AIR CANADA

ANNUAL REPORT **2015**

01

HIGHLIGHTS

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

CANADIAN DOLLARS IN MILLIONS, EXCEPT WHERE INDICATED	FOURTH QUARTER			FULL YEAR		
	2015	2014	$ Change	2015	2014	$ Change
FINANCIAL PERFORMANCE METRICS						
Operating revenues	3,182	3,104	78	13,868	13,272	596
Operating income	158	106	52	1,496	815	681
Non-operating expense	(274)	(206)	(68)	(1,188)	(710)	(478)
Net income (loss)	(116)	(100)	(16)	308	105	203
Adjusted net income [1]	116	67	49	1,222	531	691
Operating margin %	5.0%	3.4%	1.6 pp	10.8%	6.1%	4.7 pp
EBITDAR [1]	425	319	106	2,534	1,671	863
EBITDAR margin % [1]	13.4%	10.3%	3.1 pp	18.3%	12.6%	5.7 pp
Unrestricted liquidity [2]	2,968	2,685	283	2,968	2,685	283
Net cash flows from operating activities	238	16	222	2,012	954	1,058
Free cash flow [1]	(376)	(370)	(6)	197	(547)	744
Adjusted net debt [1]	6,291	5,132	1,159	6,291	5,132	1,159
Return on invested capital ("ROIC") % [1]	18.3%	12.1%	6.2 pp	18.3%	12.1%	6.2 pp
Diluted earnings per share	$ (0.41)	$ (0.35)	$ (0.06)	$ 1.03	$ 0.34	$ 0.69
Adjusted earnings per share – diluted [1]	$ 0.40	$ 0.23	$ 0.17	$ 4.18	$ 1.81	$ 2.37
OPERATING STATISTICS [3]			**% Change**			**% Change**
Revenue passenger miles ("RPM") (millions)	15,301	14,090	8.6	67,545	61,616	9.6
Available seat miles ("ASM") (millions)	18,869	17,403	8.4	80,871	73,889	9.4
Passenger load factor %	81.1%	81.0%	0.1	83.5%	83.4%	0.1
Passenger revenue per RPM ("Yield") (cents)	18.2	19.2	(5.5)	18.0	18.9	(4.6)
Passenger revenue per ASM ("PRASM") (cents)	14.7	15.6	(5.3)	15.1	15.8	(4.4)
Operating revenue per ASM (cents)	16.9	17.8	(5.4)	17.1	18.0	(4.5)
Operating expense per ASM ("CASM") (cents)	16.0	17.2	(7.0)	15.3	16.9	(9.3)
Adjusted CASM (cents) [1]	12.2	12.1	0.8	11.3	11.3	(0.2)
Average number of full-time equivalent ("FTE") employees (thousands) [4]	25.1	24.3	3.5	24.9	24.4	1.8
Aircraft in operating fleet at period-end	370	364	1.6	370	364	1.6
Average fleet utilization (hours per day)	9.4	9.2	1.4	10.0	9.9	1.1
Seats dispatched (thousands)	12,623	11,948	5.6	52,359	49,351	6.1
Aircraft frequencies (thousands)	136	135	0.9	567	555	2.1
Average stage length (miles) [5]	1,495	1,457	2.6	1,545	1,497	3.2
Fuel cost per litre (cents)	58.6	79.7	(26.5)	63.0	88.9	(29.1)
Fuel litres (millions)	1,035	992	4.3	4,478	4,213	6.3
Revenue passengers carried (thousands) [6]	9,686	9,189	5.3	41,126	38,526	6.7

1 EBITDAR, EBITDAR margin and the adjusted measures are each non-GAAP financial measures. Refer to sections 9 and 19 of Air Canada's 2015 MD&A for descriptions of Air Canada's non-GAAP financial measures and additional GAAP measures.

2 Unrestricted liquidity refers to the sum of cash, cash equivalents, short-term investments and the amount of available credit under Air Canada's revolving credit facilities. At December 31, 2015, unrestricted liquidity was comprised of cash and short-term investments of $2,672 million and undrawn lines of credit of $296 million. At December 31, 2014, unrestricted liquidity was comprised of cash and short-term investments of $2,275 million and undrawn lines of credit of $410 million.

3 Except for the reference to average number of FTE employees, operating statistics in this table include third-party carriers (such as Jazz Aviation LP ("Jazz") and Sky Regional Airlines Inc. ("Sky Regional")) operating under capacity purchase agreements with Air Canada.

4 Reflects FTE employees at Air Canada. Excludes FTE employees at third party carriers (such as Jazz and Sky Regional) operating under capacity purchase agreements with Air Canada.

5 Average stage length is calculated by dividing the total number of available seat miles by the total number of seats dispatched.

6 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.

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MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

Air Canada's 2015 results are the strongest evidence yet of the success of our transformational strategy. Among other records, our revenues, EBITDAR, operating income and adjusted net income for the year all surpassed anything we previously reported. This affirms our progress toward sustainable, long-term profitability.

Adjusted net income of $1.2 billion ($4.18 per diluted share) exceeded the previous year's record by $691 million or $2.37 per diluted share. EBITDAR was $2.5 billion, an improvement of 51.6 per cent over 2014. Our closely watched operating margin increased nearly five percentage points to 10.8 per cent from 6.1 per cent a year earlier.

Such results attest to the hard work of everyone within our organization and speak to our shared determination to deliver on our commitments to investors. Broadly stated, Air Canada is intent on pursuing profitable growth through margin expansion to achieve sustained profitability. To enable shareholders to evaluate our progress, in 2013 we set forth three quantifiable financial objectives that we subsequently increased in 2015. These included an annual EBITDAR margin of 15-to-18 per cent from 2015 to 2018; a Return on Invested Capital (ROIC) of 13-to-16 per cent from 2015 to 2018; and a Leverage Ratio of 2.2 or less by 2018.

For the sixth consecutive year, operating revenue has grown. It exceeded $13.8 billion in 2015, up $596 million from the previous year. Passenger revenues rose, with an overall system-wide increase of 5.2 per cent. In line with projections, we achieved a 0.2 per cent reduction in adjusted unit costs, which would have decreased 3.6 per cent had the Canada-U.S. dollar exchange rate remained at 2014 levels. Our operating expenses of nearly $12.4 billion decreased $85 million, or one per cent from the prior year. Overall, our total unit cost fell 9.3 per cent largely due to fuel cost savings, but we view low fuel prices during the year as transitory and our plans are not contingent on oil prices remaining at 2015 levels.

We completed the year with unrestricted liquidity of nearly $3 billion. Adjusted net debt amounted to approximately $6.3 billion, an increase of $1.2 billion from a year earlier due mainly to currency fluctuations on long-term debt and finance lease balances and continued investments in our fleet expansion. At year-end, our adjusted net debt to trailing 12-month EBITDAR ratio was 2.5 versus 3.1 for the prior period. In 2015, the major ratings agencies either upgraded or affirmed their ratings on Air Canada and its assorted debt instruments.

As at January 1, 2016, the aggregate solvency surplus in Air Canada's domestic registered pension plans is $1.3 billion, up from $660 million from a year earlier. This remarkable turnaround from our $2.2 billion solvency deficit at the end of 2010 should better secure our employees' retirements, while heightening our financial flexibility and reducing the company's overall risk profile.

Further validating our strategy is that we carried more customers than ever, flying more than 41 million people system-wide during the year at a record annual mainline load factor of 83.5 per cent. While our financial performance set records, our customers are more concerned with our operational performance and we did not disappoint. We met our key On Time Performance target for the year, even as we added complexity to our network with capacity increases and new destinations. We won customer service awards during the year and, with the renewal of our Four-Star rating from Skytrax, we remain the only Four-Star international carrier in North America. As well, the Ipsos Reid Canadian Business Traveller Survey determined 86 per cent of Canadian frequent business travellers prefer Air Canada; an improvement of 17 percentage points in the airline's ratings in the national survey over the past seven years.

In 2015, Air Canada also passed its IATA Operational Safety Audit, which looked at more than 900 standards and recommended practices, with "no findings". For the past seven years, Air Canada has passed its IOSA audits with results of "zero findings", putting the airline in the top two per cent of carriers with respect to safety. This was Air Canada *rouge*'s second IOSA audit and the second time auditors reported "no findings" for the leisure carrier.

The results we achieved in 2015, including our 130 per cent improvement in adjusted net income, exceed those of prior years to such a degree that one might conclude Air Canada did something radically different. While Air Canada, like the rest of the industry, benefited from lower fuel prices, these results really reflect the gathering momentum of our strategy to transform our airline into a company that is sustainably profitable over the long term. It is also indicative of the extent to which we at Air Canada are engaged in this task, working determinedly together, guided by our four corporate priorities first set in 2009.

The first of these is Revenue Enhancement and Cost Transformation. This entails expanding margins through reducing unit costs while concurrently seeking new means to generate incremental passenger and ancillary revenue.

Driving this priority has been Air Canada's ongoing fleet renewal program. During the year, Air Canada took delivery of six more Boeing 787 Dreamliners, bringing us to 12 of a firm order of 37 of these aircraft. The 787 yields significant efficiency and customer satisfaction gains over the older aircraft they replace. Complementing the 787 program is a conversion program underway for our Boeing 777 and Airbus A330 fleet to outfit these aircraft with an interior that is both more competitive and provides consistency with that of the 787 next generation cabin design. Lastly, Air Canada *rouge* is maturing, reaching at year-end 39 of a planned total of 50 aircraft in its fleet. Our leisure carrier has exceeded expectations, opening new opportunities for profitable growth in international leisure markets at a unit cost 25 per cent lower than that achievable with the same aircraft in the mainline fleet.

The pursuit of savings and revenue continues elsewhere through numerous other initiatives. This includes the implementation in 2015 of a new passenger revenue management system that optimizes revenue by selling based on a passenger's full trip itinerary rather than on individual flight legs. We anticipate this new system will yield $100 million in annual incremental bottom line profit when fully implemented. Additionally, we continue to develop our ancillary revenue base, which grew 16 per cent per passenger in 2015.

Along with increasing revenue, a successful company also seeks to lower its risk profile by diversifying its revenue sources. Our second priority of International Growth aims for both these goals and the benefits were evident in 2015 as the impact of slower Canadian economic growth was more than offset by the vigor of our international operations, which historically have offered higher margins. Travel outside Canada accounted for nearly two-thirds of Air Canada's passenger revenue, with an increasing amount consisting of international connecting traffic. Such so-called Sixth Freedom traffic is a promising source of future international traffic growth as Air Canada positions itself to capture a larger share of global traffic flows and channel it over our major hubs (particularly international traffic to and from the U.S. with a population base 10 times the size of Canada).

Moreover, we are using our renewed fleet to significantly expand our global network. In 2015, we introduced non-stop mainline service from Toronto to Amsterdam, Delhi and Dubai, and non-stop seasonal Air Canada *rouge* service from Montréal to Venice and from Vancouver to Osaka. Further, we continued to deepen our existing network by increasing Air Canada mainline service to Paris from both Montréal and Toronto in the summer and we added more frequent Air Canada *rouge* seasonal service to select European destinations.

A not-to-be-overlooked component of this expansion is the significant contribution our partners make. We collaborate closely with our Star Alliance partner airlines and especially with our A++ Trans-Atlantic Joint Venture partners, United Airlines and Lufthansa, who provide a vital extension to our network. For example, while Air Canada directly serves about 200 destinations, through Star Alliance our customers can reach more than 1,300 airports worldwide. Complementing these partnerships are numerous codesharing agreements that we maintain with other carriers.

Operating around the world requires that you also compete with the world and the very best that global carriers have to offer. This is why we have invested so heavily in amenities and services for our passengers and made Customer Engagement another core strategic priority. We recognize that our success depends on consistently delivering superior value and innovative products, providing the highest levels of service and anticipating the changing needs of customers.

With our ongoing fleet renewal, we are spending about $300 million to refurbish our 777s. This will enhance customer comfort and add on-board options, such as offering the only true Premium Economy cabin among North American carriers. Air Canada is also focused on other aspects of the travel experience, particularly for Premium Customers. This includes airport improvements such as priority check-in and boarding services, as well as operating 22 Maple Leaf™ Lounges in Canada, the U.S. and Europe.

Air Canada is also implementing a new customer relationship management system to gain valuable insights in customer travel patterns and preferences and to deliver a more personalized experience. This system will further allow Air Canada to better direct its product offerings to stimulate traffic, increase yields and improve customer loyalty. We also strengthened our online presence to offer a responsive experience for traditional web users while meeting the increased demands from tablet and mobile devices.

To engage customers more fully, it is essential that our employees prepare for and adapt to their changing expectations. As a result, Culture Change, including promoting entrepreneurial spirit, is another priority for Air Canada. To this end, we are refining our recruitment processes to attract people with the necessary aptitudes while at the same time we have introduced a wide range of training programs to ensure all employees have the skills, tools and support to deliver superior service.

Internal surveys have tracked a steady improvement in employee engagement and our strategy has received validation from third parties. In 2015, we were named for the third year in a row one of "Canada's Top 100 Employers" and we were ranked one of "Montréal's Top 30 Employers". Our company is cited repeatedly as a preferred employer in job seeker surveys by placement agencies.

Even more telling is that during the year Air Canada successfully concluded long-term labour agreements with our key unions. This included a 10-year agreement with CUPE, representing flight attendants, a five-year agreement with Unifor for airport and call centre employees, and, subsequent to year-end, we finalized a 10-year agreement with the IAMAW, representing aircraft mechanics and baggage handlers, and a 12-year agreement with flight dispatchers represented by CALDA. These follow on an earlier 10-year agreement with ACPA, the airline's pilot association, and cumulatively give Air Canada a level of unprecedented labour stability.

To summarize, 2015 was a year of incredible achievement for our company with impressive gains in virtually every area by which an airline can be measured. It confirmed that our strategy has our company solidly on course toward the goal of sustainable profitability in the interests of all long-term stakeholders. Yet we also retain the agility to respond quickly to changing conditions or to seize unexpected opportunities.

I thank our 28,000 employees for the commitment, determination and professionalism they demonstrate daily while delivering Air Canada's 41 million customers safely to their destinations. Further, I thank our shareholders, customers and other stakeholders for demonstrating the loyalty and support essential to the success of our ongoing transformation.

Calin Rovinescu
President and Chief Executive Officer

INTRODUCTION AND KEY ASSUMPTIONS

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 as Air Canada Vacations® ("Air Canada Vacations") and Air Canada *rouge* LP, doing business as Air Canada *rouge*® ("Air Canada *rouge*"). This MD&A provides the reader with a review and analysis, from the perspective of management, of Air Canada's financial results for the fourth quarter and the full year 2015. This MD&A should be read in conjunction with Air Canada's audited consolidated financial statements and notes for 2015. 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 financial information specifically denoted otherwise.

Except as otherwise noted, monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 20 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of February 16, 2016. Certain comparative figures have been reclassified to conform to the financial statement presentation adopted for the current year. 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 17 "Risk Factors" of this MD&A. Air Canada issued a news release dated February 17, 2016 reporting on its results for the fourth quarter and the full year 2015. This news release is available on Air Canada's website at **www.aircanada.com** and on SEDAR's website at **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**.

CAUTION REGARDING FORWARD-LOOKING INFORMATION

Air Canada's public communications may include written or oral forward-looking statements within the meaning of applicable securities laws. Such 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 may be 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 strategies, expectations, planned operations or future actions. Forward-looking statements are identified by the use of terms and phrases such as "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 herein and are subject to important risks and uncertainties. Forward-looking statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including without limitation, our ability to successfully achieve or sustain positive net profitability or to realize our initiatives and objectives, our ability to pay our indebtedness, reduce operating costs and secure financing, currency exchange, industry, market, credit, economic and geopolitical conditions, energy prices, competition, our ability to successfully implement strategic initiatives and our dependence on technology, war, terrorist acts, epidemic diseases, casualty losses, employee and labour relations, pension issues, environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), limitations due to restrictive covenants, insurance issues and costs, changes in demand due to the seasonal nature of the business, dependence on suppliers and third parties, including regional carriers, Aeroplan®† and the Star Alliance®, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties and the ability to attract and retain required personnel, as well as the factors identified throughout this MD&A and, in particular, those identified in section 17 "Risk Factors" of this MD&A. The forward-looking statements contained in this MD&A represent Air Canada's expectations as of February 16, 2016 (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 as a result of new information, future events or otherwise, except as required under applicable securities regulations.

† Aeroplan is a registered trademark of Aimia Canada Inc. used under license by Air Canada

KEY ASSUMPTIONS

Assumptions were made by Air Canada in preparing and making forward-looking statements. As part of its assumptions, Air Canada assumes relatively low to modest Canadian GDP growth for 2016. Air Canada also assumes a continuing relationship between the price of jet fuel and the value of the Canadian dollar whereby declines in the cost of fuel continue to be associated with decreases in the value of the Canadian dollar. Air Canada also expects that the Canadian dollar will trade, on average, at C$1.41 per U.S. dollar in the first quarter of 2016 and for the full year 2016 and that the price of jet fuel (taking into account fuel hedging) will average 50 cents per litre for the first quarter of 2016 and 52 cents per litre for the full year 2016.

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. 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 Annual Report may be listed without the ©, ® and ™ 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.

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ABOUT AIR CANADA

Air Canada is Canada's largest domestic, U.S. transborder and international airline and 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. In 2015, Air Canada, together with Jazz and other regional airlines operating flights on behalf of Air Canada under capacity purchase agreements, operated, on average, 1,579 daily scheduled flights to 193 direct destinations on five continents, comprised of 63 Canadian cities, 53 destinations in the United States and a total of 77 cities in Europe, the Middle East, Asia, Australia, the Caribbean, Mexico and South America. In 2015, Air Canada carried over 41 million passengers, an increase of nearly 7% from 2014.

At December 31, 2015, Air Canada mainline operated a fleet of 171 aircraft, comprised of 74 Airbus narrow-body aircraft, 60 Boeing and Airbus wide-body aircraft and 37 Embraer 190 regional jets, while Air Canada *rouge* operated a fleet of 39 aircraft, comprised of 20 Airbus A319 aircraft, four Airbus A321 aircraft and 15 Boeing 767-300 aircraft, for a total fleet of 210 aircraft.

The continued renewal and expansion of Air Canada's wide-body fleet continues to be a key element of its strategy to profitably develop its international network, and to become a global champion. In 2015, Air Canada took delivery of six Boeing 787 aircraft (for a total of 12 Boeing 787 aircraft since 2014). These aircraft, with their lower operating costs, mid-size capacity and longer range, are driving new opportunities for profitable growth at Air Canada and allowing the airline to operate routes previously operated with Boeing 767 aircraft more efficiently.

In order to improve the airline's profitability and competitive position in the leisure markets, a travel leisure group was created at Air Canada in 2012. The Air Canada Leisure Group represents a coordinated strategy which leverages the strengths of Air Canada, Air Canada *rouge*, the airline's lower-cost leisure airline, and Air Canada Vacations. Through Air Canada *rouge*, Air Canada is improving margins on leisure routes previously operated by the mainline fleet and is pursuing opportunities in international leisure markets made viable by Air Canada *rouge*'s more profitable cost structure. Air Canada Vacations is a leading Canadian tour operator, developing, marketing and distributing vacation travel packages, operating in the outbound leisure travel market (Caribbean, Mexico, U.S., Europe, Central and South America, South Pacific, Australia and Asia) and also offering cruise packages in North America, Europe and the Caribbean.

Air Canada enhances its domestic and transborder network through capacity purchase agreements ("CPAs") with regional airlines, namely Jazz, Sky Regional, Air Georgian Limited ("Air Georgian") and Exploits Valley Air Services Ltd. ("EVAS"), which operate flights on behalf of Air Canada under the Air Canada Express® banner. These carriers form an integral part of the airline's international network strategy as they provide valuable traffic feed to Air Canada and Air Canada *rouge* routes. At December 31, 2015, the Air Canada Express fleet was comprised of 43 Bombardier regional jets, 85 Bombardier Dash-8 turboprop aircraft, 15 Embraer 175 aircraft and 17 Beech 1900 aircraft, for a total of 160 aircraft. As part of Air Canada's continued focus on cost reduction, on February 2, 2015, Air Canada and Jazz concluded an amended and extended capacity purchase agreement ("Jazz CPA") which allows for significant cost reductions, a stronger relationship and better alignment of interests over the long term.

Air Canada is a founding member of the Star Alliance® network. Through the 28 member Star Alliance® network, Air Canada is able to offer its customers access to approximately 1,300 destinations in 192 countries, as well as reciprocal participation in frequent flyer programs and use of airport lounges and other common airport facilities.

Through its relationship with Aimia Canada Inc. (formerly Aeroplan Canada Inc. and referred to as "Aeroplan" in this Annual Report), Air Canada's loyalty program provider, Air Canada is able to build customer loyalty by offering those customers who are Aeroplan members the opportunity to earn Aeroplan Miles when they fly with Air Canada and with the 27 other Star Alliance® member airlines. Aeroplan is also Air Canada's single largest customer. The relationship with Aeroplan is designed to provide a stable and recurring source of revenue from the purchase of Air Canada seats by Aeroplan, which in turn are provided to Aeroplan members who choose to redeem their Aeroplan Miles for travel on Air Canada. Additionally, Aeroplan members may also choose to redeem their Aeroplan Miles for travel with the Star Alliance® member airlines. Furthermore, Aeroplan members who are among Air Canada's most frequent flyers are recognized and rewarded through Air Canada Altitude®, a frequent flyer program delivering a range of premium travel privileges and benefits depending on the status level they have reached.

Air Canada also generates revenue from its cargo division. Air Canada Cargo provides direct cargo services to over 150 Canadian, U.S. transborder and international destinations and has sales representation in over 50 countries. Air Canada Cargo is Canada's largest provider of air cargo services as measured by cargo capacity. Air cargo services are provided on domestic and U.S. transborder flights and on international flights between Canada and major markets in Europe, Asia, South America and Australia.

04 STRATEGY

Air Canada's principal objective is to be among the best global airlines, to continually improve customer experience and employee engagement, and to create value for its shareholders. Air Canada is pursuing its principal goal of becoming a global champion through its focus on four core strategies:

- Identifying and implementing cost reduction and revenue generating initiatives;
- Pursuing profitable international growth opportunities and leveraging competitive advantages to appropriately enhance margins, in large part by increasing connecting traffic through existing and new international gateways and expanding and competing effectively in the leisure market to and from Canada;
- Engaging customers by continually enhancing their travel experience and providing a consistently high level of customer service, with additional emphasis on premium and business passengers and products;
- Fostering positive culture change through employee engagement programs, including meaningful investments in required training and other tools, that promote an appreciation of how the airline and its employees can work together in a supportive and enriching environment to successfully realize Air Canada's goals and objectives, including delivering top customer care.

REVENUE ENHANCEMENT AND COST TRANSFORMATION

Margin improvement through sustainable cost transformation and profitable revenue enhancements remains a key priority at Air Canada. Air Canada continues to seek and implement measures to meaningfully reduce unit costs and enhance margins, including through fleet modernization and greater fleet productivity. Additionally, Air Canada continually seeks to improve its ability to generate incremental passenger and ancillary revenue.

Key Achievements in 2015

- Increased EBITDAR margin by 5.7 percentage points when compared to 2014.
- Reduced CASM by 9.3% from 2014. Adjusted CASM decreased 0.2% from 2014. Had the Canadian-U.S. dollar exchange rate remained at 2014 levels, adjusted CASM would have decreased 3.6% when compared to 2014.
- Implemented a new passenger revenue management system to optimize the airline's revenue performance by selling on the basis of a passenger's full trip itinerary rather than on individual flight legs.
- Continued to successfully expand Air Canada *rouge*, the airline's leisure carrier, which has significantly lower operating costs. The Air Canada *rouge* fleet is estimated to generate 25% lower CASM when compared to the same aircraft in the mainline fleet.
- Introduced an additional six Boeing 787 aircraft into the mainline fleet, allowing the airline to operate routes previously operated with Boeing 767 aircraft more efficiently and permitting the airline to pursue new, profitable international growth opportunities.
- Concluded an amended and extended capacity purchase agreement with Jazz. The agreement provides both parties with greater stability and significant cost reductions through a better alignment of their interests. Air Canada estimates that the new agreement will result in financial value of approximately $550 million until December 31, 2020 (the date the previous capacity agreement was to expire) when compared to the previous capacity purchase agreement. Post-2020, Air Canada expects Jazz will provide competitive costs and continued high service levels which will benefit Air Canada.

Ongoing Initiatives

Air Canada continues to take tangible steps to pursue its strategy for sustained value creation and profitability through the execution of new and ongoing strategic initiatives. These include:

AIR CANADA *ROUGE*

The continued strategic expansion of Air Canada *rouge* in conjunction with Air Canada's mainline fleet growth continues. Since its first flight in July 2013, the leisure carrier has been deployed to a growing number of Caribbean destinations and select leisure destinations in the United States and in Canada, as well as in international leisure markets where demand is highly elastic and responds positively to lower-priced, non-stop capacity. Air Canada *rouge*'s ability to leverage the strengths of Air Canada, including its extensive network with enhanced connection options, operational expertise and frequent flyer program, is a further competitive advantage, offering additional customer benefits vis-à-vis its competitors. Air Canada *rouge* may operate up to 50 aircraft (comprised of 25 narrow-body aircraft and 25 Boeing 767 aircraft). At December 31, 2015, Air Canada *rouge* operated 39 aircraft and expects to have a total of 50 aircraft in its fleet by summer of 2017.

Air Canada *rouge* pursues a long-term cost structure consistent with that of its leisure market competitors, effectively lowering CASM on leisure routes through increased seat density, lower wage rates, more efficient work standards, and reduced overhead costs. This is yielding enhanced margins and providing new opportunities for profitable growth in international leisure markets. The Air Canada *rouge* fleet is estimated to generate 25% lower CASM when compared to the same aircraft in the mainline fleet. Air Canada *rouge* has exceeded management expectations since its launch in 2013 and is delivering enhanced margins on leisure routes previously operated by Air Canada's mainline fleet. Air Canada *rouge* has been further strengthened by the additional flexibility provided through terms of new labour agreements with the unions representing its flight attendants and pilots.

Fleet Improvement Initiatives

CONTINUED INTRODUCTION OF FUEL-EFFICIENT BOEING 787 AIRCRAFT

In 2015, Air Canada took delivery of an additional six Boeing 787 Dreamliners, for a total of 12 Boeing 787 Dreamliners delivered since 2014 (from its firm order for 37 Boeing 787 Dreamliners, comprised of eight Boeing 787-8 and 29 Boeing 787-9 aircraft). Air Canada plans to take delivery of the remaining 25 Boeing 787-9 aircraft on firm order by the end of 2019, including nine in 2016.

RECONFIGURATION OF BOEING 777 AND AIRBUS A330-300 AIRCRAFT

In order to improve the economics of its Boeing 777 long-haul fleet and to provide customers with a product consistent with its new Boeing 787 Dreamliners, in late 2015, the airline began converting 12 Boeing 777-300ER and six Boeing 777-200LR aircraft into a more cost effective and competitive configuration, adding a premium economy cabin and refurbishing the international business class cabin to the new Boeing 787 state-of-the-art standard. Air Canada plans to complete the conversion of these aircraft in the first half of 2016. The capital expenditure related to this program is approximately $300 million with a projected payback period of less than three years. Air Canada will also be reconfiguring its fleet of eight Airbus A330-300 aircraft to allow the airline to compete more effectively and to offer customers the option of its new Premium Economy cabin. Conversion of the Airbus A330 aircraft is expected to begin in the second half of 2016 for completion during the first quarter of 2017.

NARROW-BODY FLEET RENEWAL PROGRAM

In the first quarter of 2014, Air Canada entered into agreements with The Boeing Company ("Boeing") for firm orders, options and certain rights to purchase up to 109 Boeing 737 MAX narrow-body aircraft to replace the existing mainline fleet of Airbus narrow-body aircraft. Deliveries are scheduled to begin in 2017 with two aircraft, with the remaining firm aircraft deliveries scheduled from 2018 to 2021. Air Canada estimates that the projected fuel burn and maintenance cost savings on a per seat basis of greater than 20% will generate a CASM reduction of approximately 10% as compared to the airline's existing narrow-body fleet. Twenty Embraer 190 aircraft will also be exiting the fleet to be replaced by three Airbus A321 and two Airbus A320 aircraft (leased from third parties) until the airline takes delivery of the Boeing 737 MAX aircraft. In addition, Air Canada expects to retain five Boeing 767 aircraft in 2016, which it had originally planned to remove from its fleet. The replacement of the 20 Embraer 190 aircraft with the five Airbus narrow-body aircraft and the five Boeing 767 wide-body aircraft is expected to drive a CASM reduction of 10% when compared to the existing Embraer 190 fleet.

Other Revenue Optimization and Cost Reduction Initiatives

Air Canada is committed to fostering a culture of continuous cost transformation and revenue improvement across the organization. To this end, Air Canada's Business Transformation team increasingly pursues its mission to identify and drive initiatives through productivity enhancements, process reforms and other measures. Initiatives may entail revising business and operational processes, including supply chain and maintenance operations, improving employee productivity and asset utilization, and promoting workplace policies to drive revenue and reduce costs. Below are a few such initiatives:

- Airport Continuous Improvement Program – The airline is implementing a continuous improvement program at all major airports that will optimize supplier arrangements and reduce aircraft turnaround times.

- Distribution Channels – Air Canada is actively reviewing all channels of distribution with the goal of expanding margins and broadening these channels.
- Website and Mobile Apps – In 2016, Air Canada plans to further invest in its website and mobile applications to increase its digital presence and consumer direct reach while improving the customer experience.
- Airport Fees – Air Canada is working with airport authorities to lower its airport user fees and continues to benefit from its enhanced commercial relationship with the Greater Toronto Airports Authority ("GTAA"), which allows Air Canada to more profitably target a larger share of international connecting traffic flows at Toronto Lester B. Pearson International Airport ("Toronto Pearson").
- Ancillary Offerings – In 2015, Air Canada's ancillary revenue per passenger increased 16% when compared to 2014. This revenue growth was achieved through on-board retail and other "à la carte" services, such as those related to baggage, ticket changes, seat selection and preferred seating, as well as upgrades. To better monetize its ancillary offerings and increase related revenues, Air Canada is further developing its newly implemented merchandising tool, to allow Air Canada to customize, differentiate and combine its product offerings. Air Canada is also generating revenues from its on-board offerings, including food, beverage, duty-free shopping, in-flight entertainment and on-board Wi-Fi.
- Financial Card Strategic Relationships – The airline's financial card partnerships in conjunction with Aeroplan also help bolster ancillary revenues and enhance cardholders' travel experience by providing complimentary travel benefits, such as complimentary first checked baggage, priority check-in and Maple Leaf™ Lounge access.

INTERNATIONAL GROWTH

Air Canada is specifically focused on seeking new international growth opportunities to generate increased profit and diversify its network which also lowers its risk profile. In 2016, almost 90% of the airline's planned growth in capacity is occurring in international markets, of which approximately one-third is aimed at serving new international routes. Air Canada's growth strategy focuses on the selective expansion of the airline's network and the development of additional synergies offered by alliances with foreign carriers. International growth is being pursued on a lower-cost basis, primarily through the introduction of new Boeing 787 aircraft, increased seating on Boeing 777 and Airbus A330 aircraft, and by an increase in flights operated by Air Canada *rouge*.

Key Developments in 2015

- Introduced non-stop Air Canada service from Toronto to Amsterdam, Delhi and Dubai.
- Introduced non-stop seasonal Air Canada *rouge* service from Montréal to Venice and from Vancouver to Osaka.
- Increased Air Canada mainline service to Paris to double-daily from daily from both Montréal and Toronto in the summer season.
- Increased Air Canada *rouge* seasonal service from Toronto to Athens and Barcelona to daily from five-times-weekly; from Montréal to Athens to four-times-weekly from two-times-weekly; and from Montréal to Barcelona to three-times weekly from two-times-weekly.
- Introduced a new codeshare agreement on non-stop Beijing-Montréal service with Air China to improve air travel connectivity between Canada and China.
- Transferred to Air Canada *rouge* the year-round service from Toronto Pearson to Fort Lauderdale, Lima, Panama City and Sarasota; from Montréal to Fort Lauderdale, Punta Cana and Varadero; and seasonal service from Vancouver to Kona.
- Introduced a new codeshare agreement with Brazil's GOL Linhas Aéreas Inteligentes to improve air travel connectivity between Canada and Brazil.
- Introduced a new codeshare agreement with Croatia Airlines to improve air travel between Canada and Croatia via common European gateways.
- Continued to significantly increase sixth freedom traffic (international-to-international, including U.S.) connecting at Air Canada's major Canadian hubs.

Air Canada has increasingly advanced tools, processes and other competitive attributes to profitably pursue international route opportunities. It has the ability to appreciably increase international-to-international traffic through its strategic international gateways in Toronto, Vancouver, Montréal and Calgary, and is broadening its network appeal through its membership in Star Alliance®, its revenue-sharing Atlantic joint venture and through numerous codeshare and interline agreements. Furthermore, Air Canada has access to Canada's wide portfolio of international route rights, and Canada's multi-ethnic demographic profile provides the airline with further opportunities to profitably capture demand for international travel. These attributes combined with Air Canada's powerful brand franchise and industry-leading products and services, allow it to leverage its network and benefit from the higher margins generally available in international markets.

In 2016, Air Canada plans to selectively and profitably expand its international services by leveraging its new aircraft and improved cost structure, and by exploiting the following competitive advantages:

- A widely recognized brand and a strong position in the market for trans-Atlantic and trans-Pacific travel to-and-from Canada and to-and-from North and South America via Canada.
- An extensive and expanding global network, enhanced by the airline's membership in Star Alliance®, numerous codeshare agreements and participation in a revenue sharing trans-Atlantic joint venture with United Airlines and Deutsche Lufthansa AG.
- A flexible fleet mix, including aircraft leases with staggered expiry dates over the next several years and aircraft that are owned and unencumbered which can be temporarily or permanently removed from the fleet, which enables the airline to redeploy or otherwise manage capacity to match changes in demand.
- Air Canada Altitude™, Air Canada's frequent flyer program, which recognizes the airline's more frequent flyers by offering them a range of exclusive travel privileges, including the benefits derived from Air Canada's partnership with the Aeroplan program, which allows all customers to earn and redeem Aeroplan Miles with Canada's leading coalition loyalty program.
- Competitive products and services, including lie-flat beds in the International Business Class cabin, concierge services and Maple Leaf™ Lounges.
- Geographically well-positioned hubs (Toronto, Montréal, Vancouver and Calgary) with excellent in-transit facilities, accentuating the advantages of flying Air Canada through an improved travel experience for customers travelling to or from the U.S. from or to Asia and Europe.
- Favourable slot times at busy airports, including Beijing, Shanghai, Hong Kong, Tokyo-Narita, Tokyo-Haneda, Paris-Charles de Gaulle, Frankfurt, London-Heathrow, New York-LaGuardia, and Washington-Ronald Reagan National Airport.

The airline believes that it has the potential to continue to grow sixth freedom traffic over the coming years, particularly from the U.S., given its award-winning products and services, geographically well-positioned Canadian hubs, extensive network and other competitive advantages. Toronto Pearson has a strategic advantage due to its proximity to densely populated major markets in the U.S. and the city is also a destination for a large number of business and leisure travellers. Moreover, Air Canada and its Star Alliance® partners' operations are consolidated in one terminal, and Toronto Pearson has efficient in-transit facilities that allow passengers and their bags to move seamlessly between Canadian and U.S. Customs and Immigration. For several years, Air Canada has worked closely with the GTAA to transform Toronto Pearson into a leading North American airport and gain a greater share of the global sixth freedom market.

Air Canada is growing its Vancouver hub into a premier gateway to Pacific Asia and invigorating Montréal as a gateway to French international markets. With the new flights being introduced between Vancouver and cities across North America, Air Canada is poised to offer some of the shortest elapsed travel time between continental North America and Pacific Asia, providing travellers with a better travel experience. Montréal's development into a francophone hub not only links North America with key markets in France, but also positions Montréal as a premier gateway to the Atlantic.

The development of commercial alliances with major international carriers is another important element of Air Canada's business strategy. These arrangements provide Air Canada with an effective means to leverage expansion and broaden its network offerings. Air Canada also achieves this through its membership in Star Alliance® which is comprised of 28 members and through its participation in a transatlantic revenue sharing joint venture with United Airlines and Deutsche Lufthansa AG, referred to as A++. By coordinating pricing, scheduling and sales (under such joint venture), Air Canada is better able to serve customers by offering more travel options, while reducing travel times. It can also achieve greater critical mass and network scope through numerous codeshare and interline agreements. Air Canada code shares with all Star Alliance® members, with the exception of Adria Airways, Copa, Shenzhen Airlines and Avianca in Brazil. In July 2015, Air Canada and Croatia Airlines entered into a codeshare agreement to improve air travel between Canada and Croatia via common European gateways. Furthermore, at the end of February 2016, Air Canada will introduce a codeshare agreement with EVA Air applicable for select Asian gateways and domestic Canadian points to enhance travel between Canada and Taiwan. Air Canada also code shares with a number of carriers who are not members of Star Alliance®. These include Aer Lingus, Etihad, Jet Airways, Middle East Airlines and SriLankan. In 2015, Air Canada and Brazil's GOL Linhas Aéreas Inteligentes introduced a new codeshare agreement to improve air travel connectivity between Canada and Brazil. In May 2015, Air Canada and Air China announced that they were preparing for the launch of non-stop flights between Beijing and Montréal, creating the first direct trans-Pacific link between Asia and Montréal. Air China commenced flights on September 29, 2015, initially three-times-weekly with a Boeing 777-300ER aircraft and Air Canada has placed its code for sale on the flights. In a second phase, subject to agreement of terms and requisite approvals by the relevant competition authorities, Air Canada and Air China intend to form a comprehensive revenue sharing joint venture in respect of all their flights between China and Canada.

CUSTOMER ENGAGEMENT

Providing a consistently high level of customer experience and growing the airline's premium customer base continue to be very important aspects of Air Canada's business strategy. Air Canada continually strives to improve customer loyalty and generate positive referrals for new customers. The airline recognizes that its continued success is dependent on consistently delivering superior value and innovative products, providing the highest levels of customer service and anticipating the changing needs of customers.

Key Achievements in 2015

In 2015, Air Canada earned the following important industry awards, validating its customers' appreciation of the airline's extensive network, alliance relationships and leading products and services, as well as their recognition of the dedication and professionalism of Air Canada's employees.

- Four-Star ranking by Skytrax for Air Canada's overall product and customer service offering. Air Canada was first awarded the designation in January 2013, distinguishing it as the only Four-Star airline in North America and placing it among a select group of carriers worldwide to have earned the distinction.
- "Canada's favourite airline for business travel" in the Ipsos Reid Business Traveller Survey. Air Canada was preferred by 86% of Canadian frequent business travellers surveyed in 2015, an improvement of 17 percentage points in the airline's ratings in the national survey over the past seven years. The survey showed strong ratings and improvements in customer preference for Air Canada's frequent flyer reward program, flight schedule, business class service and Maple Leaf Lounges. Among other things, the survey found:
    - Overall satisfaction with Air Canada's service climbing three percentage points over last year;
    - 95% of respondents intending to use Air Canada for business travel in the coming year, an increase of three percentage points over the previous year;
    - Air Canada as the preferred airline from Canada to the U.S. for 67% of respondents, an improvement of nine percentage points over the past seven years; and
    - Air Canada as the airline flown most often when going to the U.S. for 60% of respondents, an increase of 10 percentage points over the past seven years.

- "Leading airline in customer loyalty in North America" by the Brand Keys 2015 Customer Loyalty Engagement Index.
- "Favourite Scheduled Airline" for the 6th consecutive year at the 2015 Baxter Travel Media Agents' Choice Award.
- Winner of the "First Class Lounge" design category in the Aviation Sector of the International Yacht and Aviation Awards for Air Canada's Maple Leaf Lounge in London's Terminal 2.

Investing in products and services is vital to engaging customers. The 787 Dreamliner, with its newly-designed cabins and next generation in-flight entertainment, has been enthusiastically received and Air Canada is introducing the 787's three-cabin international product and seating standard on all 23 Boeing 777-300ER and 777-200LR aircraft and in the two new Boeing 777-300ER aircraft to be delivered in 2016. The airline's modern fleet, along with other attributes, such as its expansive global network, International Business Class service, Maple Leaf Lounges, concierge service, and Aeroplan and Altitude loyalty programs, are designed to further boost Air Canada's leading position as the carrier of choice among Canadian business travellers.

Air Canada Altitude is designed to enhance the travel experiences of its most frequent flyers. Program members benefit from a wide range of privileges, including priority travel services, upgrades to Business and Premium Economy classes and recognition across the Star Alliance® network. Altitude members also benefit from Air Canada's partnership with the Aeroplan program, which provides a wide range of ways to earn and redeem valuable Aeroplan Miles, including flights to over 1,200 destinations worldwide. In 2016, the airline will continue to optimize Altitude's constructs to improve its value and capacity to profitably engage members.

Another program, entitled "Air Canada Corporate Rewards", is designed to help businesses of all sizes save on business travel while earning rewards and benefitting from special offers. Members are eligible for flight discounts and services and can take advantage of exclusive services such as eUpgrade credits, access to Air Canada's Maple Leaf Lounges and preferred seat selection. In addition, with the Lufthansa Group joining the program (comprised of Lufthansa, Austrian Airlines, Brussels Airlines and SWISS), these features are available when flying with member airlines for travel between Canada and Europe, the Middle East, Africa and India. The program also offers an intuitive online tool to easily book business travel, reserve cars, manage and share itineraries and keep track of both travel expenses and program rewards.

Furthermore, Air Canada has preferred seats available on its entire mainline fleet and has made it easier for customers to conveniently purchase these seats when booking or at any time prior to boarding, including through its website, its airport kiosks or mobile devices. Most preferred seats are located near the front of the aircraft, enabling customers to disembark more quickly at their destination.

Air Canada is the first Canadian carrier to offer customers in-flight Wi-Fi connectivity on select North American flights. Air Canada is offering Wi-Fi on most of its mainline narrow-body aircraft within North America, including the Airbus A319, A320 and A321 and Embraer 190 aircraft, as well as its Air Canada Express Embraer 175 aircraft and Bombardier CRJ-705 – more Wi-Fi enabled aircraft than any other Canadian airline. The targeted completion date for the entire narrow-body fleet, with 131 aircraft designated, is the first quarter of 2016. Air Canada is also currently planning for the introduction of Wi-Fi connectivity on its Air Canada *rouge* and wide-body fleets.

To remain competitive within the digital ecosystem, in 2015, Air Canada strengthened its online presence to offer a responsive design experience for traditional web users, while also meeting the increased demands from tablet and mobile users. The enhancement ensures that customers, regardless of device and screen size, can seamlessly interact with Air Canada and access its products and services.

Furthermore, important initiatives are underway to improve the overall customer airport experience. For example, the airline has instituted zonal boarding, aligning its boarding process with industry best practices. For customers in the U.S., Air Canada offers TSA Pre-check, allowing eligible customers to experience expedited, more efficient security screening for flights out of American airports, and it has also made electronic boarding passes available through mobile devices at all U.S. airports. This feature is being expanded to include certain international (non-U.S.) destinations. Air Canada also introduced enhanced self-service check-in for passengers with checked baggage in collaboration with the Halifax International Airport Authority. This is the first airport in North America where passengers are required, with certain exceptions, to use the standard self-tagging process and then induct their own checked baggage using new-generation bag drop technology. The airline has removed all the traditional check-in counters for economy check-in and this new process eliminated queueing at the check-in desks. Air Canada plans on introducing this welcome improvement in Vancouver and Calgary initially, with other airports to follow.

For the comfort and convenience of premium and business customers, Air Canada operates 22 Maple Leaf™ Lounges, including three lounges in

Europe (London-Heathrow, Paris-Charles de Gaulle and Frankfurt), two lounges in the United States (Los Angeles International Airport and New York-LaGuardia) and 16 lounges across Canada, including a recently renovated lounge at Calgary International Airport. Air Canada will be upgrading its international lounge at Montréal Trudeau International Airport and plans to open an additional lounge at Toronto Pearson. In 2015, Air Canada concluded a partnership with celebrated Canadian Chef David Hawksworth to design signature dishes to be exclusively featured in Maple Leaf Lounges and on international flights departing from Canada in International Business Class.

In 2015, Air Canada created more exclusive airport check-in areas for select Air Canada Altitude members and business class customers, in addition to offering more refined product offerings in its Maple Leaf Lounges. To further improve the customer experience for its Altitude Super Elite 100K members and customers travelling in International Business Class, the airline refurbished its concierge office at Toronto Pearson and similar upgrades are underway in Vancouver and Montréal. Additionally, Premium Agent service was launched at Toronto Pearson for premium customers, offering an elevated level of personalized service at key customer touch points. Air Canada plans to introduce this premium airport service in all of its Canadian and U.S. hubs in 2016.

Air Canada is implementing a new customer relationship management system to gain valuable insights in customer travel patterns and preferences and to deliver a more personalized and satisfying customer experience. This new system will also allow Air Canada to more effectively target its product offerings to stimulate traffic, increase yields and improve customer loyalty. The first phase of the implementation is expected to be completed by the end of 2016.

In 2015, key customer service employee training programs were initiated across the system, including "Applause" and "Managing the AC Way" training, directed at all customer-facing groups. Furthermore, a special customer service training program for a new Premium Agent service was launched, initially in Toronto, with plans to expand the program in 2016. Air Canada has also developed customized language training for customer-facing employees to ensure that customers receive service in their language of choice and offers customized programs geared towards specific employee groups to encourage professional development and growth. These programs are supplemented by internal networking opportunities and cross-branch projects that allow Air Canada to build on corporate values and priorities among its employees.

CULTURE CHANGE

A healthy and dynamic corporate culture is a competitive advantage that can significantly impact Air Canada's long-term performance. A cornerstone of Air Canada's business strategy is the transformation of its corporate culture to one that embraces leadership and accountability. Air Canada is fostering positive culture change by promoting entrepreneurship, engagement, empowerment and pay for performance. It seeks to create a sense of purpose, shared values and common goals among employees and regularly communicates through multiple channels the rationale behind its strategic initiatives and the importance of adapting to changing market conditions. Recently this includes an increased focus on town hall meetings across the network and through social media. This is reinforced by continual and consistent emphasis of the four corporate priorities at every opportunity since their adoption in 2009.

Employee surveys conducted in 2010 and 2014 demonstrated a significant improvement in employee engagement over that period. The results suggested that most employees are familiar with Air Canada's key priorities and believed that the airline is on the right track towards stability. Generally, employees agreed culture change is transforming the workplace and they revealed their pride in working for Air Canada. Furthermore, the results indicated that employees share a heightened sense of community and teamwork. In 2015, Air Canada continued to make progress in employee engagement and satisfaction. The results of a management survey indicated an improving opinion that Air Canada is on the right path to sustainable profitability. The results also revealed an increase in pride in working for Air Canada and suggested that managers strongly believe that Air Canada is a good company to work for. Perception of senior managers has also improved, particularly in areas of awareness of customer-facing issues and a sense of caring about employees. An indication of improved employee engagement is evidenced by the successful launch, in late 2015, of the airline's Shine recognition program. Through Shine, employees can show appreciation for each other's contributions in various ways through social media. This program allows public online recognition of fellow employees and enables employees to award each other points which can be exchanged for merchandise and e-gifts. This is in addition to the established Award of Excellence recognition program which annually honours employees, chosen by their peers, for their outstanding performance both at work and in the community.

The cross-functional approach of Air Canada's Operational Excellence team is also driving employee engagement while increasing customer satisfaction levels. Air Canada has initiatives in place to ensure that all employees understand how the airline and its employees work together to deliver on the customer promise. These include a comprehensive employee on-boarding experience, integrated management practices, as well as development programs intended to cultivate Air Canada's leadership behaviours and values. Customer-facing, management and emerging leaders are targeted for various programs – all designed around the principles of customer orientation, innovation and promoting the importance of brand loyalty.

Air Canada's cultural evolution entails continuous improvement, learning and empowerment, all geared towards ensuring employees feel valued and have a sense of purpose. Employees are more likely to embrace the new culture if they take an active part in Air Canada's transformation. As such, Air Canada encourages employee feedback and ideas as employees are in an optimal position to identify improvements and changes necessary for success. In 2014 and 2015, Air Canada's Human Resources and Operations Excellence teams conducted focus groups for management and customer-facing employees across the system on areas of customer service improvement. This proved to be a valuable opportunity to connect with and validate the opinions and ideas of employees and, as a result of these and other focus groups, Air Canada launched its Employee Value Proposition.

In 2016, Air Canada's Human Resources team will further expand on employee engagement and development though a continued suite of learning initiatives designed to support brand and customer loyalty. This will include various levels of management and customer-facing employees, with a particular focus on leadership and accountability. Other improvements are being made to enhance the overall Human Resources experience for employees and managers through developing and delivering on client-facing strategies, enabling web and mobile-based technology, and adopting best practice policies and processes.

Recent Labour Agreements

Since the fourth quarter of 2014, Air Canada entered into multiple long-term labour agreements with unions representing its unionized workforce, a concrete indication of the collaborative partnership supporting its transformation into a global champion. These agreements include the following:

- Unifor (Customer Service and Sales Agents) – In the second quarter of 2015, Air Canada and Unifor, representing the airline's approximately 4,000 customer service and sales agents, concluded a new contract providing collective agreement terms for five years, ending February 28, 2020.
- CUPE (Flight Attendants) – In the fourth quarter of 2015, Air Canada and CUPE, representing over 7,000 flight attendants, concluded a new contract providing collective agreement terms for 10 years, ending March 31, 2025, subject to certain renegotiation provisions over this period.
- IAMAW (Maintenance, Operations and Baggage) – In the first quarter of 2016, Air Canada and the IAMAW, representing approximately 7,500 technical maintenance, operational support and airport baggage handlers, concluded a new contract providing collective agreement terms for 10 years, ending April 1, 2026, subject to certain renegotiation provisions over this period.
- ACPA (Pilots) – In the fourth quarter of 2014, Air Canada and ACPA, representing approximately 3,000 pilots, concluded a new contract providing collective agreement terms for 10 years, ending September 29, 2024, subject to certain renegotiation provisions and benchmarks over this period.
- CALDA (Dispatchers) – In the first quarter of 2016, Air Canada and CALDA, representing flight dispatchers, concluded a new contract providing collective agreement terms for 12 years, ending February 29, 2028, subject to certain renegotiation provisions over this period.

Another indicator of positive culture change is Air Canada's selection in 2015, for the third consecutive year, as one of "Canada's Top 100 Employers" for 2016, in an annual survey by Mediacorp Canada. The national competition recognizes employers with exceptional human resources programs and forward-thinking workplace policies after editors conducted a detailed review of company operations and Human Resources practices, including a comparison of others in their industry and region. Mediacorp editors grade employers on eight criteria, which have remained consistent since the project began 16 years ago: physical workplace; work atmosphere and social; health, financial and family benefits; vacation and time-off; employee communications; performance management; training and skills development; and community involvement. The editors publish detailed reasons for selection and grades for these criteria, providing transparency in the choice of winners and a catalogue of best practices for employers and job seekers alike. In selecting Air Canada, Mediacorp cited a number of employee programs at the company including the range of in-house training programs available from language, technical and flight training, to the company's formal online Air Canada University, and the Air Canada Foundation's charitable work done with children. Air Canada was ranked 8th nationally (and regionally in Quebec) as one of Canada's preferred employers in an Ipsos Reid survey, where 5,500

Canadians ranked 180 top name brand companies in terms of desirability of employment.

Air Canada was recognized for the third year in a row as one of "Montréal's Top Employers" in an annual employer survey by Mediacorp Canada Inc. The 2016 survey recognizes employers with exceptional human resources programs and forward-thinking workplace policies after editors conducted a detailed review of operations and human resources practices, including a comparison of others in the industry and region.

In 2015, Air Canada released Citizens of the World, the airline's fourth corporate sustainability report. The document provides an update on Air Canada's performance during 2014 in four key areas of sustainability: safety, the environment, employee well-being, and the airline's community involvement.

To encourage the development of a corporate culture, which is focused on transformation and performance, Air Canada has a profit sharing program that rewards eligible employees for their contributions and shares with them the financial success of the airline. Based on the financial results for the year ended December 31, 2015, the profit sharing program will provide a significant increase in total payout in early 2016 for the 2015 fiscal year as compared to the 2014 fiscal year, which itself was a record. Air Canada employees also have the ability to participate in the airline's Employee Share Ownership Plan. As at December 31, 2015, in aggregate, 23,220,446 shares or 8% of total issued and outstanding shares of Air Canada were held by Air Canada employees and unions under various programs, including 17,647,059 shares held under a trust arrangement in connection with pension arrangements concluded in 2009.

In 2016, the airline will continue to promote employee awareness of the importance of Air Canada achieving its financial goals and communicate the message that a healthy financial profile can provide stability, lower risk and support growth opportunities.

OVERVIEW

In 2015, Air Canada generated adjusted net income of $1,222 million, an improvement of $691 million from 2014. Adjusted net income is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information. On a GAAP basis, Air Canada reported 2015 operating income of $1,496 million compared to operating income of $815 million in 2014, an improvement of $681 million. Net income of $308 million in 2015 increased $203 million from 2014.

In the fourth quarter of 2015, Air Canada generated adjusted net income of $116 million, an improvement of $49 million from the fourth quarter of 2014. On a GAAP basis, Air Canada reported fourth quarter 2015 operating income of $158 million compared to operating income of $106 million in the fourth quarter of 2014, an improvement of $52 million. Air Canada recorded a net loss of $116 million in the fourth quarter of 2015 versus a net loss of $100 million in the same quarter in 2014.

FULL YEAR 2015 FINANCIAL SUMMARY

The following is an overview of Air Canada's results of operations and financial position for the full year 2015 compared to the full year 2014.

- Operating revenues of $13,868 million, an increase of $596 million or 4% from 2014.
- An ASM system capacity increase of 9.4% from 2014 (comprised of domestic capacity growth of 3.5% and international capacity growth of 11.9%), in line with the 9.0% to 10.0% system capacity increase projected in Air Canada's news release dated November 5, 2015. The capacity increase in international markets was driven by the growth of Air Canada *rouge* and the introduction of Boeing 787 aircraft into the mainline fleet.
- Passenger revenues of $12,420 million, an increase of $616 million or 5.2% from 2014. PRASM declined 4.4% from 2014 on a 4.6% decline in yield (which is consistent with the anticipated yield impact stemming from the implementation of the airline's strategic plan). Factors contributing to the yield decrease included an increase in average stage length of 3.2%, which had the effect of reducing system yield by 1.8 percentage points; a higher proportional growth of lower-yielding international-to-international passenger flows; a higher proportion of seats into long-haul leisure markets; and a reduction in carrier surcharges relating to lower fuel prices, particularly where carrier surcharges are regulated. The favourable impact of a weaker Canadian dollar on foreign currency denominated passenger revenues, which increased passenger revenues by $317 million in 2015, was a partly offsetting factor.
- A CASM reduction of 9.3% from 2014. On an adjusted basis, CASM decreased 0.2% from 2014, in line with the up to 1.0% decrease projected in Air Canada's news release dated November 5, 2015. Had the Canadian-U.S. dollar exchange rate remained at the 2014 level, adjusted CASM would have decreased 3.6% when compared to 2014. Adjusted CASM is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Operating expenses of $12,372 million, a decrease of $85 million or 1% from 2014. This decrease was mainly due to the impact of lower base jet fuel prices (before the impact of foreign exchange but taking into account fuel expense related to regional airline operations) which decreased operating expenses by $1,527 million in 2015. This decrease was largely offset by the impact of the 9.4% capacity growth and the unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses which increased operating expenses by $674 million in 2015 (comprised of $348 million relating to aircraft fuel expense and an aggregate of $326 million relating to non-fuel operating expenses). Special items, further described in section 6 of this MD&A, increased operating expenses by $8 million in 2015 while special items reduced operating expenses by $11 million in 2014.
- EBITDAR of $2,534 million compared to EBITDAR of $1,671 million in 2014, an increase of $863 million. Air Canada recorded an EBITDAR margin of 18.3% compared to an EBITDAR margin of 12.6% in 2014, an improvement of 5.7 percentage points, and better than the 15-18% annual EBITDAR margin projected in Air Canada's news release dated June 2, 2015. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Net income of $308 million or $1.03 per diluted share compared to net income of $105 million or $0.34 per diluted share in 2014, an increase of $203 million or $0.69 per diluted share. Net income in 2015 included foreign exchange losses

of $762 million while net income in 2014 included foreign exchange losses of $307 million.

- Adjusted net income of $1,222 million or $4.18 per diluted share compared to adjusted net income of $531 million or $1.81 per diluted share in 2014, an increase of $691 million or $2.37 per diluted share. Adjusted net income is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Net cash flows from operating activities of $2,012 million, an improvement of $1,058 million, largely due to the improvement in operating income and the impact of lower pension past service funding payments. Free cash flow of $197 million improved $744 million from 2014, driven by higher cash flows from operating activities partly offset by higher capital expenditures when compared to 2014. The higher level of capital expenditures was primarily driven by the delivery of four Boeing 787-9 and two Boeing 787-8 aircraft in 2015. Free cash flow (net cash flows from operating activities less additions to property, equipment and intangible assets) is a non-GAAP financial measure. Refer to section 9.5 "Consolidated Cash Flow Movements" of this MD&A for additional information.
- Adjusted net debt amounted to $6,291 million at December 31, 2015, an increase of $1,159 million from December 31, 2014 due to higher long-term debt and finance lease balances (including current portion) partly offset by higher cash balances. The increase of $1,178 million in long-term debt and finance lease balances (including current portion) was largely due to the unfavourable impact of a weaker Canadian dollar as at December 31, 2015 compared to December 31, 2014 on Air Canada's foreign currency denominated debt (mainly U.S. dollars) which accounted for an increase of $876 million. The airline's adjusted net debt to EBITDAR ratio was 2.5 at December 31, 2015 versus a ratio of 3.1 at December 31, 2014. Adjusted net debt is an additional GAAP financial measure. Refer to section 9.3 "Adjusted Net Debt" of this MD&A for additional information.
- Return on invested capital ("ROIC") for the 12 months ended December 31, 2015 of 18.3% versus 12.1% for the 12 months ended December 31, 2014, and better than the 13-16% year-over-year ROIC projected in Air Canada's news release dated June 2, 2015. ROIC is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

FOURTH QUARTER 2015 FINANCIAL SUMMARY

The following is an overview of Air Canada's results of operations and financial position for the fourth quarter of 2015 compared to the fourth quarter of 2014.

- Operating revenues of $3,182 million, an increase of $78 million or 3% from the fourth quarter of 2014.
- An ASM capacity increase of 8.4% from the fourth quarter of 2014, in line with the 7.5% to 8.5% capacity increase projected in Air Canada's news release dated November 5, 2015.
- Passenger revenues of $2,836 million, an increase of $81 million or 3.0% from the fourth quarter of 2014. PRASM declined 5.3% from the fourth quarter of 2014 on a 5.5% decline in yield (which is consistent with the anticipated yield impact stemming from the implementation of the airline's strategic plan). Factors contributing to the yield decrease included an increase in average stage length of 2.6%, which had the effect of reducing system yield by 1.5 percentage points; a higher proportional growth of lower-yielding international-to-international passenger flows; a higher proportion of seats into long-haul leisure markets; the impact of a significant increase in industry capacity and competitive pricing activities in the domestic market; and a reduction in carrier surcharges relating to lower fuel prices, particularly where carrier surcharges are regulated. The favourable impact of a weaker Canadian dollar on foreign currency denominated passenger revenues, which increased passenger revenues by $99 million in the fourth quarter 2015, was a partly offsetting factor.
- A CASM reduction of 7.0% from the fourth quarter of 2014. On an adjusted basis, CASM increased 0.8% from the fourth quarter of 2014, in line with the up to 1.0% increase projected in Air Canada's news release dated November 5, 2015. Had the Canadian-U.S. dollar exchange rate remained at the fourth quarter 2014 level, adjusted CASM would have decreased 3.5% when compared to the fourth quarter of 2014. Adjusted CASM is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.
- Operating expenses of $3,024 million, an increase of $26 million or 1% from the fourth quarter of 2014. This increase was largely due to the impact of the 8.4% capacity growth and the unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses which

increased operating expenses by $197 million in the fourth quarter of 2015 (comprised of $92 million relating to aircraft fuel expense and an aggregate of $105 million relating to non-fuel operating expenses). These increases were mostly offset by the impact of lower base jet fuel prices (before the impact of foreign exchange but taking into account fuel expense related to regional airline operations) which decreased operating expenses by $324 million in the fourth quarter of 2015. Special items, further described in section 7 of this MD&A, increased operating expenses by $31 million in the fourth quarter of 2015 while special items increased operating expenses by $30 million in the fourth quarter of 2014.

- EBITDAR of $425 million compared to EBITDAR of $319 million in the fourth quarter of 2014, an increase of $106 million. Air Canada recorded a fourth quarter 2015 EBITDAR margin of 13.4% compared to an EBITDAR margin of 10.3% in the fourth quarter of 2014, an improvement of 3.1 percentage points. In the fourth quarter of 2015, excluding special items, EBITDAR and EBITDAR margin amounted to $456 million and 14.3%, respectively. In the fourth quarter of 2014, excluding special items, EBITDAR and EBITDAR margin amounted to $349 million and 11.2%, respectively. EBITDAR is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.
- A net loss of $116 million or $0.41 per diluted share compared to a net loss of $100 million or $0.35 per diluted share in the fourth quarter of 2014. The net loss in the fourth quarter of 2015 included foreign exchange losses of $159 million while the net loss in the fourth quarter of 2014 included foreign exchange losses of $115 million.
- Adjusted net income of $116 million or $0.40 per diluted share compared to adjusted net income of $67 million or $0.23 per diluted share in the fourth quarter of 2014, an increase of $49 million or $0.17 per diluted share. Adjusted net income is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

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RESULTS OF OPERATIONS – FULL YEAR 2015 VERSUS FULL YEAR 2014

The following table and discussion compares results of Air Canada for 2015 versus 2014.

CANADIAN DOLLARS IN MILLIONS, EXCEPT PER SHARE FIGURES	FULL YEAR		CHANGE	
	2015	2014	$	%
OPERATING REVENUES				
Passenger	$ 12,420	$ 11,804	$ 616	5
Cargo	506	502	4	1
Other	942	966	(24)	(2)
TOTAL REVENUES	**13,868**	**13,272**	**596**	**4**
OPERATING EXPENSES				
Aircraft fuel	2,464	3,247	(783)	(24)
Regional airlines expense				
Aircraft fuel	359	500	(141)	(28)
Other	1,920	1,824	96	5
Wages, salaries and benefits	2,324	2,201	123	6
Airport and navigation fees	802	755	47	6
Aircraft maintenance	773	678	95	14
Depreciation, amortization and impairment	655	526	129	25
Sales and distribution costs	608	560	48	9
Ground package costs	415	377	38	10
Aircraft rent	353	302	51	17
Food, beverages and supplies	314	294	20	7
Communications and information technology	211	199	12	6
Special items	8	(11)	19	173
Other	1,166	1,005	161	16
TOTAL OPERATING EXPENSES	**12,372**	**12,457**	**(85)**	**(1)**
OPERATING INCOME	**1,496**	**815**	**681**	
NON-OPERATING INCOME (EXPENSE)				
Foreign exchange loss	(762)	(307)	(455)	
Interest income	46	39	7	
Interest expense	(402)	(322)	(80)	
Interest capitalized	70	30	40	
Net financing expense relating to employee benefits	(105)	(134)	29	
Fuel and other derivatives	(17)	(1)	(16)	
Other	(18)	(15)	(3)	
TOTAL NON-OPERATING EXPENSE	**(1,188)**	**(710)**	**(478)**	
INCOME BEFORE INCOME TAXES	**308**	**105**	**203**	
Income taxes	-	-	-	
NET INCOME	**$ 308**	**$ 105**	**$ 203**	
BASIC EARNINGS PER SHARE	**$ 1.06**	**$ 0.35**	**$ 0.71**	
DILUTED EARNINGS PER SHARE	**$ 1.03**	**$ 0.34**	**$ 0.69**	
EBITDAR (1)	**$ 2,534**	**$ 1,671**	**$ 863**	
ADJUSTED NET INCOME (1)	**$ 1,222**	**$ 531**	**$ 691**	
ADJUSTED EARNINGS PER SHARE – DILUTED (1)	**$ 4.18**	**$ 1.81**	**$ 2.37**	

1 EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent), adjusted net income (loss) and adjusted earnings (loss) per share – diluted are non-GAAP financial measures. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

SYSTEM PASSENGER REVENUES INCREASED 5.2% FROM 2014

In 2015, system passenger revenues of $12,420 million increased $616 million or 5.2% from 2014.

In 2015, business cabin system revenues increased $20 million or 0.8% from 2014 due to a yield improvement of 1.3% partly offset by a traffic decrease of 0.4%.

The table below provides passenger revenue by geographic region for 2015 and 2014.

	2015 $ MILLION	2014 $ MILLION	CHANGE $ MILLION	% CHANGE
PASSENGER REVENUE				
Canada	4,379	4,381	(2)	-
U.S. transborder	2,685	2,379	306	12.9
Atlantic	2,775	2,554	221	8.7
Pacific	1,762	1,710	52	3.0
Other	819	780	39	5.0
SYSTEM	**12,420**	**11,804**	**616**	**5.2**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for 2015 versus 2014.

	PASSENGER REVENUE % CHANGE	CAPACITY (ASMS) % CHANGE	TRAFFIC (RPMS) % CHANGE	PASSENGER LOAD FACTOR PP CHANGE	YIELD % CHANGE	PRASM % CHANGE
FULL YEAR 2015 VERSUS FULL YEAR 2014						
Canada	-	3.5	3.2	(0.2)	(4.6)	(4.9)
U.S. transborder	12.9	14.2	14.6	0.2	(1.5)	(1.2)
Atlantic	8.7	12.5	13.2	0.5	(4.0)	(3.4)
Pacific	3.0	9.1	9.4	0.2	(5.8)	(5.5)
Other	5.0	11.4	11.1	(0.2)	(5.8)	(6.0)
SYSTEM	**5.2**	**9.4**	**9.6**	**0.1**	**(4.6)**	**(4.4)**

Components of the year-over-year change in system passenger revenues included:

- The 9.6% traffic increase which reflected traffic growth in all markets. Consistent with the airline's objective of increasing global international-to-international connecting traffic through its major Canadian hubs, the traffic growth in 2015 also reflected lower-yielding incremental connecting traffic to international destinations.
- The 4.6% yield decrease which is consistent with the anticipated yield impact stemming from the implementation of the airline's strategic plan and which reflected:
  - an increase in average stage length of 3.2%, which had the effect of reducing system yield by 1.8 percentage points;
  - a higher proportional growth of lower-yielding international-to-international passenger flows in support of the airline's international expansion strategy;
  - a higher proportion of seats into long-haul leisure markets led by an increase in lower-cost flights operated by Air Canada *rouge*;
  - a decline in higher-yielding oil market-related traffic; and
  - a reduction in carrier surcharges relating to lower fuel prices, particularly where carrier surcharges are regulated such as Japan, Hong Kong, Korea and Brazil.

A favourable currency impact of $317 million was a partly offsetting factor.

DOMESTIC PASSENGER REVENUES WERE UNCHANGED FROM 2014

In 2015, domestic passenger revenues of $4,379 million remained at the 2014 level.

Components of the year-over-year change in domestic passenger revenues included:

- The 3.2% traffic increase which reflected traffic growth on all domestic services with the exception of services to the Maritimes where capacity was reduced year-over-year. Despite a capacity reduction on regional routes within Ontario and Quebec, traffic increased on these routes when compared to the same period in 2014. Also, in 2015, passenger revenues reflected incremental connecting traffic to U.S. and international destinations. Partly offsetting the traffic growth was a traffic decline in oil-related markets.
- A significant increase in baggage fee revenues following an adjustment to the airline's first checked bag policy which became effective for travel as of November 2, 2014. Baggage fee revenues are not included in Air Canada's yield and PRASM results.
- The 4.6% yield decrease which reflected:
    - the impact of increased industry capacity and competitive pricing activities;
    - higher proportional growth of lower-yielding international and U.S. transborder passenger flows in support of the airline's international expansion strategy connecting to Air Canada's routes in the domestic market;
    - a 1.4% longer average stage length which had the effect of reducing domestic yield by 0.8 percentage points in 2015; and
    - a decline in higher-yielding oil market-related traffic.

A favourable currency impact of $45 million was a partly offsetting factor.

U.S. TRANSBORDER PASSENGER REVENUES INCREASED 12.9% FROM 2014

In 2015, U.S. transborder passenger revenues of $2,685 million increased $306 million or 12.9% from 2014.

Components of the year-over-year change in U.S. transborder passenger revenues included:

- The 14.6% traffic increase which reflected traffic growth on all major U.S. transborder services. The year-over-year increase in traffic was due to strong passenger demand between Canada and the U.S. as well as growth of international-to-international passenger flows from the U.S. in support of Air Canada's international expansion strategy.
- The 1.5% yield decline which reflected a 2.3% longer average stage length, which had the effect of reducing U.S. transborder yield by 1.3 percentage points, and an increase in long-haul leisure flying led by lower-cost Air Canada *rouge*, which is allowing Air Canada to more profitably operate and effectively enhance margins on lower-yielding leisure routes. A favourable currency impact of $104 million, an improved premium cabin mix and a strong performance on U.S. short-haul routes were partly offsetting factors.

ATLANTIC PASSENGER REVENUES INCREASED 8.7% FROM 2014

In 2015, Atlantic passenger revenues of $2,775 million increased $221 million or 8.7% from 2014.

Components of the year-over-year change in Atlantic passenger revenues included:

- The 13.2% traffic increase which reflected traffic growth on all major Atlantic services with the exception of services to Germany where capacity was reduced year-over-year. The traffic increase in 2015 included traffic growth between the U.S. and Europe via the airline's major Canadian hubs, in line with Air Canada's international growth strategy, as well as incremental traffic resulting from the growth of Air Canada *rouge*.
- The 4.0% yield decline which reflected the impact of increased industry capacity and competitive pricing activities and the impact of having a higher proportion of seats in long-haul (lower-yielding) leisure markets. A favourable currency impact of $71 million and yield improvements in the business and premium economy cabins were partly offsetting factors.

PACIFIC PASSENGER REVENUES INCREASED 3.0% FROM 2014

In 2015, Pacific passenger revenues of $1,762 million increased $52 million or 3.0% from 2014.

Components of the year-over-year change in Pacific passenger revenues included:

- The 9.4% traffic increase which reflected traffic growth on all major Pacific services.
- The 5.8% yield decline which reflected a significant reduction in carrier surcharges relating

to lower fuel prices, particularly where carrier surcharges are regulated such as Japan, Hong Kong and Korea, and competitive pressures to and from Canada-Asia and to and from U.S.-Asia both in terms of added capacity and pricing. The competitive pressures impacted local, U.S. sixth freedom and beyond traffic. A favourable currency impact of $71 million was a partly offsetting factor.

OTHER PASSENGER REVENUES INCREASED 5.0% FROM 2014

In 2015, Other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of $819 million increased $39 million or 5.0% from 2014.

Components of the year-over-year change in Other passenger revenues included:

- The overall 11.1% traffic increase which reflected traffic growth on all major services. Consistent with Air Canada's strategy of increasing international-to-international traffic through its Canadian hubs, the traffic growth on services to South America in 2015 also reflected incremental lower-yielding connecting traffic from the U.S. in support of Air Canada's international expansion strategy.
- The overall 5.8% yield decrease which reflected a 2.0% longer average stage length, which had the effect of reducing yield by 1.1 percentage points, competitive pricing activities, and a higher proportional growth of lower-yielding international passenger flows to South America. A favourable currency impact of $26 million was a partly offsetting factor.

CARGO REVENUES INCREASED 0.7% FROM 2014

In 2015, cargo revenues of $506 million increased $4 million or 0.7% from 2014.

The table below provides cargo revenue by geographic region for 2015 and 2014.

	2015 $ MILLION	2014 $ MILLION	CHANGE $ MILLION
CARGO REVENUE			
Canada	67	66	1
U.S. transborder	24	20	4
Atlantic	188	191	(3)
Pacific	188	190	(2)
Other	39	35	4
SYSTEM	**506**	**502**	**4**

The table below provides year-over-year percentage changes in cargo revenues and operating statistics for 2014 versus 2013.

	CARGO REVENUE % CHANGE	CAPACITY (ETMs) % CHANGE	REV / ETM % CHANGE	TRAFFIC (RTMs) % CHANGE	YIELD / RTM % CHANGE
FULL YEAR 2015 VERSUS FULL YEAR 2014					
Canada	1.7	5.7	(3.7)	6.4	(4.4)
U.S. transborder	21.0	34.5	(10.1)	28.1	(5.6)
Atlantic	(1.7)	10.9	(11.4)	1.0	(2.7)
Pacific	(0.9)	8.0	(8.2)	(8.3)	8.2
Other	9.1	21.4	(10.1)	1.2	7.8
SYSTEM	**0.7**	**11.7**	**(9.8)**	**(1.9)**	**2.7**

Components of the year-over-year change in cargo revenues included:

- The 2.7% yield increase which reflected yield growth in the Pacific and Other markets partly offset by yield declines in the domestic, U.S. transborder and Atlantic markets. A favourable currency impact of $25 million was largely offset by a reduction in fuel surcharges of $10 million as well as by the impact of increased industry capacity and competitive pricing activities in all markets.
- The 1.9% traffic decrease which reflected a traffic decline in the Pacific market on lower cargo demand, largely offset by traffic growth in the domestic, U.S. transborder, Atlantic and Other markets. The growth in traffic in these four markets was mainly due to increased cargo capacity and market share gains within North America and between North America and Europe.

OTHER REVENUES DECREASED 2% FROM 2014

In 2015, other revenues of $942 million decreased $24 million or 2% from 2014, mainly due to the impact of the Jazz CPA, effective January 1, 2015, whereby certain costs, such as ground handling services performed by Air Canada, are no longer recovered from Jazz and passed through to Air Canada as capacity purchase fees, thereby reducing both other revenues and capacity purchase fees. A reduction in aircraft sublease revenues was also a contributing factor to the decrease in other revenues year-over-year. These decreases were largely offset by higher ground package revenues at Air Canada Vacations and an increase in passenger-fee related revenues.

CASM DECREASED 9.3% FROM 2014. ADJUSTED CASM DECREASED 0.2% FROM 2014

The following table compares Air Canada's CASM and Adjusted CASM for 2015 versus 2014.

	FULL YEAR		CHANGE	
CENTS PER ASM	2015	2014	cents	%
Aircraft fuel	3.05	4.39	(1.34)	(30.5)
Regional airlines expense				
Aircraft fuel	0.44	0.68	(0.24)	(35.3)
Other	2.38	2.47	(0.09)	(3.6)
Wages and salaries	2.21	2.31	(0.10)	(4.3)
Benefits	0.66	0.67	(0.01)	(1.5)
Airport and navigation fees	0.99	1.02	(0.03)	(2.9)
Aircraft maintenance	0.96	0.92	0.04	4.3
Depreciation, amortization and impairment	0.81	0.71	0.10	14.1
Sales and distribution costs	0.75	0.76	(0.01)	(1.3)
Ground package costs	0.51	0.51	-	-
Aircraft rent	0.44	0.41	0.03	7.3
Food, beverages and supplies	0.39	0.40	(0.01)	(2.5)
Communications and information technology	0.26	0.27	(0.01)	(3.7)
Special items	0.01	(0.01)	0.02	200.0
Other	1.44	1.35	0.09	6.7
CASM	**15.30**	**16.86**	**(1.56)**	**(9.3)**
Remove: Aircraft fuel expense [(1)], ground package costs at Air Canada Vacations, and special items	(4.03)	(5.57)	1.54	27.6
ADJUSTED CASM [(2)]	**11.27**	**11.29**	**(0.02)**	**(0.2)**

1 Includes aircraft fuel expense related to regional airline operations.
2 Adjusted CASM is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

OPERATING EXPENSES DECREASED 1% FROM 2014

In 2015, on capacity growth of 9.4%, operating expenses of $12,372 million decreased $85 million or 1% from 2014.

The more notable components of the year-over-year change in operating expenses included:

- The impact of lower base jet fuel prices (before the unfavourable impact of foreign exchange), which accounted for a decrease of $1,527 million to aircraft fuel expense.

Largely offsetting this decline were:

- The impact of the 9.4% capacity growth.
- The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) which increased operating expenses by $674 million (comprised of $348 million relating to aircraft fuel expense and an aggregate of $326 million relating to non-fuel operating expenses).

AIRCRAFT FUEL EXPENSE DECREASED 25% FROM 2014

Aircraft fuel expense, including fuel expense related to regional airline operations, amounted to $2,823 million in 2015, a decrease of $924 million or 25% from 2014. The decrease in aircraft fuel expense in 2015 was due to a significant decline in base jet fuel prices year-over-year, which accounted for a decrease of $1,527 million. This decrease was partly offset by the unfavourable impact of a weaker Canadian dollar versus the U.S. dollar when compared to 2014, which accounted for an increase of $348 million, as well as a higher volume of fuel litres consumed, which accounted for an increase of $245 million. With adoption of hedge accounting for fuel derivatives effective April 1, 2015, any premium costs associated with fuel derivatives are deferred as cost of the hedge and reclassified to aircraft fuel expense when the hedged jet fuel is used. Premium costs amounting to $10 million were reclassified to aircraft fuel expense in 2015.

The table below provides Air Canada's fuel cost per litre and economic fuel cost per litre (including aircraft fuel expense related to regional airline operations) for the periods indicated.

	FULL YEAR		CHANGE	
CANADIAN DOLLARS IN MILLIONS, EXCEPT WHERE INDICATED	2015	2014	$	%
AIRCRAFT FUEL EXPENSE – GAAP	**$ 2,464**	**$ 3,247**	**$ (783)**	**(24)**
Add: Aircraft fuel expense related to Regional airline operations	359	500	(141)	(28)
TOTAL AIRCRAFT FUEL EXPENSE	**$ 2,823**	**$ 3,747**	**$ (924)**	**(25)**
Add: Net cash payments on fuel derivatives (1)	36	16	20	125
ECONOMIC COST OF FUEL – NON-GAAP (2)	**$ 2,859**	**$ 3,763**	**$ (904)**	**(24)**
FUEL CONSUMPTION (THOUSANDS OF LITRES)	**4,477,789**	**4,213,214**	**264,575**	**6.3**
FUEL COST PER LITRE (CENTS) – GAAP	**63.0**	**88.9**	**(25.9)**	**(29.1)**
ECONOMIC FUEL COST PER LITRE (CENTS) – NON-GAAP (2)	**63.8**	**89.3**	**(25.5)**	**(28.5)**

1 Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives. With adoption of hedge accounting for fuel derivatives effective April 1, 2015, any premium costs associated with fuel derivatives are now deferred as cost of the hedge and reclassified to aircraft fuel expense when the hedged jet fuel is used ($10 million is included in aircraft fuel expense for the full year 2015).

2 The economic cost of fuel is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, and may not be comparable to similar measures presented by other public companies. Air Canada uses this measure to calculate its cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period and premium costs associated with those derivatives.

REGIONAL AIRLINES EXPENSE DECREASED 2% FROM 2014

Air Canada has capacity purchase agreements with Jazz, Sky Regional, Air Georgian and EVAS. As of 2015, Air Canada changed the presentation of the expenses related to capacity purchase agreements on its consolidated statement of operations. This change in presentation was adopted to provide an improved presentation of the economic costs associated with regional carrier operations. Prior period amounts were reclassified to conform to the current period presentation. For additional information, refer to Note 19 of Air Canada's audited consolidated financial statements for 2015.

Effective January 1, 2015, Air Canada and Jazz amended the terms of their capacity purchase agreement and extended its term through to December 31, 2025.

In 2015, regional airlines expense of $2,279 million decreased $45 million or 2% from 2014. This decrease was mainly due to lower base jet fuel prices partly offset by an unfavourable currency impact, higher capacity purchase agreement rates and related pass-through costs year-over-year.

WAGES, SALARIES AND BENEFITS EXPENSE AMOUNTED TO $2,324 MILLION IN 2015, AN INCREASE OF $123 MILLION OR 6% FROM 2014

In 2015, wages and salaries expense of $1,788 million increased $83 million or 5% from 2014, mainly due to higher average salaries, an increase in expense accruals related to the annual employee profit sharing programs and a 1.8% increase in the average number of full-time equivalent ("FTE") employees year-over-year. In 2014, Air Canada recorded a provision of $12 million related to the outsourcing of its London-Heathrow operations to a third party provider.

In 2015, employee benefits expense of $536 million increased $40 million or 8% from 2014, mainly due to the impact of lower discount rates which increased the current service cost of defined benefit pension plans, partly offset by a favourable impact of benefit plan amendments of $19 million relating to U.S. post-retirement health plans.

AIRPORT AND NAVIGATION FEES INCREASED 6% FROM 2014

In 2015, airport and navigation fees of $802 million increased $47 million or 6% from 2014, mainly due to an increase in aircraft frequencies of 2.1% and an unfavourable currency impact. These increases were partly offset by the impact of the terms of an agreement with the Greater Toronto Airports Authority which is allowing Air Canada to grow its share of international passengers connecting at Toronto Pearson International Airport on a more cost effective basis.

AIRCRAFT MAINTENANCE EXPENSE INCREASED 14% FROM 2014

In 2015, aircraft maintenance expense of $773 million increased $95 million or 14% from 2014, mainly due to an unfavourable currency impact of $108 million.

DEPRECIATION, AMORTIZATION AND IMPAIRMENT EXPENSE INCREASED 25% FROM 2014

In 2015, depreciation, amortization and impairment expense of $655 million increased $129 million or 25% from 2014, largely due to the introduction of new Boeing 787 aircraft to Air Canada's mainline fleet and, to a much lesser extent, an increase in expenses related to the airline's aircraft refurbishment programs. In addition, in 2015, Air Canada recorded impairment charges of $14 million related to the disposal of two Airbus A340-300 aircraft (neither of which was operated by Air Canada). No such charges were recorded in 2014.

SALES AND DISTRIBUTION COSTS INCREASED 9% FROM 2014

In 2015, sales and distribution costs of $608 million increased $48 million or 9% from 2014 on passenger revenue growth of 5.2%. This growth in sales and distribution costs was mainly due to an unfavourable currency impact and a higher volume of ticket sales generated through Global Distribution System ("GDS") providers and higher credit card fees, in line with sales and revenue growth. These increases were partly offset by the impact of more favourable distribution rates negotiated in 2015.

GROUND PACKAGE COSTS INCREASED 10% FROM 2014

In 2015, the cost of ground packages at Air Canada Vacations amounted to $415 million, an increase of $38 million or 10% from 2014, mainly due to higher passenger volumes and an unfavourable currency impact.

AIRCRAFT RENT INCREASED 17% FROM 2014

In 2015, aircraft rent expense amounted to $353 million, an increase of $51 million or 17% from 2014, largely due to a unfavourable currency impact of $41 million and to a higher number of aircraft leases in anticipation of the replacement of 20 of the airline's 45 Embraer 190 aircraft in late 2015 and the first half of 2016. These increases were partly offset by the favourable impact of lower rates on lease renewals.

SPECIAL ITEMS

Special items increased operating expenses by $8 million in 2015. These special items included:

- One-time payments totalling $26 million related to Air Canada's contract on collective agreement terms with CUPE;
- One-time payments totalling $36 million related to Air Canada's contract on collective agreement terms with the IAMAW;
- A $30 million recovery related to cargo investigations which was previously paid; and
- Favourable tax-related provision adjustments of $23 million.

Special items reduced operating expenses by $11 million in 2014. These special items included:

- One-time payments totalling $30 million related to Air Canada's contract on collective agreement terms with ACPA; and
- Favourable tax-related provision adjustments of $41 million.

OTHER EXPENSES INCREASED 16% FROM 2014

In 2015, other expenses of $1,166 million increased $161 million or 16% from 2014. This increase in other expenses included:

- the 9.4% capacity growth;
- an increase in terminal handling expense, mainly driven by Air Canada's international growth strategy and the impact of the outsourcing of London-Heathrow ground handling operations, in the first half of 2014, to a third party provider (the savings associated with this initiative are included in other expense categories, such as wages and salaries expense, for a net reduction overall);
- an increase in advertising and promotion expense, largely driven by the airline's international expansion strategy;

- an increase in customer inconvenience costs, proportional to the higher passenger volumes; and
- an unfavourable currency impact.

The following table provides a breakdown of the more significant items included in other expenses:

	FULL YEAR		CHANGE	
CANADIAN DOLLARS IN MILLIONS	2015	2014	$	%
Terminal handling	$ 227	$ 190	$ 37	19
Crew cycle	149	141	8	6
Building rent and maintenance	145	139	6	4
Miscellaneous fees and services	137	120	17	14
Remaining other expenses	508	415	93	22
TOTAL OTHER EXPENSES	**$ 1,166**	**$ 1,005**	**$ 161**	**16**

NON-OPERATING EXPENSE AMOUNTED TO $1,188 MILLION IN 2015 COMPARED TO NON-OPERATING EXPENSE OF $710 MILLION IN 2014

The following table provides a breakdown of non-operating expense for the periods indicated:

	FULL YEAR		CHANGE
CANADIAN DOLLARS IN MILLIONS	2015	2014	$
Foreign exchange loss	$ (762)	$ (307)	$ (455)
Interest income	46	39	7
Interest expense	(402)	(322)	(80)
Interest capitalized	70	30	40
Net financing expense relating to employee benefits	(105)	(134)	29
Fuel and other derivatives	(17)	(1)	(16)
Other	(18)	(15)	(3)
TOTAL NON-OPERATING EXPENSE	**$ (1,188)**	**$ (710)**	**$ (478)**

Factors contributing to the year-over-year change in non-operating expense included:

- Losses on foreign exchange, which amounted to $762 million in 2015 compared to losses on foreign exchange of $307 million in 2014, were mainly related to foreign exchange losses on U.S. denominated long-term debt of $876 million and foreign exchange losses on net maintenance provisions of $141 million. Partially offsetting these losses were gains of $164 million on foreign currency derivatives and $123 million on cash and short-term investments balances. The December 31, 2015 closing exchange rate was US$1 = C$1.3840 while the December 31, 2014 closing exchange rate was US$1 = C$1.1601. The losses on foreign exchange in 2015 also included a loss of $24 million related to funds held in Venezuela due to the impact of a new foreign exchange mechanism announced in the first quarter of 2015. As at December 31, 2015, the Canadian equivalent of funds held in Venezuela was nominal.
- An increase in interest expense of $80 million which was mainly due to new borrowings, a standby charge related to the financing (by way of EETCs) of aircraft which remain to be delivered, and to the impact of a weaker Canadian dollar on U.S. denominated borrowings. In addition, in 2015, Air Canada recorded a special charge of $13 million related to the prepayment of debt associated with the disposal of Embraer 190 aircraft. These increases were largely offset by an increase in capitalized interest of $40 million which largely reflected the above-noted standby charge.
- A decrease in net financing expense relating to employee benefits of $29 million which was mainly due to the impact of the lower net defined benefit obligation for pension.
- Losses on fuel and other derivatives which amounted to $17 million in 2015 versus a loss on fuel and other derivatives of $1 million in 2014. Refer to section 12 "Financial Instruments and Risk Management" of this MD&A for additional information.

RESULTS OF OPERATIONS – FOURTH QUARTER 2015 VERSUS FOURTH QUARTER 2014

The following table and discussion compares results of Air Canada for the fourth quarter 2015 versus the fourth quarter of 2014.

CANADIAN DOLLARS IN MILLIONS, EXCEPT PER SHARE FIGURES	FOURTH QUARTER		CHANGE	
	2015	2014	$	%
OPERATING REVENUES				
Passenger	$ 2,836	$ 2,755	$ 81	3
Cargo	135	133	2	2
Other	211	216	(5)	(2)
TOTAL REVENUES	**3,182**	**3,104**	**78**	**3**
OPERATING EXPENSES				
Aircraft fuel	527	680	(153)	(23)
Regional airlines expense				
Aircraft fuel	81	111	(30)	(27)
Other	468	460	8	2
Wages, salaries and benefits	590	560	30	5
Airport and navigation fees	193	178	15	8
Aircraft maintenance	203	187	16	9
Depreciation, amortization and impairment	160	130	30	23
Sales and distribution costs	145	123	22	18
Ground package costs	87	74	13	18
Aircraft rent	98	76	22	29
Food, beverages and supplies	81	70	11	16
Communications and information technology	50	51	(1)	(2)
Special items	31	30	1	3
Other	310	268	42	16
TOTAL OPERATING EXPENSES	**3,024**	**2,998**	**26**	**1**
OPERATING INCOME	**158**	**106**	**52**	
NON-OPERATING INCOME (EXPENSE)				
Foreign exchange loss	(159)	(115)	(44)	
Interest income	13	10	3	
Interest expense	(112)	(83)	(29)	
Interest capitalized	20	9	11	
Net financing expense relating to employee benefits	(27)	(32)	5	
Fuel and other derivatives	(3)	9	(12)	
Other	(6)	(4)	(2)	
TOTAL NON-OPERATING EXPENSE	(274)	(206)	(68)	
LOSS BEFORE INCOME TAXES	**(116)**	**(100)**	**(16)**	
Income taxes	-	-	-	
NET LOSS	**$ (116)**	**$ (100)**	**$ (16)**	
BASIC LOSS PER SHARE	**$ (0.41)**	**$ (0.35)**	**$ (0.06)**	
DILUTED LOSS PER SHARE	**$ (0.41)**	**$ (0.35)**	**$ (0.06)**	
EBITDAR (1)	**$ 425**	**$ 319**	**$ 106**	
ADJUSTED NET INCOME (1)	**$ 116**	**$ 67**	**$ 49**	
ADJUSTED EARNINGS PER SHARE – DILUTED (1)	**$ 0.40**	**$ 0.23**	**$ 0.17**	

1 EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent), adjusted net income (loss) and adjusted earnings (loss) per share – diluted are non-GAAP financial measures. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

SYSTEM PASSENGER REVENUES INCREASED 3.0% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, system passenger revenues of $2,836 million increased $81 million or 3.0% from the fourth quarter of 2014.

In the fourth quarter of 2015, business cabin system revenues increased $3 million or 0.6% from the fourth quarter of 2014 on yield growth of 0.9% partly offset by a traffic decrease of 0.4%.

The table below provides passenger revenue by geographic region for the fourth quarter of 2015 and the fourth quarter of 2014.

	FOURTH QUARTER 2015 $ MILLION	FOURTH QUARTER 2014 $ MILLION	CHANGE $ MILLION	% CHANGE
PASSENGER REVENUE				
Canada	1,053	1,099	(46)	(4.1)
U.S. transborder	632	572	60	10.5
Atlantic	572	525	47	9.1
Pacific	394	377	17	4.7
Other	185	182	3	1.1
SYSTEM	**2,836**	**2,755**	**81**	**3.0**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the fourth quarter of 2015 versus the fourth quarter of 2014.

	PASSENGER REVENUE % CHANGE	CAPACITY (ASMs) % CHANGE	TRAFFIC (RPMs) % CHANGE	PASSENGER LOAD FACTOR PP CHANGE	YIELD % CHANGE	PRASM % CHANGE
FOURTH QUARTER 2015 VERSUS FOURTH QUARTER 2014						
Canada	(4.1)	4.0	2.4	(1.2)	(7.3)	(8.7)
U.S. transborder	10.5	11.9	11.6	(0.2)	(0.9)	(1.1)
Atlantic	9.1	15.3	14.2	(0.7)	(4.5)	(5.4)
Pacific	4.7	3.4	7.9	3.6	(2.9)	1.3
Other	1.1	9.5	10.5	0.7	(8.6)	(7.8)
SYSTEM	**3.0**	**8.4**	**8.6**	**0.1**	**(5.5)**	**(5.3)**

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the fourth quarter of 2015 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'14	Q1'15	Q2'15	Q3'15	Q4'15
SYSTEM					
Passenger revenues	7.6	6.9	3.9	6.9	3.0
Capacity (ASMs)	8.5	9.3	9.3	10.5	8.4
Traffic (RPMs)	9.4	10.9	8.7	10.2	8.6
Passenger load factor (pp change)	0.6	1.2	(0.5)	(0.2)	0.1
Yield	(1.9)	(4.2)	(5.0)	(3.8)	(5.5)
PRASM	(1.2)	(2.7)	(5.5)	(4.0)	(5.3)

Components of the year-over-year change in system passenger revenues included:

- The 8.6% traffic increase which reflected traffic growth in all markets. Consistent with the airline's objective of increasing global international-to-international connecting traffic through its major Canadian hubs, the traffic growth in the fourth quarter of 2015 also reflected lower-yielding incremental connecting traffic to international destinations.
- The 5.5% yield decrease which is consistent with the anticipated yield impact stemming from the implementation of the airline's strategic plan and which reflected:
  - an increase in average stage length of 2.6%, which had the effect of reducing system yield by 1.5 percentage points;
  - a higher proportional growth of lower-yielding international-to-international passenger flows in support of the airline's international expansion strategy;
  - a higher proportion of seats into long-haul leisure markets led by an increase in lower-cost flights operated by Air Canada *rouge*;
  - the impact of increased industry capacity and competitive pricing activities in the domestic market as well as a decline in higher-yielding oil market-related traffic; and
  - a reduction in carrier surcharges relating to lower fuel prices, particularly where carrier surcharges are regulated such as Japan, Hong Kong, Korea and Brazil.

A favourable currency impact of $99 million was a partly offsetting factor.

DOMESTIC PASSENGER REVENUES DECREASED 4.1% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, domestic passenger revenues of $1,053 million decreased $46 million or 4.1% from the fourth quarter of 2014.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the fourth quarter of 2015 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'14	Q1'15	Q2'15	Q3'15	Q4'15
CANADA					
Passenger revenues	5.7	3.4	0.4	0.6	(4.1)
Capacity (ASMs)	6.1	2.1	2.6	4.8	4.0
Traffic (RPMs)	6.6	3.9	3.1	3.5	2.4
Passenger load factor (pp change)	0.4	1.4	0.3	(1.1)	(1.2)
Yield	(1.8)	(1.8)	(4.1)	(4.8)	(7.3)
PRASM	(1.3)	-	(3.7)	(6.0)	(8.7)

Components of the year-over-year change in fourth quarter domestic passenger revenues included:

- The 2.4% traffic increase which reflected traffic growth on all domestic services, including incremental connecting traffic to U.S. and international destinations, with the exception of routes to the Maritimes and within Western Canada.
- An increase in baggage fee revenues following an adjustment to the airline's first checked bag policy which became effective for travel as of November 2, 2014. Baggage fee revenues are not included in Air Canada's yield and PRASM results.

- The 7.3% yield decrease which reflected:
  - the impact of increased industry capacity and competitive pricing activities;
  - higher proportional growth of lower-yielding international and U.S. transborder passenger flows in support of the airline's international expansion strategy connecting to Air Canada's routes in the domestic market;
  - a 1.9% longer average stage length which had the effect of reducing domestic yield by 1.1 percentage points in the fourth quarter of 2015; and
  - a decline in higher-yielding oil market-related traffic.

A favourable currency impact of $14 million was a partly offsetting factor.

U.S. TRANSBORDER PASSENGER REVENUES INCREASED 10.5% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, U.S. transborder passenger revenues of $632 million increased $60 million or 10.5% from the fourth quarter of 2014.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the fourth quarter of 2015 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'14	Q1'15	Q2'15	Q3'15	Q4'15
U.S. TRANSBORDER					
Passenger revenues	9.5	12.6	10.9	17.3	10.5
Capacity (ASMs)	14.0	17.3	12.4	15.2	11.9
Traffic (RPMs)	15.5	17.7	12.9	15.6	11.6
Passenger load factor (pp change)	1.1	0.3	0.4	0.3	(0.2)
Yield	(5.0)	(4.3)	(1.9)	1.4	(0.9)
PRASM	(3.7)	(4.0)	(1.5)	1.8	(1.1)

Components of the year-over-year change in fourth quarter U.S. transborder passenger revenues included:

- The 11.6% traffic increase which reflected traffic growth on all major U.S. transborder services. This meaningful year-over-year increase in traffic was largely due to strong passenger demand between Canada and the U.S. as well as growth of international-to-international passenger flows from the U.S. in support of Air Canada's international expansion strategy.
- The 0.9% yield decline which reflected yield decreases on U.S. sun routes and an increase in long-haul leisure flying led by lower-cost Air Canada *rouge*, which is allowing Air Canada to effectively compete on lower-yielding leisure routes. Yield growth on U.S. short-haul routes, an improved premium cabin mix and a favourable currency impact of $31 million were partly offsetting factors.

ATLANTIC PASSENGER REVENUES INCREASED 9.1% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, Atlantic passenger revenues of $572 million increased $47 million or 9.1% from the fourth quarter of 2014.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the fourth quarter of 2015 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'14	Q1'15	Q2'15	Q3'15	Q4'15
ATLANTIC					
Passenger revenues	13.6	11.0	6.5	9.1	9.1
Capacity (ASMs)	8.7	10.7	11.2	12.7	15.3
Traffic (RPMs)	12.8	17.2	11.0	12.7	14.2
Passenger load factor (pp change)	2.9	4.2	(0.2)	-	(0.7)
Yield	0.8	(5.1)	(4.0)	(3.2)	(4.5)
PRASM	4.7	0.4	(4.2)	(3.2)	(5.4)

Components of the year-over-year change in fourth quarter Atlantic passenger revenues included:

- The 14.2% traffic increase which reflected traffic growth on all major Atlantic services with the exception of services to Germany where capacity was reduced year-over-year. The traffic growth in the fourth quarter of 2015 reflected incremental traffic between the U.S. and Europe via the airline's major Canadian hubs, in line with Air Canada's international growth strategy, as well as incremental traffic resulting from the growth of Air Canada *rouge*.
- The 4.5% yield decline which reflected an increase in average stage length of 2.9%, which had the effect of reducing system yield by 1.6 percentage points, as Air Canada offered a higher proportion of seats in long-haul (lower yielding) leisure markets, combined with increased industry capacity and competitive pricing activities. A favourable currency impact of $25 million was a partly offsetting factor.

PACIFIC PASSENGER REVENUES INCREASED 4.7% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, Pacific passenger revenues of $394 million increased $17 million or 4.7% from the fourth quarter of 2014.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the fourth quarter of 2015 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'14	Q1'15	Q2'15	Q3'15	Q4'15
PACIFIC					
Passenger revenues	6.5	(0.5)	1.4	5.6	4.7
Capacity (ASMs)	9.5	7.6	13.6	11.8	3.4
Traffic (RPMs)	7.6	6.5	10.4	12.1	7.9
Passenger load factor (pp change)	(1.4)	(0.8)	(2.5)	0.2	3.6
Yield	(0.8)	(6.5)	(8.1)	(5.7)	(2.9)
PRASM	(2.5)	(7.4)	(10.7)	(5.5)	1.3

Components of the year-over-year change in fourth quarter Pacific passenger revenues included:

- The 7.9% traffic increase which reflected traffic growth on all major Pacific services with the exception of services to Australia. The traffic decrease on services to Australia was less than the capacity decrease on services to Australia resulting in a higher passenger load factor year-over-year.

- The 2.9% yield decline which mainly reflected a significant reduction in carrier surcharges relating to lower fuel prices, particularly where carrier surcharges are regulated, such as Japan, Hong Kong and Korea, as well as competitive pressures to and from Canada-Asia and to and from U.S.-Asia, both in terms of added capacity and pricing. The competitive pressures impacted local, U.S. sixth freedom and beyond traffic. Yield growth on services to China and a favourable currency impact of $21 million were partly offsetting factors.

OTHER PASSENGER REVENUES INCREASED 1.1% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, Other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of $185 million increased $3 million or 1.1% from the fourth quarter of 2014.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the fourth quarter of 2015 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'14	Q1'15	Q2'15	Q3'15	Q4'15
OTHER					
Passenger revenues	0.4	9.5	(1.3)	8.5	1.1
Capacity (ASMs)	3.9	12.9	10.3	12.2	9.5
Traffic (RPMs)	3.0	13.4	7.9	11.5	10.5
Passenger load factor (pp change)	(0.6)	0.3	(1.9)	(0.5)	0.7
Yield	(2.7)	(3.7)	(9.0)	(3.1)	(8.6)
PRASM	(3.4)	(3.3)	(11.0)	(3.6)	(7.8)

Components of the year-over-year change in fourth quarter Other passenger revenues included:

- The overall 10.5% traffic increase which reflected traffic growth on all major services. Consistent with Air Canada's strategy of increasing international-to-international traffic through its Canadian hubs, the traffic growth on services to South America in the fourth quarter of 2015 also reflected incremental lower-yielding connecting traffic from the U.S. in support of Air Canada's international expansion strategy.
- The overall 8.6% yield decrease which reflected the impact of competitive pricing activities, driven by increased industry capacity. Partly offsetting this decrease was a favourable currency impact of $8 million.

CARGO REVENUES INCREASED 0.7% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, cargo revenues of $135 million increased $2 million or 0.7% from 2014.

The table below provides cargo revenue by geographic region for the fourth quarter of 2015 and the fourth quarter of 2014.

	FOURTH QUARTER 2015 $ MILLION	FOURTH QUARTER 2014 $ MILLION	CHANGE $ MILLION
CARGO REVENUE			
Canada	17	17	-
U.S. transborder	7	5	2
Atlantic	48	48	-
Pacific	49	51	(2)
Other	14	12	2
SYSTEM	**135**	**133**	**2**

The table below provides year-over-year percentage changes in system cargo revenues and operating statistics for the fourth quarter of 2015 and each of the previous four quarters.

	YEAR-OVER-YEAR BY QUARTER (% CHANGE)				
	Q4'14	Q1'15	Q2'15	Q3'15	Q4'15
SYSTEM					
Cargo revenues	3.9	7.9	1.3	(7.0)	0.7
Capacity (ETMs)	11.6	12.9	11.9	12.6	9.2
Revenue per ETM	(6.9)	(4.5)	(9.5)	(16.8)	(7.8)
Traffic (RTMs)	7.5	3.5	(1.9)	(5.6)	(3.0)
Yield per RTM	(3.3)	4.2	3.2	(0.8)	3.8

The table below provides year-over-year percentage changes in cargo revenues and operating statistics for the fourth quarter of 2015 versus the fourth quarter of 2014.

	CARGO REVENUE % CHANGE	CAPACITY (ETMS) % CHANGE	REV / ETM % CHANGE	TRAFFIC (RTMS) % CHANGE	YIELD / RTM % CHANGE
FOURTH QUARTER 2015 VERSUS FOURTH QUARTER 2014					
Canada	(2.1)	5.7	(7.4)	(4.6)	2.6
U.S. transborder	34.4	25.9	6.8	4.4	28.8
Atlantic	(0.3)	12.7	(11.6)	(0.4)	-
Pacific	(2.0)	3.6	(5.4)	(4.4)	2.4
Other	5.3	5.9	(0.6)	(10.3)	17.3
SYSTEM	**0.7**	**9.2**	**(7.8)**	**(3.0)**	**3.8**

Components of the year-over-year change in fourth quarter cargo revenues included:

- The 3.8% yield increase which reflected yield growth in the domestic, U.S. transborder, Pacific and Other markets, driven by a favourable currency impact of $10 million, partly offset by the impact of increased industry capacity and competitive pricing activities in all markets.
- The 3.0% traffic decrease which reflected an overall reduction in cargo demand and the impact of increased industry capacity.

OTHER REVENUES DECREASED 2% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, other revenues of $211 million decreased $5 million or 2% from the fourth quarter of 2014, mainly due to the impact of the Jazz CPA, effective January 1, 2015, whereby certain costs, such as ground handling services performed by Air Canada, are no longer recovered from Jazz and passed through to Air Canada under the Jazz CPA as capacity purchase fees, thereby reducing both other revenues and capacity purchase fees. This decrease was largely offset by higher ground package revenues at Air Canada Vacations.

CASM DECREASED 7.0% FROM THE FOURTH QUARTER OF 2014. ADJUSTED CASM INCREASED 0.8% FROM THE FOURTH QUARTER OF 2014

The following table compares Air Canada's CASM and Adjusted CASM for the fourth quarter of 2015 to the fourth quarter 2014.

	FOURTH QUARTER		CHANGE	
CENTS PER ASM	2015	2014	CENTS	%
Aircraft fuel	2.79	3.90	(1.11)	(28.5)
Regional airlines expense				
Aircraft fuel	0.43	0.64	(0.21)	(32.8)
Other	2.48	2.64	(0.16)	(6.1)
Wages and salaries	2.44	2.49	(0.05)	(2.0)
Benefits	0.68	0.73	(0.05)	(6.8)
Airport and navigation fees	1.02	1.02	-	-
Aircraft maintenance	1.08	1.07	0.01	0.9
Depreciation, amortization and impairment	0.85	0.75	0.10	13.3
Sales and distribution costs	0.77	0.70	0.07	10.0
Ground package costs	0.46	0.42	0.04	9.5
Aircraft rent	0.52	0.44	0.08	18.2
Food, beverages and supplies	0.43	0.40	0.03	7.5
Communications and information technology	0.27	0.29	(0.02)	(6.9)
Special items	0.16	0.18	(0.02)	(11.1)
Other	1.65	1.56	0.09	5.8
CASM	**16.03**	**17.23**	**(1.20)**	**(7.0)**
Remove: Aircraft fuel expense (1), ground package costs at Air Canada Vacations, and special items	(3.85)	(5.15)	1.30	25.2
Adjusted CASM (2)	**12.18**	**12.08**	**0.10**	**0.8**

1 Includes aircraft fuel expense related to regional airline operations.
2 Adjusted CASM is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

OPERATING EXPENSES INCREASED 1% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, on capacity growth of 8.4%, operating expenses of $3,024 million increased $26 million or 1% from the fourth quarter of 2014.

The more notable components of the year-over-year change in fourth quarter operating expenses included:

- The impact of the 8.4% capacity growth.
- The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) which increased operating expenses by $197 million (comprised of $92 million relating to aircraft fuel expense and an aggregate of $105 million relating to non-fuel operating expenses). Refer to section 12 "Financial Instruments and Risk Management" of this MD&A for information on Air Canada's foreign exchange risk management strategy.

Largely offsetting these increases was:

- The impact of lower base jet fuel prices (before the unfavourable impact of foreign exchange), which accounted for a decrease of $324 million to aircraft fuel expense.

AIRCRAFT FUEL EXPENSE DECREASED 23% FROM THE FOURTH QUARTER OF 2014

Aircraft fuel expense, including fuel expense related to regional airline operations, amounted to $608 million in the fourth quarter of 2015, a decrease of $183 million or 23% from the fourth quarter of 2014. The decrease in aircraft fuel expense in the fourth quarter of 2015 was due to a significant decline in jet fuel prices year-over-year, which accounted for a decrease of $324 million. This decrease was partly offset by the unfavourable impact of a weaker Canadian dollar versus the U.S. dollar when compared to the fourth quarter of 2014, which accounted for an increase of $92 million, as well as a higher volume of fuel litres consumed, which accounted for an increase of $39 million. Premium costs amounting to $10 million were reclassified to aircraft fuel expense in the fourth quarter of 2015.

The table below provides Air Canada's fuel cost per litre and economic fuel cost per litre (including aircraft fuel expense related to regional airline operations) for the periods indicated.

CANADIAN DOLLARS IN MILLIONS, EXCEPT WHERE INDICATED	FOURTH QUARTER 2015	FOURTH QUARTER 2014	CHANGE $	CHANGE %
AIRCRAFT FUEL EXPENSE – GAAP	**$ 527**	**$ 680**	**$ (153)**	**(23)**
Add: Aircraft fuel expense related to Regional airline operations	81	111	(30)	**(27)**
TOTAL AIRCRAFT FUEL EXPENSE	**$ 608**	**$ 791**	**$ (183)**	**(23)**
Add: Net cash payments on fuel derivatives (1)	-	10	(10)	**(100)**
ECONOMIC COST OF FUEL – NON-GAAP (2)	**$ 608**	**$ 801**	**$ (193)**	**(24)**
FUEL CONSUMPTION (THOUSANDS OF LITRES)	**1,034,881**	**992,320**	**42,561**	**4.3**
FUEL COST PER LITRE (CENTS) – GAAP	**58.6**	**79.7**	**(21.2)**	**(26.5)**
ECONOMIC FUEL COST PER LITRE (CENTS) – NON-GAAP (2)	**58.6**	**80.7**	**(22.2)**	**(27.5)**

1 Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives. With adoption of hedge accounting for fuel derivatives effective April 1, 2015, any premium costs associated with fuel derivatives are deferred as cost of the hedge and reclassified to aircraft fuel expense when the hedged jet fuel is used ($10 million is included in aircraft fuel expense in the fourth quarter of 2015).

2 The economic cost of fuel is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, and may not be comparable to similar measures presented by other public companies. Air Canada uses this measure to calculate its cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period and premium costs associated with those derivatives.

REGIONAL AIRLINES EXPENSE DECREASED 4% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, regional airlines expense of $549 million decreased $22 million or 4% from the fourth quarter of 2014. This decrease was mainly due to lower base jet fuel prices partly offset by an unfavourable currency impact and, to a lesser extent, higher capacity purchase agreement rates and related pass-through costs year-over-year.

WAGES, SALARIES AND BENEFITS EXPENSE AMOUNTED TO $590 MILLION IN THE FOURTH QUARTER OF 2015, AN INCREASE OF $30 MILLION OR 5% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, wages and salaries expense of $461 million increased $28 million or 6% from the fourth quarter of 2014, mainly due to higher average salaries and an increase in expense accruals related to the annual employee profit sharing programs. In addition, on capacity growth of 8.4%, the average number of full-time equivalent (FTE) employees increased 3.5% year-over-year.

In the fourth quarter of 2015, employee benefits expense of $129 million increased $2 million or 2% from the fourth quarter of 2014.

AIRPORT AND NAVIGATION FEES INCREASED 8% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, airport and navigation fees of $193 million increased $15 million or 8% from the fourth quarter of 2014, largely due to an increase in aircraft frequencies of 0.9% and an unfavourable currency impact. These increases were partly offset by the impact of the terms of an agreement with the Greater Toronto Airports Authority which is allowing Air Canada to grow its share of international passengers connecting at Toronto Pearson International Airport on a more cost effective basis.

AIRCRAFT MAINTENANCE EXPENSE INCREASED 9% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, aircraft maintenance expense of $203 million increased $16 million or 9% from the fourth quarter of 2014, mainly due to an unfavourable currency impact of $33 million partly offset by the impact of lower airframe maintenance activity.

DEPRECIATION, AMORTIZATION AND IMPAIRMENT EXPENSE INCREASED 23% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, depreciation, amortization and impairment expense of $160 million increased $30 million or 23% from the fourth quarter of 2014, largely due to the introduction of new Boeing 787 aircraft to Air Canada's mainline fleet and an increase in expenses related to the airline's aircraft refurbishment programs.

SALES AND DISTRIBUTION COSTS INCREASED 18% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, sales and distribution costs of $145 million increased $22 million or 18% from the fourth quarter of 2014 on passenger revenue growth of 3.0%. This growth in sales and distribution costs was mainly due to an unfavourable currency impact, a higher volume of ticket sales generated through GDS providers, and higher credit card fees, in line with sales and revenue growth. These increases were partly offset by the impact of more favourable distribution rates negotiated in 2015.

GROUND PACKAGE COSTS INCREASED 18% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, the cost of ground packages at Air Canada Vacations amounted to $87 million, an increase of $13 million or 18% from the fourth quarter of 2014, mainly due to an unfavourable currency impact and, to a lesser extent, a higher cost of ground packages (before the impact of foreign exchange).

AIRCRAFT RENT INCREASED 29% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, aircraft rent expense amounted to $98 million, an increase of $22 million or 29% from the fourth quarter of 2014, mainly due to an unfavourable currency impact of $13 million and an increase in the number of leased aircraft in preparation for the replacement of 20 of the airline's Embraer 190 aircraft in late 2015 and the first half of 2016. These increases were partly offset by the favourable impact of lower rates on lease renewals.

SPECIAL ITEMS

Special items increased operating expenses by $31 million in the fourth quarter of 2015. These special items included:

- One-time payments totalling $26 million related to Air Canada's contract on collective agreement terms with CUPE;
- One-time payments totalling $36 million related to Air Canada's contract on collective agreement terms with the IAMAW; and
- A $30 million recovery related to cargo investigations which was previously paid.

A special item related to Air Canada's contract on collective agreement terms with ACPA increased operating expenses by $30 million in the fourth quarter of 2014.

OTHER EXPENSES INCREASED 16% FROM THE FOURTH QUARTER OF 2014

In the fourth quarter of 2015, other expenses of $310 million increased $42 million or 16% from the fourth quarter of 2014. This increase in other expenses included:

- the 8.4% capacity growth;
- an unfavourable currency impact;
- an increase in advertising and promotion expense, largely driven by the airline's international expansion strategy;
- an increase in terminal handling expense, mainly driven by Air Canada's international expansion strategy; and
- an increase in customer inconvenience costs, proportional to the higher passenger volumes.

The following table provides a breakdown of the more significant items included in other expenses:

CANADIAN DOLLARS IN MILLIONS	FOURTH QUARTER 2015	FOURTH QUARTER 2014	CHANGE $	CHANGE %
Terminal handling	$ 53	$ 47	$ 6	13
Crew cycle	35	36	(1)	(3)
Building rent and maintenance	37	32	5	16
Miscellaneous fees and services	39	31	8	26
Remaining other expenses	146	122	24	20
TOTAL OTHER EXPENSES	**$ 310**	**$ 268**	**$ 42**	**16**

NON-OPERATING EXPENSE AMOUNTED TO $274 MILLION IN THE FOURTH QUARTER OF 2015 COMPARED TO NON-OPERATING EXPENSE OF $206 MILLION IN THE FOURTH QUARTER OF 2014

The following table provides a breakdown of non-operating expense for the periods indicated:

CANADIAN DOLLARS IN MILLIONS	FOURTH QUARTER 2015	FOURTH QUARTER 2014	CHANGE $
Foreign exchange loss	$ (159)	$ (115)	$ (44)
Interest income	13	10	3
Interest expense	(112)	(83)	(29)
Interest capitalized	20	9	11
Net financing expense relating to employee benefits	(27)	(32)	5
Fuel and other derivatives	(3)	9	(12)
Other	(6)	(4)	(2)
TOTAL NON-OPERATING EXPENSE	**$ (274)**	**$ (206)**	**$ (68)**

Factors contributing to the year-over-year change in fourth quarter non-operating expense included:

- Losses on foreign exchange, which amounted to $159 million in the fourth quarter of 2015 compared to losses on foreign exchange of $115 million in the fourth quarter of 2014 were mainly related to foreign exchange losses on U.S. denominated long-term debt of $196 million and foreign exchange losses on net maintenance provisions of $32 million. The losses in the fourth quarter of 2015 were attributable to a weaker Canadian dollar at December 31, 2015 when compared to December 31, 2014. The December 31, 2015 closing exchange rate was US$1 = C$1.3840 while the September 30, 2015 closing exchange rate was US$1 = C$1.3345. Partially offsetting these losses were gains of $46 million on foreign currency derivatives and $11 million on cash and short-term investment balances.
- An increase in interest expense of $29 million which was mainly due to new borrowings, a standby charge related to the financing (by way of EETCs) of aircraft which remain to be delivered, and to the impact of a weaker Canadian dollar on U.S. denominated borrowings. In addition, in the fourth quarter of 2015, Air Canada recorded a special charge of $13 million related to the prepayment of debt associated with the disposal of Embraer 190 aircraft. These increases were largely offset by an increase in capitalized interest of $11 million which largely reflected the above-noted standby charge.
- A decrease in net financing expense relating to employee benefits of $27 million which was mainly due to the impact of the lower net defined pension benefit obligation.
- Losses on fuel and other derivatives which amounted to $3 million in the fourth quarter of 2015 versus gains on fuel and other derivatives of $9 million in the fourth quarter of 2014. Refer to section 12 "Financial Instruments and Risk Management" of this MD&A for additional information.

MAINLINE AND AIR CANADA *ROUGE*

The following table provides Air Canada's and Air Canada *rouge*'s operating fleet as at December 31, 2015 (refer to the **Air Canada Express** section below for information on the fleet of aircraft operated by regional airlines operating flights on behalf of Air Canada under capacity purchase agreements with Air Canada).

	TOTAL SEATS	NUMBER OF OPERATING AIRCRAFT	AVERAGE AGE	OWNED	FINANCE LEASE	OWNED – SPECIAL PURPOSE ENTITIES (1)	OPERATING LEASE
MAINLINE							
WIDE-BODY AIRCRAFT							
Boeing 787-8	251	8	1.2	8	-	-	-
Boeing 787-9	298	4	0.2	4	-	-	-
Boeing 777-300ER	349/458	17	6.2	8	1	-	8
Boeing 777-200LR	270	6	8.1	4	-	-	2
Boeing 767-300ER	211	17	24.7	6	2	-	9
Airbus A330-300	265	8	15.2	2	-	6	-
NARROW-BODY AIRCRAFT							
Airbus A321	183	14	12.1	-	-	5	9
Airbus A320	146	42	22.2	1	-	-	41
Airbus A319	120	18	17.7	5	8	-	5
Embraer 190	97	37	8.8	37	-	-	-
TOTAL MAINLINE		**171**	**14.3**	**75**	**11**	**11**	**74**
AIR CANADA *ROUGE*							
WIDE-BODY AIRCRAFT							
Boeing 767-300ER	282	15	16.5	1	2	1	11
NARROW-BODY AIRCRAFT							
Airbus A321	200	4	7.8	-	-	-	4
Airbus A319 (2)	136	20	17.5	17	-	-	3
TOTAL AIR CANADA *ROUGE*		**39**	**16.1**	**18**	**2**	**1**	**18**
TOTAL MAINLINE AND AIR CANADA *ROUGE*		**210**	**14.7**	**93**	**13**	**12**	**92**

1 Aircraft under finance leases and aircraft under lease from special purpose entities that are consolidated by Air Canada are carried on Air Canada's consolidated statement of financial position.
2 The Boeing 767 aircraft and the 17 Airbus A319 aircraft reflected as owned in the table above are owned by Air Canada and leased to Air Canada *rouge*.

The following table provides the number of aircraft in Air Canada's operating fleet as at December 31, 2015, as well as Air Canada's planned operating fleet, including aircraft currently operating and expected to be operated by Air Canada *rouge*, as at December 31, 2016 and December 31, 2017.

	ACTUAL	PLANNED			
	DECEMBER 31, 2015	2016 FLEET CHANGES	DECEMBER 31, 2016	2017 FLEET CHANGES	DECEMBER 31, 2017
MAINLINE					
WIDE-BODY AIRCRAFT					
Boeing 787-8	**8**	-	**8**	-	**8**
Boeing 787-9	**4**	9	**13**	9	**22**
Boeing 777-300ER	**17**	2	**19**	-	**19**
Boeing 777-200LR	**6**	-	**6**	-	**6**
Boeing 767-300ER	**17**	(2)	**15**	(5)	**10**
Airbus A330-300	**8**	-	**8**	-	**8**
NARROW-BODY AIRCRAFT					
Boeing 737 MAX-8	**-**	-	**-**	2	**2**
Airbus A321	**14**	1	**15**	-	**15**
Airbus A320	**42**	-	**42**	-	**42**
Airbus A319	**18**	-	**18**	-	**18**
Embraer 190	**37**	(12)	**25**	-	**25**
TOTAL MAINLINE	**171**	(2)	**169**	6	**175**
AIR CANADA *ROUGE*					
WIDE-BODY AIRCRAFT					
Boeing 767-300ER	**15**	4	**19**	6	**25**
NARROW-BODY AIRCRAFT					
Airbus A321	**4**	1	**5**	-	**5**
Airbus A319	**20**	-	**20**	-	**20**
TOTAL AIR CANADA *ROUGE*	**39**	5	**44**	6	**50**
TOTAL WIDE-BODY AIRCRAFT	**75**	**13**	**88**	**10**	**98**
TOTAL NARROW-BODY AIRCRAFT	**135**	**(10)**	**125**	**2**	**127**
TOTAL MAINLINE AND AIR CANADA *ROUGE*	**210**	**3**	**213**	**12**	**225**

Air Canada expects to introduce five Boeing 787-9 aircraft in its operating fleet in 2018 (for a total of 35 Boeing 787 aircraft of the 37 on order). As discussed in section 9.6 of this MD&A, Air Canada has firm orders for 61 Boeing 737 MAX-8 aircraft, of which 16 aircraft are expected to be delivered in 2018 (for a total of 18 Boeing 737 MAX-8 aircraft of the 61 on order) to replace existing aircraft in its mainline fleet. As part of this narrow-body replacement program, Air Canada is currently reviewing which aircraft will be retired.

AIR CANADA EXPRESS

The following table provides, as at December 31, 2015, the number of aircraft operated, on behalf of Air Canada, by Jazz, Sky Regional and other airlines operating flights under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada.

	AS AT DECEMBER 31, 2015			
	JAZZ	SKY REGIONAL	OTHER	TOTAL
Embraer 175	-	15	-	15
Bombardier CRJ-100/200	20	-	7	27
Bombardier CRJ-705	16	-	-	16
Bombardier Dash 8-100	28	-	-	28
Bombardier Dash 8-300	26	-	-	26
Bombardier Dash 8-Q400	26	5	-	31
Beech 1900	-	-	17	17
TOTAL AIR CANADA EXPRESS	**116**	**20**	**24**	**160**

The following table provides the number of aircraft planned, as at December 31, 2016, to be operated, on behalf of Air Canada, by Jazz, Sky Regional and other airlines operating flights under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada.

	AS AT DECEMBER 31, 2016			
	JAZZ	SKY REGIONAL	OTHER	TOTAL
Embraer 175	-	20	-	20
Bombardier CRJ-100/200	13	-	14	27
Bombardier CRJ-705	16	-	-	16
Bombardier Dash 8-100	19	-	-	19
Bombardier Dash 8-300	26	-	-	26
Bombardier Dash 8-Q400	42	5	-	47
Beech 1900	-	-	17	17
TOTAL AIR CANADA EXPRESS	**116**	**25**	**31**	**172**

In support of Air Canada's international expansion strategy, Air Canada entered into lease agreements for five Embraer 175 aircraft. The aircraft are expected to be introduced into the Air Canada Express operating fleet in the second quarter of 2016.

In the third quarter of 2015, Air Canada and Jazz agreed to add 10 incremental growth aircraft to the Jazz CPA fleet until 2025. Chorus Aviation Inc., the parent of Jazz, announced that these aircraft, comprised of five Bombardier Dash 8-Q400 turboprops and five Bombardier CRJ-705 regional jets are being planned for delivery in 2016 and early 2017, respectively.

FINANCIAL AND CAPITAL MANAGEMENT

9.1. LIQUIDITY

Air Canada manages its liquidity needs through a variety of strategies including by seeking to sustain and improve cash from operations, sourcing committed financing 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 (including pension funding obligations), which are further discussed in sections 9.6 and 9.7 of this MD&A, as well as covenants in credit card and other agreements, discussed in section 9.8 of this MD&A. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts, 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. As part of its liquidity risk management strategy, Air Canada seeks to maintain cash, cash equivalents and short-term investments of at least $1.7 billion. At December 31, 2015, unrestricted liquidity amounted to $2,968 million (comprised of cash and short-term investments of $2,672 million and undrawn lines of credit of $296 million). In addition, Air Canada monitors its financial leverage as measured by the adjusted net debt to EBITDAR ratio, as further described in section 9.3 of this MD&A.

9.2. FINANCIAL POSITION

The following table provides a condensed consolidated statement of financial position of Air Canada as at December 31, 2015 and as at December 31, 2014.

CANADIAN DOLLARS IN MILLIONS	DECEMBER 31, 2015	DECEMBER 31, 2014	$ CHANGE
ASSETS			
Cash, cash equivalents and short-term investments	$ 2,672	$ 2,275	$ 397
Other current assets	1,453	1,203	250
Current assets	4,125	3,478	647
Property and equipment	7,030	5,998	1,032
Pension	851	-	851
Intangible assets	314	305	9
Goodwill	311	311	-
Deposits and other assets	496	556	(60)
TOTAL ASSETS	**$ 13,127**	**$ 10,648**	**$ 2,479**
LIABILITIES			
Current liabilities	$ 3,829	$ 3,537	$ 292
Long-term debt and finance leases	5,870	4,732	1,138
Pension and other benefit liabilities	2,245	2,403	(158)
Maintenance provisions	892	796	96
Other long-term liabilities	251	313	(62)
TOTAL LIABILITIES	**13,087**	**11,781**	**1,306**
TOTAL EQUITY	**40**	**(1,133)**	**1,173**
TOTAL LIABILITIES AND EQUITY	**$ 13,127**	**$ 10,648**	**$ 2,479**

Movements in current assets and current liabilities are described in section 9.4 "Working Capital" of this MD&A. Long-term debt and finance leases are discussed in sections 9.3 "Adjusted Net Debt" and 9.5 "Consolidated Cash Flow Movements" of this MD&A.

At December 31, 2015, property and equipment amounted to $7,030 million, an increase of $1,032 million from December 31, 2014. The increase in property and equipment was mainly due to additions to property and equipment of $1,845 million in 2015, offset by the impact of depreciation expense of $631 million. The additions to property and equipment included four Boeing 787-9 and two Boeing 787-8 aircraft delivered in 2015, progress payments on future aircraft deliveries, and capitalized maintenance costs.

In addition, Air Canada has temporary differences and tax loss carryforwards for which no deferred income tax assets could be recognized. However, the future tax deductions underlying these deferred income tax assets would remain available for use in the future to reduce taxable income. The temporary differences and tax loss carryforwards for which no deferred income tax assets could be recognized amounted to $4,689 million as at December 31, 2015.

Certain pension plans are now in net asset positions and, as a result, those plans are required to be reported as pension assets on Air Canada's consolidated statement of financial position. At December 31, 2015, the net pension and other benefit liabilities amounted to $1,394 million (comprised of pension and other benefit liabilities of $2,245 million less pension assets of $851 million), a decrease of $1,009 million from December 31, 2014, mainly due to strong investment returns and the impact of higher prescribed pension plan discount rates as at December 31, 2015 versus December 31, 2014. Pension funding payments of $312 million were made in 2015. Refer to section 9.7 "Pension Funding Obligations" of this MD&A for additional information.

9.3. ADJUSTED NET DEBT

The following table reflects Air Canada's adjusted net debt balances as at December 31, 2015 and as at December 31, 2014.

CANADIAN DOLLARS IN MILLIONS, EXCEPT WHERE INDICATED	DECEMBER 31, 2015	DECEMBER 31, 2014	$ CHANGE
Total long-term debt and finance leases	$ 5,870	$ 4,732	$ 1,138
Current portion of long-term debt and finance leases	524	484	40
Total long-term debt and finance leases, including current portion	6,394	5,216	1,178
Less cash, cash equivalents and short-term investments	(2,672)	(2,275)	(397)
NET DEBT	**$ 3,722**	**$ 2,941**	**$ 781**
Capitalized operating leases (1)	2,569	2,191	378
ADJUSTED NET DEBT	**$ 6,291**	**$ 5,132**	**$ 1,159**
EBITDAR (TRAILING 12 MONTHS)	**$ 2,534**	**$ 1,671**	**$ 863**
ADJUSTED NET DEBT TO EBITDAR RATIO	**2.5**	**3.1**	**(0.6)**

1 Adjusted net debt is an additional GAAP financial measure used by Air Canada and may not be comparable to measures presented by other public companies. Adjusted net debt is a key component of the capital managed by Air Canada and provides management with a measure of its net indebtedness. Air Canada includes capitalized operating leases which is a measure commonly used in the industry to ascribe a value to obligations under operating leases. Common industry practice is to multiply annualized aircraft rent expense by 7. This definition of capitalized operating leases is used by Air Canada and may not be comparable to similar measures presented by other public companies. Aircraft rent (including aircraft rent expense related to regional airline operations) was $367 million in 2015 and $313 million in 2014.

At December 31, 2015, total long-term debt and finance leases (including current portion) increased $1,178 million from December 31, 2014, which was largely due to an unfavourable impact of a weaker Canadian dollar of $876 million as at December 31, 2015 compared to December 31, 2014 on Air Canada's foreign currency denominated debt (mainly U.S. dollars). In 2015, new borrowings amounted to $905 million and debt repayments amounted to $694 million. Air Canada took delivery of six Boeing 787 aircraft in 2015. Five of the aircraft were included in the enhanced equipment trust certificates financing transactions, as described in section 9.8 "Contractual Obligations" of this MD&A, and the other delivery was financed with Export-Import Bank of the United States ("EXIM") financing support.

Adjusted net debt amounted to $6,291 million at December 31, 2015, an increase of $1,159 million from December 31, 2014. This increase in adjusted net debt reflected higher long-term debt and finance lease balances as discussed above as well as an increase in capitalized operating leases, largely driven by an unfavourable currency impact. These increases were partly offset by higher cash and short-term investment balances.

At December 31, 2015, the adjusted net debt to EBITDAR ratio amounted to 2.5 versus a ratio of 3.1 at December 31, 2014. The ratio improvement of 0.6 was due to an $863 million increase in EBITDAR year-over-year partly offset by the increase in adjusted net debt of $1,159 million as discussed above.

At December 31, 2015, Air Canada's weighted average cost of capital ("WACC"), on a pre-tax basis, was approximately 9.6%. WACC is based on an estimate by management and consists of an estimated cost of equity of 23.6% and an average cost of debt and finance leases of 5.4%.

9.4. WORKING CAPITAL

The following table provides information on Air Canada's working capital balances as at December 31, 2015 and as at December 31, 2014.

CANADIAN DOLLARS IN MILLIONS	DECEMBER 31, 2015	DECEMBER 31, 2014	$ CHANGE
Cash, cash equivalents and short-term investments	$ 2,672	$ 2,275	$ 397
Accounts receivable	654	656	(2)
Other current assets	799	547	252
TOTAL CURRENT ASSETS	**$ 4,125**	**$ 3,478**	**$ 647**
Accounts payable and accrued liabilities	1,487	1,259	228
Advance ticket sales	1,818	1,794	24
Current portion of long-term debt and finance leases	524	484	40
TOTAL CURRENT LIABILITIES	**$ 3,829**	**$ 3,537**	**$ 292**
NET WORKING CAPITAL	**$ 296**	**$ (59)**	**$ 355**

The net working capital of $296 million at December 31, 2015 represented an improvement of $355 million from December 31, 2014. This improvement was mainly driven by the significant increase in net cash flows from operations in 2015, partly offset by capital expenditures of $1,815 million (or $954 million net of the financing drawn upon the delivery of six Boeing 787 aircraft). Other current assets of $799 million, which increased $252 million versus December 31, 2014, included promissory notes of $143 million related to the sale of Embraer 190 aircraft and the net value of foreign currency derivative contracts of $89 million. Accounts payable and accrued liabilities of $1,487 million increased $228 million mainly due to higher operating activity levels, higher accruals for employee profit sharing and compensation programs, and the impact of foreign exchange on U.S. dollar denominated operating expenses.

9.5. CONSOLIDATED CASH FLOW MOVEMENTS

The following table provides the cash flow movements for Air Canada for the periods indicated:

	FOURTH QUARTER			FULL YEAR		
CANADIAN DOLLARS IN MILLIONS	2015	2014	$ Change	2015	2014	$ Change
NET CASH FLOWS FROM OPERATING ACTIVITIES	**$ 238**	**$ 16**	**$ 222**	**$ 2,012**	**$ 954**	**$ 1,058**
Proceeds from borrowings	314	200	114	905	1,178	(273)
Reduction of long-term debt and finance lease obligations	(308)	(121)	(187)	(694)	(677)	(17)
Distributions related to aircraft special purpose leasing entities	(42)	-	(42)	(51)	-	(51)
Issue of common shares	1	-	1	4	1	3
Shares purchased for cancellation	(21)	-	(21)	(63)	-	(63)
Financing fees	(9)	-	(9)	(32)	-	(32)
NET CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES	**(65)**	**79**	**(144)**	**69**	**502**	**(433)**
Short-term investments	119	37	82	(398)	(100)	(298)
Additions to property, equipment and intangible assets	(614)	(386)	(228)	(1,815)	(1,501)	(314)
Proceeds from sale of assets	6	4	2	23	72	(49)
Other	(21)	10	(31)	2	(3)	5
NET CASH FLOWS USED IN INVESTING ACTIVITIES	**(510)**	**(335)**	**(175)**	**(2,188)**	**(1,532)**	**(656)**
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	**(1)**	**4**	**(5)**	**18**	**(13)**	**31**
DECREASE IN CASH AND CASH EQUIVALENTS	**(338)**	**(236)**	**(102)**	**(89)**	**(89)**	**-**
Cash and cash equivalents, beginning of period	910	897	13	661	750	(89)
CASH AND CASH EQUIVALENTS, END OF PERIOD	**$ 572**	**$ 661**	**$ (89)**	**$ 572**	**$ 661**	**$ (89)**

The following table provides the calculation of free cash flow for Air Canada for the periods indicated:

	FOURTH QUARTER			FULL YEAR		
CANADIAN DOLLARS IN MILLIONS	2015	2014	$ Change	2015	2014	$ Change
NET CASH FLOWS FROM OPERATING ACTIVITIES	**$ 238**	**$ 16**	**$ 222**	**$ 2,012**	**$ 954**	**$ 1,058**
Additions to property, equipment and intangible assets	(614)	(386)	(228)	(1,815)	(1,501)	(314)
FREE CASH FLOW [1]	**$ (376)**	**$ (370)**	**$ (6)**	**$ 197**	**$ (547)**	**$ 744**

1 Free cash flow is not a recognized measure for financial presentation under GAAP, does not have a standardized meaning and is not comparable to measures presented by other public companies. Air Canada considers free cash flow to be an indicator of the financial strength and performance of its business because it shows how much cash is generated from the business after investing in capital assets, which is available to meet ongoing financial obligations, including repaying debt, and re-investing in Air Canada.

Free Cash Flow

Net cash flows from operating activities of $238 million for the fourth quarter of 2015 and $2,012 million in 2015 improved $222 million and $1,058 million, respectively, when compared to the same periods in 2014. These increases in net cash flows from operating activities were due to improvements in operating income and the impact of lower pension past service funding payments. Negative free cash flow of $376 million for the fourth quarter of 2015 decreased $6 million from the fourth quarter of 2014, due to a higher level of capital expenditures year-over-year, largely offset by the impact of higher cash flows from operating activities. In 2015, free cash flow of $197 million improved by $744 million when compared to 2014, driven by higher cash flows from operating activities partly offset by higher capital expenditures. Air Canada took delivery of two Boeing 787 aircraft in the fourth quarter of 2015 (for a total of six Boeing 787 aircraft delivered in 2015).

Net Cash Flows Used in Financing Activities

Proceeds from borrowings amounted to $314 million in the fourth quarter of 2015 and $905 million in 2015. In the fourth quarter and 2015, reduction of long-term debt and finance lease obligations amounted to $308 million and $694 million, respectively. Refer to sections 9.3 "Adjusted Net Debt" and 9.6 "Capital Expenditures and Related Financing Arrangements" of this MD&A for additional information on Air Canada's financing activities.

9.6. CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS

Aircraft and Related Financing

Private Offerings of Enhanced Equipment Trust Certificates

In March 2015, in connection with the financing of one Boeing 787-8 delivered in January 2015 and eight new Boeing 787-9 aircraft, four of which were delivered in the second half of 2015 and the remainder of which are scheduled for delivery by March 2016, Air Canada completed a private offering of three tranches of enhanced equipment trust certificates with a combined aggregate face amount of approximately US$1.031 billion.

In December 2015, in connection with the financing of three Boeing 787-9 aircraft and two Boeing 777-300ER aircraft, which are scheduled for delivery in April and May 2016, Air Canada completed a private offering of three tranches of enhanced equipment trust certificates with a combined aggregate face amount of approximately US$537 million.

Refer to section 9.8 "Contractual Obligations" of this MD&A for additional information.

Boeing

As at December 31, 2015, Air Canada had outstanding purchase commitments with Boeing for 25 Boeing 787 aircraft. Air Canada's Boeing 787 plan is to operate eight Boeing 787-8 aircraft, all of which are in Air Canada's operating fleet, and 29 Boeing 787-9 aircraft, four of which are in Air Canada's operating fleet. The remaining Boeing 787-9 aircraft are scheduled for delivery between 2016 and 2019.

Air Canada also has purchase options for 13 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on previously determined pricing and delivery positions), and purchase rights for 10 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on Boeing's then current pricing).

Subject to certain conditions, Air Canada has various financing or sale and leaseback commitments covering up to 21 of the remaining 25 Boeing 787 firm aircraft orders, which are summarized as follows:

- For seven Boeing 787-9 aircraft, which are currently scheduled for delivery by May 2016, and for two Boeing 777-300ER, which are currently scheduled for delivery in April and May 2016, Air Canada completed the closing of the private offerings of enhanced equipment trust certificates which are described above.
- For 12 of the 787 aircraft, which are scheduled for delivery by 2019, the financing terms are for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments.
- A sale and leaseback transaction with a third party for two Boeing 787 aircraft.

Air Canada has an agreement with Boeing for the purchase of Boeing 737 MAX aircraft which provides for:

- Firm orders for 33 737 MAX 8 and 28 737 MAX 9 aircraft with substitution rights between them as well as for the 737 MAX 7 aircraft.
- Purchase options for 18 Boeing 737 aircraft.
- Certain rights to purchase an additional 30 Boeing 737 aircraft.

Deliveries of Boeing 737 MAX aircraft are scheduled to begin in 2017 with two aircraft, with the remaining deliveries between 2018 and 2021, subject to deferral and acceleration rights.

Air Canada has financing commitments, subject to certain conditions, covering all 61 of the Boeing 737 MAX firm aircraft orders. The financing terms are for 80% of the aircraft delivery price and the term to maturity is 10 years with mortgage-style repayments.

As at December 31, 2015, Air Canada had purchase rights for 11 Boeing 777 (entitling Air Canada to purchase aircraft based on previously determined pricing).

Total committed aircraft financing, including commitments from the private offerings of enhanced equipment trust certificates and the sale and leaseback transaction with a third party, will be at least $6,421 million.

Capital Commitments

As outlined in the table below, the estimated aggregate cost of the future firm Boeing 787, Boeing 777 and Boeing 737 MAX aircraft deliveries and other capital purchase commitments as at December 31, 2015 approximates $8,749 million.

CANADIAN DOLLARS IN MILLIONS	2016	2017	2018	2019	2020	THEREAFTER	TOTAL
Projected committed expenditures	$ 2,506	$ 2,002	$ 1,708	$ 1,273	$ 799	$ 461	$ 8,749
Projected planned but uncommitted expenditures	334	300	343	323	288	not available	not available
Projected planned but uncommitted capitalized maintenance (1)	223	146	146	146	146	not available	not available
TOTAL PROJECTED EXPENDITURES (2)	**$ 3,063**	**$ 2,448**	**$ 2,197**	**$ 1,742**	**$ 1,233**	**not available**	**not available**

1 Future capitalized maintenance amounts for 2019 and beyond are not yet determinable however an estimate of $146 million has been made for 2019 and 2020.
2 U.S. dollar amounts are converted using the December 31, 2015 closing exchange rate of US$1 = C$1.3840. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at December 31, 2015.

9.7. PENSION FUNDING OBLIGATIONS

Air Canada maintains several defined benefit pension plans, including domestic registered pension plans, supplemental pension plans and international pension plans. Air Canada also has several defined contribution pension plans as well as plans providing other retirement and post-employment benefits to its employees. Total employer pension funding contributions during 2015 amounted to $312 million.

CANADIAN DOLLARS IN MILLIONS	2015
Past service domestic registered plans	$ 96
Current service domestic registered plans	$ 121
Other pension arrangements (1)	$ 95
TOTAL PENSION FUNDING OBLIGATIONS	**$ 312**

1 Includes retirement compensation arrangements, supplemental plans and international plans.

As at January 1, 2015, the aggregate solvency surplus in the domestic registered pension plans was $660 million. Based on preliminary estimates, including actuarial assumptions, as at January 1, 2016, the aggregate solvency surplus in Air Canada's domestic registered pension plans is projected to be $1.3 billion. The final valuations to be made as at January 1, 2016 will be completed in the first half of 2016. Assuming final valuations confirm that Air Canada's domestic registered pension plans are in a solvency surplus position as at January 1, 2016, Air Canada does not expect any past service cost payments in 2016. In addition, for plans funded at 105% or more on a solvency basis, as permitted by legislation, no contributions are required for current service as long as the solvency position is not reduced to less than 105%. Taking this into account, on a cash basis, for 2016, total pension funding contributions are forecast to be $76 million, $140 million less than they otherwise would have been.

In the second quarter of 2015, Air Canada elected to opt out of the Air Canada Pension Plan Funding Regulations, 2014, (the "2014 Regulations"). The 2014 Regulations became effective on January 1, 2014 and under their terms, Air Canada was required to make solvency deficit payments of $200 million per year, on average, over a seven-year period. The agreement with the Government of Canada entered into in connection with these regulations contained several restrictions, including a prohibition on dividends and share repurchases. However, the agreement allowed Air Canada to opt out at any time.

Pension funding obligations (including projected funding obligations) under normal funding rules may vary significantly based on a wide variety of factors, including the assumptions used in the most recently filed actuarial valuation reports (including the applicable discount rate used or assumed in the actuarial valuation), the plan demographics at the valuation date, the existing plan provisions, legislative and regulatory developments and changes in economic conditions (mainly the return on fund assets and changes in interest rates) and other factors. Actual contributions that are determined on the basis of future valuation reports may vary significantly from projections. In addition to changes in plan demographics and experience, actuarial assumptions and methods may be changed from one valuation to the next, including due to changes in plan experience, financial markets, future expectations, and legislation and other factors.

As at December 31, 2015, taking into account the effect of financial instrument risk management tools, approximately 75% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk. Air Canada may continue to increase the percentage of fixed income products matched to pension liabilities, subject to favourable market conditions.

CANADIAN DOLLARS IN MILLIONS	2016
Past service domestic registered plans	$ -
Current service domestic registered plans	$ 1
Other pension arrangements [1]	$ 75
TOTAL PENSION FUNDING OBLIGATIONS	**$ 76**

1 Includes retirement compensation arrangements, supplemental plans and international plans.

9.8. CONTRACTUAL OBLIGATIONS

Private Offerings of Enhanced Equipment Trust Certificates

In March 2015, in connection with the financing of one Boeing 787-8 aircraft delivered in January 2015 and eight new Boeing 787-9 aircraft, four of which were delivered in the second half of 2015, and the remaining of which are scheduled for delivery by March 2016, Air Canada completed a private offering of three tranches of enhanced equipment trust certificates with a combined aggregate face amount of approximately US$1.031 billion.

The private offering is comprised of Class A certificates, Class B certificates and Class C certificates.

- The Class A certificates, with a US$667 million face amount, have an interest rate of 3.600% per annum and a final expected distribution date of March 15, 2027.
- The Class B certificates, with a US$182 million face amount, have an interest rate of 3.875% per annum and a final expected distribution date of March 15, 2023.
- The Class C certificates, with a US$182 million face amount, have an interest rate of 5.000% per annum and a final expected distribution date of March 15, 2020.

The certificates have a combined weighted average interest rate of 3.81% per annum.

In December 2015, in connection with the financing of three Boeing 787-9 aircraft and two Boeing 777-300ER aircraft, which are scheduled for delivery in April and May 2016, Air Canada completed a private offering of three tranches of enhanced equipment trust certificates with a combined aggregate face amount of approximately US$537 million.

The private offering is comprised of Class AA certificates, Class A certificates and Class B certificates.

- The Class AA certificates, with a US$295 million face amount, have an interest rate of 3.750% per annum and a final expected distribution date of December 15, 2027.
- The Class A certificates, with a US$121 million face amount, have an interest rate of 4.125% per annum and a final expected distribution date of December 15, 2027.
- The Class B certificates, with a US$121 million face amount, have an interest rate of 5.000% per annum and a final expected distribution date of December 15, 2023.

The certificates have a combined weighted average interest rate of 4.044% per annum.

The table below provides Air Canada's contractual obligations as at December 31, 2015, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and finance lease obligations, operating lease obligations and committed capital expenditures. The table below also includes the interest and principal payments under the financing associated with the seven Boeing 787-9 and two Boeing 777-300 aircraft as described above, the proceeds of which are held in escrow and will be drawn upon the delivery of these aircraft (scheduled for end of May 2016).

CANADIAN DOLLARS IN MILLIONS	2016	2017	2018	2019	2020	THEREAFTER	TOTAL
PRINCIPAL							
Long-term debt obligations	$ 482	$ 619	$ 627	$ 1,712	$ 757	$ 1,963	$ 6,160
Finance lease obligations	42	44	52	49	53	90	330
TOTAL PRINCIPAL OBLIGATIONS	**$ 524**	**$ 663**	**$ 679**	**$ 1,761**	**$ 810**	**$ 2,053**	**$ 6,490**
INTEREST							
Long-term debt obligations	$ 299	$ 294	$ 243	$ 212	$ 104	$ 170	$ 1,322
Finance lease obligations	28	25	20	15	10	25	123
TOTAL INTEREST OBLIGATIONS	**$ 327**	**$ 319**	**$ 263**	**$ 227**	**$ 114**	**$ 195**	**$ 1,445**
TOTAL LONG-TERM DEBT AND FINANCE LEASE OBLIGATIONS	**$ 851**	**$ 982**	**$ 942**	**$ 1,988**	**$ 924**	**$ 2,248**	**$ 7,935**
Operating lease obligations	**$ 536**	**$ 477**	**$ 420**	**$ 333**	**$ 228**	**$ 346**	**$ 2,340**
Committed capital expenditures	**$ 2,506**	**$ 2,002**	**$ 1,708**	**$ 1,273**	**$ 799**	**$ 461**	**$ 8,749**
TOTAL CONTRACTUAL OBLIGATIONS (1)	**$ 3,893**	**$ 3,461**	**$ 3,070**	**$ 3,594**	**$ 1,951**	**$ 3,055**	**$ 19,024**
EETC FINANCING RELATED TO SEVEN BOEING 787-9 AND TWO BOEING 777-300ER AIRCRAFT (PRINCIPAL AND INTEREST)	**$ 98**	**$ 125**	**$ 122**	**$ 120**	**$ 228**	**$ 1,123**	**$ 1,816**
TOTAL OBLIGATIONS, INCLUDING THE IMPACT OF THE EETC FINANCING RELATED TO SEVEN BOEING 787-9 AND TWO BOEING 777-300ER AIRCRAFT	**$ 3,991**	**$ 3,586**	**$ 3,192**	**$ 3,714**	**$ 2,179**	**$ 4,178**	**$ 20,840**

1 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 in finance lease obligations due to reasons of uncertainty of timing of cash flows and items that are non-cash in nature.

Covenants in Credit Card Agreements

Air Canada's principal credit card processing agreement for credit card processing services in Canada contains triggering events upon which Air Canada would be required to provide the credit card processor with cash deposits. The obligation to provide cash deposits and the required amount of deposits are each based upon a matrix measuring, on a quarterly basis, both a fixed charge coverage ratio for Air Canada and the unrestricted cash and short-term investments of Air Canada. In 2015, Air Canada made no cash deposits under this agreement (nil in 2014).

Air Canada also has agreements with another processor for the provision of certain credit card processing services requirements for markets other than Canada and for its cargo operations worldwide where such agreements also contain deposit obligations. In 2015, Air Canada made no cash deposits under these agreements (nil in 2014).

Ratings

Air Canada's corporate credit, senior notes and/or EETCs are rated by the following rating agencies:

- Moody's Investors Service, Inc. ("Moody's");
- Standard & Poor's Rating Services ("Standard & Poor's");
- Fitch Ratings, Inc. ("Fitch"); and
- DBRS Limited ("DBRS").

Ratings are intended to provide investors with an independent view of credit quality. They are not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the rating organization. Each rating should be evaluated independently of any other rating.

Moody's Ratings

On December 11, 2015, Moody's assigned the following ratings to Air Canada's 2015-2 Class AA, Class A and Class B Enhanced Equipment Trust Certificates: A1, A3, Ba1, respectively.

On June 29, 2015, Moody's undertook the following actions relating to Air Canada:

- Air Canada's corporate family rating was upgraded to B1 (stable outlook) from B2 and probability of default ratings to B1-PD from B2-PD.
- Senior First Lien Notes rating of Ba3 was confirmed; Senior Second Lien Notes rating upgraded to B2 from B3.
- Senior Unsecured Notes rating upgraded to B3 from Caa1.
- Speculative grade liquidity rating of SGL-2 was affirmed.
- The ratings on Air Canada's 2013-1 Class A, Class B and Class C Enhanced Equipment Trust Certificates were upgraded by one notch to A3, Ba1, and Ba3, respectively.

Standard & Poor's Ratings

On December 11, 2015, Standard & Poor's assigned the following ratings to Air Canada's 2015-2 Class AA, Class A and Class B Enhanced Equipment Trust Certificates: AA, A, BBB-, respectively.

On March 25, 2015, Standard & Poor's assigned the following ratings to Air Canada's 2015-1 Class A, Class B and Class C Enhanced Equipment Trust Certificates: A, BBB, BB-, respectively.

On February 2, 2015, Standard & Poor's undertook the following actions relating to Air Canada:

- Air Canada's corporate credit rating upgraded to B+ from B, stable trend.
- Senior Unsecured Notes rating upgraded to B from B-; no change to the recovery rating of 5.
- Senior First Lien Notes rating upgraded to BB from BB-; no change to the recovery rating of 1.
- Senior Second Lien Notes rating upgraded to BB from B-; recovery rating revised to 1 from 5.
- The rating on Air Canada's 2013-1 Class A Enhanced Equipment Trust Certificates was affirmed at A and the ratings on Air Canada's 2013-1 Class B and Class C Enhanced Equipment Trust Certificates were raised by one notch each to BBB- from BB+ and to BB- from B+, respectively.

Fitch Ratings

On March 25, 2015, Fitch assigned the following ratings to Air Canada's 2015-1 Class A, Class B and Class C Enhanced Equipment Trust Certificates: A, BBB-, BB, respectively.

On February 23, 2015, Fitch undertook the following actions relating to Air Canada:

- Air Canada's long-term issuer default rating (IDR) was upgraded to B+ from B, stable trend.
- Senior First Lien Notes and Second Lien Notes ratings were upgraded to BB+ from BB with a recovery rating of RR1.
- Air Canada's 2013-1 Enhanced Equipment Trust Certificates: Class A affirmed at A, Class B upgraded to BBB- from BB+ and Class C upgraded to BB from BB-.
- Senior Unsecured Notes rating was upgraded to B from B- with a recovery rating of RR5.

DBRS Ratings

On August 21, 2015, DBRS upgraded Air Canada's Issuer Rating to B (high) from B, stable trend.

9.9. SHARE INFORMATION

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

	DECEMBER 31, 2015	DECEMBER 31, 2014
ISSUED AND OUTSTANDING SHARES		
Variable voting shares	98,059,765	69,232,535
Voting shares	184,722,413	217,256,759
TOTAL ISSUED AND OUTSTANDING SHARES	**282,782,178**	**286,489,294**
CLASS A VARIABLE VOTING AND CLASS B VOTING SHARES POTENTIALLY ISSUABLE		
Stock options	8,735,634	10,002,975
TOTAL SHARES POTENTIALLY ISSUABLE	**8,735,634**	**10,002,975**
TOTAL OUTSTANDING AND POTENTIALLY ISSUABLE SHARES	**291,517,812**	**296,492,269**

Issuer Bid

In May 2015, following receipt of approval from the Toronto Stock Exchange, Air Canada implemented a normal course issuer bid to purchase, for cancellation, up to 10,000,000 Class A variable voting shares and/or Class B voting shares (the "Shares") representing, at that time, 3.49% of the total issued and outstanding Shares. The repurchase program is in effect until May 28, 2016.

Since commencing the normal course issuer bid, Air Canada purchased and cancelled 5,583,935 Shares for cash at an average cost of $11.28 per Share for aggregate consideration of $63 million.

QUARTERLY FINANCIAL DATA

The following table summarizes quarterly financial results for Air Canada for the last eight quarters. As of 2015, expenses incurred related to capacity purchase agreements are now presented in a separate line item on Air Canada's consolidated statement of operations titled Regional airlines expense. Prior period amounts have been reclassified to conform to the current period presentation.

CANADIAN DOLLARS IN MILLIONS, EXCEPT WHERE INDICATED	2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Passenger	$ 2,608	$ 2,965	$ 3,476	$ 2,755	$ 2,786	$ 3,082	$ 3,716	$ 2,836
Cargo	119	122	128	133	129	123	119	135
Other	338	218	194	216	334	209	188	211
OPERATING REVENUES	**3,065**	**3,305**	**3,798**	**3,104**	**3,249**	**3,414**	**4,023**	**3,182**
Aircraft fuel	793	835	939	680	592	648	697	527
Regional airlines expense								
Aircraft fuel	125	127	137	111	86	97	95	81
Other	442	451	471	460	466	497	489	468
Wages, salaries & benefits	557	535	549	560	568	568	598	590
Airport and navigation fees	183	186	208	178	185	201	223	193
Aircraft maintenance	162	171	158	187	188	190	192	203
Depreciation, amortization and impairment (2)	126	128	142	130	153	177	165	160
Sales and distribution costs	148	143	146	123	154	152	157	145
Ground package costs	170	77	56	74	181	84	63	87
Aircraft rent	76	76	74	76	82	84	89	98
Food, beverages and supplies	66	74	84	70	62	80	91	81
Communications and IT	52	47	49	51	57	52	52	50
Special items	-	(41)	-	30	-	(23)	-	31
Other	227	251	259	268	275	284	297	310
OPERATING EXPENSES	**3,127**	**3,060**	**3,272**	**2,998**	**3,049**	**3,091**	**3,208**	**3,024**
OPERATING INCOME (LOSS)	**(62)**	**245**	**526**	**106**	**200**	**323**	**815**	**158**
Foreign exchange gain (loss)	(161)	40	(71)	(115)	(408)	56	(251)	(159)
Interest income	9	9	11	10	9	12	12	13
Interest expense	(77)	(81)	(81)	(83)	(90)	(94)	(106)	(112)
Interest capitalized	5	10	6	9	9	21	20	20
Net financing expense relating to employee benefits	(34)	(34)	(34)	(32)	(25)	(25)	(28)	(27)
Fuel and other derivatives	(15)	36	(31)	9	1	5	(20)	(3)
Other	(6)	(2)	(3)	(4)	(5)	(2)	(5)	(6)
TOTAL NON-OPERATING EXPENSE	**(279)**	**(22)**	**(203)**	**(206)**	**(509)**	**(27)**	**(378)**	**(274)**
Income taxes	-	-	-	-	-	-	-	-
NET INCOME (LOSS)	**$ (341)**	**$ 223**	**$ 323**	**$ (100)**	**$ (309)**	**$ 296**	**$ 437**	**$ (116)**
DILUTED EARNINGS PER SHARE	**$ (1.20)**	**$ 0.75**	**$ 1.10**	**$ (0.35)**	**$ (1.08)**	**$ 1.00**	**$ 1.48**	**$ (0.41)**
EBITDAR (1)	**$ 147**	**$ 456**	**$ 749**	**$ 319**	**$ 442**	**$ 591**	**$ 1,076**	**$ 425**
ADJUSTED NET INCOME (LOSS) (2)	**$ (132)**	**$ 139**	**$ 457**	**$ 67**	**$ 122**	**$ 250**	**$ 734**	**$ 116**
ADJUSTED EARNINGS PER SHARE – DILUTED (2)	**$(0.46)**	**$ 0.47**	**$ 1.55**	**$ 0.23**	**$ 0.41**	**$ 0.85**	**$ 2.50**	**$ 0.40**

1 EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.
2 Adjusted net income (loss) and adjusted earnings (loss) per share – diluted are non-GAAP financial measures. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

The following table provides a breakdown of the most significant items included in other expenses for the last eight quarters:

	2014				2015			
CANADIAN DOLLARS IN MILLIONS	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Terminal handling	$ 42	$ 47	$ 54	$ 47	$ 50	$ 59	$ 65	$ 53
Crew cycle	32	35	38	36	35	36	43	35
Building rent and maintenance	36	36	35	32	36	36	36	37
Miscellaneous fees and services	25	33	31	31	31	35	32	39
Remaining other expenses	92	100	101	122	123	118	121	146
TOTAL OTHER EXPENSES	$ 227	$ 251	$ 259	$ 268	$ 275	$ 284	$ 297	$ 310

The following table provides a breakdown of the most significant items included in regional airlines expense for the last eight quarters:

	2014				2015			
CANADIAN DOLLARS IN MILLIONS	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Capacity purchase fees	$ 281	$ 294	$ 312	$ 295	$ 274	$ 302	$ 298	$ 282
Aircraft fuel	125	127	137	111	86	97	95	81
Airport and navigation fees	64	70	73	69	65	70	74	69
Sales and distribution costs	27	28	27	30	33	33	32	28
Depreciation, amortization and impairment	4	4	4	4	4	4	4	4
Aircraft rent	3	3	3	3	3	3	3	5
Other operating expenses	63	52	52	59	87	85	78	80
TOTAL REGIONAL AIRLINES EXPENSE	$ 567	$ 578	$ 608	$ 571	$ 552	$ 594	$ 584	$ 549

The following table provides major quarterly operating statistics for Air Canada for the last eight quarters:

	2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenue passenger miles (millions)	13,466	15,495	18,565	14,090	14,937	16,845	20,462	15,301
Available seat miles (millions)	16,774	18,413	21,299	17,403	18,335	20,132	23,535	18,869
Passenger load factor (%)	80.3	84.2	87.2	81.0	81.5	83.7	86.9	81.1
PRASM (cents)	15.3	15.9	16.1	15.6	14.9	15.0	15.5	14.7
CASM (cents)	18.6	16.6	15.4	17.2	16.6	15.4	13.6	16.0
Adjusted CASM (cents) (1)	12.2	11.2	10.1	12.1	11.9	11.3	10.0	12.2
Economic fuel price per litre (cents) (2)	94.7	91.6	90.0	80.7	66.3	66.9	61.4	58.6

1 Adjusted CASM is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.
2 Includes aircraft fuel expense related to regional airline operations. Includes fuel handling expenses. Economic fuel price per litre is a non-GAAP financial measure. Refer to section 7 "Results of Operations" of this MD&A for additional information.

SELECTED ANNUAL INFORMATION

The following table provides selected annual information for Air Canada for the years 2013 through to 2015.

CANADIAN DOLLARS IN MILLIONS, EXCEPT PER SHARE FIGURES	FULL YEAR 2015	2014	2013
Operating revenues	$ 13,868	$ 13,272	$ 12,382
Operating expenses [(1)]	12,372	12,457	11,763
OPERATING INCOME	**1,496**	**815**	**619**
Total non-operating expense and income taxes [(2)]	(1,188)	(710)	(609)
NET INCOME (LOSS)	**308**	**105**	**10**
EBITDAR [(3)]	**$ 2,534**	**$ 1,671**	**$ 1,515**
ADJUSTED NET INCOME	**$ 1,222**	**$ 531**	**$ 340**
BASIC EARNINGS PER SHARE	**$ 1.06**	**$ 0.35**	**$ 0.02**
DILUTED EARNINGS PER SHARE	**$ 1.03**	**$ 0.34**	**$ 0.02**
ADJUSTED NET EARNINGS PER SHARE – DILUTED	**$ 4.18**	**$ 1.81**	**$ 1.20**
CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS	**$ 2,672**	**$ 2,275**	**$ 2,208**
TOTAL ASSETS	**$ 13,127**	**$ 10,648**	**$ 9,470**
TOTAL LONG-TERM LIABILITIES [(4)]	**$ 9,782**	**$ 8,728**	**$ 8,051**
TOTAL LIABILITIES	**$ 13,087**	**$ 11,781**	**$ 10,867**

1 In 2015, Air Canada recorded special items which increased operating expenses by $8 million and recorded impairment charges totalling $14 million. In 2014, Air Canada recorded special items which reduced operating expenses by $11 million. In 2013, Air Canada recorded an operating expense reduction of $82 million related to changes to early retirement provisions in Air Canada's defined benefit pension plans and impairment charges amounting to $30 million.
2 In 2015, Air Canada recorded a special interest charge of $13 million related to the prepayment of debt associated with the disposal of Embraer 190 aircraft. In 2013, Air Canada recorded an interest charge of $95 million related to the purchase of its senior secured notes which were to become due in 2015 and 2016.
3 EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.
4 Total long-term liabilities include long-term debt (including current portion) and finance leases, pension and other benefit liabilities, maintenance provisions and other long-term liabilities.

12 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

SUMMARY OF FUEL AND OTHER DERIVATIVES

The following is a summary of fuel and other derivatives included in non-operating income (expense) on Air Canada's consolidated statement of operations for the periods indicated:

	FOURTH QUARTER		FULL YEAR	
CANADIAN DOLLARS IN MILLIONS	2015	2014	2015	2014
Fuel derivatives	$ -	$ (18)	$ (11)	$ (36)
Share forward contracts	(4)	24	(9)	31
Prepayment options on senior secured notes	1	2	1	2
Interest rate swaps	-	1	2	2
TOTAL FUEL AND OTHER DERIVATIVES	**$ (3)**	**$ 9**	**$ (17)**	**$ (1)**

RISK MANAGEMENT

Under its risk management policy, Air Canada manages its fuel price risk, foreign exchange risk and interest rate risk through the use of various financial derivative instruments. Air Canada uses these instruments solely for risk management purposes, not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be offset by changes in cash flows of the relevant risk being hedged.

As noted below, Air Canada uses derivative instruments to provide economic hedges to mitigate various risks. The fair values of these instruments represent the amount of the consideration that could be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. The fair value of these derivatives is determined using prices in active markets, where available. When no such market is available, valuation techniques are applied such as discounted cash flow analysis. The valuation technique incorporates all factors that would be considered in setting a price, including Air Canada's own credit risk, as well as the credit risk of the counterparty.

FUEL PRICE RISK MANAGEMENT

Fuel price risk is the risk that future cash flows will fluctuate because of changes in jet fuel prices. In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries. Air Canada may use derivative contracts based on jet fuel, heating oil and crude oil. Air Canada's policy permits hedging of up to 75% of the projected jet fuel purchases for the next 12 months, 50% for the next 13 to 24 months and 25% for the next 25 to 36 months. These are maximum (but not mandated) limits. There is no minimum monthly hedging requirement. There are regular reviews to adjust the strategy in light of market conditions.

In 2015:

- Air Canada recorded a loss of $11 million in fuel and other derivatives on Air Canada's consolidated statement of operations related to fuel derivatives (a loss of $36 million in 2014). These derivatives were not designated as hedges for accounting purposes.
- Air Canada purchased crude oil call options covering a portion of 2015 and 2016 fuel exposures. The cash premium related to these contracts was $39 million ($44 million in 2014 for 2014 and 2015 exposures).
- Fuel derivative contracts cash settled with a net fair value of $1 million ($24 million in favour of Air Canada in 2014).

Air Canada applied fuel hedge accounting for certain designated fuel derivatives prospectively from April 1, 2015. In 2015, the fair value decrease of $21 million for derivatives under hedge accounting was deferred as a cost of the hedged item in other comprehensive income and will be reclassified to aircraft fuel expense when the underlying hedged jet fuel is used. Fuel hedging loss of $10 million was reclassified from other comprehensive income to aircraft fuel expense in 2015.

A summary of amounts related to fuel derivatives designated as hedging instruments at December 31, 2015 is presented below.

	CARRYING AMOUNT OF THE HEDGING INSTRUMENT				
	NOMINAL AMOUNT OF THE HEDGING INSTRUMENT (IN BARRELS)	ASSETS	LIABILITIES	CONSOLIDATED STATEMENT OF FINANCIAL POSITION CLASSIFICATION	CHANGES IN FAIR VALUE USED FOR CALCULATING HEDGE INEFFECTIVENESS
CASH FLOW HEDGE					
Fuel price risk – option contracts	5,646,000	$ 10 million	$ -	Prepaid expenses and other current assets	$ -

As of December 31, 2015, approximately 18% of Air Canada's anticipated purchases of jet fuel for 2016 was hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US$48 per barrel for WTI prices up to US$51 per barrel and an average equivalent capped price of US$51 per barrel for WTI prices above US$53 per barrel. Air Canada's contracts to hedge anticipated jet fuel purchases over the 2016 period are comprised of call options with notional volumes of 5,646,000 barrels. The fair value of the fuel derivatives portfolio at December 31, 2015 was $10 million in favour of Air Canada (2014 – $4 million in favour of Air Canada) and is recorded within prepaid expenses and other current assets on Air Canada's consolidated statement of financial condition.

FOREIGN EXCHANGE RISK MANAGEMENT

Air Canada's financial results are reported in Canadian dollars, while a large portion of its expenses, debt obligations and capital commitments are in foreign currencies, primarily in U.S. dollars. Foreign exchange risk is the risk that fluctuations in foreign exchange rates may have on operating results and cash flows. Air Canada's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

Air Canada generates sales in U.S. dollars and in other foreign currencies which are converted to U.S. dollars under Air Canada's risk management program. In 2015, these net cash inflows totalled approximately US$3.1 billion. Also in 2015, U.S. denominated non-fuel operating costs amounted to approximately US$2.6 billion and U.S. dollar interest costs amounted to approximately US$250 million. Air Canada views U.S. dollar revenues largely as a natural hedge against non-fuel U.S. dollar costs. Fuel expenses, which are based in U.S. dollars, amounted to US$2.2 billion. For 2015, this resulted in a U.S. dollar net cash flow exposure of approximately $2.0 billion as it relates to the statement of operations. In addition, the majority of principal payments on long-term debt are denominated in U.S. dollars.

Air Canada has a target coverage of 70% on a rolling 18 month basis to manage the net U.S. dollar cash flow exposure described above utilizing the following risk management strategies:

Air Canada holds U.S. cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash and short-term investment balances as at December 31, 2015 amounted to $490 million or US$358 million ($717 million or US$620 million as at December 31, 2014). A portion of the cash and investment reserves is an economic hedge against net long-term U.S. dollar debt while the remainder of the cash is operational cash and investment reserves which are applied against the 18-month net U.S. dollar cash flow exposure. In 2015, a gain of $123 million (a gain of $58 million in 2014) was recorded reflecting the change in Canadian equivalent market value of the U.S. dollar cash and short-term investment balances held.

The level of foreign exchange derivatives entered into and their related maturity dates are dependent upon a number of factors, which include the amount of foreign revenue conversion available, U.S. dollar net cash outflows, as well as the amount attributed to aircraft and debt payments. Based on the notional amount of currency derivatives outstanding at December 31, 2015, as further described below, approximately 85% of net U.S. cash outflows is hedged for 2016 and 24% for 2017, resulting in derivative coverage of 67% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in a coverage of 68%.

As at December 31, 2015, Air Canada had outstanding foreign currency options and swap agreements, settling in 2016 and 2017, to purchase at maturity $3,234 million (US$2,337 million) of U.S. dollars at a weighted average rate of $1.2683 per US$1.00 (as at December 31, 2014 – $2,658 million (US$2,292 million) with settlements in 2015 and 2016 at a weighted average rate of $1.0884 per US$1.00). Air Canada also has protection in place to sell a portion of its excess Euros, Sterling, Yen, Yuan, and AUD (EUR $42 million, GBP $9 million, JPY $2,052 million, CNY $288 million, AUD $18 million) which settle in 2016 at weighted average rates of $1.1663, $1.6150, $0.0088, $0.1562 and $0.7230 per US$1.00, respectively (as at December 31, 2014 – EUR $35 million, GBP $27 million with settlement in 2015 at weighted average rates of $1.2806 and $1.6217, respectively, per US$1.00). The result of these hedging activities is recorded as a foreign exchange gain (loss) in non-operating expense on Air Canada's consolidated statement of operations (not within operating income).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations, and based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at December 31, 2015 was $89 million in favour of Air Canada (2014 – $30 million in favour of Air Canada). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. In 2015, a gain of $164 million was recorded in foreign exchange gain (loss) on Air Canada's consolidated statement of operations related to these derivatives (a gain of $75 million in 2014). In 2015, foreign exchange derivative contracts cash settled with a net fair value of $104 million in favour of Air Canada ($58 million in favour of Air Canada in 2014). The total combined gain related to U.S. cash, investments and foreign exchange derivatives recorded by Air Canada in 2015 was $287 million ($133 million gain in 2014).

INTEREST RATE RISK MANAGEMENT

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Air Canada enters into both fixed and floating rate debt and leases certain assets where the rental amount fluctuates based on changes in short-term interest rates. Air Canada manages interest rate risk on a portfolio basis and seeks financing terms in individual arrangements that are most advantageous taking into account all relevant factors, including credit margin, term and basis. The risk management objective is to minimize the potential for changes in interest rates to cause adverse changes in cash flows to Air Canada. The cash and short-term investment portfolio, which earns a floating rate of return, is an economic hedge for a portion of the floating rate debt.

The ratio of fixed to floating rate obligations outstanding is designed to maintain flexibility in Air Canada's capital structure and is based upon a long-term objective of 60% fixed and 40% floating but allows the flexibility in the short-term to adjust to prevailing market conditions. The ratio at December 31, 2015, was 79% fixed and 21% floating, including the effects of interest rate swap positions (75% and 25%, respectively, as at December 31, 2014).

CRITICAL ACCOUNTING ESTIMATES

Critical accounting estimates are those that are most important to the portrayal of Air Canada's financial condition and results of operations. They require management's most difficult, subjective or complex judgments, often because of the need to make estimates about the effect of matters that are inherently uncertain. Actual results could differ from those estimates under different assumptions or conditions.

Air Canada has identified the following areas that contain critical accounting estimates utilized in the preparation of its consolidated financial statements.

EMPLOYEE FUTURE BENEFITS

Air Canada maintains several defined benefit plans providing pension, other retirement and post-employment benefits to its employees. The cost and related liabilities of Air Canada's pensions, other post-retirement and post-employment benefit programs are determined using actuarial valuations. The actuarial valuations involve assumptions, including discount rates, future salary increases, mortality rates and future benefit increases. Also, due to the long-term nature of these programs, such estimates are subject to significant uncertainty.

ASSUMPTIONS

Management is required to make significant estimates about actuarial and financial assumptions to determine the cost and related liabilities of Air Canada's employee future benefits.

Financial Assumptions

Discount Rate

The discount rate used to determine the pension obligation was determined by reference to market interest rates on corporate bonds rated "AA" or better with cash flows that approximate the timing and amount of expected benefit payments.

Future increases in compensation are based upon the current compensation policies, labour agreements and economic forecasts.

The significant weighted average assumptions used to determine Air Canada's accrued benefit obligations and cost are as follows:

	PENSION BENEFITS		OTHER EMPLOYEE FUTURE BENEFITS	
	2015	2014	2015	2014
DISCOUNT RATE USED TO DETERMINE:				
Net interest on the net benefit obligation for the year ended December 31	4.0%	4.9%	3.9%	4.8%
Service cost for the year ended December 31	4.2%	4.9%	4.1%	4.8%
Accrued benefit obligation as at December 31	4.1%	4.0%	4.1%	3.9%
RATE OF FUTURE INCREASES IN COMPENSATION USED TO DETERMINE:				
Accrued benefit cost for the year ended December 31	2.5%	2.5%	not applicable	not applicable
Accrued benefit obligation as at December 31	2.5%	2.5%	not applicable	not applicable

SENSITIVITY ANALYSIS

Sensitivity analysis is based on changing one assumption while holding all other assumptions constant. In practice, this may be unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to variations in significant actuarial assumptions, the same method (present value of the defined benefit obligation calculated with the projected unit credit method at the end of the reporting period) has been applied as that used for calculating the liability recognized in the consolidated statement of financial position.

Sensitivity analysis on 2015 pension expense and net financing expense relating to pension benefit liabilities, based on different actuarial assumptions with respect to discount rate is set out below. The effects on each pension plan of a change in an assumption are weighted proportionately to the total plan obligation to determine the total impact for each assumption presented.

	0.25 PERCENTAGE POINT	
	DECREASE	INCREASE
DISCOUNT RATE ON OBLIGATION ASSUMPTION		
Pension expense	$ 19	$ (18)
Net financing expense relating to pension benefit liabilities	17	(13)
TOTAL	**$ 36**	**$ (31)**
INCREASE (DECREASE) IN PENSION OBLIGATION	**$ 639**	**$ (618)**

The increase (decrease) in the pension obligation for a 0.25 percentage point change in the discount rate relates to the gross amount of the pension liabilities and is before the impact of any change in plan assets. As at December 31, 2015, approximately 75% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk.

An increase of one year life expectancy would increase the pension benefit obligation by $445 million.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 5.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2015 (2014 – 5.5%). The rate is assumed to decrease to 5% by 2019. A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by $4 million and the obligation by $64 million. A one percentage point decrease in assumed health care trend rates would have decreased the total of current service and interest costs by $4 million and the obligation by $62 million.

A 0.25 percentage point decrease in discount rate would have increased the total of current and interest costs by $1 million and the obligation by $51 million. A 0.25 percentage point increase in discount rate would have decreased the total of current and interest costs by $1 million and the obligation by $40 million.

IMPAIRMENT CONSIDERATIONS OF LONG-LIVED ASSETS

Long-lived assets include property and equipment, definite lived intangible assets, indefinite lived intangible assets and goodwill. Assets that have an indefinite useful life, including goodwill, are tested annually for impairment or when events or circumstances indicate that the carrying value may not be recoverable. Assets that are subject to depreciation or amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When required, an impairment test is performed by comparing the carrying amount of the asset or cash generating unit to their recoverable amount. Recoverable amount is calculated as the higher of an asset's or cash-generating unit's fair value less costs to dispose and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or CGUs). Management has determined that the appropriate level for assessing impairments in accordance with IFRS is at the North American and international fleet levels for aircraft and related assets supporting the operating fleet. Parked aircraft not used in operations and aircraft leased or subleased to third parties are assessed for impairment at the individual asset level. Value in use is calculated based upon a discounted cash flow analysis, which requires management to make a number of significant assumptions including assumptions relating to future operating plans, discount rates and future growth rates. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

DEPRECIATION AND AMORTIZATION PERIOD FOR LONG-LIVED ASSETS

Air Canada makes estimates about the expected useful lives of long-lived assets and the expected residual values of the assets based on the estimated current fair value of the assets, Air Canada's fleet plans and the cash flows they generate. Changes to these estimates, which can be significant, could be caused by a variety of factors, including changes to maintenance programs, changes in jet fuel prices and other operating costs, changes in utilization of the aircraft, and changing market prices for new and used aircraft of the same or similar types. Estimates and assumptions are evaluated at least annually. Generally, these adjustments are accounted for on a prospective basis, through depreciation and amortization expense. For the purposes of sensitivity analysis on these estimates, a 50% reduction to residual values on aircraft with remaining useful lives greater than five years results in an increase of $15 million to annual depreciation expense. For aircraft with shorter remaining useful lives, the residual values are not expected to change significantly.

MAINTENANCE PROVISIONS

The recording of maintenance provisions related to return conditions on aircraft leases requires management to make estimates of the future costs associated with the maintenance events required under the lease return condition and estimates of the expected future maintenance condition of the aircraft at the time of lease expiry. These estimates take into account current costs of these maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Any difference in the actual maintenance cost incurred and the amount of the provision is recorded in maintenance expense in the period. The effect of any changes in estimates, including changes in discount rates, inflation assumptions, cost estimates or lease expiries, is also recognized in maintenance expense in the period. Assuming the aggregate cost for return conditions increases by 5%, holding all other factors constant, there would be a cumulative balance sheet adjustment to increase the provision by $44 million at December 31, 2015 and an increase to maintenance expense in 2016 of approximately $7 million. For illustrative purposes, if the discount rates were to increase by 1%, holding all other factors constant, there would be a cumulative balance sheet adjustment to decrease the provision by $19 million at December 31, 2015. Due to low market rates of interest, a 1% decrease in discount rates was not considered a reasonable scenario.

INCOME TAXES

Deferred income tax assets are recognized only to the extent that it is probable that future taxable income will be available to realize them. In making this assessment, consideration is given to available positive and negative evidence and relevant assumptions. Consideration is given to, among other things, future projections of taxable income, overall business environment, historical financial results, and industry-wide trends and outlooks. At December 31, 2015, no deferred income tax assets have been recorded.

14 ACCOUNTING POLICIES

ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET ADOPTED

The following is an overview of accounting standard changes that Air Canada will be required to adopt in future years. Air Canada continues to evaluate the impact of these standards on its consolidated financial statements.

IFRS 15 – REVENUE FROM CONTRACTS WITH CUSTOMERS

IFRS 15 replaces IAS 18 Revenue and related interpretations. The core principle of the new standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard is intended to enhance disclosures about revenue, provide more comprehensive guidance for transactions that were not previously addressed and improve guidance for multiple-element arrangements. IFRS 15 is effective for annual periods beginning on January 1, 2018, with early adoption permitted.

IFRS 16 – LEASES

IFRS 16 replaces IAS 17 Leases and related interpretations. The core principle is that a lessee recognize assets and liabilities for all leases with a lease term of more than 12 months. A lessee is required to recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. Assets and liabilities arising from a lease are initially measured on a present value basis. The measurement includes non-cancellable lease payments (including inflation-linked payments), and also includes payments to be made in optional periods if the lessee is reasonably certain to exercise an option to extend the lease, or not to exercise an option to terminate the lease. The new standard is intended to provide a faithful representation of leasing transactions, in particular those that do not currently require the lessees to recognize an asset and liability arising from an operating lease. IFRS 16 is effective for annual periods beginning on January 1, 2019, with early adoption permitted for entities that would also apply IFRS 15 Revenue from Contracts with Customers.

OFF-BALANCE SHEET ARRANGEMENTS

15

GUARANTEES

Guarantees in Fuel Facilities Arrangements

Air Canada participates in fuel facility arrangements operated through eight Fuel Facility Corporations, and one aircraft de-icing service facility, along with other airlines that contract for fuel and de-icing services at various major airports in Canada. These entities operate on a cost recovery basis. The aggregate debt of these entities that has not been consolidated by Air Canada under IFRS 10 Consolidated Financial Statements is approximately $425 million as at December 31, 2015 (December 31, 2014 – $399 million), which is Air Canada's maximum exposure to loss before taking into consideration the value of the assets that secure the obligations and any cost sharing that would occur amongst the other contracting airlines. Air Canada views this loss potential as remote. Each contracting airline participating in these entities shares pro rata, based on system usage, in the guarantee of this debt. The maturities of these debt arrangements vary but generally extend beyond five years.

Indemnification Agreements

In the ordinary course of Air Canada's business, Air Canada enters into a variety of agreements, such as real estate leases or operating agreements, aircraft financing or leasing agreements, technical service agreements with service providers, and director/officer contracts, and other commercial agreements, some of which may provide for indemnifications to counterparties that may require Air Canada to pay for costs and/or losses incurred by such counterparties. Air Canada cannot reasonably estimate the potential amount, if any, it could be required to pay under such indemnifications. Such amount would also depend on the outcome of future events and conditions, which cannot be predicted. While certain agreements specify a maximum potential exposure, certain others do not specify a maximum amount or a limited period. Historically, Air Canada has not made any significant payments under these indemnifications.

Air Canada expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities.

RELATED PARTY TRANSACTIONS

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At December 31, 2015, 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.

17 RISK FACTORS

The risks described below should be read carefully when evaluating Air Canada's business and the forward-looking statements contained in this report and other statements Air Canada may make from time to time. Any of these risks could materially and adversely affect Air Canada's business, operating results, financial condition and the actual outcome of matters as to which forward-looking statements are made. In addition, these risks may not be the only risks faced by Air Canada. Other risks of which Air Canada is not aware or which Air Canada currently deems not to be material may surface and have a material adverse impact on Air Canada, its business, results from operations and financial condition.

RISKS RELATING TO AIR CANADA

Operating Results – Air Canada may sustain significant losses and not be able to successfully achieve and/or sustain positive net profitability or realize the objectives of any or all of its initiatives

A variety of factors, including economic conditions and other factors described in this "Risk Factors" section, may result in Air Canada incurring significant losses (which it has incurred in the past). Despite ongoing strategic and business initiatives, including efforts at securing cost reductions, revenue improvements and international growth as well as efforts relating to its seat capacity expansion and the expansion of Air Canada *rouge*, Air Canada may not be able to successfully achieve and/or sustain positive net profitability or realize the objectives of any or all of its initiatives, including those which seek to decrease costs, improve margins or offset or mitigate risks facing Air Canada, including those relating to economic conditions, foreign exchange rates, competition, labour issues, liquidity, and volatility in fuel costs and other expenses.

Leverage – Air Canada has, and is expected to continue to incur, a significant amount of indebtedness, and there can be no assurance that it will be able to pay its debts and lease obligations

Air Canada has, and is expected to continue to have and incur, a significant amount of indebtedness, including substantial fixed obligations under aircraft leases, aircraft purchases and other financings, and as a result of any challenging economic or other conditions affecting Air Canada, Air Canada may incur greater levels of indebtedness than currently exist or are planned. The amount of indebtedness that Air Canada currently has and which it may incur in the future could have a material adverse effect on Air Canada, for example, by (i) limiting Air Canada's ability to obtain additional financing, (ii) requiring Air Canada to dedicate a substantial portion of its cash flow from operations to payments on its indebtedness and fixed cost obligations, thereby reducing the funds available for other purposes, (iii) making Air Canada more vulnerable to economic downturns and (iv) limiting Air Canada's flexibility in planning for, or reacting to, competitive pressures or changes in its business environment.

The ability of Air Canada to make scheduled payments under its indebtedness will depend on, among other things, its future operating performance and its ability to refinance its indebtedness, if necessary. In addition, as Air Canada incurs indebtedness which bears interest at floating interest rates, to the extent these interest rates increase, its interest expense will increase. Moreover, Air Canada incurs a significant proportion of its indebtedness in foreign currencies, primarily in U.S. dollars, and as a result future debt servicing repayments are subject to foreign exchange risk and the Canadian equivalent amount of indebtedness may increase. There can be no assurance that Air Canada will at all times be able to generate sufficient cash from its operations to pay its debts and lease obligations. Each of these factors is, to a large extent, subject to economic, financial, competitive, regulatory, operational and other factors, many of which are beyond Air Canada's control.

Foreign Exchange – A significant deterioration of the Canadian dollar relative to the U.S. dollar could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada's financial results are sensitive to the fluctuating value of the Canadian dollar. In particular, Air Canada has a significant annual net outflow of U.S. dollars and is affected by fluctuations in the U.S./Canadian dollar exchange rate. Air Canada incurs significant expenses in U.S. dollars for items such as fuel, aircraft rental and purchases and maintenance charges, interest and debt servicing payments and computerized reservations system fees, while a substantial portion of its revenues are generated in Canadian dollars. Due to the competitive nature of the airline industry and customer sensitivity to travel costs, Air Canada may not be able to pass on increases in Canadian dollar costs to its customers by increasing its fares. In addition, Air Canada may be unable to appropriately or sufficiently hedge the risks associated with fluctuations in exchange rates. A significant deterioration of the Canadian dollar relative to the U.S. dollar or other foreign currencies would increase the costs of Air Canada relative to its U.S. or other foreign competitors and could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Economic and Geopolitical Conditions – Changes in economic and geopolitical conditions could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Airline operating results are sensitive to economic and geopolitical conditions which can have a significant impact on Air Canada. For example, economic and geopolitical conditions may impact demand for air transportation in general or to or from certain destinations, and may also impact Air Canada's operating costs, operating revenues (including by impacting our ability to repatriate funds from foreign jurisdictions), costs and availability of fuel, foreign exchange costs, pension plan contributions, and costs and availability of capital and supplies required by Air Canada. Especially in light of Air Canada's substantial fixed cost structure, any prolonged or significant impact arising from economic and geopolitical conditions, including weakness of the Canadian, U.S. or world economies, or threatened or actual outbreaks of hostilities in or adjacent to regions Air Canada serves or over which it operates flights (or to regions it plans to do so), could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Airline fares and passenger demand have fluctuated significantly in the past and may fluctuate significantly in the future. Air Canada is not able to predict with certainty market conditions and the fares that Air Canada may be able to charge. Customer expectations can change rapidly and the demand for lower fares may limit revenue opportunities. Travel, especially leisure travel, is a discretionary consumer expense. Demand for business and premium travel are also impacted by economic conditions. Depressed economic conditions in areas served by Air Canada, geopolitical instability in various areas of the world and concerns about the environmental impacts of air travel and tendencies towards "green" travel initiatives where customers reduce their travel activities, could each have the effect of reducing demand for air travel in Canada and abroad and could materially adversely impact Air Canada, its business, results of operations and financial condition.

Need for Additional Capital and Liquidity – Air Canada may not be able to timely obtain sufficient funds on acceptable terms to provide adequate liquidity and to finance necessary operating and capital expenditures

Air Canada faces a number of challenges in its business, including in relation to economic conditions, foreign exchange rates, increased competition from domestic, international, and U.S. transborder carriers, including low-cost carriers, volatile fuel prices, labour issues, and contractual covenants (which require Air Canada to maintain minimum cash reserves and which could require Air Canada to deposit cash collateral with third parties). Air Canada's liquidity levels may be adversely impacted by these as well as by other factors and risks identified in this MD&A. As part of Air Canada's efforts to manage such challenges and to support Air Canada's business strategy, significant liquidity and significant ongoing operating and capital expenditures are required. There can be no assurance that Air Canada will continue to be able to obtain, on a timely basis, sufficient funds on terms acceptable to Air Canada to provide adequate liquidity and to finance the operating and capital expenditures necessary to manage any challenges and support its business strategy if cash flows from operations and liquidity levels are insufficient.

A major decline in the market price of Air Canada's securities may negatively impact Air Canada's ability to raise capital, issue debt, retain employees, make strategic acquisitions or enter into joint arrangements. Differences between Air Canada's actual or anticipated financial results and the published expectations of financial analysts, as well as events affecting our business or operating environment, may contribute to volatility in Air Canada's securities. A major decline in the capital markets in general, or an adjustment in the market price or trading volumes of Air Canada's securities, may negatively affect our ability to raise capital, issue debt, retain senior executives and other key employees, make strategic acquisitions or enter into joint arrangements.

Failure to generate additional funds, whether from operations or additional debt or equity financings, could require Air Canada to delay or abandon some or all of its anticipated expenditures or to modify its business strategy and could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Furthermore, competitors with greater liquidity or the ability to raise money more easily or on less onerous terms could represent a competitive disadvantage to Air Canada.

Air Canada's credit ratings influence its ability to access capital markets and improve its liquidity. There can be no assurance that Air Canada's credit ratings will not be downgraded, which would add to Air Canada's borrowing costs, hamper its ability to attract capital, adversely impact its liquidity and limit its ability to operate its business, all of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Fuel Costs – Significant fluctuations or increases in fuel prices could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Fuel costs constitute one of Air Canada's largest operating cost items. Fuel prices have and may continue to fluctuate widely depending on many factors, including international market conditions, geopolitical events, jet fuel refining costs and the Canada/U.S. dollar exchange rate. Air Canada cannot accurately predict fuel prices. Due to the competitive nature of the airline industry, Air Canada may not be able to pass on increases in fuel prices to its customers by increasing its fares. Furthermore, the impact of lower jet fuel prices could be offset by increased price competition, and a resulting decrease in revenues, for all air carriers. Significant fluctuations (including increases) in fuel prices could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Competition – Air Canada operates in a highly competitive environment and faces increasing competition in North America and internationally

Air Canada operates within a highly competitive industry. Over the past few years, several carriers have entered or announced their intention to enter or expand into the domestic (including regional), the U.S. transborder and international markets in which Air Canada operates or plans to operate.

Canadian low-cost and other carriers have entered and/or expanded or announced their intention to compete in many of Air Canada's key domestic (including regional) markets and, along with some U.S. carriers, have also entered and/or expanded their operations in the U.S. transborder and leisure-oriented markets. Carriers against whom Air Canada competes, including U.S. carriers, may undergo (and some have undergone) substantial reorganizations (including by way of merger with or acquisition by another carrier), creating reduced levels of indebtedness and lower operating costs and may therefore be in a position to more effectively compete against Air Canada.

The proximity of several American airports in cities close to the Canadian border (such as Plattsburgh, Buffalo and Bellingham) has also presented an additional challenge for Air Canada. Higher taxes, charges and fees for passengers departing from Canada has redirected appreciable passenger traffic away from Canadian airports to airports in the United States. Low-cost carriers based in the United States have and may continue to increase their capacity at these airports and attract Canadian-originating, price-sensitive customers.

Given Canada's diverse and multicultural population, Canadian gateways such as Toronto, Montréal and Vancouver are deemed attractive by international carriers. In 2015, foreign carriers such as Air France-KLM, AeroMexico, EVA Air, China Airlines, China Eastern Airlines, Hainan Airlines, COPA Airlines, Icelandair, All Nippon Airways and LATAM Airlines have entered or announced their intention to enter or expand their international operations into Canada.

Increased competition in the domestic, U.S. transborder or international markets could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Strategic, Business, Technology and Other Important Initiatives – A delay or failure to identify and devise, invest in and implement certain important initiatives could have a material impact on Air Canada, its business, results from operations and financial condition

In order to operate its business, achieve its goals and remain competitive, Air Canada continually seeks to identify and devise, invest in, implement and pursue strategic, business, technology and other important initiatives, such as those relating to participation in the leisure or low-cost market (including the planned growth of Air Canada *rouge*), the aircraft fleet renewal program (including the scheduled delivery of Boeing 787 aircraft, the reconfiguration of Boeing 777 aircraft and the planned re-fleeting of narrow-body aircraft with Boeing 737 MAX aircraft), revenue enhancement initiatives, business processes, information technology, revenue management, cost transformation, improving premium passenger revenues, expansion of flying capacity (including in respect of new aircraft and routes), corporate culture transformation, initiatives seeking to ensure a consistently high-quality customer service experience and others. These initiatives, including activities relating to their development and implementation, may be adversely impacted by a wide range of factors, many of which are beyond Air Canada's control. Such factors include the need to seek legal or regulatory approvals, the performance of third parties, including suppliers, the implementation and integration of such initiatives into Air Canada's other activities and processes as well as the adoption and acceptance of these initiatives by Air Canada's customers, suppliers, unions and personnel. A delay or failure to sufficiently and successfully identify and devise, invest in or implement these initiatives could adversely affect Air Canada's ability to operate its business, achieve its goals and remain competitive and could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

For instance, a key component of Air Canada's business plan is the acquisition of new and more efficient Boeing 787 and Boeing 737 MAX aircraft. A delay or failure in the completion of Air Canada's fleet restructuring, including delays by suppliers involved in the delivery of these aircraft, or an inability to remove, as planned, certain aircraft from the fleet in coordination with the planned entry into service of new aircraft, could adversely affect the implementation of Air Canada's business plan which may, in turn, have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Revenue and Alliance Environment – Air Canada has encountered and may continue to encounter discounted and promotional fares initiated by its competitors, and any decision by Air Canada to match such fares could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada continuously encounters substantial price competition. The prevalence of low-cost carriers, Internet travel websites and other travel products distribution channels has resulted in a substantial increase in discounted and promotional fares initiated by Air Canada's competitors. A decision to match competitors' fares to maintain passenger traffic results in reduced yields which, in turn, could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Furthermore, Air Canada's ability to reduce its fares in order to effectively compete with other carriers is dependent on Air Canada's ability to achieve acceptable operating margins and may also be limited by government policies to encourage competition. Likewise, competitors continue to pursue commissions/incentive actions and, in many cases, increase these payments. The decision to modify Air Canada's current programs in order to maintain or improve its competitiveness and passenger traffic could result in increased costs to Air Canada's business.

Furthermore, consolidation within the airline industry could result in increased competition as some airlines emerging from such consolidations and entering into integrated commercial cooperation arrangements, such as joint ventures, may be able to compete more effectively, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

The Airline Industry is Characterized by Low Profit Margins and High Fixed Costs

The costs of operating any particular flight do not vary significantly with the number of passengers carried and, therefore, a relatively small change in the number of passengers or in fare pricing or traffic mix could have a significant effect on Air Canada's operating and financial results. This condition may be exacerbated by aggressive pricing by competitors, which could have the effect of driving down fares in certain markets. Accordingly, a shortfall from expected revenue levels could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Although Air Canada has sought an improved ability to weather downturns in economic cycles, such efforts may not be successful. As a result of high fixed costs, should Air Canada be required to reduce its overall capacity or the number of flights operated, it may not be able to successfully reduce certain fixed costs in the short term and may be required to incur important termination or other restructuring costs, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Dependence on Technology – Air Canada relies heavily on technology to operate its business and any technology systems failure or data breach could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada relies heavily on technology, including computer and telecommunications equipment and software and Internet-based systems, to operate its business, increase its revenues and reduce its costs. These systems include those relating to Air Canada's telecommunications, websites, computerized airline reservations and airport customer services and flight operations. Air Canada also depends on the performance of its many suppliers, whose performance is in turn dependent upon their respective technology systems.

Technology systems may be vulnerable to a variety of sources of failure, interruption or misuse, including by reason of human error, third party suppliers' acts or omissions, natural disasters, terrorist attacks, telecommunications failures, power failures, computer viruses, unauthorized or fraudulent users (including cyber-attacks or cyber intrusions over the Internet, malware, computer viruses and the like), and other operational and security issues. While Air Canada continues to pursue initiatives, including security initiatives and disaster recovery plans, these pursuits or initiatives may not be successful or adequate. Any technology systems failure, interruption or misuse, data security breach or failure to comply with applicable data confidentiality, privacy or security obligations, whether at Air Canada or a third party on whom Air Canada relies, could adversely affect Air Canada's reputation and expose Air Canada to litigation, claims for contract breach, fines, sanctions or otherwise materially and adversely affect Air Canada's operations, any of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Key Supplies and Suppliers – Air Canada's failure or inability to obtain certain goods and services from key suppliers on favourable terms could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada is dependent upon its ability to source, on favourable terms and costs, sufficient quantities of goods and services in a timely manner, including those available at airports or from airport authorities or otherwise required for Air Canada's operations, such as fuel, aircraft and related parts and aircraft maintenance services. In certain cases, Air Canada may only be able to access goods and services from a limited number of suppliers (or from sole source suppliers) and transition to new or alternative suppliers, which may be necessitated by reason of such suppliers increasing their rates or failure to perform, may not be possible or may take a significant amount of time or require significant resources. A failure, refusal or inability of a supplier may arise as a result of a wide range of causes, many of which are beyond Air Canada's control. In addition, there can be no assurance as to the continued viability of any of Air Canada's suppliers. Any failure or inability of Air Canada to successfully source goods and services, including by reason of a failure, refusal or inability of a supplier, or to source goods and services on terms and pricing and within the time frames acceptable to Air Canada, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Regional Carriers – The failure by regional carriers such as Jazz and Sky Regional to fulfill their obligations to Air Canada could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada seeks to enhance its network through capacity purchase agreements, including the Jazz CPA and other capacity purchase agreements with regional airlines, such as Sky Regional, operating flights on behalf of Air Canada.

Under the Jazz CPA, Jazz provides Air Canada's customers service in lower-density markets and higher-density markets at off-peak times throughout Canada and to and from certain destinations in the United States and also provides valuable traffic feed to Air Canada's mainline and Air Canada *rouge* routes. Pursuant to the terms of the Jazz CPA, Air Canada pays Jazz a number of fees, some of which are fixed and others which are determined based upon certain costs incurred by Jazz. Air Canada also reimburses Jazz for certain pass-through costs incurred by Jazz, such as navigation, landing and terminal fees and certain other costs. In addition, the Jazz CPA requires that Jazz maintain a minimum fleet size and contains a minimum average daily utilization guarantee which requires Air Canada to utilize Jazz for that amount of flying. Significant increases in Jazz's costs, the failure by Jazz to adequately fulfill its obligations under the Jazz CPA, factors which may reduce the utilization of Jazz fleet, including economic or market downturns, and unexpected interruptions or cessation of Jazz's services could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

The failure by Air Canada's other regional carriers to fulfill their obligations under their respective agreements, or unexpected interruptions or disruptions of their services, as well as minimum guarantees in capacity purchase agreements which may limit Air Canada's ability to effectively manage regional capacity in response to economic downturns, market pressures or other external events, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Labour Costs and Labour Relations – Air Canada may not be able to maintain labour costs at levels which do not negatively affect its business, results from operations and financial condition. There can be no assurance that collective bargaining agreements will be further renewed without labour conflicts and/or disruptions

Labour costs constitute one of Air Canada's largest operating cost items. There can be no assurance that Air Canada will be able to maintain such costs at levels that do not negatively affect its business, results from operations and financial condition. Most of Air Canada's employees are unionized. While Air Canada has established long-term arrangements with unions representing a significant portion of its unionized employees, there can be no assurance that future agreements with employees' unions or the outcome of arbitrations will be on terms consistent with Air Canada's expectations or comparable to agreements entered into by Air Canada's competitors. Any future agreements or outcomes of negotiations or arbitrations, including in relation to wages or other labour costs or work rules, may result in increased labour costs or other charges, or terms and conditions restricting or reducing, Air Canada's ability to sustain its business objectives or pursue its strategic initiatives, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

There can be no assurance that collective agreements will be further renewed without labour conflict or action or that there will not otherwise be any labour conflict or action that could also lead to a degradation, interruption or stoppage in Air Canada's service or otherwise adversely affect the ability of Air Canada to execute on its business plans or operate its business, either of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition. In respect of the unions for Canadian-based employees, strikes or lock-outs may lawfully occur following the term and negotiations of the renewal of collective agreements once a number of pre-conditions prescribed by the Canada Labour Code have been satisfied.

Any labour disruption or work stoppage by any of the unionized work groups of Jazz or other parties with whom Air Canada conducts business or relies on could have a material adverse effect on Air Canada, its business, results from operations and financial condition. In addition, labour conflicts at Star Alliance® partners could result in lower demand for connecting traffic with Air Canada, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Pension Plans – Underfunded pension plans or a failure or inability by Air Canada to make required cash contributions to its registered pension plans could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada maintains several defined benefit pension plans, including domestic registered pension plans, supplemental pension plans and international pension plans. As at January 1, 2015, the aggregate solvency surplus in the domestic registered pension plans was $660 million. Based on preliminary estimates, including actuarial assumptions, as at January 1, 2016, on an aggregate basis, Air Canada's domestic registered pension plans are projected to be in a surplus position (as further discussed in section 9.7 "Pension Funding Obligations" of this MD&A). The next required valuations to be made as at January 1, 2016, will be completed in the first half of 2016.

Canadian federal pension legislation requires that the funded status of registered pension plans be determined periodically, on both a going concern basis (essentially assuming indefinite plan continuation) and a solvency basis (essentially assuming immediate plan termination).

Air Canada's pension funding obligations are determined by a variety of factors, including pension plan solvency valuations, regulatory developments, assumptions and methods used and changes in the economic conditions (mainly the return on fund assets and changes in interest rates) as well as the application of normal past service contribution rules which would generally require one-fifth of any solvency deficit, determined on the basis of an average over the previous three years, to be funded each year in addition to required current service contributions. Deteriorating economic conditions or a prolonged period of low or decreasing interest rates may result in significant increases in Air Canada's funding obligations, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Underfunded pension plans or a failure or inability by Air Canada to make required cash contributions to its registered pension plans may have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Limitations Due to Restrictive Covenants – Covenants contained in agreements to which Air Canada is a party affect and, in some cases, significantly limit or prohibit the manner in which Air Canada operates its business

Some of the financing and other major agreements to which Air Canada is a party contain, and in the future may contain, restrictive, financial (including in relation to asset valuations, liquidity, minimum EBITDAR results, fixed charge coverage ratio and debt coverage ratios) and other covenants which affect and, in some cases, significantly limit or prohibit, among other things, the manner in which Air Canada may structure or operate its business, including by reducing Air Canada's liquidity, limiting Air Canada's ability to incur indebtedness, create liens, sell assets, pay dividends, make capital expenditures, and engage in acquisitions, mergers or restructurings or a change of control. Future financing and other significant agreements may also be subject to similar covenants which limit Air Canada's operating and financial flexibility, which could materially and adversely affect Air Canada's ability to operate its business and its profitability.

A failure by Air Canada to comply with its contractual obligations (including restrictive, financial and other covenants), or to pay its indebtedness and fixed costs, could result in a variety of material adverse consequences, including the acceleration of its indebtedness, the withholding of credit card proceeds by the credit card service providers and the exercise of remedies by its creditors, lessors or other co-contracting parties, and such defaults could trigger additional defaults under other indebtedness or agreements. In such a situation, Air Canada may not be able to repay the accelerated indebtedness or fulfill its obligations under certain contracts, make required aircraft lease payments or otherwise cover its fixed costs. Also, the lenders under the financing arrangements could foreclose upon all or substantially all of the assets of Air Canada which secure Air Canada's obligations.

Refer to section 9.8 "Contractual Obligations" of this MD&A for information on Air Canada's credit card processing agreements.

Aeroplan – Failure by Aeroplan to fulfill its obligations to Air Canada or other interruptions of Aeroplan services could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Through its commercial agreement with Aeroplan, Air Canada is able to offer its customers who are Aeroplan members the opportunity to earn Aeroplan Miles. Based on customer surveys, management believes that rewarding customers with Aeroplan Miles is a significant factor in customers' decisions to travel with Air Canada and contributes to building customer loyalty. The failure by Aeroplan to adequately fulfill its obligations towards Air Canada under the Aeroplan Commercial Participation and Services Agreement (the "CPSA") and in connection with the Aeroplan program, or other unexpected interruptions or disruptions of Aeroplan services which are beyond Air Canada's control, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Star Alliance® – Departure of a key member from Star Alliance® or the failure by such member to meet its obligations could have a material adverse effect on Air Canada, its business, results from operations and financial condition

The strategic and commercial arrangements with Star Alliance® members provide Air Canada with important benefits, including codesharing, efficient connections and transfers, reciprocal participation in frequent flyer programs and use of airport lounges from the other members. Should a key member leave Star Alliance® or otherwise fail to meet its obligations thereunder, Air Canada, its business, results from operations and financial condition could be materially adversely affected.

Interruptions or Disruptions in Service – Interruptions or disruptions in service could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada's business is significantly dependent upon its ability to operate without interruption at a number of hub airports, including Toronto Pearson. Delays or disruptions in service, including those due to security or other incidents, weather conditions, labour conflicts with airport workers, baggage handlers, air traffic controllers, security personnel, and other workers not employed by Air Canada or other causes beyond the control of Air Canada could have a material adverse impact on Air Canada, its business, results from operations and financial condition.

Interruptions and disruptions in service may be caused by, and the demand and cost of air travel may be adversely impacted by, environmental conditions, technology issues and factors in addition to those relating to the weather. Environmental conditions and factors, such as those arising from volcanic eruptions or other natural phenomena, as well as those arising from man-made sources, could cause interruptions and disruptions in service, increase Air Canada's costs or adversely impact demand for air travel, any of which could have a material adverse impact on Air Canada, its business, results from operations and financial condition.

Current Legal Proceedings – Air Canada is involved in or may be subject to legal proceedings which may materially adversely impact Air Canada

INVESTIGATIONS BY COMPETITION AUTHORITIES RELATING TO AIR CANADA CARGO

The European Commission, the United States Department of Justice and the Competition Bureau in Canada investigated alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including Air Canada. Competition authorities in several jurisdictions sought or requested information from Air Canada as part of their investigations. Air Canada cooperated with these investigations, which led to proceedings against Air Canada and a number of airlines and other cargo operators in certain jurisdictions. Air Canada is also named as a defendant or is otherwise involved in, and may become further implicated in, a number of class action lawsuits and other proceedings in Canada, Europe and the United States in connection with these allegations. The investigations instituted by the United States Department of Justice and by the Competition Bureau in Canada concluded with no proceedings having been instituted against Air Canada. In 2012, the Corporation entered into a settlement agreement relating to class action proceedings in the United States in connection with these allegations under which Air Canada made a payment of $8 million without any admission of liability.

In 2010, the European Commission rendered a decision finding that 12 air cargo carriers (including groups of related carriers) had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006. Air Canada was among the carriers subject to the decision and a fine of 21 million Euros (approximately $29 million) was imposed on Air Canada. Air Canada appealed the decision and filed an application for appeal before the European General Court. In 2011, Air Canada paid the fine, as required, pending the outcome of its appeal. On December 16, 2015, the European General Court granted Air Canada's appeal and annulled the decision of the European Union with regard to Air Canada and certain other airlines. As a result of the European General Court's decision, the European Commission was required to refund Air Canada the fine of 21 million Euros ($30 million), which amount has been recorded as a receivable as at December 31, 2015 and received in February 2016. There can be no assurance however that the decision of the European General Court will not be challenged or reversed.

As at December 31, 2015, Air Canada has a provision of $17 million ($27 million as at December 31, 2014) relating to outstanding claims in this matter, which is recorded in Accounts payable and accrued liabilities. The provision was reduced by $10 million in 2015 reflecting a change in estimated costs. This provision is an estimate based upon the status of investigations and proceedings at this time and Air Canada's assessment as to the potential outcome for certain of them. The provision does not address the proceedings and investigations in all jurisdictions, but only where there is sufficient information to do so. Air Canada has determined it is not possible at this time to predict with any degree of certainty the outcome of all remaining proceedings and investigations. Based on the outcome of any developments regarding proceedings and investigations, Air Canada may adjust the provision in its results for subsequent periods as required.

MANDATORY RETIREMENT

Air Canada is engaged in a number of proceedings involving challenges to the mandatory retirement provisions of certain of its collective agreements, including the previous Air Canada-Air Canada Pilots Association collective agreement, which incorporated provisions of the pension plan terms and conditions applicable to pilots requiring them to retire at age 60. Air Canada has fully or partially resolved some of these complaints and is defending others. At this time, it is not possible to determine with any degree of certainty the extent of any financial liability that may arise from Air Canada being unsuccessful in its defence of these proceedings, though any such financial liability, if imposed, would not be expected to be material.

FUTURE LEGAL PROCEEDINGS

Airlines are susceptible to various claims and litigation, including class action claims, in the course of operating their business or with respect to the interpretation of existing agreements. Any future claims or litigation could also have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Key Personnel – Air Canada is dependent on key employees and could be materially adversely affected by a shortfall or substantial turnover

Air Canada is dependent on the industry experience, qualifications and knowledge of a variety of employees, including its executive officers, managers, airline flight and operations personnel and other key employees to execute its business plan and operate its business. If Air Canada were to experience a shortfall or a substantial turnover in its leadership or other key employees, Air Canada, its business, results from operations and financial condition could be materially adversely affected. Additionally, Air Canada may be unable to attract and retain additional qualified key personnel as needed in the future.

RISKS RELATING TO THE AIRLINE INDUSTRY

Terrorist Attacks and Security Measures – Terrorist attacks and related consequences could have a material adverse effect on Air Canada, its business, results from operations and financial condition

The potential for terrorist attacks and terrorist activity causes concern and uncertainty in the minds of the travelling public. The occurrence of a terrorist attack or attempted attack (whether domestic or international and whether involving Air Canada or another carrier or no carrier at all), and increasingly restrictive security measures, such as those relating to the content of carry-on baggage, passenger identification document requirements, and passenger screening procedures, could have a material adverse effect on passenger demand for air travel and on the number of passengers travelling on Air Canada's flights. It could also lead to a substantial increase in insurance, airport security and other costs, including higher operating costs to avoid flying over airspace near conflict zones. Any resulting reduction in passenger revenues and/or increases in costs, including insurance, security or other costs could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Epidemic Diseases – Epidemic diseases could impact passenger demand for air travel

Outbreaks or the threat of outbreaks of viruses or other contagions or epidemic diseases, including influenza, SARS, Ebola, Zika, as well as any travel or other advisories relating to same, whether domestic or international or whether relating to Canadian cities or regions or other cities, regions or countries, could have a material adverse effect on demand for air travel and could result in a major negative impact on traffic on Air Canada's network. Any resulting reduction in traffic in the markets served by Air Canada could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Casualty Losses – Air Canada's business makes it subject to large liability claims for serious personal injury or death arising out of accidents or disasters

Due to the nature of its core operating business, Air Canada may be subject to liability claims arising out of accidents or disasters involving aircraft on which Air Canada's customers are travelling or involving aircraft of other carriers maintained or otherwise serviced by Air Canada, including claims for serious personal injury or death. Any such accident or disaster may significantly harm Air Canada's reputation for safety, which would have a material adverse effect on Air Canada, its business, results from operations and financial condition. There can be no assurance that Air Canada's insurance coverage will be sufficient to cover one or more large claims and any shortfall may be material.

Accidents and disasters may occur despite all appropriate measures being taken, and as a result of a variety of factors beyond Air Canada's control including acts of terrorism and sabotage, severe weather, lighting strikes and other natural phenomenon, bird strikes as well as the increasing prevalence of unmanned aerial vehicles.

Seasonal Nature of the Business, Other Factors and Prior Performance – Air Canada's operating results historically fluctuate due to seasonality and other factors associated with the airline industry

Air Canada has historically experienced considerably greater demand for its services in the second and third quarters of the calendar year and significantly lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the preference of a high number of leisure travellers to travel during the spring and summer months. Air Canada has substantial fixed costs that do not meaningfully fluctuate with passenger demand in the short term.

As described elsewhere in this MD&A, demand for and cost of air travel is also affected by factors such as geopolitical and economic conditions, war or the threat of war or terrorist attacks, fare levels and weather conditions. Due to these and other factors, operating results for an interim period are not necessarily indicative of operating results for an entire year, and operating results for a historical period are not necessarily indicative of operating results for a future period.

Regulatory Matters – Air Canada is subject to extensive and evolving domestic and foreign regulation

The airline industry is subject to extensive legal, regulatory and administrative controls and oversight, including in relation to taxes, airport fees and operations, route rights, security, passenger and consumer rights, advertising, privacy, data security, licensing, competition, pensions, environment (including noise levels and carbon emissions) and, in some measure, pricing. In addition to being subject to international laws and regulations and laws and regulations applicable to airlines in Canada, Air Canada is subject to laws specifically applicable to it, such as the *Air Canada Public Participation Act*.

Compliance with current or future Canadian and international laws, regulations and administrative requirements, including potentially inconsistent or conflicting laws or regulations, or laws or regulations which disproportionally apply to Canadian airlines or Air Canada specifically, may impose significant costs, impediments and/or competitive disadvantages, and there cannot be any assurance that current or future laws, regulations and administrative requirements will not adversely affect Air Canada, its business, results from operations and financial condition.

The ability of Air Canada to operate flights or otherwise offer air services on international routes between airports in Canada and other countries may be subject to change. Applicable arrangements between Canada and foreign governments, which govern many areas including traffic rights, may be amended from time to time, rules and policies with respect to airport operations may be revised, and the availability of appropriate slots or facilities may change. Air Canada currently operates a number of flights on international routes under government arrangements, regulations or policies that designate the number of carriers permitted to operate on such routes, the capacity of the carriers providing services on such routes, the airports at which carriers may operate international flights, or the number of carriers allowed access to particular airports. Any further limitations, additions or modifications to such arrangements, regulations or policies could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Additionally, if Canada were to adopt a more liberalized approach in relation to air services arrangements with foreign countries, such an approach could have a material adverse impact on Air Canada, its business, results from operations and financial condition and could result in the impairment of material amounts of related tangible and intangible assets.

Air Canada's current and future plans to enter into or expand revenue-sharing joint ventures and other alliance arrangements on various international routes are and may be subject to receipt of approvals from applicable Canadian and international authorities to their not challenging them and to satisfying the necessary applicable regulatory requirements. There can be no assurance that such conditions will be met or will continue in effect or that existing, or changes in, regulatory requirements or standards can be satisfied.

Many aspects of Air Canada's operations are also subject to increasingly stringent laws and regulations protecting the environment. The Canadian federal government elected in 2015 indicated it would seek major environmental reforms, particularly in the area of climate change, including commitments to federal targets and carbon-based pricing. While Air Canada is continually focused on efficiency improvements, including by reducing its carbon footprint, future developments, such as climate change regulations in Canada and abroad could adversely impact Air Canada and its costs. Air Canada may be not be able to offset such impact, including for example, through higher passenger and cargo rates.

The European Union ("EU") passed legislation for an emissions trading system ("ETS"), which included carbon emissions from aviation commencing in January 2012, including for flights operated between Canada and countries within the EU. As a result of sustained international opposition, the European Parliament and Council announced that they are exempting all flights between Europe and third countries from the EU ETS until and inclusive of 2016, pending the creation by 2020, of an International Civil Aviation Organization ("ICAO") led global market-based measure ("MBM") that is likely to reduce greenhouse-gas emissions. If an ICAO led global MBM agreement cannot be reached by the end of 2016, there is a risk that the EU ETS exemption may be revoked. If revoked, the EU ETS would be expected to result, possibly as early as 2017, in increased costs relating to the purchase of emissions allowances. Management cannot predict the outcome of ICAO's efforts to set-up a global MBM or the impact such global MBM may have on Air Canada. The net financial impact could, in part, depend upon how much of the increased costs, if any relating to the EU ETS or MBM, could be recovered, including in the form of higher passenger fares and cargo rates.

Air Canada is also subject to domestic and foreign laws regarding privacy and security of passenger data, employee and other data, including advance passenger information and access to airline reservation systems, which are not consistent in all countries in which Air Canada operates. The need to comply with these laws and regulatory regimes results in additional operating costs and further regulation in this area could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Non-compliance with data privacy and security requirements may have a material adverse effect on Air Canada, its business (including by impacting Air Canada's goodwill and reputation), results from operations and financial condition.

Foreign jurisdictions (including the United States, European Union countries and other jurisdictions where Air Canada operates) have enacted and implemented and they and domestic regulators may in the future enact and implement consumer protection and passenger rights measures. Such measures may impose significant, unique, inconsistent or even conflicting obligations on Air Canada, which may result in increased liability and costs to Air Canada and which may adversely impact Air Canada, its business, results from operations and financial condition.

Availability of Insurance Coverage and Increased Insurance Costs – Increases in insurance costs or reduction in insurance coverage could have a material adverse effect on Air Canada, its business, results from operations and financial condition

The aviation insurance industry has been continually re-evaluating the terrorism risks that it covers, and this activity may adversely affect some of Air Canada's existing insurance carriers or Air Canada's ability to obtain future insurance coverage (including war risk insurance coverage). To the extent that Air Canada's existing insurance carriers are unable or unwilling to provide it with insurance coverage and in the absence of measures by the Government of Canada to provide the required coverage, Air Canada's insurance costs may increase further and may result in Air Canada being in breach of regulatory requirements or contractual arrangements requiring that specific insurance be maintained, which may have a material adverse effect on Air Canada, its business, results from operations and financial condition.

CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Disclosure controls and procedures within the Corporation have been designed to provide reasonable assurance that all relevant information is identified to its President and Chief Executive Officer ("CEO"), its Executive Vice President and Chief Financial Officer ("CFO") and its Disclosure Policy Committee to ensure appropriate and timely decisions are made regarding public disclosure.

Internal controls over financial reporting have been designed by management, under the supervision of, and with the participation of the Corporation's CEO and CFO, to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and its preparation of financial statements for external purposes in accordance with GAAP.

The Corporation will file certifications, signed by the Corporation's CEO and CFO, with the Canadian Securities Administrators ("CSA") upon filing of the Corporation's Annual Information Form. In those filings, the Corporation's CEO and CFO will certify, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design and effectiveness of the Corporation's disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting. The Corporation's CEO and CFO also certify the appropriateness of the financial disclosures in the Corporation's interim filings with securities regulators. In those interim filings, the Corporation's CEO and CFO also certify the design of the Corporation's disclosure controls and procedures and the design of internal controls over financial reporting.

The Corporation's Audit, Finance and Risk Committee reviewed this MD&A and the audited consolidated financial statements, and the Corporation's Board of Directors approved these documents prior to their release.

MANAGEMENT'S REPORT ON DISCLOSURE CONTROLS AND PROCEDURES

Management, under the supervision of and with the participation of the Corporation's CEO and CFO, evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined under National Instrument 52-109) and concluded, as at December 31, 2015, that such disclosure controls and procedures were effective.

MANAGEMENT'S REPORT ON INTERNAL CONTROLS OVER FINANCIAL REPORTING

Management, under the supervision of and with the participation of the Corporation's CEO and CFO, evaluated the effectiveness of the Corporation's internal controls over financial reporting (as defined under National Instrument 52-109). In making this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control – Integrated Framework (2013). Based on that evaluation, management and the CEO and CFO have concluded that, as at December 31, 2015, the Corporation's internal controls over financial reporting were effective. This evaluation took into consideration the Corporation's Corporate Disclosure Policy and the functioning of its Disclosure Policy Committee.

CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING

There have been no changes to the Corporation's internal controls over financial reporting during the quarter ended December 31, 2015 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

19 NON-GAAP FINANCIAL MEASURES

EBITDAR

EBITDAR (earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before depreciation, amortization and impairment, and aircraft rent as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. EBITDAR is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning and may not be comparable to similar measures presented by other public companies.

EBITDAR is reconciled to operating income as follows:

	FOURTH QUARTER			FULL YEAR		
CANADIAN DOLLARS IN MILLIONS	2015	2014	$ Change	2015	2014	$ Change
OPERATING INCOME – GAAP	$ 158	$ 106	$ 52	$ 1,496	$ 815	$ 681
ADD BACK (AS REFLECTED ON AIR CANADA'S CONSOLIDATED STATEMENT OF OPERATIONS):						
Depreciation, amortization and impairment	160	130	30	655	526	129
Aircraft rent	98	76	22	353	302	51
ADD BACK (INCLUDED IN REGIONAL AIRLINES EXPENSE):						
Depreciation, amortization and impairment	4	4	-	16	16	-
Aircraft rent	5	3	2	14	12	2
EBITDAR	$ 425	$ 319	$ 106	$ 2,534	$ 1,671	$ 863

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.

Adjusted CASM is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning and may not be comparable to similar measures presented by other public companies.

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.

Therefore, excluding aircraft fuel expense, the cost of ground packages at Air Canada Vacations, and special items from operating expenses generally allows for more meaningful analysis of Air Canada's operating expense performance and a more meaningful comparison to those of other airlines.

Adjusted CASM is reconciled to GAAP operating expense as follows:

CANADIAN DOLLARS IN MILLIONS, EXCEPT WHERE INDICATED	FOURTH QUARTER			FULL YEAR		
	2015	2014	$ Change	2015	2014	$ Change
OPERATING EXPENSE – GAAP	$ 3,024	$ 2,998	$ 26	$ 12,372	$ 12,457	$ (85)
ADJUSTED FOR:						
Aircraft fuel expense (as reflected on Air Canada's consolidated statement of operations)	(527)	(680)	153	(2,464)	(3,247)	783
Aircraft fuel expense (included in Regional airlines expense)	(81)	(111)	30	(359)	(500)	141
Special items	(31)	(30)	(1)	(8)	11	(19)
Impairment charges	-	-	-	(14)	-	(14)
Ground package costs at Air Canada Vacations	(87)	(74)	(13)	(415)	(377)	(38)
OPERATING EXPENSE, ADJUSTED FOR THE ABOVE-NOTED ITEMS	$ 2,298	$ 2,103	$ 195	$ 9,112	$ 8,344	$ 768
ASMS (MILLIONS)	18,869	17,403	8.4%	80,871	73,889	9.4%
ADJUSTED CASM (CENTS)	¢ 12.18	¢ 12.08	0.8%	¢ 11.27	¢ 11.29	(0.2)%

ADJUSTED NET INCOME AND ADJUSTED EARNINGS PER SHARE – DILUTED

Air Canada uses adjusted net income and adjusted earnings per share – diluted to assess the overall financial performance of its business without the effects of foreign exchange, net financing income (expense) relating to employee benefits, mark-to-market adjustments on fuel and other derivatives and special items as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful. Air Canada also uses adjusted net income as a measure to determine return on invested capital which is further described below. These measures are not recognized measures for financial statement presentation under GAAP, do not have a standardized meaning and may not be comparable to similar measures presented by other public companies.

CANADIAN DOLLARS IN MILLIONS, EXCEPT PER SHARE VALUES	FOURTH QUARTER			FULL YEAR		
	2015	2014	$ Change	2015	2014	$ Change
NET INCOME (LOSS) ATTRIBUTABLE TO SHAREHOLDERS OF AIR CANADA	$ (117)	$ (101)	$ (16)	$ 303	$ 100	$ 203
ADJUSTED FOR:						
Special items	31	30	1	8	(11)	19
Impairment charges	-	-	-	14	-	14
Foreign exchange loss	159	115	44	762	307	455
Special interest charge related to the prepayment of debt associated with the disposal of Embraer 190 aircraft	13	-	13	13	-	13
Net financing expense relating to employee benefits	27	32	(5)	105	134	(29)
Loss (gain) on fuel and other derivatives	3	(9)	12	17	1	16
ADJUSTED NET INCOME	$ 116	$ 67	$ 49	$ 1,222	$ 531	$ 691
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	290	294	(4)	292	293	(1)
ADJUSTED EARNINGS PER SHARE – DILUTED	$ 0.40	$ 0.23	$ 0.17	$ 4.18	$ 1.81	$ 2.37

The following reflects the share amounts used in the computation of basic and diluted earnings per share on an adjusted earnings per share basis:

	FOURTH QUARTER		FULL YEAR	
IN MILLIONS	2015	2014	2015	2014
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING – BASIC	284	286	285	286
Effect of dilution	6	8	7	7
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING – DILUTED	290	294	292	293

RETURN ON INVESTED CAPITAL

Air Canada uses return on invested capital ("ROIC") to assess the efficiency with which it allocates its capital to generate returns. Return is based on adjusted net income (loss), excluding interest expense and implicit interest on operating leases. Invested capital includes (i) average year-over-year total assets (excluding pension assets), net of average year-over-year non-interest-bearing operating liabilities, and (ii) the value of capitalized operating leases (calculated by multiplying annualized aircraft rent by 7). This measure is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning and may not be comparable to similar measures presented by other public companies.

CANADIAN DOLLARS IN MILLIONS, EXCEPT WHERE INDICATED	DECEMBER 31, 2015	DECEMBER 31, 2014	$ CHANGE
NET INCOME FOR THE PERIOD ATTRIBUTABLE TO SHAREHOLDERS OF AIR CANADA	$ 303	$ 100	$ 203
Remove:			
Special items	8	(11)	19
Impairment charges	14	-	14
Foreign exchange loss	762	307	455
Special interest charge related to the prepayment of debt associated with the disposal of Embraer 190 aircraft	13	-	13
Net financing expense relating to employee benefits	105	134	(29)
Loss on financial instruments recorded at fair value	17	1	16
ADJUSTED NET INCOME	$ 1,222	$ 531	$ 691
Adjusted for:			
Interest expense (1)	389	322	67
Implicit interest on operating leases (2)	180	153	27
ADJUSTED INCOME BEFORE INTEREST	$ 1,791	$ 1,006	$ 785
Invested capital:			
Working capital excluding current portion of long-term debt and finance leases	623	449	174
Long-term assets, excluding pension assets	7,661	6,676	985
Maintenance provisions	(844)	(726)	(118)
Other operating long-term liabilities	(233)	(295)	62
Capitalized operating leases (3)	2,569	2,191	378
INVESTED CAPITAL	$ 9,776	$ 8,295	$ 1,481
RETURN ON INVESTED CAPITAL (%)	18.3%	12.1%	6.2 pp

1 Interest expense excludes the special interest expense charge related to the disposal of Embraer 190 aircraft in 2015.
2 Interest implicit on operating leases is equal to 7.0% of 7 times the trailing 12 months of aircraft rent. 7.0% is a proxy and does not necessarily represent the actual implicit interest on operating leases for any given period.
3 Capitalized operating leases are calculated by multiplying the trailing 12 months of aircraft rent by 7. Aircraft rent totalled $367 million for the 12 months ended December 31, 2015 and $313 million for the 12 months ended December 31, 2014 (includes aircraft rent related to regional operations).

GLOSSARY

2014 Regulations – Refers to the Air Canada Pension Plan Funding Regulations, 2014.

ACPA – Refers to the Air Canada Pilots Association.

Adjusted CASM – Refers to operating expense per ASM adjusted to remove the effects of aircraft fuel expense, ground packages costs, and special items. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

Adjusted net income (loss) – Refers to the consolidated net income (loss) of Air Canada attributable to the shareholders of Air Canada adjusted to remove the effects of (to the extent included in consolidated net income (loss)) foreign exchange gains or losses, net financing income (expense) relating to employee benefits, mark-to-market adjustments on fuel and other derivatives and special items. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

Air Georgian – Refers to Air Georgian Limited.

Atlantic passenger and cargo revenues – Refer to revenues from flights that cross the Atlantic Ocean with origins and destinations principally in Europe. Also refers to revenues from flights to and from India and Dubai.

Available seat miles or ASMs – Refers to a measure of passenger capacity calculated by multiplying the total number of seats available for passengers by the miles flown.

Average stage length – Refers to the average mile per departure seat and is calculated by dividing total ASMs by total seats dispatched.

Boeing – Refers to The Boeing Company.

CALDA – Refers to the Canadian Airline Dispatchers Association.

CASM – Refers to operating expense per ASM.

CUPE – Refers to the Canadian Union of Public Employees.

Domestic passenger and cargo revenues – Refer to revenues from flights within Canada.

EBITDAR – Refers to earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent. EBITDAR is a non-GAAP financial measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

EETCs – Refers to Enhanced Equipment Trust Certificates issued in connection with the financing of aircraft.

Effective ton miles or ETMs – Refers to the mathematical product of tonnage capacity times distance hauled.

EVAS – Refers to Exploits Valley Air Services Ltd.

GDS – Refers to Global Distribution System which is generally a network that enables automated transactions between third parties and booking agents in order to provide travel-related services to customers.

GTAA – Refers to the Greater Toronto Airports Authority.

Jazz – Refers to Jazz Aviation LP.

Jazz CPA – Refers to the capacity purchase agreement between Air Canada and Jazz dated January 1, 2015 which became effective on January 1, 2015.

Other passenger and cargo revenues – Refer to revenues from flights with origins and destinations principally in Central and South America and the Caribbean and Mexico.

Pacific passenger and cargo revenues – Refer to revenues from flights that cross the Pacific Ocean with origins and destinations principally in Asia and Australia.

Passenger load factor – Refers to a measure of passenger capacity utilization derived by expressing Revenue Passenger Miles as a percentage of Available Seat Miles.

Passenger revenue per available seat mile or PRASM – Refers to average passenger revenue per ASM (baggage fee revenues, which are included in passenger revenues, are removed for the purposes of calculating PRASM).

Percentage point (pp) – Refers to a measure for the arithmetic difference of two percentages.

Return on invested capital or ROIC – Refers to return on invested capital and is a measure used to assess the efficiency with which a company allocates its capital to generate returns. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

Revenue passenger carried – Refers to IATA's definition of passenger carried whereby passengers are counted on a flight number basis rather than by journey/itinerary or by leg.

Revenue passenger miles or RPMs – Refers to a measure of passenger traffic calculated by multiplying the total number of revenue passengers carried by the miles they are carried.

Revenue ton miles or RTMs – Refers to the mathematical product of weight in tons of a shipment being transported by the number of miles that it is transported.

Seats dispatched – Refers to the number of seats on non-stop flights. A non-stop flight refers to a single take-off and landing.

Sky Regional – Refers to Sky Regional Airlines Inc.

Special items – Refer to those items that, in management's view, are to be separately disclosed by virtue of their size or incidence to enable a full understanding of the Corporation's financial performance.

Unifor – Refers to the trade union in Canada, launched in 2013, as a merger of the Canadian Auto Workers and Communications, Energy and Paperworkers unions.

Weighted average cost of capital or WACC – Refers to management's estimate of its cost of capital, in which each category of capital is proportionately weighted.

Yield – Refers to average passenger revenue per RPM (baggage fee revenues, which are included in passenger revenues, are removed for the purposes of calculating yield).

2015 CONSOLIDATED FINANCIAL STATEMENTS AND NOTES

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements have been prepared by management. Management is responsible for the fair presentation of the consolidated financial statements in conformity with generally accepted accounting principles in Canada which incorporates International Financial Reporting Standards. Management is responsible for the selection of accounting policies and making significant accounting judgments and estimates. Management is also responsible for all other financial information included in management's discussion and analysis and for ensuring that this information is consistent, where appropriate, with the information contained in the consolidated financial statements.

Management is responsible for establishing and maintaining adequate internal control over financial reporting which includes those policies and procedures that provide reasonable assurance over the safeguarding of assets and over the completeness, fairness and accuracy of the consolidated financial statements and other financial information.

The Audit, Finance and Risk Committee, which is comprised entirely of independent directors, reviews the quality and integrity of the Corporation's financial reporting and recommends approval to the Board of Directors; oversees management's responsibilities as to the adequacy of the supporting systems of internal controls; provides oversight of the independence, qualifications and appointment of the external auditor; and pre-approves audit and audit-related fees and expenses. The Board of Directors approves the Corporation's consolidated financial statements, management's discussion and analysis and annual report disclosures prior to their release. The Audit, Finance and Risk Committee meets with management, the internal auditors and external auditors at least four times each year to review and discuss financial reporting, disclosures, auditing and other matters.

The external auditors, PricewaterhouseCoopers LLP, conduct an independent audit of the consolidated financial statements in accordance with Canadian generally accepted auditing standards and express their opinion thereon. Those standards require that the audit is planned and performed to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The external auditors have unlimited access to the Audit, Finance and Risk Committee and meet with the Committee on a regular basis.

Calin Rovinescu
President and Chief Executive Officer

Michael Rousseau
Executive Vice President and Chief Financial Officer

February 16, 2016

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF AIR CANADA

We have audited the accompanying consolidated financial statements of Air Canada and its subsidiaries, which comprise the consolidated statement of financial position as at December 31, 2015 and December 31, 2014 and the consolidated statement of operations, statement of comprehensive income, statement of changes in equity and statement of cash flow for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Air Canada and its subsidiaries as at December 31, 2015 and December 31, 2014 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

PricewaterhouseCoopers LLP[1]

Montréal, Quebec
February 16, 2016

[1] CPA auditor, CA, public accountancy permit NO. 18144

PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

CANADIAN DOLLARS IN MILLIONS		DECEMBER 31, 2015	DECEMBER 31, 2014
ASSETS			
CURRENT			
Cash and cash equivalents		$ 572	$ 661
Short-term investments		2,100	1,614
Total cash, cash equivalents and short-term investments		2,672	2,275
Restricted cash	Note 2P	91	89
Accounts receivable		654	656
Promissory notes receivable	Note 4	143	-
Aircraft fuel inventory		68	72
Spare parts and supplies inventory	Note 2Q	114	91
Prepaid expenses and other current assets		383	295
Total current assets		4,125	3,478
Property and equipment	Note 4	7,030	5,998
Pension	Note 8	851	-
Intangible assets	Note 5	314	305
Goodwill	Note 6	311	311
Deposits and other assets		496	556
TOTAL ASSETS		**$ 13,127**	**$ 10,648**
LIABILITIES			
CURRENT			
Accounts payable and accrued liabilities		$ 1,487	$ 1,259
Advance ticket sales		1,818	1,794
Current portion of long-term debt and finance leases	Note 7	524	484
Total current liabilities		3,829	3,537
Long-term debt and finance leases	Note 7	5,870	4,732
Pension and other benefit liabilities	Note 8	2,245	2,403
Maintenance provisions	Note 9	892	796
Other long-term liabilities		251	313
TOTAL LIABILITIES		**$ 13,087**	**$ 11,781**
EQUITY			
SHAREHOLDERS' EQUITY			
Share capital	Note 11	825	835
Contributed surplus		76	77
Hedging reserve		(11)	-
Deficit		(877)	(2,113)
Total shareholders' equity		13	(1,201)
NON-CONTROLLING INTERESTS		27	68
TOTAL EQUITY		40	(1,133)
TOTAL LIABILITIES AND EQUITY		**$ 13,127**	**$ 10,648**

The accompanying notes are an integral part of the consolidated financial statements.

On behalf of the Board of Directors:

David I. Richardson
Chairman

Christie J.B. Clark
Chair of the Audit, Finance and Risk Committee

CONSOLIDATED STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31 CANADIAN DOLLARS IN MILLIONS EXCEPT PER SHARE FIGURES		2015	2014
OPERATING REVENUES			
Passenger	Note 18	$ 12,420	$ 11,804
Cargo	Note 18	506	502
Other		942	966
TOTAL REVENUES		**13,868**	**13,272**
OPERATING EXPENSES			
Aircraft fuel		2,464	3,247
Regional airlines expense	Note 19	2,279	2,324
Wages, salaries and benefits		2,324	2,201
Airport and navigation fees		802	755
Aircraft maintenance		773	678
Depreciation, amortization and impairment		655	526
Sales and distribution costs		608	560
Ground package costs		415	377
Aircraft rent		353	302
Food, beverages and supplies		314	294
Communications and information technology		211	199
Special items	Note 20	8	(11)
Other		1,166	1,005
TOTAL OPERATING EXPENSES		**12,372**	**12,457**
OPERATING INCOME		**1,496**	**815**
NON-OPERATING INCOME (EXPENSE)			
Foreign exchange loss		(762)	(307)
Interest income		46	39
Interest expense		(402)	(322)
Interest capitalized		70	30
Net financing expense relating to employee benefits	Note 8	(105)	(134)
Fuel and other derivatives	Note 15	(17)	(1)
Other		(18)	(15)
TOTAL NON-OPERATING EXPENSE		(1,188)	(710)
INCOME BEFORE INCOME TAXES		**308**	**105**
Income taxes	Note 10	-	-
NET INCOME		**$ 308**	**$ 105**
NET INCOME ATTRIBUTABLE TO:			
Shareholders of Air Canada		303	100
Non-controlling interests		5	5
NET INCOME		**$ 308**	**$ 105**
NET INCOME PER SHARE ATTRIBUTABLE TO SHAREHOLDERS OF AIR CANADA	Note 13		
Basic earnings per share		$ 1.06	$ 0.35
Diluted earnings per share		$ 1.03	$ 0.34

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED DECEMBER 31 CANADIAN DOLLARS IN MILLIONS		2015	2014
COMPREHENSIVE INCOME			
Net income		$ 308	$ 105
Other comprehensive income, net of taxes of nil:			
Items that will not be reclassified to net income			
Remeasurements on employee benefit liabilities	Note 8	1,015	167
Items that will be reclassified to net income			
Loss on derivatives designated as cash flow hedges, net	Note 15	(11)	-
TOTAL COMPREHENSIVE INCOME		**$ 1,312**	**$ 272**
Comprehensive income attributable to:			
Shareholders of Air Canada		$ 1,307	$ 267
Non-controlling interests		5	5
TOTAL COMPREHENSIVE INCOME		**$ 1,312**	**$ 272**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

CANADIAN DOLLARS IN MILLIONS	SHARE CAPITAL	CONTRIBUTED SURPLUS	HEDGING RESERVE	DEFICIT	TOTAL SHAREHOLDERS' EQUITY	NON-CONTROLLING INTERESTS	TOTAL EQUITY
January 1, 2014	$ 827	$ 80	$ -	$ (2,367)	$ (1,460)	$ 63	$ (1,397)
Net income	-	-	-	100	100	5	105
Remeasurements on employee benefit liabilities	-	-	-	167	167	-	167
Total comprehensive income	-	-	-	267	267	5	272
Share-based compensation	-	2	-	(13)	(11)	-	(11)
Shares issued (Note 11)	2	(1)	-	-	1	-	1
Shares vested for employee recognition award (Note 11)	6	(4)	-	-	2	-	2
December 31, 2014	$ 835	$ 77	$ -	$ (2,113)	$ (1,201)	$ 68	$ (1,133)
Net income	-	-	-	303	303	5	308
Remeasurements on employee benefit liabilities	-	-	-	1,015	1,015	-	1,015
Loss on derivatives designated as cash flow hedges, net	-	-	(11)	-	(11)	-	(11)
Total comprehensive income	-	-	(11)	1,318	1,307	5	1,312
Share-based compensation	-	1	-	(35)	(34)	-	(34)
Shares issued (Note 11)	6	(2)	-	-	4	-	4
Shares purchased and cancelled under issuer bid (Note 11)	(16)	-	-	(47)	(63)	-	(63)
Distributions	-	-	-	-	-	(46)	(46)
December 31, 2015	$ 825	$ 76	$ (11)	$ (877)	$ 13	$ 27	$ 40

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOW

FOR THE YEAR ENDED DECEMBER 31 CANADIAN DOLLARS IN MILLIONS CASH FLOWS FROM (USED FOR)		2015	2014
OPERATING			
Net income		$ 308	$ 105
Adjustments to reconcile to net cash from operations			
Depreciation, amortization and impairment		671	543
Foreign exchange loss	Note 15	835	351
Employee benefit funding (greater) less than expense	Note 8	6	(117)
Fuel and other derivatives	Note 15	(5)	(12)
Change in maintenance provisions		42	76
Changes in non-cash working capital balances		191	40
Other		(36)	(32)
NET CASH FLOWS FROM OPERATING ACTIVITIES		**2,012**	**954**
FINANCING			
Proceeds from borrowings	Note 7	905	1,178
Reduction of long-term debt and finance lease obligations	Note 7	(694)	(677)
Distributions related to aircraft special purpose leasing entities		(51)	-
Issue of common shares		4	1
Shares purchased for cancellation	Note 11	(63)	-
Financing fees	Note 7	(32)	-
NET CASH FLOWS FROM FINANCING ACTIVITIES		**69**	**502**
INVESTING			
Short-term investments		(398)	(100)
Additions to property, equipment and intangible assets		(1,815)	(1,501)
Proceeds from sale of assets		23	72
Other		2	(3)
NET CASH FLOWS USED IN INVESTING ACTIVITIES		**(2,188)**	**(1,532)**
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS		**18**	**(13)**
DECREASE IN CASH AND CASH EQUIVALENTS		**(89)**	**(89)**
Cash and cash equivalents, beginning of year		661	750
CASH AND CASH EQUIVALENTS, END OF YEAR		**$ 572**	**$ 661**

The accompanying notes are an integral part of the consolidated financial statements.

01 GENERAL INFORMATION

The accompanying audited consolidated financial statements (the "financial statements") are of Air Canada (the "Corporation"). The term "Corporation" also refers to, as the context may require, Air Canada and/or one or more of its subsidiaries, including its principal wholly owned operating subsidiaries, Touram Limited Partnership doing business under the brand name Air Canada Vacations® ("Air Canada Vacations") and Air Canada *rouge* LP doing business under the brand name Air Canada rouge® ("Air Canada *rouge*"). These financial statements also include certain aircraft leasing entities, which are consolidated under IFRS 10 Consolidated Financial Statements, with nominal equity owned by other parties.

Air Canada is incorporated and domiciled in Canada. The address of its registered office is 7373 Côte-Vertu Boulevard West, Saint-Laurent, Quebec.

Air Canada is Canada's largest domestic, U.S. transborder and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-U.S. transborder market as well as the international markets to and from Canada. Certain of the scheduled passenger services offered on domestic and Canada-U.S. transborder routes are operated under the brand name "Air Canada Express" and operated by third parties such as Jazz Aviation LP ("Jazz") and Sky Regional Airlines Inc. ("Sky Regional") through capacity purchase agreements (each a "CPA"). Air Canada also offers scheduled passenger services on domestic and Canada-U.S. transborder routes through capacity purchase agreements on other regional carriers, including those operating aircraft of 18 seats or less, some of which are referred to as Tier III carriers. Through Air Canada's global route network, virtually every major market throughout the world is served either directly or through the Star Alliance® network.

Air Canada Cargo, a division of Air Canada, is Canada's largest provider of air cargo services. Air Canada offers air cargo services on domestic and U.S. transborder routes as well as on international routes between Canada and major markets in Europe, Asia, South America and Australia.

02 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation prepares its financial statements 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").

These financial statements were approved for issue by the Board of Directors of the Corporation on February 16, 2016.

These financial statements are based on the accounting policies as described below. These policies have been consistently applied to all the periods presented, except as otherwise stated.

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted for the current year.

A. BASIS OF MEASUREMENT

These financial statements have been prepared under the historical cost convention, except for the revaluation of cash, cash equivalents and short-term investments, restricted cash and derivative instruments which are measured at fair value.

B. PRINCIPLES OF CONSOLIDATION

These financial statements include the accounts of Air Canada and its subsidiaries. Subsidiaries are all entities (including structured entities) which Air Canada controls. For accounting purposes, control is established by an investor when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. All inter-company balances and transactions are eliminated.

Non-controlling interests represent equity interests in subsidiaries owned by outside parties. The share of net assets of subsidiaries attributable to non-controlling interests is presented as a component of equity.

Structured Entities

The Corporation has aircraft leasing and other agreements with a number of structured entities. Under IFRS 10 Consolidated Financial Statements, the Corporation controls and consolidates leasing entities covering 17 aircraft (22 aircraft as at December 31, 2014). The Corporation has concluded that it controls these entities because the lease or other agreements with these structured entities give Air Canada the power to control the principal economic decision on lease expiry of whether to purchase the aircraft and thereby collapse the structured entity.

C. PASSENGER AND CARGO REVENUES

Passenger and cargo revenues are recognized when the transportation is provided, except for revenue on unlimited flight passes which is recognized on a straight-line basis over the period during which the travel pass is valid. The Corporation has formed alliances with other airlines encompassing loyalty program participation, interline agreements and code sharing and coordination of services including reservations, baggage handling and flight schedules. Revenues are allocated based upon formulas specified in the agreements and are recognized as transportation is provided. Passenger revenue also includes certain fees and surcharges and revenues from passenger-related services such as seat selection and excess baggage which are recognized as the services are provided.

Airline passenger and cargo advance sales are deferred and included in Current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aimia Canada Inc. ("Aeroplan"), a corporation that provides loyalty program services to Air Canada and purchases seats from Air Canada pursuant to the Commercial Participation and Services Agreement between Aeroplan and Air Canada (the "CPSA").

D. CAPACITY PURCHASE AGREEMENTS

Air Canada has capacity purchase agreements with Jazz, Sky Regional and certain other regional carriers. Under these agreements, Air Canada markets, tickets and enters into other commercial arrangements relating to these flights and records the revenue it earns under Passenger revenue. Operating expenses under capacity purchase agreements include the capacity purchase fees, pass-through costs, which are direct costs incurred by the regional carrier and charged to the Corporation, and other costs incurred by the Corporation which are directly related to regional carrier operations. Prior to 2015, these expenses were recorded in the applicable category within Operating expenses with capacity purchase fees presented as a separate line item. As of 2015, expenses incurred related to capacity purchase agreements are now presented in a separate line item in the consolidated statement of operations titled Regional airlines expense which reflects the inclusion of all expenses related to the third-party capacity purchase agreements, including capacity purchase fees, pass-through costs and other costs. This change in presentation has been adopted to provide improved presentation of the economic costs associated with regional carrier operations. Prior period amounts have been reclassified to conform to the current period presentation. Refer to Note 19 for a reconciliation of previously reported amounts to the current year presentation.

E. AEROPLAN LOYALTY PROGRAM

Air Canada purchases Aeroplan Miles from Aeroplan, an unrelated party. Air Canada is an Aeroplan partner providing certain of Air Canada's customers with Aeroplan Miles, which can be redeemed by customers for air travel or other rewards acquired by Aeroplan.

Under the CPSA, Aeroplan purchases passenger tickets from Air Canada, which are accounted for as passenger revenues by Air Canada when transportation is provided. The cost of purchasing Aeroplan Miles from Aeroplan is accounted for as a sales incentive and charged against passenger revenues when the points are issued, which occurs upon the qualifying air travel being provided to the customer.

F. OTHER REVENUES

Other revenue includes revenues from the sale of the ground portion of vacation packages, ground handling services and other airline related services. Vacation package revenue is recognized as services are provided over the period of the vacation. Other airline related service revenues are recognized as the products are sold to passengers or the services are provided.

In certain subleases of aircraft to Jazz and Sky Regional, for accounting purposes, the Corporation acts as an agent and accordingly reports the sublease revenues net against aircraft rent expense as the terms of the sublease match the terms of the Corporation's lease. The Corporation acts as lessee and sublessor in these matters.

G. EMPLOYEE BENEFITS

The cost of pensions, other post-retirement and post-employment benefits earned by employees is actuarially determined annually as at December 31. The cost is determined using the projected unit credit method and assumptions including market interest rates, salary escalation, retirement ages of employees, mortality rates, and health care costs.

Past service costs are recognized in the period of a plan amendment, irrespective of whether the benefits have vested. Gains and losses on curtailments or settlements are recognized in the period in which the curtailment or settlement occurs.

The current service cost and any past service cost, gains and losses on curtailments or settlements are recorded in Wages, salaries and benefits. The interest arising on the net benefit obligations are presented in Net financing expense relating to employee benefits. Net actuarial gains and losses, referred to as remeasurements, are recognized in other comprehensive income and deficit without subsequent reclassification to income.

The liability in respect of minimum funding requirements, if any, is determined using the projected minimum funding requirements, based on management's best estimates of the actuarially determined funded status of the plan, market discount rates and salary escalation estimates. The liability in respect of the minimum funding requirement and any subsequent remeasurement of that liability are recognized immediately in other comprehensive income and deficit without subsequent reclassification to income.

Recognized pension assets are limited to the present value of any reductions in future contributions or any future refunds.

H. EMPLOYEE PROFIT SHARING PLANS

The Corporation has employee profit sharing plans. Payments are calculated based on full calendar year results and an expense recorded throughout the year as a charge to Wages, salaries and benefits based on the estimated annual payments under the plans.

I. SHARE-BASED COMPENSATION PLANS

Certain employees of the Corporation participate in Air Canada's Long-Term Incentive Plan, which provides for the grant of stock options, performance share units ("PSUs") and restricted share units ("RSUs"), as further described in Note 12. PSUs and RSUs are notional share units which are exchangeable, on a one-to-one basis, as determined by the Board of Directors as described in Note 12, for Air Canada shares, or the cash equivalent.

Options are expensed using a graded vesting model over the vesting period. The Corporation recognizes compensation expense and a corresponding adjustment to Contributed surplus equal to the fair value of the equity instruments granted using the Black-Scholes option pricing model taking into consideration forfeiture estimates. Compensation expense is adjusted for subsequent changes in management's estimate of the number of options that are expected to vest.

Grants of PSUs and RSUs are accounted for as equity settled instruments. Accordingly, the Corporation recognizes compensation expense offset by Contributed surplus equal to the market value of an Air Canada common share at the date of grant on a straight-line basis over the applicable vesting period, taking into consideration forfeiture estimates. Compensation expense is adjusted for subsequent changes in management's current estimate of the number of PSUs and RSUs that are expected to vest. Refer to Note 15 for a description of derivative instruments used by the Corporation to economically hedge the cash flow exposure to PSUs and RSUs.

Air Canada also maintains an employee share purchase plan. Under this plan, contributions by the Corporation's employees are matched to a specific percentage by the Corporation. Employees must remain with the Corporation until March 31 of the subsequent year for vesting of the Corporation's contributions. These contributions are expensed in Wages, salaries, and benefits expense over the vesting period.

J. MAINTENANCE AND REPAIRS

Maintenance and repair costs for both leased and owned aircraft are charged to Aircraft maintenance as incurred, with the exception of maintenance and repair costs related to return conditions on aircraft under operating lease, which are accrued over the term of the lease, and major maintenance expenditures on owned and finance leased aircraft, which are capitalized as described below in Note 2R.

Maintenance and repair costs related to return conditions on aircraft leases are recorded over the term of the lease for the end of lease maintenance return condition obligations within the Corporation's operating leases, offset by a prepaid maintenance asset to the extent of any related power-by-the-hour maintenance service agreements or any recoveries under aircraft subleasing arrangements. The provision is recorded within Maintenance provisions using a discount rate taking into account the specific risks of the liability over the remaining term of the lease. Interest accretion on the provision is recorded in Other non-operating expense. Any changes in the maintenance cost estimate, discount rates, timing of settlement or difference in the actual maintenance cost incurred and the amount of the provision are recorded in Aircraft maintenance.

K. OTHER OPERATING EXPENSES

Included in Other operating expenses are expenses related to building rent and maintenance, airport terminal handling costs, professional fees and services, crew meals and hotels, advertising and promotion, insurance costs, and other expenses. Other operating expenses are recognized as incurred.

L. FINANCIAL INSTRUMENTS

New Accounting Standard Adopted by the Corporation

The Corporation has early adopted IFRS 9 – Financial Instruments with a date of initial application of January 1, 2015. IFRS 9 introduces new requirements for the classification and measurement of financial assets. IFRS 9 requires all recognized financial assets to be measured at amortized cost or fair value in subsequent accounting periods following initial recognition. IFRS 9 also amends the requirements around hedge accounting, and introduces a single, forward-looking expected loss impairment model.

All financial assets, other than Accounts receivable, Promissory notes receivable, and Aircraft related and other deposits, are included in the measurement category of fair value through profit and loss. Financial assets previously allocated to Loans and receivables are now allocated to the amortized cost category. There was no change to the measurement category for financial liabilities at amortized cost.

The adoption of IFRS 9 had no impact on the Corporation's consolidated financial statements on the date of adoption. There was no change in the carrying amounts on the basis of allocation from original measurement categories under IAS 39 to the new measurement categories under IFRS 9.

Recognition

Financial assets and financial liabilities, including derivatives, are recognized on the consolidated statement of financial position when the Corporation becomes a party to the financial instrument or derivative contract.

Classification

From January 1, 2015, the Corporation classifies its financial assets and financial liabilities in the following measurement categories i) those to be measured subsequently at fair value (either through other comprehensive income or through profit or loss and ii) those to be measured at amortized cost. The classification of financial assets depends on the business model for managing the financial assets and the contractual terms of the cash flows. Financial liabilities are classified as those to be measured at amortized cost unless they are designated as those to be measured subsequently at fair value through profit or loss (irrevocable election at the time of recognition). For assets and liabilities measured at fair value, gains and losses are either recorded in profit or loss or other comprehensive income.

The Corporation reclassifies financial assets when and only when its business model for managing those assets changes. Financial liabilities are not reclassified.

The Corporation has implemented the following classifications:

- Cash and cash equivalents, Short-term investments, and Restricted cash are classified as assets at fair value and any period change in fair value is recorded through Interest income in the consolidated statement of operations, as applicable.
- Accounts receivable and Aircraft related and other deposits are classified as assets at amortized cost and are measured using the effective interest rate method. Interest income is recorded in the consolidated statement of operations, as applicable.
- Accounts payable, credit facilities, and long-term debt are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method. Interest expense is recorded in the consolidated statement of operations, as applicable.

Measurement

All financial instruments are required to be measured at fair value on initial recognition, plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed in profit or loss. Financial assets and financial liabilities with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

Financial assets that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of the subsequent accounting periods. All other financial assets including equity investments are measured at their fair values at the end of subsequent accounting periods, with any changes taken through profit and loss or other comprehensive income (irrevocable election at the time of recognition). The requirements for classification and measurement of financial liabilities largely carried forward existing requirements in IAS 39, Financial Instruments – Recognition and Measurement, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would, under IFRS 9, generally be recorded in other comprehensive income.

Impairment

The Corporation assesses all information available, including on a forward-looking basis the expected credit losses associated with its assets carried at amortized cost. The impairment methodology applied depends on whether there has been a significant increase in credit risk. To assess whether there is a significant increase in credit risk, the Corporation compares the risk of a default occurring on the asset as at the reporting date with the risk of default as at the date of initial recognition based on all information available, and reasonable and supportive forward-looking information. For trade receivables only, the Corporation applies the simplified approach as permitted by IFRS 9 which requires expected lifetime losses to be recognized from initial recognition of receivables.

Derivatives and Hedge Accounting

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently re-measured to their fair value at the end of each reporting period. The accounting for subsequent changes in fair value depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged and the type of hedge relationship designated. The Corporation documents at the inception of the hedging transaction the economic relationship between hedging instruments and hedged items including whether the hedging instrument is expected to offset changes in cash flows of hedged items. The Corporation documents its risk management objective and strategy for undertaking various hedge transactions at the inception of each hedging relationship.

The Corporation began to apply hedge accounting for certain designated fuel derivatives prospectively from April 1, 2015. Crude oil prices, while not contractually specified in the Corporation's jet fuel purchase contracts, are economically related to jet fuel prices. The Corporation enters into option contracts on crude oil and designates the contracts in cash flow hedges of the crude oil component of its future jet fuel purchases. The Corporation has established a hedge ratio of 1:1 for its hedging relationships. Under hedge accounting, to the extent effective, the gain or loss on fuel hedging derivatives is recorded in other comprehensive income. Premiums paid for option contracts and the time value of the option contracts are deferred as a cost of the hedge in other comprehensive income. Amounts accumulated in other comprehensive income are presented as hedging reserve in equity and are reclassified to Aircraft fuel expense when the underlying hedged jet fuel is used. Any ineffective gain or loss on fuel hedging derivatives is recorded in non-operating expense in Fuel and other derivatives. Refer to Note 15 for the results from fuel hedge accounting since the Corporation began applying hedge accounting in 2015.

When a hedging instrument expires, is sold or terminated, or when a hedge no longer meets the criteria for hedge accounting, any cumulative deferred gain or loss and deferred costs of hedging in equity at that time remains in equity until the forecast transaction occurs. When the forecast transaction is no longer expected to occur, the cumulative gain or loss and deferred costs of hedging that were reported in equity are immediately reclassified to profit or loss.

If the hedge ratio for risk management purposes is no longer optimal but the risk management objective remains unchanged and the hedge continues to qualify for hedge accounting, the hedge relationship will be rebalanced by adjusting either the volume of the hedged instrument or the volume of the hedged item so that the hedge ratio aligns with the ratio used for risk management purposes. Any hedge ineffectiveness is calculated and accounted for in profit or loss at the time of the hedge relationship rebalancing.

The Corporation enters into interest rate, foreign currency, fuel derivatives and share forward contracts to manage the associated risks. Derivative instruments are recorded on the consolidated statement of financial position at fair value, including those derivatives that are embedded in financial or non-financial contracts that are required to be accounted for separately. Changes in the fair value of derivative instruments are recognized in Non-operating income (expense), except for effective changes for designated fuel derivatives under hedge accounting as described above. Derivative contracts are included in the consolidated statement of financial position at fair value in Prepaid expenses and other current assets, Deposits and other assets, and Accounts payable and accrued liabilities based on the terms of the contractual agreements. All cash flows associated with purchasing and selling derivatives are classified as operating cash flows in the consolidated statement of cash flow.

Accounting Policy Prior to January 1, 2015

The Corporation has applied IFRS 9 retrospectively, but has elected not to restate comparatives in accordance with the transition requirements. As a result, the comparative information provided continues to be accounted for in accordance with the Corporation's previous accounting policy.

M. FOREIGN CURRENCY TRANSLATION

The functional currency of Air Canada and its subsidiaries is the Canadian dollar. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the consolidated statement of financial position. Non-monetary assets and liabilities, revenues and expenses arising from transactions denominated in foreign currencies, are translated at the historical exchange rate or the average exchange rate during the period, as applicable. Adjustments to the Canadian dollar equivalent of foreign denominated monetary assets and liabilities due to the impact of exchange rate changes are recognized in Foreign exchange gain (loss).

N. INCOME TAXES

The tax expense for the period comprises current and deferred income tax. Tax expense is recognized in the consolidated statement of operations, except to the extent that it relates to items recognized in other comprehensive income or directly in equity, in which case the tax is netted with such items.

The current income tax expense is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the jurisdictions where the Corporation and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulations are subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

O. EARNINGS PER SHARE

Basic earnings per share ("EPS") is calculated by dividing the net income (loss) for the period attributable to the shareholders of Air Canada by the weighted average number of common shares outstanding during the period.

Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive potential common shares. The Corporation's potentially dilutive common shares are comprised of stock options. The number of shares included with respect to time vesting options is computed using the treasury stock method unless they are anti-dilutive. Under this method, the proceeds from the exercise of such instruments are assumed to be used to purchase shares at the average market price for the period and the difference between the number of shares issued upon exercise and the number of shares assumed to be purchased is included in the calculation. The number of shares included with respect to performance-based employee share options is treated as contingently issuable shares because their issue is contingent upon satisfying specified conditions in addition to the passage of time. If the specified conditions are met, then the number of shares included is also computed using the treasury stock method unless they are anti-dilutive.

P. RESTRICTED CASH

The Corporation has recorded Restricted cash under Current assets representing funds held in trust by Air Canada Vacations in accordance with regulatory requirements governing advance ticket sales, as well as funds held in escrow accounts relating to Air Canada Vacations' credit card agreements, recorded under Current liabilities, for certain travel related activities.

Restricted cash with maturities greater than one year from the balance sheet date is recorded in Deposits and other assets. This restricted cash relates to funds on deposit with various financial institutions as collateral for letters of credit and other items.

Q. AIRCRAFT FUEL INVENTORY AND SPARE PARTS AND SUPPLIES INVENTORY

Inventories of aircraft fuel, spare parts and supplies are measured at cost being determined using a weighted average formula, net of related obsolescence provision, as applicable.

The Corporation did not recognize any write-downs on inventories or reversals of any previous write-downs during the periods presented. Included in Aircraft maintenance is $68 related to spare parts and supplies consumed during the year (2014 – $55).

R. PROPERTY AND EQUIPMENT

Property and equipment is recognized using the cost model. Property under finance leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments.

The Corporation allocates the amount initially recognized in respect of an item of property and equipment to its significant components and depreciates separately each component. Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Aircraft and flight equipment are componentized into airframe, engine, and cabin interior equipment and modifications. Airframes and engines are depreciated over 20 to 25 years, with 10% to 20% estimated residual values. Spare engines and related parts ("rotables") are depreciated over the average remaining useful life of the fleet to which they relate with 10% to 20% estimated residual values. Cabin interior equipment and modifications are depreciated over the lesser of eight years or the remaining useful life of the aircraft. Cabin interior equipment and modifications to aircraft on operating leases are amortized over the term of the lease. Major maintenance of airframes and engines, including replacement spares and parts, labour costs and/or third party maintenance service costs, are capitalized and amortized over the average expected life between major maintenance events. Major maintenance events typically consist of more complex inspections and servicing of the aircraft. All maintenance of fleet assets provided under power-by-the-hour contracts are charged to operating expenses in the income statement as incurred. Buildings are depreciated on a straight-line basis over their useful lives not exceeding 50 years or the term of any related lease, whichever is less. Leasehold improvements are amortized over the lesser of the lease term or five years. Ground and other equipment is depreciated over three to 25 years.

Residual values and useful lives are reviewed at least annually and depreciation rates are adjusted accordingly on a prospective basis. Gains and losses on disposals of property and equipment are determined by comparing the proceeds with the carrying amount of the asset and are included as part of non-operating gains and losses in the consolidated statement of operations.

S. INTEREST CAPITALIZED

Borrowing costs are expensed as incurred. For borrowing costs attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use, the costs are capitalized as part of the cost of that asset. Capitalization of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and the activities to prepare the asset for its intended use are in progress. Borrowing costs are capitalized up to the date when the project is completed and the related asset is available for its intended use.

To the extent that funds are borrowed specifically for the purpose of obtaining such assets, the amount of borrowing costs eligible for capitalization is determined at the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings. To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the Corporation that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

T. LEASES

Leases are classified as finance leases when the lease arrangement transfers substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Total aircraft operating lease rentals over the lease term are amortized to operating expense (aircraft rent) on a straight-line basis. Included in Deposits and other assets and Other long-term liabilities are the differences between the straight-line aircraft rent expense and the payments as stipulated under the lease agreement.

U. INTANGIBLE ASSETS

Intangible assets are initially recorded at cost. Indefinite life intangible assets are not amortized while assets with finite lives are amortized on a straight-line basis over their estimated useful lives.

	ESTIMATED USEFUL LIFE	REMAINING AMORTIZATION PERIOD AS AT DECEMBER 31, 2015
International route rights and slots	Indefinite	not applicable
Marketing based trade names	Indefinite	not applicable
Contract and customer based	10 years	nil
Technology based (internally developed)	5 years	1 to 5 years

Air Canada has international route and slot rights which enable the Corporation to provide services internationally. The value of the recorded intangible assets relates to the cost of route and slot rights at Tokyo's Narita International Airport, Washington's Reagan National Airport and London's Heathrow Airport. Air Canada expects to provide service to these international locations for an indefinite period.

Air Canada and certain of its subsidiaries have trade names, trademarks, and domain names (collectively, "Trade Names"). These items are marketing based intangible assets as they are primarily used in the sale and promotion of Air Canada's products and services. The Trade Names create brand recognition with customers and potential customers and are capable of contributing to cash flows for an indefinite period of time. Air Canada intends to continually re-invest in, and market, the Trade Names to support classification as indefinite life intangibles. If there were plans to cease using any of the Trade Names, the specific names would be classified as finite and amortized over the expected remaining useful life.

Development costs that are directly attributable to the design, development and testing of identifiable software products are recognized as technology based intangible assets if certain criteria are met, including technical feasibility and intent and ability to develop and use the technology to generate probable future economic benefits; otherwise they are expensed as incurred. Directly attributable costs that are capitalized as part of the technology based intangible assets include software-related, employee and third party development costs and an appropriate portion of relevant overhead.

V. GOODWILL

Goodwill represents the excess of the cost of an acquisition over the fair value of the Corporation's share of the net identifiable assets of the acquired business at the date of acquisition. Goodwill is tested at least annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. For the purpose of impairment testing, goodwill is tested for impairment at the lowest level within the entity at which the goodwill is monitored for internal management purposes, being the operating segment level (Note AA).

No impairment losses have been recorded against the value of goodwill since its acquisition.

W. IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets include property and equipment, finite lived intangible assets, indefinite lived intangible assets and goodwill. Assets that have an indefinite useful life, including goodwill are tested at least annually for impairment or when events or circumstances indicate that the carrying value may not be recoverable. Assets that are subject to depreciation or amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment test is performed by comparing the carrying amount of the asset or group of assets to their recoverable amount. Recoverable amount is calculated as the higher of an asset's or cash-generating unit's fair value less costs to dispose and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units or CGUs). Management has determined that the appropriate level for assessing impairments is at the North American (for narrow-body aircraft) and international (for wide-body aircraft) fleet levels for aircraft and related assets supporting the operating fleet. Parked aircraft not used in operations and aircraft leased or subleased to third parties are assessed for impairment at the individual asset level. Value in use is calculated based upon a discounted cash flow analysis. An impairment loss is recognized for the amount by which the asset's or cash generating unit's carrying amount exceeds its recoverable amount.

Long-lived assets, other than goodwill, that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date. Management assesses whether there is any indication that an impairment loss recognized in a prior period no longer exists or has decreased. In assessing whether there is a possible reversal of an impairment loss, management considers the indicators that gave rise to the impairment loss. If any such indicators exist that an impairment loss has reversed, management estimates the recoverable amount of the long-lived asset. An impairment loss recognized in prior periods for an asset other than goodwill shall be reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. The carrying amount of any individual asset in the CGU is not increased above the carrying value that would have been determined had the original impairment not occurred. A reversal of an impairment loss is recognized immediately in the consolidated statement of operations.

X. NON-CURRENT ASSETS (OR DISPOSAL GROUPS) HELD FOR SALE

Non-current assets (or disposal groups) are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction, such assets are available for immediate sale in present condition, and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to dispose.

Y. PROVISIONS

Provisions are recognized when there exists a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the obligation. If the effect is significant, the expected cash flows are discounted using a rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, interest accretion on the provision is recorded in Other non-operating expense.

Z. SPECIAL ITEMS

Special items are those items that in management's view are to be separately disclosed by virtue of their size or incidence to enable a full understanding of the Corporation's financial performance.

AA. SEGMENT REPORTING

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of operations, has been identified as the Chief Executive Officer. Air Canada is managed as one operating segment based on how financial information is produced internally for the purposes of making operating decisions.

BB. ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET ADOPTED

The following is an overview of accounting standard changes that the Corporation will be required to adopt in future years. The Corporation continues to evaluate the impact of these standards on its consolidated financial statements.

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 replaces IAS 18 Revenue and related interpretations. The core principle of the new standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard is intended to enhance disclosures about revenue, provide more comprehensive guidance for transactions that were not previously addressed and improve guidance for multiple-element arrangements. IFRS 15 is effective for annual periods beginning on January 1, 2018, with early adoption permitted.

IFRS 16 – Leases

IFRS 16 replaces IAS 17 Leases and related interpretations. The core principle is that a lessee recognize assets and liabilities for all leases with a lease term of more than 12 months. A lessee is required to recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. Assets and liabilities arising from a lease are initially measured on a present value basis. The measurement includes non-cancellable lease payments (including inflation-linked payments), and also includes payments to be made in optional periods if the lessee is reasonably certain to exercise an option to extend the lease, or not to exercise an option to terminate the lease. The new standard is intended to provide a faithful representation of leasing transactions, in particular those that do not currently require the lessees to recognize an asset and liability arising from an operating lease. IFRS 16 is effective for annual periods beginning on January 1, 2019, with early adoption permitted for entities that would also apply IFRS 15 Revenue from Contracts with Customers.

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in these financial statements and accompanying notes. These estimates and associated assumptions are based on historical experience, future operating plans and various other factors believed to be reasonable under the circumstances, and the results of such estimates form the basis of judgments about carrying values of assets and liabilities. These underlying assumptions are reviewed on an ongoing basis. Actual results could differ materially from those estimates.

Significant estimates made in the preparation of these financial statements include, but are not limited to, the following areas, with further information contained in the applicable accounting policy or note:

- **Employee future benefits**
  The cost and related liabilities of the Corporation's pensions, other post-retirement and post-employment benefit programs are determined using actuarial valuations. The actuarial valuations involve assumptions including discount rates, future salary increases, mortality rates and future benefit increases. Also, due to the long-term nature of these programs, such estimates are subject to significant uncertainty. Refer to Note 8 for additional information.

- **Depreciation and amortization period for long-lived assets**
  The Corporation makes estimates about the expected useful lives of long-lived assets and the expected residual values of the assets based on the estimated current fair value of the assets, the Corporation's fleet plans and the cash flows they generate. Changes to these estimates, which can be significant, could be caused by a variety of factors, including changes to maintenance programs, changes in jet fuel prices and other operating costs, changes in utilization of the aircraft, and changing market prices for new and used aircraft of the same or similar types. Estimates and assumptions are evaluated at least annually. Generally, these adjustments are accounted for on a prospective basis, through depreciation and amortization expense. For the purposes of sensitivity analysis on these estimates, a 50% reduction to residual values on aircraft with remaining useful lives greater than five years results in an increase of $15 to annual depreciation expense. For aircraft with shorter remaining useful lives, the residual values are not expected to change significantly.

- **Impairment considerations on long-lived assets**
  When required, an impairment test is performed by comparing the carrying amount of the asset or cash generating unit to their recoverable amount, which is calculated as the higher of an asset's or cash-generating unit's fair value less costs to dispose and its value in use. Value in use is calculated based upon a discounted cash flow analysis, which requires management to make a number of significant assumptions including assumptions relating to future operating plans, discount rates and future growth rates. Refer to Notes 5 and 6 for additional information.

- **Maintenance provisions**
  The recording of maintenance provisions related to return conditions on aircraft leases requires management to make estimates of the future costs associated with the maintenance events required under the lease return condition and estimates of the expected future maintenance condition of the aircraft at the time of lease expiry. These estimates take into account current costs of these maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Any difference in the actual maintenance cost incurred and the amount of the provision is recorded in maintenance expense in the period. The effect of any changes in estimates, including changes in discount rates, inflation assumptions, cost estimates or lease expiries, is also recognized in maintenance expense in the period. Refer to Note 9(a) for additional information.

- **Income taxes**
  Deferred income tax assets are recognized only to the extent that it is probable that future taxable income will be available to realize them. In making this assessment, consideration is given to available positive and negative evidence and relevant assumptions. Consideration is given to, among other things, future projections of taxable income, overall business environment, historical financial results, and industry-wide trends and outlook. At December 31, 2015, no deferred income tax assets have been recorded.

04 PROPERTY AND EQUIPMENT

	AIRCRAFT AND FLIGHT EQUIPMENT	BUILDINGS AND LEASEHOLD IMPROVEMENTS	GROUND AND OTHER EQUIPMENT	PURCHASE DEPOSITS AND ASSETS UNDER DEVELOPMENT	TOTAL
YEAR ENDED DECEMBER 31, 2014					
At January 1, 2014	$ 4,208	$ 352	$ 157	$ 356	$ 5,073
Additions	1,011	6	36	468	1,521
Reclassifications	259	76	2	(337)	-
Disposals	(94)	-	-	-	(94)
Depreciation	(440)	(35)	(27)	-	(502)
At December 31, 2014	$ 4,944	$ 399	$ 168	$ 487	$ 5,998
AT DECEMBER 31, 2014					
Cost	$ 7,264	$ 742	$ 397	$ 487	$ 8,890
Accumulated depreciation	(2,320)	(343)	(229)	-	(2,892)
At December 31, 2014	$ 4,944	$ 399	$ 168	$ 487	$ 5,998
YEAR ENDED DECEMBER 31, 2015					
At January 1, 2015	$ 4,944	$ 399	$ 168	$ 487	$ 5,998
Additions	1,255	-	34	556	1,845
Reclassifications	199	50	24	(273)	-
Disposals	(181)	-	(1)	-	(182)
Depreciation	(543)	(39)	(35)	-	(617)
Impairment	(14)	-	-	-	(14)
At December 31, 2015	$ 5,660	$ 410	$ 190	$ 770	$ 7,030
AT DECEMBER 31, 2015					
Cost	$ 8,278	$ 791	$ 451	$ 770	$ 10,290
Accumulated depreciation	(2,618)	(381)	(261)	-	(3,260)
	$ 5,660	**$ 410**	**$ 190**	**$ 770**	**$ 7,030**

In 2015, an impairment charge of $14 was recorded in Depreciation, amortization and impairment expense related to two A340-300 aircraft (neither of which was operated by Air Canada). The lease agreements relating to these aircraft expired, with one aircraft returned while the other was purchased and will be resold. The impairment charge was calculated on the amount carrying value exceeded the net proceeds expected upon disposal of the aircraft. The total carrying amount of the remaining aircraft is nominal as at December 31, 2015.

As at December 31, 2015, property and equipment included finance leased assets including 18 aircraft (2014 – 17) with a net book value of $170 (2014 – $145) and facilities with a net book value of $39 (2014 – $42).

Included in aircraft and flight equipment are 21 aircraft and 5 spare engines (2014 – 28 aircraft and 5 spare engines) which are leased to Sky Regional, Jazz and third parties with a cost of $349 (2014 – $361) less accumulated depreciation of $97 (2014 – $118) for a net book value of $252 (2014 – $243). Depreciation expense for 2015 for this aircraft and flight equipment amounted to $14 (2014 – $22).

Promissory notes receivable of $143 represent certain proceeds from the sale of Embraer 190 aircraft, with each of the notes due within 90 days of delivery of the aircraft.

Certain property and equipment are pledged as collateral as further described under the applicable debt instrument in Note 7.

INTANGIBLE ASSETS

	INTERNATIONAL ROUTE RIGHTS AND SLOTS	MARKETING BASED TRADE NAMES	CONTRACT AND CUSTOMER BASED	TECHNOLOGY BASED (INTERNALLY DEVELOPED)	TOTAL
YEAR ENDED DECEMBER 31, 2014					
At January 1, 2014	$ 97	$ 88	$ 3	$ 116	$ 304
Additions	-	-	-	33	33
Amortization	-	-	(3)	(29)	(32)
At December 31, 2014	$ 97	$ 88	$ -	$ 120	$ 305
AT DECEMBER 31, 2014					
Cost	$ 97	$ 88	$ 20	$ 396	$ 601
Accumulated amortization	-	-	(20)	(276)	(296)
	$ 97	**$ 88**	**$ -**	**$ 120**	**$ 305**
YEAR ENDED DECEMBER 31, 2015					
At January 1, 2015	**$ 97**	**$ 88**	**$ -**	**$ 120**	**$ 305**
Additions	-	-	-	38	38
Amortization	-	-	-	(29)	(29)
At December 31, 2015	$ 97	$ 88	$ -	$ 129	$ 314
AT DECEMBER 31, 2015					
Cost	$ 97	$ 88	$ 20	$ 419	$ 624
Accumulated amortization	-	-	(20)	(290)	(310)
	$ 97	**$ 88**	**$ -**	**$ 129**	**$ 314**

In 2015, technology based assets with cost of $15 and accumulated amortization of $15 were retired.

Certain international route rights and slots are pledged as security for senior secured notes as described in Note 7(b).

An annual impairment review is conducted on all intangible assets that have an indefinite life. International route rights and slots and marketing based trade names are considered to have an indefinite life. The impairment review is carried out at the level of a cash-generating unit. On this basis, an impairment review was performed at the North American and international fleet levels for aircraft and related assets supporting the operating fleet. The allocation of the indefinite lived intangible assets to the cash-generating units was $144 to international and $41 to North American.

The recoverable amount of the cash-generating units has been measured based on their value in use, using a discounted cash flow model. Cash flow projections are based on the annual business plan approved by the Board of Directors of Air Canada. In addition, management-developed projections are made covering a three-year period. These cash flows are management's best estimate of future events taking into account past experience and future economic assumptions, such as the forward curves for crude oil and the applicable exchange rates. Cash flows beyond the three-year period are projected to increase consistent with the long-term growth assumption of the airline considering various factors such as the Corporation's fleet plans and industry growth assumptions. The discount rate applied to the cash flow projections is derived from the Corporation's weighted average cost of capital adjusted for taxes and specific risks associated with the cash-generating unit being tested.

Due to the recoverable amount exceeding the cash-generating units carrying value by a significant margin, the most recent calculation made in the preceding period was carried forward and used in the impairment test in the current period. Key assumptions used for the value in use calculations in fiscal 2014 were as follows:

	2014
Discount rate	10.7%
Long-term growth rate	2.5%
Jet fuel price range per barrel	$128 – $133

The recoverable amount of both cash-generating units based on value in use exceeded their respective carrying values by approximately $3,900. If the discount rate were increased by 240 basis points, the excess of recoverable amount over carrying value would be reduced to nil for one of the cash-generating units.

06 GOODWILL

Goodwill is tested at least annually for impairment. For the purpose of impairment testing, goodwill is tested for impairment using the fair value less cost to dispose model at the operating segment level. Air Canada is managed as one operating segment based on how financial information is produced internally for the purposes of making operating decisions.

In assessing the goodwill for impairment, the Corporation compares the aggregate recoverable amount consisting of the sum of its quoted equity market capitalization and the fair value of its debt to the carrying value of its net assets excluding long-term debt. An impairment charge is recognized to the extent that the carrying value exceeds the recoverable amount.

No impairment charges have arisen as a result of the reviews performed as at December 31, 2015 and 2014. Reasonably possible changes in key assumptions would not cause the recoverable amount of goodwill to fall below the carrying value.

07 LONG-TERM DEBT AND FINANCE LEASES

	FINAL MATURITY	WEIGHTED AVERAGE INTEREST RATE (%)	2015	2014
AIRCRAFT FINANCING (a)				
Fixed rate U.S. dollar financing	2016 – 2027	5.12	$ 2,718	$ 2,029
Floating rate U.S. dollar financing	2017 – 2026	1.61	573	582
Floating rate CDN dollar financing	2026 – 2027	1.49	398	310
Floating rate Japanese yen financing	2020	0.21	91	94
Senior secured notes – U.S. dollar	2019 – 2020	7.61	968	812
Senior secured notes – CDN dollar	2019	7.63	300	300
Senior unsecured notes – U.S. dollar (c)	2021	7.75	554	464
Other secured financing – U.S. dollar (b), (d) and (g)	2018 – 2019	4.44	513	433
Other secured financing – CDN dollar (e)	2018	8.15	45	-
LONG-TERM DEBT		**5.20**	**6,160**	**5,024**
Finance lease obligations (f)	2016 – 2033	9.65	330	283
TOTAL DEBT AND FINANCE LEASES		**5.43**	**6,490**	**5,307**
Unamortized debt issuance costs			(96)	(91)
Current portion			(524)	(484)
LONG-TERM DEBT AND FINANCE LEASES			**$ 5,870**	**$ 4,732**

(a) Aircraft financing (US$2,379, CDN $398 and JPY $7,878) (2014 – US$2,250, CDN $310 and JPY $9,677) is secured primarily by specific aircraft with a carrying value of $4,335 (2014 – $3,835). For the majority of the financing, principal and interest is repayable quarterly until maturity and can be repaid at any time with the payment of applicable fees. US$428, CDN $398 and JPY $7,878 of the financing is supported by a loan guarantee by the Export-Import Bank of the United States ("EXIM").

In March 2015, in connection with the financing of one Boeing 787-8 delivered in January 2015 and eight new Boeing 787-9 aircraft, of which four were delivered in 2015 with the remaining scheduled for delivery by March 2016, Air Canada announced the closing of a private offering of three tranches of enhanced equipment trust certificates ("EETC") with a combined aggregate face amount of US$1,031. The private offering was comprised of Class A certificates, Class B certificates and Class C certificates with final expected maturity dates between 2020 and 2027.

The three tranches of certificates have a combined weighted average interest rate of 3.81%. Proceeds from the offering relating to each aircraft are held in escrow until the delivery of the aircraft.

In connection with the financing of the first five aircraft, an amount of US$564 was drawn from the proceeds held in escrow and is included in fixed rate U.S. dollar financing in the table above.

Financing fees paid in conjunction with the offering were $18 and are reported in Financing on the consolidated statement of cash flow.

In December 2015, in connection with the financing of three Boeing 787-9 and two Boeing 777-300ER aircraft, which are currently scheduled for delivery in April and May 2016, the Corporation completed a private offering of three tranches of enhanced equipment trust certificates with a combined aggregate face amount of US$537. The private offering was comprised of Class AA certificates, Class A certificates and Class B certificates with final expected distribution dates between 2023 and 2027. The three tranches of certificates have a combined weighted average interest rate of 4.044%. The Corporation will use the proceeds from the sale of the equipment notes to the trusts to finance the acquisition of these new aircraft. Proceeds from the offering relating to each aircraft are held in escrow until the delivery of the Boeing 787-9 or B777-300ER aircraft.

In connection with the acquisition of a Boeing 787-8 aircraft in February 2015, an amount of $118 was financed and included in floating rate CDN dollar financing. Interest and principal is payable quarterly until maturity and the financing is supported by a loan guarantee by EXIM.

While the funds from the EETC financings are held in escrow, they are not assets of Air Canada and are not reported as assets and the certificates relating thereto are not reported as debt on Air Canada's condensed consolidated statement of financial position.

In addition, the equipment notes issuable at each draw-down are structured to be secured by the respective aircraft delivered and the security interest in each aircraft is structured to benefit from the protections of the Cape Town Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters Specific to Aircraft Equipment, as enacted in Canada.

During 2015, principal of US$126 was prepaid relating to the financing of 14 Embraer 190 aircraft. An amount of $13 is included in interest charges related to the prepayment of fixed rate debt.

(b) Private offerings of senior secured notes, consist of (i) US$400 principal amount of 6.750% senior secured first lien notes due 2019 and $300 principal amount of 7.625% senior secured first lien notes due 2019 (the "Senior First Lien Notes") and (ii) US$300 principal amount of 8.750% senior secured second lien notes due 2020 (the "Senior Second Lien Notes" and together with the Senior First Lien Notes, the "Senior Notes"). The Corporation also has a US$510 senior secured (first lien) credit facility, comprised of a US$300 term loan maturing in 2019 and a US$210 revolving credit facility (collectively, the "Credit Facility"). The term loan is included in Other secured financing in the table above. As at December 31, 2015, the Corporation had not drawn on the revolving credit facility.

The Senior Notes and the Corporation's obligations under the Credit Facility are senior secured obligations of Air Canada, guaranteed on a senior secured basis by one or more of Air Canada's subsidiaries, and secured (on a first lien basis with respect to the Senior First Lien Notes and Air Canada's obligations in the Credit Facility, and on a second lien basis with respect to the Senior Second Lien Notes), subject to certain permitted liens and exclusions, by certain accounts receivable, certain real estate interests, certain spare engines, ground service equipment, certain airport slots and gate leaseholds, and certain Pacific routes and the airport slots and gate leaseholds utilized in connection with those Pacific routes.

(c) In April 2014, the Corporation completed a private offering of US$400 of 7.75% senior unsecured notes due 2021, with interest payable semi-annually. The Corporation received net proceeds of approximately $432 from the sale of these notes.

(d) Other U.S. dollar secured financings are fixed and floating rate financings that are secured by certain assets including assets described in b) above relating to the Credit Facility. It also includes a revolving credit facility for the financing of jet fuel. Financial covenants under this revolving credit facility require the Corporation to maintain certain minimum operating results and cash balances.

During 2015, the Corporation re-negotiated the interest rate terms of its US$510 Credit Facility maturing in 2019, comprised of a US$300 term loan and a US$210 revolving credit facility. The applicable margin with respect to loans under the revolving credit facility in the Credit Facility is 3.25% with respect to LIBOR loans and banker's acceptances and 2.25% with respect to the Index Rate loans or Canadian Prime Rate loans. The applicable margin with respect to term loans under the Credit Facility is 3.25% with respect to LIBOR loans and 2.25% with respect to the Index Rate loans. As at December 31, 2015, the Corporation had not drawn on the revolving credit facility and the outstanding term loan principal was US$296.

(e) Other CDN dollar secured financing is a revolving credit facility for the financing of jet fuel. Financial covenants under that fuel facility require the Corporation to maintain certain minimum operating results and cash balances.

(f) Finance leases, related to facilities and aircraft, total $330 ($71 and US$187) (2014 – $283 ($73 and US$181)). During 2015, the Corporation recorded interest expense on finance lease obligations of $27 (2014 – $32). The carrying value of aircraft and facilities under finance leases amounted to $170 and $39, respectively (2014 – $145 and $42).

Air Canada has aircraft leasing transactions with a number of structured entities (Note 2). The debt amount of these leasing transactions includes any guarantee by Air Canada in the residual value of the aircraft upon expiry of the lease. The related aircraft are collateral against the debt by the owners thereof. The creditors under these leasing arrangements have recourse to Air Canada, as lessee, in the event of default or early termination of the lease.

Certain aircraft and other secured finance agreements contain collateral fair value tests. Under the tests, Air Canada may be required to provide additional collateral or prepay part of the financings. The maximum amount payable in 2016, assuming the collateral is worth nil, is $135 (US$98) (2014 – $212 (US$183)). The maximum amount payable declines over time in relation to the outstanding principal. Total collateral as at December 31, 2015 is $4 (US$3) (2014 – $12(US$11)) in the form of cash deposits, included in Deposits and other assets, has been provided under the fair value test for certain of these aircraft leases.

Cash interest paid on Long-term debt and finance leases in 2015 by the Corporation was $328 (2014 – $287).

MATURITY ANALYSIS

Principal and interest repayment requirements as at December 31, 2015 on Long-term debt and finance lease obligations are as follows:

	2016	2017	2018	2019	2020	THEREAFTER	TOTAL
PRINCIPAL							
Long-term debt obligations	$ 482	$ 619	$ 627	$ 1,712	$ 757	$ 1,963	**$ 6,160**
Finance lease obligations	42	44	52	49	53	90	**330**
	$ 524	**$ 663**	**$ 679**	**$ 1,761**	**$ 810**	**$ 2,053**	**$ 6,490**

	2016	2017	2018	2019	2020	THEREAFTER	TOTAL
INTEREST							
Long-term debt obligations	$ 299	$ 294	$ 243	$ 212	$ 104	$ 170	**$ 1,322**
Finance lease obligations	28	25	20	15	10	25	**123**
	$ 327	**$ 319**	**$ 263**	**$ 227**	**$ 114**	**$ 195**	**$ 1,445**

Principal repayments in the table above exclude transaction costs of $96 which are offset against Long-term debt and finance leases in the consolidated statement of financial position.

PENSIONS AND OTHER BENEFIT LIABILITIES

The Corporation maintains several defined benefit and defined contribution plans providing pension, other post-retirement and post-employment benefits to its employees.

The Corporation is the administrator and sponsoring employer of 10 Domestic Registered Plans ("Domestic Registered Plans") with defined benefit commitments registered under the Pension Benefits Standard Act, 1985 (Canada). The U.S. plan, U.K. plan and Japan plan are international plans covering members in those countries. In addition, the Corporation maintains a number of supplementary pension plans which are not registered. The defined benefit pension plans provide benefits upon retirement, termination or death based on the member's years of service and final average earnings for a specified period. Under the terms of the domestic registered and supplementary pension plans, there is no indexation provided after January 1, 2007. Benefit payments are from trustee-administered funds, however there are also a number of unfunded plans where the Corporation meets the benefit payment obligation as it falls due. Plan assets held in trusts are governed by regulations. The governance of the plans, overseeing all aspects of the plans including investment decisions and contributions, lies primarily with the Corporation. The Pension Committee, a committee of the Board of Directors, assists in the monitoring and oversight of the plans to ensure pension liabilities are appropriately funded, pension assets are prudently invested, risk is managed at an acceptable level and retirement benefits are administered in a proper and effective manner.

The other employee benefits include health, life and disability. These benefits consist of both post-employment and post-retirement benefits. The post-employment benefits relate to disability benefits available to eligible active employees, while the post-retirement benefits are comprised of health care and life insurance benefits available to eligible retired employees.

PENSION PLAN CASH FUNDING OBLIGATIONS

Pension funding obligations (including projected funding obligations) under normal funding rules may vary significantly based on a wide variety of factors, including the assumptions used in the most recently filed actuarial valuation reports (including the applicable discount rate used or assumed in the actuarial valuation), the plan demographics at the valuation date, the existing plan provisions, legislative and regulatory developments and changes in economic conditions (mainly the return on fund assets and changes in interest rates) and other factors. Actual contributions that are determined on the basis of future valuation reports may vary significantly from projections. In addition to changes in plan demographics and experience, actuarial assumptions and methods may be changed from one valuation to the next, including due to changes in plan experience, financial markets, future expectations, legislation and other factors.

In the second quarter of 2015, the Corporation elected to opt out of the Air Canada Pension Plan Funding Regulations, 2014, (the "2014 Regulations"). The 2014 Regulations became effective on January 1, 2014 and under their terms, the Corporation was required to make solvency deficit payments of $200 per year, on average, over a seven-year period. The agreement with the Government of Canada entered into in connection with these regulations contained several restrictions, including a prohibition on dividends and share repurchases. However, the agreement allowed the Corporation to opt out at any time.

As at January 1, 2015, the aggregate solvency surplus in the domestic registered pension plans was $660. The next required valuation to be made as at January 1, 2016, will be completed in the first half of 2016. Total employer pension funding contributions during 2015 amounted to $312, which includes solvency deficit payments of $96 versus the $200 that would have been required under the 2014 Regulations. Assuming final valuations confirm that the Corporation's domestic registered pension plans are in a solvency surplus position as at January 1, 2016, the Corporation does not expect any past service cost payments in 2016. In addition, for plans funded at 105% or more on a solvency basis, as permitted by legislation, no contributions are required for current service as long as the solvency position is not reduced to less than 105%. Based on that information, the pension funding obligations for 2016 are expected to be $76.

BENEFIT OBLIGATION AND PLAN ASSETS

These consolidated financial statements include all of the assets and liabilities of all Corporation-sponsored plans. The amounts recorded in the statement of financial position are as follows:

	PENSION BENEFITS		OTHER EMPLOYEE FUTURE BENEFITS		TOTAL	
	2015	2014	2015	2014	2015	2014
NON-CURRENT ASSETS						
Pension	$ 851	$ -	$ -	$ -	$ 851	$ -
CURRENT LIABILITIES						
Accounts payable and accrued liabilities	-	-	64	65	64	65
NON-CURRENT LIABILITIES						
Pension and other benefit liabilities	1,021	1,183	1,224	1,220	2,245	2,403
NET BENEFIT OBLIGATION	**$ 170**	**$ 1,183**	**$ 1,288**	**$ 1,285**	**$ 1,458**	**$ 2,468**

Certain pension plans are in a net asset position and, as a result, those plans are required to be reported as Pension assets on the consolidated statement of financial position. The current portion of the net benefit obligation represents an estimate of other employee future benefits claims to be paid during 2016.

The following table presents financial information related to the changes in the pension and other post-employment benefits plans:

	PENSION BENEFITS		OTHER EMPLOYEE FUTURE BENEFITS	
	2015	2014	2015	2014
CHANGE IN BENEFIT OBLIGATION				
Benefit obligation at beginning of year	$ 18,352	$ 16,147	$ 1,285	$ 1,183
Current service cost	249	213	37	55
Past service cost	3	(13)	(19)	-
Interest cost	731	783	51	56
Employees' contributions	78	73	-	-
Benefits paid	(886)	(844)	(49)	(51)
Settlement payments for transfer to Aeroplan	-	(68)	-	-
Remeasurements:				
Experience loss (gain)	4	(9)	(29)	(110)
Loss (gain) from change in demographic assumptions	(11)	(66)	(1)	(1)
Loss (gain) from change in financial assumptions	(338)	2,117	(21)	137
Plan settlements	-	(10)	-	-
Foreign exchange loss	104	29	34	16
Total benefit obligation	18,286	18,352	1,288	1,285
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	17,433	14,745	-	-
Return on plan assets, excluding amounts included in Net financing expense	734	2,353	-	-
Interest income	687	714	-	-
Employer contributions	312	445	49	51
Employees' contributions	78	73	-	-
Benefits paid	(886)	(844)	(49)	(51)
Plan settlements for transfer to Aeroplan	-	(68)	-	-
Administrative expenses paid from plan assets	(10)	(8)	-	-
Foreign exchange gain	90	23	-	-
Total plan assets	18,438	17,433	-	-
(SURPLUS) DEFICIT AT END OF YEAR	**(152)**	**919**	**1,288**	**1,285**
Asset ceiling / additional minimum funding liability	322	264	-	-
NET BENEFIT OBLIGATION	**$ 170**	**$ 1,183**	**$ 1,288**	**$ 1,285**

The actual return on plan assets was $1,421 (2014 – $3,067).

The pension benefit deficit of only those plans that are not fully funded is as follows:

	2015	2014
Domestic registered plans	$ 2	$ 52
U.S., U.K. and Japan	80	102
Supplementary plans	939	952
	$ 1,021	**$ 1,106**

The weighted average duration of the defined benefit obligation is 13.9 years (2014 – 14.1 years).

PENSION AND OTHER EMPLOYEE FUTURE BENEFIT EXPENSE

The Corporation has recorded net defined benefit pension and other employee future benefits expense as follows:

	PENSION BENEFITS		OTHER EMPLOYEE FUTURE BENEFITS	
	2015	2014	2015	2014
CONSOLIDATED STATEMENT OF OPERATIONS				
Components of cost				
Current service cost	$ 249	$ 213	$ 37	$ 55
Past service cost	3	(13)	(19)	(1)
Gain on settlements	-	(10)	-	-
Administrative and other expenses	10	8	-	-
Actuarial gains	-	-	(18)	(15)
TOTAL COST RECOGNIZED IN WAGES, SALARIES AND BENEFITS	**$ 262**	**$ 198**	**$ -**	**$ 39**
NET FINANCING EXPENSE RELATING TO EMPLOYEE BENEFITS	**$ 54**	**$ 78**	**$ 51**	**$ 56**
TOTAL COST RECOGNIZED IN STATEMENT OF OPERATIONS	**$ 316**	**$ 276**	**$ 51**	**$ 95**
CONSOLIDATED OTHER COMPREHENSIVE (INCOME) LOSS				
Remeasurements:				
Experience loss (gain), including foreign exchange	18	(3)	24	(87)
Loss (gain) from change in demographic assumptions	(11)	(66)	(1)	(1)
Loss (gain) from change in financial assumptions	(338)	2,117	(21)	146
Return on plan assets	(734)	(2,353)	-	-
Minimum funding liability	48	80	-	-
TOTAL COST (INCOME) RECOGNIZED IN OCI	**$ (1,017)**	**$ (225)**	**$ 2**	**$ 58**

In 2015, the Corporation refined the method to estimate the current service cost for pension and other post-retirement benefits. Previously, the current service cost was estimated utilizing a single weighted-average discount rate derived from the yield curve used to measure the defined benefit obligation at the beginning of the year. Under the refined method, different discount rates are derived from the same yield curve, reflecting the different timing of benefit payments for past service (the defined benefit obligation) and future service (the current service cost). Differentiating in this way represents a refinement in the basis of estimation applied in prior periods. This change does not affect the measurement of the total defined benefit obligation recorded on the consolidated statement of financial position as at December 31, 2014 or any other period. The refinement compared to the previous method resulted in a decrease in the current service cost and interest components with an equal offset to actuarial gains (losses) with no net impact on the total benefit obligation. The refinement did not have a material impact on the 2015 consolidated statement of operations. This change is accounted for prospectively as a change in accounting estimate.

The funding of employee benefits as compared to the expense recorded in the consolidated statement of operations is summarized in the table below.

	2015	2014
NET DEFINED PENSION AND OTHER FUTURE EMPLOYEE BENEFITS EXPENSE RECORDED IN THE CONSOLIDATED STATEMENT OF OPERATIONS		
Wages, salaries and benefits	$ 262	$ 245
Net financing expense relating to employee benefit liabilities	105	134
	$ 367	**$ 379**
EMPLOYEE BENEFIT FUNDING BY AIR CANADA		
Pension benefits	$ 312	$ 445
Other employee benefits	49	51
	$ 361	**$ 496**
EMPLOYEE BENEFIT FUNDING (GREATER) LESS THAN EXPENSE	**$ 6**	**$ (117)**

COMPOSITION OF PENSION PLAN ASSETS

Domestic Registered Plans

The composition of the Domestic Registered Plan assets and the target allocation are the following:

	2015	2014	2015 TARGET ALLOCATION
Bonds	60%	54%	60%
Canadian equities	6%	10%	7%
Foreign equities	14%	21%	13%
Alternative investments	20%	15%	20%
	100%	**100%**	**100%**

For the Domestic Registered Plan assets, approximately 80% of assets as of December 31, 2015 have a quoted market price in an active market. Assets that do not have a quoted market price in an active market are mainly investments in privately held entities. The asset composition in the table represents the allocation of plan assets to each asset type.

Included in plan assets, for determining the net benefit obligation for accounting purposes, are 17,647,059 shares of Air Canada which were issued to a trust in 2009 in connection with pension funding agreements reached with all of the Corporation's Canadian-based unions. The trust arrangement provides that proceeds of any sale of the trust shares will be retained and applied to reduce future pension solvency deficits, if any should materialize. With the impact of the opt out as described above, and with the Corporation's domestic registered pension plans now in a surplus position on a solvency basis, the accounting rules prevent the recognition of the value of the shares held in trust as part of the pension assets. The shares held in trust have a fair value of $180 at December 31, 2015 (2014 – $209), however after giving effect to the asset ceiling, the recognized accounting value of the trust asset is nil.

For the Domestic Registered Plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Funds. The investment return objective is to achieve a total annualized rate of return that exceeds by a minimum of 1.0% before investment fees on average over the long-term (i.e. 10 years) the total annualized return that could have been earned by passively managing the Liability Replicating Portfolio. The Liability Replicating Portfolio, which is referenced to widely used Canadian fixed income indices (FTSE TMX Canada), closely matches the characteristics of the pension liabilities.

Recognizing the importance of surplus risk management, Air Canada manages the Domestic Registered Plans in an effort to mitigate surplus risk (defined as the difference between asset value and pension liability value), which is considered to be the key risk to be minimized and monitored. In addition, the objective of the investment strategy is to invest the plan assets in a prudent and diversified manner to mitigate the risk of price fluctuation of asset classes and individual investments within those asset classes and to combine those asset classes and individual investments in an effort to reduce overall risk.

In addition to the broad asset allocation, as summarized in the asset allocation section above, the following policies apply to individual asset classes invested within the pension funds:

- Equities are required to be diversified among regions, industries and economic sectors. Limitations are places on the overall allocation to any individual security.
- Alternative investments are investments in non-publicly traded securities and in non-traditional asset classes. They may comprise, but are not limited to investments in real estate, agriculture, timber, private equity, venture capital, infrastructure, emerging markets debt, high yield bonds and commodity futures. Alternative investments are required to be diversified by asset class, strategy, sector and geography.
- Canadian bonds are oriented toward long-term investment grade securities rated "BBB" or higher. With the exception of Government of Canada securities or a province thereof, in which the plan may invest the entire fixed income allocation, these investments are required to be diversified among individual securities and sectors.

Derivatives are permitted provided that they are used for managing a particular risk (including interest rate risk related to pension liabilities) or to create exposures to given markets and currencies and that counterparties have a minimum credit rating of A. The Corporation manages interest rate risk related to its actuarial liabilities through a combination of financial instruments including, but not limited to, bonds, bond repurchase and reverse repurchase agreements, bond forwards, bond futures and interest rate swaps. As at December 31, 2015, taking into account the effect of such financial instrument risk management tools, approximately 75% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate risk). Counterparty credit risk associated with such financial instruments is mitigated by receiving collateral from counterparties based on collateralization agreements, as well as by monitoring the counterparties' credit ratings and ensuring compliance with the investment policy. The fair value of these derivative instruments is included in the Bonds in the asset composition table and is not a significant component of the aggregate bond fair values of the portfolio.

The trusts for the supplemental plans are invested 50% in indexed equity investments, in accordance with their investment policies, with the remaining 50% held by the Canada Revenue Agency as a refundable tax, in accordance with tax legislation.

RISKS

Through its defined benefit pension plans, the Corporation is exposed to a number of risks, the most significant of which are detailed below:

Asset Risk

Asset risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market price. Asset risk comprises currency risk, credit risk, and other price risk. Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. This risk is mitigated through implementation of hedging strategies. Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. This risk is mitigated by receiving collateral from counterparties based on collateralization agreements and by monitoring the issuers' credit risk. Other price risk is the risk the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. This risk is mitigated through proper diversification of plan assets.

Interest Rate Risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. A decrease in corporate and/or government bond yields will increase plan liabilities, which will be partially offset by an increase in the value of the plans' bond holdings. As at December 31, 2015, approximately 75% of Air Canada's pension liabilities (including the effect of financial instrument risk management tools) were matched with fixed income products to mitigate a significant portion of the interest rate risk (discount rate risk).

Funding Risk

Adverse changes in the value of plan assets or in interest rates, and therefore in the discount rate used to value liabilities, could have a significant impact on pension plan solvency valuations and cash funding requirements.

Life Expectancy

The majority of the plans' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the plans' liabilities.

ASSUMPTIONS

Management is required to make significant estimates about actuarial and financial assumptions to determine the cost and related liabilities of the Corporation's employee future benefits.

Discount Rate

The discount rate used to determine the pension obligation was determined by reference to market interest rates on corporate bonds rated "AA" or better with cash flows that approximate the timing and amount of expected benefit payments.

Future increases in compensation are based upon the current compensation policies, labour agreements and economic forecasts.

The significant weighted average assumptions used to determine the Corporation's accrued benefit obligations and cost are as follows:

	PENSION BENEFITS		OTHER EMPLOYEE FUTURE BENEFITS	
	2015	2014	2015	2014
DISCOUNT RATE USED TO DETERMINE:				
Net interest on the net defined benefit obligation for the year ended December 31	4.0%	4.9%	3.9%	4.8%
Service cost for the year ended December 31	4.2%	4.9%	4.1%	4.8%
Accrued benefit obligation as at December 31	4.1%	4.0%	4.1%	3.9%
RATE OF FUTURE INCREASES IN COMPENSATION USED TO DETERMINE:				
Accrued benefit cost and service cost for the year ended December 31	2.5%	2.5%	not applicable	not applicable
Accrued benefit obligation as at December 31	2.5%	2.5%	not applicable	not applicable

SENSITIVITY ANALYSIS

Sensitivity analysis is based on changing one assumption while holding all other assumptions constant. In practice, this may be unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to variations in significant actuarial assumptions, the same method (present value of the defined benefit obligation calculated with the projected unit credit method at the end of the reporting period) has been applied as for calculating the liability recognized in the consolidated statement of financial position.

Sensitivity analysis on 2015 pension expense and net financing expense relating to pension benefit liabilities, based on different actuarial assumptions with respect to discount rate is set out below. The effects on each pension plan of a change in an assumption are weighted proportionately to the total plan obligation to determine the total impact for each assumption presented.

	0.25 PERCENTAGE POINT	
	DECREASE	INCREASE
DISCOUNT RATE ON OBLIGATION ASSUMPTION		
Pension expense	$ 19	$ (18)
Net financing expense relating to pension benefit liabilities	17	(13)
	$ 36	**$ (31)**
Increase (decrease) in pension obligation	**$ 639**	**$ (618)**

The increase (decrease) in the pension obligation for a 0.25 percentage point change in the discount rate relates to the gross amount of the pension liabilities and is before the impact of any change in plan assets. As at December 31, 2015, approximately 75% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk.

An increase of one year in life expectancy would increase the pension benefit obligation by $445.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 5.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2015 (2014 – 5.5%). The rate is assumed to decrease gradually to 5% by 2019. A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by $4 and the obligation by $64. A one percentage point decrease in assumed health care trend rates would have decreased the total of current service and interest costs by $4 and the obligation by $62.

A 0.25 percentage point decrease in discount rate would have increased the total of current and interest costs by $1 and the obligation by $51. A 0.25 percentage point increase in discount rate would have decreased the total of current and interest costs by $1 and the obligation by $40.

DEFINED CONTRIBUTION PENSION PLANS

Certain of the Corporation's management, administrative and unionized employees participate in a defined contribution pension plan or a multi-employer plan which are accounted for as defined contribution plans. The Corporation contributes an amount expressed as a percentage of employees' contributions with such percentage varying by group and for some groups, based on the number of years of service.

The Corporation's expense for these pension plans amounted to $10 for the year ended December 31, 2015 (2014 – $6). Expected total employer contributions for 2016 are $11.

PROVISIONS FOR OTHER LIABILITIES

The following table provides a continuity schedule of all recorded provisions. Refer to Note 16 for additional information on Litigation provisions. Current provisions are recorded in Accounts payable and accrued liabilities.

	MAINTENANCE (a)	ASSET RETIREMENT (b)	LITIGATION	TOTAL PROVISIONS
AT DECEMBER 31, 2014				
Current	$ -	$ -	$ 29	$ 29
Non-current	796	19	-	815
	$ 796	**$ 19**	**$ 29**	**$ 844**
Provisions arising during the year	$ 96	$ -	$ -	$ 96
Amounts disbursed	(23)	-	-	(23)
Changes in estimated costs	(144)	2	(10)	(152)
Accretion expense	16	-	-	16
Foreign exchange loss	151	-	-	151
AT DECEMBER 31, 2015	**$ 892**	**$ 21**	**$ 19**	**$ 932**
Current	$ -	$ -	$ 19	$ 19
Non-current	892	21	-	913
	$ 892	**$ 21**	**$ 19**	**$ 932**

(a) Maintenance provisions relate to the provision for the costs to meet the contractual return conditions on aircraft under operating leases. The provision relates to leases with expiry dates ranging from 2016 to 2024 with the average remaining lease term of approximately four years. The maintenance provisions take into account current costs of maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Assuming the aggregate cost for return conditions increases by 5%, holding all other factors constant, there would be a cumulative balance sheet adjustment to increase the provision by $44 at December 31, 2015 and an increase to maintenance expense in 2016 of approximately $7. If the discount rates were to increase by 1%, holding all other factors constant, there would be a cumulative balance sheet adjustment to decrease the provision by $19 at December 31, 2015. Due to low market rates of interest, a 1% decrease in discount rates was not considered a reasonable scenario.

(b) Under the terms of certain land and facilities leases, the Corporation has an obligation to restore the land to vacant condition at the end of the lease and to rectify any environmental damage for which it is responsible. The related leases expire over terms ranging from 2016 to 2056. These provisions are based on numerous assumptions including the overall cost of decommissioning and remediation and the selection of alternative decommissioning and remediation approaches. The non-current provision is recorded in Other long-term liabilities.

10 INCOME TAXES

INCOME TAX EXPENSE

	2015	2014
Current income tax	$ -	$ -
Deferred income tax	-	-
INCOME TAX	**$ -**	**$ -**

The income tax expense differs from the amount that would have resulted from applying the statutory income tax rate to income before income tax expense as follows:

	2015	2014
Income before income taxes	$ 308	$ 105
Statutory income tax rate based on combined federal and provincial rates	26.87%	26.81%
INCOME TAX EXPENSE BASED ON STATUTORY TAX RATES	**83**	**28**
EFFECTS OF:		
Non-deductible portion of capital losses	97	21
Non-deductible expenses	10	13
Income not subject to tax	(17)	-
Tax rate changes on deferred income taxes	(9)	(13)
Recognition of previously unrecognized deferred income tax assets	(155)	(53)
Adjustment in respect of deferred income tax of prior years	(8)	-
Other	(1)	4
INCOME TAX	**$ -**	**$ -**

The applicable statutory tax rate is 26.87% (2014 – 26.81%). The Corporation's applicable tax rate is the Canadian combined rates applicable in the jurisdictions in which the Corporation operates. The increase is mainly due to changes in the level of activity by province.

The income tax expense relating to components of Other comprehensive income is as follows:

	2015	2014
Net gain on remeasurements on employee benefit liabilities	$ 273	$ 65
Derivatives designated as cash flow hedges	(3)	-
Tax rate changes on deferred income taxes	(1)	(3)
Recognition of previously unrecognized deferred income tax assets	(269)	(62)
INCOME TAX EXPENSE IN OTHER COMPREHENSIVE INCOME	**$ -**	**$ -**

DEFERRED INCOME TAX

Certain intangible assets with nominal tax cost and a carrying value of $185 have indefinite lives and accordingly, the associated deferred income tax liability of $49 (2014 – $49) is not expected to reverse until the assets are disposed of, become impaired or amortizable. In addition, the Corporation has other deferred income tax liabilities in the amount of $42, against which a deferred income tax asset of similar amount has been recognized. The recognized net deferred income tax liability of $49 is included in Other long-term liabilities.

Deferred income tax assets are recognized to the extent that the realization of the related tax benefit is probable. The Corporation has temporary differences and tax loss carryforwards for which no deferred income tax assets could be recognized. However, the future tax deductions underlying these deferred income tax assets remain available for use in the future to reduce taxable income. The following are the temporary differences and tax loss carryforwards for which no deferred income tax assets could be recognized:

	2015	2014
Other deductible temporary differences	$ 4,349	$ 5,345
Non-capital losses carryforwards	316	946
Net capital losses carryforwards	24	2
TOTAL UNRECOGNIZED TEMPORARY DIFFERENCES	**$ 4,689**	**$ 6,293**

The following are the Federal non-capital tax losses expiry dates:

	TAX LOSSES
2029	$ 293
2030	11
2031	6
2032	1
2033	1
2034	4
NON-CAPITAL LOSSES CARRYFORWARDS	**$ 316**

Cash income taxes paid in 2015 by the Corporation were nil (2014 – $1 recovered).

11 SHARE CAPITAL

	NUMBER OF SHARES	VALUE
AT JANUARY 1, 2014	**284,532,439**	**$ 827**
Shares issued on the exercise of stock options	619,478	2
Shares issued under the 2011 employee recognition award	1,337,377	6
AT DECEMBER 31, 2014	**286,489,294**	**$ 835**
Shares issued on the exercise of stock options	1,876,819	6
Shares purchased and cancelled under issuer bid	(5,583,935)	(16)
AT DECEMBER 31, 2015	**282,782,178**	**$ 825**

The issued and outstanding common shares of Air Canada, along with the potential common shares, were as follows:

		2015	2014
ISSUED AND OUTSTANDING			
Class A variable voting shares		98,059,765	69,232,535
Class B voting shares		184,722,413	217,256,759
TOTAL ISSUED AND OUTSTANDING		**282,782,178**	**286,489,294**
POTENTIAL COMMON SHARES			
Stock options	Note 12	8,735,634	10,002,975
TOTAL OUTSTANDING AND POTENTIALLY ISSUABLE SHARES		**291,517,812**	**296,492,269**

COMMON SHARES

As at December 31, 2015, the common shares issuable by Air Canada consist of an unlimited number of Class A Variable Voting Shares ("Variable Voting Shares") and an unlimited number of Class B Voting Shares ("Voting Shares"). The two classes of common shares have equivalent rights as common shareholders except for voting rights. Holders of Variable Voting Shares are entitled to one vote per share unless (i) the number of Variable Voting Shares outstanding, as a percentage of the total number of voting shares of Air Canada exceeds 25% or (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting exceeds 25% of the total number of votes that may be cast at such meeting. If either of the above noted thresholds would otherwise be surpassed at any time, the vote attached to each Variable Voting Share will decrease proportionately such that (i) the Variable Voting Shares as a class do not carry more than 25% of the aggregate votes attached to all issued and outstanding Voting Shares of Air Canada and (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting do not exceed 25% of the votes that may be cast at such meeting.

Variable Voting Shares may only be held, beneficially owned or controlled, directly or indirectly, by persons who are not Canadians (within the meaning of the *Canada Transportation Act*). An issued and outstanding Variable Voting Share shall be converted into one Voting Share automatically and without any further act of Air Canada or the holder, if such Variable Voting Share becomes held, beneficially owned and controlled, directly or indirectly, otherwise than by way of security only, by a Canadian, as defined in the *Canada Transportation Act*.

Voting Shares may only be held, beneficially owned and controlled, directly or indirectly, by Canadians. An issued and outstanding Voting Share shall be converted into one Variable Voting Share automatically and without any further act of Air Canada or the holder, if such Voting Share becomes held, beneficially owned or controlled, directly or indirectly, otherwise than by way of security only, by a person who is not a Canadian.

SHAREHOLDER RIGHTS PLAN

Under the terms of the shareholder rights plan agreement (the "Rights Plan"), effective until 2017, one right (a "Right") has been issued with respect to each Class B Voting Share and each Class A Variable Voting Share (each a "Share") of Air Canada issued and outstanding as of the close of business on March 30, 2011 or subsequently issued. These Rights would become exercisable only when a person, including any party related to it, acquires or announces its intention to acquire 20% or more of the outstanding Class A Variable Voting Shares and Class B Voting Shares of Air Canada calculated on a combined basis, without complying with the "Permitted Bid" provisions of the Rights Plan or, in certain cases, without the approval of the Board. Until such time, the Rights are not separable from the shares, are not exercisable and no separate rights certificates are issued. To qualify as a "Permitted Bid" under the Rights Plan, a bid must, among other things: (i) be made to all holders of Shares, (ii) remain open for a period of not less than 60 days, (iii) provide that no Shares shall be taken up unless more than 50% of the then outstanding Class A Variable Voting Shares and Class B Voting Shares, on a combined basis, other than the Shares held by the person pursuing the acquisition and parties related to it, have been tendered and not withdrawn, and (iv) provide that if such 50% condition is satisfied, the bid will be extended for at least 10 business days to allow other shareholders to tender.

Following the occurrence of an event which triggers the right to exercise the Rights and subject to the terms and conditions of the Rights Plan, each Right would entitle the holders thereof, other than the acquiring person or any related persons, to exercise their Rights and purchase from Air Canada two hundred dollars' worth of Class A Variable Voting Shares or Class B Voting Shares for one hundred dollars (i.e. at a 50% discount to the market price at that time). Upon such exercise, holders of rights beneficially owned and controlled by Qualified Canadians would receive Class B Voting Shares and holders of rights beneficially owned or controlled by persons who are not Qualified Canadians would receive Class A Variable Voting Shares.

ISSUER BID

In May 2015, following receipt of approval from the Toronto Stock Exchange, the Corporation implemented a normal course issuer bid to purchase, for cancellation, up to 10,000,000 Shares, representing, at that time, 3.49% of the total issued and outstanding Shares. The repurchase program is in effect until May 28, 2016.

Since commencing the normal course issuer bid, the Corporation purchased and cancelled 5,583,935 Shares for cash at an average cost of $11.28 per Share for aggregate consideration of $63. The excess of the cost over the average book value of $47 was charged to the deficit.

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SHARE-BASED COMPENSATION

AIR CANADA LONG-TERM INCENTIVE PLAN

Certain of the Corporation's employees participate in the Air Canada Long-term Incentive Plan (the "Long-term Incentive Plan"). The Long-term Incentive Plan provides for the grant of options, performance share units and restricted share units to senior management and officers of Air Canada. 20,011,623 shares are authorized for issuance under the Long-term Incentive Plan in respect of either of stock options, performance or restricted share units.

STOCK OPTIONS

The options to purchase shares granted under the Long-term Incentive Plan have a maximum term of seven years and an exercise price based on the fair market value of the shares at the time of the grant of the options. Fifty per cent of options are time-based and vest over four years. The remaining options vest based upon performance conditions. The performance vesting conditions are based on operating margin (operating income over operating revenues) targets established by the Air Canada Board over the same time period. Each option entitles the employee to purchase one common share at the stated exercise price. The terms of the Long-term Incentive Plan specify that following retirement an employee may exercise options granted with the rights to exercise continuing for the three years after the retirement date.

The number of Air Canada stock options granted to employees, the related compensation expense recorded and the assumptions used to determine stock-based compensation expense, using the Black-Scholes option valuation model are as follows:

	2015	2014
Compensation expense ($ millions)	$ 4	$ 3
Number of stock options granted to Air Canada employees	984,878	1,170,710
Weighted average fair value per option granted ($)	$ 5.65	$ 2.18
Aggregated fair value of options granted ($ millions)	$ 6	$ 3
WEIGHTED AVERAGE ASSUMPTIONS:		
Share price	$ 12.48	$ 5.56
Risk-free interest rate	0.57% – 1.10%	1.44% – 2.06%
Expected volatility	52.0% – 58.5%	53.0% – 72.4%
Dividend yield	0%	0%
Expected option life (years)	5.25	5.25

Expected volatility was determined at the time of grant using the Air Canada share price on a historical basis. It reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome.

A summary of the Long-term Incentive Plan option activity is as follows:

	2015		2014	
	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE/ SHARE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE/ SHARE
Beginning of year	10,002,975	$ 2.54	10,079,694	$ 2.47
Granted	984,878	12.57	1,170,710	5.41
Exercised	(1,906,472)	2.13	(619,478)	1.99
Expired	(5,500)	8.51	(237,661)	14.71
Forfeited	(340,247)	4.30	(390,290)	2.77
OUTSTANDING OPTIONS, END OF YEAR	**8,735,634**	**$ 3.69**	**10,002,975**	**$ 2.54**
OPTIONS EXERCISABLE, END OF YEAR	**2,854,413**	**$ 2.30**	**2,112,883**	**$ 1.93**

Options exercised include 29,653 options that were exercised with shares issued in 2016. The weighted average share price on the date of exercise for options exercised in 2015 was $11.80 (2014 – $9.20).

		2015 OUTSTANDING OPTIONS			2015 EXERCISABLE OPTIONS	
RANGE OF EXERCISE PRICES	EXPIRY DATES	NUMBER OF OPTIONS OUTSTANDING	WEIGHTED AVERAGE REMAINING LIFE (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE/ SHARE	NUMBER OF EXERCISABLE OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE/ SHARE
$1.59	2016	18,750	1	$ 1.59	18,750	$ 1.59
$1.78 – $1.91	2017	-	2	-	-	-
$2.34	2018	1,222,059	3	2.34	1,222,059	2.34
$0.96 – $1.28	2019	2,154,196	4	0.96	705,515	0.97
$2.49 – $5.69	2020	3,386,598	5	2.94	784,898	2.96
$5.35 – $8.27	2021	1,013,522	6	5.42	123,191	5.42
$12.27 – $12.64	2022	940,509	7	12.57	-	-
		8,735,634		**$ 3.69**	**2,854,413**	**$ 2.30**

		2014 OUTSTANDING OPTIONS			2014 EXERCISABLE OPTIONS	
RANGE OF EXERCISE PRICES	EXPIRY DATES	NUMBER OF OPTIONS OUTSTANDING	WEIGHTED AVERAGE REMAINING LIFE (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE/ SHARE	NUMBER OF EXERCISABLE OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE/ SHARE
$8.51	2015	5,500	1	$ 8.51	5,500	$ 8.51
$0.97 – $1.59	2016	325,000	2	1.21	325,000	1.21
$1.78 – $1.91	2017	-	3	1.85	-	-
$2.34	2018	2,332,237	4	2.34	710,353	2.34
$0.96 – $1.28	2019	2,464,775	5	0.98	608,750	1.00
$2.49 – $5.69	2020	3,767,719	6	2.95	463,280	2.96
$5.35 – $8.27	2021	1,107,744	7	5.42	-	-
		10,002,975		**$ 2.54**	**2,112,883**	**$ 1.93**

PERFORMANCE AND RESTRICTED SHARE UNITS

The Long-term Incentive Plan also includes performance share units ("PSUs") and restricted share units ("RSUs"), which are accounted for as equity settled instruments. The vesting of PSUs is based on the Corporation achieving its cumulative annual earnings target over a three-year period, while RSUs will vest after three years from their date of grant. The terms of the plan specify that upon the retirement of an employee, the number of units that vest are prorated based on the total number of completed months of active service during the vesting term. The PSUs and RSUs granted may only be redeemed for Air Canada shares purchased on the secondary market and/or equivalent cash at the discretion of the Board of Directors.

The compensation expense related to PSUs and RSUs in 2015 was $9 (2014 – $8).

A summary of the Long-term Incentive Plan share unit activity is as follows:

	2015	2014
Beginning of year	7,553,010	9,437,970
Granted	778,154	1,280,922
Settled	(4,114,133)	(2,948,874)
Forfeited	(286,980)	(217,008)
OUTSTANDING SHARE UNITS, END OF YEAR	**3,930,051**	**7,553,010**

Refer to Note 15 for a description of derivative instruments used by the Corporation to mitigate the cash flow exposure to the PSUs and RSUs granted.

EMPLOYEE SHARE PURCHASE PLAN

Eligible employees can participate in the employee share purchase plan under which employees can invest between 2% and 10% of their base salary for the purchase of shares on the secondary market. Air Canada will match 33.3% of the investments made by the employee during the first year of participation in the program, with a 50% match after 12 months of continuous participation in the program. During 2015, the Corporation recorded compensation expense of $7 (2014 – $5) related to the Employee Share Purchase Plan.

EARNINGS PER SHARE

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The following table outlines the calculation of basic and diluted EPS:

IN MILLIONS, EXCEPT PER SHARE AMOUNTS	2015	2014
NUMERATOR:		
NUMERATOR FOR BASIC AND DILUTED EARNINGS PER SHARE:		
Net income attributable to shareholders of Air Canada	$ 303	$ 100
DENOMINATOR:		
WEIGHTED-AVERAGE SHARES	**285**	**286**
Effect of potential dilutive securities:		
Stock options	7	7
Total potential dilutive securities	7	7
ADJUSTED DENOMINATOR FOR DILUTED EARNINGS PER SHARE	**292**	**293**
BASIC EPS	**$ 1.06**	**$ 0.35**
DILUTED EPS	**$ 1.03**	**$ 0.34**

The calculation of EPS is based on whole dollars and not on rounded millions. As a result, the above amounts may not be recalculated to the per share amount disclosed above.

Excluded from the 2015 calculation of diluted EPS were 1,512,000 (2014 – 2,680,000) outstanding options where the options' exercise prices were greater than the average market price of the common shares for the year.

14 COMMITMENTS

CAPITAL COMMITMENTS AND OPERATING LEASES

Capital commitments consist of the future firm aircraft deliveries and commitments related to acquisition of other property and equipment. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at December 31, 2015. The Corporation has various operating lease agreements for aircraft, equipment and other property. U.S. dollar amounts are converted using the December 31, 2015 closing rate of CDN $1.384. Minimum future commitments under these contractual arrangements are shown below.

	2016	2017	2018	2019	2020	THEREAFTER	TOTAL
Capital commitments	$ 2,506	$ 2,002	$ 1,708	$ 1,273	$ 799	$ 461	**$ 8,749**
Operating leases							
Aircraft	452	422	373	308	210	181	**1,946**
Other property	84	55	47	25	18	165	**394**
TOTAL	**$ 3,042**	**$ 2,479**	**$ 2,128**	**$ 1,606**	**$ 1,027**	**$ 807**	**$ 11,089**

Flow-through Leases

For accounting purposes, the Corporation acts as an agent and subleases certain aircraft to Jazz on a flow-through basis, which are reported net on the consolidated statement of operations. These subleases relate to 20 Bombardier CRJ-200 aircraft and 15 Bombardier CRJ-705 aircraft which have final maturities ranging from 2016 to 2024. The sublease revenue and lease expense related to these aircraft each amounted to $95 in 2015 (2014 – $84). The operating lease commitments under these aircraft, which are recovered from Jazz, are not included in the aircraft operating lease commitments table above but are summarized, with U.S. dollar amounts converted using the December 31, 2015 closing rate of CDN $1.384, as follows:

	2016	2017	2018	2019	2020	THEREAFTER	TOTAL
Jazz flow-through leases	$ 84	$ 75	$ 71	$ 72	$ 72	$ 158	**$ 532**

The subleases with Jazz have the same terms and maturity as the Corporation's corresponding lease commitments to the lessors.

The Corporation leases and subleases certain aircraft to Sky Regional, which are charged back to Air Canada through the CPA with Sky Regional. These are reported net on the consolidated statement of operations. The leases and subleases relate to five Bombardier Q400 aircraft and 20 Embraer 175 aircraft. The lease and sublease revenue and expense related to these aircraft each amount to $48 in 2015 (2014 – $41).

OTHER CONTRACTUAL COMMITMENTS

The CPSA between the Corporation and Aeroplan imposes a requirement for the Corporation to purchase a minimum number of Aeroplan Miles from Aeroplan. The estimated minimum requirement for 2016 is $208. The annual commitment is based on 85% of the average total Aeroplan Miles actually issued in respect of Air Canada flights or Air Canada airline affiliate products and services in the three preceding calendar years. During 2015, the Corporation purchased $245 of Aeroplan Miles from Aeroplan.

The future minimum non-cancellable commitment for the next 12 months under the Jazz CPA is approximately $1,151 and under the capacity purchase agreements with other regional carriers is $157.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

SUMMARY OF FINANCIAL INSTRUMENTS

	CARRYING AMOUNTS				
	DECEMBER 31, 2015 FINANCIAL INSTRUMENTS CLASSIFICATION				DECEMBER 31, 2014
	FAIR VALUE THROUGH PROFIT AND LOSS	ASSETS AT AMORTIZED COST	LIABILITIES AT AMORTIZED COST	TOTAL	
FINANCIAL ASSETS					
Cash and cash equivalents	$ 572	$ -	$ -	**$ 572**	**$ 661**
Short-term investments	2,100	-	-	**2,100**	**1,614**
Restricted cash	91	-	-	**91**	**89**
Accounts receivable	-	654	-	**654**	**656**
Promissory notes receivable	-	143	-	**143**	**-**
Deposits and other assets					
Restricted cash	209	-	-	**209**	**192**
Aircraft related and other deposits	-	138	-	**138**	**135**
Prepayment option on senior secured notes	5	-	-	**5**	**4**
Derivative instruments					
Fuel derivatives	10	-	-	**10**	**4**
Share forward contracts	41	-	-	**41**	**85**
Foreign exchange derivatives	94	-	-	**94**	**30**
Interest rate swaps	4	-	-	**4**	**8**
	$ 3,126	**935**	**$ -**	**$ 4,061**	**$ 3,478**
FINANCIAL LIABILITIES					
Accounts payable	$ -	$ -	$ 1,399	**$ 1,399**	**$ 1,165**
Foreign exchange derivatives	5	-	-	**5**	**-**
Current portion of long-term debt and finance leases	-	-	524	**524**	**484**
Long-term debt and finance leases	-	-	5,870	**5,870**	**4,732**
	$ 5	**$ -**	**$ 7,793**	**$ 7,798**	**$ 6,381**

SUMMARY OF GAIN (LOSS) ON FUEL AND OTHER DERIVATIVES

	2015	2014
Fuel derivatives	$ (11)	$ (36)
Share forward contracts	(9)	31
Prepayment option on senior secured notes	1	2
Interest rate swaps	2	2
FUEL AND OTHER DERIVATIVES	**$ (17)**	**$ (1)**

RISK MANAGEMENT

Under its risk management policy, the Corporation manages its market risk through the use of various financial derivative instruments. The Corporation uses these instruments solely for risk management purposes, not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be offset by changes in cash flows of the relevant risk being hedged.

As noted below, the Corporation uses derivative instruments to provide economic hedges to mitigate various risks. The fair values of these instruments represent the amount of the consideration that could be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. The fair value of these derivatives is determined using prices in active markets, where available. When no such market is available, valuation techniques are applied such as discounted cash flow analysis. The valuation technique incorporates all factors that would be considered in setting a price, including the Corporation's own credit risk as well as the credit risk of the counterparty.

Market Risks

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk can be further divided into the following sub-classifications related to the Corporation: commodity price risk for jet fuel, foreign exchange risk, interest rate risk, and shared-based compensation risk.

Fuel Price Risk

Fuel price risk is the risk that future cash flows will fluctuate because of changes in jet fuel prices. In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, the Corporation enters into derivative contracts with financial intermediaries. The Corporation may use derivative contracts based on jet fuel, heating oil and crude oil based contracts. The Corporation's policy permits hedging of up to 75% of the projected jet fuel purchases for the next 12 months, 50% for the next 13 to 24 months and 25% for the next 25 to 36 months. These are maximum (but not mandated) limits. There is no minimum monthly hedging requirement. There are regular reviews to adjust the strategy in light of market conditions.

During 2015:

- The Corporation recorded a loss of $11 in Fuel and other derivatives related to fuel derivatives ($36 loss in 2014). These derivatives were not designated as hedges for accounting purposes.
- The Corporation purchased crude oil call options covering a portion of 2015 and 2016 fuel exposure. The cash premium related to these contracts was $39 ($44 in 2014 for 2014 and 2015 exposures).
- Fuel derivative contracts cash settled with a fair value of $1 in favour of the Corporation ($24 in favour of the Corporation in 2014).
- The Corporation applied fuel hedge accounting for certain designated fuel derivatives prospectively from April 1, 2015. In 2015, the fair value decrease of $21 for derivatives under hedge accounting was deferred as a cost of the hedged item in other comprehensive income and will be reclassified to Aircraft fuel expense when underlying hedged jet fuel is used. Fuel hedging loss of $10 was reclassified from other comprehensive income to Aircraft fuel expense in 2015.

A summary of amounts related to fuel derivatives designated as hedging instruments at December 31, 2015 is presented below.

	CARRYING AMOUNT OF THE HEDGING INSTRUMENT				
	NOMINAL AMOUNT OF THE HEDGING INSTRUMENT (IN BARRELS)	ASSETS	LIABILITIES	CONSOLIDATED STATEMENT OF FINANCIAL POSITION CLASSIFICATION	CHANGES IN FAIR VALUE USED FOR CALCULATING HEDGE INEFFECTIVENESS
CASH FLOW HEDGE					
Fuel price risk – option contracts	5,646,000	$ 10	$ -	Prepaid expenses and other current assets	$ -

As of December 31, 2015, approximately 18% of the Corporation's anticipated purchases of jet fuel for 2016 are hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US$48 per barrel for WTI prices up to US$51 per barrel and an average equivalent capped price of US$51 per barrel for WTI prices above US$53 per barrel. The Corporation's contracts to hedge anticipated jet fuel purchases over the 2016 period are comprised of call options with notional volumes of 5,646,000 barrels. The fair value of the fuel derivatives portfolio at December 31, 2015 is $10 in favour of the Corporation ($4 in favour of the Corporation in 2014) and is recorded within Prepaid expenses and other current assets.

Foreign Exchange Risk

The Corporation's financial results are reported in Canadian dollars, while a large portion of its expenses, debt obligations and capital commitments are in foreign currencies, primarily in U.S. dollars. Foreign exchange risk is the risk that fluctuations in foreign exchange rates may have on operating results and cash flows. The Corporation's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

Air Canada generates sales in U.S. dollars and in other foreign currencies which are converted to U.S. dollars under the Corporation's risk management program. In 2015, these net cash inflows totalled approximately US$3.1 billion. Also in 2015, U.S. denominated non-fuel operating costs amounted to approximately US$2.6 billion and U.S. dollar interest costs amounted to approximately US$250. The Corporation views U.S. dollar revenues largely as a natural hedge against non-fuel U.S. dollar costs. Fuel expenses, which are based in U.S. dollars, amounted to US$2.2 billion. For 2015, this resulted in a U.S. dollar net cash flow exposure of approximately $2.0 billion as it relates to the statement of operations. In addition, the majority of principal payments on long-term debt are denominated in U.S. dollars.

The Corporation has a target coverage of 70% on a rolling 18 month basis to manage the net U.S. dollar cash flow exposure described above utilizing the following risk management strategies:

- Holding U.S. dollar cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash and short-term investment balances as at December 31, 2015 amounted to $490 (US$358) ($717 (US$620) as at December 31, 2014). A portion of the cash and investment reserves are an economic hedge against net long-term U.S. dollar debt while the remainder of the cash is operational cash and investment reserves which are applied against the 18 month net U.S. dollar cash flow exposure. In 2015, a gain of $123 (gain of $58 in 2014) was recorded in Foreign exchange gain (loss) reflecting the change in Canadian equivalent market value of the U.S. dollar cash and short-term investment balances held.
- Locking in the foreign exchange rate through the use of a variety of foreign exchange derivatives which have maturity dates corresponding to the forecasted dates of U.S. dollar net outflows.

The level of foreign exchange derivatives entered into and their related maturity dates are dependent upon a number of factors, which include the amount of foreign revenue conversion available, U.S. dollar net cash outflows, as well as the amount attributed to aircraft and debt payments. Based on the notional amount of currency derivatives outstanding at December 31, 2015, as further described below, approximately 85% of net U.S. cash outflows are hedged for 2016 and 24% for 2017, resulting in derivative coverage of 67% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 68% coverage.

As at December 31, 2015, the Corporation had outstanding foreign currency options and swap agreements, settling in 2016 and 2017, to purchase at maturity $3,234 (US$2,337) of U.S. dollars at a weighted average rate of $1.2683 per US$1.00 (2014 – $2,658 (US$2,292) with settlements in 2015 and 2016 at a weighted average rate of $1.0884 per $1.00 U.S. dollar). The Corporation also has protection in place to sell a portion of its excess Euros, Sterling, YEN, YUAN and AUD (EUR $42, GBP $9, JPY $2,052, CNY $288, and AUD$18) which settle in 2016 at weighted average rates of $1.1663, $1.6150, $0.0088, $0.1562 and $0.7230 per $1.00 U.S. dollar, respectively (2014 – EUR $35, GBP $27 with settlement in 2015 at weighted average rates of $1.2806 and $1.6217, respectively per $1.00 U.S. dollar).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations, and based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at December 31, 2015 was $89 in favour of the Corporation (2014 – $30 in favour of the Corporation). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2015, a gain of $164 was recorded in Foreign exchange gain (loss) related to these derivatives (2014 – $75 gain). In 2015, foreign exchange derivative contracts cash settled with a net fair value of $104 in favour of the Corporation ($58 in 2014 in favour of the Corporation). The total combined gain, related to U.S. cash, investments and foreign exchange derivatives recorded by the Corporation in 2015 was $287 ($133 gain in 2014)

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Corporation enters into both fixed and floating rate debt and also leases certain assets where the rental amount fluctuates based on changes in short-term interest rates. The Corporation manages interest rate risk on a portfolio basis and seeks financing terms in individual arrangements that are most advantageous taking into account all relevant factors, including credit margin, term and basis. The risk management objective is to minimize the potential for changes in interest rates to cause adverse changes in cash flows to the Corporation. The cash and short-term investment portfolio which earns a floating rate of return is an economic hedge for a portion of the floating rate debt.

The ratio of fixed to floating rate obligations outstanding is designed to maintain flexibility in the Corporation's capital structure and is based upon a long-term objective of 60% fixed and 40% floating but allows flexibility in the short-term to adjust to prevailing market conditions. The ratio at December 31, 2015 is 79% fixed and 21% floating, including the effects of interest rate swap positions (75% and 25%, respectively as at December 31, 2014).

Share-based Compensation Risk

The Corporation issues share-based compensation to certain of its employees in the form of stock options, RSUs and PSUs as described in Note 12. Each RSU and PSU entitles the employees to receive a payment in the form of one Air Canada common share, cash in the amount equal to market value of one common share, or a combination thereof, at the discretion of the Board of Directors.

Share-based compensation risk refers to the risk that future cash flows to settle the RSUs and PSUs will fluctuate because of changes in the Corporation's share price. To hedge the exposure, the Corporation entered into share forward contracts to hedge PSUs and RSUs that may vest between 2016 and 2018, subject to the terms of vesting including realization of performance vesting criteria. The contracts were prepaid by the Corporation. The forward dates for the share forward contracts coincide with the vesting terms and planned settlement dates of 4,017,899 PSUs and RSUs from 2016 to 2018. These contracts were not designated as hedging instruments for accounting purposes. Accordingly, changes in the fair value of these contracts are recorded in Fuel and other derivatives in the period in which they arise. During 2015, a loss of $9 was recorded (2014 – gain of $31). Share forward contracts cash settled with a fair value of $35 in favour of the Corporation in 2015 (2014 – $7). As at December 31, 2015, the fair value of the share forward contracts is $41 in favour of the Corporation (2014 – $85 in favour of the Corporation), with those contracts maturing in 2016 valued at $15 recorded in Prepaid expenses and other current assets and the remainder of $26 is recorded in Deposits and other assets.

Liquidity risk

The Corporation manages its liquidity needs through a variety of strategies including by seeking to sustain and improve cash from operations, sourcing committed financing 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, including pension funding obligations as described in Note 8 and covenants in credit card and other agreements as described below. The Corporation monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used 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. The Corporation's principal objective in managing liquidity risk is to maintain cash, cash equivalents and short-term investments of at least $1,700. This minimum target level was determined in conjunction with the Corporation's liquidity risk management strategy. At December 31, 2015, unrestricted liquidity was $2,968 comprised of Cash and cash equivalents and Short-term investments of $2,672 and undrawn lines of credit of $296.

Cash and cash equivalents include $91 pertaining to investments with original maturities of three months or less at December 31, 2015 ($234 as at December 31, 2014).

A maturity analysis of the Corporation's principal and interest repayment requirements on long-term debt is set out in Note 7, and fixed operating commitments and capital commitments are set out in Note 14.

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. As at December 31, 2015, the Corporation's credit risk exposure consists mainly of the carrying amounts of Cash and cash equivalents, Short-term investments, Accounts receivable and derivative instruments. Cash and cash equivalents and Short-term investments are in place with major financial institutions, various levels of the Canadian government and major corporations. Accounts receivable are generally the result of sales of tickets to individuals, often through the use of major credit cards, through geographically dispersed travel agents, corporate outlets or other airlines. Credit rating guidelines are used in determining counterparties for hedging. In order to manage its exposure to credit risk and assess credit quality, the Corporation reviews counterparty credit ratings on a regular basis and sets credit limits when deemed necessary.

Sensitivity Analysis

The following table is a sensitivity analysis for each type of market risk relevant to the significant financial instruments recorded by the Corporation as at December 31, 2015. The sensitivity analysis is based on certain movements in the relevant risk factor. These assumptions may not be representative of actual movements in these risks and may not be relied upon. Given potential volatility in the financial and commodity markets, the actual movements and related percentage changes may differ significantly from those outlined below. Changes in income generally cannot be extrapolated because the relationship of the change in assumption to the change in income may not be linear. Each risk is contemplated independent of other risks; however, changes in one factor may result in changes in one or more several other factors, which may magnify or counteract the sensitivities.

The sensitivity analysis related to derivative contracts is based on the estimated fair value change applicable to the derivative as at December 31, 2015 considering a number of variables including the remaining term to maturity and does not consider the fair value change that would be applicable to the derivative assuming the market risk change was applicable to the maturity date of the derivative contract.

	INTEREST RATE RISK (1)	FOREIGN EXCHANGE RATE RISK (2)		OTHER PRICE RISK (3)	
	INCOME	INCOME		INCOME	
	1% INCREASE	5% INCREASE	5% DECREASE	10% INCREASE	10% DECREASE
Cash and cash equivalents	$ 6	$ (7)	$ 7	$ -	$ -
Short-term investments	$ 21	$ (17)	$ 17	$ -	$ -
Aircraft related deposits	$ -	$ (5)	$ 5	$ -	$ -
Long-term debt and finance leases	$ (16)	$ 284	$ (284)	$ -	$ -
Fuel derivatives	$ -	$ -	$ -	$ 8	$ (5)
Share forward contracts	$ -	$ -	$ -	$ 4	$ (4)
Foreign exchange derivatives	$ -	$ (53)	$ 48	$ -	$ -

1 Due to currently low market rates of interest, a 1% decrease in interest rates was not considered a reasonable scenario within the forecast period, being one year.
2 Increase (decrease) in foreign exchange relates to a strengthening (weakening) of the Canadian dollar versus the U.S. dollar. The impact on long-term debt and finance leases includes $5 related to the Canadian dollar versus the Japanese yen. The impact of changes in other currencies is not significant to the Corporation's financial instruments.
3 The sensitivity analysis for fuel derivatives is based upon a 10% increase or decrease in the price of the underlying commodity. Under hedge accounting, the effective gain or loss would be recorded in other comprehensive income. The sensitivity analysis for share forward contracts is based upon a 10% increase or decrease in the Air Canada share price.

Covenants in Credit Card Agreements

The Corporation's principal credit card processing agreements for credit card processing services in Canada contain triggering events upon which the Corporation is required to provide the credit card processor with cash deposits. The obligation to provide cash deposits and the required amount of deposits are each based upon a matrix measuring, on a quarterly basis, both a fixed charge coverage ratio for the Corporation and the unrestricted cash and short-term investments of the Corporation. In 2015, the Corporation made no cash deposits under these agreements (nil in 2014).

Air Canada also has agreements with another processor for the provision of certain credit card processing services requirements for markets other than Canada and for its cargo operations worldwide where such agreements also contain deposit obligations. In 2015, Air Canada made no cash deposits under these agreements (nil in 2014).

FINANCIAL INSTRUMENT FAIR VALUES IN THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION

The carrying amounts reported in the consolidated statement of financial position for short-term financial assets and liabilities, which includes Accounts receivable and Accounts payable and accrued liabilities, approximate fair values due to the immediate or short-term maturities of these financial instruments. Cash equivalents and Short-term investments are classified as held for trading and therefore are recorded at fair value.

The carrying amounts of derivatives are equal to fair value, which is based on the amount at which they could be settled based on estimated current market rates.

Management estimated the fair value of its long-term debt based on valuation techniques taking into account market information where available, market rates of interest, the condition of any related collateral, the current conditions in credit markets and the current estimated credit margins applicable to the Corporation based on recent transactions. Based on significant observable inputs (Level 2 in the fair value hierarchy), the estimated fair value of debt and finance leases is $6,494 compared to its carrying value of $6,394.

Following is a classification of fair value measurements recognized in the consolidated statement of financial position using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

		FAIR VALUE MEASUREMENTS AT REPORTING DATE USING:		
RECURRING MEASUREMENTS	DECEMBER 31, 2015	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)
FINANCIAL ASSETS				
Held-for-trading securities				
Cash equivalents	$ 91	$ -	$ 91	$ -
Short-term investments	2,100	-	2,100	-
Deposits and other assets				
Prepayment option on senior secured notes	5	-	-	5
Derivative instruments				
Fuel derivatives	10	-	10	-
Share forward contracts	41	-	41	-
Foreign exchange derivatives	94	-	94	-
Interest rate swaps	4	-	4	-
TOTAL	**$ 2,345**	**$ -**	**$ 2,340**	**$ 5**

		FAIR VALUE MEASUREMENTS AT REPORTING DATE USING:		
RECURRING MEASUREMENTS	DECEMBER 31, 2015	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)
FINANCIAL LIABILITIES				
Derivative instruments				
Foreign exchange derivatives	5	-	5	-
TOTAL	**$ 5**	**$ -**	**$ 5**	**$ -**

Financial assets held by financial institutions in the form of cash and restricted cash have been excluded from the fair value measurement classification table above as they are not valued using a valuation technique.

The Corporation's policy is to recognize transfers into and transfers out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer. There were no transfers within the fair value hierarchy during 2015.

In measuring the fair value of the prepayment option on the Senior Notes issued in 2013, which is categorized as Level 3 in the fair value hierarchy, the Corporation takes into account various factors including the prepayment terms in the notes, market rates of interest, the current conditions in credit markets and the current estimated credit margin applicable to the Corporation. The fair value of the prepayment option is $5 (2014 – $4).

Offsetting of Financial Instruments in the Consolidated Statement of Financial Position

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position where the Corporation has a legally enforceable right to set-off the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously. In the normal course of business, the Corporation enters into various master netting arrangements or other similar arrangements that do not meet the criteria for offsetting in the consolidated statement of financial position but still allow for the related amounts to be set off in certain circumstances, such as the termination of the contracts or in the event of bankruptcy or default of either party to the agreement.

Air Canada participates in industry clearing house arrangements whereby certain accounts receivable balances related to passenger, cargo and other billings are settled on a net basis with the counterparty through the clearing house. These billings are mainly the result of interline agreements with other airlines, which are commercial agreements that enable the sale and settlement of travel and related services between the carriers. Billed and work in process interline receivables are presented on a gross basis and amount to $65 as at December 31, 2015 ($67 as at December 31, 2014). These balances will be settled at a net value at a later date; however such net settlement amount is unknown until the settlement date.

The following table presents the recognized financial instruments that are offset, or subject to enforceable master netting arrangements or other similar arrangements but not offset, as at December 31, 2015 and 2014, and shows in the Net column what the net impact would be on the consolidated statement of financial position if all set-off rights were exercised.

	AMOUNTS OFFSET			AMOUNTS NOT OFFSET	NET
FINANCIAL ASSETS	GROSS ASSETS	GROSS LIABILITIES OFFSET	NET AMOUNTS PRESENTED	FINANCIAL INSTRUMENTS	
DECEMBER 31, 2015					
Derivative assets	$ 149	$ -	$ 149	$ -	$ 149
Accounts receivable	97	(45)	52	(2)	50
	$ 246	**$ (45)**	**$ 201**	**$ (2)**	**$ 199**
DECEMBER 31, 2014					
Derivative assets	$ 138	$ (11)	$ 127	$ -	$ 127
Accounts receivable	137	(49)	88	(38)	50
	$ 275	**$ (60)**	**$ 215**	**$ (38)**	**$ 177**

	AMOUNTS OFFSET			AMOUNTS NOT OFFSET	NET
FINANCIAL LIABILITIES	GROSS LIABILITIES	GROSS ASSETS OFFSET	NET AMOUNTS PRESENTED	FINANCIAL INSTRUMENTS	
DECEMBER 31, 2015					
Derivative liabilities	$ 5	$ -	$ 5	$ -	$ 5
Accounts payable	86	(45)	41	(2)	39
	$ 91	**$ (45)**	**$ 46**	**$ (2)**	**$ 44**
DECEMBER 31, 2014					
Derivative liabilities	$ 11	$ (11)	$ -	$ -	$ -
Accounts payable	113	(49)	64	(38)	26
	$ 124	**$ (60)**	**$ 64**	**$ (38)**	**$ 26**

16 CONTINGENCIES, GUARANTEES AND INDEMNITIES

CONTINGENCIES AND LITIGATION PROVISIONS

Investigations by Competition Authorities Relating to Cargo

The European Commission, the United States Department of Justice and the Competition Bureau in Canada investigated alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including Air Canada. Competition authorities in several jurisdictions sought or requested information from Air Canada as part of their investigations. Air Canada cooperated with these investigations, which led, to proceedings against Air Canada and a number of airlines and other cargo operators in certain jurisdictions. Air Canada is also named as a defendant or is otherwise involved in, and may become further implicated in, a number of class action lawsuits and other proceedings in Canada, Europe and the United States in connection with these allegations. The investigations instituted by the U.S. Department of Justice and by the Competition Bureau in Canada concluded with no proceedings having been instituted against Air Canada. In 2012, the Corporation entered into a settlement agreement relating to class action proceedings in the United States in connection with these allegations under which Air Canada made a payment of $8 without any admission of liability.

In 2010, the European Commission rendered a decision finding that 12 air cargo carriers (including groups of related carriers) had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006. Air Canada was among the carriers subject to the decision and a fine of 21 Euros (approximately $29) was imposed on Air Canada. Air Canada appealed the decision and filed an application for appeal before the European General Court. In 2011, Air Canada paid the fine, as required, pending the outcome of its appeal. On December 16, 2015, the European General Court granted Air Canada's appeal and annulled the decision of the European Union with regard to Air Canada and certain other airlines. As a result of the European General Court's decision, the European Commission was required to refund to Air Canada the fine of 21 Euros ($30), which amount has been recorded as a receivable as at December 31, 2015 and received in February 2016. There can be no assurance however that the decision of the European General Court will not be challenged or reversed.

As at December 31, 2015, Air Canada has a provision of $17 ($27 as at December 31, 2014) relating to outstanding claims in this matter, which is recorded in Accounts payable and accrued liabilities. The provision was reduced by $10 in 2015 reflecting a change in estimated costs. This provision is an estimate based upon the status of investigations and proceedings at this time and Air Canada's assessment as to the potential outcome for certain of them. The provision does not address the proceedings and investigations in all jurisdictions, but only where there is sufficient information to do so. Air Canada has determined it is not possible at this time to predict with any degree of certainty the outcome of all remaining proceedings and investigations. Based on the outcome of any developments regarding proceedings and investigations, Air Canada may adjust the provision in its results for subsequent periods as required.

Mandatory Retirement

Air Canada is engaged in a number of proceedings involving challenges to the mandatory retirement provisions of certain of its collective agreements, including the previous Air Canada-Air Canada Pilots Association collective agreement, which incorporated provisions of the pension plan terms and conditions applicable to pilots requiring them to retire at age 60. Air Canada has fully or partially resolved some of these complaints and is defending others. At this time, it is not possible to determine with any degree of certainty the extent of any financial liability that may arise from Air Canada being unsuccessful in its defence of these proceedings, though any such financial liability, if imposed, would not be expected to be material

Other Contingencies

Various other lawsuits and claims, including claims filed by various labour groups of Air Canada are pending by and against the Corporation and provisions have been recorded where appropriate. It is the opinion of management that final determination of these claims will not have a material adverse effect on the financial position or the results of the Corporation.

GUARANTEES

Guarantees in Fuel Facilities and De-Icing Arrangements

The Corporation participates in fuel facility arrangements operated through eight Fuel Facility Corporations, and one aircraft de-icing service facility, along with other airlines that contract for fuel and de-icing services at various major airports in Canada. These entities operate on a cost recovery basis. The aggregate debt of these entities that has not been consolidated by the Corporation under IFRS 10 Consolidated Financial Statements is approximately $425 as at December 31, 2015 (December 31, 2014 – $399), which is the Corporation's maximum exposure to loss before taking into consideration the value of the assets that secure the obligations and any cost sharing that would occur amongst the other contracting airlines. The Corporation views this loss potential as remote. Each contracting airline participating in these entities shares pro rata, based on system usage, in the guarantee of this debt. The maturities of these debt arrangements vary but generally extend beyond five years.

INDEMNIFICATION AGREEMENTS

In the ordinary course of the Corporation's business, the Corporation enters into a variety of agreements, such as real estate leases or operating agreements, aircraft financing or leasing agreements, technical service agreements with service providers, and director/officer contracts, and other commercial agreements, some of which may provide for indemnifications to counterparties that may require the Corporation to pay for costs and/or losses incurred by such counterparties. The Corporation cannot reasonably estimate the potential amount, if any, it could be required to pay under such indemnifications. Such amount would also depend on the outcome of future events and conditions, which cannot be predicted. While certain agreements specify a maximum potential exposure, certain others do not specify a maximum amount or a limited period. Historically, the Corporation has not made any significant payments under these indemnifications.

The Corporation expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities.

17 CAPITAL DISCLOSURES

The Corporation views capital as the sum of Long-term debt and finance leases, capitalized operating leases, Non controlling interests, and the market value of the Corporation's outstanding shares ("market capitalization"). The Corporation includes capitalized operating leases, which is a measure commonly used in the industry ascribing a value to obligations under operating leases. The value is based on annualized aircraft rent expense, including aircraft rent expense related to regional carrier operations, multiplied by 7.0, which is a factor commonly used in the airline industry. The measure used may not necessarily reflect the fair value or net present value related to the future minimum lease payments as the measure is not based on the remaining contractual payments and the factor may not recognize discount rates implicit in the actual leases or current rates for similar obligations with similar terms and risks. Market capitalization is based on the closing price of Air Canada's shares multiplied by the number of outstanding shares. This definition of capital is used by management and may not be comparable to measures presented by other public companies.

The Corporation also monitors its adjusted net debt and financial leverage ratio. Adjusted net debt is calculated as the sum of Long-term debt and finance lease obligations and capitalized operating leases less Cash and cash equivalents and Short-term investments. Financial leverage is calculated as adjusted net debt over 12 months trailing earnings before interest, taxes, depreciation, amortization and aircraft rent.

The Corporation's main objectives when managing capital are:

- To maintain financial leverage at or below a target leverage ratio of 2.2 by 2018 as set by the Corporation;
- To structure repayment obligations in line with the expected life of the Corporation's principal revenue generating assets;
- To ensure the Corporation has access to capital to fund contractual obligations as they become due and to ensure adequate cash levels to withstand deteriorating economic conditions;
- To maintain an appropriate balance between debt supplied capital versus investor supplied capital; and
- To monitor the Corporation's credit ratings to facilitate access to capital markets at competitive interest rates.

In order to maintain or adjust the capital structure, the Corporation may adjust the type of capital utilized, including purchase versus lease decisions, defer or cancel aircraft expenditures by not exercising available options or selling current aircraft options, issuing debt or equity securities, and repurchasing outstanding shares, all subject to market conditions and the terms of the underlying agreements or other legal restrictions.

The total capital and adjusted net debt as at December 31 is calculated as follows:

	2015	2014
Long-term debt and finance leases	$ 5,870	$ 4,732
Current portion of long-term debt and finance leases	524	484
	6,394	5,216
Capitalized operating leases	2,569	2,191
Adjusted debt	8,963	7,407
Non-controlling interests	27	68
Market capitalization	2,887	3,401
TOTAL CAPITAL	**$ 11,877**	**$ 10,876**
Adjusted debt	$ 8,963	$ 7,407
Less Cash and cash equivalents and Short-term investments	(2,672)	(2,275)
ADJUSTED NET DEBT	**$ 6,291**	**$ 5,132**

GEOGRAPHIC INFORMATION

A reconciliation of the total amounts reported by geographic region for Passenger revenues and Cargo revenues on the consolidated statement of operations is as follows:

	2015	2014
PASSENGER REVENUES		
Canada	$ 4,379	$ 4,381
U.S. Transborder	2,685	2,379
Atlantic	2,775	2,554
Pacific	1,762	1,710
Other	819	780
	$ 12,420	**$ 11,804**

	2015	2014
CARGO REVENUES		
Canada	$ 67	$ 66
U.S. Transborder	24	20
Atlantic	188	191
Pacific	188	190
Other	39	35
	$ 506	**$ 502**

Passenger and cargo revenues are based on the actual flown revenue for flights with an origin and destination in a specific country or region. Atlantic refers to flights that cross the Atlantic Ocean with origins and destinations principally in Europe. Pacific refers to flights that cross the Pacific Ocean with origins and destinations principally in Asia and Australia. Other passenger and cargo revenues refer to flights with origins and destinations principally in South America and the Caribbean.

Other operating revenues are principally derived from customers located in Canada and consist primarily of revenues from the sale of the ground portion of vacation packages, ground handling services, and other airline-related services, as well as revenues related to the lease or sublease of aircraft to third parties.

19 REGIONAL AIRLINES EXPENSE

The Corporation has capacity purchase agreements with Jazz, Sky Regional and certain other regional carriers. Expenses associated with these arrangements are classified as regional airlines expense on the consolidated statement of operations. Regional airlines expense consists of the following:

	2015	2014
Capacity purchase fees	$ 1,156	$ 1,182
Aircraft fuel	359	500
Airport and navigation	278	276
Sales and distribution costs	126	112
Other operating expenses	360	254
REGIONAL AIRLINES EXPENSE	**$ 2,279**	**$ 2,324**

Effective January 1, 2015, Air Canada and Jazz amended the terms of their capacity purchase agreement and extended its term to December 31, 2025. As a result of the amendments, certain costs that were previously capacity purchase agreement fees are now pass-through costs. Other costs that were pass-through costs are now costs directly incurred by Air Canada.

COMPARATIVE FIGURES

As described in Note 2D, expenses incurred related to capacity purchase agreements with its third-party regional carriers are now presented in a separate line item in the consolidated statement of operations titled Regional airlines expense. A reconciliation of operating expenses as previously reported for the year ending 2014 is provided below.

	2014	ADJUSTMENT	2014 RECLASSIFIED
OPERATING EXPENSES			
Aircraft fuel	$ 3,747	$ (500)	$ 3,247
Regional airlines expense	-	2,324	2,324
Wages, salaries and benefits	2,282	(51)	2,231
Capacity purchase agreements	1,182	(1,182)	-
Airport and navigation fees	1,031	(276)	755
Aircraft maintenance	728	(50)	678
Sales and distribution costs	672	(112)	560
Depreciation, amortization and impairment	543	(17)	526
Ground package costs	377	-	377
Aircraft rent	313	(11)	302
Food, beverages and supplies	309	(15)	294
Communications and information technology	204	(5)	199
Other	1,069	(105)	964
TOTAL OPERATING EXPENSES	**$ 12,457**	**$ -**	**$ 12,457**

Refer to Note 20 for reclassification of 2014 expenses related to Special items.

SPECIAL ITEMS

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Special items consist of the following:

	2015	2014
Labour agreement payments	$ 62	$ 30
Litigation	(40)	-
Other, net	(14)	(41)
SPECIAL ITEMS	**$ 8**	**$ (11)**

In 2015, the Corporation recorded $62 in labour agreement costs related to one-time payments for Air Canada's collective agreements with CUPE and IAMAW. In 2014, one-time payments of $30 related to Air Canada's collective agreement with ACPA were previously recorded in Wages, salaries and benefits.

Litigation is related to cargo investigations, as described in Note 16, and includes a favourable provision adjustment of $10 related to a change in estimated costs and recovery of the $30 fine previously paid to the European Commission.

Other net items are mainly related to a tax-related provision adjustment of $23. In 2014, tax-related provision adjustments of $41 were previously recorded in Other operating expenses.

RELATED PARTY TRANSACTIONS

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COMPENSATION OF KEY MANAGEMENT

Key management includes Air Canada's Board of Directors, President and Chief Executive Officer, Executive Vice-President and Chief Operating Officer, Executive Vice-President and Chief Financial Officer, and the President, Passenger Airlines. Compensation awarded to key management is summarized as follows:

	2015	2014
Salaries and other benefits	$ 10	$ 8
Pension and post-employment benefits	2	4
Share-based compensation	5	8
	$ 17	**$ 20**

OFFICERS

David I. Richardson	Chairman of the Board
Calin Rovinescu	President and Chief Executive Officer
Benjamin M. Smith	President, Passenger Airlines
Klaus Goersch	Executive Vice President and Chief Operating Officer
Michael Rousseau	Executive Vice President and Chief Financial Officer
Marcel Forget	Senior Vice President, Commercial Strategy
Lise Fournel	Senior Vice President and Chief Information Officer
Lucie Guillemette	Senior Vice President, Revenue Optimization
Kevin C. Howlett	Senior Vice President, Regional Markets
Amos Kazzaz	Senior Vice President, Financial Planning and Analysis
David J. Shapiro	Senior Vice President and Chief Legal Officer
Duncan Bureau	Vice President, Global Sales
Alan D. Butterfield	Vice President, Air Canada Maintenance and Engineering
Eddy Doyle	Vice President, Flight Operations
Yves Dufresne	Vice President, Alliances and Regulatory Affairs
Carolyn M. Hadrovic	Corporate Secretary
Chris Isford	Vice President and Controller
Craig Landry	President, Air Canada Leisure Group
Priscille LeBlanc	Vice President, Corporate Communications
Arielle Meloul-Wechsler	Vice President, Human Resources
Renee Smith-Valade	Vice President, In-Flight Service
Richard Steer	Vice President, Air Canada Maintenance and Engineering
Jim Tabor	Vice President, System Operations Control
Lise-Marie Turpin	Vice President, Cargo

DIRECTORS

David I. Richardson	Corporate Director and Chairman of the Board, Air Canada, Grafton, Ontario
Christie J.B. Clark	Corporate Director, Toronto, Ontario
Michael M. Green	Chief Executive Officer and Managing Director, Tenex Capital Management, Radnor, Pennsylvania
Jean Marc Huot	Partner, Stikeman Elliott LLP, Montréal, Quebec
Joseph B. Leonard	Corporate Director, Minneapolis, Minnesota
Madeleine Paquin	President and Chief Executive Officer, Logistec Corporation, Montréal, Quebec
Roy J. Romanow	Senior Fellow, Public Policy, University of Saskatchewan, Saskatoon, Saskatchewan
Calin Rovinescu	President and Chief Executive Officer, Air Canada, Montréal, Quebec
Vagn Sørensen	Corporate Director, London, United Kingdom
Annette Verschuren	Chair and Chief Executive Officer, NRStor Inc., Toronto, Ontario
Michael M. Wilson	Corporate Director, Bragg Creek, Alberta

INVESTOR AND SHAREHOLDER INFORMATION

Price Range and Trading Volume of Air Canada Variable Voting Shares and Voting Shares (AC)

N.B. Effective as of November 3, 2014, Air Canada Class A variable voting shares and Class B voting shares started trading under a single ticker on the the Toronto Stock Exchange.

2015	HIGH	LOW	VOLUME TRADED
1st Quarter	$ 13.35	$ 11.40	110,369,043
2nd Quarter	$ 15.09	$ 11.00	99,918,243
3rd Quarter	$ 13.60	$ 9.50	83,009,827
4th Quarter	$ 12.29	$ 9.82	88,572,340
			381,869,453

RESTRICTIONS ON VOTING SECURITIES

Currently, the *Air Canada Public Participation Act* (ACPPA) limits ownership of Air Canada's voting interests by non-residents of Canada to a maximum of 25%. The *Canada Transportation Act* (CTA) also requires that Canadians own and control at least 75% of the voting interests of licensed Canadian carriers. Accordingly, Air Canada's articles contain restrictions to ensure that it remains "Canadian" as defined under the CTA. The restrictions provide that non-Canadians can only hold variable voting shares of Air Canada, that such variable voting shares will not carry more than 25% (or any higher percentage that the Governor in Council may by regulation specify) of the aggregate votes attached to all issued and outstanding voting shares and that the total number of votes cast by the holders of such variable voting shares at any meeting of shareholders will not exceed 25% (or any such higher percentage) of the votes that may be cast at such meeting.

The *Budget Implementation Act, 2009* contains provisions whereby the restrictions on voting securities in the ACPPA would be repealed and the CTA would be amended to provide the Governor in Council with flexibility to increase the foreign ownership limit from the existing 25% level to a maximum of 49%. These provisions will come into force on a date to be fixed by order of the Governor in Council made on the recommendation of the Minister of Finance, in the case of the ACPPA, and on the recommendation of the Minister of Transport, in the case of the CTA. Air Canada cannot predict if or when new provisions relating to foreign ownership will come into force.

FOR FURTHER INFORMATION

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Air Canada complies with the rules adopted by the Toronto Stock Exchange.

TRANSFER AGENT AND REGISTRAR
CST Trust Company
Telephone: 1-800-387-0825

DUPLICATE COMMUNICATION
Shareholders receiving more than one copy are requested to call 1-800-387-0825 or write to the Transfer Agent and Registrar at the following address:
2001 Robert-Bourassa Boulevard, Suite 1600,
Montréal, Quebec H3A 2A6

Inquiries may also be submitted by email to inquiries@canstockta.com

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ENGLISH OR FRENCH, IT'S THE CLIENT'S CHOICE

OFFICIAL LANGUAGES AT AIR CANADA

For Air Canada, offering service in the language chosen by its customers is essential. Verbal exchanges with clients, public-address announcements at the airport and on board as well as briefing of passengers with special needs all constitute the very heart of customer service and call upon our employees' linguistic skills at all times. Our consideration to bilingualism not only makes good sense customerwise, but also supports our legal obligations to serve the public in the two official languages of Canada.

Air Canada puts great efforts to better serve clients in the language of their choice. It is through reach-out activities with the minority language communities as well as ongoing employee awareness and training that we can face the daily challenges, whether it is the growing difficulty to recruit bilingual candidates outside the province of Quebec and the national capital region, or for our employees to maintain their language skills with very little opportunities to practice the acquired language in some regions of the country.

CORPORATE PROFILE

Air Canada is Canada's largest domestic, U.S. transborder and international airline and 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. In 2015, Air Canada, together with Jazz and other regional airlines operating flights on behalf of Air Canada under capacity purchase agreements, operated more than 1,500 daily scheduled flights on average to 193 direct destinations on five continents, comprised of 63 Canadian cities, 53 destinations in the United States and a total of 77 cities in Europe, the Middle East, Asia, Australia, the Caribbean, Mexico and South America. Air Canada is among the 20 largest airlines in the world and in 2015 carried over 41 million passengers.

Air Canada is a founding member of the Star Alliance® network. Through the 28 member Star Alliance® network, Air Canada is able to offer its customers access to 1,300 destinations in 192 countries, as well as reciprocal participation in frequent flyer programs and use of over 1,000 airport lounges worldwide for eligible members.

Air Canada is the only international network carrier in North America to receive a Four-Star ranking according to independent U.K. research firm Skytrax.

aircanada.com

AIR CANADA