First Quarter 2018

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

April 30, 2018

AIR CANADA

A STAR ALLIANCE MEMBER

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1. HIGHLIGHTS

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

(Canadian dollars in millions, except where indicated)	First Quarter		
	2018	2017 [(1)]	$ Change
Financial Performance Metrics			
Operating revenues	4,071	3,642	429
Operating loss	(14)	(30)	16
Loss before income taxes	(184)	(13)	(171)
Net loss	(170)	(13)	(157)
Adjusted pre-tax loss [(2)]	(72)	(63)	(9)
Adjusted net loss [(2)]	(52)	(63)	11
Operating margin %	(0.3%)	(0.8%)	0.5 pp
EBITDAR (excluding special items) [(2)]	397	366	31
EBITDAR margin (excluding special items) % [(2)]	9.8%	10.0%	(0.2 pp)
Unrestricted liquidity [(3)]	4,883	4,073	810
Net cash flows from operating activities	1,111	1,027	84
Free cash flow [(2)]	193	470	(277)
Adjusted net debt [(2)]	6,063	6,702	(639)
Return on invested capital ("ROIC") % [(2)]	15.0	16.7	(1.7 pp)
Leverage ratio [(2)]	2.0	2.5	(0.5)
Diluted loss per share	$ (0.62)	$ (0.05)	$ (0.57)
Adjusted loss per share – diluted [(2)]	$ (0.19)	$ (0.23)	$ 0.04
Operating Statistics [(4)]			**% Change**
Revenue passenger miles ("RPM") (millions)	20,440	18,341	11.4
Available seat miles ("ASM") (millions)	24,862	22,894	8.6
Passenger load factor %	82.2%	80.1%	2.1 pp
Passenger revenue per RPM ("Yield") (cents)	17.1	17.0	0.4
Passenger revenue per ASM ("PRASM") (cents)	14.0	13.6	3.0
Operating revenue per ASM (cents)	16.4	15.9	2.9
Operating expense per ASM ("CASM") (cents)	16.4	16.0	2.4
Adjusted CASM (cents) [(2)]	11.5	11.5	0.4
Average number of full-time equivalent ("FTE") employees (thousands) [(5)]	28.9	26.9	7.4
Aircraft in operating fleet at period-end	406	384	5.7
Average fleet utilization (hours per day)	10.0	9.9	1.2
Seats dispatched (thousands)	14,932	14,280	4.6
Aircraft frequencies (thousands)	136.5	134.3	1.6
Average stage length (miles) [(6)]	1,665	1,603	3.9
Fuel cost per litre (cents)	73.3	63.2	16.0
Fuel litres (thousands)	1,281,838	1,193,732	7.4
Revenue passengers carried (thousands) [(7)]	11,654	10,924	6.7

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts. ROIC and leverage ratio as at March 31, 2017 have not been restated for the adoption of this new accounting standard. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

(2) Adjusted pre-tax loss, adjusted net loss, adjusted loss 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 the special items.

(3) Unrestricted liquidity refers to the sum of cash, cash equivalents, short-term investments and the amount of available credit under Air Canada's revolving credit facilities. At March 31, 2018, unrestricted liquidity was comprised of cash and short-term investments of $4,496 million and undrawn lines of credit of $387 million. At March 31, 2017, unrestricted liquidity was comprised of cash and short-term investments of $3,624 million and undrawn lines of credit of $449 million.

(4) 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.

(5) 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.

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

(7) Revenue passengers are counted on a flight number basis (rather than by journey/itinerary or by leg) which is consistent with the IATA definition of revenue passengers carried.

2. INTRODUCTION AND KEY ASSUMPTIONS

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), the "Corporation" refers, as the context may require, to Air Canada and/or one or more of Air Canada's subsidiaries, including its wholly-owned operating subsidiaries, Touram Limited Partnership, doing business as Air Canada Vacations® ("Air Canada Vacations") and Air Canada rouge LP, doing business as Air Canada Rouge® ("Air Canada Rouge"). This MD&A provides the reader with a review and analysis, from the perspective of management, of Air Canada's financial results for the first quarter of 2018. This MD&A should be read in conjunction with Air Canada's interim unaudited condensed consolidated financial statements and notes for the first quarter of 2018, Air Canada's 2017 annual audited consolidated financial statements and notes and Air Canada's 2017 MD&A dated February 16, 2018 ("Air Canada's 2017 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.

Air Canada's interim unaudited condensed consolidated financial statements for the first quarter of 2018 are based on the accounting policies consistent with those disclosed in Note 2 of Air Canada's 2017 annual consolidated financial statements, except for the adoption of accounting standard *IFRS 15 – Revenue from Contracts with Customers*. Air Canada adopted this accounting standard effective January 1, 2018 with restatement of 2017 amounts. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

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 April 29, 2018.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 18 "Risk Factors" of Air Canada's 2017 MD&A and section 12 of this MD&A. Air Canada issued a news release dated April 30, 2018 reporting on its results for the first quarter of 2018. This news release is available on Air Canada's website at **www.aircanada.com** and on SEDAR's website at **www.sedar.com**. For further information on Air Canada's public disclosures, including Air Canada's Annual Information Form, consult SEDAR at **www.sedar.com**.

CAUTION REGARDING FORWARD-LOOKING INFORMATION

Air Canada's public communications may include forward-looking statements within the meaning of applicable securities laws. Such forward-looking statements are included in this MD&A and may be included in other communications, including filings with regulatory authorities and securities regulators. Forward-looking statements may be based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to strategies, expectations, planned operations or future actions. Forward-looking statements are identified using 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, industry, market, credit, economic and geopolitical conditions, energy prices, currency exchange, competition, our dependence on technology, cybersecurity risks, our ability to pay our indebtedness and secure financing, our ability to successfully implement appropriate strategic initiatives or reduce operating costs, war, terrorist acts, epidemic diseases, airport user and related fees, high levels of fixed costs, liquidity, our dependence on key suppliers including regional carriers and Aimia Canada Inc., our success in transitioning from the Aeroplan program and launching our new loyalty program, 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 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 in Air Canada's public disclosure file available at www.sedar.com and, in particular, those identified in section 18 "Risk Factors" of Air Canada's 2017 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 because 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 the second quarter and full year 2018. Air Canada also expects that the Canadian dollar will trade, on average, at C$1.27 per U.S. dollar in the second quarter and at C$1.26 per U.S. dollar for the full year 2018 and that the price of jet fuel will average 77 CAD cents per litre in the second quarter and 75 CAD cents per litre for the full year 2018.

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.

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

3. OVERVIEW

Air Canada's principal objective is to become one of the world's top global airlines. In pursuing this goal, it focuses on continuous improvement in customer experience and employee engagement and creating value for shareholders by targeting four core priorities:

- Identifying and implementing cost reduction and revenue enhancing initiatives;
- Pursuing profitable international growth opportunities and leveraging competitive attributes to expand margins, in large part by increasing connecting traffic through its strategic international gateways in Toronto, Vancouver and Montreal, and growing and competing effectively in both the business and leisure market to and from Canada;
- Engaging customers by continuously enhancing their travel experience and providing a consistently high level of customer service, with additional emphasis on premium and business passengers and products; and
- Fostering positive culture change through employee engagement programs. This includes meaningful investments in training and other tools that support delivering exceptional customer experience and that also promote improved collaboration and an appreciation of how the airline and its talented employees can better work together in a supportive and enriching environment.

Additional information on Air Canada's strategy can be found in section 4 "Strategy" of Air Canada's 2017 MD&A.

Financial Summary

The following is an overview of Air Canada's results of operations and financial position for the first quarter of 2018 compared to the first quarter of 2017.

- Record operating revenues of $4,071 million in the first quarter of 2018, an increase of $429 million or 12% from the first quarter of 2017. On capacity growth of 8.6%, record passenger revenues of $3,489 million increased $369 million or 11.8% from the first quarter of 2017.
- Operating expenses of $4,085 million in the first quarter of 2018, an increase of $413 million or 11% from the first quarter of 2017. CASM increased 2.4% from the first quarter of 2017. Adjusted CASM increased 0.4% from the first quarter of 2017, better than the 2.0% to 3.0% increase projected in Air Canada's news release dated February 16, 2018. This improvement was mainly due to lease extensions that were negotiated earlier than anticipated, which resulted in a decrease to maintenance provisions in the first quarter of 2018, timing of certain maintenance events previously scheduled for the first quarter of 2018, and to the impact of initiatives related to Air Canada's cost transformation program. Adjusted CASM is a non-GAAP financial measure. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.
- An operating loss of $14 million in the first quarter of 2018 compared to an operating loss of $30 million in the first quarter of 2017.
- EBITDAR of $397 million in the first quarter of 2018 compared to EBITDAR of $366 million in the first quarter of 2017. The airline reported a first quarter 2018 EBITDAR margin of 9.8% compared to an EBITDAR margin of 10.0% in the first quarter of 2017. Special items are excluded from all of Air Canada's reported EBITDAR calculations. Refer to section 4 of this MD&A for information on special items. EBITDAR is a non-GAAP financial measure. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.
- A net loss of $170 million or $0.62 per diluted share in the first quarter of 2018 versus a net loss of $13 million or $0.05 per diluted share in the first quarter of 2017. In the first quarter of 2018, the loss before income taxes included losses on foreign exchange of $112 million compared to gains on foreign exchange of $70 million in the first quarter of 2017.

- An after-tax adjusted net loss of $52 million or $0.19 per diluted share in the first quarter of 2018 versus an adjusted net loss of $63 million or $0.23 per diluted share in the first quarter of 2017. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

- At March 31, 2018, adjusted net debt of $6,063 million, a decrease of $53 million from December 31, 2017, as an increase in cash and short-term investment balances of $692 million more than offset an increase in long-term debt and finance lease balances of $618 million. Adjusted net debt is an additional GAAP measure. Refer to section 6.2 "Adjusted Net Debt" of this MD&A for additional information.

- Air Canada's leverage ratio (adjusted net debt to trailing 12-month EBITDAR) was 2.0 at March 31, 2018 versus a ratio of 2.1 at December 31, 2017. Leverage ratio is a non-GAAP financial measure. Refer to section 6.2 "Adjusted Net Debt" of this MD&A for additional information.

- Record net cash flows from operating activities of $1,111 million in the first quarter of 2018, an improvement of $84 million from the first quarter of 2017. Free cash flow of $193 million decreased $277 million from the first quarter of 2017 mainly due to Air Canada having received proceeds of $369 million from the sale and leaseback of aircraft in the first quarter of 2017.

- Return on invested capital ("ROIC") for the 12 months ended March 31, 2018 of 15.0% compared to ROIC of 15.3% for the 12 months ended December 31, 2017. 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 first quarter of 2018 and the first quarter of 2017:

	First Quarter		Change	
(Canadian dollars in millions, except per share figures)	2018	2017 (1)	$	%
Operating revenues				
Passenger	$ 3,489	$ 3,120	$ 369	12
Cargo	168	148	20	14
Other	414	374	40	11
Total revenues	**4,071**	**3,642**	**429**	**12**
Operating expenses				
Aircraft fuel	825	659	166	25
Regional airlines expense				
Aircraft fuel	114	95	19	20
Other	561	537	24	4
Wages, salaries and benefits	700	644	56	9
Airport and navigation fees	221	210	11	5
Aircraft maintenance	256	228	28	12
Depreciation, amortization and impairment	267	228	39	17
Sales and distribution costs	189	181	8	4
Ground package costs	276	256	20	8
Aircraft rent	125	122	3	2
Food, beverages and supplies	96	85	11	13
Communications and information technology	79	71	8	11
Special items	-	30	(30)	(100)
Other	376	326	50	15
Total operating expenses	**4,085**	**3,672**	**413**	**11**
Operating loss	**(14)**	**(30)**	**16**	
Non-operating income (expense)				
Foreign exchange gain (loss)	(112)	70	(182)	
Interest income	20	12	8	
Interest expense	(83)	(79)	(4)	
Interest capitalized	13	9	4	
Net financing expense relating to employee benefits	(12)	(16)	4	
Gain on financial instruments recorded at fair value	1	-	1	
Gain on sale and leaseback of assets	-	26	(26)	
Gain on debt settlements and modifications	11	-	11	
Other	(8)	(5)	(3)	
Total non-operating income (expense)	**(170)**	**17**	**(187)**	
Loss before income taxes	**(184)**	**(13)**	**(171)**	
Recovery of income taxes	14	-	14	
Net loss	**$ (170)**	**$ (13)**	**$ (157)**	
Diluted loss per share	**$ (0.62)**	**$ (0.05)**	**$ (0.57)**	
EBITDAR (2)	**$ 397**	**$ 366**	**$ 31**	
Adjusted pre-tax loss (2)	**$ (72)**	**$ (63)**	**$ (9)**	
Adjusted net loss (2)	**$ (52)**	**$ (63)**	**$ 11**	
Adjusted loss per share – diluted (2)	**$ (0.19)**	**$ (0.23)**	**$ 0.04**	

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts and reflected in the table above. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

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

System Passenger Revenues

With the adoption of *IFRS 15 – Revenue from Contracts with Customers* effective January 1, 2018, certain passenger and cargo related fees and surcharges were reclassified from Other revenue to Passenger revenue and Cargo revenue on Air Canada's consolidated statement of operations, with restatement of 2017 amounts. This reclassification has no impact on total operating revenues. Concurrent with this change in presentation, Air Canada has revised the methodology used to calculate yield and PRASM. These measures are now based on total passenger revenues, with restatement of 2017 amounts on the same basis.

In the first quarter of 2018, system passenger revenues of $3,489 million increased $369 million or 11.8% from the first quarter of 2017 on traffic growth of 11.4% and a yield improvement of 0.4%. On a stage-length adjusted basis, yield increased 2.6% when compared to the same quarter in 2017. Business cabin system revenues increased $88 million or 13.8% from the first quarter of 2017 on traffic and yield growth of 9.1% and 4.3% respectively.

The table below provides passenger revenue by geographic region for the first quarter of 2018 and the first quarter of 2017.

Passenger Revenue **(Canadian dollars in millions)**	**First Quarter 2018**	**First Quarter 2017 (1)**	**$ Change**	**% Change**
Canada	$ 1,041	$ 983	$ 58	5.9
U.S. transborder	847	793	54	6.9
Atlantic	686	554	132	23.9
Pacific	511	447	64	14.2
Other	404	343	61	17.7
System	**$ 3,489**	**$ 3,120**	**$ 369**	**11.8**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts and reflected in the table above. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the first quarter of 2018 versus the first quarter of 2017.

First Quarter 2018 versus First Quarter 2017 (1)	**Passenger Revenue % Change**	**Capacity (ASMs) % Change**	**Traffic (RPMs) % Change**	**Passenger Load Factor pp Change**	**Yield % Change**	**PRASM % Change**
Canada	5.9	3.4	3.0	(0.3)	2.8	2.5
U.S. transborder	6.9	5.5	6.7	0.9	0.1	1.3
Atlantic	23.9	9.6	17.5	5.4	5.4	13.0
Pacific	14.2	12.0	15.9	2.8	(1.5)	1.9
Other	17.7	15.0	15.6	0.4	1.9	2.4
System	**11.8**	**8.6**	**11.4**	**2.1**	**0.4**	**3.0**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts and reflected in the table above. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the first quarter of 2018 and each of the previous four quarters.

System	Year-over-Year by Quarter (% Change)				
	Q1'17 (1)	**Q2'17 (1)**	**Q3'17 (1)**	**Q4'17 (1)**	**Q1'18**
Passenger revenues	8.1	11.9	9.1	11.4	11.8
Capacity (ASMs)	15.4	13.5	9.1	9.5	8.6
Traffic (RPMs)	14.0	13.6	8.8	9.9	11.4
Passenger load factor (pp change)	(1.0)	0.1	(0.2)	0.3	2.1
Yield	(5.1)	(1.4)	0.4	1.4	0.4
PRASM	(6.3)	(1.2)	0.1	1.8	3.0

(1) To provide a more meaningful comparison, the year-over-year percentage comparisons to 2016 quarters are based on previously reported 2016 and 2017 amounts as 2016 amounts have not been restated for the adoption of IFRS 15.

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

- The 11.4% traffic increase which reflected traffic growth in all markets and included gains in the business and premium economy cabins. Consistent with the airline's objective of increasing global international-to-international connecting traffic through its major Canadian hubs (sixth freedom traffic), the traffic growth in the first quarter of 2018 reflected an increase in connecting traffic via Canada to international destinations. The results also reflect the change in timing of the Easter holiday travel period, from mid-April in 2017, to late March in 2018.

- The 0.4% system yield increase which reflected:

    - greater proportional growth of high-yielding business and premium economy passengers;

    - growth in high-yielding local traffic, an improvement in the overall fare mix and an increase in carrier surcharges;

    - the introduction of an expanded suite of fare offerings on domestic services; and

    - an increase in ancillary revenue, including through airport paid upgrades and advance seat selection/preferred seating fees.

  These factors were partly offset by the following:

    - an increase in average stage length of 3.9%, due to long-haul international expansion, which had the effect of reducing system yield by 2.2 percentage points; and

    - an unfavourable currency impact of $23 million relative to the first quarter of 2017.

Domestic Passenger Revenues

In the first quarter of 2018, domestic passenger revenues of $1,041 million increased $58 million or 5.9% from the first quarter of 2017.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the first quarter of 2018 and each of the previous four quarters.

Canada	Year-over-Year by Quarter (% Change)				
	Q1'17 (1)	Q2'17 (1)	Q3'17 (1)	Q4'17 (1)	Q1'18
Passenger revenues	1.7	4.0	3.0	5.4	5.9
Capacity (ASMs)	3.2	2.8	1.5	1.4	3.4
Traffic (RPMs)	3.6	3.3	1.0	1.6	3.0
Passenger load factor (pp change)	0.3	0.5	(0.4)	0.2	(0.3)
Yield	(1.7)	0.8	2.2	3.5	2.8
PRASM	(1.3)	1.4	1.7	3.8	2.5

(1) To provide a more meaningful comparison, the year-over-year percentage comparisons from 2017 quarters to 2016 quarters are based on previously reported 2016 and 2017 amounts as 2016 amounts have not been restated for the adoption of IFRS 15.

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

- The 3.0% traffic increase which reflected strong passenger demand on services within Canada as well as incremental connecting traffic to international destinations.
- The 2.8% yield increase which reflected yield improvements on all major domestic services. The yield increase included gains in the business cabin. In addition, Air Canada launched new fare categories on domestic services which contributed to the yield improvement year-over-year.

U.S. Transborder Passenger Revenues

In the first quarter of 2018, U.S. transborder passenger revenues of $847 million increased $54 million or 6.9% from the first quarter of 2017.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the first quarter of 2018 and each of the previous four quarters.

U.S. transborder	Year-over-Year by Quarter (% Change)				
	Q1'17 (1)	Q2'17 (1)	Q3'17 (1)	Q4'17 (1)	Q1'18
Passenger revenues	9.5	16.3	8.0	6.3	6.9
Capacity (ASMs)	9.6	15.2	10.9	6.7	5.5
Traffic (RPMs)	12.0	16.2	9.3	7.1	6.7
Passenger load factor (pp change)	1.8	0.7	(1.2)	0.3	0.9
Yield	(2.2)	0.3	(1.0)	(0.7)	0.1
PRASM	-	1.2	(2.4)	(0.3)	1.3

(1) To provide a more meaningful comparison, the year-over-year percentage comparisons from 2017 quarters to 2016 quarters are based on previously reported 2016 and 2017 amounts as 2016 amounts have not been restated for the adoption of IFRS 15.

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

- The 6.7% traffic increase which reflected traffic growth on all major U.S. transborder services and included gains in the business cabin. Strong passenger demand between Canada and the U.S. and growth of international-to-international connecting passenger flows from the U.S. in support of Air Canada's international expansion strategy were also contributing factors.

- The 0.1% yield increase which reflected yield growth on U.S. sun routes, such as Florida and Hawaii, offset by the impact of increased industry capacity on certain U.S. long-haul and short-haul routes and unfavourable currency impact of $10 million.

Atlantic Passenger Revenues

In the first quarter of 2018, Atlantic passenger revenues of $686 million increased $132 million or 23.9% from the first quarter of 2017.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the first quarter of 2018 and each of the previous four quarters.

Atlantic	Year-over-Year by Quarter (% Change)				
	Q1'17 (1)	Q2'17 (1)	Q3'17 (1)	Q4'17 (1)	Q1'18
Passenger revenues	8.3	14.3	17.7	22.2	23.9
Capacity (ASMs)	19.7	12.6	13.3	13.9	9.6
Traffic (RPMs)	14.4	13.7	13.7	14.4	17.5
Passenger load factor (pp change)	(3.5)	0.8	0.3	0.3	5.4
Yield	(5.3)	0.6	3.5	6.8	5.4
PRASM	(9.5)	1.5	3.9	7.3	13.0

(1) To provide a more meaningful comparison, the year-over-year percentage comparisons from 2017 quarters to 2016 quarters are based on previously reported 2016 and 2017 amounts as 2016 amounts have not been restated for the adoption of IFRS 15.

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

- The 17.5% traffic increase which reflected traffic growth on all major Atlantic services with the exception of services to the United Arab Emirates where capacity was reduced year-over-year. The traffic increase included strong gains in all cabins as reflected in a passenger load factor improvement of 5.4 percentage points.

- The 5.4% yield increase which reflected yield improvements on all major Atlantic services and included gains in all cabins.

- Combined, the traffic, passenger load factor, and yield improvements contributed to a PRASM increase of 13% versus the first quarter of 2017, reflecting a robust demand environment.

Pacific Passenger Revenues

In the first quarter of 2018, Pacific passenger revenues of $511 million increased $64 million or 14.2% from the first quarter of 2017.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the first quarter of 2018 and each of the previous four quarters.

Pacific	Year-over-Year by Quarter (% Change)				
	Q1'17 (1)	Q2'17 (1)	Q3'17 (1)	Q4'17 (1)	Q1'18
Passenger revenues	12.5	12.5	5.7	13.5	14.2
Capacity (ASMs)	30.3	23.2	10.1	12.2	12.0
Traffic (RPMs)	22.5	19.7	9.4	13.7	15.9
Passenger load factor (pp change)	(5.1)	(2.5)	(0.6)	1.0	2.8
Yield	(8.1)	(6.0)	(3.4)	(0.2)	(1.5)
PRASM	(13.6)	(8.7)	(4.0)	1.1	1.9

(1) To provide a more meaningful comparison, the year-over-year percentage comparisons from 2017 quarters to 2016 quarters are based on previously reported 2016 and 2017 amounts as 2016 amounts have not been restated for the adoption of IFRS 15.

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

- The 15.9% traffic increase which reflected traffic growth on all major Pacific services with the exception of services to Japan where capacity was reduced year-over-year. The traffic increase was led by the launch of year-round services from Montreal to Shanghai, from Vancouver to Tapei and, to a much lesser extent, seasonal service from Vancouver to Melbourne. The use of a larger aircraft on services from Toronto to Seoul also contributed to the traffic growth year-over-year. The overall traffic increase included strong gains in the business and premium economy cabins as reflected in a passenger load factor improvement of 2.8 percentage points.

- The 1.5% yield decline which reflected yield decreases on services to Hong Kong and China, the result of increased industry capacity and competitive pricing activities, partly offset by yield improvements on services to Japan, Korea and the South Pacific.

Other Passenger Revenues

In the first quarter of 2018, Other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of $404 million increased $61 million or 17.7% from the first quarter of 2017.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the first quarter of 2018 and each of the previous four quarters.

Other	Year-over-Year by Quarter (% Change)				
	Q1'17 (1)	Q2'17 (1)	Q3'17 (1)	Q4'17 (1)	Q1'18
Passenger revenues	18.8	34.7	15.3	23.7	17.7
Capacity (ASMs)	20.1	24.1	8.4	18.7	15.0
Traffic (RPMs)	22.8	26.4	10.1	17.9	15.6
Passenger load factor (pp change)	1.9	1.5	1.4	(0.6)	0.4
Yield	(3.4)	6.5	4.4	4.8	1.9
PRASM	(1.2)	8.4	6.1	4.1	2.4

(1) To provide a more meaningful comparison, the year-over-year percentage comparisons from 2017 quarters to 2016 quarters are based on previously reported 2016 and 2017 amounts as 2016 amounts have not been restated for the adoption of IFRS 15.

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

- The 15.6% traffic increase which reflected traffic growth on services to South America and on routes to traditional sun destinations. The traffic increase year-over-year was largely driven by the launch of seasonal services from Montreal to Lima and from Toronto to Cartagena, Belize City and St. Vincent and the Grenadines. The traffic growth included gains in all cabins.

- The 1.9% yield increase which reflected yield improvements on routes to traditional sun destinations.

Cargo Revenues

In the first quarter of 2018, cargo revenues of $168 million increased $20 million or 14% from the first quarter of 2017, reflecting traffic growth of 6.6% and a yield improvement of 6.4%. Traffic growth was recorded in all markets and was in large part due to the launch and expansion of international routes. The Atlantic and Pacific markets experienced particularly strong performances from both a traffic and yield perspective.

The table below provides cargo revenue by geographic region for the first quarter of 2018 and the first quarter of 2017.

Cargo Revenue (Canadian dollars in millions)	First Quarter 2018	First Quarter 2017 (1)	$ Change	% Change
Canada	$ 19	$ 18	$ 1	5.1
U.S. transborder	9	8	1	5.2
Atlantic	62	54	8	14.8
Pacific	64	54	10	17.7
Other	14	14	-	7.2
System	**$ 168**	**$ 148**	**$ 20**	**14**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts and reflected in the table above. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

Other Revenues

In the first quarter of 2018, other revenues of $414 million increased $40 million or 11%, mainly due to an increase in ground package revenues at Air Canada Vacations on higher passenger volumes year-over-year. Air Canada Vacations' revenues in the first quarter of 2018 were the highest in its history.

CASM and Adjusted CASM

In the first quarter of 2018, CASM and adjusted CASM increased 2.4% and 0.4%, respectively, when compared to the first quarter of 2017.

The following table compares Air Canada's CASM and adjusted CASM results and components for the first quarter of 2018 to the first quarter of 2017:

	First Quarter		Change	
(cents per ASM)	**2018**	**2017 (1)**	**cents**	**%**
Aircraft fuel	3.32	2.88	0.44	15.4
Regional airlines expense				
Aircraft fuel	0.46	0.42	0.04	10.3
Other	2.26	2.35	(0.09)	(3.9)
Wages and salaries	2.07	2.06	0.01	0.5
Benefits	0.74	0.75	(0.01)	(0.8)
Airport and navigation fees	0.89	0.92	(0.03)	(3.0)
Aircraft maintenance	1.03	1.00	0.03	3.4
Depreciation, amortization and impairment	1.07	1.00	0.07	7.4
Sales and distribution costs	0.76	0.79	(0.03)	(4.3)
Ground package costs	1.11	1.12	(0.01)	(0.8)
Aircraft rent	0.50	0.53	(0.03)	(5.6)
Food, beverages and supplies	0.39	0.37	0.02	3.9
Communications and information technology	0.32	0.31	0.01	1.7
Special items	-	0.13	(0.13)	(100.0)
Other	1.51	1.41	0.10	6.6
CASM	**16.43**	**16.04**	**0.39**	**2.4**
Remove:				
Aircraft fuel expense (2), ground package costs at Air Canada Vacations and special items	(4.89)	(4.54)	(0.35)	(7.6)
Adjusted CASM (3)	**11.54**	**11.50**	**0.04**	**0.4**

(1) *Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts and reflected in the table above. Refer to section 9 "Accounting Policies" of this MD&A for additional information.*

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

(3) *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 first quarter of 2018, operating expenses of $4,085 million increased $413 million or 11% from the first quarter of 2017 on capacity growth of 8.6%.

In the first quarter of 2018, the favourable impact of a stronger Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) decreased operating expenses by $76 million (comprised of $37 million relating to aircraft fuel expense and an aggregate of $39 million relating to non-fuel operating expenses).

The more notable components of the year-over-year change in operating expenses are described below.

Aircraft Fuel Expense

In the first quarter of 2018, aircraft fuel expense (including fuel expense related to regional airline operations) amounted to $939 million, an increase of $185 million or 25% from the first quarter of 2017. This increase reflected higher jet fuel prices (before the impact of foreign exchange), which accounted for an increase of $171 million, and a higher volume of fuel litres consumed, which accounted for an increase of $55 million. These increases were partly offset by a favourable currency impact of $37 million.

Regional Airlines Expense

In the first quarter of 2018, regional airlines expense of $675 million increased $43 million or 7% from the first quarter of 2017. This increase reflected the impact of higher base jet fuel prices year-over-year, accounting for an increase of $19 million, higher CPA rates versus the first quarter of 2017, and increased flying, which was the result of fleet expansion initiatives in the Air Canada Express fleet. A favourable currency impact was a partly offsetting factor.

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

	First Quarter			
			Change	
(Canadian dollars in millions)	**2018**	**2017**	**$**	**%**
Capacity purchase fees	$ 319	$ 308	$ 11	4
Aircraft fuel	114	95	19	20
Airport and navigation	69	69	-	-
Sales and distribution costs	34	37	(3)	(8)
Aircraft rent	10	10	-	-
Depreciation, amortization and impairment	9	6	3	50
Other operating expenses	120	107	13	12
Total regional airlines expense	**$ 675**	**$ 632**	**$ 43**	**7**

Wages, Salaries and Benefits Expense

In the first quarter of 2018, wages and salaries expense of $515 million increased $43 million or 9% from the first quarter of 2017. This increase was largely due to a higher number of full-time equivalent ("FTE") employees to support the airline's international growth. The average number of FTE employees increased 7.4% when compared to the first quarter of 2017.

In the first quarter of 2018, employee benefits expense of $185 million increased $13 million or 8% from the first quarter in 2017. This increase was mainly due to the higher level of FTE employees and to the impact of lower discount rates, which increased the current service cost of defined benefit pension plans.

Airport and Navigation Fees

In the first quarter of 2018, airport and navigation fees of $221 million increased $11 million or 5% from the first quarter of 2017, 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, a 3.9% Nav Canada rate reduction effective September 1, 2017, and a favourable currency impact were largely offsetting factors.

Aircraft Maintenance Expense

In the first quarter of 2018, aircraft maintenance expense of $256 million increased $28 million or 12% from the first quarter of 2017. This increase was mainly due to timing of engine maintenance events which generated a higher level of engine maintenance activity in the first quarter of 2018 versus the first quarter of 2017. A decrease in end of lease maintenance provisions, reflecting more favourable end-of-lease conditions negotiated on narrow-body aircraft lease extensions, and a favourable currency impact were partly offsetting factors.

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

(Canadian dollars in millions)	First Quarter 2018	First Quarter 2017	Change $	Change %
Technical maintenance	$ 225	$ 195	$ 30	15
Maintenance provision [1]	20	27	(7)	(26)
Other	11	6	4	57
Total aircraft maintenance expense	**$ 256**	**$ 228**	**$ 28**	**12**

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

Depreciation, Amortization and Impairment Expense

In the first quarter of 2018, depreciation, amortization and impairment expense of $267 million increased $39 million or 17% from the first quarter of 2017. This increase largely due to the addition of Boeing 787 and 737 MAX aircraft to Air Canada's mainline fleet.

Sales and Distribution Costs

In the first quarter of 2018, sales and distribution costs of $189 million increased $8 million or 4% from the first quarter of 2017 reflecting, in large part, the growth in passenger revenues of 11.8%. This increase was largely offset by the favourable impact of new commission programs introduced in North America in the second quarter of 2017 and growth in direct bookings when compared to the first quarter of 2017.

Ground Package Costs

In the first quarter of 2018, the cost of ground packages at Air Canada Vacations amounted to $276 million, an increase of $20 million or 8% from the first quarter of 2017, reflecting higher passenger volumes year-over-year. This increase was partly offset by a lower cost of ground packages (before the impact of foreign exchange) and a favourable currency impact.

Aircraft Rent

In the first quarter of 2018, aircraft rent expense amounted to $125 million, an increase of $3 million or 2% from the first quarter of 2017, reflecting a greater number of leased aircraft, primarily Boeing 787 aircraft, largely offset by the impact of lower rates on certain lease renewals and a favourable currency impact.

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. Air Canada paid the fine in the second quarter of 2017. Air Canada has appealed the decision. 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. Refer to "Current legal proceedings' under section 18 "Risk Factors" of Air Canada's 2017 MD&A for additional information.

Other Expenses

In the first quarter of 2018, other expenses of $376 million increased $50 million or 15% from the first quarter of 2017, reflecting, in large part, the capacity growth and Air Canada's international expansion strategy. In addition, the first quarter of 2018 included expenses of $26 million related to new uniforms. An increase in customer service expense of $9 million, reflecting the impact of operational disruptions caused by severe weather, was also a contributing factor to the year-over-year increase in other expenses.

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

	First Quarter		Change	
(Canadian dollars in millions)	**2018**	**2017**	**$**	**%**
Terminal handling	$ 74	$ 68	$ 6	9
Crew cycle	47	44	3	7
Building rent and maintenance	43	42	1	2
Miscellaneous fees and services	42	37	5	14
Remaining other expenses	170	135	35	26
Total other expenses	**$ 376**	**$ 326**	**$ 50**	**15**

Non-operating Income (Expense)

In the first quarter of 2018, non-operating expense amounted to $170 million compared to non-operating income of $17 million in the first quarter of 2017.

Components of the year-over-year change in first quarter non-operating income (expense) included:

- Losses on foreign exchange of $112 million in the first quarter of 2018 compared to gains on foreign exchange of $70 million in the first quarter of 2017. Foreign exchange losses on U.S. denominated long-term debt of $172 million were partly offset by foreign exchange gains on foreign currency derivatives of $63 million. The foreign exchange losses in the first quarter of 2018 were attributable to a weaker Canadian dollar at March 31, 2018 when compared to December 31, 2017. The March 31, 2018 closing exchange rate was US$1=C$1.2900 while the December 31, 2017 closing exchange rate was US$1=C$1.2571.

- Air Canada recorded a gain of $26 million on the sale and leaseback of two Boeing 787-9 aircraft in the first quarter of 2017, whereas no such gains were recorded in the first quarter of 2018.

- Air Canada recorded a gain of $11 million on debt modifications related to the repricing (in February 2018) of the airline's US$1.1 billion senior secured credit facility in the first quarter of 2018, whereas no such gains were recorded in the first quarter of 2017.

5. FLEET

The table below provides the number of aircraft in Air Canada's operating fleet as at March 31, 2018 and December 31, 2017 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, 2018 and December 31, 2019.

	Actual			Planned			
Mainline	**December 31, 2017**	**First Quarter 2018 Fleet Changes**	**March 31, 2018**	**Remainder of 2018 Fleet Changes**	**December 31, 2018**	**2019 Fleet Changes**	**December 31, 2019**
Wide-body Aircraft							
Boeing 787-8	**8**	-	**8**	**-**	**8**	-	**8**
Boeing 787-9	**22**	3	**25**	2	**27**	2	**29**
Boeing 777-300ER	**19**	-	**19**	-	**19**	-	**19**
Boeing 777-200LR	**6**	-	**6**	-	**6**	-	**6**
Boeing 767-300ER	**10**	(1)	**9**	(3)	**6**	(5)	**1**
Airbus A330-300	**8**	-	**8**	-	**8**	4	**12**
Narrow-body Aircraft							
Boeing 737 MAX 8	**2**	8	**10**	8	**18**	18	**36**
Airbus A321	**15**	1	**16**	(1)	**15**	-	**15**
Airbus A320	**42**	-	**42**	-	**42**	(11)	**31**
Airbus A319	**18**	-	**18**	(2)	**16**	(2)	**14**
Embraer 190	**25**	-	**25**	(6)	**19**	(5)	**14**
Bombardier C-Series CS300	**-**	-	**-**	-	**-**	1	**1**
Total Mainline	**175**	**11**	**186**	**(2)**	**184**	**2**	**186**
Air Canada Rouge							
Wide-body Aircraft							
Boeing 767-300ER	**24**	1	**25**	-	**25**	-	**25**
Narrow-body Aircraft							
Airbus A321	**5**	-	**5**	1	**6**	-	**6**
Airbus A319	**20**	-	**20**	2	**22**	-	**22**
Total Air Canada Rouge	**49**	**1**	**50**	**3**	**53**	**-**	**53**
Total Wide-body Aircraft	**97**	3	**100**	(1)	**99**	1	**100**
Total Narrow-body Aircraft	**127**	**9**	**136**	**2**	**138**	**1**	**139**
Total Mainline and Air Canada Rouge	**224**	**12**	**236**	**1**	**237**	**2**	**239**

Air Canada Express

The table below provides, as at March 31, 2018, 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. No changes are expected to the Air Canada Express fleet between March 31, 2018 and December 31, 2018.

	As at March 31, 2018			
	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	15	-	-	15
Bombardier Dash 8-300	26	-	-	26
Bombardier Dash 8-Q400	44	-	-	44
Total Air Canada Express	**116**	**25**	**14**	**155**

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 March 31, 2018 and as at December 31, 2017:

(Canadian dollars in millions)	March 31, 2018	December 31, 2017 (1)	$ Change
Assets			
Cash, cash equivalents and short-term investments	$ 4,496	$ 3,804	$ 692
Other current assets	1,482	1,593	(111)
Current assets	$ **5,978**	**$ 5,397**	**$ 581**
Deposits and other assets	474	465	9
Property and equipment	9,852	9,252	600
Pension assets	1,571	1,583	(12)
Deferred income tax	451	456	(5)
Intangible assets	333	318	15
Goodwill	311	311	-
Total assets	**$ 18,970**	**$ 17,782**	**$ 1,188**
Liabilities			
Current liabilities	$ 5,716	$ 5,101	$ 615
Long-term debt and finance leases	6,117	5,448	669
Pension and other benefit liabilities	2,575	2,592	(17)
Maintenance provisions	1,051	1,003	48
Other long-term liabilities	204	216	(12)
Total liabilities	**$ 15,663**	**$ 14,360**	**$ 1,303**
Total shareholders' equity	**$ 3,307**	**$ 3,422**	**$ (115)**
Total liabilities and shareholders' equity	**$ 18,970**	**$ 17,782**	**$ 1,188**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts and reflected in the table above. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

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

At March 31, 2018, property and equipment amounted to $9,852 million, an increase of $600 million from December 31, 2017. This increase was mainly due to additions to property and equipment of $894 million and the impact of depreciation expense of $262 million. In the first quarter of 2018, additions to property and equipment included three Boeing 787-9 aircraft and seven Boeing 737 MAX 8 aircraft which were financed with proceeds from the sale of enhanced equipment trust certificates issued through a private offering in 2017 (which is further described in section 9.8 "Contractual Obligations" of Air Canada's 2017 MD&A). An eighth Boeing 737 MAX-8 aircraft was delivered on March 31, 2018, with interim financing provided through progress payments on deposit with the manufacturer until the associated financing from the EETC was completed in April 2018. In the first quarter of 2018, additions to property and equipment also included progress payments on future aircraft deliveries and capitalized maintenance costs.

6.2. Adjusted Net Debt

The following table reflects Air Canada's adjusted net debt balances as at March 31, 2018 and as at December 31, 2017:

(Canadian dollars in millions, except where indicated)	March 31, 2018	December 31, 2017	$ Change
Total long-term debt and finance leases	$ 6,117	$ 5,448	$ 669
Current portion of long-term debt and finance leases	620	671	(51)
Total long-term debt and finance leases (including current portion)	**$ 6,737**	**$ 6,119**	**$ 618**
Less cash, cash equivalents and short-term investments	(4,496)	(3,804)	(692)
Net debt	**$ 2,241**	**$ 2,315**	**$ (74)**
Capitalized operating leases (1)	3,822	3,801	21
Adjusted net debt	**$ 6,063**	**$ 6,116**	**$ (53)**
EBITDAR (trailing 12 months) (1)	**$ 2,959**	**$ 2,928**	**$ 31**
Adjusted net debt to EBITDAR ratio (2)	**2.0**	**2.1**	**(0.1)**

(1) Adjusted net debt is an additional GAAP financial measure and a key component of the capital managed by Air Canada and provides management with a measure of its net indebtedness. Air Canada includes capitalized operating leases which is a measure commonly used in the industry to ascribe a value to obligations under operating leases. Common industry practice is to multiply annualized aircraft rent expense by 7. This definition of capitalized operating leases is used by Air Canada and may not be comparable to similar measures presented by other public companies. Aircraft rent (including aircraft rent expense related to regional airline operations) was $546 million for the 12 months ended March 31, 2018 and $543 million for the 12 months ended December 31, 2017.

(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. Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts. 2016 results have not been restated for the adoption of this new accounting standard. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

At March 31, 2018, total long-term debt and finance leases (including current portion) of $6,737 million increased $618 million from December 31, 2017. In the first quarter of 2018, new borrowings of $689 million and the unfavourable impact of a weaker Canadian dollar of $172 million, as at March 31, 2018 compared to December 31, 2017, on Air Canada's foreign currency denominated debt (mainly U.S. dollars), were partly offset by debt repayments of $226 million.

Adjusted net debt amounted to $6,063 million at March 31, 2018, a decrease of $53 million from December 31, 2017. In the first quarter of 2018, the increase in cash and short-term investment balances of $692 million more than offset the increase in long-term debt and finance lease balances of $618 million. At March 31, 2018, Air Canada's adjusted net debt to EBITDAR ratio was 2.0 versus 2.1 at December 31, 2017.

At March 31, 2018, Air Canada's weighted average cost of capital ("WACC"), on a pre-tax basis, was approximately 7.7% (compared to approximately 7.6% at December 31, 2017). WACC is based on an estimate by management and consists of an estimated cost of equity of 20.8% and an average cost of debt and finance leases of 4.4% (compared to an estimated cost of equity of 20.0% and an average cost of debt and finance leases of 4.5% at December 31, 2017).

6.3. Working Capital

The following table provides information on Air Canada's working capital balances as at March 31, 2018 and as at December 31, 2017:

(Canadian dollars in millions)	March 31, 2018	December 31, 2017 (1)	$ Change
Cash, cash equivalents and short-term investments	$ 4,496	$ 3,804	$ 692
Accounts receivable	891	814	77
Other current assets	591	779	(188)
Total current assets	**$ 5,978**	**$ 5,397**	**$ 581**
Accounts payable and accrued liabilities	2,055	1,961	94
Advance ticket sales	3,041	2,469	572
Current portion of long-term debt and finance leases	620	671	(51)
Total current liabilities	**$ 5,716**	**$ 5,101**	**$ 615**
Net working capital	**$ 262**	**$ 296**	**$ (34)**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

The net working capital of $262 million at March 31, 2018 represented a decrease of $34 million from December 31, 2017. This decrease was largely due to capital expenditures of $918 million (which resulted in a net cash outflow of $229 million after deducting the financing drawn on the delivery of three Boeing 787 and seven Boeing 737 aircraft). The decrease in working capital was offset by positive cash from operations of $284 million, before the impact of changes in non-cash working capital balances.

Non-cash working capital balances generated $827 million in cash flow as a result of the seasonal build-up of advance ticket sales and activity levels heading into the second and third quarters of 2018. The decline in other current assets is mainly due to the decrease in restricted cash and prepaid ground package costs at Air Canada Vacations following the Winter season.

6.4. Consolidated Cash Flow Movements

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

(Canadian dollars in millions)	First Quarter 2018	First Quarter 2017	First Quarter $ Change
Net cash flows from operating activities	**$ 1,111**	**$ 1,027**	**$ 84**
Proceeds from borrowings	689	371	318
Reduction of long-term debt and finance lease obligations	(226)	(152)	(74)
Shares purchased for cancellation	(1)	(33)	32
Issue of shares	1	1	-
Financing fees	(4)	(3)	(1)
Net cash flows from financing activities	**$ 459**	**$ 184**	**$ 275**
Short-term investments	(121)	(162)	41
Additions to property, equipment and intangible assets	(918)	(926)	8
Proceeds from sale of assets	1	1	-
Proceeds from sale and leaseback of assets	-	369	(369)
Other	15	(6)	21
Net cash flows used in investing activities	**$ (1,023)**	**$ (724)**	**$ (299)**
Effect of exchange rate changes on cash and cash equivalents	$ 8	$ (4)	$ 12
Increase in cash and cash equivalents	**$ 555**	**$ 483**	**$ 72**

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

(Canadian dollars in millions)	First Quarter 2018	First Quarter 2017	First Quarter $ Change
Net cash flows from operating activities	**$ 1,111**	**$ 1,027**	**$ 84**
Additions to property, equipment and intangible assets, net of proceeds from sale-leaseback transactions	(918)	(557)	(361)
Free cash flow [(1)]	**$ 193**	**$ 470**	**$ (277)**

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

Free Cash Flow

In the first quarter of 2018, net cash flows from operating activities of $1,111 million improved $84 million when compared to the same quarter in 2017. This increase was mainly due to the impact of stronger cash operating results and 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 first quarter of 2018, free cash flow of $193 million decreased $277 million from the first quarter of 2017 mainly due to Air Canada having received proceeds of $369 million from the sale and leaseback of aircraft in the first quarter of 2017, while no such sale and leasebacks were effected in the first quarter of 2018.

Net Cash Flows from Financing Activities

In the first quarter of 2018, reduction of long-term debt and finance lease obligations amounted to $226 million and proceeds from borrowings totaled to $689 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 four Boeing 787 aircraft (two of which are scheduled for delivery in the second quarter of 2018 and two of which are scheduled for delivery in early 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 and available delivery positions).

The two Boeing 787 aircraft scheduled for delivery in the second quarter of 2018 have been financed under private offerings of enhanced equipment trust certificates ("EETCs"), which are further described in section 6.7 "Contractual Obligations" of this MD&A.

Subject to certain conditions, Air Canada has financing commitments covering the two Boeing 787 aircraft scheduled for delivery in early 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 50 737 MAX 8 and 11 737 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.

As of the date of this MD&A, 12 Boeing 737 MAX 8 have been delivered. Six 737 MAX 8 aircraft are scheduled for delivery in the second quarter of 2018, with the remaining 43 of the 61 737 MAX aircraft scheduled for delivery from 2019 to 2024.

In April 2018, Air Canada concluded an amendment to its Boeing 737 purchase agreement, pursuant to which certain aircraft delivery positions were accelerated and others deferred. The amendment accelerates the delivery of five 737 MAX aircraft by one year, to 2020, and defers the delivery of 11 737 MAX aircraft by up to 36 months.

Three of the six Boeing 737 MAX 8 aircraft scheduled for delivery in the second quarter of 2018 have been financed under private offerings of EETCs, which are further described in section 6.7 "Contractual Obligations" of this MD&A, and the remaining three aircraft are planned to be purchased with cash.

Subject to certain conditions, Air Canada also has financing commitments covering 25 Boeing 737 MAX firm aircraft scheduled for delivery in 2020, 2023 and 2024. 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 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.

Reconfiguration of Airbus A330 Aircraft

In order to provide customers with a product that is consistent across its wide-body fleet, Air Canada plans on reconfiguring 12 Airbus A330 aircraft (eight of which are currently in service and four scheduled to be added in 2019) to the new Boeing 787 state-of-the-art standard. The reconfiguration of the Airbus A330 aircraft is expected to begin in late 2019 for completion in the first half of 2020. The capital expenditure related to this refurbishment program (which is included in the table below) is approximately $275 million.

Capital Commitments

As outlined in the table below, the estimated aggregate cost of the future firm Boeing 787, Boeing 737 MAX and Bombardier C-Series CS300 aircraft deliveries and other capital purchase commitments as at March 31, 2018 approximates $5,726 million. The table below also includes the impact of the amendment to the Boeing 737 purchase agreement discussed above.

(Canadian dollars in millions)	Remainder of 2018	2019	2020	2021	2022	Thereafter	Total
Projected committed expenditures	$ 969	$ 1,491	$ 1,346	$ 670	$ 666	$ 584	$ 5,726
Projected planned but uncommitted expenditures	175	395	294	347	302	Not available	Not available
Projected planned but uncommitted capitalized maintenance (1)	108	173	175	56	95	Not available	Not available
Total projected expenditures (2)	**$ 1,252**	**$ 2,059**	**$ 1,815**	**$ 1,073**	**$ 1,063**	**Not available**	**Not available**

(1) Future capitalized maintenance amounts for 2021 and 2022 and beyond are not yet determinable, however estimates of $56 million and $95 million, respectively, have been made for 2021 and 2022.

(2) U.S. dollar amounts are converted using the March 31, 2018 closing exchange rate of US$1=C$1.2900. 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.

6.6. Pension Funding Obligations

Based on actuarial valuations, as at January 1, 2018, the aggregate solvency surplus in Air Canada's domestic registered pension plans is $2.6 billion. As a result, Air Canada will not make any past service payments in 2018.

As permitted by applicable legislation and subject to applicable plan rules, amounts in excess of 105% on a solvency basis may be used to reduce current service contributions under the defined benefit component or to fund the employer contribution to a defined contribution component within the same pension plan. Pension funding obligations for 2018 are expected to be $90 million.

As at March 31, 2018, 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 2017 MD&A.

6.7. Contractual Obligations

Private offering of enhanced equipment trust certificates

In December 2017, in connection with the financing of four new Boeing 787-9 and nine new Boeing 737 MAX 8 aircraft, Air Canada completed the closing of a private offering of three tranches of EETCs with a combined aggregate face amount of approximately US$719 million. The three tranches of certificates have a combined weighted average interest rate of 3.422% per annum. Three of the four Boeing 787-9 aircraft under this transaction were delivered in the first quarter of 2018 and the remaining Boeing 787-9 aircraft is scheduled for delivery in the second quarter of 2018. Seven of the nine of the Boeing 737 MAX 8 aircraft under this transaction were delivered and financed under this transaction in the first quarter of 2018. An eighth Boeing 737 MAX 8 was delivered on March 31, 2018 and financed under this transaction in early April 2018 and the remaining Boeing 737 MAX 8 aircraft under this transaction is scheduled for delivery in the second quarter of 2018.

In March 2018, in connection with the financing of one new Boeing 787-9 and four new Boeing 737 MAX 8 aircraft, Air Canada completed the closing of a Canadian dollar private offering of two tranches of EETCs with a combined aggregate face amount of approximately $301 million. All aircraft under this transaction are scheduled for delivery in the second quarter of 2018.

The private offering was comprised of Class A and Class B certificates.

- The Class A certificates, with a $238 million face amount, have an interest rate of 3.670% per annum and a final expected distribution date of April 15, 2030.

- The Class B certificates, with a $64 million face amount, have an interest rate of 4.190% per annum and a final expected distribution date of January 15, 2026.

The two tranches of certificates have a combined weighted average interest rate of 3.760% per annum.

The table below provides Air Canada's contractual obligations as at March 31, 2018, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and finance lease obligations, operating lease obligations and committed capital expenditures. The table below also includes the impact of the financing associated with two new Boeing 787-9 and six new Boeing 737 MAX 8 aircraft financed through the private offering of EETCs, as described above.

(Canadian dollars in millions)	Remainder 2018	2019	2020	2021	2022	Thereafter	Total
Principal							
Long-term debt obligations	$ 458	$ 510	$ 577	$ 915	$ 289	$ 3,887	$ 6,636
Finance lease obligations	31	45	48	16	14	56	210
Total principal obligations	**$ 489**	**$ 555**	**$ 625**	**$ 931**	**$ 303**	**$ 3,943**	**$ 6,846**
Interest							
Long-term debt obligations	197	252	226	$ 180	155	384	1,394
Finance lease obligations	13	14	10	6	5	14	62
Total interest obligations	**$ 210**	**$ 266**	**$ 236**	**$ 186**	**$ 160**	**$ 398**	**$ 1,456**
Total long-term debt and finance lease obligations	**$ 699**	**$ 821**	**$ 861**	**$ 1,117**	**$ 463**	**$ 4,341**	**$ 8,302**
Operating lease obligations	**$ 479**	**$ 560**	**$ 428**	**$ 313**	**$ 230**	**$ 942**	**$ 2,952**
Committed capital expenditures	**$ 969**	**$ 1,491**	**$ 1,346**	**$ 670**	**$ 666**	**$ 584**	**$ 5,726**
Total contractual obligations (1)	**$ 2,147**	**$ 2,872**	**$ 2,635**	**$ 2,100**	**$ 1,359**	**$ 5,867**	**$ 16,980**
EETC financing (principal and interest)	**$ 20**	**$ 60**	**$ 58**	**$ 54**	**$ 51**	**$ 413**	**$ 656**
Total obligations, including the impact of the EETC financing	**$ 2,167**	**$ 2,932**	**$ 2,693**	**$ 2,154**	**$ 1,410**	**$ 6,280**	**$ 17,636**

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

6.8. Share Information

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

	March 31, 2018	December 31, 2017
Issued and outstanding shares		
Variable voting shares	117,956,984	115,986,084
Voting shares	155,286,302	157,090,562
Total issued and outstanding shares	**273,243,286**	**273,076,646**
Class A variable voting and Class B voting shares potentially issuable		
Stock options	5,902,245	6,121,252
Total shares potentially issuable	**5,902,245**	**6,121,252**
Total outstanding and potentially issuable shares	**279,145,531**	**279,197,898**

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 first quarter of 2018, Air Canada purchased, for cancellation, a total of 54,653 Shares at an average cost of $22.49 per Share for aggregate consideration of $1 million. At March 31, 2018, a total of 20,663,912 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)	2016 [1]			2017 [1]				2018
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Passenger	$ 3,143	$ 4,106	$ 3,035	$ 3,120	$ 3,550	$ 4,514	$ 3,409	$ 3,489
Cargo	111	130	155	148	168	194	198	168
Other	204	215	235	374	192	172	213	414
Operating revenues	**3,458**	**4,451**	**3,425**	**3,642**	**3,910**	**4,880**	**3,820**	**4,071**
Aircraft fuel	527	708	598	659	701	832	735	825
Regional airlines expense								
Aircraft fuel	77	96	90	95	96	109	112	114
Other	501	543	532	537	552	553	563	561
Wages, salaries & benefits	611	658	633	644	663	690	674	700
Airport and navigation fees	211	247	203	210	230	264	201	221
Aircraft maintenance	243	230	200	228	226	241	243	256
Depreciation, amortization and impairment	202	220	212	228	242	241	245	267
Sales and distribution costs	170	179	172	181	188	232	169	189
Ground package costs	85	72	101	256	103	73	106	276
Aircraft rent	112	118	120	122	130	125	126	125
Food, beverages and supplies	86	104	82	85	97	112	89	96
Communications and information technology	59	56	60	71	58	63	62	79
Special items	-	-	91	30	-	-	-	-
Other	297	324	313	326	332	369	362	376
Operating expenses	**3,181**	**3,555**	**3,407**	**3,672**	**3,618**	**3,904**	**3,687**	**4,085**
Operating income (loss)	**277**	**896**	**18**	**(30)**	**292**	**976**	**133**	**(14)**
Foreign exchange gain (loss)	(17)	(42)	(29)	70	68	44	(62)	(112)
Interest income	13	12	13	12	14	16	18	20
Interest expense	(98)	(97)	(83)	(79)	(80)	(73)	(79)	(83)
Interest capitalized	15	12	8	9	9	9	9	13
Net financing expense relating to employee benefits	(17)	(17)	(24)	(16)	(16)	(15)	(18)	(12)
Gain (loss) on financial instruments recorded at fair value	(1)	6	9	-	7	17	(1)	1
Gain on sale and leaseback of assets	19	-	-	26	26	-	-	-
Gain (loss) on debt settlements and modifications	(1)	-	(82)	-	-	(3)	24	11
Other	(4)	(2)	(8)	(5)	(6)	(6)	(4)	(8)
Total non-operating income (expense)	**(91)**	**(128)**	**(196)**	**17**	**22**	**(11)**	**(113)**	**(170)**
Income (loss) before income taxes	186	768	(178)	(13)	314	965	20	(184)
Recovery of (provision for) income taxes	-	-	(1)	-	(3)	758	(12)	14
Net income (loss)	**$ 186**	**$ 768**	**$ (179)**	**$ (13)**	**$ 311**	**$ 1,723**	**$ 8**	**$ (170)**
Diluted earnings (loss) per share	**$ 0.66**	**$ 2.74**	**$ (0.66)**	**$(0.05)**	**$ 1.13**	**$ 6.22**	**$ 0.02**	**$ (0.62)**
EBITDAR [2]	**$ 605**	**$ 1,248**	**$ 455**	**$ 366**	**$ 681**	**$ 1,360**	**$ 521**	**$ 397**
Adjusted pre-tax income (loss) [2]	**$ 203**	**$ 821**	**$ 39**	**$ (63)**	**$ 229**	**$ 922**	**$ 77**	**$ (72)**
Adjusted net income (loss) [2]	**$ 203**	**$ 821**	**$ 38**	**$ (63)**	**$ 226**	**$ 922**	**$ 61**	**$ (52)**
Adjusted earnings (loss) per share – diluted [2]	**$ 0.72**	**$ 2.93**	**$ 0.14**	**$ (0.23)**	**$ 0.82**	**$ 3.33**	**$ 0.22**	**$ (0.19)**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts. 2016 amounts have not been restated for the adoption of this new accounting standard. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

(2) EBITDAR, adjusted pre-tax income (loss), 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.

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

	2016			2017				2018
(Canadian dollars in millions)	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**
Capacity purchase fees	$ 289	$ 313	$ 304	$ 308	$ 314	$ 315	$ 330	$ 319
Aircraft fuel	77	96	90	95	96	109	112	114
Airport and navigation	71	79	72	69	73	80	71	69
Sales and distribution costs	35	36	36	37	40	34	35	34
Aircraft rent	8	8	8	10	10	10	10	10
Depreciation, amortization and impairment	6	6	6	6	7	8	7	9
Other operating expenses	92	101	106	107	108	106	110	120
Total regional airlines expense	**$ 578**	**$ 639**	**$ 622**	**$ 632**	**$ 648**	**$ 662**	**$ 675**	$ **675**

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

	2016 (1)			2017 (1)				2018
System	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**
Passenger PRASM (cents)	13.8	14.2	13.5	13.6	14.0	14.5	14.1	14.0
CASM (cents)	14.2	12.5	15.4	16.0	14.3	12.6	15.2	16.4
Adjusted CASM (cents) (2)	11.2	9.4	11.4	11.5	10.7	9.3	11.3	11.5
Fuel cost per litre (cents) (3)	52.2	55.2	59.4	63.2	61.3	59.4	67.5	73.3

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts. 2016 amounts have not been restated for the adoption of this new accounting standard. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

(2) 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.

(3) 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:

	2016			2017				2018
System	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**
RPMs (millions)	18,418	24,328	17,643	18,341	20,928	26,472	19,396	20,440
ASMs (millions)	22,344	28,458	22,091	22,894	25,357	31,050	24,191	24,862
Passenger load factor (%)	82.4%	85.5%	79.9%	80.1%	82.5%	85.3%	80.2%	82.2%
Domestic								
RPMs (millions)	4,717	6,068	4,534	4,101	4,875	6,130	4,607	4,226
ASMs (millions)	5,678	7,066	5,510	5,108	5,837	7,173	5,584	5,280
Passenger load factor (%)	83.1%	85.9%	82.3%	80.3%	83.5%	85.4%	82.5%	80.0%
U.S. Transborder								
RPMs (millions)	3,107	3,613	3,182	3,782	3,609	3,951	3,408	4,037
ASMs (millions)	3,799	4,223	3,985	4,687	4,376	4,683	4,252	4,945
Passenger load factor (%)	81.8%	85.6%	79.9%	80.7%	82.5%	84.4%	80.1%	81.6%
Atlantic								
RPMs (millions)	5,394	8,270	4,437	3,891	6,131	9,406	5,076	4,573
ASMs (millions)	6,805	9,785	5,778	5,248	7,661	11,087	6,582	5,753
Passenger load factor (%)	79.3%	84.5%	76.8%	74.1%	80.0%	84.8%	77.1%	79.5%
Pacific								
RPMs (millions)	3,902	5,002	3,959	3,943	4,671	5,471	4,501	4,572
ASMs (millions)	4,496	5,821	4,977	4,862	5,540	6,412	5,586	5,447
Passenger load factor (%)	86.8%	85.9%	79.6%	81.1%	84.5%	85.3%	80.6%	83.9%
Other								
RPMs (millions)	1,298	1,375	1,531	2,624	1,642	1,514	1,804	3,032
ASMs (millions)	1,566	1,563	1,841	2,989	1,943	1,695	2,187	3,437
Passenger load factor (%)	82.9%	87.9%	83.1%	87.8%	84.5%	89.3%	82.5%	88.2%

8. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Air Canada's financial instruments and risk management practices are summarized in section 12 of Air Canada's 2017 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 10 of Air Canada's first quarter 2018 interim unaudited condensed consolidated financial statements.

9. ACCOUNTING POLICIES

Air Canada's accounting policies are as disclosed in Note 2 of Air Canada's 2017 annual consolidated financial statements. There have been no material changes to Air Canada's accounting policies from what was disclosed at that time, with the exception of the adoption of *IFRS 15 – Revenue from Contract with Customers* as described below.

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, with additional information provided in Note 2 of Air Canada's first quarter 2018 interim unaudited condensed consolidated financial statements. Air Canada adopted the standard effective January 1, 2018 using the full retrospective method.

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 2017 MD&A. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

11. RELATED PARTY TRANSACTIONS

At March 31, 2018, 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 18 "Risk Factors" of Air Canada's 2017 MD&A. There have been no material changes to Air Canada's risk factors from what was disclosed at that time.

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 2017 filings, the Corporation's CEO and CFO certified, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design and effectiveness of the Corporation's disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting.

In the Corporation's first quarter 2018 filings, the Corporation's CEO and CFO certified, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design of the Corporation's disclosure controls and procedures and the design of internal controls over financial reporting.

The Corporation's Audit, Finance and Risk Committee reviewed this MD&A and the interim unaudited condensed consolidated financial statements and notes, and the Corporation's Board of Directors approved these documents prior to their release.

Changes in Internal Controls over Financial Reporting

There have been no changes to the Corporation's internal controls over financial reporting during the quarter ended March 31, 2018 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 loss as follows:

	First Quarter		
(Canadian dollars in millions)	**2018**	**2017 (1)**	**$ Change**
Operating loss – GAAP	**$ (14)**	**$ (30)**	**$ 16**
Add back (as reflected on Air Canada's consolidated statement of operations):			
Depreciation, amortization and impairment	267	228	39
Aircraft rent	125	122	3
Add back (included in Regional airlines expense):			
Depreciation, amortization and impairment	9	6	3
Aircraft rent	10	10	-
EBITDAR (including special items)	**$ 397**	**$ 336**	**$ 61**
Remove effect of special items (2)	$ -	$ 30	$ (30)
EBITDAR (excluding special items)	**$ 397**	**$ 366**	**$ 31**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

(2) 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.

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.

In calculating adjusted CASM, aircraft fuel expense is excluded from operating expense results as it fluctuates widely depending on many factors, including international market conditions, geopolitical events, jet fuel refining costs and Canada/U.S. currency exchange rates. Air Canada also incurs expenses related to ground packages at Air Canada Vacations which some airlines, without comparable tour operator businesses, may not incur. In addition, these costs do not generate ASMs and therefore excluding these costs from operating expense results provides for a more meaningful comparison across periods when such costs may vary.

Excluding aircraft fuel expense, the cost of ground packages at Air Canada Vacations and special items from operating expenses generally allows for more meaningful analysis of Air Canada's operating expense performance and a more meaningful comparison to those of other airlines.

Adjusted CASM is reconciled to GAAP operating expense as follows:

	First Quarter		
(Canadian dollars in millions, except where indicated)	**2018**	**2017 (1)**	**$ Change**
Operating expense – GAAP	**$ 4,085**	**$ 3,672**	**$ 413**
Adjusted for:			
Aircraft fuel expense (as reflected on Air Canada's consolidated statement of operations)	(825)	(659)	(166)
Aircraft fuel expense (included in Regional airlines expense)	(114)	(95)	(19)
Ground package costs	(276)	(256)	(20)
Special items (2)	-	(30)	30
Operating expense, adjusted for the above-noted items	**$ 2,870**	**$ 2,632**	**$ 238**
ASMs (millions)	**24,862**	**22,894**	**8.6%**
Adjusted CASM (cents)	**¢ 11.54**	**¢ 11.50**	**0.4%**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

(2) 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.

Adjusted pre-tax income (loss)

Adjusted pre-tax income (loss) is used by Air Canada to assess the overall pre-tax financial performance of its business without the effects of 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, gains or losses on debt settlements and modifications, and special items. Air Canada uses adjusted pre-tax income (loss) to determine return on invested capital.

Adjusted pre-tax loss is reconciled to GAAP loss before income taxes as follows:

	First Quarter		
(Canadian dollars in millions)	**2018**	**2017 (1)**	**$ Change**
Loss before income taxes	**$ (184)**	**$ (13)**	**$ (171)**
Adjusted for:			
Special items (1)	-	30	(30)
Foreign exchange (gain) loss	112	(70)	182
Net financing expense relating to employee benefits	12	16	(4)
Gain on financial instruments recorded at fair value	(1)	-	(1)
Gain on sale and leaseback of assets	-	(26)	26
Gain on debt settlements and modifications	(11)	-	(11)
Adjusted pre-tax loss	**$ (72)**	**$ (63)**	**$ (9)**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts.

(2) 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.

Adjusted Net Income (Loss) and Adjusted Earnings (Loss) per Share – Diluted

Air Canada uses adjusted net income (loss) and adjusted earnings (loss) per share – diluted as a means to assess the overall financial performance of its business without the after-tax effects of 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, gains or losses on debt settlements and modifications, and special items as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful. Starting as of and including the fourth quarter of 2017, adjusted net income (loss) is determined net of tax.

Adjusted net loss is reconciled to GAAP net loss as follows:

	First Quarter		
(Canadian dollars in millions, except per share figures)	**2018**	**2017 (1)**	**$ Change**
Net loss	**$ (170)**	**$ (13)**	**$ (157)**
Adjusted for:			
Special items (1)	-	30	(30)
Foreign exchange (gain) loss	111	(70)	181
Net financing expense relating to employee benefits	9	16	(7)
Gain on financial instruments recorded at fair value	(1)	-	(1)
Gain on sale and leaseback of assets	-	(26)	26
Gain on debt settlements and modifications	(1)	-	(1)
Adjusted net loss	**$ (52)**	**$ (63)**	**$ 11**
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	**273**	**273**	**-**
Adjusted loss per share – diluted	**$ (0.19)**	**$ (0.23)**	**$ 0.04**

(1) *Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts. Refer to section 9 "Accounting Policies" of this MD&A for additional information.*

(2) *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.*

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

	First Quarter	
(in millions)	**2018**	**2017**
Weighted average number of shares outstanding – basic	**273**	**273**
Effect of dilution	4	6
remove anti-dilutive impact	(4)	(6)
Weighted average number of shares outstanding – diluted	**273**	**273**

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 pre-tax income (or loss, as applicable), excluding interest expense and implicit interest on operating leases. Invested capital includes (i) average year-over-year long-term debt, average year-over-year finance lease obligations, average year-over-year shareholders' equity and (ii) the value of capitalized operating leases (calculated by multiplying annualized aircraft rent by 7). Air Canada calculates invested capital based on a book value-based method of calculating ROIC, as described above. Following an increase in Air Canada's total cash, cash equivalents and short-term investments, Air Canada has decided to revise its methodology to reduce the average year-over-year book value of shareholders' equity by excess cash not required to run its core business operations. Air Canada has used average year-over-year advance ticket sales as a proxy for the minimum cash required for ongoing core business operations. This change would result in invested capital more closely reflecting operating capital. Refer to the definition of adjusted pre-tax income (loss) for a discussion as to why Air Canada uses this measure to assess the overall pre-tax financial performance of its business.

Return on invested capital is reconciled to GAAP income before income taxes as follows:

	12 Months Ended		
(Canadian dollars in millions, except where indicated)	**March 31, 2018**	**December 31, 2017 (1)**	**March 31, 2017 (1)**
Income before income taxes	**$ 1,115**	**$ 1,286**	**$ 739**
Remove:			
Special items (2)	-	30	121
Foreign exchange loss	62	(120)	18
Net financing expense relating to employee benefits	61	65	74
Gain on financial instruments recorded at fair value	(24)	(23)	(14)
Gain on sale and leaseback of assets	(26)	(52)	(45)
Gain on debt settlements and modifications (3)	(32)	(21)	83
Adjusted pre-tax income	**$ 1,156**	**$ 1,165**	**$ 976**
Adjusted for:			
Interest expense	315	311	357
Implicit interest on operating leases (4)	268	266	248
Adjusted pre-tax income before interest	**$ 1,739**	**$ 1,742**	**$ 1,581**
Invested capital:			
Average long-term debt and finance lease obligations	6,761	6,369	6,616
Average shareholders' equity, net of excess cash	982	1,249	(694)
Capitalized operating leases (5)	3,822	3,801	3,542
Invested capital	**$ 11,565**	**$ 11,419**	**$ 9,464**
Return on invested capital (%)	**15.0%**	**15.3%**	**16.7%**

(1) Air Canada adopted accounting standard IFRS 15 - Revenue from Contracts with Customers effective January 1, 2018 with restatement of 2017 amounts. To provide a more meaningful comparison, ROIC as at March 31, 2017 is based on previously reported amounts as 2016 amounts have not been restated for the adoption of IFRS 15. Refer to section 9 "Accounting Policies" of this MD&A for additional information.

(2) Special items for the 12 months ended December 31, 2017 included a provision of $30 million related to cargo investigations.

Special items for the 12 months ended March 31, 2017 included a provision of $30 million related to cargo investigations and a past service cost expense of $91 million related to the cost of pension increases applicable to ACPA-represented pilots who participate in a defined benefit plan.

(3) *Gain on debt settlements and modifications for the 12 months ended March 31, 2018 of $32 million included a gain of $32 million related to the repricing of its US$1.1 billion senior secured credit facility.*

Gain on debt settlements and modifications for the 12 months ended December 31, 2017 of $21 million included a gain of $27 million related to the repricing of its US$1.1 billion senior secured credit facility, a loss of $3 million related to the early exercise of a purchase option for an Airbus 330 aircraft and a loss of $2 million related to the prepayment of fixed rate debt on four Embraer 190 aircraft.

Loss on debt settlements and modifications for the 12 months ended March 31, 2017 of $83 million included $82 million related to a $1.25 billion refinancing transaction and $1 million related to the prepayment of fixed rate debt on one Embraer 190 aircraft.

(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 $546 million for the 12 months ended March 31, 2018, $543 million for the 12 months ended December 31, 2017 and $506 million for the 12 months ended March 31, 2017 (includes aircraft rent related to regional operations).*

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. 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. 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.

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.

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 after-tax effects of 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, gains or losses on debt settlements and modifications, and special items. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

Adjusted pre-tax income (loss) – Refers to the consolidated income (loss) of Air Canada before income taxes and adjusted to remove the effects of 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, gains or losses on debt settlements and modifications, 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 Limited.

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 (gain) on debt settlements and modifications – Refer to gains or losses related to debt settlements and modifications that, in management's view, are to be separately disclosed by virtue of their size or incidence to enable a fuller understanding of Air Canada's financial performance.

Other passenger and cargo revenues – Refer to revenues from flights with origins and destinations principally in Central and South America, 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.

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 the International Air Transport Association's (IATA) 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 Air Canada'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.