CHAMBRE DE COMMERCE
DU MONTRÉAL MÉTROPOLITAIN
BOARD OF TRADE OF METROPOLITAN MONTREAL

CHARTING A BETTER FUTURE FOR AIR CANADA

BÂTIR UN AVENIR MEILLEUR POUR AIR CANADA

CALIN ROVINESCU
President and Chief Executive Officer
Air Canada

January 22, 2013

Good afternoon ladies and gentlemen and thank you Michel for that kind introduction.

I would like to start with a bit of background because people are always surprised to learn just how big Air Canada has become. We are among the 15 largest airlines in the world and there are more than 1,000 airlines in the world and last year we carried close to 35 million customers – that means we transported roughly the equivalent of the entire population of Canada.

We operate a fleet of about 300 aircraft, including those of the regional carriers that fly on our behalf. Our network serves over 175 destinations on five continents. With more than 1,500 flights a day there is pretty much an Air Canada plane taking off somewhere every minute of every day.

We celebrated the airline's 75th anniversary over the past year and we have had a lot of fun marking this milestone.

But there was a serious subtext to the festivities that carry on beyond this anniversary and that is that Air Canada is an international icon with a rich

history of innovation, survival and adaptation. We are the Canadian flag-carrier and we have a well-established track record for safety, reliability and comfort. We make getting around the world and within Canada safe, easy and comfortable. Moreover, internationally the giant maple leaf on our aircraft serves as a ubiquitous billboard not only for Air Canada but for our country. How often do I hear from customers travelling in far flung countries that the sight of the maple leaf on our aircraft makes them feel that they have already arrived home.

Such a heritage is worth celebrating when you consider how many great airlines worldwide have disappeared over the past decades – iconic brands such as Eastern Airlines, Pan Am, TWA, Braniff, Swissair, Sabena, Varig and the list goes on – survivors in this very tough industry are rare and each of us certainly has the battle scars to prove it.
Profit margins for the global airline industry are less than 1% according to IATA, the International Air Transport Association.

This industry, more than any other, deals with numerous external factors over which we have little control, such as:

- fuel costs
- airports and their numerous construction projects
- weather
- an evolving international market,
- and any other “Black Swan” event you can imagine from 9/11 to the SARS epidemics, volcanoes in Iceland, earthquakes in Chile, the well-known “underwear bomber”.

Personally, I have been involved with Air Canada in one form or another for 25 years during which time I have had the great privilege to participate in many enterprise-defining moments. During some of the more turbulent moments, I might have used more colourful adjectives to describe my participation.

Indeed we have had to reinvent ourselves a few times, and, to use a baseball analogy (given that I still have not given up on the Expos), we are only in the 5th inning of this game:

- 1st inning

  the privatization in 1988-89 where the corporation left its crown corporation status behind

- 2nd inning

  the hostile takeover bid in 1999 by Onex and American Airlines, followed by the acquisition of and merger with Canadian Airlines

- 3rd inning

  post 9-11 and SARS fallout where the universe for airlines changed irrevocably and virtually all legacy North American carriers filed for restructuring including our own in 2003-2004, which ultimately resulted in many changes to our fleet, cost structure and leases, but also led to:

  a) the carve out of 3 of our subsidiaries – creating $5B in shareholder value; and

  b) a refleeting with new planes Boeing/Embraers

- 4th inning: (2008-2012)

  The dramatic spike in fuel prices during that period (>$140 per barrel), followed by the brutal recession, followed by the failure of one of our key maintenance providers, followed by wholesale changes to our labour agreements and finally today's historically low interest rate environment which has caused a ballooning of our pension deficit

We are just now into the 5th inning and I have repeatedly said that for us to succeed, we have to stay ahead of the curve, anticipate the inevitable knuckle ball that we know is coming and have the courage to change our stats over home plate if necessary. How many great brands, besides airlines, have struggled in not re-inventing themselves quickly enough? I am thinking of icons such as Kodak and Polaroid as well as the music and video distributors failed to change their business model to stay relevant. In our case we've made some very important progress over the last couple of years:

- We ended 2011 with record revenue of close to $12 billion and I can tell you that we were tracking ahead of 2011 in the first nine months of the year in very many of our key financial metrics.

- Our liquidity remained strong. We ended Q3/12 with over $2 billion in cash.

- We've repaired our balance sheet by significantly reducing debt.

- We've reduced our cost structure - our three-year Cost Transformation Program resulted in well over $530 million in recurring annual revenue and cost-saving measures.

- We've achieved some important and hard fought changes to our collective agreements which give us some badly needed operational flexibility. This along with our CTP program is significantly narrowing the cost advantage our main domestic competitor, who up to now with one fleet type, no unions and no pension fund, had long enjoyed over Air Canada as cause for concerns and attention on their part.

- Despite economic uncertainty around the world, we are posting strong operational results. Our planes last year were the fullest they have ever been with a record load factor of 82.7 per cent.

- We are hiring 1100 new employees over the next year, in many areas of the company.

In addition,

- We were recognised as Best International Airline in North America by Skytrax World Airline Awards based on a survey of more than 18 million travellers for the third year in a row.
- We are embarking on the first significant wide body aircraft growth in over a decade with the addition of new B777 aircraft which will result in new destinations and routes.
- We are launching *rouge*, our new leisure carrier this summer, which has resulted in unprecedented excitement in this country.

While we are not yet ready for the 7th inning stretch, the market is noticing – our stock price is up over 150% since last April. But in fact, this game and our transformation should never be finished. As some like to say, in this hypercompetitive world we live in, "Finished" is the "F" word.

Labour

Air Canada, as is the case with legacy carriers around the world, encountered labour turbulence over the past two years. Many long-established airlines world-wide are challenged in introducing fundamental changes in their companies against the backdrop of a hyper-competitive industry that has utterly transformed its economics.

But with the conclusion of a marathon collective bargaining process last July, we now have in place 4 to 5 year term labour agreements with our main Canadian unions that maintain generous compensation and benefits for our employees, yet also allow for some necessary transformative changes.

Going Forward

So, to get to this 5th inning, we have had many balls in the air but Air Canada today is a stronger and more stable airline and we can now fully turn our attention to the future. Lately, we have been making exciting announcements about developments at our company.

Fleet Growth

Chief among these were fleet additions focused primarily on international growth. This year we will be adding new Boeing 777-300ER aircraft to our wide body fleet to pursue strategic growth opportunities in our international network, given that one of our key priorities and objectives is global expansion.

This is only a first step as we have options to acquire more 777s and, in 2014, we will start taking into our fleet the first of a planned 37 Boeing 787 Dreamliners.

In total our widebody aircraft capital expenditure program is about $6B (at list cost), when including both the new 777s and the 787s – clearly we are committed to building for the future and putting our money where our mouth is.

The attention that the 787 has received in the past few weeks as a result of a number of technical problems for me just reconfirms the wisdom of avoiding

the “first mover” step and waiting to take delivery of a new aircraft model only after the initial problems are fixed. Problems are common during the introduction of new models, especially ones as revolutionary as the 787, which uses mostly composite materials instead of metals to create a lighter aircraft, as well as complex electronics. Boeing has built many great airplanes over their history and has been a leader in the enormous evolution that has occurred over the last several decades in commercial aviation.

We have complete confidence in the ability, the desire and indeed the imperative for Boeing, now with the support of the FAA, to resolve the lithium ion battery issues quickly and safely, and at this stage, we are not expecting any changes to our delivery schedule.

We continue to believe that this aircraft will provide cost and efficiency savings of more than 35% and their size and range is perfectly suited to Canada’s geography.

The rise of low-cost carriers has overturned the economics of our business. There are few industries such as ours where new entrants, without the labour rules, pension arrangements and other legacy encumbrances of long term

players, enjoy such a massive and immediate advantage over market incumbents. This is all the more disruptive in an industry where net profit margins are razor thin.

While entrepreneurship is commonly associated with starting a new venture, re-invention of a 75-year old business requires at least the same entrepreneurial spirit and innovation as a start-up. Put another way, we have found that as a 75-year-old you have to run pretty hard and be pretty nimble to catch that elusive 10 or 15-year-old who just showed up one day, is in great shape and has no baggage to slow him down.

Rouge

With our new leisure carrier part of our business is being re-invented to compete with these new entrants. We will launch *rouge* with two Boeing 767 and two Airbus A319 aircraft and it will begin by taking over some existing routes from Air Canada plus starting its own new routes to exciting destinations such as Venice and Edinburgh.

As Air Canada takes delivery of new wide-body jets, *rouge's* fleet will eventually grow to 20 767s and 30 A319s. So, with up to 50 aircraft, rouge has the potential to become quite a substantial player in the leisure market.

Both the arrival of our new wide-body aircraft and the creation of *rouge* will enable us to fly to new destinations and return to markets that were no longer feasible for Air Canada under the mainline model. Until now, partly due to the limitations in our old collective agreements and partly due to our capital constraints, we were somewhat limited in expanding our international network. Nonetheless, by using our aircraft to the maximum we have been able over the past three years to introduce new destinations such as Toronto-Copenhagen, Calgary-Tokyo and from Montreal year-round service to Brussels and Geneva as well as seasonal service to Athens.

Average is "over"

Our transformation initiatives are about much more than just short-term survival in this tough business. Thomas Friedman, the well-regarded NY Times journalist and author of the "World is Flat", who I saw in Montreal at a conference last week, recently wrote a brilliant piece in which he argues that in the US "Average isn't good enough anymore" – because of 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, etc.

The phrase “average is over” is particularly pertinent to us and the transformation that we are undertaking to secure Air Canada’s place as one of the world’s pre-eminent international carriers. We have the geography. 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.

We are convinced we can leverage this advantageous position to further build on our global brand if we are to be able to continue moving forward with courage and avoid the many outside forces that seek to keep us average.

Asia

Next summer, our Asian flying, will be dramatically expanded with a new Toronto-Seoul route, seven more weekly flights to China from Canada, and

the upgrading of our relatively new Calgary-Tokyo route to make it a daily service.

As a result, we will operate 77 return flights or 43,000 airline seats across the Pacific to Asia each week next summer representing a commitment of $2 billion worth of aircraft. In addition, we also announced a new Istanbul route, giving customers another means to access Asia, the Middle East and Africa.

Regulatory Environment

There are two important issues that profoundly affect our industry and that are important to tackle if we are to win. The first of these is having the proper regulatory environment in place.

Canada has been a leader with respect to negotiating Open Skies agreements with foreign countries. We at Air Canada have been and continue to be very supportive of such arrangements where mutual benefits are created and where there is a fair trade relationship.

To take the best known example, consider the Canada-US Open Skies agreements of 1995 and 2007. These were positive, watershed moments that have been a boon to carriers and consumers in both countries. Where there were 67 transborder routes before 1995, there are now more than 150 as a result of the opening of the skies. And many of these U.S. cities now feed into our Canadian hubs.

Given this, we were highly supportive of further liberalization efforts, including that with the 27 countries within the European Union. We are also actively encouraging agreements with other countries, such as Japan.

However, our support of such initiatives is not unconditional. Bilateral air transport agreements are effectively treaties that promote trade. It therefore follows that they should bring benefits to both sides, as that is the fundamental basis of any trade relationship in any industry.

We will continue to advocate that this principle is categorically respected especially where state-owned airlines, funded and supported by their governments, try to gain unfair access to divert traffic over their hubs making direct access to certain international cities from Canada less viable for a Canadian carrier. As I've said before, as a country, we cannot be boy

scouts running around in short pants when it comes to global competitiveness, especially when we see what other countries are doing.

Fees and Charges

A second, much less welcome role played by governments in our industry relates to taxes and fees. Everyone recognizes the harmful effects of these but no one seems committed to do anything about it. Many countries of the world have very high direct and indirect taxation of aviation, but Canada is amongst the worst. Airport improvement fees, airport rent, security surcharges, navigation fees and the list goes on, all serve to make airline tickets in Canada more expensive. We estimate that Air Canada's higher taxes and fees represent about $1 billion more than if we operated as a U.S. carrier with the same volume.

While I can accept that all economic activity is taxed at some level, it is perverse that our industry is treated like a cash cow given its extremely modest profit margins. And I say this because
air travel is directly linked to economic growth, whether that is travel for business or tourism. Yet, governments are still effectively imposing "sin" taxes upon us, penalizing users like is done for tobacco and alcohol.

And we are not alone in feeling this way.

- The World Economic Forum ranked Canada 125th out of 139 countries for ticket taxes and airport charges in 2011.

- Recent reports by the Canadian Senate and the Conference Board of Canada found that Canadian fees and taxes are simply uncompetitive and damaging.

Consumers recognize this too and, sadly for all of us, each year nearly 5 million Canadians now travel by land to a US border airport to catch flights to destinations that are served from Canadian airports. Quebec's fastest growing airport is in fact located in Plattsburgh, NY.

It is inconceivable to imagine the U.S. government with their "buy US policies" standing by and allowing the reverse situation. The Airport Council of Canada estimated the leakage of passengers to US border airports in 2010 cost a total $1.1 billion to GDP, 9,000 jobs and over $500 million in employment income. We are actively lobbying for concrete changes to this dynamic.

Montreal

As Air Canada is headquartered in this city and has been since 1949, this audience is naturally interested in how all of this relates to Montreal. We are one of the city's largest private sector employers. We employ over 5,000 people in Montreal and we generate thousands of other jobs with our purchase of goods and services. Our financial footprint in Quebec is estimated at over $4 billion in direct and indirect expenses.

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 hockey team – the Montreal Canadiens.

Montreal is also operationally important as one of our three Canadian hubs. In all, we have an average of 142 daily departures at Montréal Trudeau. We fly to 23 domestic, 16 transborder and 23 sun destinations. In addition, as many of you know, we also fly year-round to five international destinations

from Montreal-- London, Paris, Frankfurt, Brussels and Geneva with seasonal service to Rome and this summer our new leisure carrier *rouge* will operate our Athens route.

We are well aware that this Chamber and others in the business community are actively pressing for more international services from Montreal. Our service to Montreal is based on demand and the way the aviation market has evolved in Canada over the past 25 years. Moreover, in today's industry, most countries have but one major aviation hub. France – Paris, England – London, Japan – Tokyo, Australia – Sydney, etc., etc.

This does not mean that we will not pursue international growth for Montreal where it makes business sense for us to do so profitably. We found a solution in Calgary for the service to Tokyo when the business community and the airport gave us their concrete support. We view the two top new route priorities for Montreal to be Beirut and Beijing. I can tell you that if we had the necessary government approvals to fly to Beirut that we'd be there today. As to Beijing, late last year, we submitted a request for two additional landing slots at Beijing airport, where slots are a scarce and highly-prized commodity.

The economics of serving China dictates that one slot has to be designated for our Vancouver and Toronto gateways in order to further solidify our market presence and safeguard our already significant investment in China. We were unsuccessful in obtaining a commercially viable second slot, intended to launch service between Beijing and Montreal and also Calgary. By that I mean the scheduled departure and arrival times for the second slots were simply not feasible. But we are determined to try again in the future, given the Chinese market figures largely in our ambitions, as evidenced by our massive investment of aircraft dedicated to China.

As we transfer more aircraft to our new leisure carrier, we expect that Montreal will see *rouge* service to more sun destinations, European destinations with high leisure market demand as well as new non-stop service to Northwest Africa.

Conclusion

In conclusion, we are listening to our customers and working hard to engage them and meet their expectations. In addition to the ongoing recognition of Air Canada as Best International Airline in North America, 80% of Business Travellers in Canada prefer our airline to the competition according to a national survey last year by Ipsos Reid.

Recognition such as this is gratifying but more importantly it speaks to the hard work and dedication of our leadership team, several members of which are in the room today, as well as our other 27,000 employees. As an organization, we have made it clear 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. We have invested heavily in new aircraft, new routes, a stronger network, a better airport experience, a leading premium product. We will not permit legacy work rules, poor turn-around times or a focus on parochial issues to drag us back to “average”.

The airlines of Singapore, Dubai and Beijing know that average is “over”. So do we.

Almost two-and-half years ago, I gave a speech at the Banff Global Business Forum about Air Canada’s aspiration to be a Global Champion, a leader in the world of aviation. Whether or not we actually achieve that aspiration is frankly secondary. Rather, it is the very aspiration to become one that really matters as well as the unbridled ability and courage to operate in Beta – in test mode – all the time. In 2012, I was sincerely proud of the progress we made towards this goal and I fully expect that we will continue to challenge and reinvent ourselves well into the future. And if we don’t get the reinvention right the first time, by whatever is the highest standard, I promise we’ll try again. And again.

Thank you for your attention and interest.