



**Third Quarter 2021**

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

**November 2, 2021**

**TABLE OF CONTENTS**

<b>1. HIGHLIGHTS .....</b>	<b>2</b>
<b>2. INTRODUCTION .....</b>	<b>3</b>
<b>3. ABOUT AIR CANADA.....</b>	<b>5</b>
<b>4. OVERVIEW .....</b>	<b>6</b>
<b>5. RESULTS OF OPERATIONS.....</b>	<b>13</b>
<b>6. FLEET .....</b>	<b>22</b>
<b>7. FINANCIAL AND CAPITAL MANAGEMENT .....</b>	<b>24</b>
<b>7.1 LIQUIDITY .....</b>	<b>24</b>
<b>7.2 FINANCIAL POSITION .....</b>	<b>25</b>
<b>7.3 NET DEBT .....</b>	<b>26</b>
<b>7.4 WORKING CAPITAL .....</b>	<b>27</b>
<b>7.5 CASH FLOW MOVEMENTS .....</b>	<b>28</b>
<b>7.6 CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS.....</b>	<b>30</b>
<b>7.7 PENSION FUNDING OBLIGATIONS .....</b>	<b>31</b>
<b>7.8 CONTRACTUAL OBLIGATIONS .....</b>	<b>32</b>
<b>7.9 SHARE INFORMATION.....</b>	<b>33</b>
<b>8. QUARTERLY FINANCIAL DATA.....</b>	<b>34</b>
<b>9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT .....</b>	<b>34</b>
<b>10. ACCOUNTING POLICIES AND CONTROLS.....</b>	<b>35</b>
<b>11. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS.....</b>	<b>35</b>
<b>12. OFF-BALANCE SHEET ARRANGEMENTS.....</b>	<b>35</b>
<b>13. RELATED PARTY TRANSACTIONS .....</b>	<b>35</b>
<b>14. RISK FACTORS .....</b>	<b>35</b>
<b>15. NON-GAAP FINANCIAL MEASURES.....</b>	<b>36</b>

## 1. HIGHLIGHTS

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

(Canadian dollars in millions, except per share data or where indicated)	Third Quarter			First Nine Months		
	2021	2020	\$ Change	2021	2020	\$ Change
<b>Financial Performance Metrics</b>						
Operating revenues	2,103	757	1,346	3,669	5,006	(1,337)
Operating loss	(364)	(785)	421	(2,546)	(2,773)	227
Loss before income taxes	(679)	(821)	142	(3,364)	(3,578)	214
Net loss	(640)	(685)	45	(3,109)	(3,486)	377
Adjusted pre-tax loss <sup>(1)</sup>	(649)	(1,141)	492	(3,194)	(3,099)	(95)
EBITDA (excluding special items) <sup>(1)</sup>	(67)	(554)	487	(1,486)	(1,315)	(171)
Unrestricted liquidity <sup>(2)</sup>	14,412	8,189	6,223	14,412	8,189	6,223
Diluted loss per share	(1.79)	(2.31)	0.52	(8.97)	(12.58)	3.61
<b>Operating Statistics <sup>(3)</sup></b>	<b>2021</b>	<b>2020</b>	<b>% Change</b>	<b>2021</b>	<b>2020</b>	<b>% Change</b>
Revenue passenger miles ("RPMs") (millions)	7,915	2,517	214.5	11,433	20,807	(45.1)
Available seat miles ("ASMs") (millions)	11,116	5,949	86.8	19,327	31,703	(39.0)
Passenger load factor %	71.2%	42.3%	28.9 pp <sup>(6)</sup>	59.2%	65.6%	(6.5 pp)
Passenger revenue per RPM ("Yield") (cents)	20.7	20.2	2.5	21.5	18.8	14.4
Passenger revenue per ASM ("PRASM") (cents)	14.7	8.5	72.6	12.7	12.3	3.1
Operating revenue per ASM (cents)	18.9	12.7	49.0	19.0	15.8	20.2
Operating expense per ASM ("CASM") (cents)	22.2	25.9	(14.4)	32.2	24.5	31.0
Adjusted CASM (cents) <sup>(4)</sup>	18.7	26.1	(28.6)	28.1	20.1	40.0
Average number of full-time-equivalent ("FTE") employees (thousands) <sup>(4)</sup>	21.3	17.2	23.5	18.0	22.2	(19.0)
Fuel cost per litre (cents)	72.9	52.5	38.9	69.2	63.7	8.6
Fuel litres (thousands)	648,515	332,658	94.9	1,316,563	1,781,560	(26.1)
Revenue passengers carried (thousands) <sup>(5)</sup>	5,067	1,728	193.2	7,356	12,135	(39.4)

(1) Adjusted pre-tax income (loss), EBITDA (excluding special items) (earnings before interest, taxes, depreciation, and amortization), and adjusted CASM are each non-GAAP financial measures. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for descriptions of Air Canada's non-GAAP financial 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 and other credit facilities. At September 30, 2021, unrestricted liquidity amounted to \$14,412 million consisted of \$9,473 million in cash and cash equivalents, short-term and long-term investments, and \$4,939 million available under undrawn credit facilities. At September 30, 2020, unrestricted liquidity of \$8,189 million consisted of cash, cash equivalents and short-term investments of \$7,775 million, and long-term investments of \$414 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) 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.

(6) "pp" denotes percentage points and refers to a measure of the arithmetic difference between two percentages.

## 2. INTRODUCTION

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 third quarter of 2021. This MD&A should be read in conjunction with Air Canada's interim unaudited condensed consolidated financial statements and notes for the third quarter of 2021, as well as Air Canada's 2020 annual audited consolidated financial statements and notes and Air Canada's 2020 MD&A, each dated February 12, 2021. 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. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of November 1, 2021.

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. Air Canada issued a news release dated November 2, 2021 reporting on its results for the third quarter of 2021. This news release is available on Air Canada's website at [aircanada.com](http://aircanada.com) and on SEDAR's website at [www.sedar.com](http://www.sedar.com). For further information on Air Canada's public disclosures, including Air Canada's Annual Information Form, consult SEDAR at [www.sedar.com](http://www.sedar.com).

### **Caution Regarding Forward-Looking Information**

Air Canada's public communications may include forward-looking statements within the meaning of applicable securities laws. Such forward-looking statements are included in this MD&A and may be included in other communications, including filings with regulatory authorities and securities regulators. Forward-looking statements relate to analyses and other information that are 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 "preliminary", "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 in this MD&A and the documents incorporated by reference herein and are subject to important risks and uncertainties. Forward-looking statements cannot be relied upon due to, among other things, changing external events and general uncertainties of the business of Air Canada. 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 global airline industry, continues to face a significant decrease in traffic, as compared to the year 2019, and a corresponding decline in revenue and cash flows as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world. While it is improving, there is limited visibility on travel demand given changing government restrictions in place around the world and the severity of the restrictions which have only recently begun to ease in Canada. Air Canada cannot predict the full impact or the timing for when conditions may 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, availability of rapid, effective testing, vaccinations and treatments for the virus, government actions, and passenger reaction, the complexities of restarting an industry whose many stakeholders must act in coordination with each other as well as timing and extent of a recovery in international and business travel which are important segments of Air Canada's markets, none of which can be predicted with certainty.

Other factors that may cause results to differ materially from results indicated in forward-looking statements include economic and geopolitical conditions, Air Canada's ability to successfully achieve or sustain positive net profitability, industry and market conditions and the demand environment, Air Canada's ability to pay its indebtedness and maintain or increase liquidity, competition, energy prices, Air Canada's dependence on technology, cybersecurity risks, Air Canada's ability to successfully implement appropriate strategic and other important initiatives (including Air Canada's ability to manage operating costs), other epidemic diseases, terrorist acts, war, Air Canada's dependence on key suppliers, casualty losses, changes in laws, regulatory developments or proceedings, Air Canada's ability to successfully operate its 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, Air Canada's dependence on regional and other carriers, Air Canada's ability to preserve and grow its brand, employee and labour relations and costs, Air Canada's dependence on Star Alliance® and joint ventures, limitations due to restrictive covenants, pending and future litigation and actions by third parties, currency exchange, risks generally relating to the grounding of aircraft fleet types, pension plans, Air Canada's 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](http://www.sedar.com) and, in particular, those identified in section 17 "Risk Factors" in Air Canada's 2020 MD&A and in section 14 "Risk Factors" of this MD&A. The forward-looking statements contained or incorporated by reference in this MD&A represent Air Canada's expectations as of the date of this MD&A (or as of the date they are otherwise stated to be made) and are subject to change after such date. However, Air Canada disclaims any intention or obligation to update or revise any forward-looking statements whether because of new information, future events or otherwise, except as required under applicable securities regulations.

### **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, as applicable. 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. ABOUT AIR CANADA

Air Canada is the largest provider of scheduled passenger services in the Canadian market, the Canada-U.S. transborder market, and in the international market to and from Canada. Its mission is connecting Canada and the world.

Air Canada enhances its domestic and transborder network through a capacity purchase agreement ("CPA") with Jazz Aviation LP ("Jazz"), a wholly owned subsidiary of Chorus Aviation Inc., with regional flights operated on behalf of Air Canada under the Air Canada Express banner. Regional flying forms an integral part of the airline's international network strategy, providing valuable traffic feed to Air Canada and Air Canada Rouge routes. On March 1, 2021, Air Canada announced an agreement to revise its CPA with Jazz consolidating all its regional flying with Jazz.

In the first nine months of 2021, Air Canada together with its regional partners operated, on average, 348 daily scheduled flights to 130 direct destinations on five continents. In 2020, Air Canada together with its regional partners operated, on average, 544 daily scheduled flights to 192 direct destinations on six continents (although, as a result of the COVID-19 pandemic, operations to many destinations were suspended or did not operate continually).

At September 30, 2021, Air Canada mainline had 167 aircraft in its operating fleet, comprised of 89 Boeing and Airbus narrow-body aircraft and 78 Boeing and Airbus wide-body aircraft, while Air Canada Rouge had an operating fleet of 39 Airbus narrow-body aircraft. At September 30, 2021, the Air Canada Express fleet comprised 50 Mitsubishi regional jets, 56 De Havilland Dash-8 turboprop aircraft and 25 Embraer 175 aircraft for a total of 131 aircraft.

Air Canada is a founding member of the Star Alliance® network. Through the 26-member airline network, Air Canada offers its customers access to a wide global network, as well as reciprocal participation in frequent flyer programs and the use of airport lounges and other common airport facilities.

Air Canada's Aeroplan program is Canada's premier travel loyalty program. The Aeroplan program allows individuals to enroll as members and accumulate Aeroplan points through travel on Air Canada and select partners, as well as through the purchase of products and services from participating partners and suppliers. Members can redeem Aeroplan points for a variety of travel, merchandise, gift cards, and other rewards provided directly by participating partners, or made available through Aeroplan's suppliers. Aeroplan Elite Status recognizes Air Canada's frequent flyers, as well as Aeroplan's most engaged members, with a range of priority travel services and membership benefits.

Air Canada Vacations is a leading Canadian tour operator, developing, marketing, and distributing vacation travel packages, in the outbound leisure travel market (Caribbean, Mexico, U.S., Europe, Central and South America, South Pacific, Australia, and Asia) and the inbound leisure travel market to destinations within Canada, and offering cruise packages in North America, Europe, and the Caribbean. Air Canada Rouge is Air Canada's leisure carrier.

Air Canada Cargo, a division of Air Canada, is a global cargo service provider, offering cargo services on passenger flights and on all-cargo flights. Air Canada Cargo continues to use cargo space available in Air Canada's mainline wide-body aircraft as well as certain converted Boeing 777 and Airbus A330 aircraft with increased cargo space generated by the removal of seats from the passenger cabin. In 2021, Air Canada also expects to generate incremental cargo revenue from the e-commerce business and by converting several of its owned Boeing 767 aircraft into dedicated freighters to leverage the growth of e-commerce. Air Canada Cargo expects to operate one Boeing 767 freighter by the end of 2021 with an additional four Boeing 767 freighters to be in service by the end of 2022.

## 4. OVERVIEW

Air Canada, along with the global airline industry, continues to face a significant drop in traffic and a corresponding decline in revenue and cash flow, as compared to the year 2019, due to the COVID-19 pandemic and the travel restrictions imposed in many countries around the world, including in Canada. However, the demand environment showed meaningful signs of improvement during the third quarter of 2021. As further explained in section 5 "Results of operations" of this MD&A, total capacity and traffic increased 86.8% and 214.5%, respectively, versus the third quarter of 2020. When compared to the third quarter of 2019, capacity and traffic were down 65.8% and 71.7%, respectively.

Air Canada's vision for recovery is predicated on leveraging the solid foundation it has built over the past several years to restore and rebuild towards its global champion ambition. This involves rebuilding a strong global network with a focus on hub-to-hub flying providing seamless connectivity with Air Canada's partners, delivering consistent and superior customer service, and diversifying its revenue base, including through Aeroplan and Air Canada Cargo. For additional information on Air Canada's strategy and measures it has deployed in response to the pandemic, refer to section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of Air Canada's 2020 Annual MD&A.

### Recent Developments

#### Easing of Certain Travel Restrictions and Quarantine Measures

In Canada, certain travel restrictions and quarantine measures were lifted over the course of the third quarter of 2021. The changes included:

- Since July 5, 2021, fully vaccinated travellers who are permitted to enter Canada have not been subject to the federal requirement to quarantine or take a COVID-19 test on day eight after arrival.
- Since August 9, 2021:
  - Fully vaccinated United States ("U.S.") citizens and permanent residents, residing in the U.S., are permitted to enter Canada for non-essential travel.
  - The obligation to quarantine at a government-approved hotel ceased for all travellers.
  - Five Canadian airports (Halifax Stanfield International Airport, Québec City Jean Lesage International Airport, Ottawa Macdonald-Cartier International Airport, Winnipeg James Armstrong Richardson International Airport, and Edmonton International Airport) were allowed to receive scheduled international commercial passenger flights in addition to the four Canadian airports that were already open for international commercial passenger operations.
- Since September 7, 2021, fully vaccinated foreign nationals have been allowed to enter Canada for non-essential travel. Foreign nationals who do not meet the requirements to be considered fully vaccinated are not able to enter Canada unless they meet an exemption set out in the Orders made under the *Quarantine Act*. Unvaccinated children under the age of 12 who enter Canada with their fully vaccinated parents, stepparents, guardians or tutors, are not required to quarantine upon entering Canada, but must adhere to strict public health measures including testing rules (save for certain exceptions) and limit contact with others for 14 days.

All travellers, regardless of vaccination status, still require a negative pre-entry COVID-19 PCR test result taken within 72 hours of departure. Effective August 9, 2021, the Government of Canada adjusted its post-arrival testing requirements for fully vaccinated travellers, moving from testing all passengers to randomly testing passengers for COVID-19 upon arrival. Unvaccinated or partially vaccinated travellers allowed to



enter Canada, remain subject to the federal requirement to quarantine and take a COVID-19 test at the time of arrival and on day eight after arrival.

While Air Canada is encouraged by the progress in the easing of travel restrictions, any benefits will take time to materialize into current period revenues. In addition, the travel restrictions that remain in effect, which vary from country to country, continue to impact demand for air travel.

#### Safety First, Always

On August 13, 2021, the Government of Canada announced that by no later than the end of October 2021, it would require employees in the federally regulated air, rail, and marine transportation sectors to be vaccinated against COVID-19. On August 25, 2021, Air Canada announced and introduced a new health and safety policy to further protect employees and customers. The policy makes it mandatory for all employees of the airline to be fully vaccinated against COVID-19 (subject to certain limited exceptions required by law) by October 30, 2021, and to report their vaccination status. In addition, the airline made full vaccination a condition of employment for any individual hired by the company.

On October 6, 2021, the Government of Canada announced that effective October 30, 2021, all air passengers 12 years of age or older departing from airports in Canada on domestic, transborder or international flights, will need to be fully vaccinated in order to board a flight. There will be a short transition period for travellers who are in the process of being vaccinated, where they will be able to travel if they can show a valid COVID-19 molecular test within 72 hours of travel. By November 30, 2021, the Government of Canada will require all travellers to be fully vaccinated, with very limited exceptions to address specific situations such as emergency travel, children under the age of 12 are not able to receive a COVID-19 vaccine, and those medically unable to be vaccinated. Air Canada is committed to working with the Government of Canada to implement this new policy in an effective manner with the aim of increasing safety of its employees, customers, and all Canadians.

On October 25, 2021, Air Canada announced the introduction of new testing products, including portable self-administered COVID-19 molecular and antigen test kits, through a partnership with Switch Health, a Canadian-based healthcare company. Using the Switch Health COVID-19 RT-LAMP Kit, customers can test themselves while travelling abroad prior to their flight to Canada to meet Government of Canada testing entry requirements.

#### Customer Experience

On April 13, 2021, Air Canada announced it was offering refunds to passengers who purchased a non-refundable fare but whose flights were cancelled or who voluntarily cancelled their travel due to the COVID-19 pandemic between February 1, 2020, and April 13, 2021. The policy allowed eligible customers to submit a request for a refund online or with their travel agent until July 12, 2021. Eligible refunds processed and paid during the third quarter of 2021 amounted to \$211 million. As at September 30, 2021, the total value of refunds processed was \$1,208 million. In addition, for new tickets purchased on or after April 13, 2021, Air Canada provides its customers an option for a refund to the original form of payment in instances where Air Canada cancels their flight or reschedules the departure time by more than three hours, irrespective of the reason. Air Canada customers also have the option of accepting Aeroplan points with a 65% bonus or an Air Canada Travel Voucher.

On September 7, 2021, Air Canada unveiled its expanded Travel Ready hub, an interactive online tool to help customers plan and prepare for upcoming trips. Air Canada continues to develop practical solutions to help its customers be travel-ready, wherever they want to go. This includes assisting them in navigating the changing COVID-19 related entry requirements across its global network by making all relevant information available in one convenient place. The easy-to-use Travel Ready hub is designed to make it simple for customers to choose where to go next by showing the countries that are open to visitors through an interactive map.



During the third quarter of 2021, Aeroplan announced several enhancements to its loyalty program. These included:

- Launching partnerships with the Liquor Control Board of Ontario ("LCBO"), one of the world's largest retailers of alcoholic beverages, and with Uber Canada.
- Adding Aeroplan as a transfer option for Ultimate Rewards® points for eligible Chase cardmembers, Chase is the largest U.S. co-brand card issuer.

#### Route Network & Schedule

Over the third quarter of 2021, and following the June 15, 2021 announcement of its peak domestic summer schedule serving 50 Canadian destinations from coast to coast, Air Canada announced a series of new network developments, including:

- On July 6, 2021, Air Canada unveiled new details for its international flight schedule for the Summer of 2021 which included the resumption of 17 routes and 11 destinations across the world from its hubs.
- Following the Government of Canada's announcement to loosen travel restrictions for citizens and permanent residents of the U.S., on July 19, 2021, Air Canada announced its U.S. transborder summer schedule which included 55 routes and 34 destinations in the U.S., with up to 220 daily flights between the U.S. and Canada.
- On July 29, 2021, Air Canada announced two new winter services departing from Québec City to Orlando and Fort Lauderdale. Air Canada also announced it will be resuming its international service to Punta Cana and Cancun, from Québec City, later in the fall.
- On September 7, 2021, Air Canada Rouge resumed service with flights operating between Toronto and Las Vegas, Orlando, and Regina, with other destinations introduced in September, including Cancun and Tampa.
- On September 8, 2021, Air Canada resumed service between Montreal and Toronto Island Airport with five daily return flights.
- On September 27, 2021, Air Canada resumed its non-stop flights to and from Delhi, following the lifting of the Government of Canada restrictions on non-stop flights from India.

In October 2021, Air Canada announced additional updates to its schedule. These announcements included:

- Two new seasonal routes connecting Québec City with Vancouver and with Calgary. These routes are scheduled to begin in May 2022.
- Increase in service to several key South American destinations. Year-round service to São Paulo, Brazil from Montreal will resume on December 8, 2021. Direct service from Montreal to Bogota, Colombia is set to start on December 2, 2021. Flights from Toronto to Bogota will increase to four per week as of November 7, 2021. Service between Toronto and Santiago, Chile is scheduled to resume in January 2022. Air Canada will serve Buenos Aires, Argentina, with flights offered from both Toronto and Montreal via São Paulo.
- New seasonal service between Toronto and Santo Domingo in the Dominican Republic is scheduled to begin on December 16, 2021.

- Planned summer schedule for Europe, Africa, the Middle East and India. In addition to its established year-round services, Air Canada announced its return to key summer seasonal destinations such as Barcelona, Venice, Nice, Manchester, Edinburgh, and Reykjavik.
- Expansion of services to India with increased frequency to Delhi from Toronto, since October 15, 2021, and a new year-round service to Delhi from Montreal that started on October 31, 2021.
- New daily service between Toronto Island and Ottawa which started on October 31, 2021.

As travel restrictions ease around the world, Air Canada remains committed to rebuilding its international network and to continue as a global carrier to connect Canada to the world, while also developing additional markets and targeting new opportunities. In anticipation of expected travel demand, during the third quarter of 2021, Air Canada recalled over 6,500 employees. In the first nine months of 2021, Air Canada recalled more than 10,000 employees.

### ESG

On August 3, 2021, Air Canada published its 2020 Corporate Sustainability Report *Citizens of the World*. The report provides a fulsome view of Air Canada's efforts, governance, and management approaches, which are articulated through three sustainability pillars: Business, People, and Planet. The report is available at [www.aircanada.com/citizensoftheworld](http://www.aircanada.com/citizensoftheworld).

### Financing and Liquidity

On August 11, 2021, Air Canada closed a private offering of \$2.0 billion of 4.625% senior secured notes due 2029 (the "Canadian Dollar Notes") and US\$1.2 billion of 3.875% senior secured notes due 2026 (the "US Dollar Notes", and together with the Canadian Dollar Notes, the "Notes"). Air Canada also closed a US\$2.9 billion new senior secured credit facility, consisting of a US\$2.3 billion new term loan B maturing in 2028 (the "Term Loan"), together with a new undrawn US\$600 million revolving credit facility maturing in 2025 (the "Revolving Facility" and, together with the Term Loan, the "Senior Secured Credit Facilities").

Air Canada received aggregate gross proceeds of approximately \$7.1 billion from the sale of the Notes and from the Senior Secured Credit Facilities. Air Canada applied the proceeds from the sale of the Canadian Dollar Notes, together with the proceeds from the Term Loan, to (i) satisfy and discharge all of Air Canada's outstanding \$200 million aggregate principal amount of its 4.75% senior secured notes due 2023 and redeem all of Air Canada's outstanding \$840 million aggregate principal amount of its 9.00% second lien notes due 2024, (ii) repay all of Air Canada's US\$1,178 million of indebtedness outstanding under the loan agreement dated as of October 6, 2016, which comprised a syndicated secured US dollar term loan B facility and a syndicated secured US dollar revolving credit facility and (iii) satisfy applicable transaction costs, fees and expenses.

The balance of the proceeds is being retained for working capital and other general corporate purposes. The Revolving Facility is undrawn as of September 30, 2021, and any future borrowings thereunder are also intended to fund working capital and other general corporate purposes.

The Notes and Air Canada's obligations under the Senior Secured Credit Facilities are senior secured obligations of the Company, secured on a first-lien basis, subject to certain permitted liens, by certain collateral comprised of substantially all of Air Canada's international routes, airport slots and gate leaseholds.

In August 2021, Air Canada repaid in full its \$200 million revolving credit facility which remains available and undrawn.

As a result of the above referenced financing transactions completed during the third quarter of 2021, Air Canada's liquidity, net of related transaction fees, increased \$4,419 million, including available and undrawn lines of credit.

*Debt and Equity Financing Agreements with the Government of Canada*

On April 12, 2021, Air Canada entered into a series of debt and equity financing agreements with the Government of Canada (acting through its subsidiary, Canada Enterprise Emergency Funding Corporation) which allows Air Canada to access up to \$5.879 billion in liquidity through the Large Employer Emergency Financing Facility (LEEFF) program.

The financial package provides for fully repayable loans that Air Canada will only draw down if and as required, as well as an equity investment, and is comprised of:

- Gross proceeds of \$500 million for 21,570,942 Air Canada shares at a price of \$23.17933 per share (net proceeds of approximately \$480 million).
- \$1.5 billion in the form of a secured revolving credit facility maturing in April 2026 and bearing interest at the Canadian Dollar Offered Rate (CDOR) plus 1.5%; the facility is secured on a first lien basis by the assets of Aeroplan, Air Canada's shares in Aeroplan as well as certain assets of Air Canada, including certain intellectual property relating to the Aeroplan loyalty program. No amount has been drawn by Air Canada under this facility.
- \$2.475 billion in the form of three unsecured non-revolving credit facilities of \$825 million each with: the first, five-year tranche maturing in April 2026, at CDOR plus 1.75% per annum; the second, six-year tranche maturing in April 2027, at 6.5% per annum (increasing to 7.5% after 5 years); and the third, seven-year tranche maturing in April 2028, at 8.5% per annum (increasing to 9.5% after 5 years). No amount has been drawn under these facilities.
- As consideration for the Government making the above secured and unsecured credit facilities available to Air Canada, Air Canada issued an aggregate of 14,576,564 warrants initially exercisable for the purchase of an equal number of Air Canada shares, subject to customary adjustments, at an exercise price of \$27.2698 per share during a 10-year term, representing an aggregate exercise price equal to 10% of the total commitment available under the above secured and unsecured credit facilities; 50% of the warrants vested concurrently with the implementation of the credit facilities and the remaining 50% of the warrants will vest on a proportional basis to the amounts that Air Canada draws, if any, under the above unsecured credit facilities; the warrants are subject to a one-time call right in favour of Air Canada, pursuant to which Air Canada may, upon repayment of all indebtedness, if any, outstanding under the above secured and unsecured credit facilities and termination thereof, repurchase for cancellation all outstanding warrants at a price per warrant equal to its fair market value determined by third-party valuers. The vested warrants are exercisable by the holder either by paying the exercise price or by using a cashless exercise option.
- Up to \$1.404 billion in the form of an unsecured credit facility tranche to support customer refunds of non-refundable tickets. The facility has a seven-year term maturing in April 2028 and carries an annual interest rate of 1.211%. Draws under this facility are made monthly based on the amount of refunds processed and paid during the period. As at September 30, 2021, \$1.205 billion has been drawn under this facility to support customer refunds of non-refundable tickets, and a further \$3 million is being drawn for refunds paid up until September 30, 2021. Draws under this facility may continue up until November 30, 2021 as eligible refunds are paid.

As part of the financial package, Air Canada agreed to a number of commitments related to customer refunds, service to certain regional communities, restrictions on the use of the funds provided, employment levels and capital expenditures. Such commitments include:

- Using the proceeds from the financial package (other than the \$1.404 billion ticket refund facility) only for the payment of operating expenses and ordinary course business obligations of Air Canada as they become due in accordance with past practices.
- Offering eligible customers who purchased non-refundable fares but did not travel due to COVID-19 since February 2020 up to April 13, 2021, the option of a refund to the original form of payment.
- The resumption of service or access to Air Canada's network for most regional communities where service was suspended because of COVID-19's impact on travel, through direct services or new interline agreements with third party regional carriers.
- Restricting certain expenditures and senior executive compensation in respect of any financial year during which the secured and unsecured facilities are outstanding (other than the unsecured credit facility tranche to support customer refunds of non-refundable tickets).
- Restricting dividends or payments of distributions on Air Canada's equity interests, or any purchases, redemptions or other acquisitions or retirements for value of any equity interests or convertible indebtedness of Air Canada while any indebtedness is outstanding under any of the secured and unsecured credit facilities (excluding the unsecured credit facility tranche to support customer refunds of non-refundable tickets) and for a period of 12 months following the termination of such facilities.
- Obligations to maintain employment at levels which are no lower than those at April 1, 2021.
- The completion of the airline's acquisition of 33 Airbus A220 aircraft, manufactured at Airbus' Mirabel, Québec facility. Air Canada has also agreed to complete its existing firm order of 40 Boeing 737 MAX aircraft. Completion of these orders remains subject to the terms and conditions of the applicable purchase agreements.

Air Canada agreed to provide the Government with customary registration rights in connection with its equity investment. The Air Canada shares and warrants issued to the Government are subject to certain transfer restrictions, namely (i) restrictions on any transfer, other than to affiliates of the Government, for a period commencing on the date of issuance and ending, in the case of the shares, on the date that is one year from the date of issuance and, in respect of the warrants, the date on which Air Canada's previously described call right has expired pursuant to the terms of the warrants, (ii) restrictions on transfers to competitors and securityholders of Air Canada that beneficially own or control 5% or more of Air Canada's issued and outstanding shares, including any convertible securities, on an as converted basis, subject to customary exceptions, and (iii) in respect of the warrants, once the transfer restriction described in (i) has expired, minimum block sizes for transfers. The warrants are also subject to an exercise cap which limits the Government's aggregate ownership of Air Canada shares. The exercise cap prohibits the Government from exercising any warrants if the voting rights attached to the Air Canada shares held by the Government (including those issued upon any exercise of the warrants) would exceed 19.99% of the aggregate votes attached to all of Air Canada's voting securities outstanding immediately after giving effect to such exercise.

#### Termination of the Transat A.T. Inc. Arrangement Agreement

On April 2, 2021, Air Canada announced, together with Transat A.T. Inc. ("Transat"), that it had mutually agreed to terminate the previously disclosed Arrangement Agreement for the proposed acquisition of Transat by Air Canada. The two parties had originally agreed in June 2019 on the acquisition with subsequent amendments in August 2019 and October 2020. The Canadian regulatory authorities approved the transaction on February 11, 2021. However, following discussions with the European Commission ("EC") it became evident that the EC would not approve the transaction based on the offered remedy package. After a careful consideration, Air Canada concluded that providing additional, onerous remedies, which may still not have secured an EC approval, would significantly compromise Air Canada's ability to compete

internationally, negatively impacting customers, other stakeholders and future prospects as it recovers and rebuilds from the impact of the COVID-19 pandemic. As a result, Air Canada and Transat agreed to terminate the Arrangement Agreement with Air Canada paying Transat a termination fee of \$12.5 million and Transat no longer under any obligation to pay Air Canada any fee should Transat be involved in another acquisition or similar transaction in the future.

#### Consolidation of Air Canada Express flying with Jazz

On March 1, 2021, Air Canada announced an agreement to revise its CPA with Jazz, and consolidated all its regional flying with Jazz. As a result of the CPA revisions and consolidation of regional flying, Air Canada expects to realize \$400 million in cost reductions over the 15-year term of the agreement (\$43 million per year until 2026 and \$18 million per year thereafter). In addition, the revised CPA will lower future contractual capital expenditures and leasing costs through a restructured CPA fleet, avoiding an estimated \$193 million in future capital expenditures. The amended CPA is effective on a retroactive basis to January 1, 2021.

## 5. RESULTS OF OPERATIONS

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

(Canadian dollars in millions, except where indicated)	Third Quarter				First Nine Months			
	2021	2020	\$ Change	% Change	2021	2020	\$ Change	% Change
<b>Operating revenues</b>								
Passenger	\$ 1,636	\$ 507	\$ 1,129	223	\$ 2,457	\$ 3,907	\$ (1,450)	(37)
Cargo	366	216	150	69	1,005	634	371	59
Other	101	34	67	197	207	465	(258)	(55)
<b>Total operating revenues</b>	<b>2,103</b>	<b>757</b>	<b>1,346</b>	<b>178</b>	<b>3,669</b>	<b>5,006</b>	<b>(1,337)</b>	<b>(27)</b>
<b>Operating expenses</b>								
Aircraft fuel	472	175	297	170	911	1,135	(224)	(20)
Wages, salaries, and benefits	592	475	117	25	1,617	1,735	(118)	(7)
Regional airlines expense, excluding fuel	312	198	114	58	700	841	(141)	(17)
Depreciation and amortization	400	423	(23)	(5)	1,217	1,414	(197)	(14)
Aircraft maintenance	153	45	108	240	430	496	(66)	(13)
Airport and navigation fees	166	97	69	71	373	438	(65)	(15)
Sales and distribution costs	74	30	44	147	142	226	(84)	(37)
Ground package costs	23	5	18	360	29	236	(207)	(88)
Catering and onboard services	52	26	26	100	94	146	(52)	(36)
Communications and information technology	85	66	19	29	271	292	(21)	(7)
Special items	(103)	(192)	89	46	(157)	44	(201)	(457)
Other	241	194	47	24	588	776	(188)	(24)
<b>Total operating expenses</b>	<b>2,467</b>	<b>1,542</b>	<b>925</b>	<b>60</b>	<b>6,215</b>	<b>7,779</b>	<b>(1,564)</b>	<b>(20)</b>
<b>Operating loss</b>	<b>(364)</b>	<b>(785)</b>	<b>421</b>		<b>(2,546)</b>	<b>(2,773)</b>	<b>227</b>	
<b>Non-operating income (expense)</b>								
Foreign exchange gain (loss)	(136)	88	(224)		(74)	(381)	307	
Interest income	17	32	(15)		54	106	(52)	
Interest expense	(197)	(196)	(1)		(538)	(474)	(64)	
Interest capitalized	4	6	(2)		13	20	(7)	
Net financing expense relating to employee benefits	(1)	(6)	5		(10)	(26)	16	
Gain (loss) on financial instruments	114	46	68		(114)	(28)	(86)	
Loss on debt settlements and modifications	(110)	-	(110)		(129)	-	(129)	
Other	(6)	(6)	-		(20)	(22)	2	
<b>Total non-operating expense</b>	<b>(315)</b>	<b>(36)</b>	<b>(279)</b>		<b>(818)</b>	<b>(805)</b>	<b>(13)</b>	
<b>Loss before income taxes</b>	<b>(679)</b>	<b>(821)</b>	<b>142</b>		<b>(3,364)</b>	<b>(3,578)</b>	<b>214</b>	
Income tax recovery	39	136	(97)		255	92	163	
<b>Net loss</b>	<b>\$ (640)</b>	<b>\$ (685)</b>	<b>\$ 45</b>		<b>\$ (3,109)</b>	<b>\$ (3,486)</b>	<b>\$ 377</b>	
<b>Diluted loss per share</b>	<b>\$ (1.79)</b>	<b>\$ (2.31)</b>	<b>\$ 0.52</b>		<b>\$ (8.97)</b>	<b>\$ (12.58)</b>	<b>\$ 3.61</b>	
<b>EBITDA (excluding special items) <sup>(1)</sup></b>	<b>\$ (67)</b>	<b>\$ (554)</b>	<b>\$ 487</b>		<b>\$ (1,486)</b>	<b>\$ (1,315)</b>	<b>\$ (171)</b>	
<b>Adjusted pre-tax loss <sup>(1)</sup></b>	<b>\$ (649)</b>	<b>\$ (1,141)</b>	<b>\$ 492</b>		<b>\$ (3,194)</b>	<b>\$ (3,099)</b>	<b>\$ (95)</b>	

(1) EBITDA (excluding special items) and adjusted pre-tax income (loss) are non-GAAP financial measures. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

### System Passenger Revenues

The COVID-19 pandemic generated a system-wide impact which began to be felt in early March 2020, and by June 2020 the global commercial aviation sector came to a near standstill. Since the onset of the pandemic, Air Canada has actively managed its ASM capacity based on prevailing market trends and travel demand. In the third quarter of 2021, Air Canada increased its ASM capacity by 86.8% when compared to the third quarter of 2020 (a decrease of 65.8% when compared to the third quarter of 2019). In the third quarter of 2021, ASM capacity represented a sequential growth of 178% from the second quarter of 2021, marking the first meaningful turning point in the recovery. In the first nine months of 2021, ASM capacity decreased by 39.0% compared to the same period in 2020, as the impact of the COVID-19 pandemic only began to be felt in March 2020, and by 77.6% when compared to the first nine months of 2019.

Third quarter 2021 passenger revenues of \$1,636 million increased by \$1,129 million, more than tripling compared with the third quarter of 2020. At the system level, traffic measured as revenue passenger miles (RPM) increased 214.5%. In the first nine months of 2021, passenger revenues of \$2,457 million decreased by \$1,450 million or 37.1% from the first nine months of 2020. Compared to the same period in 2019, passenger revenues declined by 68.2% in the third quarter of 2021 and by 81.5% in the first nine months of 2021.

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

(Canadian dollars in millions)	Third Quarter			
	2021	2020	\$ Change	% Change
Canada	\$ 771	\$ 316	\$ 455	144.6
U.S. transborder	291	28	263	929.3
Atlantic	384	111	273	244.2
Pacific	112	30	82	277.0
Other	78	22	56	247.0
<b>System</b>	<b>\$ 1,636</b>	<b>\$ 507</b>	<b>\$ 1,129</b>	<b>222.4</b>

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the periods indicated.

	Third Quarter 2021 vs Third Quarter 2020					
	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	144.6	78.8	141.8	19.8	1.2	36.8
U.S. transborder	929.3	439.3	917.4	34.2	1.2	90.9
Atlantic	244.2	58.1	270.8	40.5	(7.2)	117.7
Pacific	277.0	63.6	197.3	22.6	26.8	130.4
Other	247.0	148.5	211.0	14.3	11.6	39.6
<b>System</b>	<b>222.4</b>	<b>86.8</b>	<b>214.5</b>	<b>28.9</b>	<b>2.5</b>	<b>72.6</b>



The table below provides passenger revenue by geographic region for the first nine months of 2021 versus the first nine months of 2020.

(Canadian dollars in millions)	First Nine Months			
	2021	2020	\$ Change	% Change
Canada	\$ 1,276	\$ 1,378	\$ (102)	(7.3)
U.S. transborder	352	793	(441)	(55.7)
Atlantic	546	819	(273)	(33.4)
Pacific	163	440	(277)	(63.0)
Other	120	477	(357)	(74.8)
<b>System</b>	<b>\$ 2,457</b>	<b>\$ 3,907</b>	<b>\$ (1,450)</b>	<b>(37.1)</b>

The table below provides year-over-year percentage changes in passenger revenues and operating statistics by geographic region for the first nine months of 2021 versus the first nine months of 2020.

	First Nine Months 2021 vs First Nine Months 2020					
	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	(7.3)	(3.8)	(6.4)	(1.7)	(1.0)	(3.6)
U.S. transborder	(55.7)	(64.2)	(66.2)	(3.8)	31.1	23.8
Atlantic	(33.4)	(28.6)	(28.5)	0.1	(7.0)	(6.8)
Pacific	(63.0)	(60.0)	(75.7)	(26.5)	52.3	(7.3)
Other	(74.8)	(76.1)	(81.1)	(16.7)	33.7	5.8
<b>System</b>	<b>(37.1)</b>	<b>(39.0)</b>	<b>(45.1)</b>	<b>(6.5)</b>	<b>14.4</b>	<b>3.1</b>

The table below provides, by market, Air Canada's revenue passenger miles (RPMs) and available seat miles (ASMs) for the periods indicated.

(millions)	Third Quarter				First Nine Months			
	2021		2020		2021		2020	
	RPMs	ASMs	RPMs	ASMs	RPMs	ASMs	RPMs	ASMs
Canada	3,418	4,483	1,413	2,504	5,050	7,991	5,393	8,310
U.S. transborder	974	1,336	97	250	1,163	1,824	3,444	5,097
Atlantic	2,575	3,647	694	2,306	3,776	6,541	5,277	9,158
Pacific	541	1,076	182	658	808	1,961	3,321	4,905
Other	407	574	131	231	636	1,010	3,372	4,233
<b>System</b>	<b>7,915</b>	<b>11,116</b>	<b>2,517</b>	<b>5,949</b>	<b>11,433</b>	<b>19,327</b>	<b>20,807</b>	<b>31,703</b>

### Domestic Passenger Revenues

In the third quarter of 2021, on a capacity increase of 78.8%, Domestic passenger revenues of \$771 million increased \$455 million or 144.6% from the third quarter of 2020. The year-over-year increase resulted from a better operating environment in the Canadian market as Canadian provinces and territories gradually rolled out reopening plans.

### U.S. Transborder Passenger Revenues

In the third quarter of 2021, on a five-fold capacity increase, U.S. Transborder passenger revenues of \$291 million, increased by \$263 million or more than 10 times from the third quarter of 2020. In the third quarter of 2021, Air Canada re-started several U.S. destinations.

### Atlantic Passenger Revenues

In the third quarter of 2021, on a capacity increase of 58.1%, Atlantic passenger revenues of \$384 million increased by \$273 million or more than triple from the third quarter of 2020. The year-over-year growth in passenger revenues was primarily driven by an increase in traffic of 270.8%, which resulted in a passenger load factor increase of 40.5 percentage points, was partially offset by weaker yield. In the third quarter of 2021, Air Canada restarted flights to certain European destinations that had been suspended, and close to the end of the quarter, resumed its service to India. In addition, Air Canada continued to operate its flights to Doha and Cairo, which were launched in the fourth quarter of 2020 and the second quarter of 2021, respectively.

### Pacific Passenger Revenues

In the third quarter of 2021, on a capacity increase of 63.6%, Pacific passenger revenues of \$112 million, increased by \$82 million or more than triple from the third quarter of 2020. The variance was driven by a three-fold increase in traffic from the same period of 2020, mainly on China and Hong Kong.

### Other Passenger Revenues

In the third quarter of 2021, on a capacity increase of 148.5%, Other passenger revenues of \$78 million increased by \$56 million (or about 2.5 times) year-over-year.

The impact of the COVID-19 pandemic on passenger revenues started being felt in March 2020. As such, a further discussion of passenger revenues and of factors influencing year-over-year changes by geographic region would not be meaningful and is therefore not provided.

While Air Canada saw significant progress on revenues and advance ticket sales in the third quarter of 2021, including from point of origin U.S. and international, the remaining travel restrictions imposed by various countries, including the Government of Canada, continue to have an impact on demand for certain customer segments. Most notably, in Canada, from families travelling with children under the age of 12 who are not able to be administered COVID-19 vaccines. In addition, the 72-hour prior to departure negative PCR COVID-19 test requirement from the Canadian government continues to adversely impact demand for international travel.

## **Cargo Revenues**

Cargo revenues of \$366 million in the third quarter of 2021 increased by \$150 million or 69.4% from the third quarter of 2020. In the first nine months of 2021, Air Canada Cargo surpassed the billion-dollar mark and achieved record cargo revenues of \$1,005 million, an increase of \$371 million or 58.5% from the same period in 2020.

In the third quarter of 2021, traffic and yield increased by 59.3% and 6.4%, respectively, compared to the third quarter of 2020. A total of 2,101 cargo-only flights were operated in the third quarter of 2021 and represented revenues of \$183 million or 50% of cargo revenues in the quarter. In the first nine months of

2021, traffic and yield increased by 30.7% and 21.2%, respectively, compared to the same period in 2020. A total of 7,720 cargo-only flights were operated in the first nine months of 2021 and represented revenues of \$588 million or 59% of cargo revenues during the period. Demand for air cargo services remained strong at the end of the third quarter of 2021.

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

(Canadian dollars in millions)	Third Quarter				First Nine Months			
	2021	2020	\$ Change	% Change	2021	2020	\$ Change	% Change
Canada	\$ 30	\$ 24	\$ 6	27.3	\$ 79	\$ 61	\$ 18	29.5
U.S. transborder	16	6	10	139.8	44	27	17	60.9
Atlantic	124	103	21	20.4	387	256	131	51.0
Pacific	168	72	96	134.4	426	255	171	67.1
Other	28	11	17	154.0	69	35	34	99.3
<b>System</b>	<b>\$ 366</b>	<b>\$ 216</b>	<b>\$ 150</b>	<b>69.4</b>	<b>\$ 1,005</b>	<b>\$ 634</b>	<b>\$ 371</b>	<b>58.5</b>

### Other Revenues

In the third quarter of 2021, other revenues of \$101 million increased by \$67 million from the third quarter of 2020. The increase was primarily driven by ground package revenues at Air Canada Vacations due to higher volumes and by an increase in non-air revenues related to the Aeroplan program. In the first nine months of 2021, other revenues of \$207 million declined by \$258 million or 55% from the same period in 2020. This decrease is explained by the impact of the COVID-19 pandemic which only began to be felt in early March 2020 resulting in lower ground package revenues at Air Canada Vacations, for the subsequent periods, and to a lesser extent, a reduction in passenger and airline-related fees, both due to lower passenger volumes. This decline was partially offset by an increase in non-air revenues related to the Aeroplan program.

### Operating Expenses

Operating expenses of \$2,467 million in the third quarter of 2021 increased \$925 million or 60% from the third quarter of 2020. The variance was mainly the result of increases in various line items due to the year-over-year growth of 86.8% in operating capacity. In the third quarter of 2021, Air Canada recorded a net operating expense reduction of \$103 million in special items compared to a net operating expense reduction of \$192 million in special items in the third quarter of 2020. Due to the year-over-year variance in special items, total operating expenses in the third quarter of 2021 are not directly comparable to those in the same period last year. Refer to subsection "Special Items" for additional details.

In the first nine months of 2021, operating expenses of \$6,215 million decreased \$1,564 million or 20% from the same period in 2020. A direct year-over-year comparison is not meaningful as Air Canada operated much of its regular schedule for the first two months of 2020 and given the impact of special items recorded.

The more notable year-over-year variances in operating expenses in the third quarter of 2021 and in the first nine months of 2021 compared to the third quarter of 2020 and to the first nine months of 2020, respectively, are summarized below.

### Aircraft Fuel

In the third quarter of 2021, fuel expense of \$472 million increased \$297 million from the third quarter in 2020. The increase reflected the higher volume of fuel litres consumed due to increased flying year-over-year which accounted for an increase of \$153 million. In addition, the impact of a 39%-increase in fuel cost per litre resulted in an increase of \$149 million when compared to the third quarter of 2020, net of a favourable \$31 million foreign exchange variance due to the strengthening of the Canadian dollar year-over-year. The variance was partially offset by lower handling costs year-over-year.

In the first nine months of 2021, fuel expense of \$911 million decreased \$224 million or 20% compared to the first nine months of 2020 due to a lower volume of flying compared to the first nine months of 2020 as the impact of the COVID-19 pandemic began to be felt in March 2020. The decline was partially offset by an 18% increase in fuel cost per litre, partially offset by a favourable foreign exchange variance due to the strengthening of the Canadian dollar year-over-year.

### Wages, Salaries and Benefits

In the third quarter of 2021, wages, salaries, and benefits of \$592 million increased \$117 million or 25% from the third quarter of 2020. Compared to the third quarter of 2020, wages and salaries of \$439 million increased \$104 million or 31% primarily on higher block hours and a 24% increase in FTE employees as Air Canada recalled employees to support the growth of its operations during the third quarter of 2021. In the third quarter of 2021, benefits expense of \$153 million increased \$13 million or 9% driven primarily by the increase in employees.

In the first nine months of 2021, wages, salaries, and benefits of \$1,617 million decreased \$118 million or 7% from the first nine months of 2020. Wages and salaries of \$1,147 million and benefits of \$470 million declined \$63 million or 5% and \$55 million or 10%, respectively, compared to the first nine months of 2020. The decline in both line items was primarily driven by the decline in the number of employees compared to the first nine months of 2020 as a result of the impact of the COVID-19 pandemic.

### Regional Airlines Expense

In the third quarter of 2021, regional airline expense (excluding fuel) of \$312 million increased \$114 million or 58% from the third quarter of 2020. The increase was primarily driven by higher expenses as a result of the higher volume of flying compared to the same period last year. A net operating expense reduction of \$26 million recorded in the third quarter of 2020 (adjusting for end-of-lease costs for aircraft that were returned in the fourth quarter of 2020), discounts made available to Air Canada in the third quarter of 2020 as a result of the COVID-19 pandemic, and lower Canada Emergency Wage Subsidy ("CEWS") received during the quarter also contributed to the variation. The increase was partially offset by savings resulting from the consolidation of regional flying with Jazz.

In the first nine months of 2021, regional airline expense (excluding fuel) of \$700 million decreased \$141 million or 17% from the first nine months of 2020, as a result of the lower volume of flying compared to the first nine months of 2020 due to the impact of the COVID-19 pandemic which began to be felt in March 2020. The decline was partially offset by a net operating expense reduction of \$26 million recorded in the third quarter of 2020 as an adjustment for end-of-lease costs for aircraft that were returned in the fourth quarter of 2020.

### Depreciation and Amortization

Depreciation and amortization expense of \$400 million in the third quarter of 2021 and of \$1,217 million in the first nine months of 2021, declined \$23 million or 5%, and \$197 million or 14%, respectively, from the same periods in 2020. The declines reflected the retirement of certain older aircraft from the fleet, partially offset by the addition of new Airbus A220-300 aircraft to the fleet, and of spare engines.

### Aircraft Maintenance

In the third quarter of 2021, aircraft maintenance expense of \$153 million increased \$108 million from the third quarter of 2020. The increase was mainly due to maintenance provision reductions of \$72 million recorded in the third quarter of 2020 reflecting updated end-of-lease cost estimates. The remaining increase is mainly due to the higher volume of flying year-over-year.

In the first nine months of 2021, aircraft maintenance expense of \$430 million decreased \$66 million or 13% from the first nine months of 2020. The decline is mainly due to the lower volume of maintenance activities as a consequence of reduced flying compared to the first nine months of 2020 as a result of the impact of the COVID-19 pandemic, which began to be felt in March 2020.

### Special Items

In the third quarter of 2021, Air Canada recorded special items amounting to a net operating expense reduction of \$103 million. The table below provides a breakdown of these special items.

(Canadian dollars in millions)	Third Quarter		First Nine Months	
	2021	2020	2021	2020
Impairments (impairment reversal)	\$ (12)	\$ (3)	\$ 14	\$ 327
Canada Emergency Wage Subsidy, net	(103)	(189)	(424)	(391)
Workforce reduction provisions	4	-	163	112
Benefit plan amendments	8	-	76	-
Other	-	-	14	(4)
<b>Special Items</b>	<b>\$ (103)</b>	<b>\$ (192)</b>	<b>\$ (157)</b>	<b>\$ 44</b>

### Impairments

In response to capacity reductions related to the impact of the COVID-19 pandemic, Air Canada accelerated the retirement of certain older aircraft from its fleet. As a result, a non-cash impairment charge of \$283 million was recorded in 2020 (\$295 million in the nine months ended September 30, 2020), reflecting the write-down of right-of-use assets for leased aircraft and the reduction of carrying values of owned aircraft to expected disposal proceeds.

In addition, Air Canada recorded an impairment charge of \$32 million in the nine months ended September 30, 2020 related to previously capitalized costs incurred for the development of technology based intangible assets which are now cancelled.

In the third quarter of 2021, an impairment reversal of \$12 million was recorded due to expected costs to meet lease return conditions being lower than originally estimated. In the nine months ended September 30, 2021, an additional impairment charge of \$14 million, net of impairment reversals, was recorded as a result of reductions to the estimates of the expected disposal proceeds on owned aircraft, as partially offset by lower-than-expected costs to meet contractual return conditions on lease returns. Further changes to these estimates may result in additional adjustments to the impairment charge in future periods.

### Canada Emergency Wage Subsidy

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

Air Canada has recorded a total gross subsidy under the CEWS program of \$103 million in the third quarter of 2021 (\$429 million for the nine months ended September 30, 2021; \$197 million and \$492 million for

the three-month and nine-month periods ended September 30, 2020). Cash payments of \$113 million have been received in the third quarter of 2021 (\$415 million for the nine months ended September 30, 2021; \$260 million and \$440 million for the three- and nine-month periods ended September 30, 2020). The amount of the CEWS recorded in Special items 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 attaching to the current CEWS program.

Air Canada continued its participation in the CEWS program which ended in October 2021. Air Canada will be evaluating the new programs referred to in the announcement of the Government of Canada on October 21, 2021 when further information is made available and intends to participate in any relevant program to which it is eligible.

#### Workforce reduction provisions

As a result of the COVID-19 pandemic and to mitigate the number of employees who remain on layoff status, Air Canada offered early retirement incentive programs to its unionized workforce. These programs provide for pension improvements which are payable from the defined benefit pension plan for eligible employees, and as such do not impact Air Canada's liquidity position. Termination benefits and a curtailment loss of \$6 million were recorded during the third quarter of 2021 (\$163 million for the nine-month period end September 30, 2021) as a special item.

As a result of the impact of the COVID-19 pandemic, Air Canada undertook a workforce reduction of about 50% of its workforce in the second quarter of 2020. A workforce reduction provision of \$76 million was recorded in the second quarter of 2020 related to these measures (\$78 million for the year ended December 31, 2020). In addition to the provision, termination benefits and curtailments of \$36 million related to the pension and benefit obligations were recorded in 2020.

#### Benefit Plan Amendments

In April 2021, Air Canada received the decision of the arbitrator in relation to the determination of the cap on pensionable earnings recognized in the defined benefit pension plan for IAMAW-represented technical employees. The decision resulted in an increase to the maximum pensionable earnings, effective from 2021. Air Canada recorded a one-time pension past service cost of \$68 million as a special item in the second quarter of 2021 as a result of this plan amendment. In the third quarter of 2021, the period of retroactivity was resolved and an additional cost of \$8 million was recorded for the estimated impact of employees that will elect for retroactivity to 2019. This amendment does not impact Air Canada's liquidity position as it is funded out of the surplus in the domestic registered pension plans.

#### Other

##### *Termination of the Transat Arrangement Agreement*

On April 2, 2021, Air Canada announced that the Arrangement Agreement for the proposed acquisition of Transat was terminated. Air Canada and Transat had originally agreed in June 2019 on the acquisition, the terms of which were subsequently amended in August 2019 and then revised in October 2020 as a result of the severe economic impact of the COVID-19 pandemic.

Both Air Canada and Transat agreed to terminate the Arrangement Agreement with Air Canada paying Transat a termination fee of \$12.5 million, and with Transat no longer under any obligation to pay Air Canada any fee should Transat be involved in another acquisition or similar transaction in the future.

##### *Amendments to Capacity Purchase Agreements*

In March 2021, Air Canada announced an agreement to amend the CPA with Jazz, a wholly owned subsidiary of Chorus Aviation Inc., under which Jazz currently operates certain regional Air Canada Express flights. Through the revised agreement, Air Canada has transferred operation of its Embraer E175 fleet to Jazz from Sky Regional Airlines Inc. ("Sky Regional") and, as of April 1, 2021, Jazz became the sole operator of

Air Canada Express services. The capacity purchase agreement with Sky Regional was terminated on March 31, 2021. Air Canada recorded a net expense of \$2 million, related to the CPA revisions and consolidation of regional flying. The expense includes a net provision of \$12 million in estimated termination costs to be paid, offset by the retirement of lease liabilities and inventory costs associated with exiting aircraft.

### **Non-operating Expense**

Non-operating expense of \$315 million in the third quarter of 2021 and of \$818 million in the first nine months of 2021 increased by \$279 million and by \$13 million, respectively, from the corresponding period in 2020.

Losses on foreign exchange amounted to \$136 million in the third quarter of 2021 compared to gains of \$88 million in the same period last year. The loss reflected a stronger Canadian dollar and included losses on long-term debt and lease liabilities of \$254 million and was partially offset by gains on derivatives of \$87 million. The September 30, 2021, closing exchange rate was US\$1=C\$1.2680 compared to US\$1=C\$1.2398 on June 30, 2021.

In the first nine months of 2021, losses on foreign exchange were \$74 million compared to losses of \$381 million in the first nine months of 2020. The loss reflected a weaker Canadian dollar, which negatively impacted the value of Air Canada's currency derivative positions, generating losses of \$105 million, partially offset by gains on long-term debt and lease liabilities of \$20 million. The September 30, 2021 closing exchange rate was US\$1=\$1.2680 compared to a closing exchange rate of US\$1=\$1.2725 on December 31, 2020.

Interest expense of \$197 million in the third quarter and of \$538 million in the first nine months of 2021 increased by \$1 million and by \$64 million from the same periods in 2020. In the third quarter of 2021, additional financing was incurred which resulted in interest expense similar to that in the third quarter of 2020. The variance for the first nine months of 2021 is mainly due to higher levels of debt as a result of financing transactions concluded in 2020.

In the third quarter of 2021, Air Canada recorded a gain of \$114 million on financial instruments and a loss of \$114 million in the first nine months of 2021. In both instances, it was primarily due to fluctuations in the fair value of Air Canada's convertible notes cash conversion settlement option, which resulted in a \$101 million gain and a \$109 million loss in the third quarter of 2021 and in the first nine months of 2021, respectively.

Air Canada recorded a loss on debt settlements and modifications of \$110 million in the third quarter of 2021 and \$129 million in the first nine months of 2021. The loss included the write-off of amortized costs and prepayment fees in a series of refinancing transactions completed on August 11, 2021, as described in section 4 "Overview" of this MD&A.





## 6. FLEET

In response to the COVID-19 pandemic, capacity has been actively managed through temporary grounding of aircraft and the permanent retirement of older less efficient aircraft. The temporarily grounded aircraft are included in the table below. Air Canada continues to assess its fleet and capacity and will continue to adjust its fleet and schedule and take other measures as developments warrant.

As a response to the surge in demand for air cargo space, Air Canada has been operating all-cargo flights using its passenger aircraft as well as some temporarily converted Boeing 777-300ER and Airbus A330 aircraft. The converted aircraft have increased available cargo space by removing the seats from the passenger cabin. Air Canada plans to phase out the temporarily converted aircraft by the end of 2022, as they are reconverted back to a passenger configuration. Air Canada plans to introduce one dedicated Boeing 767 freighter to its fleet by the end of 2021 and an additional four by the end of 2022. These aircraft are reflected in the table below.

The tables below provide the number of aircraft in Air Canada's and Air Canada Rouge's operating fleet as at December 31, 2020 and as at September 30, 2021 as well as the planned fleet at December 31, 2021 and at December 31, 2022.

 <b>AIR CANADA</b>	Actual			Planned			
	Dec. 31, 2020	First Nine Months 2021 Fleet Changes	Sep. 30, 2021	Remainder of 2021 Fleet Changes	Dec. 31, 2021	2022 Fleet Changes	Dec. 31, 2022
<b>Wide-body aircraft</b>							
Boeing 777-300ER	15	(3)	12	-	12	6	18
Boeing 777-300ER (cargo)	4	3	7	(1)	6	(6)	-
Boeing 777-200LR	6	-	6	-	6	-	6
Boeing 787-8	8	-	8	-	8	-	8
Boeing 787-9	29	-	29	-	29	1	30
Boeing 767-300 freighters	-	-	-	1	1	4	5
Airbus A330-300	13	(1)	12	-	12	4	16
Airbus A330-300 (cargo)	3	1	4	-	4	(4)	-
<b>Narrow-body aircraft</b>							
Boeing 737 MAX 8	24	2	26	5	31	9	40
Airbus A321	15	-	15	-	15	-	15
Airbus A320	21	(3)	18	(2)	16	-	16
Airbus A319	16	(10)	6	-	6	(4)	2
Airbus A220-300	15	9	24	3	27	6	33
<b>Total Mainline</b>	<b>169</b>	<b>(2)</b>	<b>167</b>	<b>6</b>	<b>173</b>	<b>16</b>	<b>189</b>


	Actual			Planned			
	Dec. 31, 2020	First Nine Months 2021 Fleet Changes	Sep. 30, 2021	Remainder of 2021 Fleet Changes	Dec. 31, 2021	2022 Fleet Changes	Dec. 31, 2022
<b>Narrow-body aircraft</b>							
Airbus A321	14	-	14	-	14	-	14
Airbus A320	5	-	5	-	5	-	5
Airbus A319	20	-	20	-	20	-	20
<b>Total Air Canada Rouge</b>	<b>39</b>	<b>-</b>	<b>39</b>	<b>-</b>	<b>39</b>	<b>-</b>	<b>39</b>

<b>Total Mainline &amp; Rouge</b>	<b>208</b>	<b>(2)</b>	<b>206</b>	<b>6</b>	<b>212</b>	<b>16</b>	<b>228</b>
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### Air Canada Express

The table below provides the number of aircraft operated as at December 31, 2020 and as at September 30, 2021, on behalf of Air Canada, by regional carriers operating flights under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada. The table also provides the planned fleet at December 31, 2021 and at December 31, 2022.

The table below includes a significant number of aircraft that have been grounded in response to the COVID-19 pandemic.

	Actual			Planned			
	Dec. 31, 2020	First Nine Months 2021 Fleet Changes	Sep. 30, 2021	Remainder of 2021 Fleet Changes	Dec. 31, 2021	2022 Fleet Changes	Dec. 31, 2022
Embraer 175	25	-	25	-	25	-	25
Mitsubishi CRJ-200	15	-	15	-	15	-	15
Mitsubishi CRJ-900	34	1	35	-	35	-	35
De Havilland Dash 8-300	19	(2)	17	(17)	-	-	-
De Havilland Dash 8-400	43	(4)	39	-	39	-	39
<b>Total Air Canada Express</b>	<b>136</b>	<b>(5)</b>	<b>131</b>	<b>(17)</b>	<b>114</b>	<b>-</b>	<b>114</b>

## 7. FINANCIAL AND CAPITAL MANAGEMENT

### 7.1 LIQUIDITY

#### **Impact of the COVID-19 Pandemic**

Air Canada, along with the global airline industry, continues to face a significant decrease in traffic, as compared to the year 2019, and a corresponding decline in revenue and cash flows as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world, including Canada.

The expectation is for a progressive improvement in cash flows from operating activities as travel restrictions are gradually lifted. Considering the uncertainty that has characterized the COVID-19 pandemic, the duration of the recovery phase remains difficult to predict.

Since March 2020, Air Canada has increased its cash position through a series of debt and equity transactions. This additional liquidity allows for operational flexibility and to support the implementation of Air Canada's planned mitigation and recovery measures in response to the COVID-19 pandemic. These transactions are described in section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of Air Canada's 2020 Annual MD&A and in section 4 "Overview" of this MD&A.

In April 2021, Air Canada substantially increased its available liquidity through a series of debt and equity financing agreements with the Government of Canada, which allows Air Canada to access up to \$5.379 billion in debt financing through fully repayable loans which Air Canada will only draw down if and as required, as well as an equity investment for gross proceeds of \$500 million (net proceeds of approximately \$480 million). As at September 30, 2021, \$1.205 billion had been drawn on the ticket refund facility and no amount has been drawn on any of the other facilities. Air Canada is entitled to repay and terminate these facilities at any time without penalty. Refer to section 4 "Overview" of this MD&A for additional details on the government's financial package.

In August 2021, Air Canada concluded a series of refinancing transactions, receiving aggregate gross proceeds of approximately \$7.1 billion from the sale of notes and Senior Secured Credit Facilities. Proceeds were used to repay outstanding debt of \$2.5 billion and the balance of the proceeds was retained for working capital and other general corporate purposes. These transactions resulted in a net increase to cash of \$3.7 billion, plus \$761 million of available liquidity under an undrawn line of credit. The \$200 million revolving credit facility was also repaid in August and remains undrawn. Refer to section 4 "Overview" for additional details on the refinancing transactions closed during the quarter.

Air Canada's unencumbered asset pool (excluding the value of Aeroplan, Air Canada Vacations, and Air Canada Cargo) amounted to approximately \$2.2 billion at September 30, 2021. As part of Air Canada's ongoing efforts to maintain adequate liquidity levels, these unencumbered assets could be used to raise additional liquidity should the need arise.

#### **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 7.6 "Capital Expenditures and Related Financing Arrangements", 7.7 "Pension Funding Obligations", and 7.8 "Contractual Obligations" of this MD&A. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts for minimum periods of 12 months, 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 September 30, 2021, unrestricted liquidity was \$14,412 million and consisted of \$9,473 million in cash and cash equivalents, short-term and long-term investments, and \$4,939 million available under undrawn credit facilities. This compared to unrestricted liquidity of \$8,013 million as at December 31, 2020 (comprising cash, cash equivalents and short-term and long-term investments).

## 7.2 FINANCIAL POSITION

The table below provides a condensed consolidated statement of financial position of Air Canada as at September 30, 2021, and as at December 31, 2020.

(Canadian dollars in millions)	September 30, 2021	December 31, 2020	\$ Change
<b>Assets</b>			
Cash, cash equivalents and short-term investments	\$ 8,702	\$ 7,501	\$ 1,201
Other current assets	1,157	1,170	(13)
<b>Current assets</b>	<b>\$ 9,859</b>	<b>\$ 8,671</b>	<b>\$ 1,188</b>
Investments, deposits, and other assets	1,095	833	262
Property and equipment	11,735	12,137	(402)
Pension assets	3,206	2,840	366
Deferred income tax	37	25	12
Intangible assets	1,095	1,134	(39)
Goodwill	3,273	3,273	-
<b>Total assets</b>	<b>\$ 30,300</b>	<b>\$ 28,913</b>	<b>\$ 1,387</b>
<b>Liabilities</b>			
Current liabilities	\$ 6,149	\$ 7,139	\$ (990)
Long-term debt and lease liabilities	15,667	11,201	4,466
Aeroplane and other deferred revenues	3,771	4,032	(261)
Pension and other benefit liabilities	2,551	3,015	(464)
Maintenance provisions	968	1,040	(72)
Other long-term liabilities	974	696	278
Deferred income tax	75	75	-
<b>Total liabilities</b>	<b>\$ 30,155</b>	<b>\$ 27,198</b>	<b>\$ 2,957</b>
<b>Total shareholders' equity</b>	<b>\$ 145</b>	<b>\$ 1,715</b>	<b>\$ (1,570)</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 30,300</b>	<b>\$ 28,913</b>	<b>\$ 1,387</b>

Movements in current assets and current liabilities are described in section 7.4 "Working Capital" of this MD&A. Long-term debt and lease liabilities are discussed in sections 7.3 "Net Debt" and 7.5 "Cash Flow Movements" of this MD&A.

At September 30, 2021, net pension assets of \$655 million (comprising pension assets of \$3,206 million net of pension and other benefit liabilities of \$2,551 million) increased \$830 million from December 31, 2020. This increase was mainly due to a net actuarial gain on remeasurements of employee liabilities of \$1,232 million (\$950 million, net of tax) recorded on Air Canada's consolidated statement of comprehensive income, partially offset by pension and other employee benefits expense recorded during the year. The actuarial gain included the net impact of an 86-basis point increase in the discount rate used to value the liabilities.

The long-term portion of the Aeroplan and other deferred revenue liability decreased \$261 million from December 31, 2020. This decrease included a reclassification of \$308 million from long-term to current liabilities for Aeroplan Point redemptions expected to increase over the next 12 months, partially offset by the sale of Aeroplan Points to program partners exceeding redemptions.

The increase of other long-term liabilities included a \$109 million increase in the fair value of the embedded derivative on Air Canada's convertible notes. The increase also included \$66 million for deferred grant income as well as \$84 million for the fair value of the vested warrants as at September 30, 2021 related to the debt and equity financing agreements with the Government of Canada as described in section 4 "Overview" of this MD&A.

### 7.3 NET DEBT

The table below reflects Air Canada's net debt balances as at September 30, 2021 and as at December 31, 2020.

(Canadian dollars in millions)	September 30, 2021	December 31, 2020	\$ Change
Total long-term debt and lease liabilities	\$ 15,667	\$ 11,201	\$ 4,466
Current portion of long-term debt and lease liabilities	1,015	1,788	(773)
<b>Total long-term debt and lease liabilities (including current portion)</b>	<b>16,682</b>	<b>12,989</b>	<b>3,693</b>
Less cash, cash equivalents and short and long-term investments	(9,473)	(8,013)	(1,460)
<b>Net debt <sup>(1)</sup></b>	<b>\$ 7,209</b>	<b>\$ 4,976</b>	<b>\$ 2,233</b>

(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.

As at September 30, 2021, net debt of \$7,209 million increased \$2,233 million from December 31, 2020, reflecting the impact of net cash used for operating and investing activities in the first nine months of 2021, partially offset by proceeds from the issuance of shares completed during the year. Repayments on long term debt in the first nine months of 2021 were offset with proceeds from new borrowings including proceeds from Government of Canada financing agreements relating to customer refunds of non-refundable tickets, and a series of refinancing transactions completed on August 11, 2021 as described in section 4 "Overview" of this MD&A. In addition, proceeds were received from aircraft related financings. In the nine months ended September 30, 2021, Air Canada received financing for nine Airbus A220-300 aircraft deliveries and refinanced the 2013-1 EETC Class B equipment notes. Refer to section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of Air Canada's 2020 MD&A for a description of the debt financing activities completed during 2020. The impact of a stronger Canadian dollar at September 30, 2021 compared to December 31, 2020, decreased foreign currency denominated debt (mainly U.S. dollars) by \$20 million.

## 7.4 WORKING CAPITAL

The table below provides information on Air Canada's working capital balances as at September 30, 2021 and as at December 31, 2020.

(Canadian dollars in millions)	September 30, 2021	December 31, 2020	\$ Change
Cash, cash equivalents and short-term investments	\$ 8,702	\$ 7,501	\$ 1,201
Accounts receivable	744	644	100
Other current assets	413	526	(113)
<b>Total current assets</b>	<b>\$ 9,859</b>	<b>\$ 8,671</b>	<b>\$ 1,188</b>
Accounts payable and accrued liabilities	2,341	2,465	(124)
Advance ticket sales	1,932	2,314	(382)
Aeroplan and other deferred revenues	861	572	289
Current portion of long-term debt and lease liabilities	1,015	1,788	(773)
<b>Total current liabilities</b>	<b>\$ 6,149</b>	<b>\$ 7,139</b>	<b>\$ (990)</b>
<b>Net working capital</b>	<b>\$ 3,710</b>	<b>\$ 1,532</b>	<b>\$ 2,178</b>

Net working capital of \$3,710 million as at September 30, 2021 increased \$2,178 million from December 31, 2020. This increase was mainly due to the net proceeds received under the refinancing closed in the third quarter of 2021, as described in section 7.1 "Liquidity" of this MD&A, partially offset by the cash portion of the net loss recorded during the nine months ended September 30, 2021 and capital expenditures, net of financing.

With strong advance sales in all future booking window periods, advance ticket sales increased \$213 million during the third quarter of 2021, after taking into account the payment of \$211 million of eligible refunds during the quarter. Total payments of eligible refunds from April 13, 2021 to September 30, 2021 amounted to \$1,208 million. Such customer refunds are generally neutral to liquidity and improve net working capital, with \$1,205 million in proceeds drawn under the refunds credit facility as at September 30, 2021 and \$3 million to be drawn down under the facility in October 2021 in respect of refunds already paid by Air Canada.

## 7.5 CASH FLOW MOVEMENTS

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

(Canadian dollars in millions)	Third Quarter			First Nine Months		
	2021	2020	\$ Change	2021	2020	\$ Change
<b>Net cash flows from (used in) operating activities</b>	<b>\$ 269</b>	<b>\$ (286)</b>	<b>\$ 555</b>	<b>\$ (1,996)</b>	<b>(1,557)</b>	<b>\$ (439)</b>
Proceeds from borrowings	6,760	1,114	5,646	8,027	6,008	2,019
Reduction of long-term debt and lease liabilities	(2,953)	(1,433)	(1,520)	(4,234)	(2,211)	(2,023)
Shares purchased for cancellation	-	-	-	-	(132)	132
Issue of shares	-	-	-	554	554	-
Financing fees	(196)	(13)	(183)	(203)	(75)	(128)
<b>Net cash flows from (used in) financing activities</b>	<b>\$ 3,611</b>	<b>\$ (332)</b>	<b>\$ 3,943</b>	<b>\$ 4,144</b>	<b>\$ 4,144</b>	<b>\$ -</b>
Investments, short-term and long-term	(1,299)	(368)	(931)	51	(72)	123
Additions to property, equipment, and intangible assets	(149)	(282)	133	(695)	(867)	172
Proceeds from sale of assets	5	2	3	16	6	10
Proceeds from sale and leaseback of assets	-	-	-	11	-	11
Other	20	4	16	15	41	(26)
<b>Net cash flows used in investing activities</b>	<b>\$ (1,423)</b>	<b>\$ (644)</b>	<b>\$ (779)</b>	<b>\$ (602)</b>	<b>\$ (892)</b>	<b>\$ 290</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>\$ 53</b>	<b>\$ (37)</b>	<b>\$ 90</b>	<b>\$ 16</b>	<b>\$ 5</b>	<b>\$ 11</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>\$ 2,510</b>	<b>\$ (1,299)</b>	<b>\$ 3,809</b>	<b>\$ 1,562</b>	<b>\$ 1,700</b>	<b>\$ (138)</b>

### Net Cash Flows from (used in) Operating Activities

In the third quarter of 2021, net cash flows from operating activities of \$269 million improved by \$555 million from the same quarter in 2020 due to strong advance ticket sales and a significant increase in passengers carried.

In the first nine months of 2021, net cash flows used in operating activities of \$1,996 million deteriorated by \$439 million from the same period in 2020, reflecting lower cash flows from operating activities due to the impact of the COVID-19 pandemic, in particular ticket refunds of \$1,208 million in 2021.

### Net Cash Flows from (used in) Financing Activities

In the third quarter of 2021, net cash flows from financing activities of \$3,611 million increased \$3,943 million from the third quarter of 2020. The increase was mainly due to the net proceeds of \$3.7 billion related to the August financing transactions. Proceeds from borrowings in the third quarter of 2021 also included \$347 million from the Government of Canada unsecured credit facility supporting customer refunds of non-refundable tickets.



In the first nine months of 2021, net cash flows from financing activities of \$4,144 million were equal to the net cash flows from financing for the first nine months of 2020. The 2021 financing activities include net proceeds of \$480 million from the equity financing agreement with the Government of Canada as well as the net proceeds from the August financing transactions described above. Proceeds from borrowings in 2021 also included \$1,205 million from the Government of Canada unsecured credit facility supporting customer refunds of non-refundable tickets. Refer to section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of Air Canada's 2020 MD&A for a description of the debt financing activities completed in 2020.

### Net Cash Flows used in Investing Activities

Net cash flows used in investing activities of \$1,423 million in the third quarter of 2021 increased by \$779 million when compared to the same period of 2020, primarily reflecting movements between cash and short and long-term investments. Net cash flows used in investing activities of \$602 million in the first nine months of 2021 were lower by \$290 million when compared to the same period of 2020, reflecting movements between cash and short and long-term investments as well as a decrease in additions to property, equipment, and intangible assets.

Refer to sections 7.2 "Financial Position", 7.3 "Net Debt", 7.4 "Working Capital", and 7.9 "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.

(Canadian dollars in millions)	Third Quarter			First Nine Months		
	2021	2020	\$ Change	2021	2020	\$ Change
<b>Net cash flows from (used in) operating activities</b>	\$ 269	\$ (286)	\$ 555	\$ (1,996)	\$ (1,557)	\$ (439)
Additions to property, equipment, and intangible assets, net of proceeds from sale and leaseback transactions	(149)	(282)	133	(684)	(867)	183
<b>Free cash flow <sup>(1)</sup></b>	\$ 120	\$ (568)	\$ 688	\$ (2,680)	\$ (2,424)	\$ (256)

(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. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment, and intangible assets, net of proceeds from sale and leaseback transactions. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

Free cash flow of \$120 million in the third quarter of 2021 improved by \$688 million when compared to the same period in 2020, reflecting strong advance ticket sales in future booking window periods and a significant increase in passengers carried. Negative free cash flow of \$2,680 million in the first nine months of 2021 deteriorated by \$256 million from the same period in 2020, reflecting lower cash flows from operating activities due to the impact of the COVID-19 pandemic, in particular ticket refunds of \$1,208 million in 2021 which reduce cash flows from operating activities without affecting liquidity as the refunds of non-refundable tickets are funded with the Government of Canada unsecured credit facility described in section 4 "Overview" of this MD&A.

**Net Cash Flow (Burn)**

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

(Canadian dollars in millions)	Third Quarter	First Nine Months
	2021	2021
<b>Net cash flows from (used in) operating activities</b>	<b>\$ 269</b>	<b>\$ (1,996)</b>
<b>Net cash flows from financing activities</b>	<b>3,611</b>	<b>4,144</b>
<b>Net cash flows (used in) investing activities</b>	<b>(1,423)</b>	<b>(602)</b>
<b>Remove:</b>		
Net proceeds from new non-aircraft related financings	(6,527)	(7,932)
Refund of non-refundable fares	211	1,208
Lump-sum debt repayments	2,713	3,374
Proceeds from sale and leaseback transactions	-	(11)
Investments, short-term and long-term	1,299	(51)
<b>Net cash flow (burn) <sup>(1)</sup></b>	<b>\$ 153</b>	<b>\$ (1,866)</b>

(1) Net cash flow (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 for aircraft deliveries, and investing activities. Excluded are proceeds from non-aircraft financings, lump sum debt maturities made where Air Canada has refinanced or replaced the amount, and proceeds from sale and leaseback transactions. Net cash burn also excludes movements between cash and short and long-term investments, and refunds for non-refundable fares being processed for flights impacted by the COVID-19 pandemic. Such refunds are eligible for draws under the Government of Canada \$1.404 billion refunds credit facility and, therefore, are generally cash neutral to Air Canada's liquidity position, up to the \$1.404 billion limit of the facility.

In the third quarter of 2021, net cash flow of \$153 million was substantially better than management's expectation of a net cash burn of between \$280-\$460 million discussed in Air Canada's July 23, 2021 news release. Over the quarter, Air Canada saw the benefit of strong advance ticket sales in future booking window periods and a significant increase in passengers carried versus both the second quarter of 2021 and the third quarter of 2020.

**7.6 CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS**

Air Canada's capital expenditures and related financial arrangements are discussed in section 8.6 "Capital Expenditures and Related Financing Arrangements" of Air Canada's 2020 MD&A. There have been no material changes to Air Canada's capital expenditures and related financial arrangements from what was disclosed at that time except for the following items:

- In March 2021, Air Canada concluded a committed secured facility totaling US\$475 million to finance the purchase of the next 15 Airbus A220 aircraft scheduled for delivery in 2021 and 2022.
- In the third quarter of 2021, Air Canada elected to proceed with the purchase of an additional two Airbus A220 aircraft for delivery in 2024. These two aircraft are part of the 12 Airbus A220 aircraft that Air Canada had previously determined it would no longer be purchasing under an amendment to the purchase agreement concluded with Airbus in November 2020. Air Canada may still elect to proceed with the purchase of the remaining 10 aircraft and is evaluating the fleet and economic benefits of extending the order to include all or a portion of these 10 aircraft. The table in section 7.8 "Contractual Obligations" has been updated to include the additional two Airbus A220 aircraft.

- In October 2021, Air Canada reached an agreement with Boeing to accelerate the delivery of four Boeing 737 MAX aircraft into the fourth quarter of 2021, for a total of seven deliveries in 2021. The remaining nine Boeing 737 MAX aircraft are expected to be delivered by the end of the second quarter of 2022, reaching a total of 40 Boeing 737 MAX aircraft in the narrow-body fleet.
- Air Canada exercised options for the purchase of three Boeing 787-9 aircraft which are scheduled to be delivered in 2022 and in 2023. The table in section 7.8 "Contractual Obligations" contains the additional three Boeing 787-9 aircraft.

Refer to section 7.8 "Contractual Obligations" for further details on the yearly committed capital expenditures for the period 2021 to 2025.

## 7.7 PENSION FUNDING OBLIGATIONS

Air Canada's pension funding obligations are discussed in sections 8.7 "Pension Funding Obligations" of Air Canada's 2020 MD&A. There have been no material changes to Air Canada's pension funding obligations for 2021 from what was disclosed at that time.

As described in section 5 "Results of Operations" of this MD&A, Air Canada recorded under special items charges of \$76 million and \$163 million related to the pension plan amendment for IAMAW-represented technical employees and to the early retirement incentive programs ("ERIP") respectively. The pension plan amendment and the ERIP will be funded out of the surplus in the domestic registered pension plans. Based on final actuarial valuation results as at January 1, 2021, which take into account the pension plan amendment for IAMAW-represented technical employees and the ERIP, the aggregate solvency surplus in Air Canada's domestic registered pension plans was \$2.9 billion.

## 7.8 CONTRACTUAL OBLIGATIONS

The table below provides Air Canada's contractual obligations as at September 30, 2021, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and lease liabilities and committed capital expenditures.

(Canadian dollars in millions)	Remainder of 2021 <sup>(2)</sup>	2022	2023	2024	2025	Thereafter	Total
<b>Principal</b>							
Long-term debt <sup>(1)</sup>	\$ 139	\$ 505	\$ 656	\$ 474	\$ 1,779	\$ 10,523	\$ 14,076
Lease liabilities	147	495	488	448	421	1,326	3,325
<b>Total principal obligations</b>	<b>286</b>	<b>1,000</b>	<b>1,144</b>	<b>922</b>	<b>2,200</b>	<b>11,849</b>	<b>17,401</b>
<b>Interest</b>							
Long-term debt	\$ 59	\$ 537	\$ 515	\$ 494	\$ 469	\$ 659	2,733
Lease liabilities	42	149	123	98	76	357	845
<b>Total interest obligations</b>	<b>\$ 101</b>	<b>\$ 686</b>	<b>\$ 638</b>	<b>\$ 592</b>	<b>\$ 545</b>	<b>\$ 1,016</b>	<b>\$ 3,578</b>
<b>Total long-term debt and lease liabilities</b>	<b>\$ 387</b>	<b>\$ 1,686</b>	<b>\$ 1,782</b>	<b>\$ 1,514</b>	<b>\$ 2,745</b>	<b>\$ 12,865</b>	<b>\$ 20,979</b>
<b>Committed capital expenditures</b>	<b>\$ 400</b>	<b>\$ 1,077</b>	<b>\$ 517</b>	<b>\$ 122</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 2,116</b>
<b>Total contractual obligations<sup>(2)</sup></b>	<b>\$ 787</b>	<b>\$ 2,763</b>	<b>\$ 2,299</b>	<b>\$ 1,636</b>	<b>\$ 2,745</b>	<b>\$ 12,865</b>	<b>\$ 23,095</b>

(1) Assumes the principal balance of the convertible notes, \$948 million (US\$748 million), remains unconverted and includes estimated interest payable until maturity in 2025. The full principal balance of \$1,205 million for the unsecured credit facility in connection with the Government of Canada financing to support customer refunds is included.

(2) 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.

## 7.9 SHARE INFORMATION

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

	September 30, 2021	December 31, 2020
<b>Issued and outstanding shares</b>		
Class A variable voting shares	86,007,150	111,926,060
Class B voting shares	271,741,909	220,246,228
<b>Total issued and outstanding shares</b>	<b>357,749,059</b>	<b>332,172,288</b>
<b>Class A variable voting and Class B voting shares potentially issuable</b>		
Convertible notes	48,687,441	48,687,441
Warrants <sup>(1)</sup>	14,576,564	-
Stock options	4,403,545	5,903,174
<b>Total shares potentially issuable</b>	<b>67,667,550</b>	<b>54,590,615</b>
<b>Total outstanding and potentially issuable shares</b>	<b>425,416,609</b>	<b>386,762,903</b>

(1) Includes 7,288,282 non-vested warrants at September 30, 2021. Refer to section 4 "Overview" of this MD&A for details on vesting conditions.

### Share Offerings

In connection with Air Canada's December 2020 share offering, Air Canada granted the underwriters an option to purchase up to an additional 15% of the shares in the offering, exercisable in whole or in part at any time until 30 days after closing of the offering on December 30, 2020. In January 2021, the underwriters partially exercised their over-allotment option to purchase an additional 2,587,000 Air Canada shares for gross proceeds of \$62 million. After deduction of the underwriters' fees and expenses, net proceeds from the exercise of this over-allotment option were \$60 million.

As further described in section 4 "Overview" of this MD&A, in April 2021, Air Canada entered into a series of debt and equity financing agreements with the Government of Canada, including the issuance of shares and warrants. Air Canada issued 21,570,942 shares to the Government of Canada for net proceeds of \$480 million.

## 8. QUARTERLY FINANCIAL DATA

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

	2019		2020			2021		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Operating revenues	\$ 4,429	\$ 3,722	\$ 527	\$ 757	\$ 827	\$ 729	\$ 837	\$ 2,103
Operating expenses	4,284	4,155	2,082	1,542	1,830	1,778	1,970	2,467
<b>Operating income (loss)</b>	<b>145</b>	<b>(433)</b>	<b>(1,555)</b>	<b>(785)</b>	<b>(1,003)</b>	<b>(1,049)</b>	<b>(1,133)</b>	<b>(364)</b>
<b>Non-operating income (expense)</b>	<b>27</b>	<b>(843)</b>	<b>74</b>	<b>(36)</b>	<b>(272)</b>	<b>(338)</b>	<b>(165)</b>	<b>(315)</b>
<b>Income (loss) before income taxes</b>	<b>172</b>	<b>(1,276)</b>	<b>(1,481)</b>	<b>(821)</b>	<b>(1,275)</b>	<b>(1,387)</b>	<b>(1,298)</b>	<b>(679)</b>
Income tax recovery (expense)	(20)	227	(271)	136	114	83	133	39
<b>Net income (loss)</b>	<b>\$ 152</b>	<b>\$ (1,049)</b>	<b>\$ (1,752)</b>	<b>\$ (685)</b>	<b>\$ (1,161)</b>	<b>\$ (1,304)</b>	<b>\$ (1,165)</b>	<b>\$ (640)</b>
<b>Diluted earnings (loss) per share</b>	<b>\$ 0.56</b>	<b>\$ (4.00)</b>	<b>\$ (6.44)</b>	<b>\$ (2.31)</b>	<b>\$ (3.91)</b>	<b>\$ (3.90)</b>	<b>\$ (3.31)</b>	<b>\$ (1.79)</b>
<b>Adjusted pre-tax income (loss)<sup>(1)</sup></b>	<b>\$ 66</b>	<b>\$ (520)</b>	<b>\$ (1,438)</b>	<b>\$ (1,141)</b>	<b>\$ (1,326)</b>	<b>\$ (1,335)</b>	<b>\$ (1,210)</b>	<b>\$ (649)</b>

(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 15 "Non-GAAP Financial Measures" of this MD&A.

## 9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Air Canada's financial instruments and risk management practices are summarized in section 11 "Financial Instruments and Risk Management" of Air Canada's 2020 MD&A. There have been no material changes to Air Canada's financial instruments and risk management practices from what was disclosed at that time except for the following. In managing foreign exchange risk, Air Canada has updated its target coverage to 60% on a rolling 18-month basis to manage the net U.S. dollar cash flow exposure. Target coverage was reduced to 60% on a rolling 18-month basis from 70% on a rolling 24-month basis due mainly to a lower relative risk exposure to international operations.

In addition, the recognition of the warrants issued to the Government of Canada are accounted for as a financial liability. Additional information on Air Canada's risk management practices and financial instruments is provided in Note 10 of Air Canada's interim unaudited condensed consolidated financial statements for the third quarter of 2021.

## 10. ACCOUNTING POLICIES AND CONTROLS

There have been no material changes to Air Canada's accounting policies from what was disclosed in section 12 "Accounting Policies" of Air Canada's 2020 MD&A. Additional information on Air Canada's accounting policies is provided in Note 2 of Air Canada's interim unaudited condensed consolidated financial statements for the third quarter of 2021.

### **Changes in Internal Controls over Financial Reporting**

There have been no changes to Air Canada's internal controls over financial reporting during the quarter ended September 30, 2021, that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

## 11. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Air Canada's critical accounting estimates and judgments are summarized in section 13 "Critical Accounting Estimates and Judgments" of Air Canada's 2020 MD&A. There have been no material changes to critical accounting estimates and judgments from what was disclosed at that time.

## 12. OFF-BALANCE SHEET ARRANGEMENTS

Air Canada's off-balance sheet arrangements are summarized in section 14 "Off-Balance Sheet Arrangements" of Air Canada's 2020 MD&A. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

## 13. RELATED PARTY TRANSACTIONS

At September 30, 2021, 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.

## 14. RISK FACTORS

For a description of risk factors associated with Air Canada and its business, refer to section 17 "Risk Factors" of Air Canada's 2020 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.

As further described in section 4 "Overview" of this MD&A, on April 12, 2021, Air Canada entered into debt and equity financing agreements with the Government of Canada. As part of the financial package, (i) Air Canada agreed to offer eligible customers who purchased non-refundable fares but did not travel due to COVID-19 since February 2020 up to April 13, 2021, the option of a refund to the original form of payment and (ii) an unsecured credit facility tranche of up to \$1.404 billion was made available to support customer refunds of these non-refundable tickets.



## 15. 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:

(Canadian dollars in millions)	Third Quarter			First Nine Months		
	2021	2020	\$ Change	2021	2020	\$ Change
<b>Operating loss – GAAP</b>	\$ (364)	\$ (785)	\$ 421	\$ (2,546)	\$ (2,773)	\$ 227
<b>Add back:</b>						
Depreciation and amortization	400	423	(23)	1,217	1,414	(197)
<b>EBITDA (including special items)</b>	\$ 36	\$ (362)	\$ 398	\$ (1,329)	\$ (1,359)	\$ 30
<b>Remove:</b>						
Special items	(103)	(192)	89	(157)	44	(201)
<b>EBITDA (excluding special items)</b>	\$ (67)	\$ (554)	\$ 487	\$ (1,486)	\$ (1,315)	\$ (171)

### Adjusted CASM

Air Canada uses adjusted CASM 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, except where indicated)	Third Quarter			First Nine Months		
	2021	2020	\$ Change	2021	2020	\$ Change
<b>Operating expense – GAAP</b>	\$ 2,467	\$ 1,542	\$ 925	\$ 6,215	\$ 7,779	\$ (1,564)
<b>Adjusted for:</b>						
Aircraft fuel expense	(472)	(175)	(297)	(911)	(1,135)	224
Ground package costs	(23)	(5)	(18)	(29)	(236)	207
Special items	103	192	(89)	157	(44)	201
<b>Operating expense, adjusted for the above-noted items</b>	\$ 2,075	\$ 1,554	\$ 521	\$ 5,432	\$ 6,364	\$ (932)
<b>ASMs (millions)</b>	<b>11,116</b>	<b>5,949</b>	<b>86.8%</b>	<b>19,327</b>	<b>31,703</b>	<b>(39.0)%</b>
<b>Adjusted CASM (cents)</b>	¢ 18.65	¢ 26.12	¢ (7.47)	¢ 28.10	¢ 20.07	¢ 8.03

### 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, gains or losses on sale and leaseback of assets, gains or losses on disposal of assets, gains or losses on debt settlements and modifications, and special items as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

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

(Canadian dollars in millions)	Third Quarter			First Nine Months		
	2021	2020	\$ Change	2021	2020	\$ Change
<b>Loss before income taxes – GAAP</b>	\$ (679)	\$ (821)	\$ 142	\$ (3,364)	\$ (3,578)	\$ 214
<b>Adjusted for:</b>						
Special items	(103)	(192)	89	(157)	44	(201)
Foreign exchange (gain) loss	136	(88)	224	74	381	(307)
Net financing expense relating to employee benefits	1	6	(5)	10	26	(16)
(Gain) loss on financial instruments	(114)	(46)	(68)	114	28	86
Loss on debt settlements and modifications	110	-	110	129	-	129
<b>Adjusted pre-tax loss</b>	\$ (649)	\$ (1,141)	\$ 492	\$ (3,194)	\$ (3,099)	\$ (95)

### 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 can generate from operations and after capital expenditures. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment, and intangible assets, and is net of proceeds from sale and leaseback transactions. Refer to section 7.5 "Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

**Net Cash Flow (Burn)**

Air Canada uses net cash flow (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 for aircraft deliveries, and investing activities. Excluded are proceeds from non-aircraft financings, lump sum debt maturities made where Air Canada has refinanced or replaced the amount, and proceeds from sale and leaseback transactions. Net cash burn also excludes movements between cash and short and long-term investments, and refunds for non-refundable fares being processed for flights impacted by the COVID-19 pandemic. Such refunds are eligible for draws under the Government of Canada \$1.404 billion refunds credit facility and, therefore, are generally cash neutral to Air Canada's liquidity position, up to the \$1.404 billion limit of the facility. Refer to section 7.5 "Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.