



IFRS 16 - LEASES

Information session

February 21, 2019

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IFRS 16 Leases

Important Notice

- The information relating to International Financial Reporting Standards 16 Leases ("IFRS 16") is provided solely for the purpose of allowing investors and others to obtain a better understanding of the impact of IFRS 16 on certain of Air Canada's accounting policies and financial results for the year ended December 31, 2018. Readers are cautioned that it may not be appropriate to use such information for any other purpose.
- The accounting policy changes identified 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 February 14, 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 or review.
- Air Canada cannot provide any further estimates of the future impact of adopting IFRS 16 at this time.
- For additional information, refer to Air Canada's 2018 MD&A dated February 15, 2019, available on Air Canada's website at www.aircanada.com or on SEDAR at www.sedar.com.



IFRS 16 Leases - Agenda

- **IFRS 16 overview**
- **Impact on Air Canada – Key accounting policy changes**
- **Estimated adjustments on adoption of IFRS 16**
 - Consolidated Statement of Financial Position – January 1, 2018
 - Consolidated Statement of Operations – 2018
 - Key Financial and Non-GAAP Measures
- **Appendix**
 - Contractual Commitments as at December 31, 2018
 - Non-GAAP Measures



IFRS 16 Overview

Effective for annual periods beginning on or after January 1, 2019

- Guidance applies to leases of property, plant and equipment
- Core principle is that a lessee recognizes assets and liabilities for all leases with a lease term of more than 12 months – exemptions for short-term leases and low-value assets
- A contract contains a lease if:
 - there is an **identified asset**, and
 - the contract conveys the **right to control the use** of the identified asset for a period of time in exchange for consideration
- Full retrospective application is optional
 - Air Canada is adopting IFRS 16 with the full retrospective approach with restatement of 2018 comparatives



IFRS 16 Overview

General Impacts of IFRS 16

- No longer distinguish between finance lease (on balance sheet) and operating lease contracts (off-balance sheet)
- Instead, lessees will recognize a right-of-use asset and a corresponding lease liability for almost all lease contracts
- Impact is substantial increase in recognized financial liabilities and assets for companies that have significant lease contracts that are currently accounted for as operating leases

U.S. GAAP

- IFRS 16 generally aligned with equivalent U.S. GAAP standard
- Key differences include method of adoption, transition and income statement presentation of former operating leases. Under U.S. GAAP, while the lessee will report an asset and a liability related to all leases on its balance sheet (like IFRS), the Day Two accounting for operating leases will generally continue to produce a straight-line total lease expense



IFRS 16 Overview

Measurement

- Initial measurement is:
 - Lease liability = Present value of lease payments
 - Lease payments should be discounted using the interest rate implicit in the lease, and if this cannot be readily determined, the lessee's incremental borrowing rate is used
 - Includes non-cancellable lease payments including payments to be made in optional periods if reasonably certain to exercise lease extension
 - Does not include variable lease payments other than those that depend on an index or rate
 - Right-of-use asset = lease liability plus estimate of any provisions the lessee will owe for return conditions on the leased asset



IFRS 16 Overview

Ongoing Accounting

- Lease liability is measured in subsequent periods using the effective interest rate method
- The right-of-use asset is depreciated over the lease term
 - The carrying amount of the asset and liability will no longer be equal in subsequent periods
 - In general, the asset will be below the carrying value of the lease liability as the asset will be depreciated on a straight-line basis while the effective interest rate method on the lease liability results in a decreasing lease expense throughout the lease term



IFRS 16 Overview

Ongoing Accounting (continued)

- Lease extensions – change in lease liability with an adjustment to the right-of-use asset
- Modification to a lease – treatment will depend on modification:
 - decrease or increase in scope: adjust lease liability and right-of-use asset, with p&l impact if a decrease in scope
 - increase in scope with increase in lease consideration: separate lease contract



Accounting Policy Selection

Transition – Full retrospective versus modified retrospective

- Air Canada will apply IFRS 16 retrospectively to each prior reporting period
- Enables full comparative financial information

Transition – Practical expedients

- Air Canada will elect to adopt the practical expedients, including:
 - The option to ‘grandfather’ the assessment of which contracts are leases
 - Applying the recognition exemption for short term leases and contracts that for which the underlying asset has a low value



Accounting Policy Selection

Aircraft leases – Maintenance provision

- Maintenance provision recorded for all aircraft leases as a maintenance expense over the term of the lease. Under previous IFRS, no provision was recorded for finance-leased or regional CPA aircraft
- Any changes to the maintenance provision will be recorded with a corresponding adjustment to the right-of-use asset, and depreciated over the remaining lease term. Under previous IFRS, a change in maintenance provision is taken immediately to income as maintenance expense adjustment

Aircraft leases – Sale-leaseback accounting

- Previously reported sale and leaseback transactions are restated in line with IFRS 16 guidance which generally results in lower gains on sale and a lower asset value
- Sale and leaseback gains are recorded to the extent of the asset sold; remainder is recorded as an adjustment to the right-of-use asset



Impact on Air Canada

Aircraft leases – Componentization

- Right-of-use assets are to be accounted for under IAS 16 Property, Plant and Equipment
- Aircraft recorded as right-of-use assets will have the same accounting policies as directly owned aircraft
 - Right-of-use assets will be componentized and depreciated over the lease term
 - Any qualifying maintenance events will be capitalized and depreciated over the lesser of the lease term and expected maintenance life
 - Under previous IFRS, the policy for operating leased aircraft was to expense maintenance as incurred unless reducing lease return conditions



Accounting Policy Selection

Regional leases

- CPA Aircraft are leased assets to Air Canada and the same accounting policies and transitional considerations as Air Canada direct leases will be applied

Property leases

- Air Canada has leases related to airport terminal operations and other real estate leases
- Terminal operations space generally have effective substitution rights in the hands of the lessor and therefore not considered lease contracts under IFRS 16
- Leases with reciprocal termination rights with notice period of less than 12 months would be considered short-term leases and are excluded from recognition under the practical expedient
- Airport terminal contracts with variable lease payments are also excluded, since variable lease payments, other than those based on an index or rate, are excluded from measurement



Impact on Air Canada

Scope of Impact on Air Canada: Right-of-use assets and lease liabilities upon IFRS 16 adoption

Aircraft leases

- 126 aircraft under operating leases at December 31, 2018

Regional partner aircraft leases

- 132 aircraft at December 31, 2018 used by regional carriers providing services to Air Canada under capacity purchase agreements that qualify as IFRS 16 leases

Property leases

- 46 leases representing dedicated space in Air Canada's hub locations of Toronto, Montreal and Vancouver, lease contracts on building space for offices, airport and maintenance operations, Maple Leaf Lounges and land leases



Impact on Air Canada

Income statement impacts

- Elimination of aircraft rent and building rent for those contracts which are recognized as leases, and instead will be replaced by
 - Amortization of the right-of-use asset in the same line item as other Property & Equipment
 - Interest expense on the lease liability as part of finance costs
- Maintenance expense is expected to decrease as qualifying maintenance events will now be capitalized as part of the right-of-use asset and depreciated
- Offsetting this, maintenance provisions for end-of-lease return obligations for all aircraft right-of-use assets will be recorded as a maintenance expense over the lease term
- Regional airlines expense is expected to decrease to the extent aircraft rent is removed and recorded in depreciation and interest expense outside of the Regionals airlines expense
- Since all the aircraft leases are denominated in U.S. dollars, there may be additional volatility in the foreign exchange recognized in the income statement due to the revaluation of the lease liabilities and maintenance provisions to the rate of exchange in effect at the date of the balance sheet



Estimated Expected Adjustments to the Statement of Financial Position as at January 1, 2018 under IFRS 16

(Canadian dollars in millions)	December 31, 2017 as previously reported	Air Canada aircraft	Regional aircraft	Property leases	Expected January 1, 2018 as restated
Accounts receivable	\$ 814	\$ (3)	\$ -	\$ -	\$ 811
Deposits and other assets	465	(63)	-	-	402
Property and equipment	9,252	1,649	766	160	11,827
Deferred income taxes	456	71	144	13	684
Total assets	\$ 17,782	\$ 1,654	\$ 910	\$ 173	\$ 20,519
Accounts payable and accrued liabilities	1,961	(22)	(12)	-	\$ 1,927
Current portion of long-term debt and leases	671	357	146	12	1,186
Total current liabilities	5,101	335	134	12	5,582
Long-term debt and lease liabilities	5,448	1,452	1,092	198	8,190
Maintenance provisions	1,003	70	78	-	1,151
Other long-term liabilities	167	(8)	-	-	159
Total liabilities	\$ 14,360	\$ 1,849	\$ 1,304	\$ 210	\$ 17,723
Retained earnings	2,554	(195)	(394)	(37)	1,928
Shareholders' equity	\$ 3,422	\$ (195)	\$ (394)	\$ (37)	\$ 2,796
Total liabilities and shareholders' equity	\$ 17,782	\$ 1,654	\$ 910	\$ 173	\$ 20,519



Estimated Expected Adjustments to the 2018 Consolidated Statement of Operations under IFRS 16

(Canadian dollars in millions)	December 31, 2018 as previously reported	Air Canada aircraft	Regional aircraft	Property leases	Expected December 31, 2018 as restated
Total revenues	\$ 18,065	\$ -	\$ -	\$ -	\$ 18,065
Regional airlines expense	2,842	-	(323)	-	2,519
Aircraft maintenance	1,003	(100)	-	-	903
Depreciation, amortization and impairment	1,080	424	197	16	1,717
Aircraft rent	518	(512)	-	-	6
All other (including property rent)	11,448	-	-	(27)	11,421
Total operating expenses	16,891	(188)	(126)	(11)	16,566
Operating income	1,174	188	126	11	1,499
Interest expense	(331)	(131)	(91)	(14)	(567)
Foreign exchange and other	(438)	(157)	(105)	(1)	(701)
Total non-operating expense	(769)	(288)	(196)	(15)	(1,268)
Income before income taxes	405	(100)	(70)	(4)	231
income tax expense	(238)	27	19	1	(191)
Net income	\$ 167	\$ (73)	\$ (51)	\$ (3)	\$ 40



Key Financial and Non-GAAP Measures under IFRS 16

(Canadian dollars in millions, except where indicated)

	2018 restated under IFRS 16	2018 as under previous IFRS	Change
Revenue	\$ 18,065	\$ 18,065	\$ -
Operating expense, before depreciation and aircraft rent	14,843	15,214	(371)
Depreciation and aircraft rent	1,723	1,677	46
Operating expense	16,566	16,891	(325)
Operating income	\$ 1,499	\$ 1,174	\$ 325
EBITDA (EBITDAR)	\$ 3,222	\$ 2,851	\$ 371
EBITDA (EBITDAR) Margin %	17.8%	15.8%	2.0 pp
Adjusted pre-tax income	\$ 1,039	\$ 952	\$ 87
ROIC %	14.5%	12.6%	1.9 pp
Leverage ratio	1.6	2.1	(0.5)
Free cash flow	\$ 1,322	\$ 791	\$ 531



Appendix

Contractual Obligations as at December 31, 2018 for IFRS 16 Lease Obligations

(Canadian dollars in millions)	2019	2020	2021	2022	2023	Thereafter	Total
Additional Principal							
Air Canada aircraft	\$ 403	\$ 310	\$ 230	\$ 162	\$ 162	\$ 583	1,850
Regional CPA aircraft	180	183	172	167	169	312	1,183
Property leases	10	11	9	8	8	186	232
Total principal obligations	593	504	411	337	339	1,081	3,265
Additional Interest							
Air Canada aircraft	119	88	65	51	41	85	449
Regional CPA aircraft	84	70	56	44	30	26	310
Property leases	14	14	13	12	12	199	264
Total interest obligations	\$ 217	\$ 172	\$ 134	\$ 107	\$ 83	\$ 310	\$ 1,023
Total lease obligations	\$ 810	\$ 676	\$ 545	\$ 444	\$ 422	\$ 1,391	\$ 4,288
Revised total long-term debt and lease obligations							
Principal	\$ 1,048	1,194	1,431	694	1,805	3,853	10,025
Interest	504	440	354	288	238	666	2,490
	\$ 1,552	\$ 1,634	\$ 1,785	\$ 982	\$ 2,043	\$ 4,519	\$ 12,515
Obligations related to leases not recorded as IFRS 16 lease obligations							
	\$ 28	\$ 19	\$ 13	\$ 8	\$ 7	\$ 23	\$ 98



Appendix

Non-GAAP Measures under IFRS 16

(Canadian dollars in millions)	2018 restated under IFRS 16	2018 as under previous IFRS	\$ Change
GAAP operating income	\$ 1,499	\$ 1,174	\$ 325
Add back (as reflected on the consolidated statement of operations):			
Depreciation, amortization and impairment	1,717	1,080	637
Aircraft rent	6	518	(512)
Add back (included in Regional airlines expense):			
Depreciation, amortization and impairment	-	38	(38)
Aircraft rent	-	41	(41)
EBITDAR	\$ 3,222	\$ 2,851	\$ 371



Appendix

Non-GAAP Measures under IFRS 16

(Canadian dollars in millions, except where indicated)

	2018 restated under IFRS 16	2018 under previous IFRS	\$ Change
Income before income taxes	\$ 231	\$ 405	\$ (174)
Remove:			
Foreign exchange loss	578	317	261
Net financing expense relating to employee benefits	50	50	-
Loss on financial instruments recorded at fair value	1	1	-
Gain on debt settlements and modifications	(9)	(9)	-
Loss on disposal of assets	188	188	-
Adjusted pre-tax income	\$ 1,039	\$ 952	\$ 87
Interest expense	567	331	236
Implicit interest on operating leases	-	274	(274)
Adjusted pre-tax income before interest	\$ 1,606	\$ 1,557	\$ 49
Invested capital:			
Average long-term debt and finance lease obligations	9,649	6,386	3,263
Average shareholders' equity, net of excess cash	1,375	2,065	(690)
Capitalized operating leases	-	3,913	(3,913)
Invested capital	\$ 11,024	\$ 12,364	\$ (1,340)
Return on invested capital (%)	14.5%	12.6%	1.9%



Appendix

Non-GAAP Measures under IFRS 16

(Canadian dollars in millions, except where indicated)	December 31, 2018 under IFRS 16		December 31, 2018 under previous IFRS		\$ Change
Total long-term debt and leases	\$	8,873	\$	6,197	\$ 2,676
Current portion of long-term debt and leases		1,048		455	593
Total long-term debt and leases, including current portion		9,921		6,652	3,269
Less cash, cash equivalents and short-term investments		(4,707)		(4,707)	-
Net debt	\$	5,214	\$	1,945	\$ 3,269
Capitalized operating leases		-		3,913	(3,913)
Adjusted net debt	\$	5,214	\$	5,858	\$ (644)
EBITDAR	\$	3,222	\$	2,851	\$ 371
Leverage ratio		1.6		2.1	(0.5)



Appendix

Non-GAAP Measures under IFRS 16

(Canadian dollars in millions)

	2018 restated under IFRS 16	2018 as under previous IFRS	Change \$
Net cash flows from operating activities	\$ 3,465	\$ 2,695	\$ 770
Additions to property, equipment and intangible assets, net of proceeds from sale-leaseback transactions	(2,143)	(1,904)	(239)
Free cash flow	\$ 1,322	\$ 791	\$ 531

