

Remarks for Calin Rovinescu

President and Chief Executive Officer, Air Canada

Canadian Club of Montreal,

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### **A Strategy for Global Competitiveness**

Good afternoon and thank you John for your kind introduction.

#### Introduction to Air Canada

Air Canada's headquarters have been located in Montreal since 1949, yet even in our hometown, people are often surprised when it is pointed out just how big a global company we really are. Despite Canada's small population base, Air Canada is among the top 20 largest carriers in the world, and there are more than 1,000 airlines in the world.

We have 27,000 employees – more than enough to fill every seat in the Air Canada Centre with 6,000 left standing – and they are located all over the

world. Our annual revenue exceeds \$12 billion. Each year we carry more than 35 million people; the equivalent of every man, woman and child in Canada. Our fleet of 200 aircraft proudly bears our Maple Leaf logo to more than 175 destinations on five continents. Counting our regional partners flying under the Air Canada Express banner we operate 1,500 flights a day, meaning on average somewhere in the world there is an Air Canada plane launching every minute of every day of every month of every year.

### Montreal / Quebec

While we are a very large company with a global reach, we are based right here in Montreal, with one of the city's largest corporate head offices. In total, Air Canada directly employs 5,300 people in the city – 6,700 if you include our wholly-owned subsidiary Air Canada Vacations and our Air Canada Express partners - Jazz and Sky Regional, who fly exclusively for Air Canada.

This translates into a significant economic footprint with annual salaries in Quebec exceeding \$400 million. In addition, we also support 6,500 retirees in the Montreal area.

We do business with hundreds of local suppliers with annual expenditures estimated at \$1.5 billion. Due to the multiplier effect that economists apply to aviation, our total economic impact in Quebec is estimated to be more than \$4 billion.

Of course, we are also the airline that has the largest footprint in Montreal – in terms of passengers, frequencies and connections. We carried approximately 46 per cent of all traffic from Trudeau airport in 2013, or 6.5 million people. This was an increase of five per cent from the previous year. And this coming summer we will serve 47 destinations from Montreal, including 22 internationally, 12 to the U.S. and 13 within Canada.

Because we live here, the people at Air Canada also participate in and support the community.

We are very proud of our connection with Montreal and we embrace and support its multicultural character in much of what we do from training to on-board Inflight Entertainment Programming to sponsorships – including Montreal arts and cultural assets such as l’Orchestre Symphonique de Montreal, le Musee des Beaux Arts, les Grands Ballets Canadiens, le

Festival Juste Pour Rire and of course our beloved hockey team – the Montreal Canadiens.

The Air Canada Foundation supports a number of local causes with our key Montreal initiatives being the new Shriners Hospital for Children, Breakfast Clubs of Canada and Dreams Take Flight, our employee-led initiative which takes disadvantaged children for a day of magic to Disney. I can also attest to the fact that Air Canada's employees are highly enthusiastic participants of the Ride to Conquer Cancer between Montreal and Quebec City, based on my personal experience riding with the Air Canada team. And last fall we offered all of the orphaned children of Lac-Mégantic along with companions a trip to Disney to aid somewhat in their healing following the tragedy of last year. We fully expect to be there for our communities when the need arises."

I promised that today I would discuss in particular Air Canada's Strategy for Global Competitiveness – how it is that a Montreal-based airline can steadily reinvent itself and aspire to the mantle of a true high performance global organization and play in the fields of the big leagues.

When I spoke to the Chambre de Commerce here in Montreal in January of last year, the topic was "Charting a Better Future" and I suggested that our transformation initiatives were about much more than just short-term survival in this tough business. I referenced Thomas Friedman, the well-regarded NY Times journalist and author of the "World is Flat", who had then written a brilliant piece in which he argued that for US companies to win in the global arena, "Average wasn't good enough anymore" in this brave new world.

Indeed, it simply isn't good enough to expect to do well by just showing up – because of price and product knowledge available on the Web, because of the immediacy of data, because of access to developing economies and highly skilled labour, because of intense competition for higher education, because of emerging economies' greater hunger - indeed imperative - to succeed.

The phrase "average is over" is particularly pertinent to us and the transformation that we have been undertaking to secure Air Canada's place as one of the world's pre-eminent international carriers and is a perfect segue to a discussion around our strategy for global competitiveness.

To win you need several unique selling points (U.S.P.s), factors that distinguish you from the rest of the pack, and Canada and Air Canada have several. So this is how we view global competitiveness and are truly becoming a high performance organization.

(1) **We have the geography.** This is an important USP. Our country is ideally situated between the major regions of the world including Europe, Asia, South America and the U.S. Flying times between Canada and parts of Asia, for example, are shorter than for those through U.S. hubs like Chicago or New York – and our skies are less congested.

(2) **You need to have operational excellence in all aspects of your game – product, staff, equipment, network.** As an organization, we made it clear in 2013 that we will not accept mediocrity. That, for us, “average” is indeed officially over. We have strived to improve all aspects of our business over the last several years, ranging from our aircraft refurbishment program, which made us the first North American network carrier to offer lie-flat suites fleet wide, to a host of airport and customer service and

technology innovations, to improved on-time performance and dispatch reliability.

**(3) Spend on capital where it is essential to differentiate your product, your brand or your profitability.** Basically, we have been putting our money where our mouth is with respect to CAPEX. We have invested heavily in new aircraft to both improve our bottom line by reducing fuel cost while also investing in a leading product for the future. Our 787 program represents a list-price investment of nearly \$5 billion, and our 737 program, just announced in December is a commitment of well over \$6 billion also based on list price. In addition, we purchased five new Boeing 777 aircraft in 2013 at a list cost of \$750 million in a high density seating configuration that has proven to be an extremely successful experiment on certain higher demand routes.

**(4) Don't use external factors as excuses where things are tough.** The airline industry is a challenging, tough and some would say, impossible, business. As I said earlier Air Canada transports 35 million passengers per year, to various corners of the globe. If we estimate on average 5 customer touch points per passenger – namely the booking process, the airport /

boarding process, the onboard inflight / flight operations process, baggage recovery from irregular operations, etc – that makes for a total of 175 million customer interface opportunities.

Lots of intervening factors can and do conspire to damage an airline's performance - from weather to fuel price spikes to regulatory costs to reliance on third party infrastructure.

We will not permit outside forces to drag us back to “average”, be they legacy work rules, poor aviation or airport infrastructure or services, excessive government taxes, or parochial issues in any one region. As we showed in 2013, we may not always like the cards we're dealt, but we will play them to the best of our ability and move on.

**(5) Results make a big difference and strong results an extremely big difference.** Over the past year we have reported some of our strongest results since our privatization in the late 1980s. Records were set in both the second and third quarters. In fact, in our third quarter we reported our best ever adjusted net income and EBITDAR in the corporation's history.

For all of 2013, we had a load factor of nearly 83 percent – meaning our aircraft were on average nearly 83 per cent full system wide, from the smallest regional to the largest widebodies - this was another all-time record for the company.

That we are successfully executing on our corporate priorities and delivering on our commitment is being recognized by the financial community and investors. Since Air Canada was added back into the S&P/TSX composite index last year, our shares have outperformed the entire index, being the number one stock for all of 2013 in all industries – more than tripling in value over the year. We were also the leading stock amongst all North American airlines, with the exception of American Airlines, which exited Chapter 11 in 2013.

While we cannot be complacent, I am very proud of these results and I cannot emphasize enough how they were only possible due to the hard work, dedication and commitment of our leadership team and all Air Canada employees.

**(6) You need a focused game plan – like any successful sports team.**

**You** need a solid game plan and the determination to stick with it, which is why at the start of our transformation I challenged senior management to identify key corporate priorities to achieve our goal of sustained profitability.

I felt it was essential that we articulate these simply and clearly. Partly this was to enforce clarity of thought and impose a disciplined approach on the leadership team, but it also had the added advantage of ensuring everyone in the entire company was attuned to the plan and understood their role in fulfilling it.

We identified *four* basic priorities (four, not *forty* or *four hundred*) that have become a mantra for our company. Indeed I would say these are now imprinted on our corporate DNA – cost transformation, culture change, customer engagement and international growth. No catchy phrases, such as “Slim” or “Lean” or “Six Sigma”, just words that 27,000 people could understand and sign up to.

(7) **Make sure your foundation is rock solid.** As with any structure, we started with the foundation. We implemented a Cost Transformation Program (CTP) aimed at achieving \$500 million in annual non-labour cost savings and unit revenue improvements. Within three years we exceeded that initial goal by more than \$30 million but that was just a beginning.

We followed on our CTP success by modifying certain collective agreement work rules, to make our labour costs more competitive, with certain key players who were taking away significant share on some very important markets.

(8) **Look after your employees and retirees who have built the company.** Air Canada prides itself on having industry leading employment terms and being a desirable employer, who looks after its employees extremely well. One of the attractive employment features at Air Canada since the beginning of time is the Air Canada Pension Plan, which is a defined benefit plan established at a time when Air Canada was a Crown Corporation. Employees love the plan and retirees and senior employees counted on it. There is no doubt, however, that our pension plan liabilities, in the current context created a serious impediment to our progress. The

Plan had a solvency deficit that, with historically low interest rates, rose to \$4.4 billion at its peak. Over the past four years we have had three primary objectives with respect to our pension plans – (1) to ensure our employees’ and retirees’ pensions are secure, (2) to eliminate the pension solvency deficit and (3) to make the costs associated with maintaining them affordable, predictable and stable.

As some of you may have seen, we have made significant progress on all these objectives and announced last week that based on preliminary estimates , the solvency deficit, which was more than \$3.6 billion as at January 1, 2013 was not only eliminated but we now project a small surplus position at as of January 1, 2014.

This is not only very positive news for our shareholders, but it also provides much-needed reassurance to our employees, who, as I say, counted on it, especially when retirement security is such a major concern.

We have been diligently and proactively working on the pieces of this puzzle and planning for this day over the last four years. While it happened somewhat more quickly than we had predicted at the start of last year, it is

not as if we have awakened from a “Rip Van Winkle” slumber to an unexpected surprise. Apart from a slightly higher interest rate which translates into a more favourable discount rate used to value our obligations, we did achieve top quartile returns on our pension assets over the last few years – indeed top decile in some years. In addition, we implemented important pension plan amendments to early retirement benefits with unionized and management employees.

And we settled an arrangement with the federal government to provide pension cost certainty over the next several years. This was key given the sensitivity of the deficit to long-term Government of Canada bonds which have been unnaturally low for many years, putting pressure on all defined benefit pension funds.

**(9) Reduce Leverage while lowering the overall cost of capital and, above all, increase your liquidity.** Another task we faced was repairing our balance sheet. Our net debt has been reduced by \$1.7 billion since 2009 through debt repayments and good old-fashioned cost control that produced more free cash flow to repay debt. In addition, we used some innovative capital raising techniques - for example last April we became one the first

airlines outside the US to raise aircraft-specific funding (\$700M) through Enhanced Equipment Trust Certificates (EETCs) and later in the year, we refinanced our high yield bonds in a \$1.4 billion refinancing transaction that involved several alternative forms of debt. Through these financings we were able to raise substantial amounts on the same collateral pool of assets. And we did so at a 30 per cent lower cost of capital because of our improved risk profile. At September 30, 2013 our cash levels were at a healthy \$2.4 billion.

**(10) Take some risk and bring in new products or brands while optimizing your footprint.** Another important innovation for us was the launch last July of Air Canada rouge, a lower cost leisure airline wholly-owned by Air Canada with a dedicated, very strong management team.

It allows us to better compete on leisure routes where our premium mainline brand could not do so profitably enough. Through modified work rules, lower labour costs, and aircraft reconfiguration, rouge achieves unit cost savings of 21 to 29 per cent versus the same aircraft operating in our mainline fleet – a huge savings. We continue to grow Air Canada rouge, including new sun destinations from Montreal – we announced just this

morning new service between Montreal and the Bahamas and more flights from Montreal to Cancun, Port-au-Prince and Punta Cana. And this summer we will be launching in Western Canada, where we recently announced plans to hire several hundred flight attendants.

As I said earlier, another product initiative that allowed us to grow last year was our acquisition of five new Boeing 777s that are targeted for certain long-haul routes that have higher leisure demand which allows us to add capacity - i.e. seats - and continue growing at significantly lower incremental costs, thereby lowering our overall average seat cost. With these new aircraft we also introduced a new Premium Economy service, a third cabin between Business and Economy.

The first aircraft debuted on the high-volume Montreal-Paris route last summer, followed by Vancouver- Hong Kong and we are very encouraged by both the positive customer response and especially by the very strong economic contribution of these new 777s.

We will also deploy one of these aircraft between Montreal and London next summer, thereby increasing our capacity from Montreal to this key global market by almost 73%.

In addition, we launched a special SME product that provides several advantages for small and medium-size businesses that would normally only accrue to larger corporations. These new products and other measures have strengthened our financial performance.

For the most recent third quarter, our unit costs fell 3.4 per cent from the previous year, which is a significant accomplishment for a company of our size and complexity with a high legacy cost structure, which is largely fixed.

**(11) Communicate and celebrate small and large progress on culture change with employees constantly.** To this end, we have been holding town halls to meet with employees to ensure that our strategy is clearly understood. As importantly, we are listening to their concerns so we can remove roadblocks and enable them to do their jobs better, with greater empowerment and decision-making capabilities.

There are several indicators that we are indeed succeeding with our culture change initiatives. In October, Air Canada was named one of the Top 100 Employers in Canada – the only airline to make the list – out of an initial

sample of 75,000 employers. To me it is also very telling that where we have historically received about 100 applications for every Air Canada job we fill, Air Canada rouge has received 300 applications for each available flight attendant job and since its creation last year has garnered 16,000 applications for crew positions.

Another indicator of culture change and the breaking down of silos is our airline's on-time performance in 2013. By working together we had by the busy third quarter of last year improved OTP by 20 percentage points. While the recent Polar Vortex has certainly had an impact on On Time Performance, the lessons we have learned from the exercise have made us more resilient and have increased our ability to recover from adverse circumstances.

**(12) Participate in Next Generation Game-changing Technology.** Tech companies need to be cutting edge and constantly need to operate in "beta" to succeed in the global arena. So do airlines. Anticipation is now building for our next great leap when we introduce our Boeing 787 Dreamliners into our fleet starting this spring. We have 37 of these next generation game-changing aircraft on firm order and we believe they will revolutionize the

customer experience in terms of comfort. The video clip viewed on screen earlier provides a glimpse of the new levels of comfort in store for our international customers. Further, their operating efficiencies derived from lighter weight, composite parts and new electronics will be 29 per cent more efficient than the older Boeing 767s they replace – will open new markets around the world we cannot serve profitably at present. We have announced our initial 787 routes as Tel Aviv and the very central Haneda airport in Tokyo. Future 787 will be on existing routes, including certain from Montreal.

In addition, the renewal of our fleet of smaller, narrow-body jets used in North America will provide us with more operating efficiencies and cost-savings. In December, we announced the purchase of up to 109 new Boeing 737 MAX aircraft to replace our Airbus narrow-body fleet.

Deliveries will start in 2017 and will give Air Canada one of the world's youngest, most-fuel efficient and simplified fleets.

**(13) Win a championship or two on an international ice surface.** That we are re-engaging customers, which was another of our four core priorities, has also been demonstrated by the numerous awards we have won for our

service, most recently this month being named the Best Long Haul Airline in the Americas by AirlinesRating.com, a well-regarded global traveler website.

Air Canada is the only Four Star network carrier in North America and for four straight years we have been named the Best Airline in North America by the universally-respected Skytrax World Airline Awards. Better than all U.S. carriers. And Better than all Canadian carriers. The annual Ipsos Reid study of frequent Canadian Business Travellers found Air Canada is the preferred carrier of 81 per cent of respondents – an improvement of 12 percentage points over five years.

(14) **Be as nimble as an entrepreneur in an Emerging Market.** I have the great privilege in my job of travelling around the world several times each year. I get to see interesting emerging markets such as Brazil, China, Ethiopia, South Africa, Abu Dhabi, etc where we either operate ourselves or have partnerships. I just returned from Israel, having joined the Prime Minister's business delegation there last week. And I can tell you that all of

these emerging markets share three common traits, almost without exception – speed, flexibility and audacity (chutzpah)!

Developed economics and legacy businesses have a lot to learn from the start-up culture of emerging markets – and developed economies should not wait to fail before implementing some of these lessons. It goes to selecting talent and empowering them to succeed, as we did with the Rouge leadership team. It goes to having regional and local expertise in the foreign countries and importing some of that international talent back home.

It also goes to the home country establishing an aviation policy to help develop and grow markets and eliminate artificial barriers to success – and we have multiple barriers to be eliminated in Canadian aviation, such as excessive rates and charges, a poor airport governance structure, airport curfews, etc.

For example, in a recent World Economic Forum report on Travel and Tourism, Canada ranked in the top 10 per cent with regards to air access but ranked 136th based on aviation rates and charges infrastructure. To give you an example, the federal government collected almost \$1B from the Air

Travellers Security Charge; Airport ground lease payments; and Federal and provincial government excise taxes on jet fuel. Collectively, these charges are what gives Canada the unenviable 136th ranking out of 144 countries surveyed on aviation rates and charges.

This situation is highly counterproductive as it makes the Canadian industry less competitive and travel more costly for consumers and businesses. More than five million Canadians a year, enough business to sustain a mid-size airport, travel to the U.S. for a flight. For Montreal, some estimates are that 70 per cent of passengers choosing to travel from the Plattsburgh airport are from Quebec and those should be travelers going through Montreal-Trudeau.

Another aviation impediment that needs to be addressed to facilitate travel is to ease Canadian visa requirements at least for those emerging markets where there is already a bilateral air transport agreement in place.

These are markets, such as our NAFTA partner Mexico, and other Latin American countries like Brazil and Chile, that offer true bilateral traffic and trade opportunities.

Measures such as these will ensure the Canadian airline industry remains competitive, strong and able to support jobs for tens of thousands of Canadians across the country.

If a powerful emerging market government (like China, Brazil or UAE) decided to use aviation as a tool for economic development, the shackles and barriers would be eliminated quickly. As a company, we expect to be as nimble as an entrepreneur in an emerging market and hope that governments and airports at all levels take some lessons from these markets as well.

(15) **Be globally audacious.** Our intention, somewhat immodestly stated, is to transform Air Canada into an international powerhouse for global traffic connecting over our Canadian hubs. This entails playing to our numerous strengths to build on our position as one of the world's leading international carriers and one of its 20 largest.

With respect to European expansion, since 2009, through Air Canada and Air Canada rouge, we have added or announced new European routes or destinations from Canada to Lisbon, Istanbul, Manchester, Venice, Edinburgh and Copenhagen. As well, we have added flights specifically

from **Montreal** to Brussels, Geneva and Athens. This summer, we will add seasonal Air Canada rouge service from Montreal to Barcelona, Nice and Rome and new service from Toronto to Milan.

The International Air Transport Association recently projected that international passenger numbers will rise by 25 per cent from 1.2 billion in 2012 to 1.5 billion in 2017, a compound annual growth rate of 4.6 per cent – well above the rate expected within North America alone. We aim to capture our fair share and more of this growth, but who benefits will depend on the partnerships we have with the communities and the airports we serve.

On top of this, we are also placing larger aircraft on flights from Montreal to London, Brussels and Geneva. In total we will be increasing capacity between Montreal and Europe by up to 30 per cent this summer – which alone represents an incremental investment of \$50 million on our part – and there will be increased domestic and U.S. flying to Montreal to feed passengers to these routes.

One example of this was our decision in November to extend our Montreal-San Francisco flight to year-round service. It is an attractive route for both

leisure and business travelers. The service is also a good example of the power of partnerships as Tourism Quebec, Tourism Montreal and Aeroports de Montreal are supporting a campaign to promote this new, year-round service.

For the summer then, we will serve nine European destinations from Montreal and there will be four other routes – Munich, Zurich, Frankfurt and Istanbul – served by our Star Alliance partners.

Our expansion activity is strategic and focused on building an inter-connecting global network based on our major hubs in Toronto, Montreal, Calgary and Vancouver and connecting passengers from other countries to other countries via Canada.

Toronto, for example, lying near the centre of North America, is an important pivot point, particularly for U.S. bound and originating customers who are transiting between domestic, transborder and international flights.

We have seen a 21 per cent growth in so-called 6th Freedom connecting traffic at Pearson from, say, the United States via Canada to overseas destinations, but we believe there is much more.

As for Montreal, the Aeroports de Montreal team has really demonstrated a ready grasp of our global powerhouse strategy and as importantly, of the power of partnership. ADM was the first major airport operator to rework its aircraft gating policy on the basis of passenger connection volume.

Connecting traffic is the main source of airline passenger growth in our globalized world and this positive move enables us to offer improved connection services – a key consideration for today’s global traveler.

This process is an important and critical area of focus as we grow the international travel options at Montreal. We need connecting passengers from the US to make international growth viable.

## **Conclusion**

2013 was really a great year in which we demonstrated what Air Canada is truly capable of being - an award-winning, sustainably profitable global company. A leader and innovator in aviation, who stresses safety "first and last" and produces top quartile operational performance. An employer of choice that hires, trains and retains the best, offering great working conditions and secure pensions while eliminating complacency and entitlement. A desirable investment that investors recognize as being capable of consistently delivering value. A customer centric company that takes risk in new markets and with new products while rapidly responding to increased competition in its existing markets, outshining both domestic and international competition. A global enterprise operating in 175 cities on five continents that is nonetheless adequately nimble and adaptable to continue to expand internationally. An impactful leader in corporate sustainability who makes a real difference in the lives and environments of its target stakeholders. In short, a high performance organization that is a leading brand ambassador for both Canada and commercial aviation generally.

It would be great if we could simply spike the ball and celebrate victory after ending 2013 as if it was Olympic Gold. But of course companies who aspire to be high performance organizations can't do that. So, let me assure you that for 2014, Air Canada won't rest on its 2013 laurels. Despite the curve balls or even occasional knuckle balls that Mother Nature, the Polar Vortex, a weaker Canadian dollar or other imponderables throw our way, we fully intend to keep the momentum going and produce both results and prosperity for our various stakeholders and for the Canadian economy writ large.

Thank you for your attention and above all your support -- and please keep flying - as regularly and as frequently as possible!