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ANNUAL
REPORT



 **AIR CANADA**

A STAR ALLIANCE MEMBER 

1.

Highlights

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

| | Fourth Quarter | | | Full Year | | |
|---|----------------|-----------|-------------------|-----------|-----------|-----------|
| | 2020 | 2019 | \$ CHANGE | 2020 | 2019 | \$ CHANGE |
| (Canadian dollars in millions, except per share data or where indicated) | | | | | | |
| FINANCIAL PERFORMANCE METRICS | | | | | | |
| Operating revenues | 827 | 4,429 | (3,602) | 5,833 | 19,131 | (13,298) |
| Operating income (loss) | (1,003) | 145 | (1,148) | (3,776) | 1,650 | (5,426) |
| Income (loss) before income taxes | (1,275) | 172 | (1,447) | (4,853) | 1,775 | (6,628) |
| Net income (loss) | (1,161) | 152 | (1,313) | (4,647) | 1,476 | (6,123) |
| Adjusted pre-tax income (loss) ⁽¹⁾ | (1,326) | 66 | (1,392) | (4,425) | 1,273 | (5,698) |
| EBITDA (excluding special items) ⁽¹⁾ | (728) | 665 | (1,393) | (2,043) | 3,636 | (5,679) |
| Unrestricted liquidity ⁽²⁾ | 8,013 | 7,380 | 633 | 8,013 | 7,380 | 633 |
| Net cash flows from (used in) operating activities | (796) | 677 | (1,473) | (2,353) | 5,712 | (8,065) |
| Free cash flow ⁽¹⁾ | (646) | 426 | (1,072) | (3,070) | 2,075 | (5,145) |
| Net debt ⁽¹⁾ | 4,976 | 2,841 | 2,135 | 4,976 | 2,841 | 2,135 |
| Diluted earnings (loss) per share | (3.91) | 0.56 | (4.47) | (16.47) | 5.44 | (21.91) |
| OPERATING STATISTICS⁽³⁾ | | | | | | |
| Revenue passenger miles ("RPM") (millions) | 2,432 | 21,403 | (88.6) | 23,239 | 94,113 | (75.3) |
| Available seat miles ("ASM") (millions) | 6,000 | 26,431 | (77.3) | 37,703 | 112,814 | (66.6) |
| Passenger load factor % | 40.5% | 81.0% | (40.5) pp | 61.6% | 83.4% | (21.8) pp |
| Passenger revenue per RPM ("Yield") (cents) | 19.5 | 18.6 | 5.1 | 18.9 | 18.3 | 3.0 |
| Passenger revenue per ASM ("PRASM") (cents) | 7.9 | 15.0 | (47.4) | 11.6 | 15.3 | (23.9) |
| Operating revenue per ASM (cents) | 13.8 | 16.8 | (17.8) | 15.5 | 17.0 | (8.8) |
| Operating expense per ASM ("CASM") (cents) | 30.5 | 16.2 | NM ⁽⁸⁾ | 25.5 | 15.5 | NM |
| Adjusted CASM (cents) ⁽¹⁾ | 29.8 | 11.9 | NM | 21.6 | 11.1 | NM |
| Average number of full-time-equivalent ("FTE") employees (thousands) ⁽⁴⁾ | 17.9 | 33.3 | (46.3) | 21.1 | 32.9 | (35.8) |
| Aircraft in operating fleet at period-end ⁽⁵⁾ | 344 | 403 | (14.6) | 344 | 403 | (14.6) |
| Seats dispatched (thousands) | 3,673 | 15,506 | (76.3) | 22,780 | 64,653 | (64.8) |
| Aircraft frequencies (thousands) | 31.1 | 130.3 | (76.1) | 191.5 | 548.5 | (65.1) |
| Average stage length (miles) ⁽⁶⁾ | 1,634 | 1,705 | (4.2) | 1,655 | 1,745 | (5.1) |
| Fuel cost per litre (cents) | 50.4 | 75.0 | (32.8) | 61.4 | 76.1 | (19.3) |
| Fuel litres (thousands) | 372,204 | 1,349,573 | (72.4) | 2,153,764 | 5,713,924 | (62.3) |
| Revenue passengers carried (thousands) ⁽⁷⁾ | 1,625 | 12,048 | (86.5) | 13,760 | 51,543 | (73.3) |

(1) Adjusted pre-tax income (loss), EBITDA (excluding special items) (earnings before interest, taxes, depreciation and amortization), free cash flow and adjusted CASM are each non-GAAP financial measures and net debt is an additional GAAP measure. Refer to section 19 of Air Canada's 2020 MD&A for descriptions of Air Canada's non-GAAP financial measures and additional GAAP measures.

(2) Unrestricted liquidity refers to the sum of cash, cash equivalents and short- and long-term investments, and the amount of available credit under Air Canada's revolving credit facilities. At December 31, 2020, unrestricted liquidity was comprised of cash, cash equivalents and short-term investments of \$7,501 million, and long-term investments of \$512 million. At December 31, 2019, unrestricted liquidity was comprised of cash, cash equivalents and short-term investments of \$5,889 million, long-term investments of \$512 million and undrawn lines of credit of \$979 million.

(3) Except for the reference to average number of FTE employees, operating statistics in this table include third party carriers operating under capacity purchase agreements with Air Canada.

(4) Reflects FTE employees at Air Canada and its subsidiaries. Excludes FTE employees at third party carriers operating under capacity purchase agreements with Air Canada.

(5) The number of aircraft in Air Canada's operating fleet at December 31, 2020 includes a number of aircraft that have been grounded due to the impact of the COVID-19 pandemic as well as 24 Boeing 737 MAX aircraft which remained grounded at December 31, 2020. Refer to section 7 "Fleet" of Air Canada's 2020 MD&A for additional information.

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

(7) Revenue passengers are counted on a flight number basis (rather than by journey/itinerary or by leg) which is consistent with the IATA definition of revenue passengers carried.

(8) "NM" denotes "Not Meaningful" and is included in the table above where a comparison to prior periods would not be meaningful.



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MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

Calin Rovinescu

Due to the calamitous effects of COVID-19, 2020 was the worst year for commercial aviation in its 106-year history. Global air traffic was abruptly cut back amid public health concerns and as governments imposed severe restrictions and measures on travel. The pandemic's impact on trade, commerce and employment further compounded the challenges as the economic activity that drives much of air travel declined precipitously.

Like every other airline in the world, Air Canada endured significant losses during the year. However, the resiliency and agility we have developed over the past decade through our transformation program enabled us to adapt quickly and continually to the ever-changing circumstances. As a result, Air Canada often led the industry and governments in its response to the pandemic — most importantly in the areas of health and safety. These same qualities give me every confidence the company has the strengths to rebound ahead of its competitors as the COVID-19 pandemic recedes.

For 2020, Air Canada reported operating revenue of \$5.833 billion versus \$19.131 billion in 2019. EBITDA⁽¹⁾ was negative \$2.043 billion, a decrease of \$5.679 billion from the previous year. We reported an operating loss

(1) EBITDA is a non-GAAP financial measure. Such measure is not a recognized measure for financial statement presentation under GAAP, does not have standardized meanings, may not be comparable to similar measures presented by other entities and should not be considered a substitute for or superior to GAAP results. Refer to section 19 of Air Canada's 2020 MD&A for additional information on Air Canada's non-GAAP financial measures.



of \$3.776 billion from an income of \$1.650 billion in the prior year, a reversal of \$5.426 billion. On a capacity decrease of 67%, system passenger revenues decreased to \$4.382 billion from \$17.232 billion, or nearly 75% year-over-year. One bright spot was Air Canada Cargo, whose operating revenues reached \$920 million, up 28% from 2019.

Operating expenses of \$9.609 billion decreased \$7.872 billion or 45% from 2019, reflecting the reduction in capacity and the significant progress made on both managing variable costs and reducing fixed expenses. Air Canada completed a company-wide cost-cutting and capital reduction and deferral program for 2020 that reached \$1.7 billion.

There were also significant fleet changes, resulting in the retirement of certain older aircraft and the renegotiation of contracts for new narrow-body aircraft that will position well for the future. Through fleet restructuring and other capital reduction initiatives, planned capital expenditures were lowered by approximately \$3.0 billion for the period 2020–23 compared to our original capital expenditure projections at the end of 2019.

Air Canada also succeeded in concluding a series of financing transactions totalling \$6.780 billion in 2020 to support COVID-19 mitigation and recovery measures and to provide additional operational flexibility. Apart from confirming the market's confidence in our airline, these transactions increased net working capital.

Our financings, very importantly, allowed Air Canada to end the year with unrestricted liquidity of \$8.013 billion. This liquidity is expected to be adequate to enable Air Canada to withstand the impact of COVID-19 and to ensure it has the financial ability to emerge competitively from the pandemic and regain its previous industry leading position.

That Air Canada will succeed in the post-pandemic world is evidenced by its rapid and effective response to the COVID-19 pandemic. Our nimble culture and agility enabled us to move almost immediately. Weeks before the federal government halted flights to China, Air Canada suspended its service to that country. In April, it mandated masks be worn by all customers on board its aircraft, a month before officials recommended wearing masks in public. In May, Air Canada instituted pre-boarding temperature checks for all customers — something the government only mandated a month later — and it also introduced its comprehensive biosafety program, Air Canada CleanCare+.

Air Canada has also been a strong advocate of testing. In the fall of 2020, it spearheaded a study to test arriving international passengers at Canada's biggest airport, Toronto-Pearson. The largest-ever study of its kind anywhere in the world, it was conducted by the independent research body, McMaster HealthLabs. The Greater Toronto Airports Authority also took part and, once the study was underway, the federal government recognized its value and agreed to participate.

The study was conducted in September, October and November of 2020. Preliminary results, based on 20,000 tests, found 99% of study participants tested negative for COVID-19. Of the 1% that did test positive, 70% were discovered on arrival while the other 30% were detected by a test seven days later. These results suggest there are other, more effective means to manage COVID-19 than resorting to blanket travel bans, lengthy quarantine periods, and broad travel restrictions. This is something the government has acknowledged as it looks to begin restoring travel responsibly and safely in 2021, guided by the findings of this and other science-based analyses.

Our strategy for dealing with COVID-19 has been two-pronged. First, our aim was to mitigate the worst effects, particularly by implementing stringent safety measures for customers and employees and by ensuring we had sufficient financial resources to withstand a prolonged downturn. Second, we were also determined to have in place all the necessary elements to recover quickly in a radically different, post-pandemic aviation environment.



I am absolutely confident about the future of Air Canada under the extremely capable leadership of my successor, Michael Rousseau, previously our Deputy Chief Executive and Chief Financial Officer, who worked very closely with me for nearly 12 years. He and the rest of our highly experienced leadership team have helped to establish a very strong financial position and commercial footprint that will serve us well into the future.

Above all, it must be remembered that the effects of COVID-19 are transitory whereas the solid foundations built over the past 12 years are permanent. The airline has been transformed in all its aspects. It will emerge from the pandemic still a Canadian global champion, with a powerful footprint and brand.

Over time, we will rebuild our global network. Over the past decade we had effectively doubled our airline's reach to more than 100 international destinations before COVID-19 forced a retrenchment. A retrenchment that I am confident is temporary.

Helping us rebuild will be our Star Alliance partners and our revenue-sharing joint ventures with Air China across the Pacific and A++ with Lufthansa and United Airlines over the Atlantic. In addition, we have a wealth of codeshare and interline agreements that give us access to every corner of the Earth.

Our success capturing new air freight business during the pandemic also opened incredible new vistas for Air Canada Cargo, demonstrating our nimbleness and ability to capitalize on new opportunities. In 2020 global demand surged for cargo space to ship urgently required protective equipment and critical goods. From March to end-December 2020, Air Canada operated more than 4,000 all-cargo international flights, using a combination of Boeing 787 and Boeing 777 aircraft, as well as four Boeing 777 and three Airbus A330 aircraft temporarily converted to exclusive cargo use by removing seats from the passenger cabin.

Air Canada plans to permanently convert several of its owned Boeing 767 aircraft into dedicated freighters to participate in the growth of e-commerce and leverage Air Canada's global footprint. We expect to generate incremental cargo revenue by providing specialized e-commerce delivery services and our goal is to drive end-to-end value using enhanced technology, dynamic pricing and transparency across the delivery supply chain.

To best serve our network, we have rationalized our fleet. We are permanently retiring certain older aircraft and adding next-generation, fuel-efficient aircraft. Our wide-body fleet includes the Boeing 777 aircraft with its competitive CASM, and a seat configuration ideally suited to the high-volume leisure and Visiting Friends and Relatives markets that we expect to rebound first. These are complemented by the Boeing 787 aircraft with its lower operating costs, mid-size capacity and range flexibility. As well, we retain options and rights to acquire additional aircraft quickly and affordably, if required.

We are also renewing our narrow-body fleet. Older, less-efficient aircraft are being replaced with modern and fuel-efficient Airbus A220 and Boeing 737 MAX aircraft types. The A220's range and economics create greater deployment opportunities, enabling Air Canada to serve new markets ill-suited to larger narrow-body aircraft. Early in 2021, we returned the Boeing 737 MAX aircraft to service. Its range gives us added network flexibility, maintenance cost advantages and greater fuel efficiency.

Beyond improving the operating economics of our fleet, these changes will also help us meet our environmental and other goals of ESG, which is of interest to all stakeholders and rightly of increasing importance to the investment community. This is also why, throughout the pandemic, we were careful to maintain the Air Canada Foundation so that it can continue its vital core mission of improving the lives of ill or disadvantaged children, assisting in times of disaster both in Canada and abroad, and supporting other major health-related causes. ESG will remain a central consideration in decision-making at Air Canada.

Reinforcing our network are Air Canada's Toronto global hub and its gateway hubs of Vancouver and Montréal. We often compare Canada to Australia and New Zealand, but unlike these countries, Canada sits in the middle of some of the busiest travel corridors in the world, such as from the U.S. to Europe, and the U.S. to Asia. The strategy of connecting this traffic through our attractive and highly competitive hubs is key to our long-term recovery and prosperity. Additionally, our hub cities have the benefit of a strong local multicultural population base to help sustain our international network with both origin and destination traffic.



Despite the severe restrictions imposed by COVID-19, we have not forgotten the vital and differentiating importance of customer service. We provide a customer experience enhanced by competitive products and services, including lie-flat seats in the Signature Class cabin, concierge services, Maple Leaf Lounges and the Air Canada Signature Suites, onboard amenities such as in-flight entertainment and Wi-Fi, and a range of fare products tailored to appeal to each market segment.

Prior to COVID-19, Air Canada was named Best Airline in North America for eight of 10 years and it remains North America's only four-star network carrier as rated by Skytrax. During 2020, it continued to win numerous accolades and recognitions, including being named Global Traveler's Best Airline in North America for a second straight year. In January 2021, Air Canada received APEX's Diamond Status Certification for Air Canada CleanCare+, which made us the only airline in Canada to attain the highest APEX ranking.

Our focus on a customer-friendly experience and innovation has carried on throughout the COVID-19 pandemic with new touchless airport services and technology such as our biometric boarding pilot project. These innovations will remain in place post-COVID-19 because they are convenient and can speed airport passage.

The transformed Aeroplan program that we launched in late 2020 further enriches the customer experience and promotes loyalty. The program now offers a wide range of new features such as improved value on flight rewards, Aeroplan Family Sharing, the ability to use Aeroplan points for travel extras like cabin upgrades and in-flight Wi-Fi, and expanded merchandise rewards. Aeroplan Elite Status Members also have access to new benefits including Priority Rewards.

Air Canada has many other attributes, some of which, such as our rich heritage, predate our transformation. But a final element that I regard most important of all is the entrepreneurial culture that has taken deep root at our airline. This culture — and the strong commitment and 'just do it' mindset of our employees — is now ingrained in our DNA and was fully on display as we responded to the COVID-19 crisis.

While my tenure is ending, I know that Air Canada's continued pursuit of excellence, under Michael Rousseau's leadership, will not end. Air Canada will continue to innovate and evolve, always focusing on safety and the customer, and enhancing new products and services.

I will conclude by thanking our employees for their unflagging efforts over the past 12 years, working to make a reality, the once aspirational goal of Air Canada becoming a Global Champion. I also would like to thank our shareholders for entrusting us with their investments and for their faith in our plan. And, finally, I thank the Air Canada Board of Directors for endorsing our transformation strategy and the wise counsel that members, past and present, generously provided on every step of the long journey to creating the new Air Canada.

Best regards,



Calin Rovinescu
President and Chief Executive Officer
February 12, 2021

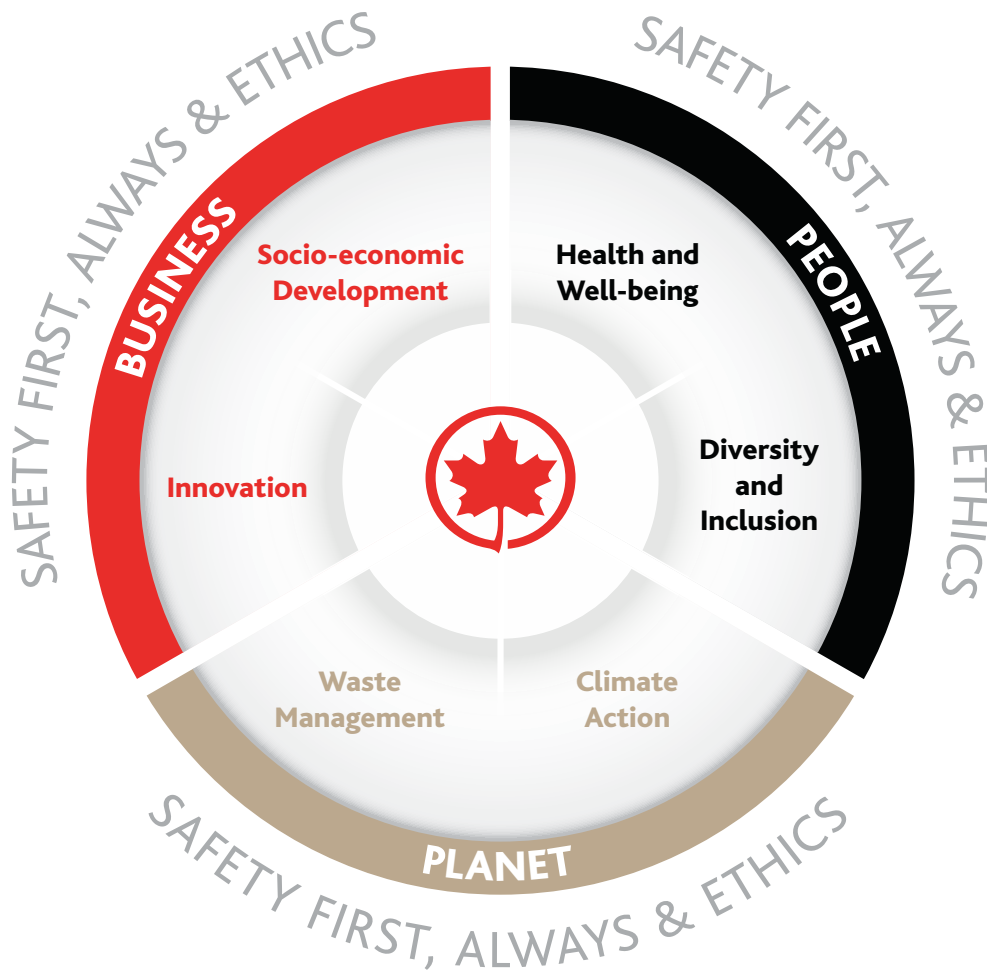






SUSTAINABILITY AND SOCIAL IMPACT





The following is an overview of Air Canada’s environmental, social and governance (“ESG”) achievements in 2020, a year singularly dominated by the severe impacts of the COVID-19 pandemic, as well as a preview of certain objectives for 2021 and beyond. This overview is presented through Air Canada’s three sustainability pillars: Business, People, Planet.

A more detailed ESG discussion will be provided in Air Canada’s upcoming 2020 Corporate Sustainability Report.



Business

Air Canada accomplished the following in 2020, contributing to its long-term sustainable business plan:

Repatriation flights – Air Canada operated repatriation flights to bring nearly 10,500 Canadians home from abroad.

COVID-19 Mitigation and Recovery Plan – In 2020, focusing on safety, public health and well-being and, as a result of the pandemic, Air Canada:

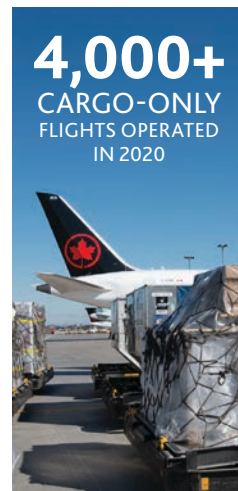
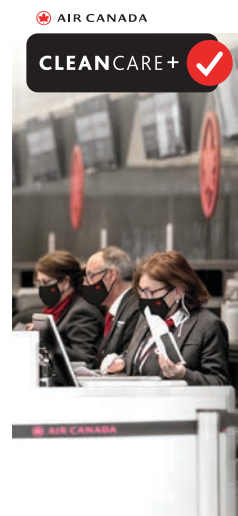
- Developed and launched Air Canada CleanCare+, an industry-leading comprehensive program.
- Implemented health checks and face coverings in advance of any regulatory requirement to do so.
- Launched TouchFree Bag Check for flights departing Canadian airports.
- Forged medical and testing collaborations (e.g., MHL Labs, BlueDot, Cleveland Clinic Canada).
- Introduced optional facial biometrics boarding for certain flights to Canada from the U.S.
- Offered special benefits and accommodation for Aeroplan Members in light of COVID-19, including complimentary Manulife COVID-19 insurance.
- Continued to respond to Transport Canada, IATA/IOSA requirements for audits and continuously ensured risk to the organization is mitigated.
- Maintained approximately 50% of its workforce at the end of 2020 despite the severe impact of the COVID-19 pandemic, including the significant drop in customer traffic compared to the 2019 levels.

Air Canada quickly reacted to the pandemic by expanding and modifying its cargo operations, and more than 4,000 cargo-only flights were operated. In addition:

- An agreement was reached with ACPA (the union representing its pilots) to allow for expanded cargo operations.
- Aircraft were retrofitted and Transport Canada approval was received to convert passenger aircraft to all-cargo flights.

Air Canada launched the transformed Aeroplan Loyalty Program, designed to put the member experience first.

Air Canada Vacations continued efforts with suppliers and hotel partners to reduce activities related to attractions involving dolphins and conducted sustainability practices audits with its hotel partners.



Recognitions



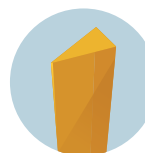
Airline Passenger Experience Association (APEX)
 – 5-star rating
 – Diamond Status Certification for Air Canada CleanCare+



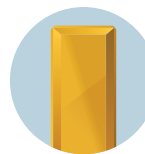
GT Tested Reader Survey Awards (Global Traveler)
 – Best Airline in North America
 – Best Airline Cabin Cleanliness (inaugural award)
 – Best Frequent-Flyer Award Redemption – Aeroplan
 – Best Airline for Onboard Entertainment (second consecutive year)
 – Best Airline, Premium Economy (second consecutive year)
 – Best Airline, Onboard Menu – Business Class



The Trazees (aimed at travellers aged 25-40)
 (Global Traveler)
 – Favourite Airline in North America (second consecutive year)



Wherever Awards (aimed at the modern travelling family)
 (Global Traveler)
 – Best Family-Friendly Airline in North America (second consecutive year)
 – Best Family-Friendly International Airline



Institutional Investor
 – Top company for corporate leadership and investor relations expertise
 – Highest ranked organization in the consumer business category.



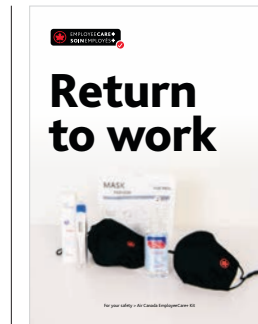
Loyalty360 Awards
 – Platinum Award – Innovation in Corporate Social Responsibility
 – Bronze Award – Business Transformation



People

— In 2020, in response to the COVID-19 pandemic, Air Canada implemented or initiated:

- COVID-19 rapid response screening facilities for office-based and operational employees at primary hubs.
 - A trial application of COVID-19 contact tracing technology in certain Toronto workplace facilities, using the Bluetooth-enabled TraceSCAN app and wearable technology developed by Canadian-based Facedrive Inc.
 - A telework policy for employees.
 - A COVID-19 Return to Work manual, providing up-to-date guidelines for employees when re-entering the workplace.
 - A Leadership in COVID-19 training series to support people managers and employees.
 - Weekly COVID-19 communications in collaboration with Cleveland Clinic Canada for all employees.
- The Virtual Reality Back Injury Prevention Program, leveraging technology to provide a new training experience for employees.
- The corporate safety pulse survey, with a response rate of above 30%, was conducted.
- A ramp Gamification Program for hazard identification was introduced to training materials.
- A total of 125 digital learning courses for career and self-development and specific development opportunities were introduced through conversation sessions, online learning cohorts, and self-led online programs.
- Unlock the Best in You, Air Canada's Corporate Wellness Program, was expanded.
- Air Canada stepped up its diversity and inclusion initiatives and developed new partnerships.
- Air Canada and the Air Canada Foundation engaged with and supported communities by distributing in-kind support, engaging in partnerships, carrying out fundraising initiatives and granting financial support to Canadian-registered charities.



Recognitions



(seventh consecutive year)



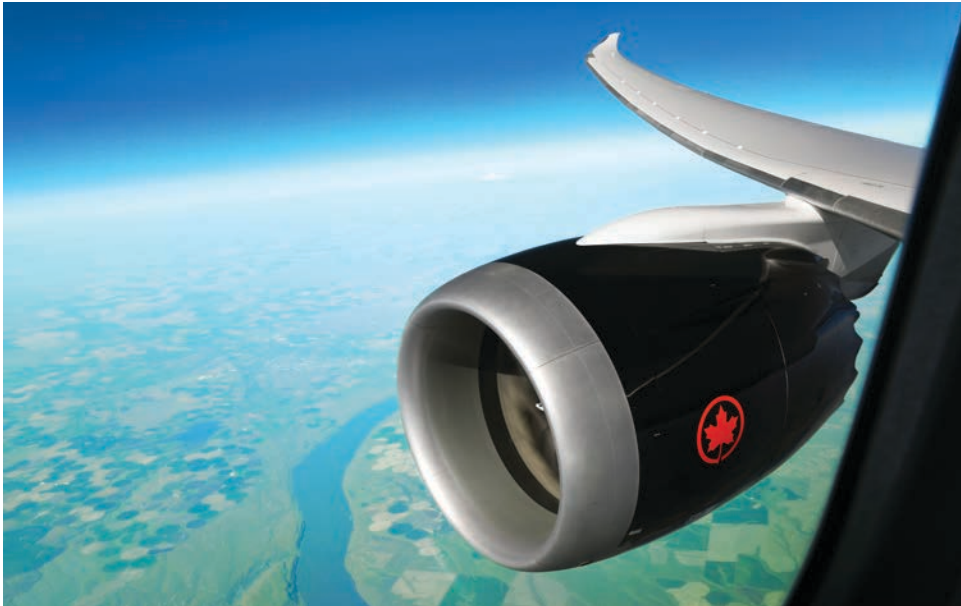
(sixth consecutive year)



Employment Equity Achievement Award
Diversity & Inclusion from Employment and Social Development Canada (ESDC)



Planet



Despite the financial impact of the global pandemic, Air Canada continued to advance its environmental initiatives and reduce its carbon footprint by:

- Installing electric chargers for ground support equipment (GSE) in Montréal.
- Receiving the YVR Green Excellence Award for a second consecutive year in recognition of Air Canada's efforts to reduce its energy and water consumption usage.
- Attaining IEnvA stage 2 certification for its Environmental Management System.
- Signing the Buckingham Palace Declaration and attaining International Air Transport Association (IATA) Illegal Wildlife Trade (IWT) certification for cargo operations.
- Achieving pre-pandemic, 2020 Corporate Waste Strategy targets.
- Repurposing 809 tonnes of Air Canada materials rather than sending them to landfills.
- Making socially responsible items available for sale through Aeroplan eStore.
- Reducing the number of printed brochures at Air Canada Vacations by 60% (year over year) and engaging with partners to do the same.

Recognitions



YVR Green Excellence Award
(second consecutive year)



SUSTAINABILITY AND SOCIAL IMPACT

Air Canada's vision for its recovery—to restore and rebuild towards its global champion ambition—is predicated on leveraging the solid foundation it has built over the past several years, which focuses on the following four core priorities to continuously improve the customer experience and employee engagement and to create value for shareholders, employees, customers, communities, and other stakeholders:



Pursuing profitable international growth opportunities and leveraging competitive attributes.



Engaging customers by continually enhancing their travel experience and by consistently achieving customer service excellence.



Identifying and implementing cost-reduction and revenue-enhancing initiatives.



Fostering positive culture change.

These priorities will continue to be important pillars of Air Canada's success, as it seeks to recover from the impact of the COVID-19 pandemic.



Sustainable Culture

At the heart of Air Canada's culture is its overriding value: Safety First, Always. It is the foremost consideration of everyone at Air Canada including customers, employees and the communities it serves. Air Canada also recognizes that a cornerstone of its success is sustainable development and that it must also be embedded in Air Canada's culture. Culture enables and drives sustainability in various ways and at various levels: it influences long-term behaviours, builds identity, encourages innovation and contributes to sustainable management practices. Air Canada's culture has also been critical to its agility—its ability to navigate, to quickly and continually adapt to the pandemic. Air Canada's culture is what drives our plan of action for people, the business and the planet.



Business

Please refer to Air Canada's public disclosure file, including in its fourth quarter Management Discussion & Analysis, for a description of the efforts deployed to preserve the sustainability of the business in response to the impact of the COVID-19 pandemic.



CHANGING THE HEPA FILTER ON A BOEING 787-9 DREAMLINER

2021 Objectives Preview

The following is an overview of programs to be initiated or continued in 2021:

BUSINESS

- » Continue to promote Air Canada's Safety First, Always culture, through key objectives, focused on risk management and reporting, the safe reintroduction of the Boeing 737 MAX, cargo operations, and new routes, equipment, initiatives and projects.
- » Continue to support and promote COVID-19 biosafety compliance and measures.
- » Reduce lost-time injuries (per 10,000 flights) by 8% from 2020 levels.
- » Build custom business apps for compliance monitoring of injury programs.
- » Further sustainable procurement practices, through procurement policies and training.
- » Act on Air Canada's 2020–23 Linguistic Action Plan to further Air Canada's official languages maturity.
- » Air Canada Vacations will continue to enhance sustainable tourism practices with employee training and raise customer awareness about responsible excursions and via promotion and introduction of additional initiatives.
- » Include SASB standards in 2021 Corporate Sustainability Report.
- » Enhance the UN Communication of Progress accompanying the Corporate Sustainability Report and publish a Sustainable Development Goals index, identifying Air Canada's progress against each goal.



People



Health and Safety

Air Canada has an extensive health and safety program to prevent work accidents and injuries. Key to these measures is the Hazard Prevention Program, which allows health and safety committees to identify and assess workplace hazards and to determine appropriate controls for mitigating risks. These committees cover all employee groups at Air Canada. The Corporate Safety branch, through its Corporate Safety and Emergency Management department, is responsible for ensuring that employee safety programs are documented, implemented, effective and adapted to realize identified improvements. Among other activities, the Corporate Safety branch monitors compliance with applicable laws and regulations while tracking employee safety-related incidents.

Biannual, voluntary and confidential safety culture surveys are conducted to collect employees' insight on safety. The results from the survey effected in 2020 show that the majority of employees feel safe to report errors, concerns and hazards, understand why safety operating procedures are created and feel supported in their ability to learn and be taught new safety procedures.

Air Canada continues to maintain exemplary IATA Operational Safety Audit results.

Privacy and Cybersecurity

Air Canada has developed a cybersecurity framework and continues to implement its privacy action plan to progress its privacy maturity, cyber security resilience and manage risks through multi-layered means, including through more robust infrastructure, consistent processes and effective governance. Privacy efforts are focused notably in the areas of policies governance, vendor privacy risk management, record of processing activities, privacy impact assessments and data subject rights management. As part of its security efforts, Air Canada implemented a Multi-Factor Authentication Program for employee and customer-facing applications. Internal controls and Payment Card Industry Data Security Standard (PCI DSS) controls are assessed annually in accordance with the National Instrument 52-109 (NI 52-109) auditing standard and PCI DSS 3.2.1 respectively.

Wellness

Specific COVID-19 workplace measures were implemented such as COVID-19 screening facilities for office-based and operational employees at primary hubs, training to support people managers in dealing with the new realities, weekly COVID-19 communications via employee communication channels with Cleveland Clinic Canada, including live broadcasts, and a telework policy. Air Canada is





also working with the Creative Destruction Labs Rapid Screening Consortium on rapid antigen screening in the workplace starting with pilots in Toronto and Montréal.

Air Canada has other workplace safety measures in place to ensure the well-being of employees. These include policies on workplace violence and harassment, drugs and alcohol, and workplace safety training, and providing automated external defibrillator units in all facilities.

Employees may benefit from the Employee and Family Assistance Program (or other similar programs), which provides immediate and confidential help for any work, health or life concern, and Air Canada’s unique corporate wellness program, called Unlock the Best in You (UBY). UBY provides tools, resources and training in relation to health and wellness, mental health, financial health, and work health. It was expanded in 2020 with the launch of a mobile application that offers an extensive pool of resources, tools and health challenges for employees, as well as a virtual counselling program for employees’ and their families’ mental health, workplace training for managers and expert blogs on navigating and managing the COVID-19 pandemic. A special employee engagement campaign outlining the importance of mental health was held in October 2020 as well.

2021 Objectives Preview

The following is an overview of programs to be initiated or continued in 2021:

PEOPLE

- » Continue to promote and improve resources, tools and programs for employees’ development, engagement and well-being, especially in the face of the continued pandemic, including through:
 - Appropriate tools and continuous workplace safety measures.
 - New and continuous UBY offerings and other assistance programs.
 - Talent development plans.
- » Engage with customers with adapted offerings, as the ability to travel gradually returns.
- » Continue to help communities in need from coast to coast, through in-kind donations, employee volunteering, fundraising or special initiatives.
- » Deepen community relations by supporting socio-economic development and by supporting organizations focused on innovation, health and wellness, diversity and inclusion, official languages and the environment.

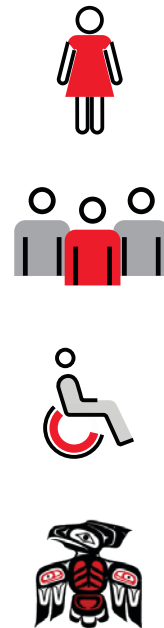


Employee and Labour Relations

Air Canada’s deep and strong relationship with its major union groups is a fundamental pillar of Air Canada’s sustainable future. This was exemplified through their close and constructive work to transform cargo operations and mitigate, as best as possible, the unavoidable workforce reduction effected as a result of the unprecedented impacts of the COVID-19 pandemic.

Retention and development of employees is the cornerstone of a healthy work culture and protects the longevity of a business while setting it up for future success. Air Canada focuses on building a sustainable workforce and, as such, contributes to

the socio-economic development in Canada. Air Canada is an important contributor to the travel and tourism sector worldwide. Notwithstanding the impacts of the COVID-19 pandemic, talent management and retention remain a key focus for the future of the organization. Air Canada is committed to providing development opportunities and career progression to its employees. In accordance with its Recruitment Policy, recruitment initiatives emphasize its dedication to encouraging internal transfers and promotions. Some collective agreements also provide for opportunities to trial other positions within the Company, while protecting seniority and job positions for some time.



Diversity and Inclusion

Air Canada believes that diverse perspectives maximize the effectiveness and quality of decision-making. Air Canada’s commitment to diversity was affirmed in a written Board Diversity Policy first adopted by its Board of Directors in February 2015 and, more recently, affirmed in an amended policy in February 2020.

Air Canada is a member of the 30% Club and a signatory to the Catalyst Accord 2022, whose objective is to increase the average percentage of women on boards and in executive positions in corporate Canada to 30% or greater by 2022. Air Canada established and exceeded a target of women representing at least 30% of senior management by 2020. One-third of Air Canada’s Executive Committee is composed of women, and over 30% of its Board of Directors is represented by women, and one out of the 12 directors (8%) of the Board of Directors is a member of a visible minority.

Air Canada pursues a comprehensive diversity management strategy with the goal of ensuring an inclusive and diverse workplace based on respect, where all employees feel they belong, which

creates an environment in which they can best use their talents. On March 4, 2021, Air Canada announced that it been named one of Canada’s Best Diversity Employers for the sixth consecutive year by MediaCorp Canada Inc. The airline was selected again for its ongoing commitment to inclusiveness through various initiatives and programs that promote equal opportunities for all people and a work environment where all employees feel respected and recognized. In 2020, Air Canada signed the BlackNorth Initiative CEO pledge to acknowledge the existence of anti-Black systemic racism and on creating opportunities for Black people within the company. As part of the Pledge Air Canada committed to, at a minimum, have 3.5% of executive and board roles being held by Black leaders by 2025. Air Canada also launched a new leadership bursary with the Pinball Clemons Foundation for people of colour.

Air Canada introduced training to facilitate accessible transportation for persons with disabilities and for all customer-facing employees and management involved in decision-making or policy or procedure setting. Air Canada takes great pride in ensuring its customers are well taken care of during all phases of the journey, from booking to departure and to their destination arrival. In order to deliver



SUSTAINABILITY AND SOCIAL IMPACT

accessible services, considerable resources are devoted to meet the needs of customers. This training, itself built on an inclusive approach, is an additional layer to these efforts, consistently raising awareness and providing increased support when needed.

Communities

In a year that was challenging unlike any other and despite the impact of the pandemic on its business, Air Canada and the Air Canada Foundation continued to help communities in need from coast to coast, through in-kind donations, employee volunteering, fundraising or special initiatives.

Air Canada provided and promoted opportunities for Aeroplan Members to support communities through special offers, matching campaigns and donation opportunities, including during the Travel at Home campaign. In 2020, more than 150 million Aeroplan points were donated by members to charities.

With the Gift of Travel campaign, Air Canada celebrated the actions of community heroes who made a memorable impact, helping their fellow Canadians during the COVID-19 pandemic. It also enabled the raising of funds and Aeroplan points for charitable organizations in Canada, while offering customers aspiring to travel a new flexible travel pass product. More than \$135,000 (net) was raised by the Air Canada Foundation through an inaugural public online auction, along with over one million Aeroplan points through its annual Matching Campaign.

Air Canada and the Air Canada Foundation initiated a food rescue effort across Canada, offering more than 770,000 kilograms of food from April to December, representing over 1.3 million meals. These efforts supported more than 70 front-line social service organizations across eight provinces and averted roughly over 1.5 million kg of greenhouse gas (GHG) emissions from the avoidance of new food production, processing or retailing.

In October, Air Canada Cargo and the Foundation brought Drone Delivery Canada (DDC), the Pontiac Group, GlobalMedic and



generous donors together to implement DDC's drone delivery solution for the Beausoleil First Nation Community in Ontario.

More than 4,000 cargo-only flights were operated in 2020, providing needed global capacity to ensure the flow of essential goods in the supply chain, including personal protective equipment (PPE). As of December 2020, more than 2.6 million kg of PPE were transported.

Air Canada Cargo underwent an extensive preparedness exercise in 2020 to ensure all aspects of its operations were up to date and reflective of current requirements and standards for transporting vaccines. COVID-19 vaccines are being transported around the world, and Air Canada Cargo, a trusted supply chain partner, is proudly involved in bringing the vaccines to Canadians.

Over 300 employees helped their local communities across the country, supporting The Canadian Red Cross efforts in the fight against COVID-19. Becoming Santa for a day, brightening the spirits of more than 200 children in need, they assembled backpacks full of brand-new gifts for youth experiencing homelessness or they raised funds for various causes.

DRONE DELIVERY SOLUTION FOR THE BEAUSOLEIL FIRST NATION COMMUNITY IN ONTARIO.

IMPLEMENTED BY:
AIR CANADA CARGO AND THE
AIR CANADA FOUNDATION



Planet

Air Canada's environmental focus is two-fold: Leave less: less energy use through operations, less carbon in the atmosphere, less waste on land and in water, and less noise in communities; and Do more to address environmental issues: more collaboration and participation with industry partners, and more involvement in communities and with employees and customers.

Air Canada has developed an Environmental Policy, consistent with the requirements of IEnvA and ISO 14001:2015, which documents its environmental commitments. The Environmental Policy is the basis of Air Canada's Environmental Management System (EMS) through which Air Canada maintains environmental management programs to meet regulatory compliance requirements and other additional commitments to which it has subscribed.

In support of its efforts to reduce waste, pollution and GHG emissions and to improve environmental performance, Air Canada advanced to a third-party certified system through the IATA IEnvA program. IEnvA is a two-stage certification process, specific for airlines that complies with and demonstrates equivalency to the ISO 14001: 2015 environmental management systems standard. Air Canada is proud to be the first airline in North America to be IEnvA Stage 2 certified, which provides recognition that its existing environmental compliance activities and sustainability initiatives are more integrated into Air Canada's operations.

In June 2020, Air Canada signed the Buckingham Palace Declaration, which confirms its commitment to stop traffickers of illegal wildlife trade from moving their contraband. On September 30, 2020, Air Canada became Illegal Wildlife Trade ("IWT") certified — the first airline in North America to achieve this industry standard. Introduced in 2019 by IATA, the IWT certification incorporates the 11 commitments of the United for Wildlife Buckingham Palace Declaration for airlines engaged in fighting the trade in illegal wildlife. Air Canada Vacations also acted on its commitment to no longer sell or promote packages to, or generate revenue from, attractions that involve the captivity of current or future generations of dolphins, working with its suppliers and contracted hotels to continuously reduce the practice of keeping dolphins in captivity.

Climate Action

A global challenge that knows no national borders, climate change requires international solutions and coordination to help countries lower their carbon emissions. Commercial aviation produces around 2% of the total man-made carbon emissions. Air Canada monitors its GHG emissions closely and is committed to mitigating its environmental footprint. As 99% of the airline's carbon dioxide (CO₂) emissions are generated from aircraft engine combustion, there is a strong positive correlation between meeting



its environmental targets and reducing fuel burn, emissions and operating costs.

IATA's aviation industry climate action plan has set targets to mitigate CO₂ emissions from air transport:

- An average **improvement in fuel efficiency** of 1.5% per year from 2009 to 2020.
- A cap on net aviation CO₂ emissions from 2020 (**carbon-neutral growth**).
- A **reduction in net aviation CO₂ emissions of 50%** by 2050, relative to 2005 levels.

IATA's stated approach to achieving these targets is through more efficient aircraft operations, improved technology and sustainable aviation fuels, infrastructure improvements and single, global market-based measures to address remaining emissions gaps. Air Canada has adopted this collective industry approach and has worked towards these targets.

Air Canada continues to bolster its climate change strategy to further improve on its emissions **and has subscribed to ambitious goals and targets going forward**. To date, Air Canada is engaged in the following notable actions:

- **Fleet Modernization:** Air Canada's fleet modernization program offers substantive fuel efficiency improvements and meaningfully contributes to its environmental impact and emissions reduction efforts. In May 2020, Air Canada announced the permanent retirement of certain older aircraft from its fleet, consisting of its Airbus A319, Embraer 190 and some select Boeing 767 aircraft, leaving it with a more modern and fuel-efficient fleet. The Boeing 787-8 and Boeing 787-9, also known as Dreamliner, deliver an approximate 20% improvement



in fuel efficiency over the aircraft they replaced. The airline is also renewing its narrow-body fleet with the Airbus A220 and the Boeing 737 MAX. These aircraft are expected to average approximately 20% less fuel consumption per seat and emit approximately 20% less CO₂ and 50% less nitrogen oxide than the aircraft they replace.

- **Fuel Efficiency Working Group:** Air Canada created a fuel efficiency working group that identifies opportunities to reduce weight on board its aircraft and reduce fuel consumption. Since 2016, over 100 projects were achieved, resulting in more than 135,000 tCO₂e avoided.
- **Sustainable Fuels:** Air Canada has been involved in advancement and development of sustainable aviation fuel since 2012, having performed eight biofuel flights and contributing to important Canadian initiatives on biojet supply chain knowledge and research on the impact of biojet on contrail development. Air Canada is a supporting airline of “The Sky’s the Limit” Challenge, through Natural Resources Canada, an initiative to accelerate innovation of sustainable aviation fuel in Canada. Through the National Airlines Council of Canada (“NACC”), Air Canada engages with governments in Canada on policy discussions for mechanisms needed to support a Canadian biofuel supply chain.
- **CORSIA:** Air Canada has endorsed the aviation industry’s climate action targets and recognizes the ongoing work to be done in collaboration with the industry, to cap the emissions growth of international aviation at 2020 levels. The Government of Canada has adopted the voluntary phase of ICAO’s Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA), applicable to certain Air Canada international flights. CORSIA is designed to complement the basket of mitigation measures the air transport industry is already pursuing to reduce its CO₂ emissions and will be the first global sector carbon offset scheme for a single industry. Emissions monitoring in 2019 form the 2020 baseline, with CORSIA obligations in effect January 1, 2021.
- **Canada Action Plan:** Air Canada is also a signatory, through the NACC, to the *Canadian Action Plan to Reduce Greenhouse Gas Emissions from Aviation*. This multiparty action plan between aviation industry stakeholders and the federal government outlines how the parties intend to reduce greenhouse gas emissions from aviation activities.

Information on Air Canada’s carbon footprint, targets and climate protection strategy have been reported through the CDP for the past 13 years. The CDP questionnaire incorporates and aligns with the Task Force on Climate-related Financial Disclosures (“TCFD”) framework. To access Air Canada’s CDP response, visit www.cdp.net. In addition to reporting through the CDP, Air Canada also plans on further aligning with the TCFD framework for its 2021 ESG disclosures.

Less Waste

Despite the operational and financial impacts of the pandemic, Air Canada diverted 64.8% of its waste from landfill in offices and facilities and has maintained its commitment to waste reduction under its Corporate Waste Strategy. The strategy is focused on decreasing the amount of waste generated and sent to landfill

2021 Objectives Preview

The following is an overview of programs to be initiated or continued in 2021:

PLANET

- » Advance Air Canada’s climate change strategy and partnerships, focusing on the following ambitious goal and targets:
 - 2050 goal:
 - net-zero GHG emissions from all Air Canada operations
 - 2030 targets:
 - 20% absolute GHG reductions from flights compared to 2019
 - 30% absolute GHG reductions from ground operations compared to 2019
 - Investments in sustainable fuels and carbon compensation mechanisms
- » Incorporate TCFD framework in 2021 climate-related reporting.
- » Demonstrate commitment to the Buckingham Palace Declaration through specific activities designed to raise awareness of illegal wildlife trafficking.
- » Continue advancing Air Canada’s IEnvA certified environmental management system.
- » Evolve the next set of Corporate Waste Strategy targets.
- » Implement a water conservation program.

by (1) reducing waste by 20% in offices, Maple Leaf Lounges and other facilities; and (2) recycling 50% of approved items on board domestic flights. The Corporate Waste Strategy targets have been achieved, and Air Canada will now evaluate new goals taking into consideration the COVID-19 pandemic. This includes developing solutions for new waste streams created by the pandemic and working with departmental partners to re-evaluate the way waste is produced, disposed of, and tracked across all lines of business.

In 2020, 809 tonnes of Air Canada materials were donated for use rather than sent to landfill. This consisted of donations of banners, duvets, uniforms, food from its in-flight kitchens and other items.

Socially responsible items are also now available for sale through the Aeroplan eStore: members have the ability to purchase carbon offsets, support ocean plastic reduction and acquire upcycled items, such as leather bags, from Air Canada aircraft.





MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

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 under the brand name Air Canada Vacations® ("Air Canada Vacations"), Air Canada Rouge LP, doing business under the brand name Air Canada Rouge® ("Air Canada Rouge") and Aeroplan Inc. ("Aeroplan"). 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 full year 2020. This MD&A should be read in conjunction with Air Canada's audited consolidated financial statements and notes for 2020. 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 non-GAAP measures and any financial information specifically denoted otherwise.

Except as otherwise noted, monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 20 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of February 11, 2021.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 17 "Risk Factors" of this MD&A. Air Canada issued a news release dated February 12, 2021 reporting on its results for the fourth quarter and full year 2020. This news release is available on Air Canada's website at 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 forward-looking statements within the meaning of applicable securities laws. Such forward-looking 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 relate to analyses and other information that are 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 guidance, strategies, expectations, planned operations or future actions. Forward-looking statements are identified using terms and phrases such as "preliminary", "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 in this MD&A and the documents incorporated by reference herein and are subject to important risks and uncertainties. Forward-looking statements cannot be relied upon due to, among other things, changing external events and general uncertainties of the business of Air Canada. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including those discussed below.

Air Canada, along with the rest of the global airline industry, continues to face a severe drop in traffic and a corresponding decline in revenue and cash flows as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world, and particularly in Canada. The impact of the COVID-19 pandemic began to be felt in traffic and sales figures commencing in early March 2020. These impacts include drastic declines in earnings and cash flow from operations. There is very limited visibility on travel demand given changing government restrictions in place around the world and the severity of the restrictions in Canada; these restrictions and concerns about travel due to the COVID-19 pandemic as well as passenger concerns and expectations about the need for certain precautions, such as physical distancing, are severely inhibiting demand. The COVID-19 pandemic is also having significant economic impacts, including on business and consumer spending, which may in turn significantly impact demand for travel. Air Canada cannot predict the full impact or the timing for when conditions may improve. Air Canada is actively monitoring the situation and will respond as the impact of the COVID-19 pandemic evolves, which will depend on a number of factors including the course of the virus, availability of rapid, effective testing, vaccinations and treatments for the virus, government actions, and passenger reaction, as well as timing of a recovery in international and business travel which are important segments of Air Canada's markets, none of which can be predicted with any degree of certainty.



Other factors which may cause results to differ materially from results indicated in forward-looking statements include economic and geopolitical conditions, Air Canada's ability to successfully achieve or sustain positive net profitability, industry and market conditions and the demand environment, Air Canada's ability to pay its indebtedness and maintain or increase liquidity, including through government financial assistance, competition, energy prices, Air Canada's dependence on technology, cybersecurity risks, Air Canada's ability to successfully implement appropriate strategic and other important initiatives (including Air Canada's ability to reduce operating costs), other epidemic diseases, terrorist acts, war, Air Canada's dependence on key suppliers, casualty losses, changes in laws, regulatory developments or proceedings, Air Canada's ability to successfully operate its new loyalty program, climate change and environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), interruptions of service, Air Canada's dependence on regional and other carriers, Air Canada's ability to preserve and grow its brand, employee and labour relations and costs, Air Canada's dependence on Star Alliance and joint ventures, limitations due to restrictive covenants, pending and future litigation and actions by third parties, currency exchange, the grounding of the Boeing 737 MAX aircraft in certain jurisdictions and risks generally relating to the grounding of aircraft fleet types, pension plans, Air Canada's ability to attract and retain required personnel, insurance issues and costs, as well as the factors identified in Air Canada's public disclosure file available at www.sedar.com and, in particular, those identified in section 17 "Risk Factors" of this MD&A. Furthermore, the acquisition of Transat A.T. Inc. is subject to regulatory approvals and certain conditions, and there are no assurances that the acquisition will be completed as described in this MD&A or at all. The forward-looking statements contained or incorporated by reference in this MD&A represent Air Canada's expectations as of the date of this MD&A (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 because of new information, future events or otherwise, except as required under applicable securities regulations.

Key Assumptions

Air Canada, along with the rest of the global airline industry, continues to face a severe drop in traffic and a corresponding decline in revenue as a result of the COVID-19 pandemic. In light of the COVID-19 pandemic, as well as the economic environment and the recent significant volatility in fuel price and foreign exchange rates, Air Canada is not providing any assumptions relating to GDP, fuel prices or foreign exchange rates.

Intellectual Property

Air Canada owns or has rights to trademarks, service marks or trade names used in connection with the operation of its business. In addition, Air Canada's names, logos and website names and addresses are owned or licensed by Air Canada. Air Canada also owns or has the rights to copyrights that also protect the content of its products and/or services. Solely for convenience, the trademarks, service marks, trade names and copyrights referred to in this MD&A may be listed without the ©, ® and TM symbols, but Air Canada reserves all rights to assert, to the fullest extent under applicable law, its rights or the rights of the applicable licensors to these trademarks, service marks, trade names and copyrights.

This MD&A may also include trademarks, service marks or trade names of other parties. Air Canada's use or display of other parties' trademarks, service marks, trade names or products is not intended to, and does not imply a relationship with, or endorsement or sponsorship of Air Canada by, the trademark, service mark or trade name owners or licensees.



3.

About Air Canada

Air Canada is 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. Its mission is connecting Canada and the World.



Air Canada enhances its domestic and transborder network through capacity purchase agreements (“CPAs”) with regional airlines operating flights on behalf of Air Canada under the Air Canada Express banner. Regional carriers form an integral part of the airline’s international network strategy, providing valuable traffic feed to Air Canada and Air Canada Rouge routes.

In 2020, Air Canada, together with Jazz Aviation LP (“Jazz”), Sky Regional Airlines Inc. (“Sky Regional”) and other regional airlines operating flights on behalf of Air Canada under CPAs, operated, on average, 544 daily scheduled flights to 192 direct destinations on six continents, comprised of 61 Canadian destinations, 50 destinations in the United States and a total of 81 international destinations (though operations to many destinations were suspended or did not operate continually as they otherwise would throughout the year as a result of the COVID-19 pandemic). In comparison, in 2019, Air Canada, together with its CPA carriers, operated, on average, 1,531 daily scheduled flights to 217 direct destinations on six continents, comprised of 62 Canadian destinations, 56 destinations in the United States and a total of 99 international destinations. The significant decline in flight operations in 2020 was due to the severe impact of the COVID-19 pandemic which is further discussed in section 4 “Strategy and Covid-19 Mitigation and Recovery Plan” of this MD&A.

At December 31, 2020, Air Canada mainline had an operating fleet of 169 aircraft, comprised of 91 Boeing and Airbus narrow-body aircraft (including 24 Boeing 737 MAX aircraft which were grounded in 2020 and some of which resumed commercial flying on February 1, 2021), 78 Boeing and Airbus wide-body aircraft, while Air Canada Rouge had an operating fleet of 39 aircraft, comprised of 14 Airbus A321 aircraft, five Airbus A320 aircraft and 20 Airbus A319 aircraft. At December 31, 2020, the Air Canada Express fleet was comprised of 49 Mitsubishi regional jets, 62 De Havilland Dash-8 turboprop aircraft and 25 Embraer 175 aircraft for a total of 136 aircraft. In comparison, at December 31, 2019, Air Canada mainline had an operating fleet of 188 aircraft, comprised of 94 Boeing and Airbus narrow-body aircraft (including 24 Boeing 737 MAX aircraft which were grounded for the duration of the year in March 2019), 80 Boeing and Airbus wide-body aircraft, and 14 Embraer 190 regional jets, while Air Canada Rouge operated a fleet of 64 aircraft, comprised of 14 Airbus A321 aircraft, three Airbus A320 aircraft, 22 Airbus A319 aircraft and 25 Boeing 767-300ER aircraft. At December 31, 2019, the Air Canada Express fleet was comprised of 48 Mitsubishi regional jets, 73 De Havilland Dash-8 turboprop aircraft and 25 Embraer 175 aircraft for a total of 146 aircraft. At December 31, 2019, a total of five 18-passenger Beech 1900 aircraft were also operated by regional airlines on behalf of Air Canada.



Air Canada is a founding member of the Star Alliance® network. Through the 26-member airline network, Air Canada offers its customers access to a vast global network, as well as reciprocal participation in frequent flyer programs and the use of airport lounges and other common airport facilities.

Air Canada's Aeroplan program is Canada's premier travel loyalty program. The Aeroplan program allows individuals to enrol as members and accumulate Aeroplan points through travel on Air Canada and select partners, as well as through the purchase of products and services from participating partners and suppliers. Members can redeem Aeroplan points for a variety of travel, merchandise, gift card, and other rewards provided directly by participating partners, or made available through Aeroplan's suppliers. Aeroplan Elite Status recognizes Air Canada's frequent flyers, as well as Aeroplan's most engaged members, with a range of priority travel services and membership benefits.

Air Canada Vacations is a leading Canadian tour operator, developing, marketing, and distributing vacation travel packages, operating in the outbound leisure travel market (Caribbean, Mexico, U.S., Europe, Central and South America, South Pacific, Australia and Asia), and the inbound leisure travel market to destinations within Canada, and offering cruise packages in North America, Europe and the Caribbean. Air Canada Rouge is Air Canada's leisure carrier.

Air Canada Cargo is a global cargo service provider, offering cargo services through scheduled flights and via chartered, specialized flights. In addition to transporting freight on Air Canada's aircraft operating scheduled passenger services, in 2020, Air Canada Cargo started transporting freight on cargo-only flights using Air Canada's mainline wide-body aircraft, as well as four converted Boeing 777 and three converted Airbus 330 aircraft where it has increased available cargo space by removing seats from the passenger cabin.



4.

Strategy and COVID-19 Mitigation and Recovery Plan

Air Canada, along with the rest of the global airline industry, continues to face a severe and abrupt drop in traffic and a corresponding decline in revenue and cash flows as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world, and particularly in Canada. The impacts of the COVID-19 pandemic began to be felt in traffic and sales figures commencing in early March 2020. These impacts include drastic declines in earnings and cash from operations. Canada has among the strictest travel restrictions and quarantine requirements in the world, including barring most inbound travel by non-Canadians and imposing a 14-day quarantine on passengers returning from abroad. In addition, effective January 7, 2021, international travellers five years of age or older entering Canada are required to present, prior to boarding a flight, a negative COVID-19 PCR test. On January 29, 2021, the Government of Canada announced further restrictions to international travel including PCR testing upon arrival and mandatory quarantine in a government-approved hotel for three days at the travellers' expense (and, for travellers with a positive COVID-19 test, an additional quarantine in government facilities). Additional details on the measures announced on January 29, 2021 are expected to be announced in the coming days or weeks.

COVID-19 Mitigation and Recovery Plan

Air Canada has implemented or will be implementing the following measures as part of its COVID-19 Mitigation and Recovery Plan:

Customer Service and Safety

Air Canada makes safety its first consideration in all that it does and has been continually updating its health and safety policies and procedures for travellers and employees in airports, onboard aircraft and in other workplaces to account for new information about COVID-19 as it becomes available. This includes a requirement for customers and crew to wear a protective face covering, as well as enhanced protective personal equipment for airport agents and crews, the reinforcement of safe practices such as frequent handwashing and collaborating with the Canadian federal government to screen passengers to help determine fitness for flying.

— To underscore its commitment to customer and employee safety, Air Canada introduced Air Canada CleanCare+. This program is designed to reduce the risk of exposure to COVID-19 through such measures as enhanced aircraft grooming, mandatory preflight customer temperature checks and facial coverings, in addition to required health questionnaires and providing all customers with care kits for hand cleaning and hygiene. In January 2021, Air Canada received the Diamond certification from the Airline Passenger Experience Association (APEX) Health Safety powered by SimpliFlying. The Diamond



Certification recognized the airline for achieving hospital-grade levels of biosecurity across multiple passenger touchpoints. The certification program aims to create a global standard for health and safety measures focused on airline customers.

- Air Canada has introduced numerous touchless processes throughout the customer journey, including: TouchFree Bag Check for flights departing from Canadian airports, the ability to order food directly in Maple Leaf Lounges from smartphones and tablets, touchless self-entry to the Air Canada Café for when it reopens, and provisioning of all newspapers and magazines in digital format via PressReader.
- Air Canada has undertaken several medical collaborations to continue advancing biosafety across its business, including with Cleveland Clinic Canada in Toronto, a renowned global health care leader, to provide additional science-based evidence in our ongoing COVID-19 response; with Ottawa-based Spartan Bioscience to explore rapid COVID-19 testing in an aviation environment; and, since early 2019, with Toronto-based BlueDot, a company that monitors infectious diseases globally in real time to provide accurate, relevant information to make business and safety decisions quickly.
- Air Canada partnered with McMaster HealthLabs and the Greater Toronto Airports Authority in a study of international travellers arriving at Toronto Pearson International Airport. Preliminary results have indicated that testing can provide an effective, responsible alternative to facilitate the safe relaxation of quarantines. Final results are currently being analyzed and are expected to be published by McMaster HealthLabs and the University of Toronto during the first quarter of 2021.
- Air Canada is finalizing an initial order of Abbott's ID NOW COVID-19 rapid response tests as part of its ongoing evaluation of COVID-19 testing technology and protocols, one of the first private sector companies to do so.
- Air Canada recently conducted a trial with the application of COVID-19 contact tracing technology in its workplace using the





Bluetooth-enabled TraceSCAN app and wearable technology developed by Canadian-based Facedrive Inc. Following an initial pilot, the use of this technology is being further expanded on a trial basis in other Air Canada workplaces.

- Air Canada is collaborating with Shoppers Drug Mart to provide Air Canada customers with the opportunity to take a pre-departure COVID-19 PCR test to support compliance with international travel requirements. The test is now available to travellers in Ontario, Alberta, and British Columbia.
- Air Canada is working with the Creative Destruction Labs rapid testing consortium on rapid antigen screening in the workplace starting with pilots in Toronto and Montréal.
- Air Canada is the first Canadian airline to offer its customers the safety and convenience of a new boarding option utilizing facial biometrics. The technology is now available for customers departing from San Francisco International Airport. The airline plans to expand biometric boarding options to other U.S. airports in the near future and is currently exploring options which could be viable at Canadian airports.

Capacity and Route Network

As a result of the impact of the COVID-19 pandemic and related travel restrictions, Air Canada reduced ASM capacity by 67% in 2020 compared to 2019 and plans to reduce first quarter 2021 capacity approximately 85% compared to the first quarter of 2019 (also represents a reduction of approximately 83% compared to the first quarter of 2020). The airline will continue to dynamically adjust capacity and take other measures as required to adjust for demand, including as a result of health warnings, travel restrictions, quarantines, border closures and market and regulatory conditions.

Canadian travel and quarantine restrictions include the following:

- Travel bans prohibiting all foreign nationals from entering Canada by air under provisions of the Aeronautics Act and Quarantine

Act under two different orders (one for United States arrivals and one for all other international arrivals), subject to limited exceptions (for example, for family members, compassionate reasons, and international students).

- 14-day quarantine requirements under the Quarantine Act for all travellers entering Canada, including Canadians.
- Interprovincial restrictions on travel and/or quarantines in numerous provinces, including Nova Scotia, New Brunswick, Prince Edward Island, Newfoundland, Manitoba, and in the three territories — for all persons including Canadians.
- The Government of Canada also has a global travel advisory in place advising Canadians to avoid all nonessential travel outside of Canada.
- Effective January 7, 2021, the Government of Canada requires airline passengers five years of age or older entering Canada from an international destination to provide, prior to boarding a flight, a negative COVID-19 PCR test, subject to limited exceptions (for example, airline crews re-entering Canada and aircraft maintenance engineers). Despite a negative COVID-19 PCR test, all customers entering Canada are required to complete the full mandatory 14-day quarantine.
- On January 29, 2021, the Canadian government announced the following additional restrictions and measures:
 - Effective February 4, 2021, all scheduled international passenger flights into Canada must land at the following four airports: Montréal-Trudeau International Airport, Toronto Pearson International Airport, Calgary International Airport, and Vancouver International Airport.
 - All Canadian airlines have suspended flight to Mexico and the Caribbean between February 1 and April 30, 2021.
 - All air travellers arriving in Canada, with limited exceptions, will shortly be required to take a COVID-19 PCR test upon arrival and quarantine at a Government of Canada-approved hotel at their own expense while they await their results. If



the result of the COVID-19 PCR test is negative, travellers will be able to complete the 14-day mandatory quarantine at a suitable location of their choice that allows them to observe their quarantine. If the COVID-19 PCR result is positive, travellers will have to complete the mandatory 14-day quarantine at a Government of Canada-supervised facility.

Financing and Liquidity

Air Canada concluded a series of financing transactions in 2020, totalling \$6,780 million, to support the implementation of its planned mitigation and recovery measures in response to the COVID-19 pandemic and provide it with additional operational flexibility.

- In March 2020, Air Canada drew down its US\$600 million and \$200 million revolving credit facilities for aggregate net proceeds of \$1,027 million.
- In June 2020, Air Canada concluded an underwritten public offering of 35,420,000 Class A variable voting shares and/or Class B voting shares of Air Canada at a price of \$16.25 per share, for aggregate proceeds of \$576 million, and a concurrent private placement of convertible senior unsecured notes due 2025 for aggregate proceeds of US\$748 million (\$1,011 million).
- In June 2020, Air Canada completed a private offering of \$840 million aggregate principal amount of 9.00% Second Lien Secured Notes due 2024, which were sold at 98% of par.
- In June 2020, Air Canada completed a private offering of one tranche of Class C Enhanced Equipment Trust Certificates ("EETCs") with a combined aggregate face amount of approximately US\$316 million (\$426 million), which were sold at 95.002% of par.
- In September 2020, Air Canada concluded a private offering of two tranches of EETCs, the proceeds of which were used to purchase equipment notes issued by Air Canada and secured by three Boeing 787-9 aircraft, three Boeing 777-300ER aircraft, one Boeing 777-200LR and nine Airbus A321-200 aircraft. The two tranches of certificates have a combined aggregate face amount of US\$553 million (\$740 million) and a weighted average interest rate of 5.73%. Air Canada used the proceeds from this financing together with cash on hand to repay in full the US\$600 million (\$803 million) 364-day term loan originally put in place in April 2020 and discussed in Air Canada's second quarter 2020 MD&A.
- In September 2020, Air Canada concluded a committed secured facility totalling \$788 million to finance the purchase of the first 18 Airbus A220 aircraft. As aircraft are financed under this facility, the bridge financing of \$788 million put in place in April 2020 (and discussed in Air Canada's second quarter 2020 MD&A) will be repaid concurrently. At December 31, 2020, there were 15 Airbus A220 aircraft financed under this facility with the corresponding bridge financing repaid.
- In October 2020, Air Canada completed sale and leaseback transactions for nine Boeing 737 MAX 8 aircraft for total proceeds of US\$365 million (\$485 million). The nine aircraft were delivered to Air Canada in the past three years.
- In December 2020, Air Canada concluded an underwritten public offering of 35,420,000 Class A variable voting shares and/or Class B voting shares of Air Canada at a price of \$24 per share,

for aggregate proceeds of \$850 million. In January 2021, the underwriters exercised their over-allotment option to purchase an additional 2,587,000 shares at a price of \$24 per share, for gross proceeds of \$62 million.

- Air Canada's unencumbered asset pool (excluding the value of Aeroplan, Air Canada Vacations and Air Canada Cargo) amounted to approximately \$1.7 billion at December 31, 2020. As part of Air Canada's ongoing efforts to maintain adequate liquidity levels, additional financing arrangements continue to be assessed and may be pursued.
- Air Canada suspended share purchases under its Normal Course Issuer Bid in early March 2020 and did not renew its issuer bid upon its expiry in the second quarter of 2020.

Refer to section 8.1 "Liquidity" of this MD&A for a discussion on Air Canada's unrestricted liquidity and section 8.5 "Consolidated Cash Flow Movements" of this MD&A for a discussion on Air Canada's net cash burn.

Cost Reduction and Capital Reduction and Deferral Program

- Air Canada completed a company-wide cost reduction and capital reduction and deferral program for 2020 which reached \$1.7 billion. On a capacity reduction of 67%, 2020 operating expenses decreased \$7,872 million or 45% from 2019, reflecting the significant progress made on both managing variable costs and reducing fixed expenses. Air Canada continues to seek additional opportunities for cost reduction and cash preservation.
- Air Canada completed a workforce reduction of approximately 20,000 employees, representing more than 50% of its workforce. This was achieved through layoffs, terminations of employment, voluntary separations, early retirements, and special leaves. In January 2021, Air Canada announced another workforce reduction of approximately 1,700 employees. The airline is working with its unions on mitigation programs.
- Air Canada adopted the Canada Emergency Wage Subsidy (CEWS) for most of its workforce effective March 15, 2020. The net benefit for employee wages under this program in 2020 was \$554 million. In September 2020, the Government of Canada announced an extension of the program to June 2021. Air Canada intends to continue its participation in the CEWS program, subject to meeting the eligibility requirements.
- Air Canada is permanently retiring certain older aircraft from its fleet – consisting of its less efficient Boeing 767, Airbus A319 and Embraer 190 aircraft. Their retirement will reduce Air Canada's cost structure, simplify the airline's overall fleet, and lower its carbon footprint.
- Air Canada concluded an amendment to the purchase agreement for Airbus A220-300 aircraft which became effective in early November 2020 and pursuant to which Air Canada has deferred 18 aircraft deliveries over 2021 and 2022. Also, Air Canada will not be purchasing the last 12 Airbus A220 aircraft from its original order of 45 aircraft.





- In early November 2020, Air Canada also amended its agreement with Boeing to cancel 10 Boeing 737 MAX 8 aircraft deliveries from its firm order of 50 aircraft and to defer its remaining 16 aircraft deliveries over the late 2021 to 2023 period.
- Through its fleet restructuring and other capital reduction initiatives, Air Canada lowered its planned capital expenditures by approximately \$3.0 billion for the 2020 to 2023 period compared to its projected capital expenditures at the end of 2019.

Strategy

Air Canada's vision for its recovery is predicated on leveraging the solid foundations it has built over the past several years to restore and rebuild towards its global champion ambition. This involves rebuilding a strong global network with a focus on hub to hub flying providing seamless connectivity with Air Canada's partners, delivering consistent and superior customer service and diversifying the revenue base, including through Aeroplan and Air Canada Cargo. Seeking and implementing measures to reduce costs and increase revenues remain key priorities. This is being progressed while mitigating the effects of the COVID-19 pandemic through a variety of strategic initiatives such as fleet modernization, the airline's expanded suite of branded fare products, a renewed and improved loyalty program, the expansion of Air Canada Cargo, and investments in technology.

Air Canada has a modern and efficient fleet, including the Boeing 777 aircraft with its competitive cost per available seat mile particularly adapted to service high-volume leisure markets and the Boeing 787 aircraft with its lower operating costs, mid-size capacity and range flexibility. The airline has also renewed its narrow-body fleet. At December 31, 2020, Air Canada had taken delivery of 15 Airbus A220 aircraft. The Airbus A220 aircraft replaces the Embraer 190 aircraft and, with its longer range and better efficiency,

offers greater deployment opportunities, enabling Air Canada to serve new markets not as well suited to Air Canada's larger Boeing 737 MAX or Airbus A321 aircraft. Air Canada also has 24 Boeing 737 MAX 8 aircraft in its fleet (of a firm order of 40). The Boeing 737 MAX aircraft has a longer range and offers greater maintenance and fuel efficiencies than the aging mainline narrow-body Airbus aircraft it replaces.

Over the last several years, Air Canada Rouge, Air Canada's leisure carrier, has been deployed to Caribbean destinations and leisure destinations in the United States and in Canada, as well as to international leisure markets. Air Canada Rouge leverages the strengths of Air Canada, including its extensive network with enhanced connection options, operational expertise, and frequent flyer program. Air Canada Rouge seeks to maintain a cost structure consistent with that of its leisure market competitors, effectively lowering CASM on leisure routes through increased seat density, lower wage rates, more efficient work standards, and reduced overhead costs. Air Canada Rouge also provides Air Canada with the ability to compete against lower-cost carriers and ultra-low-cost carriers. In 2021, the Air Canada Rouge fleet will be comprised of narrow-body aircraft only. Subject to the impact of the COVID-19 pandemic, the Air Canada Rouge fleet will be operated primarily to leisure destinations in the U.S., the Caribbean and Canada.

As the impact of the COVID-19 pandemic subsides, Air Canada expects that the leisure and Visiting Friends & Relatives ("VFR") markets will lead the recovery, followed by the business market.

Air Canada's hubs of Toronto, Vancouver and Montréal each offer complementary geography and demographics. Not only are these hubs well positioned to capture global traffic flows, but they also have the benefit of a strong local multicultural population base which offers Air Canada a variety of opportunities globally. Air Canada's wide-body aircraft are not only more fuel





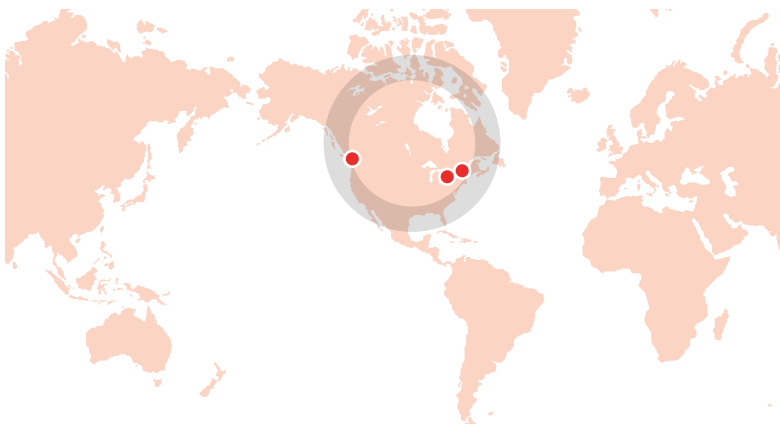
efficient, but also offer best-in-class seating density which lowers the CASM and thereby reduces the overall dependence on premium business travel during the recovery.

Air Canada has the ability to enhance its network through its membership in Star Alliance, its revenue-sharing joint venture with Air China on routes between Canada and China, and its A++ trans-Atlantic revenue-sharing joint venture with United Airlines and Deutsche Lufthansa AG. Air Canada's network may also be enhanced through numerous codeshare and interline agreements. Prior to the onset of the COVID-19 pandemic, Air Canada had been focused on growing global connecting traffic via Canada ("sixth freedom traffic") through its world-class hub in Toronto and its strong international gateways in Montréal and Vancouver. The further development of commercial alliances with major international carriers and the airline's sixth freedom strategy are important elements of Air Canada's recovery plan.

Air Canada is also well positioned to retain its leadership in the North America market through its fleet investments. The narrow-body fleet is being transformed away from older, less efficient aircraft to modern and fuel-efficient Airbus A220 and Boeing 737 MAX aircraft types. This will allow Air Canada to better compete during the recovery through improved operating economics. Air Canada Rouge will also play an important role in the recovery, competing with an efficient Airbus A319, A320 and A321 fleet to a variety of sun and leisure destinations in the U.S., the Caribbean and Canada. Air Canada Rouge will also be used strategically in the leisure segment of the domestic market, in addition to tactical leisure markets.

Air Canada leverages its suite of branded fare products, allowing it to further segment its customer base and offer a variety of fare options and a customized onboard experience. Branded fares provide customers with a wide range of choices and are designed to stimulate sales based on specific attributes, driving incremental revenue. Air Canada also seeks to optimize its ancillary revenue from its "à la carte" services, such as those related to baggage, ticket changes, seat selection, preferred seating, and upgrades.

In 2020, Air Canada announced special benefits and accommodations for Aeroplan Members in response to the COVID-19 pandemic. These include pausing the expiration of Aeroplan points, extending 2020 Aeroplan Elite Status through the end of 2021, waiving certain change and cancellation fees for Aeroplan flight rewards, and launching special offers to help members earn Elite Status and additional points, without leaving home. In 2021, Air Canada is aiming to leverage its fully transformed Aeroplan program. The program now offers a wide range of new features such as: an improved value on flight rewards, Aeroplan Family Sharing, the ability to use Aeroplan points for travel extras such as cabin upgrades and in-flight Wi-Fi, and expanded merchandise & travel rewards. In addition, Aeroplan Elite Status Members have access to new benefits, including Priority Rewards, Status Pass and Everyday Status Qualification. Finally, the new Aeroplan co-branded credit cards issued by TD Bank, American Express and CIBC will also enable members to earn points faster. In late 2020, JPMorgan Chase & Co. ("Chase") and Air Canada announced a strategic partnership that will make Chase the exclusive issuer of the airline's Aeroplan U.S. credit card. This multi-year agreement is designed to provide U.S. customers with improved access to the unique rewards and flexibility offered by the Aeroplan program. The new Aeroplan credit card from Chase is scheduled to launch in late 2021. Building upon its successful relaunch, in 2021, Aeroplan intends to introduce additional program features, while expanding its partnership network in various categories, to further grow and engage its membership base.



Air Canada expects to generate incremental cargo revenue by entering the e-commerce business, providing specialized e-commerce delivery services using its existing fleet. The airline's goal is to drive end-to-end value through enhanced technology, dynamic pricing, and transparency across the delivery supply chain. This new initiative will be implemented in phases and is expected to be completed over the next year or so in Canada. In addition, Air Canada plans to convert several of its owned Boeing 767 aircraft to dedicated freighters to leverage the growth of e-commerce and Air Canada's global footprint.

Air Canada has been investing in technology and transforming core operational process. In 2020, Air Canada concluded the last phase of its cutover to its new passenger service system — the Amadeus Altéa Suite. Altéa, as a shared infrastructure solution, enables simplification and lowers costs in Air Canada's technology environments while improving operational efficiency, including automation of functions. The new system also enables revenue enhancements and growth opportunities as well as significant customer service improvements. Air Canada also has a multi-year distribution agreement in place with Amadeus, supporting its focus on delivering a consistent brand and customer experience across all channels. Amadeus users worldwide can access Air Canada's industry-leading customizable fare products and availability via the Amadeus Global Distribution System, as well as Air Canada's ancillary offerings. In 2020 with the launch of the new Aeroplan program, Air Canada completed significant investments in technology related to the delivery of this digital-first program. Leveraging artificial intelligence ("AI") has also become a key part of Air Canada's strategy as it moves forward on a series of technology-driven initiatives that will help shape its future.

In 2021, Air Canada plans to continue to leverage the following competitive advantages:

- A widely recognized and powerful brand.
- A strong safety culture.
- A global network, well positioned to meet demand from various customer segments, and enhanced by the airline's membership in Star Alliance and by numerous commercial arrangements.
- A simple, modern, fuel efficient and versatile fleet.
- High environmental, social and governance standards.
- A customer experience enhanced by competitive products and services, including lie-flat seats in the Signature Class cabin, concierge services, Maple Leaf Lounges™ and fully transformed Aeroplan program.
- Air Canada Rouge, a lower-cost leisure carrier.
- Geographically well-positioned hubs (Toronto, Montréal, and Vancouver) with efficient in-transit facilities.
- A strong and resilient employee culture supported by strong relationships with various union groups.
- New core technologies, including PROS (revenue management system), Amadeus Altéa Suite (passenger service systems) and the new Aeroplan loyalty system.
- The transformation of content and sales capabilities to move from a "one-size-fits-all" strategy to customized offers that offer meaningful revenue upside potential.

Being a global champion involves being a responsible corporate citizen and doing what is right for the longer-term interest of its shareholders, employees, customers, communities, and other stakeholders; it includes supporting research and development of innovative ways to reduce its environmental footprint and governing its business responsibly, safely, and ethically. Air Canada's social and environmental achievements are reported through its Corporate Sustainability Report "Citizens of the World" in accordance with the Global Reporting Initiative ("GRI") standards. Internationally recognized as a leader in sustainability reporting standards, GRI standards help maintain transparency in corporate reporting related to performance on governance, environmental, and social matters. Seven indicators, including Scope 1 and 2 emissions, are verified by an independent external party, following internationally recognized standards. Air Canada also reports through the CDP. The CDP questionnaire aligns with the Task Force on Climate-related Financial Disclosures ("TCFD") framework. To access the CDP, please visit: www.cdp.net.

Air Canada is also committed to pursuing the Sustainable Development Goals ("SDGs") and has joined the UN Global Compact, an organization that encourages all businesses to adopt sustainable, socially responsible practices. The 17 SDGs are at the heart of the 2030 Agenda for Sustainable Development, adopted by all United Nations Member States in 2015 and provide a shared blueprint for peace and prosperity for people and the planet, now and into the future.

Air Canada's Corporate Sustainability Report, GRI Content Index (and related charts), and the United Nations Communication of Progress are available at www.aircanada.com/citizensoftheworld.

Proposed Acquisition of Transat

On October 10, 2020, Air Canada announced amendments to the acquisition transaction with Transat A.T. Inc. ("Transat") previously disclosed. The acquisition agreement provides for the acquisition by Air Canada of all the shares of Transat for \$5.00 per share, payable at the option of Transat shareholders in cash or shares of Air Canada at a fixed exchange ratio of 0.2862 Air Canada share for each Transat share (representing a price for the Air Canada shares of \$17.47). However, the transaction remains subject to certain conditions including, notably, the ongoing approval process of regulatory authorities, and while Air Canada has endeavoured to adequately address all relevant considerations in all jurisdictions, there can be no assurance that all required regulatory approvals will be granted, that relevant delays for completion will be extended or that the transaction will be successfully completed.

Under the acquisition agreement with Transat, closing of the transaction was to be completed no later than February 15, 2021; it may be extended at any time by agreement of the parties and remains in force unless terminated by either of them.



5.

Results of Operations – Full Year 2020 versus Full Year 2019

The table and discussion below provide and compare results of Air Canada for the periods indicated.

| (Canadian dollars in millions, except per share figures) | Full Year | | | |
|---|-------------------|-----------------|-------------------|-------------------|
| | 2020 | 2019 | \$ CHANGE | % CHANGE |
| OPERATING REVENUES | | | | |
| Passenger | \$ 4,382 | \$ 17,232 | \$ (12,850) | (75) |
| Cargo | 920 | 717 | 203 | 28 |
| Other | 531 | 1,182 | (651) | (55) |
| Total revenues | 5,833 | 19,131 | (13,298) | (70) |
| OPERATING EXPENSES | | | | |
| Aircraft fuel | 1,322 | 4,347 | (3,025) | (70) |
| Wages, salaries, and benefits | 2,242 | 3,184 | (942) | (30) |
| Regional airlines expense, excluding fuel | 1,086 | 1,956 | (870) | (44) |
| Depreciation and amortization | 1,849 | 1,986 | (137) | (7) |
| Aircraft maintenance | 681 | 1,004 | (323) | (32) |
| Airport and navigation fees | 545 | 990 | (445) | (45) |
| Sales and distribution costs | 252 | 874 | (622) | (71) |
| Ground package costs | 250 | 627 | (377) | (60) |
| Catering and onboard services | 171 | 445 | (274) | (62) |
| Communications and information technology | 372 | 397 | (25) | (6) |
| Special items | (116) | - | (116) | NM ⁽²⁾ |
| Other | 955 | 1,671 | (716) | (43) |
| Total operating expenses | 9,609 | 17,481 | (7,872) | (45) |
| Operating income (loss) | (3,776) | 1,650 | (5,426) | |
| NON-OPERATING INCOME (EXPENSE) | | | | |
| Foreign exchange gain (loss) | (293) | 499 | (792) | |
| Interest income | 132 | 164 | (32) | |
| Interest expense | (656) | (515) | (141) | |
| Interest capitalized | 25 | 35 | (10) | |
| Net financing expense relating to employee benefits | (27) | (39) | 12 | |
| Gain (loss) on financial instruments recorded at fair value | (242) | 23 | (265) | |
| Gain on sale and leaseback of assets | 18 | - | 18 | |
| Other | (34) | (42) | 8 | |
| Total non-operating income (expense) | (1,077) | 125 | (1,202) | |
| Income (loss) before income taxes | (4,853) | 1,775 | (6,628) | |
| Income tax recovery (expense) | 206 | (299) | 505 | |
| Net income (loss) | \$ (4,647) | \$ 1,476 | \$ (6,123) | |
| Diluted earnings (loss) per share | \$ (16.47) | \$ 5.44 | \$ (21.91) | |
| EBITDA (excluding special items)⁽¹⁾ | \$ (2,043) | \$ 3,636 | \$ (5,679) | |
| Adjusted pre-tax income (loss)⁽¹⁾ | \$ (4,425) | \$ 1,273 | \$ (5,698) | |

(1) EBITDA (excluding special items) and adjusted pre-tax income (loss) are non-GAAP financial measures. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

(2) "NM" denotes "Not Meaningful" and is included in the table above where a comparison to prior periods would not be meaningful.



System Passenger Revenues

The system-wide negative impact of the COVID-19 pandemic, including government-regulated travel restrictions, began in early March 2020 and resulted in a system ASM capacity reduction of 66.6% in 2020 compared to 2019.

In 2020, passenger revenues of \$4,382 million decreased \$12,850 million or 74.6% from 2019.

On a system basis, in 2020, traffic declined 75.3% while yield increased 3.0% compared to 2019. The yield increase is mainly the result of the significant change in traffic mix and, given the low revenue base, is not a meaningful indicator.

In 2020, PRASM decreased 23.9% from 2019, reflecting a passenger load factor decline of 21.8 percentage points versus 2019, partly offset by the yield improvement noted above.

Due to the abrupt and severe impact of the COVID-19 pandemic, a more in-depth discussion of passenger revenues and of factors influencing year-over-year changes in traffic and yield by geographic region would not be meaningful and is therefore not provided.

The table below provides passenger revenues by geographic region for the full year 2020 and the full year 2019.

| (Canadian dollars in millions) | Full Year | | | |
|--------------------------------|-----------------|------------------|--------------------|---------------|
| | 2020 | 2019 | \$ CHANGE | % CHANGE |
| Canada | \$ 1,640 | \$ 5,233 | \$ (3,593) | (68.7) |
| U.S. transborder | 840 | 3,795 | (2,955) | (77.9) |
| Atlantic | 909 | 4,468 | (3,559) | (79.7) |
| Pacific | 468 | 2,449 | (1,981) | (80.9) |
| Other | 525 | 1,287 | (762) | (59.2) |
| System | \$ 4,382 | \$ 17,232 | \$ (12,850) | (74.6) |

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the full year 2020 versus the full year 2019.

| | Full Year 2020 versus Full Year 2019 | | | | | |
|------------------|--------------------------------------|-----------------|----------------|-----------------------|------------|---------------|
| | Passenger Revenue | Capacity (ASMs) | Traffic (RPMs) | Passenger Load Factor | Yield | PRASM |
| | % CHANGE | % CHANGE | % CHANGE | PP CHANGE | % CHANGE | % CHANGE |
| Canada | (68.7) | (57.4) | (68.3) | (21.1) | (1.0) | (26.4) |
| U.S. transborder | (77.9) | (71.8) | (77.1) | (15.3) | (3.3) | (21.5) |
| Atlantic | (79.7) | (67.8) | (79.6) | (30.7) | (0.5) | (36.8) |
| Pacific | (80.9) | (75.3) | (82.0) | (22.7) | 5.9 | (22.6) |
| Other | (59.2) | (55.5) | (60.1) | (8.7) | 2.1 | (8.3) |
| System | (74.6) | (66.6) | (75.3) | (21.8) | 3.0 | (23.9) |



Cargo Revenues

In 2020, cargo revenues of \$920 million increased \$203 million or 28% from 2019 on a system-wide capacity reduction of 61%. During 2020, yield increased 105% while traffic declined 37% compared to 2019. The triple-digit yield increase reflected the considerably reduced industry capacity, due to a significant number of passenger aircraft grounded globally during the COVID-19 pandemic at the time of a sudden surge in demand for cargo space to meet the urgent global demand for protective equipment and critical goods, particularly in the first half of 2020. To meet this demand, Air Canada operated more than 4,000 all-cargo international flights since March 22, 2020 using a combination of Boeing 787 and Boeing 777 aircraft as well as four converted Boeing 777 and three converted Airbus 330 aircraft where it has increased available cargo space by removing seats from the passenger cabin.

The table below provides cargo revenues by geographic region for the full year 2020 and the full year 2019.

| (Canadian dollars in millions) | Full Year | | | |
|--------------------------------|---------------|---------------|---------------|-------------|
| | 2020 | 2019 | \$ CHANGE | % CHANGE |
| Canada | \$ 90 | \$ 113 | \$ (23) | (20.1) |
| U.S. transborder | 35 | 48 | (13) | (27.1) |
| Atlantic | 387 | 258 | 129 | 49.6 |
| Pacific | 354 | 241 | 113 | 47.3 |
| Other | 54 | 57 | (3) | (6.8) |
| System | \$ 920 | \$ 717 | \$ 203 | 28.2 |

Other Revenues

In 2020, other revenues of \$531 million decreased \$651 million or 55% from 2019, mainly due to a reduction in ground package revenues at Air Canada Vacations and, to a lesser extent, a reduction in passenger and airline-related fees, both due to lower passenger volumes resulting from the COVID-19 pandemic.

Operating Expenses

In 2020, on a capacity reduction of 67%, operating expenses of \$9,609 million decreased \$7,872 million or 45% from 2019, reflecting the reduction in capacity and the significant progress made on both managing variable costs and reducing fixed expenses. Refer to section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of this MD&A for additional discussion on Air Canada's 2020 cost reduction and capital reduction and deferral program.

The more notable year-over-year changes in operating expenses in 2020 compared to 2019 are summarized below.

Aircraft Fuel

In 2020, aircraft fuel expense of \$1,322 million decreased \$3,025 million or 70% versus 2019, reflecting a lower volume of fuel litres consumed, accounting for a decrease of \$2,666 million, and the impact of lower jet fuel prices (before the impact of foreign exchange), accounting for a decrease of \$332 million.

Wages, Salaries and Benefits

In 2020, wages, salaries and benefits expense of \$2,242 million decreased \$942 million or 30% from 2019. In 2020, Air Canada had an average of 21,113 full-time equivalent ("FTE") employees versus 32,903 FTEs in 2019, a reduction of 35.8%. A decrease in expenses related to employee profit sharing programs, a reduction in stock-based compensation expense reflecting a decline in Air Canada's share price, particularly in the first quarter of 2020, and management wage reductions for active employees were also contributing factors to the decrease in wages, salaries, and benefits expense year-over-year. As further discussed below under special items, Air Canada adopted the Canada Emergency Wage Subsidy (CEWS) in the second quarter of 2020 retroactively to March 15, 2020. The net benefit of this program was \$554 million in 2020.

Regional Airlines

In 2020, regional airlines expense (excluding fuel) of \$1,086 million decreased \$870 million or 44% from 2019, reflecting the impact of reduced flying by Jazz and other airlines operating flights on behalf of Air Canada.



Depreciation and Amortization

In 2020, depreciation and amortization expense of \$1,849 million decreased \$137 million or 7% from 2019, reflecting, in large part, aircraft that have been retired or impaired due to the accelerated retirement of certain older aircraft, partially offset by the impact of new aircraft deliveries. The impairment charge recorded in 2020 is further described below under Special Items.

Aircraft Maintenance

In 2020, aircraft maintenance expense of \$681 million decreased \$323 million or 32% from 2019, reflecting a lower volume of maintenance activity due to reduced flying year-over-year and the retirement of the Embraer 190 fleet and certain other aircraft. In 2020, and as a result of updated cost estimates in preparing these aircraft for return to lessors upon lease expiry, a favourable adjustment to aircraft maintenance expense of \$76 million was recorded primarily related to Airbus A320 and regional aircraft. The updated cost estimates include the impact of reduced flying (as a result of the COVID-19 pandemic) since the last maintenance event projected at the lease expiry date.

Special Items

In 2020, Air Canada recorded special items amounting to a net operating expense reduction of \$116 million. The breakdown of these special items is described below.

| (Canadian dollars in millions) | Full Year |
|------------------------------------|-----------------|
| | 2020 |
| Impairments | \$ 315 |
| Workforce reduction provision | 127 |
| Canada Emergency Wage Subsidy, net | (554) |
| Other | (4) |
| Special items | \$ (116) |

Impairments

In response to capacity reductions related to the impact of the COVID-19 pandemic, Air Canada is accelerating the retirement of certain older aircraft from its fleet consisting of Boeing 767, Airbus A319 and Embraer 190 aircraft.

A non-cash impairment charge of \$283 million was recorded in 2020 reflecting the write-down of right-of-use assets for leased aircraft and reduction of carrying values of owned aircraft to expected disposal proceeds. Changes to the estimates around the expected disposal proceeds may result in adjustments to the impairment charge in future periods.

In addition, Air Canada recorded an impairment charge of \$32 million in 2020 related to previously capitalized costs incurred for the development of technology based intangible assets which are now cancelled.

Workforce Reduction Provisions

As a result of the impact of COVID-19, Air Canada undertook a workforce reduction of approximately 20,000 employees in the second quarter of 2020, representing more than 50% of its staff. These reductions were achieved through layoffs, terminations of employment, early retirements and special leaves. A workforce reduction provision of \$78 million was recorded related to these measures. Payments of \$32 million have been made for the year, resulting in a remaining obligation of \$46 million at December 31, 2020. The provision includes the estimated notice of termination and severance costs under Air Canada's collective agreements and applicable law, which amount is subject to adjustment depending on a number of factors such as the relevant notice period and the duration and number of employees who remain on layoff status. In addition, termination benefits and curtailments of \$49 million related to the pension and benefit obligations were recorded.

Canada Emergency Wage Subsidy

In April 2020, the Government of Canada announced the Canada Emergency Wage Subsidy ("CEWS") to help employers retain and/or return Canadian-based employees to payrolls in response to challenges posed by the COVID-19 pandemic.

Air Canada determined that it met the employer eligibility criteria and applied for the CEWS retroactively to March 15, 2020. Air Canada has recorded a total gross subsidy under the CEWS program of \$656 million for the year 2020. Cash payments of \$586 million have been received in 2020. In July 2020, the program was redesigned and extended until December 2020. In September and November 2020, the Government of Canada announced further extensions of the program to June 2021. Air Canada intends to continue its participation in the CEWS program, subject to meeting the eligibility requirements. The amount of the CEWS recorded in special items is net of the cost for inactive employees who were eligible for the wage subsidy under the program.



Non-operating Income (Expense)

In 2020, non-operating expense amounted to \$1,077 million versus non-operating income of \$125 million in 2019.

In 2020, losses on foreign exchange amounted to \$293 million compared to gains on foreign exchange of \$499 million in 2019. The December 31, 2020 closing exchange rate was US\$1=C\$1.2725 while the December 31, 2019 closing exchange rate was US\$1=C\$1.2990. The losses on foreign exchange in 2020 included losses on foreign currency derivatives of \$583 million and foreign exchange gains on long-term debt and lease liabilities of \$346 million.

When compared to 2019, interest expense increased \$141 million due to higher debt levels as a result of financings concluded in 2020, partially offset by the impact of lower interest rates. The convertible notes, which are further discussed in section 11 "Financial Instruments and Risk Management" of this MD&A, were initially measured at the net present value of the liability without conversion option using a discount rate reflective of a liability instrument without a conversion factor. The non-cash accretion related to the convertible notes in interest expense was \$39 million.

The loss on financial instruments recorded at fair value was mainly related to a non-cash charge of \$214 million pertaining to the equity settlement option within the convertible notes. This reflected the increase in the market price of the bonds which was largely driven by the increase in Air Canada's share price since issuance.

Income Taxes

Income taxes recorded in 2020 and 2019 are summarized below.

| (Canadian dollars in millions) | Full Year | |
|--|---------------|-----------------|
| | 2020 | 2019 |
| Current income tax recovery (expense) | \$ 42 | \$ (72) |
| Deferred income tax recovery (expense) | 164 | (227) |
| Income tax recovery (expense) | \$ 206 | \$ (299) |

As a result of the COVID-19 pandemic, there is considerable negative evidence relating to losses incurred in 2020 and uncertainty exists as to when conditions will improve. Such negative evidence currently outweighs the positive historical evidence and, accordingly, net deferred tax assets are not being recognized, commencing from the second quarter of 2020. The future tax deductions underlying the unrecognized deferred income tax assets, which amounted to \$1,114 million as at December 31, 2020, remain available for use in the future to reduce taxable income. The deferred income tax expense recorded in other comprehensive income (loss) related to remeasurements on employee benefit liabilities is offset by a deferred income tax recovery which was recorded through Air Canada's consolidated statement of operations.

In consideration of not recording net deferred income tax assets, Air Canada suspended its reporting of adjusted net income as the results are not meaningfully different than the adjusted pre-tax income measure, which continues to be reported.



6.

Results of Operations – Fourth Quarter 2020 versus Fourth Quarter 2019

The table and discussion below provide and compare results of Air Canada for the periods indicated.

| (Canadian dollars in millions, except per share figures) | Fourth Quarter | | | |
|---|-------------------|----------------|-------------------|-------------------|
| | 2020 | 2019 | \$ CHANGE | % CHANGE |
| OPERATING REVENUES | | | | |
| Passenger | \$ 475 | \$ 3,975 | \$ (3,500) | (88) |
| Cargo | 286 | 186 | 100 | 53 |
| Other | 66 | 268 | (202) | (75) |
| Total revenues | 827 | 4,429 | (3,602) | (81) |
| OPERATING EXPENSES | | | | |
| Aircraft fuel | 187 | 1,013 | (826) | (82) |
| Wages, salaries, and benefits | 507 | 816 | (309) | (38) |
| Regional airlines expense, excluding fuel | 245 | 505 | (260) | (51) |
| Depreciation and amortization | 435 | 520 | (85) | (16) |
| Aircraft maintenance | 185 | 250 | (65) | (26) |
| Airport and navigation fees | 107 | 230 | (123) | (53) |
| Sales and distribution costs | 26 | 194 | (168) | (87) |
| Ground package costs | 14 | 131 | (117) | (89) |
| Catering and onboard services | 25 | 105 | (80) | (76) |
| Communications and information technology | 80 | 109 | (29) | (27) |
| Special items | (160) | - | (160) | NM ⁽²⁾ |
| Other | 179 | 411 | (232) | (56) |
| Total operating expenses | 1,830 | 4,284 | (2,454) | (57) |
| Operating income (loss) | (1,003) | 145 | (1,148) | |
| NON-OPERATING INCOME (EXPENSE) | | | | |
| Foreign exchange gain | 88 | 92 | (4) | |
| Interest income | 26 | 41 | (15) | |
| Interest expense | (182) | (122) | (60) | |
| Interest capitalized | 5 | 9 | (4) | |
| Net financing expense relating to employee benefits | (1) | (10) | 9 | |
| Gain (loss) on financial instruments recorded at fair value | (214) | 5 | (219) | |
| Gain on sale and leaseback of assets | 18 | - | 18 | |
| Other | (12) | 12 | (24) | |
| Total non-operating income (expense) | (272) | 27 | (299) | |
| Income (loss) before income taxes | (1,275) | 172 | (1,447) | |
| Income tax recovery (expense) | 114 | (20) | 134 | |
| Net income (loss) | \$ (1,161) | \$ 152 | \$ (1,313) | |
| Diluted earnings (loss) per share | \$ (3.91) | \$ 0.56 | \$ (4.47) | |
| EBITDA (excluding special items)⁽¹⁾ | \$ (728) | \$ 665 | \$ (1,393) | |
| Adjusted pre-tax income (loss)⁽¹⁾ | \$ (1,326) | \$ 66 | \$ (1,392) | |

(1) EBITDA (excluding special items) and adjusted pre-tax income (loss) are non-GAAP financial measures. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

(2) "NM" denotes "Not Meaningful" and is included in the table above where a comparison to prior periods would not be meaningful.



System Passenger Revenues

In the fourth quarter of 2020, on a capacity reduction of 77.3%, passenger revenues of \$475 million decreased \$3,500 million or 88.1% from the fourth quarter of 2019.

In the fourth quarter of 2020, traffic on a system basis, declined 88.6% while yield increased 5.1% compared to the fourth quarter of 2019. This yield increase is mainly the result of the significant change in traffic mix and, given the low revenue base, is not a meaningful indicator.

In the fourth quarter of 2020, PRASM decreased 47.4% compared to the fourth quarter of 2019. This PRASM decrease reflected a passenger load factor decline of 40.5 percentage points compared to the fourth quarter of 2019, partly offset by the yield improvement noted above.

Due to the abrupt and severe impact of the COVID-19 pandemic, a more in-depth discussion of passenger revenues and of factors influencing year-over-year changes in traffic and yield by geographic region would not be meaningful and is therefore not provided.

The table below provides passenger revenues by geographic region for the fourth quarter of 2020 and the fourth quarter of 2019.

| (Canadian dollars in millions) | Fourth Quarter | | | |
|--------------------------------|----------------|-----------------|-------------------|---------------|
| | 2020 | 2019 | \$ CHANGE | % CHANGE |
| Canada | \$ 262 | \$ 1,258 | \$ (995) | (79.1) |
| U.S. transborder | 47 | 903 | (856) | (94.8) |
| Atlantic | 90 | 942 | (853) | (90.5) |
| Pacific | 28 | 555 | (527) | (94.9) |
| Other | 48 | 317 | (270) | (85.1) |
| System | \$ 475 | \$ 3,975 | \$ (3,500) | (88.1) |

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the fourth quarter of 2020 versus the fourth quarter of 2019.

| | Fourth Quarter 2020 versus Fourth Quarter 2019 | | | | | |
|------------------|--|-----------------|----------------|-----------------------|------------|---------------|
| | Passenger Revenue | Capacity (ASMs) | Traffic (RPMs) | Passenger Load Factor | Yield | PRASM |
| | % CHANGE | % CHANGE | % CHANGE | PP CHANGE | % CHANGE | % CHANGE |
| Canada | (79.1) | (62.5) | (77.7) | (32.4) | (6.3) | (44.3) |
| U.S. transborder | (94.8) | (91.4) | (95.0) | (32.6) | 3.5 | (39.4) |
| Atlantic | (90.5) | (73.4) | (88.7) | (46.8) | (16.0) | (64.4) |
| Pacific | (94.9) | (85.7) | (95.9) | (58.8) | 24.2 | (64.2) |
| Other | (85.1) | (79.0) | (86.2) | (28.6) | 8.2 | (28.9) |
| System | (88.1) | (77.3) | (88.6) | (40.5) | 5.1 | (47.4) |



Cargo Revenues

In the fourth quarter of 2020, cargo revenues of \$286 million increased \$100 million or 53% from the fourth quarter of 2019 on a system-wide capacity reduction of 61%. In the fourth quarter of 2020, yield increased 127% while traffic declined 33% compared to the fourth quarter of 2019. The triple-digit yield increase reflected the considerably reduced industry capacity due to a significant number of passenger aircraft grounded globally during the COVID-19 pandemic at the time of a sudden surge in demand for cargo space.

The table below provides cargo revenues by geographic region for the periods indicated.

| (Canadian dollars in millions) | Fourth Quarter | | | |
|--------------------------------|----------------|---------------|---------------|-------------|
| | 2020 | 2019 | \$ CHANGE | % CHANGE |
| Canada | \$ 29 | \$ 27 | \$ 2 | 6.9 |
| U.S. transborder | 8 | 11 | (3) | (29.2) |
| Atlantic | 131 | 69 | 62 | 88.2 |
| Pacific | 99 | 64 | 35 | 54.7 |
| Other | 19 | 15 | 4 | 26.4 |
| System | \$ 286 | \$ 186 | \$ 100 | 53.0 |

Other Revenues

In the fourth quarter of 2020, other revenues of \$66 million decreased \$202 million or 75% from the same quarter in 2019, reflecting, in large part, a reduction in ground package revenues at Air Canada Vacations and, to a lesser extent, a reduction in passenger and airline-related fees, both due to lower passenger volumes resulting from the COVID-19 pandemic.

Operating Expenses

In the fourth quarter of 2020, on a capacity reduction of 77%, operating expenses of \$1,830 million decreased \$2,454 million or 57% from the fourth quarter of 2019.

The more notable year-over-year changes in operating expenses in the fourth quarter of 2020 compared to the fourth quarter of 2019 are summarized below.

Aircraft Fuel

In the fourth quarter of 2020, aircraft fuel expense of \$187 million decreased \$826 million or 82% versus the fourth quarter of 2019, reflecting a lower volume of fuel litres consumed, accounting for a decrease of \$721 million, and the impact of lower jet fuel prices (before the impact of foreign exchange), accounting for a decrease of \$97 million.

Wages, Salaries and Benefits

In the fourth quarter of 2020, wages, salaries, and benefits expense of \$507 million decreased \$309 million or 38% from the fourth quarter of 2019. In the fourth quarter of 2020, Air Canada had an average of 17,863 full-time equivalent ("FTE") employees versus 33,268 FTEs in 2019, a reduction of 46.3%. A decrease in expenses related to employee profit sharing programs, and management wage reductions for active employees were also contributing factors to the decrease in wages, salaries and benefits expense year-over-year.

Regional Airlines

In the fourth quarter of 2020, regional airlines expense (excluding fuel) of \$245 million decreased \$260 million or 51% from the fourth quarter of 2019, reflecting the continued impact of reduced flying by Jazz and Sky Regional due to the COVID-19 pandemic.

Depreciation and Amortization

In the fourth quarter of 2020, depreciation and amortization expense of \$435 million decreased \$85 million or 16% from the fourth quarter of 2019, reflecting, in large part, aircraft that have been retired or impaired due to the accelerated retirement of certain older aircraft and a lower volume of capitalized airframe and engine maintenance events on leased aircraft, partially offset by the impact of new aircraft deliveries.



Aircraft Maintenance

In the fourth quarter of 2020, aircraft maintenance expense of \$185 million decreased \$65 million or 26% from the fourth quarter of 2019, reflecting a lower volume of maintenance activity due to reduced flying year-over-year and the retirement of the Embraer 190 fleet, partially offset by an increase in maintenance provisions as a result of updated end-of-lease cost estimates in anticipation of returning aircraft (primarily De Havilland Dash 8-400 aircraft) to lessors upon lease expiry (over the next 12 months).

Special Items

In the fourth quarter of 2020, Air Canada recorded special items amounting to a net operating expense reduction of \$160 million. The table below provides a breakdown of these special items. Refer to section 5 "Results of Operations – Full Year 2020 versus Full Year 2019" of this MD&A for additional information.

| | Fourth Quarter |
|------------------------------------|-----------------------|
| | 2020 |
| (Canadian dollars in millions) | |
| Impairments | \$ (12) |
| Workforce reduction provision | 15 |
| Canada Emergency Wage Subsidy, net | (163) |
| Other | - |
| Special items | \$ (160) |

Non-operating Income (Expense)

In the fourth quarter of 2020, non-operating expense amounted to \$272 million versus non-operating income of \$27 million in the fourth quarter of 2019.

Gains on foreign exchange amounted to \$88 million in the fourth quarter of 2020 compared to gains on foreign exchange of \$92 million in the fourth quarter of 2019. The December 31, 2020 closing exchange rate was US\$1=C\$1.2725 while the December 31, 2019 closing exchange rate was US\$1=C\$1.2990. The gains on foreign exchange in the fourth quarter included foreign exchange gains on long-term debt and lease liabilities of \$487 million and foreign exchange losses on foreign currency derivatives of \$375 million.

When compared to the fourth quarter of 2019, interest expense increased \$60 million due to higher debt levels as a result of financings concluded in 2020, partially offset by the impact of lower interest rates. The non-cash accretion related to the convertible notes issued in June 2020 in interest expense for the fourth quarter of 2020 was \$17 million.

The loss on financial instruments recorded at fair value was mainly related to a non-cash charge of \$220 million pertaining to the equity settlement option within the convertible notes issued in June 2020. This reflected the increase in the market price of the bonds which was largely driven by the increase in Air Canada's share price in the fourth quarter of 2020.



7.

Fleet

In response to the COVID-19 pandemic, Air Canada, together with regional airlines operating flights on behalf of Air Canada under capacity purchase agreements, have reduced capacity through the temporary grounding of aircraft and will continue to assess fleet, capacity and schedule adjustments and other measures as developments warrant. The tables below provide the number of aircraft in Air Canada's and Air Canada Rouge's operating fleet at December 31, 2020 and at December 31, 2021. The fleet plan assumes deliveries of three Boeing 737 MAX and 12 Airbus A220-300 aircraft in 2021.

Air Canada is permanently retiring certain older aircraft from its fleet. Their retirement will reduce Air Canada's cost structure, simplify the airline's overall fleet, and lower its carbon footprint.

| Mainline | Actual | Planned | |
|--|-------------------|--------------------|-------------------|
| | DECEMBER 31, 2020 | 2021 FLEET CHANGES | DECEMBER 31, 2021 |
| WIDE-BODY AIRCRAFT | | | |
| Boeing 787-8 | 8 | - | 8 |
| Boeing 787-9 | 29 | - | 29 |
| Boeing 777-300ER | 19 | (1) | 18 |
| Boeing 777-200LR | 6 | - | 6 |
| Airbus A330-300 | 16 | - | 16 |
| NARROW-BODY AIRCRAFT | | | |
| Boeing 737 MAX 8 | 24 | 3 | 27 |
| Airbus A321 | 15 | - | 15 |
| Airbus A320 | 21 | (6) | 15 |
| Airbus A319 | 16 | (10) | 6 |
| Airbus A220-300 | 15 | 12 | 27 |
| Total Mainline | 169 | (2) | 167 |
| Air Canada Rouge | | | |
| NARROW-BODY AIRCRAFT | | | |
| Airbus A321 | 14 | - | 14 |
| Airbus A320 | 5 | - | 5 |
| Airbus A319 | 20 | - | 20 |
| Total Air Canada Rouge | 39 | - | 39 |
| Total Mainline and Air Canada Rouge | 208 | (2) | 206 |

Air Canada has a firm order for 40 Boeing 737 MAX 8 aircraft. Air Canada has 24 Boeing 737 MAX 8 aircraft in its operating fleet, with the remaining 16 aircraft deliveries expected over the late 2021 to 2023 period.

On March 13, 2019, Transport Canada issued a safety notice closing Canadian airspace to Boeing 737 MAX aircraft. Following Transport Canada's Airworthiness Directive, on January 20, 2021 lifting the safety notice, the aircraft ungrounding by regulatory bodies worldwide, and Air Canada's own independent assessments of the aircraft and operating procedures by its specialized safety and flight operations experts, Air Canada resumed Boeing 737 MAX commercial operations on February 1, 2021.

At December 31, 2020, Air Canada had taken delivery of 15 Airbus A220 aircraft. The remaining 18 aircraft deliveries are expected over the 2021 and 2022 period.



Air Canada Express

The table below provides the number of aircraft operated, at December 31, 2020 and the planned fleet as at December 31, 2021, on behalf of Air Canada, by Jazz and Sky Regional operating flights under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada. The table below includes a significant number of aircraft that have been grounded in response to the COVID-19 pandemic.

| Air Canada Express | Actual | Planned | |
|---------------------------------|-------------------|--------------------|-------------------|
| | DECEMBER 31, 2020 | 2021 FLEET CHANGES | DECEMBER 31, 2021 |
| Embraer 175 | 25 | - | 25 |
| Mitsubishi CRJ-200 | 15 | - | 15 |
| Mitsubishi CRJ-900 | 34 | 1 | 35 |
| De Havilland Dash 8-300 | 19 | - | 19 |
| De Havilland Dash 8-400 | 43 | (4) | 39 |
| Total Air Canada Express | 136 | (3) | 133 |



8.

Financial and Capital Management

8.1. Liquidity

Impact of the COVID-19 Pandemic

Air Canada, along with the rest of the global airline industry, continues to face a severe drop in traffic and a corresponding decline in revenue and cash flows as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world, particularly in Canada.

The impact of the COVID-19 pandemic began to be felt in traffic and sales figures commencing in early March 2020. These impacts include drastic declines in earnings and cash from operations. The expectation is for continuing considerable negative impact to cash flows and Air Canada's liquidity position, including after considering the mitigation responses described in section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of this MD&A. In light of the ongoing uncertainty relating to the COVID-19 pandemic, the full extent and duration of any impact remain unknown.

Air Canada concluded a number of financing transactions in 2020, as described in section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of this MD&A, increasing Air Canada's cash position, thereby allowing for additional flexibility operationally and to support the implementation of its planned mitigation and recovery measures in response to the COVID-19 pandemic.

Air Canada's unencumbered asset pool (excluding the value of Aeroplan, Air Canada Vacations and Air Canada Cargo) amounted to approximately \$1.7 billion at December 31, 2020. As part of Air Canada's ongoing efforts to maintain adequate liquidity levels, additional financing arrangements continue to be assessed.

Liquidity Risk Management

Air Canada manages its liquidity needs through a variety of strategies, including by seeking to sustain and improve cash from operations and free cash flow, sourcing committed financing, as necessary, 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, which are further discussed in sections 8.6, 8.7 and 8.8 of this MD&A. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts for a minimum period of at least 12 months, including under various scenarios and assumptions, monitoring the condition and value of assets available for use as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements.

At December 31, 2020, unrestricted liquidity amounted to \$8,013 million (comprised of cash, cash equivalents and short-term investments of \$7,501 million and long-term investments of \$512 million). This compared to unrestricted liquidity of \$7,380 million at December 31, 2019 (comprised of cash, cash equivalents and short-term investments of \$5,889 million, undrawn lines of credit of \$979 million, and long-term investments of \$512 million).

Given the impact of the COVID-19 pandemic on passenger revenues and advance ticket sales, Air Canada updated its definition of the minimum cash it requires to support ongoing business operations. The minimum cash estimate has been updated to a fixed amount of \$2,400 million, as compared to the previous minimum cash estimate of 20% of trailing 12 months operating revenue. This minimum cash estimate considers Air Canada's various financial covenants, provides adequate coverage for advance ticket sales, and supports Air Canada's liquidity needs, as described above. Air Canada no longer reports on excess cash as this metric is not meaningful in the current environment.



8.2. Financial Position

The table below provides a condensed consolidated statement of financial position of Air Canada as at December 31, 2020 and as at December 31, 2019.

| (Canadian dollars in millions) | DECEMBER 31, 2020 | DECEMBER 31, 2019 | \$ CHANGE |
|---|-------------------|-------------------|-------------------|
| ASSETS | | | |
| Cash, cash equivalents and short-term investments | \$ 7,501 | \$ 5,889 | \$ 1,612 |
| Other current assets | 1,170 | 1,627 | (457) |
| Current assets | \$ 8,671 | \$ 7,516 | \$ 1,155 |
| Investments, deposits, and other assets | 833 | 936 | (103) |
| Property and equipment | 12,137 | 12,834 | (697) |
| Pension assets | 2,840 | 2,064 | 776 |
| Deferred income tax | 25 | 134 | (109) |
| Intangible assets | 1,134 | 1,002 | 132 |
| Goodwill | 3,273 | 3,273 | - |
| Total assets | \$ 28,913 | \$ 27,759 | \$ 1,154 |
| LIABILITIES | | | |
| Current liabilities | \$ 7,139 | \$ 7,775 | \$ (636) |
| Long-term debt and lease liabilities | 11,201 | 8,024 | 3,177 |
| Aeroplan and other deferred revenues | 4,032 | 3,136 | 896 |
| Pension and other benefit liabilities | 3,015 | 2,930 | 85 |
| Maintenance provisions | 1,040 | 1,240 | (200) |
| Other long-term liabilities | 696 | 181 | 515 |
| Deferred income tax | 75 | 73 | 2 |
| Total liabilities | \$ 27,198 | \$ 23,359 | \$ 3,839 |
| Total shareholders' equity | \$ 1,715 | \$ 4,400 | \$ (2,685) |
| Total liabilities and shareholders' equity | \$ 28,913 | \$ 27,759 | \$ 1,154 |

Movements in current assets and current liabilities are described in section 8.4 "Working Capital" of this MD&A. Long-term debt and lease liabilities are discussed in sections 8.3 "Net Debt" and 8.5 "Consolidated Cash Flow Movements" of this MD&A.

At December 31, 2020, net pension and benefit liabilities of \$175 million (comprised of pension assets of \$2,840 million net of pension and other benefit liabilities of \$3,015 million) decreased \$691 million from December 31, 2019. This decrease was mainly due to a net actuarial gain on remeasurements of employee liabilities of \$1,077 million (\$765 million, net of tax) recorded on Air Canada's consolidated statement of comprehensive income, partially offset by pension and other employee benefits expense recorded during the year. The actuarial gain included the impact of higher returns on plan assets, partially offset by a 54-basis point decrease in the discount rate used to value the liabilities.

The long-term portion of the Aeroplan and other deferred revenue liability increased \$896 million from December 31, 2019. This increase included both the growth in the program due to the sale of Aeroplan points to program partners exceeding redemptions and a reclassification of \$590 million from current to long-term liabilities as a result of lower current Aeroplan points redemptions due to the impact of the COVID-19 pandemic.

At December 31, 2020, the long-term portion of maintenance provisions of \$1,040 million declined \$200 million versus December 31, 2019. This decline reflected the reclassification of \$313 million to current liabilities for leases expiring over the next 12 months. The decline also included the impact of a \$26 million reduction to maintenance provisions as a result of extensions and updated end-of-lease cost estimates in anticipation of returning aircraft to lessors upon lease expiry (over the next 12 months), which included the impact of reduced flying due to the COVID-19 pandemic, offset by the impact of ongoing maintenance provision expenses.

Air Canada's option to deliver cash or a combination of cash and shares on its convertible notes issued in June 2020 gives rise to an embedded derivative financial liability. The fair value of the embedded derivative was \$534 million at December 31, 2020 and is included in other long-term liabilities.



8.3. Net Debt

The table below reflects Air Canada's net debt balances at December 31, 2020 and as at December 31, 2019.

| (Canadian dollars in millions) | DECEMBER 31, 2020 | DECEMBER 31, 2019 | \$ CHANGE |
|---|-------------------|-------------------|-----------------|
| Total long-term debt and lease liabilities | \$ 11,201 | \$ 8,024 | \$ 3,177 |
| Current portion of long-term debt and lease liabilities | 1,788 | 1,218 | 570 |
| Total long-term debt and lease liabilities (including current portion) | \$ 12,989 | \$ 9,242 | \$ 3,747 |
| Less cash, cash equivalents and short- and long-term investments | (8,013) | (6,401) | (1,612) |
| Net debt⁽¹⁾ | \$ 4,976 | \$ 2,841 | \$ 2,135 |

(1) Net debt is an additional GAAP financial measure and a key component of the capital managed by Air Canada and provides management with a measure of its net indebtedness.

At December 31, 2020, net debt of \$4,976 million increased \$2,135 million from December 31, 2019, reflecting the impact of net cash used for operating and investing activities in 2020, partially offset by the proceeds from the equity offerings in 2020. Refer to section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of this MD&A for a description of the debt financing activities completed during 2020. The impact of a stronger Canadian dollar, at December 31, 2020 compared to December 31, 2019, decreased foreign currency denominated debt (mainly U.S. dollars) by \$346 million.

Air Canada suspended reporting its leverage ratio and its weighted average cost of capital ("WACC") as these metrics are not meaningful given the COVID-19 pandemic's severe impact on earnings. In the current environment, liquidity levels (refer to section 8.1 "Liquidity" of this MD&A for discussion on liquidity levels) and net cash burn (refer to section 8.5 "Consolidated Cash Flow Movements" of this MD&A for discussion on net cash burn) are part of the key measures monitored by management. Net cash burn is a non-GAAP measure. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

8.4. Working Capital

The table below provides information on Air Canada's working capital balances at December 31, 2020 and at December 31, 2019.

| (Canadian dollars in millions) | DECEMBER 31, 2020 | DECEMBER 31, 2019 | \$ CHANGE |
|---|-------------------|-------------------|-----------------|
| Cash, cash equivalents and short-term investments | \$ 7,501 | \$ 5,889 | \$ 1,612 |
| Accounts receivable | 644 | 926 | (282) |
| Other current assets | 526 | 701 | (175) |
| Total current assets | \$ 8,671 | \$ 7,516 | \$ 1,155 |
| Accounts payable and accrued liabilities | 2,465 | 2,456 | 9 |
| Advance ticket sales | 2,314 | 2,939 | (625) |
| Aeroplan and other deferred revenues | 572 | 1,162 | (590) |
| Current portion of long-term debt and lease liabilities | 1,788 | 1,218 | 570 |
| Total current liabilities | \$ 7,139 | \$ 7,775 | \$ (636) |
| Net working capital | \$ 1,532 | \$ (259) | \$ 1,791 |

Net working capital of \$1,532 million at December 31, 2020 increased \$1,791 million from December 31, 2019. Working capital was favourably impacted by the financings discussed in section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of this MD&A and by the reclassification of a portion of Aeroplan deferred revenues from current into long term, reflecting an estimated reduction in Aeroplan redemptions over the next 12 months. These factors, which increased net working capital, were partially offset by negative cash flows from operating activities, reflecting the operating losses recorded in 2020 and the decline in advance ticket sales during the period due to the COVID-19 pandemic. Advance ticket sales generally increase in the first and second quarters prior to the summer peak travel season. However, because of the COVID-19 pandemic and the abrupt decline in travel demand, coupled with an increase in refunds to customers, the advance ticket sales liability decreased during 2020. In addition, the unused amounts of non-refundable tickets in respect of flights cancelled due to the COVID-19 pandemic can be converted into either a transferable travel voucher (with no expiry date) or into Aeroplan points, which may further result in lower advance sales in future periods as these unused amounts are applied to new ticket purchases. Customers have the ability to use the travel vouchers within the next 12 months and Air Canada does not have an unconditional right to defer settlement beyond the next 12 months. As such, the entire liability amount related to these vouchers has been recorded in current liabilities even though some could be used after the next 12 months.



8.5. Consolidated Cash Flow Movements

The table below provides the cash flow movements for Air Canada for the periods indicated.

| (Canadian dollars in millions) | Fourth Quarter | | | Full Year | | |
|---|-----------------|-----------------|-------------------|-------------------|-------------------|-------------------|
| | 2020 | 2019 | \$ CHANGE | 2020 | 2019 | \$ CHANGE |
| Net cash flows from (used in) operating activities | \$ (796) | \$ 677 | \$ (1,473) | \$ (2,353) | \$ 5,712 | \$ (8,065) |
| Proceeds from borrowings | 254 | - | 254 | 6,262 | - | 6,262 |
| Reduction of long-term debt and lease liabilities | (508) | (276) | (232) | (2,719) | (1,084) | (1,635) |
| Shares purchased for cancellation | - | (125) | 125 | (132) | (373) | 241 |
| Issue of shares | 815 | 1 | 814 | 1,369 | 9 | 1,360 |
| Financing fees | (3) | (1) | (2) | (78) | (1) | (77) |
| Net cash flows from (used in) financing activities | \$ 558 | \$ (401) | \$ 959 | \$ 4,702 | \$ (1,449) | \$ 6,151 |
| Investments, short-term and long-term | 9 | 67 | (58) | (63) | (255) | 192 |
| Additions to property, equipment, and intangible assets | (335) | (251) | (84) | (1,202) | (2,025) | 823 |
| Proceeds from sale of assets | 6 | 18 | (12) | 12 | 24 | (12) |
| Proceeds from sale and leaseback of assets | 485 | - | 485 | 485 | - | 485 |
| Acquisition of Aeroplan | - | - | - | - | (517) | 517 |
| Investment in Chorus | - | - | - | - | (97) | 97 |
| Other | (6) | 13 | (19) | 35 | 75 | (40) |
| Net cash flows from (used in) investing activities | \$ 159 | \$ (153) | \$ 312 | \$ (733) | \$ (2,795) | \$ 2,062 |
| Effect of exchange rate changes on cash and cash equivalents | \$ (53) | \$ (9) | \$ (44) | \$ (48) | \$ (8) | \$ (40) |
| Increase in cash and cash equivalents | \$ (132) | \$ 114 | \$ (246) | \$ 1,568 | \$ 1,460 | \$ 108 |

Net Cash Flows from (used in) Operating Activities

In the fourth quarter of 2020, net cash flows used in operating activities of \$796 million deteriorated by \$1,473 million from the same quarter in 2019 on lower operating results, reflecting the impact of the COVID-19 pandemic.

In 2020, net cash used in operating activities of \$2,353 million deteriorated by \$8,065 million from 2019 on lower operating results and lower cash from working capital due to lower advance ticket sales, both reflecting the impact of the COVID-19 pandemic. The first quarter of 2019 was favourably impacted by receipts amounting to \$1,612 million in conjunction with Air Canada's acquisition of Aeroplan.

Net Cash Flows from (used in) Financing Activities

In the fourth quarter of 2020, net cash flows from financing activities of \$558 million increased \$959 million from the fourth quarter of 2019. In 2020, net cash flows from financing activities of \$4,702 million increased \$6,151 million from 2019. Refer to section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of this MD&A for a description of the debt and equity financing transactions concluded in 2020.

Net Cash Flows from (used in) Investing Activities

In the fourth quarter of 2020, net cash flows from investing activities of \$159 million reflected an increase of \$312 million from the fourth quarter of 2019, mainly due to proceeds received from the sale and leaseback of nine Boeing 737 MAX 8 aircraft.

In 2020, net cash flows used in investing activities of \$733 million reflected a reduction of \$2,062 million from 2019, mainly due to a lower level of capital expenditures year-over-year, proceeds from the sale and leaseback of nine Boeing 737 MAX 8 aircraft, and movements between short- and



long-term investments. In 2020, Air Canada took delivery of 15 Airbus A220 aircraft. Additions to property and equipment is net of additional settlement payments received from Boeing related to the grounding of the 737 MAX fleet. The first quarter of 2019 included the impact of Air Canada's acquisition of Aeroplan on January 10, 2019.

Refer to sections 8.4 "Working Capital", 8.2 "Financial Position", 8.3 "Net Debt" and 8.9 "Share Information" of this MD&A for additional information.

Free Cash Flow

The table below provides the calculation of free cash flow for Air Canada for the periods indicated.

| (Canadian dollars in millions) | Fourth Quarter | | | Full Year | | |
|---|-----------------|---------------|-------------------|-------------------|-----------------|-------------------|
| | 2020 | 2019 | \$ CHANGE | 2020 | 2019 | \$ CHANGE |
| Net cash flows from (used in) operating activities | \$ (796) | \$ 677 | \$ (1,473) | \$ (2,353) | \$ 5,712 | \$ (8,065) |
| Additions to property, equipment, and intangible assets, net of proceeds from sale and leaseback transactions | 150 | (251) | 401 | (717) | (2,025) | 1,308 |
| One-time proceeds related to the acquisition of Aeroplan (as described above) | - | - | - | - | (1,612) | 1,612 |
| Free cash flow⁽¹⁾ | \$ (646) | \$ 426 | \$ (1,072) | \$ (3,070) | \$ 2,075 | \$ (5,145) |

(1) Free cash flow is a non-GAAP financial measure used by Air Canada as an indicator of the financial strength and performance of its business, indicating how much cash it can generate from operations after capital expenditures and excluding one-time proceeds related to the acquisition of Aeroplan. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment, and intangible assets, net of proceeds from sale and leaseback transactions. The one-time proceeds related to the acquisition of Aeroplan in 2019 were also excluded from Air Canada's calculation of free cash flow. Refer to section 19 "Non-GAAP Financial Measures" of this MD&A for additional information.

In the fourth quarter of 2020, negative free cash flow of \$646 million deteriorated by \$1,072 million from the fourth quarter of 2019, reflecting lower cash flows from operating activities due to the impact of the COVID-19 pandemic, partially offset by a lower level of net capital expenditures.

In 2020, negative free cash flow of \$3,070 million deteriorated by \$5,145 million from 2019, reflecting lower cash flows from operating activities due to the impact of the COVID-19 pandemic, partially offset by a lower level of capital expenditures versus 2019.

Net Cash Burn

The table below provides the calculation of net cash burn for Air Canada for the periods indicated.

| (Canadian dollars in millions) | Fourth Quarter | Full Year |
|---|-------------------|-------------------|
| | 2020 | 2020 |
| Net cash flows used in operating activities | \$ (796) | \$ (2,353) |
| Net cash flows from financing activities | 558 | 4,702 |
| Net cash flows from (used in) investing activities | 159 | (733) |
| Remove: | | |
| Net proceeds from new financings | (1,066) | (7,553) |
| Lump-sum debt repayments | 255 | 1,687 |
| Proceeds from sale and leaseback transactions | (485) | (485) |
| Investments, short-term and long-term | (9) | 63 |
| Net cash burn⁽¹⁾ | \$ (1,384) | \$ (4,672) |

(1) Net cash burn is a non-GAAP financial measure used by Air Canada as a measure of cash used to maintain operations, support capital expenditures, and settle normal debt repayments, all before the net impact of new financing proceeds. Net cash burn is defined as net cash flows from operating, financing, and investing activities, and excludes proceeds from new financings, any lump sum debt maturities where Air Canada has refinanced or replaced the amount and proceeds from sale and leaseback transactions. Net cash burn also excludes movements between cash and short- and long-term investments.

In the fourth quarter of 2020, net cash burn of \$1,384 million (or approximately \$15 million per day, on average) was in line with management's net cash burn expectations of an average of \$14 million to \$16 million per day, discussed in Air Canada's December 15, 2020 news release.



8.6. Capital Expenditures and Related Financing Arrangements

Boeing 737 MAX Aircraft

Air Canada's agreement with Boeing for the purchase of Boeing 737 MAX aircraft provides for:

- Firm orders for 40 Boeing 737 MAX 8 aircraft.
- Purchase options for 10 Boeing 737 MAX aircraft.

In 2019, Air Canada concluded discussions with Boeing to settle the terms of an arrangement in relation to the grounding of the Boeing 737 MAX aircraft. The settlement payments contemplated by the arrangement were made to Air Canada during the fourth quarter of 2019 and during the first and second quarters of 2020. The compensation is accounted for as an adjustment to the purchase price of current and future deliveries and will flow through Air Canada's consolidated statement of operations as reduced depreciation expense over the life of the aircraft, and as a reduction to additions to property and equipment on the consolidated statement of cash flow.

In the first quarter of 2020, Air Canada finalized an amendment to its 2014 order, reducing its initial order by 11 Boeing 737 MAX 9 aircraft previously scheduled for delivery in 2023 and 2024. This amendment reflected Air Canada's evolving and long-term fleet planning requirements at that time.

In early November 2020, Air Canada amended its agreement with Boeing to cancel 10 Boeing 737 MAX 8 aircraft deliveries from its firm order of 50 aircraft and to defer its remaining 16 aircraft deliveries over the late 2021 to 2023 period. The capital commitments table below has been updated to reflect the cancellation and the changes to the delivery schedule. As part of this amendment, options for eight aircraft and the rights to purchase an additional 30 aircraft were also cancelled.

Twenty-four Boeing 737 MAX 8 aircraft have been delivered to date.

Airbus A220-300 Aircraft

Air Canada's agreement with Airbus Canada Limited Partnership (as successor to Bombardier Inc.) originally provided for an order for 45 Airbus A220-300 aircraft (formerly called Bombardier C-Series CS300 aircraft) and options for an additional 30 Airbus A220-300 aircraft.

Air Canada concluded an amendment to the purchase agreement effective in early November 2020. As a result, Air Canada deferred 18 aircraft deliveries over 2021 and 2022 and will not be purchasing the last 12 Airbus A220 aircraft included in the original order.

At December 31, 2020, 15 Airbus A220 aircraft had been delivered.

As disclosed in section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of this MD&A, in September 2020, Air Canada concluded a committed secured facility totalling \$788 million to finance the purchase of the first 18 Airbus A220 aircraft.



Capital Commitments

As outlined in the table below, the estimated aggregate cost of all aircraft expected to be delivered and other capital purchase commitments at December 31, 2021 approximates \$2,544 million. The table below includes the impact of the capital reduction and deferral program discussed in section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of this MD&A.

| (Canadian dollars in millions) | 2021 | 2022 | 2023 | 2024 | 2025 | THEREAFTER | TOTAL |
|--|-----------------|-----------------|-----------------|---------------|-----------------|----------------------|----------------------|
| Projected committed expenditures | \$ 969 | \$ 961 | \$ 410 | \$ 204 | \$ - | \$ - | \$ 2,544 |
| Projected planned but uncommitted expenditures | 134 | 452 | 394 | 517 | 894 | Not available | Not available |
| Projected planned but uncommitted capitalized maintenance ⁽¹⁾ | 107 | 208 | 283 | 215 | 264 | Not available | Not available |
| Total projected expenditures⁽²⁾ | \$ 1,210 | \$ 1,621 | \$ 1,087 | \$ 936 | \$ 1,158 | Not available | Not available |

(1) Future capitalized maintenance amounts for 2024 and beyond are not yet determinable, however estimates of \$215 million and \$264 million have been made for 2024 and 2025.

(2) U.S. dollar amounts are converted using the December 31, 2020 closing exchange rate of US\$1=C\$1.2725. 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, 2020.

8.7. Pension Funding Obligations

Air Canada maintains several defined benefit pension plans, including domestic registered pension plans, supplemental pension plans and pension plans for foreign employees. Air Canada also has several defined contribution pension plans as well as plans providing other retirement and post-employment benefits to its employees.

On a preliminary basis, at January 1, 2021, the aggregate solvency surplus in Air Canada's domestic registered pension plans was \$3.0 billion. The final valuations will be completed in the first half of 2021. As permitted by applicable legislation and subject to applicable plan rules, amounts in excess of 105% on a solvency basis may be used to reduce current service contributions under the defined benefit component or to fund the employer contribution to a defined contribution component within the same pension plan.

Total employer defined benefit pension funding contributions (including international and supplemental plans) were \$103 million in 2020 and are forecasted to be \$88 million in 2021.

At December 31, 2020, approximately 75% of Air Canada's pension assets were invested in fixed income instruments to mitigate a significant portion of the interest rate (discount rate) risk. Air Canada seeks to maintain a high percentage of long-term fixed income products to hedge pension liabilities.



8.8. Contractual Obligations

The table below provides Air Canada's contractual obligations as at December 31, 2020, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and lease liabilities and committed capital expenditures.

| (Canadian dollars in millions) | 2021 ⁽²⁾ | 2022 | 2023 | 2024 | 2025 | THEREAFTER | TOTAL |
|--|---------------------|-----------------|-----------------|-----------------|-----------------|-----------------|------------------|
| PRINCIPAL | | | | | | | |
| Long-term debt | \$ 1,244 | \$ 665 | \$ 2,275 | \$ 1,254 | \$ 1,622 | \$ 2,785 | \$ 9,845 |
| Lease liabilities | 544 | 471 | 465 | 430 | 410 | 1,276 | 3,596 |
| Total principal obligations | \$ 1,788 | \$ 1,136 | \$ 2,740 | \$ 1,684 | \$ 2,032 | \$ 4,061 | \$ 13,441 |
| INTEREST | | | | | | | |
| Long-term debt | \$ 394 | \$ 353 | \$ 320 | \$ 231 | \$ 174 | \$ 260 | \$ 1,732 |
| Lease liabilities | 178 | 147 | 122 | 97 | 74 | 351 | 969 |
| Total interest | \$ 572 | \$ 500 | \$ 442 | \$ 328 | \$ 248 | \$ 611 | \$ 2,701 |
| Total long-term debt and lease liabilities | \$ 2,360 | \$ 1,636 | \$ 3,182 | \$ 2,012 | \$ 2,280 | \$ 4,672 | \$ 16,142 |
| Committed capital expenditures | \$ 969 | \$ 961 | \$ 410 | \$ 204 | \$ - | \$ - | \$ 2,544 |
| Total contractual obligations⁽¹⁾ | \$ 3,329 | \$ 2,597 | \$ 3,592 | \$ 2,216 | \$ 2,280 | \$ 4,672 | \$ 18,686 |

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

(2) 2021 debt repayments include \$159 million remaining on a bridge loan related to the purchase of Airbus A220 aircraft, as further described in section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of this MD&A. After the delivery of the remaining three Airbus A220 aircraft under this loan, a secured facility is in place that allows Air Canada to defer the debt repayment related to these aircraft over 12 years from the delivery date.

8.9. Share Information

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

| | DECEMBER 31, 2020 | DECEMBER 31, 2019 |
|--|--------------------|--------------------|
| ISSUED AND OUTSTANDING SHARES | | |
| Class A variable voting shares | 111,926,060 | 126,664,740 |
| Class B voting shares | 220,246,228 | 137,151,838 |
| Total issued and outstanding shares | 332,172,288 | 263,816,578 |
| Convertible notes | 48,687,441 | - |
| Stock options | 5,903,174 | 4,890,095 |
| Total shares potentially issuable | 54,590,615 | 4,890,095 |
| Total outstanding and potentially issuable shares | 386,762,903 | 268,706,673 |



Issuer Bid

In response to the COVID-19 pandemic, in early March 2020 Air Canada suspended share purchases under its normal course issuer bid. Air Canada's normal course issuer bid expired in May 2020 and Air Canada did not renew it.

Prior to suspending purchases under its normal course issuer bid, in the first quarter of 2020, Air Canada purchased, for cancellation, a total of 2,910,800 shares at an average cost of \$43.76 per share for aggregate consideration of \$127 million. The excess of the cost over the average book value of \$119 million was charged to Retained earnings.

In 2019, Air Canada purchased, for cancellation, 9,082,487 shares at an average cost of \$41.64 per share for aggregate consideration of \$378 million. The excess of the cost over the average book value of \$351 million was charged to Retained earnings.

Share Offerings

In June 2020, Air Canada completed an underwritten public offering of 35,420,000 shares at a price of \$16.25 per share, for aggregate gross proceeds of \$576 million, which includes the exercise in full by the underwriters of their over-allotment option to purchase up to 4,620,000 shares for gross proceeds of \$75 million. After deduction of the underwriters' fees and expenses of the offering, net proceeds were \$552 million. Air Canada also concluded a concurrent marketed private placement of convertible senior unsecured notes due 2025. Refer to section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of this MD&A for additional information.

In December 2020, Air Canada completed an underwritten public offering of 35,420,000 shares at a price of \$24.00 per share, for aggregate proceeds of \$850 million. After deduction of the underwriters' fees and expenses of the offering, net proceeds were \$815 million. Air Canada granted the underwriters an option to purchase up to an additional 15% of the shares in the offering, exercisable in whole or in part at any time until 30 days after closing of the offering on December 30, 2020. On January 18, 2021, Air Canada announced that the underwriters exercised their over-allotment option to purchase an additional 2,587,000 shares for gross proceeds of \$62 million.

Proposed Acquisition of Transat

As discussed in section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of this MD&A, on October 10, 2020, Air Canada announced amendments to the acquisition transaction with Transat. Assuming closing of the acquisition of Transat and that all Transat shareholders elect to receive Air Canada shares as consideration for their Transat shares (and that no holders of options of Transat exercise their options before the applicable election deadline and elect to receive Air Canada shares for the Transat shares underlying their options), Air Canada would expect to issue an aggregate of up to 10,803,217 shares in connection with the acquisition (based on 37,747,090 outstanding shares of Transat, as reported by Transat). The table above does not reflect the potential issuance of these shares.



9.

Quarterly Financial Data

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

| (Canadian dollars in millions, except where indicated) | 2019 | | | | 2020 | | | |
|---|----------------|----------------|----------------|----------------|-------------------|-------------------|-------------------|-------------------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Operating revenues | \$ 4,434 | \$ 4,738 | \$ 5,529 | \$ 4,429 | \$ 3,722 | \$ 527 | \$ 757 | \$ 827 |
| Operating expenses | 4,307 | 4,316 | 4,573 | 4,284 | 4,155 | 2,082 | 1,542 | 1,830 |
| Operating income (loss) | 127 | 422 | 956 | 145 | (433) | (1,555) | (785) | (1,003) |
| Non-operating income (expense) | 158 | 18 | (78) | 27 | (843) | 74 | (36) | (272) |
| Income (loss) before income taxes | 285 | 440 | 878 | 172 | (1,276) | (1,481) | (821) | (1,275) |
| Income tax recovery (expense) | 60 | (97) | (242) | (20) | 227 | (271) | 136 | 114 |
| Net income (loss) | \$ 345 | \$ 343 | \$ 636 | \$ 152 | \$ (1,049) | \$ (1,752) | \$ (685) | \$ (1,161) |
| Diluted earnings (loss) per share | \$ 1.26 | \$ 1.26 | \$ 2.35 | \$ 0.56 | \$ (4.00) | \$ (6.44) | \$ (2.31) | \$ (3.91) |
| Adjusted pre-tax income (loss)⁽¹⁾ | \$ 24 | \$ 326 | \$ 857 | \$ 66 | \$ (520) | \$ (1,438) | \$ (1,141) | \$ (1,326) |

(1) Adjusted pre-tax income (loss) is a non-GAAP financial measure. A reconciliation of this measure to a comparable GAAP measure can be found in section 19 "Non-GAAP Financial Measures" of this MD&A.

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

| (Canadian dollars in millions) | 2019 | | | | 2020 | | | |
|--|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Capacity purchase fees ⁽¹⁾ | \$ 252 | \$ 247 | \$ 266 | \$ 277 | \$ 253 | \$ 117 | \$ 127 | \$ 139 |
| Airport and navigation | 69 | 74 | 78 | 71 | 63 | 12 | 24 | 28 |
| Sales and distribution costs | 36 | 41 | 43 | 38 | 33 | (1) | 12 | 7 |
| Other | 118 | 113 | 114 | 119 | 122 | 44 | 35 | 71 |
| Total regional airlines expense | \$ 475 | \$ 475 | \$ 501 | \$ 505 | \$ 471 | \$ 172 | \$ 198 | \$ 245 |

(1) Capacity purchase fees exclude the component of fees related to aircraft costs which are accounted for as lease liabilities in accordance with IFRS 16 – Leases.



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

| | 2019 | | | | 2020 | | | |
|--|------|------|------|------|------|------|------|------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| SYSTEM | | | | | | | | |
| PRASM (cents) | 14.6 | 15.5 | 15.8 | 15.0 | 13.6 | 9.2 | 8.5 | 7.9 |
| CASM (cents) | 16.6 | 15.5 | 14.1 | 16.2 | 17.7 | 92.9 | 25.9 | 30.5 |
| Adjusted CASM (cents) ⁽¹⁾ | 11.6 | 11.1 | 10.1 | 11.9 | 13.1 | 76.9 | 26.1 | 29.8 |
| Fuel cost per litre (cents) ⁽²⁾ | 75.5 | 79.2 | 74.7 | 75.0 | 69.2 | 51.8 | 52.5 | 50.4 |

(1) Adjusted CASM is a non-GAAP financial measure. A reconciliation of this measure to a comparable GAAP measure can be found in section 19 "Non-GAAP Financial Measures" of this MD&A.

(2) Includes aircraft fuel expense related to regional airline operations and fuel handling expenses.

The table below provides Air Canada's revenue passenger miles (RPMs), available seat miles (ASMs) and passenger load factors, on a system basis and by market, for the last eight quarters.

| | 2019 | | | | 2020 | | | |
|---------------------------|--------|--------|--------|--------|--------|-------|-------|-------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| SYSTEM | | | | | | | | |
| RPMs (millions) | 21,293 | 23,463 | 27,954 | 21,403 | 17,507 | 783 | 2,517 | 2,432 |
| ASMs (millions) | 26,016 | 27,910 | 32,457 | 26,431 | 23,511 | 2,243 | 5,949 | 6,000 |
| Passenger load factor (%) | 81.8 | 84.1 | 86.1 | 81.0 | 74.5 | 34.9 | 42.3 | 40.5 |
| DOMESTIC | | | | | | | | |
| RPMs (millions) | 4,251 | 5,097 | 6,298 | 4,682 | 3,604 | 376 | 1,413 | 1,043 |
| ASMs (millions) | 5,274 | 6,068 | 7,474 | 5,861 | 4,930 | 876 | 2,504 | 2,198 |
| Passenger load factor (%) | 80.6 | 84.0 | 84.3 | 79.9 | 73.1 | 43.0 | 56.4 | 47.4 |
| U.S. TRANSBORDER | | | | | | | | |
| RPMs (millions) | 4,296 | 3,845 | 4,010 | 3,695 | 3,322 | 25 | 97 | 186 |
| ASMs (millions) | 5,341 | 4,686 | 4,764 | 4,700 | 4,741 | 106 | 250 | 404 |
| Passenger load factor (%) | 80.4 | 82.0 | 84.2 | 78.6 | 70.1 | 23.8 | 38.6 | 46.0 |
| ATLANTIC | | | | | | | | |
| RPMs (millions) | 4,943 | 7,496 | 10,580 | 6,265 | 4,369 | 214 | 694 | 707 |
| ASMs (millions) | 6,177 | 8,882 | 12,068 | 7,710 | 5,964 | 888 | 2,306 | 2,053 |
| Passenger load factor (%) | 80.0 | 84.4 | 87.7 | 81.3 | 73.3 | 24.1 | 30.1 | 34.4 |
| PACIFIC | | | | | | | | |
| RPMs (millions) | 4,486 | 5,072 | 5,364 | 4,504 | 3,026 | 113 | 182 | 185 |
| ASMs (millions) | 5,367 | 5,971 | 6,217 | 5,456 | 3,957 | 290 | 658 | 778 |
| Passenger load factor (%) | 83.6 | 84.9 | 86.3 | 82.6 | 76.5 | 38.9 | 27.7 | 23.8 |
| OTHER | | | | | | | | |
| RPMs (millions) | 3,317 | 1,953 | 1,702 | 2,257 | 3,186 | 55 | 131 | 311 |
| ASMs (millions) | 3,857 | 2,303 | 1,934 | 2,704 | 3,919 | 83 | 231 | 567 |
| Passenger load factor (%) | 86.0 | 84.8 | 88.0 | 83.5 | 81.3 | 66.3 | 56.8 | 54.9 |



10.

Selected Annual Information

The following table provides selected annual information for Air Canada for the years 2018 through 2020.

| (Canadian dollars in millions, except per share figures) | Full Year | | |
|--|-------------------|---------------------|----------------|
| | 2020 | 2019 ⁽¹⁾ | 2018 |
| Operating revenues | \$ 5,833 | \$ 19,131 | \$ 18,003 |
| Operating expenses | 9,609 | 17,481 | 16,507 |
| Operating income (loss) | (3,776) | 1,650 | 1,496 |
| Income (loss) before income taxes | (4,853) | 1,775 | 228 |
| Income tax recovery (expense) | 206 | (299) | (191) |
| Net income (loss) | \$ (4,647) | \$ 1,476 | \$ 37 |
| Basic earnings (loss) per share | \$ (16.47) | \$ 5.51 | \$ 0.14 |
| Diluted earnings (loss) per share | \$ (16.47) | \$ 5.44 | \$ 0.13 |
| Cash, cash equivalents and short-term investments | \$ 7,501 | \$ 5,889 | \$ 4,707 |
| Total assets | \$ 28,913 | \$ 27,759 | \$ 21,883 |
| Total long-term liabilities | \$ 20,059 | \$ 15,584 | \$ 12,930 |
| Total liabilities | \$ 27,198 | \$ 23,359 | \$ 18,606 |

(1) Air Canada began consolidating Aeroplan's financial results on the January 10, 2019, the date of its acquisition of Aeroplan.



11.

Financial Instruments and Risk Management

Summary of Gain (Loss) on Financial Instruments Recorded at Fair Value

The following is a summary of gains (losses) on financial instruments recorded at fair value included in non-operating income (expense) on Air Canada's consolidated statement of operations for the periods indicated.

| (Canadian dollars in millions) | Fourth Quarter | | Full Year | |
|--|-----------------|-------------|-----------------|--------------|
| | 2020 | 2019 | 2020 | 2019 |
| Share forward contracts | \$ 6 | \$ 5 | \$ (28) | \$ 23 |
| Embedded derivative on convertible notes | (220) | - | (214) | - |
| Gain (loss) on financial instruments recorded at fair value | \$ (214) | \$ 5 | \$ (242) | \$ 23 |

Risk Management

Under its risk management policy, Air Canada manages its market risk using various financial derivative instruments. Air Canada uses these instruments solely for risk management purposes, not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be an economic hedge and offset by changes in cash flows of the relevant risk being hedged.

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

Fuel Price Risk Management

Fuel price risk is the risk that future cash flows will fluctuate because of changes in jet fuel prices. To manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, Air Canada can elect to enter into derivative contracts with financial intermediaries. Air Canada may use derivative contracts based on jet fuel, heating oil and crude oil. Air Canada's policy permits hedging of up to 75% of the projected jet fuel purchases for the current calendar year, 50% of the projected jet fuel purchases for the next calendar year, and 25% of projected jet fuel purchases for any calendar year thereafter. These are maximum (but not mandated) limits. There is no minimum monthly hedging requirement. Air Canada performs regular reviews to assess market conditions and adjust its hedging strategy where management considers it warranted.

There was no fuel hedging activity during 2020 and there were no outstanding fuel derivatives as at December 31, 2020 and December 31, 2019.

Foreign Exchange Risk

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

Air Canada generates certain sales in U.S. dollars and in other foreign currencies which are converted to U.S. dollars under Air Canada's risk management program. In 2020, these net operating cash inflows totalled approximately US\$1.0 billion and U.S.-denominated operating costs amounted to approximately US\$3.0 billion. Non-operating cash outflows in U.S. dollars, primarily related to interest payments on U.S. dollar denominated debt and net financing outflows, amounted to approximately US\$1.5 billion. For 2020, this resulted in a U.S. dollar net cash flow exposure of approximately US\$3.5 billion.



Air Canada has a target coverage of 70% on a rolling 24-month basis to manage the net U.S. dollar cash flow exposure described above utilizing the following risk management strategies:

- Holding U.S. dollar cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash, short- and long-term investment balances as at December 31, 2020 amounted to \$1,747 million (US\$1,371 million) (\$1,123 million (US\$862 million) as at December 31, 2019). A portion of the cash and investment reserves are an economic hedge against long-term U.S. dollar debt while the remainder of the cash is operational cash and investment reserves which are applied against the rolling 24-month net U.S. dollar cash flow exposure. In 2020, a loss of \$69 million (loss of \$36 million in 2019) was recorded in Foreign exchange gain (loss) reflecting the change in Canadian equivalent market value of the U.S. dollar cash and short-term investment balances held.
- Locking in the foreign exchange rate through the use of a variety of foreign exchange derivatives which have maturity dates corresponding to the forecasted dates of U.S. dollar net outflows.

The level of foreign exchange derivatives entered into and their related maturity dates are dependent upon a number of factors, which include the amount of foreign revenue conversion available, U.S. dollar net cash outflows, as well as the amount attributed to aircraft and debt payments. Based on the notional amount of currency derivatives outstanding at December 31, 2020, as further described below, approximately 90% of net U.S. cash outflows are hedged for 2021 and 21% for 2022, resulting in derivative coverage of 63% over the next 24 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 68% coverage.

As at December 31, 2020, Air Canada had outstanding foreign currency options and swap agreements, settling in 2021 and 2022, to purchase at maturity \$5,730 million (US\$4,499 million) of U.S. dollars at a weighted average rate of \$1.3586 per US\$1.00 (2019 – \$6,599 million (US\$5,080 million) with settlements in 2020 and 2021 at a weighted average rate of \$1.2775 per \$1.00 U.S. dollar). Air Canada also has protection in place to sell a portion of its excess Euros, Sterling, YEN, YUAN, and AUD (EUR €464 million, GBP £64 million, JPY ¥4,963 million, CNH ¥415 million and AUD \$88 million) which settle in 2021 and 2022 at weighted average rates of €1.1414, £1.3277, ¥0.0094, ¥0.1463, and AUD \$0.6942 per \$1.00 U.S. dollar, respectively (as at December 31, 2019 – EUR €335 million, GBP £202 million, JPY ¥46,655 million, CNH ¥286 million and AUD \$209 million with settlements in 2020 and 2021 at weighted average rates of €1.1577, £1.3238, ¥0.0096, ¥0.1469, and AUD \$0.7092 respectively per \$1.00 U.S. dollar).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations, and based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at December 31, 2020 was \$591 million in favour of the counterparties (2019 – \$114 million in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2020, a loss of \$583 million was recorded in Foreign exchange gain (loss) related to these derivatives (2019 – \$92 million gain). In 2020, foreign exchange derivative contracts cash settled with a net fair value of \$106 million in favour of the counterparties (2019 – \$173 million in favour of Air Canada).

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.

Air Canada 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. 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 flexibility to adjust to prevailing market conditions. The ratio at December 31, 2020 is 74% fixed and 26% floating (83% and 17%, respectively as at December 31, 2019).



12.

Accounting Policies

Interbank Offered Rate (“IBOR”) Reform

In August 2020, the IASB published amendments to IFRS 9 Financial Instruments, IAS 39 Financial Instruments: Recognition and Measurement, IFRS 7 Financial Instruments: Disclosures, IFRS 4 Insurance Contracts and IFRS 16 Leases.

The amendments address issues that arise from implementation of IBOR reform, where IBORs are replaced with alternative benchmark rates. For financial instruments at amortized cost, the amendments introduce a practical expedient such that if a change in the contractual cash flows is as a result of IBOR reform and occurs on an economically equivalent basis, the change will be accounted for by updating the effective interest rate with no immediate gain or loss recognized. The amendments also provide additional temporary relief from applying specific IAS 39 hedge accounting requirements to hedging relationships affected by IBOR reform.

The amendments are effective for fiscal years beginning on or after January 1, 2021 with early adoption permitted. Air Canada will adopt the amendment on January 1, 2021, electing to apply the practical expedient. Air Canada is in the process of evaluating potential changes to debt and lease contracts to transition from IBORs to alternative rates prior to the cessation of IBORs. As at December 31, 2020, the amount of debt and lease contracts likely subject to IBOR reform is US\$1,718 million LIBOR. There are also debt and aircraft leases referencing interest rate benchmarks in multi-rate jurisdictions, including the Canadian Dollar Offered Rate (“CDOR”) of \$1,007 million and \$5 million of JPY LIBOR.

13.

Critical Accounting Estimates and Judgments

Critical accounting estimates are those estimates of management 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 and judgments about the effect of matters that are inherently uncertain. Actual results could differ from those estimates and judgments under different assumptions or conditions.

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

Impairment Considerations on Long-lived Assets

When required, an impairment test is performed by comparing the carrying amount of the asset or cash-generating unit to their recoverable amount, which is calculated as the higher of an asset’s or cash-generating unit’s fair value less costs to dispose and its value in use. Fair value less costs to dispose may be calculated based upon a discounted cash flow analysis, which requires management to make a number of significant market participant assumptions including assumptions relating to cash flow projections, discount rates and future growth rates.

Income Taxes

Commencing in the second quarter of 2020, the net deferred income tax assets related to unused tax losses and other deductible temporary differences were not recognized. Management assessed the available positive and negative evidence to estimate whether sufficient future taxable income will be generated to permit use of the existing deferred tax assets. As a result of the COVID-19 pandemic, there is considerable negative evidence relating to losses incurred in the current year and uncertainty exists as to when conditions will improve. Such negative evidence currently outweighs the positive historical evidence and accordingly, the net deferred tax asset was not recognized. Deferred tax assets have only been recognized to the extent of taxable temporary differences expected to reverse and generate taxable income against which the deferred tax assets can be utilized. The future income tax deductions underlying the unrecognized deferred income tax assets remain available for use in the future to reduce taxable income.



Aeroplan Loyalty Program

Loyalty program accounting requires management to make several estimates including the ETV of Aeroplan points issued and the breakage on Aeroplan points. The ETV of Aeroplan points issued is determined based on the value a passenger receives by redeeming Aeroplan points for a ticket rather than paying cash. This ETV is estimated with reference to historical Aeroplan redemptions as compared to equivalent ticket purchases after considering similar fare conditions, advance booking periods and other relevant factors including the selling price of Aeroplan points to third parties. ETV estimates and assumptions are considered for updates at least annually. A change in the ETV rate is accounted for prospectively on future Aeroplan points issued.

Breakage represents the estimated Aeroplan points that are not expected to be redeemed. Breakage is estimated by management based on the terms and conditions of membership and historical accumulation and redemption patterns, as adjusted for changes to any terms and conditions or other circumstances that may affect future redemptions. Management uses statistical and simulation models to estimate breakage.

A change in assumptions as to the number of Aeroplan points expected to be redeemed could have a material impact on revenue in the year in which the change occurs.

As at December 31, 2020, the Aeroplan points deferred revenue balance was \$3,256 million. For illustrative purposes, a hypothetical 1% change in the number of outstanding Aeroplan points estimated to be redeemed would result in an approximate impact of \$33 million on revenue with a corresponding adjustment to Aeroplan deferred revenue.

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 value of the assets based on the estimated current and future fair values 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 \$14 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 consider 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 at the end of the lease and the amount of the provision is recorded in aircraft 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 recognized as an adjustment to the right-of-use asset.

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 compensation increases, and mortality assumptions. 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.

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 and employment agreements and economic forecasts.

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

| | Pension Benefits | | Other Employee Future Benefits | |
|---|------------------|-------|--------------------------------|----------------|
| | 2020 | 2019 | 2020 | 2019 |
| Discount rate used to determine: | | | | |
| Net interest on the net benefit obligation for the year ended December 31 | 3.13% | 3.81% | 3.13% | 3.81% |
| Service cost for the year ended December 31 | 3.20% | 3.93% | 3.20% | 3.93% |
| Accrued benefit obligation as at December 31 | 2.59% | 3.13% | 2.59% | 3.13% |
| 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 |

Sensitivity Analysis

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

Sensitivity analysis on 2020 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.

| (Canadian dollars in millions) | 0.25 Percentage Point | |
|---|-----------------------|-----------------|
| | DECREASE | INCREASE |
| Discount rate on obligation assumption | | |
| Pension expense | \$ 21 | \$ (20) |
| Net financing expense relating to pension benefit liabilities | - | 5 |
| Total | \$ 21 | \$ (15) |
| Increase (decrease) in pension obligation | \$ 851 | \$ (822) |

The increase (decrease) in the pension obligation for a 0.25 percentage point change in the discount rate relates to the gross amount of the pension liabilities and is before the impact of any change in plan assets. As at December 31, 2020, approximately 75% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk.

An increase of one-year life expectancy would increase the pension benefit obligation by \$558 million.

Assumed health care cost trend rates impact the amounts reported for the health care plans. A 5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2020 (2019 – 5.25%). The rate is assumed to decrease gradually to 4.5% by 2023 (2019 – assumed to decrease gradually to 5% by 2020). A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by \$6 million and the obligation by \$81 million. A one percentage point decrease in assumed health care trend rates would have decreased the total of current service and interest costs by \$5 million and the obligation by \$80 million.

A 0.25 percentage point decrease in discount rate for other employee future benefits would have increased the total of current and interest costs by less than \$1 million and the obligation by \$65 million. A 0.25 percentage point increase in discount rate would have decreased the total of current and interest costs by less than \$1 million and the obligation by \$61 million.



14.

Off-Balance Sheet Arrangements

Guarantees

Guarantees in Fuel and De-icing Arrangements

Air Canada participates in fuel facility arrangements operated through nine Fuel Facility Corporations, and three aircraft de-icing service facilities, along with other airlines that contract for fuel and de-icing services at various major airports in Canada. These entities operate on a cost recovery basis. The aggregate debt of these entities that has not been consolidated by Air Canada under IFRS 10 Consolidated Financial Statements is approximately \$1,047 million as at December 31, 2020 (December 31, 2019 - \$643 million), which is Air Canada's maximum exposure to loss before taking into consideration the value of the assets that secure the obligations and any cost sharing that would occur amongst the other contracting airlines. Air Canada views this loss potential as remote. Each contracting airline participating in these entities shares pro rata, based on system usage, in the guarantee of this debt. The maturities of these debt arrangements vary but generally extend beyond five years.

Indemnification Agreements

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

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

15.

Related Party Transactions

At December 31, 2020, 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.



16.

Enterprise Risk Management and Governance

Overview

The management of opportunities and risks is an integral part of Air Canada's business processes. Strategic decisions are made by the executive team with consideration of risk implications to the business and its stakeholders. Risks which may be material to Air Canada are identified and monitored on an ongoing basis through Air Canada's Enterprise Risk Management (ERM) program which provides insight on a regular basis to the Board of Directors through the Board's Audit, Finance and Risk Committee.

Implications of COVID-19

While confronting the challenges that the COVID-19 pandemic has had and its major impact on Air Canada's business in 2020, Air Canada has remained vigilant to continue to maintain the integrity and resiliency of its key governance, oversight and risk management processes as outlined below. Processes have been adjusted as necessary to reflect changes to Air Canada's business and working environments; ensuring important risks continue to be managed appropriately.

Board Oversight

Risk management is an integral part of Air Canada's corporate governance. The Board of Directors has established board committees (Audit, Finance and Risk Committee; Safety, Health, Environment and Security Committee; Governance and Nominating Committee; and Human Resources and Compensation Committee) to assist in the oversight responsibilities.

Risk information is reviewed by the Board or the relevant board committee on a quarterly basis. In addition, board committees review and discuss with management, on a regular basis, all key enterprise risk exposures based on their respective terms of reference set out in committee charters and the steps taken that seek to monitor/control and mitigate those exposures to satisfy themselves as to the effective risk management of the individual risks. These processes seek to appropriately mitigate rather than eliminate risk.

The Audit, Finance and Risk Committee is responsible for the oversight of the ERM program and the work carried out by the Corporate Audit and Advisory department, as stated in its committee charter.

ERM risk reporting is maintained by the Corporate Audit and Advisory department, which provides an independent update as to the state of each enterprise risk on a quarterly basis.

Risk Management Framework and Structure

Air Canada's enterprise risk management framework has been developed to support governance and oversight over the Corporation's most important strategic risks and is aligned to the ISO 31000 standard and COSO ERM 2017 framework.

Formal policies and management committees are in place to manage specific risks such as safety, security, fraud, information security, privacy, environment and fuel price.

Sound business practices and ethical behaviour are also fundamental to Air Canada's risk governance culture. Air Canada has in place (and updates, as required) a Corporate Policy and Guidelines on Business Conduct ("Code of Conduct"), which sets out guiding principles and ethical standards that apply to all Air Canada's corporate activities. A confidential, anonymous reporting process and ethics committee are also in place to oversee adherence to the Code of Conduct.



Air Canada’s risk management structure is aligned with the “Three Lines of Defence” approach to risk management:

- 1st line - Business functions are expected to integrate risk management when performing their day-to-day core commercial and operational activities.
- 2nd line - Support functions establish policies, provide guidance and expertise, and risk oversight (e.g., Safety, Security, Legal and Compliance, Finance/Treasury/Tax, Sourcing and Procurement, Government Affairs, People, Environment, IT Operations and IT Security).
- 3rd line - Corporate Audit and Advisory department provides an independent and objective perspective on Air Canada’s governance, risk management practices and controls.

Air Canada’s ERM and governance structure is as follows:



Although the risk management framework described in this section is aligned with industry best practices, there can be no assurance that it will be sufficient to prevent the occurrence of events that could have a material adverse effect on our financial position, financial performance, cash flows, business or reputation.



17.

Risk Factors

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

COVID-19 – The effects of the COVID-19 pandemic have materially affected Air Canada and could have a further material adverse impact on Air Canada's financial position and results of operations

Air Canada, along with the rest of the global airline industry, continues to face a severe drop in traffic and a corresponding decline in revenue and cash flows as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world, and particularly in Canada. The impact of the COVID-19 pandemic began to be felt in traffic and sales figures commencing in early March 2020. These impacts include drastic declines in earnings and cash flow from operations. Travel demand has been drastically suppressed, and there is very limited visibility on when travel demand might recover. Given changing government restrictions and advisories in place in Canada and around the world and the severity of restrictions in Canada as well as concerns about travel due to the COVID-19 pandemic and passenger concerns and expectations about the need for certain precautions, such as physical distancing, demand remains severely inhibited. The COVID-19 pandemic is also having significant economic impacts, including on business and consumer spending, which may in turn significantly impact demand for travel. Air Canada cannot predict the full impact or the timing for when conditions may improve. Air Canada is actively monitoring the situation and will continue to respond as the impact of the COVID-19 pandemic evolves, which will depend on a number of factors including the course of the virus (including any variants), availability and effectiveness of rapid testing, screening, vaccinations and treatments for the virus, government actions, travel restrictions and advisories, and passenger reaction, as well as timing of a recovery in international and business travel which are important segments of Air Canada's markets, none of which can be predicted with any degree of certainty.

Air Canada has taken and implemented a number of safety measures in light of the COVID-19 pandemic, including the Air Canada CleanCare+ program and has publicly appealed to governments and other parties in an effort to recognize the efficacy of such safety measures and to allow for a measured and

responsible reduction of travel restrictions. Air Canada continues to be adversely impacted to the extent that travel restrictions and advisories remain in place over time. Air Canada as well as its brand and reputation may also be adversely impacted to the extent that safety measures introduced are not perceived to adequately address the risks of transmission of COVID-19 or justify relaxing the travel restrictions and advisories issued by governments or by perceptions that any efforts Air Canada makes to mitigate the risk of transmission of COVID-19 during the course of a journey or otherwise to support or promote travel are designed to induce travel and are inconsistent with public health interests.

Air Canada's operations could also be adversely impacted further if its employees (or third-party employees such as those of airports or suppliers) are unable or restricted in their ability to work, including by reasons of being quarantined or becoming ill as a result of exposure to COVID-19, or if they are subject to government or other restrictions.

Air Canada is providing customers who booked with Air Canada and who are affected by COVID-19 related cancellations with the option to convert their ticket to an Air Canada travel voucher that has no expiry date and is fully transferable. Alternatively, customers may convert the unused value of their ticket into Aeroplan points and receive additional bonus Aeroplan points. Air Canada is refunding refundable fares according to the terms and conditions that govern them. Air Canada may be required to refund non-refundable fares depending on the laws of the jurisdictions applicable to such flights. Not refunding non-refundable tickets exposes Air Canada to litigation, as well as enforcement action by regulators in certain jurisdictions, and may also adversely impact Air Canada's brand and reputation. Class actions claiming the refund of non-refundable tickets or tour packages have been filed against Air Canada, and other carriers, in Canada and in the United States, and additional class actions or other proceedings may be instituted in these or other jurisdictions. In countries where refund requirements are or will be enhanced, maintained or enforced, ensuing refunds may adversely impact Air Canada's liquidity and the impact of all these risks could be material.

COVID-19 has also materially disrupted Air Canada's strategic operating plans in the near-term, and there are risks to it and Air Canada's business, operating results and financial condition associated with executing Air Canada's strategic operating plans in the long-term. In recent years, Air Canada developed several strategic operating plans, including several revenue-generating initiatives and plans to optimize Air Canada's revenue, such as plans to add capacity, including international expansion, initiatives and plans to optimize and control Air Canada's costs and opportunities to enhance segmentation and improve the customer experience at all points in air travel. In developing strategic operating plans, Air Canada makes certain assumptions, including, but not limited to, those related to customer demand, competition, market consolidation, the availability of aircraft and the global economy. Actual economic, market and other conditions have been and may continue to be different from Air Canada's assumptions. In 2020,



demand was, and is expected to continue to be in 2021, significantly impacted by COVID-19, which has materially disrupted the timely execution of Air Canada's strategic operating plans, including plans to add capacity in 2020. If Air Canada does not successfully develop, execute or adjust Air Canada's strategic operating plans in the long-term, or if actual conditions and results continue to vary significantly from the assumptions on which they are based, Air Canada's business, operating results and financial condition could be materially and adversely impacted.

These risks have materially affected Air Canada and could have a further material adverse impact on Air Canada's financial position and results of operations. The COVID-19 pandemic may also exacerbate or increase the likelihood of the occurrence of other risk factors described in this MD&A, including in relation to operating results, financial leverage, economic and geopolitical conditions, fares and market demand and strategic, business, technology and other important initiatives. In addition, the impact of the COVID-19 pandemic on Air Canada's financial condition may reduce Air Canada's ability to adequately respond to these and other risks that may arise.

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

Air Canada's operating results, like those of other airlines, are sensitive to and may be significantly impacted by economic and geopolitical conditions, which may impact demand for air transportation in general or to or from certain destinations, operating costs, operating revenues, costs and availability of fuel, foreign exchange costs, tax costs and costs and availability of capital and supplies. Any prolonged or significant impact arising from economic and geopolitical conditions, including the COVID-19 pandemic, weakness of the Canadian, U.S. or world economies, changes to political, economic, fiscal or trade relationships within or between jurisdictions where Air Canada operates flights or does business, or threatened or actual outbreaks of hostilities in or adjacent to regions Air Canada serves or over which it operates flights or does business could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

A variety of factors, including economic conditions and other factors described in this MD&A, may result in Air Canada incurring significant losses. The airline industry has historically been characterized by low profit margins and high fixed costs and the costs of operating a flight do not vary significantly with the number of passengers carried. Therefore, a relatively small change in the number of passengers, fare pricing or traffic mix, or increased costs, could have a significant impact on Air Canada's operating and financial results. Due to the competitive nature of the airline industry and customer sensitivity to travel costs, Air Canada may not be able to pass on cost increases to its customers. Despite a focus on improving resiliency to downturns in its business as well as

ongoing and planned strategic and business initiatives, Air Canada may not be able to successfully achieve and/or sustain positive net profitability or realize all of its objectives, including those which seek to increase revenues, decrease costs, improve margins, profitably deploy additional capacity, generate sufficient returns on its capital expenditures or offset or mitigate risks facing Air Canada, including those described in this MD&A.

Fares and market demand – Fluctuations in fares and demand for air travel and could materially adversely impact Air Canada, its business, results of operations and financial condition

Air Canada fares and passenger demand, like those of other airlines, have fluctuated significantly in the past and may fluctuate significantly in the future, including due to the impact of the COVID-19 pandemic. Air Canada is not able to predict with certainty market conditions and the fares that Air Canada may be able to charge. Customer expectations and perception can change rapidly due to many factors, and the demand for lower fares or alternative modes of transportation may impact revenues. Travel, especially leisure travel, is a discretionary consumer expense. Demand for business and premium travel is also impacted by economic conditions. Depressed economic conditions, geopolitical instability, security, health and concerns about the environmental impacts of air travel and tendencies towards less environmentally impactful travel where customers may reduce or alter their travel activities, could each have the effect of reducing demand for air travel and could materially adversely impact Air Canada, its business, results of operations and financial condition.

Financial Leverage – Air Canada has a significant amount of financial leverage, and there can be no assurance that it will be able to satisfy its debt, lease and other obligations

Air Canada has a significant amount of financial leverage from fixed obligations, including substantial obligations under aircraft leases, aircraft purchases and other financings, and as a result of any challenging economic or other conditions affecting Air Canada, Air Canada may incur greater levels of indebtedness than currently exist or are planned.

Although prior to the COVID-19 pandemic Air Canada had been focusing on reducing its level of indebtedness and improving its leverage ratios, the amount of indebtedness that Air Canada has and which it may incur in the future could have a material adverse effect on Air Canada. 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. Air Canada incurs a significant proportion of its indebtedness in foreign currencies, primarily in U.S. dollars, and as a result, future debt servicing repayments are subject to foreign exchange risk. There can be no assurance that Air Canada will at all times be able to generate sufficient cash from its operations to satisfy its debts, lease and other 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 capital and liquidity – Air Canada may not be able to obtain sufficient funds in a timely way and on acceptable terms to provide adequate liquidity and to finance necessary operating and capital expenditures

Air Canada's liquidity levels may be adversely impacted by risks identified in this MD&A, including the effects of the COVID-19 pandemic, geopolitical, economic and public health conditions, foreign exchange rates, increased competition, volatile fuel prices, labour issues, and contractual covenants (which require Air Canada to maintain minimum cash reserves and which could require Air Canada to deposit cash collateral with third parties). As part of Air Canada's efforts to manage such challenges and to support Air Canada's business strategy, significant liquidity and significant ongoing operating and capital expenditures are required.

In addition, in response to the travel restrictions, decreased demand and other effects the COVID-19 pandemic has had and is expected to have on Air Canada's business, Air Canada has sought and may seek material amounts of additional financial liquidity, which may include the issuance of additional unsecured or secured debt securities, equity securities and equity-linked securities, the sale of assets as well as additional secured and/or unsecured credit facilities, among other items. There can be no assurance as to the timing of any such issuance, or that any such additional financing will be completed on favourable terms, or at all.

Air Canada's substantial level of indebtedness, particularly following the additional liquidity transactions completed and contemplated in response to the impacts of the COVID-19 pandemic, as well as market conditions and the availability of assets as collateral for loans or other indebtedness, which may be reduced as Air Canada continues to seek material amounts of additional financial liquidity, together with the effect the COVID-19 pandemic has had on the global economy generally and the air transportation industry specifically, may make it difficult for Air Canada to raise additional capital if needed to meet its liquidity needs on acceptable terms, or at all.

Although Air Canada's current liquidity levels exceed the minimum cash it requires to support ongoing business operations, there can be no assurance that Air Canada will continue to maintain sufficient liquidity, whether from operations or by obtaining funds on terms acceptable to Air Canada, to finance the operating and capital expenditures necessary to manage any challenges and support its business strategy.

A major decline in the market price of Air Canada's securities, including a major decline in capital markets in general, a downgrade in Air Canada's credit ratings, differences between Air Canada's actual or anticipated financial results and the published expectations of financial analysts, as well as events affecting our business or operating environment, may negatively impact Air Canada's ability to raise capital, issue debt, borrow on acceptable terms, attract and/or retain key employees, make strategic acquisitions, enter into business arrangements or operate its business, and such factors may contribute to volatility in Air Canada's securities.

Competition – Air Canada operates in a highly competitive environment, faces increasing competition in North America and internationally and competes against carriers that receive significant government aid

Air Canada operates within a highly competitive industry and continuously encounters substantial price competition. Carriers, including low-cost, ultra-low-cost, domestic, U.S. and other foreign carriers, have entered, announced their intention to enter or continue to enter or expand into markets Air Canada operates in or plans to operate in, including domestic, U.S. transborder, international and leisure-oriented markets.

Certain carriers against which Air Canada competes have received airline sector-specific government aid in relation to the COVID-19 pandemic which may strengthen their ability to compete, including against Canadian airlines who have not received such government support. Carriers against which Air Canada competes, including U.S. and Canadian carriers, may also undergo (and some have undergone) substantial reorganizations (including by way of merger with or acquisition by another carrier or entity), creating greater access to capital, reduced levels of indebtedness, lower operating costs and other competitive advantages, and may therefore be able to more effectively compete against Air Canada. Consolidation within the airline industry and carriers increasingly entering into integrated commercial cooperation arrangements may also strengthen the ability of carriers to compete.

The prevalence of Internet travel websites and other travel product distribution channels has also resulted in a substantial increase in new routings and discounted and promotional fares initiated by Air Canada's competitors. Competitors also continue to pursue commissions/incentive actions and, in many cases, increase these payments. Air Canada's ability to reduce its fares in order to effectively compete is dependent on Air Canada's ability to achieve acceptable operating margins and may be limited by applicable laws or government policies to encourage competition.

Increased competition, from existing, emerging or new competitors, including competitors entering into new or expanded joint ventures and other arrangements, or utilizing disruptive business models or technologies, and other competitive actions, or benefiting from foreign subsidies, government aid or other advantages not available to Air Canada, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Government Financial Assistance – There can be no assurance that government financial assistance will be made available to Air Canada

Unlike in many other countries, including the United States and many European countries, the Canadian government has not provided any financial assistance or other relief specifically for Canadian airlines in response to the COVID-19 pandemic. In the second quarter of 2020, the Canadian government announced a program entitled the "Large Employer Emergency Financing Facility" ("LEEFF"), addressed to "large Canadian employers". Due to its terms, as of the date hereof, Air Canada has not applied and does not intend to seek financial assistance under the LEEFF but may seek



financial assistance under other programs discussed below or which may be available in future.

In the fourth quarter of 2020, the Canadian government announced it is “developing a package of assistance to Canadian airlines, airports and the aerospace sector” and indicated that any assistance provided as part of such package would (i) include conditions to protect Canadians and the public interest, (ii) require airlines to provide ticket refunds for flights postponed or cancelled in relation to the COVID-19 pandemic, and (iii) ensure Canadians and regional communities retain air connections within Canada.

The application of the above conditions, as well as the specific terms and conditions, pursuant to which Air Canada could receive any government financial assistance or any other government aid initiative, are not clear. Any such financial assistance and, in turn, the conditions imposed in connection with operations and in connection with receipt of financial assistance, may significantly limit Air Canada’s corporate activities, and its terms could adversely impact its business and operations. Financing under any government aid program or otherwise could require Air Canada to (i) issue ticket refunds for flights postponed or cancelled in relation to the COVID-19 pandemic; (ii) offer and/or maintain service to regional communities within Canada; (iii) seek amendments or waivers under agreements governing Air Canada’s existing or future indebtedness; (iv) issue warrants to purchase equity securities (or provide cash consideration equivalent to the value of the warrants); (v) restrict or otherwise limit Air Canada’s ability to declare dividends; or (vi) be subject to other limitations, covenants or restrictions on its business and operations. As a result of the foregoing, there can be no assurance that any government financial assistance will be made available to Air Canada on terms that provide a net benefit to Air Canada, are acceptable to it, or at all.

As indicated under 4 “Strategy and COVID-19 Mitigation and Recovery Plan”, as part of its ongoing efforts to increase liquidity levels, Air Canada continues to pursue additional financing arrangements. Such financings may include secured or unsecured credit agreements or debt securities, as well as the issuance of additional Shares or equity-linked instruments. If Air Canada determines to pursue government funding under a government financial assistance program but is unable to secure it, or if such program or other assistance is not made available to Air Canada on terms acceptable to it, the amount of financing that Air Canada would be required to seek from other third parties would be increased accordingly. However, no assurance can be made that any such replacement financing will be available on acceptable terms or at all. See 4 “Strategy and COVID-19 Mitigation and Recovery Plan” for additional information.

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

Fuel costs constitute one of Air Canada’s largest operating cost items. Fuel prices have and may continue to fluctuate widely depending on many factors, including international market conditions, geopolitical events, jet fuel refining costs, carbon pricing, as further described below, and the Canada/U.S. dollar exchange rate. Air Canada cannot accurately predict the future

price of fuel, and it may not be able to sufficiently, or may not, hedge the risk associated with fluctuations in fuel prices. Due to the competitive nature of the airline industry, Air Canada may not be able to pass on increases in fuel prices to its customers by increasing its fares. Furthermore, the impact of lower jet fuel prices could trigger increased competition, resulting in a decrease in revenues for all carriers. Significant fluctuations (including increases) in fuel prices could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

Air Canada relies heavily on technology to operate its business, including to increase its revenues and reduce its costs. These systems include those relating to Air Canada’s websites, passenger services, reservations, airport customer services, flight operations, communications and loyalty program. Air Canada’s websites and other technology systems must efficiently accommodate a high volume of traffic and securely, and accurately deliver information and process information critical to Air Canada’s business and operations. Air Canada also depends on the performance of its many suppliers, whose performance is in turn dependent upon their respective technologies.

As part of regular business operations, Air Canada collects, processes and stores sensitive data, including personal information of our passengers, Aeroplan Members, employees and information of our business partners. The secure operation of the networks and systems on which this type of information is stored, processed and maintained is critical to Air Canada’s business.

Technology systems may be vulnerable to a variety of sources of failure, interruption or misuse, including by reason of human error, third party suppliers’ acts or omissions, natural disasters, terrorist attacks, telecommunications failures, power failures, unauthorized or fraudulent users (including cyber-attacks, malware, ransomware, computer viruses and the like), and other operational and security issues.

Technology Systems are at risk of cybersecurity incidents and it is generally viewed that cyber-attacks have increased and will continue to increase in both prevalence and sophistication. Air Canada invests in initiatives, including security initiatives and disaster recovery plans; however, these initiatives may not be successful or adequately address a highly dynamic and continually evolving threat landscape. Any technology system failure, degradation, interruption or misuse, security breach, efficiency of migration to a new system, or failure to comply with applicable data confidentiality, privacy, security or other related obligations, whether at Air Canada or a third party on whom Air Canada relies, could adversely affect Air Canada’s reputation and expose Air Canada to litigation, claims for contract breach, fines, sanctions, remediation costs or otherwise materially and adversely affect Air Canada’s operations, any of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.



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

In order to operate its business, achieve its goals and remain competitive, Air Canada continually seeks to identify and devise, invest in, implement and pursue strategic, business, technology and other important initiatives, such as those relating to the recent implementation of its passenger services system, the launch of Air Canada's new loyalty program, its aircraft fleet renewal program (including the planned re-fleeting of its narrow-body aircraft with Boeing 737 MAX aircraft and Airbus A220 aircraft and disposal of aircraft that are being replaced), participation in the leisure or lower cost market (including through Air Canada Rouge), expanding its cargo business, including operating dedicated cargo freighter aircraft, joint venture arrangements, revenue enhancement initiatives, business processes, information technology, revenue management, cost transformation, improving premium passenger revenues, expansion of flying capacity (including in respect of new aircraft and routes), corporate culture transformation initiatives seeking to ensure a consistently high-quality customer service experience and others. These initiatives, including activities relating to their development and implementation, may be adversely impacted by a wide range of factors, many of which are beyond Air Canada's control. Such factors include the need to seek legal or regulatory approvals, the performance and reliability of third parties (including suppliers), their services and their products, 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 and personnel. A delay or failure to sufficiently and successfully identify and devise, invest in or implement any of 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.

Infectious diseases – Infectious diseases could impact passenger demand for air travel

Outbreaks or the threat of outbreaks of viruses or other contagions or infectious diseases, including an epidemic, a pandemic such as COVID-19, influenza, SARS, Ebola, Zika, as well as any travel or other advisories relating to same, whether domestic or international or whether relating to Canadian cities or regions or other cities, regions or countries, could have a material adverse effect on demand for air travel and could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Refer to the COVID-19 risk factor above and elsewhere in this MD&A for more information on the risks related to the COVID-19 pandemic.

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

The potential for terrorist attacks and terrorist activity causes concern and uncertainty in the minds of the travelling public. The occurrence of a terrorist attack, an attempted attack or the perceived threat of one (whether or not involving Air Canada or another carrier, or involving Air Canada's destinations, or other destinations or regions), and 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, security and other costs, including higher operating costs to avoid flying over airspace near conflict zones. Any resulting reduction in passenger revenues and/or increases in costs, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

Air Canada is dependent upon its ability to source, on favourable terms and costs, sufficient quantities of goods and services of desirable quality, in a timely manner or within planned timeframes, required for Air Canada's business or operations, such as fuel, aircraft and related parts, airport services, aircraft maintenance services, and information technology systems and services, and to address the impact of the COVID-19 pandemic. In certain cases, Air Canada may only be able to source goods and services from a limited number of suppliers (or from sole source suppliers) and the transition to new or alternative suppliers, which may be necessitated by reason of such suppliers increasing their rates or by their failure, refusal or inability to deliver or perform, may not be possible or may take a significant amount of time or require significant resources. A failure, refusal, delay or inability of a supplier, may arise as a result of a wide range of causes including as a result of the COVID-19 pandemic, many of which are beyond Air Canada's control. Any failure or inability of Air Canada to successfully source goods and services, or to source goods and services of desirable quality on terms and pricing and within the timeframes acceptable to Air Canada, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.



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

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

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

Regulatory matters – Air Canada is subject to extensive and evolving domestic and foreign regulation in a wide range of matters

The airline industry is subject to extensive legal, regulatory and administrative controls and oversight, including in relation to taxes, airport fees and operations, route rights, security, passenger and consumer rights, accessibility of transportation, flight crew and other labour rules, privacy, data security, advertising, licensing, competition, pensions, environment (including noise levels and carbon emissions), foreign exchange controls and, in some measure, pricing.

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

The ability of Air Canada to operate flights or otherwise offer air services on international routes between airports in Canada and other countries may be subject to change, including as a result of the COVID-19 pandemic. Applicable arrangements between Canada and foreign governments, which govern many areas including traffic rights, may be amended from time to time, rules and policies with respect to airport operations may be revised, and the availability of appropriate airport slots or facilities may change. Air Canada currently operates a number of flights on international routes under government arrangements, regulations or policies that designate the number of carriers permitted to operate on such routes, the capacity of the carriers providing services on such routes, the airports at which carriers may operate international

flights, or the number of carriers allowed access to particular airports. Any further limitations, additions or modifications to such arrangements, regulations or policies could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Additionally, if Canada were to adopt a more liberalized approach in relation to air services arrangements with foreign countries, such an approach could have a material adverse impact on Air Canada, its business, results from operations and financial condition and could result in the impairment of material amounts of related tangible and intangible assets.

Air Canada’s current and future plans to enter into or expand revenue-sharing joint ventures and other alliance arrangements on various international routes or consummate acquisitions or other transactions may be challenged by applicable Canadian and international authorities or third parties, and are and may subject to conditions or receipt of approvals, from applicable Canadian and international authorities, and to satisfying the necessary applicable regulatory requirements. There can be no assurance that such conditions will be met or will continue in effect or that existing, or changes in, regulatory requirements or standards can be satisfied.

Many aspects of Air Canada’s operations may also be subject to the proliferation of increasingly stringent laws and regulations relating to environmental reforms, such as in the area of climate change, and including the following:

The International Civil Aviation Organization (“ICAO”) global market-based measure known as the Carbon Offsetting Reduction Scheme for International Aviation (“CORSIA”), adopted in 2016, includes emissions from applicable international flights. CORSIA is being implemented in phases, with the first two phases (occurring from 2021 to 2023, and 2024 to 2026, respectively) to be voluntary and with the third phase (from 2027 to 2035) to be mandatory. Canada voluntarily adopted the first phase. On the basis of CORSIA, the European Parliament and Council has continued exempting flights between Europe and third countries from the European Union (“EU”) emissions trading system (“ETS”). In 2016, the Canadian Federal Government proposed a pan-Canadian benchmark for carbon pricing to be implemented in all Canadian jurisdictions by 2018, with pricing based on greenhouse gas emissions from all fossil fuel sources including jet fuel and other fuels used by Air Canada in ground operations and stationary combustion equipment. Canadian provinces may either apply an explicit price-based system, such as a carbon tax or levy, or a cap-and-trade system. Certain provinces, such British Columbia and Québec have implemented a carbon pricing system; others have had the federal carbon pricing backstop system applied. Air Canada and regional carriers operating flights on behalf of Air Canada have been subject to a carbon tax for flights operating on an intra-provincial basis.

Air Canada cannot predict whether, or the manner in which, these or other initiatives will ultimately be implemented or their impact on Air Canada, and future developments in Canada and abroad could adversely impact Air Canada, including by increasing its costs. While Air Canada is continually focused on efficiency improvements, including carbon footprint reduction initiatives, the impact to Air Canada of climate change and other environmental initiatives may, in part, depend upon the extent to which the



increased costs relating such initiatives, if any, could be recovered, including in the form of higher passenger fares and cargo rates.

Air Canada is also subject to domestic and foreign laws regarding privacy and security of passenger, employee and other data, including advance passenger information and access to airline reservation systems, which are not consistent in all countries which may assert jurisdiction over Air Canada, including in countries where Air Canada operates, conducts business or processes or stores data. These laws and regulations are proliferating, are becoming increasingly stringent and may conflict with one another. The need to comply with these laws and regulatory regimes results in additional complexities, operating costs and potential exposure to fines and penalties, and further regulation in this area or non-compliance, including in relation to data privacy and security requirements, could 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.

In December 2020, the Minister of Transport mandated the Canadian Transportation Agency to develop a new regulation regarding passenger refunds, stating it would apply to "future flights that are cancelled for reasons outside an air carrier's control, such as a pandemic, and where it is not possible for the carrier to complete the passenger's itinerary within a reasonable timeframe." The Canadian Transportation Agency, announced the opening of consultations on these regulations, stated its intention to pass these new regulations by summer 2021. Air Canada cannot predict whether, or the manner in which, these new regulations will ultimately be implemented or their impact on Air Canada.

Certain jurisdictions (including Canada, the United States, European Union countries and other jurisdictions where Air Canada operates or conducts business or which may assert jurisdiction over Air Canada) have enacted and implemented, and they and domestic regulators may in the future enact and implement, consumer protection and passenger rights and accessibility 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 could adversely impact Air Canada, its business, results from operations and financial condition.

Aeroplan loyalty program – Loss of redemption or accrual partners, changes to accrual or redemption settlement rates, increased redemption rates of loyalty points, or disruptions or other interruptions of services affecting the Aeroplan loyalty program could have a material adverse effect on Air Canada, its business, results from operations and financial condition

After completing the acquisition of Aeroplan Inc. (formerly Aimia Canada Inc.), owner and operator of the Aeroplan loyalty business and program in January 2019, Air Canada implemented, in November 2020 a new, redesigned Aeroplan loyalty program. Air Canada offers its customers who are Aeroplan Members the opportunity to earn Aeroplan points, which management believes is a significant factor in many customers' decision to travel with Air Canada and contributes to building customer loyalty. The success of the Aeroplan program is dependent on attracting new and retaining current members and on maintaining sufficient

accumulation and redemption partners. Increases in redemption rates for outstanding Aeroplan points, any failures to adequately operate the Aeroplan program or interruptions or disruptions of Aeroplan program services, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Climate Change – Changes in environmental conditions, environmental regulations and public opinion regarding air travel could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada, like other airlines, is subject to climate change-related risks, including in relation to other factors described in this MD&A. The airline industry is a source of carbon dioxide and other greenhouse gases and faces extensive related laws and regulations, including those described in this MD&A. Climate change may increase the frequency and intensity of severe weather on the ground and at altitude (including turbulence events) which could impact many aspects of airline operations and increase operating costs. Severe weather events at airports or destinations served by Air Canada may impact the viability or cost of flying to such destinations. Concern about climate change and the impact of carbon emissions from flights may result in additional regulation, expanded aviation fuel taxes and levies, reduced demand for air travel and adversely impact public perception of Air Canada and its brand. Climate change as well as a failure to adapt to and address evolving related regulations, or changes in public opinion, failure to implement technologies which adequately reduce climate or environmental impacts, improve sustainability of its operations or otherwise respond to climate change-related challenges, in a timely manner, could have a material adverse effect on Air Canada, its brand, its business, results from operations and financial condition.

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

Air Canada's business is significantly dependent upon its ability to operate without interruption to or from a number of hub airports, including Toronto Pearson. Delays or disruptions in service, including those due to security, computer malfunctions 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, epidemics, pandemics and public health restrictions 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, including those identified in this MD&A. Environmental conditions and factors, such as those arising from volcanic eruptions or other natural phenomena, those arising from man-made sources, and those arising from increases in the frequency, strength and duration of severe weather events, including as a result of climate change, 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.

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

Air Canada seeks to enhance its network through capacity purchase agreements with certain airlines and regional airlines such as Jazz and Sky Regional operating flights on behalf of Air Canada. Pursuant to the terms of the Jazz CPA, Air Canada pays Jazz a number of fees, some of which are fixed and others which are determined based upon certain costs incurred by Jazz. Air Canada also reimburses Jazz for certain pass-through costs incurred by Jazz (or arranges to provide the related supplies to Jazz), such as fuel, navigation, landing and terminal fees. 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 the Jazz fleet, including economic or market downturns, and unexpected interruptions or cessation of Jazz's services, as well as similar circumstances relating to other airlines from whom Air Canada sources capacity, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

The significant decline in demand for air travel services resulting from the COVID-19 pandemic has materially and adversely impacted demand for regional carrier services and, as a result, Air Canada's utilization of its regional network is significantly reduced and is expected to remain so for the foreseeable future. Air Canada expects the disruption to services resulting from the COVID-19 pandemic to continue to adversely affect its regional carriers. If, as a result of the COVID-19 pandemic or another significant disruption to the Air Canada's regional network, one or more of the regional carriers with which Air Canada has relationships is unable to perform its obligations over an extended period of time, there could be a material adverse effect on Air Canada's business, operating results and financial condition.

Air Canada's brand – The failure to preserve or grow the value of Air Canada's brand could have a material adverse effect on Air Canada, its business, results from operations and financial condition

Air Canada believes that its success is dependent on the value of its brand and on Air Canada's ability to preserve, grow and leverage that value. The Air Canada brand is recognized throughout the world, and Air Canada has received high ratings in external brand value studies, based in part on consumer perceptions on a variety of subjective qualities. Air Canada believes it has and continues to build an excellent reputation globally for the safety and quality of its services, and for the delivery of a consistently positive passenger experience. Air Canada's reputation and brand could be damaged if exposed to significant adverse publicity through social media. Adverse publicity, whether justified or not, can rapidly spread through social or digital media. To the extent we

are unable to respond timely and appropriately to adverse publicity, our brand and reputation may be damaged. Any failure to preserve or grow Air Canada's brand, including by reason of the conduct of Air Canada or any of its business partners or other external parties, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Labour costs and labour relations – Air Canada may not be able to maintain labour costs at appropriate levels or secure labour agreements which permit it to successfully pursue its strategic initiatives. There can be no assurance that collective bargaining agreements will be further renewed without labour conflicts and/or disruptions

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

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

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



Star Alliance and Joint Ventures – Departure of a key member from Star Alliance or the failure by a key member to meet its obligations, including under joint ventures arrangements, could have a material adverse effect on Air Canada, its business, results from operations and financial condition

The strategic and commercial arrangements with Star Alliance members, including Air Canada's A++ joint venture counterparties, Lufthansa AG and United Airlines, 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 towards Air Canada, Air Canada, its business, results from operations and financial condition could be materially adversely affected.

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

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

Moreover, as a result of Air Canada's recent financing activities in response to the COVID-19 pandemic including as described in this MD&A, the number of financings with respect to which such covenants and provisions apply has increased, thereby subjecting Air Canada to more substantial risk of cross-default and cross-acceleration in the event of breach, and additional covenants and provisions could become binding on Air Canada as it continues to seek additional liquidity.

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.

Legal proceedings – Air Canada may be subject to legal proceedings which could have a material adverse impact

In the course of conducting its business, Air Canada is subject to various claims and litigation (including class action claims), including with respect to its contractual arrangements and current or new laws and regulations. Any future claims or litigation could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

Air Canada's financial results are sensitive to the fluctuating value of the Canadian dollar. Air Canada incurs significant expenses in U.S. dollars for items such as fuel, aircraft purchases, aircraft leasing and maintenance, airport charges, ground package costs, sales and distribution costs, interest and debt servicing payments, while a substantial portion of its revenues are generated in Canadian dollars. In addition, Air Canada may not be able to sufficiently, or may not, hedge the risk associated with fluctuations in exchange rates. A significant deterioration of the Canadian dollar relative to the U.S. dollar or other foreign currencies would increase the costs of Air Canada relative to its U.S. or other foreign competitors. Any of these factors could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Boeing 737 MAX Aircraft – The grounding of the Boeing 737 MAX aircraft in certain jurisdictions and negative passenger perceptions could materially adversely impact Air Canada, its business, results of operations and financial condition as may the grounding of other fleet types should they occur

In March 2019, the European Aviation Safety Agency ("EASA"), Transport Canada and the Federal Aviation Administration ("FAA") closed their respective airspace to the operation of Boeing 737 MAX aircraft and Boeing announced it would suspend Boeing 737 MAX deliveries to airline customers. On November 18, 2020, the FAA rescinded its order grounding Boeing 737 MAX aircraft and has permitted their return to service in U.S. airspace upon compliance with certain conditions, including compliance with a new airworthiness directive and pilot training requirements. In January 2021, Transport Canada issued an Airworthiness Directive mandating the aircraft modifications required for a return to service in Canadian airspace, as well as an interim order with additional crew training requirements. Effective on January 20, 2021, Transport Canada allowed the Boeing 737 MAX to return to service in Canada, subject to compliance with the Airworthiness Directive and interim order. EASA has not yet authorized the Boeing 737 MAX's return to service in European airspace. The continued grounding of the Boeing 737 MAX aircraft in the airspace of certain jurisdictions could negatively affect operations, future network plans, reduce revenues and increase costs, based on a number of factors, including the period of time the aircraft remain unavailable to operate in such jurisdictions, and the circumstances of any reintroduction of the aircraft to service. In addition, passengers' perceptions of the safety of the Boeing 737 MAX aircraft could



negatively impact Air Canada's ability to successfully re-introduce the Boeing 737 MAX into its operations.

Similar factors arising in relation to other fleet types, as well as issues or grounding of other aircraft or fleet types which Air Canada may operate, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

Air Canada maintains several defined benefit pension plans, including domestic registered pension plans, supplemental pension plans and international pension plans. 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). In addition, current service contributions in respect of a domestic registered plan are required except to the extent they are funded (and if permitted subject to applicable plan rules and legislation) through a sufficient surplus in such plan. Air Canada's pension funding obligations (including projected funding obligations) may vary significantly based on a wide variety of factors, including pension plan solvency valuations, regulatory developments, plan demographics, changes to plan provisions, changes to pension asset investment strategies, assumptions and methods used and changes in economic conditions (mainly the return on fund assets and changes in interest rates) and other factors. Deteriorating economic conditions or a significant decline in Air Canada's revenues could cause Air Canada's funding obligations to have, a material adverse effect on Air Canada, its business, results from operations and financial condition. See section 8.7 "Pension Funding Obligations" of this MD&A for additional information.

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

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

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

The insurance industry in general, including the aviation insurance industry, has been experiencing increasing losses and decreased insurer profitability in recent years, resulting in reduced capacity levels and premium increases. These conditions may adversely affect some of Air Canada's existing insurance carriers or Air Canada's ability to obtain future insurance coverage, including desired levels of coverage or on terms acceptable to Air Canada. To the extent that Air Canada's existing insurance carriers are unable or unwilling to provide 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 could have a material adverse effect on Air Canada, its business, results from operations and financial condition.



18.

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 Deputy Chief Executive Officer 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, 2020, 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 Commissions (“COSO”) in Internal Control - Integrated Framework (2013). Based on that evaluation, management and the CEO and CFO have concluded that, as at December 31, 2020, 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 2020 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.



19.

Non-GAAP Financial Measures

Below is a description of certain non-GAAP financial measures used by Air Canada to provide readers with additional information on its financial and operating performance. Such measures are not recognized measures for financial statement presentation under GAAP, do not have standardized meanings, may not be comparable to similar measures presented by other entities and should not be considered a substitute for or superior to GAAP results.

EBITDA

EBITDA (earnings before interest, taxes, depreciation and amortization) is commonly used in the airline industry and is used by Air Canada as a means to view operating results before interest, taxes, depreciation and amortization as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. Air Canada excludes special items from EBITDA as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

EBITDA is reconciled to GAAP operating income (loss) as follows:

| (Canadian dollars in millions) | Fourth Quarter | | | Full Year | | |
|---|-------------------|---------------|-------------------|-------------------|-----------------|-------------------|
| | 2020 | 2019 | \$ CHANGE | 2020 | 2019 | \$ CHANGE |
| Operating income (loss) – GAAP | \$ (1,003) | \$ 145 | \$ (1,148) | \$ (3,776) | \$ 1,650 | \$ (5,426) |
| Add back: | | | | | | |
| Depreciation and amortization | 435 | 520 | (85) | 1,849 | 1,986 | (137) |
| EBITDA (including special items) | \$ (568) | \$ 665 | \$ (1,233) | \$ (1,927) | \$ 3,636 | \$ (5,563) |
| Remove effect of special items | (160) | - | (160) | (116) | - | (116) |
| EBITDA (excluding special items) | \$ (728) | \$ 665 | \$ (1,393) | \$ (2,043) | \$ 3,636 | \$ (5,679) |

Adjusted CASM

Air Canada uses adjusted CASM to assess the operating and cost performance of its ongoing airline business without the effects of aircraft fuel expense, the cost of ground packages at Air Canada Vacations, and special items as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

In calculating adjusted CASM, aircraft fuel expense is excluded from operating expense results as it fluctuates widely depending on many factors, including international market conditions, geopolitical events, jet fuel refining costs and Canada/U.S. currency exchange rates. Air Canada also incurs expenses related to ground packages at Air Canada Vacations which some airlines, without comparable tour operator businesses, may not incur. In addition, these costs do not generate ASMs and therefore excluding these costs from operating expense results provides for a more meaningful comparison across periods when such costs may vary.

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

Adjusted CASM is reconciled to GAAP operating expense as follows:

| (Canadian dollars in millions, except where indicated) | Fourth Quarter | | | Full Year | | |
|---|-----------------|-----------------|-------------------|-----------------|------------------|-------------------|
| | 2020 | 2019 | \$ CHANGE | 2020 | 2019 | \$ CHANGE |
| Operating expense – GAAP | \$ 1,830 | \$ 4,284 | \$ (2,454) | \$ 9,609 | \$ 17,481 | \$ (7,872) |
| Adjusted for: | | | | | | |
| Aircraft fuel expense | (187) | (1,013) | 826 | (1,322) | (4,347) | 3,025 |
| Ground package costs | (14) | (131) | 117 | (250) | (627) | 377 |
| Special items | 160 | - | 160 | 116 | - | 116 |
| Operating expense, adjusted for the above- noted items | \$ 1,789 | \$ 3,140 | \$ (1,351) | \$ 8,153 | \$ 12,507 | \$ (4,354) |
| ASMs (millions) | 6,000 | 26,431 | (77.3)% | 37,703 | 112,814 | (66.6)% |
| Adjusted CASM (cents) | ¢ 29.82 | ¢ 11.88 | 150.9% | ¢ 21.62 | ¢ 11.09 | 95.1% |



Adjusted Pre-tax Income (Loss)

Adjusted pre-tax income (loss) is used by Air Canada to assess the overall pre-tax financial performance of its business without the effects of foreign exchange gains or losses, net financing expense relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

Adjusted pre-tax income (loss) is reconciled to GAAP income (loss) before income taxes as follows:

| (Canadian dollars in millions) | Fourth Quarter | | | Full Year | | |
|---|-------------------|---------------|-------------------|-------------------|-----------------|-------------------|
| | 2020 | 2019 | \$ CHANGE | 2020 | 2019 | \$ CHANGE |
| Income (loss) before income taxes – GAAP | \$ (1,275) | \$ 172 | \$ (1,447) | \$ (4,853) | \$ 1,775 | \$ (6,628) |
| Adjusted for: | | | | | | |
| Special items | (160) | - | (160) | (116) | - | (116) |
| Foreign exchange (gain) loss | (88) | (92) | 4 | 293 | (499) | 792 |
| Net financing expense relating to employee benefits | 1 | 10 | (9) | 27 | 39 | (12) |
| (Gain) loss on financial instruments recorded at fair value | 214 | (5) | 219 | 242 | (23) | 265 |
| Gain on sale and leaseback of assets | (18) | - | (18) | (18) | - | (18) |
| Gain on debt settlements and modifications | - | (6) | 6 | - | (6) | 6 |
| Gain on disposal of assets | | (13) | 13 | | (13) | 13 |
| Adjusted pre-tax income (loss) | \$ (1,326) | \$ 66 | \$ (1,392) | \$ (4,425) | \$ 1,273 | \$ (5,698) |

Free Cash Flow

Air Canada uses free cash flow as an indicator of the financial strength and performance of its business, indicating the amount of cash Air Canada can generate from operations and after capital expenditures. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment, and intangible assets, and is net of proceeds from sale and leaseback transactions. Free cash flow in 2019 also excludes the one-time proceeds related to the Aeroplan acquisition. Refer to section 8.5 "Consolidated Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

Net Cash Burn

Air Canada uses net cash burn as a measure of cash used to maintain operations, support capital expenditures, and settle normal debt repayments, all before the net impact of new financing proceeds. Net cash burn is defined as net cash flows from operating, financing, and investing activities, and excludes proceeds from new financings, lump sum debt maturities made where the Corporation has refinanced or replaced the amount, and proceeds from sale and leaseback transactions. Net cash burn also excludes movements between cash and short- and long-term investments. Refer to section 8.5 "Consolidated Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.



20.

Glossary

Adjusted net income (loss) – Refers to the consolidated net income (loss) of Air Canada adjusted to remove the after-tax effects of foreign exchange gains or losses, net financing expense relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items. Adjusted net income (loss) is a non-GAAP financial measure.

Adjusted CASM – Refers to operating expense per ASM adjusted to remove the effects of aircraft fuel expense, ground packages costs at Air Canada Vacations and special items. Adjusted CASM is a non-GAAP financial measure. Refer to section 19 “Non-GAAP Financial Measures” of this MD&A for additional information.

Adjusted pre-tax income (loss) – Refers to the consolidated income (loss) of Air Canada before income taxes and adjusted to remove the effects of foreign exchange gains or losses, net financing expense relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items. Adjusted pre-tax income (loss) is a non-GAAP financial measure. Refer to section 19 “Non-GAAP Financial Measures” of this MD&A for additional information.

Aeroplan – Refers to Aeroplan Inc.

Atlantic passenger and cargo revenues – Refers to revenues from flights that cross the Atlantic Ocean with origins and destinations principally in Europe, India, the Middle East and North Africa.

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.

Bombardier – Refers to Bombardier Inc.

CASM – Refers to operating expense per ASM.

De Havilland – Refers to De Havilland Aircraft of Canada Limited.

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

EBITDA – Refers to earnings before interest, taxes, depreciation and amortization. EBITDA is a non-GAAP financial measure. Refer to section 19 “Non-GAAP Financial Measures” of this MD&A for additional information. Air Canada excludes special items from EBITDA.

Free cash flow – Refers to net cash flows from operating activities minus additions to property, equipment, and intangible assets, and is net of proceeds from sale and leaseback transactions. Free cash flow in 2019 also excludes the one-time proceeds related to the Aeroplan acquisition. Free cash flow is a non-GAAP financial measure. Refer to sections 8.5 “Consolidated Cash Flow Movements” and 19 “Non-GAAP Financial Measures” of this MD&A for additional information.

Jazz – Refers to Jazz Aviation LP.

Jazz CPA – Refers to the capacity purchase agreement between Air Canada and Jazz.

Leverage ratio – Refers to the ratio of net debt to trailing 12-month EBITDA (calculated by dividing net debt by trailing 12-month EBITDA). Leverage ratio is a non-GAAP financial measure.

Loss (gain) on debt settlements and modifications – Refers to gains or losses related to debt settlements and modifications that, in management’s view, are to be separately disclosed by virtue of their size or incidence to enable a fuller understanding of the Corporation’s financial performance.

Mitsubishi – Refers to Mitsubishi Heavy Industries, Ltd.

Net cash burn – Refers to net cash flows from operating, financing, and investing activities, and excludes proceeds from new financings, lump sum debt maturities made where the Corporation has refinanced or replaced the amount, and proceeds from sale and leaseback transactions. Net cash burn also excludes movements between cash and short- and long-term investments. Refer to sections 8.5 “Consolidated Cash Flow Movements” and 19 “Non-GAAP Financial Measures” of this MD&A for additional information.

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

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

Revenue passenger carried – Refers to the International Air Transport Association’s (IATA) definition of passenger carried whereby passengers are counted on a flight number basis rather than by journey/itinerary or by leg.

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

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

Sky Regional – Refers to Sky Regional Airlines Inc.

Special items – Refers to those items that, in management’s view, are to be separately disclosed by virtue of their significance to the financial statements, to enable a fuller understanding of the Corporation’s financial performance.

Yield – Refers to average passenger revenue per RPM.



CONSOLIDATED FINANCIAL STATEMENTS AND NOTES



Statement of Management's Responsibility for Financial Reporting

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

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

The Audit, Finance and Risk Committee, which is comprised entirely of independent directors, reviews the quality and integrity of the Corporation's financial reporting and provides its recommendations, in respect of the approval of the financial statements, 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, audit-related, and non-audit fees and expenses. The Board of Directors approves the Corporation's consolidated financial statements and management's discussion and analysis disclosures prior to their release. The Audit, Finance and Risk Committee meets with management, the internal auditors and external auditors at least four times each year to review and discuss financial reporting, disclosures, auditing and other matters.

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



Calin Rovinescu
President and Chief Executive Officer



Michael Rousseau
Deputy Chief Executive Officer and
Chief Financial Officer

February 11, 2021



Independent Auditor's Report

To the Shareholders of Air Canada

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Air Canada and its subsidiaries (together, the Corporation) as at December 31, 2020 and 2019, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

What we have audited

The Corporation's consolidated financial statements comprise:

- the consolidated statements of financial position as at December 31, 2020 and 2019;
- the consolidated statements of operations for the years then ended;
- the consolidated statements of comprehensive income (loss) for the years then ended;
- the consolidated statements of changes in equity for the years then ended;
- the consolidated statements of cash flow for the years then ended; and
- the notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report.

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

Independence

We are independent of the Corporation in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the year ended December 31, 2020. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.



| Key audit matter | How our audit addressed the key audit matter |
|--|--|
| <p>Passenger and cargo revenue recognition</p> <p><i>Refer to Note 2, Basis of presentation and summary of significant accounting policies and Note 20, Revenue to the consolidated financial statements.</i></p> <p>Airline passenger and cargo revenues are key measures of financial performance and recognized as revenues when the transportation is provided. Total passenger and cargo revenues recognized for the year ended December 31, 2020 amounted to \$4,382 million and \$920 million, respectively.</p> <p>Such transactions rely on Information and Technology (IT) systems and controls to process, record and recognize a high volume of low value revenue transactions. Multiple processes and transfer points of large amounts of data exist between a combination of IT systems, outsourced service providers, industry clearing houses and other partner airlines.</p> <p>We considered this is a key audit matter due to the significance of passenger and cargo revenues and the volume of these transactions resulting in significant audit effort to test the revenue recognized.</p> | <p>Our approach to addressing the matter involved the following procedures, amongst others:</p> <ul style="list-style-type: none"> — Tested the operating effectiveness of internal controls relating to passenger and cargo revenue recognition: <ul style="list-style-type: none"> • Tested the controls over the relevant IT systems that management used to recognize passenger and cargo revenues; • For the IT systems or processes that are outsourced to third party service providers, assessed the assurance reports attesting to the appropriateness and effectiveness of the internal control systems established by the service providers. — Tested a sample of passenger and cargo revenue transactions recorded during the year by inspecting the consideration received and the evidence of when transportation is provided for passengers or cargo, including supporting documentation from clearing houses and other partner airlines as applicable. |
| <p>Measurement of the total benefit obligation</p> <p><i>Refer to Note 2 – Basis of presentation and summary of significant accounting policies, Note 3 – Critical accounting estimates and judgments, and Note 10 – Pension and other benefit liabilities to the consolidated financial statements.</i></p> <p>The Corporation has a net benefit obligation of \$237 million, which includes a total benefit obligation associated with pension benefits of \$23,720 million and other employee future benefits of \$1,562 million as at December 31, 2020.</p> <p>The total benefit obligation associated with pension benefits and other employee future benefits is actuarially determined annually as at December 31 and is prepared by the Corporation's consulting actuaries (management's experts). The total benefit obligation is determined using the projected unit credit method, including assumptions such as discount rates, future increases in compensation, mortality rates and health care costs. Management applied significant judgment in determining the appropriate discount rates and mortality assumptions to determine the present value of total benefit obligation.</p> <p>We considered this is a key audit matter due to the significance of the total benefit obligation and the significant judgment made by management, including the use of management's experts, in determining the appropriate discount rates and mortality assumptions, which resulted in the high degree of auditor judgment and subjectivity in performing procedures relating to those assumptions. The audit effort involved the use of professionals with specialized skill and knowledge in the field of actuarial services.</p> | <p>Our approach to addressing the matter included the following procedures, amongst others:</p> <ul style="list-style-type: none"> — Tested how management developed the estimates for the total benefit obligation: <ul style="list-style-type: none"> • The work of management's experts was used in performing the procedures to evaluate the reasonableness of the total benefit obligation associated with pension benefits and other employee future benefits. As a basis for using this work, management's experts' competence, capability and objectivity were evaluated, their work performed was understood and the appropriateness of their work as audit evidence was evaluated by considering the relevance and reasonableness of the assumptions, methods and findings. • Tested the underlying data used in the determination of the total benefit obligation. — Professionals with specialized skill and knowledge in the field of actuarial services assisted in assessing the appropriateness of the method and evaluation of the reasonableness of the discount rates, future increases in compensation, mortality rates and health care costs. — Tested the disclosures, including the sensitivity analysis, made in the consolidated financial statements with regard to the measurement of the total benefit obligation. |



| Key audit matter | How our audit addressed the key audit matter |
|--|---|
| <p><i>Impairment assessment of property and equipment and intangible assets of the narrow body and wide body cash generating units (CGU)</i></p> <p><i>Refer to Note 2 – Basis of presentation and summary of significant accounting policies, Note 3 – Critical accounting estimates and judgments and Note 7 – Intangible assets to the consolidated financial statements.</i></p> <p>The Corporation had \$13,271 million of property and equipment and intangible assets as at December 31, 2020. A significant portion of these assets relate to the narrow body and wide body CGUs (the CGUs). When impairment indicators exist, an impairment assessment is conducted at the level of the CGU. An impairment loss is recognized if the carrying amount of a CGU exceeds its recoverable amount.</p> <p>An assessment of the recoverable amounts of the CGUs compared to their carrying values was performed based on updated cash flow projections in light of the current COVID-19 pandemic.</p> <p>Management has estimated the recoverable amount of each of the CGUs based on the fair value less cost of disposal method, using a discounted cash flow model. The cash flow projections are based on current and anticipated market conditions covering a five-year period. However, management has disclosed that these projections are inherently uncertain due to the recent and fluidly evolving impact of the COVID-19 pandemic. The key assumptions applied by management in estimating the recoverable amounts of the CGUs included: the cash flow projections, long-term growth rates after the five year period and discount rates.</p> <p>We considered this a key audit matter due to the significant judgment made by management in estimating the recoverable amounts of the CGUs, including the application of key assumptions. This in turn resulted in significant audit effort and subjectivity in performing audit procedures to test the recoverable amounts estimated by management. Professionals with specialized skill and knowledge in the field of valuation assisted us in performing our procedures.</p> | <p>Our approach to addressing the matter included the following procedures, among others:</p> <ul style="list-style-type: none"> — Tested how management estimated the recoverable amounts of the CGUs, which included the following: <ul style="list-style-type: none"> • Evaluated the appropriateness of the method and model used. • Tested the reasonableness of the cash flow projections and long-term growth rates by comparing them with external airline industry economic data and the results historically achieved by the Corporation. • With the assistance of professionals with specialized skill and knowledge in the field of valuation, assessed the reasonableness of the discount rates applied. • Tested underlying data used in the discounted cash flow model. — Tested the disclosures made in the consolidated financial statements with respect to the key assumptions and related sensitivity. |



Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis, which we obtained prior to the date of this auditor's report and the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, which is expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express an opinion or any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard. When we read the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, 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.

In preparing the consolidated financial statements, management is responsible for assessing the Corporation's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Corporation or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Corporation's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Corporation's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Corporation's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Corporation to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.



- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Corporation to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Michael Trudeau.

PricewaterhouseCoopers LLP¹

Montréal, Québec
February 11, 2021

¹ CPA auditor, CA, public accountancy permit No. A113048



Consolidated Statements of Financial Position

| (Canadian dollars in millions) | | DECEMBER 31, 2020 | DECEMBER 31, 2019 |
|--|---------|----------------------|----------------------|
| ASSETS | | | |
| Current | | | |
| Cash and cash equivalents | | \$ 3,658 | \$ 2,090 |
| Short-term investments | | 3,843 | 3,799 |
| Total cash, cash equivalents and short-term investments | | 7,501 | 5,889 |
| Restricted cash | Note 2P | 106 | 157 |
| Accounts receivable | Note 20 | 644 | 926 |
| Aircraft fuel inventory | | 41 | 102 |
| Spare parts and supplies inventory | Note 2Q | 125 | 110 |
| Prepaid expenses and other current assets | Note 20 | 254 | 332 |
| Total current assets | | 8,671 | 7,516 |
| Investments, deposits and other assets | Note 5 | 833 | 936 |
| Property and equipment | Note 6 | 12,137 | 12,834 |
| Pension assets | Note 10 | 2,840 | 2,064 |
| Deferred income tax | Note 12 | 25 | 134 |
| Intangible assets | Note 7 | 1,134 | 1,002 |
| Goodwill | Note 8 | 3,273 | 3,273 |
| Total assets | | \$ 28,913 | \$ 27,759 |
| LIABILITIES | | | |
| Current | | | |
| Accounts payable and accrued liabilities | | \$ 2,465 | \$ 2,456 |
| Advance ticket sales | Note 20 | 2,314 | 2,939 |
| Aeroplan and other deferred revenue | Note 20 | 572 | 1,162 |
| Current portion of long-term debt and lease liabilities | Note 9 | 1,788 | 1,218 |
| Total current liabilities | | 7,139 | 7,775 |
| Long-term debt and lease liabilities | Note 9 | 11,201 | 8,024 |
| Aeroplan and other deferred revenue | Note 20 | 4,032 | 3,136 |
| Pension and other benefit liabilities | Note 10 | 3,015 | 2,930 |
| Maintenance provisions | Note 11 | 1,040 | 1,240 |
| Other long-term liabilities | | 696 | 181 |
| Deferred income tax | Note 12 | 75 | 73 |
| Total liabilities | | \$ 27,198 | \$ 23,359 |
| SHAREHOLDERS' EQUITY | | | |
| Share capital | Note 13 | 2,150 | 785 |
| Contributed surplus | | 98 | 83 |
| Accumulated other comprehensive income (loss) | | (39) | 25 |
| Retained earnings (deficit) | | (494) | 3,507 |
| Total shareholders' equity | | 1,715 | 4,400 |
| Total liabilities and shareholders' equity | | \$ 28,913 | \$ 27,759 |

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

On behalf of the Board of Directors:



Vagn Sørensen
Chairman



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



Consolidated Statements of Operations

For the year ended December 31

(Canadian dollars in millions except per share figures)

| | | 2020 | 2019 |
|---|---------|-------------------|-----------------|
| OPERATING REVENUES | | | |
| Passenger | Note 20 | \$ 4,382 | \$ 17,232 |
| Cargo | Note 20 | 920 | 717 |
| Other | | 531 | 1,182 |
| Total revenues | | 5,833 | 19,131 |
| OPERATING EXPENSES | | | |
| Aircraft fuel | | 1,322 | 4,347 |
| Wages, salaries and benefits | | 2,242 | 3,184 |
| Regional airlines expense, excluding fuel | Note 21 | 1,086 | 1,956 |
| Depreciation and amortization | Note 6 | 1,849 | 1,986 |
| Aircraft maintenance | Note 3 | 681 | 1,004 |
| Airport and navigation fees | | 545 | 990 |
| Sales and distribution costs | | 252 | 874 |
| Ground package costs | | 250 | 627 |
| Catering and onboard services | | 171 | 445 |
| Communications and information technology | | 372 | 397 |
| Special items | Note 4 | (116) | - |
| Other | | 955 | 1,671 |
| Total operating expenses | | 9,609 | 17,481 |
| Operating income (loss) | | (3,776) | 1,650 |
| NON-OPERATING INCOME (EXPENSE) | | | |
| Foreign exchange gain (loss) | | (293) | 499 |
| Interest income | | 132 | 164 |
| Interest expense | Note 9 | (656) | (515) |
| Interest capitalized | | 25 | 35 |
| Net financing expense relating to employee benefits | Note 10 | (27) | (39) |
| Gain (loss) on financial instruments recorded at fair value | Note 17 | (242) | 23 |
| Gain on sale and leaseback of assets | Note 22 | 18 | - |
| Other | | (34) | (42) |
| Total non-operating income (expense) | | (1,077) | 125 |
| Income (loss) before income taxes | | (4,853) | 1,775 |
| Income tax recovery (expense) | Note 12 | 206 | (299) |
| Net income (loss) | | \$ (4,647) | \$ 1,476 |
| Net income (loss) per share | Note 15 | | |
| Basic earnings (loss) per share | | \$ (16.47) | \$ 5.51 |
| Diluted earnings (loss) per share | | \$ (16.47) | \$ 5.44 |

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



Consolidated Statements of Comprehensive Income (Loss)

For the year ended December 31

(Canadian dollars in millions)

| | | 2020 | 2019 |
|---|---------|-------------------|-----------------|
| COMPREHENSIVE INCOME | | | |
| Net income (loss) | | \$ (4,647) | \$ 1,476 |
| Other comprehensive income, net of tax expense: | Note 12 | | |
| Items that will not be reclassified to net income | | | |
| Remeasurements on employee benefit liabilities | Note 10 | 765 | (22) |
| Remeasurements on equity investments | | (64) | 25 |
| Total comprehensive income (loss) | | \$ (3,946) | \$ 1,479 |

Consolidated Statements of Changes in Equity

| (Canadian dollars in millions) | SHARE CAPITAL | CONTRIBUTED SURPLUS | ACCUMULATED OCI | RETAINED EARNINGS (DEFICIT) | TOTAL SHAREHOLDERS' EQUITY |
|---|---------------|---------------------|-----------------|-----------------------------|----------------------------|
| January 1, 2019 | \$ 798 | \$ 75 | \$ – | \$ 2,404 | \$ 3,277 |
| Net income (loss) | – | – | – | 1,476 | 1,476 |
| Remeasurements on employee benefit liabilities | – | – | – | (22) | (22) |
| Remeasurements on equity investments | – | – | 25 | – | 25 |
| Total comprehensive income (loss) | – | – | 25 | 1,454 | 1,479 |
| Share-based compensation | – | 13 | – | – | 13 |
| Shares issued | 14 | (5) | – | – | 9 |
| Shares purchased and cancelled under issuer bid | (27) | – | – | (351) | (378) |
| December 31, 2019 | \$ 785 | \$ 83 | \$ 25 | \$ 3,507 | \$ 4,400 |
| Net income (loss) | – | – | – | (4,647) | (4,647) |
| Remeasurements on employee benefit liabilities | – | – | – | 765 | 765 |
| Remeasurements on equity investments | – | – | (64) | – | (64) |
| Total comprehensive income (loss) | – | – | (64) | (3,882) | (3,946) |
| Share-based compensation | – | 15 | – | – | 15 |
| Shares issued, net (Note 13) | 1,373 | – | – | – | 1,373 |
| Shares purchased and cancelled under issuer bid | (8) | – | – | (119) | (127) |
| December 31, 2020 | \$ 2,150 | \$ 98 | \$ (39) | \$ (494) | \$ 1,715 |

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



Consolidated Statements of Cash Flow

For the year ended December 31

(Canadian dollars in millions)

| | | 2020 | 2019 |
|---|---------|-----------------|-----------------|
| Cash flows from (used for) | | | |
| OPERATING | | | |
| Net income (loss) | | \$ (4,647) | \$ 1,476 |
| Adjustments to reconcile to net cash from operations | | | |
| Deferred income tax | Note 12 | (164) | 227 |
| Depreciation and amortization | Note 6 | 1,849 | 1,986 |
| Foreign exchange (gain) loss | Note 17 | 82 | (361) |
| Card agreement proceeds | Note 24 | - | 1,212 |
| Aeroplan points prepayment proceeds | Note 24 | - | 400 |
| Gain on sale and leaseback of assets | Note 22 | (18) | - |
| Employee benefit funding less than expense | Note 10 | 260 | 210 |
| Financial instruments recorded at fair value | Note 17 | 242 | (37) |
| Change in maintenance provisions | | (54) | 49 |
| Changes in non-cash working capital balances | | (236) | 566 |
| Special items | Note 4 | 315 | - |
| Other | | 18 | (16) |
| Net cash flows from (used in) operating activities | | (2,353) | 5,712 |
| FINANCING | | | |
| Proceeds from borrowings | Note 9 | 6,262 | - |
| Reduction of long-term debt and lease liabilities | Note 9 | (2,719) | (1,084) |
| Shares purchased for cancellation | Note 13 | (132) | (373) |
| Issue of shares | Note 13 | 1,369 | 9 |
| Financing fees | | (78) | (1) |
| Net cash flows from (used in) financing activities | | 4,702 | (1,449) |
| INVESTING | | | |
| Investments, short-term and long-term | | (63) | (255) |
| Additions to property, equipment and intangible assets | | (1,202) | (2,025) |
| Proceeds from sale of assets | | 12 | 24 |
| Proceeds from sale and leaseback of assets | Note 22 | 485 | - |
| Acquisition of Aeroplan | Note 24 | - | (517) |
| Investment in Chorus | Note 25 | - | (97) |
| Other | | 35 | 75 |
| Net cash flows used in investing activities | | (733) | (2,795) |
| Effect of exchange rate changes on cash and cash equivalents | | (48) | (8) |
| Increase in cash and cash equivalents | | 1,568 | 1,460 |
| Cash and cash equivalents, beginning of year | | 2,090 | 630 |
| Cash and cash equivalents, end of year | | \$ 3,658 | \$ 2,090 |

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



1.

General Information

The accompanying audited consolidated financial statements (the “financial statements”) are of Air Canada (the “Corporation”). The term “Corporation” also refers, as the context may require, to 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”), Air Canada Rouge LP doing business under the brand name Air Canada Rouge®, and Aeroplan Inc. (“Aeroplan”).

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

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 market 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”). 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 also 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.

Aeroplan operates a loyalty rewards and recognition program that allows individuals to enrol as members and open an Aeroplan account, to accumulate Aeroplan points through the purchase of products and services from participating partners and suppliers and to redeem Aeroplan points for a variety of travel, merchandise, gift card, and other rewards provided directly by participating partners or made available through Aeroplan’s intermediary suppliers.

Air Canada, along with the rest of the global airline industry, is facing a severe and abrupt drop in traffic and a corresponding decline in revenue and cash flows as a result of the coronavirus (“COVID-19”) pandemic and the travel restrictions imposed in many countries around the world, and particularly in Canada. The impact of the COVID-19 pandemic began to be felt in traffic and sales figures commencing in early March 2020. These impacts include drastic declines in earnings and cash flow from operations. There is very limited visibility on travel demand given changing government restrictions in place around the world and the severity of the restrictions in Canada; these restrictions and concerns about travel due to the COVID-19 pandemic as well as passenger concerns and expectations about the need for certain precautions, such as physical distancing, are severely inhibiting demand. The COVID-19 pandemic is also having significant economic impacts, including on business and consumer spending, which may in turn significantly impact demand for travel. Air Canada cannot predict the full impact or the timing for when conditions may improve. Air Canada is actively monitoring the situation and will respond as the impact of the COVID-19 pandemic evolves, which will depend on a number of factors including the course of the virus, availability of rapid, effective testing, vaccinations and treatments for the virus, government actions, and passenger reaction, as well as timing of a recovery in international and business travel which are important segments of Air Canada’s market, none of which can be predicted with any degree of certainty. Refer to Note 17 for information on financing activities and other actions taken in response to the COVID-19 crisis. Refer to Note 3 for considerations related to critical accounting estimates and judgments updated to reflect the currently known impact of the COVID-19 pandemic. Since mid-March, capacity has been significantly reduced when compared to 2019 and is expected to continue to be at significantly reduced levels in 2021. The airline continues to dynamically adjust capacity as required.



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 11, 2021.

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

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted for the current year. Aircraft fuel expense related to regional airline operations is now presented within Aircraft fuel on the consolidated statement of operations. Previously included in Regional airlines expense, this reclassification provides improved presentation of the total cost of fuel associated with the Corporation's operations.

A) Basis of Measurement

These financial statements have been prepared under the historical cost convention, except for the revaluation of cash, cash equivalents, short-term investments, restricted cash, long-term investments, 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.

C) Passenger and Cargo Revenues

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

surcharges and revenues from passenger-related services such as seat selection and excess baggage which are recognized when the transportation is provided. Passenger revenues are reduced for the amount of any passenger compensation for delayed and cancelled flights paid directly to a customer. Airline passenger and cargo advance sales are deferred and included in Current liabilities. The Corporation records an estimate of breakage revenue, which is recorded at the time when transportation was scheduled to be provided, for tickets that will expire unused. These estimates are based on historical experience and other considerations.

D) Capacity Purchase Agreements

Air Canada has capacity purchase agreements with regional carriers. Under these agreements, Air Canada markets, tickets and enters into other commercial arrangements relating to these flights and records the revenue it earns under Passenger revenue when transportation is provided. Operating expenses under capacity purchase agreements, which are aggregated in a separate line item in the consolidated statement of operations titled Regional airlines expense, include the capacity purchase fees, pass-through costs, which are direct costs incurred by the regional carrier and charged to the Corporation, and other costs incurred by the Corporation which are directly related to regional carrier operations, excluding fuel. Capacity purchase fees exclude the component of fees related to aircraft costs which are accounted for as lease liabilities in accordance with IFRS 16. Aircraft fuel expense related to regionals is presented within Aircraft fuel for presentation of the total cost of fuel associated with the Corporation's operations.

E) Aeroplan Loyalty Program

The Aeroplan loyalty program generates customer loyalty by rewarding customers who travel with Air Canada. This program allows program members to earn Aeroplan points by flying on Air Canada, Star Alliance partners and other airlines that participate in the Aeroplan loyalty program. When travelling, program members earn redeemable Aeroplan points based on a number of factors including the passenger's loyalty program status, distance travelled, booking class and travel fare paid. Members can also earn Aeroplan points through participating Aeroplan program partners such as credit card companies, hotels, car rental agencies and other program partners. Aeroplan points are redeemable by members for air travel on Air Canada and other participating airlines, and for other program awards, such as hotel, car rentals, gift cards, merchandise and other non-air rewards.

Aeroplan Members can earn Aeroplan points: (1) through travel and (2) based on spending with program partners.

Points Earned with Travel

Passenger ticket sales earning Aeroplan points under the Aeroplan loyalty program provide members with (1) air transportation and



(2) Aeroplan points. As a revenue arrangement with multiple performance obligations, each performance obligation is valued on a relative standalone fair value basis. The value of Aeroplan points issued is determined based on the value a passenger receives by redeeming points for a ticket rather than paying cash, which is referred to as Equivalent Ticket Value ("ETV"). The ETV is adjusted for points that are not expected to be redeemed ("breakage"). The consideration allocated to the ETV for points earned with travel is recorded in Aeroplan deferred revenue.

Points Sold to Program Partners

Aeroplan Members can earn Aeroplan points based on their spending with participating Aeroplan partners such as credit card companies, hotels and car rental agencies and other program partners. Aeroplan points issued under program partner agreements are accounted for as a single performance obligation being the future delivery of a redemption reward to the Aeroplan Members. The consideration received for Aeroplan points issued to Aeroplan Members under these agreements is recorded as Aeroplan deferred revenue.

Breakage represents the estimated Aeroplan points that are not expected to be redeemed by Aeroplan Members. The amount of revenue recognized related to breakage is based on the number of Aeroplan points redeemed in a period in relation to the total number of Aeroplan points expected to be redeemed. The number of Aeroplan points redeemed in a period also factors into any revised estimate for breakage. Changes in breakage are accounted for as follows: in the period of change, the deferred revenue balance is adjusted as if the revised estimate had been used in prior periods with the offsetting amount recorded as an adjustment to passenger revenue; and for subsequent periods, the revised estimate is used.

F) Other Revenues

Other revenue is primarily comprised of revenues from the sale of the ground portion of vacation packages, ground handling services, onboard sales, lounge pass sales and loyalty program marketing fees. 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.

Redemption of Aeroplan points for non-air goods and services is recorded in other revenue. For non-air redemptions, the Corporation has determined that, for accounting purposes, it is not the principal in the transaction between the member and the ultimate supplier of the goods or service. When points are redeemed for non-air goods and services, the net margin is recorded in other revenue when the performance obligation is satisfied.

In certain subleases of aircraft to Jazz, for accounting purposes, the Corporation acts as an agent and accordingly reports the sublease revenues net against regional airlines expense. 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 and is prepared by the Corporation's consulting actuaries. The cost is determined using the projected unit credit method and assumptions including discount rates, future increases in compensation, 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 Retained earnings without subsequent reclassification to income.

The current service cost is estimated utilizing different discount rates derived from the yield curve used to measure the defined benefit obligation at the beginning of the year, reflecting the different timing of benefit payments for past service (the defined benefit obligation) and future service (the current service cost).

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

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

H) Employee Profit Sharing Plans

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

I) Share-Based Compensation Plans

Certain employees of the Corporation participate in Air Canada's Long-Term Incentive Plan, which provides for the grant of stock options, performance share units ("PSUs") and restricted share units ("RSUs"), as further described in Note 14. PSUs and RSUs are notional share units which are exchangeable on a one-to-one basis for Air Canada shares or the cash equivalent, as determined by the Board of Directors.



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

PSUs and RSUs are accounted for as cash settled instruments based on settlement experience. In accounting for cash settled instruments, compensation expense is adjusted for subsequent changes in the fair value of the PSUs and RSUs taking into account forfeiture estimates. The liability related to cash settled PSUs and RSUs is recorded in Other long-term liabilities. Refer to Note 17 for a description of derivative instruments used by the Corporation to economically hedge the cash flow exposure to PSUs and RSUs.

Air Canada also maintains an employee share purchase plan. Under this plan, contributions by the Corporation's employees are matched to a specific percentage by the Corporation. Employees must remain with the Corporation and retain their shares 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. The Corporation's matching of employee contributions was suspended May 1, 2020, refer to Note 14.

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 lease, which are accrued over the term of the lease, and major maintenance expenditures on owned and leased aircraft, which are capitalized as described below in Note 2R.

Maintenance and repair costs related to return conditions on aircraft leases are recorded over the term of the lease for the end of lease maintenance return condition obligations within the Corporation's 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. Maintenance provisions for end-of-lease return obligations are recorded, as applicable, on aircraft leases as a maintenance expense over the term of the lease, taking into account the specific risks of the liability over the remaining term of the lease. Interest accretion on the provision is recorded in Other non-operating expense. Any changes to the provision for end-of-lease conditions are recognized as an adjustment to the right-of-use asset and subsequently amortized to the income statement over the remaining term of the lease. Any 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

Recognition

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

Classification

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

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

The Corporation has implemented the following classifications:

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



Measurement

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

Financial assets that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of the subsequent accounting periods. All other financial assets including equity investments are measured at their fair values at the end of subsequent accounting periods, with any changes taken through profit and loss or other comprehensive income (irrevocable election at the time of recognition).

Impairment

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

Derivatives and Hedge Accounting

The Corporation enters into foreign currency, fuel derivatives and share forward contracts to manage the associated risks. Derivative instruments are recorded on the consolidated statement of financial position at fair value, including those derivatives that are embedded in financial or non-financial contracts that are required to be accounted for separately. Changes in the fair value of derivative instruments are recognized in Non-operating income (expense), except for effective changes for designated fuel derivatives under hedge accounting as described below. Derivative instruments are recorded in Prepaid expenses and other current assets, Deposits and other assets, Accounts payable and accrued liabilities, and 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 applies hedge accounting for designated fuel derivatives. Crude oil prices, while not contractually specified in the Corporation's jet fuel purchase contracts, are economically related to jet fuel prices. The Corporation enters into option contracts on crude oil and designates the contracts in cash flow hedges of the crude oil component of its future jet fuel purchases.

The Corporation has established a hedge ratio of 1:1 for its hedging relationships. Under hedge accounting, to the extent effective, the gain or loss on fuel hedging derivatives is recorded in other comprehensive income. Premiums paid for option contracts and the time value of the option contracts are deferred as a cost of the hedge in other comprehensive income. Amounts accumulated in other comprehensive income are presented as hedging reserve in equity and are reclassified to Aircraft fuel expense when the underlying hedged jet fuel is used. Any ineffective gain or loss on fuel hedging derivatives is recorded in non-operating expense in Gain on financial instruments recorded at fair value.

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

M) Foreign Currency Translation

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

N) Income Taxes

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

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

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



deferred income tax asset is realized or the deferred income tax liability is settled.

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

O) Earnings (Loss) per Share

Basic earnings (loss) 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 shares outstanding during the period.

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

The weighted average number of shares outstanding in diluted EPS is also adjusted for the number of shares that would be issued on the conversion of the convertible notes. Additionally, the net income (loss) is adjusted for the after-tax effect of any changes to net income (loss) that would result from the conversion, including interest recognized in the period, foreign exchange recognized on the debt principal, and the mark to market revaluation of the embedded derivative, unless the result of the adjustments are anti-dilutive.

P) Restricted Cash

The Corporation has recorded Restricted cash under Current assets representing funds held in trust by Air Canada Vacations in accordance with regulatory requirements governing advance ticket sales.

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

Q) Aircraft Fuel Inventory and Spare Parts and Supplies Inventory

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

The Corporation did not recognize any write-downs on inventories or reversals of any previous write-downs during the periods presented. Included in Aircraft maintenance is \$48 million related to spare parts and supplies consumed during the year (2019 – \$72 million).

R) Property and Equipment

Property and equipment is recognized using the cost model. Property under leases, recognized as right-of-use assets, and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the asset 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 periods not exceeding 25 years, with residual values initially estimated at 10% of the original cost and updated for changes in estimates over time. Spare engines and related parts ("rotables") are depreciated over the average remaining useful life of the fleet to which they relate with residual values initially estimated at 10%. Cabin interior equipment and modifications are depreciated over the lesser of eight years or the remaining useful life of the aircraft. Cabin interior equipment and modifications to aircraft on lease are amortized over the lesser of eight years or 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 power-by-the-hour fleet maintenance contract costs are charged to operating expenses in the income statement as incurred. Buildings are depreciated on a straight-line basis over their useful lives not exceeding 50 years or the term of any related lease, whichever is less. Leasehold improvements are amortized over the lesser of the lease term or five years. Ground and other equipment is depreciated over three to 25 years.

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



S) Interest Capitalized

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

To the extent that funds are borrowed specifically for the purpose of obtaining such assets, the amount of borrowing costs eligible for capitalization is determined as 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. Borrowings made specifically for the purpose of obtaining a qualifying asset are excluded from this calculation until substantially all the activities necessary to prepare the asset for its intended use are complete.

T) Leases

Accounting for Leases and Right-of-Use Assets

Leases are recognized as a right-of-use asset and corresponding liability at the date of which the leased asset is available for use by the Corporation. Each lease payment is allocated between the liability and interest expense. The interest cost is charged to the consolidated statement of operations over the lease period to produce a constant rate of interest on the remaining balance of the liability for each period.

Right-of-use assets are accounted for under IAS 16 Property, Plant and Equipment. Aircraft recorded as right-of-use assets have the same accounting policies as directly owned aircraft, meaning the right-of-use assets are componentized and depreciated over the lease term. Consistent with owned aircraft, any qualifying maintenance events are capitalized and depreciated over the lesser of the lease term and expected maintenance life.

Changes to the terms and conditions, or events impacting the extension of a lease would usually require an assessment of whether it is a lease modification which could involve recalculating lease assets and liabilities using a revised discount rate.

Maintenance provisions for end-of-lease return obligations are recorded, as applicable, on aircraft leases as a maintenance expense over the term of the lease. Any changes to the provision for end-of-lease conditions are recognized as an adjustment to the right-of-use asset and subsequently amortized to the income statement over the remaining term of the lease.

Sale and Leaseback

For sale and leaseback transactions, the Corporation applies the requirements of IFRS 15 Revenue to determine whether the transfer of the asset should be accounted for as a sale, and is generally considered as such if there is no repurchase option on the asset at the end of the lease term. If the transfer of the asset is a sale, the Corporation de-recognizes the underlying asset and recognizes a right-of-use asset arising from the leaseback equal to the retained portion of the previous carrying amount of the sold asset. The residual is recognized through the statement of operations as a gain on sale and leaseback of assets.

Aircraft Leases

As at December 31, 2020 the Corporation had 107 aircraft under right-of-use leases (127 aircraft as at December 31, 2019), and Air Canada recorded such aircraft as right-of-use assets and lease liabilities of Air Canada in accordance with the requirements of IFRS 16. Additionally, Air Canada is the lessee in respect of aircraft used by regional carriers providing services under the respective capacity purchase agreements ("CPA") and recorded such aircraft as right-of-use assets and lease liabilities of Air Canada. As at December 31, 2020, there were 121 aircraft (131 aircraft as at December 31, 2019) operating under these arrangements on behalf of Air Canada.

Property Leases

The Corporation has leases related to airport terminal operations space and other real estate leases. For leases related to terminal operations space, there are generally effective substitution rights in the hands of the lessor and therefore these are not considered lease contracts under the standard. Leases with reciprocal termination rights with a notice period of less than 12 months are considered short-term leases and therefore excluded from balance sheet recognition under the practical expedient. Finally, those airport terminal contracts with entirely variable lease payments are also excluded since variable lease payments, other than those based on an index or rate, are excluded from the measurement of the lease liability. This results in a portfolio of property leases that are recorded as right-of-use assets and lease liabilities under the standard which relate to dedicated space in Air Canada's hub locations of Toronto, Montréal and Vancouver, lease contracts on building space dedicated to the Corporation for offices, airport and maintenance operations, Maple Leaf Lounges and land leases.



U) Intangible Assets

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

| | ESTIMATED USEFUL LIFE | REMAINING AMORTIZATION PERIOD AS AT DECEMBER 31, 2020 |
|---|-----------------------|---|
| International route rights and slots | Indefinite | not applicable |
| Marketing based trade names | Indefinite | not applicable |
| Technology based (internally developed) | 5 -15 years | 1 to 15 years |
| Contract based (Aeroplan commercial agreements) | 11.5 years | 10 years |

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

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

Development costs that are directly attributable to the design, development, implementation, 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.

Contract based and marketing based trade name intangible assets were recorded upon the acquisition of Aeroplan. The contract based intangible assets have an estimated remaining useful life of 10 years, being the term of the primary commercial agreements with program partners, which expire in 2030. The marketing-based trade name is considered an indefinite life intangible asset.

V) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Corporation's share of the net identifiable assets of the acquired business at the date of acquisition. Goodwill is tested at least annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. For the purpose of impairment testing, goodwill is tested for impairment at the lowest level within the entity at which the goodwill is monitored for internal management purposes, being the operating segment level (Note 2AA).

W) Impairment of Long-Lived Assets

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

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



X) Non-Current Assets (Or Disposal Groups) Held For Sale

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

Y) Provisions

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

Z) Special Items

Special items are those items that in management's view are to be separately disclosed by virtue of their size or incidence to enable a full understanding of the Corporation's financial performance. Refer to Note 4.

AA) Segment Reporting

Air Canada is managed as one operating segment based on how financial information is produced internally for the purposes of making operating decisions. The operating segment is 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.

BB) Government Grants

The Corporation recognizes government grants when there is reasonable assurance that the Corporation will comply with the conditions of the grant and the grant will be received. Government grants receivable are recorded in Accounts receivable on the consolidated statement of financial position. The Corporation recognizes government grants in the consolidated statement of operations in the same period as the expenses for which the grant is intended to compensate. In cases where a government grant becomes receivable as compensation for expenses already incurred in prior periods, the grant is recognized in profit or loss in the period in which it becomes receivable.

CC) Accounting Standards and Amendments Issued But Not Yet Adopted

Interbank Offered Rate ("IBOR") Reform

In August 2020, the IASB published amendments to IFRS 9 Financial Instruments, IAS 39 Financial Instruments: Recognition and Measurement, IFRS 7 Financial Instruments: Disclosures, IFRS 4 Insurance Contracts and IFRS 16 Leases.

The amendments address issues that arise from implementation of IBOR reform, where IBORs are replaced with alternative benchmark rates. For financial instruments at amortized cost, the amendments introduce a practical expedient such that if a change in the contractual cash flows is as a result of IBOR reform and occurs on an economically equivalent basis, the change will be accounted for by updating the effective interest rate with no immediate gain or loss recognized. The amendments also provide additional temporary relief from applying specific IAS 39 hedge accounting requirements to hedging relationships affected by IBOR reform.

The amendments are effective for fiscal years beginning on or after January 1, 2021 with early adoption permitted. The Corporation will adopt the amendment on January 1, 2021, electing to apply the practical expedient. The Corporation is in the process of evaluating potential changes to debt and lease contracts to transition from IBORs to alternative rates prior to the cessation of IBORs. As at December 31, 2020, the amount of debt and lease contracts likely subject to IBOR reform is \$1,718 million USD LIBOR. There are also debt and aircraft leases referencing interest rate benchmarks in multi-rate jurisdictions, including the Canadian Dollar Offered Rate ("CDOR") of \$1,007 million and \$5 million of JPY TIBOR.



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 and judgments 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:

Impairment Considerations on Long-lived Assets

When required, an impairment test is performed by comparing the carrying amount of the asset or cash-generating unit to their recoverable amount, which is calculated as the higher of an asset's or cash-generating unit's fair value less costs to dispose and its value in use. Fair value less costs to dispose may be calculated based upon a discounted cash flow analysis, which requires management to make a number of significant market participant assumptions including assumptions relating to cash flow projections, discount rates and future growth rates. Refer to Note 7.

Employee Future Benefits

The cost and related liabilities of the Corporation's pension, other post-retirement and post-employment benefit programs are determined using actuarial valuations. The actuarial valuations involve assumptions and estimates including discount rates, future increases in compensation, and mortality assumptions. Also, due to the long-term nature of these programs, such estimates are subject to significant uncertainty. Refer to Note 10 for additional information.

Income Taxes

Commencing in the second quarter of 2020, the net deferred income tax assets related to unused tax losses and other deductible temporary differences were not recognized. Management assessed the available positive and negative evidence to estimate whether sufficient future taxable income will be generated to permit use of the existing deferred tax assets. As described in Note 1, as a result of the COVID-19 pandemic, there is considerable negative evidence relating to losses incurred in the current year and uncertainty exists as to when conditions will improve. Such negative evidence currently outweighs the positive historical evidence and accordingly, the net deferred tax asset was not recognized. Deferred tax assets have only been recognized to the extent of taxable temporary

differences expected to reverse and generate taxable income against which the deferred tax assets can be utilized. The future income tax deductions underlying the unrecognized deferred income tax assets remain available for use in the future to reduce taxable income. Refer to Note 12.

Aeroplan Loyalty Program

Loyalty program accounting requires management to make several estimates including the ETV of Aeroplan points issued and the breakage on Aeroplan points. The ETV of Aeroplan points issued is determined based on the value a passenger receives by redeeming points for a ticket rather than paying cash. This ETV is estimated with reference to historical Aeroplan redemptions as compared to equivalent ticket purchases after considering similar fare conditions, advance booking periods and other relevant factors including the selling price of points to third parties. ETV estimates and assumptions are considered for updates at least annually. A change in the ETV rate is accounted for prospectively on future points issued.

Breakage represents the estimated points that are not expected to be redeemed. Breakage is estimated by management based on the terms and conditions of membership and historical accumulation and redemption patterns, as adjusted for changes to any terms and conditions or other circumstances that may affect future redemptions. Management uses statistical and simulation models to estimate breakage. A change in assumptions as to the number of points expected to be redeemed could have a material impact on revenue in the year in which the change occurs.

As at December 31, 2020, the Aeroplan points deferred revenue balance was \$3,256 million. For illustrative purposes, a hypothetical 1% change in the number of outstanding points estimated to be redeemed would result in an approximate impact of \$33 million on revenue with a corresponding adjustment to Aeroplan deferred revenue.

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 value of the assets based on the estimated current and future fair values 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 \$14 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 at the end of the lease and the amount of the provision is recorded in Aircraft 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 recognized as an adjustment to the right-of-use asset. Refer to Note 11(a) for additional information.



4.

Special Items

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

Special items recorded within operating expenses consist of the following:

| (Canadian dollars in millions) | 2020 | 2019 |
|------------------------------------|-----------------|-------------|
| Impairments | \$ 315 | \$ - |
| Workforce reduction provisions | 127 | - |
| Canada emergency wage subsidy, net | (554) | - |
| Other | (4) | - |
| Special items | \$ (116) | \$ - |

Impairments

In response to capacity reductions related to the impact of the COVID-19 pandemic, Air Canada is accelerating the retirement of certain older aircraft from its fleet consisting of Boeing 767, Airbus A319 and Embraer 190 aircraft. These aircraft are being retired and removed from the cash-generating units for evaluation of whether impairments exist. A fair value less cost to dispose model based on level 3 inputs was used in the evaluation of impairment. The recoverable amount of the owned aircraft is \$91 million, equal to expected proceeds on disposal reflecting management's best estimate including inputs from published pricing guides adjusted to reflect management's best estimate of the current market environment. The recoverable amount for the leased aircraft was determined as the estimated net obligation to settle the leases comprised of contractual future lease payments and end of lease return costs.

A non-cash impairment charge of \$283 million was recorded reflecting the write-down of right-of-use assets for leased aircraft and reduction of carrying values of owned aircraft to expected disposal proceeds. Changes to the estimates around the expected disposal proceeds may result in adjustments to the impairment charge in future periods.

In addition, the Corporation recorded an impairment charge of \$32 million in the year ended December 31, 2020, related to previously capitalized costs incurred for the development of technology based intangible assets which are now cancelled.

Workforce Reduction Provisions

As a result of COVID-19, Air Canada undertook a workforce reduction of approximately 20,000 employees in the second quarter of 2020, representing more than 50% of its staff, achieved through layoffs, terminations of employment, early retirements and special leaves. A workforce reduction provision of \$78 million was recorded related to these measures. Payments of \$32 million have been made for the year, resulting in a remaining obligation of \$46 million at December 31, 2020. The provision includes the estimated notice of termination and severance costs under the Corporation's collective agreements and the applicable law, which amount is subject to adjustment depending on a number of factors such as the relevant notice period and the duration and number of employees who remain on layoff status. In addition to such provision, termination benefits and curtailments of \$49 million related to the pension and benefit obligations were recorded.

Canada Emergency Wage Subsidy

In April 2020, the Government of Canada announced the Canada Emergency Wage Subsidy ("CEWS") in order to help employers retain and/or return Canadian-based employees to payrolls in response to challenges posed by the COVID-19 pandemic.

Air Canada determined that it met the employer eligibility criteria and applied for the CEWS retroactively to March 15, 2020. The Corporation has recorded a total gross subsidy under the CEWS program of \$656 million for the year 2020. Cash payments of \$586 million have been received in the year 2020. In July 2020, the program was redesigned and extended until December 2020. In September and November 2020, the Government of Canada announced further extensions of the program to June 2021. Air Canada intends to continue its participation in the CEWS program, subject to meeting the eligibility requirements. The amount of the CEWS recorded in Special items is net of the cost for inactive employees who were eligible for the wage subsidy under the program. There are no unfulfilled conditions or other contingencies attaching to the current CEWS program.



5.

Investments, Deposits and Other Assets

(Canadian dollars in millions)

| | | 2020 | 2019 |
|--|---------|---------------|---------------|
| Long-term investments | | \$ 512 | \$ 512 |
| Investment in Chorus | Note 25 | 58 | 126 |
| Restricted cash | Note 2P | 87 | 102 |
| Aircraft related deposit | | 79 | 98 |
| Prepayments under maintenance agreements | | 72 | 56 |
| Share forward contracts | Note 17 | 14 | 27 |
| Other deposits | | 11 | 15 |
| | | \$ 833 | \$ 936 |



6.

Property and Equipment

| (Canadian dollars in millions) | DECEMBER 31, 2020 | | | DECEMBER 31, 2019 | | |
|--|-------------------|--------------------------|------------------|-------------------|--------------------------|------------------|
| | COST | ACCUMULATED DEPRECIATION | NET BOOK VALUE | COST | ACCUMULATED DEPRECIATION | NET BOOK VALUE |
| OWNED TANGIBLE ASSETS | | | | | | |
| Aircraft and flight equipment | \$ 13,251 | \$ 5,419 | \$ 7,832 | \$ 12,920 | \$ 4,616 | \$ 8,304 |
| Buildings and leasehold improvements | 1,033 | 553 | 480 | 923 | 501 | 422 |
| Ground and other equipment | 665 | 439 | 226 | 640 | 395 | 245 |
| Purchase deposits and assets under development | 754 | - | 754 | 1,041 | - | 1,041 |
| Owned tangible assets | \$ 15,703 | \$ 6,411 | \$ 9,292 | \$ 15,524 | \$ 5,512 | \$ 10,012 |
| Air Canada aircraft | \$ 5,019 | \$ 3,340 | \$ 1,679 | \$ 5,055 | \$ 3,282 | \$ 1,773 |
| Regional aircraft | 2,002 | 1,169 | 833 | 1,893 | 1,135 | 758 |
| Land and buildings | 510 | 177 | 333 | 447 | 156 | 291 |
| Right-of-use assets | \$ 7,531 | \$ 4,686 | \$ 2,845 | \$ 7,395 | \$ 4,573 | \$ 2,822 |
| Property and equipment | \$ 23,234 | \$ 11,097 | \$ 12,137 | \$ 22,919 | \$ 10,085 | \$ 12,834 |

Additions to owned aircraft in 2020 include 14 new Airbus A220 aircraft.

As described in Note 4, an impairment charge of \$283 million was recorded in 2020 in Special items related to the accelerated retirement of certain older aircraft and ancillary equipment from Air Canada's fleet and which charge is aggregated with accumulated depreciation in the table above.

Included in aircraft and flight equipment are 15 aircraft and 15 spare engines (2019 – 16 aircraft and 15 spare engines) which are leased to CPA carriers with a cost of \$389 million (2019 – \$353 million) less accumulated depreciation of \$172 million (2019 – \$154 million) for a net book value of \$217 million (2019 – \$199 million). Depreciation expense for 2020 for these aircraft and flight equipment amounted to \$24 million (2019 – \$21 million).

As further described in Note 22, during 2020, the Corporation sold and leased back nine Boeing 737 MAX aircraft.

Certain property and equipment are pledged as collateral as further described under the applicable debt instruments in Note 9.

| (Canadian dollars in millions) | JANUARY 1, 2020 | ADDITIONS | RECLASSIFICATION | DISPOSALS | DEPRECIATION AND IMPAIRMENT | DECEMBER 31, 2020 |
|--|------------------|-----------------|------------------|-----------------|-----------------------------|-------------------|
| OWNED TANGIBLE ASSETS | | | | | | |
| Aircraft and flight equipment | \$ 8,304 | \$ 720 | \$ 269 | \$ (419) | \$ (1,042) | \$ 7,832 |
| Buildings and leasehold improvements | 422 | - | 112 | - | (54) | 480 |
| Ground and other equipment | 245 | 28 | - | - | (47) | 226 |
| Purchase deposits and assets under development | 1,041 | 94 | (381) | - | - | 754 |
| Owned tangible assets | \$ 10,012 | \$ 842 | \$ - | \$ (419) | \$ (1,143) | \$ 9,292 |
| Right-of-use assets | | | | | | |
| Air Canada aircraft | \$ 1,773 | \$ 573 | \$ - | \$ - | \$ (667) | \$ 1,679 |
| Regional aircraft | 758 | 257 | - | (6) | (176) | 833 |
| Land and buildings | 291 | 75 | - | (3) | (30) | 333 |
| Right-of-use assets | \$ 2,822 | \$ 905 | \$ - | \$ (9) | \$ (873) | \$ 2,845 |
| Property and equipment | \$ 12,834 | \$ 1,747 | \$ - | \$ (428) | \$ (2,016) | \$ 12,137 |



| (Canadian dollars in millions) | JANUARY 1, 2019 | ADDITIONS | RECLASSIFI- CATION | DISPOSALS | DEPRECIATION | DECEMBER 31, 2019 |
|--|--------------------|-----------------|-----------------------|----------------|-------------------|----------------------|
| OWNED TANGIBLE ASSETS | | | | | | |
| Aircraft and flight equipment | \$ 8,109 | \$ 893 | \$ 355 | \$ (14) | \$ (1,039) | \$ 8,304 |
| Buildings and leasehold improvements | 404 | 26 | 41 | - | (49) | 422 |
| Ground and other equipment | 197 | 66 | 21 | (1) | (38) | 245 |
| Purchase deposits and assets under development | 933 | 525 | (417) | - | - | 1,041 |
| Owned tangible assets | \$ 9,643 | \$ 1,510 | \$ - | \$ (15) | \$ (1,126) | \$ 10,012 |
| Right-of-use assets | | | | | | |
| Air Canada aircraft | \$ 1,620 | \$ 704 | \$ - | \$ (7) | \$ (544) | \$ 1,773 |
| Regional aircraft | 707 | 234 | - | (7) | (176) | 758 |
| Land and buildings | 213 | 104 | - | - | (26) | 291 |
| Right-of-use assets | \$ 2,540 | \$ 1,042 | \$ - | \$ (14) | \$ (746) | \$ 2,822 |
| Property and equipment | \$ 12,183 | \$ 2,552 | \$ - | \$ (29) | \$ (1,872) | \$ 12,834 |

Depreciation and amortization recorded in the consolidated statement of operations is detailed as follows.

| (Canadian dollars in millions) | 2020 | 2019 |
|--------------------------------------|-----------------|-----------------|
| Aircraft and flight equipment | \$ 930 | \$ 1,039 |
| Buildings and leasehold improvements | 54 | 49 |
| Ground and other equipment | 47 | 38 |
| Owned tangible assets | 1,031 | 1,126 |
| Air Canada aircraft | 496 | 544 |
| Regional aircraft | 176 | 176 |
| Land and buildings | 30 | 26 |
| Right-of-use assets | 702 | 746 |
| Property and equipment | 1,733 | 1,872 |
| Spare part and supplies inventory | 14 | 19 |
| Intangible assets | 102 | 95 |
| Depreciation and amortization | \$ 1,849 | \$ 1,986 |



7.

Intangible Assets

(Canadian dollars in millions)

| | INTERNATIONAL ROUTE RIGHTS AND SLOTS | CONTRACT BASED | MARKETING BASED TRADE NAMES | TECHNOLOGY BASED (INTERNALLY DEVELOPED) | TOTAL |
|-------------------------------------|--|-------------------|-----------------------------------|--|----------|
| YEAR ENDED DECEMBER 31, 2019 | | | | | |
| At January 1, 2019 | \$ 97 | \$ - | \$ 88 | \$ 219 | \$ 404 |
| Additions | - | 225 | 90 | 378 | 693 |
| Amortization | - | (19) | - | (76) | (95) |
| At December 31, 2019 | \$ 97 | \$ 206 | \$ 178 | \$ 521 | \$ 1,002 |
| AT DECEMBER 31, 2019 | | | | | |
| Cost | \$ 97 | \$ 225 | \$ 178 | \$ 928 | \$ 1,428 |
| Accumulated amortization | - | (19) | - | (407) | (426) |
| | \$ 97 | \$ 206 | \$ 178 | \$ 521 | \$ 1,002 |
| YEAR ENDED DECEMBER 31, 2020 | | | | | |
| At January 1, 2020 | \$ 97 | \$ 206 | \$ 178 | \$ 521 | \$ 1,002 |
| Additions | - | - | - | 259 | 259 |
| Amortization and impairment | - | (19) | - | (108) | (127) |
| At December 31, 2020 | \$ 97 | \$ 187 | \$ 178 | \$ 672 | \$ 1,134 |
| AT DECEMBER 31, 2020 | | | | | |
| Cost | \$ 97 | \$ 225 | \$ 178 | \$ 1,051 | \$ 1,551 |
| Accumulated amortization | - | (38) | - | (379) | (417) |
| | \$ 97 | \$ 187 | \$ 178 | \$ 672 | \$ 1,134 |

In 2020, technology-based assets with cost and accumulated amortization of \$110 million (2019 – \$29 million) were retired.

Certain international route rights and slots are pledged as security for senior secured notes as described in Note 9.

Impairment Assessment

An assessment of the recoverable amount of the Corporation's cash-generating units compared to their carrying values was performed based on cash flow projections taking into account the COVID-19 pandemic. This review was also performed in conjunction with the annual impairment review conducted on all intangible assets that have an indefinite life. The allocation of the indefinite lived intangible assets to the cash-generating units was \$165 million to wide-body aircraft and \$110 million to narrow-body aircraft. The recoverable amount of the cash-generating units has been measured based on fair value less cost to dispose, using a discounted cash flow model. The discounted cash flow model would represent a level 3 fair value measurement within the IFRS 13 fair value hierarchy. The cash flows are management's best projections using current and anticipated market conditions covering a five-year period. The COVID-19 pandemic and its impact on the economy are expected to last several years. These projections are inherently uncertain and continually evolving in an unpredictable manner which present many variables and contingencies for modeling.

It is possible that long-term underperformance relative to these projections could occur if passenger demand is below projected levels and travel restrictions continue to prevail with a duration and impact greater than currently anticipated.

The recoverable amount of both cash-generating units exceeded their respective carrying values by an aggregate amount ranging from approximately \$2 billion to \$5 billion under different scenarios. Management has considered reasonably possible changes in key assumptions using multiple modeling scenarios and sensitivity analysis and determined such changes would not cause the recoverable amount of each CGU to be less than the carrying value.



Key assumptions used for the fair value less cost to dispose calculations in fiscal 2020 were as follows:

| Key Assumption | 2020 | Approach used to determine values |
|---------------------------------|-----------------|---|
| Average discount rate | 9.25% | Derived from market participant assumptions regarding the Corporation's weighted average cost of capital adjusted for taxes and specific risks applicable to each cash-generating unit being tested. Inputs to the various scenarios ranged from 9.5%-11% for the wide-body CGU and 7.5%-9% for the narrow-body CGU. |
| Long-term growth rate | 2.5% | Cash flows beyond the five-year period are projected to increase at 2.5% consistent with the long-term growth assumption of the airline industry considering various factors such as the Corporation's fleet plans and industry growth assumptions. |
| Jet fuel price range per barrel | US\$66 – US\$89 | Jet fuel prices are assumed to follow the global market recovery and represent management's best estimate of the range of future market conditions. Emerging issues in climate-related matters, such as change in regulations, may impact this assumption in future years. |

An impairment assessment of the aircraft that will be permanently leaving the fleet was done separately from the Corporation's CGUs with an impairment charge of \$283 million recorded in Special items in 2020 as described in Note 4.



8.

Goodwill

Goodwill is tested at least annually for impairment. Goodwill is tested for impairment using the fair value less cost to dispose model at the operating segment level. Air Canada is managed as one operating segment based on how financial information is produced internally for the purposes of making operating decisions, and it is the lowest level at which goodwill is monitored for internal management purposes.

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 losses have been recorded against the value of goodwill since its acquisition.

No impairment charges have arisen as a result of the reviews performed as at December 31, 2020 and 2019. Reasonably possible changes in key assumptions would not cause the recoverable amount of goodwill to fall below the carrying value.



9.

Long-Term Debt and Lease Liabilities

| | FINAL MATURITY | WEIGHTED AVERAGE INTEREST RATE | DECEMBER 31, 2020 | DECEMBER 31, 2019 |
|---|----------------|--------------------------------|--------------------------------|--------------------------------|
| | | (%) | (Canadian dollars in millions) | (Canadian dollars in millions) |
| Aircraft financing (a) | | | | |
| Fixed rate U.S. dollar financing | 2021 – 2030 | 4.86 | \$ 3,791 | \$ 3,200 |
| Floating rate U.S. dollar financing | 2026 – 2027 | 2.12 | 483 | 544 |
| Fixed rate CDN dollar financing | 2026 – 2030 | 3.78 | 232 | 259 |
| Floating rate CDN dollar financing | 2021 – 2032 | 2.50 | 1,007 | 264 |
| Fixed rate Japanese yen financing | 2027 | 1.84 | 145 | 141 |
| Floating rate Japanese yen financing | 2027 | 3.00 | 5 | 8 |
| Convertible notes (b) | 2025 | 4.00 | 667 | - |
| Senior and Second Lien secured notes – CDN dollar (c) | 2023 – 2024 | 8.18 | 1,040 | 200 |
| Senior unsecured notes – U.S. dollar (d) | 2021 | 7.75 | 509 | 520 |
| Other secured financing – U.S. dollar (e) | 2023 | 1.90 | 1,483 | 737 |
| Other secured financing – CDN dollar (e) | 2022 | 2.92 | 199 | - |
| Long-term debt | | 4.36 | 9,561 | 5,873 |
| Lease liabilities | | | | |
| Air Canada aircraft | 2021 – 2029 | 5.31 | 1,996 | 1,924 |
| Regional aircraft | 2023 – 2035 | 6.51 | 1,171 | 1,149 |
| Land and buildings | 2021 – 2078 | 5.23 | 429 | 386 |
| Lease liabilities (f) | | 5.69 | 3,596 | 3,459 |
| Total debt and lease liabilities | | 4.72 | 13,157 | 9,332 |
| Unamortized debt issuance costs and discounts | | | (168) | (90) |
| Current portion – Long-term debt | | | (1,244) | (587) |
| Current portion – Air Canada aircraft | | | (340) | (418) |
| Current portion – Regional aircraft | | | (179) | (185) |
| Current portion – Land and buildings | | | (25) | (28) |
| Long-term debt and lease liabilities | | | \$ 11,201 | \$ 8,024 |

(a) Aircraft financing (US\$3,359 million, CDN \$1,239 million and JPY ¥12,159 million) (2019 – US\$2,882 million, CDN \$523 million and JPY ¥12,425 million) is secured primarily by specific aircraft with a carrying value of \$6,037 million (2019 – \$4,777 million). 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\$138 million and CDN \$228 million of the financing is supported by a loan guarantee by the Export-Import Bank of the United States ("EXIM").

In September 2020, Air Canada concluded a private offering of two tranches of Enhanced Equipment Trust Certificates ("EETCs"), the proceeds of which were used to purchase equipment notes issued by Air Canada and secured by three Boeing 787-9 aircraft, three Boeing 777-300ER aircraft, one Boeing 777-200LR and nine A321-200 aircraft. The two tranches of certificates have a combined aggregate face amount of US\$553 million (\$740 million) and a weighted average interest rate of 5.73%. The offering is comprised of Class A Certificates and Class B Certificates. The Class A Certificates totaling US\$453 million (\$606 million) have an interest rate of 5.25% per annum and a final expected distribution date of April 1, 2029. The Class B Certificates totaling US\$100 million (\$134 million) have an interest rate of 9.00% per annum and a final expected distribution date of October 1, 2025. Air Canada used the proceeds from this financing together with cash on hand to repay in full the US\$600 million (\$803 million) 364-day term loan originally put in place in April 2020.

In September 2020, Air Canada concluded a committed secured facility totaling \$788 million to finance the purchase of the first 18 Airbus A220 aircraft. As aircraft are financed under this new Canadian dollar facility, the bridge financing of \$788 million put in place in April 2020 will be repaid concurrently. As at December 31, 2020, 15 Airbus A220 aircraft were financed under this facility with the corresponding bridge financing repaid. Any amount left unpaid under the bridge financing will be repaid following the financing of the 18th A220 aircraft expected



in the first quarter of 2021. The security facility has a term of 12 years from delivery of each aircraft on a floating interest basis based on CDOR. This equates to an interest rate of approximately 2.36% using CDOR rates at December 31, 2020.

In June 2020, Air Canada completed a private offering of one tranche of Class C EETCs with a combined aggregate face amount of approximately US\$316 million, which were sold at 95.002% of par, for net proceeds of \$392 million. The Class C tranche ranks junior to the previously issued Series 2015-1, Series 2015-2, and Series 2017-1 EETCs, and is secured by liens on the 27 aircraft financed under these previously issued Series. The Class C EETCs have an interest rate of 10.500% per annum, and a final expected distribution date of July 15, 2026.

- (b) In June 2020, Air Canada closed US\$748 million (\$1,011 million) of convertible unsecured notes ("Convertible Notes"), for net proceeds of \$986 million. The Convertible Notes bear interest semi-annually in arrears at a rate of 4.000% per annum and will mature on July 1, 2025, unless earlier repurchased, redeemed or converted. The conversion rate of the Convertible Notes is 65.1337 shares per US\$1,000 principal amount of Convertible Notes, or a conversion price of approximately US\$15.35 per share. The Convertible Notes will be convertible, at the Corporation's election, into cash or into Class A Variable Voting shares and/or Class B Voting shares of the Corporation, or a combination thereof.

The Corporation's option to deliver cash or a combination of cash and shares on the conversion date in lieu of shares (based on the daily conversion values for 40 consecutive trading days) gives rise to an embedded derivative financial liability measured separately at fair value through profit or loss. On initial recognition, the derivative financial liability is measured at fair value, and the carrying value of the underlying notes is measured as the difference between this amount and the proceeds of issue. Subsequent to initial recognition, the Corporation measures the derivative financial liability at fair value at each reporting date, recognizing changes in the fair value in Gain (loss) on financial instruments recorded at fair value in the statement of operations, and accretes the carrying value of the underlying notes to their face value using the effective interest method, which results in an effective interest rate of 10.76%. The fair value of the embedded derivative at initial recognition was \$320 million and is recorded in Other long-term liabilities. At December 31, 2020, the fair value was \$534 million and the Corporation recorded an unrealized loss of \$214 million for the year. Refer to Note 17.

- (c) In June 2020, Air Canada completed a private offering of \$840 million aggregate principal amount of 9.00% Second Lien Secured Notes due 2024 (the "2024 Notes"), which were sold at 98% of par, for net proceeds of \$812 million. The 2024 Notes are secured obligations of Air Canada, secured on a second lien basis by certain real estate interest, ground service equipment, certain airport slots and gate leaseholds, and certain routes and the airport slots and gate leaseholds utilized in connection with those routes.

The senior secured notes also include a private offering of \$200 million aggregate principal amount of 4.75% senior secured first lien notes due 2023 (the "2016 Senior Notes"), which were sold at par. Air Canada may redeem at any time and from time to time prior to October 6, 2021, during any 12-month period, up to 10% of the original aggregate principal amount of the 2016 Senior Notes at a redemption price of 103% of the principal amount, plus accrued and unpaid interest.

- (d) Private offering of US\$400 million of 7.75% senior unsecured notes due 2021, with interest payable semi-annually. Air Canada may at any time and from time to time redeem some or all of the senior unsecured notes at a redemption price equal to the greater of (i) 100% of the principal amount of the notes being redeemed and (ii) a "make-whole" amount, if any, plus, in either case accrued and unpaid interest.
- (e) Other secured financing consists of a US\$600 million term loan, maturing in 2023, a US\$600 million revolving credit facility expiring in 2023 (collectively with the term loan, the "2016 Credit Facility"), and a \$200 million revolving credit facility available until 2022.

In March 2020, Air Canada drew down in full on its US\$600 million revolving credit facility and its Canadian \$200 million revolving credit facility (interest rate of 175 basis points over LIBOR and Bankers Acceptances plus 2%, respectively).

The 2016 Senior Notes and the Corporation's obligations under the 2016 Credit Facility are senior secured obligations of Air Canada, secured on a first lien basis, subject to certain permitted liens and exclusions, by certain real estate interests, 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.

Other U.S. dollar secured financings are floating rate financings that are secured by certain assets including assets described above relating to the 2016 Credit Facility.

- (f) Lease liabilities, related to facilities and aircraft, total \$3,596 million (\$377 million, US\$2,503 million and GBP £15 million) (2019 – \$3,459 million (\$346 million, US\$2,369 million and GBP £15 million)). The carrying value of aircraft and facilities under lease liabilities amounted to \$2,512 million and \$333 million respectively (2019 – \$2,532 million and \$291 million).

Cash interest paid on Long-term debt and lease liabilities in 2020 by the Corporation was \$528 million (2019 – \$493 million).



The Corporation has recorded Interest expense as follows:

| (Canadian dollars in millions) | 2020 | 2019 |
|--------------------------------|---------------|---------------|
| Interest on debt | \$ 449 | \$ 284 |
| Interest on lease liabilities | | |
| Air Canada aircraft | 110 | 126 |
| Regional aircraft | 76 | 83 |
| Land and buildings | 21 | 22 |
| Interest expense | \$ 656 | \$ 515 |

The consolidated statement of operations includes the followings amounts related to leases which have not been recorded as right-of-use assets and lease liabilities.

| (Canadian dollars in millions) | 2020 | 2019 |
|---|--------------|---------------|
| Short-term leases | \$ 62 | \$ 83 |
| Variable lease payments not included in lease liabilities | 32 | 31 |
| Expense related to leases (included in Other operating expenses) | \$ 94 | \$ 114 |

Total cash outflows for payments on lease liabilities was \$870 million for the year ended December 31, 2020 (2019 – \$882 million), of which \$663 million was for principal repayments (2019 – \$651 million).

Maturity Analysis

Principal and interest repayment requirements as at December 31, 2020 on Long-term debt and lease liabilities are as follows. U.S. dollar amounts are converted using the December 31, 2020 closing rate of CDN\$1.2725.

| (Canadian dollars in millions) | 2021 | 2022 | 2023 | 2024 | 2025 | THEREAFTER | TOTAL |
|---|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|------------------|
| PRINCIPAL | | | | | | | |
| Long-term debt obligations ⁽¹⁾ | \$ 1,244 | \$ 665 | \$ 2,275 | \$ 1,254 | \$ 1,622 | \$ 2,785 | \$ 9,845 |
| Air Canada aircraft | 340 | 277 | 271 | 262 | 255 | 591 | 1,996 |
| Regional aircraft | 179 | 169 | 171 | 145 | 132 | 375 | 1,171 |
| Land and buildings | 25 | 25 | 23 | 23 | 23 | 310 | 429 |
| Lease liabilities | 544 | 471 | 465 | 430 | 410 | 1,276 | 3,596 |
| Total long-term debt and lease liabilities | \$ 1,788 | \$ 1,136 | \$ 2,740 | \$ 1,684 | \$ 2,032 | \$ 4,061 | \$ 13,441 |
| INTEREST | | | | | | | |
| Long-term debt obligations ⁽¹⁾ | \$ 394 | \$ 353 | \$ 320 | \$ 231 | \$ 174 | \$ 260 | \$ 1,732 |
| Air Canada aircraft | 89 | 71 | 58 | 46 | 33 | 45 | 342 |
| Regional aircraft | 68 | 56 | 45 | 33 | 24 | 98 | 324 |
| Land and buildings | 21 | 20 | 19 | 18 | 17 | 208 | 303 |
| Lease liabilities | 178 | 147 | 122 | 97 | 74 | 351 | 969 |
| Total long-term debt and lease liabilities | \$ 572 | \$ 500 | \$ 442 | \$ 328 | \$ 248 | \$ 611 | \$ 2,701 |

(1) Assumes the principal balance of the convertible notes remains unconverted and includes estimated interest payable until maturity.



Principal repayments for 2021 include \$159 million remaining on the April 2020 bridge financing and, subsequent to delivery of the remaining three Airbus A220 aircraft, a secured facility is in place that allows Air Canada to defer this debt repayment over the next 12 years from the delivery date.

Principal repayments in the table above exclude discounts and transaction costs of \$168 million which are offset against Long-term debt and lease liabilities in the consolidated statement of financial position.

Cash Flows from Financing Activities

Information on the change in liabilities for which cash flows have been classified as financing activities in the statement of cash flows is presented below.

| | JAN. 1, 2020 | Cash Flows | | | Non-Cash Changes | | | DEC. 31, 2020 |
|--|-----------------|-----------------|-------------------|----------------|------------------------------|--|---|------------------|
| | | BORROWINGS | REPAYMENTS | FINANCING FEES | FOREIGN EXCHANGE ADJUSTMENTS | AMORTIZATION OF FINANCING FEES AND OTHER ADJUSTMENTS | NEW LEASE LIABILITIES (NEW AND RENEWED CONTRACTS) | |
| (Canadian dollars in millions) | | | | | | | | |
| Long-term debt | \$ 5,873 | \$ 6,300 | \$ (2,056) | \$ - | \$ (280) | \$ (276) | \$ - | \$ 9,561 |
| Air Canada aircraft | 1,924 | - | (447) | - | (43) | - | 562 | 1,996 |
| Regional aircraft | 1,149 | - | (188) | - | (23) | - | 233 | 1,171 |
| Land and buildings | 386 | - | (28) | - | - | - | 71 | 429 |
| Lease liabilities | 3,459 | - | (663) | - | (66) | - | 866 | 3,596 |
| Unamortized debt issuance costs | (90) | (38) | - | (78) | - | 38 | - | (168) |
| Total liabilities from financing activities | \$ 9,242 | \$ 6,262 | \$ (2,719) | \$ (78) | \$ (346) | \$ (238) | \$ 866 | \$ 12,989 |

| | JAN. 1, 2019 | Cash Flows | | | Non-Cash Changes | | | DEC. 31, 2019 |
|--|-----------------|-------------|-------------------|----------------|------------------------------|--|---|------------------|
| | | BORROWINGS | REPAYMENTS | FINANCING FEES | FOREIGN EXCHANGE ADJUSTMENTS | AMORTIZATION OF FINANCING FEES AND OTHER ADJUSTMENTS | NEW LEASE LIABILITIES (NEW AND RENEWED CONTRACTS) | |
| (Canadian dollars in millions) | | | | | | | | |
| Long-term debt | \$ 6,573 | \$ - | \$ (433) | \$ - | \$ (266) | \$ (1) | \$ - | \$ 5,873 |
| Air Canada aircraft | 1,926 | - | (453) | - | (93) | - | 544 | 1,924 |
| Regional aircraft | 1,233 | - | (177) | - | (57) | - | 150 | 1,149 |
| Land and buildings | 297 | - | (21) | - | (1) | - | 111 | 386 |
| Lease liabilities | 3,456 | - | (651) | - | (151) | - | 805 | 3,459 |
| Unamortized debt issuance costs | (108) | - | - | (1) | - | 19 | - | (90) |
| Total liabilities from financing activities | \$ 9,921 | \$ - | \$ (1,084) | \$ (1) | \$ (417) | \$ 18 | \$ 805 | \$ 9,242 |



10.

Pensions and Other Benefit Liabilities

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

The Corporation is the administrator and sponsoring employer of eight domestic registered plans ("Domestic Registered Plans") with defined benefit commitments registered under the Pension Benefits Standard Act, 1985 (Canada). The defined benefit components of the Domestic Registered Plans are closed to new members, except for the hybrid component of three plans which are open to new members. The Corporation also has a U.S. plan, a UK plan and a Japan plan, which 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. 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 Human Resources and Compensation 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.

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

Pension Plan Cash Funding Obligations

Pension funding obligations (including projected funding obligations) may vary significantly based on a wide variety of factors, including the assumptions used in the most recently filed actuarial valuation reports (including the applicable discount rate used or assumed in the actuarial valuation), the plan demographics at the valuation date, the existing plan provisions, legislative and regulatory developments and changes in economic conditions (mainly the return on plan assets and changes in interest rates) and other factors.

As at January 1, 2020, the aggregate solvency surplus in the Domestic Registered Plans was \$2.5 billion. The next required valuation to be made as at January 1, 2021 will be completed in the first half of 2021. With the Corporation's Domestic Registered Plans in a solvency surplus position as at January 1, 2020, past service contributions were not required in 2020. In addition, in accordance with legislation and applicable plan rules, the excess over 105% on a solvency basis can be used to reduce current service contributions under the defined benefit component or to fund the employer contribution to a defined contribution component within the same pension plan. Based on that, and including the international and supplemental plans, the total employer pension funding contributions during 2020 amounted to \$90 million (\$103 million employer contribution net of \$13 million used to fund employer contribution in defined contribution components of the same plans). Pension funding obligations for 2021 are expected to be \$88 million.

Benefit Obligation and Plan Assets

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

| (Canadian dollars in millions) | Pension Benefits | | Other Employee Future Benefits | | Total | |
|--|-------------------|-----------------|--------------------------------|-----------------|---------------|---------------|
| | 2020 | 2019 | 2020 | 2019 | 2020 | 2019 |
| NON-CURRENT ASSETS | | | | | | |
| Pension assets | \$ 2,840 | \$ 2,064 | \$ - | \$ - | \$ 2,840 | \$ 2,064 |
| CURRENT LIABILITIES | | | | | | |
| Accounts payable and accrued liabilities | - | - | 62 | 65 | 62 | 65 |
| NON-CURRENT LIABILITIES | | | | | | |
| Pension and other benefit liabilities | 1,515 | 1,477 | 1,500 | 1,453 | 3,015 | 2,930 |
| Net benefit obligation (asset) | \$ (1,325) | \$ (587) | \$ 1,562 | \$ 1,518 | \$ 237 | \$ 931 |



The current portion of the net benefit obligation represents an estimate of other employee future benefits claims to be paid during 2021.

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

| (Canadian dollars in millions) | Pension Benefits | | Other Employee Future Benefits | |
|--|-------------------|-----------------|--------------------------------|-----------------|
| | 2020 | 2019 | 2020 | 2019 |
| CHANGE IN BENEFIT OBLIGATION | | | | |
| Benefit obligation at beginning of year | \$ 21,931 | \$ 19,690 | \$ 1,518 | \$ 1,279 |
| Acquisition of Aeroplan | - | 181 | - | 19 |
| Current service cost | 275 | 271 | 45 | 35 |
| Past service cost | 46 | - | (3) | (1) |
| Interest cost | 664 | 751 | 45 | 51 |
| Employees' contributions | 66 | 81 | - | - |
| Benefits paid | (936) | (880) | (42) | (48) |
| Remeasurements: | | | | |
| Experience loss (gain) | (48) | 17 | (56) | 29 |
| Loss (gain) from change in demographic assumptions | (51) | (189) | 3 | 5 |
| Loss (gain) from change in financial assumptions | 1,774 | 2,027 | 56 | 159 |
| Foreign exchange loss (gain) | (1) | (18) | (4) | (10) |
| Total benefit obligation | 23,720 | 21,931 | 1,562 | 1,518 |
| CHANGE IN PLAN ASSETS | | | | |
| Fair value of plan assets at beginning of year | 23,424 | 20,857 | - | - |
| Acquisition of Aeroplan | - | 161 | - | - |
| Return on plan assets, excluding amounts included in Net financing expense | 2,537 | 2,350 | - | - |
| Interest income | 711 | 782 | - | - |
| Employer contributions | 90 | 96 | 42 | 48 |
| Employees' contributions | 66 | 81 | - | - |
| Benefits paid | (936) | (880) | (42) | (48) |
| Administrative expenses paid from plan assets | (9) | (9) | - | - |
| Foreign exchange gain (loss) | 4 | (14) | - | - |
| Total plan assets | 25,887 | 23,424 | - | - |
| (Surplus) deficit at end of year | (2,167) | (1,493) | 1,562 | 1,518 |
| Asset ceiling / additional minimum funding liability | 842 | 906 | - | - |
| Net benefit obligation (asset) | \$ (1,325) | \$ (587) | \$ 1,562 | \$ 1,518 |

The actual return on plan assets was \$3,248 million (2019 – \$3,132 million).

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

| (Canadian dollars in millions) | 2020 | 2019 |
|--------------------------------|-----------------|-----------------|
| Domestic Registered Plans | \$ 8 | \$ 44 |
| International plans | 99 | 86 |
| Supplementary plans | 1,408 | 1,347 |
| | \$ 1,515 | \$ 1,477 |

The weighted average duration of the defined benefit obligation is 14.4 years (2019 – 14.9 years).



Pension and Other Employee Future Benefit Expense

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

| (Canadian dollars in millions) | Pension Benefits | | Other Employee Future Benefits | |
|--|-------------------|-----------------|--------------------------------|---------------|
| | 2020 | 2019 | 2020 | 2019 |
| CONSOLIDATED STATEMENT OF OPERATIONS | | | | |
| Components of cost | | | | |
| Current service cost | \$ 275 | \$ 271 | \$ 45 | \$ 35 |
| Past service cost | - | - | (6) | (1) |
| Administrative and other expenses | 9 | 9 | - | - |
| Actuarial losses (gains), including foreign exchange | - | - | (7) | 1 |
| Total cost recognized in Wages, salaries and benefits | \$ 284 | \$ 280 | \$ 32 | \$ 35 |
| Total cost recognized in Special items (note 4) | \$ 46 | \$ - | \$ 3 | \$ - |
| Net financing expense relating to employee benefits | \$ (18) | \$ (12) | \$ 45 | \$ 51 |
| Total cost recognized in statement of operations | \$ 312 | \$ 268 | \$ 80 | \$ 86 |
| CONSOLIDATED OTHER COMPREHENSIVE (INCOME) LOSS | | | | |
| Remeasurements: | | | | |
| Experience loss (gain), including foreign exchange | (53) | 13 | (48) | 19 |
| Loss (gain) from change in demographic assumptions | (51) | (189) | - | 5 |
| Loss (gain) from change in financial assumptions | 1,774 | 2,027 | 54 | 159 |
| Return on plan assets | (2,660) | (2,363) | - | - |
| Change in asset ceiling | (93) | 361 | - | - |
| Total cost (income) recognized in OCI | \$ (1,083) | \$ (151) | \$ 6 | \$ 183 |

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

| (Canadian dollars in millions) | 2020 | 2019 |
|--|---------------|---------------|
| NET DEFINED PENSION AND OTHER FUTURE EMPLOYEE BENEFITS EXPENSE RECORDED IN THE CONSOLIDATED STATEMENT OF OPERATIONS | | |
| Wages, salaries and benefits | \$ 316 | \$ 315 |
| Special items | 49 | - |
| Net financing expense relating to employee benefit liabilities | 27 | 39 |
| | \$ 392 | \$ 354 |
| EMPLOYEE BENEFIT FUNDING BY AIR CANADA | | |
| Pension benefits | \$ 90 | \$ 96 |
| Other employee benefits | 42 | 48 |
| | \$ 132 | \$ 144 |
| Employee benefit funding less than expense | \$ 260 | \$ 210 |



Composition of Defined Benefit Pension Plan Assets

Domestic Registered Plans

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

| | 2020 | 2019 | TARGET ALLOCATION |
|-------------------------|-------------|-------------|-------------------|
| Bonds | 65% | 71% | 65% |
| Canadian equities | 3% | 3% | 3% |
| Foreign equities | 7% | 7% | 7% |
| Alternative investments | 25% | 19% | 25% |
| | 100% | 100% | 100% |

For the Domestic Registered Plan assets, approximately 80% of assets as of December 31, 2020 have a quoted market price in an active market. Assets that do not have a quoted market price in an active market are mainly investments in privately held entities. The asset composition in the table represents the allocation of plan assets to each asset type.

Included in plan assets, for determining the net benefit obligation for accounting purposes, are 17,646,765 (2019 – 17,646,765) shares of Air Canada which were issued to a trust in 2009 in connection with pension funding agreements reached with all of the Corporation's Canadian-based unions. The trust arrangement provides that proceeds of any sale of the trust shares will be retained and applied to reduce future pension solvency deficits, if any should materialize. With the Corporation's Domestic Registered Plans now in a surplus position on a solvency basis, the accounting rules prevent the recognition of the value of the shares held in trust as part of the pension assets. The shares held in trust have a fair value of \$402 million at December 31, 2020 (2019 – \$856 million), however after giving effect to the asset ceiling, the recognized accounting value of the trust asset is nil.

For the Domestic Registered Plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Funds. As permitted under the investment policy, the actual asset mix may deviate from the target allocation from time to time. The deviations at December 31, 2020 are within the limits established in the investment policy. The investment return objective is to achieve a total annualized rate of return that exceeds by a minimum of 1.0% before investment fees on average over the long term (i.e., 10 years) the total annualized return that could have been earned by passively managing the Liability Replicating Portfolio. The Liability Replicating Portfolio, which is referenced to widely used Canadian fixed income indices (FTSE TMX Canada), closely matches the characteristics of the pension liabilities.

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

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

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

Derivatives are permitted provided that they are used for managing a particular risk (including interest rate risk related to pension liabilities) or to create exposures to given markets and currencies and that counterparties have a minimum credit rating of A. The Corporation manages interest rate risk related to its actuarial liabilities through a combination of financial instruments including, but not limited to, bonds, bond repurchase and reverse repurchase agreements, bond forwards, bond futures and interest rate swaps. As at December 31, 2020, approximately 75% of Air Canada's pension assets were invested in fixed income instruments to mitigate a significant portion of the interest rate (discount rate) risk. Counterparty credit risk associated with such financial instruments is mitigated by receiving collateral from counterparties based on collateralization agreements, as well as by monitoring the counterparties' credit ratings and ensuring compliance with the investment policy. The fair value of these derivative instruments is included in the Bonds in the asset composition table and is not a significant component of the aggregate bond fair values of the portfolio.



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

Risks

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

Asset risk

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

Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. A decrease in corporate and/or government bond yields will increase plan liabilities, which will be partially offset by an increase in the value of the plans' bond holdings. As at December 31, 2020, approximately 75% of Air Canada's pension assets were invested in fixed income instruments to mitigate a significant portion of the interest rate risk (discount rate risk).

Funding risk

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

Life expectancy

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

Assumptions

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

Discount Rate

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

Future Increases in Compensation

Estimates surrounding assumptions of future increases in compensation are based upon the current compensation policies, the Corporation's long range-plans, labour and employment agreements and economic forecasts.

Mortality Assumptions

In 2014, the Canadian Institute of Actuaries ("CIA") published a report on Canadian Pensioners' Mortality ("Report"). The Report contained Canadian pensioners' mortality tables and improvement scales based on experience studies conducted by the CIA. The CIA's conclusions were taken into account in selecting management's best estimate mortality assumption used to calculate the projected benefit obligation as at December 31, 2020 and 2019.



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

| | Pension Benefits | | Other Employee Future Benefits | |
|---|------------------|-------|--------------------------------|----------------|
| | 2020 | 2019 | 2020 | 2019 |
| Discount rate used to determine: | | | | |
| Net interest on the net defined benefit obligation for the year ended December 31 | 3.13% | 3.81% | 3.13% | 3.81% |
| Service cost for the year ended December 31 | 3.20% | 3.93% | 3.20% | 3.93% |
| Accrued benefit obligation as at December 31 | 2.59% | 3.13% | 2.59% | 3.13% |
| Rate of future increases in compensation used to determine: | | | | |
| Accrued benefit cost and service 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 |

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 2020 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.

| (Canadian dollars in millions) | 0.25 Percentage Point | |
|---|-----------------------|-----------------|
| | DECREASE | INCREASE |
| Discount rate on obligation assumption | | |
| Pension expense | \$ 21 | \$ (20) |
| Net financing expense relating to pension benefit liabilities | - | 5 |
| | \$ 21 | \$ (15) |
| Increase (decrease) in pension obligation | \$ 851 | \$ (822) |

The increase (decrease) in the pension obligation for a 0.25 percentage point change in the discount rate relates to the gross amount of the pension liabilities and is before the impact of any change in plan assets. As at December 31, 2020, approximately 75% of Air Canada's pension assets were invested in fixed income instruments to mitigate a significant portion of the interest rate (discount rate) risk.

An increase of one year in life expectancy would increase the pension benefit obligation by \$558 million.

Assumed health care cost trend rates impact the amounts reported for the health care plans. A 5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2020 (2019 – 5.25%). The rate is assumed to decrease gradually to 4.5% by 2023 (2019 – assumed to decrease gradually to 5% by 2020). A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by \$6 million and the obligation by \$81 million. A one percentage point decrease in assumed health care trend rates would have decreased the total of current service and interest costs by \$5 million and the obligation by \$80 million.

A 0.25 percentage point decrease in discount rate for other employee future benefits would have increased the total of current and interest costs by less than \$1 million and the obligation by \$65 million. A 0.25 percentage point increase in discount rate would have decreased the total of current and interest costs by less than \$1 million and the obligation by \$61 million.



Defined Contribution Pension Plans

Certain of the Corporation's management, administrative and unionized employees participate in a defined contribution pension plan, a defined contribution component of a plan which also includes a defined benefit component 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. As permitted by legislation and applicable plan rules, surplus in the defined benefit component can be used to cover the employer contributions in the defined contribution component of such plan. As such, \$13 million of surplus in the defined benefit components of the Domestic Registered Plans was used to cover the employer contributions in the defined contribution components during 2020 (2019 – \$13 million).

The Corporation's expense for these pension plans amounted to \$33 million for the year ended December 31, 2020 (2019 – \$40 million). Taking into account available surplus in the defined benefit components of applicable plans which may be expected to be used, expected total employer contributions for 2021 are \$17 million.



11.

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.

| (Canadian dollars in millions) | MAINTENANCE ^(a) | ASSET RETIREMENT ^(b) | LITIGATION | TOTAL PROVISIONS |
|------------------------------------|----------------------------|------------------------------------|--------------|---------------------|
| At December 31, 2019 | | | | |
| Current | \$ 162 | \$ - | \$ 34 | \$ 196 |
| Non-current | 1,240 | 33 | - | 1,273 |
| | \$ 1,402 | \$ 33 | \$ 34 | \$ 1,469 |
| Provisions arising during the year | \$ 173 | \$ - | \$ 11 | \$ 184 |
| Amounts utilized | (182) | - | (4) | (186) |
| Changes in estimated costs | (26) | 1 | (3) | (28) |
| Accretion expense | 18 | 1 | - | 19 |
| Foreign exchange gain | (32) | - | - | (32) |
| At December 31, 2020 | \$ 1,353 | \$ 35 | \$ 38 | \$ 1,426 |
| Current | \$ 313 | \$ - | \$ 38 | \$ 351 |
| Non-current | 1,040 | 35 | - | 1,075 |
| | \$ 1,353 | \$ 35 | \$ 38 | \$ 1,426 |

(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 2021 to 2035 with the average remaining lease term of approximately 3 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 \$51 million at December 31, 2020 and an increase to maintenance expense in 2021 of approximately \$7 million. Expected future cash flows to settle the obligation are discounted. 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 \$23 million at December 31, 2020. An equivalent but opposite movement in the discount rate would result in a similar impact in the opposite direction.

In 2020 and as a result of updated cost estimates in preparation for returning certain aircraft to lessors upon lease expiry, a favorable adjustment to Aircraft maintenance expense of \$76 million was recorded primarily related to Airbus A320 and regional aircraft. These aircraft leases are expiring in accordance with their terms and are not part of the accelerated retirements discussed in Note 4. The cost to meet contractual return conditions on upcoming lease returns has been favorably impacted due to reduced flying since the last maintenance event and projected to the lease expiry dates as a result of the COVID-19 pandemic.

(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 2021 to 2078. 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.



12.

Income Taxes

Income Tax Recovery (Expense)

Income tax recorded in the consolidated statement of operations is presented below.

| (Canadian dollars in millions) | 2020 | 2019 |
|--|---------------|-----------------|
| Current income tax recovery (expense) | \$ 42 | \$ (72) |
| Deferred income tax recovery (expense) | 164 | (227) |
| Income tax recovery (expense) | \$ 206 | \$ (299) |

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

| (Canadian dollars in millions) | 2020 | 2019 |
|--|---------------|-----------------|
| (Loss) income before income taxes | \$ (4,853) | \$ 1,775 |
| Statutory income tax rate based on combined federal and provincial rates | 26.54% | 26.73% |
| Income tax recovery (expense) based on statutory tax rates | 1,288 | (474) |
| Effects of: | | |
| Non-taxable portion of capital gains | 20 | 32 |
| Recognition of (unrecognized) deferred income tax assets | (1,018) | 37 |
| Non-deductible items | (82) | (24) |
| Tax rate changes on deferred income taxes | - | (5) |
| Unrecognized deferred income tax liability on outside basis difference | - | 126 |
| Other | (2) | 9 |
| Income tax recovery (expense) | \$ 206 | \$ (299) |

The applicable statutory tax rate is 26.54% (2019 – 26.73%). The Corporation's applicable tax rate is the Canadian combined tax rate applicable in the jurisdiction in which the Corporation operates. The income tax recovery (expense) in the consolidated statement of operations differs from the amount that would have resulted from applying the statutory income tax rate to the (loss) income before income taxes in the consolidated statement of operations primarily due to not recognizing all deferred income tax assets.

Income tax recorded in the consolidated statement of comprehensive income is presented below.

| (Canadian dollars in millions) | 2020 | 2019 |
|--|-----------------|-------------|
| Remeasurements on employee benefit liabilities | | |
| - current income tax (expense) recovery | \$ (33) | \$ - |
| - deferred income tax (expense) recovery | (279) | 10 |
| Remeasurements on equity investments | | |
| - deferred income tax (expense) recovery | 4 | (4) |
| Income tax (expense) recovery | \$ (308) | \$ 6 |



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

| (Canadian dollars in millions) | 2020 | 2019 |
|--|-----------------|-------------|
| Other comprehensive income (loss) before income taxes | \$ 1,009 | \$ (3) |
| Statutory income tax rate based on combined federal and provincial rates | 26.54% | 26.73% |
| Income tax (expense) recovery based on statutory tax rates | (268) | 1 |
| Non-deductible portion of capital loss | (9) | - |
| Unrecognized deferred income tax assets | (28) | - |
| Tax rate changes on deferred income taxes | 1 | 5 |
| Other | (4) | - |
| Income tax (expense) recovery | \$ (308) | \$ 6 |

Deferred Income Tax

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, including, historical financial results, and expectations relating to future taxable income, the overall business environment, and industry-wide trends.

As a result of the COVID-19 pandemic, there is considerable negative evidence relating to losses incurred in the current year and uncertainty exists as to when conditions will improve. Such negative evidence currently outweighs the positive historical evidence and, accordingly, net deferred tax assets are not being recognized, commencing from the second quarter of 2020. The future tax deductions underlying the unrecognized deferred income tax assets of \$1,114 million remain available for use in the future to reduce taxable income. The deferred income tax expense recorded in Other comprehensive income (loss) related to remeasurements on employee benefit liabilities is offset by a deferred income tax recovery which was recorded through the statement of operations. As such, a deferred income tax recovery of \$164 million was recorded for the year, which is partially offsetting the deferred income tax expense of \$275 million recorded in Other comprehensive income (loss).

Deferred tax assets and liabilities of \$25 million are recorded net as a noncurrent deferred income tax asset and deferred tax liabilities of \$75 million are recorded as a noncurrent deferred income tax liability on the consolidated statement of financial position. Certain intangible assets with nominal tax cost and a carrying value of \$275 million have indefinite lives and accordingly, the associated deferred income tax liability of \$73 million (2019 – \$73 million) is not expected to reverse until the assets are disposed of, become impaired or amortizable and as a result is included as part of the noncurrent deferred income tax liability.



The significant components of deferred income tax assets and liabilities were as follows:

| (Canadian dollars in millions) | 2020 | 2019 |
|---|----------------|--------------|
| DEFERRED INCOME TAX ASSETS | | |
| Non-capital losses | \$ 1,126 | \$ 48 |
| Post-employment obligations – other employee future benefits | - | 402 |
| Accounting provisions not currently deductible for tax | 9 | 85 |
| Investment tax credits and recoverable taxes | - | 22 |
| Lease liabilities | 1,110 | 1,092 |
| Maintenance provisions | 215 | 372 |
| Other | - | 197 |
| | 2,460 | 2,218 |
| DEFERRED INCOME TAX LIABILITIES | | |
| Post-employment obligations – pension | (353) | (154) |
| Property, equipment, technology-based and other intangible assets | (2,023) | (1,930) |
| Indefinite-lived intangible assets | (73) | (73) |
| Other | (61) | - |
| | (2,510) | (2,157) |
| Net recognized deferred income tax (liabilities) assets | \$ (50) | \$ 61 |
| BALANCE SHEET PRESENTATION | | |
| Deferred income tax assets | 25 | 134 |
| Deferred income tax liabilities | (75) | (73) |
| Net recognized deferred income tax (liabilities) assets | \$ (50) | \$ 61 |



The following table presents the variation of the components of deferred income tax balances:

| (Canadian dollars in millions) | JANUARY 1, 2020 | 2020 INCOME STATEMENT MOVEMENT | 2020 OCI MOVEMENT | DECEMBER 31, 2020 |
|---|--------------------|--------------------------------------|----------------------|----------------------|
| Non-capital losses | \$ 48 | \$ 1,078 | \$ - | \$ 1,126 |
| Post-employment obligations – other employee future benefits | 402 | (382) | (20) | - |
| Accounting provisions not currently deductible for tax | 85 | (76) | - | 9 |
| Investment tax credits and recoverable taxes | 22 | (22) | - | - |
| Lease liabilities | 1,092 | 18 | - | 1,110 |
| Maintenance provisions | 372 | (157) | - | 215 |
| Other deferred tax assets | 197 | (201) | 4 | - |
| Post-employment obligations – pension | (154) | 60 | (259) | (353) |
| Property, equipment, technology-based and other intangible assets | (1,930) | (93) | - | (2,023) |
| Indefinite-lived intangible assets | (73) | - | - | (73) |
| Other deferred tax liabilities | - | (61) | - | (61) |
| Total recognized deferred income tax assets (liabilities) | \$ 61 | \$ 164 | \$ (275) | \$ (50) |

| (Canadian dollars in millions) | JANUARY 1, 2019 | 2019 INCOME STATEMENT MOVEMENT | 2019 OCI MOVEMENT | AEROPLAN ACQUISITION | DECEMBER 31, 2019 |
|---|--------------------|--------------------------------------|----------------------|-------------------------|----------------------|
| Non-capital losses | \$ 353 | \$ (305) | \$ - | \$ - | \$ 48 |
| Post-employment obligations – other employee future benefits | 342 | 6 | 49 | 5 | 402 |
| Accounting provisions not currently deductible for tax | 67 | 12 | - | 6 | 85 |
| Investment tax credits and recoverable taxes | 37 | (15) | - | - | 22 |
| Lease liabilities | 1,125 | (42) | - | 9 | 1,092 |
| Maintenance provisions | 386 | (14) | - | - | 372 |
| Other deferred tax assets | - | 228 | (4) | (27) | 197 |
| Post-employment obligations – pension | (171) | 51 | (39) | 5 | (154) |
| Property, equipment, technology-based and other intangible assets | (1,791) | (185) | - | 46 | (1,930) |
| Indefinite-lived intangible assets | (49) | - | - | (24) | (73) |
| Other deferred tax liabilities | (37) | 37 | - | - | - |
| Total recognized deferred income tax assets (liabilities) | \$ 262 | \$ (227) | \$ 6 | \$ 20 | \$ 61 |

At December 31, 2020, the Corporation has deductible temporary differences of an operating and a capital nature for which no deferred income tax asset has been recognized at this time as the ability to utilize these tax attributes is limited to future taxable income and capital gains. Net capital losses do not have an expiry date.



The following are the temporary differences and tax loss carryforwards for which no deferred income tax assets could be recognized:

| (Canadian dollars in millions) | 2020 | 2019 |
|---|-----------------|---------------|
| Recognized non-capital losses carryforwards | \$ 4,255 | - |
| Lease liabilities | 4,168 | - |
| Maintenance provisions | 811 | - |
| Less: Property, equipment, technology-based and other intangible assets | (7,840) | - |
| Less: Post-employment obligations – pension | (1,333) | - |
| Less: Other deferred tax liabilities | (61) | - |
| Total recognized net temporary differences | - | - |
| Unrecognized non-capital losses carryforwards | 30 | - |
| Post-employment obligations - other employee future benefits | 1,562 | - |
| Accounting provisions not currently deductible for tax | 323 | - |
| Maintenance provision | 542 | - |
| Deferred revenue | 1,461 | - |
| Unrecognized net capital losses carryforwards | 154 | 91 |
| Unrealized foreign exchange (gains) losses | (18) | 101 |
| Unrealized net capital gain on investment | - | (14) |
| Other | 8 | - |
| Total unrecognized net temporary differences | \$ 4,062 | \$ 178 |
| Deferred income tax rate based on combined federal and provincial rates | 26.51% | 26.54% |
| | 1,077 | 47 |
| Unrecognized recoverable taxes | 37 | - |
| Total unrecognized net deferred income tax assets | \$ 1,114 | \$ 47 |

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

| (Canadian dollars in millions) | TAX LOSSES |
|---|-----------------|
| 2030 | \$ 11 |
| 2031 | 6 |
| 2032 | 2 |
| 2033 | 1 |
| 2034 | 3 |
| 2036 | 3 |
| 2037 | 2 |
| 2038 | 2 |
| 2040 | 4,178 |
| Non-capital losses carryforwards | \$ 4,208 |

Cash income taxes paid in 2020 by the Corporation were \$8 million (2019 – \$62 million).



13.

Share Capital

| | NUMBER OF SHARES | VALUE (Canadian dollars in millions) |
|--|--------------------|---|
| At January 1, 2019 | 270,729,911 | \$ 798 |
| Shares issued on the exercise of stock options | 2,069,354 | 14 |
| Shares purchased and cancelled under issuer bid | (8,982,687) | (27) |
| At December 31, 2019 | 263,816,578 | \$ 785 |
| Shares issued on the exercise of stock options | 285,138 | 2 |
| Shares issued on settlement of performance share units | 241,172 | 4 |
| Shares issued in public offering | 70,840,000 | 1,367 |
| Shares purchased and cancelled under issuer bid | (3,010,600) | (8) |
| At December 31, 2020 | 332,172,288 | \$ 2,150 |

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

| | 2020 | 2019 |
|--|----------------------|--------------------|
| ISSUED AND OUTSTANDING | | |
| Class A variable voting shares | 111,926,060 | 126,664,740 |
| Class B voting shares | 220,246,228 | 137,151,838 |
| Total issued and outstanding | 332,172,288 | 263,816,578 |
| POTENTIAL SHARES | | |
| Convertible notes | Note 9 48,687,441 | - |
| Stock options | Note 14 5,903,174 | 4,890,095 |
| Total outstanding and potentially issuable shares | 386,762,903 | 268,706,673 |

An additional 2,587,000 shares were issued in January 2021 in connection with the underwriters' exercise of an over-allotment option as described below under Share Offering.

Shares

As at December 31, 2020, the 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 shares have equivalent rights as shareholders except for voting rights.

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 is 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 is 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.

Air Canada's articles provide that 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 49% or (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting exceeds 49% 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 49% 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 49% of the votes that may be cast at such meeting. Air Canada's articles also provide for the automatic reduction of the voting rights attached to Variable Voting Shares in the event any of the following limits are exceeded. In such event, the votes attributable to Variable Voting Shares will be affected as follows:

- **first**, if required, a reduction of the voting rights of any single non-Canadian holder (including a single non-Canadian holder authorized to provide an air service) carrying more than 25% of the votes to ensure that such non-Canadian holder never carries more than 25% of the votes which holders of Voting Shares cast at any meeting of shareholders;
- **second**, if required and after giving effect to the first proration set out above, a further proportional reduction of the voting rights of all non-Canadian holders authorized to provide an air service to ensure that such non-Canadian holders authorized to provide an air service, in the aggregate, never carry more than 25% of the votes which holders of Voting Shares cast at any meeting of shareholders; and
- **third**, if required and after giving effect to the first two prorations set out above, a proportional reduction of the voting rights for all non-Canadian holders as a class to ensure that non-Canadians never carry, in aggregate, more than 49% of the votes which holders of Voting Shares cast at any meeting of shareholders.

Shareholder Rights Plan

Under the terms of the shareholder rights plan agreement (the "Rights Plan"), effective until the day after Air Canada's 2023 annual meeting of shareholders, one right (a "Right") is issued with respect to each share of Air Canada issued and outstanding. 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 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 105 days (or such shorter minimum period determined in accordance with National Instrument 62-104 - *Take-Over Bids and Issuer Bids* ("NI 62-104")), (iii) provide that no shares shall be taken up unless more than 50% of the then outstanding shares, 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 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 shares for one hundred dollars (i.e., at a 50% discount to the market price at that time). Upon such exercise, holders of rights beneficially owned and controlled by Qualified Canadians would receive Class B Voting Shares and holders of rights beneficially owned or controlled by persons who are not Qualified Canadians would receive Class A Variable Voting Shares.

Issuer Bid

In response to the COVID-19 pandemic, in early March 2020 Air Canada suspended share purchases under its normal course issuer bid. Air Canada's normal course issuer bid expired in May 2020 and Air Canada did not renew it.

Prior to suspending purchases under its normal course issuer bid, in the first quarter of 2020, the Corporation purchased, for cancellation, a total of 2,910,800 shares at an average cost of \$43.76 per share for aggregate consideration of \$127 million. The excess of the cost over the average book value of \$119 million was charged to Retained earnings.

In 2019, the Corporation purchased, for cancellation, 9,082,487 shares at an average cost of \$41.64 per share for aggregate consideration of \$378 million. The excess of the cost over the average book value of \$351 million was charged to Retained earnings.

Share Offering

In June 2020, Air Canada completed an underwritten public offering of 35,420,000 shares at a price of \$16.25 per share, for aggregate gross proceeds of \$576 million, which includes the exercise in full by the underwriters of their over-allotment option to purchase up to 4,620,000 shares for gross proceeds of \$75 million. After deduction of the underwriters' fees and expenses of the offering, net proceeds were \$552 million.

In December 2020, Air Canada completed an underwritten public offering of 35,420,000 shares at a price of \$24.00 per share, for aggregate proceeds of \$850 million. After deduction of the underwriters' fees and expenses of the offering, net proceeds were \$815 million. Air Canada granted the underwriters an option to purchase up to an additional 15% of the shares in the offering, exercisable in whole or in part at any time until 30 days after closing of the offering on December 30, 2020. On January 18, 2021, the Corporation announced that the underwriters exercised their over-allotment option to purchase an additional 2,587,000 shares for gross proceeds of \$62 million.



14.

Share-Based Compensation

Air Canada Long-Term Incentive Plan

Certain of the Corporation's employees participate in the Air Canada Long-term Incentive Plan (the "Long-term Incentive Plan"). The Long-term Incentive Plan provides for the grant of stock options, performance share units and restricted share units to senior management and officers of Air Canada. With respect to the stock options, 19,381,792 shares were initially authorized for issuance under the Long-term Incentive Plan of which 6,803,772 remain available for future issuance. The outstanding performance share units and restricted share units will generally not result in the issuance of new shares as these share units will be redeemed for shares purchased on the secondary market (and not issued from treasury) and/or equivalent cash, at the discretion of the Corporation.

Stock Options

The options to purchase shares granted under the Long-term Incentive Plan have a maximum term of up to 10 years and an exercise price based on the fair market value of the shares at the time of the grant of the options. Fifty per cent of options are time-based and vest over four years. The remaining options vest based upon performance conditions, which 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 share at the stated exercise price.

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:

| | 2020 | 2019 |
|---|-------------|-------------|
| Compensation expense (\$ millions) | \$ 16 | \$ 13 |
| Number of stock options granted to Air Canada employees | 1,428,322 | 1,075,182 |
| Weighted average fair value per option granted (\$) | \$ 8.95 | \$ 10.75 |
| Aggregated fair value of options granted (\$ millions) | \$ 13 | \$ 12 |
| Weighted average assumptions: | | |
| Share price | \$ 31.08 | \$ 33.29 |
| Risk-free interest rate | 0.22%-0.62% | 1.36%-1.71% |
| Expected volatility | 33.35% | 35.0% |
| Dividend yield | 0% | 0% |
| Expected option life (years) | 5.25 | 5.25 |

Expected volatility was determined at the time of grant using the 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:

| | 2020 | | 2019 | |
|---|------------------|---|------------------|---|
| | OPTIONS | WEIGHTED AVERAGE EXERCISE PRICE/SHARE | OPTIONS | WEIGHTED AVERAGE EXERCISE PRICE/SHARE |
| Beginning of year | 4,890,095 | \$ 18.80 | 6,014,464 | \$ 11.40 |
| Granted | 1,428,322 | 31.08 | 1,075,182 | 33.29 |
| Exercised | (285,138) | 8.78 | (2,069,354) | 4.60 |
| Expired or cancelled | - | - | - | - |
| Forfeited | (130,105) | 28.66 | (130,197) | 22.48 |
| Outstanding options, end of year | 5,903,174 | \$ 22.06 | 4,890,095 | \$ 18.80 |
| Options exercisable, end of year | 2,414,643 | \$ 13.05 | 1,550,930 | \$ 11.02 |



The weighted average share price on the date of exercise for options exercised in 2020 was \$26.22 (2019 – \$43.51).

| RANGE OF EXERCISE PRICES | EXPIRY DATES | 2020 Outstanding Options | | | 2020 Exercisable Options | |
|--------------------------|--------------|-------------------------------|---|---------------------------------------|-------------------------------|---------------------------------------|
| | | NUMBER OF OPTIONS OUTSTANDING | WEIGHTED AVERAGE REMAINING LIFE (YEARS) | WEIGHTED AVERAGE EXERCISE PRICE/SHARE | NUMBER OF EXERCISABLE OPTIONS | WEIGHTED AVERAGE EXERCISE PRICE/SHARE |
| \$5.35 – \$5.39 | 2021 | 347,188 | 1 | \$ 5.39 | 347,188 | \$ 5.39 |
| \$12.64 | 2022 | 327,827 | 2 | 12.64 | 327,827 | 12.64 |
| \$9.23 – \$9.61 | 2023 | 988,974 | 3 | 9.27 | 988,974 | 9.27 |
| \$12.83 – \$26.40 | 2027 | 859,261 | 7 | 14.40 | 305,801 | 14.25 |
| \$22.53 – \$27.75 | 2028 | 983,085 | 8 | 26.46 | 241,947 | 26.46 |
| \$33.11 – \$43.22 | 2029 | 1,007,192 | 9 | 33.27 | 125,906 | 33.27 |
| \$15.35 – \$32.42 | 2030 | 1,389,647 | 10 | 31.04 | 77,000 | 18.02 |
| | | 5,903,174 | | \$ 22.06 | 2,414,643 | \$ 13.05 |

| RANGE OF EXERCISE PRICES | EXPIRY DATES | 2019 Outstanding Options | | | 2019 Exercisable Options | |
|--------------------------|--------------|-------------------------------|---|---------------------------------------|-------------------------------|---------------------------------------|
| | | NUMBER OF OPTIONS OUTSTANDING | WEIGHTED AVERAGE REMAINING LIFE (YEARS) | WEIGHTED AVERAGE EXERCISE PRICE/SHARE | NUMBER OF EXERCISABLE OPTIONS | WEIGHTED AVERAGE EXERCISE PRICE/SHARE |
| \$3.02 – \$3.04 | 2020 | 67,035 | 1 | \$ 3.04 | 67,035 | \$ 3.04 |
| \$5.35 – \$5.39 | 2021 | 368,705 | 2 | 5.39 | 368,705 | 5.39 |
| \$12.64 | 2022 | 404,843 | 3 | 12.64 | 404,843 | 12.64 |
| \$9.23 – \$9.61 | 2023 | 1,096,332 | 4 | 9.26 | 370,897 | 9.26 |
| \$12.83 – \$26.40 | 2027 | 893,788 | 8 | 14.38 | 214,285 | 14.38 |
| \$22.53 – \$27.75 | 2028 | 1,016,939 | 9 | 26.47 | 125,165 | 26.47 |
| \$33.11 – \$43.22 | 2029 | 1,042,453 | 10 | 33.29 | - | - |
| | | 4,890,095 | | \$ 18.80 | 1,550,930 | \$ 11.02 |



Performance and Restricted Share Units

The Long-term Incentive Plan also includes performance share units ("PSUs") and restricted share units ("RSUs"). 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 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 (credit) related to PSUs and RSUs in 2020 was \$(23) million (2019 – \$50 million). The compensation credit in 2020 reflected the decrease in share price during 2020 and the resulting decrease to the compensation liability.

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

| | 2020 | 2019 |
|---|------------------|------------------|
| Beginning of year | 2,085,811 | 2,500,764 |
| Granted | 1,124,146 | 643,186 |
| Settled | (724,539) | (984,087) |
| Forfeited | (111,412) | (74,052) |
| Outstanding share units, end of year | 2,374,006 | 2,085,811 |

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 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. The Corporation's matching of employee contributions was suspended effective May 1, 2020. For 2020 contributions made between January 1 and April 30, Air Canada will match 33.33% of the contributions made by employees. During 2020, the Corporation recorded compensation expense of \$5 million (2019 – \$13 million) related to the Employee Share Purchase Plan.



15.

Earnings (Loss) per Share

The following table outlines the calculation of basic and diluted earnings (loss) per share:

| (in millions, except per share amounts) | 2020 | 2019 |
|---|------------|------------|
| NUMERATOR: | | |
| Net income (loss) | \$ (4,647) | \$ 1,476 |
| Effect of assumed conversion of convertible notes | 216 | - |
| Remove anti-dilutive impact | (216) | - |
| Adjusted numerator for diluted earnings (loss) per share | \$ (4,647) | \$ 1,476 |
| DENOMINATOR: | | |
| Weighted-average shares | 282 | 268 |
| Effect of potential dilutive securities: | | |
| Stock options | 1 | 4 |
| Convertible notes | 28 | - |
| Total potential dilutive securities | 29 | 4 |
| Remove anti-dilutive impact | (29) | - |
| Adjusted denominator for diluted earnings (loss) per share | 282 | 272 |
| Basic earnings (loss) per share | \$ (16.47) | \$ 5.51 |
| Diluted earnings (loss) per share | \$ (16.47) | \$ 5.44 |

The calculation of earnings per share is based on whole dollars and not on rounded millions. As a result, the above amounts may not be recalculated to the per share amount disclosed above.

Excluded from the 2020 calculation of diluted earnings per share were 2,817,000 (2019 – 178,000) outstanding options where the options' exercise prices were greater than the average market price of the shares for the year.



16.

Commitments

Capital Commitments and Leases

Capital commitments consist of the future firm aircraft deliveries and commitments related to acquisition of other property and equipment. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at December 31, 2020. U.S. dollar amounts are converted using the December 31, 2020 closing rate of CDN\$1.2725. Minimum future commitments under these contractual arrangements are shown below.

| (Canadian dollars in millions) | 2021 | 2022 | 2023 | 2024 | 2025 | THEREAFTER | TOTAL |
|--------------------------------|--------|--------|--------|--------|------|------------|----------|
| Capital commitments | \$ 969 | \$ 961 | \$ 410 | \$ 204 | \$ - | \$ - | \$ 2,544 |

The Corporation leases and subleases certain aircraft and spare engines to its regional carriers which are charged back to Air Canada through their respective CPAs. These are reported net on the consolidated statement of operations. The leases and subleases relate to 10 De Havilland Q400 aircraft, 22 Mitsubishi CRJ-200 aircraft, 20 Mitsubishi CRJ-705/900 aircraft, 25 Embraer 175 aircraft, and 15 spare engines. The lease and sublease revenue and expense related to these aircraft and engines each amount to \$183 million in 2020 (2019 – \$181 million).

Other Contractual Commitments

The future minimum non-cancellable commitment for the next 12 months under the capacity purchase agreements is approximately \$921 million.



17.

Financial Instruments and Risk Management

Summary of Financial Instruments

| | Carrying Amounts | | | | | DECEMBER 31, 2019 |
|---|--------------------------------------|------------------------|--------------------------|-------------------------------|------------------|----------------------|
| | DECEMBER 31, 2020 | | | | | |
| | Financial instruments classification | | | | | |
| (Canadian dollars in millions) | FAIR VALUE THROUGH PROFIT AND LOSS | FAIR VALUE THROUGH OCI | ASSETS AT AMORTIZED COST | LIABILITIES AT AMORTIZED COST | TOTAL | |
| FINANCIAL ASSETS | | | | | | |
| Cash and cash equivalents | \$ 3,658 | \$ - | \$ - | \$ - | \$ 3,658 | \$ 2,090 |
| Short-term investments | 3,843 | - | - | - | 3,843 | 3,799 |
| Restricted cash | 106 | - | - | - | 106 | 157 |
| Accounts receivable | - | - | 644 | - | 644 | 926 |
| Investments, deposits and other assets | | | | | | |
| Long-term investments | 512 | - | - | - | 512 | 512 |
| Equity investment in Chorus | - | 58 | - | - | 58 | 126 |
| Restricted cash | 87 | - | - | - | 87 | 102 |
| Aircraft related and other deposits | - | - | 90 | - | 90 | 113 |
| Derivative instruments | | | | | | |
| Share forward contracts | 20 | - | - | - | 20 | 45 |
| Foreign exchange derivatives | - | - | - | - | - | 3 |
| | \$ 8,226 | \$ 58 | \$ 734 | \$ - | \$ 9,018 | \$ 7,873 |
| FINANCIAL LIABILITIES | | | | | | |
| Accounts payable | \$ - | \$ - | \$ - | \$ 1,775 | \$ 1,775 | \$ 2,240 |
| Foreign exchange derivatives | 591 | - | - | - | 591 | 117 |
| Embedded derivative on convertible notes | 534 | - | - | - | 534 | - |
| Current portion of long-term debt and lease liabilities | - | - | - | 1,788 | 1,788 | 1,218 |
| Long-term debt and lease liabilities | - | - | - | 11,201 | 11,201 | 8,024 |
| | \$ 1,125 | \$ - | \$ - | \$ 14,764 | \$ 15,889 | \$ 11,599 |

Summary of Gain (Loss) on Financial Instruments Recorded at Fair Value

| (Canadian dollars in millions) | | 2020 | 2019 |
|--|--------|-----------------|--------------|
| Share forward contracts | | \$ (28) | \$ 23 |
| Embedded derivative on convertible notes | Note 9 | (214) | - |
| Gain (loss) on financial instruments recorded at fair value | | \$ (242) | \$ 23 |



Risk Management

Under its risk management policy, the Corporation manages its market risk through the use of various financial derivative instruments. The Corporation uses these instruments solely for risk management purposes, not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be an economic hedge and offset by changes in cash flows of the relevant risk being hedged.

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

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. The Corporation monitors and manages liquidity risk by preparing rolling cash flow forecasts for a minimum period of at least 12 months after each reporting period, 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. At December 31, 2020, unrestricted liquidity was \$8,013 million comprised of Cash and cash equivalents, Short-term investments, and Long-term investments.

Cash and cash equivalents include \$667 million pertaining to investments with original maturities of three months or less at December 31, 2020 (\$381 million as at December 31, 2019).

In response to the COVID-19 pandemic, Air Canada has taken the following actions to support its liquidity position:

- As described in Notes 9, 13, and 22, completed financing transactions raising a total of \$6.8 billion of liquidity since March 2020.
- Significantly reduced capacity and its workforce since March 2020 when compared to the same period of 2019. The airline continues to proactively adjust capacity as required.
- In addition to the projected cost savings associated with capacity reductions, including workforce reductions and other programs, Air Canada has initiated a company-wide cost reduction and capital deferral and reduction program.

- Suspended purchases under its share repurchase program in early March 2020 and did not renew its issuer bid upon its expiry in May 2020

A maturity analysis of the Corporation's principal and interest repayment requirements on long-term debt and lease liabilities is set out in Note 9, and fixed operating commitments and capital commitments are set out in Note 16.

Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk can be further divided into the following sub-classifications related to the Corporation: fuel price risk, foreign exchange risk, interest rate risk, and share-based compensation risk.

Fuel Price Risk

Fuel price risk is the risk that future cash flows will fluctuate because of changes in jet fuel prices. To manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, the Corporation can elect to enter into derivative contracts with financial intermediaries. The Corporation may use derivative contracts based on jet fuel, heating oil and crude-oil based contracts. The Corporation's policy permits hedging of up to 75% of the projected jet fuel purchases for the current calendar year, 50% of the projected jet fuel purchases for the next calendar year, and 25% of projected jet fuel purchases for any calendar year thereafter. 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.

There was no fuel hedging activity during 2020 and there were no outstanding fuel derivatives as at December 31, 2020 and December 31, 2019.

Foreign Exchange Risk

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

Air Canada generates certain sales in U.S. dollars and in other foreign currencies which are converted to U.S. dollars under the Corporation's risk management program. In 2020, these net operating cash inflows totalled approximately US\$1.0 billion and U.S.-denominated operating costs amounted to approximately US\$3.0 billion. Non-operating cash outflows in U.S. dollars, primarily related to interest payments on U.S. dollar denominated debt and net financing outflows, amounted to approximately US\$1.5 billion. For 2020, this resulted in a U.S. dollar net cash flow exposure of approximately US\$3.5 billion.

The Corporation has a target coverage of 70% on a rolling 24 month basis to manage the net U.S. dollar cash flow exposure described above utilizing the following risk management strategies:



- Holding U.S. dollar cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash, short- and long-term investment balances as at December 31, 2020 amounted to \$1,747 million (US\$1,371 million) (\$1,123 million (US\$862 million) as at December 31, 2019). A portion of the cash and investment reserves are an economic hedge against long-term U.S. dollar debt while the remainder of the cash is operational cash and investment reserves which are applied against the rolling 24 month net U.S. dollar cash flow exposure. In 2020, a loss of \$69 million (loss of \$36 million in 2019) was recorded in Foreign exchange gain (loss) reflecting the change in Canadian equivalent market value of the U.S. dollar cash and short-term investment balances held.
- Locking in the foreign exchange rate through the use of a variety of foreign exchange derivatives which have maturity dates corresponding to the forecasted dates of U.S. dollar net outflows.

The level of foreign exchange derivatives entered into and their related maturity dates are dependent upon a number of factors, which include the amount of foreign revenue conversion available, U.S. dollar net cash outflows, as well as the amount attributed to aircraft and debt payments. Based on the notional amount of currency derivatives outstanding at December 31, 2020, as further described below, approximately 90% of net U.S. cash outflows are hedged for 2021 and 21% for 2022, resulting in derivative coverage of 63% over the next 24 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 68% coverage.

As at December 31, 2020, the Corporation had outstanding foreign currency options and swap agreements, settling in 2021 and 2022, to purchase at maturity \$5,730 million (US\$4,499 million) of U.S. dollars at a weighted average rate of \$1.3586 per US\$1.00 (2019 – \$6,599 million (US\$5,080 million) with settlements in 2020 and 2021 at a weighted average rate of \$1.2775 per \$1.00 U.S. dollar). The Corporation also has protection in place to sell a portion of its excess Euros, Sterling, YEN, YUAN, and AUD (EUR €464 million, GBP £64 million, JPY ¥4,963 million, CNH ¥415 million and AUD \$88 million) which settle in 2021 and 2022 at weighted average rates of €1.1414, £1.3277, ¥0.0094, ¥0.1463, and AUD \$0.6942 per \$1.00 U.S. dollar, respectively (as at December 31, 2019 – EUR €335 million, GBP £202 million, JPY ¥46,655 million, CNH ¥286 million and AUD \$209 million with settlements in 2020 and 2021 at weighted average rates of €1.1577, £1.3238, ¥0.0096, ¥0.1469, and AUD \$0.7092 respectively per \$1.00 U.S. dollar).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations, and based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at December 31, 2020 was \$591 million in favour of the counterparties (2019 – \$114 million in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2020, a loss of \$583 million was recorded in Foreign exchange gain (loss) related to these derivatives (2019 – \$92 million gain). In 2020, foreign exchange derivative contracts cash settled with a net

fair value of \$106 million in favour of the counterparties (2019 – \$173 million 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 to adjust to prevailing market conditions. The ratio at December 31, 2020 is 74% fixed and 26% floating (83% and 17%, respectively as at December 31, 2019).

Share-based Compensation Risk

The Corporation issues RSUs and PSUs to certain of its employees, as described in Note 14, which entitles the employees to receive a payment in the form of one share, cash in the amount equal to market value of one share, or a combination thereof, at the discretion of the Board of Directors.

To hedge the share price exposure, the Corporation entered into share forward contracts to hedge PSUs and RSUs that may vest between 2021 and 2023, subject to the terms of vesting including realization of performance vesting criteria. The forward dates for the share forward contracts coincide with the vesting terms and planned settlement dates of 869,809 PSUs and RSUs from 2021 to 2023. These contracts were not designated as hedging instruments for accounting purposes. Accordingly, changes in the fair value of these contracts are recorded in Gain (loss) on financial instruments recorded at fair value in the period in which they arise. During 2020, a loss of \$28 million was recorded (2019 – gain of \$23 million). Share forward contracts cash settled with a fair value of \$9 million in favour of the Corporation in 2020 (2019 – \$30 million), with new contract purchases of \$12 million for 2023 hedges. As at December 31, 2020, the fair value of the share forward contracts is \$20 million in favour of the Corporation (2019 – \$45 million in favour of the Corporation), with those contracts maturing in 2021 valued at \$6 million recorded in Prepaid expenses and other current assets and the remainder of \$14 million recorded in Deposits and other assets.

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. As at December 31, 2020, the Corporation's credit risk exposure consists mainly of the carrying amounts of Cash and



cash equivalents, Short-term investments, Accounts receivable, Long-term investments and derivative instruments. Cash and cash equivalents and Short- and long-term investments are in place with major financial institutions, various levels of government in Canada, and major corporations. Accounts receivable are generally the result of sales of passenger tickets to individuals, largely through the use of major credit cards, through geographically dispersed travel agents, corporate outlets, or other airlines. Similarly, accounts receivable related to cargo revenues relate to accounts from a large number of geographically dispersed customers. Accounts receivable related to the sale of Aeroplan points are mainly with major financial institutions and any exposure associated with these customers is mitigated by the relative size and nature of business carried on by such partners. Credit rating guidelines are used in determining derivative counterparties. 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, 2020. 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. For purposes of presentation, each risk is contemplated independent of other risks; however, in reality, 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, 2020 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.

| (Canadian dollars in millions) | Interest rate risk | | Foreign exchange rate risk ⁽¹⁾ | | Other price risk ^{(2),(3)} | |
|--|--------------------|-------------|---|-------------|-------------------------------------|--------------|
| | Income | | Income | | Income | |
| | 1% INCREASE | 1% DECREASE | 5% INCREASE | 5% DECREASE | 10% INCREASE | 10% DECREASE |
| Cash and cash equivalents | \$ 37 | \$ (37) | \$ (59) | \$ 59 | \$ - | \$ - |
| Short-term investments | \$ 38 | \$ (38) | \$ (28) | \$ 28 | \$ - | \$ - |
| Long-term investments | \$ 5 | \$ (5) | \$ - | \$ - | \$ - | \$ - |
| Aircraft related deposits | \$ 4 | \$ (4) | \$ - | \$ - | \$ - | \$ - |
| Long-term debt and lease liabilities | \$ (32) | \$ 10 | \$ 529 | \$ (529) | \$ - | \$ - |
| Share forward contracts | \$ - | \$ - | \$ - | \$ - | \$ 2 | \$ (2) |
| Foreign exchange derivatives | \$ - | \$ - | \$ (432) | \$ 529 | \$ - | \$ - |
| Embedded derivative on convertible notes | \$ - | \$ - | \$ - | \$ - | \$ (53) | \$ 53 |

(1) 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 lease liabilities includes \$5 million 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.

(2) The sensitivity analysis for share forward contracts is based upon a 10% increase or decrease in the Air Canada share price.

(3) The sensitivity analysis for the embedded derivative on the convertible notes is based on a total 10% change in value.

For Air Canada's equity investment in Chorus, a 10% increase (decrease) to the Chorus share price would increase (decrease) Other comprehensive income by \$6 million.

Covenants in Credit Card Agreements

The Corporation's principal credit card processing agreements for credit card processing services contain triggering events upon which the Corporation is required to provide the applicable credit card processor with cash deposits. The obligations 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 2020, the Corporation made no cash deposits under these agreements (nil in 2019).



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- and long-term investments are classified as held for trading and therefore are recorded at fair value.

The carrying amounts of derivatives are equal to fair value, which is based on the amount at which they could be settled based on estimated current market rates.

Management estimated the fair value of its long-term debt based on valuation techniques including discounted cash flows, taking into account market information and traded values 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 unobservable inputs (Level 3 in the fair value hierarchy), the estimated fair value of debt approximates its carrying value of \$9,561 million.

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.

(Canadian dollars in millions)

| | DECEMBER 31, 2020 | Fair value measurements at reporting date using: | | |
|--|-------------------|--|---|---|
| | | QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1) | SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2) | SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3) |
| Recurring measurements | | | | |
| FINANCIAL ASSETS | | | | |
| Held-for-trading securities | | | | |
| Cash equivalents | \$ 667 | \$ - | \$ 667 | \$ - |
| Short-term investments | 3,843 | - | 3,843 | - |
| Long-term investments | 512 | - | 512 | - |
| Equity investment in Chorus | 58 | 58 | - | - |
| Derivative instruments | | | | |
| Share forward contracts | 20 | - | 20 | - |
| Total | \$ 5,100 | \$ 58 | \$ 5,042 | \$ - |
| FINANCIAL LIABILITIES | | | | |
| Derivative instruments | | | | |
| Foreign exchange derivatives | 591 | - | 591 | - |
| Embedded derivative on convertible notes | 534 | - | 534 | - |
| Total | \$ 1,125 | \$ - | \$ 1,125 | \$ - |

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 2020.



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 \$9 million as at December 31, 2020 (\$86 million as at December 31, 2019). 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, 2020 and 2019, 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.

| (Canadian dollars in millions) | Amounts offset | | | Amounts not offset | Net |
|--------------------------------|----------------|--------------------------|-----------------------|-----------------------|--------------|
| | GROSS ASSETS | GROSS LIABILITIES OFFSET | NET AMOUNTS PRESENTED | FINANCIAL INSTRUMENTS | |
| FINANCIAL ASSETS | | | | | |
| December 31, 2020 | | | | | |
| Derivative assets | \$ - | \$ - | \$ - | \$ 20 | \$ 20 |
| | \$ - | \$ - | \$ - | \$ 20 | \$ 20 |
| December 31, 2019 | | | | | |
| Derivative assets | \$ 11 | \$ (8) | \$ 3 | \$ 45 | \$ 48 |
| | \$ 11 | \$ (8) | \$ 3 | \$ 45 | \$ 48 |

| (Canadian dollars in millions) | Amounts offset | | | Amounts not offset | Net |
|--------------------------------|-------------------|---------------------|-----------------------|-----------------------|---------------|
| | GROSS LIABILITIES | GROSS ASSETS OFFSET | NET AMOUNTS PRESENTED | FINANCIAL INSTRUMENTS | |
| FINANCIAL LIABILITIES | | | | | |
| December 31, 2020 | | | | | |
| Derivative liabilities | \$ 646 | \$ (55) | \$ 591 | \$ - | \$ 591 |
| | \$ 646 | \$ (55) | \$ 591 | \$ - | \$ 591 |
| December 31, 2019 | | | | | |
| Derivative liabilities | \$ 178 | \$ (61) | \$ 117 | \$ - | \$ 117 |
| | \$ 178 | \$ (61) | \$ 117 | \$ - | \$ 117 |



18.

Contingencies, Guarantees and Indemnities

Contingencies and Litigation Provisions

Various lawsuits and claims, including claims filed by various labour groups of Air Canada are pending by and against the Corporation and provisions have been recorded where appropriate. It is the opinion of management that final determination of these claims will not have a material adverse effect on the financial position or the results of the Corporation.

Guarantees

Guarantees in Fuel Facilities and De-Icing Arrangements

The Corporation participates in fuel facility arrangements operated through nine Fuel Facility Corporations, and three aircraft de-icing service facilities, along with other airlines that contract for fuel and de-icing services at various major airports in Canada. These entities operate on a cost recovery basis. The aggregate debt of these entities that has not been consolidated by the Corporation under IFRS 10 Consolidated Financial Statements is approximately \$1,047 million as at December 31, 2020 (December 31, 2019 – \$643 million), which is the Corporation's maximum exposure to loss before taking into consideration the value of the assets that secure the obligations and any cost sharing that would occur amongst the other contracting airlines. The Corporation views this loss potential as remote. Each contracting airline participating in these entities shares pro rata, based on system usage, in the guarantee of this debt. The maturities of these debt arrangements vary but generally extend beyond five years.

Indemnification Agreements

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

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



19.

Capital Disclosures

The Corporation views capital as the sum of Long-term debt and lease liabilities, the embedded derivative on convertible notes, and the book value of Shareholders' equity. Air Canada no longer includes excess cash as a reduction to its capital as the amount is not meaningful in the current environment. The Corporation also monitors its net debt. Net debt is calculated as the sum of Long-term debt and lease liabilities less Cash and cash equivalents, Short-term investments, and Long-term investments.

The Corporation's main objectives when managing capital are:

- 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 ensure capital allocation decisions generate sufficient returns and to assess the efficiency with which the Corporation allocates its capital to generate returns;
- To structure repayment obligations in line with the expected life of the Corporation's principal revenue generating assets;
- To maintain an appropriate balance between debt supplied capital versus investor supplied capital; and
- To monitor the Corporation's credit ratings to facilitate access to capital markets at competitive interest rates.

In order to maintain or adjust the capital structure, the Corporation may adjust the type or amount of capital utilized, including purchase versus debt financing versus lease decisions, defer or cancel aircraft expenditures by not exercising available options or selling aircraft options, redeeming or issuing debt securities, issuing equity securities, and repurchasing outstanding shares, all subject to market conditions and the terms of the underlying agreements (or any consents required) or other legal restrictions.

The total capital and net debt as at December 31 are calculated as follows:

| (Canadian dollars in millions) | DECEMBER 31, 2020 | DECEMBER 31, 2019 |
|---|-------------------|-------------------|
| Long-term debt and lease liabilities | \$ 11,201 | \$ 8,024 |
| Current portion of long-term debt and lease liabilities | 1,788 | 1,218 |
| Total long-term debt and lease liabilities | 12,989 | 9,242 |
| Embedded derivative on convertible notes | 534 | - |
| Shareholders' equity | 1,715 | 4,400 |
| Total Capital | \$ 15,238 | \$ 13,642 |
| Total long-term debt and lease liabilities | \$ 12,989 | \$ 9,242 |
| Less Cash and cash equivalents, Short-term investments, and Long-term investments | (8,013) | (6,401) |
| Net debt | \$ 4,976 | \$ 2,841 |



20.

Revenue

Disaggregation of revenue

The Corporation disaggregates revenue from contracts with customers according to the nature of the air transportation services. The nature of services is presented as passenger, cargo and other revenue on its consolidated statement of operations. The Corporation further disaggregates passenger and cargo air transportation service revenue according to geographic market segments.

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:

| (Canadian dollars in millions) | 2020 | 2019 |
|--------------------------------|-----------------|------------------|
| PASSENGER REVENUES | | |
| Canada | \$ 1,640 | \$ 5,233 |
| U.S. Transborder | 840 | 3,795 |
| Atlantic | 909 | 4,468 |
| Pacific | 468 | 2,449 |
| Other | 525 | 1,287 |
| | \$ 4,382 | \$ 17,232 |

| (Canadian dollars in millions) | 2020 | 2019 |
|--------------------------------|---------------|---------------|
| CARGO REVENUES | | |
| Canada | \$ 90 | \$ 113 |
| U.S. Transborder | 35 | 48 |
| Atlantic | 387 | 258 |
| Pacific | 354 | 241 |
| Other | 54 | 57 |
| | \$ 920 | \$ 717 |

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, India, the Middle East and North Africa. 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 Central and South America and the Caribbean and Mexico.

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, redemption of Aeroplan points for non-air goods and services, buy on board and related passenger ancillary services and charges, and other airline-related services.

Contract balances

The following table provides information about receivables, contract assets, and contract liabilities from contracts with customers.

| (Canadian dollars in millions) | DECEMBER 31, 2020 | DECEMBER 31, 2019 |
|--|-------------------|-------------------|
| Receivables, which are included in Accounts receivable | \$ 332 | \$ 578 |
| Contract costs which are included in Prepaid expenses and other current assets | 68 | 124 |
| Contract liabilities – Advance ticket sales | 2,314 | 2,939 |
| Contract liabilities – Aeroplan deferred revenue (current and long-term) | 3,256 | 2,825 |
| Contract liabilities – Other deferred revenue (current and long-term) | 1,348 | 1,473 |



Receivables include passenger, cargo and other receivables from contracts with customers. The Corporation sells passenger ticket and related ancillary services via cash, credit card or other card-based forms of payment with payment generally collected in advance of the performance of related transportation services. Passenger ticket and ancillary receivables are amounts due from other airlines for interline travel, travel agency payment processing intermediaries or credit card processors associated with sales for future travel and are included in Accounts receivable on the consolidated statement of financial position. Aeroplan points are sold to program partners based on member accumulations and which billings are generally settled monthly. Cargo and other accounts receivable relate to amounts owing from customers, including from freight forwarders and interline partners for cargo and other services provided.

Contract costs include payment card fees, commissions and global distribution system charges on passenger tickets. These costs are capitalized at time of sale and expensed at the time of passenger revenue recognition.

Airline passenger and cargo sales transactions rely on multiple information technology systems and controls to process, record, and recognize a high volume of low value transactions, including through a combination of internal information technology systems, outsourced service providers, industry clearing houses, global distribution systems, and other partner airlines. Passenger sales and the ground portion of vacation packages are deferred and included in Current liabilities. A portion of the passenger sale related to the equivalent ticket value of any Aeroplan points issued is separated and deferred in Aeroplan deferred revenue. The Advance ticket sales liability is recognized in revenue when the related flight occurs or over the period of the vacation. Depending on the fare class, passengers may exchange their tickets up to the time of the flight or obtain a refund, generally in exchange for the payment of a fee. The Corporation performs regular evaluations on the advance ticket sales liability.

The practical expedient in IFRS 15 allows entities not to disclose the amount of the remaining transaction prices and its expected timing of recognition for performance obligations if the contract has an original expected duration of one year or less. The Corporation elects to use this practical expedient for the passenger travel performance obligation as passenger tickets expire within a year if unused.

In response to the COVID-19 pandemic, Air Canada offered customers the option of converting their existing booking into a travel voucher with no expiry date should their travel plans change. Customers have the ability to use the travel vouchers within the next 12 months and the Corporation does not have an unconditional right to defer settlement beyond the next 12 months. As such, the entire liability amount related to these vouchers has been recorded in current liabilities even though some could be used after the next 12 months.

A reconciliation of the Aeroplan deferred revenue is as follows.

(Canadian dollars in millions)

| | |
|--|-----------------|
| Fair value as at January 10, 2019 acquisition | \$ 2,779 |
| Proceeds from Aeroplan points issued to program partners | 953 |
| Equivalent ticket value of Aeroplan points issued | 201 |
| Aeroplan points redeemed | (1,108) |
| Aeroplan deferred revenue, December 31, 2019 | \$ 2,825 |
| Proceeds from Aeroplan points issued to program partners | 687 |
| Equivalent ticket value of Aeroplan points issued | 63 |
| Aeroplan points redeemed | (319) |
| Aeroplan deferred revenue, December 31, 2020 | \$ 3,256 |

Proceeds from points issued to Aeroplan program partners and the equivalent ticket value of points issued through travel are deferred until the points are redeemed and the reward is provided to the member. The Corporation expects the majority of the points outstanding will be redeemed within three years.

In connection with new commercial agreements signed in 2019, Air Canada received payments from TD Bank, CIBC, Visa, and AMEX in the aggregate amount of \$1,212 million. Additionally, TD Bank and CIBC made payments to the Corporation in the aggregate amount of \$400 million as prepayments to be applied towards future monthly payments in respect of Aeroplan points. These considerations are accounted for as a contract liability within Aeroplan and other deferred revenue.



21.

Regional Airlines Expense

The Corporation has capacity purchase agreements with regional carriers. Expenses associated with these arrangements are classified as regional airlines expense on the consolidated statement of operations. Regional airlines expense consists of the following, which amounts exclude fuel expense and the component of capacity purchase fees related to aircraft utilization:

| (Canadian dollars in millions) | 2020 | 2019 |
|--|-----------------|-----------------|
| Capacity purchase fees | \$ 636 | \$ 1,042 |
| Airport and navigation fees | 127 | 292 |
| Sales and distribution costs | 51 | 158 |
| Other operating expenses | 272 | 464 |
| Regional airlines expense, excluding fuel | \$ 1,086 | \$ 1,956 |

22.

Sale-Leaseback

In 2020, the Corporation completed sale and leaseback transactions for nine Boeing 737 MAX 8 aircraft for total proceeds of US\$365 million (\$485 million), which resulted in the recognition of a gain on sale of \$18 million. The aircraft will continue to be operated under 12-year leases entered into under such sale-leaseback agreement.

23.

Related Party Transactions

Compensation of Key Management

Key management includes Air Canada's Board of Directors, President and Chief Executive Officer, Deputy Chief Executive Officer and Chief Financial Officer, Executive Vice President and Chief Commercial Officer, Executive Vice President of Operations, Executive Vice President - Chief Human Resources and Communications Officer, and Executive Vice President - International and Regulatory Affairs and Chief Legal Officer. Key management was expanded with these latter two positions added in the 2020 period (2019 comparative figures are not amended). Amounts reported are based upon the expense as reported in the consolidated financial statements. Compensation to key management is summarized as follows:

| (Canadian dollars in millions) | 2020 | 2019 |
|--------------------------------------|-------------|--------------|
| Salaries and other benefits | \$ 7 | \$ 7 |
| Pension and post-employment benefits | 6 | 5 |
| Share-based compensation | (9) | 36 |
| | \$ 4 | \$ 48 |



24.

Acquisition of Aeroplan

On January 10, 2019, Air Canada completed its purchase of Aimia Canada Inc. (now Aeroplan Inc.). The aggregate purchase price for the acquisition consisted of \$450 million in cash plus \$67 million in cash for closing adjustments (total purchase consideration of \$517 million). The acquisition also included the assumption of the Aeroplan points liability.

Concurrently with the conclusion of the Aeroplan purchase, Air Canada, Aeroplan, The Toronto-Dominion Bank ("TD Bank"), Canadian Imperial Bank of Commerce ("CIBC"), and Visa Canada Corporation ("Visa") finalized various commercial agreements relating to and in support of the acquisition, including credit card loyalty program and network agreements for future participation in the Aeroplan program. Similarly, in the first quarter of 2019, Air Canada, Aeroplan, and AMEX Bank of Canada ("AMEX") concluded agreements enabling AMEX's continued participation in the Aeroplan program. Air Canada received payments from TD Bank, CIBC, Visa, and AMEX in the aggregate amount of \$1,212 million. This consideration has been accounted for as deferred revenue and will be amortized into passenger revenue over the terms of the related agreements.

In addition, TD Bank and CIBC made payments to the Corporation in the aggregate amount of \$400 million as prepayments to be applied towards future monthly payments in respect of Aeroplan points. This consideration is accounted for as a contract liability within Aeroplan and other deferred revenue.

25.

Equity Investment in Chorus

In February 2019, Air Canada concluded an agreement to amend and extend its capacity purchase agreement with Jazz, a wholly-owned subsidiary of Chorus Aviation Inc., by 10 years from January 1, 2026 to December 31, 2035.

Concurrently, Air Canada subscribed for 15,561,600 class B voting shares in the capital of Chorus, representing, at time of issuance, approximately 9.99% of the total issued and outstanding voting shares of Chorus. This represented an investment of \$97 million by Air Canada.

26.

Proposed Acquisition of Transat

On June 27, 2019, Air Canada and Transat A.T. Inc. ("Transat") announced a definitive arrangement agreement that provides for Air Canada's acquisition of all issued and outstanding shares of Transat. Under the terms of the agreement, Air Canada would have acquired all outstanding shares of Transat for \$13 per share. The value of the all-cash transaction was, at that time, approximately \$520 million.

On August 11, 2019, Air Canada and Transat announced that Air Canada had agreed to increase the purchase price for the acquisition of all issued and outstanding shares of Transat, from \$13 to \$18 per share and had amended the Arrangement Agreement dated June 27, 2019 accordingly. Based on the increased consideration, the value of the all-cash transaction was approximately \$720 million.

On October 10, 2020, Air Canada announced amendments to the transaction with Transat. The acquisition agreement provides for the acquisition by Air Canada of all the shares of Transat for \$5.00 per share, payable at the option of Transat shareholders in cash or shares of Air Canada at a fixed exchange ratio of 0.2862 Air Canada share for each Transat share (representing a price for the Air Canada shares of \$17.47).

Assuming closing of the acquisition of Transat and that all Transat shareholders elect to receive Air Canada shares as consideration for their Transat shares (and that no holders of options of Transat exercise their options before the applicable election deadline and elect to receive Air Canada shares for the Transat shares underlying their options), Air Canada would expect to issue an aggregate of up to 10,803,217 shares in connection with the acquisition (based on 37,747,090 outstanding shares of Transat, as reported by Transat). However, the transaction remains subject to certain conditions including, notably, the ongoing approval process of regulatory authorities, and while Air Canada has endeavoured to adequately address all relevant considerations in all jurisdictions, there can be no assurance that all required regulatory approvals will be granted, that relevant delays for completion will be extended or that the transaction will be successfully completed.

Under the acquisition agreement with Transat, closing of the transaction was to be completed no later than February 15, 2021; it may be extended at any time by agreement of the parties and remains in force unless terminated by either of them.



Directors

| | |
|----------------------------|---|
| Amee Chande | Corporate Director and Strategy Consultant, Los Altos, California |
| Christie J.B. Clark | Corporate Director, Toronto, Ontario |
| Gary A. Doer | Corporate Director, Winnipeg, Manitoba |
| Rob Fyfe | Corporate Director, Auckland, New Zealand |
| Michael M. Green | Chief Executive Officer and Managing Director, Tenex Capital Management, New York, New York |
| Jean Marc Huot | Partner, Stikeman Elliott LLP, Montréal, Québec |
| Madeleine Paquin | President and Chief Executive Officer, Logistec Corporation, Montréal, Québec |
| Michael Rousseau | President and Chief Executive Officer, Air Canada, Saint-Lambert, Québec |
| Vagn Sørensen | Chairman of the Board, Air Canada, London, United Kingdom |
| Kathleen Taylor | Corporate Director, Toronto, Ontario |
| Annette Verschuren | Chair and Chief Executive Officer, NRStor Inc., Toronto, Ontario |
| Michael M. Wilson | Corporate Director, Bragg Creek, Alberta |



Executive Officers⁽¹⁾

| | |
|--------------------------------|--|
| Michael Rousseau | President and Chief Executive Officer |
| Lucie Guillemette | Executive Vice President and Chief Commercial Officer |
| Amos S. Kazzaz | Executive Vice President and Chief Financial Officer |
| Craig Landry | Executive Vice President, Operations |
| Arielle Meloul-Wechsler | Executive Vice President, Chief Human Resources Officer and Public Affairs |
| David J. Shapiro | Executive Vice President, International and Regulatory Affairs and Chief Legal Officer |
| Mark Galardo | Senior Vice President, Network Planning and Revenue Management |
| Catherine Luelo | Senior Vice President and Chief Information Officer |
| Mark Nasr | Senior Vice President, Products, Marketing and eCommerce |
| Richard Steer | Senior Vice President, Operations and Express Carriers |
| Murray Strom | Senior Vice President, Flight Operations |
| Carolyn M. Hadrovic | Vice President and Corporate Secretary |

(1) Executive officers include the Chief Executive Officer, the Chief Financial Officer, the Corporate Secretary and all Executive Vice Presidents and Senior Vice Presidents.





PRODUCED IN-HOUSE BY: AIR CANADA MULTIMEDIA COMMUNICATIONS 2021



Investor and Shareholder Information

TSX price range and trading volume of Air Canada variable voting shares and voting shares (AC)

| 2020 | HIGH | LOW | VOLUME TRADED |
|-------------|---------|---------|----------------------|
| 1st Quarter | \$52.71 | \$9.26 | 224,507,798 |
| 2nd Quarter | \$23.55 | \$12.80 | 471,490,629 |
| 3rd Quarter | \$19.48 | \$15.02 | 295,928,353 |
| 4th Quarter | \$28.24 | \$14.48 | 377,945,401 |
| | | | 1,369,872,181 |

Restrictions on voting securities

In 2018, the Government of Canada passed the *Transportation Modernization Act*. This Act, among other things, amended the *Canada Transportation Act* ("CTA") by increasing, from 25% to 49%, the permitted level of foreign ownership of Canadian air carriers, while capping the voting rights of any single non-Canadian and of the aggregate of non-Canadian air carriers to 25%. At its 2019 annual and special meeting of shareholders, Air Canada received approval for a plan of arrangement under section 192 of the *Canada Business Corporations Act* to effect amendments to Air Canada's restated articles of incorporation to align the restrictions on the level of non-Canadian ownership and voting control with those prescribed by the definition of "Canadian" in section 55(1) of the recently amended CTA. The Québec Superior Court subsequently issued a final order approving this plan of arrangement, and Air Canada's amended articles became effective on May 8, 2019.

English or French, it's the customer's choice

Official Languages at Air Canada

Air Canada is Canada's largest private sector corporation offering bilingual services across Canada and globally. We are proud to offer services in both official languages, demonstrating true leadership among major Canadian companies in promoting bilingualism.

For Air Canada, offering service in the language chosen by our customers is essential. Verbal exchanges with customers, public address announcements at the airport and on board, as well as briefing of passengers are all central elements of customer service and call up on our employees' linguistic skills at all times.

Air Canada puts great efforts to better serve customers in the language of their choice. Outreach activities with minority language communities as well as ongoing employee awareness and training have been key areas of focus over the years.

We are encouraged by feedback from our customers stating the majority feel that we are continuously improving our bilingual service offering.

For further information

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Air Canada complies with the rules adopted by the Toronto Stock Exchange.

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Ce rapport annuel est publié dans les deux langues officielles du Canada. Pour en recevoir un exemplaire en français, veuillez communiquer avec les Relations avec les actionnaires.





Corporate profile

Air Canada is Canada’s largest domestic and international airline and, in 2020, was among the top 20 largest airlines in the world. It is Canada’s flag carrier and a founding member of Star Alliance, the world’s most comprehensive air transportation network. 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. In 2020, Air Canada was named Global Traveler’s Best Airline in North America — received for the second straight year. In January 2021, Air Canada received APEX’s Diamond Status Certification for the Air Canada CleanCare+ biosafety program for managing COVID-19 virus, the only airline in Canada to attain the highest APEX ranking.



The only Four-Star international network carrier in North America



A STAR ALLIANCE MEMBER 