







AIR CANADA 🏶





ANNUAL REPORT 2014

1. HIGHLIGHTS

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

CANADIAN DOLLARS IN MILLIONS,	FC	URTH QUAF	RTER		FULL YEAR	
EXCEPT WHERE INDICATED	2014	2013	\$ Change	2014	2013	\$ Change
FINANCIAL PERFORMANCE METRICS						
Operating revenues	3,104	2,894	210	13,272	12,382	890
Operating income	106	135	(29)	815	619	196
Non-operating expense (1)	(206)	(141)	(65)	(710)	(617)	(93)
Net income (loss)	(100)	(6)	(94)	105	10	95
Adjusted net income (2)	67	3	64	531	340	191
Operating margin, excluding the impact of benefit plan amendments $\%^{ (3)}$	3.4%	1.8%	1.6 рр	6.1%	4.3%	1.8 рр
Operating margin %	3.4%	4.7%	(1.3) pp	6.1%	5.0%	1.1 рр
EBITDAR, excluding the impact of benefit plan amendments (3)(4)	319	277	42	1,671	1,433	238
EBITDAR (4)	319	359	(40)	1,671	1,515	156
EBITDAR margin, excluding the impact of benefit plan amendments % (3)(4)	10.3%	9.6%	0.7 рр	12.6%	11.6%	1.0 рр
EBITDAR margin % (4)	10.3%	12.4%	(2.1) pp	12.6%	12.2%	0.4 pp
Unrestricted liquidity (5)	2,685	2,364	321	2,685	2,364	321
Free cash flow ⁽⁶⁾	(366)	(276)	(90)	(560)	(231)	(329)
Adjusted net debt ⁽⁷⁾	5,132	4,351	781	5,132	4,351	781
Return on invested capital ("ROIC") % $^{(8)}$	12.1%	10.5%	1.6 рр	12.1%	10.5%	1.6 рр
Net income (loss) per share – diluted	\$ (0.35)	\$ (0.02)	\$ (0.33)	\$ 0.34	\$ 0.02	\$ 0.32
Adjusted net income per share – diluted (2)	\$ 0.23	\$ 0.01	\$ 0.22	\$ 1.81	\$ 1.20	\$ 0.61
OPERATING STATISTICS (9)			% Change			% Change
Revenue passenger miles (millions) ("RPM")	14,090	12,883	9.4	61,616	56,791	8.5
Available seat miles (millions) ("ASM")	17,403	16,033	8.5	73,889	68,573	7.8
Passenger load factor %	81.0%	80.3%	0.6 рр	83.4%	82.8%	0.6 рр
Passenger revenue per RPM ("Yield") (cents)	19.2	19.6	(1.9)	18.9	19.1	(1.3)
Passenger revenue per ASM ("PRASM") (cents)	15.6	15.7	(1.2)	15.8	15.9	(0.6)
Operating revenue per ASM (cents)	17.8	18.1	(1.2)	18.0	18.1	(0.5)
Operating expense per ASM ("CASM"), excluding the impact of benefit plan amendments (cents)	17.2	17.7	(2.8)	16.9	17.3	(2.4)
Adjusted CASM (cents) (10)	12.1	12.1	-	11.3	11.6	(2.6)
Average number of full-time equivalent ("FTE") employees (thousands) (11)	24.1	24.2	(0.3)	24.4	24.5	(0.4)
Aircraft in operating fleet at period-end	364	352	3.4	364	352	3.4
Average fleet utilization (hours per day)	9.2	9.4	(1.4)	9.9	10.0	(0.9)
Seats dispatched (thousands)	11,948	11,246	6.2	49,351	46,832	5.4
Aircraft frequencies (thousands)	135	131	2.9	555	548	1.3
Average stage length (miles) (12)	1,457	1,426	2.2	1,497	1,464	2.3
Economic fuel cost per litre (cents) (13)	80.7	88.4	(8.7)	89.3	89.0	0.3
Fuel litres (millions)	992	943	5.2	4,213	3,993	5.5
Revenue passengers carried (thousands) (14)	9,189	8,499	8.1	38,526	35,761	7.7

- In the third quarter of 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
- Adjusted net income (loss) and adjusted net income (loss) per share diluted are non-GAAP financial measures. Refer to section 20 "Non-GAAP Financial Measures" of Air Canada's 2014 MD&A for additional information.

 In the fourth quarter of 2013, Air Canada recorded an operating expense reduction of

- In the fourth quarter of 2013, Air Canada recorded an operating expense reduction of \$82 million related to amendments to defined benefit pension plans. EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of Air Canada's 2014 MD&A for additional information. 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, 2014, unrestricted liquidity was comprised of cash and short-term investments of \$2,275 million and undrawn lines of credit of \$410 million. At December 31, 2013, unrestricted liquidity was comprised of cash and short-term investments of \$2,208 million and undrawn lines of credit of \$156 million. Free cash flow (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 Air Canada's 2014 MD&A for additional information.
- Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is a non-GAAP financial measure. Refer to section 9.3 "Adjusted Net Debt" of Air Canada's 2014 MD&A for additional information. Return on invested capital ("ROIC") is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of Air Canada's 2014 MD&A for additional information.
- Operating statistics (except for average number of FTE employees) 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.

 10 Adjusted CASM is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of Air Canada's 2014 MD&A for additional information.

 11 Reflects FTE employees at Air Canada. Excludes FTE employees at third party carriers (ACM).
- (such as Jazz and Sky Regional) operating under capacity purchase agreements with
- Consequence of seats dispatched.

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

 13 Includes fuel handling expenses. Economic fuel price per litre is a non-GAAP financial measure. Refer to sections 6 and 7 "Results of Operations" of Air Canada's 2014 MD&A for additional information.
- 14 Revenue passengers are counted on a flight number basis which is consistent with the IATA definition of revenue passengers carried.



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MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

2014 was a breakout year for Air Canada, where the Corporation showed what we are truly capable of. Record sales. Record EBITDAR. Record Adjusted Net Profit. Record number of passengers carried. Record load factor. Best airline in North America for the fifth year in a row.

Adjusted net income of \$531 million (\$1.81 per diluted share) exceeded the previous year's record by \$191 million (\$0.61 per diluted share) or by 56.2 per cent. On a GAAP basis, annual net income was \$105 million (\$0.34 per diluted share), up from \$10 million (\$0.02 cents per diluted share) in the prior period. EBITDAR was \$1.67 billion, an improvement of 16.6 per cent over 2013 excluding the impact of benefit plan amendments.

These results were achieved thanks to everyone in the organization working together to both effectively increase revenues and take bold action to reduce costs. We achieved an operating margin of 6.1 per cent in 2014, up 1.8 percentage points from the previous year, excluding the impact of benefit plan amendments.

I am extremely pleased to see Air Canada execute on our margin enhancement strategies and build a sustainably profitable enterprise. Return on invested capital at year end was 12.1 per cent, versus 10.5 per cent a year earlier. This puts us squarely within our stated target of a sustainable ROIC of 10-to-13 per cent by 2015.

Operating revenue grew for the sixth consecutive year to reach a record \$13.3 billion, up \$890 million from 2013. All market segments showed an increase, with passenger revenue climbing 7.1 per cent over 2013. As anticipated and planned, passenger yield on a stage length adjusted basis decreased 1.3 per cent, attributable to our strategy of profitably increasing long-haul international flying, particularly in the leisure market using incremental lower cost capacity. Overall, we achieved a 2.6 per cent reduction in adjusted unit costs despite an unfavourable currency impact owing to the much weaker Canadian dollar as compared to the previous year.

Air Canada flew more customers than ever in 2014, with a passenger load factor of 83.4 per cent. We ended the year with nearly \$2.7 billion in liquidity,

well above our target minimum liquidity level of \$1.7 billion. Adjusted net debt grew in 2014 to \$5.1 billion, primarily as a result of the financing of new aircraft purchases; however, our adjusted net debt to trailing 12 month EBITDAR ratio as at year end was 3.1 times, which is well within our objective of maintaining it below 3.5 times.

As for our pension plan exposure, which previously presented a huge challenge to the company given the size of the deficit in prior years, our Canadian plans ended the year with an estimated \$780 million surplus, which dramatically improves our financial flexibility and lowers the airline's overall risk profile.

For our investors, the most significant financial measure is our share price. Our stock price increased 60 per cent in 2014, far in excess of the S&P/TSX Composite's 10.5 per cent total return for the year, and over two years it has returned almost 600 per cent.

Our progress in 2014 was not only financial in nature. We also showed strong operational results as we continued to improve our on-time performance, and seamlessly introduced the Boeing 787 Dreamliner into our fleet. But state-of-the-art aircraft alone cannot secure customer loyalty; loyalty demands superior service, which our frontline employees delivered, as evidenced by our winning the Skytrax Award for Best Airline North America for the fifth consecutive year and we also remain the only Skytrax Four-Star North American network carrier. Our cachet among business travellers in Canada rose even further in 2014, as the Ipsos Reid Canadian Business Traveller Survey found we were the preferred carrier of 83 per cent among this all-important group, an improvement of 14 percentage points in six years.

Safety first and last is our mantra and I am pleased to report that in 2014 Air Canada was awarded a gold medal in Canada's Safest Employers Awards in the transportation category. To be eligible, an employer must not have experienced a fatality or serious injury in the previous five years, nor any occupational health and safety act charges. In another sign of the primacy accorded safety at Air Canada, the company passed its sixth biennial IATA Operational Safety Audit in 2014 with "no findings; three observations". This is our third "zero finding" audit and puts us in the top 2 per cent of the industry.

Our results for 2014 are the culmination of a great deal of hard work and unwavering commitment and determination. However, we are building this company not for one year but for long-term sustainable and profitable growth – and to achieve that long-term success, it requires more than just enthusiasm. It demands a well-thought-out plan that includes carefully selected goals and strategies, which in our case have been established as our four key

corporate priorities. It also requires consistency, focus and communication of those priorities for maximum effectiveness.

The first of these priorities is Revenue Enhancement and Cost Transformation, which entails both lowering costs and enhancing revenue. A major driver of this priority in 2014 was the introduction of our new Boeing 787s with lower operating costs than the aircraft they replace. We are also reconfiguring the cabins of current wide-body aircraft to reduce unit operating costs through greater seating density while at the same time introducing a new Premium Economy cabin across the wide-body fleet beginning in 2015.

In addition, our lower-cost Air Canada rouge® leisure carrier achieved a critical mass of 28 aircraft by the end of 2014 as we expanded its network during the year – including the announcement that it will serve select domestic leisure markets in 2015.

We remain focused on ancillary revenue generation through retail and other à la carte services, such as those related to ticket changes, baggage, seat selection, upgrades and preferred seating. This includes a number of onboard initiatives such as food services, duty free shopping, in-flight entertainment and onboard Wi-Fi, which we began to roll out across the narrow-body fleet during 2014. Moreover, the airline is generating other revenue from its tripartite credit card agreements and loyalty partnerships. During the year, ancillary revenue per passenger increased 10 per cent over 2013, with an 18 per cent per passenger jump in the fourth quarter alone, largely attributable to an adjustment to the airline's baggage fee policy in late 2014.

We determined several years ago that accessing global traffic flows would offer a very strong opportunity for meaningful profitable growth, which in turn leads to our second priority of International Expansion. Capturing international connecting traffic and channelling it through our major hubs is central to this strategy and our early success is witnessed by a 23 per cent increase in such traffic during the year.

The ongoing expansion of our international network in 2014 saw the introduction of mainline service to Milan, Tokyo-Haneda, Rio de Janeiro and Panama City as well as new Air Canada rouge service to Nice, Lisbon and Manchester. We also announced new mainline services commencing in 2015 to Amsterdam, Dubai and Delhi and, on Air Canada rouge, to Osaka. We augmented these new destinations with such schedule enhancements as additional routings, increased frequencies and equipment upgauges to certain existing destinations.

On the alliances front, we continue to work with our Star Alliance and A++ Trans-Atlantic Joint Venture partners which, together with numerous codeshare partnerships, provide a vital extension to our network. For example, while Air Canada directly serves about 185 destinations, through Star Alliance, customers can reach more than 1,300 airports worldwide. In 2014, Air Canada signed a memorandum of understanding with Air China for a comprehensive revenue sharing joint venture and enhanced partnership on routes between Canada and China, subject to appropriate government approvals.

While our extensive global network is attractive, that alone is insufficient to increase customer loyalty in our highly competitive industry. This is why we have also made Customer Engagement a core priority, with special emphasis on higher-yield business and premium passengers.

We are proud of our various customer service awards in this regard, as we continue to invest not only in new aircraft and in aircraft reconfigurations, but also in other aspects of our product at airports and elsewhere. In 2014, we opened a new Maple Leaf Lounge – our 21st such lounge – at Heathrow's new Terminal 2 building. Elsewhere, we developed enhanced airport self-service tools, introduced a simplified zonal boarding process and qualified for the TSA's pre-check program to expedite security screening at U.S. airports, the first foreign carrier to do so. In 2014, we also formalized a Customer Service Council consisting of senior executives with a mandate that includes ensuring frontline policies and procedures are customer-centric.

In addition to their comfort, customers also put a premium on their time; thus it is vital that airlines maintain their schedules. In 2014, Air Canada opened a new \$60 million Operations Centre in Toronto that brought together under a single roof operational oversight with customer care and other functions. This has contributed to a smoother running of the airline and, in 2014, Air Canada was ranked among the top five North America airlines in the FlightStats 2014 Airline On-time Performance Service Awards.

Delivering superior customer service requires motivated employees, therefore we have made Culture Change another central priority. One effective way of advancing it is to ensure employees have the tools and training to do their jobs, which is why Air Canada implemented a number of customer training initiatives with plans for more in 2015. More broadly, Air Canada continues to foster positive culture change by promoting entrepreneurship, engagement, empowerment and pay for performance. I was extremely pleased to see a well-deserved \$15 million increase to \$46 million for our 2014 employee profit-sharing pool.

Employee surveys conducted in 2010 and again in 2014 demonstrated significant improvements in employee engagement over the four-year period. One of the most tangible signs of a positive shift in culture occurring at Air Canada was a landmark 10-year agreement reached with the Air Canada Pilots Association. It provides us with the stability to confidently invest further in aircraft, technology, product and new destinations – effectively supporting all corporate priorities.

In summary, 2014 was a remarkable year for our company that provided a clear perspective as to what Air Canada can achieve as it continues to focus on profitable growth. Yet, apart from a stronger airline, we are also building one that will be increasingly nimble and responsive over the long-term.

I thank our 27,000 employees who demonstrate their commitment and professionalism every day transporting our customers safely and in comfort to their destinations. Also, I thank our customers, shareholders and other partners for their unfailing support and loyalty on our common journey.

Calin Rovinescu

President and Chief Executive Officer

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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 fourth quarter and the full year 2014. This MD&A should be read in conjunction with Air Canada's audited consolidated financial statements and notes for 2014. 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 21 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of February 10, 2015. Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in 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 18 "Risk Factors" of this MD&A. Air Canada issued a news release dated February 11, 2015 reporting on its results for the fourth quarter and the full year 2014. 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, industry, market, credit and economic conditions, the ability to reduce operating costs and secure financing, energy prices, currency exchange and interest rates, competition, employee and labour relations, pension issues, war, terrorist acts, epidemic diseases, environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), insurance issues and costs, changes in demand due to the seasonal nature of the business, supply issues, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in section 18 "Risk Factors" of this MD&A. The forward-looking statements contained in this MD&A represent Air Canada's expectations as of February 10, 2015 (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 Canadian GDP growth of 1.75% to 2.25% for 2015. In addition, Air Canada expects that the Canadian dollar will trade, on average, at C\$1.25 per U.S. dollar in the first quarter of 2015 and for the full year 2015 and that the price of jet fuel will average 66 cents per litre for the first quarter of 2015 and 67 cents per litre for the full year 2015.



3. 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 2014, Air Canada, together with Jazz and other regional airlines operating flights on behalf of Air Canada under capacity purchase agreements, operated, on average, 1,519 daily scheduled flights to 186 direct destinations on five continents, comprised of 61 Canadian cities, 50 destinations in the United States and a total of 75 cities in Europe, the Middle East, Asia, Australia, the Caribbean, Mexico and South America. Domestic, U.S. transborder and international departures accounted for approximately 67%, 25% and 8%, respectively, of the 1,519 average daily departures. In 2014, Air Canada carried over 38.5 million passengers.

At December 31, 2014, Air Canada operated a mainline fleet of 172 aircraft, comprised of 69 Airbus narrow-body aircraft, 58 Boeing and Airbus wide-body aircraft and 45 Embraer 190 regional jets, while Air Canada rouge operated a fleet of 28 aircraft, comprised of 20 Airbus A319 aircraft and eight Boeing 767-300 aircraft, for a total fleet of 200 aircraft.

Air Canada's wide-body fleet is an important element of its strategy to develop its network internationally and further strengthen its position as a global player. In 2014, Air Canada took delivery of six of 37 Boeing 787 aircraft on order. 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 existing Boeing 767 mainline routes in a more efficient manner. In the last year, Air Canada also expanded its mainline wide-body fleet by adding five high-density Boeing 777-300ER aircraft, with an additional two such aircraft scheduled for delivery in 2016. These aircraft are being deployed on select routes where there is high demand for economy travel.

In order to improve the airline's profitability and competitive position in the expanding 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 competitive cost structure. Air Canada Vacations is a leading Canadian tour operator. Based in Montreal and Toronto, Air Canada Vacations operates its business in the outbound leisure travel market (Caribbean, Mexico, U.S., Europe, Central and South America, South Pacific, Australia and Asia) by developing, marketing and distributing vacation travel packages. Air Canada Vacations also offers 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 mainline and rouge routes. At December 31, 2014, the Air Canada Express fleet was comprised of 46 Bombardier regional jets, 86 Bombardier Dash-8 turboprop aircraft, 15 Embraer 175 regional jets and 17 Beech 1900 aircraft. As part of Air Canada's continued focus on cost reduction, on February 2, 2015, Air Canada and Jazz Aviation LP ("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. The agreement extends the Jazz CPA by five years to December 31, 2025.

Air Canada is a founding member of the Star Alliance® network. Through Star Alliance® network's 27 member airlines, Air Canada is able to offer its customers access to approximately 1,321 destinations in 193 countries, as well as reciprocal participation in frequent flyer programs and use of airport lounges and other common airport facilities.

Air Canada participates in a transatlantic joint venture with United Airlines and Deutsche Lufthansa AG through which the carriers provide customers with more choice and streamlined service on routings between North and Central America, and Africa, India, Europe and the Middle East. This transatlantic joint venture, including its revenue sharing structure, was implemented effective January 1, 2010. Furthermore, in the fourth quarter of 2014, Air Canada concluded a memorandum of understanding with Air China which sets out the main principles for a comprehensive revenue sharing joint venture providing for an enhanced partnership on routes between Canada and China which will stimulate traffic growth between the

two countries. Subject to Air Canada and Air China making the necessary filings, obtaining competition and other regulatory approvals and finalizing documentation, the joint venture is expected to come into effect by the end of 2015. The airline also has the ability to create a transborder joint venture with United Airlines.

Through its long-term relationship with Aimia Canada Inc. (formerly Aeroplan Canada Inc. and referred to as "Aeroplan" in this MD&A), 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 26 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 on routes between Canada and major markets in Europe, Asia, South America and Australia.

4. STRATEGY

Air Canada's goal is to fully develop as a leading global airline, to be among those with the highest levels of customer experience, employee engagement and value creation for shareholders and other stakeholders. This is being pursued through the following four key strategies:

- Continually identifying and implementing cost reduction and revenue generating initiatives
- Expanding internationally and increasing connecting traffic through international gateways, on a sustainable and profitable basis, and competing effectively in the leisure market to and from Canada
- Engaging customers by continually enhancing the travel experience and providing a consistently high level of customer experience, with additional emphasis on premium and business passengers and products
- Fostering positive culture change through employee engagement programs designed to promote an understanding of how the airline and its employees can work together to deliver on the customer promise and investing in the tools and training required to provide a culture of 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. Over the last several years, Air Canada has taken significant actions to reduce costs and generate incremental revenue.

Key achievements in 2014

- Reduced adjusted CASM by 2.6% when compared to 2013
- Increased ancillary revenue per passenger by 10% from 2013
- Continued to successfully expand Air Canada rouge, the airline's lower-cost leisure carrier
- Introduced six Boeing 787 aircraft into the mainline fleet, allowing Air Canada to operate existing Boeing 767 routes in a more cost-efficient manner and permitting the airline to pursue new, profitable international growth opportunities
- Took delivery of one high-density
 Boeing 777-300ER aircraft, for a total of five of
 these aircraft in the mainline fleet. These aircraft
 are primarily being deployed to lower-yielding,
 high-volume markets

- Exercised purchase rights for two additional Boeing 777-300ER aircraft to be delivered, in the second quarter of 2016, in the lower-cost, high-density configuration
- Announced plans to reconfigure 12
 Boeing 777-300ER and six 777-200LR aircraft
 in the mainline fleet into the three-cabin
 international product and Boeing 787 seating
 standard and to harmonize the interior of the
 five higher-density Boeing 777-300 aircraft in
 the mainline fleet to Boeing 787 standards
- Aligned Air Canada's first checked bag policy for North American travel with prevailing North American industry practice
- Aligned the airline's operations to industry standards to allow for a ratio of one flight attendant for every 50 passenger seats on its narrow-body aircraft, with expected annual savings of \$28 million

Ongoing Initiatives

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

AIR CANADA ROUGE

The continued strategic expansion of Air Canada rouge in conjunction with Air Canada's mainline fleet expansion is a key driver of the airline's strategy for sustainable, profitable growth. Air Canada rouge's lower and more competitive cost structure has effectively delivered enhanced margins on leisure routes previously operated by Air Canada and provides new opportunities for profitable growth in international leisure markets. To date, Air Canada rouge has exceeded management expectations. Since its first flight in July 2013, Air Canada rouge has been deployed to a growing number of Caribbean destinations and select leisure destinations in the United States, as well as in international leisure markets where demand is highly elastic and responds positively to lowerpriced, non-stop capacity. In 2015, Air Canada also plans on deploying Air Canada rouge in certain domestic markets that have high volumes of leisure traffic. Air Canada rouge believes that its ability to leverage the strengths of Air Canada, including its extensive network with enhanced connection options, operational expertise and frequent flyer program, is a competitive advantage, generating additional

customer benefits vis-à-vis its competitors in the leisure markets.

Air Canada rouge operates under the principle of maintaining a long-term cost structure consistent with that of its competitors in the leisure market. Air Canada has effectively lowered its CASM on leisure routes through increased seat density, lower wage rates, more efficient work rules, and reduced overhead costs. Air Canada rouge launched its operations in 2013 with four aircraft and by the end of 2014 its fleet grew to 28 aircraft (20 Airbus A319 and eight Boeing 767 aircraft). Six Boeing 767-300 aircraft (four of which will be transferred from the mainline fleet and two of which will be leased from third parties) and two Airbus A321 aircraft (which will be leased from third parties) will be added to the Air Canada rouge fleet during 2015 for a planned fleet of 36 aircraft by the end of 2015. Air Canada continues to seek additional opportunities to accelerate the growth of the Air Canada rouge fleet in order to further expand margins.

The 2014 collective agreement concluded with the Air Canada Pilots Association ("ACPA"), the union representing Air Canada's pilots, further facilitates rouge's evolution with improved fleet flexibility and terms. While the maximum number of aircraft Air Canada rouge may operate remains at 50, Air Canada rouge's fleet may now have up to 25 wide-body aircraft (previously 20) and 25 Airbus narrow-body aircraft (previously 30).

CONTINUED INTRODUCTION OF FUEL-EFFICIENT BOEING 787 AIRCRAFT

Air Canada is generating fuel and maintenance cost savings with the arrival of its first seven Boeing 787-8 Dreamliners (six aircraft in 2014 and an additional aircraft in January 2015). Air Canada plans to take delivery of an additional 30 Boeing 787 aircraft by the end of 2019, comprised of eight Boeing 787-8 aircraft and 22 larger capacity Boeing 787-9 aircraft. The Boeing 787 Dreamliner is driving new opportunities for profitable growth at Air Canada. In addition to replacing Boeing 767s on existing mainline routes, these aircraft are also serving new international destinations made viable by its lower operating costs, mid-size capacity and longer range. The approximately 30% greater cargo capacity on the Boeing 787 aircraft when compared to the Boeing 767 aircraft also improves Air Canada's revenue potential.

RECONFIGURATION OF BOEING 777 AND AIRBUS A330-300 AIRCRAFT

In order to improve the economics of its standard configuration Boeing 777 long-haul fleet and to provide customers with a product consistent with its new Boeing 787 Dreamliners, the airline plans to convert 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 stateof-the-art standard. The capital expenditure related to this program is approximately \$300 million with a projected payback period of less than three years. Air Canada also plans to reconfigure its fleet of eight Airbus A330-300 aircraft to lower unit costs, allow the airline to compete more effectively, offer customers the option of its new Premium Economy cabin and to deliver a harmonized product offering across its flagship international fleet. Conversion of these Boeing 777 and Airbus A330 aircraft is scheduled from late 2015 to the second half of 2016.

NARROW-BODY FLEET RENEWAL PROGRAM

In March 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 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 an estimated CASM reduction of approximately 10% as compared to the airline's existing narrow-body fleet. Refer to section 8 "Fleet" of this MD&A for additional information.

REGIONAL AIRLINE DIVERSIFICATION

Over the last several years, Air Canada has also focused on lowering its regional costs. The 2014 agreement concluded with ACPA provides increased flexibility in the airline's relationships with regional airlines and Air Canada may also replace Bombardier CRJ-100/200 and Bombardier Dash 8-100/300 aircraft with Bombardier Dash 8-Q400 aircraft under certain conditions. Furthermore, the airline has diversified its regional operations across multiple regional partners. For example, in 2013, Air Canada transferred



all of its 15 Embraer 175 aircraft from the mainline fleet to Sky Regional which operates these aircraft on behalf of Air Canada at a much lower-cost. In addition, since 2014, Air Georgian, also a lower-cost regional provider, operates a number of regional routes on Air Canada's behalf using Bombardier CRJ-100 and Beechcraft 1900. In 2015, Air Canada plans to continue to seek opportunities to further reduce regional costs and optimize its regional fleet deployment.

On February 2, 2015, Air Canada announced that it had concluded an amended and extended capacity purchase agreement with Jazz, a wholly owned subsidiary of Chorus Aviation Inc. The agreement provides both parties with greater stability and significant cost reductions through a better alignment of their interests. The agreement also provides for long-term stability by eliminating the risks, uncertainties and set-up costs of a potential transition to alternative regional providers in 2021. Post-2020, Air Canada expects Jazz will provide competitive costs and continued high service levels.

The highlights of the new capacity purchase agreement include:

- Extension of the term by five years to December 31, 2025
- Establishment of a pilot mobility agreement that provides Jazz pilots with access to pilot vacancies at Air Canada, thus allowing a significant reduction in Jazz operating costs
- Simplification and modernization of the Jazz fleet which will provide improved service and greater efficiency through the addition of 23 Bombardier Dash 8-Q400 aircraft
- Reduction in Air Canada and Jazz costs derived from a combination of improved fleet economics, greater network flexibility and reduced operating and labour costs. This supports Air Canada's cost reduction initiatives
- Modification of Jazz's CPA fee structure, moving from a "cost plus" mark-up to a more industry standard fixed fee compensation structure. This provides a more competitive structure and better aligns the cost reduction goals of both Air Canada and Jazz. This change also eliminates non-value added costs and the necessity of the 2015 benchmarking exercise

OTHER REVENUE OPTIMIZATION AND COST REDUCTION INITIATIVES

Air Canada continues to foster a culture of continuous cost transformation and revenue improvement across the organization. To this end, Air Canada's Business

Transformation team actively pursues its mission to identify and help implement initiatives through productivity enhancements, process reforms and other measures. Initiatives may include revising business and operational processes, including supply chain and maintenance operations, improving employee productivity and asset utilization, consolidating call centres and promoting workplace policies to drive revenue and reduce costs. The airline is also implementing a continuous improvement program at airports which will also optimize supplier arrangements and reduce aircraft turnaround times. Lowering distribution costs, including through the renegotiation of global distribution system ("GDS") and other agreements, is another key initiative aimed at increasing margins.

In the area of yield management, Air Canada is implementing a new passenger revenue management system to optimize its revenue performance on the basis of a passenger's full trip itinerary rather than on individual flight legs. Given the number of connecting passengers Air Canada serves, this new system will allow the airline to better optimize passenger flows across the network. Air Canada estimates that this initiative, which will be implemented in the second quarter of 2015, will drive incremental annual revenues in excess of \$100 million.

Air Canada is also increasing its ancillary revenues through onboard retail and other à la carte services, such as those related to ticket changes, baggage, seat selection, upgrades, preferred seating, as well as onboard offerings, including food, duty free shopping, in-flight entertainment and onboard Wi-Fi.

The airline is also generating revenues from its tripartite credit card agreements and loyalty partnerships. New and renewed financial card partnerships in conjunction with Aeroplan help bolster overall ancillary revenues and enhance cardholders' travel experience by providing complimentary travel benefits, such as first checked baggage, priority checkin and certain access to Maple Leaf Lounges. These Aeroplan co-brand financial card partner agreements included the introduction of TD co-branded cards as well as the renewal of the American Express and CIBC card partnerships.

To better monetize its ancillary offerings and increase related revenues, in August 2014, Air Canada introduced a new merchandising tool to help customize, differentiate and combine its offerings. This new tool also provides the airline with the ability to more quickly introduce new products.

In 2014, Air Canada's ancillary revenue per passenger increased 10% when compared to 2013.

PENSION

In December 2013, the Government of Canada formally approved the Air Canada Pension Plan Funding Regulations, 2014 (the "2014 Regulations").

Air Canada maintains several pension plans, including defined benefit and defined contribution pension plans and plans providing other retirement and post-employment benefits to its employees. As at January 1, 2014, the aggregate solvency surplus in the domestic registered pension plans was \$89 million. The next required valuations to be made as at January 1, 2015, will be completed in the first half of 2015 but, as described in section 9.7 "Pension Funding Obligations" of this MD&A, they will not impact the 2015 pension past service cost funding obligations unless Air Canada opts out of the 2014 Regulations (described below), deciding instead to fund its domestic registered pension plans pursuant to normal funding rules. Based on preliminary estimates, including actuarial assumptions, as at January 1, 2015, the aggregate solvency surplus in Air Canada's domestic registered pension plans is projected to be \$780 million.

Air Canada is permitted to opt out of the 2014 Regulations and have past service payments in respect of all Air Canada pension plans, collectively, determined in accordance with normal funding rules.

Air Canada would consider opting out of the 2014 Regulations when the annual solvency deficit payments under normal funding rules, which are determined using deficit levels over three years, would be less than \$200 million and when there would be a strong basis for confidence that the airline's de-risking strategy would make a future significant deficit unlikely to re-occur. At December 31, 2014, approximately 72.5% of the pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk.

In the event that Air Canada opts out of the 2014 Regulations, based on the normal funding rules and subject to the finalization of the preliminary estimate of the pension solvency surplus of \$780 million at January 1, 2015, Air Canada's pension solvency payment would be approximately \$90 million in 2015.

For a more detailed discussion on Air Canada's pension and related funding matters, please see section 9.7 "Pension Funding Obligations" of this MD&A.

INTERNATIONAL GROWTH

Air Canada is specifically focused on seeking new international growth opportunities to generate sustainable profit, with approximately 90% of Air Canada's planned growth in 2015 targeted to such initiatives. Air Canada now has at its disposal more cost-efficient aircraft, improved tools and processes and other competitive attributes to profitably pursue new international route opportunities. Air Canada also has access to Canada's wide portfolio of international routes 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 Air Canada to leverage its network and benefit from the higher margins generally available in international markets. The airline will also continue to leverage its world-class hub at Toronto Lester B. Pearson International Airport ("Toronto Pearson") and other Canadian hubs with the objective of increasing global connecting traffic via Canada.

Key achievements in 2014

- Introduced mainline service from Toronto Pearson to Milan and Tokyo-Haneda
- Introduced non-stop mainline service between Toronto Pearson and Rio de Janeiro, reinforcing Air Canada's market-leading position as the only carrier flying non-stop between Canada and South America
- Introduced non-stop mainline service from Toronto Pearson to Panama City, making it the only Canadian network carrier operating between Canada and Panama
- Introduced Air Canada rouge service from Montreal to Nice, Toronto Pearson to Lisbon and Toronto Pearson to Manchester
- Converted the airline's routes from Vancouver to Shanghai and Vancouver to Toyko-Narita to 787 Dreamliner service
- Introduced a series of new codeshare routes with Air India to improve air travel connectivity between Canada and India
- Concluded a memorandum of understanding with Air China which remains subject to certain conditions and which sets out the main principles for a comprehensive revenue sharing joint venture
- Increased sixth freedom traffic (international-to-international, including U.S.) connecting at Air Canada major Canadian hubs by 23% from 2013



In 2015, Air Canada plans on continuing to selectively and profitably expand its international services by leveraging its new aircraft, improved cost structure, as well as the following additional competitive advantages:

- A widely recognized brand and a strong position in the market for transatlantic and transpacific travel to and from Canada and to and from 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 transatlantic joint venture with United Airlines and Lufthansa
- A flexible fleet mix with low-cost swing capacity, which helps the airline redeploy or otherwise manage capacity to match changes in demand
- Air Canada Altitude[™], Air Canada's frequent flyer program, which recognizes the airline's most 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, Montreal, 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. to Asia and Europe
- The only non-U.S. carrier to offer TSA Pre-check, allowing eligible customers to experience expedited and more efficient security screening for flights out of the U.S.
- 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

Air Canada is enhancing its 2015 international offerings, including through:

 Year-round Air Canada service between Toronto Pearson and Amsterdam. Flights are scheduled to begin June 4, 2015 and will be operated up to six times weekly

- Double-daily Air Canada service from both Toronto Pearson and Montreal to Paris-Charles de Gaulle. The additional flights will be offered from June to September 2015
- New Air Canada rouge twice-weekly service between Montreal and Venice beginning May 14, 2015 and up to five flights per week between Vancouver and Osaka-Kansai beginning May 1, 2015
- An increase to daily from five times a week on Air Canada rouge service from Toronto Pearson to Athens and Barcelona, and an increase to four times from three weekly on service from Toronto Pearson to Venice. From Montreal, Air Canada rouge service to Athens will double to four-times-weekly and service to Barcelona will increase to three-times-weekly from twice-weekly in summer 2014. Overall, Air Canada rouge service to Athens, Barcelona, Lisbon, Manchester and Nice will operate a longer season during the summer of 2015 compared to the summer 2014
- The transfer from mainline to Air Canada rouge of year-round service between Toronto Pearson and Lima, Peru, beginning May 2, 2015, subject to government approval
- Air Canada four-times-weekly service between
 Toronto Pearson and Delhi, the only non-stop
 flight from Canada to India. This new route, which
 will be inaugurated on November 1, 2015, is the
 first to be dedicated for Air Canada's Boeing 787-9
 series aircraft and will open new opportunities
 in the Indian subcontinent, currently the largest
 international market not served by Air Canada
- Air Canada three-times-weekly service between Toronto Pearson and Dubai, the airline's first nonstop flight to the UAE at a time when air travel between North America and the region is growing. Flights will be operated beginning November 3, 2015 with a Boeing 787-9 aircraft. This new route will increase Air Canada's presence in the Middle East by providing its customers with direct, nonstop access to Dubai, complementing its other services in the region. Air Canada currently serves the region primarily through its transatlantic joint venture with Lufthansa over Frankfurt and Munich. This new route will also build on Air Canada's existing codeshare relationship with Etihad Airways, with whom it codeshares on three flights a week between Toronto Pearson and Abu Dhabi, in the UAE

STAR ALLIANCE MEMBERSHIP, CODESHARE AND JOINT VENTURE AGREEMENTS ENHANCE MARKET PRESENCE

The development of commercial alliances with major international carriers continues to be an important aspect of Air Canada's business strategy. These arrangements provide Air Canada with an effective way to leverage expansion and broaden its network appeal. Air Canada extends its global reach through its membership in Star Alliance® which is comprised of 27 members. The airline also enhances its network 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, Air Canada is better able to serve customers by offering more travel options, while reducing travel times. Air Canada is also achieving greater critical mass and network scope through numerous codeshare and interline agreements. Air Canada codeshares with all Star Alliance members, with the exception of Adria Airways, Copa Airlines, Croatia Airlines, EVA Air, Shenzhen Airlines and Thai Airways. In October 2014, Air Canada and Air India introduced a series of new codeshare routes to improve air travel connectivity between Canada and India.

In November 2014, Air Canada concluded a memorandum of understanding with Air China which sets out the main principles for a comprehensive revenue sharing joint venture between the parties. The agreement provides for an enhanced partnership on routes between Canada and China which will stimulate traffic growth between the two countries. The joint venture will generate additional service and pricing benefits for consumers travelling between the two countries as well as provide for enhanced cooperation between the two carriers in the areas of sales, marketing and airport operations. Subject to Air Canada and Air China making the necessary filings, obtaining competition and other regulatory approvals and finalizing documentation, the joint venture is expected to come into effect by the end of 2015.

INCREASING INTERNATIONAL-TO-INTERNATIONAL TRAFFIC FLOWS THROUGH MAJOR CANADIAN HUBS

Air Canada has made targeted and meaningful progress in increasing international-to-international traffic flows (also known as sixth freedom traffic) through its major Canadian hubs.

In 2015, Air Canada plans to continue to grow this traffic through its world-class hub in Toronto and its strong international gateways in Montreal, Vancouver and Calgary. The airline believes that it has the potential to grow sixth freedom traffic, particularly from the U.S., over the coming years given its award-winning products and services, geographically well-positioned hubs in Canada, extensive network and other competitive advantages.

In 2014, Air Canada increased sixth freedom traffic connecting at Air Canada major Canadian hubs by 23% from 2013. Based on an airline industry benchmark indicating the percentage of traffic from the U.S. to Europe and Asia by non-U.S. carriers, Air Canada's current share is 0.8% (this market share is consistent with Air Canada's previously reported 0.3% share but is now adjusted to include certain GDS and fuel surcharge revenue). Air Canada has determined that its fair share of this international-to-international transit traffic should be 1.5% and has estimated that a successful increase to this level (taking into account the above-referenced GDS and 2014 industry fuel surcharge levels) would drive incremental annual revenues of approximately \$600 million.

For several years, Air Canada has worked closely with the Greater Toronto Airports Authority ("GTAA") to transform Toronto Pearson into a leading North American airport and gain a greater share of the global sixth freedom market. In late 2013, the GTAA and Air Canada concluded an enhanced commercial relationship which is designed to deliver continued improvements to customer service and which has placed Air Canada in a better position to more profitably target a larger share of international traffic flows. Toronto Pearson has a strategic advantage due to its proximity to densely populated major markets in the U.S. and 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 which allow passengers and their bags to move seamlessly between Canada and U.S. Customs and Immigration.



CUSTOMER ENGAGEMENT

Providing a consistently high level of customer experience and growing the airline's premium customer base are important elements of Air Canada's business strategy. Air Canada aims to give travellers every reason to fly Air Canada. The airline recognizes that its continued and growing 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.

In 2014, Air Canada received the following important industry awards which demonstrate 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. Air Canada also continues to be the only international network carrier in North America ranked as a Four-Star airline by Skytrax.

Key achievements in 2014

- "Best Airline in North America" in the Skytrax 2014 World Airline Awards, the fifth consecutive year Air Canada has been recognized as the best airline in North America. The annual poll, based on surveys of nearly 19 million global passengers, is regarded as a key benchmarking tool for product excellence and customer satisfaction by the global airline industry
- "Canada's Favourite Airline for Business Travel" in the 2014 Ipsos Reid Canadian Business Traveller Study. Air Canada was the preferred airline of 83% of Canadian frequent business travellers surveyed for 2014, an improvement of 14 percentage points in Air Canada's ratings in the national survey over the past six years. The survey showed consistently strong ratings in customer preference for Air Canada's frequent flyer reward program, flight schedule, business class service, Maple Leaf Lounges and complimentary in-flight entertainment
- "Best Long Haul Airline (Americas)" by the respected airline safety and product reviewing website, AirlineRatings.com. The results are based on ratings of 450 airlines globally by hundreds of thousands of passengers

IMPROVING THE CUSTOMER EXPERIENCE THROUGH INDUSTRY-LEADING PRODUCTS AND SERVICES

Air Canada recognizes that investing in products and services is vital to engaging customers. The Dreamliner, with its newly designed cabins and next generation IFE, has been enthusiastically received and Air Canada has announced plans to introduce the 787's three-cabin international product and seating standard on all 25 Boeing 777-300ER and 777-200LR aircraft in its mainline fleet. 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[™], Air Canada's frequent flyer program, is designed to enhance the travel experiences of its most frequent flyers. Air Canada continues to optimize its frequent flyer program to reward its most valuable and engaged members and remains committed to offering one of the world's best frequent flyer programs. Air Canada Altitude™ 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. Air Canada 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 2015, the airline will continue to optimize the program constructs in an effort to continue improving the program's value and its capacity to profitably affect member engagement.

Air Canada's program entitled "Air Canada Corporate Rewards" offers powerful online tools to help businesses of all sizes better manage their travel, track and reduce costs and earn rewards to enhance travel while at the same time building loyalty to Air Canada. Members are eligible to receive offers for discounts on Air Canada flights and services along with rewards such as complimentary eUpgrades, Maple Leaf Lounge access, advance seat selection and other exclusive offers.

In 2014, Air Canada expanded its Preferred Seat program with the reconfiguration of the mainline narrow-body fleet. Preferred seats are available on the entire mainline fleet and Air Canada is making 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. The airline began rolling out connectivity across its North American narrow-body fleet in 2014 under an agreement with Gogo® and continues to do so. Air Canada plans to outfit its Airbus A319, A320 and A321 and Embraer 190 aircraft, as well as its Air Canada Express Bombardier CRJ-705 and Embraer 175 aircraft, with Air-To-Ground Wi-Fi connectivity. At December 31, 2014, 31 aircraft were operating with the Wi-Fi system. The targeted completion date for the entire narrow-body fleet, with a designated 131 aircraft, is the first quarter of 2016.

In order to remain competitive within the digital ecosystem, Air Canada plans on enhancing its online presence to provide a responsive design experience for traditional web users, while also meeting the increased demands from its tablet and mobile users. The goal is to ensure that all customers, regardless of device and screen size, can seamlessly interact with Air Canada and access its products and services. A new mobile App is planned for the third quarter of 2015 while the transition to a new web platform is expected to be completed by the end of 2015.

NEW GLOBAL OPERATIONS CENTRE IN TORONTO

Air Canada opened its Global Operations Centre in January 2014. The new facility is the nerve centre for Air Canada's entire operation, ensuring delivery of Air Canada's schedule and the safe transport of Air Canada customers (over 38 million in 2014). Efficiencies have been gained by co-locating all key operational personnel under one roof outfitted with the latest in technological, acoustical and ergonomically sound design elements.

CUSTOMER RELATIONSHIP MANAGEMENT SYSTEM

Air Canada is planning to implement, later in 2015, a customer relationship management system which will allow it to gain valuable customer insights and deliver a more personalized and satisfying customer experience. This new system will also allow Air Canada to more effectively target its product offerings in order to stimulate traffic, increase yields and improve customer loyalty.

CUSTOMER SERVICE TRAINING PROGRAMS

In 2014, Air Canada implemented a number of customer training initiatives, including "Standing Ovation" which is a dedicated customer service training program for the In-Flight Service branch.

Similar training will be expanded for the airline's customer sales and service agents in 2015.

In 2014, the Customer Service Council, which is comprised of leaders of those departments at Air Canada who have a direct impact on the customer experience, was formed with a vision to make Air Canada the global carrier of choice, known for its first-rate Canadian brand of customer service excellence and a mission to ensure Air Canada policies and projects are customer-oriented. The Council has been listening to customers through a number of forums that capture customer feedback and it is making adjustments to policies, procedures and programs as a result, such as those relating to the application of change fees, bereavement fares, military and jury duty travel and name changes for domestic travel. The Customer Service Council has also reached out to those best-placed to report on customer issues – Air Canada's frontline employees. Focus groups have been held with frontline employees across Canada and in the U.S., and the information collected will help remove roadblocks and enable employees to better do their jobs, with greater empowerment and decision-making capabilities.

IMPROVING THE AIRPORT EXPERIENCE

Air Canada has implemented a number of important initiatives to improve the overall customer airport experience. For example, Air Canada is the only non-U.S. carrier to offer TSA pre-check, allowing eligible customers to experience expedited, more efficient security screening for flights out of the U.S. In addition, the airline has recently instituted zonal boarding, aligning its boarding process with industry best practices.

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 in North America where passengers 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, through the new self-service product, has eliminated queuing at the check-in desks. Air Canada plans on introducing this important process improvement in Montreal and Calgary, with other airports to follow.

In June 2014, Air Canada officially opened its latest International Maple Leaf Lounge® at London Heathrow Airport's new Terminal 2. Located at Star Alliance's largest airport hub, Air Canada's newest International Maple Leaf Lounge was created as an extension of the overall travel experience for its International Business customers. Air Canada's London International lounge is



the airline's 21st Maple Leaf Lounge and one of three lounges in Europe, along with departure lounges at Paris-Charles de Gaulle and Frankfurt. In the United States, Air Canada operates Maple Leaf Lounges at Los Angeles International Airport and at New York LaGuardia. In Canada, Air Canada has 15 Maple Leaf Lounges at airports across the country.

In 2015, Air Canada plans on enhancing its airport offerings to ensure it remains competitive with the world's leading carriers. The airline intends on upgrading its airport facilities to create more exclusive check-in areas for Air Canada Altitude members and Business Class customers, in addition to refining its 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 will be opening additional concierge offices at Toronto Pearson, Montreal-Pierre Elliott Trudeau International Airport and Vancouver International Airport. Air Canada has also introduced airside car service for select premium customers at Toronto Pearson.

CULTURE CHANGE

A healthy and dynamic corporate culture bestows a competitive advantage that can have a significant impact on 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, accountability and entrepreneurship. Air Canada continues to foster positive culture change by promoting entrepreneurship, engagement, empowerment and earnings for performance. Air Canada 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. This is reinforced by continual and consistent invocation 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. Most notably, the results suggested that most employees are familiar with Air Canada's key priorities and believe that the airline is on the right track towards stability. Generally, employees observed signs of increased and improved culture change occurring in the workplace and revealed their pride in working for Air Canada. Furthermore, the results indicated employees shared a heightened sense of community and teamwork.

The cross-functional approach of the airline'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 new employee on-boarding experience and integrated management practices, as well as programs intended to nurture Air Canada's leadership behaviours and values.

Air Canada believes that employees are more likely to embrace culture change if they take an active part in the transformation. As such, Air Canada continues to encourage employee feedback and ideas as employees are often in a good position to identify improvements and changes for success. In 2014, Air Canada's HR and Operations Excellence teams partnered to conduct frontline focus groups across the system in order to gather meaningful feedback on numerous customer service improvements.

The airline is equally focused on ensuring that employees have the tools and training required to provide top customer care. Air Canada's customized and adapted language training for frontline employees ensures that customers receive service in their language of choice. In addition, Air Canada also offers specific programs geared towards different employee groups to encourage professional development and growth. Internal networking opportunities and crossbranch projects allow Air Canada to remind employees of its priorities.

Air Canada regularly celebrates its employees and their achievements and will continue to host such employee recognition events going forward. A number of employee events in 2014 were aimed to foster a sense of pride and community, including a "World Skytrax Day", where employees around the world celebrated being named by Skytrax as "Best Airline in North America" for the fifth consecutive year, Boeing 787 events held in Montreal, Vancouver, Toronto and Calgary, and Family Days in those same cities.

In October 2014, Air Canada concluded a 10-year collective agreement with ACPA, which the airline considers a tangible indication of the positive shift in culture that is taking shape.

Another indicator of culture change is Air Canada's selection in 2015, for the second consecutive year, as one of "Canada's Top 100 Employers", in an annual survey by Mediacorp Canada. The national competition evaluates and identifies the country's leading companies and organizations for attracting and retaining employees after a detailed review of their operations and human resources practices, including a comparison to others in their industry and region. It focuses on eight key areas: physical workplace; work and social atmosphere; health, financial and family benefits; vacation and time

off; employee communications; performance management; training and skills development and community involvement. In citing Air Canada, Mediacorp noted that Air Canada "recognizes and encourages employee volunteers through the Volunteer Involvement Program — donating airline tickets to charitable organizations where employees volunteer." Air Canada was also selected as one of "Montreal's Top Employers" in an annual competition organized by the editors of Canada's Top 100 Employers. This special designation recognizes the Montreal-area employers that lead their industries in offering exceptional places to work.

In August 2014, Air Canada released *Citizens of the World*, the airline's third corporate sustainability report. The document evaluates Air Canada's performance during 2013 in four key areas of sustainability: safety, the environment, the wellbeing of employees, and the company's community involvement. Communities are important to Air Canada because they are home to its customers and employees and connecting people and communities is the essence of the airline's business. For this reason, Air Canada ensures economic, environmental and social sustainability considerations are part of its decision-making and one way the airline does this is by reporting on its activities through *Citizens of the World*.

To encourage the development of a corporate culture, which is focused on transformation and performance, Air Canada has a profit sharing program which allows eligible employees to be rewarded for their contributions and share in the financial success of the airline. Based on the financial results for the year ended December 31, 2014, the profit sharing program will pay out \$46 million in early 2015, an increase of \$15 million or 48% when compared to 2013. Air Canada employees also have the ability to participate in the airline's Employee Share Ownership Plan. As at December 31, 2014, in aggregate, 23,056,408 shares or almost 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 2015, the airline will continue to promote employee awareness of the importance of Air Canada achieving its financial goals and will continue to communicate the message that a healthy financial profile can provide stability, lower risk and support growth opportunities.

5. OVFRVIFW

In 2014, Air Canada generated adjusted net income of \$531 million, the highest in Air Canada's history and an improvement of \$191 million from 2013. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information. On a GAAP basis, Air Canada reported net income of \$105 million or \$0.34 per diluted share compared to net income of \$10 million or \$0.02 per diluted share in 2013, an improvement of \$95 million or \$0.32 per diluted share.

Full Year 2014 Financial Summary

The following provides an overview of Air Canada's results of operations and financial position for the full year 2014 compared to the full year 2013.

- Operating revenues of \$13,272 million, an increase of \$890 million or 7% from 2013
- Passenger revenues of \$11,804 million, an increase of \$783 million or 7.1% from 2013, on traffic growth of 8.5% partly offset by a yield decline of 1.3%. An increase in average stage length of 2.3% had the effect of reducing system yield by 1.3 percentage points. On a stage length adjusted basis, system yield was unchanged from 2013
- An ASM capacity increase of 7.8% from 2013, in line with the 7.0% to 8.0% full year 2014 ASM capacity growth projected in Air Canada's news release dated November 6, 2014. The capacity growth in 2014 was primarily driven by increased seat density from Air Canada rouge and the introduction of six Boeing 787 aircraft and five higher-density Boeing 777 aircraft into the mainline fleet
- The favourable impact of a weaker Canadian dollar on foreign currency denominated passenger revenues increased passenger revenues by \$208 million in 2014. The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S.) increased operating expenses by approximately \$397 million in 2014
- An adjusted CASM reduction of 2.6% from 2013, in line with the 2.5% to 3.5% decrease projected in Air Canada's news release dated November 6, 2014. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information
- Operating income of \$815 million compared to operating income of \$619 million in 2013, an improvement of \$196 million. In 2013, Air Canada recorded operating expense reductions related

- to benefits plan amendments of \$82 million as a result of amendments to defined benefit pension plans. Air Canada reported an operating margin of 6.1% compared to an operating margin (excluding the impact of benefits plan amendments) of 4.3% in 2013, an improvement of 1.8 percentage points
- Net income of \$105 million or \$0.34 per diluted share compared to net income of \$10 million or \$0.02 per diluted share in 2013. The net income in 2014 included foreign exchange losses of \$307 million, favourable tax-related provision adjustments of \$41 million, as well as onetime payments totaling \$30 million made to ACPA members pursuant to the ACPA collective agreement concluded in October 2014. The net income in 2013 included foreign exchange losses of \$120 million, an interest charge of \$95 million pertaining to the purchase of the airline's senior secured notes which were to become due in 2015 and 2016, impairment charges amounting to \$30 million and the favourable impact of benefits plan amendments of \$82 million
- EBITDAR of \$1,671 million compared to EBITDAR (excluding the impact of benefits plan amendments) of \$1,433 million in 2013, an increase of \$238 million. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information
- Adjusted net income of \$531 million or \$1.81 per diluted share compared to adjusted net income of \$340 million or \$1.20 per diluted share in 2013, an improvement of \$191 million or \$0.61 per diluted share. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information
- Cash flow from operations of \$941 million, an improvement of \$210 million versus 2013, consistent with the improvement in operating income. Free cash flow was negative \$560 million, a decline of \$329 million due to an increase in capital expenditures which included the acquisition of one Boeing 777-300 and six Boeing 787-8 aircraft in 2014. Free cash flow (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 \$5,132 million at December 31, 2014, an increase of \$781 million from December 31, 2013, mainly due to the purchase of six Boeing 787-8 and one Boeing 777

aircraft in 2014 and the unfavourable impact of a weaker Canadian dollar as at December 31, 2014 compared to December 31, 2013 on Air Canada's foreign currency denominated debt (mainly U.S. dollars), which accounted for an increase of \$365 million to long-term debt in 2014. The airline's adjusted net debt to EBITDAR ratio was 3.1 at December 31, 2014 versus a ratio of 3.0 at December 31, 2013. Air Canada uses this ratio to manage its financial leverage risk and its objective is to maintain the ratio below 3.5. Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is a non-GAAP financial measure. Refer to section 9.3 "Adjusted Net Debt" of this MD&A for additional information

- Unrestricted liquidity (cash, short-term investments and undrawn lines of credit) of \$2,685 million at December 31, 2014 (December 31, 2013 – \$2,364 million). 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, 2014, cash and shortterm investments amounted to \$2,275 million and undrawn lines of credit amounted to \$410 million. At December 31, 2013, cash and short-term investments amounted to \$2,208 million and undrawn lines of credit amounted to \$156 million. Air Canada's principal objective in managing liquidity risk is to maintain a minimum unrestricted liquidity level of \$1.7 billion
- Return on invested capital ("ROIC") at December 31, 2014 of 12.1% versus 10.5% at December 31, 2013. Air Canada's goal is to achieve a sustainable ROIC of 10% to 13% by 2015. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information

Fourth Quarter 2014 Financial Summary

The following is an overview of Air Canada's results of operations and financial position for the fourth quarter of 2014 compared to the fourth quarter of 2013.

- Operating revenues of \$3,104 million, an increase of \$210 million or 7% from the fourth quarter of 2013
- An ASM capacity increase of 8.5% from the fourth quarter of 2013, in line with the 7.75% to 8.75% capacity increase projected in Air Canada's news release dated November 6, 2014. The capacity growth in the fourth quarter of 2014

- was primarily driven by increased seat density from Air Canada rouge and the introduction of six Boeing 787 aircraft and one higher-density Boeing 777 aircraft into the mainline fleet
- Passenger revenues of \$2,755 million, an increase of \$195 million or 7.6% from the fourth quarter of 2013, on traffic growth of 9.4% partly offset by a yield decline of 1.9%. An increase in average stage length of 2.2% had the effect of reducing system yield by 1.2 percentage points. On a stage length adjusted basis, system yield decreased 0.7% year-over-year
- A PRASM decline of 1.2% from the fourth quarter of 2013, as the 1.9% decline in yield was partly offset by a passenger load factor improvement of 0.6 percentage points
- The favourable impact of a weaker Canadian dollar on foreign currency denominated passenger revenues increased passenger revenues by \$33 million in the fourth quarter of 2014. The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S.) increased operating expenses by approximately \$89 million in the fourth quarter of 2014
- An adjusted CASM which was unchanged from the fourth quarter of 2013 versus the 1.0% to 2.0% decrease projected in Air Canada's news release dated November 6, 2014. This difference was primarily due to higher than forecasted employee benefits expense mainly due to revised actuarial valuations related to pension and post-employment benefits, an increase in accruals related to employee profit sharing programs, the timing of maintenance events versus what was previously projected and, to a lesser extent, the impact of a weaker than anticipated Canadian dollar. Adjusted CASM is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information
- Operating income of \$106 million compared to operating income of \$135 million in the fourth quarter of 2013, a decrease of \$29 million. In the fourth quarter of 2014, one-time payments totaling \$30 million were made to ACPA members pursuant to the ACPA collective agreement concluded in October 2014. In the fourth quarter of 2013, Air Canada recorded an operating expense reduction of \$82 million related to amendments to defined benefit pension plans. Air Canada reported an operating margin of 3.4% compared to an operating margin (excluding the impact of benefits plan amendments) of 1.8% in the fourth quarter of 2013, an improvement of 1.6 percentage points

- A net loss of \$100 million or \$0.35 per diluted share compared to a net loss of \$6 million or \$0.02 per diluted share in the fourth quarter of 2013. The net loss in the fourth quarter of 2014 included foreign exchange losses of \$115 million and one-time payments totaling \$30 million as discussed above. The net loss in the fourth quarter of 2013 included foreign exchange losses of \$55 million and the favourable impact of benefit plan amendments of \$82 million
- EBITDAR of \$319 million compared to EBITDAR (excluding the impact of benefit plan amendments) of \$277 million in the fourth quarter of 2013, an increase of \$42 million. In the fourth quarter of 2014, as discussed above, one-time payments totaling \$30 million were made to ACPA members. Air Canada previously estimated that EBITDAR was negatively impacted in December 2013 by \$15 million as a result of severe weather conditions. EBITDAR is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information
- Adjusted net income of \$67 million or \$0.23 per diluted share compared to adjusted net income of \$3 million or \$0.01 per diluted share in the fourth quarter of 2013, an improvement of \$64 million or \$0.22 per diluted share. Adjusted net-income is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information
- Negative free cash flow of \$366 million, \$90 million less than 2013, driven by the addition of two Boeing 787-8 aircraft, as well as changes in non-cash working capital, particularly the timing of fuel payments when compared to the same quarter in 2013. Free cash flow (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

6. RESULTS OF OPERATIONS -FULL YEAR 2014 VERSUS FULL YEAR 2013

The following table and discussion compares results of Air Canada for the full year of 2014 versus the full year of 2013.

CANADIAN DOLLARS IN MILLIONS,	FULL YEAR				CHANGE			
EXCEPT PER SHARE FIGURES	2014 2013				\$	%		
OPERATING REVENUES								
Passenger	\$ 11,8	304	\$	11,021	\$	783	7	
Cargo	5	502		474		28	6	
Other	9	966		887		79	9	
TOTAL REVENUES	13,2	272	1	2,382		890	7	
OPERATING EXPENSES								
Aircraft fuel	3,7	747		3,534		213	6	
Wages, salaries and benefits (1)	2,2	282		2,247		35	2	
Benefit plan amendments (2)		_		(82)		82	100	
Capacity purchase agreements	1,1	182		1,123		59	5	
Airport and navigation fees	1,0	031		983		48	5	
Aircraft maintenance	7	728		632		96	15	
Sales and distribution costs	6	572		613		59	10	
Depreciation, amortization and impairment (3)	5	543		578		(35)	(6)	
Ground package costs	3	377		327		50	15	
Aircraft rent	3	313		318		(5)	(2)	
Food, beverages and supplies	3	309		289		20	7	
Communications and information technology	2	204		190		14	7	
Other ⁽⁴⁾	1,0)69		1,011		58	6	
TOTAL OPERATING EXPENSES	12,4	157	1	11,763		694	6	
OPERATING INCOME	8	315		619		196		
NON-OPERATING INCOME (EXPENSE)								
Foreign exchange loss	(30	07)		(120)		(187)		
Interest income		39		32		7		
Interest expense (5)	(3)	22)		(397)		75		
Interest capitalized		30		46		(16)		
Net financing expense relating to employee benefits	(1:	34)		(208)		74		
Fuel and other derivatives		(1)		37		(38)		
Other		15)		(7)		(8)		
TOTAL NON-OPERATING EXPENSE	(7	10)		(617)		(93)		
INCOME BEFORE INCOME TAXES		105		2		103	1	
Income taxes		-		8		(8)		
NET INCOME	\$ 1	105	\$	10	\$	95	1	
NET INCOME PER SHARE – DILUTED	\$ 0.	.34	\$	0.02	\$	0.32		
EBITDAR, EXCLUDING THE IMPACT OF BENEFIT PLAN AMENDMENTS (2)(6)	\$ 1,6	571	\$	1,433	\$	238		
EBITDAR (6)	\$ 1,6	571	\$	1,515	\$	156	1	
ADJUSTED NET INCOME (7)		531	\$	340	\$	191	1	
		.81	\$	1.20	\$	0.61	1	

¹ In 2014, one-time payments totaling \$30 million were made to ACPA members under a collective agreement concluded in October 2014.
2 In 2013, Air Canada recorded an operating expense reduction of \$82 million related to amendments to defined benefit pension plans.
3 In 2013, Air Canada recorded impairment charges amounting to \$30 million.
4 In 2014, Air Canada recorded favourable tax-related provision adjustments of \$41 million.
5 In 2013, Air Canada recorded an interest charge of \$95 million related to the purchase of its senior secured notes due in 2015 and 2016.
6 EBITDAR is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.
7 Adjusted net income (loss) and adjusted net income (loss) per share – diluted are non-GAAP financial measures. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

SYSTEM PASSENGER REVENUES INCREASED 7.1% FROM 2013

In 2014, on capacity growth of 7.8%, system passenger revenues of \$11,804 million increased \$783 million or 7.1% from 2013. This increase was mainly due to traffic growth of 8.5% partly offset by a yield decline of 1.3%. Modest yield declines are an anticipated and natural consequence of the successful implementation of Air Canada's business strategy to profitably increase long-haul international and leisure flying.

In 2014, system business cabin revenues increased \$109 million or 4.9% from 2013 due to a yield improvement.

The table below provides passenger revenue by geographic region for 2014 and 2013.

	2014 \$ MILLION	2013 \$ MILLION	CHANGE \$ MILLION	% CHANGE
PASSENGER REVENUE				
Canada	4,381	4,237	144	3.4
U.S. transborder	2,379	2,176	203	9.4
Atlantic	2,554	2,263	291	12.8
Pacific	1,710	1,618	92	5.6
Other	780	727	53	7.3
SYSTEM	11,804	11,021	783	7.1

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

FULL YEAR 2014 VERSUS FUL	PASSENGER REVENUE % CHANGE	CAPACITY (ASMS) % CHANGE	TRAFFIC (RPMS) % CHANGE	PASSENGER LOAD FACTOR PP CHANGE	YIELD % CHANGE	PRASM % CHANGE
FULL YEAR 2014 VERSUS FUL	L YEAR 2013					
Canada	3.4	4.8	5.3	0.4	(2.3)	(1.8)
U.S. transborder	9.4	9.8	13.1	2.4	(2.8)	0.1
Atlantic	12.8	14.3	13.6	(0.5)	(0.6)	(1.1)
Pacific	5.6	4.3	4.6	0.3	1.3	1.7
Other	7.3	3.3	5.7	1.9	2.1	4.5
SYSTEM	7.1	7.8	8.5	0.6	(1.3)	(0.6)

In 2014, Air Canada's system capacity was 7.8% higher than in 2013, with capacity growth reflected in all markets.

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

- The 8.5% 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 2014 also reflected incremental connecting traffic to international destinations.
- The 1.3% yield decrease which was the result of an increase in average stage length of 2.3%, which had the effect of reducing system yield by 1.3 percentage points, the impact of 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, and the use of lower-cost Boeing 777 high-density aircraft which have a larger economy cabin. On a stage length adjusted basis, system yield was unchanged from 2013. These decreases were offset by a favourable currency impact of \$208 million and improvements in Air Canada's business cabin revenue performance.

The 0.6% PRASM decrease was due to the lower yield largely offset by a passenger load factor improvement of 0.6 percentage points.

Refer to section 7 "Results of Operations" of this MD&A for year-over-year percentage changes in passenger revenues, capacity, traffic, passenger load factor, yield and PRASM by quarter for the fourth quarter 2014 and each of the previous four quarters.

DOMESTIC PASSENGER REVENUES INCREASED 3.4% FROM 2013

In 2014, on a capacity increase of 4.8%, domestic passenger revenues of \$4,381 million increased \$144 million or 3.4% from 2013 due to traffic growth of 5.3% as well as an increase in baggage fee revenue year-over-year (baggage fee revenues are not included in Air Canada's yield and PRASM results). These increases were partly offset by a yield decline of 2.3%.

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

The 5.3% traffic increase which reflected traffic growth on all major domestic services. The traffic growth in 2014 reflected increases on services within Canada, as well as incremental connecting traffic to international destinations.

An increase in baggage fee revenue following an adjustment to the airline's first checked bag policy which became effective for travel on or after November 2, 2014.

The yield decline of 2.3% which reflected increased industry capacity and significant competitive pricing activities on routes within Ontario and Quebec and on routes within Western Canada. Also, early in 2014, domestic yields were under pressure due to certain commercial initiatives in the marketplace related to channels of distribution. In addition, in 2014, Air Canada experienced higher proportional growth of lower-yielding international and U.S. transborder passenger flows connecting onto domestic flights. These yield decreases were partly offset by a favourable currency impact of \$29 million.

The 1.8% PRASM decrease was due to the yield decline as passenger load factor improved 0.4 percentage points year-over-year.

U.S. TRANSBORDER PASSENGER REVENUES INCREASED 9.4% FROM 2013

In 2014, on capacity growth of 9.8%, U.S. transborder passenger revenues of \$2,379 million increased \$203 million or 9.4% from 2013 mainly due to traffic growth of 13.1% partly offset by a yield decrease of 2.8%.

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

- The traffic increase of 13.1% which reflected traffic growth on all major U.S. transborder services with the exception of services to Hawaii where capacity was reduced year-over-year. The traffic growth was achieved by successfully filling longhaul capacity and through traffic growth on U.S. short-haul routes. Air Canada also experienced higher proportional growth of international-tointernational passenger flows from the U.S. when compared to 2013 in addition to traffic growth between Canada and the U.S.
- The 2.8% yield decline which reflected a 3.4% longer average stage length, driven by route composition changes as long-haul (lower-yielding) capacity grew while short-haul (higher-yielding) capacity was slightly reduced when compared to 2013. This increase in average stage length had the effect of reducing U.S. transborder yield by 1.9 percentage points. Long-haul growth was led by lower-cost Air Canada rouge flying allowing Air Canada to effectively compete on lower-yielding leisure routes. Additionally, 2014 experienced a significantly higher proportion of lower-yielding incremental international-tointernational passenger flows in support of the airline's international expansion strategy. These yield declines were largely offset by improvements in Air Canada's business cabin revenue performance, traffic growth on high-yielding short-haul routes, and a favourable currency impact of \$47 million.

The 0.1% PRASM increase was due to a passenger load factor improvement of 2.4 percentage points which was almost fully offset by the yield decline.

ATLANTIC PASSENGER REVENUES INCREASED 12.8% FROM 2013

In 2014, on capacity growth of 14.3%, Atlantic passenger revenues of \$2,554 million increased \$291 million or 12.8% from 2013 due to traffic growth of 13.6% partly offset by a yield decrease of 0.6%.

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

- The 13.6% traffic increase which reflected traffic growth on all major Atlantic services.
- The 0.6% yield decline which reflected a longer average stage length, which had the effect of reducing Atlantic yield by 0.4 percentage points, a higher proportion of seats into leisure-focused long-haul markets, additional Atlantic services being served with lower-cost Boeing 777 higher-



density aircraft which have a larger economy cabin, as well as new and increased lower-cost flying by Air Canada rouge which offers a Premium rouge product but has no international business cabin. These yield decreases were largely offset by improvements in Air Canada's business cabin revenue performance, an increase in premium economy traffic which resulted in higher average fares, and a favourable currency impact of \$82 million.

The 1.1% PRASM decrease was due to the yield decline and a 0.5 percentage point decrease in passenger load factor.

PACIFIC PASSENGER REVENUES INCREASED 5.6% FROM 2013

In 2014, on capacity growth of 4.3%, Pacific passenger revenues of \$1,710 million increased \$92 million or 5.6% from 2013 due to traffic and yield growth of 4.6% and 1.3%, respectively.

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

- The 4.6% traffic increase which reflected traffic growth on services to Hong Kong, Japan and Australia where capacity was increased year-overyear partly offset by traffic decreases on services to Korea and China where capacity was reduced year-over-year.
- The 1.3% yield increase which reflected yield growth on all Pacific services with the exception of Hong Kong, a strong yield performance on services to Korea, China and Australia and, to a lesser extent, Japan, improvements in the airline's business cabin revenue performance, growth in premium economy traffic which resulted in higher average fares, and a favourable currency impact of \$36 million. With respect to the airline's services to Hong Kong, Air Canada operates a lower-cost Boeing 777 higher-density aircraft on its Vancouver-Hong Kong route which has a larger economy cabin. The use of this lower-cost aircraft on high-volume routes, such as Vancouver-Hong Kong, is allowing the airline to access traditionally lower-yielding traffic while improving profitability of the routes.

The 1.7% PRASM increase was due to the higher yield and to a passenger load factor improvement of 0.3 percentage points.

OTHER PASSENGER REVENUES INCREASED 7.3% FROM 2013

In 2014, on a capacity increase of 3.3%, Other passenger revenues (comprised of routes to the Caribbean, Mexico and Central and South America) of \$780 million increased \$53 million or 7.3% from 2013 due to traffic and yield growth of 5.7% and 2.1%, respectively.

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

- The overall 5.7% traffic increase which reflected traffic growth on all major services in the Other markets with the exception of South America where capacity was reduced year-over-year.
- The overall 2.1% yield increase which reflected yield growth on the airline's routes to Mexico and to traditional sun destinations on higher average fares and a favourable currency impact of \$14 million. These yield increases were partly offset by a yield decline on services to South America, in large part due to the airline's suspension of service to Venezuela.

The 4.5% PRASM increase was due to the yield growth and a 1.9 percentage point improvement in passenger load factor. PRASM improvements were recorded on all major services in the Other markets.

CARGO REVENUES INCREASED 5.9% FROM 2013

In 2014, cargo revenues of \$502 million increased \$28 million or 5.9% from 2013 due to traffic growth of 8.0% partly offset by a yield decline of 1.9%.

The table below provides cargo revenue by geographic region for 2014 and 2013.

	2014 \$ MILLION	2013 \$ MILLION	CHANGE \$ MILLION
CARGO REVENUE			
Canada	66	63	3
U.S. transborder	20	18	2
Atlantic	191	171	20
Pacific	190	185	5
Other	35	37	(2)
SYSTEM	502	474	28

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 2014 VERSUS FULL Y	EAR 2013				
Canada	5.6	21.0	(12.8)	32.3	(20.2)
U.S. transborder	11.7	25.1	(10.7)	13.6	(1.7)
Atlantic	11.8	10.6	1.1	16.2	(3.8)
Pacific	2.1	0.7	1.4	(0.5)	2.6
Other	(4.3)	1.3	(5.5)	(4.1)	(0.2)
SYSTEM	5.9	8.5	(2.4)	8.0	(1.9)

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

- The 8.0% traffic increase which reflected traffic growth in all markets with the exception of the Pacific
 and Other markets. The overall traffic growth reflected more favourable economic conditions in the
 U.S. and Europe.
- The 1.9% overall yield decrease which reflected increased industry capacity and aggressive competitive
 pricing activities when compared to 2013. These yield decreases were partly offset by yield growth in the
 Pacific market and a favourable currency impact.

OTHER REVENUES INCREASED 9% FROM 2013

Other revenues 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. In 2014, Other revenues of \$966 million increased \$79 million or 9% from 2013 mainly due to higher ground package revenues at Air Canada Vacations, the result of higher passenger volumes, as well as growth in passenger-related fees.

CASM (EXCLUDING THE IMPACT OF BENEFIT PLAN AMENDMENTS) DECREASED 2.4% FROM 2013. ADJUSTED CASM DECREASED 2.6% FROM 2013

The following table compares Air Canada's CASM for 2014 versus 2013.

	FULL	YEAR	CH	ANGE
CENTS PER ASM	2014	2013	cents	%
Aircraft fuel	5.07	5.15	(0.08)	(1.6)
Wages and salaries	2.42	2.48	(0.06)	(2.4)
Benefits	0.67	0.79	(0.12)	(15.2)
Benefit plan amendments (1)	-	(0.12)	0.12	100.0
Capacity purchase agreements	1.60	1.64	(0.04)	(2.4)
Airport and navigation fees	1.40	1.43	(0.03)	(2.1)
Aircraft maintenance	0.99	0.92	0.07	7.6
Sales and distribution costs	0.91	0.89	0.02	2.2
Depreciation, amortization and impairment	0.73	0.84	(0.11)	(13.1)
Ground package costs	0.51	0.48	0.03	6.3
Aircraft rent	0.42	0.46	(0.04)	(8.7)
Food, beverages and supplies	0.42	0.42	-	-
Communications and information technology	0.28	0.28	-	-
Other	1.44	1.49	(0.05)	(3.4)
CASM	16.86	17.15	(0.29)	(1.7)
Remove: Benefit plan amendments ⁽¹⁾	-	0.12	(0.12)	(100.0)
CASM (excluding the impact of benefit plan amendments)	16.86	17.27	(0.41)	(2.4)
1 In 2013, Air Canada recorded an operating expense reduction of \$82 n	nillion related to amendments	s to defined benefit pension	olans.	

CASM	16.86	17.15	(0.29)	(1.7)
Remove: Fuel expense, ground package costs at Air Canada Vacations, benefit plan amendments and unusual items (1)(2)(3)(4)	(5.57)	(5.55)	(0.02)	(0.4)
ADJUSTED CASM (5)	11.29	11.60	(0.31)	(2.6)

OPERATING EXPENSES INCREASED 6% FROM 2013

In 2014, operating expenses of \$12,457 million increased \$694 million or 6% from 2013 on capacity growth of 7.8%. The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) in 2014, when compared to 2013, increased operating expenses by approximately \$397 million. Refer to section 12 "Financial Instruments and Risk Management" of this MD&A for information on Air Canada's foreign exchange risk management strategy. In 2013, Air Canada recorded an operating expense reduction of \$82 million in Benefit plan amendments and impairment charges amounting to \$30 million in Depreciation, amortization and impairment expense.

In 2013, Air Canada recorded an operating expense reduction of \$82 million related to amendments to defined benefit pension plans.
 In 2013, Air Canada recorded impairment charges amounting to \$30 million.
 In 2014, Air Canada recorded favourable tax-related provision adjustments of \$41 million.
 In 2014, non-time payments totaling \$30 million were made to ACPA members under a collective agreement concluded in October 2014.
 Adjusted CASM is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

FUEL EXPENSE INCREASED 6% FROM 2013

In 2014, fuel expense of \$3,747 million increased \$213 million or 6% from 2013. The increase in fuel expense year-over-year was due to the unfavourable impact of a weaker Canadian dollar versus the U.S. dollar when compared to 2013, which accounted for an increase of \$221 million or 7%, and a higher volume of fuel litres consumed, which accounted for an increase of \$192 million. These increases were partly offset by the impact of a 6% year-over-year decline in jet fuel prices, which accounted for a decrease of \$200 million to fuel expense in 2014.

The table below provides Air Canada's fuel cost per litre and economic fuel cost per litre for the periods indicated.

	FULL YEAR			СНА	NGE	
CANADIAN DOLLARS IN MILLIONS, EXCEPT WHERE INDICATED	7	2014		2013	\$	%
AIRCRAFT FUEL EXPENSE – GAAP	\$	3,747	\$	3,534	\$ 213	6
Add: Net cash payments on fuel derivatives (1)		16		21	(5)	(24)
Economic cost of fuel – Non-GAAP (2)	\$	3,763	\$	3,555	\$ 208	6
FUEL CONSUMPTION (THOUSANDS OF LITRES)	4,	213,214	3,	992,617	220,597	5.5
FUEL COST PER LITRE (CENTS) – GAAP		88.9		88.5	0.4	0.5
ECONOMIC FUEL COST PER LITRE (CENTS) – NON-GAAP (2)		89.3		89.0	0.3	0.3

¹ Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives.
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.

WAGES, SALARIES AND BENEFITS EXPENSE AMOUNTED TO \$2,282 MILLION IN 2014, AN INCREASE OF \$35 MILLION OR 2% FROM 2013

In 2014, wages and salaries expense of \$1,786 million increased \$82 million or 5% from 2013, mainly due to higher average salaries, Air Canada having recorded one-time payments totaling \$30 million related to its collective agreement with ACPA in 2014 while no such payments were recorded in 2013, and an increase in expense accruals related to the annual employee profit sharing programs. These increases were partly offset by the favourable impact of Air Canada having outsourced its London ground handling operations to a third party provider in 2014.

In 2014, employee benefits expense of \$496 million decreased \$47 million or 9% from 2013, reflecting a reduction in foreign pension plan liabilities and the impact of higher discount rates which decreased the current service cost of defined benefit pension plans. These decreases were partly offset by an increase in Air Canada's match of employee contributions in the Employee Share Ownership Plan.

CAPACITY PURCHASE COSTS INCREASED 5% FROM 2013

In 2014, capacity purchase costs of \$1,182 million increased \$59 million or 5% from 2013, mainly due to an increase in block hours flown by Sky Regional and, to a lesser extent, other third party carriers (excluding Jazz) operating under capacity purchase agreements with Air Canada, higher rates under the Jazz CPA and an unfavourable currency impact. These increases were partly offset by a decline in block hours flown by Jazz under the Jazz CPA.

AIRPORT AND NAVIGATION FEES INCREASED 5% FROM 2013

In 2014, airport and navigation fees of \$1,031 million increased \$48 million or 5% from 2013, largely due to the addition of Boeing 777 and 787 aircraft to Air Canada's operating fleet, an unfavourable currency impact, and rate increases in certain stations. These increases were partly offset by the favourable impact of the agreement, concluded in October 2013, with the GTAA which is allowing the airline to grow its share of international connecting traffic at Toronto Pearson on a more cost effective basis.

AIRCRAFT MAINTENANCE EXPENSE INCREASED 15% FROM 2013

In 2014, aircraft maintenance expense of \$728 million increased \$96 million or 15% from 2013. This increase in aircraft maintenance expense was due to a \$43 million unfavourable currency impact, an increase in expenses related to maintenance provisions, a higher volume of engine and airframe activity, as well as the impact of Air Canada having recorded favourable accrual adjustments of \$15 million in 2013 while no such adjustments were recorded in 2014. The increase in expenses related to maintenance provisions was mainly due to a fewer number of aircraft lease extensions when compared to 2013 which resulted in an expense increase of \$27 million. Lease term extensions postpone the expected timing of the end of lease costs and lengthen the period over which expenses are recorded, and result in a cumulative adjustment to reflect the revised provision required as at the balance sheet date, thus reducing maintenance expense in the period. These increases were partly offset by the impact of favourable terms and discounts negotiated on new maintenance service agreements.

SALES AND DISTRIBUTION COSTS INCREASED 10% FROM 2013

In 2014, sales and distribution costs of \$672 million increased \$59 million or 10% from 2013 on passenger revenue growth of 7.1%. This growth in sales and distribution costs was mainly due to the impact of a higher volume of ticket sales generated through GDS providers, a change in commission structure to drive higher passenger revenues, and an increase in credit card expenses which was in line with sales and revenue growth. An unfavourable currency impact was also a contributing factor to the increase in sales and distribution costs year-over-year.

DEPRECIATION, AMORTIZATION AND IMPAIRMENT EXPENSE DECREASED 6% FROM 2013

In 2014, depreciation, amortization and impairment expense of \$543 million decreased \$35 million or 6% from 2013.

In 2013, Air Canada recorded an impairment charge of \$30 million, including \$24 million related to four Airbus A340-300 aircraft (none of which were being operated by Air Canada), while no such charge was recorded in 2014.

The impact of the addition of five Boeing 777 and six Boeing 787 aircraft to the airline's operating fleet was largely offset by the impact of certain engine and airframe maintenance events becoming fully amortized, the disposal of Airbus A340-300 aircraft (none of which were being operated by Air Canada) and by a decrease in depreciation expense related to the airline's interior refurbishment programs.

GROUND PACKAGE COSTS INCREASED 15% FROM 2013

In 2014, the cost of ground packages at Air Canada Vacations amounted to \$377 million, an increase of \$50 million or 15% from 2013. This increase was primarily due to higher passenger volumes and an unfavourable currency impact.

AIRCRAFT RENT EXPENSE DECREASED 2% FROM 2013

In 2014, aircraft rent expense of \$313 million decreased \$5 million or 2% from 2013. A decrease in aircraft rent expense due to more favourable rates on lease renewals was largely offset by an unfavourable currency impact of \$20 million.

OTHER OPERATING EXPENSES INCREASED 6% FROM 2013

In 2014, Other operating expenses of \$1,069 million increased \$58 million or 6% from 2013. The increase in Other expenses was driven by the 7.8% capacity growth, an increase in terminal handling expenses as a result of Air Canada's international expansion and the impact of the airline having outsourced its London ground handling operations to a third party provider in 2014 (the savings associated with this initiative are included in other expense categories, such as wages and salaries expense, for a net overall cost reduction), and by higher advertising and promotion expenses. Partly offsetting these increases was the impact of Air Canada having recorded favourable tax-related provision adjustments of \$41 million in 2014 while

no such adjustments were recorded in 2013. In addition, one-time start-up expenses related to the transfer of Embraer 175 aircraft from the mainline fleet to Sky Regional were incurred in 2013 while no such charges were recorded in 2014.

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

	FULL YEAR				СНА	NGE										
CANADIAN DOLLARS IN MILLIONS	2014 2		2013		2013		2013		2013		2013		2013		\$	%
Terminal handling	\$ 235	\$	196	\$	39	20										
Building rent and maintenance	147		131		16	12										
Crew cycle	141		120		21	18										
Miscellaneous fees and services	122		128		(6)	(5)										
Remaining other expenses	424		436		(12)	(3)										
OTHER OPERATING EXPENSES	\$ 1,069	\$	1,011	\$	58	6										

NON-OPERATING EXPENSE AMOUNTED TO \$710 MILLION IN 2014 COMPARED TO NON-OPERATING EXPENSE OF \$617 MILLION IN 2013

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

	FULL YEAR				CHANGE
CANADIAN DOLLARS IN MILLIONS	2014 2013			\$	
Foreign exchange loss	\$ (307)	\$	(120)	\$	(187)
Interest income	39		32		7
Interest expense	(322)		(397)		75
Interest capitalized	30		46		(16)
Net financing expense relating to employee benefits	(134)		(208)		74
Fuel and other derivatives	(1)		37		(38)
Other	(15)		(7)		(8)
TOTAL NON-OPERATING EXPENSE	\$ (710)	\$	(617)	\$	(93)

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

- Losses on foreign exchange which amounted to \$307 million in 2014 compared to losses of \$120 million in 2013. These losses were mainly related to unrealized foreign exchange losses on the translation of U.S. dollar denominated debt. Partly offsetting these foreign exchange losses were revaluation gains related to foreign currency derivatives of \$74 million and favourable foreign currency derivative settlements of \$58 million. The December 31, 2014 closing exchange rate was US\$1 = C\$1.1601 while the December 30, 2013 closing exchange rate was US\$1 = C\$1.0636. Refer to section 12 "Financial Instruments and Risk Management" of this MD&A for additional information.
- In 2013, Air Canada recorded a charge of \$95 million in interest expense pertaining to the purchase of
 its senior secured notes due in 2015 and 2016, comprised of \$61 million related to premium costs paid,
 in respect of notes purchased, and \$34 million related to the write-off of existing transaction costs and
 discounts. No such charge was recorded in 2014.
- A decrease in net financing expense relating to employee benefits of \$74 million which was mainly due to the impact of lower pension liabilities.
- Losses related to fuel and other derivatives which amounted to \$1 million in 2014 versus gains of \$37 million in 2013. Refer to section 12 "Financial Instruments and Risk Management" of this MD&A for additional information.

7. RESULTS OF OPERATIONS – FOURTH QUARTER 2014 VERSUS FOURTH QUARTER 2013

The following table and discussion compares results of Air Canada for the fourth quarter 2014 versus the fourth quarter of 2013.

ANADIAN DOLLARS IN MILLIONS,		FOURTH QUARTER			CHANGE		
EXCEPT PER SHARE FIGURES		2014	1	2013		\$	%
OPERATING REVENUES							
Passenger	\$	2,755	\$	2,560	\$	195	8
Cargo		133		128		5	4
Other		216		206		10	5
TOTAL REVENUES		3,104		2,894		210	7
OPERATING EXPENSES							
Aircraft fuel		791		831		(40)	(5)
Wages, salaries and benefits (1)		604		553		51	9
Benefit plan amendments (2)		-		(82)		82	100
Capacity purchase agreements		295		280		15	5
Airport and navigation fees		247		232		15	6
Aircraft maintenance		201		158		43	27
Sales and distribution costs		153		138		15	11
Depreciation, amortization and impairment		134		148		(14)	(9)
Ground package costs		74		66		8	12
Aircraft rent		79		76		3	4
Food, beverages and supplies		74		71		3	4
Communications and information technology		52		45		7	16
Other		294		243		51	21
TOTAL OPERATING EXPENSES		2,998		2,759		239	9
OPERATING INCOME		106		135		(29)	
NON-OPERATING INCOME (EXPENSE)							
Foreign exchange loss		(115)		(55)		(60)	
Interest income		10		10		-	
Interest expense		(83)		(73)		(10)	
Interest capitalized		9		10		(1)	
Net financing expense relating to employee benefits		(32)		(53)		21	
Fuel and other derivatives		9		22		(13)	
Other		(4)		(2)		(2)	
TOTAL NON-OPERATING EXPENSE		(206)		(141)		(65)	
LOSS BEFORE INCOME TAXES		(100)		(6)		(94)	
Income taxes		-		_		-	
NET LOSS	\$	(100)	\$	(6)	\$	(94)	
NET LOSS PER SHARE – DILUTED	\$	(0.35)	\$	(0.02)	\$	(0.33)	
EBITDAR, EXCLUDING THE IMPACT OF BENEFIT PLAN AMENDMENTS ⁽²⁾⁽³⁾	\$	319	\$	277	\$	42	
EBITDAR (3)	\$	319	\$	359	\$	(40)	
ADJUSTED NET INCOME (4)	\$	67	\$	3	\$	64	
ADJUSTED NET INCOME PER SHARE – DILUTED (4)	\$	0.23	\$	0.01	\$	0.22	

In the fourth quarter of 2014, one-time payments totaling \$30 million were made to ACPA members under a collective agreement concluded processor 2014.

In the fourth quarter of 2013, Air Canada recorded an operating expense reduction of \$82 million related to amendments to defined benefit pension plans.

EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

A djusted net income (loss) and adjusted net income (loss) per share – diluted are non-GAAP financial measures. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

SYSTEM PASSENGER REVENUES INCREASED 7.6% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, on capacity growth of 8.5%, system passenger revenues of \$2,755 million increased \$195 million or 7.6% from the fourth quarter of 2013. The increase in system passenger revenues was due to traffic growth of 9.4% partly offset by a yield decline of 1.9%. Modest yield declines are an anticipated and natural consequence of the successful implementation of Air Canada's business strategy to profitably increase long-haul international and leisure flying.

In the fourth quarter of 2014, system business cabin revenues increased \$28 million or 5.0% from 2013 due to a yield improvement of 6.7% partly offset by a traffic decrease of 1.5%.

The table below provides passenger revenue by geographic region for the fourth quarter of 2014 and the fourth quarter of 2013.

	FOURTH QUARTER 2014 \$ MILLION	FOURTH QUARTER 2013 \$ MILLION	CHANGE \$ MILLION	% CHANGE
PASSENGER REVENUE				
Canada	1,099	1,040	59	5.7
U.S. transborder	572	523	49	9.5
Atlantic	525	462	63	13.6
Pacific	377	353	24	6.5
Other	182	182	-	0.4
SYSTEM	2,755	2,560	195	7.6

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the fourth quarter of 2014 versus the fourth quarter of 2013.

	PASSENGER REVENUE % CHANGE	CAPACITY (ASMS) % CHANGE	TRAFFIC (RPMS) % CHANGE	PASSENGER LOAD FACTOR PP CHANGE	YIELD % CHANGE	PRASM % CHANGE
FOURTH QUARTER 2014 VERSUS F	OURTH QUAR	TER 2013				
Canada	5.7	6.1	6.6	0.4	(1.8)	(1.3)
U.S. transborder	9.5	14.0	15.5	1.1	(5.0)	(3.7)
Atlantic	13.6	8.7	12.8	2.9	0.8	4.7
Pacific	6.5	9.5	7.6	(1.4)	(0.8)	(2.5)
Other	0.4	3.9	3.0	(0.6)	(2.7)	(3.4)
SYSTEM	7.6	8.5	9.4	0.6	(1.9)	(1.2)

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the fourth quarter of 2014 and each of the previous four quarters.

YEAR-OVER-YEAR BY QUARTER (% CHANGE)

	TEM OVER TEMEST QUARTER (70 CHARTOL)						
	Q4'13	Q1'14	Q2'14	Q3'14	Q4'14		
SYSTEM							
Passenger revenues	1.9	3.2	7.5	9.4	7.6		
Capacity (ASMs)	3.5	3.8	8.5	9.8	8.5		
Traffic (RPMs)	2.5	2.9	9.9	11.0	9.4		
Passenger load factor (pp change)	(0.9)	(0.7)	1.1	1.0	0.6		
Yield	(0.6)	0.4	(2.1)	(1.3)	(1.9)		
PRASM	(1.7)	(0.5)	(0.8)	(0.2)	(1.2)		

In the fourth quarter of 2014, Air Canada's system capacity was 8.5% higher than in the fourth quarter of 2013, with capacity growth reflected in all markets.

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

- The 9.4% 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 2014 also reflected lower-yielding incremental connecting traffic to international destinations.
- The 1.9% yield decrease which was largely due to an increase in average stage length of 2.2%, which had the effect of reducing system yield by 1.2 percentage points, 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, and the use of lower-cost Boeing 777 high-density aircraft which have a larger economy cabin. These decreases were largely offset by a favourable currency impact of \$33 million and improvements in Air Canada's business cabin revenue performance.

The 1.2% PRASM decrease was due to the lower yield partly offset by a passenger load factor improvement of 0.6 percentage points.

DOMESTIC PASSENGER REVENUES INCREASED 5.7% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, on capacity growth of 6.1%, domestic passenger revenues of \$1,099 million increased \$59 million or 5.7% from the fourth quarter of 2013. The increase in domestic passenger revenues was due to traffic growth of 6.6% and an increase in baggage fee revenues (baggage fee revenues are not included in Air Canada's yield and PRASM results). These increases were partly offset by a yield decline of 1.8%.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the fourth quarter of 2014 and each of the previous four quarters.

YEAR-OVER-YEAR BY QUARTER (% CHANGE)

	Q4'13	Q1′14	Q2'14	Q3'14	Q4'14
CANADA					
Passenger revenues	(1.1)	(1.5)	2.2	6.5	5.7
Capacity (ASMs)	3.2	3.9	3.6	5.3	6.1
Traffic (RPMs)	2.6	1.7	5.3	6.9	6.6
Passenger load factor (pp change)	(0.4)	(1.8)	1.3	1.2	0.4
Yield	(3.6)	(3.5)	(3.3)	(0.7)	(1.8)
PRASM	(4.1)	(5.5)	(1.8)	0.8	(1.3)

In the fourth quarter of 2014, the 6.1% domestic capacity growth reflected capacity increases on all major domestic services.

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

- The 6.6% traffic increase which reflected traffic growth on all major domestic services. The traffic growth in the fourth quarter of 2014 reflected increases on services within Canada, as well as incremental connecting traffic to U.S. and international destinations.
- An increase in baggage fee revenues following an adjustment to the airline's first checked bag policy
 which became effective for travel on or after November 2, 2014. Baggage fee revenues are not included in
 Air Canada's yield and PRASM results.
- The 1.8% yield decrease which reflected an increase in average stage length which had the effect of reducing domestic yield by 0.9 percentage points, higher proportional growth of lower-yielding international

and U.S. transborder passenger flows, as well as declines on regional routes within Ontario and Quebec and on routes within Western Canada. These yield decreases were partly offset by yield growth on transcontinental services.

The domestic PRASM decrease of 1.3% was due to the yield decrease, partly offset by a 0.4 percentage point improvement in passenger load factor.

U.S. TRANSBORDER PASSENGER REVENUES INCREASED 9.5% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, on a capacity growth of 14.0%, U.S. transborder passenger revenues of \$572 million increased \$49 million or 9.5% from the fourth quarter of 2013. The increase in U.S. transborder passenger revenues was due to traffic growth of 15.5% partly offset by a yield decline of 5.0%.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the fourth quarter of 2014 and each of the previous four quarters.

YEAR-OVER-YEAR BY QUARTER (% CHANGE)

	Q4'13	Q1'14	Q2'14	Q3'14	Q4'14
U.S. TRANSBORDER					
Passenger revenues	8.1	5.7	11.5	11.2	9.5
Capacity (ASMs)	1.6	1.9	12.2	12.7	14.0
Traffic (RPMs)	4.0	5.7	16.2	16.2	15.5
Passenger load factor (pp change)	1.8	2.9	2.8	2.5	1.1
Yield	4.2	0.3	(3.3)	(3.7)	(5.0)
PRASM	6.6	4.0	0.1	(0.7)	(3.7)

In the fourth quarter of 2014, the 14.0% U.S. transborder capacity growth reflected capacity increases on certain U.S. long-haul routes such as Los Angeles and San Francisco, on certain U.S. short-haul routes, such as Chicago, and on services to Florida, Las Vegas and Hawaii. This capacity growth was partly offset by capacity reductions on certain long-haul routes such as Denver.

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

- The 15.5% traffic increase which reflected traffic growth on all major U.S. transborder services with the exception of services from eastern Canada to the U.S. where capacity was reduced year-over-year. The traffic growth was achieved through additional long-haul capacity and improved load factors on short-haul flying. The year-over-year increase in traffic was largely due to significantly higher proportional growth of lower-yielding international-to-international passenger flows from the U.S., as well as strong passenger demand on services between Canada and the U.S.
- The 5.0% yield decline which largely reflected a 3.6% longer average stage length, driven by route composition changes as long-haul (lower-yielding) capacity grew while short-haul (higher-yielding) capacity was unchanged when compared to the fourth quarter of 2013. This increase in average stage length had the effect of reducing U.S. transborder yield by 2.0 percentage points. Long-haul growth was led by lower-cost Air Canada rouge flying allowing Air Canada to effectively compete on lower-yielding leisure routes. Additionally, the fourth quarter of 2014 experienced a higher proportion of lower-yielding incremental international-to-international passenger flows in support of the airline's international expansion strategy. These yield decreases were partly offset by a favourable currency impact of \$9 million and a significant increase in high-yielding short-haul traffic.

PRASM decreased 3.7% as the lower yield was partly offset by a passenger load factor improvement of 1.1 percentage points.

ATLANTIC PASSENGER REVENUES INCREASED 13.6% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, on capacity growth of 8.7%, Atlantic passenger revenues of \$525 million increased \$63 million or 13.6% from the fourth quarter of 2013. The increase in Atlantic passenger revenues was due to traffic growth of 12.8% and, to a lesser extent, a yield improvement of 0.8%.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the fourth quarter of 2014 and each of the previous four quarters.

YEAR-OVER-YEAR BY QUARTER (% CHANGE)

	Q4'13	Q1′14	Q2'14	Q3′14	Q4'14
ATLANTIC					
Passenger revenues	2.7	8.3	12.3	14.9	13.6
Capacity (ASMs)	5.9	7.6	16.2	20.2	8.7
Traffic (RPMs)	1.7	1.2	14.7	19.2	12.8
Passenger load factor (pp change)	(3.1)	(4.5)	(1.1)	(0.8)	2.9
Yield	0.7	7.1	(2.0)	(3.5)	0.8
PRASM	(3.2)	0.7	(3.3)	(4.4)	4.7

In the fourth quarter of 2014, the Atlantic capacity growth of 8.7% reflected capacity increases on all major Atlantic services.

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

- The 12.8% traffic increase which reflected traffic growth on all major Atlantic services, including traffic growth between the U.S. and Europe via the airline's major Canadian hubs, in line with Air Canada's international growth strategy.
- The 0.8% yield growth which reflected improvements in Air Canada's business cabin revenue performance, an increase in premium economy traffic which resulted in higher average fares, and a favourable currency impact of \$10 million. This yield growth was largely offset by the impact of having a higher proportion of seats in long-haul leisure markets due to additional Atlantic services being served with lower-cost Boeing 777 higher-density aircraft which have a larger economy cabin, and new and increased lower-cost leisure flying by Air Canada rouge which offers a Premium rouge product but has no international business cabin. The yield growth was also achieved despite an increase in average stage length which reduced Atlantic yield by 0.4 percentage points.

The 4.7% PRASM growth was mainly due to a passenger load factor improvement of 2.9 percentage points and, to a lesser extent, the yield growth.

PACIFIC PASSENGER REVENUES INCREASED 6.5% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, on capacity growth of 9.5%, Pacific passenger revenues of \$377 million increased \$24 million or 6.5% from the fourth quarter of 2013. The increase in Pacific passenger revenues was due to traffic growth of 7.6% partly offset by a yield decline of 0.8%.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the fourth quarter of 2014 and each of the previous four quarters.

YEAR-OVER-YEAR BY QUARTER (% CHANGE)

	Q4'13	Q1'14	Q2'14	Q3'14	Q4'14
PACIFIC					
Passenger revenues	(3.2)	1.2	5.7	8.3	6.5
Capacity (ASMs)	4.4	4.6	1.8	1.6	9.5
Traffic (RPMs)	0.7	3.2	4.1	3.6	7.6
Passenger load factor (pp change)	(3.0)	(1.1)	1.9	1.7	(1.4)
Yield	(4.0)	(1.6)	1.8	4.9	(0.8)
PRASM	(7.4)	(2.8)	4.1	7.0	(2.5)

In the fourth quarter of 2014, the 9.5% Pacific capacity growth reflected capacity increases on all services with the exception of Korea.

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

- The 7.6% traffic increase which reflected traffic growth on all major Pacific services.
- The 0.8% yield decline which mainly reflected yield decreases on services to Hong Kong and China. Air Canada operates a lower-cost Boeing 777 higher-density aircraft on its Vancouver-Hong Kong service which has a larger economy cabin. The use of this lower-cost aircraft on high-volume routes, such as Vancouver-Hong Kong, is allowing the airline to access traditionally lower-yielding traffic while improving profitability. Hong Kong's "Occupy Central" political protest movement also negatively impacted Hong Kong yields in the fourth quarter of 2014. The yield reduction on services to China was largely driven by increased industry capacity from the U.S. and aggressive pricing activities. These yield decreases were largely offset by improvements in Air Canada's business cabin revenue performance, an increase in premium economy traffic which resulted in higher average fares, and a favourable currency impact of \$6 million.

The 2.5% PRASM decrease was due to a decrease in passenger load factor of 1.4 percentage points and the yield decline.

OTHER PASSENGER REVENUES INCREASED 0.4% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, on capacity growth of 3.9%, Other passenger revenues (comprised of routes to the Caribbean, Mexico and Central and South America) of \$182 million increased 0.4% from the fourth quarter of 2013. The increase in Other passenger revenues was due to traffic growth of 3.0% partly offset by a yield decline of 2.7%.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the fourth quarter of 2014 and each of the previous four quarters.

YEAR-OVER-YEAR BY QUARTER (% CHANGE)

	Q4'13	Q1′14	Q2'14	Q3′14	Q4'14
OTHER					
Passenger revenues	11.5	11.0	17.7	0.5	0.4
Capacity (ASMs)	0.6	(1.0)	11.0	2.2	3.9
Traffic (RPMs)	5.0	3.1	15.7	3.6	3.0
Passenger load factor (pp change)	3.4	3.3	3.5	1.1	(0.6)
Yield	6.5	8.5	2.6	(2.4)	(2.7)
PRASM	11.1	12.9	7.0	(1.1)	(3.4)

In the fourth quarter of 2014, the 3.9% capacity growth reflected capacity increases on routes to Mexico and to traditional sun destinations largely offset by a capacity reduction on services to South America.



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

- The overall 3.0% traffic increase which reflected traffic growth on routes to Mexico and to traditional sun
 destinations largely offset by a traffic decrease on services to South America where capacity was reduced
 year-over-year.
- The overall 2.7% yield decrease which reflected a decline on routes to South America and to traditional sun
 destinations partly offset by yield growth on routes to Mexico. South American yields were impacted by
 the airline's suspension of service to Venezuela while routes to traditional sun destinations were affected by
 increased industry capacity and aggressive pricing activities.

The overall 3.4% PRASM decrease was due to the lower yield and, to a lesser extent, a passenger load factor decline of 0.6 percentage points.

CARGO REVENUES INCREASED 3.9% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, cargo revenues of \$133 million increased \$5 million or 3.9% from the fourth quarter of 2013 due to traffic growth of 7.5% partly offset by a yield decline of 3.3% year-over-year.

The table below provides cargo revenue by geographic region for the fourth quarter of 2014 and the fourth quarter of 2013.

	FOURTH QUARTER 2014 \$ MILLION	FOURTH QUARTER 2013 \$ MILLION	CHANGE \$ MILLION
CARGO REVENUE			
Canada	17	16	1
U.S. transborder	5	5	-
Atlantic	48	46	2
Pacific	51	50	1
Other	12	11	1
SYSTEM	133	128	5

The table below provides year-over-year percentage changes in system cargo revenues and operating statistics for the fourth quarter of 2014 and each of the previous four quarters.

YEAR-OVER-YEAR BY QUARTER (% CHANGE)

	Q4'13	Q1′14	Q2'14	Q3′14	Q4'14
SYSTEM					
Cargo revenues	1.6	7.0	6.6	6.5	3.9
Capacity (ETMs)	3.5	4.1	8.2	9.6	11.6
Revenue per ETM	(2.2)	2.8	(1.5)	(3.0)	(6.9)
Traffic (RTMs)	4.3	6.4	11.3	6.9	7.5
Yield per RTM	(2.9)	0.5	(4.3)	(0.5)	(3.3)

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

	CARGO REVENUE % CHANGE	CAPACITY (ETMS) % CHANGE	REV / ETM % CHANGE	TRAFFIC (RTMS) % CHANGE	YIELD / RTM % CHANGE					
FOURTH QUARTER 2014 VERSUS FOURTH QUARTER 2013										
Canada	9.8	24.3	(11.6)	38.8	(20.9)					
U.S. transborder	9.7	39.3	(21.2)	19.9	(8.5)					
Atlantic	5.6	8.1	(2.3)	15.3	(8.4)					
Pacific	(1.2)	5.8	(6.6)	(5.3)	4.3					
Other	9.0	12.4	(3.1)	11.8	(2.5)					
SYSTEM	3.9	11.6	(6.9)	7.5	(3.3)					

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

- The 7.5% traffic increase which reflected traffic growth in all markets with the exception of the Pacific market
 which was impacted by load restrictions on certain key routes such as Sydney and Hong Kong. The overall growth in
 traffic was mainly due to increased capacity, market share gains and strong demand from North America to Europe.
- The 3.3% yield decrease which reflected yield declines in all markets with the exception of the Pacific market. The overall yield decline was due to the impact of increased industry capacity and aggressive competitive pricing activities. The deployment of additional wide-body aircraft on transcontinental routes has allowed the airline to increase cargo revenues by carrying a new mix of traffic and larger shipments at a lower yield. The yield decrease was partly offset by the favourable impact of a weaker Canadian dollar on foreign currency denominated cargo revenues and strong demand out of Asia which enabled price increases.

OTHER REVENUES INCREASED 5% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, Other revenues of \$216 million increased \$10 million or 5% from the fourth quarter of 2013 mainly due to growth in passenger-related fees and higher ground package revenues at Air Canada Vacations, the result of higher passenger volumes.

CASM (EXCLUDING THE IMPACT OF BENEFIT PLAN AMENDMENTS) DECREASED 2.8% FROM THE FOURTH QUARTER OF 2013. ADJUSTED CASM WAS UNCHANGED FROM THE FOURTH QUARTER OF 2013

The following table compares Air Canada's fourth quarter 2014 and fourth quarter 2013 CASM.

	FOURTH	QUARTER	CHANGE		
CENTS PER ASM	2014	2013	CENTS	%	
Aircraft fuel	4.54	5.18	(0.64)	(12.4)	
Wages and salaries	2.74	2.68	0.06	2.2	
Benefits	0.73	0.76	(0.03)	(3.9)	
Benefit plan amendments (1)	-	(0.51)	0.51	100.0	
Capacity purchase agreements	1.70	1.74	(0.04)	(2.3)	
Airport and navigation fees	1.42	1.45	(0.03)	(2.1)	
Aircraft maintenance	1.16	0.99	0.17	17.2	
Sales and distribution costs	0.88	0.86	0.02	2.3	
Depreciation, amortization and impairment	0.77	0.92	(0.15)	(16.3)	
Ground package costs	0.42	0.41	0.01	2.4	
Aircraft rent	0.45	0.48	(0.03)	(6.2)	
Food, beverages and supplies	0.42	0.44	(0.02)	(4.5)	
Communications and information technology	0.30	0.28	0.02	7.1	
Other	1.70	1.53	0.17	11.1	
CASM	17.23	17.21	0.02	0.1	
Remove: Benefit plan amendments ⁽¹⁾	-	0.51	(0.51)	(100.0)	
CASM (excluding the impact of benefit plan amendments)	17.23	17.72	(0.49)	(2.8)	
In the fourth quarter of 2013, Air Canada recorded an operating expense reduction of	of \$82 million related to a	mendments to defined b	enefit pension plans.		
CASM	17.23	17.21	0.02	0.1	
Remove:					
Fuel expense, ground package costs at Air Canada Vacations, benefit plan amendments and unusual items (1)(2)	(5.15)	(5.12)	(0.03)	(0.5)	
Adjusted CASM (3)	12.08	12.09	(0.01)	-	

¹ In the fourth quarter of 2013, Air Canada recorded an operating expense reduction of \$82 million related to amendments to defined benefit pension plans.
2 In the fourth quarter of 2014, one-time payments totaling \$30 million were made to ACPA members under a collective agreement concluded in October 2014.
3 Adjusted CASM is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

OPERATING EXPENSES INCREASED 9% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, operating expenses of \$2,998 million increased \$239 million or 9% from the fourth quarter of 2013 on capacity growth of 8.5%. The unfavourable impact of a weaker Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) in the fourth quarter of 2014, when compared to the fourth quarter of 2013, increased operating expenses by approximately \$89 million. Refer to section 12 "Financial Instruments and Risk Management" of this MD&A for information on Air Canada's foreign exchange risk management strategy. In the fourth quarter of 2014, Air Canada recorded one-time payments totaling \$30 million in Wages, salaries and benefits relating to its collective agreement with ACPA (which was concluded in October 2014). In 2013, Air Canada recorded an operating expense reduction of \$82 million in Benefit plan amendments.

FUEL EXPENSE DECREASED 5% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, fuel expense of \$791 million decreased \$40 million or 5% from the fourth quarter of 2013. The decrease in fuel expense year-over-year was due to the impact of a 16% decline in Jet fuel prices year-over-year, which accounted for a decrease of \$133 million to fuel expenses in the fourth quarter of 2014. These decreases were largely offset by the unfavourable impact of a weaker Canadian dollar versus the U.S. dollar when compared to the fourth quarter of 2013, which accounted for an increase of \$50 million, as well as a higher volume of fuel litres consumed, which accounted for an increase of \$43 million.

The table below provides Air Canada's fuel cost per litre and economic fuel cost per litre for the periods indicated.

CANADIAN DOLLARS IN MILLIONS, EXCEPT WHERE INDICATED		FOURTH QUARTER				CHANGE		
		2014		2013		\$	%	
AIRCRAFT FUEL EXPENSE – GAAP	\$	791	\$	831	\$	(40)	(5)	
Add: Net cash payments on fuel derivatives (1)		10		3		7	233	
ECONOMIC COST OF FUEL – NON-GAAP (2)	\$	801	\$	834	\$	(33)	(4)	
fuel consumption (thousands of litres)	992,320		992,320 942,940			49,380	5.2	
FUEL COST PER LITRE (CENTS) – GAAP		79.7		88.2		(8.5)	(9.6)	
ECONOMIC FUEL COST PER LITRE (CENTS) – NON-GAAP (2)		80.7		88.4		(7.7)	(8.7)	

WAGES, SALARIES AND BENEFITS EXPENSE AMOUNTED TO \$604 MILLION IN THE FOURTH QUARTER OF 2014, AN INCREASE OF \$51 MILLION OR 9% FROM THE **FOURTH QUARTER OF 2013**

In the fourth quarter of 2014, wages and salaries expense of \$477 million increased \$46 million or 11% from the fourth quarter of 2013, mainly due to Air Canada having recorded one-time payments totaling \$30 million related to its collective agreement with ACPA in 2014 while no such payments were recorded in the fourth quarter of 2013. Higher average salaries and an increase in expense accruals related to the annual employee profit sharing programs were also contributing factors to the increase year-over-year. These increases were partly offset by the favourable impact of Air Canada having outsourced its London ground handling operations to a third party provider.

In the fourth quarter of 2014, employee benefits expense of \$127 million increased \$5 million or 4% from the fourth quarter of 2013, mainly due to an increase in expenses related to post-employment benefits, which included premiums with the transition to an insured model for new long-term disability claims. This increase was largely offset by the impact of higher discount rates which decreased the current service cost of defined benefit pension plans.

CAPACITY PURCHASE COSTS INCREASED 5% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, capacity purchase costs of \$295 million increased \$15 million or 5% from the fourth quarter of 2013, mainly due to higher rates under the capacity purchase agreement with Jazz and an unfavourable currency impact. These increases were partly offset by a decline in block hours flown by Jazz under the Jazz CPA.

¹ Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives.
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.

AIRPORT AND NAVIGATION FEES INCREASED 6% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, airport and navigation fees of \$247 million increased \$15 million or 6% from the fourth quarter of 2013, largely due to the addition of Boeing 777 and 787 aircraft to Air Canada's operating fleet, an unfavourable currency impact, and rate increases in certain stations.

AIRCRAFT MAINTENANCE EXPENSE INCREASED 27% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, aircraft maintenance expense of \$201 million increased \$43 million or 27% from the fourth quarter of 2013, largely due a higher volume of engine and airframe maintenance activity versus the fourth quarter of 2013 and an unfavourable currency impact of \$12 million.

SALES AND DISTRIBUTION COSTS INCREASED 11% FROM THE FOURTH OUARTER OF 2013

In the fourth quarter of 2014, sales and distribution costs of \$153 million increased \$15 million or 11% from the fourth quarter of 2013 on passenger revenue growth of 7.6%. This growth in sales and distribution costs was mainly due to the impact of a higher volume of ticket sales generated through GDS providers, a change in commission structure to drive higher passenger revenues, and an increase in credit card expenses which was in line with sales and revenue growth. An unfavourable currency impact was also a contributing factor to the increase in sales and distribution costs year-over-year.

DEPRECIATION, AMORTIZATION AND IMPAIRMENT EXPENSE DECREASED 9% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, depreciation, amortization and impairment expense of \$134 million decreased \$14 million or 9% from the fourth quarter of 2013. This decrease in depreciation, amortization and impairment expense was due to Air Canada having recorded an impairment charge of \$6 million in the fourth quarter of 2013 while no such charge was recorded in the fourth quarter of 2014 and to the impact of certain maintenance events becoming fully amortized. These decreases were partly offset by the impact of additional Boeing 777 and 787 aircraft in the airline's operating fleet.

GROUND PACKAGE COSTS INCREASED 12% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, the cost of ground packages at Air Canada Vacations amounted to \$74 million, an increase of \$8 million or 12% from the fourth quarter of 2013. This increase was mainly due to higher passenger volumes and, to a lesser extent, an increase in the price of ground packages and an unfavourable currency impact.

OTHER OPERATING EXPENSES INCREASED 21% FROM THE FOURTH QUARTER OF 2013

In the fourth quarter of 2014, Other operating expenses of \$294 million increased \$51 million or 21% from the fourth quarter of 2013 mainly due to the 8.5% capacity growth and an increase in Remaining other expenses of \$32 million or 31%. The increase in Remaining other expenses included growth in advertising and promotion expenses and higher customer inconvenience costs, as well as certain unfavourable accrual variances of \$15 million, which were mainly related to various commodity taxes and which are not expected to re-occur. The increase in advertising and promotion expenses was driven by additional promotional programs, such as those related to Air Canada's new Boeing 787 Dreamliners, while the higher customer inconvenience costs was mainly driven by an increase in passenger volumes and higher passenger compensation pursuant to a Canadian Transportation Agency ruling. An increase in terminal handling expenses of \$10 million or 21% was due to Air Canada's international expansion, as well as the airline having outsourced its London ground handling operations to a third party provider in 2014 (the savings associated with this initiative are included in other expense categories, such as wages and salaries expense, for a net overall cost reduction).

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

	FOURTH	QUARTER	CHANGE		
CANADIAN DOLLARS IN MILLIONS	2014	2013	\$	%	
Terminal handling	\$ 58	\$ 48	\$ 10	21	
Building rent and maintenance	35	34	1	3	
Crew cycle	36	30	6	20	
Miscellaneous fees and services	30	28	2	7	
Remaining other expenses	135	103	32	31	
OTHER OPERATING EXPENSES	\$ 294	\$ 243	\$ 51	21	

NON-OPERATING EXPENSE AMOUNTED TO \$206 MILLION IN THE FOURTH QUARTER OF 2014 COMPARED TO NON-OPERATING EXPENSE OF \$141 MILLION IN THE FOURTH QUARTER OF 2013

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

	FOURTH	CHANGE	
CANADIAN DOLLARS IN MILLIONS	2014	2013	\$
Foreign exchange loss	\$ (115)	\$ (55)	\$ (60)
Interest income	10	10	-
Interest expense	(83)	(73)	(10)
Interest capitalized	9	10	(1)
Net financing expense relating to employee benefits	(32)	(53)	21
Fuel and other derivatives	9	22	(13)
Other	(4)	(2)	(2)
TOTAL NON-OPERATING EXPENSE	\$ (206)	\$ (141)	\$ (65)

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

- Losses on foreign exchange, mainly related to U.S. denominated long-term debt, which amounted to \$115 million in the fourth quarter of 2014 compared to losses of \$55 million in the fourth quarter of 2013. The losses in the fourth quarter of 2014 were mainly attributable to a weaker Canadian dollar at December 31, 2014 when compared to December 31, 2013. Partially offsetting these losses were gains of \$41 million on foreign currency derivatives. The December 31, 2014 closing exchange rate was US\$1 = C\$1.1601 while the September 30, 2014 closing exchange rate was US\$1 = C\$1.1200. Refer to section 12 "Financial Instruments and Risk Management" of this MD&A for additional information.
- A decrease in net financing expense relating to employee benefits of \$21 million which was mainly due to the impact of lower pension liabilities.
- Gains on fuel and other derivatives which amounted to \$9 million in the fourth quarter of 2014 versus gains of \$22 million in the fourth quarter of 2013. Refer to section 12 "Financial Instruments and Risk Management" of this MD&A for additional information.

8. FLEET

MAINLINE AND AIR CANADA ROUGE

The following table provides Air Canada's and Air Canada rouge's operating fleet as at December 31, 2014 (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	6	0.4	6	-	-	-
Boeing 777-300ER	349/458	17	5.2	8	1	-	8
Boeing 777-200LR	270	6	7.1	4	-	-	2
Boeing 767-300ER	211	21	21.7	5	5	2	9
Airbus A330-300	265	8	14.2	-	-	8	-
NARROW-BODY AIRCRAFT							
Airbus A321	174	10	12.8	-	-	5	5
Airbus A320	146	41	21.7	1	-	-	40
Airbus A319	120	18	16.7	5	10	-	3
Embraer 190	97	45	7.8	45	-	-	-
TOTAL MAINLINE		172	13.8	74	16	15	67
AIR CANADA ROUGE							
WIDE-BODY AIRCRAFT							
Boeing 767-300ER	282	8	17.6	-	1	-	7
NARROW-BODY AIRCRAFT							
Airbus A319 (2)	142	20	16.5	17	-	-	3
TOTAL AIR CANADA ROUGE		28	16.8	17	1	-	10
TOTAL MAINLINE AND AIR CANADA ROUGE		200	14.2	91	17	15	77

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.
 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, 2014 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, 2015, December 31, 2016 and December 31, 2017.

	ACTUAL	PLANNED					
	DECEMBER 31, 2014	2015 FLEET CHANGES	DECEMBER 31, 2015	2016 FLEET CHANGES	DECEMBER 31, 2016	2017 FLEET CHANGES	DECEMBER 31, 2017
MAINLINE							
WIDE-BODY AIRCRAFT							
Boeing 787-8	6	2	8	-	8	-	8
Boeing 787-9	-	3	3	10	13	9	22
Boeing 777-300ER	17	-	17	2	19	-	19
Boeing 777-200LR	6	-	6	-	6	-	6
Boeing 767-300ER	21	(4)	17	(2)	15	(5)	10
Airbus A330-300	8	-	8	-	8	-	8
NARROW-BODY AIRCRAFT			'				
Boeing 737 MAX	-	-	-	-	-	2	2
Airbus A321	10	3	13	1	14	-	14
Airbus A320	41	2	43	-	43	-	43
Airbus A319	18	-	18	-	18	-	18
Embraer 190	45	(13)	32	(7)	25	-	25
TOTAL MAINLINE	172	(7)	165	4	169	6	175
AIR CANADA ROUGE							
WIDE-BODY AIRCRAFT							
Boeing 767-300ER	8	6	14	4	18	7	25
NARROW-BODY AIRCRAFT							
Airbus A321	-	2	2	3	5	-	5
Airbus A319	20	-	20	-	20	-	20
TOTAL AIR CANADA ROUGE	28	8	36	7	43	7	50
TOTAL WIDE-BODY AIRCRAFT	66	7	73	14	87	11	98
TOTAL NARROW-BODY AIRCRAFT	134	(6)	128	(3)	125	2	127
TOTAL MAINLINE AND AIR CANADA ROUGE	200	1	201	11	212	13	225

In 2014, Air Canada exercised purchase rights for two Boeing 777-300ER aircraft, with scheduled deliveries in the second quarter of 2016. The configuration of these aircraft will be high-density in a three-cabin configuration, including a premium economy cabin and an International Business Class cabin that will offer Air Canada's new international product standard as introduced on the airline's Boeing 787 aircraft. Air Canada also announced that it plans on harmonizing the interior of its existing five higher-density Boeing 777-300 aircraft to Boeing 787 standards.

On March 31, 2014, Air Canada concluded an agreement with Boeing for the purchase of Boeing 737 MAX aircraft to replace the airline's narrow-body aircraft. Refer to section 9.6 "Capital Expenditures and Related Financing Arrangements" of this MD&A for additional information. The renewal of its narrow-body fleet with more fuel-efficient aircraft is a key element of Air Canada's ongoing cost transformation program.

As part of the Boeing 737 MAX order, Boeing will be purchasing 20 of the 45 Embraer 190 aircraft currently in the airline's fleet. The Embraer 190 aircraft exiting the fleet will initially be replaced by three Airbus A321 and two Airbus A320 aircraft (which have been 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 return to lessors.

AIR CANADA EXPRESS

The following table provides, as at December 31, 2014, the number of aircraft operated on behalf of Air Canada by Jazz, Sky Regional and other airlines operating flights on behalf of Air Canada under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada.

	AS AT DECEMBER 31, 2014						
	JAZZ	SKY REGIONAL	OTHER	TOTAL			
Embraer 175	-	15	-	15			
Bombardier CRJ-100	-	-	5	5			
Bombardier CRJ-200	25	-	-	25			
Bombardier CRJ-705	16	-	-	16			
Bombardier Dash 8-100	34	-	-	34			
Bombardier Dash 8-300	26	-	-	26			
Bombardier Dash 8-Q400	21	5	-	26			
Beech 1900	-	-	17	17			
TOTAL AIR CANADA EXPRESS	122	20	22	164			

The following table provides, as at December 31, 2015, the number of aircraft planned to be operated by Jazz, Sky Regional and other airlines operating flights on behalf of Air Canada under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada. On February 2, 2015, Air Canada announced that it had concluded an amended and extended capacity purchase agreement with Jazz. The fleet information provided below reflects the amended Jazz CPA. Refer to section 4 "Strategy" of this MD&A for additional information.

		AS AT DECEM	IBER 31, 2015	
	JAZZ	SKY REGIONAL	OTHER	TOTAL
Embraer 175	-	15	-	15
Bombardier CRJ-100	-	-	2	2
Bombardier CRJ-200	18	-	4	22
Bombardier CRJ-705	16	-	-	16
Bombardier Dash 8-100	28	-	-	28
Bombardier Dash 8-300	26	-	-	26
Bombardier Dash 8-Q400	27	5	-	32
Beech 1900	-	-	17	17
TOTAL AIR CANADA EXPRESS	115	20	23	158

9. 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), and covenants in credit card and other agreements. Refer to sections 9.6, 9.7 and 9.8 of this MD&A for information on Air Canada's capital commitments, pension funding obligations and contractual obligations. Air Canada 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. Air Canada's principal objective in managing liquidity risk is to maintain a minimum unrestricted liquidity level of \$1.7 billion. This minimum target level was determined in conjunction with Air Canada's liquidity risk management strategy. At December 31, 2014, unrestricted liquidity amounted to \$2,685 million (comprised of cash and short-term investments of \$2,275 million and undrawn lines of credit of \$410 million). This compared to unrestricted liquidity of \$2,364 million (comprised of cash and short-term investments of \$2,208 million and undrawn lines of credit of \$156 million) at December 31, 2013.

In January 2015, in order to effectively manage financing costs, the amount outstanding under an undrawn line of credit was reduced by \$116 million. As at January 31, 2015, the amount available under undrawn lines of credit was \$315 million.

9.2. FINANCIAL POSITION

The following table provides a condensed consolidated statement of financial position of Air Canada as at December 31, 2014 and as at December 31, 2013.

CANADIAN DOLLARS IN MILLIONS	DECEMBER 31, 2014		DECEN	MBER 31, 2013	\$ CHANGE		
ASSETS							
Cash, cash equivalents and short-term investments	\$	2,275	\$	2,208	\$	67	
Other current assets		1,203		1,080		123	
Current assets		3,478		3,288		190	
Property and equipment		5,998		5,073		925	
Intangible assets		305		304		1	
Goodwill		311		311		-	
Deposits and other assets		556		494		62	
TOTAL ASSETS	\$	10,648	\$	9,470	\$	1,178	
LIABILITIES							
Current liabilities	\$	3,537	\$	3,190		347	
Long-term debt and finance leases		4,732		3,959		773	
Pension and other benefit liabilities		2,403		2,687		(284)	
Maintenance provisions		796		656		140	
Other long-term liabilities		313		375		(62)	
TOTAL LIABILITIES		11,781		10,867		914	
TOTAL EQUITY		(1,133)		(1,397)		264	
TOTAL LIABILITIES AND EQUITY	\$	10,648	\$	9,470	\$	1,178	

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, 2014, Property and equipment amounted to \$5,998 million, an increase of \$925 million from December 31, 2013. The increase in Property and equipment was mainly due to additions to Property and equipment of \$1,521 million in 2014, partially offset by the impact of depreciation expense of \$502 million. The additions to Property and equipment included flight equipment purchases of \$937 million, which included one Boeing 777-300ER aircraft delivered in February and six Boeing 787-8 aircraft delivered in 2014, progress payments on future aircraft deliveries of \$229 million, and capitalized maintenance costs of \$177 million.

At December 31, 2014, Pension and other benefit liabilities decreased \$284 million from December 31, 2013, mainly due to strong investment returns on pension plan assets partly offset by the impact of lower prescribed pension plan discount rates as at December 31, 2014 versus 2013 with respect to its pension plans. Pension funding payments of \$445 million were made in 2014. 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, 2014 and as at December 31, 2013.

CANADIAN DOLLARS IN MILLIONS, EXCEPT WHERE INDICATED	DECEM	IBER 31, 2014	DECEM	IBER 31, 2013	\$ C	HANGE
Total long-term debt and finance leases	\$	4,732	\$	3,959	\$	773
Current portion of long-term debt and finance leases		484		374		110
Total long-term debt and finance leases, including current portion		5,216		4,333		883
Less cash, cash equivalents and short-term investments		(2,275)		(2,208)		(67)
NET DEBT	\$	2,941	\$	2,125	\$	816
Capitalized operating leases (1)		2,191		2,226		(35)
ADJUSTED NET DEBT	\$	5,132	\$	4,351	\$	781
EBITDAR (EXCLUDING THE IMPACT OF BENEFIT PLAN AMENDMENTS) (TRAILING 12 MONTHS)	\$	1,671	\$	1,433	\$	238
ADJUSTED NET DEBT TO EBITDAR RATIO		3.1		3.0	\$	0.1

¹ Adjusted net debt is a non-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 was \$313 million for the 12 months ended December 31, 2014 and \$318 million for the 12 months ended December 31, 2013.

At December 31, 2014, total long-term debt and finance leases, including current portion, amounted to \$5,216 million, an increase of \$883 million from December 31, 2013. This increase was due to new borrowings of \$1,178 million partly offset by debt repayments of \$677 million. In 2014, Air Canada completed a private offering of US\$400 million of 7.75% senior unsecured notes due 2021 which is further described below. In addition, Air Canada took delivery of the fifth Boeing 777-300ER aircraft, which was financed under the private offering of enhanced equipment trust certificates, as well as the first six of 37 Boeing 787 aircraft, which were financed with support from the Export-Import Bank of the United States ("EXIM"). Refer to section 9.6 "Capital Expenditures and Related Financing Arrangements" of this MD&A for additional information. Debt repayments included an optional repayment of \$182 million on the outstanding balance under a revolving loan facility. In addition, in 2014, Air Canada disposed of its two Airbus A340-500 aircraft and repaid the financing related to these aircraft in the amount of \$90 million. No gain or loss was recorded on the sale. The unfavourable impact of a weaker Canadian dollar as at December 31, 2014 compared to December 31, 2013 on Air Canada's foreign currency denominated debt (mainly U.S. dollars), which accounted for an increase of \$365 million, was also a contributing factor to the increase in long-term debt.

Adjusted net debt amounted to \$5,132 million at December 31, 2014, an increase of \$781 million from December 31, 2013, mainly due to the higher long-term debt and finance lease balances.

At December 31, 2014, the adjusted net debt to EBITDAR ratio amounted to 3.1 versus a ratio of 3.0 at December 31, 2013. Air Canada uses this ratio to manage its financial leverage risk and has an objective to maintain the ratio below 3.5.

At December 31, 2014, Air Canada's weighted average cost of capital ("WACC"), on a pre-tax basis, was approximately 10.1%. WACC is based on an estimate by management and consists of an estimated cost of equity of 20.1% and an average cost of debt and finance leases of 5.6%.

Unsecured Financing

In April 2014, Air Canada completed a private offering of US\$400 million of 7.75% senior unsecured notes due 2021 (the "Notes"). Air Canada received net proceeds of approximately \$432 million from the sale of the Notes. The Notes were sold at par and provide for interest payable semi-annually. The Notes are senior unsecured obligations of Air Canada and are guaranteed on a senior unsecured basis by one of Air Canada's subsidiaries.

9.4. WORKING CAPITAL

The following table provides information on Air Canada's working capital balances as at December 31, 2014 and as at December 31, 2013.

CANADIAN DOLLARS IN MILLIONS	DECEMBER 31, 2014		DECE	MBER 31, 2013	\$ CHANGE		
Cash, cash equivalents and short-term investments	\$	2,275	\$	2,208	\$	67	
Accounts receivable		656		589		67	
Other current assets		547		491		56	
Accounts payable and accrued liabilities		(1,259)		(1,129)		(130)	
Advance ticket sales		(1,794)		(1,687)		(107)	
Current portion of long-term debt and finance leases		(484)		(374)		(110)	
NET WORKING CAPITAL	\$	(59)	\$	98	\$	(157)	

The net negative working capital of \$59 million at December 31, 2014 represented a decrease of \$157 million from December 31, 2013 and was largely due to capital expenditures of \$1,501 million (or \$732 million net of the financing drawn upon the delivery of the fifth Boeing 777-300ER aircraft and the six Boeing 787-8 aircraft received in 2014) and pension funding payments of \$445 million. Air Canada also repaid a revolving credit facility in the amount of \$182 million as the liquidity was no longer required, which decreased net working capital by this amount. These factors were largely offset by the impact of strong operating results, with cash from operations of \$941 million, as well as the proceeds from the US\$400 million senior unsecured notes completed in the second quarter of 2014.

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	2014	2013	\$ Change	2014	2013	\$ Change	
NET CASH FLOWS FROM OPERATING ACTIVITIES	\$ 20	\$ 68	\$ (48)	\$ 941	\$ 731	\$ 210	
Proceeds from borrowings	200	304	(104)	1,178	1,973	(795)	
Reduction of long-term debt and finance lease obligations	(121)	(238)	117	(677)	(1,646)	969	
Issue of common shares, net	-	8	(8)	1	14	(13)	
Other	-	-	-	-	(15)	15	
NET CASH FLOWS FROM FINANCING ACTIVITIES	79	74	5	502	326	176	
Short-term investments	37	59	(22)	(100)	(210)	110	
Additions to property, equipment and intangible assets	(386)	(344)	(42)	(1,501)	(962)	(539)	
Proceeds from sale of assets	4	35	(31)	72	70	2	
Other	10	46	(36)	(3)	41	(44)	
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(335)	(204)	(131)	(1,532)	(1,061)	(471)	
DECREASE IN CASH AND CASH EQUIVALENTS	(236)	(62)	(174)	(89)	(4)	(85)	
Cash and cash equivalents, beginning of period	897	812	85	750	754	(4)	
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 661	\$ 750	\$ (89)	\$ 661	\$ 750	\$ (89)	

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

	FOL	JRTH QUAF	RTER	FULL YEAR			
CANADIAN DOLLARS IN MILLIONS	2014	2013	\$ Change	2014	2013	\$ Change	
CASH FLOWS FROM OPERATING ACTIVITIES	\$ 20	\$ 68	\$ (48)	\$ 941	\$ 731	\$ 210	
Additions to property, equipment and intangible assets	(386)	(344)	(42)	(1,501)	(962)	(539)	
FREE CASH FLOW (1)	\$ (366)	\$ (276)	\$ (90)	\$ (560)	\$ (231)	\$ (329)	

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

Cash from operations of \$941 million for the full year 2014 improved \$210 million versus 2013, consistent with the improvement in operating income. Negative free cash flow deteriorated \$90 million in the fourth quarter of 2014 and \$329 million in the full year 2014 from the same periods in 2013. Free cash flow was impacted by the addition of one Boeing 777-300 and six Boeing 787-8 aircraft in 2014. The decline in free cash flow in the fourth quarter of 2014 was driven by the addition of two Boeing 787-8 aircraft, as well as changes in non-cash working capital, particularly the timing of fuel payments when compared to the same quarter in 2013.

Net cash flows used in financing activities

Proceeds from borrowings amounted to \$200 million in the fourth quarter of 2014 and \$1,178 million in the full year 2014. In the fourth quarter and the full year 2014, reduction of long-term debt and finance lease obligations amounted to \$121 million and \$677 million, respectively. Refer to section 9.3 "Adjusted Net Debt" 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

As at December 31, 2014, Air Canada had outstanding purchase commitments with Boeing for the acquisition of 31 Boeing 787 aircraft. Deliveries for these aircraft are scheduled from 2015 to 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 financing or sale and leaseback commitments covering up to 26 of the remaining 31 Boeing 787 firm aircraft orders, which such commitments are summarized as follows:

- Final commitment from EXIM, subject to documentation and other conditions, for one 787 aircraft scheduled for delivery in February 2015.
- For one 787 aircraft, the financing under the commitment, which is subject to conditions, covers up to 90% of the capital expenditure and the term to maturity is 15 years with principal payments made on a mortgage-style basis resulting in equal installment payments of principal and interest over the term to maturity.
- For 22 787 aircraft, the financing, which is subject to conditions, covers terms for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments.
- In the fourth quarter of 2014, Air Canada entered into a sale and leaseback transaction with a third party for two Boeing 787 firm aircraft.

In March 2014, Air Canada concluded an agreement with Boeing for the purchase of Boeing 737 MAX aircraft. This agreement includes 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. It also provides for purchase options for 18 Boeing 737 aircraft and certain rights to purchase an additional 30 Boeing 737 aircraft. Deliveries are scheduled to begin in 2017 with two aircraft, and with the remaining deliveries between 2018 and 2021, subject to deferral and acceleration rights.

Air Canada has financing commitments, subject to certain conditions, covering up to 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.

In 2014, Air Canada exercised purchase rights for two Boeing 777 aircraft, with scheduled deliveries in the second quarter of 2016. Financing alternatives will be considered prior to the planned delivery dates of these aircraft. As at December 31, 2014, Air Canada has purchase rights for 11 Boeing 777 aircraft (entitling Air Canada to purchase aircraft based on previously determined pricing).

Certain of the financing commitments for the Boeing 787 aircraft and/or the Boeing 737 MAX aircraft will be reduced based on allocation of the commitment between aircraft type to be determined by Air Canada, although the specifics of the reduction have not yet been determined. Taking the estimated financing reduction into consideration, the total committed financing on these Boeing 787 aircraft and/or the Boeing 737 MAX aircraft, including commitments from EXIM and the sale and leaseback transaction with a third party, will be at least \$4,643 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, 2014 approximates \$8,256 million.

CANADIAN DOLLARS IN MILLIONS	2015	2016	2017	2018	2019	THEREAFTER	TOTAL
Projected committed expenditures	\$ 1,067	\$ 2,122	\$ 1,598	\$ 1,362	\$ 1,066	\$ 1,041	\$ 8,256
Projected planned but uncommitted expenditures	134	254	302	286	331	not available	not available
Projected planned but uncommitted capitalized maintenance (1)	200	159	109	109	109	not available	not available
TOTAL PROJECTED EXPENDITURES (2)	\$ 1,401	\$ 2,535	\$ 2,009	\$ 1,757	\$ 1,506	not available	not available

9.7. PENSION FUNDING OBLIGATIONS

Air Canada maintains several pension plans, including defined benefit and defined contribution pension plans and plans providing other retirement and post-employment benefits to its employees. As at January 1, 2014, the aggregate solvency surplus in the domestic registered pension plans was \$89 million. The next required valuations to be made as at January 1, 2015, will be completed in the first half of 2015, but as described below, they will not impact the 2015 pension past service cost funding obligations unless Air Canada opts out of the 2014 Regulations (described below), deciding instead to fund its domestic registered pension plans pursuant to normal funding rules. Based on preliminary estimates, including actuarial assumptions, as at January 1, 2015, the aggregate solvency surplus in Air Canada's domestic registered pension plans is projected to be \$780 million.

Pension funding obligations under the normal funding rules are generally dependent on a number of factors, including the assumptions used in the most recently filed actuarial valuation reports for current service (including the applicable discount rate used or assumed in the actuarial valuation), the plan demographics at the valuation date, the existing plan provisions, existing pension legislation and changes in economic conditions (mainly the return on fund assets and changes in interest rates). Actual contributions that are determined on the basis of future valuation reports filed annually 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 changes in legislation and other factors.

In December 2013, the Government of Canada formally approved the Air Canada Pension Plan Funding Regulations, 2014 (the "2014 Regulations") under the Pension Benefits Standards Act, 1985 in respect of special payments required to be made to amortize the deficit under Air Canada's defined benefit plans applicable to the period between 2014 and 2020 inclusively, expiring December 31, 2020. According to the terms of the 2014 Regulations, Air Canada will be required to make payments of at least \$150 million annually with an average of \$200 million per year, to contribute an aggregate minimum of \$1,400 million over seven years in solvency deficit payments, in addition to its pension current service payments.

Under an agreement reached with the Government of Canada, in respect of the plan years during which Air Canada funds its plans pursuant to the 2014 Regulations, Air Canada is subject to a series of covenants and undertakings, including a prohibition on dividends and share repurchases, as well as certain limitations on executive compensation arrangements. As requested by the Government of Canada, Air Canada has also agreed to use reasonable efforts, during the negotiations of the next collective agreements with Air Canada's Canadian-based unions, to seek to include in those collective agreements provisions which would have employees contribute fifty per cent of their pension plan normal costs, and has agreed not to implement pension plan benefit improvements without regulatory approval.

¹ Future capitalized maintenance amounts for 2018 and beyond are not yet determinable however an estimate of \$109 million has been made for 2018 and 2019.
2 U.S. dollar amounts are converted using the December 31, 2014 closing exchange rate of US\$1 = C\$1.1601. 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, 2014.

Giving effect to the 2014 Regulations as outlined above, total employer pension funding contributions during 2014 amounted to \$445 million.

CANADIAN DOLLARS IN MILLIONS	2014
Past service domestic registered plans	\$ 222
Current service domestic registered plans	127
Other pension arrangements (1)	96
TOTAL PENSION FUNDING OBLIGATIONS	\$ 445

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

Air Canada is permitted to opt out of the 2014 Regulations and have past service payments in respect of all Air Canada pension plans, collectively, determined in accordance with normal funding rules.

Air Canada would consider opting out of the 2014 Regulations when the annual solvency deficit payments under normal funding rules, which are determined using deficit levels over three years, would be less than \$200 million and when there would be a strong basis for confidence that the airline's de-risking strategy would make a future significant deficit unlikely to re-occur. At December 31, 2014, approximately 72.5% of the pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk.

In the event that Air Canada opts out of the 2014 Regulations, based on the normal funding rules and subject to the finalization of the preliminary estimate of the pension solvency surplus of \$780 million at January 1, 2015, Air Canada's past service payments to the domestic registered plans would be approximately \$90 million in 2015.

In the event that Air Canada does not opt out and continues funding its domestic registered pension plans under the 2014 Regulations, Air Canada's projected pension funding obligations, on a cash basis, for the years 2015 to 2019 would be as follows:

CANADIAN DOLLARS IN MILLIONS	2015	2016	2017	2018	2019
Past service domestic registered plans	\$ 200	\$ 200	\$ 200	\$ 200	\$ 200
Current service domestic registered plans	143	142	141	139	137
Other pension arrangements (1)	81	84	88	89	89
TOTAL PROJECTED PENSION FUNDING OBLIGATIONS	\$ 424	\$ 426	\$ 429	\$ 428	\$ 426

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



9.8. CONTRACTUAL OBLIGATIONS

The table below provides Air Canada's contractual obligations as at December 31, 2014 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.

CANADIAN DOLLARS IN MILLIONS	2015	2016	2017	2018	2019	THI	EREAFTER	1	OTAL
Long-term debt obligations	\$ 418	\$ 381	\$ 505	\$ 484	\$ 1,485	\$	1,751	\$	5,024
Finance lease obligations	66	28	29	32	35		93		283
TOTAL PRINCIPAL OBLIGATIONS	\$ 484	\$ 409	\$ 534	\$ 516	\$ 1,520	\$	1,844	\$	5,307
Long-term debt obligations	\$ 262	\$ 242	\$ 243	\$ 194	\$ 167	\$	152	\$	1,260
Finance lease obligations	25	20	17	14	11		27		114
TOTAL INTEREST OBLIGATIONS	\$ 287	\$ 262	\$ 260	\$ 208	\$ 178	\$	179	\$	1,374
TOTAL LONG-TERM DEBT AND FINANCE LEASE OBLIGATIONS	\$ 771	\$ 671	\$ 794	\$ 724	\$ 1,698	\$	2,023	\$	6,681
Operating lease obligations	\$ 359	\$ 300	\$ 266	\$ 227	\$ 185	\$	296	\$	1,633
Committed capital expenditures	\$ 1,067	\$ 2,122	\$ 1,598	\$ 1,362	\$ 1,066	\$	1,041	\$	8,256
TOTAL CONTRACTUAL OBLIGATIONS (1)(2)	\$ 2,197	\$ 3,093	\$ 2,658	\$ 2,313	\$ 2,949	\$	3,360	\$	16,570

Covenants in Credit Card Agreements

Air Canada has various agreements with companies that process customer credit card transactions. Approximately 85% of Air Canada's sales are processed using credit cards, with remaining sales processed through cash based transactions. Air Canada receives payment for a credit card sale generally in advance of when the passenger transportation is provided.

Air Canada's principal credit card processing agreements for credit card processing services in North America contain triggering events upon which Air Canada 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 Air Canada and the unrestricted cash and short-term investments of Air Canada. In 2014, Air Canada made no cash deposits under these agreements (nil in 2013).

Air Canada also has agreements with another processor for the provision of certain credit card processing services requirements for markets other than North America and for its cargo operations worldwide where such agreements also contain deposit obligations. In 2014, Air Canada made no cash deposits under these agreements (nil in 2013).

¹ Total contractual obligations exclude commitments for goods and services required in the ordinary course of business. Also excluded are other long-term liabilities mainly due to reasons of uncertainty of timing of cash flows and items that are non-cash in nature.

2 The table above excludes the future minimum non-cancellable commitments under CPA arrangements which, at December 31, 2014, for the year 2015, amounted to approximately \$856 million with Jazz and \$115 million for the other regional carriers. In February 2015, Air Canada and Jazz concluded an amendment to the Jazz CPA, effective as of January 1, 2015.

Air Canada is assessing the impact to the minimum non-cancellable commitment under the amended Jazz CPA, which includes modification to the fee structure by creating a fixed fee compensation structure to replace the current variable mark-up structure.

Ratings

Air Canada's corporate credit and/or Air Canada's Senior Notes are rated by the following rating agencies:

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

Moody's Ratings

On September 17, 2014, Moody's upgraded the following ratings relating to Air Canada:

- Air Canada's corporate family rating to B2 from B3 and probability of default ratings to B2-PD from B3-PD
- Senior First Lien Notes rating to Ba3 from B1 and Senior Second Lien Notes rating to B3 from Caa1
- · Senior Unsecured Notes rating to Caa1 from Caa2
- Air Canada's speculative grade liquidity rating was affirmed at SGL-2
- The ratings on Air Canada's 2013-1 Class A, Class B and Class C Enhanced Equipment Trust Certificates ("EETCs") were upgraded by one notch to Baa1, Ba2, and B1, respectively
- The rating outlooks for Air Canada and the EETCs were changed to stable from positive

Standard & Poor's Ratings

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

- Air Canada's corporate credit rating to B+ from B, stable trend
- Senior Unsecured Notes rating to B from B-.
 - No change to the recovery rating: Senior Unsecured Notes rating of 5
- Senior First Lien Notes rating to BB from BB- and Senior Second Lien Notes rating to BB from B-.
 - No change to the recovery rating: Senior First Lien Notes rating of 1
 - Senior Second Lien Notes rating revised to 1 from 5
- The rating on Air Canada's 2013-1 Class A enhanced equipment trust certificate ("EETC") was reaffirmed at A and the ratings on Air Canada's 2013-1 Class B and Class C EETCs were raised by one notch each to BBB- from BB+ and to BB- from B+, respectively

Fitch Ratings

On April 8, 2014, Fitch undertook the following actions relating to Air Canada:

- Fitch affirmed the following ratings:
 - Air Canada's long-term issuer default rating (IDR) of B
 - Senior First Lien Notes rating of BB with a recovery rating of RR1
 - Air Canada's 2013-1 Class A,
 Class B and Class C EETCs of A, BB+ and BB-, respectively
- Fitch upgraded the following ratings:
 - Senior Second Lien Notes rating to BB with a recovery rating of RR1 from BB- with a recovery rating of RR2
- · Fitch assigned the following rating:
 - Senior Unsecured Notes rating of B- with a recovery rating of RR5 (EXP)

DBRS Ratings

On November 11, 2014, DBRS reaffirmed Air Canada's Issuer Rating of "B", and changed the trend to positive from stable.

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.

9.9. SHARE INFORMATION

The issued and outstanding shares of Air Canada, along with shares potentially issuable, as of December 31, 2014, are as follows:

	DECEMBER 31, 2014
ISSUED AND OUTSTANDING SHARES	
Class A variable shares	69,232,535
Class B voting shares	217,256,759
TOTAL ISSUED AND OUTSTANDING SHARES	286,489,294
SHARES POTENTIALLY ISSUABLE	
Shares held in trust for employee recognition award	-
Stock options	10,002,975
TOTAL SHARES POTENTIALLY ISSUABLE	10,002,975
TOTAL OUTSTANDING AND POTENTIALLY ISSUABLE SHARES	296,492,269

Effective November 3, 2014, Air Canada's Class B voting shares and Class A variable voting shares are listed for trading on the Toronto Stock Exchange under the single ticker "AC".

Earnings per Share

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

	FOURTH	QUARTER	FULL YEAR			
IN MILLIONS	2014	2013	2014	2013		
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING – BASIC	286	282	286	277		
Effect of potential dilution	8	9	7	7		
Add back anti-dilutive impact	(8)	(9)	-	-		
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING – DILUTED	286	282	293	284		

10. QUARTERLY FINANCIAL DATA

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

CANADIAN DOLLARS IN MILLIONS,		20	13		2014			
EXCEPT WHERE INDICATED	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
OPERATING REVENUES	\$ 2,952	\$ 3,057	\$ 3,479	\$ 2,894	\$ 3,065	\$ 3,305	\$ 3,798	\$ 3,104
Aircraft fuel	870	831	1,002	831	918	962	1,076	791
Ownership (DAR) (1)(2)	251	211	210	224	209	211	223	213
Other operating expenses (3)(4)(5)	1,937	1,841	1,851	1,704	2,000	1,887	1,973	1,994
OPERATING EXPENSES	3,058	2,883	3,063	2,759	3,127	3,060	3,272	2,998
OPERATING INCOME (LOSS)	(106)	174	416	135	(62)	245	526	106
TOTAL NON-OPERATING INCOME (EXPENSE) (6)	(154)	(197)	(125)	(141)	(279)	(22)	(203)	(206)
Income taxes	-	-	8	-	-	-	-	-
NET INCOME (LOSS)	\$ (260)	\$ (23)	\$ 299	\$ (6)	\$ (341)	\$ 223	\$ 323	\$ (100)
EARNINGS (LOSS) PER SHARE – DILUTED	\$(0.95)	\$(0.09)	\$ 1.05	\$ (0.02)	\$ (1.20)	\$ 0.75	\$ 1.10	\$(0.35)
EBITDAR, EXCLUDING THE IMPACT OF BENEFIT PLAN AMENDMENTS (3)(6)	\$ 145	\$ 385	\$ 626	\$ 277	\$ 147	\$ 456	\$ 749	\$ 319
EBITDAR (7)	\$ 145	\$ 385	\$ 626	\$ 359	\$ 147	\$ 456	\$ 749	\$ 319
ADJUSTED NET INCOME (LOSS) (8)	\$ (143)	\$ 115	\$ 365	\$ 3	\$ (132)	\$ 139	\$ 457	\$ 67
ADJUSTED NET INCOME (LOSS) PER DILUTED SHARE ⁽⁸⁾	\$ (0.52)	\$ 0.41	\$ 1.29	\$ 0.01	\$(0.46)	\$ 0.47	\$ 1.55	\$ 0.23

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

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenue passenger miles (millions)	13,087	14,093	16,726	12,882	13,466	15,495	18,565	14,090
Available seat miles (millions)	16,164	16,972	19,404	16,033	16,774	18,413	21,299	17,403
Passenger load factor (%)	81.0	83.0	86.2	80.3	80.3	84.2	87.2	81.0
Passenger PRASM (cents)	15.4	16.0	16.2	15.7	15.3	15.9	16.1	15.6
CASM, excluding the impact of benefit plan amendments (cents) (1)	18.9	17.0	15.8	17.7	18.6	16.6	15.4	17.2
Adjusted CASM (cents) (2)	12.5	11.7	10.4	12.1	12.2	11.2	10.1	12.1
Economic fuel price per litre (cents) (3)	92.4	85.7	89.6	88.4	94.7	91.6	90.0	80.7

¹ In the fourth quarter of 2013, Air Canada recorded an operating expense reduction of \$82 million related to changes to early retirement provisions in Air Canada's defined

¹ DAR refers to the combination of depreciation, amortization and impairment, and aircraft rent expense.
2 In the first quarter of 2013, Air Canada recorded an impairment charge of \$24 million related to Airbus A340-300 aircraft.
3 In the fourth quarter of 2013, Air Canada recorded an operating expense reduction of \$82 million related to changes to early retirement provisions in Air Canada's defined

 ³ In the fourth quarter of 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.
 4 In the second quarter of 2014, Air Canada recorded favourable tax-related provision adjustments of \$41 million.
 5 In the fourth quarter of 2014, one-time payments totaling \$30 million were made to ACPA members under a collective agreement concluded in October 2014.
 6 In the third quarter of 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.
 7 EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.
 8 Adjusted net income (loss) and adjusted net income (loss) per diluted share are non-GAAP financial measures. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

benefit pension plans.

2 Adjusted CASM is a non-GAAP financial measure. Refer to section 20 "Non-GAAP financial measures" of this MD&A for additional information.

3 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.

11. SELECTED ANNUAL INFORMATION

The following table provides selected annual information for Air Canada for the years 2012 through to 2014.

CANADIAN DOLLARS IN MILLIONS,	FULL YEAR							
EXCEPT PER SHARE FIGURES		2014		2013		2012		
Operating revenues	\$	13,272	\$	12,382	\$	12,114		
Operating expenses (1)(2)(3)		12,457		11,763		11,672		
OPERATING INCOME		815		619		442		
Total non-operating expense and income taxes (4)(5)		(710)		(609)		(523)		
NET INCOME (LOSS) FROM CONTINUING OPERATIONS		105		10		(81)		
NET LOSS FROM DISCONTINUED OPERATIONS – AVEOS		-		-		(55)		
NET INCOME (LOSS)	\$	105	\$	10	\$	(136)		
EBITDAR, EXCLUDING THE IMPACT OF BENEFIT PLAN AMENDMENTS (1)(6)	\$	1,671	\$	1,433	\$	1,320		
EBITDAR (6)	\$	1,671	\$	1,515	\$	1,447		
ADJUSTED NET INCOME	\$	531	\$	340	\$	55		
BASIC EARNINGS (LOSS) PER SHARE FROM CONTINUING OPERATIONS	\$	0.35	\$	0.02	\$	(0.31)		
DILUTED EARNINGS (LOSS) PER SHARE FROM CONTINUING OPERATIONS	\$	0.34	\$	0.02	\$	(0.31)		
BASIC AND DILUTED LOSS PER SHARE FROM DISCONTINUED OPERATIONS	\$	-	\$	-	\$	(0.20)		
DILUTED EARNINGS (LOSS) PER SHARE	\$	0.34	\$	0.02	\$	(0.51)		
ADJUSTED NET INCOME PER DILUTED SHARE	\$	1.81	\$	1.20	\$	0.20		
CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS	\$	2,275	\$	2,208	\$	1,973		
TOTAL ASSETS	\$	10,648	\$	9,470	\$	8,847		
TOTAL LONG-TERM LIABILITIES (7)	\$	8,728	\$	8,051	\$	9,434		
TOTAL LIABILITIES	\$	11,781	\$	10,867	\$	12,194		

¹ 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. In 2012, Air Canada recorded an operating expense reduction of \$127 million related to changes to the terms of the ACPA collective agreement pertaining to retirement age.
2 In 2014, one-time payments totaling \$30 million were made to ACPA members under a collective agreement concluded in October 2014 and favourable tax-related provision adjustments of \$41 million.
3 In 2013, Air Canada recorded impairment charges amounting to \$30 million.
4 In 2013, Air Canada recorded a interest charge of \$95 million related to the purchase of its senior secured notes which were to become due in 2015 and 2016.
5 In 2012, Air Canada recorded a \$65 million loss on its investment in Aveos' parent holding company.
6 EBITDAR (earnings before interest, taxes, depreciation, amortization, impairment and aircraft rent) is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.
7 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. FINANCIAI 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	2014	2013	2014	2013	
Fuel derivatives	\$ (18)	\$ (9)	\$ (36)	\$ (6)	
Share forward contracts	24	29	31	42	
Prepayment options on senior secured notes	2	2	2	2	
Interest rate swaps	1	-	2	(1)	
FUEL AND OTHER DERIVATIVES	\$ 9	\$ 22	\$ (1)	\$ 37	

RISK MANAGEMENT

Under its risk management policy, Air Canada manages its interest rate risk, foreign exchange risk, share based compensation risk and market risk through the use of various derivative financial instruments. Air Canada uses derivative financial instruments only 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 related to the risk being hedged.

As noted below, Air Canada engages in derivative hedging in an effort to mitigate various risks. The derivative fair values 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. Fair value of these derivatives is determined using active markets, where available. When no such market is available, valuation techniques are applied such as discounted cash flow analysis. Where practical, the valuation technique incorporates all factors that would be considered in setting a price, including Air Canada's own credit risk and 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 uses derivative contracts based on jet fuel, heating oil and crude oilbased contracts. 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 2014:

- Air Canada recorded a loss of \$36 million in Fuel and other derivatives on Air Canada's consolidated statement of operations related to fuel derivatives (loss of \$6 million in 2013).
- Air Canada purchased crude-oil and refined products-based call options covering a portion of 2014 and 2015 fuel exposure. The cash premium related to these contracts was \$44 million (\$39 million in 2013 for 2013 and 2014 exposures).
- Fuel derivative contracts cash settled with a fair value of \$24 million in favour of Air Canada (\$29 million in favour of Air Canada in 2013).

As of December 31, 2014, approximately 22% of Air Canada's anticipated purchases of jet fuel for 2015 was hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US\$97 per barrel. Air Canada's contracts to hedge anticipated jet fuel purchases over the 2015 period are comprised of call options with notional volumes of 6,267,000 barrels. The fair value of the fuel derivatives portfolio at December 31, 2014 was \$4 million in favour of Air Canada (\$20 million in favour of Air Canada in 2013) 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.

In order to manage exposure to the U.S dollar and other foreign exchange exposures, Air Canada holds U.S. dollar cash reserves and enters into currency derivative contracts. These derivatives and U.S. dollar cash reserves serve to mitigate the cash flow exposure from adverse currency movements. The result of these hedging activities is recorded as a Foreign exchange gain or loss in Non-operating expense on Air Canada's consolidated statement of operations (not within Operating income).

Air Canada's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

Air Canada's cash inflows are primarily in Canadian dollars, while a large portion of its outflows are in U.S. dollars. This unbalanced mix results in an annual U.S. dollar shortfall from operations. In order to mitigate this imbalance, Air Canada has adopted a program to convert excess revenues from offshore currencies into U.S. dollars. In 2014, this conversion generated coverage for approximately 23% of the imbalance.

For the remainder of the currency imbalance (i.e. the net U.S. dollar shortfall), Air Canada has a target coverage of 60% on a rolling 18-month basis 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, 2014 amounted to \$717 million (US\$620 million) (\$791 million (US\$743 million) as at December 31, 2013). In 2014, an unrealized gain of \$58 million (unrealized gain of \$44 million in 2013) was recorded in Foreign exchange gain (loss) on Air Canada's consolidated statement of operations 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 target coverage of the above strategies is to cover 60% of the net U.S dollar exposure on a rolling 18-month basis. 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 flows, as well as the amount attributed to aircraft and debt

payments. Based on the notional amount of currency derivatives outstanding at December 31, 2014, as further described below, approximately 69% of net U.S. cash outflows are hedged for 2015 and 13% for 2016, resulting in derivative coverage of 52% over the next 18 months.

As at December 31, 2014, Air Canada had outstanding foreign currency options and swap agreements, settling in 2015 and 2016, to purchase at maturity \$2,658 million (US\$2,292 million) of U.S. dollars at a weighted average rate of \$1.0884 per \$1.00 U.S. dollar (2013 – \$1,645 million (US\$1,547 million) with settlements in 2014 and 2015 at a weighted average rate of \$1.0341 per \$1.00 U.S. dollar). Air Canada also has protection in place to sell a portion of its excess Euros and Sterling (EUR \$35 million, GBP \$27 million) which settle in 2015 at weighted average rates of \$1.2806 and \$1.6217 per \$1.00 U.S. dollar respectively (2013 - EUR \$34 million, GBP \$16 million with settlement in 2014 at weighted average rates of \$1.3511 and \$1.6130 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 fair value of these foreign currency contracts as at December 31, 2014 was \$30 million in favour of Air Canada (2013 - \$13 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 2014, a gain of \$75 million was recorded in Foreign exchange gain (loss) on Air Canada's consolidated statement of operations related to these derivatives (2013 -\$68 million gain). In 2014, foreign exchange derivative contracts cash settled with a net fair value of \$58 million in favour of Air Canada (\$56 million in 2013 in favour of Air Canada).

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, 2014, was 75% fixed and 25% floating, including the effects of interest rate swap positions (74% and 26%, respectively, as at December 31, 2013).

The following are the current derivatives employed in interest rate risk management activities and the adjustments recorded during 2014:

· As at December 31, 2014, Air Canada had two interest rate swap agreements in place with terms to July 2022 and January 2024 relating to two Boeing 767 aircraft financing agreements with an aggregate notional value of \$60 million (US\$52 million) (2013 – \$62 million (US\$58 million)). These swaps convert the lease payments on the two aircraft leases from fixed to floating rates. The fair value of these contracts as at December 31, 2014 was \$8 million in favour of Air Canada (2013 - \$10 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 2014, a gain of \$2 million was recorded on the two interest rate swaps in Fuel and other derivatives on Air Canada's consolidated statement of operations (2013 - \$1 million loss).

Interest income includes \$35 million (2013 – \$29 million) related to Cash and cash equivalents and Short-term investments, which are classified as held for trading. Interest expense reflected on Air Canada's consolidated statement of operations relates to financial liabilities recorded at amortized cost.

13. 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 EMPLO					
	2014	2013	2014	2013				
DISCOUNT RATE USED TO DETERMINE:								
Accrued benefit cost for the year ended December 31	4.90%	4.30%	4.80%	4.17%				
Accrued benefit liability as at December 31	4.00%	4.90%	3.90%	4.80%				
RATE OF FUTURE INCREASES IN COMPENSATION USED TO DETERMINE:								
Accrued benefit cost for the year ended December 31	2.50%	2.50%	not applicable	not applicable				
Accrued benefit obligation as at December 31	2.50%	2.50%	not applicable	not applicable				

Actuarial assumptions

Mortality rates

The cost and related liabilities of Air Canada's pension plans and other post-retirement and post-employment benefit programs are determined using actuarial valuations. The actuarial valuations include several economic and demographic assumptions including mortality rates. For the December 31, 2013 accounting valuations, the mortality assumption has been updated to reflect the results of a mortality study specific to Air Canada pension plan membership. The change in mortality rate assumptions resulted in an actuarial remeasurement of the accounting liabilities with the impact being recorded in Other comprehensive income. The improvements in assumed mortality rates are consistent with those presented by the Canadian Institute of Actuaries ("CIA") which issued new mortality tables for use in the valuation of Canadian pension and benefit plans in early 2014.

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 2014 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

	DE	CREASE	INCREASE
DISCOUNT RATE ON OBLIGATION ASSUMPTION			
Pension expense	\$	17	\$ (16)
Net financing expense relating to pension benefit liabilities		18	(8)
TOTAL	\$	35	\$ (24)
INCREASE (DECREASE) IN PENSION OBLIGATION	\$	652	\$ (630)

An increase of one year life expectancy would increase the pension benefit obligation by \$447 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 2014 (2013 – 6.0%). 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 \$5 million and the obligation by \$61 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 \$60 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 \$52 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 \$41 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 sell 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 \$32 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 \$40 million at December 31, 2014 and an increase to maintenance expense in 2015 of approximately \$3 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 \$17 million at December 31, 2014. 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 outlook. At December 31, 2014, no deferred income tax assets have been recorded.

14. ACCOUNTING POLICIES

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, 2017, with early adoption permitted.

IFRS 9 – FINANCIAL INSTRUMENTS

IFRS 9 introduces new requirements for the classification and measurement of financial assets. IFRS 9 requires all recognized financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement to be measured at amortized cost or fair value in subsequent accounting periods following initial recognition. Specifically,

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 subsequent accounting periods. All other financial assets including equity investments are measured at their fair values at the end of subsequent accounting periods.

Requirements for classification and measurement of financial liabilities were added in October 2010 and they 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 generally be recorded in other comprehensive income.

IFRS 9 was amended in November 2013, to (i) include guidance on hedge accounting, and (ii) allow entities to early adopt the requirement to recognize changes in fair value attributable to changes in an entity's own credit risk, from financial liabilities designated under the fair value option, in Other comprehensive income, without having to adopt the remainder of IFRS 9.

The final version of IFRS 9 was issued in July 2014 and includes (i) a third measurement category for financial assets – fair value through other comprehensive income; (ii) a single, forward-looking expected loss impairment model, and (iii) a mandatory effective date for IFRS 9 of annual periods beginning on or after January 1, 2018, with early adoption permitted.

15. OFF-BALANCE SHEET ARRANGEMENTS

GUARANTEES

Performance Obligations Relating to Aircraft Leasing Agreements

With respect to 12 aircraft leases, the difference between the reduced rents as a result of the implementation of the Plan of Reorganization, Compromise and Arrangement under the *Companies' Creditors Arrangement Act* ("CCAA") on September 30, 2004 and amounts which would have been due under the original lease contracts will be forgiven at the expiry date of the leases if no material default has occurred by such date. In the event of a material default which does not include any cross defaults to other unrelated agreements (including unrelated agreements with the counterparties to these aircraft leases), this difference plus interest

will become due and payable and all future rent will be based on the original contracted rates. Rent expense is being recorded on the renegotiated lease agreements and any additional liability would be recorded only at the time management believes the amount is likely to be incurred.

Guarantees in Fuel Facilities Arrangements

Air Canada participates in fuel facility arrangements operated through eight Fuel Facility Corporations, along with other airlines that contract for fuel services at various major airports in Canada. The Fuel Facility Corporations operate on a cost recovery basis. The purpose of the Fuel Facility Corporations is to own and finance the system that distributes the fuel to the contracting airlines, including leasing the land rights under the land leases. The aggregate debt of



the five Fuel Facility Corporations in Canada that have not been consolidated by Air Canada under IFRS 10 Consolidated Financial Statements is approximately \$399 million as at December 31, 2014 (December 31, 2013 – \$394 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 a Fuel Facility Corporation shares prorata, 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, 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 enters into real estate leases or operating agreements, which grant a license to Air Canada to use certain premises, in substantially all cities that it serves. It is common in such commercial lease transactions for Air Canada, as the lessee, to agree to indemnify the lessor and other related third parties for tort liabilities that arise out of or relate to Air Canada's use or occupancy of the leased or licensed premises. Exceptionally, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by their gross negligence or wilful misconduct. Additionally,

Air Canada typically indemnifies such parties for any environmental liability that arises out of or relates to its use or occupancy of the leased or licensed premises.

In aircraft financing or leasing agreements, Air Canada typically indemnifies the financing parties, trustees acting on their behalf and other related parties and/or lessors against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft and for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, except for their gross negligence or wilful misconduct. In addition, in aircraft financing or leasing transactions, including those structured as leveraged leases, Air Canada typically provides indemnities in respect of various tax consequences including in relation to the leased or financed aircraft, the use, possession, operation maintenance, leasing, subleasing, repair, insurance, delivery, import, export of such aircraft, the lease or finance arrangements entered in connection therewith, changes of law and certain income, commodity and withholding tax consequences.

When Air Canada, as a customer, enters into technical service agreements with service providers, primarily service providers who operate an airline as their main business, Air Canada has from time to time agreed to indemnify the service provider against certain liabilities that arise from third party claims, which may relate to services performed by the service provider.

Under its general by-laws and pursuant to contractual agreements between Air Canada and each of its officers and directors, Air Canada has indemnification obligations to its directors and officers. Pursuant to such obligations, Air Canada indemnifies these individuals, to the extent permitted by law, against any and all claims or losses (including amounts paid in settlement of claims) incurred as a result of their service to Air Canada.

16. RELATED PARTY TRANSACTIONS

At December 31, 2014, 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. SENSITIVITY OF RESULTS

Air Canada's financial results are subject to many different internal and external factors which can have a significant impact on operating results. The following table describes, on an indicative basis, the financial impact that changes in certain assumptions would generally have had on Air Canada's operating results. These guidelines were derived from 2014 levels of activity and make use of management estimates. The impacts are not additive, do not reflect the interdependent relationship of the elements and actual results may vary significantly due to a wide range of factors many of which are beyond the control of Air Canada. An equivalent but opposite movement of the sensitivity factor in the table below would generally result in a similar impact in the opposite direction.

CANADIAN DOLLARS IN MILLIONS, EXCEPT WHERE INDICATED KEY VARIABLE	2014 MEASURE		SENSITIVITY FACTOR	(UNFAVO ESTIMATED	IRABLE/ DURABLE) OPERATING EIMPACT
REVENUE MEASURES					
Passenger yield (cents)	System	18.9	1% increase in yield	\$	110
	Canada	24.5		\$	41
Traffic (RPMs) (millions)	System	61,616	1% increase in traffic	\$	105
	Canada	17,662		\$	39
Passenger load factor (%)	System	83.4	1 percentage point increase in passenger load factor	\$	126
PRASM (cents)	System	15.8	1% increase in PRASM	\$	107
COST MEASURES					
Fuel – Jet fuel price (US\$/barrel) (1)		124	US\$1/barrel increase in price of jet fuel	\$	(29)
Fuel – jet fuel price (CAD cents/litre) (1)		89	1% increase in price of jet fuel (CAD cents/litre)	\$	(33)
Cost per ASM (cents)		16.9	1% increase in CASM	\$	(125)
Adjusted cost per ASM (cents) (2)		11.3	1% increase in adjusted CASM	\$	(83)

¹ Excludes the impact of fuel surcharges and fuel hedging. Refer to section 12 "Financial Instruments and Risk Management" of this MD&A for information on Air Canada's fuel derivative instruments.

fuel derivative instruments.

Adjusted CASM is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

CANADIAN DOLLARS IN MILLIONS KEY VARIABLE	2014 MEASURE	SENSITIVITY FACTOR	(UNFAV ESTI OPER	URABLE/ OURABLE) MATED RATING IE IMPACT
CURRENCY EXCHANGE				
C\$ to US\$	C\$1 = US\$1.16	1 cent increase in exchange rate (i.e. \$1.16 to \$1.15 per U.S. dollar)		
		Operating income (1)	\$	33
		Net interest expense	\$	2
		Revaluation of long-term debt, U.S. dollar cash and short-term investments and other long-term monetary items, net	\$	33
		Remeasurement of outstanding currency derivatives	\$	(23)
		PRE-TAX INCOME IMPACT	\$	45

¹ The operating income impact of currency exchange movements is before the impact of hedging activities, such as through the use of foreign currency derivatives and holding U.S. dollar cash reserves. The gains and losses related to these hedging activities are recorded in non-operating income (expense) on Air Canada's consolidated statement of operations.



18. RISK FACTORS

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

Leverage

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. 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 fluctuating interest rates, to the extent these interest rates increase, its interest expense will 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.

Need for Additional Capital and Liquidity

Air Canada faces a number of challenges in its business, including in relation to economic conditions, foreign exchange rates, labour issues, volatile fuel prices, contractual covenants (which require Air Canada to maintain minimum cash reserves and which could require Air Canada to deposit cash collateral with third parties), and increased competition from international, U.S. transborder and low-cost domestic carriers. 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 meet 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 overcome challenges and support its business strategy if cash flows from operations and cash on hand are insufficient.

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.

Foreign Exchange

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./Canada dollar exchange rate. Management estimates that during 2014, a \$0.01 strengthening of the Canadian dollar versus the U.S. dollar (i.e. \$1.16 to \$1.15 per U.S. dollar) would have had an estimated \$33 million favourable impact on operating income and a \$45 million favourable impact on pretax income. Conversely, a corresponding opposite change in the exchange rate would have had the corresponding opposite effect. Air Canada incurs significant expenses in U.S. dollars for items such as fuel, aircraft rental and purchases and maintenance charges, interest payments, debt servicing and computerized reservations system fees, while a substantial portion of its revenues are generated in Canadian dollars. A significant deterioration of the Canadian dollar relative to the U.S. dollar would increase the costs of Air Canada relative to its U.S. competitors and could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Due to the competitive nature of the airline industry and consumer 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 hedge the risks associated with fluctuations in exchange rates.

Economic and Geopolitical Conditions

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, 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 operates flights over, 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 North America and other areas served by Air Canada, as well as geopolitical instability in various areas of the world, concerns about the environmental impacts of air travel and tendencies towards "green" travel initiatives where consumers reduce their travel activities. could have the effect of reducing demand for air travel in Canada and abroad and could materially adversely impact Air Canada, its business, results from operations and financial condition.

Fuel Costs

Fuel costs constituted the largest percentage of the total operating costs of Air Canada in 2014. 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. Significant fluctuations (including increases) in fuel prices could have a material adverse effect on Air Canada, its business, results from operations and financial condition. 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 aircraft fuel prices could be offset by increased price competition, and a resulting decrease in revenues, for all air carriers. Based on 2014 volumes, management estimates that a US\$1 per barrel movement in the average price of jet fuel would have resulted in an approximate \$29 million change in 2014 fuel expense for Air Canada (excluding any impact of surcharges, foreign exchange rates and fuel hedging), assuming flying capacity remained unchanged and that refining spreads between WTI crude oil and jet fuel as well as foreign exchange rates remained constant.

COMPETITION

North America

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.



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 which 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 with 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 travelling to the U.S. has redirected appreciable passenger traffic away from Canadian airports. Low-cost carriers based in the U.S. have and may continue to increase their capacity at these airports and attract Canadian-originating, pricesensitive customers.

International

Air Canada is also facing increasing competition in international markets as carriers increase their international capacity, both by expansion and by shifting existing domestic capacity to international operations to avoid low-cost domestic competition.

Given Canada's diverse, sustained immigration levels and multicultural population, Canadian gateways such as Toronto, Montreal and Vancouver are deemed attractive by international carriers. In 2014, 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, transborder or international markets could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

LABOUR COSTS AND LABOUR RELATIONS

Labour costs constituted another one of Air Canada's largest operating cost items in 2014. 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. 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 outcome 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.

Most of Air Canada's employees are unionized and collective agreements with certain unions are coming up for renewal and negotiation. In 2011, tentative collective agreements with UNIFOR (formerly called CAW), the union representing Air Canada's customer service employees at airports and call centres, as well as with CUPE, the union representing Air Canada's flight attendants, were concluded and, respectively, ratified or conclusively settled through arbitration. The agreement with UNIFOR is in effect until February 28, 2015 and the agreement with CUPE is in effect until March 31, 2015. In the first quarter of 2012, Air Canada concluded agreements with UNIFOR, in relation to in-flight crew schedulers and flight operations crew schedulers, and with CALDA, in relation to flight dispatchers. In June 2012, the decision of the arbitrator was issued in respect of the IAMAW final offer selection arbitration conducted in accordance with the process legislated by the federal government in the Protecting Air Service Act. The arbitrator's final offer selection concluded a new five-year collective agreement between Air Canada and the IAMAW which is in effect until March 31, 2016. On October 6, 2014, Air Canada reached a new agreement with ACPA which provides collective agreement terms for 10 years, ending September 29, 2024, subject to certain openers and benchmarks over this period.

ACPA and the IAMAW have, each, independently, instituted proceedings to contest the constitutional validity of the legislation which referred to arbitration the resolution of the issues that had not been resolved in bargaining. Air Canada is not currently a party to these proceedings. Air Canada expects that in both cases the legislation (and therefore the collective agreements concluded through the arbitration process) will be upheld.

There can be no assurance that collective agreements, including any which may be expiring in the near term, 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 conduct its operations, any 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 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 and, ultimately, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

STRATEGIC, BUSINESS, TECHNOLOGY AND OTHER IMPORTANT INITIATIVES

In order to operate its business, achieve its goals and remain competitive, Air Canada continuously 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 restructuring (including the scheduled delivery of Boeing 787 aircraft and the planned re-fleeting of narrow-body aircraft with Boeing 737 MAX aircraft), revenue enhancement initiatives, business processes, information technology, revenue management (including the planned implementation of Air Canada's revenue management system), 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 the manufacturers in the delivery of the 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.

PENSION PLANS

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).

Pension plan solvency valuations are influenced primarily by long-term interest rates and by the investment return on plan assets, which in turn may be dependent on a variety of factors, including economic conditions. Deteriorating economic conditions or 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.

Refer to section 9.7 "Pension Funding Obligations" of this MD&A for additional information relating to Air Canada's pension funding obligations. In December 2013, further to an agreement reached with Air Canada in March 2013, the Government of Canada formally approved the Air Canada Pension Plan Funding Regulations, 2014 (the "2014 Regulations") under the Pension Benefits Standards Act, 1985. Absent the 2014 Regulations and under generally applicable regulations, Air Canada's pension funding obligations would be determined by a variety of factors, including 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.

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.

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.

REVENUE AND ALLIANCE ENVIRONMENT

Air Canada encounters substantial price competition. The prevalence of low-cost carriers, Internet travel websites and other travel products distribution channels, have 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 remain competitive and maintain 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.

AIRLINE INDUSTRY CHARACTERIZED BY LOW GROSS PROFIT MARGINS AND HIGH FIXED COSTS

The airline industry is characterized by low gross 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 would have a significant effect on Air Canada's operating and financial results. This condition may be exacerbated by aggressive pricing by low-cost carriers, which can 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. 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

LIMITATIONS DUE TO RESTRICTIVE COVENANTS

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 major 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.

AIRPORT USER FEES AND AIR NAVIGATION FEES

With the privatization of airports and air navigation authorities in Canada, airport and air navigation authorities have significantly increased their fees. Air Canada may not be in a position to prevent or develop alternatives to overcome fee increases. Though certain authorities have implemented some fee reductions, if authorities in Canada or elsewhere were to significantly increase their fees, Air Canada, its business, results from operations and financial condition could be materially adversely affected.

DEPENDENCE ON TECHNOLOGY

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 key 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 third party suppliers' acts or omissions, natural disasters, terrorist attacks, telecommunications failures, power failures, computer viruses, unauthorized or fraudulent users, and other operational and security issues. While Air Canada continues to invest in initiatives, including security initiatives and disaster recovery plans, these measures may not be adequate or implemented properly. Any such technology systems failure, interruption or misuse, whether at Air Canada or a third party on whom Air Canada relies, could materially and adversely affect Air Canada's operations and could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

KEY SUPPLIES AND SUPPLIERS

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 and transition to new suppliers may take a significant amount of time and 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.

AEROPLAN®

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' decision 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 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.

REGIONAL CARRIERS

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 rouge routes. Pursuant to the terms of the Jazz CPA, Air Canada pays Jazz a number of fees, some 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 fuel, 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.

STAR ALLIANCE®

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

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

Investigations by Competition Authorities Relating to Cargo

The European Commission and the United States

Department of Justice investigated, and the Competition Bureau in Canada is investigating, 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 have sought or requested information from Air Canada as part of their investigations. Air Canada has been cooperating with these investigations, which are likely to lead, or have 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, and has, and may otherwise, become implicated, in a number of class action lawsuits and other proceedings in Canada, Europe and the United States in connection with these allegations. In the United States, the investigation by the U.S. Department of Justice concluded with no proceedings having been instituted against Air Canada, and 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 Commissions 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 C\$29 million) was imposed on Air Canada. Air Canada is appealing this 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.

As at December 31, 2014, Air Canada has a provision of \$27 million relating to outstanding claims in this matter, which is recorded in accounts payable and accrued liabilities on Air Canada's consolidated statement of financial position. This provision is an estimate based upon the status of the 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 proceedings and investigations. As stated above, Air Canada is appealing the decision issued by the European Commission and, if and as appropriate, based on the outcome of any updates regarding this appeal as well as developments regarding proceedings and investigations in other jurisdictions, may record adjustments to the provision and/or its income in 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-ACPA 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 the experience and industry knowledge of its executive officers and other key employees to execute its business plan. If Air Canada were to experience 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

The potential for terrorist attacks and terrorist activity causes uncertainty in the minds of the travelling public. The occurrence of a terrorist attack (or attempted attacks) (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. 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 (Severe Acute Respiratory Syndrome (SARS), H1N1 Influenza, Ebola or Other Epidemic Diseases)

The international outbreaks of Severe Acute Respiratory Syndrome (SARS) in 2003, and the resulting actions of the World Health Organization (the "WHO"), including a travel advisory against nonessential travel to Toronto, Canada, had a significant adverse effect on passenger demand for air travel in Air Canada's markets and resulted in a major negative impact on traffic on the entire network. An outbreak of influenza, SARS, H1N1 influenza virus, Ebola or of another virus or epidemic disease (whether domestic or international) or any WHO or similar travel advisories (whether relating to Canadian cities or regions or other cities, regions or countries) could have a material adverse effect on passenger demand for air travel. 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

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 repaired by Air Canada, including claims for serious personal injury or death. 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. Additionally, any accident or disaster involving an aircraft operated by or on behalf of Air Canada or an aircraft of another carrier receiving line maintenance services from Air Canada 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.

Seasonal Nature of the Business, Other Factors and Prior Performance

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, 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 an historical period are not necessarily indicative of operating results for a future period.

Regulatory Matters

The airline industry is subject to extensive Canadian and foreign government regulations relating to, among other things, security, safety, consumer rights, privacy, data security, licensing, competition, environment (including noise levels and carbon emissions) and, in some measure, pricing. For example, new and proposed legislation have been considered or adopted concerning carbon emissions emanating from the aviation industry. Such legislative initiatives include, for example, market-based mechanisms called emissions trading systems, which are being proposed and implemented to reduce the amount of carbon emissions through the setting of emissions allowances and charging aircraft operators for a certain percentage of theses allowances. The implementation of additional regulations or decisions, including potentially inconsistent or conflicting regulations, including in relation to carbon emissions, and others, whether by Transport Canada, the Competition Bureau and/or the Competition Tribunal, the Canadian Transportation Agency or other local, domestic or foreign governmental entities, may have a material adverse effect on Air Canada, its business, results from operations and financial condition.

The European Union passed legislation for an Emissions Trading System, which included carbon emissions from aviation commencing in January 2012, including for flights operated between Canada and countries within the European Union. As a result of ongoing 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 ICAO led global market-based measure (MBM) that is likely to reduce greenhouse-gas emissions. If reinstated, the EU ETS would be expected to result in increased costs relating to the purchase of emissions allowances. The net financial impact would, in part, depend upon how much of such cost, if any, would be recovered, including in the form of higher passenger fares and cargo rates. 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, its business, results from operations and financial condition.

The availability of international routes to Canadian air carriers is regulated by agreements between Canada and foreign governments. Changes in Canadian or foreign government aviation policy could result in the alteration or termination of these agreements and could adversely affect Air Canada and its international operations.

Air Canada is subject to domestic and foreign laws regarding privacy and security of passenger, 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 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.

There can be no assurances that new laws, regulations or revisions to same, or decisions, will not be adopted or rendered, from time to time, and these could impose additional requirements or restrictions, which may adversely impact Air Canada, its business, results from operations and financial condition.

AVAILABILITY OF INSURANCE COVERAGE AND INCREASED INSURANCE COSTS

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. 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.

THIRD PARTY WAR RISK INSURANCE

There is a risk that the Government of Canada may not continue to provide an indemnity for third party war risk liability coverage, which it is currently providing to Air Canada and certain other carriers in Canada until December 31, 2015 or that it may amend, in a manner adverse to Air Canada, the terms of the indemnity which it is providing. In the event that the Government of Canada does not continue to provide such indemnity or amends such indemnity (in a manner adverse to Air Canada), Air Canada and other industry participants would have to turn to the commercial insurance market to seek such coverage. Air Canada estimates that such coverage would cost Air Canada approximately US\$2.5 million per year. Alternative solutions, such as those envisioned by the International Civil Aviation Organization ("ICAO") and the International Air Transport Association ("IATA"), have not developed as planned, due to actions taken by other countries and the recent availability of supplemental insurance products. ICAO and IATA are continuing their efforts in this area; however, the achievement of a global solution is not likely in the immediate or near future. The U.S. federal government has set up its own facility to provide war risk coverage to U.S. carriers, thus removing itself as a key component of any global plan.

19. 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, 2014, 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, 2014, 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 year ended December 31, 2014 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

20. NON-GAAP FINANCIAL MEASURES

OPERATING INCOME, EXCLUDING THE IMPACT OF BENEFIT PLAN AMENDMENTS

Air Canada uses Operating income, excluding the impact of benefit plan amendments, to assess the operating performance of its ongoing airline business without the effects of unusual items, such as benefit plan amendments, as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

Operating income, excluding the impact of benefit plan amendments, 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.

Operating income, excluding the impact of benefit plan amendments, is reconciled to operating income as follows:

	FO	URTH QUAR	TER	FULL YEAR			
CANADIAN DOLLARS IN MILLIONS	2014	2013	\$ Change	2014	2013	\$ Change	
GAAP operating income	\$ 106	\$ 135	\$ (29)	\$ 815	\$ 619	\$ 196	
Add back:							
Benefit plan amendments (1)	-	(82)	82	-	(82)	82	
OPERATING INCOME, EXCLUDING THE IMPACT OF BENEFIT PLAN AMENDMENTS	\$ 106	\$ 53	\$ 53	\$ 815	\$ 537	\$ 278	

¹ In 2013, Air Canada recorded an operating expense reduction of \$82 million related to amendments to defined benefit pension plans.

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 and EBITDAR, excluding the impact of benefit plan amendments, are reconciled to operating income as follows:

	FO	URTH QUAR	TER	FULL YEAR			
CANADIAN DOLLARS IN MILLIONS	2014	2013	\$ Change	2014	2013	\$ Change	
GAAP operating income	\$ 106	\$ 135	\$ (29)	\$ 815	\$ 619	\$ 196	
Add back:							
Aircraft rent	79	76	3	313	318	(5)	
Depreciation, amortization and impairment	134	148	(14)	543	578	(35)	
EBITDAR	\$ 319	\$ 359	\$ (40)	\$ 1,671	\$ 1,515	\$ 156	
Add back:							
Benefit plan amendments (1)	-	(82)	82	-	(82)	82	
EBITDAR, EXCLUDING THE IMPACT OF BENEFIT PLAN AMENDMENTS	\$ 319	\$ 277	\$ 42	\$ 1,671	\$ 1,433	\$ 238	

¹ In 2013, Air Canada recorded an operating expense reduction of \$82 million related to amendments to defined benefit pension plans.



ADJUSTED CASM

Air Canada uses Adjusted CASM to assess the operating performance of its ongoing airline business without the effects of fuel expense, the cost of ground packages at Air Canada Vacations and unusual 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.

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 fuel expense, the cost of ground packages at Air Canada Vacations and unusual 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,	FO	URTH QUAR	TER			
EXCEPT WHERE INDICATED	2014	2013	\$ Change	2014	2013	\$ Change
GAAP OPERATING EXPENSE	\$ 2,998	\$ 2,759	\$ 239	\$12,457	\$ 11,763	\$ 694
Adjusted for:						
Aircraft fuel	(791)	(831)	40	(3,747)	(3,534)	(213)
One-time payments – ACPA (1)	(30)	-	(30)	(30)	-	(30)
Benefit plan amendments (2)	-	82	(82)	-	82	(82)
Tax-related provision adjustments (3)	-	-	-	41	-	41
Ground packages costs at Air Canada Vacations	(74)	(66)	(8)	(377)	(327)	(50)
Impairment charge (4)	-	(6)	6	-	(30)	30
OPERATING EXPENSE, ADJUSTED FOR THE ABOVE-NOTED ITEMS	\$ 2,103	\$ 1,938	\$ 165	\$ 8,344	\$ 7,954	\$ 390
ASMs (MILLIONS)	17,403	16,033	8.5%	73,889	68,573	7.8%
ADJUSTED CASM (CENTS)	¢ 12.08	¢ 12.09	-	¢ 11.29	¢ 11.60	(2.6)%

¹ In 2014, one-time payments totaling \$30 million were made to ACPA members under a collective agreement concluded in October 2014.

² In 2013, Air Canada recorded an operating expense reduction of \$82 million related to amendments to defined benefit pension plans.
3 In 2014, Air Canada recorded favourable tax-related provision adjustments of \$41 million.
4 In 2013, Air Canada recorded impairment charges amounting to \$30 million.

ADJUSTED NET INCOME AND ADJUSTED NET INCOME PER SHARE – DILUTED

Air Canada uses adjusted net income and adjusted net income per share - diluted to assess the 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 unusual items. 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,	FO	URT	H QUAR	TER		FULL YEAR					
EXCEPT PER SHARE VALUES	2014		2013	\$ (Change		2014	- :	2013		Change
NET INCOME (LOSS) FOR THE PERIOD ATTRIBUTABLE TO SHAREHOLDERS	\$ (101)	\$	(7)	\$	(94)	\$	100	\$	6	\$	94
Adjusted for:											
One-time payments – ACPA (1)	30		-		30		30		-		30
Benefit plan amendments (2)	-		(82)		82		-		(82)		82
Tax-related provision adjustments (3)	-		-		-		(41)		-		(41)
Impairment charge (4)	-		6		(6)		-		30		(30)
Foreign exchange loss	115		55		60		307		120		187
Interest charge (5)	-		-		-		-		95		(95)
Net financing expense relating to employee benefits	32		53		(21)		134		208		(74)
(Gain) loss on fuel and other derivatives	(9)		(22)		13		1		(37)		38
ADJUSTED NET INCOME	\$ 67		\$3	\$	64	\$	531	\$	340	\$	191
Weighted average number of outstanding shares used in computing diluted income per share (in millions)	294		291		3		293		284		9
ADJUSTED NET INCOME PER SHARE – DILUTED	\$ 0.23	\$	0.01	\$	0.22	\$	1.81	\$	1.20	\$	0.61

In 2014, one-time payments totaling \$30 million were made to ACPA members under a collective agreement concluded in October 2014.
 In 2013, Air Canada recorded an operating expense reduction of \$82 million related to amendments to defined benefit pension plans.
 In 2014, Air Canada recorded favourable tax-related provision adjustments of \$41 million.
 In 2013, Air Canada recorded impairment charges amounting to \$30 million.
 In 2013, Air Canada recorded an interest charge of \$95 million related to the purchase of its senior secured notes due in 2015 and 2016.

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

	FOURTH QUARTER		FULL YEAR		
IN MILLIONS	2014	2013	2014	2013	
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING – BASIC	286	282	286	277	
Effect of potential dilution	8	9	7	7	
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING – DILUTED	294	291	293	284	

RETURN ON INVESTED CAPITAL

Air Canada uses Return on invested capital (or ROIC) to assess the efficiency with which it allocates its capital to generate returns. Return is based on Adjusted net income (loss) (as defined above), excluding interest expense and implicit interest on operating leases. Invested capital includes (i) average year-over-year total 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.

In the second quarter of 2014, Air Canada changed its approach in calculating invested capital from a financing method to an operating method. Management believes this change provides more relevant information as the return is based on the book value of invested capital used for operations and is not subject to changes in the market price of Air Canada's outstanding shares. For comparative purposes, the information as at December 31, 2013 provided below reflects this new methodology.

The following table provides Air Canada's return on invested capital for the periods indicated:

CANADIAN DOLLARS IN MILLIONS, EXCEPT WHERE INDICATED	DEC	CEMBER 31, 2014	DEC	EMBER 31, 2013	\$	CHANGE
NET INCOME FOR THE PERIOD ATTRIBUTABLE TO SHAREHOLDERS (TRAILING 12 MONTHS)	\$	100	\$	6	\$	94
Remove:						
One-time payments - ACPA (1)		30		-		30
Benefit plan amendments (2)		-		(82)		82
Tax-related provision adjustments (3)		(41)		-		(41)
Impairment charge (4)		-		30		(30)
Foreign exchange loss		307		120		187
Interest expense charge (5)		-		95		(95)
Net financing expense relating to employee benefits		134 208				(74)
(Gain) loss on fuel and other derivatives		1		(37)		38
ADJUSTED NET INCOME (TRAILING 12 MONTHS)	\$	531	\$	340	\$	191
Adjusted for:						
Interest expense (6)		322		302		20
Implicit interest on operating leases (7)		153		156		(3)
ADJUSTED INCOME BEFORE INTEREST (TRAILING 12 MONTHS)	\$	1,006	\$	798	\$	208
Invested capital:						
Working capital, excluding current portion of long-term debt and finance leases		449		357		92
Long-term non-financial assets		6,676		6,014		662
Maintenance provisions		(726)		(614)		(112)
Other operating long-term liabilities		(295)		(348)		53
Capitalized operating leases (8)		2,191		2,226		(35)
INVESTED CAPITAL	\$	8,295	\$	7,635	\$	660
RETURN ON INVESTED CAPITAL (%)		12.1%		10.5%		1.6 рр

In 2014, one-time payments totaling \$30 million were made to ACPA members under a collective agreement concluded in October 2014.



² 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.
3 In 2014, Air Canada recorded favourable tax-related provision adjustments of \$41 million.
4 In 2013, Air Canada recorded impairment charges amounting to \$30 million.
5 In 2013, Air Canada recorded impairment charges amounting to \$30 million.
6 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.

⁵ int 2015, Air Carlada recorded at interest chalge of 355 million retarded to the purchase of its senior section of loss which were to become due in 2015 and 2016.

6 Interest expense excludes the non-recurring interest expense charge on the repayment of the senior secured notes recognized in 2013 as described in (5) above.

7 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.

8 Capitalized operating leases are calculated by multiplying the trailing 12 months of aircraft rent by 7. Aircraft rent totaled \$313 million for the 12 months ended December 31, 2014 (for the 12 months ended December 31, 2013 - \$318 million).

21. GLOSSARY

ACPA - Refers to the Air Canada Pilots Association.

Adjusted CASM – Refers to operating expense per ASM adjusted to remove the effects of fuel expense, ground packages costs and unusual items. Refer to section 20 "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 unusual items. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

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

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.

CAW – Refers to the Canadian Auto Workers Union, the predecessor to UNIFOR.

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 20 "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.

EXIM – Refers to Export-Import Bank of the United States.

GTAA – Refers to the Greater Toronto Airports Authority.

IAMAW – Refers to the International Association of Machinists and Auto Workers.

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 20 "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 no. 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.

UNIFOR – Refers to UNIFOR the Union, the successor to CAW.



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).



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 judgement 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 issues and 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

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President and Chief Executive Officer

Michael Rousseau

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Executive Vice President and Chief Financial Officer

February 10, 2015



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, 2014 and December 31, 2013 and the consolidated statement of operations, statement of comprehensive income, statement of changes in equity and statement of cash flow for the years ended December 31, 2014 and December 31, 2013, 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 audits 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, 2014 and December 31, 2013 and their financial performance and their cash flows for the years ended December 31, 2014 and December 31, 2013 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Pricewaterhouse Coopers LLP

Montreal, Quebec February 10, 2015

¹ CPA auditor, CA, public accountancy permit No. 18144

[&]quot;PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

CANADIAN DOLLARS IN MILLIONS		DECEMBER 31, 2014	DECEMBER 31, 2013
ASSETS			
CURRENT			
Cash and cash equivalents	Note 2P	\$ 661	\$ 750
Short-term investments	Note 2Q	1,614	1,458
Total cash, cash equivalents and short-term investments		2,275	2,208
Restricted cash	Note 2R	89	92
Accounts receivable		656	589
Aircraft fuel inventory		72	71
Spare parts and supplies inventory	Note 2S	91	65
Prepaid expenses and other current assets		295	263
Total current assets		3,478	3,288
Property and equipment	Note 4	5,998	5,073
Intangible assets	Note 5	305	304
Goodwill	Note 6	311	311
Deposits and other assets	Note 7	556	494
TOTAL ASSETS		\$ 10,648	\$ 9,470
LIABILITIES			
CURRENT			
Accounts payable and accrued liabilities		\$ 1,259	\$ 1,129
Advance ticket sales		1,794	1,687
Current portion of long-term debt and finance leases	Note 8	484	374
Total current liabilities		3,537	3,190
Long-term debt and finance leases	Note 8	4,732	3,959
Pension and other benefit liabilities	Note 9	2,403	2,687
Maintenance provisions	Note 10	796	656
Other long-term liabilities	Note 11	313	375
TOTAL LIABILITIES		\$ 11,781	\$ 10,867
EQUITY			
SHAREHOLDERS' EQUITY			
Share capital	Note 13	835	827
Contributed surplus		77	80
Deficit		(2,113)	(2,367)
Total shareholders' equity		(1,201)	(1,460)
NON-CONTROLLING INTERESTS		68	63
TOTAL EQUITY		(1,133)	(1,397)
TOTAL LIABILITIES AND EQUITY		\$ 10,648	\$ 9,470

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

On behalf of the Board of Directors:

David I. Richardson

Chairman Chair of the Audit, Finance and Risk Committee

Christie J.B. Clark

CONSOLIDATED STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31 CANADIAN DOLLA IN MILLIONS EXCEPT PER SHARE FIGURES OPERATING REVENUES	RS	2014	2013
Passenger	Note 20	\$ 11,804	\$ 11,021
Cargo	Note 20	502	474
Other	11111	966	887
TOTAL REVENUES		13,272	12,382
OPERATING EXPENSES			
Aircraft fuel		3,747	3,534
Wages, salaries and benefits		2,282	2,247
Benefit plan amendments	Note 9	-	(82)
Capacity purchase agreements		1,182	1,123
Airport and navigation fees		1,031	983
Aircraft maintenance		728	632
Sales and distribution costs		672	613
Depreciation, amortization and impairment		543	578
Ground package costs		377	327
Aircraft rent		313	318
Food, beverages and supplies		309	289
Communications and information technology		204	190
Other		1,069	1,011
TOTAL OPERATING EXPENSES		12,457	11,763
OPERATING INCOME		815	619
NON-OPERATING INCOME (EXPENSE)			
Foreign exchange loss		(307)	(120)
Interest income		39	32
Interest expense		(322)	(397)
Interest capitalized		30	46
Net financing expense relating to employee benefits	Note 9	(134)	(208)
Fuel and other derivatives	Note 17	(1)	37
Other		(15)	(7)
TOTAL NON-OPERATING EXPENSE		(710)	(617)
INCOME BEFORE INCOME TAXES		105	2
Income taxes	Note 12	-	8
NET INCOME		\$ 105	\$ 10
NET INCOME ATTRIBUTABLE TO:			
Shareholders of Air Canada		100	6
Non-controlling interests		5	4
NET INCOME		\$ 105	\$ 10
NET INCOME PER SHARE ATTRIBUTABLE TO SHAREHOLDERS OF AIR CANADA	Note 15		
Basic earnings per share		0.35	0.02
Diluted earnings per share		0.34	0.02

 $\label{thm:companying} The accompanying notes are an integral part of the consolidated financial statements.$

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED DECEMBER 31 CANADIAN DOLLARS IN MILLIONS			2014	2013
COMPREHENSIVE INCOME				
Net income		\$	105	\$ 10
Other comprehensive income, net of taxes of nil:				
Items that will not be reclassified to net income				
Remeasurements on employee benefit liabilities	Note 9		167	1,908
TOTAL COMPREHENSIVE INCOME		\$	272	\$ 1,918
Comprehensive income attributable to:				
Shareholders of Air Canada		\$	267	\$ 1,914
Non-controlling interests			5	4
TOTAL COMPREHENSIVE INCOME		\$	272	\$ 1.918

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

CANADIAN DOLLARS IN MILLIONS	SHARE APITAL	TRIBUTED IRPLUS	I	DEFICIT	SHA	TOTAL AREHOLD- S' EQUITY	TRO	-CON- LLING RESTS	I	TOTAL EQUITY
January 1, 2013	\$ 813	\$ 62	\$	(4,281)	\$	(3,406)	\$	59	\$	(3,347)
Net income	-	-		6		6		4		10
Remeasurements on employee benefit liabilities	-	-		1,908		1,908		-		1,908
Total comprehensive income	-	-		1,914		1,914		4		1,918
Share-based compensation	-	12		-		12		-		12
Share units reclassed to equity settled (Note 2i)	-	7		-		7		-		7
Repurchase of warrants (Note 13)	(2)	-		-		(2)		-		(2)
Shares issued (Note 13)	16	(1)		-		15		-		15
December 31, 2013	\$ 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 13)	2	(1)		-		1		-		1
Shares vested for employee recognition award (Note 13)	6	(4)		-		2		-		2
December 31, 2014	\$ 835	\$ 77	\$	(2,113)	\$	(1,201)	\$	68	\$	(1,133)

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)		2014	2013
OPERATING			
Net income		\$ 105	\$ 10
Adjustments to reconcile to net cash from operations			
Depreciation, amortization and impairment		543	578
Foreign exchange loss	Note 17	338	200
Employee benefit funding greater than expense	Note 9	(117)	(3)
Benefit plan amendments	Note 9	-	(82)
Fuel and other derivatives	Note 17	(12)	(33)
Discontinued operations – Aveos	Note 19	-	(29)
Change in maintenance provisions		76	29
Changes in non-cash working capital balances		40	33
Other		(32)	28
NET CASH FLOWS FROM OPERATING ACTIVITIES		941	731
FINANCING			
Proceeds from borrowings	Note 8	1,178	1,973
Reduction of long-term debt and finance lease obligations	Note 8	(677)	(1,646)
Issue of common shares, net		1	14
Other		-	(15)
NET CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES	5	502	326
INVESTING			
Short-term investments		(100)	(210)
Additions to property, equipment and intangible assets		(1,501)	(962)
Proceeds from sale of assets		72	70
Other		(3)	41
NET CASH FLOWS USED IN INVESTING ACTIVITIES		(1,532)	(1,061)
DECREASE IN CASH AND CASH EQUIVALENTS		(89)	(4)
Cash and cash equivalents, beginning of year		750	754
CASH AND CASH EQUIVALENTS, END OF YEAR		\$ 661	\$ 750

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

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013 CANADIAN DOLLARS IN MILLIONS – EXCEPT PER SHARE AMOUNTS

1. 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, an operating 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.

The Air Canada Leisure Group consists of Air Canada Vacations and Air Canada rouge. Air Canada Vacations is a leading Canadian tour operator. Based in Montreal and Toronto, Air Canada Vacations operates its business in the outbound leisure travel market (Caribbean, Mexico, U.S., Europe, Central and South America, South Pacific, Australia and Asia) by developing, marketing and distributing vacation travel packages. Air Canada Vacations also offers cruise packages in North America, Europe and the Caribbean.

Air Canada rouge launched its operations on July 1, 2013 and provides scheduled passenger service within certain of Air Canada's leisure travel markets and domestic destinations

2. 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 10, 2015.

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

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 aircraft (22 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.

The Corporation also leases certain aircraft from structured entities where it does not guarantee any portion of the residual value of the aircraft on lease expiry. In the absence of residual value guarantees, the Corporation's maximum exposure to loss from its involvement with these structured entities is limited principally to its lease payments. These entities are not controlled and are not consolidated by the Corporation.

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 ticket changes, 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, including those operating aircraft of 18 seats or less, some of which are referred to as Tier III 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 and pass-through costs. Pass-through costs are non-marked-up costs charged to the Corporation and include fuel, airport and user fees and other costs. These expenses are recorded in the applicable category within Operating expenses.

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 to meet its obligation for the redemption of Aeroplan Miles® for air travel. The proceeds from the sale of passenger tickets to Aeroplan are included in Advance ticket sales. Revenue related to these passenger tickets is recorded in passenger revenues when transportation is provided.

For Aeroplan Miles® earned by Air Canada customers, Air Canada purchases Aeroplan Miles® from Aeroplan in accordance with the terms of the CPSA. 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.

Other revenue also includes revenue related to the lease or sublease of aircraft to third parties. Lease



or sublease revenues are recognized on a straight line basis over the term of the lease or sublease. Rental revenue from operating leases and subleases amounted to \$35 in 2014 (2013 – \$53).

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.

Certain of the Corporation's pension plans are subject to minimum funding requirements. The liability in respect of minimum funding requirements 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.

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 14. PSUs and RSUs are notional share units which are exchangeable, on a one-to-one basis, as determined by the Board of Directors based on factors such as the remaining number of shares authorized under the Long-term Incentive Plan as described in Note 14, for Air Canada shares, or the cash equivalent. The options, PSUs and RSUs granted contain time and/or performance based vesting features as those further described in Note 14.

The fair value of stock options with a graded vesting schedule is determined based on different expected lives for the options that vest each year, as it would be if the award were viewed as several separate awards, each with a different vesting date, and it is accounted for over the respective vesting period taking into consideration forfeiture estimates. For a stock option award attributable to an employee who is eligible to retire at the grant date, the fair value of the stock option award is expensed on the grant date. For a stock option award attributable to an employee who will become eligible to retire during the vesting period, the fair value of the stock option award is recognized over the period from the grant date to the date the employee becomes eligible to retire. 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 17 for a description of derivative instruments used by the Corporation to hedge the cash flow exposure to PSUs.

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 2T.

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. For aircraft under operating leases which are subleased to third parties, the expense relating to the provision is presented net on the income statement of the amount recognized for any reimbursement of maintenance cost which is the contractual obligation of the sublessee. The reimbursement is recognized when it is virtually certain that the reimbursement will be received when the Corporation settles the obligation. 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

Under the Corporation's risk management policy, derivative financial instruments are used only for risk management purposes and not for generating trading profits.

Financial assets and financial liabilities, including derivatives, are recognized on the consolidated

statement of financial position when the Corporation becomes a party to the contractual provisions of the financial instrument or derivative contract. All financial instruments are required to be measured at fair value on initial recognition. The Corporation's own credit risk and the credit risk of the counterparty are taken into consideration in determining the fair value of financial assets and financial liabilities, including derivative instruments. Measurement in subsequent periods is dependent upon the classification of the financial instrument. The Corporation classifies its financial assets as either fair value through profit or loss ("FVTPL"), loans and receivables or, held to maturity. The classification depends on the purpose for which the financial assets were acquired.

Management determines the classification of its financial assets at initial recognition. Financial assets at FVTPL are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the shortterm. Derivatives are also categorized as held for trading unless they are designated as hedges. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. For financial instruments classified as other than held-for-trading, transaction costs are added to the initial fair value of the related financial instrument. Financial assets and financial liabilities classified as held-for-trading are measured at FVTPL. Loans and receivables, or other financial liabilities are measured at amortized cost using the effective interest rate method.

The Corporation assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. For loans and receivables, the amount of the loss is measured as the difference between the asset's carrying value and the present value of estimated future cash flows. The carrying amount of the asset is reduced by the amount of the loss and the latter is recognized in the consolidated statement of operations.

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). These 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, Accounts payable and accrued liabilities, or Other long-term 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.

The Corporation has implemented the following classifications:

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

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 OCI 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. However, deferred tax liabilities are not recognized if they arise from the initial recognition of goodwill. 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. Shares held in trust for employee share-based compensation awards are treated as treasury shares and excluded from basic shares outstanding in the calculation of basic EPS.

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 comprise stock options, warrants and any shares held in trust for employee share-based compensation awards. The number of shares included with respect to time vesting options and warrants 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 Class B Voting 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 are 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. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include \$234 pertaining to investments with original maturities of three months or less at December 31, 2014 (\$186 as at December 31, 2013).

Q. SHORT-TERM INVESTMENTS

Short-term investments have original maturities over three months, but not more than one year.

R. 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 booking transactions, 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.

S. AIRCRAFT FUEL INVENTORY AND SPARE PARTS AND SUPPLIES INVENTORY

Inventories of aircraft fuel and spare parts, other than rotables, 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 \$55 related to spare parts and supplies consumed during the year (2013 – \$48).

T. 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 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-bythe-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.

Previously, cabin interior equipment and modifications were depreciated over the lesser of five years or the remaining useful life of the aircraft. Effective April 1, 2014, cabin interior equipment and modifications are depreciated over the lesser of eight years or the remaining useful life of the aircraft. The adjustment to their useful lives was made prospectively as a change in accounting estimate and reflects product developments, and is in line with fleet plans. The impact of this change in accounting estimate is a decrease of \$6 in depreciation expense for the year ended December 31, 2014.

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.

U. 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 a qualifying asset, 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.

V. 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. Gains and losses on sale and operating leaseback transactions are recognized immediately in the consolidated statement of operations when it is clear that the transactions are established at fair value. If the sale price is below fair value, any loss is recognized immediately except that, if the loss is compensated for by future lease payments at below market price, it is deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the gain is deferred and amortized over the period for which the asset is expected to be used. In the context of sale and finance leaseback transactions, any gain on the sale is deferred and amortized over the lease term.

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.

W. 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, 2014
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 selling 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 continuously reinvest 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.

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

Y. 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 sell 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 narrowbody 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.

Z. 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 sell. There are currently no assets held for sale.

AA. PROVISIONS

Provisions are recognized when there is 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.

The Corporation records an asset and related provision for the costs associated with the retirement of long-lived tangible assets when a legal or constructive obligation to retire such assets exists. The provision recorded in Other long-term liabilities is measured as the best estimate of the expenditure required to settle the present obligation. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and then amortized in accordance with the accounting policy in Note 2T. In subsequent periods, interest accretion on the asset retirement provision is recorded in Other non-operating expense. Any change in the amount of the underlying cash flows, due to changes in the discount rate or changes in the estimate of the expenditure required to settle the present obligation, adjusts both the asset retirement provision and the related asset.



BB. EXCEPTIONAL ITEMS

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

CC. 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.

DD. ACCOUNTING STANDARDS ADOPTED EFFECTIVE JANUARY 1, 2014

The Corporation has adopted the amendments to IAS 32 – Financial Instruments: Presentation effective January 1, 2014. The IAS 32 amendments address inconsistencies when applying the offsetting requirements.

EE. 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, 2017, with early adoption permitted.

IFRS 9 - Financial Instruments

IFRS 9 introduces new requirements for the classification and measurement of financial assets. IFRS 9 requires all recognized financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement to be measured at amortized cost or fair value in subsequent accounting periods following initial recognition. Specifically, 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 subsequent accounting periods. All other financial assets including equity investments are measured at their fair values at the end of subsequent accounting periods.

Requirements for classification and measurement of financial liabilities were added in October 2010 and they 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 generally be recorded in other comprehensive income.

IFRS 9 was amended in November 2013, to (i) include guidance on hedge accounting, and (ii) allow entities to early adopt the requirement to recognize changes in fair value attributable to changes in an entity's own credit risk, from financial liabilities designated under the fair value option, in OCI, without having to adopt the remainder of IFRS 9.

The final version of IFRS 9 was issued in July 2014 and includes (i) a third measurement category for financial assets – fair value through other comprehensive income; (ii) a single, forward-looking expected loss impairment model, and (iii) a mandatory effective date for IFRS 9 of annual periods beginning on or after January 1, 2018, with early adoption permitted.

3. 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 9 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 \$32 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 sell
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 10(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, 2014, no deferred income tax assets have been recorded.

4. PROPERTY AND EQUIPMENT

	ANI	RCRAFT D FLIGHT JIPMENT	LEAS	INGS AND SEHOLD OVEMENTS	AND	OUND OTHER IPMENT	DEPO ASSET	RCHASE SITS AND IS UNDER LOPMENT	1	*OTAL
YEAR ENDED DECEMBER 31, 201	13									
At January 1, 2013	\$	3,869	\$	385	\$	133	\$	324	\$	4,711
Additions		736		(4)		27		198		957
Reclassifications		143		3		20		(166)		-
Disposals		(65)		-		-		-		(65)
Depreciation		(445)		(32)		(23)		-		(500)
Impairment		(30)		-		-		-		(30)
At December 31, 2013	\$	4,208	\$	352	\$	157	\$	356	\$	5,073
AT DECEMBER 31, 2013										
Cost	\$	6,119	\$	660	\$	359	\$	356	\$	7,494
Accumulated depreciation		(1,911)		(308)		(202)		-		(2,421)
	\$	4,208	\$	352	\$	157	\$	356	\$	5,073
YEAR ENDED DECEMBER 31, 20°	14									
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)
	\$	4,944	\$	399	\$	168	\$	487	\$	5,998

During 2014, the Corporation took delivery of six Boeing 787 aircraft and one Boeing 777 aircraft. In 2014, the Corporation disposed of two A340-500 aircraft and repaid the financing related to these aircraft. No gain or loss was recorded on the disposition.

In 2013, an impairment charge of \$30 was recorded in Depreciation, amortization and impairment expense related mainly to four A340-300 aircraft (none of which were operated by Air Canada). The impairment charge was based upon the net proceeds expected upon the return or other disposition of these aircraft. In 2013, these four A340-300 aircraft were sold with proceeds approximating book value.

As at December 31, 2014, property and equipment included finance leased assets including 17 aircraft (2013 – 18) with a net book value of \$145 (2013 – \$150) and facilities with a net book value of \$42 (2013 – \$45).

Included in aircraft and flight equipment are 28 aircraft and 5 spare engines (2013 – 32 aircraft and six spare engines) which are leased to Sky Regional, Jazz (Note 16) and third parties with a cost of \$361 (2013 – \$481) less accumulated depreciation of \$118 (2013 – \$124) including accumulated impairment losses of \$19 related to the fleet of A340-300 aircraft (2013 – \$26) for a net book value of \$243 (2013 – \$357). Depreciation expense for 2014 for this aircraft and flight equipment amounted to \$22 (2013 – \$38).

Interest capitalized during 2014 amounted to \$30 at an interest rate of 5.29% (2013 – \$46 at an interest rate of 8.36%) and is included in Purchase deposits and assets under development in the table above.

Certain property and equipment are pledged as collateral as further described under the applicable debt instrument in Note 8.

5 INTANGIBLE ASSETS

	INTERNATIONAL ROUTE RIGHTS AND SLOTS		MARKETING BASED TRADE NAMES		CONTRACT AND CUSTOMER BASED		TECHNOLOGY BASED (INTERNALLY DEVELOPED)		TOTAL	
YEAR ENDED DECEMBER 31, 2013										
At January 1, 2013	\$	97	\$	88	\$	7	\$	122	\$	314
Additions		-		-		-		30		30
Amortization		-		-		(4)		(36)		(40)
At December 31, 2013	\$	97	\$	88	\$	3	\$	116	\$	304
AT DECEMBER 31, 2013										
Cost	\$	97	\$	88	\$	20	\$	363	\$	568
Accumulated amortization		-		-		(17)		(247)		(264)
	\$	97	\$	88	\$	3	\$	116	\$	304
YEAR ENDED DECEMBER 31, 2014	4									
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

Certain international route rights and slots are pledged as security for senior secured notes as described in Note 8(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.

Key assumptions are as of the date of the test at October 31, 2014 and may not be indicative of current values for these assumptions. 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.



6. 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 sell 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, 2014 and 2013. Reasonably possible changes in key assumptions would not cause the recoverable amount of goodwill to fall below the carrying value.

7. DEPOSITS AND OTHER ASSETS

		2014	2013
Restricted cash	Note 2R	\$ 192	\$ 190
Aircraft related deposits (a)		107	84
Aircraft lease payments in excess of rent expense	Note 2V	82	65
Prepayments under maintenance agreements	Note 2J	73	64
Share forward contracts	Note 17	60	36
Deposit related to pension and benefits agreements	Note 19	-	9
Other deposits		28	29
Other		14	17
		\$ 556	\$ 494

(a) Represents the amount of deposits with lessors for the lease of aircraft and flight simulators.

8. LONG-TERM DEBT AND FINANCE LEASES

	FINAL	WEIGHTED AVERAGE INTEREST RATE		
	MATURITY	(%)	2014	2013
AIRCRAFT FINANCING (A)				
Fixed rate U.S. dollar financing	2015 - 2026	\$ 5.92	\$ 2,029	\$ 1,706
Floating rate U.S. dollar financing	2015 - 2026	1.79	582	609
Floating rate CDN dollar financing	2026	1.93	310	-
Floating rate Japanese yen financing	2020	0.24	94	116
Senior secured notes – U.S. dollar (b)	2019 - 2020	7.61	812	745
Senior secured notes – CDN dollar (b)	2019	7.63	300	300
Senior unsecured notes – U.S. dollar (c)	2021	7.75	464	-
Other secured financing – U.S. dollar (b) and (d)	2016 - 2019	5.63	433	467
Other secured financing – CDN dollar (e)	2016	-	-	126
LONG-TERM DEBT		5.61	5,024	4,069
Finance lease obligations (f)	2015 - 2033	10.08	283	328
TOTAL DEBT AND FINANCE LEASES		5.85	5,307	4,397
Unamortized debt issuance costs			(91)	(64)
Current portion			(484)	(374)
LONG-TERM DEBT AND FINANCE LEASES			4,732	3,959

The total weighted average interest rate presented above excludes the impact of interest rate swaps applicable to certain aircraft financing arrangements.

(a) Aircraft financing (US\$2,250, CDN \$310 and JPY9,677) is secured primarily by specific aircraft with a carrying value of \$3,835 (2013 – \$3,222). 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\$490, CDN \$310 and JPY9,677 of the financing is supported by a loan guarantee by the Export-Import Bank of the United States ("EXIM").

In 2013, in connection with the financing of five new Boeing 777-300ER aircraft, four of which were delivered in 2013, with the remaining aircraft delivered in 2014, the Corporation completed a private offering of three tranches of enhanced equipment trust certificates ("EETC") with a combined aggregate face amount of US\$715.

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

- The Class A certificates, with a US\$425 face amount, have an interest rate of 4.125% per annum, with interest paid semi-annually, and a final expected distribution date of May 15, 2025.
- The Class B certificates, with a US\$182 face amount, have an interest rate of 5.375% per annum, with interest paid semi-annually, and a

final expected distribution date of May 15, 2021.

 The Class C certificates, with US\$108 face amount, will have an interest rate of 6.625% per annum, with interest paid semi-annually and a final expected distribution date of May 15, 2018.

The trust certificates have a weighted average interest rate of approximately 4.7% per annum.

The trust certificates represent an interest in three separate pass through trusts. The trusts consist of a separate trust for each of the Class A, B and C certificates. The trusts use the proceeds from the offering to acquire equipment notes that are issued to finance the acquisition of each of the five new Boeing 777-300ER aircraft.

The equipment notes issued are secured by each of the five Boeing 777-300ER aircraft acquired, and the security interest in each of the aircraft benefits 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.

(b) In September 2013, the Corporation completed private offerings of senior secured notes, consisting 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 "New Senior First Lien Notes") and (ii) US\$300 principal amount of 8.750% senior secured second

lien notes due 2020 (the "New Senior Second Lien Notes" and together with the New Senior First Lien Notes, the "New Senior Notes"). At the same time, the Corporation also completed the closing of its US\$400 new senior secured (first lien) credit facility, comprised of a US\$300 term loan maturing in 2019 and a US\$100 revolving credit facility (collectively, the "New Credit Facility"). The revolving credit facility was increased to US\$210 in 2014. The term loan is included in Other secured financing in the table above. As at December 31, 2014, the Corporation had not drawn on the revolving credit facility.

The Corporation received, in total, net proceeds of approximately \$1,300 from the sale of the New Senior Notes and from term loan borrowings under the New Credit Facility (in each case, after deduction of the applicable transaction costs, fees and expenses). The Corporation applied a portion of such net proceeds and borrowings to purchase all of its outstanding 9.250% Senior Secured Notes due 2015, 10.125% Senior Secured Notes due 2015 and 12.000% Senior Second Lien Notes due 2016 (collectively, the "Existing Notes").

In conjunction with the purchase of the Existing Notes, the premium costs paid, in the amount of \$61, as well as the write-off of existing transaction costs and discounts related to the Existing Notes, in the amount of \$34, were recorded as an interest charge in 2013.

The New Senior Notes and the Corporation's obligations under the New 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 New Senior First Lien Notes and Air Canada's obligations in the New Credit Facility, and on a second lien basis with respect to the New 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. The applicable margin with respect to loans under the revolving credit facility in the New Credit Facility is 4.50% with respect to LIBOR loans and banker's acceptances and 3.50% with respect to the Index Rate loans or Canadian Prime Rate loans. The applicable margin with respect to the term loans under the New Credit Facility is 4.50% with respect to LIBOR loans and 3.50% with respect to the Index Rate loans. All such applicable margins are subject to the adjustments and other terms provided for in the New Credit Facility.

(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 New Credit Facility. It also includes a revolving credit facility for the financing of jet fuel. Financial covenants under the revolving credit facility require the Corporation to maintain certain minimum operating results and cash balances.
- (e) Other CDN dollar secured financing is a revolving credit facility for the financing of jet fuel. Financial covenants under the agreement require the Corporation to maintain certain minimum operating results and cash balances.
- (f) Finance leases, related to facilities and aircraft, total \$283 (\$73 and US\$181) (2013 \$328 (\$76 and US\$237)). During 2014, the Corporation recorded interest expense on finance lease obligations of \$32 (2013 \$46). The carrying value of aircraft and facilities under finance leases amounted to \$145 and \$42 respectively (2013 \$150 and \$45).

Air Canada has aircraft leasing transactions with a number of structured entities. Air Canada controls and consolidates leasing entities covering 22 aircraft as at December 31, 2014. This debt amount includes any guarantee by Air Canada in the residual value of the aircraft upon expiry of the lease. The related aircraft are charged as 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 2015, assuming the collateral is worth nil, is \$212 (US\$183). The maximum amount payable declines over time in relation to the outstanding principal. Total collateral as at December 31, 2014 is \$12 (US\$11) (2013 – \$5 (US\$5)) 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 2014 by the Corporation was \$287 (2013 – \$345).

Refer to Note 16 for the Corporation's principal and interest repayment requirements as at December 31, 2014.

9. 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, and to former employees for whom the related pension assets and liabilities have not yet been settled.

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 Standards Act, 1985 (Canada). The US plan, UK 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 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 postemployment 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.

AMENDMENTS TO THE DEFINED BENEFIT PENSION PLANS

In December 2013, amendments to the defined benefit pension plans, determined in accordance with new collective agreements during 2011 and 2012 and changes applicable to non-unionized employees as communicated to them in 2013, were approved by OSFI and became effective January 1, 2014.

As a result of this approval, the Corporation has recorded a credit of \$82 in Benefit plan amendments in 2013 related to the impact of those amendments on pension liabilities. By virtue of its size and incidence, this item is separately disclosed within the consolidated statement of operations.

PENSION PLAN CASH FUNDING OBLIGATIONS

As at January 1, 2014, the aggregate solvency surplus in the domestic registered pension plans was \$89. The next required valuations to be made as at January 1, 2015, will be completed in the first half of 2015, but they will not impact the 2015 pension past service cost funding obligations should the Corporation continue to fund its domestic registered pension plans pursuant to the 2014 Regulations.

Pension funding obligations under the normal funding rules are generally dependent on a number of factors, including the assumptions used in the most recently filed actuarial valuation reports for current service (including the applicable discount rate used or assumed in the actuarial valuation), the plan demographics at the valuation date, the existing plan provisions, existing pension legislation and changes in economic conditions (mainly the return on fund assets and changes in interest rates). Actual contributions that are determined on the basis of future valuation reports filed annually 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, changes in legislation and other factors.

In December 2013, the Government of Canada formally approved the Air Canada Pension Plan Funding Regulations, 2014 ("the 2014 Regulations") under the Pension Benefits Standards Act, 1985 in respect of special payments under Air Canada's defined benefit plans applicable to the period between 2014 to 2020 inclusive, expiring December 31, 2020. According to the terms of the 2014 Regulations, Air Canada will be required to make payments of at least \$150 annually with an average of \$200 per year, to contribute an aggregate minimum of \$1,400 over seven years in solvency deficit payments, in addition to its pension current service payments. Air Canada may elect to opt out of the regulations and have special payments in respect of all Air Canada pension plans, collectively, determined in accordance with normal funding rules.

Under the agreement with the Government of Canada, in respect of the plan years during which Air Canada funds its plan pursuant to the 2014 Regulations, Air Canada is subject to a series of covenants and undertakings, including a prohibition on dividends and share repurchases, as well as certain limitations on executive compensation arrangements. As requested by the Government of Canada, Air Canada has also agreed to use reasonable efforts, during the negotiations of the next collective agreements with Air Canada's Canadian-based unions, to seek to include in those collective agreements

provisions which would have employees contribute fifty per cent of their pension plan normal costs, and has agreed not to implement pension plan benefit improvements without regulatory approval.

Giving effect to the Air Canada 2014 Pension Regulations as outlined above, total employer pension funding contributions during 2014 amounted to \$445. In the event that Air Canada does not opt out and continues funding its domestic registered pension plans under the 2014 Regulations, total employer contributions to defined benefit pension plans for 2015 are expected to be \$424.

BENEFIT OBLIGATION AND PLAN ASSETS

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

	2014	2013
ACCRUED BENEFIT LIABILITIES FOR		
Pension benefits obligation	\$ 1,183	\$ 1,578
Other employee future benefits	1,285	1,183
NET BENEFIT OBLIGATION	2,468	2,761
Current portion	(65)	(74)
PENSION AND OTHER BENEFIT LIABILITIES	\$ 2,403	\$ 2,687

The current portion of the net benefit obligation represents an estimate of other employee future benefits claims to be paid during 2015. The current portion is included in Accounts payable and accrued liabilities.

In 2012, the Corporation concluded an agreement with Aimia Canada Inc. (formerly Aeroplan) through which the Corporation would transfer to the Aeroplan defined pension plan all the pension plan assets and obligations related to pension benefits accrued by certain Air Canada employees who chose to transition to employment at Aeroplan in 2009. The Corporation continued to retain plan assets and report plan liabilities for services accrued for the transferred Aeroplan employees' pension until such transfer was approved by OSFI. Approval was received and the transfer completed in 2014. A settlement gain of \$2 was recorded.

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

	PENSION	BENEFITS	OTHER EMPLOYEE FUTU BENEFITS		
	2014	2013	2014	2013	
CHANGE IN BENEFIT OBLIGATION					
Benefit obligation at beginning of year	\$ 16,147	\$ 16,446	\$ 1,183	\$ 1,230	
Current service cost	213	264	55	60	
Past service cost	(13)	(82)	-	-	
Interest cost	783	704	56	53	
Employees' contributions	73	71	-	-	
Benefits paid	(844)	(850)	(51)	(50)	
Settlement payments for transfer to Aeroplan	(68)	-	-	-	
Remeasurements:					
Experience loss (gain)	(9)	30	(110)	(28)	
Loss (gain) from change in demographic assumptions	(66)	764	(1)	32	
Loss (gain) from change in financial assumptions	2,117	(1,245)	137	(101)	
Plan settlements	(10)	-	-	(26)	
Foreign exchange loss	29	45	16	13	
Total benefit obligation	18,352	16,147	1,285	1,183	
CHANGE IN PLAN ASSETS					
Fair value of plan assets at beginning of year	14,745	13,253	-	-	
Return on plan assets, excluding amounts included in Net financing expense	2,353	1,199	-	-	
Interest income	714	563	-	-	
Employer contributions	445	475	51	50	
Employees' contributions	73	71	-	-	
Benefits paid	(844)	(850)	(51)	(50)	
Plan settlements for transfer to Aeroplan	(68)	-	-	-	
Administrative expenses paid from plan assets	(8)	(7)	-	-	
Foreign exchange gain	23	41	-	-	
Total plan assets	17,433	14,745	-	-	
DEFICIT AT END OF YEAR	919	1,402	1,285	1,183	
Additional minimum funding liability	264	176	-	-	
NET BENEFIT OBLIGATION	\$ 1,183	\$ 1,578	\$ 1,285	\$ 1,183	

The actual return on plan assets was \$3,067 (2013 – \$1,762).

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

	2014	2013
Domestic registered plans	\$ 52	\$ 574
US, UK and Japan	102	63
Supplementary plans	952	798
	\$ 1,106	\$ 1,435

The net benefit obligation for pension benefits was 1,183 (2013 – 1,578). The decrease is mainly the result of the increase in plan assets and the employer contributions of 445.

The weighted average duration of the defined benefit obligation is 14.1 years (2013 – 13.3 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			
	2	2014	i	2013	2	2014	2	2013	
CONSOLIDATED STATEMENT OF OPERATIONS									
Components of cost									
Current service cost	\$	213	\$	264	\$	55	\$	60	
Past service cost		(13)		(82)		(1)		-	
Gain on settlements		(10)		-		-		-	
Administrative and other expenses		8		7		-		-	
Actuarial gains		-		-		(15)		(16)	
TOTAL COST RECOGNIZED IN WAGES, SALARIES AND BENEFITS	\$	198	\$	189	\$	39	\$	44	
NET FINANCING EXPENSE RELATING TO EMPLOYEE BENEFITS	\$	78	\$	155	\$	56	\$	53	
TOTAL COST RECOGNIZED IN STATEMENT OF OPERATIONS	\$	276	\$	344	\$	95	\$	97	
CONSOLIDATED OTHER COMPREHENSIVE (INCOME) LOSS									
Remeasurements:									
Experience loss (gain), including foreign exchange		(3)		35		(87)		(23)	
Loss (gain) from change in demographic assumptions		(66)		764		(1)		32	
Loss (gain) from change in financial assumptions		2,117	(1,245)		146		(98)	
Return on plan assets	(2,353)		(1,199)		-		-	
Minimum funding liability		80		(174)		-		-	
TOTAL COST (INCOME) RECOGNIZED IN OCI	\$	(225)	\$ (1,819)	\$	58	\$	(89)	

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

	2014		2	.013
NET DEFINED PENSION AND OTHER FUTURE EMPLOYEE BENEFITS EXPENSE RECORDED IN THE CONSOLIDATED STATEMENT OF OPERATIONS				
Wages, salaries and benefits	\$	245	\$	314
Net financing expense relating to employee benefit liabilities		134		208
	\$	379	\$	522
EMPLOYEE BENEFIT FUNDING BY AIR CANADA				
Pension benefits	\$	445	\$	475
Other employee benefits		51		50
	\$	496	\$	525
EMPLOYEE BENEFIT FUNDING (GREATER) LESS THAN EXPENSE	\$	(117)	\$	(3)

COMPOSITION OF PENSION PLAN ASSETS

Domestic Registered Plans

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

	2014	2013	2014 TARGET ALLOCATION
Bonds	54%	46%	53%
Canadian equities	10%	15%	11%
Foreign equities	21%	31%	21%
Alternative investments	15%	8%	15%
	100%	100%	100%

For the Domestic Registered Plan assets, approximately 85% of assets as of December 31, 2014 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.

Included in plan assets, for determining the net benefit obligation for accounting purposes, are 17,647,059 Class B Voting Shares of Air Canada with a fair value of \$209 (2013 – \$131) which were issued in 2009 in connection with pension funding agreements reached with all of the Corporation's Canadian-based unions. All future net proceeds of sale of such shares, when realised, are to be contributed to the pension plans.

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 Benchmark. The Liability Benchmark, which is referenced to widely used Canadian fixed income indices (FTSE TMX Canada), that 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 optimally minimize 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 minimize 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 nontraditional 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. As of December 31, 2014, a 20% derivatives exposure to matched assets is in place to hedge interest rate risk related to pension liabilities.

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

Investments in equity and alternative investments are subject to changes in price which may not be offset by changes in the value of plan liabilities. The plan liabilities are calculated using a discount rate set with reference to corporate bond yields. If plan assets underperform this yield, this will create a deficit. Certain plan assets are also subject to foreign exchange risk.

Interest rate risk

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.

Funding risk

Adverse changes in the value of plan assets or in interest rates could have a significant impact on pension plan solvency valuations and cash funding requirements. Refer to discussion above with respect to past service funding obligations while the 2014 Regulations are in effect.

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.

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 the Corporation's accrued benefit obligations and cost are as follows:

	PENSION	BENEFITS	OTHER EMPLO	
	2014	2013	2014	2013
DISCOUNT RATE USED TO DETERMINE:				
Accrued benefit cost for the year ended December 31	4.90%	4.30%	4.80%	4.17%
Accrued benefit liability as at December 31	4.00%	4.90%	3.90%	4.80%
RATE OF FUTURE INCREASES IN COMPENSATION U	SED TO DETERMII	NE:		
Accrued benefit cost for the year ended December 31	2.50%	2.50%	not applicable	not applicable
Accrued benefit obligation as at December 31	2.50%	2.50%	not applicable	not applicable

Actuarial assumptions Mortality rates

The cost and related liabilities of the Corporation's pension plans, and other post-retirement and postemployment benefit programs are determined using actuarial valuations. The actuarial valuations include several economic and demographic assumptions including mortality rates. For the December 31, 2013 accounting valuations, the mortality assumption was updated to reflect the results of a mortality study specific to Air Canada pension plan membership. The change in mortality rate assumptions resulted in an actuarial remeasurement of the accounting liabilities with the impact being recorded in other comprehensive income. The improvements in assumed mortality rates were consistent with those presented by the Canadian Institute of Actuaries ("CIA") which issued new mortality tables for use in the valuation of Canadian pension and benefit plans in early 2014.

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 2014 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	\$ 17	\$ (16)
Net financing expense relating to pension benefit liabilities	18	(8)
	\$ 35	\$ (24)
Increase (decrease) in pension obligation	\$ 652	\$ (630)

An increase of one year in life expectancy would increase the pension benefit obligation by \$447.

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 2014 (2013 – 6%). 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 \$5 and the obligation by \$61. 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 \$60.

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 \$52.

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 \$41.

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 \$6 for the year ended December 31, 2014 (2013 – \$5). Expected total employer contributions for 2015 are \$7.

10. PROVISIONS FOR OTHER LIABILITIES

The following table provides a continuity schedule of all recorded provisions. Refer to Note 18 for additional information on Litigation provisions. Current provisions are recorded in Accounts payable and accrued liabilities.

	MAIN	MAINTENANCE (A)		ASSET RETIREMENT (B)				TOTAL OVISIONS
AT DECEMBER 31, 2013								
Current	\$	-	\$	-	\$	29	\$ 29	
Non-current		656		17		-	673	
	\$	656	\$	17	\$	29	\$ 702	
Provisions arising during the year	\$	91	\$	-	\$	1	\$ 92	
Amounts disbursed		(14)		-		(1)	(15)	
Changes in estimated costs		(13)		2		-	(11)	
Accretion expense		11		-		-	11	
Foreign exchange loss		65		-		-	65	
AT DECEMBER 31, 2014	\$	796	\$	19	\$	29	\$ 844	
Current	\$	-	\$	-	\$	29	\$ 29	
Non-current		796	\$	19		-	815	
	\$	796	\$	19	\$	29	\$ 844	

- (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 2015 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 \$40 at December 31, 2014 and an increase to maintenance expense in 2015 of approximately \$3. 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 \$17 at December 31, 2014. 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 2015 to 2041. 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.

11. OTHER LONG-TERM LIABILITIES

		2014	2013
Proceeds from contractual commitments (a)		\$ 89	\$ 107
Deferred income tax	Note 12	49	49
Collateral held in leasing arrangements and other deposits		23	29
Aircraft rent in excess of lease payments	Note 2V	22	27
Long-term employee liabilities		20	25
Other	Note 10(b)	110	138
		\$ 313	\$ 375

(a) Proceeds from contractual commitments represent non-refundable proceeds received, net of related costs and deposits, in consideration of various contractual commitments and will be recognized as reductions in the cost of those contractual commitments when incurred.

12. INCOME TAXES

INCOME TAX EXPENSE

	20	2014		013
Current income tax recovery in respect of prior years	\$	-	\$	(8)
Deferred income tax expense		-		-
INCOME TAX RECOVERY	\$	-	\$	(8)

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

	2014	2013
Income before income taxes	\$ 105	\$ 2
Statutory income tax rate based on combined federal and provincial rates	26.81%	26.57%
INCOME TAX EXPENSE BASED ON STATUTORY TAX RATES	28	1
EFFECTS OF:		
Non-taxable portion of capital (gains) losses	21	(3)
Non-deductible expenses	13	11
Tax rate changes on deferred income taxes	(13)	(6)
Recognition of previously unrecognized deferred income tax assets	(53)	(9)
Adjustment in respect of current income tax of prior years	-	(8)
Other	4	6
INCOME TAX RECOVERY	\$ -	\$ (8)

The applicable statutory tax rate is 26.81% (2013 - 26.57%). 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:

	2	2014		013
Net gain on remeasurements on employee benefit liabilities	\$	65	\$	521
Recognition of previously unrecognized deferred income tax assets		(62)		(525)
Tax rate changes on deferred income taxes		(3)		4
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 (2013 - \$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 \$45, 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 unrecognized tax loss carryforwards and temporary differences 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 unrecognized tax loss carryforwards and the temporary differences for which no deferred income tax assets could be recognized:

	2014	2013
Non-capital losses carryforwards	\$ 946	\$ 1,402
Net capital losses carryforwards	2	2
Other deductible temporary differences	5,345	5,290
TOTAL UNRECOGNIZED TEMPORARY DIFFERENCES	\$ 6,293	\$ 6,694

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

	TAX LOSSES
2026	\$ 2
2027	3
2028	507
2029	411
2030	11
2031	6
2032	1
2033	1
2034	4
NON-CAPITAL LOSSES CARRYFORWARDS	\$ 946

Cash income taxes recovered in 2014 by the Corporation were \$1 (2013 – \$5 recovered).

13. SHARE CAPITAL

	NUMBER OF SHARES	VALUE
AT JANUARY 1, 2013	274,443,803	\$ 813
Shares issued on the exercise of stock options	2,064,264	4
Shares issued on the exercise of warrants	7,916,667	12
Repurchase of warrants	-	(2)
Shares in trust for employee recognition award	107,705	-
AT DECEMBER 31, 2013	284,532,439	827
Shares issued on the exercise of stock options	619,478	2
Shares in trust for employee recognition award	1,337,377	6
AT DECEMBER 31, 2014	286,489,294	\$ 835

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

		2014	2013
ISSUED AND OUTSTANDING			
Class A variable voting shares		69,232,535	26,577,512
Class B voting shares		217,256,759	257,954,927
TOTAL ISSUED AND OUTSTANDING		286,489,294	284,532,439
POTENTIAL COMMON SHARES			
Shares held in trust	Note 14	-	1,337,377
Stock options	Note 14	10,002,975	10,079,694
TOTAL POTENTIAL COMMON SHARES		10,002,975	11,417,071

COMMON SHARES

As at December 31, 2014, 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.

Effective November 3, 2014, Air Canada's Class B voting shares and Class A variable voting shares are listed for trading on the Toronto Stock Exchange under the single ticker "AC".



WARRANTS

In 2013, the Corporation purchased for cancellation 2,083,333 warrants expiring July 30, 2013 for an aggregate purchase price of \$2, representing the average trading price, at the time of purchase, of Air Canada shares on the Toronto Stock Exchange less the exercise price of \$1.51 of each warrant. In addition, the outstanding number of common shares increased by 7,916,667 upon exercise of warrants with proceeds to Air Canada of \$12.

The Corporation has no warrants left outstanding.

SHAREHOLDER RIGHTS PLAN

Under the terms of the shareholder rights plan agreement (the "Rights Plan"), renewed until 2017 at Air Canada's annual meeting of shareholders held in 2014, 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.



14. SHARF-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 will 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:

	2014	2013
Compensation expense (\$ millions)	\$ 3	\$ 3
Number of stock options granted to Air Canada employees	1,170,710	4,052,085
Weighted average fair value per option granted (\$)	\$ 2.18 \$1.	
Aggregated fair value of options granted (\$ millions)	\$ 3	\$ 5
WEIGHTED AVERAGE ASSUMPTIONS:		
Share price	\$ 5.56	\$ 2.95
Risk-free interest rate	1.44%-2.06%	1.20%-2.21%
Expected volatility	53.0%-72.4%	48.8%-74.2%
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:

	20	014	2013		
	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE/ SHARE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE/ SHARE	
Beginning of year	10,079,694	\$ 2.47	8,410,403	\$ 2.68	
Granted	1,170,710	5.41	4,052,085	2.95	
Exercised	(619,478)	1.99	(2,064,264)	1.44	
Expired	(237,661)	14.71	(311,655)	21.00	
Forfeited	(390,290)	2.77	(6,875)	12.18	
OUTSTANDING OPTIONS, END OF YEAR	10,002,975	\$ 2.54	10,079,694	\$ 2.47	
OPTIONS EXERCISABLE, END OF YEAR	2,112,883	\$ 1.93	1,609,601	\$ 3.61	

The weighted average share price on the date of exercise for options exercised in 2014 was 9.20 (2013 – 6.56).

		2014 (DUTSTANDING OP	2014 EXERCISABLE OPTIONS		
RANGE OF EXERCISE PRICES	EXPIRY DATES	OPTIONS REMAINING LIFE EXERCISE PRICE/ EX		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

		2013 (DUTSTANDING OP	2013 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
\$11.08 – 18.60	2014	237,661	1	\$ 14.71	237,661	\$ 14.71
\$8.51	2015	5,500	2	8.51	5,500	8.51
\$0.97 – \$1.59	2016	442,500	3	1.30	442,500	1.30
\$1.78 – \$1.91	2017	31,250	4	1.85	_	_
\$2.34	2018	2,612,356	5	2.34	577,828	2.34
\$0.96 – \$1.28	2019	2,698,342	6	0.98	346,112	1.00
\$2.49 - \$5.69	2020	4,052,085	7	2.95	_	_
		10,079,694		\$ 2.47	1,609,601	\$ 3.61

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 2014 was \$8 (2013 - \$12).

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

	2014	2013
Beginning of year	9,437,970	7,255,711
Granted	1,280,922	4,047,136
Settled	(2,948,874)	(1,661,624)
Forfeited	(217,008)	(203,253)
OUTSTANDING SHARE UNITS, END OF YEAR (1)	7,553,010	9,437,970

^{1 1,105,433} PSUs were eligible for vesting as at December 31, 2014, of which all were vested in accordance with the terms of the program. These PSUs which vested in 2014 are planned to be settled in 2015.

Refer to Note 17 for a description of derivative instruments used by the Corporation to mitigate the cash flow exposure to the PSUs and RSUs granted.

EMPLOYEE RECOGNITION AWARD

In 2011, Air Canada's Board of Directors approved a special one-time Employee Recognition Award in the form of Air Canada shares granted to all eligible unionized and certain non-unionized employees worldwide, where permitted. Under the award, eligible employees were granted an aggregate of approximately 3.3 million shares with a grant date fair value of \$11. Half of these shares vested immediately upon issuance and the other half vested at the end of three years. Pursuant to the award, the Corporation purchased approximately 3.3 million shares for \$11, of which half were distributed to the eligible employees and the other half were held in trust over the vesting period. The shares held in trust were recorded at cost of \$6 and were reported net against Share capital. Compensation expense for these shares was recognized over the vesting period from 2011 to 2013. The compensation expense recorded in 2013 was \$2.

During 2014, all remaining shares held in trust for the Employee Recognition award vested.

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 2014, the Corporation recorded compensation expense of 5 (2013 – 1) related to the Employee Share Purchase Plan.



15. FARNINGS PER SHARE

The following table outlines the calculation of basic and diluted EPS:

IN MILLIONS, EXCEPT PER SHARE AMOUNTS	2014	2013
NUMERATOR:		
NUMERATOR FOR BASIC AND DILUTED EARNINGS PER SHARE:		
Net income attributable to shareholders of Air Canada	\$ 100	\$ 6
DENOMINATOR:		
WEIGHTED-AVERAGE SHARES	286	277
Effect of potential dilutive securities:		
Stock options	7	4
Warrants	-	2
Shares held in Trust for employee share-based compensation award	-	1
Total potential dilutive securities	7	7
ADJUSTED DENOMINATOR FOR DILUTED EARNINGS PER SHARE	293	284
BASIC EPS	\$ 0.35	\$ 0.02
DILUTED EPS	\$ 0.34	\$ 0.02

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.

Basic EPS is calculated based on the weighted average number of common shares outstanding after deducting shares held in trust for the purposes of the Employee Recognition Award. All of the remaining shares held in trust for the Employee Recognition Award vested in 2014.

Excluded from the 2014 calculation of diluted EPS were 2,680,000 (2013 - 7,027,000) outstanding options where the options' exercise prices were greater than the average market price of the common shares for the year.

16. COMMITMENTS

AIRCRAFT AND RELATED FINANCING

As at December 31, 2014, the Corporation has outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of 31 Boeing 787 aircraft. Deliveries for these aircraft are scheduled from 2015 to 2019. The Corporation 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, the Corporation has financing or sale and leaseback commitments covering up to 26 of the remaining 31 Boeing 787 firm aircraft orders, which such commitments are summarized as follows:

- Final commitment from EXIM, subject to documentation and other conditions, for one 787 aircraft scheduled for delivery in February 2015
- For one 787 aircraft, the financing under the commitment covers up to 90% of the capital expenditure and the term to maturity is 15 years with principal payments made on a mortgagestyle basis resulting in equal installment payments of principal and interest over the term to maturity
- For 22 of the 787 aircraft, the financing terms are for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments
- In the fourth quarter of 2014, the Corporation entered into a sale and leaseback transaction with a third party for two Boeing 787 firm aircraft

In March 2014, the Corporation concluded an agreement with Boeing for the purchase of Boeing 737 MAX aircraft. This agreement includes 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. It also provides for purchase options for 18 Boeing 737 aircraft and certain rights to purchase an additional 30 Boeing 737 aircraft. Deliveries are scheduled to begin in 2017 with two aircraft, and with the remaining deliveries between 2018 to 2021, subject to deferral and acceleration rights.

The Corporation has financing commitments, subject to certain conditions, covering up to 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.

In 2014, the Corporation exercised purchase rights for two Boeing 777 aircraft, with scheduled deliveries in the second quarter of 2016. Financing alternatives will be considered prior to the planned delivery dates of these aircraft. As at December 31, 2014, the Corporation has purchase rights for 11 Boeing 777 (entitling the Corporation to purchase aircraft based on previously determined pricing).

Certain of the financing commitments for the Boeing 787 aircraft and/or the Boeing 737 MAX aircraft will be reduced based on allocation of the commitment between aircraft type to be determined by the Corporation, although the specifics of the reduction have not yet been determined. Taking the estimated financing reduction into consideration, the total committed financing on these Boeing 787 aircraft and/or the Boeing 737 MAX aircraft, including commitments from EXIM and the sale and leaseback transaction with a third party will be at least \$4,643.

OPERATING LEASE AND CAPITAL COMMITMENTS

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, 2014 approximates \$8,256. U.S. dollar amounts are converted using the December 31, 2014 closing rate of CDN\$1.1601. 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, 2014.

	2015	2016	2017	2018	2019	THEREAFTER	TOTAL
Capital commitments	\$ 1,067	\$ 2,122	\$ 1,598	\$ 1,362	\$ 1,066	\$ 1,041	\$8,256

As at December 31, 2014 the future minimum lease payments under existing operating leases of aircraft and other property amount to \$1,633 using year end exchange rates.

	2015	2016	2017	2018	2019	THEREAFTER	TOTAL
Aircraft	\$ 313	\$ 268	\$ 238	\$ 204	\$ 172	\$ 145	\$ 1,340
Other property	46	32	28	23	13	151	293
TOTAL	\$ 359	\$ 300	\$ 266	\$ 227	\$ 185	\$ 296	\$ 1,633

The future minimum non-cancellable commitment for the next 12 months under the Jazz CPA is approximately \$856 and under the capacity purchase agreements with other regional carriers is \$115. In February 2015, the Corporation and Jazz concluded an amendment to the Jazz CPA, effective as of January 1, 2015. The Corporation is assessing the impact to the minimum non-cancellable commitment under the amended Jazz CPA, which includes modifications to the fee structure by creating a fixed fee compensation structure to replace the current variable mark-up structure.

Non-cancellable Lease and Sublease Receipts

The Corporation leases or subleases to third parties eight aircraft and five spare engines which have final maturities ranging from 2015 to 2016 and the future minimum rentals receivable under such leases and subleases amount to \$9 using year end exchange rates.

	20	15	20 ⁻	16	20	17	20	18	20 [.]	19	THERE	AFTER	TO	TAL
Subleases	\$	6	\$	1	\$	1	\$	1	\$	-	\$	-	\$	9

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 25 Bombardier CRJ-200 aircraft and 15 Bombardier CRJ-705 aircraft which have final maturities ranging from 2015 to 2024. The sublease revenue and lease expense related to these aircraft each amounted to \$84 in 2014 (2013 – \$78). The operating lease commitments under these aircraft, which are recovered from Jazz, are not included in the aircraft operating lease commitments or non-cancellable lease and sublease receipt tables above but are summarized as follows:

	2015	2016	2017	2018	2019	THEREAFTER	TOTAL
Jazz flow-through leases	\$ 86	\$ 80	\$ 73	\$ 70	\$ 69	\$ 233	\$ 611

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 15 Embraer 175 aircraft. The lease and sublease revenue and expense related to these aircraft each amount to \$41 in 2014 (2013 - \$27) and are not included in the non-cancellable lease and sublease receipts above.

MATURITY ANALYSIS

Principal and interest repayment requirements as at December 31, 2014 on Long-term debt and finance lease obligations are as follows:

PRINCIPAL	2015	2016	2017	2018	2019	THEREAFTER	TOTAL
Long-term debt obligations	\$ 418	\$ 381	\$ 505	\$ 484	\$ 1,485	\$ 1,751	\$ 5,024
Finance lease obligations	66	28	29	32	35	93	283
	\$ 484	\$ 409	\$ 534	\$ 516	\$ 1,520	\$ 1,844	\$ 5,307

INTEREST	2015	2016	2017	2018	2019	THEREAFTER	TOTAL
Long-term debt obligations	\$ 262	\$ 242	\$ 243	\$ 194	\$ 167	\$ 152	\$ 1,260
Finance lease obligations	25	20	17	14	11	27	114
	\$ 287	\$ 262	\$ 260	\$ 208	\$ 178	\$ 179	\$ 1,374

Principal repayments in the table above exclude transaction costs of \$91 which are offset against Long-term debt and finance leases in the consolidated statement of financial position. The following is a maturity analysis, based on contractual undiscounted cash flows, for financial liabilities. The analysis includes both the principal and interest component of the payment obligations on long-term debt and is based on interest rates and the applicable foreign exchange rate effective as at December 31, 2014.

	2015	2016	2017	2018	2019	THEREAFTER	TOTAL
Long-term debt obligations	\$ 680	\$ 623	\$ 748	\$ 678	\$ 1,652	\$ 1,903	\$ 6,284
Finance lease obligations	91	48	46	46	46	120	397
Accounts payable and accrued liabilities	1,259	-	-	-	-	-	1,259
	\$ 2,030	\$ 671	\$ 794	\$ 724	\$ 1,698	\$ 2,023	\$ 7,940

MINIMUM COMMITTED PURCHASE OF AEROPLAN MILES

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 2015 is \$211. 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 2014, the Corporation purchased \$248 of Aeroplan Miles® from Aeroplan.

17. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

SUMMARY OF FINANCIAL INSTRUMENTS

CARRYING AMOUNTS

	FINA	TION	DECEMBER 31, 2013		
	HELD FOR TRADING	LOANS AND RECEIVABLES	LIABILITIES AT AMORTIZED COST	TOTAL	20.0
FINANCIAL ASSETS					
Cash and cash equivalents	\$ 661	\$ -	\$ -	\$ 661	\$ 750
Short-term investments	1,614	-	-	1,614	1,458
Restricted cash	89	-	-	89	92
Accounts receivable	-	656	-	656	589
Deposits and other assets					
Restricted cash	192	-	-	192	190
Aircraft related and other deposits	-	135	-	135	122
Prepayment option on senior secured notes	4	-	-	4	2
Derivative instruments					
Fuel derivatives	4	-	-	4	20
Share forward contracts	85	-	-	85	56
Foreign exchange derivatives	30	-	-	30	13
Interest rate swaps	8	-	-	8	10
	\$ 2,687	\$ 791	\$ -	\$ 3,478	\$ 3,302
FINANCIAL LIABILITIES					
Accounts payable	\$ -	\$ -	\$ 1,165	\$ 1,165	\$ 1,026
Current portion of long-term debt and finance leases	-	-	484	484	374
Long-term debt and finance leases	-	-	4,732	4,732	3,959
	\$ -	\$ -	\$ 6,381	\$ 6,381	\$ 5,359

There have been no changes in classification of financial instruments since December 31, 2013.

For cash flow purposes, the Corporation may settle, from time to time, certain cash equivalents and short-term investments prior to their original maturity. For this reason, these financial instruments do not meet the criteria of held to maturity and are therefore designated as held for trading. They are recorded at fair value with changes in fair value recorded in Interest income.

SUMMARY OF GAIN (LOSS) ON FUEL AND OTHER DERIVATIVES

	2014	2013
Fuel derivatives	\$ (36)	\$ (6)
Share forward contracts	31	42
Prepayment option on senior secured notes	2	2
Interest rate swaps	2	(1)
FUEL AND OTHER DERIVATIVES	\$ (1)	\$ 37

RISK MANAGEMENT

Under its risk management policy, the Corporation manages its interest rate risk, foreign exchange risk, share-based compensation risk and market risk (e.g. fuel price risk) through the use of various derivative financial instruments. The Corporation uses derivative financial instruments only 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 related to the risk being hedged.

As noted below, the Corporation uses derivative instruments to provide economic hedges to mitigate various risks. The derivative fair values 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. 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 and 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 because of changes in market prices. Market risk comprises three types of risk: foreign exchange risk; interest rate risk; and other price risk, which includes commodity price risk for jet fuel.

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 uses 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 2014:

- The Corporation recorded a loss of \$36 in Fuel and other derivatives related to fuel derivatives (\$6 loss in 2013).
- The Corporation purchased crude-oil and refined products-based call options covering a portion of 2014 and 2015 fuel exposure. The cash premium related to these contracts was \$44 (\$39 in 2013 for 2013 and 2014 exposures).
- Fuel derivative contracts cash settled with a fair value of \$24 in favour of the Corporation (\$29 in favour of the Corporation in 2013).

As of December 31, 2014, approximately 22% of the Corporation's anticipated purchases of jet fuel for 2015 are hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US\$97 per barrel. The Corporation's contracts to hedge anticipated jet fuel purchases over the 2015 period are comprised of call options with notional volumes of 6,267,000 barrels. The fair value of the fuel derivatives portfolio at December 31, 2014 is \$4 in favour of the Corporation (\$20 in favour of the Corporation in 2013) 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.

The Corporation's cash inflows are primarily in Canadian dollars, while a large portion of its outflows are in U.S. dollars. This unbalanced mix results in an annual U.S. dollar shortfall from operations. In order to mitigate this imbalance, the Corporation has adopted a program to convert excess revenues from offshore currencies into U.S. dollars. In 2014, this conversion generated coverage for approximately 23% of the imbalance.

For the remainder of the currency imbalance (i.e. the net U.S. dollar shortfall), the Corporation has a target coverage of 60% on a rolling 18 month basis 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, 2014 amounted to \$717 (US\$620) (\$791 (US\$743) as at December 31, 2013). In 2014, an unrealized gain of \$58 (unrealized gain of \$44 in 2013) 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 flows, as well as the amount attributed to aircraft and debt payments. Based on the notional amount of currency derivatives outstanding at December 31, 2014, as further described below, approximately 69% of net US cash outflows are hedged for 2015 and 13% for 2016, resulting in derivative coverage of 52% over the next 18 months.

As at December 31, 2014, the Corporation had outstanding foreign currency options and swap agreements, settling in 2015 and 2016, to purchase at maturity \$2,658 (US\$2,292) of U.S. dollars at a weighted average rate of \$1.0884 per US\$1.00. (2013 – \$1,645 (US\$1,547) with settlements in 2014 and 2015 at a weighted average rate of \$1.0341 per \$1.00 U.S. dollar). The Corporation also has protection in place to sell a portion of its excess Euros and Sterling (EUR \$35, GBP \$27) which settle in 2015 at weighted average rates of \$1.2806 and \$1.6217 per \$1.00 U.S. dollar respectively (2013 – EUR \$34, GBP \$16 with settlement in 2014 at weighted average rates of \$1.3511 and \$1.6130 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 fair value of these foreign currency contracts as at December 31, 2014 was \$30 in favour of the Corporation (2013 – \$13 in favour of the Corporation). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2014, a gain of \$75 was recorded in Foreign exchange gain (loss) related to these derivatives (2013 – \$68 gain). In 2014, foreign exchange derivative contracts cash settled with a net fair value of \$58 in favour of the Corporation (\$56 in 2013 in favour of the Corporation).

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, 2014 is 75% fixed and 25% floating, including the effects of interest rate swap positions (74% and 26%, respectively as at December 31, 2013). The following are the current derivatives employed in interest rate risk management activities and the adjustments recorded during 2014:

As at December 31, 2014, the Corporation had two interest rate swap agreements in place with terms to July 2022 and January 2024 relating to two Boeing 767 aircraft financing agreements with an aggregate notional value of \$60 (US\$52) (2013 – \$62 (US\$58)). These swaps convert the lease payments on the two aircraft leases from fixed to floating rates. The fair value of these contracts as at December 31, 2014 was \$8 in favour of the Corporation (2013 – \$10 in favour of the Corporation). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2014, a gain of \$2 was recorded in Fuel and other derivatives related to these derivatives (2013 – \$1 loss).

Interest income includes \$35 (2013 – \$29) related to Cash and cash equivalents and Short-term investments, which are classified as held for trading. Interest expense reflected on the consolidated statement of operations relates to financial liabilities recorded at amortized cost.

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 14. 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 2015 and 2017, 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 7,198,609 PSUs and RSUs from 2015 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 2014, a gain of \$31 was recorded (2013 – gain of \$42). Share forward contracts cash settled with a fair value of \$7 in favour of the Corporation in 2014. As at December 31, 2014, the fair value of the share forward contracts is \$85 in favour of the Corporation (2013 – \$56 in favour of the Corporation), with those contracts maturing in 2015 of \$25 recorded in Prepaid expenses and other current assets and the remainder of \$60 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 9 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 a minimum unrestricted liquidity level of \$1,700. This minimum target level was determined in conjunction with the Corporation's liquidity risk management strategy. At December 31, 2014, unrestricted liquidity was \$2,685 comprised of Cash and cash equivalents and Short-term investments of \$2,275 and undrawn lines of credit of \$410.

In January 2015, in order to effectively manage financing costs, the amount outstanding under an undrawn line of credit was reduced by \$116. As at January 31, 2015, the amount available under undrawn lines of credit was \$315.

A maturity analysis of the Corporation's financial liabilities, other fixed operating commitments and capital commitments is set out in Note 16.

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. As at December 31, 2014, the Corporation's credit risk exposure consists mainly of the carrying amounts of Cash and cash equivalents, Short-term investments and Accounts receivable. Cash and cash equivalents and Shortterm investments are in place with major financial institutions, 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, 2014. 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, 2014 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.

		EREST ERISK (1)	FOREIG	GN EXCHA	NGE RA	ATE RISK (2)	OTHER PRICE RISK ⁽³⁾			
	IN	INCOME		INCOME				INC	OME	
	1% IN	ICREASE	5% IN	ICREASE	5% D	ECREASE	10% IN	CREASE	10% D	ECREASE
Cash and cash equivalents	\$	7	\$	(8)	\$	8	\$	-	\$	-
Short-term investments	\$	16	\$	(28)	\$	28	\$	-	\$	-
Aircraft related deposits	\$	-	\$	(4)	\$	4	\$	-	\$	-
Long-term debt and finance leases	\$	(13)	\$	231	\$	(231)	\$	-	\$	-
Fuel derivatives	\$	-	\$	-	\$	-	\$	3	\$	(3)
Share forward contracts		-		-		-		9		(9)
Foreign exchange derivatives	\$	-	\$	(27)	\$	22	\$	-	\$	-
Interest rate swaps	\$	(1)	\$	-	\$	-	\$	-	\$	-

- 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 Air Canada share price.

Covenants in Credit Card Agreements

The Corporation has various agreements with companies that process customer credit card transactions. Approximately 85% of the Corporation's sales are processed using credit cards, with remaining sales processed through cash or online banking based transactions. The Corporation receives payment for a credit card sale generally in advance of when the passenger transportation is provided.

The Corporation's principal credit card processing agreements for credit card processing services in North America 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 2014, the Corporation made no cash deposits under these agreements (nil in 2013).

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 interest rate swaps, share forward contracts, foreign exchange, and fuel 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 is \$5,306 compared to its carrying value of \$5,216.

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, 2014	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	\$ 234	\$ -	\$ 234	\$ -					
Short-term investments	1,614	-	1,614	-					
Deposits and other assets									
Prepayment option on senior secured notes	4	-	-	4					
Derivative instruments									
Fuel derivatives	4	-	4	-					
Share forward contracts	85	-	85	-					
Foreign exchange derivatives	30	-	30	-					
Interest rate swaps	8	-	8	-					
TOTAL	\$ 1,979	\$ -	\$ 1,975	\$ 4					

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 2014.

In measuring the fair value of the prepayment option on the New 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 \$4.

The Corporation's credit margin is considered a Level 3 input and an increase of 1% to the credit margin would result in a decrease of \$2 to the prepayment option asset, and a decrease of 1% to the credit margin would result in a \$4 increase to the prepayment option asset

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 \$67 as at December 31, 2014 (\$61 as at December 31, 2013). 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, 2014 and 2013, 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.

	A	AMOUNTS OFFSE	Т	AMOUNTS NOT OFFSET	NET	
FINANCIAL ASSETS	GROSS ASSETS	GROSS LIABILITIES OFFSET	NET AMOUNTS PRESENTED	FINANCIAL INSTRUMENTS		
DECEMBER 31, 2014						
Derivative assets	\$ 138	\$ (11)	\$ 127	\$ -	\$ 127	
Accounts receivable	137	(49)	88	\$ (38)	50	
	\$ 275	\$ (60)	\$ 215	\$ (38)	\$ 177	
DECEMBER 31, 2013						
Derivative assets	\$ 99	\$ -	\$ 99	\$ -	\$ 99	
Accounts receivable	96	(48)	48	\$ (36)	12	
	\$ 195	\$ (48)	\$ 147	\$ (36)	\$ 111	

	A	AMOUNTS OFFSE	AMOUNTS NOT OFFSET	NET	
FINANCIAL LIABILITIES	GROSS LIABILITIES	GROSS ASSETS OFFSET	NET AMOUNTS PRESENTED	FINANCIAL INSTRUMENTS	
DECEMBER 31, 2014					
Derivative liabilities	\$ 11	\$ (11)	\$ -	\$ -	\$ -
Accounts payable	113	(49)	64	(38)	26
	124	(60)	64	(38)	26
DECEMBER 31, 2013					
Accounts payable	\$ 118	\$ (48)	\$ 70	\$ (36)	\$ 34

18. CONTINGENCIES, GUARANTEES AND INDEMNITIES

CONTINGENCIES AND LITIGATION PROVISIONS

Investigations by Competition Authorities Relating to Cargo

The European Commission and the United States Department of Justice investigated, and the Competition Bureau in Canada is investigating, 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 has been cooperating with these investigations, which are likely to lead, or have 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. In the United States, the investigation by the U.S. Department of Justice concluded with no proceedings having been instituted against Air Canada and 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 Commissions 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 C\$29) was imposed on Air Canada. Air Canada is appealing this 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.

As at December 31, 2014, Air Canada has a provision of \$27 relating to outstanding claims in this matter, which is recorded in Accounts payable and accrued liabilities. 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 proceedings

and investigations. As stated above, Air Canada is appealing the decision issued by the European Commission and, if and as appropriate, based on the outcome of any updates regarding this appeal as well as developments regarding proceedings and investigations in other jurisdictions, 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.

With respect to 12 aircraft leases, the difference between the reduced rents as a result of the implementation of the Plan of Reorganization, Compromise and Arrangement under the Companies' Creditors Arrangement Act ("CCAA") on September 30, 2004 and amounts which would have been due under the original lease contracts will be forgiven at the expiry date of the leases if no material default has occurred by such date. In the event of a material default which does not include any cross defaults to other unrelated agreements (including unrelated agreements with the counterparties to these aircraft leases), this difference plus interest will become due and payable and all future rent will be based on the original contracted rates. Rent expense is being recorded on the renegotiated lease agreements and any additional liability would be recorded only at the time management believes the amount is likely to be incurred.



GUARANTEES

Guarantees in Fuel Facilities Arrangements

The Corporation participates in fuel facility arrangements operated through eight Fuel Facility Corporations, along with other airlines that contract for fuel services at various major airports in Canada. The Fuel Facility Corporations operate on a cost recovery basis. The purpose of the Fuel Facility Corporations is to own and finance the system that distributes the fuel to the contracting airlines, including leasing the land rights under the land leases. The aggregate debt of the eight Fuel Facility Corporations in Canada that have not been consolidated by the Corporation under IFRS 10 Consolidated Financial Statements is approximately \$399 as at December 31, 2014 (December 31, 2013 – \$394), 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 a Fuel Facility Corporation 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, 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 enters into real estate leases or operating agreements, which grant a license to the Corporation to use certain premises, in substantially all cities that it serves. It is common in such commercial lease transactions for the Corporation, as the lessee, to agree to indemnify the lessor and other related third parties for tort liabilities that arise out of or relate to the Corporation's use or occupancy of the leased or licensed premises. Exceptionally, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by their gross

negligence or wilful misconduct. Additionally, the Corporation typically indemnifies such parties for any environmental liability that arises out of or relates to its use or occupancy of the leased or licensed premises.

In aircraft financing or leasing agreements, the Corporation typically indemnifies the financing parties, trustees acting on their behalf and other related parties and/or lessors against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft and for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, except for their gross negligence or wilful misconduct. In addition, in aircraft financing or leasing transactions, including those structured as leveraged leases, the Corporation typically provides indemnities in respect of various tax consequences including in relation to the leased or financed aircraft, the use, possession, operation maintenance, leasing, subleasing, repair, insurance, delivery, import, export of such aircraft, the lease or finance arrangements entered in connection therewith, changes of law and certain income, commodity and withholding tax consequences.

When the Corporation, as a customer, enters into technical service agreements with service providers, primarily service providers who operate an airline as their main business, the Corporation has from time to time agreed to indemnify the service provider against certain liabilities that arise from third party claims, which may relate to services performed by the service provider.

Under its general by-laws and pursuant to contractual agreements between the Corporation and each of its officers and directors, the Corporation has indemnification obligations to its directors and officers. Pursuant to such obligations, the Corporation indemnifies these individuals, to the extent permitted by law, against any and all claims or losses (including amounts paid in settlement of claims) incurred as a result of their service to the Corporation.

The maximum amount payable under the foregoing indemnities cannot be reasonably estimated. The Corporation expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities described above.

19. INVESTMENTS IN AVEOS

In 2012, as a result of Aveos Fleet Performance Inc. ("Aveos") ceasing operations and filing for court protection pursuant to the *Companies' Creditors Arrangement Act* ("CCAA"), Air Canada reduced the carrying value of its investment in Aveos Holding Company, Aveos' parent company, as well as the carrying value of a long-term note receivable from Aveos to nil and recorded an aggregate loss on investments of \$65 in Non-operating expense. In addition, Air Canada recorded a liability of \$55, which was charged to Discontinued Operations, related to Air Canada's commitment under a separation program. For the 12 months ended December 31, 2013, a cash outflow of \$29 was generated in relation to this separation program (\$26 in 2012).

A settlement and termination agreement pertaining to operating amounts owing between Air Canada and Aveos, including disputed invoices, was concluded during 2013. This agreement resulted in the set-off,

settlement and release of all outstanding invoices between Air Canada and Aveos. Settlement of the Pension and Benefits Agreement was concluded in October 2013 with payment in trust to Aveos, for distribution to identified Aveos eligible recipients. The letter of credit of \$20 previously issued in favour of Aveos was returned to Air Canada. Following this, obligations under the other post-retirement and postemployment benefit plans pertaining to transferred unionized Aveos employees are no longer included in the Corporation's consolidated financial statements as at December 31, 2013. In 2012, OSFI ordered the termination of Aveos' defined benefit pension plan and, as a result, the assets and liabilities accruing prior to July 14, 2011 in respect of transferred Aveos employees could not be transferred to Aveos' plans and remain under Air Canada's pension plans.

20. 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:

	2014		2013
PASSENGER REVENUES			
Canada	\$	4,381	\$ 4,237
U.S. Transborder		2,379	2,176
Atlantic		2,554	2,263
Pacific		1,710	1,618
Other		780	727
	\$	11,804	\$ 11,021

	2	014	2	2013
CARGO REVENUES				
Canada	\$	66	\$	63
U.S. Transborder		20		18
Atlantic		191		171
Pacific		190		185
Other		35		37
	\$	502	\$	474

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.

21. CAPITAL DISCLOSURES

The Corporation views capital as the sum of Longterm 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 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. 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.

The Corporation's main objectives when managing capital are:

- 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
- 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:

	2014		2013	
Long-term debt and finance leases	\$	4,732	\$	3,959
Current portion of long-term debt and finance leases		484		374
		5,216		4,333
Capitalized operating leases		2,191		2,226
Adjusted debt		7,407		6,559
Non-controlling interests		68		63
Market capitalization		3,401		2,108
TOTAL CAPITAL	\$	10,876	\$	8,730
Adjusted debt	\$	7,407	\$	6,559
Less Cash and cash equivalents and Short-term investments		(2,275)		(2,208)
ADJUSTED NET DEBT	\$	5,132	\$	4,351

Total capital has increased by \$2,146, which reflects an increase in market capitalization due to a higher Air Canada share price, as well as the impact of higher debt levels as the Corporation continues to invest in new aircraft.

22. RELATED PARTY TRANSACTIONS

COMPENSATION OF KEY MANAGEMENT

Compensation of key management is reported on the accrual basis of accounting consistent with the amounts recognized on the consolidated statement of operations. 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:

	2014	2013
Salaries and other benefits	\$ 8	\$ 8
Pension and post-employment benefits	4	1
Share-based compensation	8	7
	\$ 20	\$ 16

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

Lise Fournel Senior Vice President and Chief Information Officer

Kevin C. Howlett Senior Vice President, Regional Markets

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

Yves Dufresne Vice President, Alliances and Regulatory Affairs

Marcel Forget Vice President, Network Planning

Michael Friisdahl President and Chief Executive Officer, Air Canada Leisure Group

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Carolyn M. Hadrovic Corporate Secretary

Chris Isford Vice President and Controller

Amos Kazzaz Vice President, Financial Planning and Analysis

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Priscille LeBlanc Vice President, Corporate Communications

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Jim Tabor Vice President, System Operations Control

Lise-Marie Turpin Vice President, Cargo

Derek Vanstone Vice President, Corporate Strategy, Industry and Government Affairs

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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, Montreal, Quebec Joseph B. Leonard Corporate Director, Minneapolis, Minnesota

Roy J. Romanow Senior Fellow, Public Policy, University of Saskatchewan, Saskatoon, Saskatchewan

Calin Rovinescu President and Chief Executive Officer, Air Canada, Montreal, 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 (AC.A)

2014	HIGH	LOW	VOLUME TRADED
1 st Quarter	\$ 9.88	\$ 5.13	13,469,441
2 nd Quarter	\$ 10.89	\$ 5.67	12,547,300
3 rd Quarter	\$ 10.30	\$ 7.92	11,878,765
			43,526,082

Price Range and Trading Volume of Air Canada Voting Shares (AC.B)

2014	HIGH	LOW	VOLUME TRADED
1st Quarter	\$ 9.90	\$ 5.14	228,914,229
2 nd Quarter	\$ 10.90	\$ 5.65	170,139,899
3 rd Quarter	\$ 10.34	\$ 7.90	116,873,294
			569.904.018

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.

2014	HIGH	LOW	VOLUME TRADED
4 th Quarter	\$ 12.67	\$ 8.87	100,798,569

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.

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 University Street, Suite 1600, Montreal, 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 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 2014, Air Canada, together with its Air Canada Express regional partners, operated more than 1,500 daily scheduled flights on average to 186 destinations on five continents, comprised of 61 Canadian cities, 50 destinations in the United States and a total of 75 cities in Europe, the Middle East, Asia, Australia, the Caribbean, Mexico and Central and South America. Air Canada is among the 20 largest airlines in the world and in 2014 carried over 38.5 million passengers.

Air Canada is a founding member of the Star Alliance® network. Through Star Alliance network's 27 member airlines, Air Canada is able to offer its customers access to approximately 1,321 destinations in 193 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 that ranked Air Canada in a worldwide survey of nearly 19 million airline passengers as Best Airline in North America in 2014 for the fifth consecutive year.

