Aeroplan Acquisition

Accounting Information Session

May 6, 2019

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Aeroplan Acquisition Accounting
Important Notice

- The information relating to Aeroplan acquisition accounting is provided solely for the purpose of providing an additional understanding of the impact of Aeroplan on certain of Air Canada's accounting policies and financial results. Readers are cautioned that it may not be appropriate to use such information for any other purpose.
- The accounting policies, critical accounting estimates and other accounting impacts of the acquisition of Aeroplan in this presentation should not be considered as complete or final as further changes or other effects and other policy differences may be identified. In addition, the information provided reflects Air Canada's assumptions, estimates and expectations as of May 6, 2019, all of which are subject to change. Circumstances may arise, including changes in IFRS, regulations or economic conditions, which could change these assumptions, estimates or expectations or the information provided.
- All figures presented are preliminary and subject to the completion of an external audit.
- Air Canada cannot provide any further estimates of the future impact of the acquisition of Aeroplan at this time.
- For additional information, refer to Air Canada's First Quarter 2019 MD&A dated May 6, 2019, available on Air Canada's website at www.aircanada.com or on SEDAR at www.sedar.com.

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Miles Earned with Travel

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

Miles Earned with Travel – Equivalent Ticket Value Calculation

ETV Calculation
Illustrative Example:

	Total per Direction
YVR-YYZ	
Aeroplan Miles redeemed	20,000
Equivalent market fare	$ 300
Equivalent ticket value per Mile	$ 0.0150

- Amounts are illustrative only for purposes of explaining the nature of the calculation

Miles Earned with Travel – Accounting Example

Sale of ticket for $350 which includes 1,000 Aeroplan Miles
Illustrative Example of accounting entries:

Record cash sale (debit cash)	$ 350
Record value of Aeroplan Miles (credit Aeroplan deferred revenue for 1,000 Aeroplan Miles @ $0.015 ETV per mile)	$ (15)
Record value of advance ticket sale	$ (335)
	$ -

- Illustrative example only. Example does not include all of the accounting elements including the relative selling price calculation, the impact of breakage or the impact of taxes and other charges.

Miles Sold to Program Partners

- Aeroplan members can earn Aeroplan Miles based on their spending with participating companies such as credit card companies, hotels and car rental agencies and other program partners.
- Aeroplan Miles issued under program partner agreements are accounted for as a single performance obligation being the future delivery of a redemption reward to the Aeroplan member.
- The consideration received for Aeroplan Miles issued to Aeroplan members under these agreements is recorded as Aeroplan deferred revenue.
- From the date of acquisition on January 10, 2019 to March 31, 2019, total consideration received for the issuance of Aeroplan Miles under these agreements was $198 million.

Aeroplan Redemptions for Air Travel

- Advance ticket sales include the proceeds from the sale of flight tickets to Aeroplan, which are accounted for as Passenger revenue by Air Canada when transportation is provided.
- The value of Aeroplan deferred revenue related to Aeroplan Miles is determined with reference to their Equivalent Ticket Value ("ETV") for Aeroplan Miles issued from qualifying air travel, or with reference to the consideration received for Aeroplan Miles sold to third party Aeroplan program partners.
- When Aeroplan Miles are redeemed for air travel, the value of Aeroplan Miles redeemed is removed from Aeroplan deferred revenue and recorded in Advance ticket sales. The revenue is then recognized in Passenger revenue when the transportation is provided.

Aeroplan Redemptions for Non-air Rewards

- Aeroplan Miles are redeemable by customers for air travel on Air Canada and other participating airlines, and for other program awards, such as hotel, car rentals, gift cards, merchandise and other non-air rewards.

- For non-air redemptions, Air Canada has determined that, for accounting purposes, it is not acting as the principal in the transaction between the member and the ultimate supplier of the goods or services.

- When Aeroplan Miles are redeemed for non-air goods and services, the net margin is recorded in Other revenue when the performance obligation is satisfied.

Breakage Accounting

- Breakage represents the estimated Aeroplan Miles that are not expected to be redeemed by members.
- Breakage is estimated by management based on the terms and conditions of membership and historical accumulation and redemption patterns, as adjusted for changes to any terms and conditions or other circumstances that may affect members' future redemption practices. Management uses statistical and simulation models to estimate breakage.
- The amount of revenue recognized related to breakage is based on the number of Aeroplan Miles redeemed in a period in relation to the total number of Aeroplan Miles expected to be redeemed.
- Changes in breakage are accounted for as follows: in the period of change, the deferred revenue balance is adjusted as if the revised estimate had been used in prior periods with the offsetting amount recorded as an adjustment to Passenger revenue; and for subsequent periods, the revised estimate is used.

Business Combination Accounting

- On January 10, 2019, Air Canada completed the closing of its purchase of all of the outstanding equity of Aimia Canada Inc., owner and operator of the Aeroplan loyalty business. The aggregate purchase price for the acquisition consisted of $450 million in cash plus $47 million in cash for pre-closing adjustments (total purchase consideration of $497 million). The purchase price is subject to post-closing adjustments and the acquisition also includes the assumption of the Aeroplan Miles liability.

- The Corporation’s business acquisition of Aeroplan was accounted for using the acquisition method of accounting.

- Under the acquisition method, the estimated fair values of the acquired company’s assets and assumed liabilities are added to the consolidated statement of financial position as at the acquisition date.

Deferred Revenue – Fair Value

- The deferred revenues recognized on the acquisition of Aeroplan relate to the estimated fair value of outstanding Aeroplan Miles.
- The liability assumed was recorded based on the estimated fair value to service the Aeroplan Miles outstanding that are expected to be redeemed (consistent with ETV calculation).
- On a fair value basis as at the date of acquisition, the fair value of the Aeroplan deferred revenue incorporated the estimate of Aeroplan Miles to be redeemed in the future.

Partner Contributions

- Concurrently with the conclusion of the Aeroplan purchase, Air Canada, TD, CIBC, and Visa finalized various commercial agreements relating to and in support of the acquisition, including credit card loyalty program and network agreements for future participation in the Aeroplan program.

- Similarly, in the first quarter of 2019, Air Canada and AMEX concluded agreements enabling AMEX's participation in the Aeroplan program. Air Canada received payments from TD, CIBC, Visa and AMEX in the aggregate amount of $1,212 million. This consideration has been accounted for as deferred revenue and will be amortized into Passenger revenue over the terms of the related agreements.

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

Aeroplan & Other Deferred Revenue Summary as at March 31, 2019

Composition of Aeroplan & Other Deferred Revenue
As at March 31, 2019
(in millions)

Prepayment of Aeroplan Miles	$ 393
Deferred Partner Agreement Proceeds	1,187
Aeroplan Deferred Miles Revenue	2,727
	$ 4,307

Current portion of Aeroplan & Other Deferred Revenue	$ 1,054
Long-term Aeroplan & Other Deferred Revenue	3,253
	$ 4,307

Purchase Price Allocation

The preliminary allocation of the purchase price to the fair value of assets and liabilities is summarized as follows:

Fair value of assets acquired	(in millions)
Cash	$ -
Accounts receivable	188
Prepaid expenses and other current assets	8
Property and equipment	55
Deferred income tax	28
Intangible assets – Technology-based	44
Intangible assets – Contract-based	225
Intangible assets – Trade name	90
	$ 638
Fair value of liabilities assumed	
Accounts payable and accrued liabilities	226
Deferred revenue (current and long-term)	2,726
Long-term debt (lease liabilities)	41
Pension and other benefit liabilities	40
Deferred income tax	24
	$ 3,057
Fair value of net assets acquired	**(2,419)**
Goodwill	**2,916**
Total purchase consideration	**$ 497**

Intangible Assets

Aeroplan
Fair value of intangible assets on acquisition date
(in millions)

Technology-based (systems)	$ 44
Contract-based (3rd party contracts and member database)	$ 225
Marketing-based (trade name)	$ 90
Intangible Assets Total:	**$ 359**

- The contract-based intangible asset is subject to amortization over the term of the related commercial agreements with program partners (annual amortization of $19 million), while the trade name is considered to have an indefinite life.

Litigation Provisions –

Class Actions Related to Certain Passenger Charges

- On acquisition date, Aimia Canada Inc. had, amongst other proceedings, three class action proceedings outstanding related to claims by Aeroplan members residing in Quebec for:
  - fuel surcharges paid by them since December 12, 2011 when redeeming Aeroplan Miles for flights operated by Air Canada, Air Canada Rouge and Air Canada Express within North America;
  - airport improvement fees for a number of Canadian airports paid by them since December 15, 2011 when redeeming Aeroplan Miles for affected flights; and
  - passenger charges paid by them for a number of airports in Europe and Japan since June 9, 2012 when redeeming Aeroplan Miles for Air Canada flight tickets.
- Under the share purchase agreement with Aimia, Aimia will bear 50% of the liability and costs, if any, associated with these class action proceedings against Aimia Canada, up to a cap of $25 million for Aimia, after which Air Canada is solely responsible. The net liability to Air Canada in these actions, if any, is not expected to be material.

Segment Reporting

- There are no changes to the Corporation’s segment reporting policy as the Corporation’s financial results will be reviewed at the consolidated level.
- Air Canada is managed as one operating segment based on how financial information is produced internally for the purposes of making operating decisions. The operating segment is reported in a manner consistent with the internal reporting provided to the chief operating decision maker.
- The operations of Aeroplan are an integral component of the passenger airline business and the nature of the customer and the services provided are consistent between the loyalty program and the passenger airline business.
- This segment reporting policy is consistent with all North American airlines.
- As a result, the goodwill recorded related to the Aeroplan acquisition will be tested for impairment at the consolidated level.

First Quarter 2019 – MD&A Discussion

System Passenger Revenues

- In the first quarter of 2019, system passenger revenues of $3,816 million increased $327 million or 9.4% from the first quarter of 2018 on a yield improvement of 5.0% and traffic growth of 4.2%. The yield improvement year-over-year included additional revenue from Aeroplan flight redemptions subsequent to the Aeroplan acquisition on January 10, 2019, amortization revenue related to card agreement proceeds of $1,212 million, breakage revenues related to the Aeroplan program, and ancillary fees related to Aeroplan flight redemptions.

Non-GAAP Measures – Adjusted CASM

- Adjusted CASM excludes the operating expenses of Aeroplan since the date of acquisition in order to improve comparability of unit costs as no equivalent amounts are recorded in the prior period.

	First Quarter		
(in millions, except where indicated)	2019	2018	$ Change
Operating expense – GAAP	**$ 4,326**	**$ 3,985**	**$ 341**
Adjusted for:			
Aircraft fuel expense (including Regional airlines)	(997)	(939)	(58)
Ground Package costs	(294)	(276)	(18)
Operating expenses of Aeroplan	(45)	-	(45)
Operating expense – Adjusted for the above-noted items	**$ 2,990**	**$ 2,770**	**$ 220**
ASMs (millions)	26,016	24,862	4.6%
Adjusted CASM (cents)	¢ 11.49	¢ 11.14	3.2%