



First Quarter 2016

MANAGEMENT DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

April 29, 2016



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1. HIGHLIGHTS

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

(Canadian dollars in millions, except where indicated)	First Quarter		
	2016	2015	\$ Change
Financial Performance Metrics			
Operating revenues	3,343	3,249	94
Operating income	154	200	(46)
Non-operating expense	(53)	(509)	456
Net income (loss)	101	(309)	410
Adjusted net income ⁽¹⁾	85	122	(37)
Operating margin %	4.6%	6.2%	(1.6) pp
EBITDAR ⁽¹⁾	460	442	18
EBITDAR margin % ⁽¹⁾	13.8%	13.6%	0.2 pp
Unrestricted liquidity ⁽²⁾	3,229	3,123	106
Net cash flows from operating activities	968	810	158
Free cash flow ⁽¹⁾	(148)	385	(533)
Adjusted net debt ⁽¹⁾	6,308	5,190	1,118
Return on invested capital ("ROIC") % ⁽¹⁾	17.4%	15.2%	2.2 pp
Basic earnings per share	\$ 0.36	\$ (1.08)	\$ 1.44
Diluted earnings per share	\$ 0.35	\$ (1.08)	\$ 1.43
Adjusted earnings per share – diluted ⁽¹⁾	\$ 0.30	\$ 0.41	\$ (0.11)
Operating Statistics ⁽³⁾			% Change
Revenue passenger miles ("RPM") (millions)	16,092	14,937	7.7
Available seat miles ("ASM") (millions)	19,833	18,335	8.2
Passenger load factor %	81.1%	81.5%	(0.3) pp
Passenger revenue per RPM ("Yield") (cents)	17.4	18.3	(4.7)
Passenger revenue per ASM ("PRASM") (cents)	14.1	14.9	(5.1)
Operating revenue per ASM (cents)	16.9	17.7	(4.9)
Operating expense per ASM ("CASM") (cents)	16.1	16.6	(3.3)
Adjusted CASM (cents) ⁽¹⁾	12.3	11.9	3.3
Average number of full-time equivalent ("FTE") employees (thousands) ⁽⁴⁾	25.4	24.5	3.7
Aircraft in operating fleet at period-end	374	369	1.4
Average fleet utilization (hours per day)	9.8	9.7	0.9
Seats dispatched (thousands)	13,177	12,337	6.8
Aircraft frequencies (thousands)	134	134	(0.2)
Average stage length (miles) ⁽⁵⁾	1,505	1,486	1.3
Fuel cost per litre (cents)	48.1	65.2	(26.3)
Fuel litres (millions)	1,062	1,039	2.1
Revenue passengers carried (thousands) ⁽⁶⁾	9,957	9,487	5.0

- (1) *EBITDAR, EBITDAR margin and the adjusted measures are each non-GAAP financial measures (with the exception of adjusted net debt which is an additional GAAP measure). Refer to sections 6 and 14 of this 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 March 31, 2016, unrestricted liquidity was comprised of cash and short-term investments of \$2,947 million and undrawn lines of credit of \$282 million. At March 31, 2015, unrestricted liquidity was comprised of cash and short-term investments of \$2,850 million and undrawn lines of credit of \$273 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.*

2. 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 first quarter of 2016. This MD&A should be read in conjunction with Air Canada's interim unaudited condensed consolidated financial statements and notes for the first quarter of 2016, Air Canada's 2015 annual audited consolidated financial statements and notes and Air Canada's 2015 MD&A dated February 17, 2016 ("Air Canada's 2015 MD&A"). 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 15 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of April 28, 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 Air Canada's 2015 MD&A. Air Canada issued a news release dated April 29, 2016 reporting on its results for the first quarter of 2016. 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**.

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 Air Canada's 2015 MD&A. The forward-looking statements contained in this MD&A represent Air Canada's expectations as of April 28, 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.

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 changes in the cost of fuel continue to be associated, to some degree, with changes in the opposite direction in the value of the Canadian dollar. Air Canada also expects that the Canadian dollar will trade, on average, at C\$1.29 per U.S. dollar in the second quarter of 2016 and C\$1.31 per U.S. dollar for the full year 2016 and that the price of jet fuel (taking fuel hedging into account) will average 52 CAD cents per litre for the second quarter and the full year 2016.

INTELLECTUAL PROPERTY

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3. OVERVIEW

In the first quarter of 2016, Air Canada reported record EBITDAR of \$460 million compared to record EBITDAR of \$442 million in the first quarter of 2015, an increase of \$18 million. Air Canada generated adjusted net income of \$85 million or \$0.30 per diluted share, a decrease of \$37 million or \$0.11 per diluted share from the first quarter of 2015. EBITDAR and adjusted net income are non-GAAP financial measures. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information. On a GAAP basis, Air Canada reported first quarter 2016 operating income of \$154 million compared to operating income of \$200 million in the first quarter of 2015, a decrease of \$46 million. Air Canada recorded net income of \$101 million in the first quarter of 2016 versus a net loss of \$309 million in the same quarter in 2015.

First Quarter 2016 Financial Summary

The following is an overview of Air Canada's results of operations and financial position for the first quarter of 2016 compared to the first quarter of 2015.

- Operating revenues of \$3,343 million, an increase of \$94 million or 3% from the first quarter of 2015.
- An ASM capacity increase of 8.2% from the first quarter of 2015. This capacity growth was primarily driven by the continuing introduction of Boeing 787 aircraft into the mainline fleet and the growth of Air Canada *rouge*. This increase was partly offset by the impact of Boeing 777 aircraft being temporarily removed from operations for conversion into more competitive configurations in support of Air Canada's business strategy.
- Passenger revenues of \$2,864 million, an increase of \$78 million or 2.8% from the first quarter of 2015. A yield decline of 4.7% versus the same quarter in 2015 reflected the impact of increased market capacity, increased competition on regional routes and competitive pricing activities affecting certain domestic markets; a decline in higher-yielding oil market-related traffic; a reduction in carrier surcharges relating to lower fuel prices; an increase in average stage length of 1.3%, which had the effect of reducing system yield by 0.7 percentage points; a higher proportion of seats into long-haul leisure markets; and a higher proportional growth of lower-yielding international connecting traffic (sixth freedom traffic). The favourable impact of a weaker Canadian dollar on foreign currency denominated passenger revenues, which increased passenger revenues by \$90 million in the first quarter 2016, was a partly offsetting factor.
- A CASM reduction of 3.3% from the first quarter of 2015. On an adjusted basis, CASM increased 3.3% from the first quarter of 2015, better than the 7.0% to 8.0% increase forecast in Air Canada's news release dated February 17, 2016. This improvement was primarily driven by the impact of less flying by airlines operating flights on behalf of Air Canada under the Air Canada Express banner (which are typically lower stage length flights), the timing of certain aircraft maintenance events, the impact of a stronger Canadian dollar versus what had previously been assumed, and other operating expense reductions. Had the Canadian-U.S. dollar exchange rate remained at the first quarter 2015 level, adjusted CASM for the first quarter of 2016 would have been essentially unchanged from the first quarter of 2015. Adjusted CASM is a non-GAAP financial measure. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

- Operating expenses of \$3,189 million, an increase of \$140 million or 5% from the first quarter of 2015. This increase was mainly due to the impact of the 8.2% capacity growth and the unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses which increased operating expenses by \$152 million in the first quarter of 2016 (comprised of \$46 million relating to aircraft fuel expense and an aggregate of \$106 million relating to non-fuel operating expenses). These increases were partly 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 \$238 million in the first quarter of 2016.
- Adjusted net debt of \$6,308 million increased \$17 million from December 31, 2015. The impact of higher capitalized operating lease balances, largely driven by additional aircraft leases in the first three months of 2016 and an unfavourable currency impact on aircraft rent expense, was mostly offset by higher cash and short-term investment balances.
- The airline's adjusted net debt to EBITDAR ratio was 2.5 at March 31, 2016, unchanged from December 31, 2015. Adjusted net debt is an additional GAAP financial measure. Refer to section 6.2 "Adjusted Net Debt" of this MD&A for additional information.
- Net cash flows from operating activities of \$968 million, which reflected strong operating results, an improvement of \$158 million compared to the same quarter in 2015. This increase in net cash flows from operating activities was mainly due to the impact of higher cash inflows from working capital and the impact of lower pension past service funding payments. Negative free cash flow of \$148 million for the first quarter of 2016 decreased \$533 million from the first quarter of 2015, due to a higher level of capital expenditures year-over-year, partly offset by the impact of higher cash flows from operating activities. 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 6.4 "Consolidated Cash Flow Movements" of this MD&A for additional information.
- Return on invested capital ("ROIC") for the 12 months ended March 31, 2016 of 17.4% versus 15.2% for the 12 months ended March 31, 2015, and better than the 13-16% year-over-year ROIC projected in Air Canada's news release dated February 17, 2016. ROIC is a non-GAAP financial measure. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

4. RESULTS OF OPERATIONS – FIRST QUARTER 2016 VERSUS FIRST QUARTER 2015

The following table and discussion compares results of Air Canada for the first quarter 2016 versus the first quarter of 2015.

(Canadian dollars in millions, except per share figures)	First Quarter		Change	
	2016	2015	\$	%
Operating revenues				
Passenger	\$ 2,864	\$ 2,786	\$ 78	3
Cargo	116	129	(13)	(10)
Other	363	334	29	9
Total revenues	3,343	3,249	94	3
Operating expenses				
Aircraft fuel	446	592	(146)	(25)
Regional airlines expense				
Aircraft fuel	64	86	(22)	(26)
Other	505	466	39	8
Wages, salaries and benefits	608	568	40	7
Airport and navigation fees	198	185	13	7
Aircraft maintenance	217	188	29	15
Depreciation, amortization and impairment	182	153	29	19
Sales and distribution costs	182	154	28	18
Ground package costs	231	181	50	28
Aircraft rent	112	82	30	37
Food, beverages and supplies	77	62	15	24
Communications and information technology	67	57	10	18
Other	300	275	25	9
Total operating expenses	3,189	3,049	140	5
Operating income	154	200	(46)	
Non-operating income (expense)				
Foreign exchange gain (loss)	50	(408)	458	
Interest income	10	9	1	
Interest expense	(102)	(90)	(12)	
Interest capitalized	23	9	14	
Net financing expense relating to employee benefits	(18)	(25)	7	
Gain (loss) on financial instruments recorded at fair value	(10)	1	(11)	
Other	(6)	(5)	(1)	
Total non-operating expense	(53)	(509)	456	
Income (loss) before income taxes	101	(309)	410	
Income taxes	-	-	-	
Net income (loss) for the period	\$ 101	\$ (309)	\$ 410	
Basic earnings (loss) per share	\$ 0.36	\$ (1.08)	\$ 1.44	
Diluted earnings (loss) per share	\$ 0.35	\$ (1.08)	\$ 1.43	
EBITDAR ⁽¹⁾	\$ 460	\$ 442	\$ 18	
Adjusted net income ⁽¹⁾	\$ 85	\$ 122	\$ (37)	
Adjusted earnings per share – diluted ⁽¹⁾	\$ 0.30	\$ 0.41	\$ (0.11)	

(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 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

System passenger revenues increased 2.8% from the first quarter of 2015

In the first quarter of 2016, system passenger revenues of \$2,864 million increased \$78 million or 2.8% from the first quarter of 2015.

In the first quarter of 2016, business cabin system revenues increased \$13 million or 2.4% from the first quarter of 2015 on a traffic increase and yield growth of 1.7% and 0.6%, respectively.

The table below provides passenger revenue by geographic region for the first quarter of 2016 and the first quarter of 2015.

Passenger Revenue	First Quarter 2016 \$ Million	First Quarter 2015 \$ Million	Change \$ Million	% Change
Canada	954	976	(22)	(2.3)
U.S. transborder	717	699	18	2.5
Atlantic	508	450	58	12.9
Pacific	398	369	29	7.7
Other	287	292	(5)	(1.5)
System	2,864	2,786	78	2.8

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the first quarter of 2016 versus the first quarter of 2015.

First Quarter 2016 versus First Quarter 2015	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	(2.3)	6.3	4.1	(1.7)	(6.5)	(8.4)
U.S. transborder	2.5	10.2	5.8	(3.3)	(3.3)	(7.1)
Atlantic	12.9	13.6	15.8	1.5	(2.5)	(0.6)
Pacific	7.7	3.1	6.3	2.6	1.4	4.6
Other	(1.5)	7.5	8.1	0.4	(9.2)	(8.8)
System	2.8	8.2	7.7	(0.3)	(4.7)	(5.1)

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the first quarter of 2016 and each of the previous four quarters.

System	Year-over-Year by Quarter (% Change)				
	Q1'15	Q2'15	Q3'15	Q4'15	Q1'16
Passenger revenues	6.9	3.9	6.9	3.0	2.8
Capacity (ASMs)	9.3	9.3	10.5	8.4	8.2
Traffic (RPMs)	10.9	8.7	10.2	8.6	7.7
Passenger load factor (pp change)	1.2	(0.5)	(0.2)	0.1	(0.3)
Yield	(4.2)	(5.0)	(3.8)	(5.5)	(4.7)
PRASM	(2.7)	(5.5)	(4.0)	(5.3)	(5.1)

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

- The 7.7% 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 first quarter of 2016 also reflected incremental connecting traffic to international destinations.
- The 4.7% yield decrease which reflected:
 - o the impact of increased market capacity, increased competition on regional routes and competitive pricing activities affecting certain domestic markets;
 - o a decline in higher-yielding oil market-related traffic;
 - o a reduction in carrier surcharges relating to lower fuel prices, particularly where carrier surcharges are regulated such as Japan, Hong Kong, South Korea and Brazil;
 - o an increase in average stage length of 1.3%, which had the effect of reducing system yield by 0.7 percentage points;
 - o a higher proportion of seats into long-haul leisure markets led by an increase in lower-cost flights operated by Air Canada *rouge*; and
 - o a higher proportional growth of lower-yielding international connecting traffic (sixth freedom traffic) in support of the airline's international expansion strategy.

A favourable currency impact of \$90 million was a partly offsetting factor.

Domestic passenger revenues decreased 2.3% from the first quarter of 2015

In the first quarter of 2016, domestic passenger revenues of \$954 million decreased \$22 million or 2.3% from the first quarter of 2015.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the first quarter of 2016 and each of the previous four quarters.

Canada	Year-over-Year by Quarter (% Change)				
	Q1'15	Q2'15	Q3'15	Q4'15	Q1'16
Passenger revenues	3.4	0.4	0.6	(4.1)	(2.3)
Capacity (ASMs)	2.1	2.6	4.8	4.0	6.3
Traffic (RPMs)	3.9	3.1	3.5	2.4	4.1
Passenger load factor (pp change)	1.4	0.3	(1.1)	(1.2)	(1.7)
Yield	(1.8)	(4.1)	(4.8)	(7.3)	(6.5)
PRASM	-	(3.7)	(6.0)	(8.7)	(8.4)

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

- The 6.5% yield decrease which reflected:
 - the impact of increased market capacity, increased competition on regional routes and competitive pricing activities affecting certain domestic markets;
 - a decline in higher-yielding oil market-related traffic;
 - a 1.7% longer average stage length which had the effect of reducing domestic yield by 0.9 percentage points in the first quarter of 2016; and
 - higher proportional growth of lower-yielding international and U.S. transborder passenger flows connecting to Air Canada's routes in the domestic market in support of the airline's international expansion strategy.
- The 4.1% 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 within western Canada where traffic was slightly lower than in the first quarter of 2015.

A favourable currency impact of \$12 million was a partly offsetting factor.

U.S. transborder passenger revenues increased 2.5% from the first quarter of 2015

In the first quarter of 2016, U.S. transborder passenger revenues of \$717 million increased \$18 million or 2.5% from the first quarter of 2015.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the first quarter of 2016 and each of the previous four quarters.

U.S. transborder	Year-over-Year by Quarter (% Change)				
	Q1'15	Q2'15	Q3'15	Q4'15	Q1'16
Passenger revenues	12.6	10.9	17.3	10.5	2.5
Capacity (ASMs)	17.3	12.4	15.2	11.9	10.2
Traffic (RPMs)	17.7	12.9	15.6	11.6	5.8
Passenger load factor (pp change)	0.3	0.4	0.3	(0.2)	(3.3)
Yield	(4.3)	(1.9)	1.4	(0.9)	(3.3)
PRASM	(4.0)	(1.5)	1.8	(1.1)	(7.1)

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

- The 5.8% traffic increase which reflected traffic growth on most major U.S. transborder services. This year-over-year increase in traffic was largely due to increased passenger demand between Canada and the U.S. as well as growth of international-to-international connecting passenger flows from the U.S. in support of Air Canada's international expansion strategy.

- The 3.3% yield decline which mainly reflected the impact of increased industry capacity and pricing activities on lower-cost Air Canada *rouge* operated U.S. sun routes to stimulate demand due to a weaker Canadian dollar. Improved yield from the premium cabin and U.S.-originating traffic as well as a favourable currency impact of \$27 million were partly offsetting factors.

Atlantic passenger revenues increased 12.9% from the first quarter of 2015

In the first quarter of 2016, Atlantic passenger revenues of \$508 million increased \$58 million or 12.9% from the first quarter of 2015.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the first quarter of 2016 and each of the previous four quarters.

Atlantic	Year-over-Year by Quarter (% Change)				
	Q1'15	Q2'15	Q3'15	Q4'15	Q1'16
Passenger revenues	11.0	6.5	9.1	9.1	12.9
Capacity (ASMs)	10.7	11.2	12.7	15.3	13.6
Traffic (RPMs)	17.2	11.0	12.7	14.2	15.8
Passenger load factor (pp change)	4.2	(0.2)	-	(0.7)	1.5
Yield	(5.1)	(4.0)	(3.2)	(4.5)	(2.5)
PRASM	0.4	(4.2)	(3.2)	(5.4)	(0.6)

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

- The 15.8% traffic increase which reflected traffic growth on all major Atlantic services with the exception of services to France and Italy, where capacity was reduced year-over-year, and from western Canada to the U.K. and Germany.
- The 2.5% yield decline which reflected an increase in average stage length of 4.1%, which had the effect of reducing Atlantic yield by 2.3 percentage points, a higher proportion of seats offered into long-haul (lower yielding) leisure markets, combined with increased industry capacity and competitive pricing activities. An improved premium cabin mix and a favourable currency impact of \$21 million were partly offsetting factors.

Pacific passenger revenues increased 7.7% from the first quarter of 2015

In the first quarter of 2016, Pacific passenger revenues of \$398 million increased \$29 million or 7.7% from the first quarter of 2015.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the first quarter of 2016 and each of the previous four quarters.

Pacific	Year-over-Year by Quarter (% Change)				
	Q1'15	Q2'15	Q3'15	Q4'15	Q1'16
Passenger revenues	(0.5)	1.4	5.6	4.7	7.7
Capacity (ASMs)	7.6	13.6	11.8	3.4	3.1
Traffic (RPMs)	6.5	10.4	12.1	7.9	6.3
Passenger load factor (pp change)	(0.8)	(2.5)	0.2	3.6	2.6
Yield	(6.5)	(8.1)	(5.7)	(2.9)	1.4
PRASM	(7.4)	(10.7)	(5.5)	1.3	4.6

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

- The 6.3% traffic increase which reflected traffic growth on all major Pacific services with the exception of services to Australia and Hong Kong where capacity was reduced year-over-year. The traffic decrease on services to Australia was less than the capacity decrease resulting in a higher passenger load factor year-over-year on services to Australia.
- The 1.4% yield increase mainly reflected yield growth on all major services with the exception of South Korea where Pacific yield remained essentially at the 2015 level. A favourable currency impact of \$22 million and a stronger performance in the business cabin were also contributing factors to the yield growth year-over-year. A reduction in carrier surcharges relating to lower fuel prices, particularly where carrier surcharges are regulated, was a partly offsetting factor.

Other passenger revenues decreased 1.5% from the first quarter of 2015

In the first quarter of 2016, Other passenger revenues (from routes to and from the Caribbean, Mexico and Central and South America) of \$287 million decreased \$5 million or 1.5% from the first quarter of 2015.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the first quarter of 2016 and each of the previous four quarters.

Other	Year-over-Year by Quarter (% Change)				
	Q1'15	Q2'15	Q3'15	Q4'15	Q1'16
Passenger revenues	9.5	(1.3)	8.5	1.1	(1.5)
Capacity (ASMs)	12.9	10.3	12.2	9.5	7.5
Traffic (RPMs)	13.4	7.9	11.5	10.5	8.1
Passenger load factor (pp change)	0.3	(1.9)	(0.5)	0.7	0.4
Yield	(3.7)	(9.0)	(3.1)	(8.6)	(9.2)
PRASM	(3.3)	(11.0)	(3.6)	(7.8)	(8.8)

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

- The 9.2% yield decrease which reflected the impact of competitive pricing activities, driven by increased industry capacity and weaker economic conditions from point of origin Brazil. Partly offsetting this decrease was a favourable currency impact of \$8 million.
- The 8.1% traffic increase which reflected traffic growth on most major services, led by lower-cost Air Canada *rouge* flying. A traffic decline on services to South America year-over-year was essentially in line with the capacity reduction on these services. International connections to and from South America increased compared to the same quarter in 2015 which is consistent with Air Canada's strategy of growing international-to-international traffic through its Canadian hubs.

Cargo revenues decreased 10.2% from the first quarter of 2015

In the first quarter of 2016, cargo revenues of \$116 million decreased \$13 million or 10.2% from 2015, reflecting an overall reduction in cargo demand, increased industry capacity and competitive pricing activities.

The table below provides cargo revenue by geographic region for the first quarter of 2016 and the first quarter of 2015.

Cargo Revenue	First Quarter 2016 \$ Million	First Quarter 2015 \$ Million	Change \$ Million
Canada	14	17	(3)
U.S. transborder	7	6	1
Atlantic	47	50	(3)
Pacific	38	46	(8)
Other	10	10	-
System	116	129	(13)

Other revenues increased 9% from the first quarter of 2015

In the first quarter of 2016, other revenues of \$363 million increased \$29 million or 9% due to higher ground package revenues at Air Canada Vacations which was primarily driven by growth in passenger volumes.

CASM decreased 3.3% from the first quarter of 2015. Adjusted CASM increased 3.3% from the first quarter of 2015

The following table compares Air Canada's CASM and Adjusted CASM for the first quarter of 2016 to the first quarter 2015.

(cents per ASM)	First Quarter		Change	
	2016	2015	cents	%
Aircraft fuel	2.25	3.23	(0.98)	(30.3)
Regional airlines expense				
Aircraft fuel	0.32	0.47	(0.15)	(31.9)
Other	2.55	2.54	0.01	0.4
Wages and salaries	2.28	2.27	0.01	0.4
Benefits	0.79	0.83	(0.04)	(4.8)
Airport and navigation fees	1.00	1.01	(0.01)	(1.0)
Aircraft maintenance	1.09	1.02	0.07	6.9
Depreciation, amortization and impairment	0.92	0.84	0.08	9.5
Sales and distribution costs	0.92	0.84	0.08	9.5
Ground package costs	1.17	0.99	0.18	18.2
Aircraft rent	0.56	0.45	0.11	24.4
Food, beverages and supplies	0.39	0.34	0.05	14.7
Communications and information technology	0.34	0.31	0.03	9.7
Other	1.50	1.49	0.01	0.7
CASM	16.08	16.63	(0.55)	(3.3)
Remove:				
Aircraft fuel expense ⁽¹⁾ and ground package costs at Air Canada Vacations	(3.74)	(4.69)	0.95	20.3
Adjusted CASM ⁽²⁾	12.34	11.94	0.40	3.3

(1) Includes aircraft fuel expense related to regional airline operations.

(2) Adjusted CASM is a non-GAAP financial measure. Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

Operating expenses increased 5% from the first quarter of 2015

In the first quarter of 2016, on capacity growth of 8.2%, operating expenses of \$3,189 million increased \$140 million or 5% from the first quarter of 2015.

The components of the year-over-year change in first quarter operating expenses included:

- The impact of the 8.2% 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 \$152 million (comprised of \$46 million relating to aircraft fuel expense and an aggregate of \$106 million relating to non-fuel operating expenses).

Partly 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 \$238 million to aircraft fuel expense (including fuel expense related to regional airline operations).

Aircraft fuel expense decreased 25% from the first quarter of 2015

Aircraft fuel expense, including fuel expense related to regional airline operations, amounted to \$510 million in the first quarter of 2016, a decrease of \$168 million or 25% from the first quarter of 2015. The decrease in aircraft fuel expense in the first quarter of 2015 was due to a significant decline in base jet fuel prices year-over-year, which accounted for a decrease of \$238 million. This decrease was partly offset by the unfavourable impact of a weaker Canadian dollar versus the U.S. dollar when compared to the first quarter of 2015, which accounted for an increase of \$46 million, as well as a higher volume of fuel litres consumed, which accounted for an increase of \$14 million. Premium costs associated with fuel derivatives of \$10 million were reclassified from hedging reserve to aircraft fuel expense in the first quarter of 2016.

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.

	First Quarter		Change	
	2016	2015	\$	%
(Canadian dollars in millions, except where indicated)				
Aircraft fuel expense	\$ 446	\$ 592	\$ (146)	(25)
Aircraft fuel expense related to Regional airline operations	64	86	(22)	(26)
Total Aircraft fuel expense - GAAP	\$ 510	\$ 678	\$ (168)	(25)
Add: Net cash payments on fuel derivatives ⁽¹⁾	-	11	(11)	(100)
Economic cost of fuel - Non-GAAP ⁽²⁾	\$ 510	\$ 689	\$ (179)	(26)
Fuel consumption (thousands of litres)	1,061,660	1,039,421	22,239	2.1
Fuel cost per litre (cents) - GAAP	48.1	65.2	(17.1)	(26.3)
Economic fuel cost per litre (cents) - Non-GAAP ⁽²⁾	48.1	66.3	(18.2)	(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 first quarter of 2016).

(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 increased 3% from the first quarter of 2015

In the first quarter of 2016, regional airlines expense of \$569 million increased \$17 million or 3% from the first quarter of 2015, driven by an unfavourable currency impact as well as fleet expansion initiatives in the Air Canada Express fleet at Sky Regional and Air Georgian. These increases were partly offset by the impact of lower base jet fuel prices when compared to the same quarter in 2015.

The following table provides a breakdown of Regional airlines expense for the periods indicated:

(Canadian dollars in millions)	First Quarter		Change	
	2016	2015	\$	%
Capacity purchase fees	\$ 293	\$ 274	\$ 19	7
Aircraft fuel	64	86	(22)	(26)
Airport and navigation	68	65	3	5
Sales and distribution costs	35	33	2	6
Aircraft rent	7	3	4	133
Depreciation, amortization and impairment	5	4	1	25
Other operating expenses	97	87	10	11
Total regional airlines expense	\$ 569	\$ 552	\$ 17	3

Wages, salaries and benefits expense amounted to \$608 million in the first quarter of 2016, an increase of \$40 million or 7% from the first quarter of 2015

In the first quarter of 2016, wages and salaries expense of \$451 million increased \$34 million or 8% from the first quarter of 2015 due to higher average salaries, which were primarily driven by the impact of collective agreements concluded in 2014 and 2015; an increase in crew training related to Air Canada's new Boeing 787 aircraft; and a 3.7% increase in the average number of full-time equivalent (FTE) employees.

In the first quarter of 2016, employee benefits expense of \$157 million increased \$6 million or 4% from the first quarter of 2015.

Airport and navigation fees increased 7% from the first quarter of 2015

In the first quarter of 2016, airport and navigation fees of \$198 million increased \$13 million or 7% from the first quarter of 2015, largely due to growth in wide-body and international flying and an unfavourable currency impact.

Aircraft maintenance expense increased 15% from the first quarter of 2015

In the first quarter of 2016, aircraft maintenance expense of \$217 million increased \$29 million or 15% from the first quarter of 2015, mainly due to the impact of Air Canada having extended fewer aircraft leases and an unfavourable currency impact of \$26 million. These increases were partly offset by the timing of scheduled airframe and components maintenance activity versus the first quarter of 2015.

Depreciation, amortization and impairment expense increased 19% from the first quarter of 2015

In the first quarter of 2016, depreciation, amortization and impairment expense of \$182 million increased \$29 million or 19% from the first quarter of 2015, largely due to the addition of 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 first quarter of 2015

In the first quarter of 2016, sales and distribution costs of \$182 million increased \$28 million or 18% from the first quarter of 2015 on passenger revenue growth of 2.8%. This growth in sales and distribution costs was mainly due to an unfavourable currency impact, a higher volume of ticket sales generated through all sales channels, including Global Distribution System providers, as well as higher credit card fees (in line with sales and revenue growth).

Ground package costs increased 28% from the first quarter of 2015

In the first quarter of 2016, the cost of ground packages at Air Canada Vacations amounted to \$231 million, an increase of \$50 million or 28% from the first quarter of 2015, mainly due to an unfavourable currency impact, higher passenger volumes and, to a lesser extent, a higher cost of ground packages (before the impact of foreign exchange).

Aircraft rent increased 37% from the first quarter of 2015

In the first quarter of 2016, aircraft rent expense amounted to \$112 million, an increase of \$30 million or 37% from the first quarter of 2015. This increase was mainly due to a greater number of leased aircraft, primarily Airbus A321 and Boeing 767 aircraft to replace Embraer 190 aircraft which are exiting the fleet, an unfavourable currency impact of \$11 million, and the reclassification of certain finance leases to operating leases. These increases were partly offset by the favourable impact of lower rates on lease renewals.

Other expenses increased 9% from the first quarter of 2015

In the first quarter of 2016, other expenses of \$300 million increased \$25 million or 9% from the first quarter of 2015. This increase in other expenses included the effect of the 8.2% capacity growth, an unfavourable currency impact, and an increase in terminal handling expense which is mainly driven by Air Canada's international expansion strategy.

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

	First Quarter		Change	
	2016	2015	\$	%
(Canadian dollars in millions)				
Terminal handling	\$ 59	\$ 50	\$ 9	18
Crew cycle	40	35	5	14
Building rent and maintenance	39	36	3	8
Miscellaneous fees and services	33	31	2	6
Remaining other expenses	129	123	6	5
Total other expenses	\$ 300	\$ 275	\$ 25	9

Non-operating expense amounted to \$53 million in the first quarter of 2016 compared to non-operating expense of \$509 million in the first quarter of 2015

Factors contributing to the \$456 million year-over-year reduction in first quarter non-operating expense included:

- Gains on foreign exchange, which amounted to \$50 million in the first quarter of 2016 compared to losses on foreign exchange of \$408 million in the first quarter of 2015 were mainly related to foreign exchange gains on U.S. denominated long-term debt of \$335 million and foreign exchange gains on net maintenance provisions of \$57 million. The gains in the first quarter of 2016 were attributable to a stronger Canadian dollar at March 31, 2016 when compared to December 31, 2015. The March 31, 2016 closing exchange rate was US\$1 = C\$1.2987 while the December 31, 2015 closing exchange rate was US\$1 = C\$1.3840. Partially offsetting these gains were losses of \$264 million on foreign currency derivatives and \$47 million on cash and short-term investment balances.
- An increase in interest expense of \$12 million which was mainly due to a standby charge on amounts not yet drawn related to the financing of aircraft which remain to be delivered and to new borrowings. In addition, in the first quarter of 2016, Air Canada recorded a special charge of \$6 million related to the prepayment of debt associated with the disposal of Embraer 190 aircraft. These increases in interest expense were more than offset by an increase in capitalized interest of \$14 million which largely reflected the above-noted standby charge.
- A decrease in net financing expense relating to employee benefits of \$7 million which was mainly due to the impact of the lower net defined pension benefit obligation.
- Losses on financial instruments recorded at fair value which amounted to \$10 million in the first quarter of 2016 versus gains on financial instruments recorded at fair value of \$1 million in the first quarter of 2015.

5. FLEET

There are no changes to the fleet as at March 31, 2016 versus what was provided in section 8 of Air Canada's 2015 MD&A. The following table provides the number of aircraft in Air Canada's operating fleet as at December 31, 2015 and March 31, 2016, 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	First Quarter 2016 Fleet Changes	March 31, 2016	Remainder of 2016 Fleet Changes	December 31, 2016	2017 Fleet Changes	December 31, 2017
Mainline							
<u>Wide-body Aircraft</u>							
Boeing 787-8	8	-	8	-	8	-	8
Boeing 787-9	4	4	8	5	13	9	22
Boeing 777-300ER	17	-	17	2	19	-	19
Boeing 777-200LR	6	-	6	-	6	-	6
Boeing 767-300ER	17	-	17	(2)	15	(5)	10
Airbus A330-300	8	-	8	-	8	-	8
<u>Narrow-body Aircraft</u>							
Boeing 737 MAX	-	-	-	-	-	2	2
Airbus A321	14	1	15	-	15	-	15
Airbus A320	42	-	42	-	42	-	42
Airbus A319	18	-	18	-	18	-	18
Embraer 190	37	(9)	28	(3)	25	-	25
Total Mainline	171	(4)	167	2	169	6	175
Air Canada <i>rouge</i>							
<u>Wide-body Aircraft</u>							
Boeing 767-300ER	15	2	17	2	19	6	25
<u>Narrow-body Aircraft</u>							
Airbus A321	4	-	4	1	5	-	5
Airbus A319	20	-	20	-	20	-	20
Total Air Canada <i>rouge</i>	39	2	41	3	44	6	50
Total wide-body Aircraft	75	6	81	7	88	10	98
Total narrow-body Aircraft	135	(8)	127	(2)	125	2	127
Total Mainline and Air Canada <i>rouge</i>	210	(2)	208	5	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). Air Canada has firm orders for 61 Boeing 737 MAX aircraft, of which 16 aircraft are expected to be delivered in 2018, 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 March 31, 2016, 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 March 31, 2016			
	Jazz	Sky Regional	Other	Total
Embraer 175	-	20	-	20
Bombardier CRJ-100/200	16	-	11	27
Bombardier CRJ-705	16	-	-	16
Bombardier Dash 8-100	24	-	-	24
Bombardier Dash 8-300	26	-	-	26
Bombardier Dash 8-Q400	31	5	-	36
Beech 1900	-	-	17	17
Total Air Canada Express	113	25	28	166

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.

6. FINANCIAL AND CAPITAL MANAGEMENT

6.1. Financial Position

The following table provides a condensed consolidated statement of financial position of Air Canada as at March 31, 2016 and as at December 31, 2015.

(Canadian dollars in millions)	March 31, 2016	December 31, 2015	\$ Change
Assets			
Cash, cash equivalents and short-term investments	\$ 2,947	\$ 2,672	\$ 275
Other current assets	1,335	1,453	(118)
Current assets	4,282	4,125	157
Property and equipment	7,727	7,030	697
Pension	398	851	(453)
Intangible assets	312	314	(2)
Goodwill	311	311	-
Deposits and other assets	473	496	(23)
Total assets	\$ 13,503	\$ 13,127	\$ 376
Liabilities			
Current liabilities	\$ 4,538	\$ 3,829	\$ 709
Long-term debt and finance leases	5,991	5,870	121
Pension and other benefit liabilities	2,647	2,245	402
Maintenance provisions	822	892	(70)
Other long-term liabilities	237	251	(14)
Total liabilities	14,235	13,087	1,148
Total equity	(732)	40	(772)
Total liabilities and equity	\$ 13,503	\$ 13,127	\$ 376

Movements in current assets and current liabilities are described in section 6.3 "Working Capital" of this MD&A. Long-term debt and finance leases are discussed in sections 6.2 "Adjusted Net Debt" and 6.4 "Consolidated Cash Flow Movements" of this MD&A.

At March 31, 2016, property and equipment amounted to \$7,727 million, an increase of \$697 million from December 31, 2015. The increase in property and equipment was mainly due to additions to property and equipment of \$1,110 million partly offset by the disposal of nine Embraer 190 aircraft, and the impact of depreciation expense of \$176 million. The additions to property and equipment in the first quarter of 2016 included four Boeing 787-9 aircraft, progress payments on future aircraft deliveries and capitalized maintenance costs.

The net pension and other benefit liabilities of \$2,249 million (comprised of pension and other benefit liabilities of \$2,647 million net of pension assets of \$398 million) increased \$855 million from December 31, 2015, mainly due to a 30 basis point decrease in the discount rate used to value the liabilities, which contributed to a loss of \$819 million recorded in Other comprehensive income.

6.2. Adjusted Net Debt

The following table reflects Air Canada's adjusted net debt balances as at March 31, 2016 and as at December 31, 2015.

(Canadian dollars in millions, except where indicated)	March 31, 2016	December 31, 2015	\$ Change
Total long-term debt and finance leases	\$ 5,991	\$ 5,870	\$ 121
Current portion of long-term debt and finance leases	457	524	(67)
Total long-term debt and finance leases, including current portion	6,448	6,394	54
Less cash, cash equivalents and short-term investments	(2,947)	(2,672)	(275)
Net debt	\$ 3,501	\$ 3,722	\$ (221)
Capitalized operating leases ⁽¹⁾	2,807	2,569	238
Adjusted net debt	\$ 6,308	\$ 6,291	\$ 17
EBITDAR (trailing 12 months)	\$ 2,552	\$ 2,534	\$ 18
Adjusted net debt to EBITDAR ratio	2.5	2.5	-

(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 \$401 million for the 12 months ended March 31, 2016 and \$367 million for the 12 months ended December 31, 2015.

At March 31, 2016, total long-term debt and finance leases (including current portion) of \$6,448 million increased \$54 million from December 31, 2015. In the first quarter of 2016, new borrowings of \$616 million were largely offset by debt repayments of \$224 million and the favourable impact of a stronger Canadian dollar of \$335 million, as at March 31, 2016 compared to December 31, 2015, on Air Canada's foreign currency denominated debt (mainly U.S. dollars).

Adjusted net debt amounted to \$6,308 million at March 31, 2016, an increase of \$17 million from December 31, 2015. The impact of higher capitalized operating lease balances, largely driven by additional aircraft leases in the first three months of 2016 and an unfavourable currency impact on aircraft rent expense, was mostly offset by higher cash and short-term investment balances.

At March 31, 2016, the adjusted net debt to EBITDAR ratio was 2.5, unchanged from December 31, 2015.

At March 31, 2016, Air Canada's weighted average cost of capital ("WACC"), on a pre-tax basis, was approximately 9.0% (compared to 11.0% at March 31, 2015). 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 5.25% (compared to an estimated cost of equity of 24.1% and an average cost of debt and finance leases of 5.5% at March 31, 2015).

6.3. Working Capital

The following table provides information on Air Canada's working capital balances as at March 31, 2016 and as at December 31, 2015.

(Canadian dollars in millions)	March 31, 2016	December 31, 2015	\$ Change
Cash, cash equivalents and short-term investments	\$ 2,947	\$ 2,672	\$ 275
Accounts receivable	758	654	104
Other current assets	577	799	(222)
Total current assets	\$ 4,282	\$ 4,125	\$ 157
Accounts payable and accrued liabilities	1,774	1,487	287
Advance ticket sales	2,307	1,818	489
Current portion of long-term debt and finance leases	457	524	(67)
Total current liabilities	\$ 4,538	\$ 3,829	\$ 709
Net working capital	\$ (256)	\$ 296	\$ (552)

The negative net working capital of \$256 million at March 31, 2016 represented a deterioration of \$552 million from December 31, 2015. This deterioration was mainly due to capital expenditures of \$1,116 million (or \$500 million net of the financing drawn upon the delivery of four Boeing 787 aircraft) and the impact of debt repayments of \$224 million partly offset by the cash flow benefit of positive operating results in the first quarter of 2016. As expected, working capital balances increased in the first quarter of 2016 as a result of the seasonal build-up of advance ticket sales and activity levels heading into the second and third quarters of 2016.

6.4. Consolidated Cash Flow Movements

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

(Canadian dollars in millions)	First Quarter		
	2016	2015	\$ Change
Net cash flows from operating activities	\$ 968	\$ 810	\$ 158
Proceeds from borrowings	616	282	334
Reduction of long-term debt and finance lease obligations	(224)	(115)	(109)
Shares purchased for cancellation	(34)	-	(34)
Distributions related to aircraft special purpose leasing entities	(32)	(9)	(23)
Issue of common shares	-	1	(1)
Financing fees	(1)	(15)	14
Net cash flows from financing activities	325	144	181
Short-term investments	36	(151)	187
Additions to property, equipment and intangible assets	(1,116)	(425)	(691)
Proceeds from sale of assets	144	1	143
Other	-	(3)	3
Net cash flows used in investing activities	(936)	(578)	(358)
Effect of exchange rate changes on cash and cash equivalents	(21)	(2)	(19)
Increase in cash and cash equivalents	336	374	(38)

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

(Canadian dollars in millions)	First Quarter		
	2016	2015	\$ Change
Net cash flows from operating activities	\$ 968	\$ 810	\$ 158
Additions to property, equipment and intangible assets	(1,116)	(425)	(691)
Free cash flow ⁽¹⁾	\$ (148)	\$ 385	\$ (533)

(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 reinvesting in Air Canada.

Free cash flow

Net cash flows from operating activities of \$968 million for the first quarter of 2016 reflected strong operating results which improved \$158 million when compared to the same quarter in 2015. This increase in net cash flows from operating activities was mainly due to the impact of higher cash inflows from working capital and the impact of lower pension past service funding payments. The higher cash inflows from working capital was mainly due to the impact of the growth in advance tickets sales. Negative free cash flow of \$148 million for the first quarter of 2016 deteriorated by \$533 million from the first quarter of 2015, due to a higher level of capital expenditures year-over-year, partly offset by the impact of higher cash flows from operating activities.

Net cash flows from financing activities

Proceeds from borrowings amounted to \$616 million in the first quarter of 2016 and reduction of long-term debt and finance lease obligations amounted to \$224 million. Refer to sections 6.1 "Financial Position" and 6.2 "Adjusted Net Debt" of this MD&A for additional information.

6.5. Capital Expenditures and Related Financing ArrangementsBoeing

As at March 31, 2016, Air Canada had outstanding purchase commitments with Boeing for 21 Boeing 787 aircraft and firm orders for 33 Boeing 737 MAX 8 and 28 737 MAX 9 aircraft with substitution rights between them as well as for the 737 MAX 7 aircraft. Additional information on Air Canada's purchase commitments and related financial arrangements is described in section 9.6 of Air Canada's 2015 MD&A.

In February 2016, Air Canada entered into a Letter of Intent with Bombardier Inc. for the acquisition of up to 75 Bombardier CS300 aircraft as part of its narrow-body fleet renewal plan. The Letter of Intent contemplates 45 firm orders plus options to purchase up to an additional 30 aircraft and includes substitution rights to CS100 aircraft in certain circumstances. Deliveries are provided to be scheduled to begin in late 2019 and extend to 2022. The first 25 aircraft on delivery would replace Air Canada's existing mainline fleet of Embraer E190 aircraft, with the incremental aircraft supporting Air Canada's hub and network growth. The C Series purchase is subject to completion of final documentation and satisfaction of certain other conditions. Capital expenditures which would be related to the purchase of Bombardier CS300 aircraft are not included in the table below.

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 March 31, 2016 approximates \$7,387 million.

(Canadian dollars in millions)	Remainder of 2016	2017	2018	2019	2020	Thereafter	Total
Projected committed expenditures	\$ 1,560	\$ 1,892	\$ 1,618	\$ 1,194	\$ 744	\$ 379	\$ 7,387
Projected planned but uncommitted expenditures	161	293	332	313	280	Not available	Not available
Projected planned but uncommitted capitalized maintenance ⁽¹⁾	143	137	137	137	137	Not available	Not available
Total projected expenditures ⁽²⁾	\$ 1,864	\$ 2,322	\$ 2,087	\$ 1,644	\$ 1,161	Not available	Not available

(1) Future capitalized maintenance amounts for 2019 and beyond are not yet determinable however an estimate of \$137 million has been made for 2019 and 2020.

(2) U.S. dollar amounts are converted using the March 31, 2016 closing exchange rate of US\$1 = C\$1.2987. 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 March 31, 2016.

6.6. Pension Funding Obligations

Based on recently finalized actuarial valuations, as at January 1, 2016, the aggregate solvency surplus in Air Canada's domestic registered pension plans was \$1.3 billion. Based on the results of the actuarial valuations, as at January 1, 2016, all Canadian domestic registered pension plans are in a surplus position on both a solvency and going-concern basis. No contributions are required or permitted to any plan for past service. For current service, depending on the level of surplus on a going concern basis, a contribution is either not permitted or is optional (except for one small plan), depending on applicable pension rules. Air Canada does not intend to make current service cost payments for 2016 for all plans for which it is allowed to do so. Taking this into account, on a cash basis, total pension funding contributions for 2016 are forecasted to be \$94 million.

As at March 31, 2016, taking into account the effect of financial instrument risk management tools, approximately 75% of Air Canada's pension liabilities were matched to 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.

For additional information on Air Canada's pension funding obligations, refer to section 9.7 "Pension Funding Obligations" of Air Canada's 2015 MD&A.

6.7. Contractual Obligations

The table below provides Air Canada's contractual obligations as at March 31, 2016, 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 enhanced equipment trust certificate based financing associated with the three Boeing 787-9 and two Boeing 777-300 aircraft, 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
<i>Principal</i>							
Long-term debt obligations	\$ 320	\$ 604	\$ 610	\$ 1,637	\$ 845	\$ 2,228	\$ 6,244
Finance lease obligations	29	41	49	47	50	87	303
Total principal obligations	\$ 349	\$ 645	\$ 659	\$ 1,684	\$ 895	\$ 2,315	\$ 6,547
<i>Interest</i>							
Long-term debt obligations	\$ 224	\$ 296	\$ 249	\$ 219	\$ 113	\$ 220	\$ 1,321
Finance lease obligations	20	23	19	14	10	24	110
Total interest obligations	\$ 244	\$ 319	\$ 268	\$ 233	\$ 123	\$ 244	\$ 1,431
Total long-term debt and finance lease obligations	\$ 593	\$ 964	\$ 927	\$ 1,917	\$ 1,018	\$ 2,559	\$ 7,978
Operating lease obligations	\$ 390	\$ 466	\$ 413	\$ 335	\$ 236	\$ 354	\$ 2,194
Committed capital expenditures	\$ 1,560	\$ 1,892	\$ 1,618	\$ 1,194	\$ 744	\$ 379	\$ 7,387
Total contractual obligations ⁽¹⁾	\$ 2,543	\$ 3,322	\$ 2,958	\$ 3,446	\$ 1,998	\$ 3,292	\$ 17,559
EETC financing related to three Boeing 787-9 and two Boeing 777-300ER aircraft (principal and interest)	\$ 642	\$ 1,032	\$ 994	\$ 1,982	\$ 1,081	\$ 3,175	\$ 8,906
Total obligations, including the impact of the EETC financing related to three Boeing 787-9 and two Boeing 777-300ER aircraft	\$ 3,185	\$ 4,354	\$ 3,952	\$ 5,428	\$ 3,079	\$ 6,467	\$ 26,465

(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.

6.8. Share Information

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

	March 31, 2016	December 31, 2015
Issued and outstanding shares		
Variable voting shares	96,831,727	98,059,765
Voting shares	181,593,927	184,722,413
Total issued and outstanding shares	278,425,654	282,782,178
Class A variable voting and Class B voting shares potentially issuable		
Stock options	9,869,591	8,735,634
Total shares potentially issuable	9,869,591	8,735,634
Total outstanding and potentially issuable shares	288,295,245	291,517,812

Issuer Bid

In May 2015, 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"). This maximum allotment was completed in the first quarter of 2016, with a total of 10,000,000 Shares purchased and cancelled for aggregate consideration of \$97 million. Of this amount, Air Canada purchased, for cancellation, 4,416,065 Shares at an average cost of \$7.78 per Share for aggregate consideration of \$34 million in the first quarter of 2016. The excess of the cost over the average book value of \$21 million was charged to the deficit.

In March 2016, the Board of Directors of Air Canada approved the purchase for cancellation of up to an additional 5,000,000 Shares as part of and before the expiry of the existing normal course issuer bid on May 28, 2016.

7. QUARTERLY FINANCIAL DATA

The following table summarizes quarterly financial results for Air Canada for the last eight quarters.

(Canadian dollars in millions, except where indicated)	2014			2015				2016
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Passenger	\$ 2,965	\$ 3,476	\$ 2,755	\$ 2,786	\$ 3,082	\$ 3,716	\$ 2,836	\$ 2,864
Cargo	122	128	133	129	123	119	135	116
Other	218	194	216	334	209	188	211	363
Operating revenues	3,305	3,798	3,104	3,249	3,414	4,023	3,182	3,343
Aircraft fuel	835	939	680	592	648	697	527	446
Regional airlines expense								
Aircraft fuel	127	137	111	86	97	95	81	64
Other	451	471	460	466	497	489	468	505
Wages, salaries & benefits	535	549	560	568	568	598	590	608
Airport and navigation fees	186	208	178	185	201	223	193	198
Aircraft maintenance	171	158	187	188	190	192	203	217
Depreciation, amortization and impairment ⁽²⁾	128	142	130	153	177	165	160	182
Sales and distribution costs	143	146	123	154	152	157	145	182
Ground package costs	77	56	74	181	84	63	87	231
Aircraft rent	76	74	76	82	84	89	98	112
Food, beverages and supplies	74	84	70	62	80	91	81	77
Communications and IT	47	49	51	57	52	52	50	67
Special items	(41)	-	30	-	(23)	-	31	-
Other	251	259	268	275	284	297	310	300
Operating expenses	3,060	3,272	2,998	3,049	3,091	3,208	3,024	3,189
Operating income (loss)	245	526	106	200	323	815	158	154
Foreign exchange gain (loss)	40	(71)	(115)	(408)	56	(251)	(159)	50
Interest income	9	11	10	9	12	12	13	10
Interest expense	(81)	(81)	(83)	(90)	(94)	(106)	(112)	(102)
Interest capitalized	10	6	9	9	21	20	20	23
Net financing expense relating to employee benefits	(34)	(34)	(32)	(25)	(25)	(28)	(27)	(18)
Gain (loss) on financial instruments recorded at fair value	36	(31)	9	1	5	(20)	(3)	(10)
Other	(2)	(3)	(4)	(5)	(2)	(5)	(6)	(6)
Total non-operating expense	(22)	(203)	(206)	(509)	(27)	(378)	(274)	(53)
Income taxes	-	-	-	-	-	-	-	-
Net income (loss)	\$ 223	\$ 323	(100)	\$ (309)	\$ 296	\$ 437	\$ (116)	\$ 101
Diluted earnings (loss) per share	\$ 0.75	\$ 1.10	\$ (0.35)	\$ (1.08)	\$ 1.00	\$ 1.48	\$ (0.41)	\$ 0.35
EBITDAR ⁽¹⁾	\$ 456	\$ 749	\$ 319	\$ 442	\$ 591	\$ 1,076	\$ 425	\$ 460
Adjusted net income ⁽²⁾	\$ 139	\$ 457	\$ 67	\$ 122	\$ 250	\$ 734	\$ 116	\$ 85
Adjusted earnings per share – diluted ⁽²⁾	\$ 0.47	\$ 1.55	\$ 0.23	\$ 0.41	\$ 0.85	\$ 2.50	\$ 0.40	\$ 0.30

(1) EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 14 "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 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

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

	2014			2015				2016
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Revenue passenger miles (millions)	15,495	18,565	14,090	14,937	16,845	20,462	15,301	16,092
Available seat miles (millions)	18,413	21,299	17,403	18,335	20,132	23,535	18,869	19,833
Passenger load factor (%)	84.2	87.2	81.0	81.5	83.7	86.9	81.1	81.1
Passenger PRASM (cents)	15.9	16.1	15.6	14.9	15.0	15.5	14.7	14.1
CASM (cents)	16.6	15.4	17.2	16.6	15.4	13.6	16.0	16.1
Adjusted CASM (cents) ⁽¹⁾	11.2	10.1	12.1	11.9	11.3	10.0	12.2	12.3
Economic fuel price per litre (cents) ⁽²⁾	91.6	90.0	80.7	66.3	66.9	61.4	58.6	48.1

(1) *Adjusted CASM is a non-GAAP financial measure. Refer to section 14 "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 4 "Results of Operations" of this MD&A for additional information.*

8. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Air Canada's financial instruments and risk management practices are summarized in section 12 of Air Canada's 2015 MD&A. There have been no material changes to Air Canada's financial instruments and risk management practices from what was disclosed at that time. Additional information on Air Canada's risk management practices and financial instruments is discussed in Note 8 of Air Canada's first quarter 2016 interim unaudited condensed consolidated financial statements.

9. ACCOUNTING POLICIES

Air Canada's accounting policies are as disclosed in Air Canada's audited consolidated financial statements and notes for 2015. There have been no material changes to Air Canada's accounting policies from what was disclosed at that time.

10. OFF-BALANCE SHEET ARRANGEMENTS

Information on Air Canada's off-balance sheet arrangements is disclosed in section 15 "Off-Balance Sheet Arrangements" of Air Canada's 2015 MD&A. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

11. RELATED PARTY TRANSACTIONS

At March 31, 2016, 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.

12. RISK FACTORS

For a detailed description of risk factors associated with Air Canada and its business, refer to section 17 "Risk Factors" of Air Canada's 2015 MD&A. Air Canada is not aware of any significant changes to its risk factors from those disclosed at that time.

13. 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.

In the Corporation's 2015 filings, the Corporation's CEO and CFO certified, 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.

In the Corporation's first quarter 2016 filings, the Corporation's CEO and CFO certified, as required by National Instrument 52-109, the appropriateness of the financial disclosure, 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 interim unaudited condensed consolidated financial statements and notes, and the Corporation's Board of Directors approved these documents prior to their release.

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 March 31, 2016 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

14. 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:

(Canadian dollars in millions)	First Quarter		
	2016	2015	\$ Change
Operating income – GAAP	\$ 154	\$ 200	\$ (46)
Add back (as reflected on Air Canada's consolidated statement of operations):			
Depreciation, amortization and impairment	182	153	29
Aircraft rent	112	82	30
Add back (included in Regional airlines expense):			
Depreciation, amortization and impairment	5	4	1
Aircraft rent	7	3	4
EBITDAR	\$ 460	\$ 442	\$ 18

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)	First Quarter		
	2016	2015	\$ Change
Operating expense – GAAP	\$ 3,189	\$ 3,049	\$ 140
Adjusted for:			
Aircraft fuel expense (as reflected on Air Canada's consolidated statement of operations)	(446)	(592)	146
Aircraft fuel expense (included in Regional airlines expense)	(64)	(86)	22
Ground package costs at Air Canada Vacations	(231)	(181)	(50)
Operating expense, adjusted for the above-noted items	\$ 2,448	\$ 2,190	\$ 258
ASMs (millions)	19,833	18,335	8.2
Adjusted CASM (cents)	¢ 12.34	¢ 11.94	3.3%

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 derivatives and other financial instruments recorded at fair value 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 its return on invested capital which is 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)	First Quarter		
	2016	2015	\$ Change
Net income (loss) attributable to shareholders of Air Canada	\$ 101	\$ (310)	\$ 411
Adjusted for:			
Foreign exchange (gain) loss	(50)	408	(458)
Special interest charge related to the prepayment of debt associated with the disposal of Embraer 190 aircraft	6	-	6
Net financing expense relating to employee benefits	18	25	(7)
Loss (gain) on financial instruments recorded at fair value	10	(1)	11
Adjusted net income	\$ 85	\$ 122	\$ (37)
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	287	294	(7)
Adjusted earnings per share – diluted	\$ 0.30	\$ 0.41	\$ (0.11)

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

(in millions)	First Quarter	
	2016	2015
Weighted average number of shares outstanding – basic	282	287
Effect of dilution	5	7
add back anti-dilutive impact	-	-
Weighted average number of shares outstanding – diluted	287	294

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.

	Twelve Months Ended		
	March 31, 2016	March 31, 2015	\$ Change
(Canadian dollars in millions, except where indicated)			
Net income for the period attributable to shareholders of Air Canada	\$ 714	\$ 132	\$ 582
Remove:			
Special items ⁽¹⁾	8	(11)	19
Impairment charges	14	-	14
Foreign exchange loss	304	554	(250)
Special interest charge related to the prepayment of debt associated with the disposal of Embraer 190 aircraft	19	-	19
Net financing expense relating to employee benefits	98	125	(27)
Loss (gain) on financial instruments recorded at fair value	28	(15)	43
Adjusted net income	\$ 1,185	\$ 785	\$ 400
Adjusted for:			
Interest expense ⁽²⁾	395	335	60
Implicit interest on operating leases ⁽³⁾	196	156	40
Adjusted income before interest	\$ 1,776	\$ 1,276	\$ 500
Invested capital:			
Working capital excluding current portion of long-term debt and finance leases	331	344	(13)
Long-term assets, excluding pension assets	8,130	6,905	1,225
Maintenance provisions	(836)	(771)	(65)
Other operating long-term liabilities	(223)	(292)	69
Capitalized operating leases ⁽⁴⁾	2,807	2,233	574
Invested capital	\$ 10,209	\$ 8,419	\$ 1,790
Return on invested capital (%)	17.4%	15.2%	2.2 pp

(1) Special items for 2015 included one-time payments totaling \$62 million related to Air Canada's contract on collective agreement terms with CUPE and the IAMAW; a \$30 million recovery related to cargo investigations for a fine that was paid and recovered; and favourable tax-related provision adjustments of \$23 million. Special items for 2014 included one-time payments totaling \$30 million related to Air Canada's contract on collective agreement terms with ACPA; and favourable tax-related provision adjustments of \$41 million.

(2) Interest expense excludes the special interest expense charge related to the disposal of Embraer 190 aircraft.

(3) 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.

(4) Capitalized operating leases are calculated by multiplying the trailing 12 months of aircraft rent by 7. Aircraft rent totaled \$401 million for the 12 months ended March 31, 2016 and \$319 million for the 12 months ended March 31, 2015 (includes aircraft rent related to regional operations).

15. GLOSSARY

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 14 "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 derivatives and other financial instruments recorded at fair value and special items. Refer to section 14 "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.

CASM – Refers to operating expense per ASM.

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 14 "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.

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 14 "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.

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 fuller understanding of the Corporation's financial performance.

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).