Second Quarter 2019

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

July 30, 2019

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)	Second Quarter			First Six Months		
	2019 (1)	2018 (2)	$ Change	2019 (1)	2018 (2)	$ Change
Financial Performance Metrics						
Operating revenues	4,757	4,333	424	9,210	8,404	806
Operating income	422	308	114	549	394	155
Income (loss) before income taxes	440	(106)	546	725	(335)	1,060
Net income (loss)	343	(102)	445	688	(305)	993
Adjusted pre-tax income (3)	326	185	141	350	153	197
Adjusted net income (3)	240	129	111	257	103	154
Operating margin %	8.9%	7.1%	1.8 pp	6.0%	4.7%	1.3 pp
EBITDA (3)	916	739	177	1,499	1,243	256
EBITDA margin % (3)	19.3%	17.1%	2.2 pp	16.3%	14.8%	1.5 pp
Unrestricted liquidity (4)	6,907	5,064	1,843	6,907	5,064	1,843
Net cash flows from operating activities	1,090	1,081	9	4,201	2,372	1,829
Free cash flow (3)	537	124	413	1,116	442	674
Net debt (3)	3,277	5,705	(2,428)	3,277	5,705	(2,428)
Return on invested capital ("ROIC") % (2)(3)	15.5%	NM	NM	15.5%	NM	NM
Leverage ratio (2)(3)	0.9	NM	NM	0.9	NM	NM
Diluted earnings (loss) per share	1.26	(0.37)	1.63	2.51	(1.12)	3.63
Adjusted earnings per share – diluted (3)	0.88	0.47	0.41	0.94	0.37	0.57
Operating Statistics (5)			% Change			% Change
Revenue passenger miles ("RPM") (millions)	23,463	22,654	3.6	44,756	43,094	3.9
Available seat miles ("ASM") (millions)	27,910	27,269	2.3	53,926	52,131	3.4
Passenger load factor %	84.1%	83.1%	1.0 pp	83.0%	82.7%	0.3 pp
Passenger revenue per RPM ("Yield") (cents)	18.5	17.3	6.8	18.2	17.2	6.0
Passenger revenue per ASM ("PRASM") (cents)	15.5	14.4	8.1	15.1	14.2	6.4
Operating revenue per ASM (cents)	17.0	15.9	7.3	17.1	16.1	5.9
Operating expense per ASM ("CASM") (cents)	15.5	14.8	5.2	16.1	15.4	4.5
Adjusted CASM (cents) (3)	10.9	10.3	5.9	11.2	10.7	4.6
Average number of full-time equivalent ("FTE") employees (thousands) (6)	33.1	30.0	10.1	32.6	29.4	10.7
Aircraft in operating fleet at period-end	400	413	(3.1)	400	413	(3.1)
Average fleet utilization (hours per day)	10.7	10.1	4.9	10.4	10.1	2.9
Seats dispatched (thousands)	15,955	15,713	1.5	31,367	30,645	2.4
Aircraft frequencies (thousands)	136.6	145.2	(6.0)	270.1	281.7	(4.1)
Average stage length (miles) (7)	1,749	1,736	0.8	1,719	1,701	1.1
Fuel cost per litre (cents)	79.2	80.2	(1.2)	77.4	76.9	0.7
Fuel litres (thousands)	1,410,466	1,370,194	2.9	2,731,231	2,652,032	3.0
Revenue passengers carried (thousands) (8)	12,837	12,535	2.4	24,868	24,189	2.8

(1) Air Canada began consolidating Aeroplan Inc.'s ("Aeroplan") financial results on January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.

(2) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts. ROIC and leverage ratio as at June 30, 2018 are not meaningful as trailing 12 months financial data is used in the calculation of both measures and 2017 amounts have not been restated for the adoption of IFRS 16 - Leases.

(3) Adjusted pre-tax income (loss), adjusted net income (loss), EBITDA (earnings before interest, taxes, depreciation, amortization and impairment), EBITDA margin, free cash flow, ROIC, leverage ratio, adjusted earnings (loss) per share – diluted and adjusted CASM are each non-GAAP financial measures and net debt is an additional GAAP measure. Refer to section 16 of this MD&A for descriptions of Air Canada's non-GAAP financial measures and additional GAAP measures.

(4) Unrestricted liquidity refers to the sum of cash, cash equivalents and short-term investments and the amount of available credit under Air Canada's revolving credit facilities. At June 30, 2019, unrestricted liquidity was comprised of cash, cash equivalents and short-term investments of $5,921 million and undrawn lines of credit of $986 million. At June 30, 2018, unrestricted liquidity was comprised of cash, cash equivalents and short-term investments of $4,670 million and undrawn lines of credit of $394 million.

(5) 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.

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

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

(8) 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 under the brand name Air Canada Vacations® ("Air Canada Vacations"), Air Canada Rouge LP, doing business under the brand name Air Canada Rouge® ("Air Canada Rouge") and, effective January 10, 2019, Aeroplan Inc. ("Aeroplan"). This MD&A provides the reader with a review and analysis, from the perspective of management, of Air Canada's financial results for the second quarter of 2019. This MD&A should be read in conjunction with Air Canada's interim unaudited condensed consolidated financial statements and notes for the second quarter of 2019, Air Canada's 2018 annual audited consolidated financial statements and notes and Air Canada's 2018 MD&A dated February 15, 2019. 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 non-GAAP measures and any financial information specifically denoted otherwise. Air Canada's interim unaudited condensed consolidated financial statements for the second quarter of 2019 are based on the accounting policies consistent with those disclosed in Note 2 of Air Canada's 2018 annual consolidated financial statements, except for the adoption of accounting standard IFRS 16 – Leases, those applicable following the acquisition of Aeroplan on January 10, 2019 and IFRIC 23 – Uncertainty over Income Tax Treatments. Additional information can be found in Note 2 of Air Canada's interim unaudited condensed consolidated financial statements and notes for the second quarter of 2019.

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 17 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of July 29, 2019.

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 14 "Risk Factors" of this MD&A and section 18 "Risk Factors" of Air Canada's 2018 MD&A. Air Canada issued a news release dated July 30, 2019 reporting on its results for the second quarter 2019. This news release is available on Air Canada's website at **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 successfully implement appropriate strategic initiatives (including the return to service of Boeing 737 MAX aircraft in our fleet as well as the introduction of those on order) or reduce operating costs, our ability to successfully integrate and operate the Aeroplan loyalty business following its acquisition from Aimia Inc. and to successfully launch our new loyalty program, our ability to preserve and grow our brand, airport user and related fees, high levels of fixed costs, our dependence on key suppliers including regional carriers, employee and labour relations and costs, our dependence on Star Alliance and joint ventures, interruptions of service, environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), our ability to pay our indebtedness and maintain liquidity, pension issues, limitations due to restrictive covenants, pending and future litigation and actions by third parties, our ability to attract and retain required personnel, war, terrorist acts, casualty losses, changes in laws, regulatory developments or proceedings, epidemic diseases, insurance issues and costs, 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 14 "Risk Factors" of this MD&A and section 18 "Risk Factors" of Air Canada's 2018 MD&A. Furthermore, the acquisition of Transat A.T. Inc. is subject to Transat A.T. Inc. shareholder approval, court approval, regulatory approvals, and certain customary conditions, and there are no assurances that the acquisition will be completed as described in this MD&A or at all. 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 continued relatively modest Canadian GDP growth for the third quarter and full year 2019. Air Canada also expects that the Canadian dollar will trade, on average, at C$1.31 per U.S. dollar in the third quarter and C$1.32 per U.S. dollar for the full year 2019 and that the price of jet fuel will average 78 CAD cents per litre in the third quarter and the full year 2019.

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 a sustainably profitable global champion. In pursuing this goal, Air Canada seeks to continually improve customer experience and employee engagement and create value for shareholders by focusing on four core priorities:

- Identifying and implementing cost reduction and revenue enhancing initiatives;
- Pursuing profitable international growth opportunities and leveraging its competitive attributes to expand margins, in large part by increasing connecting traffic through its strategic international gateways in Toronto, Vancouver and Montreal, and grow and compete effectively in both the business and leisure market to and from Canada;
- Engaging customers by continually enhancing their travel experience and by consistently achieving customer service excellence; and
- Fostering positive culture change through employee engagement programs. This includes making meaningful investments in training and other tools that support delivering exceptional customer experience and that also promote improved collaboration to enable Air Canada and its employees to 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 2018 MD&A.

Acquisition of Aeroplan

On January 10, 2019, Air Canada completed its purchase from Aimia Inc. ("Aimia") of all of the outstanding equity of Aeroplan (formerly Aimia Canada Inc.), owner and operator of the Aeroplan loyalty business. The aggregate purchase price for the acquisition consisted of $450 million in cash plus $67 million in cash for closing adjustments (total purchase consideration of $517 million). The acquisition also included the assumption of the Aeroplan Miles liability.

Concurrently with the conclusion of the Aeroplan purchase, Air Canada, The Toronto-Dominion Bank ("TD Bank"), Canadian Imperial Bank of Commerce ("CIBC") and Visa Canada Corporation ("Visa") finalized various commercial agreements relating to and in support of the acquisition, including credit card loyalty program and network agreements for future participation in the Aeroplan program. Similarly, in the first quarter of 2019, Air Canada and Amex Bank of Canada ("AMEX") concluded agreements enabling AMEX's continued participation in the Aeroplan program. Air Canada received payments from TD Bank, CIBC, Visa and AMEX in the aggregate amount of $1,212 million. This consideration has been accounted for as deferred revenue and will be amortized into passenger revenue over the terms of the related agreements.

In addition, TD Bank and CIBC made payments to Air Canada in the aggregate amount of $400 million as prepayments to be applied towards future monthly payments in respect of Aeroplan Miles. This consideration is accounted for as a contract liability within Aeroplan and other deferred revenue.

Air Canada began consolidating Aeroplan's financial results on January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.

Definitive Arrangement Agreement for the Acquisition of Transat

On June 27, 2019, Air Canada and Transat A.T. Inc. ("Transat") announced a definitive arrangement agreement that provides for Air Canada's acquisition of all issued and outstanding shares of Transat. Under the terms of the agreement, Air Canada will acquire all outstanding shares of Transat for $13 per share. The value of the all-cash transaction is approximately $520 million.

The acquisition of Transat remains subject to regulatory and shareholder approvals and other closing conditions usual in this type of transaction. If such approvals are obtained and conditions are met, the transaction is expected to be completed in early 2020.

Second Quarter 2019 Financial Summary

The following is an overview of Air Canada's results of operations and financial position for the second quarter 2019 compared to the second quarter 2018.

- Record second quarter operating revenues of $4,757 million compared to record second quarter operating revenues of $4,333 million in 2018, an increase of $424 million or 10%. On capacity growth of 2.3%, record second quarter passenger revenues of $4,338 million increased $417 million or 11% from the second quarter of 2018 on a yield improvement of 6.8% and traffic growth of 3.6%. The yield improvement year-over-year included additional revenue from Aeroplan flight redemptions and other revenues subsequent to the Aeroplan acquisition on January 10, 2019.

- Operating expenses of $4,335 million in the second quarter of 2019 versus operating expenses of $4,025 million in the second quarter of 2018, an increase of $310 million or 8%. CASM and adjusted CASM increased 5.2% and 5.9%, respectively, from the second quarter of 2018. These increases reflected, in large part, the impact of the Boeing 737 MAX aircraft grounding which resulted in ASM growth of less than half of what had originally been planned, higher costs associated with replacement aircraft, and on-going operating expenses, including depreciation and pilot wages that continued to be incurred in relation to the Boeing 737 MAX aircraft despite their grounding. Given that the Aeroplan loyalty business was not consolidated in Air Canada's financial results in 2018, for a more meaningful comparison of the cost performance of the ongoing airline business, Air Canada's adjusted CASM for the second quarter of 2019 excludes the operating expenses of Aeroplan. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

- Operating income of $422 million in the second quarter of 2019 compared to operating income of $308 million in the second quarter of 2018, an increase of $114 million.

- EBITDA of $916 million in the second quarter of 2019 compared to EBITDA of $739 million in the second quarter of 2018, an increase of $177 million. The airline reported a second quarter 2019 EBITDA margin (EBITDA as a percentage of operating revenue) of 19.3% compared to an EBITDA margin of 17.1% in the second quarter of 2018. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

- Record income before income taxes of $440 million in the second quarter of 2019 versus a loss before income taxes of $106 million in the second quarter of 2018.

- Record adjusted pre-tax income of $326 million in the second quarter of 2019 versus adjusted pre-tax income of $185 million in the second quarter of 2018. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

- Net income of $343 million or $1.26 per diluted share in the second quarter of 2019 versus a net loss of $102 million or $0.37 per diluted share in the second quarter of 2018.

- Adjusted net income of $240 million or $0.88 per diluted share in the second quarter of 2019 versus adjusted net income of $129 million or $0.47 per diluted share in the second quarter of 2018. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

- Net debt of $3,277 million at June 30, 2019 versus net debt of $5,214 million at December 31, 2018, a decrease of $1,937 million, reflecting an increase in cash, cash equivalents and short-term and long-term investment balances of $1,467 million and a decrease in long-term debt and lease liabilities of $470 million. Net debt is an additional GAAP measure. Refer to section 6.3 "Net Debt" of this MD&A for additional information. Air Canada's leverage ratio (net debt to trailing 12-month EBITDA) was 0.9 at June 30, 2019 versus a leverage ratio of 1.6 at December 31, 2018. Leverage ratio is a non-GAAP financial measure. Refer to section 6.3 "Net Debt" of this MD&A for additional information.

- Net cash flows from operating activities of $1,090 million in the second quarter of 2019 versus net cash flows from operating activities of $1,081 million in the second quarter of 2018. In the second quarter of 2019, free cash flow of $537 million increased $413 million from the second quarter of 2018 mainly due to a lower level of capital expenditures year-over-year, in large part due to the deferral of Boeing 737 MAX aircraft deliveries. Free cash flow is a non-GAAP financial measure. Refer to section 6.5 "Consolidated Cash Flow Movements" of this MD&A for additional information.

- Return on invested capital ("ROIC") for the 12 months ended June 30, 2019 of 15.5% versus 13.5% at December 31, 2018. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

4. RESULTS OF OPERATIONS

The table and discussion below provide and compare results of Air Canada for the periods indicated.

(Canadian dollars in millions, except per share figures)	Second Quarter 2019 [1]	Second Quarter 2018 [2]	Change $	Change %	First Six Months 2019 [1]	First Six Months 2018 [2]	Change $	Change %
Operating revenues								
Passenger	$ 4,338	$ 3,921	$ 417	11	$ 8,154	$ 7,410	$ 744	10
Cargo	177	200	(23)	(12)	354	368	(14)	(4)
Other	242	212	30	14	702	626	76	12
Total revenues	**4,757**	**4,333**	**424**	**10**	**9,210**	**8,404**	**806**	**10**
Operating expenses								
Aircraft fuel	991	964	27	3	1,872	1,789	83	5
Wages, salaries and benefits	781	711	70	10	1,580	1,411	169	12
Regional airlines expense								
Aircraft fuel	126	135	(9)	(7)	242	249	(7)	(3)
Other	478	507	(29)	(6)	956	999	(43)	(4)
Depreciation, amortization and impairment	494	431	63	15	950	849	101	12
Airport and navigation fees	248	237	11	5	476	458	18	4
Aircraft maintenance	255	214	41	19	500	420	80	19
Sales and distribution costs	219	199	20	10	432	388	44	11
Ground package costs	116	114	2	2	410	390	20	5
Catering and onboard services	112	108	4	4	215	204	11	5
Communications and IT	91	67	24	36	192	146	46	32
Other	424	338	86	25	836	707	129	18
Total operating expenses	**4,335**	**4,025**	**310**	**8**	**8,661**	**8,010**	**651**	8
Operating income	**422**	**308**	**114**		**549**	**394**	**155**	
Non-operating income (expense)								
Foreign exchange gain (loss)	117	(82)	199		380	(279)	659	
Interest income	41	24	17		79	44	35	
Interest expense	(131)	(143)	12		(264)	(285)	21	
Interest capitalized	9	7	2		17	20	(3)	
Net financing expense relating to employee benefits	(9)	(13)	4		(19)	(25)	6	
Gain (loss) on financial instruments recorded at fair value	6	(9)	15		14	(8)	22	
Gain (loss) on debt settlements and modifications	-	(1)	1		-	10	(10)	
Loss on disposal of assets	-	(186)	186		-	(186)	186	
Other	(15)	(11)	(4)		(31)	(20)	(11)	
Total non-operating income (expense)	**18**	**(414)**	**432**		**176**	**(729)**	**905**	
Income (loss) before income taxes	**440**	**(106)**	**546**		**725**	**(335)**	**1,060**	
Income tax (expense) recovery	(97)	4	(101)		(37)	30	(67)	
Net income (loss)	**$ 343**	**$ (102)**	**$ 445**		**$ 688**	**$ (305)**	**$ 993**	
Diluted earnings (loss) per share	**$ 1.26**	**$ (0.37)**	**$ 1.63**		**$ 2.51**	**$ (1.12)**	**$ 3.63**	
EBITDA [3]	**$ 916**	**$ 739**	**$ $177**		**$ 1,499**	**$ 1,243**	**$ 256**	
Adjusted pre-tax income [3]	**$ 326**	**$ 185**	**$ 141**		**$ 350**	**$ 153**	**$ 197**	
Adjusted net income [3]	**$ 240**	**$ 129**	**$ 111**		**$ 257**	**$ 103**	**$ 154**	
Adjusted earnings per share – diluted [3]	**$ 0.88**	**$ 0.47**	**$ 0.41**		**$ 0.94**	**$ 0.37**	**$ 0.57**	

(1) Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.

(2) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.

(3) EBITDA, adjusted pre-tax income (loss), adjusted net income (loss) and adjusted earnings (loss) per share – diluted are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

System Passenger Revenues

In the second quarter of 2019, system passenger revenues of $4,338 million increased $417 million or 10.7% from the second quarter of 2018 on a yield improvement of 6.8% and traffic growth of 3.6%. System yield and passenger load factor in the second quarter of 2019 improved due to the constrained capacity resulting from the grounding of the Boeing 737 MAX aircraft as well as a generally improved pricing environment. The yield increase also included additional revenue from Aeroplan flight redemptions and other revenues subsequent to the Aeroplan acquisition on January 10, 2019.

Business cabin revenues, on a system-basis, increased $83 million or 10.2% from the second quarter of 2018 on both traffic and yield growth of 5.0%.

The table below provides passenger revenues by geographic region for the second quarter of 2019 and the second quarter of 2018.

Passenger Revenue (Canadian dollars in millions)	**Second Quarter 2019**	**Second Quarter 2018**	**$ Change**	**% Change**
Canada	$ 1,338	$ 1,210	$ 128	10.7
U.S. transborder	959	865	94	11.0
Atlantic	1,159	1,035	124	12.0
Pacific	621	582	39	6.6
Other	261	229	32	13.5
System	**$ 4,338**	**$ 3,921**	**$ 417**	**10.7**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the second quarter of 2019 versus the second quarter of 2018.

Second Quarter 2019 versus Second Quarter 2018	**Passenger Revenue % Change**	**Capacity (ASMs) % Change**	**Traffic (RPMs) % Change**	**Passenger Load Factor pp Change**	**Yield % Change**	**PRASM % Change**
Canada	10.7	0.7	1.9	1.0	8.6	9.9
U.S. transborder	11.0	0.3	(0.1)	(0.3)	11.1	10.7
Atlantic	12.0	3.6	5.8	1.7	5.8	8.1
Pacific	6.6	2.4	2.7	0.3	3.7	4.0
Other	13.5	6.1	9.6	2.7	3.6	7.0
System	**10.7**	**2.3**	**3.6**	**1.0**	**6.8**	**8.1**

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the second quarter of 2019 and each of the previous four quarters.

System	**Year-over-Year by Quarter (% Change)**				
	Q2'18	**Q3'18**	**Q4'18**	**Q1'19**	**Q2'19**
Passenger revenues	10.4	11.2	11.3	9.4	10.7
Capacity (ASMs)	7.5	6.7	5.8	4.6	2.3
Traffic (RPMs)	8.2	7.5	7.2	4.2	3.6
Passenger load factor (pp change)	0.5	0.6	1.1	(0.4)	1.0
Yield	2.0	3.4	3.8	5.0	6.8
PRASM	2.7	4.2	5.2	4.5	8.1

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

- The 6.8% system yield increase which reflected increases in fares and carrier surcharges and additional yield earned on Aeroplan redemption revenues. Growth in higher-yielding local traffic, an improvement in the overall fare mix, and a favourable currency impact of $31 million were also contributing factors to the yield growth year-over-year.

- The 3.6% traffic increase which reflected traffic growth in all markets with the exception of the U.S. transborder market. The small traffic decline in the U.S. transborder market was due to a reduction in capacity on short and long-haul U.S. transborder services, in large part due to the grounding of the Boeing 737 MAX aircraft. The overall traffic growth year-over-year 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 second quarter of 2019 also reflected an increase in connecting traffic via Canada to international destinations.

Compared to the second quarter of 2018, PRASM increased 8.1% on the higher yield and the 1.0 percentage point improvement in passenger load factor.

In the first six months of 2019, system passenger revenues of $8,154 million increased $744 million or 10.0% from the first six months of 2018 on yield and traffic growth of 6.0% and 3.9%, respectively.

Business cabin revenues, on a system-basis, increased $173 million or 11.2% from the first six months of 2018 on traffic and yield growth of 6.4% and 4.5%, respectively.

The table below provides passenger revenue by geographic region for the first six months of 2019 versus the first six months of 2018.

Passenger Revenue (Canadian dollars in millions)	**First Six Months 2019**	**First Six Months 2018**	**$ Change**	**% Change**
Canada	$ 2,442	$ 2,251	$ 191	8.5
U.S. transborder	1,906	1,712	194	11.4
Atlantic	1,926	1,721	205	11.9
Pacific	1,156	1,093	63	5.7
Other	724	633	91	14.4
System	**$ 8,154**	**$ 7,410**	**$ 744**	**10.0**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics by geographic region for the first six months of 2019 versus the first six months of 2018.

First Six Months 2019 versus First Six Months 2018	**Passenger Revenue % Change**	**Capacity (ASMs) % Change**	**Traffic (RPMs) % Change**	**Passenger Load Factor pp change**	**Yield % Change**	**PRASM % Change**
Canada	8.5	0.3	1.3	0.8	7.1	8.2
U.S. transborder	11.4	4.3	3.2	(0.8)	7.9	6.8
Atlantic	11.9	5.1	6.7	1.2	4.9	6.5
Pacific	5.7	0.6	0.5	-	5.1	5.1
Other	14.4	9.8	9.4	(0.3)	4.5	4.1
System	**10.0**	**3.4**	**3.9**	**0.3**	**6.0**	**6.4**

Components of the year-over-year change in system passenger revenues in the first six months of 2019 versus the first six months of 2018 included:

- The 6.0% system yield increase which reflected increases in fares and carrier surcharges and additional yield earned on Aeroplan redemption revenues. Growth in higher-yielding local traffic, an improvement in the overall fare mix, and a favourable currency impact of $66 million were also contributing factors to the yield growth year-over-year.

- The 3.9% traffic increase which reflected traffic growth in all markets. The traffic growth year-over-year 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 six months of 2019 also reflected an increase in connecting traffic via Canada to international destinations.

Compared to the first six months of 2018, PRASM increased 6.4% mainly on the higher yield.

Domestic Passenger Revenues

In the second quarter of 2019, domestic passenger revenues of $1,338 million increased $128 million or 10.7% from the second quarter of 2018.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the second quarter of 2019 and each of the previous four quarters.

Canada	Year-over-Year by Quarter (% Change)				
	Q2'18	**Q3'18**	**Q4'18**	**Q1'19**	**Q2'19**
Passenger revenues	6.6	4.3	5.6	6.0	10.7
Capacity (ASMs)	3.2	4.3	1.5	(0.1)	0.7
Traffic (RPMs)	2.6	3.4	1.7	0.6	1.9
Passenger load factor (pp change)	(0.5)	(0.7)	0.2	0.6	1.0
Yield	3.9	0.9	3.9	5.3	8.6
PRASM	3.2	-	4.1	6.1	9.9

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

- The 8.6% yield increase which reflected yield improvements on all major domestic services. The yield growth versus the second quarter of 2018 reflected the impact of fare increases and new fare categories on domestic services, resulting in growth in ancillary revenue. Additional yield earned on Aeroplan redemption revenues and growth in higher-yielding local traffic were also contributing factors to the yield increase year-over-year.

- The 1.9% traffic increase which reflected traffic growth on all major domestic services. The traffic growth year-over-year included incremental connecting traffic within Canada to international destinations as well as gains in the business cabin.

Compared to the second quarter of 2018, domestic PRASM increased 9.9% on the higher yield and the 1.0 percentage point improvement in passenger load factor.

In the first six months of 2019, domestic passenger revenues of $2,442 million increased $191 million or 8.5% from the first six months of 2018 on a yield improvement of 7.1% and traffic growth of 1.3%. Compared to the first six months of 2018, domestic PRASM increased 8.2% on the higher yield and the 0.8 percentage point improvement in passenger load factor.

U.S. Transborder Passenger Revenues

In the second quarter of 2019, U.S. transborder passenger revenues of $959 million increased $94 million or 11.0% from the second quarter of 2018.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the second quarter of 2019 and each of the previous four quarters.

U.S. transborder	Year-over-Year by Quarter (% Change)				
	Q2'18	Q3'18	Q4'18	Q1'19	Q2'19
Passenger revenues	8.9	9.7	13.4	11.7	11.0
Capacity (ASMs)	6.8	5.9	9.7	8.0	0.3
Traffic (RPMs)	6.6	5.6	9.6	6.4	(0.1)
Passenger load factor (pp change)	(0.1)	(0.3)	(0.1)	(1.2)	(0.3)
Yield	2.2	3.8	3.5	5.0	11.1
PRASM	2.0	3.5	3.4	3.4	10.7

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

- The 11.1% yield increase which reflected yield growth on all major U.S. transborder services. The overall yield improvement versus the second quarter of 2018 included the impact of an improved traffic mix and the launch of new fare categories on U.S. transborder services, resulting in growth in ancillary revenue and an improved fare mix. Additional yield earned on Aeroplan redemption revenues, growth in higher-yielding local traffic, and a favourable currency impact of $14 million were also contributing factors to the yield increase year-over-year.

- The 0.1% traffic decrease which reflected, in large part, reduced capacity on short and long-haul U.S. transborder services, in large part due to the grounding of the Boeing 737 MAX aircraft. Gains in the business cabin and growth in international-to-international connecting passenger flows from the U.S. were offsetting factors.

Compared to the second quarter of 2018, U.S. transborder PRASM increased 10.7% on the higher yield.

In the first six months of 2019, U.S. transborder passenger revenues of $1,906 million increased $194 million or 11.4% from the first six months of 2018 on a yield improvement of 7.9% and traffic growth of 3.2%. Compared to the first six months of 2018, U.S. transborder PRASM increased 6.8% on the higher yield.

Atlantic Passenger Revenues

In the second quarter of 2019, Atlantic passenger revenues of $1,159 million increased $124 million or 12.0% from the second quarter of 2018.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the second quarter of 2019 and each of the previous four quarters.

Atlantic	Year-over-Year by Quarter (% Change)				
	Q2'18	Q3'18	Q4'18	Q1'19	Q2'19
Passenger revenues	17.8	20.3	18.0	11.8	12.0
Capacity (ASMs)	11.9	10.3	9.5	7.4	3.6
Traffic (RPMs)	15.5	13.1	14.5	8.1	5.8
Passenger load factor (pp change)	2.6	2.2	3.5	0.5	1.7
Yield	1.9	6.4	3.0	3.5	5.8
PRASM	5.3	9.1	7.7	4.1	8.1

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

- The 5.8% traffic increase which reflected traffic growth on all major Atlantic services with the exception of India, with the suspension of services from Toronto to Delhi due to the closure of Pakistani airspace that was re-opened on July 18, 2019, and on services to Germany (Montreal-Frankfurt) as a result of the grounding of the Boeing 737 MAX aircraft which both had a negative effect on traffic. The traffic growth year-over-year included gains in all cabins and the impact of the launch of Air Canada's new service from Toronto to Vienna.

- The 5.8% yield increase which reflected yield improvements on all major Atlantic services and included additional yield earned on Aeroplan redemption revenues. An increase in carrier surcharges year-over-year, the launch of a new fare category on Atlantic services, resulting in growth in ancillary revenue and an improved fare mix, and gains in the business cabin were also contributing factors to the yield increase year-over-year.

Compared to the second quarter of 2018, Atlantic PRASM increased 8.1% on the higher yield and the 1.7 percentage point improvement in passenger load factor.

In the first six months of 2019, Atlantic passenger revenues of $1,926 million increased $205 million or 11.9% from the first six months of 2018 on traffic growth of 6.7% and a yield improvement of 4.9%. Compared to the first six months of 2018, Atlantic PRASM increased 6.5% on the higher yield and the 1.2 percentage point improvement in passenger load factor.

Pacific Passenger Revenues

In the second quarter of 2019, Pacific passenger revenues of $621 million increased $39 million or 6.6% from the second quarter of 2018.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the second quarter of 2019 and each of the previous four quarters.

Pacific	Year-over-Year by Quarter (% Change)				
	Q2'18	Q3'18	Q4'18	Q1'19	Q2'19
Passenger revenues	9.9	9.9	9.7	4.7	6.6
Capacity (ASMs)	5.2	1.1	(0.8)	(1.5)	2.4
Traffic (RPMs)	5.7	2.9	0.3	(1.9)	2.7
Passenger load factor (pp change)	0.4	1.5	0.9	(0.4)	0.3
Yield	4.0	6.8	9.3	6.7	3.7
PRASM	4.5	8.6	10.6	6.3	4.0

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

- The 3.7% yield increase which reflected yield growth on all major Pacific services with the exception of services to Australia. The yield increase in the second quarter of 2019 included additional yield earned on Aeroplan redemption revenues. An improved traffic mix and an increase in carrier surcharges were also contributing factors to the yield growth year-over-year. The lower yield on services to Australia reflected increased industry capacity compared to the same quarter in 2018.

- The 2.7% traffic increase which reflected traffic growth on all major Pacific services with the exception of services to China and Hong Kong. The geopolitical situation between Canada and China continued to negatively impact travel demand in the quarter, particularly business-related traffic demand between Canada-China/Hong Kong. In the second quarter of 2019, Air Canada reduced capacity to China to better align it with demand.

Compared to the second quarter of 2018, Pacific PRASM increased 4.0% on the higher yield and a 0.3 percentage point improvement in passenger load factor.

In the first six months of 2019, Pacific passenger revenues of $1,156 million increased $63 million or 5.7% from the first six months of 2018 on a yield improvement of 5.1% and traffic growth of 0.5%. Compared to the first six months of 2018, Pacific PRASM increased 5.1% on the higher yield.

Other Passenger Revenues

In the second quarter of 2019, Other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of $261 million increased $32 million or 13.5% from the second quarter of 2019.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the second quarter of 2019 and each of the previous four quarters.

Other	Year-over-Year by Quarter (% Change)				
	Q2'18	Q3'18	Q4'18	Q1'19	Q2'19
Passenger revenues	7.6	7.9	14.5	14.8	13.5
Capacity (ASMs)	11.7	16.8	15.2	12.2	6.1
Traffic (RPMs)	8.6	11.1	14.0	9.4	9.6
Passenger load factor (pp change)	(2.4)	(4.3)	(0.9)	(2.2)	2.7
Yield	(0.9)	(2.8)	0.5	5.0	3.6
PRASM	(3.7)	(7.6)	(0.6)	2.3	7.0

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

- The 9.6% traffic increase which reflected traffic growth on all major services. The traffic growth in the second quarter of 2019 included gains in all cabins.
- The 3.6% yield increase which reflected yield growth on all major services and included additional yield earned on Aeroplan redemption revenues. On April 1, 2019, Air Canada reverted back to one-stop service to Buenos Aires with a connection in Santiago. The resulting decrease in average stage length of 3.9% in the second quarter of 2019 versus the second quarter of 2018 had the effect of improving yield in the Other markets by 2.3 percentage points.

Compared to the second quarter of 2018, PRASM in the Other markets increased 7.0% on the higher yield and the 2.7 percentage point improvement in passenger load factor.

In the first six months of 2019, Other passenger revenues of $724 million increased $91 million or 14.4% from the first six months of 2018 on traffic growth of 9.4% and a yield improvement of 4.5%. Compared to the first six months of 2018, PRASM in the Other markets increased 4.1% on the higher yield.

Cargo Revenues

Cargo revenues of $177 million in the second quarter of 2019 and $354 million in the first six months of 2019 decreased $23 million or 12.1% and $14 million or 4.1%, respectively, from the same periods in 2018. Compared to the 2018 periods, cargo traffic and yield decreased 7.0% and 5.4%, respectively, in the second quarter of 2019, and 2.3% and 1.8%, respectively, in the first six months of 2019. Demand for air cargo decreased industry-wide, particularly in the Atlantic and Pacific markets, causing reductions in volumes and putting downward pressure on yields. This industry-wide situation reflects the impact of external factors, primarily centered around on-going trade disputes.

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

Cargo revenue (Canadian dollars in millions)	Second Quarter				First Six Months			
	2019	2018	Change $	Change %	2019	2018	Change $	Change %
Canada	$ 29	$ 24	$ 5	20.5	$ 55	$ 43	$ 12	28.6
U.S. transborder	13	10	3	18.4	25	19	6	26.5
Atlantic	57	70	(13)	(17.8)	119	132	(13)	(9.4)
Pacific	64	82	(18)	(22.1)	126	146	(20)	(13.8)
Other	14	14	-	(3.7)	29	28	1	0.7
System	**$ 177**	**$ 200**	**$ (23)**	**(12.1)**	**$ 354**	**$ 368**	**$ (14)**	**(4.1)**

Other Revenues

Other revenues of $242 million in the second quarter of 2019 and $702 million in the first six months of 2019 increased $30 million or 14% and $76 million or 12%, respectively, from the same periods in 2018. These increases were mainly due to the net margin recorded on the redemption and delivery of non-air goods and services related to the Aeroplan program in 2019, and to an increase in ground package revenue at Air Canada Vacations, particularly in the first quarter of 2019. The increase in ground package revenue at Air Canada Vacations was largely driven by a higher price of ground packages and, to a lesser extent, higher passenger volumes year-over-year.

CASM and Adjusted CASM

In the second quarter of 2019, CASM increased 5.2% and adjusted CASM increased 5.9% compared to the second quarter of 2018. In the first six months of 2019, CASM increased 4.5% and adjusted CASM increased 4.6% compared to the first six months of 2018. These increases reflected, in large part, the impact of the Boeing 737 MAX aircraft grounding which resulted in ASM growth of less than half of what had originally been planned, higher costs associated with replacement aircraft, and on-going operating expenses, including depreciation and pilot wages that continued to be incurred in relation to the Boeing 737 MAX aircraft despite their grounding.

The table below compares Air Canada's CASM and adjusted CASM for the periods indicated. Given that the Aeroplan loyalty business was not consolidated in Air Canada's financial results in 2018, for a more meaningful comparison of the cost performance of the on-going airline business, Air Canada's adjusted CASM for the second quarter and the first six months of 2019 excludes the operating expenses of Aeroplan.

(cents per ASM)	Second Quarter				First Six Months			
	2019 (1)	2018 (2)	Change ¢	Change %	2019 (1)	2018 (2)	Change ¢	Change %
CASM	**¢ 15.53**	**¢ 14.76**	**¢ 0.77**	**5.2**	**¢ 16.06**	**¢ 15.36**	**¢ 0.70**	**4.5**
Remove: Aircraft fuel expense (3), ground package costs at Air Canada Vacations, and the operating expenses of Aeroplan	(4.61)	(4.45)	(0.16)	(3.6)	(4.86)	(4.65)	(0.21)	(4.5)
Adjusted CASM (4)	**¢ 10.92**	**¢ 10.31**	**¢ 0.61**	**5.9**	**¢ 11.20**	**¢ 10.71**	**¢ 0.49**	**4.6**

(1) Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.

(2) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.

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

(4) Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Operating Expenses

In the second quarter of 2019, operating expenses of $4,335 million increased $310 million or 8% from the second quarter of 2018 on capacity growth of 2.3%. In the second quarter of 2019, the unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars), compared to the same quarter in 2018, increased operating expenses by $52 million (comprised of $29 million related to aircraft fuel expense and an aggregate of $23 million relating to non-fuel operating expenses).

In the first six months of 2019, operating expenses of $8,661 million increased $651 million or 8% from the first six months of 2018 on capacity growth of 3.4%. In the first six months of 2019, the unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars), compared to the first six months of 2018, increased operating expenses by $133 million (comprised of $70 million relating to aircraft fuel expense and an aggregate of $63 million relating to non-fuel operating expenses).

Aeroplan-related operating expenses amounted to $55 million in the second quarter of 2019 and $99 million in the first six months of 2019. These expenses mainly impact wages, salaries and benefits, depreciation and amortization, communications and information technology and other expenses.

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

Aircraft Fuel Expense

In the second quarter of 2019, aircraft fuel expense (including fuel expense related to regional airline operations) amounted to $1,117 million, an increase of $18 million or 2% from the second quarter of 2018. This increase reflected the impact of a higher volume of fuel litres consumed, accounting for an increase of $32 million, and an unfavourable currency impact of $29 million. These increases were partly offset by the impact of lower jet fuel prices (before the impact of foreign exchange), accounting for a decrease of $42 million, and other factors amounting to a decrease of $1 million.

In the first six months of 2019, aircraft fuel expense (including fuel expense related to regional airline operations) amounted to $2,114 million, an increase of $76 million or 4% from the first six months of 2018. This increase reflected an unfavourable currency impact of $70 million and the impact of a higher volume of fuel litres consumed, accounting for an increase of $60 million. These increases were partly offset by the impact of lower jet fuel prices (before the impact of foreign exchange), accounting for a decrease of $52 million, and other factors amounting to a decrease of $2 million.

Wages, Salaries and Benefits Expense

Wages and salaries expense of $603 million in the second quarter of 2019 and $1,199 million the first six months of 2019 increased $70 million or 13% and $151 million or 14%, respectively, from the same periods in 2018. These increases were largely due to an increase in the number of full-time equivalent employees ("FTEs") (10.1% in the second quarter of 2019 and 10.7% in the first six months of 2019 versus the same periods in 2018), reflecting the capacity growth and the impact of the acquisition of Aeroplan on January 10, 2019. Higher stock-based compensation expense and increase in expenses related to employee profit sharing programs were also contributing factors to the increase in wages and salaries year-over-year.

In the second quarter of 2019, employee benefits expense of $178 million was unchanged from the same quarter in 2018. In the first six months of 2019, employee benefits expense of $381 million increased $18 million or 5% from the first six months of 2019, mainly due to the higher level of FTE employees and the impact of the acquisition of Aeroplan on January 10, 2019. These increases were partly offset by the favourable impact of higher discount rates related to pension and post-employment benefits.

Regional Airlines Expense

Regional airlines expense of $604 million in the second quarter of 2019 and $1,198 million in the first six months of 2019 decreased $38 million or 6% and $50 million or 4%, respectively, compared to the same periods in 2018. These decreases reflected the impact of a lower volume of engine maintenance events, in part due to timing of events versus the same quarter in 2018, the impact of Air Canada's extended and amended capacity purchase agreement with Jazz which became effective on January 1, 2019, and lower aircraft fuel expense year-over-year.

The table below provides a breakdown of regional airlines expense for the periods indicated.

	Second Quarter				First Six Months			
			Change				Change	
(Canadian dollars in millions)	2019	2018 (1)	$	%	2019	2018 (1)	$	%
Capacity purchase fees (2)	$ 247	$ 274	$ (27)	(10)	$ 499	$ 538	$ (39)	(7)
Aircraft fuel	126	135	(9)	(7)	242	249	(7)	(3)
Airport and navigation	74	76	(2)	(3)	143	145	(2)	(1)
Sales and distribution costs	41	41	-	-	77	75	2	3
Other operating expenses	116	116	-	-	237	241	(4)	(2)
Total regional airlines expense	**$ 604**	**$ 642**	**$ (38)**	**(6)**	**$ 1,198**	**$ 1,248**	**$ (50)**	**(4)**

(1) *Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.*

(2) *Capacity purchase fees exclude the component of fees related to aircraft costs which are accounted for as lease liabilities in accordance with IFRS 16 – Leases.*

Depreciation, Amortization and Impairment Expense

Depreciation, amortization and impairment expense of $494 million in the second quarter of 2019 and $950 million in the first six months of 2019 increased $63 million or 15% and $101 million or 12%, respectively, from the same periods in 2018. These increases were largely due to a higher volume of engine maintenance events on leased aircraft, the addition of Boeing 737 MAX and Boeing 787 aircraft into the mainline fleet, and the amortization of intangible assets recorded on the acquisition of Aeroplan on January 10, 2019. The effect of the sale of 25 Embraer 190 aircraft (which Air Canada leased back) in August 2018 was a partly offsetting factor.

Airport and Navigation Fees

Airport and navigation fees of $248 million in the second quarter of 2019 and $476 million in the first six months of 2019 increased $11 million or 5% and $18 million or 4%, respectively, from the same periods in 2018, reflecting the use of larger aircraft, in part due to the grounding of the Boeing 737 MAX aircraft, and Air Canada's international expansion. 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, was a partly offsetting factor.

Aircraft Maintenance Expense

Aircraft maintenance expense of $255 million in the second quarter of 2019 and $500 million in the first six months of 2019 increased $41 million or 19% and $80 million or 19%, respectively, from the same periods in 2018. These increases reflected, in large part, timing of maintenance activity compared to the same periods in 2018, an increase in expenses related to engines under power-by-the-hour arrangements due to increased flying, and an unfavourable currency impact.

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

(Canadian dollars in millions)	Second Quarter				First Six Months			
	2019	2018 (1)	Change $	Change %	2019	2018 (1)	Change $	Change %
Technical maintenance	$ 224	$ 182	$ 42	23	$ 433	$ 350	$ 83	24
Maintenance provisions (2)	28	33	(5)	(15)	50	65	(15)	(23)
Other	3	(1)	4	400	17	5	12	240
Total aircraft maintenance expense	**$ 255**	**$ 214**	**$ 41**	**19**	**$ 500**	**$ 420**	**$ 80**	**19**

(1) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.
(2) Maintenance provisions relate to return conditions on aircraft leases which are recorded over the term of the lease.

Sales and Distribution Costs

Sales and distribution costs of $219 million in the second quarter of 2019 and $432 million in the first six months of 2019 increased $20 million or 10% and $44 million or 11%, respectively, from the same periods in 2018. These increases reflected, in large part, the growth in passenger revenues. An increase in transaction fees paid to global distribution service providers and an unfavourable currency impact were also contributing factors to the increase in sales and distribution costs year-over-year. Growth in direct bookings was a partly offsetting factor.

Ground Package Costs

The cost of ground packages at Air Canada Vacations of $116 million in the second quarter of 2019 and $410 million in the first six months of 2019 increased $2 million or 2% and $20 million or 5%, respectively, compared to the same periods in 2018. These increases were due a higher cost of ground packages, including an unfavourable currency impact, and to higher passenger volumes year-over-year.

Communication and Technology Expense

Communication and technology expense of $91 million in the second quarter of 2019 and $192 million in the first six months of 2019 increased $24 million or 36% and $46 million or 32%, respectively, from the same periods in 2018. These increases reflected additional information technology projects year-over-year, including those related to security, data platforms and systems resiliency and modernization. The increase in communication and technology expense also included the impact of the acquisition of Aeroplan on January 10, 2019, as well as transitional costs associated with the decision to insource key functions previously outsourced to third parties.

Other Expenses

Other expenses of $424 million in the second quarter of 2019 and $836 million in the first six months of 2019 increased $86 million or 25% and $129 million or 18%, respectively, from the same periods in 2018. These increases reflected the capacity growth and Air Canada's international expansion strategy, higher customer service costs, and the cost of short-term aircraft leases, including for additional capacity related to the grounding of the Boeing 737 MAX aircraft. These increases also reflected the impact of the acquisition of Aeroplan on January 10, 2019.

The table below provides a breakdown of the more significant items included in other expenses for the periods indicated.

(Canadian dollars in millions)	Second Quarter				First Six Months			
	2019 [(1)]	2018 [(2)]	Change $	Change %	2019 [(1)]	2018 [(2)]	Change $	Change %
Terminal handling	$ 86	$ 82	$ 4	5	$ 170	$ 156	$ 14	9
Crew cycle	56	51	5	10	107	98	9	9
Building rent and maintenance	44	35	9	26	88	72	16	22
Miscellaneous fees and services	51	35	16	46	102	77	25	32
Remaining other expenses	187	135	52	39	369	304	65	21
Total other expenses	**$ 424**	**$ 338**	**$ 86**	**25**	**$ 836**	**$ 707**	**$ 129**	**18**

(1) Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.

(2) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.

Non-operating Income (Expense)

In the second quarter of 2019, non-operating income amounted to $18 million versus non-operating expense of $414 million in the second quarter of 2018. In the first six months of 2019, non-operating income amounted to $176 million versus non-operating expense of $729 million in the first six months of 2018.

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

- In the second quarter of 2019, gains on foreign exchange amounted to $117 million compared to losses on foreign exchange of $82 million in the second quarter of 2018. The June 30, 2019 closing exchange rate was US$1=C$1.3095 while the March 31, 2019 closing exchange rate was US$1=C$1.3349. The gains on foreign exchange in the second quarter of 2019 included foreign exchange gains on long-term debt and lease liabilities of $161 million and foreign exchange losses on foreign currency derivatives of $47 million. In the first six months of 2019, gains on foreign exchange amounted to $380 million compared to losses on foreign exchange of $279 million in the first six months of 2018. The June 30, 2019 closing exchange rate was US$1=C$1.3095 while the December 31, 2018 closing exchange rate was US$1=C$1.3637. The gains on foreign exchange in the first six months of 2019 included foreign exchange gains on long-term debt and lease liabilities of $352 million and foreign exchange gains on foreign currency derivatives of $30 million.

- Air Canada recorded a gain of $11 million on debt modifications related to the repricing of the airline's senior secured credit facility in the first six months of 2018, whereas no such gains were recorded in the first six months of 2019.

- Air Canada recorded a loss on disposal of assets of $186 million in the second quarter of 2018 related to the sale of 25 Embraer 190 aircraft, whereas no such loss was recorded in the second quarter of 2019.

5. FLEET

The tables below provide the number of aircraft in Air Canada's operating fleet as at June 30, 2019 as well as Air Canada's planned operating fleet as at December 31, 2019 and December 31, 2020. Given the grounding of the Boeing 737 MAX aircraft, as described below, Air Canada assumes, in the table below, that the remaining 12 Boeing 737 MAX aircraft deliveries scheduled for 2019 will be delivered in 2020.

	Actual			Planned			
Mainline	**December 31, 2018**	**First Six Months 2019 Fleet Changes**	**June 30, 2019**	**Reminder of 2019 Fleet Changes**	**December 31, 2019**	**2020 Fleet Changes**	**December 31, 2020**
Wide-body aircraft							
Boeing 787-8	**8**	-	**8**	-	**8**	-	**8**
Boeing 787-9	**27**	2	**29**	-	**29**	-	**29**
Boeing 777-300ER	**19**	-	**19**	-	**19**	-	**19**
Boeing 777-200LR	**6**	-	**6**	-	**6**	-	**6**
Boeing 767-300ER	**6**	-	**6**	(1)	**5**	(5)	**-**
Airbus A330-300	**8**	2	**10**	4	**14**	1	**15**
Narrow-body aircraft							
Boeing 737 MAX 8 (1)	**18**	6	**24**	-	**24**	26	**50**
Airbus A321	**15**	-	**15**	-	**15**	-	**15**
Airbus A320	**42**	(1)	**41**	-	**41**	(25)	**16**
Airbus A319	**16**	-	**16**	-	**16**	-	**16**
Airbus A220-300	**-**	-	**-**	1	**1**	14	**15**
Embraer 190	**19**	(1)	**18**	(1)	**17**	(17)	**-**
Total Mainline	**184**	**8**	**192**	**3**	**195**	**(6)**	**189**
Air Canada Rouge							
Wide-body aircraft							
Boeing 767-300ER	**25**	-	**25**	-	**25**	-	**25**
Narrow-body aircraft							
Airbus A321	**6**	4	**10**	4	**14**	-	**14**
Airbus A320	**-**	2	**2**	2	**4**	1	**5**
Airbus A319	**22**	-	**22**	-	**22**	-	**22**
Total Air Canada Rouge	**53**	**6**	**59**	**6**	**65**	**1**	**66**
Total wide-body aircraft	**99**	4	**103**	3	**106**	(4)	**102**
Total narrow-body aircraft	**138**	10	**148**	6	**154**	(1)	**153**
Total Mainline and Air Canada Rouge	**237**	**14**	**251**	**9**	**260**	**(5)**	**255**

(1) Grounding of Boeing 737 MAX Aircraft

On March 12, 2019 the European Aviation Safety Agency ("EASA") issued an Emergency Directive suspending the operation of the Boeing 737 MAX within, to and from the European skies (including outside territories). On March 13, 2019, Transport Canada issued a safety notice closing Canadian airspace to Boeing 737 MAX aircraft until further notice, followed by the Federal Aviation Administration which issued a temporary grounding order for the Boeing 737 MAX aircraft. On March 14, 2019, Boeing announced it would suspend Boeing 737 MAX deliveries to airline customers. Air Canada was expecting to receive another 12 aircraft for a total fleet of 36 Boeing 737 MAX aircraft by July 2019. Because the timeline for the return to service of the Boeing 737 MAX aircraft remains uncertain, for planning purposes, Air Canada is removing Boeing 737 MAX flying from its schedule until at least January 8, 2020. The table above may change once the duration and related impact of the grounding, or Boeing's decision to suspend deliveries, of the Boeing 737 MAX aircraft is known. Final decisions on returning the Boeing 737 MAX aircraft to service will be based on Air Canada's safety assessment following the lifting of government safety notices and approval by international regulatory authorities.

Measures taken by Air Canada to mitigate the impact of the Boeing 737 MAX grounding include:

- Substituting different aircraft on Boeing 737 MAX routes, extended leases for three Airbus A320 and three Embraer 190 aircraft which were scheduled to exit the fleet and accelerating the in-take of up to six Airbus A321 aircraft from WOW Air into its fleet.

- Contracting other carriers to provide additional capacity.

- Implementing several route changes, either changing operating times or substituting larger aircraft with fewer frequencies on routes operated more frequently by smaller aircraft.

- In some cases, deploying Air Canada Rouge aircraft to serve mainline routes and, in a small number of cases, suspending service on certain Boeing 737 MAX routes where alternative capacity is not yet available. Air Canada remains committed to these routes and will resume service as soon as possible. In addition, some seasonal route launches, such as Montreal-Bordeaux and Vancouver-Boston, have been delayed.

- Maintaining Boeing 737 MAX aircraft training and flying requirements of pilots assigned to the Boeing 737 MAX aircraft.

Sale of Embraer 190 Aircraft

In August 2018, Air Canada finalized the sale and leaseback of 25 Embraer 190 aircraft. Six of these aircraft were returned to the lessor in 2018 and one of these aircraft was returned to the lessor in the first quarter of 2019. Air Canada plans to return one of these aircraft to the lessor in the second half of 2019, with the remaining 17 aircraft exiting the fleet in 2020.

Air Canada Express

The table below provides the number of aircraft operated, as at June 30, 2019, and planned, as at December 31, 2019 and December 31, 2020, 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.

	Actual			Planned			
	December 31, 2018	**First Six Months 2019 Fleet Changes**	**June 30, 2019**	**Remainder of 2019 Fleet Changes**	**December 31, 2019**	**2020 Fleet Changes**	**December 31, 2020**
Embraer 175	**25**	**-**	**25**	-	**25**	-	**25**
Bombardier CRJ-100/200	**24**	**-**	**24**	-	**24**	(9)	**15**
Bombardier CRJ-900	**21**	1	**22**	4	**26**	9	**35**
Bombardier Dash 8-100	**15**	(8)	**7**	(5)	**2**	(2)	**-**
Bombardier Dash 8-300	**25**	(3)	**22**	1	**23**	(4)	**19**
Bombardier Dash 8-Q400	**44**	-	**44**	-	**44**	(8)	**36**
Total Air Canada Express	**154**	**(10)**	**144**	**-**	**144**	**(14)**	**130**

Other Aircraft with CPA Carriers

A total of five 18-passenger Beech 1900 aircraft were also operated by CPA carriers on behalf of Air Canada.

6. FINANCIAL AND CAPITAL MANAGEMENT

6.1. Liquidity

Air Canada manages its liquidity needs through a variety of strategies, including by seeking to sustain and improve cash from operations and free cash flow, sourcing committed financing, as necessary, for new and existing aircraft, and through other financing activities.

Liquidity needs are primarily related to meeting obligations associated with financial liabilities, capital commitments, on-going operations, contractual and other obligations, which are further discussed in sections 6.6, 6.7 and 6.8 of this MD&A. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available for use as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. At June 30, 2019, unrestricted liquidity amounted to $6,907 million (comprised of cash, cash equivalents and short-term investments of $5,921 million and undrawn lines of credit of $986 million). This compared to unrestricted liquidity of $5,064 million at June 30, 2018 (comprised of cash, cash equivalents and short-term investments of $4,670 million and undrawn lines of credit of $394 million). Air Canada also has long-term investments of $253 million at June 30, 2019. These investments can be used to meet long-term financial commitments or converted to cash, if needed.

Air Canada defines excess cash as total cash and investments in excess of the minimum cash required to support operations. This measure of liquidity includes cash, cash equivalents, short-term investments, short-term restricted cash and long-term investments. Air Canada uses 20% of trailing 12 months operating revenue as its estimate of the minimum cash required to support on-going business operations. This estimate of minimum cash provides adequate coverage for advance ticket sales and to meet Air Canada's liquidity needs, as described above. Excess cash amounted to $2,479 million at June 30, 2019. Excess cash is used in the calculation of return on invested capital. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

In addition, Air Canada monitors its financial leverage as measured by the net debt to EBITDA ratio, as further described in section 6.3 of this MD&A.

6.2. Financial Position

The table below provides a condensed consolidated statement of financial position of Air Canada as at June 30, 2019 and as at December 31, 2018.

(Canadian dollars in millions)	June 30, 2019 (1)	December 31, 2018 (2)	$ Change
Assets			
Cash, cash equivalents and short-term investments	$ 5,921	$ 4,707	$ 1,214
Other current assets	1,691	1,594	97
Current assets	**$ 7,612**	**$ 6,301**	**$ 1,311**
Investments, deposits and other assets	707	401	306
Property and equipment	13,076	12,183	893
Pension assets	1,609	1,969	(360)
Deferred income tax	518	314	204
Intangible assets	850	404	446
Goodwill	3,288	311	2,977
Total assets	**$ 27,660**	**$ 21,883**	**$ 5,777**
Liabilities			
Current liabilities	$ 8,475	$ 5,676	$ 2,799
Long-term debt and lease liabilities	8,202	8,873	(671)
Aeroplan and other deferred revenue	3,240	-	3,240
Pension and other benefit liabilities	2,974	2,547	427
Maintenance provisions	1,174	1,307	(133)
Other long-term liabilities	156	151	5
Deferred income tax	73	52	21
Total liabilities	**$ 24,294**	**$ 18,606**	**$ 5,688**
Total shareholders' equity	**$ 3,366**	**$ 3,277**	**$ 89**
Total liabilities and shareholders' equity	**$ 27,660**	**$ 21,883**	**$ 5,777**

(1) Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.

(2) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.

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

At June 30, 2019, property and equipment amounted to $13,076 million, an increase of $893 million from December 31, 2018. This increase was due to the non-cash impact of the Jazz CPA extension, as described below, and due to additions to property and equipment of $1,395 million, offset by the impact of depreciation expense of $908 million.

In the first six months of 2019, additions to property and equipment included two new Boeing 787-9 aircraft, six new Boeing 737 MAX 8 aircraft and four used Airbus A321 aircraft. These aircraft were purchased with cash. In the first six months of 2019, additions to property and equipment also included progress payments on future aircraft deliveries and capitalized maintenance costs.

At June 30, 2019, the net long-term pension and other benefit liabilities of $1,365 million (comprised of pension and other benefit liabilities of $2,974 million net of pension assets of $1,609 million) increased $787 million from December 31, 2018. This increase was mainly due to a 81-basis point decrease in the discount rate used to value the liabilities, resulting in a net loss on remeasurements on employee liabilities of $639 million ($466 million, net of tax) in the first six months of 2019 (recorded on Air Canada's consolidated statement of comprehensive income). The increase also included the impact of the Aeroplan acquisition, as described below.

Acquisition of Aeroplan

In January 2019, Air Canada completed the acquisition of Aeroplan, as further described in section 3 "Overview" of this MD&A. In addition to the commercial agreement consideration of $1,212 million and the $400 million prepayment of Aeroplan Miles (both of which are recorded within Aeroplan and other deferred revenue), the table below summarizes the additions to Air Canada's consolidated statement of financial position on the acquisition date.

(Canadian dollars in millions)

Fair value of assets acquired		
Cash	**$**	-
Accounts receivable		188
Prepaid expenses and other current assets		8
Property and equipment		55
Deferred income tax		42
Intangible assets – Technology-based		44
Intangible assets – Contract-based		225
Intangible assets – Trade name		90
	$	**652**
Fair value of liabilities assumed		
Accounts payable and accrued liabilities		229
Deferred revenue (current and long-term)		2,779
Long-term debt (lease liabilities)		41
Pension and other benefit liabilities		39
Deferred income tax		24
	$	**3,112**
Fair value of net assets acquired		**(2,460)**
Goodwill		**2,977**
Total purchase consideration	**$**	**517**

Capacity Purchase Agreement with Jazz and Equity Investment in Chorus

In February 2019, Air Canada concluded an agreement to amend and extend its capacity purchase agreement ("Jazz CPA") with Jazz, a wholly owned subsidiary of Chorus Aviation Inc. The amendments provide an extension of the CPA term by 10 years from January 1, 2026 to December 31, 2035. The amendments include various minimum levels of covered aircraft at different points in time, providing Air Canada the flexibility to optimize the fleet within its network strategy. The amendments became effective retroactively as at January 1, 2019. With the extension of the Jazz CPA term, increases of $95 million to the right-of-use asset and $104 million to the lease liability and a decrease of $9 million to the maintenance provision were recorded in the first quarter of 2019. The increases to the right-of-use asset and lease liability relate only to those aircraft that are specifically identified to be extended at this time. As additional aircraft are confirmed for extension during the term of the contract, additional right-of-use assets and lease liabilities will be recorded.

Concurrently with the Jazz CPA amendments, Air Canada subscribed for 15,561,600 class B voting shares in the capital of Chorus, representing, at time of issuance, approximately 9.99% of the issued and outstanding class A variable voting shares and class B voting shares of Chorus on a combined basis. This represents an investment of $97 million by Air Canada. The Chorus shares were issued to Air Canada at a price of $6.25 per share, representing a 5% premium to the five-day volume weighted average price of the shares as of the close of trading on January 10, 2019. Air Canada and Chorus entered into an investor rights agreement under which, among other things, Air Canada will hold the investment shares for a period of at least 60 months, subject to certain limited exceptions. The equity investment in Chorus is accounted for at fair value, with all changes in fair value recorded through other comprehensive income. The fair value of the investment at June 30, 2019 was $120 million and is recorded in investments, deposits and other assets. The change in fair value recorded through other comprehensive income for the three months ended June 30, 2019 was $9 million, comprised of a gain of $8 million plus a deferred income tax recovery of $1 million (gain of $20 million for the six months ended June 30, 2019, comprised of a gain of $23 million less deferred income tax expense of $3 million).

6.3. Net Debt

The table below reflects Air Canada's net debt balances as at June 30, 2019 and as at December 31, 2018.

(Canadian dollars in millions, except where indicated)	**June 30, 2019 (1)**	**December 31, 2018 (2)**	**$ Change**
Total long-term debt and lease liabilities	$ 8,202	$ 8,873	(671)
Current portion of long-term debt and lease liabilities	1,249	1,048	201
Total long-term debt and lease liabilities (including current portion)	**$ 9,451**	**$ 9,921**	**(470)**
Less cash, cash equivalents, short-term investments and long-term investments	(6,174)	(4,707)	(1,467)
Net debt (3)	**$ 3,277**	**$ 5,214**	**(1,937)**
EBITDA (trailing 12 months)	**$ 3,469**	**$ 3,213**	**256**
Net debt to EBITDA ratio (4)	**0.9**	**1.6**	**(0.7)**

(1) *Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.*

(2) *Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.*

(3) *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.*

(4) *Net debt to trailing 12-month EBITDA ratio (also referred to as "leverage ratio" in this MD&A) is a non-GAAP financial measure and is used by Air Canada to measure financial leverage. Leverage ratio is calculated by dividing net debt by trailing 12-month EBITDA. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.*

At June 30, 2019, total long-term debt and lease liabilities (including current portion) of $9,451 million decreased $470 million from December 31, 2018. The favourable impact of a stronger Canadian dollar, as at June 30, 2019 compared to December 31, 2018, decreased foreign currency denominated debt (mainly U.S. dollars) by $352 million. Partially offsetting this decrease was the impact of the Jazz CPA extension, as described in section 6.2 "Financial Position" of this MD&A, which increased lease liabilities by $104 million.

At June 30, 2019, net debt of $3,277 million decreased $1,937 million from December 31, 2018, reflecting an increase in cash, cash equivalents and short-term and long-term investment balances of $1,467 million and a decrease in long-term debt and lease liabilities of $470 million. At June 30, 2019, Air Canada's leverage ratio (net debt to trailing 12-month EBITDA ratio) was 0.9 versus a leverage ratio of 1.6 at December 31, 2018.

In 2019, Air Canada began placing cash in long-term investment accounts and, as at June 30, 2019, long-term investments amounted to $253 million. These investments can be used to meet long-term financial commitments or converted to cash, if needed. As such, Air Canada updated its definition of net debt to include these long-term investments (as a deduction) to arrive at net debt.

At June 30, 2019, Air Canada's weighted average cost of capital ("WACC"), on a pre-tax basis, was 7.2%. WACC is based on an estimate by management and consists of an estimated cost of equity of 15.2% and a blended average cost of debt and lease liabilities of 5.2% (comprised of an average cost of debt of 4.2% and an average cost of lease liabilities of 7.1%). This compared to WACC, on a pre-tax basis, of 8.0% at December 31, 2018 which consisted of an estimated cost of equity of 18.2% and a blended average cost of debt and lease liabilities of 5.4% (comprised of an average cost of debt of 4.2% and an average cost of lease liabilities of 7.6%).

6.4. Working Capital

The table below provides information on Air Canada's working capital balances as at June 30, 2019 and as at December 31, 2018.

(Canadian dollars in millions)	June 30, 2019 (1)	December 31, 2018 (2)	$ Change
Cash, cash equivalents and short-term investments	$ 5,921	$ 4,707	$ 1,214
Accounts receivable	1,050	796	254
Other current assets	641	798	(157)
Total current assets	**$ 7,612**	**$ 6,301**	**$ 1,311**
Accounts payable and accrued liabilities	2,404	1,911	493
Advance ticket sales	3,729	2,717	1,012
Aeroplan and other deferred revenue	1,093	-	1,093
Current portion of long-term debt and lease liabilities	1,249	1,048	201
Total current liabilities	**$ 8,475**	**$ 5,676**	**$ 2,799**
Net working capital	**$ (863)**	**$ 625**	**$ (1,488)**

(1) *Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.*

(2) *Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.*

The net negative working capital of $863 million at June 30, 2019 represented a decrease of $1,488 million from December 31, 2018. Investing and financing activities related to aircraft acquisitions, the investment in Chorus and share repurchases were the main drivers of the decrease in net working capital. In addition, as noted in section 6.3 "Net Debt" of this MD&A, in 2019, Air Canada began placing cash in long-term investment accounts and, as at June 30, 2019, long-term investments amounted to $253 million. This had the effect of decreasing net working capital as well.

The net cash impact of the Aeroplan acquisition and related agreements amounted to an increase in cash of $1,115 million as at the acquisition date, representing the commercial agreement consideration of $1,212 million and the $400 million prepayment of Aeroplan Miles, which are reported as operating cash inflows, less the share purchase price of $517 million, which is reported as an investing outflow. On a working capital basis, this cash impact was largely offset with the current portion of Aeroplan and other deferred revenue.

Accounts receivable, accounts payable and accrued liabilities, and advance ticket sales increased in the first six months of 2019 as is typical with the seasonal build-up of sales and activity levels heading into the busier third quarter. These balances have also increased due to the addition of Aeroplan amounts since the date of acquisition, as described in section 6.2 "Financial Position" above, net of the elimination of intercompany balances.

6.5. Consolidated Cash Flow Movements

The table below provides the cash flow movements for Air Canada for the periods indicated.

(Canadian dollars in millions)	Second Quarter			First Six Months		
	2019 (1)	2018 (2)	$ Change	2019 (1)	2018 (2)	$ Change
Net cash flows from operating activities	**$ 1,090**	**$ 1,081**	**$ 9**	**$ 4,201**	**$ 2,372**	**$ 1,829**
Proceeds from borrowings	-	521	(521)	-	1,210	(1,210)
Reduction of long-term debt and lease liabilities	(280)	(495)	215	(532)	(846)	314
Shares purchased for cancellation	(103)	(22)	(81)	(154)	(23)	(131)
Issue of shares	2	1	1	3	2	1
Financing fees	-	(4)	4	-	(8)	8
Net cash flows from (used in) financing activities	**$ (381)**	**$ 1**	**$ (382)**	**$ (683)**	**$ 335**	**$ (1,018)**
Investments, short-term and long-term	(139)	(504)	365	(519)	(625)	106
Additions to property, equipment and intangible assets	(553)	(957)	404	(1,473)	(1,930)	457
Proceeds from sale of assets	1	5	(4)	3	6	(3)
Acquisition of Aeroplan	(20)	-	(20)	(517)	-	(517)
Investment in Chorus	-	-	-	(97)	-	(97)
Other	15	30	(15)	51	45	6
Net cash flows used in investing activities	**$ (696)**	**$ (1,426)**	**$ 730**	**$ (2,552)**	**$ (2,504)**	**$ (48)**
Effect of exchange rate changes on cash and cash equivalents	**$ (4)**	**$ 3**	**$ (7)**	**$ (5)**	**$ 11**	**$ (16)**
Increase (decrease) in cash and cash equivalents	**$ 9**	**$ (341)**	**$ 350**	**$ 961**	**$ 214**	**$ 747**

(1) Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.

(2) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.

In conjunction with Air Canada's acquisition of Aeroplan, Air Canada received payments from TD Bank, CIBC, Visa and AMEX in the aggregate amount of $1,212 million. In addition, TD Bank and CIBC made payments to Air Canada in the aggregate amount of $400 million as prepayments to be applied towards future monthly payments in respect of Aeroplan Miles. Air Canada has excluded these one-time proceeds in its calculation of free cash flow.

The table below provides the calculation of free cash flow for Air Canada for the periods indicated.

(Canadian dollars in millions)	Second Quarter			First Six Months		
	2019 (1)	**2018 (2)**	**$ Change**	**2019 (1)**	**2018 (2)**	**$ Change**
Net cash flows from operating activities	**$ 1,090**	**$ 1,081**	**$ 9**	**$ 4,201**	**$ 2,372**	**$ 1,829**
Additions to property, equipment and intangible assets	(553)	(957)	404	(1,473)	(1,930)	457
One-time proceeds related to the acquisition of Aeroplan (as described above)	-	-	-	(1,612)	-	(1,612)
Free cash flow (3)	**$ 537**	**$ 124**	**$ 413**	**$ 1,116**	**$ 442**	**$ 674**

(1) *Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.*

(2) *Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.*

(3) *Free cash flow is a non-GAAP financial measures used by Air Canada as an indicator of the financial strength and performance of its business, indicating how much cash it can generate from operations and after capital expenditures and after one-time proceeds related to the acquisition of Aeroplan. 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. The one-time proceeds related to the acquisition of Aeroplan in 2019 were also excluded from Air Canada's calculation of free cash flow. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.*

Free Cash Flow

In the second quarter of 2019, net cash flows from operating activities of $1,090 million increased $9 million compared to the same quarter in 2018. In the second quarter of 2019, free cash flow of $537 million increased $413 million from the second quarter of 2018, mainly due to a lower level of capital expenditures year-over-year, in large part due to the deferral of Boeing 737 MAX aircraft deliveries.

In the first six months of 2019, net cash flows from operating activities of $4,201 million increased $1,829 million compared to the same period in 2018. As described above, the operating cash inflows related to the Aeroplan acquisition amounted to $1,612 million. The cash flow benefit of an improvement in operating income year-over-year and gross billings of Aeroplan Miles to program partners since the date of acquisition were contributing factors to the improvement in net cash flows from operating activities in the second quarter and the first six months of 2019.

Excluding the one-time proceeds related to the Aeroplan acquisition, free cash flow of $1,116 million in the first six months of 2019 increased $674 million from the first six months of 2018 due to the higher cash flows from operating activities and to a lower level of capital expenditures year-over-year, in large part due to the deferral of Boeing 737 MAX aircraft deliveries.

Net Cash Flows from (used in) Financing Activities

Reduction of long-term debt and lease liabilities amounted to $280 million in the second quarter of 2019 and $532 million in the first six months of 2019.

Refer to sections 6.4 "Working Capital", 6.2 "Financial Position" and 6.3 "Net Debt" and 6.9 "Share Information" of this MD&A for additional information.

6.6. Capital Expenditures and Related Financing Arrangements

Boeing 787 Aircraft

Air Canada took delivery of the last of 37 Boeing 787 aircraft at the end of April 2019 and has no remaining purchase commitment with The Boeing Company ("Boeing") for this aircraft type. Air Canada 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).

Boeing 737 MAX Aircraft

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

- Firm orders for 61 Boeing 737 MAX aircraft, consisting of 50 Boeing 737 MAX 8 and 11 Boeing 737 MAX 9 aircraft with substitution rights between them as well as for the Boeing 737 MAX 7 aircraft.
- Purchase options for 18 Boeing 737 MAX aircraft.
- Certain rights to purchase an additional 30 Boeing 737 MAX aircraft.

Twenty-four Boeing 737 MAX 8 aircraft have been delivered, with the delivery of the remaining 37 Boeing 737 MAX aircraft scheduled from 2019 to 2024. Given the grounding of the Boeing 737 MAX aircraft and the uncertainty surrounding their return to service, Air Canada assumes, in the capital commitments table below, that the remaining 12 Boeing 737 MAX aircraft scheduled for delivery in 2019 will be delivered in 2020. Refer to section 5 "Fleet" of this MD&A for additional information.

Subject to certain conditions, Air Canada has financing commitments covering 25 firm Boeing 737 MAX 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.

Airbus A220-300 Aircraft

In June 2016, Air Canada and Bombardier Inc. ("Bombardier") finalized a purchase agreement which provides for a firm order for 45 Airbus A220-300 aircraft (formerly called Bombardier C-Series CS300 aircraft) and options for an additional 30 Airbus A220-300 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.

Capital Commitments

As outlined in the table below, the estimated aggregate cost of the future firm Boeing 737 MAX and Airbus A220-300 aircraft deliveries and other capital purchase commitments as at June 30, 2019 approximates $4,581 million. Air Canada assumes, in the table below, that the remaining 12 Boeing 737 MAX aircraft deliveries scheduled for 2019 will be delivered in 2020. The capital commitments in the table below may change once the duration and related impact of the grounding, and Boeing's decision to suspend deliveries, of the Boeing 737 MAX aircraft are known.

(Canadian dollars in millions)	Remainder of 2019	2020	2021	2022	2023	Thereafter	Total
Projected committed expenditures	$ 573	$ 1,996	$ 762	$ 703	$ 359	$ 188	$ 4,581
Projected planned but uncommitted expenditures	218	453	402	426	786	Not available	Not available
Projected planned but uncommitted capitalized maintenance (1)	178	384	475	406	450	Not available	Not available
Total projected expenditures (2)	**$ 969**	**$ 2,833**	**$ 1,639**	**$ 1,535**	**$ 1,595**	**Not available**	**Not available**

(1) Future capitalized maintenance amounts for 2022 and 2023 and beyond are not yet determinable, however estimates of $406 million and $450 million, respectively, have been made for 2022 and 2023.

(2) U.S. dollar amounts are converted using the June 30, 2019 closing exchange rate of US$1=C$1.3095. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at June 30, 2019.

6.7. Pension Funding Obligations

Air Canada maintains several defined benefit pension plans, including domestic registered pension plans, supplemental pension plans and pension plans for foreign employees. Air Canada also has several defined contribution pension plans as well as plans providing other retirement and post-employment benefits to its employees.

Based on actuarial valuations as at January 1, 2019, the aggregate solvency surplus in Air Canada's domestic registered pension plans is $2.5 billion. As a result, Air Canada will not make any past service payments to these plans in 2019.

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.

As a result of the acquisition of Aeroplan on January 10, 2019, Air Canada's net pension benefit obligation increased $20 million. The Aeroplan pension plan has past service and current service funding requirements in 2019.

On a cash basis, total employer pension funding contributions (including the international and supplemental plans and the Aeroplan pension plan) are forecasted to be $100 million in 2019.

As at June 30, 2019, taking into account the effect of financial instrument risk management tools, approximately 82.5% 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.

6.8. Contractual Obligations

The table below provides Air Canada's contractual obligations as at June 30, 2019, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and lease liabilities and committed capital expenditures. The contractual obligations in the table below may change once the duration and related impact of the grounding, or Boeing's decision to suspend deliveries, of the Boeing 737 MAX aircraft is known.

(Canadian dollars in millions)	Remainder of 2019	2020	2021	2022	2023	Thereafter	Total
Principal							
Long-term debt	$ 187	$ 608	$ 965	$ 331	$ 1,402	$ 2,639	$ 6,132
Lease liabilities	336	571	440	364	355	1,351	3,417
Total principal obligations	**$ 523**	**$ 1,179**	**$ 1,405**	**$ 695**	**$ 1,757**	**$ 3,990**	**$ 9,549**
Interest							
Long-term debt	129	247	204	168	145	329	1,222
Lease liabilities	113	187	146	118	95	393	1,052
Total interest	**$ 242**	**$ 434**	**$ 350**	**$ 286**	**$ 240**	**$ 722**	**$ 2,274**
Total long-term debt and lease liabilities	**$ 765**	**$ 1,613**	**$ 1,755**	**$ 981**	**$ 1,997**	**$ 4,712**	**$ 11,823**
Committed capital expenditures	**$ 573**	**$ 1,996**	**$ 762**	**$ 703**	**$ 359**	**$ 188**	**$ 4,581**
Total contractual obligations (1)	**$ 1,338**	**$ 3,609**	**$ 2,517**	**$ 1,684**	**$ 2,356**	**$ 4,900**	**$ 16,404**

(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 and lease liabilities due to reasons of uncertainty of timing of cash flows and items that are non-cash in nature.

6.9. Share Information

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

	June 30, 2019	December 31, 2018
Issued and outstanding shares		
Variable voting shares	119,148,342	125,214,350
Voting shares	147,580,793	145,515,561
Total issued and outstanding shares	**266,729,135**	**270,729,911**
Class A variable voting and Class B voting shares potentially issuable		
Stock options	6,795,070	6,014,464
Total shares potentially issuable	**6,795,070**	**6,014,464**
Total outstanding and potentially issuable shares	**273,524,205**	**276,744,375**

Normal Course Issuer Bid

In May 2019, Air Canada received approval from the Toronto Stock Exchange for the renewal of its normal course issuer bid for its Class A variable voting shares and Class B voting shares (collectively the "shares"), authorizing, between May 31, 2019 and May 30, 2020, the purchase of up to 24,130,551 shares, representing 10% of Air Canada's public float of 241,305,518 shares as at May 17, 2019. The renewal followed the conclusion of the 2018 normal course issuer bid which expired on May 30, 2019.

In connection with the renewal of its issuer bid, Air Canada renewed its automatic share purchase plan (the "Plan") with its designated broker to facilitate the purchase of shares under the issuer bid at times when Air Canada would ordinarily not be permitted to purchase its Shares due to regulatory restrictions or self-imposed blackout periods. Air Canada self-imposes regular blackouts during the period commencing fifteen days prior to the end of each fiscal quarter to, and including, two trading days after the public announcement of Air Canada's quarterly or annual financial results. Pursuant to the Plan, before entering a blackout period, Air Canada may, but is not required to, instruct the designated broker to make purchases under the issuer bid based on parameters established by Air Canada. Such purchases will be determined by the designated broker based on Air Canada's parameters in accordance with the rules of the TSX, applicable securities laws and the terms of the Plan. The Plan was implemented effective May 31, 2019.

In the second quarter of 2019, Air Canada purchased, for cancellation, a total of 2,770,000 shares at an average cost of $38.83 per share for aggregate consideration of $108 million (a total of 4,314,487 shares at an average cost of $36.77 per share for aggregate consideration of $159 million in the first six months of 2019). At June 30, 2019, a total of 22,645,551 shares remained available for purchase under the existing normal course issuer bid.

7. QUARTERLY FINANCIAL DATA

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

(Canadian dollars in millions, except where indicated)	2017 [1]		2018 [1]				2019 [2]	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Operating revenues	$ 4,880	$ 3,820	$ 4,071	$ 4,333	$ 5,415	$ 4,246	$ 4,453	$ 4,757
Operating expenses	3,904	3,687	3,985	4,025	4,492	4,067	4,326	4,335
Operating income	**976**	**133**	**86**	**308**	**923**	**179**	**127**	**422**
Non-operating income (expense)	**(11)**	**(113)**	**(315)**	**(414)**	**31**	**(570)**	**158**	**18**
Income (loss) before income taxes	**965**	**20**	**(229)**	**(106)**	**954**	**(391)**	**285**	**440**
Income tax (expense) recovery	758	(12)	26	4	(252)	31	60	(97)
Net income (loss)	**$ 1,723**	**$ 8**	**$ (203)**	**$ (102)**	**$ 702**	**$ (360)**	**$ 345**	**$ 343**
Diluted earnings (loss) per share	**$ 6.22**	**$ 0.02**	**$ (0.74)**	**$ (0.37)**	**$ 2.55**	**$ (1.33)**	**$ 1.26**	**$ 1.26**
Adjusted pre-tax income (loss) [3]	**$ 922**	**$ 77**	**$ (32)**	**$ 185**	**$ 815**	**$ 68**	**$ 24**	**$ 326**
Adjusted net income (loss) [3]	**$ 922**	**$ 60**	**$ (26)**	**$ 129**	**$ 580**	**$ 55**	**$ 17**	**$ 240**
Adjusted earnings (loss) per share – diluted [3]	**$ 3.33**	**$ 0.22**	**$ (0.10)**	**$ 0.47**	**$ 2.10**	**$ 0.20**	**$ 0.06**	**$ 0.88**

(1) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts. 2017 amounts have not been restated for the adoption of this new accounting standard.

(2) Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.

(3) Adjusted pre-tax income (loss), adjusted net income (loss) and adjusted earnings (loss) per share – diluted are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

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

(Canadian dollars in millions)	2018 [1]				2019 [2]	
	Q1	Q2	Q3	Q4	Q1	Q2
Capacity purchase fees [2]	$ 264	$ 274	$ 265	$ 264	$ 252	$ 247
Aircraft fuel	114	135	149	133	116	126
Airport and navigation	69	76	78	73	69	74
Sales and distribution costs	34	41	44	34	36	41
Other	125	116	113	118	121	116
Total regional airlines expense	**$ 606**	**$ 642**	**$ 649**	**$ 622**	$ **594**	**$ 604**

(1) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.

(2) Capacity purchase fees exclude the component of fees related to aircraft costs which are accounted for as lease liabilities in accordance with IFRS 16 – Leases.

The table below provides major quarterly operating statistics for Air Canada for the last six quarters.

System	2018 (1) Q1	2018 (1) Q2	2018 (1) Q3	2018 (1) Q4	2019 (2) Q1	2019 (2) Q2
Passenger PRASM (cents)	14.0	14.4	15.1	14.8	14.7	15.5
CASM (cents)	16.0	14.8	13.6	15.9	16.6	15.5
Adjusted CASM (cents) (3)	11.1	10.3	9.2	11.1	11.5	10.9
Fuel cost per litre (cents) (4)	73.3	80.2	83.0	84.3	75.5	79.2

(1) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.

(2) Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.

(3) Adjusted CASM is a non-GAAP financial measure. A reconciliation of this measure to a comparable GAAP measure can be found in section 16 "Non-GAAP Financial Measures" of this MD&A and in Air Canada's MD&A reports, available at aircanada.com.

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

The table below 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.

	2017		2018				2019	
System	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
RPMs (millions)	26,472	19,396	20,440	22,654	28,465	20,801	21,293	23,463
ASMs (millions)	31,050	24,191	24,862	27,269	33,137	25,598	26,016	27,910
Passenger load factor (%)	85.3	80.2	82.2	83.1	85.9	81.3	81.8	84.1
Domestic								
RPMs (millions)	6,130	4,607	4,226	5,003	6,339	4,684	4,251	5,097
ASMs (millions)	7,173	5,584	5,280	6,026	7,482	5,667	5,274	6,068
Passenger load factor (%)	85.4	82.5	80.0	83.0	84.7	82.7	80.6	84.0
U.S. Transborder								
RPMs (millions)	3,951	3,408	4,037	3,848	4,172	3,734	4,296	3,845
ASMs (millions)	4,683	4,252	4,945	4,673	4,962	4,662	5,341	4,686
Passenger load factor (%)	84.4	80.1	81.6	82.3	84.1	80.1	80.4	82.0
Atlantic								
RPMs (millions)	9,406	5,076	4,573	7,084	10,642	5,813	4,943	7,496
ASMs (millions)	11,087	6,582	5,753	8,571	12,231	7,206	6,177	8,882
Passenger load factor (%)	84.8	77.1	79.5	82.7	87.0	80.6	80.0	84.4
Pacific								
RPMs (millions)	5,471	4,501	4,572	4,936	5,630	4,514	4,485	5,072
ASMs (millions)	6,412	5,586	5,447	5,829	6,484	5,541	5,368	5,971
Passenger load factor (%)	85.3	80.6	83.9	84.7	86.8	81.5	83.6	84.9
Other								
RPMs (millions)	1,514	1,804	3,032	1,783	1,682	2,056	3,317	1,953
ASMs (millions)	1,695	2,187	3,437	2,170	1,978	2,522	3,857	2,303
Passenger load factor (%)	89.3	82.5	88.2	82.1	85.0	81.6	86.0	84.8

8. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Air Canada's financial instruments and risk management practices are summarized in section 12 of Air Canada's 2018 MD&A. There have been no material changes to Air Canada's financial instruments and risk management practices from that which was disclosed at that time. Additional information on Air Canada's risk management practices and financial instruments is discussed in Note 13 of Air Canada's interim unaudited condensed consolidated financial statements for the second quarter of 2019.

9. ACCOUNTING POLICIES

Air Canada's accounting policies are summarized in section 14 of Air Canada's 2018 MD&A. Air Canada adopted IFRS 16 – Leases on January 1, 2019. The accounting policies disclosed at that time have been updated, as described below, to reflect the acquisition of Aeroplan on January 10, 2019.

Acquisition of Aeroplan – Accounting Policy Impacts

The following are updates to Air Canada's accounting policies applicable prospectively following the acquisition of Aeroplan on January 10, 2019. Refer to section 10 "Critical Accounting Estimates and Judgements" for additional information.

Passenger Revenues – Update from Aeroplan Acquisition

Prior to the acquisition of Aeroplan, advance ticket sales included the proceeds from the sale of flight tickets to Aeroplan, a corporation that provides loyalty program services to Air Canada and purchased seats from Air Canada pursuant to the Commercial Participation and Services Agreement between Aeroplan and Air Canada (the "CPSA"). Under the CPSA, Aeroplan purchased passenger tickets from Air Canada, which are accounted for as passenger revenues by Air Canada when transportation is provided.

Subsequent to the acquisition of Aeroplan on January 10, 2019, advance ticket sales continue to include the value of Aeroplan Mile redemptions for flight tickets issued by Air Canada post-acquisition. For Aeroplan Miles issued after the acquisition date, the value of Aeroplan deferred revenue related to Aeroplan Miles issued but not yet redeemed is determined with reference to their Equivalent Ticket Value ("ETV") for Miles issued from qualifying air travel, or with reference to the consideration received for Aeroplan Miles sold to third party Aeroplan program partners. ETV is determined based on the value a passenger receives by redeeming Aeroplan Miles for a ticket rather than paying cash. The ETV is adjusted for Aeroplan Miles that are not expected to be redeemed ("breakage"). On the acquisition date, the outstanding Aeroplan Miles were recorded at fair value as Aeroplan deferred revenue.

Breakage represents the estimated Aeroplan Miles that are not expected to be redeemed by Aeroplan members. The amount of revenue recognized related to breakage is based on the number of Aeroplan Miles redeemed in a period in relation to the total number of Aeroplan Miles expected to be redeemed. The number of Aeroplan Miles redeemed in a period also factors into any revised estimate for breakage. Changes in breakage are accounted for as follows: in the period of change, the deferred revenue balance is adjusted as if the revised estimate had been used in prior periods with the offsetting amount recorded as an adjustment to passenger revenue; and for subsequent periods, the revised estimate is used.

Intangible Assets

Contract-based, marketing-based and technology-based intangible assets, with an acquisition fair value of $225 million, $90 million and $44 million, respectively, were recorded upon the acquisition of Aeroplan on January 10, 2019. The contract-based intangible assets have an estimated useful life of 11.5 years, being the term of the primary commercial agreements with program partners, which expire in 2030. The marketing-based trade name is considered an indefinite life intangible asset.

IFRIC 23 – Uncertainty over Income Tax Treatments

IFRIC 23 is effective for years beginning on or after January 1, 2019. IFRIC 23 provides a framework to consider, recognize and measure the accounting impact of tax uncertainties and provides specific guidance in several areas where previously IAS 12 Income Taxes was silent. The Corporation has adopted the interpretation of IFRIC 23 and concluded that it has no impact on previously reported results.

10. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Air Canada's critical accounting estimates and judgements are summarized in section 13 of Air Canada's 2018 MD&A. The estimates and judgements disclosed at that time have been updated to include those related to the acquisition of Aeroplan on January 10, 2019.

Business Combinations

Air Canada's business acquisition of Aeroplan was accounted for using the acquisition method of accounting. Under the acquisition method, the estimated fair values of the acquired company's assets and assumed liabilities are added to the consolidated statement of financial position as at the acquisition date. There were various assumptions made when determining the fair values of Aeroplan's assets and assumed liabilities. The most significant assumptions and those requiring the most judgement involve the estimated fair values of intangible assets and the estimated fair values of deferred revenues related to the outstanding Aeroplan Miles obligation ("Aeroplan deferred revenue").

The intangible assets recognized on the acquisition of Aeroplan include technology-based, contract-based and marketing-based (trade name) intangible assets. To determine the fair value of technology-based intangible assets, Air Canada applied a depreciated replacement cost methodology. For contract-based intangible assets, Air Canada used the multi-period excess earnings method. This valuation technique values the intangible assets based on the capitalization of the excess earnings, which are calculated to be in excess of what a reasonable amount of earnings would be on the tangible assets used to generate the earnings. Significant assumptions include, among others, the determination of projected revenues, cash flows, customer retention rates, discount rates and anticipated average income tax rates. To determine the fair value of the trade name, Air Canada used the relief from royalty method. This valuation technique values the intangible assets based on the present value of the expected after-tax royalty cash flow stream using a hypothetical licensing arrangement. Significant assumptions include, among others, the determination of projected revenues, royalty rate, discount rates and anticipated average income tax rates.

The deferred revenues recognized on the acquisition of Aeroplan relate to the estimated fair value of outstanding Aeroplan Miles. The liability assumed was recorded based on the estimated fair value to service the Miles outstanding that are expected to be redeemed.

Aeroplan Loyalty Program

The Aeroplan loyalty program generates customer loyalty by rewarding customers to travel on Air Canada. This program allows program members to earn Miles by flying on Air Canada, Star Alliance partners and other airlines that participate in the loyalty program. When traveling, members earn redeemable Miles based on the passenger's loyalty program status, distance traveled, booking class and travel fare paid. Members can also earn Miles through participating Aeroplan program partners such as credit card companies, hotels, car rental agencies and other program partners. Aeroplan Miles are redeemable by members for air travel on Air Canada and other participating airlines, and for other program awards, such as hotel, car rentals, gift cards, merchandise and other non-air rewards.

Aeroplan members can earn Aeroplan Miles through: (1) Aeroplan Miles earned with travel and (2) Aeroplan Miles sold to program partners.

Miles Earned with Travel

Passenger ticket sales earning Miles under the Aeroplan loyalty program provide members with (1) air transportation and (2) Aeroplan Miles. As a revenue arrangement with multiple performance obligations, each performance obligation is valued on a relative standalone fair value basis. The value of Aeroplan Miles issued is determined based on the value a passenger receives by redeeming Miles for a ticket rather than paying cash, which is referred to as equivalent ticket value ("ETV"). The ETV is adjusted for Miles that are not likely to be redeemed ("breakage"). The consideration allocated to the ETV for Miles earned with travel is recorded in Aeroplan deferred revenue.

Miles Sold to Program Partners

Aeroplan members can earn Aeroplan Miles based on their spending with participating companies such as credit card companies, hotels and car rental agencies and other program partners. Aeroplan Miles issued under these agreements are accounted for as a single performance obligation being the future delivery of a redemption reward to the Aeroplan member. The consideration received for Aeroplan Miles issued to Aeroplan members under these agreements is recorded as Aeroplan deferred revenue.

From the date of acquisition on January 10, 2019 to June 30, 2019, total consideration received for the issuance of Aeroplan Miles under these agreements was $459 million ($261 million in the second quarter of 2019).

Redemption Revenue

When Aeroplan Miles are redeemed for air travel, the value of Miles redeemed is removed from Aeroplan deferred revenue and recorded in advance ticket sales. The revenue is then recognized in passenger revenue when the transportation is provided.

For non-air redemptions, Air Canada has determined that, for accounting purposes, it is not the principal in the transaction between the member and the ultimate supplier of the goods or service. When Miles are redeemed for non-air goods and services, the net margin is recorded in other revenue when the performance obligation is satisfied.

Breakage

Breakage represents the estimated Miles that are not expected to be redeemed by members. Breakage is estimated by management based on the terms and conditions of membership and historical accumulation and redemption patterns, as adjusted for changes to any terms and conditions or other circumstances that may affect members' future redemption practices. Management uses statistical and simulation models to estimate breakage.

Subsequent to the acquisition date, the amount of revenue recognized related to breakage is based on the number of Miles redeemed in a period in relation to the total number of Miles expected to be redeemed, which factors in Air Canada's estimate for breakage. Changes in breakage are accounted for as follows: in the period of change, the deferred revenue balance is adjusted as if the revised estimate had been used in prior periods with the offsetting amount recorded as an adjustment to passenger revenue; and for subsequent periods, the revised estimate is used. A change in assumptions as to the number of Miles expected to be redeemed could have a material impact on revenue in the year in which the change occurs.

On a fair value basis as at the date of acquisition, the fair value of the Aeroplan deferred revenue incorporated the estimate of Miles to be redeemed in the future.

As at June 30, 2019, the Aeroplan Miles deferred revenue balance was $2,786 million. For illustrative purposes, a hypothetical 1% change in the number of outstanding Miles estimated to be redeemed would result in an approximate impact of $28 million on revenue with a corresponding adjustment to Aeroplan deferred revenue.

11. OFF-BALANCE SHEET ARRANGEMENTS

Information on Air Canada's off-balance sheet arrangements is disclosed in section 15 "Off-Balance Sheet Arrangements" of Air Canada's 2018 MD&A. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

12. RELATED PARTY TRANSACTIONS

At June 30, 2019, Air Canada had no transactions with related parties as defined in the CPA Handbook, except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship agreements.

13. SENSITIVITY OF RESULTS

Air Canada's financial results are subject to many different internal and external factors which can have a significant impact on operating results. The following table describes, on an indicative basis, the financial impact that changes in fuel prices and the value of the Canadian dollar would generally have had on Air Canada's past operating results. An equivalent but opposite movement of the sensitivity factor in the table below would have generally resulted in a similar but opposite impact. These guidelines were derived from 2018 levels of activity and make use of management estimates. The impacts are not additive, do not reflect the interdependent relationship of the elements and may not be indicative of future trends or results which may vary significantly due to a wide range of factors many of which are beyond the control of Air Canada.

The table below has been updated from what was disclosed in Air Canada's 2018 MD&A to reflect the impact of accounting standard IFRS 16 – Leases effective January 1, 2019 with restatement of 2018 amounts.

Key Variable (Canadian dollars in millions)	2018 Measure	Sensitivity Factor	Favourable/ (Unfavourable) Estimated Operating Income Impact
Fuel			
Fuel – Jet fuel price (US$/barrel) (1)	93.0	US$1/barrel increase	$ (46)
Fuel – Jet fuel price (CAD cents/litre) (1)	80.4	1% increase	$ (43)

Key Variable (Canadian dollars in millions)	2018 Measure	Sensitivity Factor	Favourable/ (Unfavourable) Estimated Operating Income and Pre-Tax Income Impacts
Currency Exchange			
C$ to US$	US$1 = C$1.33	1 cent increase (i.e. $1.33 to $1.32 per US$)	
		Operating income (2)	$ 15
		Net interest expense	4
		Revaluation of long-term debt and lease liabilities, U.S. dollar cash, cash equivalents and short-term investments, and other long-term monetary items, net	67
		Remeasurement of outstanding currency derivatives	(37)
		Pre-tax income impact	**$ 49**

(1) *Excludes the impact of carrier surcharges and fuel hedging.*

(2) *The operating income impact of currency exchange movements is before the impact of hedging activities, such as through the use of foreign currency derivatives and holding U.S. dollar cash reserves. The gains and losses related to these hedging activities are recorded in non-operating income (expense) on Air Canada's consolidated statement of operations.*

14. 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 2018 MD&A. Except for the following updates, there have been no material changes to Air Canada's risk factors from what was disclosed at that time.

On March 12, 2019 the European Aviation Safety Agency ("EASA") issued an Emergency Directive suspending the operation of the Boeing 737 MAX within, to and from the European skies (including outside territories). On March 13, 2019, Transport Canada issued a safety notice closing Canadian airspace to Boeing 737 MAX aircraft until further notice, followed by the Federal Aviation Administration which issued a temporary grounding order for the Boeing 737 MAX aircraft. On March 14, 2019, Boeing announced it would suspend Boeing 737 MAX deliveries to airline customers. At that time, Air Canada had 24 Boeing 737 MAX aircraft in its operating fleet, with an additional 12 Boeing 737 MAX aircraft scheduled for delivery in 2019, and 25 scheduled for delivery from 2020 to 2024. The Boeing 737 MAX aircraft in Air Canada's 2019 fleet plans would have represented approximately 8% of Air Canada's projected 2019 ASMs. The duration and ongoing impact of this action is uncertain and could negatively affect operations, reduce revenues and increase costs, based on a number of factors, including, among others, the period of time the aircraft are unavailable, the availability and cost of appropriate replacement aircraft, and the circumstances of any reintroduction of the aircraft to service. The grounding will also affect the delivery schedule for Air Canada's remaining Boeing 737 MAX aircraft on order. Air Canada has been adjusting its schedule to optimize its fleet and accommodate passengers through a series of mitigation measures, including schedule changes, temporary route suspensions and sourcing alternative aircraft. Final decisions on returning the Boeing 737 MAX aircraft to service will be based on Air Canada's safety assessment following the lifting of Transport Canada's safety notice and approval by international regulatory authorities.

Air Canada is updating the risk factor in its 2018 MD&A relating to the *Air Passenger Protection Regulations* to specify that certain obligations imposed by the regulations entered into force on July 15, 2019, pertaining to compensation and standards of treatment for flight delays and cancellations, while others will come into force on December 15, 2019.

15. 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 Deputy Chief Executive Officer and Chief Financial Officer ("CFO") and its Disclosure 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 2018 filings, the Corporation's CEO and CFO certified, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design and effectiveness of the Corporation's disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting.

In the Corporation's second quarter 2019 filings, the Corporation's CEO and CFO certified, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design of the Corporation's disclosure controls and procedures and the design of internal controls over financial reporting.

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

Changes in Internal Controls over Financial Reporting

There have been no changes to the Corporation's internal controls over financial reporting during the quarter ended June 30, 2019 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

16. NON-GAAP FINANCIAL MEASURES

Below is a description of certain non-GAAP financial measures used by Air Canada 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.

EBITDA

EBITDA (earnings before interest, taxes, depreciation, amortization and impairment) 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 and impairment 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 EBITDA as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

EBITDA is reconciled to GAAP operating income as follows:

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2019 (1)**	**2018 (2)**	**$ Change**	**2019 (1)**	**2018 (2)**	**$ Change**
Operating income – GAAP	**$ 422**	**$ 308**	**$ 114**	**$ 549**	**$ 394**	**$ 155**
Add back:						
Depreciation, amortization and impairment	494	431	63	950	849	101
EBITDA (including special items)	**$ 916**	**$ 739**	**$ 177**	**$ 1,499**	**$ 1,243**	**$ 256**
Remove effect of special items (2)	-	-	-	-	-	-
EBITDA (excluding special items)	**$ 916**	**$ 739**	**$ 177**	**$ 1,499**	**$ 1,243**	**$ 256**

(1) Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.

(2) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.

Adjusted CASM

Air Canada uses adjusted CASM as a means to assess the operating and cost performance of its on-going airline business without the effects of aircraft fuel expense, the cost of ground packages at Air Canada Vacations, the operating costs of Aeroplan, 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 a more meaningful analysis of Air Canada's operating expense performance and a more meaningful comparison to those of other airlines.

Following the completion of Air Canada's acquisition of Aeroplan on January 10, 2019, Air Canada began consolidating Aeroplan's results. Given that the Aeroplan loyalty business was not consolidated in Air Canada's financial results in 2018, for a more meaningful comparison of the cost performance of the on-going airline business, Air Canada's adjusted CASM for 2019 excludes the operating expenses of Aeroplan.

Adjusted CASM is reconciled to GAAP operating expense as follows:

	Second Quarter			First Six Months		
(Canadian dollars in millions, except where indicated)	**2019 (1)**	**2018 (2)**	**$ Change**	**2019 (1)**	**2018 (2)**	**$ Change**
Operating expense – GAAP	**$ 4,335**	**$ 4,025**	**$ 310**	**$ 8,661**	**$ 8,010**	**$ 651**
Adjusted for:						
Aircraft fuel expense	(1,117)	(1,099)	(18)	(2,114)	(2,038)	(76)
Ground package costs	(116)	(114)	(2)	(410)	(390)	(20)
Operating expenses of Aeroplan	(55)	-	(55)	(99)	-	(99)
Operating expense, adjusted for the above-noted items	**$ 3,047**	**$ 2,812**	**$ 235**	**$ 6,038**	**$ 5,582**	**$ 456**
ASMs (millions)	**27,910**	**27,269**	**2.3%**	**53,926**	**52,131**	**3.4%**
Adjusted CASM (cents)	**¢ 10.92**	**¢ 10.31**	**5.9%**	**¢ 11.20**	**¢ 10.71**	**4.6%**

(1) Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.

(2) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.

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 expense relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful. Air Canada uses adjusted pre-tax income (loss) before interest to determine return on invested capital.

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

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2019 (1)**	**2018 (2)**	**$ Change**	**2019 (1)**	**2018 (2)**	**$ Change**
Income (loss) before income taxes – GAAP	**$ 440**	**$ (106)**	**$ 546**	**$ 725**	**$ (335)**	**$ 1,060**
Adjusted for:						
Foreign exchange (gain) loss	(117)	82	(199)	(380)	279	(659)
Net financing expense relating to employee benefits	9	13	(4)	19	25	(6)
(Gain) loss on financial instruments recorded at fair value	(6)	9	(15)	(14)	8	(22)
(Gain) loss on debt settlements and modifications	-	1	(1)	-	(10)	10
Loss on disposal of assets (3)	-	186	(186)	-	186	(186)
Adjusted pre-tax income	**$ 326**	**$ 185**	**$ 141**	**$ 350**	**$ 153**	**$ 197**

(1) Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.

(2) Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.

(3) In the second quarter of 2018, Air Canada recorded a loss on disposal of assets of $186 million related to the sale of 25 Embraer 190 aircraft.

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 expense relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

Adjusted net income is reconciled to GAAP net income (loss) as follows:

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2019 (1)**	**2018 (2)**	**$ Change**	**2019 (1)**	**2018 (2)**	**$ Change**
Net income (loss) – GAAP	**$ 343**	**$ (102)**	**$ 445**	**$ 688**	**$ (305)**	**$ 993**
Adjusted for:						
Foreign exchange (gain) loss	(108)	85	(193)	(329)	255	(584)
Net financing expense relating to employee benefits	7	9	(2)	14	18	(4)
(Gain) loss on financial instruments recorded at fair value	(4)	6	(10)	(10)	5	(15)
(Gain) loss on debt settlements and modifications	-	1	(1)	-	-	-
Loss on disposal of assets (3)	-	130	(130)	-	130	(130)
Special net income tax expense (recovery) (4)	2	-	2	(106)	-	(106)
Adjusted net income	**$ 240**	**$ 129**	**$ 111**	**$ 257**	**$ 103**	**$ 154**
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	**273**	277	(4)	274	277	(3)
Adjusted earnings per share – diluted	**$ 0.88**	**$ 0.47**	**$ 0.41**	**$ 0.94**	**$ 0.37**	**$ 0.57**

(1) *Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.*

(2) *Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.*

(3) *In the second quarter of 2018, Air Canada recorded a loss on disposal of assets of $186 million related to the sale of 25 Embraer 190 aircraft.*

(4) *Air Canada recorded special net income tax items in the first and second quarters of 2019 mainly related to Air Canada's acquisition of Aeroplan on January 10, 2019.*

The table below reflects the share amounts used in the computation of basic and diluted earnings per share on an adjusted earnings per share basis.

	Second Quarter		First Six Months	
(in millions)	**2019**	**2018**	**2019**	**2018**
Weighted average number of shares outstanding – basic	**269**	**273**	**270**	**273**
Effect of dilution	4	4	4	4
Weighted average number of shares outstanding – diluted	**273**	**277**	**274**	**277**

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. ROIC is based on adjusted pre-tax income (loss), excluding interest expense. Invested capital includes average year-over-year long-term debt, average year-over-year lease obligations, average year-over-year shareholders' equity, net of excess cash. Air Canada defines excess cash as total cash and investments in excess of the minimum cash required to support operations. This measure of liquidity includes cash, cash equivalents, short-term investments, short-term restricted cash and long-term investments. Air Canada uses 20% of trailing 12 months operating revenue as its estimate of the minimum cash required to support on-going business operations. This estimate of minimum cash provides adequate coverage for advance ticket sales and to meet Air Canada's liquidity needs, as described in section 6.1 "Liquidity" of this MD&A. Air Canada calculates invested capital based on a book value-based method of calculating ROIC, as described above. Refer to the definition of adjusted pre-tax income (loss) for a discussion as to why Air Canada uses adjusted pre-tax income (loss) 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)	**June 30, 2019 (1)**	**December 31, 2018 (2)**
Income before income taxes - GAAP	**$ 1,288**	**$ 228**
Remove:		
Foreign exchange (gain) loss	(81)	578
Net financing expense relating to employee benefits	44	50
(Gain) loss on financial instruments recorded at fair value	(21)	1
(Gain) loss on debt settlements and modifications (3)	1	(9)
Loss on disposal of assets (4)	2	188
Adjusted pre-tax income	**$ 1,233**	**$ 1,036**
Adjusted for:		
Interest expense	546	567
Adjusted pre-tax income before interest	**$ 1,779**	**$ 1,603**
Invested capital:		
Average long-term debt and finance lease obligations	9,913	9,649
Average shareholders' equity, net of excess cash	1,572	2,240
Invested capital	**$ 11,485**	**$ 11,889**
Return on invested capital (%)	**15.5**	**13.5**

(1) *Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan. Refer to section 9 "Accounting Policies" and section 10 "Critical Accounting Estimates and Judgements" of this MD&A for additional information.*

(2) *Air Canada adopted accounting standard IFRS 16 - Leases effective January 1, 2019 with restatement of 2018 amounts.*

(3) *In the 12 months ended December 31, 2018, Air Canada recorded a gain on debt settlements and modifications of $11 million related to the repricing of its US$1.1 billion senior secured credit facility.*

(4) *In the second quarter of 2018, Air Canada recorded a loss on disposal of assets of $186 million related to the sale of 25 Embraer 190 aircraft.*

Net Debt to Trailing 12-Month EBITDA (Leverage Ratio)

Net debt to trailing 12-month EBITDA 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 net debt by trailing 12-month EBITDA (excluding special items). As mentioned above, Air Canada excludes special items from EBITDA results (which are used to determine leverage ratio) as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful. Refer to section 6.3 "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. Free cash flow in 2019 also excludes the one-time proceeds related to the Aeroplan acquisition. Refer to section 6.5 "Consolidated Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

17. 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, the operating expenses of Aeroplan, and special items. Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "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 expense relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items. Adjusted net income (loss) is a non-GAAP financial measure. Refer to section 16 "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 expense relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items. Adjusted pre-tax income (loss) is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Aeroplan – Refers to Aeroplan Inc., formerly known as Aimia Canada Inc.

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.

EBITDA – Refers to earnings before interest, taxes, depreciation, amortization and impairment. EBITDA is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information. Air Canada excludes special items from EBITDA.

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 in the second quarter of 2019 also excludes the one-time proceeds related to the Aeroplan acquisition. Free cash flow is a non-GAAP financial measure. Refer to sections 6.5 "Consolidated Cash Flow Movements" and 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Jazz – Refers to Jazz Aviation LP.

Jazz CPA – Refers to the capacity purchase agreement between Air Canada and Jazz.

Leverage ratio – Refers to the ratio of net debt to trailing 12-month EBITDA (calculated by dividing net debt by trailing 12-month EBITDA). Leverage ratio is a non-GAAP financial measure. Refer to sections 6.3 "Net Debt" and 16 "Non-GAAP Financial Measures" 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 the Corporation's financial performance.

Other passenger and cargo revenues – Refer to revenues from flights with origins and destinations principally in Central and South America, 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. ROIC is a non-GAAP financial measure. Refer to section 16 "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 the Corporation's financial performance.

Weighted average cost of capital or WACC – Refers to management's estimate of its cost of capital, in which each category of capital is proportionately weighted.

Yield – Refers to average passenger revenue per RPM.