|------------------------------------|---------------------------------------|
| | 2018 | 2017 Restated - note 2 |
| Comprehensive income (loss) | | |
| Net loss for the period | \$ (170) | \$ (13) |
| Other comprehensive income (loss), net of tax expense: | | |
| Items that will not be reclassified to net income | | |
| Remeasurements on employee benefit liabilities | Note 5 & 6 54 | (203) |
| Items that will be reclassified to net income | | |
| Fuel derivatives designated as cash flow hedges, net | Note 10 - | (5) |
| Total comprehensive loss | \$ (116) | \$ (221) |

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| Unaudited (Canadian dollars in millions) | Share capital | Contributed surplus | Hedging reserve | Retained earnings⁽¹⁾ | Total shareholders' equity⁽¹⁾ |
|--|----------------------|----------------------------|------------------------|--|---|
| January 1, 2017 | \$ 797 | \$ 83 | \$ 3 | \$ 388 | \$ 1,271 |
| Net loss | - | - | - | (13) | (13) |
| Remeasurements on employee benefit liabilities | - | - | - | (203) | (203) |
| Fuel derivatives designated as cash flow hedges, net | - | - | (5) | - | (5) |
| Total comprehensive loss | - | - | (5) | (216) | (221) |
| Share-based compensation | - | (2) | - | (4) | (6) |
| Shares issued | 1 | - | - | - | 1 |
| Shares purchased and cancelled under issuer bid | (7) | - | - | (26) | (33) |
| Reclassification of equity settled award to cash settled award | - | (9) | - | (2) | (11) |
| March 31, 2017 | \$ 791 | \$ 72 | \$ (2) | \$ 140 | \$ 1,001 |
| January 1, 2018 | \$ 799 | \$ 69 | \$ - | \$ 2,554 | \$ 3,422 |
| Net loss | - | - | - | (170) | (170) |
| Remeasurements on employee benefit liabilities | - | - | - | 54 | 54 |
| Total comprehensive loss | - | - | - | (116) | (116) |
| Share-based compensation | - | 1 | - | - | 1 |
| Shares issued | 2 | (1) | - | - | 1 |
| Shares purchased and cancelled under issuer bid | - | - | - | (1) | (1) |
| March 31, 2018 | \$ 801 | \$ 69 | \$ - | \$ 2,437 | \$ 3,307 |

(1) Amounts for prior periods as restated – Refer to note 2

The accompanying notes are an integral part of the condensed consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOW

| Unaudited (Canadian dollars in millions) | Three months ended March 31 | | |
|---|------------------------------------|---|-------|
| | 2018 | 2017 Restated - note 2 | |
| Cash flows from (used for) | | | |
| Operating | | | |
| Net loss for the period | \$ (170) | \$ (13) | |
| Adjustments to reconcile to net cash from operations | | | |
| Deferred income tax | (14) | - | |
| Depreciation, amortization and impairment | 275 | 235 | |
| Foreign exchange (gain) loss | 90 | (64) | |
| Gain on sale and leaseback of assets | Note 13 | (26) | |
| Gain on debt settlements and modifications | (11) | - | |
| Employee benefit funding less than expense | Note 5 | 66 | |
| Financial instruments recorded at fair value | Note 10 | 8 | |
| Change in maintenance provisions | 28 | 34 | |
| Changes in non-cash working capital balances | 827 | 786 | |
| Other | 18 | 1 | |
| Net cash flows from operating activities | 1,111 | 1,027 | |
| Financing | | | |
| Proceeds from borrowings | 689 | 371 | |
| Reduction of long-term debt and finance lease obligations | (226) | (152) | |
| Shares purchased for cancellation | Note 7 | (33) | |
| Issue of shares | 1 | 1 | |
| Financing fees | (4) | (3) | |
| Net cash flows from financing activities | 459 | 184 | |
| Investing | | | |
| Short-term investments | (121) | (162) | |
| Additions to property, equipment and intangible assets | (918) | (926) | |
| Proceeds from sale of assets | 1 | 1 | |
| Proceeds from sale and leaseback of assets | Note 13 | 369 | |
| Other | 15 | (6) | |
| Net cash flows used in investing activities | (1,023) | (724) | |
| Effect of exchange rate changes on cash and cash equivalents | 8 | (4) | |
| Increase in cash and cash equivalents | 555 | 483 | |
| Cash and cash equivalents, beginning of period | 642 | 787 | |
| Cash and cash equivalents, end of period | \$ 1,197 | \$ 1,270 | |
| Cash payments of interest | Note 4 | \$ 51 | \$ 53 |
| Cash payments of income taxes | | \$ 22 | \$ 1 |

The accompanying notes are an integral part of the condensed consolidated financial statements.



Notes to the interim condensed consolidated financial statements (unaudited)
(Canadian dollars in millions – except per share amounts)

1. GENERAL INFORMATION

The accompanying unaudited interim condensed consolidated financial statements (the “financial statements”) are of Air Canada (the “Corporation”). The term “Corporation” also refers to, as the context may require, Air Canada and/or one or more of its subsidiaries, including its principal wholly-owned operating subsidiaries, Touram Limited Partnership doing business under the brand name Air Canada Vacations® (“Air Canada Vacations”) and Air Canada rouge LP doing business under the brand name Air Canada Rouge® (“Air Canada Rouge”). These financial statements also include, for the relevant periods, certain aircraft leasing entities, which are consolidated under IFRS 10 Consolidated Financial Statements. During 2017, all related aircraft were purchased by the Corporation and the structured entities were collapsed.

Air Canada is incorporated and domiciled in Canada. The address of its registered office is 7373 Côte-Vertu Boulevard West, Saint-Laurent, Quebec.

The Corporation historically experiences greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the spring and summer months. The Corporation has substantial fixed costs in its cost structure that do not meaningfully fluctuate with passenger demand in the short term.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation prepares its financial statements 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"). These financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 "Interim Financial Reporting". In accordance with GAAP, these financial statements do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the Corporation's annual consolidated financial statements for the year ended December 31, 2017. In management's opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim period presented.

These financial statements were approved for issue by the Board of Directors of the Corporation on April 29, 2018.

These financial statements are based on the accounting policies consistent with those disclosed in Note 2 to the 2017 annual consolidated financial statements, except as described below under IFRS 15.

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 replaces IAS 18 Revenue and related interpretations. The core principle of the new standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard is intended to enhance disclosures about revenue, provide more comprehensive guidance for transactions that were not previously addressed and improve guidance for multiple-element arrangements.

The Corporation adopted the standard effective January 1, 2018 using the full retrospective method, which requires each prior reporting period presented to be restated. The main changes are explained below.

Accounting for costs to obtain a contract

Under IFRS 15, incremental costs of obtaining passenger revenues, such as credit card fees and global distribution system charges, are capitalized at time of sale and expensed at the time of passenger revenue recognition. Prior to adoption of IFRS 15, these costs were expensed as incurred at the time the flight ticket was sold. With this change in accounting policy for contract costs, the timing of expense recognition is impacted.

The impact on the consolidated statement of financial position as at January 1, 2017 is an increase to Prepaid expenses and other current assets of \$58 and an equivalent increase to opening Retained earnings (\$65 as at December 31, 2017). In addition, deferred commission costs in the amount of \$40 as at December 31, 2016, previously recorded net against the Advance ticket sales liability, were reclassified to Prepaid expenses and other current assets (\$35 as at December 31, 2017).

Accounting for change fees

Revenue arising from change fees which are collected by travel agents on Air Canada's behalf will be deferred and recognized in passenger revenue at the time of the related flight, rather than at time of collection. The impact on the consolidated statement of financial position as at January 1, 2017 is an increase to Advance ticket sales of \$6 and an equivalent decrease to opening Retained earnings (\$6 as at December 31, 2017).

Presentation

Certain passenger and cargo related fees and surcharges were reclassified from Other to Passenger revenue and to Cargo revenue on the consolidated statement of operations to better reflect the nature and aggregation of similar revenue items. This reclassification has no impact on total operating revenues.

Impact to previously reported results

Selected adjusted financial statement information, which reflect the adoption of IFRS 15, is presented below. Line items that were not affected by the change in accounting policy have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided. In summary, the following adjustments were made to the amounts recognized in the consolidated statement of financial position for the date of initial application on January 1, 2017 and at the end of the comparative period, December 31, 2017.

| (Canadian dollars in millions) | December 31, 2016 as previously reported | Reclassification | Remeasurements | January 1, 2017 as restated |
|---|---|-------------------------|-----------------------|--|
| Prepaid expenses and other current assets | \$ 349 | \$ 40 | \$ 58 | \$ 447 |
| Deferred income tax | - | - | - | - |
| Total assets | \$ 15,114 | \$ 40 | \$ 58 | \$ 15,212 |
| Advance ticket sales | 2,073 | 40 | 6 | 2,119 |
| Total current liabilities | \$ 4,424 | \$ 40 | \$ 6 | \$ 4,470 |
| Retained earnings | 336 | - | 52 | 388 |
| Total shareholders' equity | \$ 1,219 | \$ - | \$ 52 | \$ 1,271 |
| Total liabilities and shareholders' equity | \$ 15,114 | \$ 40 | \$ 58 | \$ 15,212 |

| (Canadian dollars in millions) | December 31, 2017 as previously reported | Reclassification | Remeasurements | December 31, 2017 as restated |
|---|---|-------------------------|-----------------------|--|
| Prepaid expenses and other current assets | \$ 325 | \$ 35 | \$ 65 | \$ 425 |
| Deferred income tax | 472 | - | (16) | 456 |
| Total assets | \$ 17,698 | \$ 35 | \$ 49 | \$ 17,782 |
| Advance ticket sales | 2,428 | 35 | 6 | 2,469 |
| Total current liabilities | \$ 5,060 | \$ 35 | \$ 6 | \$ 5,101 |
| Retained earnings | 2,511 | - | 43 | 2,554 |
| Total shareholders' equity | \$ 3,379 | \$ - | \$ 43 | \$ 3,422 |
| Total liabilities and shareholders' equity | \$ 17,698 | \$ 35 | \$ 49 | \$ 17,782 |

No deferred income tax was recorded on the restatement as of January 1, 2017 due to deferred income tax assets not being recognized at that time. Starting in the third quarter of 2017, the adjustments include their corresponding income tax effect resulting in a \$16 decrease of the tax recovery recorded in the consolidated statement of operations.

Adoption of the standard impacted the Corporation's previously reported consolidated statement of operations as follows.

| (Canadian dollars in millions) | Three months ended March 31, 2017 as previously reported | Reclassification | Remeasurements | Three months ended March 31, 2017 as restated |
|--|---|-------------------------|-----------------------|--|
| Operating revenues | | | | |
| Passenger | \$ 3,095 | \$ 25 | \$ - | \$ 3,120 |
| Cargo | 134 | 14 | - | 148 |
| Other | 413 | (39) | - | 374 |
| Total revenues | 3,642 | - | - | 3,642 |
| Operating expenses | | | | |
| Sales and distribution costs | 205 | - | (24) | 181 |
| Total operating expenses | 3,696 | - | (24) | 3,672 |
| Operating income (loss) | (54) | - | 24 | (30) |
| Recovery of (provision for) income taxes | - | - | - | - |
| Net income (loss) for the period | \$ (37) | \$ - | \$ 24 | \$ (13) |
| Basic earnings (loss) per share | \$ (0.14) | \$ - | \$ 0.09 | \$ (0.05) |
| Diluted earnings (loss) per share | \$ (0.14) | \$ - | \$ 0.09 | \$ (0.05) |

| (Canadian dollars in millions) | Twelve months ended December 31, 2017 as previously reported | Reclassification | Remeasurements | Twelve months ended December 31, 2017 as restated |
|--|---|-------------------------|-----------------------|--|
| Operating revenues | | | | |
| Passenger | \$ 14,471 | \$ 122 | \$ - | \$ 14,593 |
| Cargo | 650 | 58 | - | 708 |
| Other | 1,131 | (180) | - | 951 |
| Total revenues | 16,252 | - | - | 16,252 |
| Operating expenses | | | | |
| Sales and distribution costs | 777 | - | (7) | 770 |
| Total operating expenses | 14,888 | - | (7) | 14,881 |
| Operating income | 1,364 | - | 7 | 1,371 |
| Recovery of (provision for) income taxes | 759 | - | (16) | 743 |
| Net income | \$ 2,038 | \$ - | \$ (9) | \$ 2,029 |
| Basic earnings per share | \$ 7.48 | \$ - | \$ (0.04) | \$ 7.44 |
| Diluted earnings per share | \$ 7.34 | \$ - | \$ (0.03) | \$ 7.31 |

Adoption of IFRS 15 does not have any net impact on the consolidated statement of cash flows.

3. REVENUE

Passenger and cargo revenues are recognized when the transportation is provided, except for revenue on unlimited flight passes which is recognized on a straight-line basis over the period during which the travel pass is valid. The Corporation has formed alliances with other airlines encompassing loyalty program participation, interline agreements and code sharing and coordination of services including reservations, baggage handling and flight schedules. Revenues are allocated based upon formulas specified in the agreements and are recognized as transportation is provided. Passenger revenue also includes certain fees and surcharges and revenues from passenger-related services such as seat selection and excess baggage which are recognized when the transportation is provided.

Air Canada has capacity purchase agreements with Jazz, Sky Regional and certain other regional carriers. Under these agreements, Air Canada markets, tickets and enters into other commercial arrangements relating to these flights and records the revenue it earns under Passenger revenue when transportation is provided.

Air Canada purchases Aeroplan Miles[®] from Aimia Canada Inc. ("Aeroplan"), an unrelated party that provides loyalty program services to Air Canada and purchases seats from Air Canada pursuant to the Commercial Participation and Services Agreement between Aeroplan and Air Canada. Air Canada is an Aeroplan partner providing certain of Air Canada's customers with Aeroplan Miles[®], which Aeroplan customers can redeem for air travel or other rewards offered by Aeroplan pursuant to its program. The cost of purchasing Aeroplan Miles[®] from Aeroplan is accounted for as a sales incentive and charged against passenger revenues when the points are issued, which occurs upon the qualifying air travel being provided to the customer. Aeroplan purchases passenger tickets from Air Canada, which are accounted for as passenger revenues by Air Canada when transportation is provided.

Other revenue is primarily comprised of revenues from the sale of the ground portion of vacation packages, ground handling services, on-board sales, lounge pass sales and loyalty program marketing fees. Vacation package revenue is recognized as services are provided over the period of the vacation. Other airline related service revenues are recognized as the products are sold to passengers or the services are provided.

Disaggregation of revenue

The Corporation disaggregates revenue from contracts with customers according to the nature of the air transportation services. The nature of services is presented as passenger, cargo and other revenue on its consolidated statement of operations. The Corporation further disaggregates air transportation service revenue according to geographic market segments, as presented in Note 12 Geographic information.

Contract balances

The following table provides information about receivables, contract assets, and contract liabilities from contracts with customers.

| | March 31, 2018 | December 31, 2017 Restated – note 2 | January 1, 2017 Restated – note 2 |
|--|---------------------------|--|--|
| Receivables, which are included in Accounts receivable | \$ 692 | \$ 587 | \$ 540 |
| Contract costs which are included in Prepaid expenses and other current assets | 125 | 100 | 98 |
| Contract liabilities – Advance ticket sales | 3,041 | 2,469 | 2,119 |

Receivables include passenger, cargo and other receivables from contracts with customers. The Corporation sells passenger ticket and related ancillary services via cash, credit card or other card based forms of payment with payment generally collected in advance of the performance of related transportation services. Passenger ticket and ancillary receivables are amounts due from other airlines for interline travel, travel agency payment processing intermediaries or credit card processors associated with sales for future travel, and are included in Accounts receivable on the consolidated statement of



financial position. Cargo and other accounts receivable relate to amounts owing from customers, including from freight forwarders and interline partners for cargo and other services provided.

Contract costs include credit card fees, commissions and global distribution system charges on passenger tickets. These costs are capitalized at time of sale and expensed at the time of passenger revenue recognition.

Airline passenger advance sales and the ground portion of vacation packages are deferred and included in Current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aeroplan. The deferred revenue is recognized when the related flight occurs or over the period of the vacation. The Corporation performs regular evaluations on the advance ticket sales liability. The Corporation records an estimate of breakage revenue for tickets that will expire unused. These estimates are based on historical experience.

Depending on the fare class, passengers may exchange their tickets up to the time of the flight or obtain a refund, generally in exchange for the payment of a fee. For non-refundable tickets, the Corporation recognizes the full amount into revenue at time when transportation is provided. For refundable tickets that remain unused at the time of the flight, the Corporation recognizes the net revenue after any refund amount is issued to the passenger.

The practical expedient in IFRS 15 allows entities not to disclose the amount of the remaining transaction prices and its expected timing of recognition for performance obligations if the contract has an original expected duration of one year or less. The Corporation elects to use this practical expedient for the passenger travel performance obligation as passenger tickets expire within a year if unused.

4. LONG-TERM DEBT AND FINANCE LEASES

| | Final Maturity | Weighted Average Interest Rate (%) | March 31, 2018 | December 31, 2017 |
|--|-----------------------|---|-----------------------|--------------------------|
| Aircraft financing | | | | |
| Fixed rate U.S. dollar financing | 2018 – 2030 | 4.06 | \$ 3,545 | \$ 2,828 |
| Floating rate U.S. dollar financing | 2018 – 2027 | 3.81 | 857 | 871 |
| Floating rate CDN dollar financing | 2026 – 2027 | 2.33 | 324 | 332 |
| Fixed rate Japanese yen financing | 2027 | 1.85 | 142 | 131 |
| Floating rate Japanese yen financing | 2020 – 2027 | 0.75 | 60 | 61 |
| Senior secured notes – CDN dollar | 2023 | 4.75 | 200 | 200 |
| Senior unsecured notes – U.S. dollar | 2021 | 7.75 | 516 | 503 |
| Other secured financing – U.S. dollar | 2023 | 3.98 | 992 | 1,073 |
| Long-term debt | | 4.16 | 6,636 | 5,999 |
| Finance lease obligations | 2020 – 2033 | 9.38 | 210 | 223 |
| Total debt and finance leases | | 4.32 | 6,846 | 6,222 |
| Unamortized debt issuance costs | | | (109) | (103) |
| Current portion | | | (620) | (671) |
| Long-term debt and finance leases | | | \$ 6,117 | \$ 5,448 |

The above table provides terms of instruments disclosed in Note 7 to the 2017 annual consolidated financial statements of the Corporation as well as terms of instruments concluded during the three months ended March 31, 2018 and described below.

In connection with the acquisition of three Boeing 787-9 and seven Boeing 737 MAX-8 aircraft in the first quarter of 2018, a principal amount of US\$548 is included in fixed rate U.S. dollar financing in the table above. The acquisition of these aircraft was financed with proceeds from the sale of the enhanced equipment trust certificates that were issued through a private offering in 2017 as described in Note 7 to the 2017 annual consolidated financial statements of the Corporation. An eighth Boeing 737 MAX-8 was delivered on March 31, 2018 with the associated financing completed in April 2018.

In the first quarter of 2018, in connection with the financing of the acquisition of one new Boeing 787-9 aircraft and four new Boeing 737 MAX-8 aircraft, which are scheduled for delivery in the second quarter of 2018, Air Canada entered into a certificate purchase agreement for a private offering of two tranches of enhanced equipment trust certificates with a combined aggregate face amount of \$301 and a weighted average interest rate of 3.76% per annum, and a final expected maturity date of 2030. Proceeds from the offering are scheduled to be disbursed in April and May 2018 at or following delivery of the aircraft.

In February 2018, Air Canada completed the repricing of its US\$1.1 billion senior secured facility, reducing the interest rate by 25 basis points, to an interest rate of 200 basis points over LIBOR (subject to a LIBOR floor of 75 basis points). The Corporation recorded an \$11 Gain on debt settlements and modifications related to this transaction.

During the first quarter of 2018, principal of US\$9 was prepaid relating to the financing of one Embraer 190 aircraft. The loss recorded in Gain on debt settlements and modifications in respect of the prepayment of such fixed rate debt was less than \$1.

Maturity Analysis

Principal and interest repayment requirements as at March 31, 2018 on Long-term debt and finance lease obligations are as follows. U.S. dollar amounts are converted using the March 31, 2018 closing rate of CDN\$1.29.

| Principal | Remainder of 2018 | 2019 | 2020 | 2021 | 2022 | Thereafter | Total |
|----------------------------|--------------------------|---------------|---------------|---------------|---------------|-------------------|-----------------|
| Long-term debt obligations | \$ 458 | \$ 510 | \$ 577 | \$ 915 | \$ 289 | \$ 3,887 | \$ 6,636 |
| Finance lease obligations | 31 | 45 | 48 | 16 | 14 | 56 | 210 |
| | \$ 489 | \$ 555 | \$ 625 | \$ 931 | \$ 303 | \$ 3,943 | \$ 6,846 |

| Interest | Remainder of 2018 | 2019 | 2020 | 2021 | 2022 | Thereafter | Total |
|----------------------------|--------------------------|---------------|---------------|---------------|---------------|-------------------|-----------------|
| Long-term debt obligations | \$ 197 | \$ 252 | \$ 226 | \$ 180 | \$ 155 | \$ 384 | \$ 1,394 |
| Finance lease obligations | 13 | 14 | 10 | 6 | 5 | 14 | 62 |
| | \$ 210 | \$ 266 | \$ 236 | \$ 186 | \$ 160 | \$ 398 | \$ 1,456 |

5. PENSIONS AND OTHER BENEFIT LIABILITIES

Pension and Other Employee Future Benefit Expense

The Corporation has recorded net defined benefit pension and other employee future benefits expense as follows:

| | Three months ended March 31 | |
|---|-----------------------------|-----------------|
| | 2018 | 2017 |
| Consolidated Statement of Operations | | |
| Operating expenses | | |
| Wages, salaries and benefits | | |
| Pension benefits | \$ 79 | \$ 71 |
| Other employee benefits | 3 | 5 |
| | \$ 82 | \$ 76 |
| Non-operating income (expense) | | |
| Net financing expense relating to employee benefit liabilities | | |
| Pension benefits | \$ - | \$ (3) |
| Other employee benefits | (12) | (13) |
| | \$ (12) | \$ (16) |
| Consolidated Other Comprehensive Income (Loss) | | |
| Remeasurements on employee benefit liabilities | | |
| Pension benefits | \$ 62 | \$ (165) |
| Other employee benefits | 11 | (38) |
| | \$ 73 | \$ (203) |

The funding of employee benefits as compared to the expense recorded in the consolidated statement of operations is summarized in the table below.

| | Three months ended March 31 | |
|--|-----------------------------|--------------|
| | 2018 | 2017 |
| Net defined pension and other future employee benefits expense recorded in the consolidated statement of operations | | |
| Wages, salaries and benefits | \$ 82 | \$ 76 |
| Net financing expense relating to employee benefit liabilities | 12 | 16 |
| | \$ 94 | \$ 92 |
| Employee benefit funding by Air Canada | | |
| Pension benefits | \$ 16 | \$ 16 |
| Other employee benefits | 9 | 10 |
| | \$ 25 | \$ 26 |
| Employee benefit funding less than expense | \$ 69 | \$ 66 |

6. INCOME TAXES

Income Tax Expense

Income tax recorded in the consolidated statement of operations is presented below.

| | Three months ended March 31 | |
|----------------------------|-----------------------------|-------------|
| | 2018 | 2017 |
| Current income tax | \$ - | \$ - |
| Deferred income tax | (14) | - |
| Income tax recovery | \$ (14) | \$ - |

The Corporation's effective tax rate for the three months ended March 31, 2017 was nil due to deferred income tax assets not being recognized at that time. During the third quarter of 2017, the Corporation determined that it was probable that substantially all of the deferred income tax assets would be realized. Income tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full year.

The Corporation's effective tax rate for the three months ended March 31, 2018 was 7.6%. The income tax recovery differs from the amounts computed by applying the statutory tax rate, principally due to the impact of unrecognized tax benefits on foreign exchange capital losses and the effect of non-deductible expenses.

Income tax recorded in the consolidated statement of comprehensive income is presented below.

| | Three months ended March 31 | |
|--|-----------------------------|-------------|
| | 2018 | 2017 |
| Remeasurements on employee benefit liabilities - deferred income tax | \$ 19 | \$ - |
| Income tax expense | \$ 19 | \$ - |

7. SHARE CAPITAL

Issuer Bid

In May 2017, Air Canada received approval from the Toronto Stock Exchange 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 Air Canada's 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 first quarter of 2018, the Corporation purchased, for cancellation, a total of 54,653 shares at an average cost of \$22.49 per share for aggregate consideration of \$1. The excess of the cost over the average book value of \$1 was charged to Retained earnings. At March 31, 2018, a total of 20,663,912 shares remained available for repurchase under the existing issuer bid.

In the first quarter of 2017, the Corporation purchased, for cancellation, 2,397,200 shares at an average cost of \$13.62 per share for aggregate consideration of \$33. The excess of the cost over the average book value of \$26 was charged to Retained earnings.

8. EARNINGS PER SHARE

The following table outlines the calculation of basic and diluted earnings per share.

| (in millions, except per share amounts) | Three months ended March 31 | |
|--|-----------------------------|------------------------------|
| | 2018 | 2017 Restated - note 2 |
| Numerator: | | |
| Numerator for basic and diluted earnings per share: | | |
| Net loss | \$ (170) | \$ (13) |
| Denominator: | | |
| Weighted-average shares | 273 | 273 |
| Effect of potential dilutive securities: | | |
| Stock options | 4 | 6 |
| Total potential dilutive securities | 4 | 6 |
| Remove anti-dilutive impact | (4) | (6) |
| Adjusted denominator for diluted earnings per share | 273 | 273 |
| Basic and diluted loss per share | \$ (0.62) | \$ (0.05) |

The calculation of earnings per share is based on whole numbers and not on rounded millions. As a result, the above amounts may not be recalculated to the per share amount disclosed above.

Excluded from the calculation of diluted earnings per share were outstanding options where the options' exercise prices were greater than the average market price of the shares for the period.

9. COMMITMENTS

Capital Commitments

Capital commitments consist of the future firm aircraft deliveries and commitments related to acquisition of other property and equipment. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at March 31, 2018. U.S. dollar amounts are converted using the March 31, 2018 closing rate of CDN\$1.29. Minimum future commitments under these contractual arrangements are shown below.

| | Remainder of 2018 | 2019 | 2020 | 2021 | 2022 | Thereafter | Total |
|---------------------|----------------------|----------|----------|--------|--------|------------|-----------------|
| Capital commitments | \$ 969 | \$ 1,491 | \$ 1,346 | \$ 670 | \$ 666 | \$ 584 | \$ 5,726 |

**10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

Refer also to Note 15 to the 2017 annual consolidated financial statements for information on the Corporation's risk management strategy.

Summary of gain on financial instruments recorded at fair value

| | Three months ended March 31 | |
|---|-----------------------------|-------------|
| | 2018 | 2017 |
| Share forward contracts | 1 | - |
| Gain on financial instruments recorded at fair value | \$ 1 | \$ - |

Fuel Price Risk Management

There was no fuel hedging activity during the first quarter of 2018. During the first quarter of 2017:

- Hedging gains on the settlement of fuel derivatives of \$4 and the associated premium costs of \$9, for a net hedging loss of \$5 were reclassified from other comprehensive income to Aircraft fuel expense. No hedging ineffectiveness was recorded.
- The Corporation purchased crude-oil call options covering a portion of its 2017 fuel exposure. The cash premium related to these contracts was \$1.
- Fuel derivative contracts cash settled with a fair value of \$4 in favour of the Corporation.

There were no outstanding fuel derivatives as at March 31, 2018 or at December 31, 2017.

Foreign Exchange Risk Management

Based on the notional amount of currency derivatives outstanding at March 31, 2018, as further described below, approximately 79% of net U.S. cash outflows are hedged for the remainder of 2018 and 50% for 2019, resulting in derivative coverage of 66% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 73% coverage over the next 18 months.

As at March 31, 2018, the Corporation had outstanding foreign currency options and swap agreements, settling in 2018 and 2019, to purchase at maturity \$4,494 (US\$3,485) of U.S. dollars at a weighted average rate of \$1.2527 per US\$1.00 (as at December 31, 2017 – \$3,400 (US\$2,704) with settlements in 2018 and 2019 at a weighted average rate of \$1.2703 per \$1.00 U.S. dollar). The Corporation also has protection in place to sell a portion of its excess Euros, Sterling, YEN, and AUD (EUR €97, GBP £119, JPY ¥16,463, and AUD \$64) which settle in 2018 and 2019 at weighted average rates of €1.2032, £1.3497, ¥0.0091, and \$0.7969 per \$1.00 U.S. dollar respectively (as at December 31, 2017 - EUR €101, GBP £105, JPY ¥8,623, CNY ¥41, and AUD \$32 with settlement in 2018 at weighted average rates of €1.1664, £1.3259, ¥0.0090, ¥0.1468 and \$0.7576 respectively per \$1.00 U.S. dollar).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations, and based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at March 31, 2018 was \$126 in favour of the counterparties (as at December 31, 2017 – \$215 in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During the first quarter of 2018, a gain of \$63 was recorded in Foreign exchange gain (loss) related to these derivatives (\$22 gain in the first quarter of 2017). In the first quarter of 2018, foreign exchange derivative contracts cash settled with a net fair value of \$26 in favour of the counterparties (\$16 in the first quarter of 2017 in favour of the Corporation).

The Corporation also holds U.S. cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash and short-term investment balances as at March 31, 2018 amounted to \$897 (US\$699) (\$686 (US\$542) as at December 31, 2017). During the three months ended March 31, 2018, a gain of \$16 (three months ended March 31, 2017 – loss of \$4) was recorded in Foreign exchange gain (loss) reflecting the change in Canadian equivalent market value of the U.S. dollar cash and short-term investment balances held.

Financial Instrument Fair Values in the Consolidated Statement of Financial Position

The carrying amounts reported in the consolidated statement of financial position for short term financial assets and liabilities, which includes Accounts receivable and Accounts payable and accrued liabilities, approximate fair values due to the immediate or short-term maturities of these financial instruments.

The carrying amounts of derivatives are equal to their fair value, which is based on the amount at which they could be settled based on estimated market rates at March 31, 2018.

Management estimated the fair value of its long-term debt based on valuation techniques including discounted cash flows, taking into account market information and traded values where available, market rates of interest, the condition of any related collateral, the current conditions in credit markets and the current estimated credit margins applicable to the Corporation based on recent transactions. Based on significant unobservable inputs (Level 3 in the fair value hierarchy), the estimated fair value of long term debt approximates its carrying value.

The following is a classification of fair value measurements recognized in the consolidated statement of financial position using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. There are no changes in classifications or methods of measuring fair value from those disclosed in Note 15 to the 2017 annual consolidated financial statements. There were no transfers within the fair value hierarchy during the three months ended March 31, 2018.

| | March 31, 2018 | Fair value measurements at reporting date using: | | |
|------------------------------|-------------------|--|---|---|
| | | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Financial Assets | | | | |
| Held-for-trading securities | | | | |
| Cash equivalents | \$ 86 | \$ - | \$ 86 | \$ - |
| Short-term investments | 3,299 | - | 3,299 | - |
| Derivative instruments | | | | |
| Share forward contracts | 44 | - | 44 | - |
| Total | \$ 3,429 | \$ - | \$ 3,429 | \$ - |
| Financial Liabilities | | | | |
| Derivative instruments | | | | |
| Foreign exchange derivatives | 126 | - | 126 | - |
| Total | \$ 126 | \$ - | \$ 126 | \$ - |

Financial assets held by financial institutions in the form of cash and restricted cash have been excluded from the fair value measurement classification table above as they are not valued using a valuation technique.

11. CONTINGENCIES AND LITIGATION PROVISIONS

Investigations by Competition Authorities Relating to Cargo

As described in Note 16 to the 2017 annual consolidated financial statements, in 2010, the European Commission rendered a decision finding that 12 air cargo carriers (including groups of related carriers) had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006. Air Canada was among the carriers subject to the decision and a fine of 21 Euros (approximately \$29 at that time) was imposed on Air Canada in 2010. Air Canada appealed the decision and the European General Court granted Air Canada's appeal in 2015 and annulled the decision of the European Union with regard to Air Canada and certain other airlines, following which the European Commission refunded Air Canada the fine of 21 Euros (\$30).

In March 2017, the Commission issued a new decision, based on the same allegations and imposed the same fine (21 Euros; approximately \$30) on Air Canada as it had in 2010. 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 an appeal it made in 2017 to the European General Court. 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.

12. GEOGRAPHIC INFORMATION

A reconciliation of the total amounts reported by geographic region for Passenger revenues and Cargo revenues on the consolidated statement of operations is as follows:

| Passenger Revenues | 2018 | 2017 Restated - note 2 |
|---------------------------|-----------------|---------------------------------------|
| Canada | \$ 1,041 | \$ 983 |
| U.S. Transborder | 847 | 793 |
| Atlantic | 686 | 554 |
| Pacific | 511 | 447 |
| Other | 404 | 343 |
| | \$ 3,489 | \$ 3,120 |

| Cargo Revenues | 2018 | 2017 Restated - note 2 |
|-----------------------|---------------|---------------------------------------|
| Canada | \$ 19 | \$ 18 |
| U.S. Transborder | 9 | 8 |
| Atlantic | 62 | 54 |
| Pacific | 64 | 54 |
| Other | 14 | 14 |
| | \$ 168 | \$ 148 |

Passenger and cargo revenues are based on the actual flown revenue for flights with an origin and destination in a specific country or region. Atlantic refers to flights that cross the Atlantic Ocean with origins and destinations principally in Europe, India, the Middle East and North Africa. Pacific refers to flights that cross the Pacific Ocean with origins and destinations principally in Asia and Australia. Other passenger and cargo revenues refer to flights with origins and destinations principally in Central and South America and the Caribbean and Mexico.



13. SALE-LEASEBACK

In the three months ended March 31, 2017, the Corporation took delivery of two 787 aircraft that were financed under sale-leaseback transactions with proceeds of \$369. The sales were at fair value and accordingly the resulting gain on sale of \$26 was recognized in non-operating income. The leases are accounted for as operating leases with 12 year terms, paid monthly.