Second Quarter 2020

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

July 31, 2020

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		
	2020	2019	$ Change	2020	2019	$ Change
Financial Performance Metrics						
Operating revenues	527	4,738	(4,211)	4,249	9,172	(4,923)
Operating income (loss)	(1,555)	422	(1,977)	(1,988)	549	(2,537)
Income (loss) before income taxes	(1,481)	440	(1,921)	(2,757)	725	(3,482)
Net income (loss)	(1,752)	343	(2,095)	(2,801)	688	(3,489)
Adjusted pre-tax income (loss) (1)	(1,438)	326	(1,764)	(1,958)	350	(2,308)
EBITDA (excluding special items) (1)	(832)	916	(1,748)	(761)	1,499	(2,260)
Unrestricted liquidity (2)	9,120	7,160	1,960	9,120	7,160	1,960
Net cash flows from (used in) operating activities	(1,251)	1,090	(2,341)	(1,271)	4,201	(5,472)
Free cash flow (1)	(1,493)	537	(2,000)	(1,856)	1,116	(2,972)
Net debt (1)	4,564	3,277	1,287	4,564	3,277	1,287
Diluted earnings (loss) per share	(6.44)	1.26	(7.70)	(10.48)	2.51	(12.99)
Operating Statistics (3)			**% Change**			**% Change**
Revenue passenger miles ("RPM") (millions)	783	23,463	(96.7)	18,290	44,756	(59.1)
Available seat miles ("ASM") (millions)	2,243	27,910	(92.0)	25,754	53,927	(52.2)
Passenger load factor %	34.9%	84.1%	(49.1) pp	71.0%	83.0%	(12.0) pp
Passenger revenue per RPM ("Yield") (cents)	26.4	18.4	43.3	18.6	18.1	2.5
Passenger revenue per ASM ("PRASM") (cents)	9.2	15.5	(40.5)	13.2	15.1	(12.3)
Operating revenue per ASM (cents)	23.5	17.0	38.4	16.5	17.0	(3.0)
Operating expense per ASM ("CASM") (cents)	92.9	15.5	NM	24.2	16.0	NM
Adjusted CASM (cents) (1)	76.9	11.1	NM	18.7	11.3	NM
Average number of full-time equivalent ("FTE") employees (thousands) (4)	16.4	33.1	(50.4)	24.7	32.6	(24.3)
Aircraft in operating fleet at period-end (5)	348	400	(13.0)	348	400	(13.0)
Seats dispatched (thousands)	1,347	15,955	(91.6)	15,510	31,367	(50.6)
Aircraft frequencies (thousands)	15.1	136.6	(88.9)	130.3	270.1	(51.8)
Average stage length (miles) (6)	1,664	1,749	(4.9)	1,660	1,719	(3.4)
Fuel cost per litre (cents)	51.8	79.2	(34.7)	66.3	77.4	(14.4)
Fuel litres (thousands)	240,783	1,410,466	(82.9)	1,448,902	2,731,231	(47.0)
Revenue passengers carried (thousands) (7)	480	12,837	(96.3)	10,407	24,868	(58.2)

(1) Adjusted pre-tax income (loss), EBITDA (excluding special items) (earnings before interest, taxes, depreciation and amortization), free cash flow 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.

(2) Unrestricted liquidity refers to the sum of cash, cash equivalents and short and long-term investments, and the amount of available credit under Air Canada's revolving credit facilities. At June 30, 2020, unrestricted liquidity was comprised of cash, cash equivalents and short-term investments of $8,644 million, and long-term investments of $476 million. At June 30, 2019, unrestricted liquidity was comprised of cash, cash equivalents and short-term investments of $5,921 million, long-term investments of $253 million and undrawn lines of credit of $986 million.

(3) Except for the reference to average number of FTE employees, operating statistics in this table include third party carriers operating under capacity purchase agreements with Air Canada.

(4) Reflects FTE employees at Air Canada and its subsidiaries. Excludes FTE employees at third party carriers operating under capacity purchase agreements with Air Canada.

(5) Such number of aircraft in Air Canada's operating fleet at June 30, 2020 includes a number of aircraft that have been temporarily grounded due to the COVID-19 pandemic as well as 24 Boeing 737 MAX aircraft which have been grounded since 2019. Refer to section 5 "Fleet" of this MD&A for additional information.

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

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

2. INTRODUCTION AND KEY ASSUMPTIONS

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), the "Corporation" refers, as the context may require, to Air Canada and/or one or more of Air Canada's subsidiaries, including its wholly owned operating subsidiaries, Touram Limited Partnership, doing business 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 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 2020. 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 2020, as well as Air Canada's 2019 annual audited consolidated financial statements and notes and Air Canada's 2019 MD&A each dated February 18, 2020. 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.

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 30, 2020.

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 20 "Risk Factors" of Air Canada's 2019 MD&A. Air Canada issued a news release dated July 31, 2020 reporting on its results for the second quarter of 2020. 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 guidance, 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 those discussed below.

Air Canada, along with the rest of the global airline industry, is facing a severe and abrupt drop in traffic and a corresponding decline in revenue as a result of the coronavirus ("COVID-19") pandemic and the travel restrictions imposed in many countries around the world, and particularly in Canada as well as the United States. The impact of the COVID-19 pandemic began to be felt in traffic and sales figures commencing in early March 2020. These impacts include drastic declines in earnings and cash from operations. There is very limited visibility on travel demand given changing government restrictions in place around the world and the severity of the restrictions in Canada; these restrictions and concerns about travel due to the COVID-19 pandemic and passenger expectations about the need for certain precautions such as physical distancing are severely inhibiting demand. The COVID-19 pandemic is also

having significant economic impacts, including on business and consumer spending, which may in turn significantly impact demand for travel. Air Canada cannot predict the full impact or the timing for when conditions improve. Air Canada is actively monitoring the situation and will respond as the impact of the COVID-19 pandemic evolves, which will depend on a number of factors including the course of the virus, government actions, and passenger reaction, as well as timing of a recovery in international and business travel which are important segments of Air Canada's market, none of which can be predicted with any degree of certainty.

Other factors which may cause results to differ materially from results indicated in forward-looking statements include our ability to successfully achieve or sustain positive net profitability, economic and geopolitical conditions, the timing and conditions of the return to service of Boeing 737 MAX aircraft into our fleet (including the introduction of those on order and the management of our fleet and operations until their return to service or introduction), industry and market conditions and the demand environment, competition, energy prices, our dependence on technology, our ability to successfully implement appropriate strategic and other important initiatives (including our ability to reduce operating costs), cybersecurity risks, war, terrorist acts, other epidemic diseases, our dependence on key suppliers, casualty losses, changes in laws, regulatory developments or proceedings, our ability to successfully launch and operate our new loyalty program, climate change and environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), interruptions of service, our dependence on regional and other carriers, our ability to preserve and grow our brand, employee and labour relations and costs, our dependence on Star Alliance and joint ventures, limitations due to restrictive covenants, our ability to pay our indebtedness and maintain liquidity, pending and future litigation and actions by third parties, currency exchange, pension plans, our ability to attract and retain required personnel, 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 20 "Risk Factors" of Air Canada's 2019 MD&A. Furthermore, the acquisition of Transat A.T. Inc. is subject to 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

Air Canada, along with the rest of the global airline industry, is facing a severe and abrupt drop in traffic and a corresponding decline in revenue as a result of the coronavirus (COVID-19) pandemic. In light of the COVID-19 pandemic, as well as the economic environment and the recent significant volatility in fuel price and foreign exchange rates, Air Canada is not disclosing any assumptions around GDP, fuel price or foreign exchange rates. As previously disclosed, Air Canada has withdrawn all previous guidance provided, including all first quarter and full year 2020 guidance as well as full year 2021 guidance (including its free cash flow guidance for the 2019-2021 period).

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 is taking the following measures in response to the COVID-19 pandemic:

Customer Service and Safety

- Air Canada makes safety its first consideration in all that it does and has been continually updating its health and safety policies and procedures for travellers and employees in all workplaces, airports, and onboard aircraft to account for new information about COVID-19 as it becomes available. This now includes a requirement for customers to wear a protective face covering, as well as enhanced protective personal equipment for airport agents and crews, the reinforcement of safe practices such as frequent hand-washing and collaborating with the Canadian federal government to screen passengers to help determine fitness for flying.

- To underscore its commitment to customer and employee safety, Air Canada introduced Air Canada CleanCare+. The new program is designed to reduce the risk of exposure to COVID-19 through such measures as enhanced aircraft grooming, mandatory preflight customer temperature checks in addition to required health questionnaires and providing all customers with care kits for hand cleaning and hygiene.

- Air Canada has undertaken several medical collaborations to continue advancing biosafety across its business, including with Cleveland Clinic Canada in Toronto, a renowned global healthcare leader to provide additional science-based evidence in our ongoing COVID-19 response; with Ottawa-based Spartan Bioscience to explore rapid COVID-19 testing in an aviation environment; and since last year with Toronto-based BlueDot, a company that monitors infectious diseases globally in real time to give us accurate, relevant information to make business and safety decisions quickly.

- To assist with global requirements of goods and personal protective equipment during the pandemic, Air Canada operated more than 2,000 all-cargo international flights since March 22, 2020, and plans to operate up to 100 all-cargo flights per week in the third quarter using a combination of Boeing 787 and Boeing 777 aircraft as well as four recently converted Boeing 777 and three converted Airbus 330 aircraft where it has doubled available cargo space by removing seats from the passenger cabin.

- Air Canada announced special benefits and accommodations for Aeroplan and Altitude members in light of COVID-19. These include pausing mileage expiration, grandfathering mileage-earned status, waiving certain change and redeposit fees, and launching new promotions so that members can earn additional Aeroplan Miles without leaving home.

Capacity

- Air Canada reduced second quarter 2020 capacity by 92% compared to the second quarter of 2019 and plans to reduce its third quarter 2020 capacity by approximately 80% compared to the third quarter of 2019. The airline will continue to dynamically adjust capacity and take other measures as required to adjust for demand including as a result of health warnings, travel restrictions, border closures and passenger demand. The Canadian travel and quarantine restrictions, as of today, are as follows:

    - Travel bans prohibiting foreign nationals from entering Canada by air under *Aeronautics Act.*

    - 14-day quarantine requirements under the *Quarantine Act* for all travellers entering Canada, including Canadians.

    - Ban on foreign nationals travelling for nonessential reasons arriving from the U.S.

- Interprovincial restrictions on travel and/or quarantines in Nova Scotia, New Brunswick, Prince Edward Island, Newfoundland, Manitoba and in the three territories – for all persons including Canadians travelling in their own country.

The Government of Canada also has a global travel advisory in place warning Canadians to avoid nonessential travel outside of Canada.

- Air Canada suspended service indefinitely on 30 domestic regional routes and closed eight stations at regional airports in Canada.

Financing and Liquidity

- In March 2020, Air Canada drew down its US$600 million and $200 million revolving credit facilities for aggregate net proceeds of $1,027 million.

- In April 2020, Air Canada concluded a 364-day term loan in the amount of US$600 million, secured by aircraft and spare engines, for net proceeds of $829 million.

- In April 2020, Air Canada concluded a bridge financing of $788 million for 18 Airbus A220 aircraft which Air Canada expects to replace with longer-term secured financing arrangements later in 2020. The longer-term financing is expected to be secured by the 18 Airbus A220 aircraft,

- In June 2020, Air Canada concluded an underwritten marketed public offering of 35,420,000 Class A variable voting shares and/or Class B voting shares of the Company at a price of $16.25 per share, for aggregate proceeds of $576 million, and a concurrent marketed private placement of convertible senior unsecured notes due 2025 for aggregate proceeds of US$748 million ($1,011 million).

- In June 2020, Air Canada completed a private offering of $840 million aggregate principal amount of 9.00% Second Lien Secured Notes due 2024 (the "2024 Notes"), which were sold at 98% of par. The 2024 Notes are secured obligations of Air Canada, secured on a second lien basis by certain real estate interests, ground service equipment, certain airport slots and gate leaseholds, and certain routes and the airport slots and gate leaseholds utilized in connection with those routes.

- In June 2020, Air Canada completed a private offering of one tranche of Class C EETCs with a combined aggregate face amount of approximately US$315 million ($426 million), which were sold at 95.002% of par. The Class C tranche ranks junior to the previously issued Series 2015-1, Series 2015-2, and Series 2017-1 EETCs, and is secured by liens on the 27 aircraft financed under the Series 2015-1, Series 2015-2, and Series 2017-1 EETCs. The Class C EETCs have an interest rate of 10.500% per annum, and a final expected distribution date of July 15, 2026.

- As a result of the above financing activities, unrestricted liquidity amounted to $9,120 million and excess cash amounted to $6,820 million as at June 30, 2020. See section 6.1 "Liquidity" of this MD&A for a discussion on Air Canada's excess cash.

- Air Canada's unencumbered asset pool (excluding the value of Aeroplan and Air Canada Vacations) amounted to approximately $2.5 billion as at June 30, 2020. As part of Air Canada's ongoing efforts to increase liquidity levels, additional financing arrangements continue to be assessed.

- Air Canada suspended share purchases under its Normal Course Issuer Bid in early March 2020 and did not renew its issuer bid upon its expiry in the second quarter of 2020.

Cost Reduction and Capital Reduction and Deferral Program

- Air Canada initiated a company-wide cost reduction and capital reduction and deferral program as a result of COVID-19 which has now reached approximately $1.3 billion, increased from an initial target of $500 million. Excluding depreciation, amortization, and special items, second quarter

2020 operating expenses decreased $2,462 million or 64% from the same quarter in 2019. Air Canada continues to seek additional opportunities for cash preservation.

- Air Canada announced a workforce reduction of approximately 20,000 employees, representing more than 50% of its workforce. This was achieved through layoffs, terminations of employment, voluntary separations, early retirements, and special leaves.

- Air Canada adopted the Canada Emergency Wage Subsidy (CEWS) for most of its workforce effective March 15, 2020. On July 17, 2020, the Government of Canada announced that the program would be redesigned and extended to December 2020. . Air Canada intends to continue its participation in the CEWS program, subject to meeting the eligibility requirements.

- Air Canada is retiring 79 older aircraft from its fleet – consisting of Boeing 767, Airbus A319 and Embraer 190 aircraft. Their retirement will simplify the airline's overall fleet, reduce its cost structure, and lower its carbon footprint.

Special Items

In the second quarter of 2020, Air Canada recorded charges related to special items amounting to $236 million. These charges relate to aircraft fleet retirements, workforce reductions and other items. Refer to section 4 "Results of Operations" 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				First Six Months			
	2020	2019	Change		2020	2019	Change	
			$	%			$	%
Operating revenues								
Passenger	$ 207	$ 4,319	$ (4,112)	(95)	$ 3,400	$ 8,116	$ (4,716)	(58)
Cargo	269	177	92	52	418	354	64	18
Other	51	242	(191)	(79)	431	702	(271)	(39)
Total revenues	**527**	**4,738**	**(4,211)**	**(89)**	**4,249**	**9,172**	**(4,923)**	**(54)**
Operating expenses								
Aircraft fuel	124	1,117	(993)	(89)	960	2,114	(1,154)	(55)
Wages, salaries, and benefits	464	781	(317)	(41)	1,260	1,580	(320)	(20)
Regional airlines expense, excluding fuel	172	475	(303)	(64)	643	950	(307)	(32)
Depreciation and amortization	487	494	(7)	(1)	991	950	41	4
Aircraft maintenance	181	255	(74)	(29)	451	500	(49)	(10)
Airport and navigation fees	113	248	(135)	(54)	341	476	(135)	(28)
Sales and distribution costs	13	219	(206)	(94)	196	432	(236)	(55)
Ground package costs	(3)	116	(119)	(103)	231	410	(179)	(44)
Catering and onboard services	23	112	(89)	(79)	120	215	(95)	(44)
Communications and information technology	91	91	-	-	226	192	34	18
Special items	236	-	236	NM	236	-	236	NM
Other	181	408	(227)	(56)	582	804	(222)	(28)
Total operating expenses	**2,082**	**4,316**	**(2,234)**	**(52)**	**6,237**	**8,623**	**(2,386)**	**(28)**
Operating income (loss)	**(1,555)**	**422**	**(1,977)**		**(1,988)**	**549**	**(2,537)**	
Non-operating income (expense)								
Foreign exchange gain (loss)	242	117	125		(469)	380	(849)	
Interest income	32	41	(9)		74	79	(5)	
Interest expense	(149)	(131)	(18)		(278)	(264)	(14)	
Interest capitalized	6	9	(3)		14	17	(3)	
Net financing expense relating to employee benefits	(9)	(9)	-		(20)	(19)	(1)	
Gain (loss) on financial instruments recorded at fair value	(40)	6	(46)		(74)	14	(88)	
Other	(8)	(15)	7		(16)	(31)	15	
Total non-operating income (expense)	**74**	**18**	**56**		**(769)**	**176**	**(945)**	
Income (loss) before income taxes	**(1,481)**	**440**	**(1,921)**		**(2,757)**	**725**	**(3,482)**	
Income tax expense	(271)	(97)	(174)		(44)	(37)	(7)	
Net income (loss)	**$ (1,752)**	**$ 343**	**$ (2,095)**		**$ (2,801)**	**$ 688**	**$ (3,489)**	
Diluted earnings (loss) per share	**$ (6.44)**	**$ 1.26**	**$ (7.70)**		**$ (10.48)**	**$ 2.51**	**$ (12.99)**	
EBITDA (excluding special items) (1)	**$ (832)**	**$ 916**	**$ (1,748)**		**$ (761)**	**$ 1,499**	**$ (2,260)**	
Adjusted pre-tax income (loss) (1)	**$ (1,438)**	**$ 326**	**$ (1,764)**		**$ (1,958)**	**$ 350**	**$ (2,308)**	

(1) EBITDA (excluding special items) and adjusted pre-tax income (loss) are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

System Passenger Revenues

The system-wide impact of the COVID-19 pandemic, including government-regulated travel restrictions, was felt starting in early March 2020 and resulted in a system ASM capacity reduction of 92.0% in the second quarter of 2020 and 52.2% in the first six months of 2020 compared to the same periods in 2019.

Passenger revenues of $207 million in the second quarter of 2020 and $3,400 million in the first six months of 2020 decreased $4,112 million or 95.2% and $4,716 million or 58.1%, respectively, from the same periods in 2019.

On a system basis, in the second quarter of 2020, yield increased 43.3% while traffic declined 96.7% compared to the second quarter of 2019. This yield increase is mainly the result of the significant change in traffic mix, and given the low revenue base, is not a meaningful indicator. In the first six months of 2020, yield increased 2.5% while traffic declined 59.1% compared to the first six months of 2019.

PRASM decreased 40.5% in the second quarter of 2020 and 12.3% in the first six months of 2020 compared to the same periods in 2019. These PRASM decreases reflected passenger load factor declines of 49.1 percentage points in the second quarter of 2020 and 12.0 percentage points in the first six months of 2020 compared to the same periods in 2019, partly offset by the yield improvements as noted above.

Due to the abrupt and severe impact and the very limited visibility of demand due to the COVID-19 pandemic, a discussion of passenger revenues and of factors influencing year-over-year changes in traffic and yield by geographic region would not be meaningful and is therefore not provided.

The table below provides passenger revenues by geographic region for the second quarter of 2020 and the second quarter of 2019.

	Second Quarter		Change	
(Canadian dollars in millions)	2020	2019	$	%
Canada	$ 118	$ 1,333	$ (1,215)	(91.1)
U.S. transborder	10	955	(945)	(99.0)
Atlantic	49	1,151	(1,102)	(95.8)
Pacific	18	621	(603)	(97.0)
Other	12	259	(247)	(95.6)
System	**$ 207**	**$ 4,319**	**$ (4,112)**	**(95.2)**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the second quarter of 2020 versus the second quarter of 2019.

Second Quarter 2020 versus Second Quarter 2019	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	(91.1)	(85.6)	(92.6)	(41.0)	19.8	(38.7)
U.S. transborder	(99.0)	(97.7)	(99.3)	(58.2)	57.7	(54.2)
Atlantic	(95.8)	(90.0)	(97.2)	(60.3)	49.0	(57.5)
Pacific	(97.0)	(95.1)	(97.8)	(46.0)	34.1	(38.6)
Other	(95.6)	(96.4)	(97.2)	(18.5)	54.7	20.8
System	**(95.2)**	**(92.0)**	**(96.7)**	**(49.1)**	**43.3**	**(40.5)**

The table below provides passenger revenue by geographic region for the first six months of 2020 versus the first six months of 2019.

(Canadian dollars in millions)	First Six Months		Change	
	2020	2019	$	%
Canada	$ 1,062	$ 2,430	$ (1,368)	(56.3)
U.S. transborder	765	1,897	(1,132)	(59.7)
Atlantic	708	1,913	(1,205)	(63.0)
Pacific	410	1,155	(745)	(64.5)
Other	455	721	(266)	(37.0)
System	**$ 3,400**	**$ 8,116**	**$ (4,716)**	**(58.1)**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics by geographic region for the first six months of 2020 versus the first six months of 2019.

First Six Months 2020 versus First Six Months 2019	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp change	Yield % Change	PRASM % Change
Canada	(56.3)	(48.8)	(57.4)	(13.8)	2.6	(14.6)
U.S. transborder	(59.7)	(51.7)	(58.9)	(12.1)	(1.9)	(16.6)
Atlantic	(63.0)	(54.5)	(63.2)	(15.7)	0.5	(18.7)
Pacific	(64.5)	(62.5)	(67.2)	(10.4)	8.1	(5.2)
Other	(37.0)	(35.0)	(38.5)	(4.6)	2.5	(3.0)
System	**(58.1)**	**(52.2)**	**(59.1)**	**(12.0)**	**2.5**	**(12.3)**

Cargo Revenues

Cargo revenues of $269 million in the second quarter of 2020 and $418 million in the first six months of 2020 increased $92 million or 52.5% and $64 million or 18.4%, respectively, from the same periods in 2019. On a system basis, in the second quarter of 2020, yield increased 224.6% while traffic declined 53.0% compared to the second quarter of 2019. In the first six months of 2020, yield increased 80.3% while traffic declined 34.4% compared to the first six months of 2019. The significant yield increase reflected the urgent global demand for protective equipment and critical goods with limited industry capacity due to a significant number of passenger aircraft temporarily grounded globally during the COVID-19 pandemic. To meet the immediate and exceptional demand for this equipment, critical goods, and the regular movement of other time-sensitive air cargo, while industry air cargo capacity was reduced in the short term by many other airlines, Air Canada has been operating all-cargo international flights since mid-March 2020. To facilitate this program, it converted four Boeing 777 and three Airbus A330 aircraft by removing economy cabin seating.

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

(Canadian dollars in millions)	Second Quarter				First Six Months			
	2020	2019	Change		2020	2019	Change	
			$	%			$	%
Canada	$ 18	$ 29	$ (11)	(35.7)	$ 37	$ 55	$ (18)	(31.7)
U.S. transborder	12	13	(1)	(4.8)	21	25	(4)	(14.6)
Atlantic	84	60	24	40.6	153	128	25	20.0
Pacific	145	61	84	135.8	183	117	66	56.1
Other	9	14	(4)	(31.8)	24	29	(5)	(19.1)
System	**$ 269**	**$ 177**	**$ 92**	**52.5**	**$ 418**	**$ 354**	**$ 64**	**18.4**

Other Revenues

Other revenues of $51 million in the second quarter of 2020 and $431 million in the first six months of 2020 decreased $191 million or 79% and $271 million or 39%, respectively, from the same periods in 2019. These decreases were mainly due to a reduction in ground package revenues at Air Canada Vacations and, to a lesser extent, a reduction in passenger and airline-related fees, both due to lower passenger volumes resulting from the COVID-19 pandemic.

Operating Expenses

Operating expenses of $2,082 million in the second quarter of 2020 and $6,237 million in the first six months of 2020 decreased $2,234 million or 52% and $2,386 million or 28%, respectively, compared to the same periods in 2019. The more notable year-over-year changes in operating expenses in the second quarter and first six months of 2020 compared to the same periods in 2019 are summarized below.

- Aircraft fuel expense of $124 million in the second quarter of 2020 and $960 million in the first six months of 2020 decreased $993 million or 89% and $1,154 million or 55%, respectively, from the same periods in 2019. These decreases reflected a lower volume of fuel litres consumed, accounting for a decrease of $954 million in the second quarter of 2020 and $1,040 million in the first six months of 2020, and the impact of lower jet fuel prices (before the impact of foreign exchange), accounting for a decrease of $43 million in the second quarter of 2020 and $118 million in the first six months of 2020, respectively, compared to the same periods in 2019.

- Wages, salaries and benefits expense of $464 million in the second quarter of 2020 and $1,260 million in the first six months of 2020 decreased $317 million or 41% and $320 million or 20%, respectively, from the same periods in 2019. In the second quarter of 2020, Air Canada had an average of 16,406 full-time equivalent ("FTE") employees versus 33,055 FTEs in the second quarter of 2019, a reduction of 50.4%. Air Canada continues to monitor the demand environment and will adjust its staffing levels accordingly. A decrease in stock-based compensation expense, reflecting a decline in Air Canada's share price, particularly in the first quarter of 2020, a reduction in expenses related to employee profit sharing programs, and management wage reductions for active employees were also contributing factors to the decrease in wages, salaries and benefits expense year-over-year. Air Canada adopted the Canada Emergency Wage Subsidy in the second quarter of 2020 which resulted in a net benefit of $202 million recorded as a special item, as described below.

- Regional airlines expense (excluding fuel) of $172 million in the second quarter of 2020 and $643 million in the first six months of 2020 decreased $303 million or 64% and $307 million or 32%, respectively, from the same periods in 2019. These decreases reflected the impact of reduced flying by Jazz and other airlines operating flights on behalf of Air Canada, particularly in the second quarter of 2020, as a result of the COVID-19 pandemic.

- In the second quarter of 2020, depreciation and amortization expense of $487 million decreased $7 million or 1% from the second quarter of 2020, reflecting the retirement of Air Canada's Boeing 767 and Airbus A319 fleets, offset by the impact of new aircraft deliveries compared to the same quarter in 2019. In the first six months of 2020, depreciation and amortization expense of $991 million increased $41 million or 4% from the same period in 2019, largely reflecting a higher volume of engine maintenance events on leased aircraft, the addition of aircraft into the mainline fleet, including six Airbus A220 aircraft, and aircraft refurbishment programs. Partly offsetting these increases was the impact of the retirement of aircraft in the second quarter of 2020 as mentioned above. In the second quarter of 2020, Air Canada recorded, as a special item, impairment charges of $330 million, as described below.

- Aircraft maintenance expense of $181 million in the second quarter of 2020 and $451 million in the first six months of 2020 decreased $74 million or 29% and $49 million or 10%, respectively, from the same periods in 2019. These decreases mainly reflected a lower volume of maintenance activity due to reduced flying year-over-year and the retirement of the Boeing 767 and Embraer 190 fleets in the second quarter of 2020.

- Airport and navigation fees of $113 million in the second quarter of 2020 and $341 million in the first six months of 2020 decreased $135 million or 54% and $135 million or 28%, respectively, from the same periods in 2019. These decreases reflected the impact of reduced flying, particularly in the second quarter of 2020, as a result of the COVID-19 pandemic.

- Sales and distribution costs of $13 million in the second quarter of 2020 and $196 million in the first six months of 2020 decreased $206 million or 94% and $236 million or 55%, respectively, from the same periods in 2019. These decreases reflected the decline in passenger revenues, particularly in the second quarter of 2020, as a result of the COVID-19 pandemic.

- In the first six months of 2020, ground package costs of $231 million decreased $179 million or 44% from the same period in 2019, reflecting the decline in passenger volumes as a result of the COVID-19 pandemic.

- In the second quarter of 2020, Air Canada recorded special items amounting to $236 million. The table below provides a breakdown of these special items which are further described below.

	Second Quarter		First Six Months	
(Canadian dollars in millions)	**2020**	**2019**	**2020**	**2019**
Impairments	$ 330	$ -	$ 330	$ -
Workforce reduction provision	112	-	112	-
Canada Emergency Wage Subsidy, net	(202)	-	(202)	-
Other	(4)	-	(4)	-
Special items	**$ 236**	$ **-**	**$ 236**	**$ -**

Impairment

In response to capacity reductions related to the impact of the COVID-19 pandemic, Air Canada is accelerating the retirement of 79 older aircraft from its fleet – consisting of Boeing 767, Airbus A319 and Embraer 190 aircraft. These aircraft are being permanently retired and removed from the cash-generating units for evaluation of whether impairments exist. A fair value less cost to dispose model based on level 3 inputs was used in the evaluation of impairment. The recoverable amount of the owned aircraft is equal to expected proceeds on disposal reflecting management's best estimate including inputs from published pricing guides adjusted to reflect management's best estimate of the current market environment. The recoverable amount for the leased aircraft was determined as the estimated net obligation to settle the leases comprised of contractual future lease payments and end of lease return costs. A non-cash impairment charge of $295

million was recorded in the second quarter of 2020 reflecting the write-down of right-of-use assets for leased aircraft and reduction of carrying values of owned aircraft to expected disposal proceeds.

In addition, Air Canada recorded an impairment charge of $35 million related to previously capitalized costs incurred for the development of technology-based intangible assets which are now cancelled.

Workforce Reduction Provisions

As a result of COVID-19, Air Canada undertook a workforce reduction of approximately 20,000 employees in the second quarter of 2020, representing more than 50% of its staff achieved through layoffs, terminations of employment, voluntary separations, early retirements, and special leaves. A workforce reduction provision of $76 million was recorded related to these measures. To date, payments of $6 million have been made related to the provision, resulting in a remaining obligation of $70 million at June 30, 2020. The provision includes the estimated notice of termination and severance costs under Air Canada's collective agreements and the *Canada Labour Code*. This amount is subject to adjustment depending on the duration and number of employees who remain on layoff status. In addition, termination benefits and curtailments of $36 million related to the pension and benefit obligations were recorded.

Canada Emergency Wage Subsidy

In April 2020, the Government of Canada announced the Canada Emergency Wage Subsidy ("CEWS") in order to help employers, keep and/or return Canadian-based employees to payrolls in response to challenges posed by the COVID-19 pandemic.

In the second quarter of 2020, Air Canada determined that it met the employer eligibility criteria and applied for the CEWS retroactively to March 15, 2020. To the end of June 2020, Air Canada has received instalments of $180 million under the payroll support program, with a further $115 million accrued up to June 30, 2020. The amount of the Canada Emergency Wage Subsidy (recorded as a special item) is net of the cost for inactive employees who were eligible for the wage subsidy under the program. There are no unfulfilled conditions or other contingencies attached to the CEWS.

On July 17, 2020, the Government of Canada announced that the program would be redesigned and extended to December 2020. Air Canada intends to continue its participation in the CEWS program, subject to meeting the eligibility requirements.

Non-operating Income (Expense)

In the second quarter of 2020, non-operating income amounted to $74 million versus non-operating income of $18 million in the second quarter of 2019. In the first six months of 2020, non-operating expense amounted to $769 million versus non-operating income of $176 million in the first six months of 2019.

In the second quarter of 2020, gains on foreign exchange amounted to $242 million compared to gains on foreign exchange of $117 million in the second quarter of 2019. The June 30, 2020 closing exchange rate was US$1=C$1.3576 while the March 31, 2020 closing exchange rate was US$1=C$1.4062. The gains on foreign exchange in the second quarter of 2020 included foreign exchange gains on long-term debt and lease liabilities of $342 million.

In the first six months of 2020, losses on foreign exchange amounted to $469 million compared to gains on foreign exchange of $380 million in the first six months of 2019. The June 30, 2020 closing exchange rate was US$1=C$1.3576 while the December 31, 2019 closing exchange rate was US$1=C$1.2990. The losses on foreign exchange in the first six months of 2020 included foreign exchange losses on long-term debt and lease liabilities of $350 million and foreign exchange losses on foreign currency derivatives of $87 million. Air Canada realized a gain on foreign exchange derivative contracts of $44 million in the first six months of 2020.

Income Taxes

Air Canada recorded an income tax expense of $271 million in the second quarter of 2020 and an income tax expense of $44 million in the first six months of 2020. This compared to an income tax expense of $97 million in the second quarter of 2019 and an income tax expense of $37 million in first six months of 2019.

(Canadian dollars in millions)	Second Quarter		First Six Months	
	2020	2019	2020	2019
Current income tax (expense) recovery	$ 7	$ (16)	$ 38	$ (30)
Deferred income tax expense	(278)	(81)	(82)	(7)
Income tax expense	**$ (271)**	**$ (97)**	**$ (44)**	**$ (37)**

In consideration of not recording net deferred income tax assets, Air Canada has suspended its reporting of adjusted net income as the results are not meaningfully different than the adjusted pre-tax income measure, which continues to be reported.

5. FLEET

In response to the COVID-19 pandemic, Air Canada, together with regional airlines operating flights on behalf of Air Canada under capacity purchase agreements, have reduced capacity through the temporary grounding of aircraft and will continue to assess fleet, capacity and schedule adjustments and other measures as developments warrant. In light of the ongoing uncertainty relating to the COVID-19 pandemic and the grounding and timing for return of the Boeing 737 MAX aircraft, the information disclosed in section 9 "Fleet" of Air Canada's 2019 MD&A is no longer indicative of Air Canada's operating fleet plan or delivery schedule, nor can Air Canada reasonably project at this stage what its fleet plan, schedule or capacity will be during and following the COVID-19 pandemic until such time as demand projections can be more reliably made and the impact and duration of the grounding of the Boeing 737 MAX aircraft are known. The tables below provide the number of aircraft in Air Canada's and Air Canada Rouge's operating fleet at December 31, 2019 and at June 30, 2020. The tables below include a significant number of aircraft that have been temporarily grounded due to the COVID-19 pandemic as well as 24 Boeing 737 MAX aircraft in the mainline fleet which remain grounded since March 2019.

In the first quarter of 2020, Air Canada announced that it was retiring 79 older aircraft, of which 50 were removed from the operating fleet in the second quarter of 2020 – consisting of 14 Embraer 190, 30 Boeing 767 and six Airbus A319 aircraft. Their retirement will simplify the airline's overall fleet, reduce its cost structure, and lower its carbon footprint.

	Actual		
Mainline	**December 31, 2019**	**First Six Months 2020 Fleet Changes**	**June 30, 2020**
Wide-body aircraft			
Boeing 787-8	**8**	-	**8**
Boeing 787-9	**29**	-	**29**
Boeing 777-300ER	**19**	-	**19**
Boeing 777-200LR	**6**	-	**6**
Boeing 767-300ER	**5**	(5)	**-**
Airbus A330-300	**13**	2	**15**
Narrow-body aircraft			
Boeing 737 MAX 8	**24**	-	**24**
Airbus A321	**15**	-	**15**
Airbus A320	**38**	-	**38**
Airbus A319	**16**	-	**16**
Airbus A220-300	**1**	6	**7**
Embraer 190	**14**	(14)	**-**
Total Mainline	**188**	**(11)**	**177**

Air Canada Rouge

Wide-body aircraft			
Boeing 767-300ER	**25**	(25)	**-**
Narrow-body aircraft			
Airbus A321	**14**	-	**14**
Airbus A320	**3**	1	**4**
Airbus A319	**22**	(6)	**16**
Total Air Canada Rouge	**64**	**(30)**	**34**
Total Mainline and Air Canada Rouge	**252**	**(41)**	**211**

On March 13, 2019, Transport Canada issued a safety notice closing Canadian airspace to Boeing 737 MAX aircraft until further notice. The Federal Aviation Administration also issued a temporary grounding order for such aircraft and Boeing has suspended all Boeing 737 MAX deliveries to airline customers. At the time of grounding, Air Canada had 24 Boeing 737 MAX aircraft in its operating fleet.

In the first quarter of 2020, Air Canada finalized an amendment to its 2013 order originally placed with Boeing for 61 Boeing 737 MAX aircraft, reducing its initial order by 11 Boeing 737 MAX 9 aircraft previously scheduled for delivery in 2023 and 2024. This amendment reflected Air Canada's evolving and long-term fleet planning requirements as of that time.

Air Canada has a firm order for 45 Airbus A220-300 aircraft. To date, Air Canada has taken delivery of seven of these aircraft and expects to take delivery of an additional eight in 2020.

Air Canada expects the delivery of one additional Airbus A330 aircraft in 2020.

Air Canada Express

The table below provides the number of aircraft operated, as at December 31, 2019 and June 30, 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. The table below includes a significant number of aircraft that have been temporarily grounded due to the COVID-19 pandemic.

	Actual		
	December 31, 2019	**First Six Months 2020 Fleet Changes**	**June 30, 2020**
Embraer 175	**25**	-	**25**
Bombardier CRJ-100/200	**22**	(3)	**19**
Bombardier CRJ-900	**26**	-	**26**
Bombardier Dash 8-100	**6**	(6)	**-**
Bombardier Dash 8-300	**23**	-	**23**
Bombardier Dash 8-Q400	**44**	-	**44**
Total Air Canada Express	**146**	**(9)**	**137**

Other Aircraft with CPA Carriers

In the second quarter of 2020, five 18-passenger Beech 1900 aircraft operated by CPA carriers on behalf of Air Canada were retired from the fleet.

6. FINANCIAL AND CAPITAL MANAGEMENT

6.1. Liquidity

Liquidity Risk Management

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, ongoing 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, including under various scenarios and assumptions, 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, 2020, unrestricted liquidity amounted to $9,120 million (comprised of cash, cash equivalents and short-term investments of $8,644 million and long-term investments of $476 million). This compared to unrestricted liquidity of $7,160 million at June 30, 2019 (comprised of cash, cash equivalents and short-term investments of $5,921 million, long-term investments of $253 million, and undrawn lines of credit of $986 million). Refer to "Impact of the COVID-19 Pandemic" below for a description of the financings undertaken in 2020.

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. Given the impact of the COVID-19 pandemic on passenger revenues and advance ticket sales, Air Canada has updated its definition of excess cash in the second quarter of 2020. Air Canada was previously using 20% of trailing 12 months operating revenue as its estimate of the minimum cash required to support ongoing business operations. The minimum cash estimate has now been updated to a fixed amount of $2,400 million. This minimum cash estimate takes into account Air Canada's various financial covenants, provides adequate coverage for advance ticket sales, and supports Air Canada's liquidity needs, as described above. Excess cash amounted to $6,820 million at June 30, 2020 (compared to $4,158 million as at December 31, 2019 and as calculated on the new basis).

Impact of the COVID-19 Pandemic

Air Canada, along with the rest of the global airline industry, is facing a severe and abrupt drop in traffic and a corresponding decline in revenue as a result of the coronavirus ("COVID-19") pandemic and the travel restrictions imposed in many countries around the world, and particularly in Canada as well as the United States. The impact of the COVID-19 pandemic began to be felt in traffic and sales figures commencing in early March 2020. These impacts include drastic declines in earnings and cash from operations. The expectation is for continuing considerable negative impact to cash flows and Air Canada's liquidity position, including after considering the mitigation responses described in section 3 "Overview" of this MD&A. In light of the ongoing uncertainty relating to the COVID-19 pandemic, the full extent and duration of any impact remain unknown.

Air Canada concluded the following financing transactions in 2020, increasing Air Canada's cash position, thereby allowing for additional flexibility operationally and to support the implementation of its planned mitigation and recovery measures in response to the COVID-19 pandemic.

- In March 2020, Air Canada drew down its US$600 million and $200 million revolving credit facilities for aggregate proceeds of $1,027 million.

- In April 2020, Air Canada concluded a 364-day term loan in the amount of US$600 million, secured by aircraft and spare engines, for proceeds of $829 million.

- In April 2020, Air Canada concluded a bridge financing of $788 million for 18 Airbus A220 aircraft which Air Canada expects to replace with longer-term secured financing arrangements later in 2020. The longer-term financing is expected to be secured by the 18 Airbus A220 aircraft.

- In June 2020, Air Canada concluded an underwritten marketed public offering of 35,420,000 Class A variable voting shares and/or Class B voting shares of the Corporation at a price to the public of $16.25 per share, for aggregate proceeds of $576 million, and a concurrent marketed private placement of convertible senior unsecured notes due 2025 for aggregate proceeds of US$748 million ($1,011 million). The Convertible Notes bear interest semi-annually in arrears at a rate of 4.000% per annum and will mature on July 1, 2025, unless earlier repurchased, redeemed or converted. The initial conversion rate of the convertible notes is 65.1337 shares per US$1,000 principal amount of convertible notes, or an initial conversion price of approximately US$15.35 per share. The convertible notes will be convertible, at Air Canada's election, into cash or into Class A variable voting shares and/or Class B voting shares of Air Canada, or a combination thereof. Refer to section 6.9 "Share Information" of this MD&A for additional information.

- In June 2020, Air Canada completed a private offering of $840 million aggregate principal amount of 9.00% Second Lien Secured Notes due 2024 (the "2024 Notes"), which were sold at 98% of par. The 2024 Notes are secured obligations of Air Canada, secured on a second lien basis by certain real estate interests, ground service equipment, certain airport slots and gate leaseholds, and certain routes and the airport slots and gate leaseholds utilized in connection with those routes.

- In June 2020, Air Canada completed a private offering of one tranche of Class C EETCs with a combined aggregate face amount of approximately US$315 million ($426 million), which were sold at 95.002% of par. The Class C tranche ranks junior to the previously issued Series 2015-1, Series 2015-2, and Series 2017-1 EETCs, and is secured by liens on the 27 aircraft financed under the Series 2015-1, Series 2015-2, and Series 2017-1 EETCs. The Class C EETCs have an interest rate of 10.500% per annum, and a final expected distribution date of July 15, 2026.

- Air Canada's unencumbered asset pool (excluding the value of Aeroplan and Air Canada Vacations) amounted to approximately $2.5 billion as at June 30, 2020. As part of Air Canada's ongoing efforts to increase liquidity levels, additional financing arrangements continue to be assessed.

6.2. Financial Position

The table below provides a condensed consolidated statement of financial position of Air Canada as at June 30, 2020 and as at December 31, 2019.

(Canadian dollars in millions)	June 30, 2020	December 31, 2019	$ Change
Assets			
Cash, cash equivalents and short-term investments	$ 8,644	$ 5,889	$ 2,755
Other current assets	1,153	1,627	(474)
Current assets	**$ 9,797**	**$ 7,516**	**$ 2,281**
Investments, deposits, and other assets	774	936	(162)
Property and equipment	12,369	12,834	(465)
Pension assets	2,108	2,064	44
Deferred income tax	15	134	(119)
Intangible assets	1,069	1,002	67
Goodwill	3,273	3,273	-
Total assets	**$ 29,405**	**$ 27,759**	**$ 1,646**
Liabilities			
Current liabilities	$ 8,374	$ 7,775	$ 599
Long-term debt and lease liabilities	10,448	8,024	2,424
Aeroplan and other deferred revenue	3,787	3,136	651
Pension and other benefit liabilities	3,064	2,930	134
Maintenance provisions	1,126	1,240	(114)
Other long-term liabilities	490	181	309
Deferred income tax	73	73	-
Total liabilities	**$ 27,362**	**$ 23,359**	**$ 4,003**
Total shareholders' equity	**$ 2,043**	**$ 4,400**	**$ (2,357)**
Total liabilities and shareholders' equity	**$ 29,405**	**$ 27,759**	**$ 1,646**

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.

6.3. Net Debt

The table below reflects Air Canada's net debt balances as at June 30, 2020 and as at December 31, 2019.

(Canadian dollars in millions, except where indicated)	June 30, 2020	December 31, 2019	$ Change
Total long-term debt and lease liabilities	$ 10,448	8,024	$ 2,424
Current portion of long-term debt and lease liabilities	3,236	1,218	2,018
Total long-term debt and lease liabilities (including current portion)	**$ 13,684**	**9,242**	**$ 4,442**
Less cash, cash equivalents and short and long-term investments	(9,120)	(6,401)	(2,719)
Net debt (1)	**$ 4,564**	**2,841**	**$ 1,723**

(1) 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.

At June 30, 2020, net debt of $4,564 million increased $1,723 million from December 31, 2019, reflecting the impact of net cash used for operating and investing activities in the first six months of 2020. Refer to section 6.1 "Liquidity" of this MD&A for a description of the debt financing activities completed during 2020. As further explained in Note 6 of Air Canada's interim unaudited condensed consolidated financial statements for the second quarter of 2020, the conversion option in the convertible senior unsecured notes due 2025 is accounted for as an embedded derivative financial liability and is recorded in other long-term liabilities on Air Canada's consolidated statement of financial position. The unfavourable impact of a weaker Canadian dollar, as at June 30, 2020 compared to December 31, 2019, increased foreign currency denominated debt (mainly U.S. dollars) by $350 million.

Air Canada has suspended its reporting of its leverage ratio as this metric is not meaningful given the COVID-19 pandemic's severe impact on earnings. In the current environment, liquidity levels (refer to section 6.1 "Liquidity" of this MD&A for discussion on liquidity levels and excess cash) and net cash burn (refer to section 6.5 "Consolidated Cash Flow Movements" of this MD&A for discussion on net cash burn) are part of the key measures monitored by management. Net cash burn is a non-GAAP measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

At June 30, 2020, Air Canada's weighted average cost of capital ("WACC"), on a pre-tax basis, was 7.5%. WACC is based on an estimate by management and consists of an estimated cost of equity of 18.5% and a blended average cost of debt and lease liabilities of 4.7% (comprised of an average cost of debt of 4.3% and an average cost of lease liabilities of 6.1%). This compared to WACC, on a pre-tax basis, of 7.0% at December 31, 2019 which consisted of an estimated cost of equity of 15.0% and a blended average cost of debt and lease liabilities of 5.0% (comprised of an average cost of debt of 4.1% and an average cost of lease liabilities of 6.5%).

6.4. Working Capital

The table below provides information on Air Canada's working capital balances as at June 30, 2020 and as at December 31, 2019.

(Canadian dollars in millions)	June 30, 2020	December 31, 2019	$ Change
Cash, cash equivalents and short-term investments	$ 8,644	$ 5,889	$ 2,755
Accounts receivable	677	926	(249)
Other current assets	476	701	(225)
Total current assets	**$ 9,797**	**$ 7,516**	**$ 2,281**
Accounts payable and accrued liabilities	2,029	2,456	(427)
Advance ticket sales	2,433	2,939	(506)
Aeroplan and other deferred revenue	676	1,162	(486)
Current portion of long-term debt and lease liabilities	3,236	1,218	2,018
Total current liabilities	**$ 8,374**	**$ 7,775**	**$ 599**
Net working capital	**$ 1,423**	**$ (259)**	**$ 1,682**

Net working capital of $1,423 million at June 30, 2020 increased $1,682 million from December 31, 2019. Working capital was favourably impacted by the financings discussed in section 6.1 "Liquidity" of this MD&A and by the reclassification of a portion of Aeroplan deferred revenues from current into long-term, reflecting an estimated reduction in Aeroplan redemptions over the next 12 months. These factors, which increased net working capital, were partially offset by negative cash flows from operating activities, reflecting the decline in earnings and advance ticket sales during the period due to the COVID-19 pandemic. Advance ticket sales generally increase in the first and second quarters prior to the summer peak travel season. However, as a result of the COVID-19 pandemic and the abrupt decline in travel demand, coupled with an increase in refunds to customers, the advance ticket sales liability decreased during the first and second quarters of 2020. In addition, the unused amounts of non-refundable tickets in respect of flights cancelled due to the COVID-19 pandemic can be converted into either a travel voucher with no expiry date that is transferable or into Aeroplan Miles, which may further result in lower advance sales in future periods as these unused amounts are applied to new ticket purchases.

6.5. Consolidated Cash Flow Movements

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

	Second Quarter			First Six Months		
(Canadian dollars in millions)	2020	2019	$ Change	2020	2019	$ Change
Net cash flows from (used in) operating activities	**$ (1,251)**	**$ 1,090**	**$ (2,341)**	**$ (1,271)**	**$ 4,201**	**$ (5,472)**
Proceeds from borrowings	3,867	-	3,867	4,894	-	4,894
Reduction of long-term debt and lease liabilities	(269)	(280)	11	(778)	(532)	(246)
Shares purchased for cancellation	-	(103)	103	(132)	(154)	22
Issue of shares	553	2	551	554	3	551
Financing fees	(62)	-	(62)	(62)	-	(62)
Net cash flows from (used in) financing activities	**$ 4,089**	**$ (381)**	**$ 4,470**	**$ 4,476**	**$ (683)**	**$ 5,159**
Investments, short-term and long-term	(112)	(139)	27	296	(519)	815
Additions to property, equipment, and intangible assets	(212)	(553)	341	(585)	(1,473)	888
Proceeds from sale of assets	2	1	1	4	3	1
Acquisition of Aeroplan	-	(20)	20	-	(517)	517
Investment in Chorus	-	-	-	-	(97)	97
Other	6	15	(9)	37	51	(14)
Net cash flows used in investing activities	**$ (316)**	**$ (696)**	**$ 380**	**$ (248)**	**$ (2,552)**	**$ 2,304**
Effect of exchange rate changes on cash and cash equivalents	**$ (21)**	**$ (4)**	**$ (17)**	**$ 42**	**$ (5)**	**$ 47**
Increase in cash and cash equivalents	**$ 2,501**	**$ 9**	**$ 2,492**	**$ 2,999**	**$ 961**	**$ 2,038**

Net Cash Flows from (used in) Operating Activities

Net cash flows used in operating activities of $1,251 million in the second quarter of 2020 and $1,271 million in the first six months of 2020 deteriorated by $2,341 million and $5,472 million, respectively, from the same periods in 2019 on lower operating results and lower cash from working capital as a result of lower advance ticket sales, both reflecting the impact of the COVID-19 pandemic. The first quarter of 2019 was favourably impacted by receipts amounting to $1,612 million in conjunction with Air Canada's acquisition of Aeroplan.

Net Cash Flows from (used in) Financing Activities

Net cash inflows from financing activities of $4,089 million in the second quarter of 2020 and $4,476 million in the first six months of 2020 increased $4,470 million and $5,159 million, respectively, from the same periods in 2019. Net proceeds from debt and equity financings of $4,358 million in the second quarter of 2020 and $5,386 million in the first six months of 2020 reflected the impact of financings discussed in section 6.1 "Liquidity" of this MD&A. Reduction of long-term debt and lease liabilities amounted to $269 million in the second quarter of 2020 and $778 million in the first six months of 2020.

Net Cash Flows used in Investing Activities

Net cash flows used in investing activities amounted to $316 million in the second quarter of 2020 and $248 million in the first six months of 2020, an improvement of $380 million and $2,304 million, respectively, from the same periods in 2019. This reflected, in large part, movements between cash and short and long-term investments in the first quarter of 2020, as well as a lower level of net additions to property and equipment. Additions to property and equipment is also net of additional settlement payments received from Boeing related to the grounding of the 737 MAX fleet. The first quarter of 2019 included the impact of Air Canada's acquisition of Aeroplan on January 10, 2019.

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

Free Cash Flow

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

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2020**	**2019**	**$ Change**	**2020**	**2019**	**$ Change**
Net cash flows from (used in) operating activities	**$ (1,251)**	**$ 1,090**	**$ (2,341)**	**$ (1,271)**	**$ 4,201**	**$ (5,472)**
Additions to property, equipment, and intangible assets	(212)	(553)	341	(585)	(1,473)	888
One-time proceeds related to the acquisition of Aeroplan (as described above)	-	-	-	-	(1,612)	1,612
Free cash flow (1)	**$ (1,463)**	**$ 537**	**$ (2,000)**	**$ (1,856)**	**$ 1,116**	**$ (2,972)**

(1) Free cash flow is a non-GAAP financial measure used by Air Canada as an indicator of the financial strength and performance of its business, indicating how much cash it can generate from operations 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. 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.

Negative free cash flow of $1,463 million deteriorated by $2,000 million from the second quarter of 2019, reflecting lower cash flows from operating activities due to the impact of the COVID-19 pandemic, partially offset by a lower level of capital expenditures year-over-year.

Net Cash Burn

The table below provides the calculation of net cash burn for Air Canada for the periods indicated.

(Canadian dollars in millions)	Second Quarter 2020	First Six Months 2020
Net cash flows used in operating activities	$ **(1,251)**	$ **(1,271)**
Net cash flows from financing activities	**4,089**	**4,476**
Net cash flows used in investing activities	**(316)**	**(248)**
Remove:		
Net proceeds from new financings	(4,358)	(5,386)
Lump-sum EETC repayment	-	255
Investments, short-term and long-term	112	(296)
Net cash burn [(1)]	**$ (1,724)**	**$ (2,470)**

(1) Net cash burn is a non-GAAP financial measure used by Air Canada as a measure of cash used to maintain operations, support capital expenditures, and settle normal debt repayments, all before the net impact of new financing proceeds. Net cash burn is defined as net cash flows from operating, financing, and investing activities, and excludes proceeds from new financings, a lump sum debt maturity made in March 2020 of $255 million and any future lump sum debt maturities where the Corporation has refinanced or replaced the amount. Net cash burn also excludes movements between cash and short and long-term investments.

Net cash burn in the second quarter of 2020 was $1,724 million or approximately $19 million per day, in line with management's expectation for the period. Net cash burn improved progressively throughout the second quarter of 2020 as the amount of cash used for working capital began to stabilize and Air Canada's cost reduction measures continued to materialize.

6.6. Capital Expenditures and Related Financing Arrangements

Boeing 737 MAX Aircraft

Air Canada's agreement with Boeing for the purchase of Boeing 737 MAX aircraft provides for:

- Firm orders for 50 Boeing 737 MAX 8 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. The delivery schedule for the remaining 26 Boeing 737 MAX 8 aircraft and their return to service is uncertain. The capital commitments table below reflects Air Canada's assumptions surrounding the delivery schedule, which may change in light of the duration and any related impact of the grounding of the Boeing 737 MAX aircraft.

Air Canada has concluded its discussions with Boeing to settle the terms of an arrangement in relation to the grounding of the Boeing 737 MAX aircraft. The settlement payments contemplated by the arrangement were made to Air Canada during the fourth quarter of 2019 and during the first and second quarters of 2020. The compensation is accounted for as an adjustment to the purchase price of current and future deliveries and will flow through Air Canada's consolidated statement of operations as reduced depreciation expense over the life of the aircraft, and as a reduction to additions to property and equipment on the consolidated statement of cash flow.

Airbus A220-300 Aircraft

Under a purchase agreement concluded by Air Canada and Bombardier Inc. ("Bombardier") in June 2016, Air Canada has 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. The first Airbus A220 was delivered in late 2019, an additional six were delivered in the first half of 2020 and an additional eight are expected to be delivered in the remainder of 2020. As disclosed in section 6.1 "Liquidity" of this MD&A, Air Canada concluded a bridge financing of $788 million for 18 Airbus A220 aircraft in April 2020 which it expects to replace with longer-term secured financing arrangements later in 2020.

Capital Commitments

As outlined in the table below, the estimated aggregate cost of all aircraft expected to be delivered and other capital purchase commitments as at June 30, 2020 approximates $4,046 million. The table below includes the impact of the capital reduction and deferral program discussed in section 3 "Overview" of this MD&A.

(Canadian dollars in millions)	Remainder of 2020	2021	2022	2023	2024	Thereafter	Total
Projected committed expenditures	$ 752	$ 2,213	$ 892	$ 189	$ -	$ -	$ 4,046
Projected planned but uncommitted expenditures	30	463	486	652	682	Not available	Not available
Projected planned but uncommitted capitalized maintenance (1)	52	324	415	407	407	Not available	Not available
Total projected expenditures (2)	**$ 834**	**$ 3,000**	**$ 1,793**	**$ 1,248**	**$ 1,089**	**Not available**	**Not available**

(1) Future capitalized maintenance amounts for 2023 and beyond are not yet determinable, however an estimate of $407 million has been made for 2023 and 2024.

(2) U.S. dollar amounts are converted using the June 30, 2020 closing exchange rate of US$1=C$1.3576. 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, 2020.

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.

As at July 1, 2020, the aggregate solvency surplus in Air Canada's domestic registered pension plans was $2.5 billion. 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.

Total employer defined benefit pension funding contributions (including the international and supplemental plans) are forecasted to be $100 million in 2020.

As at June 30, 2020, approximately 75% of Air Canada's pension assets were invested in fixed income instruments to mitigate a significant portion of the interest rate (discount rate) risk. Air Canada seeks to maintain a high percentage of long-term fixed income products to hedge pension liabilities.

6.8. Contractual Obligations

The table below provides Air Canada's contractual obligations as at June 30, 2020, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and lease liabilities and committed capital expenditures. The committed capital expenditures in the table below may change once the duration and related impact of the grounding of the Boeing 737 MAX aircraft are known. The contractual obligations reported below do not reflect the impact of the fleet changes being implemented subsequent to June 30, 2020 and which impacts are still being determined.

(Canadian dollars in millions)	Remainder of 2020	2021	2022	2023	2024	Thereafter	Total
Principal							
Long-term debt	$ 182	$ 2,596	$ 540	$ 2,258	$ 1,142	$ 3,865	$ 10,583
Lease liabilities	336	534	456	447	410	1,411	3,594
Total principal obligations	**$ 518**	**$ 3,130**	**$ 996**	**$ 2,705**	**$ 1,552**	**$ 5,276**	**$ 14,177**
Interest							
Long-term debt	193	374	322	293	209	354	1,745
Lease liabilities	100	168	136	110	83	364	961
Total interest	**$ 293**	**$ 542**	**$ 458**	**$ 403**	**$ 292**	**$ 718**	**$ 2,706**
Total long-term debt and lease liabilities	**$ 811**	**$ 3,672**	**$ 1,454**	**$ 3,108**	**$ 1,844**	**$ 5,994**	**$ 16,883**
Committed capital expenditures	**$ 752**	**$ 2,213**	**$ 892**	**$ 189**	**$ -**	**$ -**	**$ 4,046**
Total contractual obligations (1)	**$ 1,563**	**$ 5,885**	**$ 2,346**	**$ 3,297**	**$ 1,844**	**$ 5,994**	**$ 20,929**

(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, 2020	December 31, 2019
Issued and outstanding shares		
Variable voting shares	103,111,935	126,664,740
Voting shares	193,589,041	137,151,838
Total issued and outstanding shares	**296,700,976**	**263,816,578**
Class A variable voting and Class B voting shares potentially issuable		
Convertible notes	48,687,441	-
Stock options	5,916,010	4,890,095
Total shares potentially issuable	**54,603,451**	**4,890,095**
Total outstanding and potentially issuable shares	**351,304,427**	**268,706,673**

In June 2020, Air Canada concluded an underwritten marketed public offering of 35,420,000 Class A variable voting shares and/or Class B voting shares of the company and a concurrent marketed private placement of convertible senior unsecured notes due 2025. Refer to section 6.1 "Liquidity" of this MD&A for additional information.

Normal Course Issuer Bid

In response to the COVID-19 pandemic, in early March 2020, Air Canada suspended share purchases under its normal course issuer bid (which had received approval from the Toronto Stock Exchange for the renewal of its previous 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 as at May 17, 2019. Air Canada's normal course issuer bid expired in May 2020 and Air Canada did not renew it. As such, no shares were purchased in the second quarter of 2020.

In the first quarter of 2020, Air Canada purchased, for cancellation, a total of 2,910,800 shares at an average cost of $43.76 per share for aggregate consideration of $127 million.

Share Offering

In June 2020, Air Canada completed an underwritten marketed public offering of 35,420,000 shares at a price of $16.25 per share, for aggregate gross proceeds of $576 million, which includes the exercise in full by the underwriters of their over-allotment option to purchase up to 4,620,000 shares for gross proceeds of $75 million. After deduction of the underwriters' fees and expenses of the offering, net proceeds amounted to $552 million.

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)	2018		2019				2020	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Operating revenues	$ 5,395	$ 4,227	$ 4,434	$ 4,738	$ 5,529	$ 4,429	$ 3,722	$ 527
Operating expenses	4,472	4,048	4,307	4,316	4,573	4,284	4,155	2,082
Operating income (loss)	**923**	**179**	**127**	**422**	**956**	**145**	**(433)**	**(1,555)**
Non-operating income (expense)	**31**	**(570)**	**158**	**18**	**(78)**	**27**	**(843)**	**74**
Income (loss) before income taxes	**954**	**(391)**	**285**	**440**	**878**	**172**	**(1,276)**	**(1,481)**
Income tax (expense) recovery	(252)	31	60	(97)	(242)	(20)	227	(271)
Net income (loss)	**$ 702**	**$ (360)**	**$ 345**	**$ 343**	**$ 636**	**$ 152**	**$ (1,049)**	**$ (1,752)**
Diluted earnings (loss) per share	**$ 2.55**	**$ (1.33)**	**$ 1.26**	**$ 1.26**	**$ 2.35**	**$ 0.56**	**$ (4.00)**	**$ (6.44)**
Adjusted pre-tax income (loss) (1)	**$ 815**	**$ 68**	**$ 24**	**$ 326**	**$ 857**	**$ 66**	**$ (520)**	**$ (1,438)**

(1) Adjusted pre-tax income (loss) 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.

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)	2019				2020	
	Q1	Q2	Q3	Q4	Q1	Q2
Capacity purchase fees (1)	$ 252	$ 247	$ 266	$ 277	$ 253	$ 117
Airport and navigation	69	74	78	71	63	12
Sales and distribution costs	36	41	43	38	33	(1)
Other	118	113	114	119	122	44
Total regional airlines expense	**$ 475**	**$ 475**	**$ 501**	**$ 505**	**$ 471**	**$ 172**

(1) 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	2019				2020	
	Q1	Q2	Q3	Q4	Q1	Q2
Passenger PRASM (cents)	14.6	15.5	15.8	15.0	13.6	9.2
CASM (cents)	16.6	15.5	14.1	16.2	17.7	92.9
Adjusted CASM (cents) (1)	11.6	11.1	10.1	11.9	13.1	76.9
Fuel cost per litre (cents) (2)	75.5	79.2	74.7	75.0	69.2	51.8

(1) 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.

(2) 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.

	2018		2019				2020	
System	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
RPMs (millions)	28,465	20,801	21,293	23,463	27,954	21,403	17,507	783
ASMs (millions)	33,137	25,598	26,016	27,910	32,457	26,431	23,511	2,243
Passenger load factor (%)	85.9	81.3	81.8	84.1	86.1	81.0	74.5	34.9
Domestic								
RPMs (millions)	6,339	4,684	4,251	5,097	6,298	4,682	3,604	376
ASMs (millions)	7,482	5,667	5,274	6,068	7,474	5,861	4,930	876
Passenger load factor (%)	84.7	82.7	80.6	84.0	84.3	79.9	73.1	43.0
U.S. Transborder								
RPMs (millions)	4,172	3,734	4,296	3,845	4,010	3,695	3,322	25
ASMs (millions)	4,962	4,662	5,341	4,686	4,764	4,700	4,741	106
Passenger load factor (%)	84.1	80.1	80.4	82.0	84.2	78.6	70.1	23.8
Atlantic								
RPMs (millions)	10,642	5,813	4,943	7,496	10,580	6,265	4,369	214
ASMs (millions)	12,231	7,206	6,177	8,882	12,068	7,710	5,964	888
Passenger load factor (%)	87.0	80.6	80.0	84.4	87.7	81.3	73.3	24.1
Pacific								
RPMs (millions)	5,630	4,514	4,486	5,072	5,364	4,504	3,026	113
ASMs (millions)	6,484	5,541	5,367	5,971	6,217	5,456	3,957	290
Passenger load factor (%)	86.8	81.5	83.6	84.9	86.3	82.6	76.5	38.9
Other								
RPMs (millions)	1,682	2,056	3,317	1,953	1,702	2,257	3,186	55
ASMs (millions)	1,978	2,522	3,857	2,303	1,934	2,704	3,919	83
Passenger load factor (%)	85.0	81.6	86.0	84.8	88.0	83.5	81.3	66.3

8. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Air Canada's financial instruments and risk management practices are summarized in section 13 "Financial Instruments and Risk Management" of Air Canada's 2019 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 10 of Air Canada's interim unaudited condensed consolidated financial statements for the second quarter of 2020.

9. ACCOUNTING POLICIES

Air Canada's accounting policies are summarized in section 14 "Accounting Policies" of Air Canada's 2019 MD&A. There have been no material changes to Air Canada's accounting policies from what was disclosed at that time with the exception of the addition below. Additional information on Air Canada's accounting policies is discussed in Note 2 of Air Canada's interim unaudited condensed consolidated financial statements for the second quarter of 2020.

Government grants

Air Canada recognizes government grants when there is reasonable assurance that the grant will be received, and that Air Canada will comply with the conditions of the grant. Government grants receivable are recorded in accounts receivable on Air Canada's consolidated statement of financial position. Air Canada recognizes government grants in its consolidated statement of operations in the same period as the expenses for which the grant is intended to compensate. In cases where a government grant becomes receivable as compensation for expenses already incurred in prior periods, the grant is recognized in profit or loss in the period in which it becomes receivable.

10. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Air Canada's critical accounting estimates and judgments are summarized in section 15 "Critical Accounting Estimates and Judgments" of Air Canada's 2019 MD&A. There have been no material changes to this section from what was disclosed at that time with the exception as to the impact of the COVID-19 pandemic which is a fluidly evolving situation and discussed further in Note 3 of Air Canada's interim unaudited condensed consolidated financial statements for the second quarter of 2020.

The COVID-19 pandemic and its impact on the economy are constantly evolving in an unpredictable manner and present many variables and contingencies for modelling. In future periods, the effects of the pandemic may have material impacts on the Corporation's anticipated revenue levels and the recoverable amount of the CGUs.

11. OFF-BALANCE SHEET ARRANGEMENTS

Air Canada's off-balance sheet arrangements are summarized in section 16 "Off-Balance Sheet Arrangements" of Air Canada's 2019 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, 2020, 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

In its 2019 MD&A, Air Canada provided 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. In light of the COVID-19 pandemic and its impact on Air Canada's financial results, the information provided at that time is not indicative of future trends or results and, given the uncertainty, it is not possible for Air Canada to predict any such trends or results.

14. RISK FACTORS

For a description of risk factors associated with Air Canada and its business, refer to section 20 "Risk Factors" of Air Canada's 2019 MD&A. Except as otherwise discussed in this MD&A and the following update, there have been no material changes to Air Canada's risk factors from what was disclosed at that time

Air Canada, along with the rest of the global airline industry, is facing a severe and abrupt drop in traffic and a corresponding decline in revenue as a result of the coronavirus ("COVID-19") pandemic and the travel restrictions imposed in many countries around the world, and particularly in Canada as well as the United States. The impact of the COVID-19 pandemic began to be felt in traffic and sales figures commencing in early March 2020. These impacts include drastic declines in earnings and cash from operations. There is very limited visibility on travel demand given changing government restrictions in place around the world and the severity of the restrictions in Canada; these restrictions and concerns about travel due to the COVID-19 pandemic and passenger expectations about the need for certain precautions such as physical distancing are severely inhibiting demand. The COVID-19 pandemic is also having significant economic impacts, including on business and consumer spending, which may in turn significantly impact demand for travel. Air Canada cannot predict the full impact or the timing for when conditions improve. Air Canada is actively monitoring the situation and will respond as the impact of the COVID-19 pandemic evolves, which will depend on a number of factors including the course of the virus, government actions, and passenger reaction, as well as timing of a recovery in international and business travel which are important segments of Air Canada's market, none of which can be predicted with any degree of certainty.

Air Canada has taken and touted a number of safety measures in light of the COVID-19 pandemic, including the Air Canada CleanCare+ program and has publicly appealed to governments and other parties in an effort to recognize the efficacy of such safety measures and to allow for a measured and responsible reduction of travel restrictions which other jurisdictions have adopted. Air Canada will continue to be adversely impacted to the extent that such restrictions remain in place over time. Air Canada as well as its brand and reputation may also be adversely impacted to the extent it is perceived that safety measures introduced do not adequately address the risks of transmission of COVID-19 or justify relaxing the travel restrictions imposed by governments.

Air Canada's operations could also be adversely impacted further if our employees (or third party employees such as those of airports or suppliers) are unable or restricted in their ability to work, including by reasons of being quarantined or becoming ill as a result of exposure to COVID-19, or if they are subject to government or other restrictions.

As a result of the COVID-19 pandemic, Air Canada reduced capacity by 92% in the second quarter of 2020 compared to the second quarter of 2019 and plans to reduce capacity by approximately 80% in the third quarter of 2020 compared to the third quarter of 2019. The airline will continue to dynamically adjust capacity and take other measures as required to adjust for demand including as a result of health warnings, travel restrictions, border closures and passenger demand.

Air Canada is providing customers who booked with Air Canada and who are affected by cancellations with the option to convert their ticket to an Air Canada travel voucher that has no expiry date and is transferable. Alternatively, customers may convert the unused value of their ticket into Aeroplan Miles with additional bonus miles. Air Canada is refunding refundable fares according to the terms and conditions that govern them. Air Canada may be required to refund non-refundable fares depending on the laws of the jurisdictions applicable to such flights. Not refunding non-refundable tickets exposes Air

Canada to litigation, including class actions, as well as enforcement action by regulators in certain jurisdictions and may also adversely impact Air Canada's brand and reputation. In countries where refund requirements are or will be maintained or enforced, ensuing refunds will impact Air Canada's liquidity. The impact of any of these risks could be material.

Refer to section 3 "Overview" of this MD&A for information on financing activities and other actions taken in response to the COVID-19 crisis and to section 10 "Critical Accounting Estimates and Judgments' of this MD&A for considerations related to critical estimates and judgments updated to reflect the currently known impact of the COVID-19 pandemic.

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 2019 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 2020 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 material changes to the Corporation's internal controls over financial reporting during the quarter ended June 30, 2020 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 and amortization) is commonly used in the airline industry and is used by Air Canada as a means to view operating results before interest, taxes, depreciation and amortization 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 (loss) as follows:

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2020**	**2019**	**$ Change**	**2020**	**2019**	**$ Change**
Operating income (loss) – GAAP	**$ (1,555)**	**$ 422**	**$ (1,977)**	**$ (1,988)**	**$ 549**	**$ (2,537)**
Add back:						
Depreciation and amortization	487	494	(7)	991	950	41
EBITDA (including special items)	**$ (1,068)**	**$ 916**	**$ (1,984)**	**$ (997)**	**$ 1,499**	**$ (2,496)**
Remove effect of special items (1)	236	-	236	236	-	236
EBITDA (excluding special items)	**$ (832)**	**$ 916**	**$ (1,748)**	**$ (761)**	**$ 1,499**	**$ (2,260)**

(1) In the second quarter of 2020, Air Canada recorded special items related to the COVID-19 pandemic amounting to $236 million. Refer to section 4 "Results of Operations" of this MD&A for additional information.

Adjusted CASM

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

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

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

Adjusted CASM is reconciled to GAAP operating expense as follows:

(Canadian dollars in millions)	Second Quarter			First Six Months		
	2020	2019	$ Change	2020	2019	$ Change
Operating expense – GAAP	**$ 2,082**	**$ 4,316**	**$ (2,234)**	**$ 6,237**	**$ 8,623**	**$ (2,386)**
Adjusted for:						
Aircraft fuel expense	(124)	(1,117)	993	(960)	(2,114)	1,154
Ground package costs	3	(116)	119	(231)	(410)	179
Special items [1]	(236)	-	(236)	(236)	-	(236)
Operating expense, adjusted for the above-noted items	**$ 1,725**	**$ 3,083**	**$ (1,358)**	**$ 4,810**	**$ 6,099**	**$ (1,289)**
ASMs (millions)	**2,243**	**27,910**	**(92.0%)**	**25,754**	**53,927**	**(52.2%)**
Adjusted CASM (cents)	**¢ 76.91**	**¢ 11.05**	**596.2%**	**¢ 18.68**	**¢ 11.31**	**65.1%**

(1) In the second quarter of 2020, Air Canada recorded special items related to the COVID-19 pandemic amounting to $236 million. Refer to section 4 "Results of Operations" of this MD&A for additional information.

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.

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

(Canadian dollars in millions)	Second Quarter			First Six Months		
	2020	2019	$ Change	2020	2019	$ Change
Income (loss) before income taxes – GAAP	**$ (1,481)**	**$ 440**	**$ (1,921)**	**$ (2,757)**	**$ 725**	**$ (3,482)**
Adjusted for:						
Special items [1]	236	-	236	236	-	236
Foreign exchange (gain) loss	(242)	(117)	(125)	469	(380)	849
Net financing expense relating to employee benefits	9	9	-	20	19	1
(Gain) loss on financial instruments recorded at fair value	40	(6)	46	74	(14)	88
Adjusted pre-tax income (loss)	**$ (1,438)**	**$ 326**	**$ (1,764)**	**$ (1,958)**	**$ 350**	**$ (2,308)**

(1) In the second quarter of 2020, Air Canada recorded special items related to the COVID-19 pandemic amounting to $236 million. Refer to section 4 "Results of Operations" of this MD&A for additional information.

Free Cash Flow

Air Canada uses free cash flow 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.

Net Cash Burn

Air Canada uses net cash burn as a measure of cash used to maintain operations, support capital expenditures, and settle normal debt repayments, all before the net impact of new financing proceeds. Net cash burn is defined as net cash flows from operating, financing, and investing activities, and excludes proceeds from new financings, a lump sum debt maturity made in March 2020 of $255 million and any future lump sum debt maturities where the corporation has refinanced or replaced the amount. Net cash burn also excludes movements between cash and short and long-term investments. 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 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 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.

Atlantic passenger and cargo revenues – Refers 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 – Refers to revenues from flights within Canada.

EBITDA – Refers to earnings before interest, taxes, depreciation and amortization. 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.

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 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.

Loss (gain) on debt settlements and modifications – Refers 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.

Net cash burn – Refers to net cash flows from operating, financing, and investing activities, excluding proceeds from new financings, a lump sum debt maturity made in March 2020 of $255 million and any future lump sum debt maturities where the Corporation has refinanced or replaced the amount. Net cash burn also excludes movements between cash and short and long-term investments. Refer to sections 6.5 "Consolidated Cash Flow Movements" and 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Other passenger and cargo revenues – Refers to revenues from flights with origins and destinations principally in Central and South America, the Caribbean and Mexico.

Pacific passenger and cargo revenues – Refers 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.

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 – Refers 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.