Annual Report

2021

AIR CANADA

A STAR ALLIANCE MEMBER

Caution Regarding Forward-Looking Information

Air Canada's public communications may include forward-looking statements within the meaning of applicable securities laws. 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 herein 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, continued to face significantly lower traffic in 2021, as compared to the year 2019, 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, including in Canada. While there are signs of improvement, there is limited visibility on future demand trends given changing government restrictions. Air Canada cannot predict the full impact or the timing for when conditions may improve. The COVID-19 pandemic is also having and may continue to have significant economic impacts, including on business and consumer spending and behaviour, which may in turn significantly impact demand for travel. The return of business travel to pre-pandemic levels may be challenged by the evolving nature of business models and remote-work practices in light of the impacts of the COVID-19 pandemic, including the growth and continued use of videoconferencing and other remote-work technologies as well as tendencies towards less environmentally impactful business and consumer behaviour. 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 including its variants, availability of rapid, effective testing, vaccinations and treatments for the virus, government actions including health measures and other restrictions, and passenger reaction, the complexities of restarting an industry whose many stakeholders must act in coordination with each other as well as timing and extent of recovery in international and business travel which are important segments of Air Canada's market, none of which can be predicted with certainty.

Other factors that 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, competition, Air Canada's dependence on technology, cybersecurity risks, energy prices, Air Canada's ability to successfully implement appropriate strategic and other important initiatives (including Air Canada's ability to manage operating costs), other epidemic diseases, terrorist acts, war, Air Canada's dependence on key suppliers, Air Canada's ability to successfully operate its loyalty program, interruptions of service, Air Canada's ability to attract and retain required personnel, the availability of Air Canada's workforce, casualty losses, changes in laws, regulatory developments or proceedings, climate change and environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), 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, pending and future litigation and actions by third parties, currency exchange, limitations due to restrictive covenants, insurance issues and costs, pension plans, 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 18 "Risk Factors" of Air Canada's 2021 MD&A which section is incorporated into the Annual Report by this reference. The forward-looking statements contained or incorporated by reference in this Annual Report represent Air Canada's expectations as of the date of this Annual Report (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.

Intellectual Property

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

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INTRODUCTION

FINANCIALS

Message from the President and Chief Executive Officer, Michael Rousseau

In 2021, Air Canada did not allow itself to be defined or limited by COVID-19 even though the pandemic remained the key determining factor in the airline industry's fortunes. Instead, we worked diligently throughout the year advancing our company's recovery from what has been the most severe downturn in our 85-year history.

During the year, we strengthened our finances, undertook the rebuilding of our network, pursued transformative business and ESG initiatives, and, most importantly, recalled more than 10,000 of our people. We did all this while maintaining strict health and safety protocols to protect our customers and employees.

And while the onset of the Omicron variant at year end delayed aspects of our recovery, our improving financial performance throughout the year was tangible evidence a sustainable rebound is underway. We anticipate this recovery will accelerate in 2022 as the pandemic subsides.

Financial position

For 2021, Air Canada reported operating revenue of $6.400 billion versus $5.833 billion in 2020. EBITDA (1), excluding special items, was negative $1.464 billion, an improvement of $579 million from the previous year, with fourth quarter EBITDA turning positive for the first time in seven quarters. We reported an operating loss of $3.049 billion, a change of $727 million from a loss of $3.776 billion in the prior year.

Despite an operating capacity decrease of around 11 per cent, passenger revenues rose to $4.498 billion from $4.382 billion, or

(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 20 of Air Canada 's 2021 MD&A for additional information on non-GAAP financial measures used by Air Canada and for a reconciliation of such non-GAAP financial measure to their nearest measure under GAAP.

3 per cent year-over-year. At the same time, operating expenses of $9.449 billion decreased $160 million or 2 per cent from 2020.

During the year, despite uncertainty besetting the industry, Air Canada's share price held constant, having recovered to a degree from the sharp drop in 2020 experienced by many in our industry.

While net debt [(2)] increased to $7.120 billion from $4.976 billion year-over-year, our unrestricted liquidity improved, ending 2021 at $10.4 billion, compared to about $8 billion a year earlier.

The completion of $7.1 billion in refinancing transactions during the year lowered our cost of capital and ensures we have adequate liquidity to manage the pandemic and the resources to compete effectively in the post-pandemic environment. The fact we completed the financings on attractive terms illustrates the confidence investors and the markets have in Air Canada's potential.

Our ability to secure market-based financing also enabled the company to withdraw from credit agreements provided by the Government of Canada. We left untouched nearly $4 billion in available secured and unsecured credit facilities with the Government, accessing only another facility used to refund non-refundable tickets held by customers.

Our strong liquidity position has provided a foundation to further rebuild our company. It has allowed us to carry on or complete important long-term, transformative projects that will give us meaningful competitive advantages in the post-pandemic market.

Rebuilding our network and services

There were other indicators that Air Canada shifted solidly into recovery in 2021. One key measure was the rebuilding of our network, including the introduction of new routes such as Montreal-Cairo and expanded services to South America. In January 2021, we had an average of 245 daily flights and served 101 destinations.

In 2021, we increased the number of destinations to 154 and operated 665 daily flights in December. During the low point of the pandemic, in May 2020, we operated to only 40 destinations.

We also restored many of the services which have made Air Canada the only four-star network carrier in North America, according to Skytrax. We reopened all 23 of our airport Maple Leaf Lounges during the year and reintroduced many features of our onboard service. Such efforts were recognized in 2021 with prestigious awards, including Best Business Class Lounge in North America from Skytrax, Global Traveler's Best Airline in North America for the third straight year, and the APEX Five-Star rating based on customer feedback.

Fleet renewal

Our ongoing fleet renewal program has benefitted from our strong liquidity. During the year, we committed to purchasing twelve additional Airbus A220s, reversing an earlier decision to reduce our orders. We took delivery of twelve A220s in 2021. We also took delivery of seven Boeing 737 Max aircraft in 2021 after accelerating orders for four of these aircraft in the fourth quarter. Finally, we exercised options to purchase three Boeing 787-9 aircraft to be delivered later this year and next year. These efficient, new aircraft-types will not only allow us to serve new and recovering markets more efficiently, but they will also help us reach our ambitious environmental targets.

Aeroplan

Another major initiative that continued to gain traction in 2021 was our transformed Aeroplan loyalty program that relaunched in 2020. Aeroplan will be a pronounced differentiator for Air Canada in a more crowded Canadian airline industry. This is particularly relevant in the recovery phase because Aeroplan's target market has been expanded to leisure travellers – the customers we expected to return first.

(2) 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. Refer to section 9.3 of Air Canada's 2021 MD&A for additional information, including a reconciliation of such financial measure to Total long-term debt and lease liabilities.

The new program is delivering financially with increased billings. Members are enjoying improved value and greater certainty on what flight rewards cost, and more options, such as family sharing of points. Customers are also finding it appealing that we have added new and popular partners, such as Uber and Starbucks, with whom members can earn and redeem points. The new program has received numerous commendations and high ratings in specialized media devoted to loyalty programs. As a testament to its success, in 2021, our Aeroplan loyalty program welcomed 1.2 million new members, more than in any other year.

Aeroplan also has strong relationships with major credit card partners. This includes TD, CIBC, American Express, Visa in Canada and, in the U.S., where the potential membership base is a multiple of Canada's, Chase and Mastercard.

Air Canada Cargo

A third significant program is the expansion of Air Canada Cargo. Although historically a small part of Air Canada's business, Air Canada Cargo's annual revenue of $1.495 billion in 2021 marked the first time that cargo revenues exceeded $1 billion. We achieved this by identifying an opportunity early-on – the lack of global air freight capacity due to the COVID-19 pandemic – and then by moving quickly to seize it by expanding to fill the void.

We were one of the first airlines to remove seats from the passenger cabin of certain aircraft to accommodate cargo and we operated approximately 10,200 such all-cargo flights in 2021, whereas prior to the pandemic we flew none. We developed a plan to permanently convert eight, retired Boeing 767s from our fleet into dedicated freighters, and the first arrived late in 2021. These freighter aircraft will provide us with a good foothold in the air cargo business, where tight capacity and rising e-commerce demand are expanding margins. To capture more e-commerce parcel delivery business, we have also launched Rivo, a first-mile, last-mile service we will operate in conjunction with third-party delivery companies.

To further support Air Canada Cargo's growth, we undertook to modernize and expand our Toronto-Pearson cargo facility for greater cold-chain capability. This facility will enable us to better handle shipments such as pharmaceuticals and perishables. The Toronto facility will be the only one of its kind in Canada and one of the most modern in North America. We are also looking for other opportunities to expand our facilities in anticipation of continued growth, for example in Vancouver for the Asia-Pacific market.

Sustainability

A final, pre-pandemic initiative that we have carried on – with even greater urgency – is Air Canada's environmental and social programs, or more broadly its ESG programs. One highlight of 2021 was our announcement of ambitious targets to reduce greenhouse gas (GHG) emissions that contribute to global warming. We have set a goal of net-zero emissions by 2050, with equally ambitious interim targets of 20 per cent GHG net reductions from flights and 30 per cent from ground operations that we are already well on the way to meeting. To increase accountability and transparency, this year's annual report has an expanded ESG section.

We are also leveraging our developing expertise in alternative fuels, which will be an environmental game-changer for our industry. Since our first demonstrated biofuel flight in 2012, we have remained involved with research on alternative fuels. As part of our net zero-emissions announcement, we committed to an investment of $50 million in sustainable aviation fuels (SAF) research, as well as in carbon reduction and removal.

To advance these goals, in 2021 we became a founding member of – and the first Canadian carrier to join – the Aviation Climate Taskforce to address CO_2 emissions from commercial aviation. The new, non-profit organization, founded by ten global airlines and the Boston Consulting Group, aims to accelerate research and advance innovation related to emerging decarbonization technologies, including through the development of SAF. In this vein, we also entered into an agreement with a Canadian firm,

"Our strong liquidity position is also providing a foundation to further rebuild our company. It has allowed us to carry on or complete important long-term, transformative projects that will give us meaningful competitive advantages in the post-pandemic place."

Carbon Engineering Ltd., to explore the use of that company's proprietary Direct Air Capture technology to remove CO_2 from the atmosphere.

Social responsibility; diversity and inclusion

In addition to our environmental initiatives, Air Canada has maintained other social responsibility programs. The Air Canada Foundation supported 162 Canadian charities focused on the health and well-being of children with cash and in-kind support, including $580,000 in donations and close to 11 million Aeroplan points during the year. We also successfully resumed our annual golf tournament following a one-year hiatus due to COVID-19. Similarly, our diversity and inclusion programs also carried on and during the year we were recognized as one of Canada's Best Diversity Employers for the sixth consecutive year in a national competition.

Our employees

Our focus on diversity speaks to the importance we place on our employees and our desire to create a welcoming, inclusive and fulfilling work environment. This is especially important given the impact of the pandemic on society, and the challenges it has presented our industry in particular. That we were able to recall all eligible employees and have them work safely to take care of our customers was perhaps our greatest accomplishment during the year. I thank them for their dedication and was extremely pleased to see their efforts recognized with global awards, including being named Best Airline Employees in Canada and Best Airline Employees in North America in the Skytrax World Airline Awards.

As we move forward in 2022, our prime objective will be advancing the recovery of our airline as the effects of COVID-19 diminish. Our strong financial position will allow us to make strategic investments essential to our future success, including in the areas of customer service and technology. Our liquidity position will also enable us to overcome temporary challenges to the end of the pandemic and capitalize on opportunities that may unexpectedly arise.

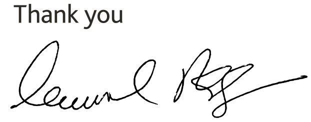
Concluding remarks

In conclusion, in addition to reiterating my gratitude to our employees for their hard work, I also thank our customers for their continued loyalty. This includes both those who have continued to travel and the many more we know are planning to resume flying with us soon, as well as shippers who entrust us to carry their goods. I also thank our shareholders for their support. Many of you have been long time investors in Air Canada and have shared our vision to create a company that could be sustainably profitable over the long term. I believe our successful management of the COVID-19 pandemic and all our other accomplishments during these incredibly challenging times demonstrate that we will achieve our goals.

Lastly, to thrive in an industry as complex and dynamic as ours requires thoughtful long-term planning and the courage to adhere to a chosen course. For this reason, I am grateful for our Board of Directors' faithful support of both myself and senior management, and for their wise counsel during the past year.

I look forward to reporting to you again next year on our accomplishments in 2022.

Thank you



2021 Highlights

BIOSAFETY MEASURES AND SERVICE ENHANCEMENTS

- → CleanCare+ biosafety program
- → Travel Ready hub

OUR PEOPLE

RECALLED
over 10,000 employees
IN 2021

THE NUMBERS

$6.400 billion
OPERATING REVENUES
(compared to $5.833 billion in 2020)

NEGATIVE
$1.464 billion
EBITDA (excluding special items)

$(3.049) billion
OPERATING LOSS

$10.4 billion
IN **UNRESTRICTED LIQUIDITY**
at end of 2021

154
DESTINATIONS
served in 2021

665
AVERAGE NUMBER OF DAILY FLIGHTS
in December 2021 (from 245 in January 2021)

CARGO

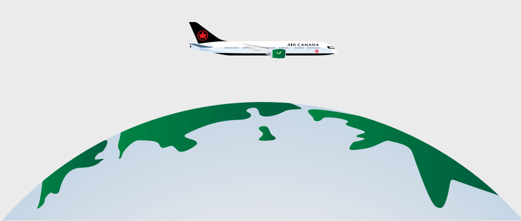
OVER
10,200
CARGO-ONLY FLIGHTS
IN 2021

CLOSE TO
$1.5 billion
IN CARGO REVENUES
FOR 2021

First Boeing 767 freighter in service

ENVIRONMENT

Climate Action Plan with ambitious goal of net-zero GHG throughout global operations
BY 2050

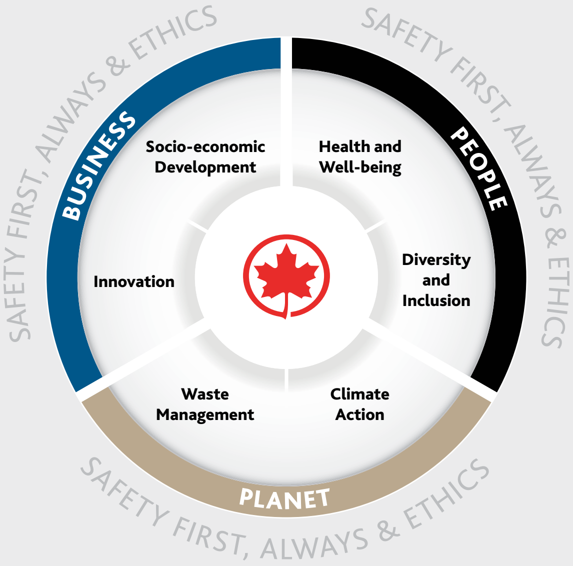


AEROPLAN

OVER
1.2 million
NEW AEROPLAN MEMBERS
IN 2021

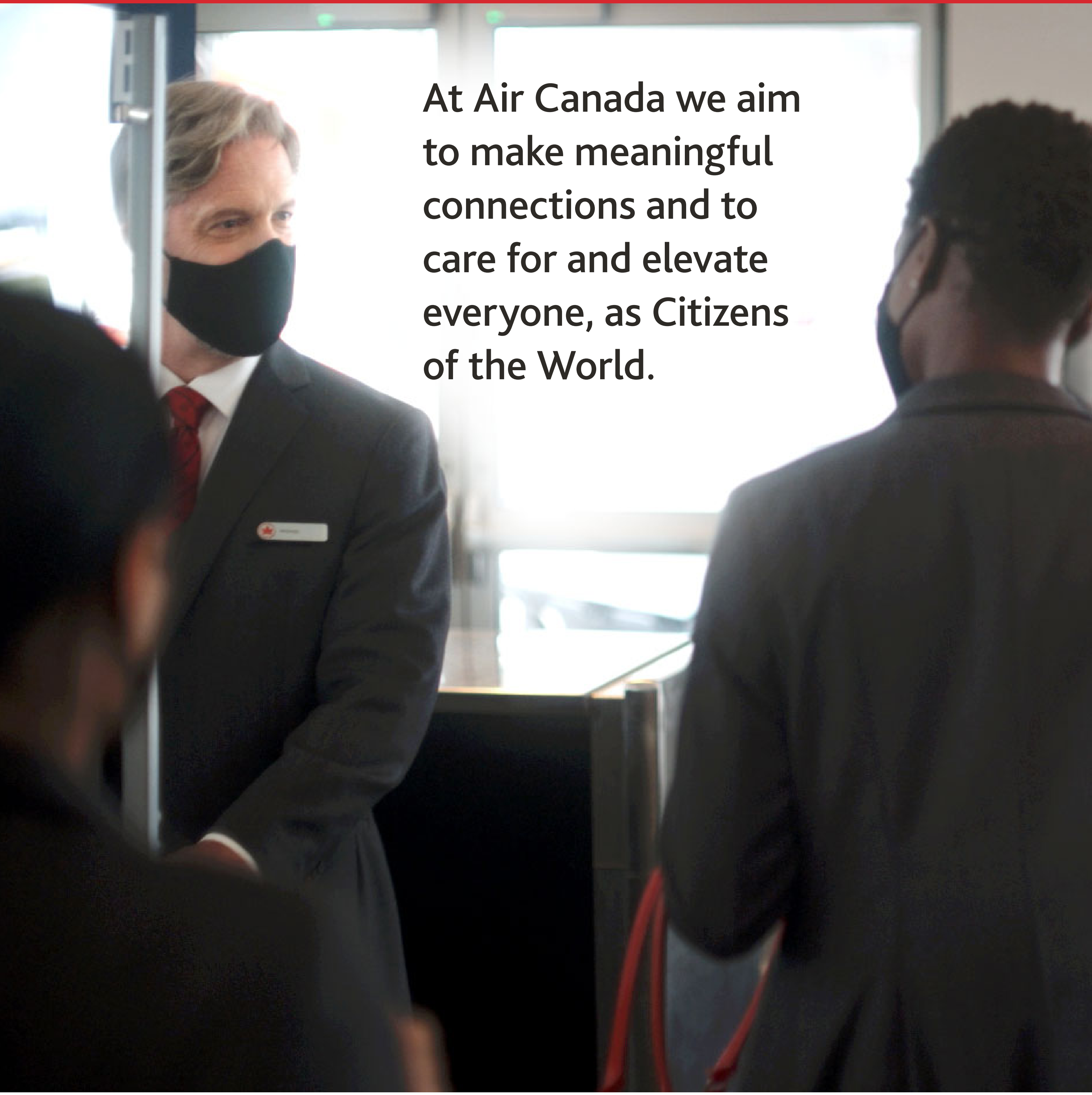
EXPANDED
Aeroplan airline partner network
AND EVERYDAY PARTNERSHIPS WITH STARBUCKS, LCBO, UBER CANADA, AND MORE

TOWARDS A SUSTAINABLE FUTURE



Being a global champion demands responsible corporate citizenship and doing what is right for the long-term interest of shareholders, employees, customers, communities, and other stakeholders; it includes supporting research and innovation to reduce one's environmental footprint and governing one's business responsibly, safely, and ethically.

Through its various committees, the Board of Directors has responsibility for environment, social and governance (ESG) practices at Air Canada. ESG is integrated in Air Canada's business and informs decision-making. Corporate sustainability initiatives are identified and coordinated through a Corporate Sustainability Working Group and a Corporate Sustainability Steering Committee. The Corporate Sustainability Working Group, comprising senior management subject matter experts from diverse functions, is tasked with the coordination and monitoring of Air Canada's corporate sustainability initiatives. The Working Group reports on the progress of these initiatives to the Steering Committee, which includes senior executives.



At Air Canada we aim to make meaningful connections and to care for and elevate everyone, as Citizens of the World.

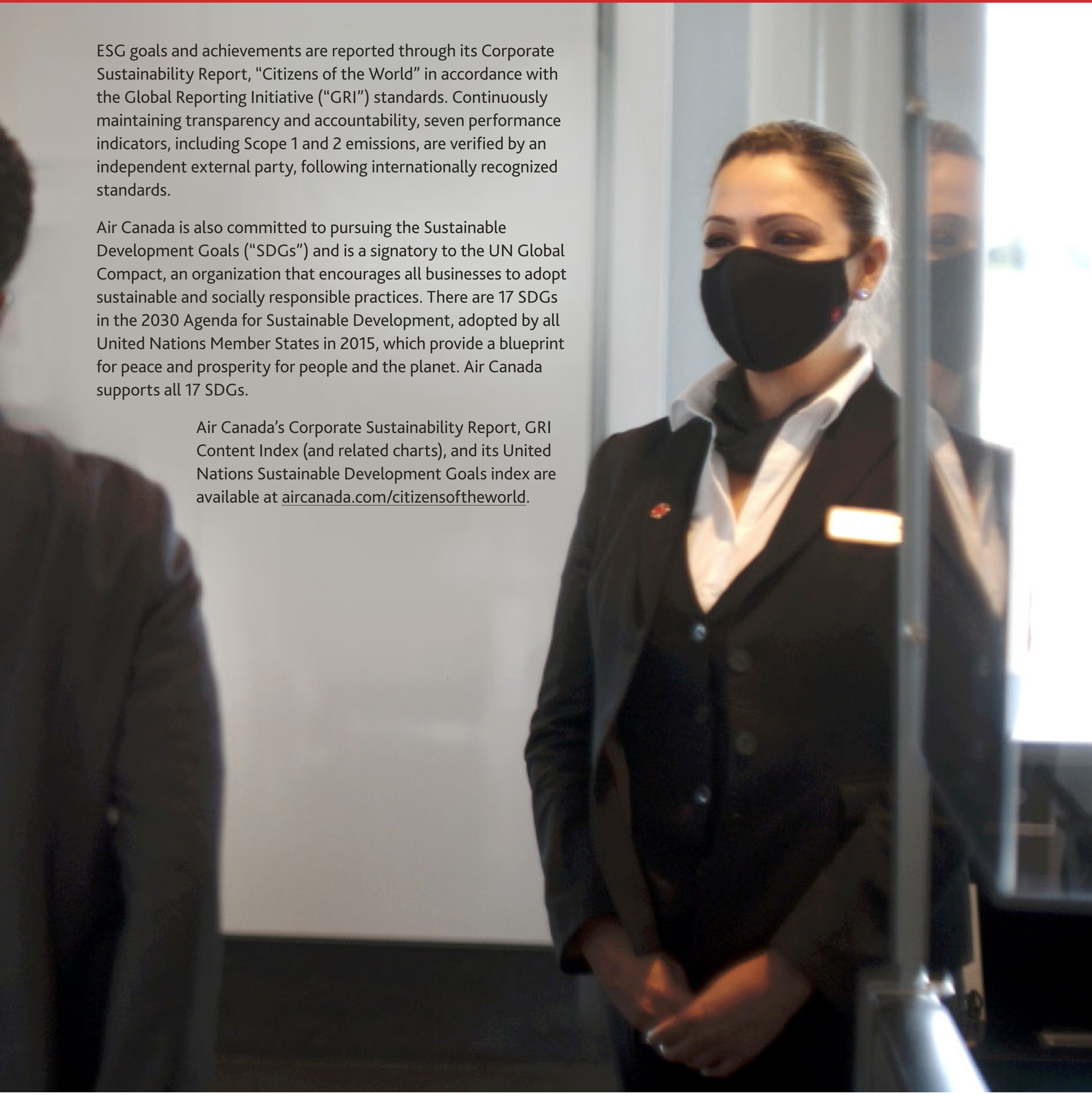
APEX
OFFICIAL AIRLINE RATINGS™
FIVE STAR
GLOBAL AIRLINE
2022
CERTIFIED • VALIDATED • VERIFIED

APEX
HEALTH SAFETY
powered by SimpliFlying
DIAMOND
CERTIFIED 2021

ESG goals and achievements are reported through its Corporate Sustainability Report, "Citizens of the World" in accordance with the Global Reporting Initiative ("GRI") standards. Continuously maintaining transparency and accountability, seven performance indicators, including Scope 1 and 2 emissions, are verified by an independent external party, following internationally recognized standards.

Air Canada is also committed to pursuing the Sustainable Development Goals ("SDGs") and is a signatory to the UN Global Compact, an organization that encourages all businesses to adopt sustainable and socially responsible practices. There are 17 SDGs in the 2030 Agenda for Sustainable Development, adopted by all United Nations Member States in 2015, which provide a blueprint for peace and prosperity for people and the planet. Air Canada supports all 17 SDGs.

Air Canada's Corporate Sustainability Report, GRI Content Index (and related charts), and its United Nations Sustainable Development Goals index are available at aircanada.com/citizensoftheworld.



WORLD AIRLINE SKYTRAX AWARDS 2021

Best Airline Staff in North America
Best Airline Staff in Canada
Best Business Class Lounge in North America
COVID-19 Airline Excellence award

People

SAFETY, HEALTH AND WELLNESS

Air Canada's number one core value is: Safety First, Always. The safety of customers, employees, and that of those in the communities Air Canada serves is always the top priority.

Air Canada aims to create a healthy, inclusive and rewarding work environment where everyone feels that they belong, can excel and realize their full potential. Air Canada seeks to inspire, encourage and challenge its employees to be their best in all they do. The airline is committed to contributing to the socio-economic growth and wellness of communities in which it operates and, together with its value chain and customers, seeks to make a positive difference in the lives of people in need across Canada through financial and in-kind support. To accomplish this, Air Canada fosters a healthy environment that prioritizes and encourages good health and well-being, effectively providing resources, supporting worthy causes, and partnering with organizations to further its impact with employees and communities.

In partnership with its employees, Air Canada is committed to conducting its business in a manner that ensures the health and safety of its employees, customers, contractors and the general public, while meeting obligations under applicable regulations. To ensure this commitment to safety, Air Canada (i) supports and promotes effective training; (ii) supports the continued development and integration of safety data analytics and artificial intelligence into its Safety Management System (SMS); (iii) continually assesses and manages safety risks associated with the introduction of new equipment, new routes and new initiatives or projects; and (iv) reinforces and promotes safety reporting, protecting safety critical information in order to inform its decisions.

Air Canada has implemented a Safety Policy, appropriate for the size and complexity of the organization. The Safety Policy is the basis of the Air Canada Safety Management System.

Air Canada has an extensive Health and Safety Program to prevent work accidents and injuries. It includes a policy on drugs and alcohol as well as a policy to prevent Workplace Violence and Harassment. Key to these measures is the Hazard Prevention Program, which enables 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.

Biannual, voluntary and confidential safety culture surveys are conducted to collect employee insights on safety.

Employees have access to and may benefit from the Employee and Family Assistance Program (or other similar programs), which provides confidential help for any work, health, or other life-related concern. Air Canada's unique corporate wellness program, Unlock the Best in You ("UBY"), provides a library of tools, resources and training in relation to health and wellness, mental health, financial health, and work health.

Air Canada Named Best Airline in North America for Third Straight Year by *Global Traveler*

- → *Global Traveler*'s Best Airline in North America for the third straight year
- → *Global Traveler*'s Best Airline Cabin Cleanliness for the second straight year
- → *Business Traveler* Magazine's Best North American Airline for International Travel
- → Air Canada also sweeps StudentUniverse's six Canadian travel awards voted in annual airline survey

Recognized in FXExpress Publications Awards for leisure, family and millennial travel, notably:

→ Leisure Lifestyle Awards
- Best Airline for Onboard Entertainment for the third consecutive year
- Best Premium Economy Class for the third consecutive year
- Best Airline for Onboard Menu for the third consecutive year

→ The Trazees Awards
- Favourite Airline in North America for the third consecutive year

→ The Wherever Awards
- Best Family-Friendly Airline in North America for the third consecutive year
- Best Family Friendly International Airline for the second consecutive year

Air Canada continually updates its health and safety policies and procedures for travellers and employees in airports, onboard aircraft and in other workplace environments to account for new information about COVID-19 as it becomes available. Early on in the pandemic, as part of its COVID-19 Mitigation and Recovery Plan, the airline developed and launched Air Canada CleanCare+, an industry-leading comprehensive program, along with several other initiatives, including TouchFree Bag Check for flights departing from Canadian airports and medical and testing collaborations. Employees have worked diligently to ensure Safety First, Always, for each other and for customers through their entire journey.

As part of its commitment to safety as the number one priority, numerous measures have been taken to protect employees, reduce the risk and mitigate the spread of COVID-19. This included:

→ **A COVID-19 Wellness Assessment Tool** to help employees determine whether they should report for work.

→ **A COVID-19 Safe Behaviour Policy** formulated to minimize the risk of COVID-19 community spread while at work. Air Canada also launched a workplace rapid antigen screening program for employees and was the first company in Canada to launch rapid antigen home screening for its employees.

Air Canada quickly adjusted practices to enable employees to physically distance safely; pivoted recruitment, talent development and retention practices; shifted training so it could be completed predominantly online; enabled remote work where possible; and developed flexible return-to-work models. In 2020, a Telework Policy was developed to assist employees and managers transition to the new reality brought about by the pandemic. The policy is reviewed annually or when circumstances warrant. From October 31, 2021, we required all employees be fully vaccinated against COVID-19 subject to medical or religious exemptions under applicable law.

WELLNESS OF COMMUNITIES

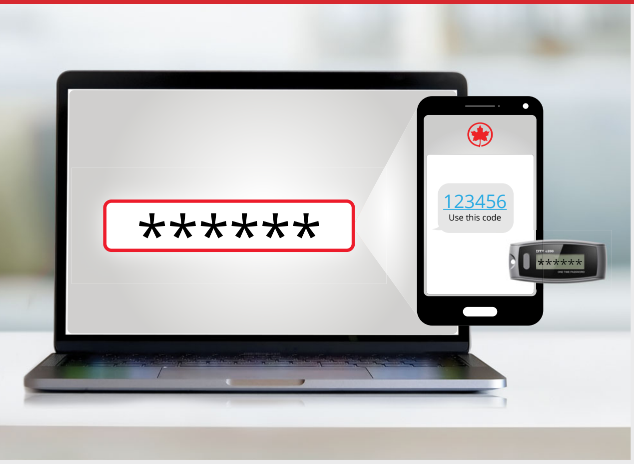
Air Canada was the first company in Canada to launch rapid antigen home screening for its employees.

In 2021, Air Canada partnered with provincial governments, public health organizations and other aviation industry partners to host vaccination hubs in Montreal, Toronto and Vancouver with the capacity to vaccinate close to 300,000 members of the community, relieving pressure on the public health sector.

Air Canada and the Air Canada Foundation also supported a number of humanitarian efforts in 2021, including by raising funds and sending specialized volunteers to help with clean-up and recovery operations after flooding, wildfires and extreme weather events impacted communities throughout British Columbia and Ontario. Air Canada also operated 13 relief charters to deliver drinking water to affected communities in Nunavut when the city of Iqaluit had declared a state of emergency due to fuel-contaminated drinking water, and proudly assisted in welcoming Afghan refugees to Canada.

In 2021, Air Canada and the Air Canada Foundation continued their food rescue efforts across the country, offering more than 180,000 kg of extra food from flight kitchens, representing over 400,000 meals. These efforts supported over 88 not-for-profit agencies in 16 cities in Canada and averted the emission of

Early on in the pandemic, as part of its COVID-19 Mitigation and Recovery Plan, the airline developed and launched Air Canada CleanCare+, an industry-leading comprehensive program, along with several other initiatives, including TouchFree Bag Check for flights departing from Canadian airports and medical and testing collaborations. Employees have worked diligently to ensure Safety First, Always, for each other and for customers through their entire journey.



more than 1.2 million kg of GHG through the avoidance of new food production, processing or retailoring, as estimated by Second Harvest (Second Harvest is Canada's largest food rescue charity). In total, since beginning its food rescue efforts in March of 2020, Air Canada has donated more than 950,000 kg of food, which represents over 2.1 million meals.

PRIVACY AND CYBERSECURITY

Air Canada has developed a cybersecurity framework and continues to implement a privacy action plan to improve its privacy maturity and cybersecurity resilience. To address the growing threat of cyber-attacks, Air Canada invests in security initiatives that include technology, processes, resourcing, training, disaster recovery, and regular testing and benchmarking against best practices. We also seek to ensure that vendors have effective cybersecurity controls that are aligned with Air Canada's best practice cybersecurity policies and standards.

Privacy efforts are focused notably in the areas of policy 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 regularly assessed.

EMPLOYEE AND LABOUR RELATIONS

Air Canada's strong relationships with its major union groups are a fundamental pillar of Air Canada's collaborative culture and sustainable future. This was exemplified through close and constructive work on mitigation measures to reduce the unprecedented impact of the COVID-19 pandemic.

Retention and development of employees is a cornerstone of a healthy work culture and protects the longevity of a business while setting it up for future success. Air Canada is committed to providing development opportunities and career progression to its employees. Recruitment initiatives emphasize Air Canada's dedication to encouraging internal transfers and promotions. Some collective agreements also provide for opportunities to trial other positions within the organization, while protecting seniority and job positions. Air Canada continually strives to create opportunities for talent to evolve and grow. Air Canada developed a rotational talent agility model, both in training and experience, which provides a unique opportunity for some employees to acquire new skills while sustaining operational needs across the organization.

2025 OBJECTIVES

The Board has established as its objective that **women represent at least 40% of the directors.**

Air Canada committed to have at least **3.5% of board and executive roles being held by Black leaders.**

DIVERSITY, EQUITY AND INCLUSION

For many years, Air Canada has had a Diversity Policy for employees. Over time, the policy has been updated and enhanced, with the goal of achieving and maintaining a workforce at all levels of the Corporation that represents the external qualified workforce available. Air Canada places emphasis on women, persons with disabilities, Indigenous Peoples and members of visible minorities.

From promoting diversity and inclusion to building a workforce made up of people from a wide array of cultures, traditions and languages, Air Canada aims to reflect the country's cultural fabric — that of unity in diversity. Air Canada pursues a diversity management strategy with the goal of ensuring an inclusive and diverse workplace based on respect, where all employees feel they belong. This creates an environment in which they can best use their talents.

Of critical importance to Air Canada is that the internal talent pool and development and promotion processes are equitable, balanced and diverse. This is true at all levels of the Corporation, including in leadership. Because many future executives may come from senior leadership ranks, the Corporation's talent and engagement team pays a significant amount of attention to ensuring that diversity is reflected among multiple layers of senior leaders and that emerging leaders programs comprise a diverse group of talent.

The Board has established as its objective that women represent at least 40 per cent of the directors at Air Canada by 2025. The Board also takes other dimensions of diversity into account in the process of selecting individual candidates. Through its ongoing renewal, it is the Board's aspiration that its composition will reflect the changing population demographics of Canada, recognizing the diversity of the customers and employees of Air Canada.

Air Canada is Parity Certified with Women in Governance and 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 per cent or greater by 2022. In addition, the Corporation is a signatory to the BlackNorth Initiative CEO Pledge which recognizes the need to create opportunities and foster inclusiveness for Black people and leaders in Canada. As part of the Pledge, Air Canada committed to have at least 3.5 per cent of board and executive roles being held by Black leaders by 2025.

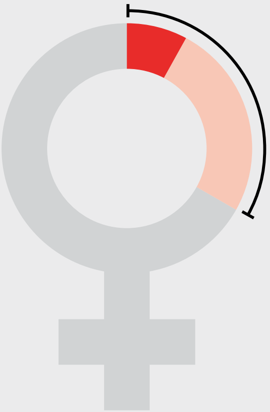
2021 CANADA'S BEST DIVERSITY EMPLOYERS

WOMEN IN GOVERNANCE PARITY CERTIFIED 2021 SILVER

WOMEN in GOVERNANCE

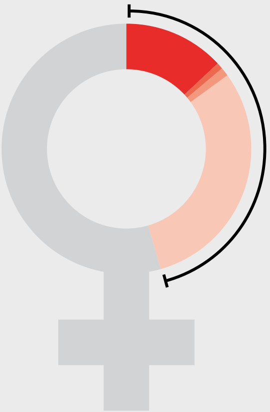
Presently, four of 12 directors (33 per cent) are women, and one director (8 per cent) is a member of a visible minority. Following Air Canada's meeting of shareholders scheduled for March 28, 2022, assuming that all director nominees are elected, four out of 12 directors (33 per cent) will be women and there will be one director (8 per cent) that is a member of a visible minority. None of the current directors or nominees have self-identified as an Indigenous person or a person with a disability.

Currently, three out of 20 members (15 per cent) of Air Canada's executives are women, and minorities represent one out of 20 members (5 per cent). There are no members of Air Canada's executives that have identified as being Indigenous or as having a disability. As at December 31, 2021, out of 255 senior leaders, 91 (36 per cent) are women, four (about 2 per cent) are disabled, two (under 1 per cent) are Indigenous and 39 (about 16 per cent) are visible minorities. Data on the representation is obtained through voluntary self-identification.



33% of board members are women.

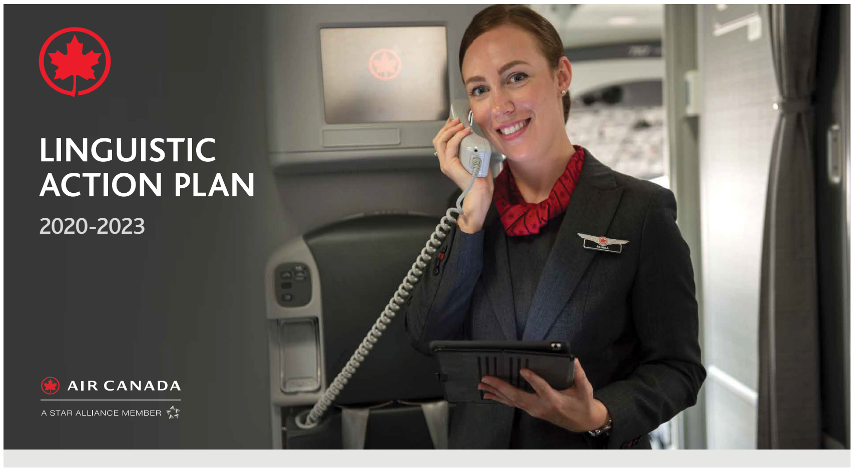
- **1** person is a member of a visible minority



As at December 31, 2021, out of 255 senior leaders 36% are women:

- **16%** are visible minorities
- **2%** are disabled
- **<1%** are Indigenous

OFFICIAL LANGUAGES



Air Canada is Canada's largest private sector company offering bilingual services across Canada. We are proud to offer services in both of Canada's official languages, demonstrating true leadership among major Canadian companies in promoting bilingualism. Over the years, Air Canada has implemented a series of sustained initiatives in its Linguistic Action Plan, to maintain delivery of the services it offers customers in both official languages and to promote a bilingual workplace.

Air Canada supports organizations to promote the Francophonie in a sustainable manner and to develop the Francophone culture and tourism industry.

Based on equal qualifications, priority is always given to bilingual candidates in its recruitment efforts. Air Canada invests in language training and offers awareness sessions to familiarize employees with the active offering of bilingual services.

Air Canada's Climate Action Plan builds on its already-existing value streams and activities and has identified four key carbon reduction pillars:

FLEET AND OPERATIONS

INNOVATION

SAF AND CLEAN ENERGY

CARBON REDUCTION AND REMOVALS

Planet

CLIMATE ACTION

Air Canada is committed to advancing climate change sustainability throughout its business and reporting on its progress. The ambitious net-zero goal will be realized through a series of five-year climate action plans.

Since 2007, information on Air Canada's carbon footprint, targets and climate strategy has been reported through the CDP, a global disclosure system that is used to assist investors, companies, cities, states and regions in managing their environmental impact. The CDP questionnaire incorporates elements of the Task Force on Climate-related Financial Disclosures (TCFD) framework. Air Canada holds a B- for its Climate Change 2021 CDP score report. To access Air Canada's CDP response, visit www.cdp.net. Air Canada will be issuing its first TCFD in 2022.

Since 2019, Air Canada has been reporting its annual CO_2 emissions to Transport Canada for the ICAO Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA), applicable to certain international flights and designed to achieve the aviation industry carbon neutral growth target.

Air Canada is a signatory, through the National Airlines Council of Canada (NACC), to the Canadian Action Plan to Reduce Greenhouse Gas Emissions from Aviation. This multi-party action plan between aviation industry stakeholders and the federal government outlines how the parties intend to reduce greenhouse gas emissions from aviation. This Action Plan forms the basis of the Government of Canada's national action plan submitted to ICAO and sets out measures to address international aviation emissions.

Air Canada is actively engaged with industry stakeholders in several initiatives to better understand, strategize and effect environmental protection locally and globally. Air Canada is a member of the IATA Sustainability and Environment Advisory Council (SEAC). In addition, it is chair of the NACC Environmental Subcommittee and is involved with other environment committees and working groups with the Airlines for America (A4A), the Star Alliance® Sustainability

Our Climate Action Plan

In March 2021, Air Canada released its new Climate Action Plan that includes ambitious milestones to achieve its long-term goal of net-zero emissions by 2050. In defining the pathway to this goal, Air Canada has set 2030 absolute mid-term GHG net-reduction targets:

20%
GHG net reductions
from air operations **by 2030** compared to our 2019 baseline.

30%
GHG net reductions
from ground operations **by 2030** compared to our 2019 baseline.

$50 million
Investment
in sustainable aviation fuels (SAF) as well as in carbon reductions and removals.

Committee and is a member of Canadian Business for Social Responsibility (CBSR).

Through the NACC, Air Canada has also participated in the formulation of domestic aviation carbon pricing, as part of the Canadian Government's Pan-Canadian Framework on Clean Growth and Climate Change.

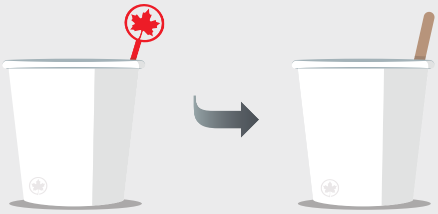
Air Canada is a founding member of, and the first Canadian carrier to join, the Aviation Climate Taskforce (ACT), formed to tackle the challenge of rising CO_2 emissions from commercial aviation. The new, non-profit organization, made up of 10 global airlines and the Boston Consulting Group, was established in 2021 to accelerate research and advance innovation related to emerging decarbonization technologies, including through the development of sustainable aviation fuels.

- In May 2021, **Air Canada engaged with the Edmonton International Airport ("EIA") in a new partnership to reduce carbon emissions and advance a green and sustainable aviation sector**. The EIA-Air Canada Sustainability Partnership aims to reduce the carbon impact of air travel with both organizations working together to test emerging green technologies at EIA's Airport City Sustainability Campus, an ecosystem that EIA created to foster environmental innovation. The partnership reflects both organizations' pledges to sustainability and reducing carbon emissions to a net-zero future.
- In October 2021, **Air Canada launched its new Leave Less Travel Program**, which offers its corporate customers effective options to offset or reduce GHG emissions related to business travel and reduce their carbon footprint.
- In November 2021, **Air Canada and Carbon Engineering Ltd. ("CE") announced a preliminary agreement to identify potential opportunities for CE's proprietary Direct Air Capture technology**, which captures carbon dioxide from the atmosphere, to advance aviation decarbonization. The two Canadian companies plan to explore potential cooperation activities in SAF, permanent carbon dioxide removal and innovation, including opportunities for Air Canada to purchase SAF utilizing CE's technologies.

LESS WASTE

Despite the operational and financial impact of the COVID-19 pandemic, Air Canada has maintained its commitment to waste reduction. In 2020, Air Canada achieved its Corporate Waste Objectives, which were focused on decreasing the amount of waste generated and sent to landfill by (1) reducing waste by 20 per cent in offices, facilities and Maple Leaf Lounges; and (2) recycling 50 per cent of approved items on board domestic flights. In 2021, Air Canada maintained its waste reduction efforts adapting where needed to the impact of the COVID-19 pandemic. Recycling of personal protective equipment including facial masks was implemented through our Canadian operations as well as disposal processes for our rapid testing program as per applicable provincial requirements.

Air Canada is evaluating new goals, taking into consideration the impact of the COVID-19 pandemic. This may include developing solutions for changes in waste streams as a result of the pandemic, reducing single-use plastics onboard, and working across departments at Air Canada to re-evaluate the way waste is generated, disposed of and tracked across all lines of business.



In March 2021, Air Canada hosted a virtual forum on Illegal Wildlife Trade (IWT) in Canada's transportation industry with over 250 participants. As the country's largest airline, Air Canada's goal was to raise awareness about the illegal wildlife trade in Canada and around the world.

CONTRIBUTING TO BIODIVERSITY

Air Canada is dedicated to combatting the illegal wildlife trade and to raising awareness on the issue and its consequences. In addition to threatening ecosystems, illegal wildlife trade can play a role in spreading zoonotic diseases. As such, fighting illegal wildlife trade is also important in preventing pandemics of zoonotic origin. Through IATA's MOU with the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES), Air Canada assists in the implementation of CITES within its operations. As such, we do not permit carriage of species covered by CITES unless the shipper certifies that the species is carried under a government issued CITES permit. Air Canada also has an embargo on the carriage of shipments of lion, leopard, elephant, rhinoceros, and water buffalo trophies, of shark fins and of non-human primates intended for laboratory research and/or experimental purposes.

In June 2020, Air Canada signed the Buckingham Palace Declaration, a landmark agreement of 11 commitments designed to remove the vulnerabilities in transportation and stop the illegal wildlife trade. On September 30, 2020, Air Canada also became Illegal Wildlife Trade (IWT) certified — the first airline in all the Americas to achieve this industry standard. Introduced in 2019 by IATA, the IWT certification demonstrates that an airline has incorporated into its operations the 11 commitments of the United for Wildlife Buckingham Palace Declaration.

Air Canada continues to look for new opportunities to collaborate with industry partners and organizations to support the fight against the illegal wildlife trade. More recent collaborations include an awareness campaign with the Edmonton International Airport, also a signatory to the Buckingham Palace Declaration, and a member-to-member webinar with the Canadian International Freight Forwarder Association (CIFFA).

Ready for Take Off

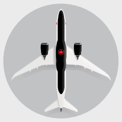
RISE HIGHER

Over the past decade, Air Canada has aimed to be a sustainable global champion by pursuing profitable international growth opportunities and leveraging its competitive attributes, identifying and implementing cost reduction and revenue enhancing initiatives, engaging customers by continually enhancing their travel experience and consistently achieving customer service excellence, and by fostering positive culture change.

Air Canada's recovery is predicated on leveraging the solid foundation it has built over the past several years to restore and rebuild towards its global champion ambition, while taking advantage of ground-breaking opportunities and an unwavering commitment to safety, service excellence, and the customer journey.

Air Canada is evolving its business to prepare for the future. As part of these efforts, it is introducing "Rise Higher", its newly articulated business imperatives, intended to elevate everything about its business. As it embarks on this next chapter, Air Canada will:

Fund its future by staying vigilant on costs, seizing on opportunities, and making the right strategic investments



Reach new frontiers, by embracing its competitive strengths to grow the business by expanding its international reach, and continually exploring new opportunities

Elevate its customers, and support the creation of meaningful customer experiences and human connections by leveraging innovations in technology, loyalty and products

Foster a collaborative workplace that respects diverse cultures and languages, while making impactful contributions to society

In pursuit of this goal, in 2022, Air Canada will build upon and leverage its numerous competitive advantages, including:

- → Its talented people, and award-winning culture
- → A widely recognized and powerful brand
- → A streamlined, modern, fuel efficient and versatile fleet, with market-leading aircraft configurations
- → 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 customer experience enhanced by competitive products and services, including the fully transformed Aeroplan program
- → Air Canada Rouge, a lower-cost leisure carrier
- → A growing cargo offering
- → New core technologies and other technological improvements
- → Its commitment to sustainability


AIR CANADA

Investor and Shareholder Information

TSX price range and trading volume of Air Canada variable voting shares and voting shares (AC)

2021	HIGH	LOW	VOLUME TRADED
1st Quarter	31.00	19.37	295,825,811
2nd Quarter	29.17	22.70	227,087,773
3rd Quarter	27.41	22.30	158,870,394
4th Quarter	26.80	19.31	193,792,761

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.

For further information

SHAREHOLDER RELATIONS

Telephone: 514-422-6644
Facsimile: 514-422-0296
shareholders.actionnaires@aircanada.ca

INVESTOR RELATIONS

Telephone: 514-422-7849
Facsimile: 514-422-7877
investors.investisseurs@aircanada.ca

HEAD OFFICE

Air Canada Centre
7373 Côte-Vertu Boulevard West
Saint-Laurent, Québec H4S 1Z3

Internet: aircanada.com

Air Canada complies with the rules adopted by the Toronto Stock Exchange.

TRANSFER AGENT AND REGISTRAR

TSX Trust Company
2001 Robert-Bourassa Blvd.
Suite 1600
Montreal, Quebec H3A 2A6

Telephone: 1-800-387-0825
(Canada and United States)
416-682-3860 (other countries)

Email: shareholderinquiries@tmx.com

Web: tsxtrust.com

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.

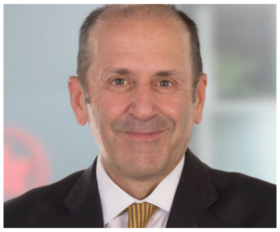
Board of Directors and Committees

	Audit, Finance and Risk Committee	Safety, Health, Environment and Security Committee	Governance and Nominating Committee	Human Resources and Compensation Committee
Vagn Sørensen Chairman of the Board, Air Canada London, United Kingdom			Member	
Amee Chande Corporate Director and Strategy Consultant Los Altos, California	Member	Member		
Christie J.B. Clark Corporate Director Toronto, Ontario	Chair		Member	
Gary A. Doer Corporate Director Winnipeg, Manitoba		Member		Member
Rob Fyfe Corporate Director Auckland, New Zealand		Chair		Member
Michael M. Green Chief Executive Officer and Managing Director, Tenex Capital Management East Hampton, New York		Member		Member
Jean Marc Huot Partner, Stikeman Elliott LLP Montréal, Québec		Member	Member	
Madeleine Paquin President and Chief Executive Officer, Logistec Corporation Montréal, Québec		Member	Member	
Michael Rousseau President and Chief Executive Officer, Air Canada Saint-Lambert, Québec				
Kathleen Taylor Corporate Director Toronto, Ontario	Member		Member	Member
Annette Verschuren Chair and Chief Executive Officer, NRStor Inc. Toronto, Ontario	Member		Chair	
Michael M. Wilson Corporate Director Bragg Creek, Alberta	Member			Chair

Committee mandates are available at https://www.aircanada.com/ca/en/aco/home/about/corporate-governance.html#/

Executive Officers [1]

Michael Rousseau
President and Chief Executive Officer



Marc Barbeau
Executive Vice President and Chief Legal Officer

Lucie Guillemette
Executive Vice President and Chief Commercial Officer

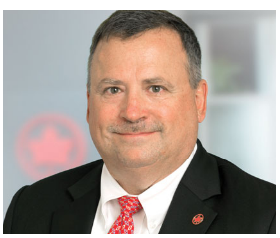
Amos S. Kazzaz
Executive Vice President and Chief Financial Officer

Craig Landry
Executive Vice President and Chief Operations Officer

Arielle Meloul-Wechsler
Executive Vice President, Chief Human Resources Officer and Public Affairs

Mark Galardo
Senior Vice President, Network Planning and Revenue Management

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.

2021

Management's Discussion and Analysis of Results of Operations and Financial Condition

1. SELECTED FINANCIAL METRICS AND STATISTICS

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

(Canadian dollars in millions, except per share data or where indicated)	Fourth Quarter			Full Year		
Financial Performance Metrics	**2021**	**2020**	**Change $**	**2021**	**2020**	**Change $**
Operating revenues	2,731	827	1,904	6,400	5,833	567
Operating loss	(503)	(1,003)	500	(3,049)	(3,776)	727
Loss before income taxes	(617)	(1,275)	658	(3,981)	(4,853)	872
Net loss	(493)	(1,161)	668	(3,602)	(4,647)	1,045
Adjusted pre-tax loss (1)	(574)	(1,326)	752	(3,768)	(4,425)	657
EBITDA (excluding special items) (1)	22	(728)	750	(1,464)	(2,043)	579
Unrestricted liquidity (2)	10,361	8,013	2,348	10,361	8,013	2,348
Diluted loss per share	(1.38)	(3.91)	2.53	(10.25)	(16.47)	6.22
Operating Statistics (3)	**2021**	**2020**	**Change %**	**2021**	**2020**	**Change %**
Revenue passenger miles ("RPMs") (millions)	9,612	2,432	295.2	21,045	23,239	(9.4)
Available seat miles ("ASMs") (millions)	14,057	6,000	134.3	33,384	37,703	(11.5)
Passenger load factor %	68.4%	40.5%	27.9 pp (8)	63.0%	61.6%	1.4 pp
Passenger revenue per RPM ("Yield") (cents)	21.2	19.5	8.8	21.4	18.9	13.3
Passenger revenue per ASM ("PRASM") (cents)	14.5	7.9	83.6	13.5	11.6	15.9
Operating revenue per ASM (cents)	19.4	13.8	40.9	19.2	15.5	23.9
Operating expense per ASM ("CASM") (cents)	23.0	30.5	(24.6)	28.3	25.5	11.1
Adjusted CASM (cents) (1)	16.7	29.8	(43.9)	23.3	21.6	7.8
Average number of full-time-equivalent ("FTE") employees (thousands) (4)	25.2	17.9	40.8	19.8	21.1	(6.4)
Aircraft in operating fleet at period-end (5)	337	344	(2.0)	337	344	(2.0)
Seats dispatched (thousands)	8,772	3,673	138.8	21,105	22,780	(7.4)
Aircraft frequencies (thousands)	71.5	31.1	130.5	175.3	191.5	(8.4)
Average stage length (miles) (6)	1,602	1,634	(1.9)	1,582	1,655	(4.4)
Fuel cost per litre (cents)	83.9	50.4	66.6	74.7	61.4	21.7
Fuel litres (thousands)	791,581	372,204	112.7	2,108,144	2,153,764	(2.1)
Revenue passengers carried (thousands) (7)	5,836	1,625	259.2	13,192	13,760	(4.1)

(1) Adjusted pre-tax income (loss), EBITDA (excluding special items) (earnings before interest, taxes, depreciation, and amortization), and adjusted CASM are each non-GAAP financial measures. 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. Refer to section 20 "Non-GAAP Financial Measures" of this 2021 Annual Report for descriptions of Air Canada's non-GAAP financial measures.

(2) Unrestricted liquidity refers to the sum of cash, cash equivalents and short and long-term investments, and the amounts available under Air Canada's credit facilities. At December 31, 2021, unrestricted liquidity amounted to $10,361 million and consisted of $9,403 million in cash and cash equivalents, short-term and long-term investments, and $958 million available under undrawn credit facilities. At December 31, 2020, unrestricted liquidity of $8,013 million consisted of cash, cash equivalents and short-term and long-term investments.

(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. As of December 31, 2021, there were 25,775 employees based in Canada.

(5) The number of aircraft in Air Canada's operating fleet at December 31, 2021 and at December 31, 2020 include aircraft that were grounded due to the impact of the COVID-19 pandemic.

(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) "pp" denotes percentage points and refers to a measure of the arithmetic difference between two percentages.

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, Aeroplan Inc. ("Aeroplan"), Touram Limited Partnership, doing business under the brand name Air Canada Vacations® ("Air Canada Vacations"), and Air Canada Rouge LP, doing business under the brand name Air Canada Rouge® ("Air Canada Rouge"). 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 2021. This MD&A should be read in conjunction with Air Canada's audited consolidated financial statements and notes for the full year 2021. 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 21 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of February 17, 2022.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 18 "Risk Factors" of this MD&A. Air Canada issued a news release dated February 18, 2022 reporting on its results for the fourth quarter and full year 2021. This news release is available on Air Canada's website at aircanada.com and on SEDAR's website at sedar.com. For further information on Air Canada's public disclosures, including Air Canada's Annual Information Form, consult SEDAR at sedar.com.

Caution Regarding Forward-Looking Information

Air Canada's public communications may include forward-looking statements within the meaning of applicable securities laws. 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 herein 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, continued to face significantly lower traffic in 2021, as compared to the year 2019, 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, including in Canada. While there are signs of improvement, there is limited visibility on future demand trends given changing government restrictions. Air Canada cannot predict the full impact or the timing for when conditions may improve. The COVID-19 pandemic is also having and may continue to have significant economic impacts, including on business and consumer spending and behaviour, which may in turn significantly impact demand for travel. The return of business travel to pre-pandemic levels may be challenged by the evolving nature of business models and remote-work practices in light of the impacts of the COVID-19 pandemic, including the growth and continued use of videoconferencing and other remote-work technologies as well as tendencies towards less environmentally impactful business and consumer behaviour. 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 including its variants, availability of rapid, effective testing, vaccinations and treatments for the virus, government actions including health measures and other restrictions, and passenger reaction, the complexities of restarting an industry whose many stakeholders must act in coordination with each other as well as timing and extent of recovery in international and business travel which are important segments of Air Canada's market, none of which can be predicted with certainty.

Other factors that 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, competition, Air Canada's dependence on technology, cybersecurity risks, energy prices, Air Canada's ability to successfully implement appropriate strategic and other important initiatives (including Air Canada's ability to manage operating costs), other epidemic diseases, terrorist acts, war, Air Canada's dependence on key suppliers, Air Canada's ability to successfully operate its loyalty program, interruptions of service, Air Canada's ability to attract and retain required personnel, the availability of Air Canada's workforce, casualty losses, changes in laws, regulatory developments or proceedings, climate change and environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), 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, pending and future litigation and actions by third parties, currency exchange, limitations due to restrictive covenants, insurance issues and costs, pension plans, as well as the factors identified in Air Canada's public disclosure file available at sedar.com and, in particular, those identified in section 18 "Risk Factors" of this MD&A. 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

In light of the impact 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 ™ 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.

Incorporation of Other Information

No information contained on or accessed via Air Canada's websites (or any other website referred to in this MD&A), and no document referred to in this MD&A, is incorporated into or forms part of this MD&A, except if it is expressly stated in this MD&A to be incorporated into this MD&A.

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 a capacity purchase agreement ("CPA") with Jazz Aviation LP ("Jazz"), a wholly owned subsidiary of Chorus Aviation Inc., with regional flights operated on behalf of Air Canada under the Air Canada Express banner. Regional flying forms an integral part of the airline's international network strategy, providing valuable traffic feed to Air Canada and Air Canada Rouge routes. On March 1, 2021, Air Canada announced an agreement (further discussed in this MD&A) revising its CPA and consolidating all its regional flying with Jazz.

In 2021, Air Canada together with its regional partners operated, on average, 448 daily scheduled flights to 154 direct destinations on six continents (although, as a result of the COVID-19 pandemic, operations to many destinations were suspended or did not operate continually throughout 2021). In comparison, in 2019, Air Canada, together with its regional partners, operated, on average, 1,531 daily scheduled flights to 217 direct destinations on six continents, consisting of 62 Canadian destinations, 56 destinations in the United States and 99 international destinations.

At December 31, 2021, Air Canada mainline had 175 aircraft in its operating fleet, which consisted of 97 Boeing and Airbus narrow-body aircraft and 78 Boeing and Airbus wide-body aircraft, including one Boeing 767 freighter, while Air Canada Rouge had an operating fleet of 39 Airbus narrow-body aircraft. At December 31, 2021, the Air Canada Express fleet comprised 50 Mitsubishi regional jets, 48 De Havilland Dash 8 turboprop aircraft and 25 Embraer E175 aircraft for a total of 123 aircraft.

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 wide 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 enroll 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 cards, 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 Cargo, a division of Air Canada, is a global cargo service provider, offering cargo services on passenger flights and on all-cargo flights, including on dedicated freighter aircraft. Air Canada Cargo uses cargo space available in Air Canada's mainline wide-body aircraft, certain converted Boeing 777 and Airbus A330 aircraft with increased cargo space generated by the removal of seats from the passenger cabin, and one dedicated Boeing 767 freighter. Air Canada Cargo operated one Boeing 767 freighter as at December 31, 2021 and expects to have three more Boeing 767 freighters in service by the end of 2022.

In 2022, Air Canada Cargo plans to leverage its fleet of dedicated freighters to benefit from the growth in freight.

Air Canada Vacations is a leading Canadian tour operator, developing, marketing, and distributing vacation travel packages, 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.

Photo: Jason Berry, Vice President, Cargo, is pictured here on the main deck of our first converted Boeing 767-300ER freighter. Combined with the belly capacity of Air Canada's domestic and international network, freighters will offer our customers in the supply chain industry long-term access to the reliable, year-round freight capacity we have been harnessing with cargo-only flights during the pandemic.

4. 2021 HIGHLIGHTS

Air Canada, along with the rest of the global airline industry, continued to face a significant decrease in traffic in 2021, as compared to the year 2019, 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, including Canada.

The impact of the COVID-19 pandemic began to be felt in traffic and sales figures commencing in early March 2020. The impact included drastic declines in earnings and cash from operations and it continued into 2021 as Canada had among the strictest travel restrictions and quarantine requirements in the world. When compared to 2020, operating revenues in 2021 increased 10%, while capacity and traffic declined 11% and 9%, respectively. When compared to 2019, in 2021, operating revenues, capacity, and traffic declined 67%, 70%, and 78%, respectively. Additional information concerning full year and fourth quarter 2021 results is provided in section 6 "Results of operations – Full year 2021 versus full year 2020", and section 7 "Results of operations – Q4 2021 versus Q4 2020".

Financing and Liquidity

Debt and Equity Financing Agreements with the Government of Canada

On April 12, 2021, Air Canada entered into a series of debt and equity financing agreements with the Government of Canada (acting through Canada Enterprise Emergency Funding Corporation) which allowed Air Canada to access up to $5.879 billion in liquidity through the Large Employer Emergency Financing Facility (LEEFF) program.

In November 2021, Air Canada withdrew from Government of Canada financial support, having only accessed the facility solely dedicated to refunding customers' non-refundable tickets. None of the $3.975 billion available under the secured revolving and the unsecured non-revolving credit facilities was ever drawn and, under the terms of its agreement with the government, Air Canada was entitled to terminate these facilities at any time without penalty, which it did in November 2021.

The financial package provided for fully repayable loans that Air Canada would only draw down if and as required, as well as an equity investment, and was comprised of:

- Up to $1.404 billion in the form of an unsecured credit facility tranche to support customer refunds of non-refundable tickets. The facility has a seven-year term maturing April 2028 and carries an annual interest rate of 1.211%. Draws under this facility were available and made monthly based on the amount of refunds processed and paid until November 30, 2021. As at December 31, 2021, $1.273 billion was drawn under this facility to support customer refunds of non-refundable tickets. No further amounts can be drawn under this facility.
- Gross proceeds of $500 million for 21,570,942 Air Canada shares, at a price of $23.17933 per share (net proceeds of $480 million), which the government continues to hold.
- $1.5 billion in the form of a secured revolving credit facility maturing in April 2026 and bearing interest at the Canadian Dollar Offered Rate (CDOR) plus 1.5%. The facility was secured on a first lien basis by the assets of Aeroplan, Air Canada's shares in Aeroplan as well as certain assets of Air Canada. No amount was drawn by Air Canada under this facility, which as stated above has since been terminated by Air Canada.
- $2.475 billion in the form of three unsecured non-revolving credit facilities of $825 million each, with: the first, five-year tranche maturing in April 2026, at CDOR plus 1.75% per annum; the second, six-year tranche maturing in April 2027, at 6.5% per annum (increasing to 7.5% after 5 years); and the third, seven-year tranche maturing in April 2028, at 8.5% per annum (increasing to 9.5% after 5 years). No amount was drawn under these facilities, which as stated above have since been terminated by Air Canada.
- Air Canada issued 14,576,564 warrants initially exercisable during a 10-year term for the purchase of an equal number of Air Canada shares, to the Government of Canada, at an exercise price of $27.2698 per share. Half of the warrants vested upon the implementation of the above secured and unsecured credit facilities, while the remaining half would have vested on a proportional basis to the amounts that Air Canada may have drawn under the now terminated unsecured credit facilities. The warrants were subject to a one-time call right in

favour of Air Canada, pursuant to which Air Canada on certain conditions could repurchase for cancellation all outstanding warrants at a price per warrant equal to their fair market value. The vested warrants were exercisable by the holder either by paying the exercise price or by using a cashless exercise option. With the termination of the operating credit facilities, the unvested warrants were cancelled. In addition, Air Canada exercised its call right on the vested warrants repurchasing and cancelling the warrants in January 2022 at a price of $82 million which is equivalent to the carrying value of the vested warrants as at December 31, 2021.

As part of the financial package, Air Canada had agreed to a number of commitments related to customer refunds, service to certain regional communities, restrictions on the use of the funds provided, employment levels and capital expenditures. These commitments included:

→ Offering eligible customers who purchased non-refundable fares but did not travel due to COVID-19 since February 2020 up to April 13, 2021, the option of a refund to the original form of payment. In support of its travel agency partners, Air Canada decided that it would not retract agency sales commissions on refunded fares.
→ The resumption of service or access to Air Canada's network for most regional communities where service had been suspended because of COVID-19's impact on travel, through direct services or new interline agreements with third party regional carriers.
→ Restricting dividends or payments of distributions on Air Canada's equity interests, or any purchases, redemptions or other acquisitions or retirements for value of any equity interests or convertible indebtedness of Air Canada while any indebtedness was outstanding under any of the secured and unsecured credit facilities (excluding the unsecured credit facility tranche to support customer refunds of non-refundable tickets) and for a period of 12 months following the termination of such facilities.
→ Obligations to maintain employment at levels which are no lower than those at April 1, 2021.
→ The completion of the airline's acquisition of 33 Airbus A220 aircraft, manufactured at Airbus' Mirabel, Québec facility. Air Canada also agreed to complete its existing firm order of 40 Boeing 737 MAX aircraft. Completion of these orders remains subject to the terms and conditions of the applicable purchase agreements.

In connection with the Government's equity investment, Air Canada agreed to provide the Government with customary registration rights. The Air Canada shares issued to the Government are subject to certain transfer restrictions, namely (i) restrictions on any transfer, other than to affiliates of the Government, for a period commencing on the date of issuance and ending on the date that is one year from the date of issuance, and (ii) restrictions on transfers to competitors and securityholders of Air Canada that beneficially own or control 5% or more of Air Canada's issued and outstanding shares, including any convertible securities, on an as converted basis, subject to customary exceptions.

Refinancing Transactions

In August 2021, Air Canada closed a private offering of $2.0 billion of 4.625% senior secured notes due 2029 (the "Canadian Dollar Notes") and US$1.2 billion of 3.875% senior secured notes due 2026 (the "US Dollar Notes", and together with the Canadian Dollar Notes, the "Notes"). Air Canada also closed a US$2.9 billion new senior secured credit facility, consisting of a US$2.3 billion new term loan B maturing in 2028 (the "Term Loan"), together with a new undrawn US$600 million revolving credit facility maturing in 2025 (the "Revolving Facility" and, together with the Term Loan, the "Senior Secured Credit Facilities").

Air Canada received aggregate gross proceeds of approximately $7.1 billion from the sale of the Notes and from the Senior Secured Credit Facilities. Air Canada applied the proceeds from the sale of the Canadian Dollar Notes, together with the proceeds from the Term Loan, to (i) satisfy and discharge all of Air Canada's outstanding $200 million aggregate principal amount of its 4.75% senior secured notes due 2023 and redeem all of Air Canada's outstanding $840 million aggregate principal amount of its 9% second lien notes due 2024, (ii) repay all of Air Canada's US$1.178 billion of indebtedness outstanding under the loan agreement dated as of October 6, 2016, which comprised a syndicated secured US dollar term loan B facility and a syndicated secured US dollar revolving credit facility and (iii) satisfy applicable transaction costs, fees and expenses. The Revolving Facility was undrawn as of December 31, 2021.

The Notes and Air Canada's obligations under the Senior Secured Credit Facilities are senior secured obligations of the Company, secured on a first-lien basis, subject to certain permitted liens, by certain collateral comprised of substantially all of Air Canada's international routes, airport slots and gate leaseholds.

In addition, in 2021, Air Canada repaid in full its US$400 million of 7.75% senior unsecured notes and its $200 million revolving credit facility. The $200 million revolving credit facility remains available and undrawn.

Navigating through the COVID-19 Pandemic

On June 21, 2021, the Government of Canada announced the initial phase to ease border measures. This announcement included:

→ Since July 5, 2021, fully vaccinated travellers who are permitted to enter Canada have not been subject to the federal requirement to quarantine or take a COVID-19 test on day eight after arrival.

→ Since August 9, 2021, fully vaccinated United States ("U.S.") citizens and permanent residents, residing in the U.S., are permitted to enter Canada for non-essential travel, under certain conditions. The obligation to quarantine at a government-approved hotel also ceased for all travellers as of that date.

→ Since September 7, 2021, fully vaccinated foreign nationals have been allowed to enter Canada for non-essential travel. Foreign nationals who do not meet the requirements to be considered fully vaccinated are not able to enter Canada unless

they meet an exemption set out in the Orders made under the Quarantine Act. Unvaccinated children under the age of 12, later adjusted to children under the age of five, who enter Canada with their fully vaccinated parents, stepparents, guardians or tutors, are not required to quarantine upon entering Canada, but must adhere to strict public health measures including testing rules (save for certain exceptions) and limit contact with others for 14 days.

On August 25, 2021, Air Canada announced and introduced a new health and safety policy to further protect employees and customers. The policy made it mandatory for all employees of the airline to be fully vaccinated against COVID-19 (subject to certain limited exceptions required by law) by October 30, 2021, and to report their vaccination status. In addition, the airline made full vaccination a condition of employment for any individual hired by the company.

Since November 30, 2021, the Government of Canada has required all travellers to be fully vaccinated to board a flight in Canada, subject to certain limited exceptions.

In response to the Omicron variant, the Government of Canada added post-arrival testing requirements for fully vaccinated travellers from any country other than the U.S. Since December 2021, it has required such passengers to take a COVID-19 PCR test upon arrival and to quarantine in a suitable place until the receipt of a negative arrival test result. Travellers arriving from the U.S., who have not been in any other country in the previous 14 days, continue to be subject to a random selection process for COVID-19 testing upon arrival. Unvaccinated or partially vaccinated travellers allowed to enter Canada, remain subject to the federal requirement to quarantine and take a COVID-19 PCR test at the time of arrival and on day eight after arrival.

Until February 28, 2022, all travellers, regardless of vaccination status, will be required to provide a negative pre-entry COVID-19 PCR test result taken within 72 hours of departure or a proof of a positive test result received in the previous 11 to 180 days.

On February 15, 2022, the Government of Canada announced further easing of certain travel restrictions for fully vaccinated travellers. These changes, which became effective February 28, 2022, included:

- Fully vaccinated travellers arriving to Canada will be subject to a random selection process for COVID-19 testing upon arrival with no need to quarantine while waiting for their result.
- Children under 12 years old travelling with fully vaccinated adults will continue to be exempt from the quarantine requirement but they will no longer need to avoid school, camp or daycare or other public spaces.
- Travellers will have the option to present a COVID-19 rapid antigen test result (taken the day prior to their scheduled flight), or a molecular test result (taken no more than 72 hours before their scheduled flight.)
- Travel Health advisory will change from a Level 3 to a Level 2, meaning that the Government will no longer recommend that Canadians avoid travel for non-essential purposes.
- International flights carrying passengers will be permitted to land at all remaining Canadian airports that are designated by the Canada Border Services Agency to receive international passenger flights.

Route Network and Schedule

Between January 31, 2021 and June 26, 2021, Air Canada suspended flights to Mexican and Caribbean destinations in response to COVID-19 concerns, particularly over the spring break period. The decision, designed to achieve an orderly reduction in service and minimize customer impact, was taken in collaboration with the Government of Canada, following consultations.

On June 15, 2021, Air Canada announced its peak 2021 domestic summer schedule serving a total of 50 Canadian destinations from coast to coast. It included three new routes, the re-establishment of select regional routes, and wide-body aircraft featuring Air Canada Signature Class and Premium Economy Class on select transcontinental routes.

On June 18, 2021, Air Canada operated its first non-stop service between Montreal and Cairo, serving the large Egyptian community established in Montreal and throughout North America, and providing an additional gateway to Africa.

Following the Government of Canada's announcement to loosen travel restrictions for citizens and permanent residents of the U.S., on July 19, 2021, Air Canada announced its U.S. transborder summer schedule which included 55 routes and 34 destinations in the U.S., with up to 220 daily flights between Canada and the U.S.

In the third quarter of 2021, Air Canada announced a series of new routes, including new winter services departing from Québec City to Orlando and Fort Lauderdale, and resumption of services to Punta Cana and Cancun, from Québec City, between Montreal and Toronto Island. Air Canada also announced the resumption of non-stop flights to and from Delhi, following the lifting of the Government of Canada restrictions on non-stop flights from India.

In September 2021, Air Canada Rouge resumed service between Toronto and Las Vegas, Orlando, and Regina, with other destinations introduced through the end of 2021, including Cancun and Tampa.

In October 2021, Air Canada announced additional updates to its schedule, including:

- Two new seasonal routes connecting Québec City with Vancouver and with Calgary. These routes are scheduled to begin in May 2022.
- Increase in service to several key South American destinations. Year-round service to São Paulo, Brazil from Montreal resumed in December 2021. Direct service from Montreal to Bogota, Colombia started in early December 2021. Flights from Toronto to Bogota increased to four per week in November 2021. Service between Toronto and Santiago, Chile resumed in January 2022. Air Canada now serves Buenos Aires, Argentina, with flights offered from both Toronto and Montreal via São Paulo.
- New seasonal service between Toronto and Santo Domingo in the Dominican Republic, which began in December 2021.

- Planned summer 2022 schedule for Europe, Africa, the Middle East and India. In addition to its established year-round services, Air Canada announced its return to key summer seasonal destinations such as Barcelona, Venice, Nice, Manchester, Edinburgh, and Reykjavik.
- Since October 2021, expansion of services to India with increased frequency to Delhi from Toronto, and a new year-round non-stop route to Delhi from Montreal.

In 2021, Air Canada recalled more than 10,000 employees, which had been placed on layoff status in 2020 due to the impact of the COVID-19 pandemic.

People and Culture

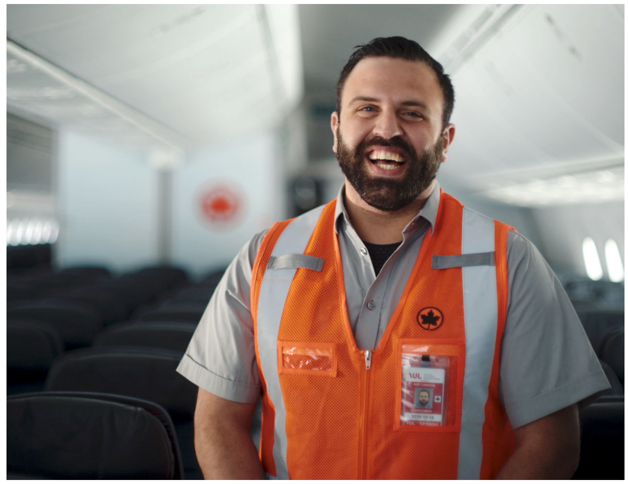
In 2021, Air Canada was recognized by Mediacorp Canada Inc. as one of Canada's Best Diversity Employers for the sixth consecutive year and one of "Montreal's Top Employers" for the eighth consecutive year. Air Canada was ranked among the 50 Most Engaged Workplaces™ for the fifth consecutive year and was recognized as being one of the 'Elite 8' companies within the 2021 Achievers 50 Most Engaged Workplaces® Awards, which celebrates the top 50 employers that make engagement, alignment, and recognition central to the employee experience.

In October 2021, Air Canada was recognized for its people, products, and services at the 2021 Skytrax World Airline Awards with honours for: Best Airline Staff in North America, Best Airline Staff in Canada, Best Business Class Lounge in North America, and Skytrax COVID-19 Airline Excellence award.

Customer Experience

On April 13, 2021, Air Canada announced it was offering refunds to passengers who purchased a non-refundable fare but whose flights were cancelled or who voluntarily cancelled their travel due to the COVID-19 pandemic between February 1, 2020, and April 13, 2021. The policy allowed eligible customers to submit a refund request until July 12, 2021. In addition, for new tickets purchased as of April 13, 2021, Air Canada provides its customers an option for a refund to the original form of payment in instances where Air Canada cancels their flight or reschedules the departure time by more than three hours, irrespective of the reason. Air Canada customers also have the option of accepting Aeroplan points with a 65% bonus or an Air Canada Travel Voucher.

On September 7, 2021, Air Canada unveiled its expanded Travel Ready hub, an interactive online tool to help customers plan and prepare for upcoming trips. Air Canada continues to develop practical solutions to help its customers be travel-ready, wherever they want to go. This includes assisting them in navigating the changing COVID-19 related entry requirements across its global network by making relevant information available in one convenient place. The easy-to-use Travel Ready hub is designed to make it simple for customers to choose where to go next by showing the countries that are open to visitors through an interactive map.



In 2021, Air Canada was named the Best Airline in North America for the third straight year by readers of *Global Traveler*. The airline also won for Best Airline Cabin Cleanliness for the second consecutive year in the 18th edition of the GT Tested Reader Survey of the magazine's readership of frequent business and luxury travellers. Additionally, in its annual ratings for 2022, the Airline Passenger Experience Association ("APEX") reaffirmed Air Canada as a Five-Star Global Airline in the APEX Official Airline Ratings, based on customer feedback. For the 2022 awards, nearly one million flights were evaluated by passengers across more than 600 airlines from around the world using a five-star scale.

On October 25, 2021, Air Canada announced the introduction of new testing products, including portable self-administered COVID-19 molecular and antigen test kits, through a partnership with Switch Health, a Canadian-based healthcare company. Using the COVID-19 RT-LAMP Kit, customers can test themselves while travelling abroad prior to their flight to Canada to meet Government of Canada testing entry requirements.

Aeroplan

Building on the successful launch of the new Aeroplan program, in 2021, Air Canada announced several enhancements and updates to its loyalty program. These included:

- Extending Aeroplan Elite Status through the end of 2022 as well as enhancing other flexible policies.
- Launching partnerships with Starbucks, the Liquor Control Board of Ontario (LCBO), one of the world's largest retailers of alcoholic beverages, Rocky Mountaineer, and with Uber Canada.
- Launching the new Chase Aeroplan® World Elite Mastercard® Credit Card providing U.S. cardmembers with the ability to earn Aeroplan points faster. Chase is the largest co-brand card issuer in the United States.
- Adding Aeroplan as a transfer option for Ultimate Rewards® points for eligible Chase cardmembers.

Cargo

In 2021, Air Canada operated a total of 10,217 cargo-only flights, compared to 4,235 cargo-only flights in 2020.

In October 2021, Air Canada announced the start of a $16 million project to expand and enhance Air Canada Cargo's cold chain handling capabilities for shipments such as pharmaceuticals, fresh food, and other perishables at its Toronto Pearson International Airport cargo facility. The project is part of Air Canada's strategy to further develop its cargo division, which also includes the introduction of additional freighter aircraft, the launch of dedicated freighter routes and an expansion into the e-commerce delivery service.

In December 2021, Air Canada introduced its first Boeing 767 dedicated freighter to its operating fleet, which was first deployed to British Columbia to provide additional cargo capacity needed into and out of Vancouver to meet ongoing demand as a result of the flooding that disrupted British Columbia's transportation network. Air Canada expects to have three more Boeing 767 freighters in service by the end of 2022.

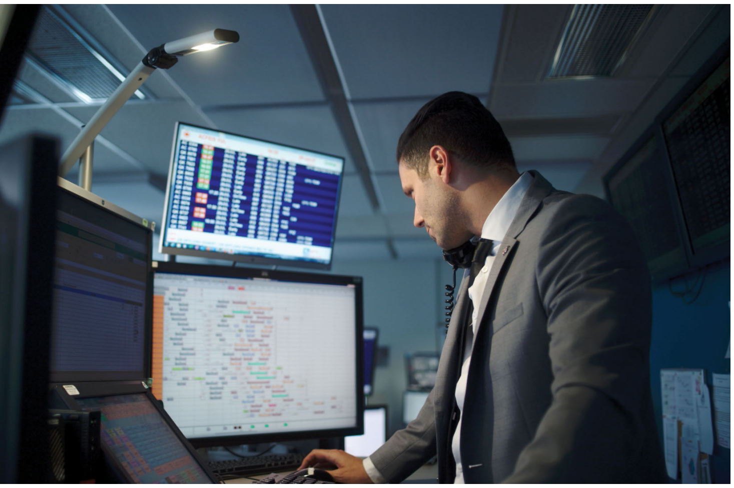
Consolidation of Air Canada Express flying with Jazz

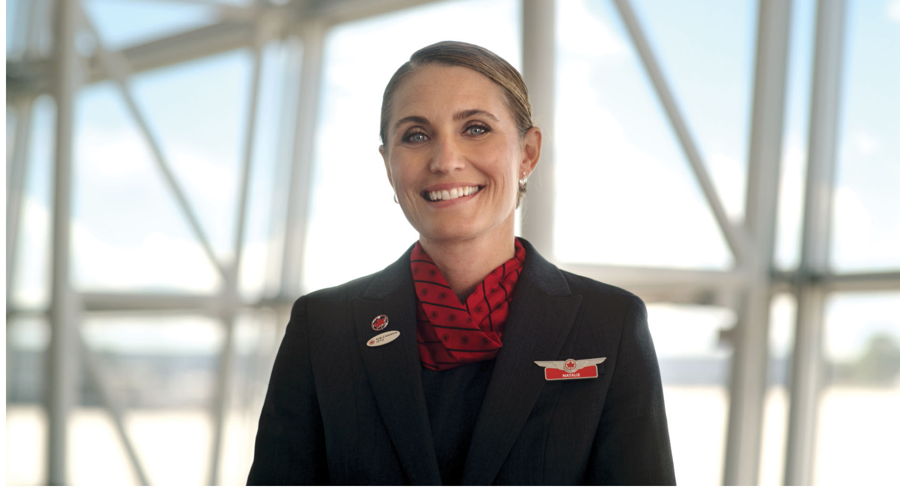
On March 1, 2021, Air Canada announced an agreement to revise its CPA with Jazz and consolidated all its regional flying with Jazz. As a result of the CPA revisions and consolidation of regional flying, Air Canada expects to realize $400 million in cost reductions over the 15-year term of the agreement expiring in 2035 ($43 million per year until 2026 and $18 million per year thereafter). In addition, the revised CPA lowered future contractual capital expenditures and leasing costs through a restructured CPA fleet, avoiding an estimated $193 million in future capital expenditures. The amended CPA was effective on a retroactive basis to January 1, 2021.

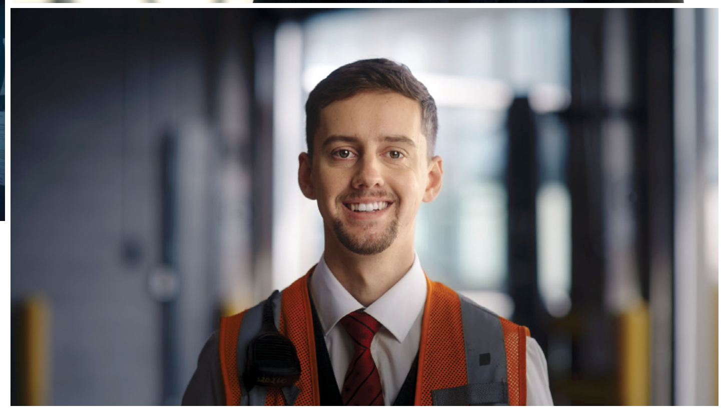
Termination of Transat A.T. Inc. Arrangement Agreement

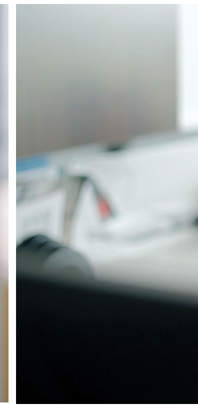
On April 2, 2021, Air Canada announced that the arrangement agreement for the proposed acquisition by Air Canada of Transat A.T. Inc. ("Transat") was terminated, with Air Canada paying Transat a termination fee of $12.5 million, and with Transat no longer under any obligation to pay Air Canada any fee should Transat be involved in another acquisition or similar transaction in the future.

5. STRATEGY









Over the past decade, Air Canada has aimed to be a sustainable global champion by (i) pursuing profitable international growth opportunities and leveraging its competitive attributes, (ii) identifying and implementing cost reduction and revenue enhancing initiatives, (iii) engaging customers by continually enhancing their travel experience and by consistently achieving customer service excellence, and (iv) fostering positive culture change.

Air Canada's vision for its recovery is predicated on leveraging the solid foundation it has built over the past several years to restore and rebuild towards its global champion ambition, while taking advantage of ground-breaking opportunities and continuing to execute on Air Canada's unwavering commitment to safety, service excellence, and the customer journey.

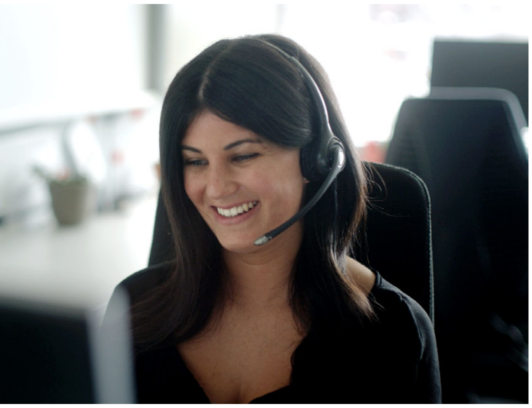
Now, Air Canada is evolving its business to better prepare for the future. As part of these efforts, it is introducing "Rise Higher", its newly articulated business imperatives, intended to elevate everything about its business. As it embarks on this next chapter, Air Canada will:

Fund its future by staying vigilant on costs, seizing on opportunities, and making the right strategic investments

Reach new frontiers, by embracing its competitive strengths to grow the business by expanding its international reach, and continually exploring new opportunities

Elevate its customers, and support the creation of meaningful customer experiences and human connections by leveraging innovations in technology, loyalty and products

Foster a collaborative workplace that respects diverse cultures and languages, while making impactful contributions to society



In pursuit of this goal, in 2022, Air Canada will build upon and leverage its numerous competitive advantages, including:

- Its talented people, and award-winning culture
- A widely recognized and powerful brand
- A streamlined, modern, fuel efficient and versatile fleet, with market-leading aircraft configurations
- 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 customer experience enhanced by competitive products and services, including the fully transformed Aeroplan program
- Air Canada Rouge, a lower-cost leisure carrier
- A growing cargo offering
- New core technologies and other technological improvements
- Its commitment to sustainability

Air Canada's people, and the corporate culture built and cultivated over the past decade, rooted in resilience, teamwork, and empathy has carried Air Canada through the challenge of the COVID-19 pandemic. This culture allowed Air Canada to pivot quickly to effectively manage through the crisis, while keeping customers safe, and will serve as an important foundation to support Air Canada's goal to Rise Higher.

Air Canada has a modern and efficient fleet, including the Boeing 777 aircraft with its competitive cost per ASM 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 continued renewing its narrow-body fleet. As of December 31, 2021, Air Canada had 31 Boeing 737 MAX 8 aircraft in its fleet. The Boeing 737 MAX 8 resumed commercial operations on February 1, 2021. At December 31, 2021, Air Canada had taken delivery of 27 Airbus A220-300

aircraft. The Airbus A220-300 aircraft replaced the Embraer E190 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 A320 family aircraft. Through its fleet investments, Air Canada is well positioned to retain its leadership in the various markets served. The narrow-body fleet is being transformed to modern, cost- and fuel-efficient Airbus A220 and Boeing 737 MAX aircraft types.

As the impact of the COVID-19 pandemic softened, the leisure and Visiting Friends & Relatives ("VFR") markets have led the recovery, as expected, while business travel has remained depressed. Air Canada's hubs of Toronto, Vancouver, and Montreal 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. With regards to corporate travel, certain business sectors and small-medium enterprises have shown signs of resiliency throughout the pandemic as they have continued to travel for business, Air Canada expects this trend to continue into 2022. As the pandemic subsides and return to office policies evolve, Air Canada expects corporate customers to return to the skies, as there is a desire to travel again.

Air Canada Rouge, Air Canada's leisure carrier, 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. Over the last several years, Air Canada Rouge, had been deployed to Caribbean destinations and leisure destinations in the United States and in Canada, as well as to international leisure markets. As a result of the COVID-19 pandemic, Air Canada Rouge suspended operations in the spring of 2021, and resumed service on September 7, 2021. In addition, with the retirement of all the Boeing 767 aircraft from its fleet, Air Canada Rouge now only operates narrow-body aircraft. In 2022, the Air Canada Rouge fleet will be operated primarily to leisure destinations in the U.S., the Caribbean and to select destinations in Canada.

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 is also 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 Montreal 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 strategy going forward.

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 on-board 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.

Aeroplan is Air Canada's loyalty program, offering personalized, flexible, and easy-to-use benefits designed to allow members to travel more and better. The program includes a wide range of features, such as: access to every seat on Air Canada for flight rewards with no cash surcharges, Aeroplan Family Sharing, the ability to use Aeroplan points for travel extras such as cabin upgrades, and best-in-class perks for Aeroplan Elite Status holders, such as Priority Rewards. The range of Aeroplan co-branded credit cards issued by TD, American Express, and CIBC are the only ones in Canada offering extensive Air Canada travel perks. In December 2021, Air Canada and Chase launched the new Chase Aeroplan World Elite Mastercard® Credit Card, providing U.S. members the ability to earn Aeroplan points every day and enjoy the unique rewards and flexibility offered by the Aeroplan program. The Aeroplan program enables members to earn and redeem through everyday partnerships with well-loved brands such as Starbucks Canada, Uber Canada, Rocky Mountaineer, and LCBO. This is complemented by Aeroplan's 45 airline partners, the largest network of airline partners of any airline loyalty program, allowing our members to redeem their points for travel to hundreds of destinations across the globe. Building upon its successful relaunch, in 2022, Aeroplan intends to introduce additional program features and expand its partnership network in various categories, to continue with its aim to further grow and engage its membership base.

Air Canada Cargo is an important contributor to the airline's recovery and long-term growth, contributing to revenue diversification and to seasonality mitigation. The airline aims to drive end-to-end value to its customers through enhanced technology, dynamic pricing, and transparency across the delivery supply chain. Air Canada Cargo continues to use cargo space available in Air Canada's mainline wide-body aircraft, certain converted Boeing 777 and Airbus A330 aircraft with increased cargo space generated by the removal of seats from the passenger cabin as well as its recently inaugurated dedicated freighter aircraft. Air Canada Cargo operated one Boeing 767 freighter as at December 31, 2021. Air Canada expects to have all temporarily converted Boeing 777 and Airbus A330 aircraft back in a passenger configuration, and to have three more Boeing 767 freighters in service by the end of 2022. In 2022, Air Canada Cargo expects to continue benefitting from the growth in freight by leveraging its fleet of dedicated freighters.

Air Canada has been investing in technology and transforming core operational process. In 2021, after concluding the last phase of its implementation, Air Canada's new passenger service system - the Amadeus Altéa Suite was fully operational. 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. 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, mainly focused on improving operations, customer experience, and enhancing the revenue management practice.

Commitment to Sustainability

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. Environment, social and governance (ESG) practices are integrated in Air Canada's business and inform decision-making. ESG 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. Continuously maintaining transparency and accountability, seven performance indicators, including Scope 1 and 2 emissions are verified by an independent external party, following internationally recognized standards.

Air Canada is also committed to pursuing the Sustainable Development Goals ("SDGs") and is a signatory to the UN Global Compact, an organization that encourages all businesses to adopt sustainable and 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 supports all 17 SDGs.

Air Canada's Corporate Sustainability Report, GRI Content Index (and related charts), and its United Nations Sustainable Development Goals index are available at aircanada.com/citizensoftheworld.

In March 2021, Air Canada released its new Climate Action Plan that includes ambitious climate targets to achieve its long-term goal of net-zero greenhouse ("GHG") emissions throughout its global operations by 2050. To reach this, Air Canada has set the following absolute mid-term GHG net reduction targets:

- 20% GHG net reductions from its air operations by 2030 compared to its 2019 baseline
- 30% GHG net reductions from its ground operations by 2030 compared to its 2019 baseline

Air Canada has also committed to investing, by 2030, $50 million in sustainable aviation fuels ("SAF"), as well as in carbon reductions and removals.

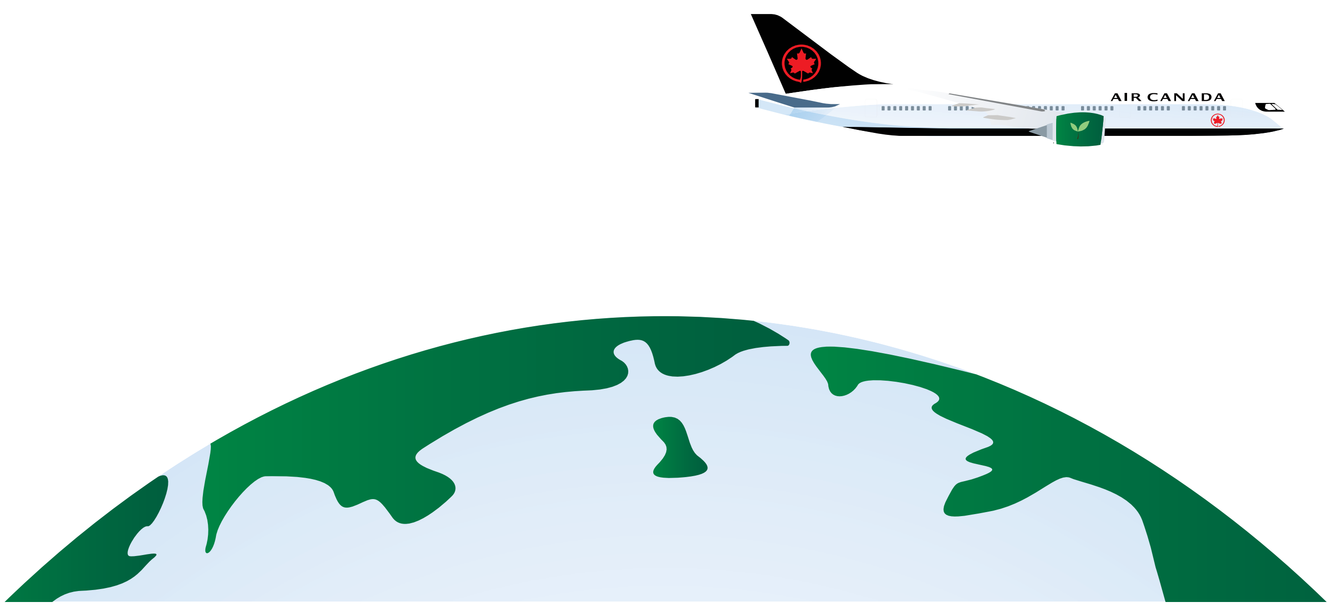
Air Canada is committed to advancing climate change sustainability throughout its business and continually reporting on its progress. Air Canada's ambitious net-zero goal will be realized through a series of five-year period implementation plans.

In 2021, Air Canada engaged with the Edmonton International Airport ("EIA") in a new partnership to reduce carbon emissions and advance a green and sustainable aviation sector. The EIA-Air Canada Sustainability Partnership aims to reduce the carbon impact of air travel with both organizations working together to test emerging green technologies at EIA's Airport City Sustainability Campus, an ecosystem that EIA created to foster environmental innovation. The partnership reflects both organizations' pledges to sustainability and reducing carbon emissions to a net-zero future.

In October 2021, Air Canada launched its new LEAVE LESS Travel Program, which offers its corporate customers effective options to offset or reduce GHG related to business travel and reduce their carbon footprint.

In November 2021, Air Canada and Carbon Engineering Ltd. ("CE") announced a preliminary agreement to identify potential opportunities for CE's proprietary Direct Air Capture technology, which captures carbon dioxide from the atmosphere, to advance aviation decarbonization. The two Canadian companies plan to explore potential cooperation activities in SAF, permanent carbon dioxide removal and innovation, including opportunities for Air Canada to purchase SAF utilizing CE's technologies.

Since 2007, information on Air Canada's carbon footprint, targets and climate strategy has been reported through the CDP, a global disclosure system that has been in place for 20 years and is used to assist investors, companies, cities, states and regions in managing their environmental impacts. The CDP questionnaire incorporates elements of the Climate-related Financial Disclosures ("TCFD") framework. Air Canada holds a B- for its Climate Change 2021 CDP score report. To access Air Canada's CDP response, visit cdp.net. Air Canada's detailed climate disclosures will be available through its TCFD Report which will be published later in 2022.



6. RESULTS OF OPERATIONS – FULL YEAR 2021 VERSUS FULL YEAR 2020

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

	Full Year			
(Canadian dollars in millions, except where indicated)	2021	2020	Change $	Change %
Operating revenues				
Passenger	$ 4,498	$ 4,382	$ 116	3
Cargo	1,495	920	575	63
Other	407	531	(124)	(23)
Total operating revenues	**6,400**	**5,833**	**567**	**10**
Operating expenses				
Aircraft fuel	1,576	1,322	254	19
Wages, salaries, and benefits	2,283	2,242	41	2
Regional airlines expense, excluding fuel	1,042	1,086	(44)	(4)
Depreciation and amortization	1,616	1,849	(233)	(13)
Aircraft maintenance	656	681	(25)	(4)
Airport and navigation fees	562	545	17	3
Sales and distribution costs	244	252	(8)	(3)
Ground package costs	120	250	(130)	(52)
Catering and onboard services	165	171	(6)	(4)
Communications and information technology	362	372	(10)	(3)
Special items	(31)	(116)	85	(73)
Other	854	955	(101)	(11)
Total operating expenses	**9,449**	**9,609**	**(160)**	**(2)**
Operating loss	**(3,049)**	**(3,776)**	**727**	
Non-operating income (expense)				
Foreign exchange loss	(52)	(293)	241	
Interest income	72	132	(60)	
Interest expense	(749)	(656)	(93)	
Interest capitalized	17	25	(8)	
Net financing expense relating to employee benefits	(8)	(27)	19	
Loss on financial instruments recorded at fair value	(55)	(242)	187	
Loss on debt settlements and modifications	(129)	-	(129)	
Gain on sale and leaseback of assets	-	18	(18)	
Other	(28)	(34)	6	
Total non-operating expense	**(932)**	**(1,077)**	**145**	
Loss before income taxes	**(3,981)**	**(4,853)**	**872**	
Income tax recovery	379	206	173	
Net loss	**$ (3,602)**	**$ (4,647)**	**$ 1,045**	
Diluted loss per share	**$ (10.25)**	**$ (16.47)**	**$ 6.22**	
EBITDA (excluding special items) [1]	**$ (1,464)**	**$ (2,043)**	**$ 579**	
Adjusted pre-tax loss [1]	**$ (3,768)**	**$ (4,425)**	**$ 657**	

(1) EBITDA (excluding special items) and adjusted pre-tax income (loss) are non-GAAP financial measures. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

System Passenger Revenues

The COVID-19 pandemic generated a system-wide impact which began to be felt in early March 2020, and by June 2020 the global commercial aviation sector came to a near standstill. Air Canada operated much of its pre-pandemic planned schedule for the first two months of 2020. Since the onset of the pandemic, Air Canada has actively managed its ASM capacity based on prevailing market trends and travel demand. In 2021, Air Canada decreased its ASM capacity by 11.5% when compared to 2020, largely as a result of the capacity change from the first quarter of 2021 versus the first quarter of 2020 (a decrease of 70.4% when compared to 2019).

Passenger revenues of $4,498 million in 2021 increased $116 million or 2.6% compared to 2020. At the system level, traffic measured as revenue passenger miles (RPMs) decreased 9.4% from 2020. Compared to 2019, passenger revenues declined 73.9% and RPMs declined 77.6%.

When compared to 2020, passenger revenues for business, premium economy, and economy cabins in 2021 increased 5.2%, 3.6% and 1.9%, respectively. When compared to 2020, in 2021, PRASM for these cabins grew 15.6%, 10.7%, and 15.8%, respectively; when compared to 2019, PRASM for these cabins declined 16.0%, 24.7%, and 6.8%, respectively.

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

	Full Year			
(Canadian dollars in millions)	**2021**	**2020**	**Change $**	**Change %**
Canada	$ 2,050	$ 1,640	$ 410	25.0
U.S. transborder	770	840	(70)	(8.4)
Atlantic	1,100	909	191	21.0
Pacific	245	468	(223)	(47.6)
Other	333	525	(192)	(36.5)
System	**$ 4,498**	**$ 4,382**	**$ 116**	**2.6**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the periods indicated.

	2021 vs 2020					
	Passenger Revenue	**Capacity (ASMs)**	**Traffic (RPMs)**	**Passenger Load Factor**	**Yield**	**PRASM**
Change	%	%	%	pp	%	%
Canada	25.0	14.9	24.3	5.0	0.6	8.8
U.S. transborder	(8.4)	(23.8)	(25.5)	(1.4)	22.9	20.2
Atlantic	21.0	1.6	19.1	9.2	1.6	19.0
Pacific	(47.6)	(48.0)	(61.4)	(15.9)	35.8	0.8
Other	(36.5)	(42.3)	(49.5)	(9.6)	25.8	10.0
System	**2.6**	**(11.5)**	**(9.4)**	**1.4**	**13.3**	**15.9**

Domestic Passenger Revenues

In 2021, on a capacity increase of 14.9%, domestic passenger revenues of $2,050 million increased $410 million or 25.0% from 2020. The main driver for the variance was increased traffic in almost all major domestic services, which resulted in a year-over-year traffic increase of 24.3%. The demand uptick in the second half of 2021 was significant and was a result of the easing of certain government restrictions, including inter-provincial and border restrictions. However, the competitive environment in the domestic market resulted in some yield pressure.

U.S. Transborder Passenger Revenues

In 2021, on a capacity reduction of 23.8%, U.S. transborder passenger revenues of $770 million, decreased $70 million or 8.4% from 2020. The main driver for the variance was a decline in traffic of 25.5% as Air Canada operated much of its pre-pandemic planned schedule for the first two months of 2020; however, it was partially offset by increased demand in the second half of 2021 following the easing of travel restrictions.

Atlantic Passenger Revenues

In 2021, on a capacity increase of 1.6%, Atlantic passenger revenues of $1,100 million, increased $191 million or 21.0% from 2020. The increase was a result of significantly better traffic, following the easing of travel restrictions, as well as better yields compared to 2020.

Pacific Passenger Revenues

In 2021, on a capacity reduction of 48.0%, Pacific passenger revenues of $245 million, decreased $223 million or 47.6% from 2020. The decline was due to lower traffic compared to 2020 as Air Canada operated much of its pre-pandemic planned schedule for the first two months of 2020; however, it was partially offset by increased demand in the second half of 2021 following the easing of travel restrictions, albeit at a slower pace than other international markets as strict COVID-related restrictions remained in place in many countries in the Asia-Pacific region.

Other Passenger Revenues

In 2021, on a capacity reduction of 42.3%, Other passenger revenues of $333 million, decreased $192 million or 36.5% from 2020. The decline was due to lower traffic compared to 2020 as Air Canada operated much of its pre-pandemic planned schedule for the first two months of 2020 (with the first quarter of the calendar year being, historically, the strongest quarter for the Other service). The decline was partially offset by increased demand in the second half of 2021 following the easing of travel restrictions.

Air Canada saw significant progress on revenues, traffic, and advance ticket sales, in the second half of 2021, following the gradual easing of travel restrictions imposed by the Canadian government; including from point of origin U.S. and international. However, the remaining travel restrictions imposed by various countries, including Canada, and the uncertainty presented by continually changing travel requirements, continued to have an adverse impact on demand for certain customer segments (for example, in Canada, for families travelling with children under the age of five for whom COVID-19 vaccines are not available.) In addition, the reinstated Canadian government travel advisory against non-essential travel and the 72-hour prior to departure negative PCR COVID-19 test requirement from the Canadian government continued to negatively impact demand for international travel.

Cargo Revenues

In 2021, Cargo revenues of $1,495 million increased $575 million or 62.5% from 2020. The year-over-year increase was primarily due to a 32% increase in volume and a 23% increase in yield compared to 2020. A total of 10,217 cargo-only flights were operated during the year, an increase of 142% from 2020. Cargo-only flights represented revenues of $839 million in 2021 compared to $303 million in 2020.

Demand for air cargo services continued to be strong in 2021, most notably, in the Atlantic and the Pacific markets. While the demand for air cargo capacity remained high in 2021, the global supply of air cargo capacity continued to be negatively impacted by the COVID-19 pandemic due to reduced capacity as a result of fewer flights operated worldwide, in particular by commercial airlines. In 2021, Air Canada generated record cargo revenues by continuing to fly several temporarily converted Boeing 777 and Airbus A330 passenger aircraft and introducing, in December 2021, its first Boeing 767 dedicated freighter.

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

	Full Year			
(Canadian dollars in millions)	2021	2020	$ Change	% Change
Canada	$ 124	$ 90	$ 34	37.0
U.S. transborder	62	35	27	76.9
Atlantic	538	387	151	39.3
Pacific	667	354	313	88.2
Other	104	54	50	93.2
System	**$ 1,495**	**$ 920**	**$ 575**	**62.5**

Other Revenues

In 2021, other revenues of $407 million decreased $124 million or 23% from 2020. The decrease was primarily due to the impact of the COVID-19 pandemic, which only began to be felt in early March 2020, resulting in lower ground package revenues at Air Canada Vacations. The decline was partially offset by an increase in non-air revenues related to the Aeroplan program.

Operating Expenses

Compared to 2020, in 2021, operating expenses of $9,449 million decreased $160 million or 2%. In 2021, Air Canada recorded an operating expense reduction of $31 million under special items, compared to an operating expense reduction of $116 million under special items in 2020. Additional information on special items is provided in the subsection below titled "Special Items".

The more notable year-over-year variances in operating expenses in 2021 compared to 2020 are summarized below. However, a direct year-over-year comparison of total operating expenses is not meaningful as Air Canada operated much of its pre-pandemic planned schedule for the first two months of 2020 and given the impact of special items recorded.

Aircraft Fuel

In 2021, fuel expense of $1,576 million increased $254 million or 19% compared to 2020 due to a 33% increase in jet fuel prices. The increase was partially offset by lower litres of fuel consumed in 2021 compared to 2020 as the impact of the COVID-19 pandemic only began to be felt in March 2020, and by a favourable variance in foreign exchange as a result of the strengthening of the Canadian dollar versus the U.S. dollar.

Wages, Salaries and Benefits

In 2021, wages, salaries, and benefits of $2,283 million increased $41 million or 2% from 2020. Compared to 2020, wages and salaries of $1,652 million increased $62 million or 4% primarily on higher average salaries year-over-year largely the result of a change in mix of active employees related to the increased operation of wide-body aircraft and contractual wage increases.

Compared to 2020, benefits expense of $631 million decreased $21 million or 2% mainly due to a lower average number of full-time employees. In addition, the current service cost for pensions decreased slightly as compared to 2020 due to the decrease in overall pensionable earnings and the changes in the discount rates.

Regional Airlines Expense

In 2021, regional airline expense (excluding fuel and aircraft ownership costs) of $1,042 million decreased $44 million or 4% from 2020. The decrease was primarily driven by net savings that resulted from the consolidation of the regional flying with Jazz. To a lesser extent, the strengthening of the Canadian dollar also contributed to the favourable variance.

The following table provides a breakdown of regional airlines expense for the periods indicated.

	Full Year			
(Canadian dollars in millions)	**2021**	**2020**	**$ Change**	**% Change**
Capacity purchase fees [(1)]	$ 558	$ 636	$ (78)	(12)
Airport and navigation	161	127	34	27
Sales and distribution costs	42	51	(9)	(18)
Other operating expenses	281	272	9	3
Total regional airlines expense	**$ 1,042**	**$ 1,086**	**$ (44)**	**(4)**

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

Depreciation and Amortization

In 2021, depreciation and amortization expense of $1,616 million decreased $233 million or 13% from 2020. This variance was mainly driven by the retirement of certain older aircraft from the fleet, partially offset by the addition of new Airbus A220-300 and Boeing 737 MAX aircraft to the fleet.

Aircraft Maintenance

In 2021, aircraft maintenance expense of $656 million decreased $25 million or 4% from 2020. The decline was mainly due to the lower volume of maintenance activities as a consequence of reduced flying compared to 2020 as a result of the impact of the COVID-19 pandemic. The decline was partially offset by increased expenses related to engines under power-by-the-hour agreements as a result of certain favourable adjustments recorded in 2020.

Ground package costs

In 2021, ground package costs of $120 million declined $130 million or 52% as a result of (i) lower volume of passengers year-over-year (as the impact of the COVID-19 pandemic only began to be felt in March 2020) and (ii) the suspension of flights to Mexico and the Caribbean between January 31, 2021 and June 26, 2021.

Special Items

In 2021, Air Canada recorded special items amounting to a net operating expense reduction of $31 million compared to a net operating expense reduction of $116 million recorded in 2020. The table below provides a breakdown of these special items.

	Full Year	
(Canadian dollars in millions)	**2021**	**2020**
Impairments	$ 38	$ 315
Canada Emergency Wage Subsidy, net	(451)	(554)
Workforce reduction provisions	161	127
Benefit plan amendments	82	-
Benefit plan settlement	125	-
Other	14	(4)
Special Items	**$ (31)**	**$ (116)**

Impairments

In response to COVID-19 related capacity reductions, Air Canada accelerated the retirement of certain older aircraft from its fleet. As a result, 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 the reduction of carrying values of owned aircraft to expected disposal proceeds.

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 were cancelled.

In 2021, an additional impairment charge of $46 million, net of impairment reversals of $8 million, was recorded as a result of reductions to the estimates of the expected disposal proceeds on owned aircraft and flight equipment, partially offset by lower-than-expected costs to meet contractual return conditions on lease returns. Further changes to these estimates may result in additional adjustments to the impairment charge in future periods.

Canada Emergency Wage Subsidy

In 2020, in response to challenges posed by the COVID-19 pandemic, 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. Air Canada continued its participation in the CEWS program until the program ended in October 2021. In October 2021, the Government of Canada announced two new programs designed to support businesses that are still facing challenges due to the COVID-19 pandemic: the Hardest Hit Business Recovery Program ("HHBRP") and the Tourism and Hospitality Recovery Program ("THRP").

Air Canada recorded a total gross subsidy under the CEWS and HHBRP programs of $457 million for 2021; $451 million net of the cost for inactive employees who were eligible for the wage subsidy under the program (gross subsidy of $656 million for 2020; $554 million net of costs). Cash payments of $518 million were received in the year 2021 ($586 million in 2020). There are no unfulfilled conditions or other contingencies attaching to the CEWS program.

Workforce reduction provisions

As a result of the impact of the COVID-19 pandemic, Air Canada offered early retirement incentive programs to its unionized workforce. These programs provided for pension improvements which are payable from the defined benefit pension plan for eligible employees, and as such do not impact Air Canada's liquidity position. Termination benefits and a curtailment loss of $161 million were recorded in 2021 as a special item.

As a result of the impact of the COVID-19 pandemic, Air Canada undertook a workforce reduction in the second quarter of 2020 and recorded a workforce reduction provision of $78 million in the year ended December 31, 2020. In addition to the provision, termination benefits and curtailments of $49 million related to the pension and benefit obligations were recorded in 2020.

Benefit Plan Amendments

In 2021, Air Canada received the decision of the arbitrator determining the cap on pensionable earnings recognized in the defined benefit pension plan for IAMAW-represented technical employees. The decision resulted in an increase to the maximum pensionable earnings, effective from 2021, with retroactivity to 2019 for employees that so elect. Air Canada recorded a one-time pension past service cost of $82 million as a special item in 2021 as a result of this plan amendment. This amendment does not impact Air Canada's liquidity position as it is funded out of the surplus in the domestic registered pension plans.

Benefit Plan Settlement

A settlement loss of $125 million was recognized and represents the difference between the premium paid on the purchase of an annuity to insure the liabilities and the related defined pension benefit obligation for the UK defined benefit pension plan.

Other

Termination of the Transat Arrangement Agreement

On April 2, 2021, Air Canada announced that the arrangement agreement for the proposed acquisition by Air Canada of Transat A.T. Inc. ("Transat") was terminated, with Air Canada paying Transat a termination fee of $12.5 million, and with Transat no longer under any obligation to pay Air Canada any fee should Transat be involved in another acquisition or similar transaction in the future.

Amendments to Capacity Purchase Agreements

In March 2021, Air Canada announced an agreement to amend the CPA with Jazz, under which Jazz currently operates regional flights under the Air Canada Express brand. Through the revised agreement, Air Canada transferred the operation of its Embraer E175 fleet to Jazz from Sky Regional and Jazz became the sole operator of flights under the Air Canada Express brand. The capacity purchase agreement with Sky Regional was terminated. Air Canada recorded a net expense of $2 million, related to the CPA revisions and consolidation of regional flying. The expense included a net provision of $12 million in estimated termination costs to be paid, largely offset by retirement of lease liabilities and inventory costs associated with exiting aircraft.

Other operating expenses

In 2021, other operating expenses of $854 million decreased $101 million or 11% from 2020. The main driver of the variance was the termination of the wet leases Air Canada had, in 2020, with some carriers to support its planned schedule as a result of the grounding of the Boeing 737 MAX and prior to the COVID-19 pandemic being declared.

Non-operating Expense

In 2021, non-operating expense of $932 million decreased $145 million from 2020.

Losses on foreign exchange amounted to $52 million in 2021 compared to losses of $293 million in 2020. The December 31, 2021 closing exchange rate was US$1=$1.2637 compared to a closing exchange rate of US$1=$1.2725 on December 31, 2020.The losses in 2021 were driven by losses of $114 million on foreign currency derivatives and partially offset by gains of $66 million on long-term debt and lease liabilities.

Interest expense of $749 million in 2021 increased $93 million from 2020. The variance was mainly due to higher levels of debt as a result of financing transactions concluded from March 2020 through the end of 2021.

In 2021, Air Canada recorded a loss of $55 million on financial instruments recorded at fair value. This was primarily due to fluctuations in the fair value of Air Canada’s convertible notes cash conversion settlement option, which resulted in a $45 million loss in 2021.

In 2021, Air Canada recorded a loss on debt settlements and modifications of $129 million. The loss included the write-off of amortized costs and prepayment fees in a series of refinancing transactions completed in 2021, as described in section 4 “2021 Highlights” of this MD&A.

Income Taxes

Income taxes recorded in 2021 and in 2020 are summarized below.

	Full Year	
(Canadian dollars in millions)	**2021**	**2020**
Current income tax recovery (expense)	$ (16)	$ 42
Deferred income tax recovery	395	164
Income tax recovery	**$ 379**	**$ 206**

As a result of the COVID-19 pandemic, there is negative evidence relating to losses incurred in the current and prior 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. The future tax deductions underlying the unrecognized deferred income tax assets of $1,719 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 $395 million was recorded for the year, which is partially offsetting the deferred income tax expense of $379 million recorded in Other comprehensive income (loss).

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 from the adjusted pre-tax income measure, which continues to be reported.

7. RESULTS OF OPERATIONS – Q4 2021 VERSUS Q4 2020

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

(Canadian dollars in millions, except where indicated)	Fourth Quarter 2021	2020	$ Change	% Change
Operating revenues				
Passenger	$ 2,041	$ 475	$ 1,566	330
Cargo	490	286	204	71
Other	200	66	134	203
Total operating revenues	**2,731**	**827**	**1,904**	**230**
Operating expenses				
Aircraft fuel	665	187	478	256
Wages, salaries, and benefits	666	507	159	31
Regional airlines expense, excluding fuel	342	245	97	40
Depreciation and amortization	399	435	(36)	(8)
Aircraft maintenance	226	185	41	22
Airport and navigation fees	189	107	82	77
Sales and distribution costs	102	26	76	292
Ground package costs	91	14	77	550
Catering and onboard services	71	25	46	184
Communications and information technology	91	80	11	14
Special items	126	(160)	286	179
Other	266	179	87	49
Total operating expenses	**3,234**	**1,830**	**1,404**	**77**
Operating loss	**(503)**	**(1,003)**	**500**	
Non-operating income (expense)				
Foreign exchange gain	22	88	(66)	
Interest income	18	26	(8)	
Interest expense	(211)	(182)	(29)	
Interest capitalized	4	5	(1)	
Net financing expense relating to employee benefits	2	(1)	3	
Gain (loss) on financial instruments recorded at fair value	59	(214)	273	
Gain on sale and leaseback of assets	-	18	(18)	
Other	(8)	(12)	4	
Total non-operating expense	**(114)**	**(272)**	**158**	
Loss before income taxes	**(617)**	**(1,275)**	**658**	
Income tax recovery	124	114	10	
Net loss	**$ (493)**	**$ (1,161)**	**$ 668**	
Diluted loss per share	**$ (1.38)**	**$ (3.91)**	**$ 2.53**	
EBITDA (excluding special items) (1)	**$ 22**	**$ (728)**	**$ 750**	
Adjusted pre-tax loss (1)	**$ (574)**	**$ (1,326)**	**$ 752**	

(1) EBITDA (excluding special items) and adjusted pre-tax income (loss) are non-GAAP financial measures. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

System Passenger Revenues

Since the onset of the pandemic, Air Canada has actively managed its ASM capacity based on prevailing market trends and travel demand. In the fourth quarter of 2021, Air Canada increased its ASM capacity by 134.3% when compared to the fourth quarter of 2020 (a decrease of 46.8% when compared to the fourth quarter of 2019). In the fourth quarter of 2021, ASM capacity grew 26.5% from the third quarter of 2021. Air Canada's fourth quarter 2021 ASM capacity increase was consistent with the projected capacity increase of about 135% discussed in Air Canada's news release dated November 2, 2021.

Fourth quarter 2021 passenger revenues of $2,041 million increased by $1,566 million or about four times compared to the same period in 2020. Better traffic across all markets resulted in a four-fold increase in traffic at the system level. The year-over-year variance resulted from a better operating environment in the Canadian and international markets despite the challenges presented by the emergence of the Omicron variant in November 2021 and by the sharp rise, towards the end of December, in COVID-19 cases Canada-wide and in many countries around the world.

In the fourth quarter of 2021, revenues for business, premium economy, and economy cabins increased 4.7 times, 5.5 times, and 4.1 times, respectively, when compared to the fourth quarter of 2020. At the cabin level, the revenue increases were primarily driven by traffic increases in all cabins versus the same period in 2020. To a lesser extent, yield gains, in all cabins, versus the fourth quarter of 2020 also contributed to the variance. When compared to the fourth quarter of 2019, revenues in these cabins declined 47.8%, 52.9%, and 46.7%, respectively.

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

	Fourth Quarter			
(Canadian dollars in millions)	2021	2020	$ Change	% Change
Canada	$ 774	$ 262	$ 512	194.7
U.S. transborder	418	47	371	788.1
Atlantic	554	90	464	520.8
Pacific	82	28	54	191.1
Other	213	48	165	348.8
System	**$ 2,041**	**$ 475**	**$ 1,566**	**330.0**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the periods indicated.

	Fourth Quarter 2021 vs Fourth Quarter 2020					
	Passenger Revenue	Capacity (ASMs)	Traffic (RPMs)	Passenger Load Factor	Yield	PRASM
Change	%	%	%	pp	%	%
Canada	194.7	85.7	183.0	24.9	4.1	58.7
U.S. transborder	788.1	485.3	728.6	19.1	7.2	51.7
Atlantic	520.8	136.5	374.2	34.6	30.9	162.5
Pacific	191.1	27.9	194.8	31.0	(1.3)	127.7
Other	348.8	210.0	292.6	14.6	14.3	44.8
System	**330.0**	**134.3**	**295.2**	**27.9**	**8.8**	**83.6**

Domestic Passenger Revenues

In the fourth quarter of 2021, on a capacity increase of 85.7%, domestic passenger revenues of $774 million increased $512 million or about three times from the fourth quarter of 2020.

U.S. Transborder Passenger Revenues

In the fourth quarter of 2021, on a capacity increase of 485.3%, U.S. transborder passenger revenues of $418 million, increased $371 million or almost nine times from the fourth quarter of 2020.

Atlantic Passenger Revenues

In the fourth quarter of 2021, on a capacity increase of 136.5%, Atlantic passenger revenues of $554 million increased $464 million or approximately six times from the fourth quarter of 2020.

Pacific Passenger Revenues

In the fourth quarter of 2021, on a capacity increase of 27.9%, Pacific passenger revenues of $82 million, increased $54 million, almost tripling from the fourth quarter of 2020.

Other Passenger Revenues

In the fourth quarter of 2021, on a capacity increase of 210.0%, other passenger revenues of $213 million increased $165 million or about four times from the fourth quarter of 2020.

The table below provides, by market, Air Canada's revenue passenger miles (RPMs) and available seat miles (ASMs) for the periods indicated.

	Fourth Quarter				Full Year			
	2021		2020		2021		2020	
(millions)	RPMs	ASMs	RPMs	ASMs	RPMs	ASMs	RPMs	ASMs
Canada	2,952	4,081	1,043	2,198	8,002	12,072	6,436	10,508
U.S. transborder	1,542	2,366	186	404	2,705	4,190	3,630	5,501
Atlantic	3,350	4,855	707	2,053	7,126	11,396	5,984	11,211
Pacific	545	995	185	778	1,353	2,956	3,506	5,683
Other	1,223	1,760	311	567	1,859	2,770	3,683	4,800
System	**9,612**	**14,057**	**2,432**	**6,000**	**21,045**	**33,384**	**23,239**	**37,703**

Cargo Revenues

Cargo revenues of $490 million in the fourth quarter of 2021 increased $204 million or 71.4% from the fourth quarter of 2020.

In the fourth quarter of 2021, volume and yield increased 35% and 27%, respectively, compared to the same period in 2020. A total of 2,497 cargo-only flights were operated in the fourth quarter of 2021 and represented revenues of $251 million or 51% of cargo revenues in the quarter. In the fourth quarter of 2021, demand for air cargo was especially strong in the Pacific market.

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

	Fourth Quarter			
(Canadian dollars in millions)	2021	2020	$ Change	% Change
Canada	$ 45	$ 29	$ 16	52.8
U.S. transborder	18	8	10	134.9
Atlantic	151	131	20	16.3
Pacific	241	99	142	142.4
Other	35	19	16	82.2
System	**$ 490**	**$ 286**	**$ 204**	**71.4**

Other Revenues

In the fourth quarter of 2021, other revenues of $200 million increased $134 million from the fourth quarter of 2020. The increase was primarily driven by ground package revenues from ACV reflecting an increase in vacation packages sold compared to the same period in 2020. To a lesser extent, higher onboard sales and higher passenger-related fees related to a year-over-year increase in traffic also contributed to the variance.

Operating Expenses

Operating expenses of $3,234 million in the fourth quarter of 2021 increased $1,404 million or 77% from the fourth quarter of 2020. The variance was mainly the result of increases in various line items largely reflecting the year-over-year growth of 134.3% in operating capacity.

The more notable year-over-year variances in operating expenses in the fourth quarter of 2021 compared to the fourth quarter of 2020 are summarized below.

Aircraft Fuel

In the fourth quarter of 2021, fuel expense of $665 million increased $478 million from the fourth quarter of 2020. The increase was a result of a 66.6% increase in jet fuel prices, as well as more jet fuel litres used as a result of higher volume of flying compared to the fourth quarter of 2020.

Wages, Salaries and Benefits

In the fourth quarter of 2021, wages, salaries, and benefits of $666 million increased $159 million or 31% from the fourth quarter of 2020. The variance was mainly due to an increase of 41% in FTEs compared to the same period in 2020.

Regional Airlines Expense

In the fourth quarter of 2021, regional airline expense (excluding fuel and aircraft ownership costs) of $342 million increased $97 million or 40% from the fourth quarter of 2020. The increase was primarily driven by higher expenses due to higher volume of flying compared to the same period in 2020. The increase was partially offset by savings from the consolidation of regional flying.

The following table provides a breakdown of regional airlines expense for the periods indicated.

(Canadian dollars in millions)	Fourth Quarter			
	2021	2020	$ Change	% Change
Capacity purchase fees [1]	$ 164	$ 139	$ 25	18
Airport and navigation	66	28	38	136
Sales and distribution costs	18	7	11	157
Other operating expenses	94	71	23	32
Total regional airlines expense	**$ 342**	**$ 245**	**$ 97**	**40**

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

Depreciation and Amortization

In the fourth quarter of 2021, depreciation and amortization expense of $399 million decreased $36 million or 8% from the same period in 2020. The variance was primarily due to the retirement of certain older aircraft, partially offset by the addition of new Airbus A220-300 and Boeing 737 MAX aircraft to the fleet.

Aircraft Maintenance

In the fourth quarter of 2021, aircraft maintenance expense of $226 million increased $41 million or 22% from the same period in 2020. The increase was primarily due to higher volume of flying compared to the same period in 2020 and the resulting increase in power-by-hour maintenance expense. To a lesser extent, an increase in maintenance provisions, as a result of updated end-of-lease cost estimates related to an aircraft returned to the lessor in late 2021, also contributed to the variance.

Special Items

In the fourth quarter of 2021, Air Canada recorded special items amounting to $126 million. The table below provides a breakdown of these special items. Refer to subsection “Special Items” in section 6 “Results of Operations – Full Year 2021 versus Full Year 2020” of this MD&A for additional information.

(Canadian dollars in millions)	Fourth Quarter	
	2021	2020
Impairments (impairment reversal)	$ 24	$ (12)
Canada Emergency Wage Subsidy, net	(27)	(163)
Workforce reduction provisions	(2)	15
Benefit plan amendments	6	-
Benefit plan settlement	125	-
Special Items	**$ 126**	**$ (160)**

Non-operating Expense

In the fourth quarter of 2021, Air Canada recorded a non-operating expense of $114 million compared to a non-operating expense of $272 million in the fourth quarter of 2020.

Gains on foreign exchange amounted to $22 million in the fourth quarter of 2021 compared to gains of $88 million in the same period in 2020. The gain was primarily driven by gains of $46 million on long-term debt and lease liabilities and was partially offset by losses on foreign currency derivatives. The December 31, 2021, closing exchange rate was US$1=C$1.2637 compared to US$1=C$1.2680 on September 30, 2021.

Interest expense of $211 million in the fourth quarter increased by $29 million compared to the fourth quarter of 2020. The variance was mainly due to higher levels of debt as a result of financing transactions concluded since the COVID-19 pandemic began.

Gains on financial instruments recorded at fair value were $59 million in the fourth quarter of 2021 compared to losses of $214 million in the fourth quarter of 2020. The gains were primarily due to fluctuations in the fair value of Air Canada's convertible notes cash conversion settlement option, which resulted in a $64 million gain in the fourth quarter 2021.

8. FLEET

In response to the COVID-19 pandemic, Air Canada has actively managed its capacity through the temporary grounding of aircraft and the permanent retirement of older less efficient aircraft. Temporarily grounded aircraft are included in the tables below. Air Canada continues to assess its fleet and capacity and will continue to adjust its fleet and schedule and take other measures as developments warrant.

As a response to the surge in demand for air cargo space, Air Canada has been operating all-cargo flights using its passenger aircraft as well as some temporarily converted Boeing 777-300ER and Airbus A330 aircraft. The converted aircraft have increased available cargo space by removing the seats from the passenger cabin. Air Canada plans to phase out the temporarily converted aircraft by the end of 2022, as their cabins are reconverted back to a passenger configuration. Air Canada introduced one dedicated Boeing 767 freighter to its fleet in December 2021 and plans to add three additional Boeing 767 freighters to the fleet by the end of 2022. These freighter aircraft are reflected in the table below.

The tables below provide the number of aircraft in Air Canada's and Air Canada Rouge's operating fleet as at December 31, 2020 and as at December 31, 2021 as well as the planned fleet at December 31, 2022 and at December 31, 2023.

The tables below include aircraft that have been grounded in response to the COVID-19 pandemic.

	Actual			Planned			
Air Canada (Mainline)	Dec. 31, 2020	2021 Fleet Changes	Dec. 31, 2021	2022 Fleet Changes	Dec. 31, 2022	2023 Fleet Changes	Dec. 31, 2023
Wide-body aircraft							
Boeing 777-300ER	15	(4)	11	7	18	-	18
Boeing 777-300ER (cargo)	4	3	7	(7)	-	-	-
Boeing 777-200LR	6	-	6	-	6	-	6
Boeing 787-8	8	-	8	-	8	-	8
Boeing 787-9	29	-	29	1	30	2	32
Boeing 767-300 freighters	-	1	1	3	4	4	8
Airbus A330-300	13	(1)	12	4	16	-	16
Airbus A330-300 (cargo)	3	1	4	(4)	-	-	-
Total wide-body aircraft	**78**	**-**	**78**	**4**	**82**	**6**	**88**
Narrow-body aircraft							
Boeing 737 MAX 8	24	7	31	9	40	-	40
Airbus A321	15	-	15	-	15	-	15
Airbus A320	21	(3)	18	(2)	16	-	16
Airbus A319	16	(10)	6	(3)	3	-	3
Airbus A220-300	15	12	27	6	33	-	33
Total narrow-body aircraft	**91**	**6**	**97**	**10**	**107**	**-**	**107**
Total Mainline	**169**	**6**	**175**	**14**	**189**	**6**	**195**
Air Canada Rouge							
Narrow-body aircraft							
Airbus A321	14	-	14	-	14	-	14
Airbus A320	5	-	5	-	5	-	5
Airbus A319	20	-	20	-	20	-	20
Total Rouge	**39**	**-**	**39**	**-**	**39**	**-**	**39**
Total Mainline & Rouge	**208**	**6**	**214**	**14**	**228**	**6**	**234**

Air Canada Express

The table below provides the number of aircraft operated as at December 31, 2020 and as at December 31, 2021, on behalf of Air Canada, by its regional carriers operating flights under the Air Canada Express banner pursuant to capacity purchase agreements with Air Canada. The table also provides the planned fleet at December 31, 2022 and at December 31, 2023.

The table below includes aircraft that have been grounded in response to the COVID-19 pandemic.

	Actual			Planned			
Air Canada Express	Dec. 31, 2020	2021 Fleet Changes	Dec. 31, 2021	2022 Fleet Changes	Dec. 31, 2022	2023 Fleet Changes	Dec. 31, 2023
Embraer E175	25	-	25	-	25	-	25
Mitsubishi CRJ-200	15	-	15	-	15	-	15
Mitsubishi CRJ-900	34	1	35	-	35	-	35
De Havilland Dash 8-300	19	(10)	9	(9)	-	-	-
De Havilland Dash 8-400	43	(4)	39	-	39	-	39
Total Air Canada Express	**136**	**(13)**	**123**	**(9)**	**114**	**-**	**114**

9. FINANCIAL AND CAPITAL MANAGEMENT

9.1 LIQUIDITY

Impact of the COVID-19 Pandemic

Air Canada, along with the global airline industry, continued to face a significant decrease in traffic in 2021, as compared to the year 2019, 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, including Canada.

The expectation is for a progressive improvement in cash flows from operating activities as travel restrictions, testing mandates or travel advisories and other COVID-19 related measures are gradually lifted and/or when travel demand recovers. Considering the uncertainty that has characterized the COVID-19 pandemic, the duration of the recovery phase remains difficult to predict. One of Air Canada's key objectives is to return to profitability and sustain and improve cash flows from operations to manage its liquidity needs.

Since March 2020, Air Canada has increased its cash position through a series of debt and equity financing transactions. The additional liquidity allows for operational flexibility and provides support for the implementation of Air Canada's planned mitigation and recovery measures in response to the COVID-19 pandemic. These transactions are described in section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of Air Canada's 2020 Annual MD&A and in section 4 "2021 Highlights" of this MD&A.

In April 2021, Air Canada entered into a series of debt and equity financing agreements with the Government of Canada, which allowed Air Canada to access up to $5.379 billion in debt financing through fully repayable loans, as well as an equity investment for gross proceeds of $500 million (net proceeds of approximately $480 million). In November 2021, Air Canada exited the credit facilities with the Government of Canada, except for the unsecured credit facility solely dedicated to refunding customers' non-refundable tickets. As at December 31, 2021, $1.273 billion had been drawn on the ticket refund facility. Refer to section 4 "2021 Highlights" of this MD&A for additional information on the government's financial package.

In August 2021, Air Canada concluded a series of refinancing transactions, receiving aggregate gross proceeds of approximately $7.1 billion from Senior Secured Credit Facilities and the sale of Senior Secured Notes. Proceeds were used to repay outstanding debt of $2.5 billion and the balance of the proceeds was retained for working capital and other general corporate purposes. These transactions resulted in a net increase to cash of $3.7 billion, plus US$600 million of available liquidity under an undrawn line of credit. The $200 million revolving credit facility was also repaid in August and remains undrawn. Refer to section 4 "2021 Highlights" for additional information on the 2021 financing transactions.

Air Canada's unencumbered asset pool (excluding the value of Aeroplan, Air Canada Vacations, and Air Canada Cargo) amounted to approximately $3.4 billion at December 31, 2021. These unencumbered assets may be used to raise additional liquidity should the need arise.

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 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 9.6 "Capital Expenditures and Related Financing Arrangements", 9.7 "Pension Funding Obligations", and 9.8 "Contractual Obligations" of this MD&A. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts for a minimum period of at least twelve months after each reporting period, including under various scenarios and assumptions, 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, 2021, unrestricted liquidity was $10,361 million consisting of $9,403 million in cash and cash equivalents, short-term and long-term investments, and $958 million available under undrawn credit facilities.

Air Canada estimates that it requires a minimum unrestricted liquidity balance of $2,400 million to support ongoing business operations. 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. Given the uncertainty that has characterized the COVID-19 pandemic, Air Canada's current unrestricted liquidity position permits it to better support ongoing investments, including in fleet and technology, as Air Canada continues to navigate through the recovery phase and build back the airline.

9.2 FINANCIAL POSITION

The table below provides a condensed consolidated statement of financial position of Air Canada as at December 31, 2021, and as at December 31, 2020.

(Canadian dollars in millions)	Dec. 31, 2021	Dec. 31, 2020	$ Change
Assets			
Cash, cash equivalents and short-term investments	$ 8,802	$ 7,501	$ 1,301
Other current assets	1,251	1,170	81
Current assets	**$ 10,053**	**$ 8,671**	**$ 1,382**
Investments, deposits, and other assets	858	833	25
Property and equipment	11,740	12,137	(397)
Pension assets	3,571	2,840	731
Deferred income tax	39	25	14
Intangible assets	1,080	1,134	(54)
Goodwill	3,273	3,273	-
Total assets	**$ 30,614**	**$ 28,913**	**$ 1,701**
Liabilities			
Current liabilities	$ 6,924	$ 7,139	$ (215)
Long-term debt and lease liabilities	15,511	11,201	4,310
Aeroplan and other deferred revenues	3,656	4,032	(376)
Pension and other benefit liabilities	2,588	3,015	(427)
Maintenance provisions	1,032	1,040	(8)
Other long-term liabilities	821	696	125
Deferred income tax	73	75	(2)
Total liabilities	**$ 30,605**	**$ 27,198**	**$ 3,407**
Total shareholders' equity	**$ 9**	**$ 1,715**	**$ (1,706)**
Total liabilities and shareholders' equity	**$ 30,614**	**$ 28,913**	**$ 1,701**

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

At December 31, 2021, net long-term benefit assets of $983 million (comprising pension assets of $3,571 million net of pension and other benefit liabilities of $2,588 million) increased $1,158 million from December 31, 2020. This increase was mainly due to a net actuarial gain on remeasurements of employee liabilities of $1,731 million ($1,311 million, net of tax) recorded on Air Canada's consolidated statement of comprehensive income, partially offset by pension and other employee benefits expense recorded in 2021. The actuarial gain included the net impact of a 61-basis point increase in the discount rate used to value the liabilities.

The long-term portion of the Aeroplan and other deferred revenue liability decreased $376 million from December 31, 2020. This decrease included a reclassification of $430 million from long-term to current liabilities for Aeroplan point redemptions expected to increase over the next 12 months, partially offset by the sale of Aeroplan points to program partners exceeding redemptions.

The increase of other long-term liabilities included a $45 million increase in the fair value of the embedded derivative on Air Canada's convertible notes and $62 million for deferred grant income related to the debt and equity financing agreements with the Government of Canada described in section 4 "2021 Highlights" of this MD&A. With the termination of the operating credit facilities, the unvested warrants were automatically cancelled. In addition, Air Canada exercised its call right to purchase and cancel the vested warrants at fair market value, with settlement completed in January 2022.

9.3 NET DEBT

The table below reflects Air Canada's net debt balances as at December 31, 2021 and as at December 31, 2020.

(Canadian dollars in millions)	Dec. 31, 2021	Dec. 31, 2020	$ Change
Total long-term debt and lease liabilities	$ 15,511	$ 11,201	$ 4,310
Current portion of long-term debt and lease liabilities	1,012	1,788	(776)
Total long-term debt and lease liabilities (including current portion)	**16,523**	**12,989**	**3,534**
Less cash, cash equivalents and short and long-term investments	(9,403)	(8,013)	(1,390)
Net debt (1)	**$ 7,120**	**$ 4,976**	**$ 2,144**

(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.

As at December 31, 2021, net debt of $7,120 million increased $2,144 million from December 31, 2020, reflecting the impact of net cash used for operating and investing activities in 2021, partially offset by the proceeds from equity offerings received in 2021. Proceeds from new borrowings included proceeds from the Government of Canada financing agreement related to customer refunds of non-refundable tickets and a series of refinancing transactions completed in the third quarter of 2021; repayments on long-term debt in 2021 partially offset these proceeds. Additional information on the transactions completed in 2021 is provided in section 4 "2021 Highlights" of this MD&A. In addition, in 2021, Air Canada drew financing for 11 Airbus A220 deliveries (financing for the last A220 delivery in 2021 was drawn in January 2022) and refinanced the 2013-1 EETC Class B equipment notes. The impact of a stronger Canadian dollar at December 31, 2021 compared to December 31, 2020, decreased foreign currency denominated debt (mainly U.S. dollars) by $66 million.

9.4 WORKING CAPITAL

The table below provides information on Air Canada's working capital balances as at December 31, 2021 and as at December 31, 2020.

(Canadian dollars in millions)	Dec. 31, 2021	Dec. 31, 2020	$ Change
Cash, cash equivalents and short-term investments	$ 8,802	$ 7,501	$ 1,301
Accounts receivable	691	644	47
Other current assets	560	526	34
Total current assets	**$ 10,053**	**$ 8,671**	**$ 1,382**
Accounts payable and accrued liabilities	2,603	2,465	138
Advance ticket sales	2,326	2,314	12
Aeroplan and other deferred revenues	983	572	411
Current portion of long-term debt and lease liabilities	1,012	1,788	(776)
Total current liabilities	**$ 6,924**	**$ 7,139**	**$ (215)**
Net working capital	**$ 3,129**	**$ 1,532**	**$ 1,597**

Net working capital of $3,129 million as at December 31, 2021 increased $1,597 million from December 31, 2020. This increase was mainly due to the net proceeds received under the refinancing transactions closed in 2021, as described in section 9.1 "Liquidity" of this MD&A, partially offset by the cash portion of the net loss recorded during the year, and capital expenditures, net of financing.

Since April 13, 2021, total payments of refunds eligible under the refunds credit facility amounted to $1,273 million. Such customer refunds were generally neutral to liquidity and improved net working capital, as they were eligible for draws under the refunds credit facility. Draws under this facility were made monthly based on the amount of refunds processed and paid until November 30, 2021.

9.5 CASH FLOW MOVEMENTS

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

	Fourth Quarter			Full Year		
(Canadian dollars in millions)	2021	2020	$ Change	2021	2020	$ Change
Net cash flows from (used in) operating activities	**$ 433**	**$ (796)**	**$ 1,229**	**$ (1,563)**	**$ (2,353)**	**$ 790**
Proceeds from borrowings	144	254	(110)	8,171	6,262	1,909
Reduction of long-term debt and lease liabilities	(276)	(508)	232	(4,510)	(2,719)	(1,791)
Shares purchased for cancellation	-	-	-	-	(132)	132
Issue of shares	1	815	(814)	555	1,369	(814)
Financing fees	(2)	(3)	1	(205)	(78)	(127)
Net cash flows from (used in) financing activities	**$ (133)**	**$ 558**	**$ (691)**	**$ 4,011**	**$ 4,702**	**$ (691)**
Investments, short-term and long-term	(913)	9	(922)	(862)	(63)	(799)
Additions to property, equipment, and intangible assets	(378)	(335)	(43)	(1,073)	(1,202)	129
Proceeds from sale of assets	3	6	(3)	19	12	7
Proceeds from sale and leaseback of assets	-	485	(485)	11	485	(474)
Other	21	(6)	27	36	35	1
Net cash flows from (used in) investing activities	**$ (1,267)**	**$ 159**	**$ (1,426)**	**$ (1,869)**	**$ (733)**	**$ (1,136)**
Effect of exchange rate changes on cash and cash equivalents	**$ (5)**	**$ (53)**	**$ 48**	**$ 11**	**$ (48)**	**$ 59**
Increase (decrease) in cash and cash equivalents	**$ (972)**	**$ (132)**	**$ (840)**	**$ 590**	**$ 1,568**	**$ (978)**

Net Cash Flows from (used in) Operating Activities

In the fourth quarter of 2021, net cash flows from operating activities of $433 million improved $1,229 million from the same quarter in 2020 due to strong advance ticket sales and a significant increase in passengers carried. In 2021, net cash flows used in operating activities of $1,563 million improved $790 million compared to the previous year as the operating environment improved, most notably in the second half of 2021.

Net Cash Flows from (used in) Financing Activities

In the fourth quarter of 2021, net cash flows used in financing activities of $133 million declined $691 million when compared to the same quarter in 2020, primarily due to proceeds received from the issuance of shares in the fourth quarter of 2020. In 2021, net cash flows from financing activities of $4,011 million decreased $691 million from 2020. The 2021 financing activities include net proceeds of $480 million from the equity financing agreement with the Government of Canada, as well as the net proceeds from the refinancing transactions completed in the third quarter of 2021. Proceeds from borrowings in 2021 also included $1,273 million from the Government of Canada unsecured credit facility supporting customer refunds of non-refundable tickets. Further details on the transactions completed in 2021 are provided in section 4 "2021 Highlights" of this MD&A.

Net Cash Flows from (used) in Investing Activities

In the fourth quarter of 2021, net cash flows used in investing activities of $1,267 million decreased $1,426 million from the same quarter in 2020, primarily reflecting movements between cash, short- and long-term investments. In addition, the net cash flows from investing activities in the fourth quarter of 2020 included $485 million received from the sale and leaseback of nine Boeing 737 MAX 8 aircraft. In 2021, net cash flows used in investing activities of $1,869 million decreased $1,136 million when compared to 2020, primarily due to movements between cash and short- and long-term investments in 2021 as well as $485 million from sale and leaseback transactions in 2020.

Refer to sections 9.2 "Financial Position", 9.3 "Net Debt", 9.4 "Working Capital", and 9.9 "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.

	Fourth Quarter			Full Year		
(Canadian dollars in millions)	2021	2020	$ Change	2021	2020	$ Change
Net cash flows from (used in) operating activities	$ 433	$ (796)	$ 1,229	$ (1,563)	$ (2,353)	$ 790
Additions to property, equipment, and intangible assets, net of proceeds from sale and leaseback transactions	(378)	150	(528)	(1,062)	(717)	(345)
Free cash flow (1)	$ 55	$ (646)	$ 701	$ (2,625)	$ (3,070)	$ 445

(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. 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. Such measure is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, 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 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Free cash flow of $55 million in the fourth quarter of 2021 improved $701 million when compared to the same period in 2020. The increase was due to better net cash flow from operations reflecting the better operating environment. The increase was partially offset by an increase in net additions to property, equipment and intangible assets. In the fourth quarter of 2020, Air Canada received proceeds of $485 million related to the sale and leaseback of nine Boeing 737 MAX aircraft.

Negative free cash flow of $2,625 million in 2021 improved $445 million from 2020, reflecting lower cash used from operating activities as the operating environment improved from 2020, most notably in the second half of 2021. In addition, ticket refunds of $1,273 million in 2021 reduced cash flows from operating activities without affecting liquidity as the refunds of non-refundable tickets were funded with the Government of Canada unsecured credit facility described in section 4 "2021 Highlights" of this MD&A.

Net Cash Flow (Burn)

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

(Canadian dollars in millions)	Fourth Quarter 2021	Full Year 2021
Net cash flows from (used in) operating activities	**$ 433**	**$ (1,563)**
Net cash flows from (used in) financing activities	**(133)**	**4,011**
Net cash flows used in investing activities	**(1,267)**	**(1,869)**
Remove:		
Net proceeds from new non-aircraft related financings	(67)	(7,999)
Refund of non-refundable fares	65	1,273
Lump-sum debt repayments	-	3,374
Proceeds from sale and leaseback transactions	-	(11)
Investments, short-term and long-term	913	862
Net cash flow (burn) (1)	**$ (56)**	**$ (1,922)**

(1) Net cash flow (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 for aircraft deliveries, and investing activities. Excluded are proceeds from non-aircraft financings, lump sum debt maturities made 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, and refunds for non-refundable fares being processed for flights impacted by the COVID-19 pandemic. Such refunds were eligible for draws under the Government of Canada refunds credit facility and, therefore, were generally cash neutral to Air Canada's liquidity position. Draws under this facility were made monthly based on the amount of refunds processed and paid until November 30, 2021. Net cash flow (burn) is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, may not be comparable to similar measures presented by other entities and should not be considered a substitute for or superior to GAAP results.

In the fourth quarter of 2021, net cash burn of $56 million resulted from positive net cash flow from operations reflecting the better operating environment more than offset by the cash outflows related to the additions to property and equipment and net financing activities.

9.6 CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS

Airbus A220-300 Aircraft

Air Canada's agreement with Airbus Canada for the purchase of Airbus A220-300 aircraft provides for:

- Firm orders for 45 Airbus A220-300 aircraft
- Purchase options for 30 additional Airbus A220-300 aircraft

In January 2022, Air Canada elected to proceed with the purchase of an additional 10 Airbus A220 aircraft, in addition to the two A220 aircraft that were added in 2021. These 12 aircraft are those that Air Canada had previously determined it would no longer be purchasing under an amendment to the purchase agreement concluded with Airbus in November 2020. Planned deliveries for the 12 aircraft are: six in 2024, and six in 2025.

In March 2021, Air Canada concluded a committed secured facility totalling US$475 million to finance the purchase of the next 15 Airbus A220 aircraft scheduled for delivery in 2021 and 2022. In September 2020, Air Canada concluded a committed secured facility totalling $788 million to finance the purchase of the first 18 Airbus A220 aircraft, all of which were delivered before the end of 2020.

As at December 31, 2021, 27 Airbus A220-300 aircraft had been delivered.

Boeing 737 MAX

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 October 2021, Air Canada reached an agreement with Boeing to accelerate the delivery of four Boeing 737 MAX aircraft into the fourth quarter of 2021, for a total of seven deliveries in 2021. The remaining nine Boeing 737 MAX aircraft are expected to be delivered by the end of the second quarter of 2022, reaching a total of 40 Boeing 737 MAX aircraft in the narrow-body fleet.

At December 31, 2021, 31 Boeing 737 MAX 8 aircraft had been delivered.

Boeing 787-9 Aircraft

Air Canada exercised options for the purchase of three Boeing 787-9 aircraft which are scheduled to be delivered in 2022 and in 2023. Air Canada has no additional purchase options for Boeing 787 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 amounted to about $2,499 million.

(Canadian dollars in millions)	2022	2023	2024	2025	2026	Thereafter	Total
Committed expenditures	$ 1,154	$ 611	$ 356	$ 338	$ 40	$ -	$ 2,499
Projected planned but uncommitted expenditures	149	350	302	445	354	Not available	Not available
Projected planned but uncommitted capitalized maintenance (1)	282	386	452	262	340	Not available	Not available
Total projected expenditures (2)	**$ 1,585**	**$ 1,347**	**$ 1,110**	**$ 1,045**	**$ 734**	**Not available**	**Not available**

(1) Future capitalized maintenance amounts for 2025 and beyond are not yet determinable, however estimates of $262 million and $340 million have been made for 2025 and 2026, respectively.
(2) U.S. dollar amounts are converted using the December 31, 2021 closing exchange rate of US$1=C$1.2637. 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, 2021.

9.7 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 sponsors several defined contribution pension plans and contributes to some multi-employer pension plans. In addition, Air Canada has plans providing other retirement and post-employment benefits to its employees.

On a preliminary basis, at January 1, 2022, the aggregate solvency surplus in Air Canada's domestic registered pension plans was estimated at $4.7 billion. The final valuations will be completed in the first half of 2022. As permitted by 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) amounted to $91 million in 2021 and are forecasted to be $90 million in 2022.

After taking into account the surplus in the defined benefit components which was used to fund the employer contribution to a defined contribution component within the same pension plan, total employer contributions for the defined contribution plans and multi-employer plans amounted to $23 million in 2021. Similarly, considering the available surplus in the defined benefit components which may be used to fund the employer contribution to a defined contribution component within the same pension plan, total employer contributions for the defined contribution plans and multi-employer plans are forecasted to be $36 million in 2022.

At December 31, 2021, 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.

Pension plan assets

Included in plan assets, for determining the net benefit obligation for accounting purposes, are 17,646,765 (2020 – 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 Air Canada's Canadian-based unions. The trust arrangement provides that proceeds of the sale of the trust shares will be retained and applied to reduce future pension solvency deficits, if any should materialize. With Air Canada's domestic registered plans 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 had a fair value of $373 million at December 31, 2021 (2020 – $402 million), however after giving effect to the asset ceiling, the recognized accounting value of the trust asset is nil.

In November 2021, Air Canada announced that its Canadian unions and the Air Canada Pionairs agreed in principle to permit certain other uses of the proceeds of the shares discussed above. If all conditions are met, shares in the trust will be gradually sold over a period of up to 15 years with the net proceeds from the sales used to make lump sum payments to Canadian pensioners and to fund voluntary separation packages for senior unionized employees and non-executive employees. There are several conditions to the completion of the agreement and effecting such sales and payments. These include the conclusion of definitive documentation, and the receipt of all required regulatory and other approvals. There can be no assurance that these or any other conditions will be satisfied.

9.8 CONTRACTUAL OBLIGATIONS

The table below provides Air Canada's projected contractual obligations as at December 31, 2021, 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)	2022	2023	2024	2025	2026	Thereafter	Total
Principal							
Long-term debt [1]	$ 511	$ 660	$ 482	$ 1,780	$ 2,369	$ 8,243	$ 14,045
Lease liabilities	501	487	447	420	291	1,033	3,179
Total principal obligations	**1,012**	**1,147**	**929**	**2,200**	**2,660**	**9,276**	**17,224**
Interest							
Long-term debt	$ 540	$ 517	$ 495	$ 471	$ 393	$ 668	$ 3,084
Lease liabilities	147	123	100	79	63	127	639
Total interest obligations	**$ 687**	**$ 640**	**$ 595**	**$ 550**	**$ 456**	**$ 795**	**$ 3,723**
Total long-term debt and lease liabilities	**$ 1,699**	**$ 1,787**	**$ 1,524**	**$ 2,750**	**$ 3,116**	**$ 10,071**	**$ 20,947**
Committed capital expenditures	**$ 1,154**	**$ 611**	**$ 356**	**$ 338**	**$ 40**	**$ -**	**$ 2,499**
Total contractual obligations [2]	**$ 2,853**	**$ 2,398**	**$ 1,880**	**$ 3,088**	**$ 3,156**	**$ 10,071**	**$ 23,446**

(1) Assumes the principal balance of the convertible notes, $945 million (US$748 million), remains unconverted and includes estimated interest payable until maturity in 2025. The full principal balance of $1,273 million for the unsecured credit facility in connection with the Government of Canada financing to support customer refunds is included.

(2) 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.

9.9 SHARE INFORMATION

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

	Dec. 31, 2021	Dec. 31, 2020
Issued and outstanding shares		
Class A variable voting shares	82,897,507	111,926,060
Class B voting shares	274,944,350	220,246,228
Total issued and outstanding shares	**357,841,857**	**332,172,288**
Class A variable voting and Class B voting shares potentially issuable		
Convertible notes	48,687,441	48,687,441
Warrants (1)	7,288,282	-
Stock options	4,330,993	5,903,174
Total shares potentially issuable	**60,306,716**	**54,590,615**
Total outstanding and potentially issuable shares	**418,148,573**	**386,762,903**

(1) With the termination of the operating credit facilities as described in section 4 "2021 Highlights", the unvested warrants were automatically cancelled. In addition, Air Canada exercised its call right to purchase and cancel the 7,288,282 vested warrants at fair market value, with settlement completed in January 2022.

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.

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.

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 net proceeds of $60 million.

As further described in section 4 "2021 Highlights" of this MD&A, in April 2021, Air Canada entered into a series of debt and equity financing agreements with the Government of Canada, including the issuance of shares and warrants. Air Canada issued 21,570,942 shares to the Government of Canada for net proceeds of $480 million. With the termination of the operating credit facilities, the unvested warrants were automatically cancelled. In addition, Air Canada exercised its call right to purchase and cancel the vested warrants at fair market value, with settlement completed in January 2022.

10. QUARTERLY FINANCIAL DATA

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

(Canadian dollars in millions, except per share figures)	2020				2021			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Operating revenues	$ 3,722	$ 527	$ 757	$ 827	$ 729	$ 837	$ 2,103	$ 2,731
Operating expenses	4,155	2,082	1,542	1,830	1,778	1,970	2,467	3,234
Operating income (loss)	**(433)**	**(1,555)**	**(785)**	**(1,003)**	**(1,049)**	**(1,133)**	**(364)**	**(503)**
Non-operating income (expense)	**(843)**	**74**	**(36)**	**(272)**	**(338)**	**(165)**	**(315)**	**(114)**
Income (loss) before income taxes	**(1,276)**	**(1,481)**	**(821)**	**(1,275)**	**(1,387)**	**(1,298)**	**(679)**	**(617)**
Income tax recovery (expense)	227	(271)	136	114	83	133	39	124
Net income (loss)	**$ (1,049)**	**$ (1,752)**	**$ (685)**	**$ (1,161)**	**$ (1,304)**	**$ (1,165)**	**$ (640)**	**$ (493)**
Diluted earnings (loss) per share	**$ (4.00)**	**$ (6.44)**	**$ (2.31)**	**$ (3.91)**	**$ (3.90)**	**$ (3.31)**	**$ (1.79)**	**$ (1.38)**
Adjusted pre-tax income (loss) (1)	**$ (520)**	**$ (1,438)**	**$ (1,141)**	**$ (1,326)**	**$ (1,335)**	**$ (1,210)**	**$ (649)**	**$ (574)**

(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 20 "Non-GAAP Financial Measures" of this MD&A.

11. SELECTED ANNUAL INFORMATION

The following table provides selected annual information for Air Canada for the periods indicated.

	Full Year		
(Canadian dollars in millions, except per share figures)	2021	2020	2019 (1)
Operating revenues	$ 6,400	$ 5,833	$ 19,131
Operating expenses	9,449	9,609	17,481
Operating income (loss)	**(3,049)**	**(3,776)**	**1,650**
Income (loss) before income taxes	(3,981)	(4,853)	1,775
Income tax recovery (expense)	379	206	(299)
Net income (loss)	**$ (3,602)**	**$ (4,647)**	**$ 1,476**
Basic earnings (loss) per share	**$ (10.25)**	**$ (16.47)**	**$ 5.51**
Diluted earnings (loss) per share	**$ (10.25)**	**$ (16.47)**	**$ 5.44**
Cash, cash equivalents and short-term investments	**$ 8,802**	**$ 7,501**	**$ 5,889**
Total assets	**$ 30,614**	**$ 28,913**	**$ 27,759**
Total long-term liabilities	**$ 23,681**	**$ 20,059**	**$ 15,584**
Total liabilities	**$ 30,605**	**$ 27,198**	**$ 23,359**

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

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

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.

	Fourth Quarter		Full Year	
(Canadian dollars in millions)	2021	2020	2021	2020
Share forward contracts	$ (2)	$ 6	$ (1)	$ (28)
Embedded derivative on convertible notes	64	(220)	(45)	(214)
Warrants	2	-	27	-
Financial assets	(5)	-	(36)	-
Gain (loss) on financial instruments recorded at fair value	**$ 59**	**$ (214)**	**$ (55)**	**$ (242)**

The recognition of the warrants issued to the Government of Canada are accounted for as a financial liability. Subsequent to initial recognition, Air Canada measured the financial liability at fair value at each reporting date, recognizing changes in fair value in Gain (loss) on financial instruments recorded at fair value. With the termination of the credit facilities, Air Canada exercised its call right on the vested warrants at fair market value, with settlement completed in January 2022.

Risk Management

Under its risk management policy, Air Canada manages its market risk through the use of various financial derivative instruments. Air Canada uses these instruments solely for risk management purposes, not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be 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-based contracts. 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 adjust the strategy in light of market conditions.

There was no fuel hedging activity during 2021 and there were no outstanding fuel derivatives as at December 31, 2021 and December 31, 2020.

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 2021, these net operating cash inflows totalled approximately US$1.6 billion and U.S. denominated operating costs amounted to approximately US$3.2 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$2.0 billion. In 2021, this resulted in a U.S. dollar net cash flow exposure of approximately US$3.6 billion.

In 2021, mainly due to a lower relative risk exposure to international operations, Air Canada updated its target coverage to 60% on a rolling 18-month basis (from 70% on a 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, 2021 amounted to $1,403 million (US$1,110 million) ($1,747 million (US$1,371 million) as at December 31, 2020). 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 18-month net U.S. dollar cash flow exposure. In 2021, a gain of $10 million (loss of $69 million in 2020) 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, 2021, as further described below, approximately 52% of net U.S. cash outflows are hedged for 2022 and 30% for 2023, resulting in derivative coverage of 45% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage result in 60% coverage.

As at December 31, 2021, Air Canada had outstanding foreign currency options and swap agreements, settling in 2022 and 2023, to purchase at maturity $2,423 million (US$1,925 million) of U.S. dollars at a weighted average rate of $1.2742 per US$1.00 (2020 – $5,730 million (US$4,499 million) with settlements in 2021 and 2022 at a weighted average rate of $1.3586 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 €260 million, GBP £56 million, JPY ¥4,577 million, CNH ¥31 million and AUD $36 million) which settle in 2022 and 2023 at weighted average rates of €1.1704, £1.4125, ¥0.0092, ¥0.1471, and AUD $0.7300 per $1.00 U.S. dollar, respectively (as at December 31, 2020 – EUR €464 million, GBP £64 million, JPY ¥4,963 million, CNH ¥415 million and AUD $88 million with settlement in 2021 and 2022 at weighted average rates of €1.1414, £1.3277, ¥0.0094, ¥0.1463, and AUD $0.6942 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, 2021 was $268 million in favour of the counterparties (2020 – $591 million in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. In 2021, a loss of $114 million was recorded in foreign exchange gain (loss) related to these derivatives (2020 – $583 million loss). In 2021, foreign exchange derivative contracts cash settled with a net fair value of $437 million in favour of the counterparties (2020 – $106 million in favour of the counterparties).

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, 2021 is 73% fixed and 27% floating (74% and 26%, respectively as at December 31, 2020).

13. ACCOUNTING POLICIES

Information on Air Canada's accounting policies is provided in Note 2 of Air Canada's audited Consolidated Financial Statements and Notes for 2021.

14. 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 materially from those estimates and judgments under different assumptions or conditions.

Significant estimates and judgments made in the preparation of Air Canada's consolidated financial statements include, but are not limited to, the following areas.

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.

Aeroplan Loyalty Program

Loyalty program accounting requires management to make several estimates including the Equivalent Ticket Value ("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.

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 significant impact on revenue in the year in which the change occurs. Given the impact of the COVID-19 pandemic on travel demand and consumer spending patterns, and considering the launch of the new Aeroplan program in 2020 and the special benefits and accommodations for Aeroplan members in response to the COVID-19 pandemic, the breakage estimate is unchanged in 2021 and is based on a qualitative update of the prior assessment. In addition, the estimate is based on management's long-term expectations of breakage over the life of the program.

As at December 31, 2021, the Aeroplan Points deferred revenue balance was $3,452 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 $35 million on revenue with a corresponding adjustment to Aeroplan deferred revenue.

Breakage

Breakage estimates and resulting amount of breakage revenues recorded are subject to measurement uncertainty and estimates of breakage may vary in future periods. These estimates have been impacted by the COVID-19 pandemic including: (i) flight cancellations, (ii) the conversion of certain tickets into non-expiring travel vouchers for flights that were cancelled with travel dates after February 1, 2020 and purchased before April 13, 2021, and (iii) changes in ticket usage and exchange patterns.

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

Maintenance Provisions

The recording of maintenance provisions related to return conditions on aircraft leases requires management to make estimates of the future costs associated with the maintenance events required under the lease return condition and estimates of the expected future maintenance condition of the aircraft at the time of lease expiry. These estimates take into account current costs of these maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Any difference in the actual maintenance cost incurred 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

The cost and related liabilities of Air Canada'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.

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

Estimates surrounding assumptions of future increases in compensation are based upon the current compensation policies, Air Canada'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, 2021 and 2020.

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	
	2021	**2020**	**2021**	**2020**
Discount rate used to determine:				
Net interest on the net benefit obligation for the year ended December 31	2.82% (1)	3.13%	2.59%	3.13%
Service cost for the year ended December 31	3.10% (1)	3.20%	3.16% (1)	3.20%
Accrued benefit obligation as at December 31	3.20%	2.59%	3.20%	2.59%
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

(1) Weighted average reflecting remeasurements during the year due to special items related to early retirement incentive programs.

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 2021 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	0.25 Percentage Point Increase
Discount rate on obligation assumption		
Pension expense	$ 26	$ (24)
Net financing expense relating to pension benefit liabilities	15	(17)
Total	**$ 41**	**$ (41)**
Increase (decrease) in pension obligation	**$ 775**	**$ (748)**

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, 2021, 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 $519 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 2021 (2020 – 5%). The rate is assumed to decrease gradually to 4.5% by 2023 (2020 – assumed to decrease gradually to 4.5% by 2023). A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by $7 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 $79 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 $56 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 $53 million.

15. OFF-BALANCE SHEET ARRANGEMENTS

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 $1,038 million as at December 31, 2021 (December 31, 2020 – $1,047 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.

16. RELATED PARTY TRANSACTIONS

At December 31, 2021, Air Canada had no transactions with related parties as defined in the CPA Handbook, except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship agreements.

17. 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 on-going 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 2021, 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.

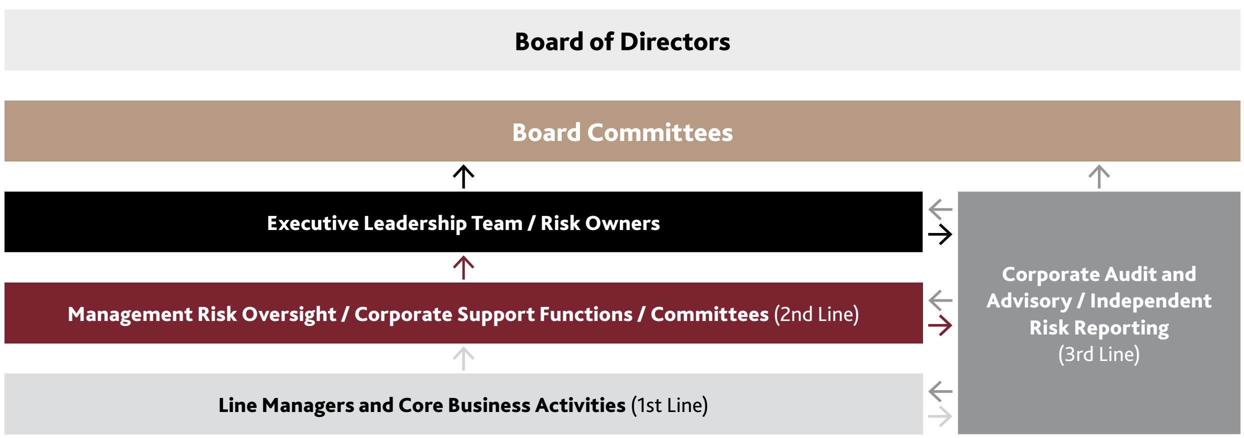
Air Canada's risk management structure is aligned with the "Three Lines Model" approach to risk management:

→ **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.

18. 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, results from operations, 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 business, results from operations and financial position

Air Canada, along with the rest of the global airline industry, continued to face significantly lower traffic in 2021, as compared to the year 2019, 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, including in Canada. While there are signs of improvement, there is limited visibility on future demand trends given changing government restrictions in place around the world and in Canada. Air Canada cannot predict the full impact or the timing for when conditions may recover due to a number of factors, including changing government restrictions, requirements and advisories, concerns about travel and expectations about the need for certain precautions due to the COVID-19 pandemic, the risk of waning vaccine efficacy and the accessibility and timeliness of roll out of booster doses and treatments, the threat of and uncertainty surrounding known and new COVID-19 variants, the availability and acceptance of specific vaccine programs by various governments as well as passengers, the acceptance of certificates evidencing vaccination by various governments, the cost and efficiency of testing requirements, quarantine requirements in various jurisdictions (including in Pacific route jurisdictions which may significantly impact the recovery of those markets). The COVID-19 pandemic is also having and may continue to have significant economic impacts, including on business and consumer spending and behaviour, which may in turn significantly impact demand for travel. The return of business travel to pre-pandemic levels may be challenged by the evolving nature of business models and remote-work practices in light of the impacts of the COVID-19 pandemic, including the growth and continued use of videoconferencing and other remote-work technologies as well as tendencies towards less environmentally impactful business and consumer behaviour. 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 including its variants, availability of rapid, effective testing, vaccinations and treatments for the virus, government actions including health measures and other restrictions, and passenger reaction, the complexities of restarting an industry whose many stakeholders must act in coordination with each other as well as timing and extent of recovery in international and business travel which are important segments of Air Canada's market, none of which can be predicted with 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 a health and safety policy that makes it mandatory for all employees of Air Canada, and anyone accessing Air Canada's facilities, to be fully vaccinated against COVID-19 (subject to certain limited exceptions required by law). Air Canada continues to appeal 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 and requirements. Air Canada's business, results from operations and financial condition will continue to be adversely impacted to the extent that travel restrictions, requirements and advisories remain in place or are expanded upon over time.

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

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, results from operations and financial condition associated with executing Air Canada's strategic operating plans in the longer-term may be adversely affected. In recent years, Air Canada developed strategic operating plans, including revenue-generating initiatives to optimize Air Canada's revenue, such as plans to add capacity, including international expansion, initiatives 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. Since the onset of the COVID-19 pandemic, demand has and is expected to continue to be significantly impacted, which has materially disrupted the timely execution of Air Canada's strategic operating plans, including plans to add capacity. If Air Canada does not successfully develop, execute or adjust its strategic operating plans in the longer-term, or if actual conditions and results continue to vary significantly from the assumptions on which they are based, Air Canada's business, results from operations 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, its business, results from operations and financial position. 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 results from operations, 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 in relation to the COVID-19 pandemic, weakness of the Canadian, U.S. or world economies, inflation, 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 on-going 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 could materially adversely impact Air Canada, its business, results from 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 a variety of factors such as economic and geopolitical conditions and the COVID-19 pandemic. Many factors such as the COVID-19 pandemic, depressed economic conditions, geopolitical instability, and concerns about the environmental impacts of air travel and tendencies towards less environmentally impactful travel, could each have the effect of reducing demand for air travel and could materially adversely impact Air Canada, its business, results from operations and financial condition.

FINANCIAL LEVERAGE

Air Canada has a significant amount of financial leverage

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 may 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 and continue pursue capital expenditures, and other business initiatives or strategic plans. 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.

COMPETITION

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

Air Canada operates within a highly competitive industry 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, as well as cargo transportation markets, including and more recently as a result of potential and changing opportunities created by the COVID-19 pandemic.

Certain carriers against whom Air Canada competes have received (or may continue to seek) airline sector-specific government aid in relation to the COVID-19 pandemic which may strengthen their ability to compete, including against airlines who have not received, or who have not made use of, such government support. Carriers against whom 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 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 benefitting 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.

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. As part of Air Canada's efforts to manage such challenges and to support Air Canada's business strategy, significant liquidity and significant on-going 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 sources. 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 in response to the impact of the COVID-19 pandemic, as well as market conditions and the availability of assets as collateral for loans or other indebtedness, 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 the market price of Air Canada's securities.

DEPENDENCE ON TECHNOLOGY

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

Air Canada relies heavily on technology, including to operate its business, increase its revenues and reduce its costs. Air Canada's technology systems include those relating to its websites, passenger sales and services, cargo services, airport customer services, flight operations, loyalty program, communications, accounting, business and administrative systems. Air Canada's websites and other technology systems must efficiently accommodate a high volume of traffic, and they must securely and effectively process and deliver information critical to Air Canada's business and operations. The technology systems Air Canada relies on also depend on the performance of its many suppliers, whose performance is in turn dependent upon their respective technology ecosystems.

As part of its business operations, Air Canada collects, processes and stores sensitive data, including personal information of its passengers, Aeroplan members, employees and information of its business partners. The effective, reliable and secure operation of the networks and systems on which sensitive information is stored, transmitted, 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. Like other entities operating in today's digital business environment, we are subject to threats to the security of our networks, systems and data. These threats continue to increase as the frequency, intensity and sophistication of attempted attacks and intrusions increase around the world. We have been the target of cybersecurity attacks in the past and expect that we will continue to be in the future.

The increase in remote working arrangements since the onset of the COVID-19 pandemic has also increased the risk of cybersecurity incidents. Air Canada invests in initiatives in an attempt to mitigate these risks, including security initiatives and disaster recovery plans; however, these initiatives may not be successful or adequately address the highly dynamic and continuously evolving threat landscape.

Any technology system failure, degradation, interruption or misuse, security breach, failures in migrating to a new system, or failure to comply with applicable confidentiality, privacy, security or other related obligations, whether at Air Canada or a third party on whom Air Canada or its suppliers rely, could adversely affect Air Canada, including by damaging its reputation and exposing Air Canada to litigation, claims for contract breach, fines, sanctions and/or remediation costs, any of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

FUEL COSTS

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

Fuel costs constitute one of Air Canada's largest operating cost items. Fuel prices fluctuate widely depending on many factors, including international market conditions, geopolitical events, jet fuel supply and refining costs, carbon pricing, as further described below, or other regulations, taxes or levies in response to climate change, 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 pricing. 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.

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, including those relating to the expansion of its cargo business (including operating dedicated cargo freighter aircraft), the renewal of its aircraft fleet (including the on-going re-fleeting of its narrow-body aircraft with Boeing 737 MAX, and Airbus A220 aircraft), participation in the leisure or lower cost market (including through Air Canada Rouge), initiatives to address climate change, expand joint venture arrangements, enhance revenues, reduce costs, improve business processes, implement new technologies, expand flying capacity (including in respect of new aircraft and routes), and corporate culture transformation initiatives seeking to ensure a consistently high-quality customer service experience and others. These initiatives, including activities relating to their development and implementation, may be adversely impacted by a wide range of factors, many of which are beyond Air Canada's control. Such factors include the need to seek legal or regulatory approvals, the performance of third parties (including suppliers), 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 or other significant 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 or 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 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 (including customs and security services and infrastructure to support demand), de-icing services, airport slots, aircraft maintenance services, cargo handling services and facilities, 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 to supply Air Canada with goods and services of desirable quality on terms and pricing and within timeframes acceptable to Air Canada may arise as a result of a wide range of causes, many of which are beyond Air Canada's control, including as a result of the COVID-19 pandemic and related disruptions in supply chains or labour shortages. Any failure or inability of Air Canada to successfully 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.

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

In 2020, Air Canada implemented 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, failures to adequately operate the Aeroplan program, reductions in the prevailing interchange rates in Canada, 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.

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 airports, including its main hubs at Toronto, Montreal and Vancouver. Delays or disruptions in service, including those due to security issues, computer malfunctions or other incidents, weather conditions, labour shortages or conflicts with personnel not employed by Air Canada such as airport workers, baggage handlers, air traffic controllers, security personnel, and others supporting airport related operations, epidemics, pandemics and public health restrictions (including in relation to the COVID-19 pandemic) 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 also 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.

PERSONNEL

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

Air Canada is dependent on its ability to attract and retain a variety of employees, including senior leadership, managers, airline flight, technology and operations personnel and other key employees having the necessary industry experience, qualifications and knowledge, in order to execute its business plan and operate its business. If Air Canada were to experience a shortfall or a substantial turnover in its key employees (including as a result of the more competitive labour market driven by the COVID-19 pandemic or by employees refusing to be vaccinated or maintain their vaccination in accordance with Air Canada's health and safety policies), Air Canada, its business, results from operations and financial condition could be materially adversely affected.

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, airport slots, security, passenger and consumer rights, public health and safety (including in light of the COVID-19 pandemic), accessibility of transportation, flight crew and other labour rules, privacy, data security, marketing and advertising, licensing, competition, pensions, environment (including noise levels and carbon emissions), customs, immigration, 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 disproportionally 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 materially 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 as a result of a wide variety of factors, including changing rules, regulations, administrative requirements, and 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. Airport rules and policies 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 limitations, additions or modifications to such arrangements, rules, 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 three 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. Given the COVID-19 pandemic's impact on the airline industry and its emissions in 2020, ICAO recognized that calculating offsetting requirements based on the average of 2019 and 2020 emissions would lead to a substantial unexpected increase in offsetting requirements. Instead, it was agreed to use 2019 emissions for CORSIA's baseline during the pilot phase (2021-2023). Baseline calculation for subsequent phases of CORSIA are scheduled to be discussed by the ICAO Council in 2022. On the basis of CORSIA, the European Parliament and Council has continued exempting flights between Europe and third countries from the European Union ("EU") greenhouse gas ("GHG") emissions trading system ("ETS"). In 2021, the European Commission published the "Fit for 55 Package" consisting of regulatory proposals aimed at delivering a reduction of net GHG emissions of 55% by 2030 as compared to 1990 levels. The proposal includes an amendment to the EU ETS that would make non-EU airlines flying intra-EU routes subject to both EU ETS and CORSIA. In addition, the European Commission is proposing to cease exempting international flights between Europe and third countries from EU ETS as of 2027 if ICAO decides to exclude 2020 emissions from CORSIA's baseline for CORSIA's mandatory third phase (2027-2035). The European Commission has also proposed a ReFuelEU Aviation regulation with a stated aim of increasing, in the EU, the supply and demand for sustainable aviation fuels ("SAF"), which costs significantly more than conventional jet fuel. If adopted, it would require aviation fuel suppliers to supply all airports in the EU with a minimum volume share of 2% SAF as of 2025, increasing to 63% by 2050. This requirement would impact all aircraft operators uplifting fuel at EU airports.

In Canada, since 2018, the federal pan-Canadian benchmark for carbon pricing has been in effect with pricing based on GHG 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 as 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. In December 2020, the government of Canada published its proposed Clean Fuel Regulations for liquid fossil fuels which would set carbon intensity targets that would decline over time in order to drive the development of sustainable and low carbon fuels in Canada. Conventional jet fuel is not currently on the list of liquid fossil fuels that would be required to achieve a carbon intensity target, however, the production of SAF may be eligible to generate compliance credits that would create a financial incentive for the production of SAF in Canada. The government of Canada is expected to publish the final Clean Fuel Regulations in the spring of 2022. In 2021, the province of British Columbia published its CleanBC Roadmap to 2030, which includes proposed amendments to its Low Carbon Fuel Standard (LCFS) to expand coverage to marine and aviation fuels beginning 2023. The BC LCFS requires fuel suppliers to progressively decrease the average carbon intensity of the fuels they supply to users in the province.

A number of jurisdictions are implementing regulations banning the use and distribution of single-use plastic items. The European Commission adopted a directive in 2019 aimed at reducing the use of certain single-use products which took effect in July 2021 and affects onboard catering activities. In 2020, the government of Canada announced its intention and proposed regulations to achieve zero plastic waste by 2030 through proposed regulations that would ban the use of certain single-use plastics.

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 reducing the environmental impact of its operations through efficiency improvements, waste reduction initiatives, and 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's business requires the secure processing and storage of sensitive information relating to our customers, employees, business partners and others. There has been a heightened legislative and regulatory focus on data privacy and cybersecurity in Canada, the EU and elsewhere. As a result, Air Canada is subject to proliferating and increasingly stringent domestic and foreign laws and regulations regarding privacy and cybersecurity, including in relation to passenger, employee and other data, advance passenger information, access to airline reservation systems, and requirements for notifying regulators and affected individuals in the event of a data security incident, which may not be consistent across 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 regulatory regimes are increasingly challenging, result in additional complexities, operating costs and potential exposure to fines and penalties, and further regulation in this area or non-compliance, 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.

Air Canada's operations are complex and related tax laws and regulations, as well as their interpretation, are continually evolving. A number of countries in which Air Canada operates have implemented, or are considering implementing, and may in the future implement, changes in relevant tax laws, regulations and interpretations. A change in applicable tax laws, treaties or regulations or in their interpretation could materially adversely affect Air Canada, its business, results from operations and financial condition.

Certain jurisdictions where Air Canada operates or conducts business or which may assert jurisdiction over Air Canada have enacted and implemented or 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.

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. Carbon emissions by the aviation industry and their impact on climate change have become a particular focus of regulators (including securities regulators), businesses and consumers.

Climate change may also 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 including by increasing operating costs. Severe weather events at airports or destinations served by Air Canada may impact the viability or cost of flying to such destinations.

In 2021, Air Canada announced its long-term commitment to advancing climate change sustainability throughout its business. The airline set climate targets to realize a goal of net-zero greenhouse gas emissions ("GHG") throughout its global operations by the year 2050 as well as absolute midterm GHG net reduction targets by the year 2030 in its air and ground operations compared to its 2019 baseline. Air Canada also committed to investing in sustainable aviation fuel ("SAF") and carbon reduction and removal initiatives and is supporting efforts to develop SAF to further reduce emissions and its impact on the environment.

Concerns about carbon emissions from flights and efforts to effectively address climate change may result in additional regulation, expanded aviation fuel taxes and levies, reduced demand for air travel and may 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 initiatives which adequately reduce climate or environmental impacts (including those already announced by Air Canada), or which 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 business, results from operations and financial condition.

REGIONAL CARRIER SERVICE

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

Air Canada enhances its network through capacity purchase agreements with regional airlines who operate flights on behalf of Air Canada. In 2021, Air Canada consolidated its regional flying with Jazz. 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 costs, navigation fees, landing fees 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 or the effects of the COVID-19 pandemic, and unexpected interruptions or cessation of Jazz's services, as well as similar circumstances relating to other airlines from whom Air Canada may source regional capacity, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

The decline in demand for air travel services resulting from the COVID-19 pandemic continues to impact demand for regional carrier services and, as a result, Air Canada's utilization of its regional network is reduced and adapting to better support the airline. Air Canada expects the disruption to services resulting from the COVID-19 pandemic to continue to adversely affect its regional carrier. If, as a result of the COVID-19 pandemic or another significant disruption to the Air Canada's regional network, Jazz or other airlines from whom Air Canada may source regional capacity are unable to perform their obligations over an extended period of time, there could be a material adverse effect on Air Canada's business, results from operations 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 including through social media. Adverse publicity, whether justified or not, can rapidly spread through social or digital media. To the extent we are subject to, or 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.

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.

LIMITATIONS DUE TO RESTRICTIVE COVENANTS

Covenants in agreements which Air Canada is or may enter into may affect or limit 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.

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.

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.

PENSION PLANS

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, the success of its 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. While Air Canada has taken significant steps to reduce its pension plan risk, and its plans are in surplus position, there can be no assurance that such risk will not materialize and adversely impact Air Canada's ability to meet its funding obligations, which in turn could have a material adverse effect on Air Canada, its business, results from operations and financial condition. See section 9.7 "Pension Funding Obligations" of this MD&A for additional information.

19. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures and Internal Controls over Financial Reporting

Disclosure controls and procedures within Air Canada have been designed to provide reasonable assurance that all relevant information is identified to its President and Chief Executive Officer ("CEO") and its 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 Air Canada's CEO and CFO, to provide reasonable assurance regarding the reliability of Air Canada's financial reporting and its preparation of financial statements for external purposes in accordance with GAAP.

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

Air Canada's Audit, Finance and Risk Committee reviewed this MD&A and the audited consolidated financial statements, and Air Canada'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 Air Canada's CEO and CFO, evaluated the effectiveness of Air Canada's disclosure controls and procedures (as defined under National Instrument 52-109) and concluded, as at December 31, 2021, 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 Air Canada's CEO and CFO, evaluated the effectiveness of Air Canada'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, 2021, Air Canada's internal controls over financial reporting were effective. This evaluation took into consideration Air Canada'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 Air Canada's internal controls over financial reporting during 2021 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

20. 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:

	Fourth Quarter			Full Year		
(Canadian dollars in millions)	2021	2020	$ Change	2021	2020	$ Change
Operating loss – GAAP	$ (503)	$ (1,003)	$ 500	$ (3,049)	$ (3,776)	$ 727
Add back:						
Depreciation and amortization	399	435	(36)	1,616	1,849	(233)
EBITDA (including special items)	**$ (104)**	**$ (568)**	**$ 464**	**$ (1,433)**	**$ (1,927)**	**$ 494**
Remove:						
Special items	126	(160)	286	(31)	(116)	85
EBITDA (excluding special items)	**$ 22**	**$ (728)**	**$ 750**	**$ (1,464)**	**$ (2,043)**	**$ 579**

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:

	Fourth Quarter			Full Year		
(Canadian dollars in millions, except where indicated)	2021	2020	$ Change	2021	2020	$ Change
Operating expense – GAAP	**$ 3,234**	**$ 1,830**	**$ 1,404**	**$ 9,449**	**$ 9,609**	**$ (160)**
Adjusted for:						
Aircraft fuel	(665)	(187)	(478)	(1,576)	(1,322)	(254)
Ground package costs	(91)	(14)	(77)	(120)	(250)	130
Special items	(126)	160	(286)	31	116	(85)
Operating expense, adjusted for the above-noted items	**$ 2,352**	**$ 1,789**	**$ 563**	**$ 7,784**	**$ 8,153**	**$ (369)**
ASMs (millions)	**14,057**	**6,000**	**134.3%**	**33,384**	**37,703**	**(11.5)%**
Adjusted CASM (cents)	**¢ 16.74**	**¢ 29.82**	**¢ (13.08)**	**¢ 23.32**	**¢ 21.62**	**¢ 1.70**

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, gains or losses on sale and leaseback of assets, gains or losses on disposal of assets, gains or losses on debt settlements and modifications, 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:

	Fourth Quarter			Full Year		
(Canadian dollars in millions)	2021	2020	$ Change	2021	2020	$ Change
Loss before income taxes – GAAP	**$ (617)**	**$ (1,275)**	**$ 658**	**$ (3,981)**	**$ (4,853)**	**$ 872**
Adjusted for:						
Special items	126	(160)	286	(31)	(116)	85
Foreign exchange (gain) loss	(22)	(88)	66	52	293	(241)
Net financing expense relating to employee benefits	(2)	1	(3)	8	27	(19)
(Gain) loss on financial instruments recorded at fair value	(59)	214	(273)	55	242	(187)
Loss on debt settlements and modifications	-	-	-	129	-	129
Gain on sale and leaseback of assets	-	(18)	18	-	(18)	18
Adjusted pre-tax loss	**$ (574)**	**$ (1,326)**	**$ 752**	**$ (3,768)**	**$ (4,425)**	**$ 657**

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. Refer to section 9.5 "Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

Net Cash Flow (Burn)

Air Canada uses net cash flow (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 for aircraft deliveries, and investing activities. Excluded are proceeds from non-aircraft financings, lump sum debt maturities made 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, and refunds for non-refundable fares processed for flights impacted by the COVID-19 pandemic. Such refunds were eligible for draws under the Government of Canada refunds credit facility and, therefore, are generally cash neutral to Air Canada's liquidity position, up to the $1.404 billion limit of the facility. Refer to section 9.5 "Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

21. GLOSSARY

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 20 "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 20 "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.

CASM – Refers to operating expense per ASM.

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 20 "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 is a non-GAAP financial measure. Refer to sections 9.5 "Cash Flow Movements" and 20 "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.

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.

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. Net cash burn is a non-GAAP financial measure. Refer to sections 9.5 "Cash Flow Movements" and 20 "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.

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 Air Canada's financial performance.

Yield – Refers to average passenger revenue per RPM.

2021

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.

Michael Rousseau
President and Chief Executive Officer

Amos Kazzaz
Executive Vice President and Chief Financial Officer

February 17, 2022

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, 2021 and 2020, 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, 2021 and 2020;
- the consolidated statements of operations for the years then ended;
- the consolidated statements of comprehensive 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, 2021. 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
Passenger and cargo revenue recognition *Refer to note 2 - Basis of presentation and summary of significant accounting policies and note 21 - Revenue to the consolidated financial statements.* Airline passenger and cargo revenues are recognized as revenues when the transportation is provided. Total passenger and cargo revenues recognized for the year ended December 31, 2021 amounted to $4,498 million and $1,495 million, respectively. Such transactions rely on multiple Information Technology (IT) systems and controls to process, record, and recognize a high volume of low-value revenue transactions through a combination of IT systems, outsourced service providers, industry clearing houses, global distribution systems and other partner airlines. We considered this 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.	Our approach to addressing the matter included the following procedures, amongst others: → Tested the operating effectiveness of internal controls related to passenger and cargo revenue recognition: • 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 industry clearing houses and other partner airlines as applicable.
Measurement of the total benefit obligation *Refer to note 2 – Basis of presentation and summary of significant accounting policies, note 3 – Critical accounting estimates and judgments, and note 11 – Pensions and other benefit liabilities to the consolidated financial statements.* The Corporation has a net benefit asset of $916 million, which includes a total benefit obligation associated with pension benefits of $22,051 million and other employee future benefit obligations of $1,463 million as at December 31, 2021. 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. Management applied significant judgment in determining the discount rates and mortality assumptions to develop the estimates for the total benefit obligation. We considered this 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 discount rates and mortality assumptions, which resulted in a high degree of auditor judgment and subjectivity in performing procedures related to those assumptions. The audit effort involved the use of professionals with specialized skill and knowledge in the field of actuarial services.	Our approach to addressing the matter included the following procedures, amongst others: → Tested how management developed the estimates for the total benefit obligation: • 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, capabilities and objectivity were evaluated, the work performed was understood and the appropriateness of the work as audit evidence was evaluated. The procedures performed also included evaluation of the methods and assumptions used by management's experts, tests of the data used by management's experts and an evaluation of their findings. • Professionals with specialized skill and knowledge in the field of actuarial services assisted in evaluating the appropriateness of the projected unit credit method and the reasonableness of the discount rates and mortality assumptions. → Tested the disclosures, including the sensitivity analysis, made in the consolidated financial statements with regard to the measurement of the total benefit obligation.

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 LLP[1]

Montréal, Quebec
February 17, 2022

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Canadian dollars in millions)		December 31, 2021	December 31, 2020
ASSETS			
Current			
Cash and cash equivalents		$ 4,248	$ 3,658
Short-term investments		4,554	3,843
Total cash, cash equivalents and short-term investments		8,802	7,501
Restricted cash	Note 2P	167	106
Accounts receivable	Note 21	691	644
Aircraft fuel inventory		122	41
Spare parts and supplies inventory	Note 2Q	102	125
Prepaid expenses and other current assets	Note 21	169	254
Total current assets		10,053	8,671
Investments, deposits and other assets	Note 6	858	833
Property and equipment	Note 7	11,740	12,137
Pension assets	Note 11	3,571	2,840
Deferred income tax	Note 13	39	25
Intangible assets	Note 8	1,080	1,134
Goodwill	Note 9	3,273	3,273
Total assets		**$ 30,614**	**$ 28,913**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		$ 2,603	$ 2,465
Advance ticket sales	Note 21	2,326	2,314
Aeroplan and other deferred revenue	Note 21	983	572
Current portion of long-term debt and lease liabilities	Note 10	1,012	1,788
Total current liabilities		6,924	7,139
Long-term debt and lease liabilities	Note 10	15,511	11,201
Aeroplan and other deferred revenue	Note 21	3,656	4,032
Pension and other benefit liabilities	Note 11	2,588	3,015
Maintenance provisions	Note 12	1,032	1,040
Other long-term liabilities		821	696
Deferred income tax	Note 13	73	75
Total liabilities		**$ 30,605**	**$ 27,198**
SHAREHOLDERS' EQUITY			
Share capital	Notes 5 & 14	2,735	2,150
Contributed surplus		104	98
Accumulated other comprehensive loss		(45)	(39)
Deficit		(2,785)	(494)
Total shareholders' equity		9	1,715
Total liabilities and shareholders' equity		**$ 30,614**	**$ 28,913**

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)		2021	2020
Operating revenues			
Passenger	Note 21	$ 4,498	$ 4,382
Cargo	Note 21	1,495	920
Other	Note 5	407	531
Total revenues		**6,400**	**5,833**
Operating expenses			
Aircraft fuel		1,576	1,322
Wages, salaries and benefits		2,283	2,242
Regional airlines expense, excluding fuel	Note 22	1,042	1,086
Depreciation and amortization	Note 7	1,616	1,849
Aircraft maintenance		656	681
Airport and navigation fees		562	545
Sales and distribution costs		244	252
Ground package costs		120	250
Catering and onboard services		165	171
Communications and information technology		362	372
Special items	Note 4	(31)	(116)
Other		854	955
Total operating expenses		**9,449**	**9,609**
Operating loss		**(3,049)**	**(3,776)**
Non-operating income (expense)			
Foreign exchange loss		(52)	(293)
Interest income		72	132
Interest expense	Note 10	(749)	(656)
Interest capitalized		17	25
Net financing expense relating to employee benefits	Note 11	(8)	(27)
Loss on financial instruments recorded at fair value	Note 18	(55)	(242)
Loss on debt settlements and modifications	Note 10	(129)	-
Gain on sale and leaseback of assets	Note 23	-	18
Other		(28)	(34)
Total non-operating expense		**(932)**	**(1,077)**
Loss before income taxes		**(3,981)**	**(4,853)**
Income tax recovery	Note 13	379	206
Net loss		**$ (3,602)**	**$ (4,647)**
Net loss per share			
Basic and diluted loss per share	Note 16	$ (10.25)	$ (16.47)

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

For the year ended December 31 (Canadian dollars in millions)		2021	2020
Comprehensive income (loss)			
Net loss		$ (3,602)	$ (4,647)
Other comprehensive income (loss), net of tax expense:	Note 13		
Items that will not be reclassified to net income			
Remeasurements on employee benefit liabilities	Note 11	1,311	765
Remeasurements on equity investments		(6)	(64)
Total comprehensive loss		**$ (2,297)**	**$ (3,946)**

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Canadian dollars in millions)	Share capital	Contributed surplus	Accumulated OCI	Retained earnings (Deficit)	Total shareholders' equity
January 1, 2020	$ 785	$ 83	$ 25	$ 3,507	$ 4,400
Net loss	–	–	–	(4,647)	(4,647)
Remeasurements on employee benefit liabilities	–	–	–	765	765
Remeasurements on equity investments	–	–	(64)	–	(64)
Total comprehensive loss	–	–	(64)	(3,882)	(3,946)
Share-based compensation	–	15	–	–	15
Shares issued, net (Note 14)	1,373	–	–	–	1,373
Shares purchased and cancelled under issuer bid	(8)	–	–	(119)	(127)
December 31, 2020	$ 2,150	$ 98	$ (39)	$ (494)	$ 1,715
Net loss	–	–	–	(3,602)	(3,602)
Remeasurements on employee benefit liabilities	–	–	–	1,311	1,311
Remeasurements on equity investments	–	–	(6)	–	(6)
Total comprehensive loss	–	–	(6)	(2,291)	(2,297)
Share-based compensation	–	12	–	–	12
Shares issued, net (Note 14)	585	(6)	–	–	579
December 31, 2021	$ 2,735	$ 104	$ (45)	$ (2,785)	$ 9

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)		2021	2020
Cash flows from (used for)			
Operating			
Net loss		$ (3,602)	$ (4,647)
Adjustments to reconcile to net cash from operations			
Deferred income tax	Note 13	(395)	(164)
Depreciation and amortization	Note 7	1,616	1,849
Foreign exchange (gain) loss	Note 18	(339)	82
Gain on sale and leaseback of assets	Note 23	-	(18)
Employee benefit funding less than expense	Note 11	571	260
Financial instruments recorded at fair value	Note 18	55	242
Loss on debt settlements and modifications	Note 10	129	-
Change in maintenance provisions		(129)	(54)
Changes in non-cash working capital balances		412	(236)
Special items	Note 4	25	315
Other		94	18
Net cash flows used in operating activities		**(1,563)**	**(2,353)**
Financing			
Proceeds from borrowings	Note 10	8,171	6,262
Reduction of long-term debt and lease liabilities	Note 10	(4,510)	(2,719)
Shares purchased for cancellation	Note 14	-	(132)
Issue of shares	Note 14	555	1,369
Financing fees	Note 10	(205)	(78)
Net cash flows from financing activities		**4,011**	**4,702**
Investing			
Investments, short-term and long-term		(862)	(63)
Additions to property, equipment and intangible assets		(1,073)	(1,202)
Proceeds from sale of assets		19	12
Proceeds from sale and leaseback of assets	Notes 7 & 23	11	485
Other		36	35
Net cash flows used in investing activities		**(1,869)**	**(733)**
Effect of exchange rate changes on cash and cash equivalents		**11**	**(48)**
Increase in cash and cash equivalents		**590**	**1,568**
Cash and cash equivalents, beginning of year		3,658	2,090
Cash and cash equivalents, end of year		**$ 4,248**	**$ 3,658**

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 to, as the context may require, Air Canada and/or one or more of its subsidiaries, including its principal wholly-owned operating subsidiaries, Aeroplan Inc. ("Aeroplan"), Touram Limited Partnership doing business under the brand name Air Canada Vacations® ("Air Canada Vacations"), and Air Canada Rouge LP doing business under the brand name Air Canada Rouge® ("Air Canada Rouge").

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

Air Canada is Canada's largest domestic, U.S. transborder and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-U.S. transborder market as well as the international 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" by a third party, namely Jazz Aviation LP ("Jazz"), a wholly-owned subsidiary of Chorus Aviation Inc. ("Chorus"), through a capacity purchase agreement ("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 enroll 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, continued to face a significant decrease in traffic in 2021, as compared to the year 2019, 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 including Canada. While there are signs of improvement, there is limited visibility on travel demand given changing government restrictions in place. 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 including its variants, availability of rapid, effective testing, vaccinations and treatments for the virus, government actions including health measures and other restrictions, and passenger reaction, the complexities of restarting an industry whose many stakeholders must act in coordination with each other as well as timing and extent of recovery in international and business travel which are important segments of Air Canada's market, none of which can be predicted with certainty. Refer to Note 18 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. 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 17, 2022.

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.

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 AGREEMENT

Air Canada has a capacity purchase agreement with Jazz. Under this agreement, 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.

In March 2021, Air Canada announced an agreement to amend its CPA with Jazz. Through the revised agreement, Air Canada transferred the operation of its Embraer E175 fleet to Jazz from Sky Regional and Jazz became the sole operator of flights under the "Air Canada Express" brand. The capacity purchase agreement with Sky Regional was terminated.

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: (i) through travel and (ii) 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 member. 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, on-board 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 generally, with certain gains and losses on curtailments, termination benefits or settlements separately disclosed in special items as described below in Note 2Z. 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 applicable, 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 15. 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 18 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 15.

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. 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 and Financial instruments recorded at fair value 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.

Subsequent to initial recognition, 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. 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, convertible notes, and warrants. The number of shares included with respect to time vesting options and warrants is computed using the treasury stock method unless they are anti-dilutive. Under this method, the proceeds from the exercise of such instruments are assumed to be used to purchase 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 of the convertible notes or the exercise of the warrants, including interest recognized in the period, foreign exchange recognized on the debt principal, the mark to market revaluation of the embedded derivative, and the change in fair value of the warrants liability 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 for tour operators.

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 $33 million related to spare parts and supplies consumed during the year (2020 – $48 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 10 years. Ground and other equipment is depreciated over periods ranging from 3 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, 2021 the Corporation had 78 aircraft under right-of-use leases (107 aircraft as at December 31, 2020), 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 CPAs and recorded such aircraft as right-of-use assets and lease liabilities of Air Canada. As at December 31, 2021, there were 99 aircraft (121 aircraft as at December 31, 2020) 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, Montreal 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, 2021
International route rights and slots	Indefinite	Not applicable
Marketing-based trade names	Indefinite	Not applicable
Technology-based (internally developed)	5 to 15 years	1 to 14 years
Contract-based (Aeroplan commercial agreements)	11.5 years	9 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 and/or a subsidiary'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. Configuration or customization costs in a cloud computing arrangement are also included when they meet the capitalization criteria as an intangible asset.

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 9 years, being the initial term of the primary commercial agreements with program partners at acquisition. 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 President and 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 ADOPTED ON JANUARY 1, 2021

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 Corporation adopted these amendments on January 1, 2021, electing to apply the practical expedient. The adoption of these amendments has no impact on the Corporation's consolidated financial statements on date of adoption or for comparative periods. IBORs have not been replaced as of December 31, 2021, and it is expected that when they are replaced there will be no significant impact to the financial statements.

Configuration or Customization Costs in a Cloud Computing Arrangement (IAS 38 Intangible Assets)

In April 2021, the IASB ratified an agenda decision by the International Financial Reporting Interpretations Committee ("IFRIC") that clarifies the accounting for configuration and customization costs in a cloud computing arrangement. The decision provides guidance on assessing whether costs incurred can be capitalized as intangible assets and timing of expense recognition. The Corporation evaluated the impact of this agenda decision and determined there was no impact on its consolidated financial statements.

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 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 8.

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 11 for additional information.

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.

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 significant impact on revenue in the year in which the change occurs. Given the impact of the COVID-19 pandemic on travel demand and consumer spending patterns, and considering the launch of the new Aeroplan program in 2020 and the special benefits and accommodations for Aeroplan members in response to the COVID-19 pandemic, the breakage estimate is unchanged in 2021 and is based on a qualitative update of the prior assessment. In addition, the estimate is based on management's long-term expectations of breakage over the life of the program.

As at December 31, 2021, the Aeroplan Points deferred revenue balance was $3,452 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 $35 million on revenue with a corresponding adjustment to Aeroplan deferred revenue.

Breakage

Breakage estimates and resulting amount of breakage revenues recorded are subject to measurement uncertainty and estimates of breakage may vary in future periods. These estimates have been impacted by the COVID-19 pandemic including: (i) flight cancellations, (ii) the conversion of certain tickets into non-expiring travel vouchers for flights that were cancelled with travel dates after February 1, 2020 and purchased before April 13, 2021, and (iii) changes in ticket usage and exchange patterns.

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 $15 million to annual depreciation expense. For aircraft with shorter remaining useful lives, the residual values are not expected to change significantly.

Maintenance Provisions

The recording of maintenance provisions related to return conditions on aircraft leases requires management to make estimates of the future costs associated with the maintenance events required under the lease return condition and estimates of the expected future maintenance condition of the aircraft at the time of lease expiry. These estimates take into account current costs of these maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Any difference in the actual maintenance cost incurred 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 12 (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)	2021	2020
Impairments	$ 38	$ 315
Canada Emergency Wage Subsidy, net	(451)	(554)
Workforce reduction provisions	161	127
Benefit plan amendments	82	-
Benefit plan settlement	125	-
Other	14	(4)
Special Items	**$ (31)**	**$ (116)**

Impairments

In response to COVID-19 related capacity reductions, Air Canada accelerated the retirement of certain older aircraft from its fleet. These aircraft were 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 was determined as the 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 in 2020 reflecting the write-down of right-of-use assets for leased aircraft and the reduction of carrying values of owned aircraft to expected disposal proceeds. 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 were cancelled.

In 2021, an additional impairment charge of $46 million, net of impairment reversals of $8 million, was recorded as a result of reductions to the estimates of the expected disposal proceeds on owned aircraft and flight equipment, partially offset by lower-than-expected costs to meet contractual return conditions on lease returns. Further changes to these estimates may result in additional adjustments to the impairment charge in future periods.

Canada Emergency Wage Subsidy

In 2020, in response to challenges posed by the COVID-19 pandemic, 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. Air Canada continued its participation in the CEWS program until the program ended in October 2021. In October 2021, the Government of Canada announced two new programs designed to support businesses that are still facing challenges due to the COVID-19 pandemic: the Hardest Hit Business Recovery Program ("HHBRP") and the Tourism and Hospitality Recovery Program ("THRP").

The Corporation has recorded a total gross subsidy under the CEWS and HHBRP programs of $457 million for the year 2021; $451 million net of the cost for inactive employees who were eligible for the wage subsidy under the program (gross subsidy of $656 million for 2020; $554 million net of costs). Cash payments of $518 million were received in the year 2021 ($586 million in 2020). There are no unfulfilled conditions or other contingencies attaching to the CEWS program.

Workforce reduction provisions

As a result of the COVID-19 pandemic and to mitigate the number of employees who remain on layoff status, Air Canada offered early retirement incentive programs to its unionized workforce. These programs provided for pension improvements which are payable from the defined benefit pension plan for eligible employees, and as such do not impact the Corporation's liquidity position. Termination benefits and a curtailment loss of $161 million were recorded for the year ended December 31, 2021 as a special item.

As a result of the impact of the COVID-19 pandemic, Air Canada undertook a workforce reduction in the second quarter of 2020 and recorded a workforce reduction provision of $78 million in the year ended December 31, 2020. Payments of $40 million were made from such provision in the year 2021 ($32 million in 2020), resulting in a remaining obligation of $4 million at December 31, 2021. The provision includes the estimated notice of termination and severance costs under the Corporation's collective agreements and the Canada Labour Code, which amount is subject to adjustment depending on the duration and number of employees who remain on layoff status. In addition to this provision, termination benefits and curtailments of $49 million related to the pension and benefit obligations were recorded in 2020.

Benefit Plan Amendments

In 2021, Air Canada received the decision of the arbitrator determining the cap on pensionable earnings recognized in the defined benefit pension plan for IAMAW-represented technical employees. The decision resulted in an increase to the maximum pensionable earnings, effective from 2021, with retroactivity to 2019 for employees that so elect. The Corporation recorded a one-time pension past service cost of $82 million as a special item in 2021 as a result of this plan amendment. This amendment does not impact the Corporation's liquidity position as it is funded out of the surplus in the domestic registered pension plans.

Benefit Plan Settlement

A settlement loss of $125 million was recognized and represents the difference between the premium paid on the purchase of an annuity to insure the liabilities and the related defined pension benefit obligation for the UK defined benefit pension plan.

Other

Termination of Transat Arrangement Agreement

On April 2, 2021, Air Canada announced that the arrangement agreement for the proposed acquisition by Air Canada of Transat A.T. Inc. ("Transat") was terminated, with Air Canada paying Transat a termination fee of $12.5 million, and with Transat no longer under any obligation to pay Air Canada any fee should Transat be involved in another acquisition or similar transaction in the future.

Amendments to Capacity Purchase Agreements

In March 2021, Air Canada announced an agreement to amend the CPA with Jazz, under which Jazz currently operates regional flights under the Air Canada Express brand. Through the revised agreement, Air Canada transferred the operation of its Embraer E175 fleet to Jazz from Sky Regional and Jazz became the sole operator of flights under the Air Canada Express brand. The capacity purchase agreement with Sky Regional was terminated. The Corporation recorded a net expense of $2 million, related to the CPA revisions and consolidation of regional flying. The expense included a net provision of $12 million in estimated termination costs to be paid, largely offset by retirement of lease liabilities and inventory costs associated with exiting aircraft.

5. DEBT AND EQUITY FINANCING AGREEMENTS WITH THE GOVERNMENT OF CANADA

On April 12, 2021, Air Canada entered into a series of debt and equity financing agreements with the Government of Canada (acting through Canada Enterprise Emergency Funding Corporation) which allowed Air Canada to access up to $5.879 billion in liquidity through the Large Employer Emergency Financing Facility (LEEFF) program.

In November 2021, Air Canada withdrew from Government of Canada financial support, having only accessed the facility solely dedicated to refunding customers' non-refundable tickets. None of the $3.975 billion available under the secured revolving facility and unsecured non-revolving credit facilities was ever drawn and, under the terms of its agreement with the government, Air Canada was entitled to terminate these facilities at any time without penalty, which it did in November 2021.

The financial package provided for fully repayable loans that Air Canada would only draw down if and as required, as well as an equity investment, and was comprised of:

- Up to $1.404 billion in the form of an unsecured credit facility tranche to support customer refunds of non-refundable tickets. The facility has a seven-year term maturing April 2028 and carries an annual interest rate of 1.211%. Draws under this facility were available and made monthly based on the amount of refunds processed and paid until November 30, 2021. As at December 31, 2021, $1.273 billion has been drawn under this facility and paid to customers as refunds of non-refundable tickets. No further amounts can be drawn under this facility.
- Gross proceeds of $500 million for 21,570,942 Air Canada shares at a price of $23.17933 per share (net proceeds of $480 million), which the government continues to hold.
- $1.5 billion in the form of a secured revolving credit facility maturing in April 2026 and bearing interest at the Canadian Dollar Offered Rate (CDOR) plus 1.5%. The facility was secured on a first lien basis by the assets of Aeroplan, Air Canada's shares in Aeroplan as well as certain assets of Air Canada. No amount was drawn by Air Canada under this facility, which as stated above has since been terminated by Air Canada.
- $2.475 billion in the form of three unsecured non-revolving credit facilities of $825 million each, with: the first, five-year tranche maturing in April 2026, at CDOR plus 1.75% per annum; the second, six-year tranche maturing in April 2027, at 6.5% per annum (increasing to 7.5% after 5 years); and the third, seven-year tranche maturing in April 2028, at 8.5% per annum (increasing to 9.5% after 5 years). No amount was drawn under these facilities, which as stated above have since been terminated by Air Canada.
- Air Canada issued 14,576,564 warrants initially exercisable for the purchase of an equal number of Air Canada shares, subject to customary adjustments, at an exercise price of $27.2698 per share during a 10-year term. Half of the warrants vested upon the implementation of the above secured and unsecured credit facilities, while the remaining half would vest on a proportional basis to the amounts that Air Canada may have drawn under the above unsecured credit facilities. The warrants were subject to a one-time call right in favour of Air Canada, pursuant to which Air Canada on certain conditions could repurchase for cancellation all outstanding warrants at a price per warrant equal to their fair market value. The vested warrants were exercisable by the holder either by paying the exercise price or by using a cashless exercise option. With the termination of the operating credit facilities, the unvested warrants were cancelled. In addition, Air Canada exercised its call right on the vested warrants repurchasing and cancelling the warrants in January 2022 at a price of $82 million which is equivalent to the carrying value of the vested warrants as at December 31, 2021.

As part of the financial package, Air Canada had agreed to a number of commitments related to customer refunds, service to certain regional communities, restrictions on the use of the funds provided, employment levels and capital expenditures. These commitments included:

- Offering eligible customers who purchased non-refundable fares but did not travel due to COVID-19 since February 2020 up to April 13, 2021 the option of a refund to the original form of payment. In support of its travel agency partners, Air Canada decided that it would not retract agency sales commissions on refunded fares.

- The resumption of service or access to Air Canada's network for most regional communities where service had been suspended because of COVID-19's impact on travel, through direct services or new interline agreements with third party regional carriers.
- Restricting dividends or payments of distributions on Air Canada's equity interests, or any purchases, redemptions or other acquisitions or retirements for value of any equity interests or convertible indebtedness of Air Canada while any indebtedness was outstanding under any of the secured and unsecured credit facilities (excluding the unsecured credit facility tranche to support customer refunds of non-refundable tickets) and for a period of 12 months following the termination of such facilities.
- Obligations to maintain employment at levels which are no lower than those at April 1, 2021.
- The completion of the airline's acquisition of 33 Airbus A220 aircraft, manufactured at Airbus' Mirabel, Quebec facility. Air Canada also agreed to complete its existing firm order of 40 Boeing 737 MAX aircraft. Completion of these orders remains subject to the terms and conditions of the applicable purchase agreements.

In connection with the Government's equity investment, Air Canada agreed to provide the Government with customary registration rights. The Air Canada shares issued to the Government are subject to certain transfer restrictions, namely (i) restrictions on any transfer, other than to affiliates of the Government, for a period commencing on the date of issuance and ending on the date that is one year from the date of issuance, and (ii) restrictions on transfers to competitors and securityholders of Air Canada that beneficially own or control 5% or more of Air Canada's issued and outstanding shares, including any convertible securities, on an as converted basis, subject to customary exceptions.

Accounting impact

The debt and equity instruments issued are measured at fair value at inception. Any difference between fair value and proceeds received is recognized for accounting purposes as a government grant. The deferred grant income recorded at the inception of the agreement, and taking into account the amounts drawn under the ticket refund facility up to December 31, 2021, was $138 million. This deferred grant income reflects the aggregate net fair value adjustments of the ticket refund facility, the shares issued, and the vested warrants and will be amortized into Other revenues on a straight line basis over three years. The vested warrants have since been repurchased and cancelled with settlement completed in January 2022. The amortization period is based on the Corporation's approximation of the expected timing of the costs for which the grant is intended to compensate. During 2021, grant income of $26 million was recognized in Other revenues.

The Government's ability at the time to choose whether to exercise the warrants by paying the strike price or to use a cashless exercise option gave rise to a financial liability. Fair value of the warrants was determined using the Black-Scholes option valuation model and recorded in Other long-term liabilities at inception. Subsequent to initial recognition, the Corporation measured the financial liability at fair value at each reporting date, recognizing changes in fair value in Gain (loss) on financial instruments. Refer to Note 18.

6. INVESTMENTS, DEPOSITS AND OTHER ASSETS

(Canadian dollars in millions)		2021	2020
Long-term investments		$ 601	$ 512
Investment in Chorus [a]		52	58
Restricted cash	Note 2P	75	87
Aircraft related deposit		57	79
Prepayments under maintenance agreements		52	72
Share forward contracts	Note 18	7	14
Other deposits		14	11
		$ 858	$ 833

(a) The investment represents Air Canada's holding of 15,561,600 class B voting shares in the capital of Chorus.

7. PROPERTY AND EQUIPMENT

(Canadian dollars in millions)	December 31, 2021 Cost	Accumulated depreciation	Net book value	December 31, 2020 Cost	Accumulated depreciation	Net book value
Owned tangible assets						
Aircraft and flight equipment	$ 13,704	$ 5,610	$ 8,094	$ 13,251	$ 5,419	$ 7,832
Buildings and leasehold improvements	1,050	599	451	1,033	553	480
Ground and other equipment	656	472	184	665	439	226
Purchase deposits and assets under development	549	-	549	754	-	754
Owned tangible assets	**$ 15,959**	**$ 6,681**	**$ 9,278**	**$ 15,703**	**$ 6,411**	**$ 9,292**
Air Canada aircraft	$ 4,083	$ 2,599	$ 1,484	$ 5,019	$ 3,340	$ 1,679
Regional aircraft	1,924	1,254	670	2,002	1,169	833
Land and buildings	508	200	308	510	177	333
Right-of-use assets	**$ 6,515**	**$ 4,053**	**$ 2,462**	**$ 7,531**	**$ 4,686**	**$ 2,845**
Property and equipment	**$ 22,474**	**$ 10,734**	**$ 11,740**	**$ 23,234**	**$ 11,097**	**$ 12,137**

Additions to owned aircraft in 2021 include 12 new Airbus A220 and seven new Boeing 737 MAX-8 aircraft.

As described in Note 4, an impairment charge of $46 million was recorded in 2021 ($283 million 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 (2020 – 15 aircraft and 15 spare engines) which are leased to Jazz with a cost of $400 million (2020 – $389 million) less accumulated depreciation of $198 million (2020 – $172 million) for a net book value of $202 million (2020 – $217 million). Depreciation expense for 2021 for these aircraft and flight equipment amounted to $26 million (2020 – $24 million).

As further described in Note 23, during 2021, the Corporation sold and leased back two Boeing 767 aircraft and, 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 10.

(Canadian dollars in millions)	January 1, 2021	Additions	Reclassific-ations	Disposals	Depreciation and impairment	December 31, 2021
Owned tangible assets						
Aircraft and flight equipment	$ 7,832	$ 767	$ 411	$ (48)	$ (868)	$ 8,094
Buildings and leasehold improvements	480	-	22	-	(51)	451
Ground and other equipment	226	7	-	-	(49)	184
Purchase deposits and assets under development	754	228	(433)	-	-	549
Owned tangible assets	**$ 9,292**	**$ 1,002**	**$ -**	**$ (48)**	**$ (968)**	**$ 9,278**
Right-of-use assets						
Air Canada aircraft	$ 1,679	$ 190	$ -	$ (10)	$ (375)	$ 1,484
Regional aircraft	833	36	-	(24)	(175)	670
Land and buildings	333	1	-	-	(26)	308
Right-of-use assets	**$ 2,845**	**$ 227**	**$ -**	**$ (34)**	**$ (576)**	**$ 2,462**
Property and equipment	**$ 12,137**	**$ 1,229**	**$ -**	**$ (82)**	**$ (1,544)**	**$ 11,740**

(Canadian dollars in millions)	January 1, 2020	Additions	Reclassific-ations	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**

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

(Canadian dollars in millions)	2021	2020
Aircraft and flight equipment	$ 822	$ 930
Buildings and leasehold improvements	51	54
Ground and other equipment	49	47
Owned tangible assets	**922**	**1,031**
Air Canada aircraft	375	496
Regional aircraft	175	176
Land and buildings	26	30
Right-of-use assets	**576**	**702**
Property and equipment	**1,498**	**1,733**
Spare part and supplies inventory	14	14
Intangible assets	104	102
Depreciation and amortization	**$ 1,616**	**$ 1,849**

8. 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, 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
Year ended December 31, 2021					
At January 1, 2021	$ 97	$ 187	$ 178	$ 672	$ 1,134
Additions	-	-	-	50	50
Amortization	-	(20)	-	(84)	(104)
At December 31, 2021	$ 97	$ 167	$ 178	$ 638	$ 1,080
At December 31, 2021					
Cost	$ 97	$ 225	$ 178	$ 1,021	$ 1,521
Accumulated amortization	-	(58)	-	(383)	(441)
	$ 97	**$ 167**	**$ 178**	**$ 638**	**$ 1,080**

In 2021, technology-based assets with cost and accumulated amortization of $80 million (2020 – $110 million) were retired.

International route rights and slots are pledged as security for senior secured notes as described in Note 10.

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.

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 an impact greater than currently anticipated.

The recoverable amount of both cash-generating units exceeded their respective carrying values by an aggregate amount of approximately $13 billion. Management considered reasonably possible changes in key assumptions using multiple modelling scenarios and sensitivity analysis and determined such changes would not cause the recoverable amount of each CGU to be less than the carrying value. In addition, management has updated the impairment review to take into account the most recent projections from the annual business plan.

Key assumptions used for the fair value less cost to dispose calculations in fiscal 2021 were as follows:

Key Assumption	2021	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$92 – US$97	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. In 2021, an additional impairment charge of $46 million, net of impairment reversals of $8 million, was recorded as a result of reductions to the estimates of the expected disposal proceeds on owned aircraft and flight equipment, partially offset by lower-than-expected costs to meet contractual return conditions on lease returns.

9. 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, 2021 and 2020. Reasonably possible changes in key assumptions would not cause the recoverable amount of goodwill to fall below the carrying value.

10. LONG-TERM DEBT AND LEASE LIABILITIES

	Final Maturity	Weighted Average Interest Rate (%)	December 31, 2021 (Canadian dollars in millions)	December 31, 2020 (Canadian dollars in millions)
Aircraft financing [a]				
Fixed rate U.S. dollar financing	2023 – 2030	4.88	$ 3,471	$ 3,791
Floating rate U.S. dollar financing	2026 – 2027	2.09	427	483
Fixed rate CDN dollar financing	2026 – 2030	3.78	206	232
Floating rate CDN dollar financing	2026 – 2033	2.27	1,169	1,007
Fixed rate Japanese yen financing	2027	1.84	129	145
Floating rate Japanese yen financing	2027	3.00	2	5
Convertible notes [b]	2025	4.00	723	667
Credit facility – CDN dollar [c]	2028	1.21	1,018	-
Senior secured notes – CDN dollar [d]	2029	4.63	2,000	-
Senior secured notes – U.S. dollar [d]	2026	3.88	1,516	-
Senior secured credit facility – U.S. dollar [d]	2028	4.25	2,907	-
Senior and Second Lien secured notes – CDN dollar [d]			-	1,040
Senior unsecured notes – U.S. dollar [e]			-	509
Other secured financing – U.S. dollar [d],[f]			-	1,483
Other secured financing – CDN dollar [f]			-	199
Long-term debt		**3.91**	**13,568**	**9,561**
Lease liabilities				
Air Canada aircraft	2022 – 2031	4.88	1,792	1,996
Regional aircraft	2023 – 2035	6.08	981	1,171
Land and buildings	2022 – 2078	5.26	406	429
Lease liabilities [g]		**5.30**	**3,179**	**3,596**
Total debt and lease liabilities		**4.18**	**16,747**	**13,157**
Unamortized debt issuance costs and discounts			(224)	(168)
Current portion – Long-term debt			(511)	(1,244)
Current portion – Air Canada aircraft			(310)	(340)
Current portion – Regional aircraft			(166)	(179)
Current portion – Land and buildings			(25)	(25)
Long-term debt and lease liabilities			**$ 15,511**	**$ 11,201**

(a) Aircraft financing (US$3,085 million, CDN $1,375 million and JPY ¥11,884 million) (2020 – US$3,359 million, CDN $1,239 million and JPY ¥12,159 million) is secured primarily by specific aircraft with a carrying value of $6,025 million (2020 – $6,037 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$114 million and CDN $192 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 was comprised of Class A Certificates and Class B Certificates. The Class A Certificates totalling 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 totalling US$100 million ($134 million) have an interest rate of 9.00% per annum and a final expected distribution date of October 1, 2025.

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 were financed under this facility, the bridge financing of $788 million put in place in April 2020 was repaid concurrently. Air Canada took delivery of the final three Airbus A220 aircraft under this facility in the first quarter of 2021 and as at March 31, 2021, all 18 Airbus A220 aircraft were financed under this facility and the corresponding bridge financing was repaid. The security facility has a term of 12 years from delivery of each aircraft on a floating interest basis based on CDOR plus a margin of 1.88%.

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.

In March 2021, Air Canada concluded a committed secured facility totalling US$475 million to finance the purchase of the next 15 Airbus A220 aircraft scheduled for delivery in 2021 and 2022, the first of which arrived in March 2021. As at December 31, 2021, Air Canada has drawn $292 million under this facility. Financing remains available for an additional seven A220 aircraft under this facility. Loans for each aircraft have a final maturity date 10 years after delivery of the applicable aircraft. Interest rates, which can be floating or fixed, are set on draw down of each loan. Floating interest rates are generally CDOR plus a margin of 2.28%. Fixed interest rates are based on the rate to swap floating rate debt of CDOR plus a margin of 2.28% to a fixed rate debt plus a margin of 2.49%.

Aircraft-related financings include the financing facilities related to the 2013-1 EETC offering. In May 2021, US$84 million ($101 million) related to the series 2013-1B equipment notes were refinanced, at their original maturity, with an interest rate of 4.75% per annum and a final expected distribution date of May 2025.

(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 4.0% 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, 2021, the fair value was $579 million and the Corporation recorded an unrealized loss of $45 million for the year ended December 31, 2021 ($214 million unrealized loss for the year 2020). Refer to Note 18.

(c) In connection with the Government of Canada financing agreements described in Note 5, as at December 31, 2021, Air Canada accessed $1.273 billion of the $1.404 billion unsecured credit facility tranche to support customer refunds of non-refundable tickets. The facility has a seven-year term maturing April 2028 with a stated annual interest rate of 1.211%, with the balance due on maturity. The book value of the debt, $1,018 million at December 31, 2021, was recognized at inception using an effective interest rate of 4.90%. The difference accretes the carrying value of the underlying debt upwards to its face value using the effective interest rate method. Draws under this facility were made monthly based on the amount of refunds processed and paid during the period until November 30, 2021. No further amounts can be drawn under this facility.

(d) In August 2021, Air Canada completed a private offering of $2.0 billion of 4.625% senior secured notes due 2029 (the "Canadian Dollar Notes") and US$1.2 billion of 3.875% senior secured notes due 2026 (the "US Dollar Notes", and together with the Canadian Dollar Notes, the "Notes"). Air Canada also closed a US$2.9 billion new senior secured credit facility, comprised of a US$2.3 billion new term loan B maturing in 2028 (the "Term Loan"), together with a new undrawn US$600 million revolving credit facility maturing in 2025 (the "Revolving Facility" and, together with the Term Loan, the "Senior Secured Credit Facilities"). Air Canada received aggregate gross proceeds of approximately $7.1 billion from the sale of the Notes and from the Senior Secured Credit Facilities. Air Canada applied the proceeds from the sale of the Canadian Dollar Notes, together with the proceeds from the Term Loan, to (i) satisfy and discharge all of the Corporation's outstanding $200 million aggregate principal amount of its 4.75% senior secured notes due 2023 and redeem all of the Corporation's outstanding $840 million aggregate principal amount of its 9% second lien notes due 2024, (ii) repay all of the Corporation's US$1,178 million of indebtedness outstanding under the loan agreement dated as of October 6, 2016, which was comprised of a syndicated secured US dollar term loan B facility and a syndicated secured US dollar revolving credit facility and (iii) satisfy applicable transaction costs, fees and expenses. The Corporation recorded a $110 million loss on debt settlements related to these repayments. The Revolving Facility was undrawn as of December 31, 2021.

The Notes and Air Canada's obligations under the Senior Secured Credit Facilities are senior secured obligations of the Corporation, secured on a first-lien basis, subject to certain permitted liens, by certain collateral comprised of substantially all of the Corporation's international routes, airport slots and gate leaseholds.

(e) In 2021, Air Canada's US$400 million 7.75% senior unsecured notes due 2021, with interest payable semi-annually were repaid.

(f) Other secured financings consist of the Term Loan and the Revolving Facility as described in d) above.

The proceeds from the offering in August 2021 described in (d) above were used to repay the US$600 million term loan, maturing in 2023 and a US$600 million revolving credit facility expiring in 2024 that were included in Other secured financings at December 31, 2020. Separate from the offering, in August 2021, the $200 million revolving credit facility was repaid and was extended to December 2024 and remains undrawn as of December 31, 2021.

In February 2021, the Corporation had extended its US$600 million revolving credit facility by one year to April 2024 and increased the interest rate by 75 basis points, to an interest rate margin of 250 basis points over LIBOR. The Corporation had also extended its $200 million revolving credit facility by one year to December 2023 and increased the interest rate by 25 basis points, to an interest rate margin of 275 basis points over banker's acceptance rates. The Corporation recorded a $19 million loss on debt modification related to this transaction.

(g) Lease liabilities, related to facilities and aircraft, total $3,179 million ($361 million, US$2,195 million and GBP £12 million) (2020 – $3,596 million ($377 million, US$2,503 million and GBP £15 million)). The carrying value of aircraft and facilities under lease liabilities amounted to $2,154 million and $308 million respectively (2020 – $2,512 million and $333 million).

Cash interest paid on Long-term debt and lease liabilities in 2021 by the Corporation was $531 million (2020 – $528 million).

The Corporation has recorded Interest expense as follows:

(Canadian dollars in millions)	2021	2020
Interest on debt	$ 576	$ 449
Interest on lease liabilities		
Air Canada aircraft	90	110
Regional aircraft	62	76
Land and buildings	21	21
Interest expense	**$ 749**	**$ 656**

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

(Canadian dollars in millions)	2021	2020
Short-term leases	$ 10	$ 62
Variable lease payments not included in lease liabilities	27	32
Expense related to leases (included in Other operating expenses)	**$ 37**	**$ 94**

Total cash outflows for payments on lease liabilities was $731 million for the year ended December 31, 2021 (2020 – $870 million), of which $558 million was for principal repayments (2020 – $663 million).

Maturity Analysis

Principal and interest repayment requirements as at December 31, 2021 on Long-term debt and lease liabilities are as follows. U.S. dollar amounts are converted using the December 31, 2021 closing rate of CDN$1.2637.

(Canadian dollars in millions)	2022	2023	2024	2025	2026	Thereafter	Total
Principal							
Long-term debt obligations (1)	$ 511	$ 660	$ 482	$ 1,780	$ 2,369	$ 8,243	$ 14,045
Air Canada aircraft	310	301	288	274	225	394	1,792
Regional aircraft	166	163	136	122	43	351	981
Land and buildings	25	23	23	24	23	288	406
Lease liabilities	501	487	447	420	291	1,033	3,179
Total long-term debt and lease liabilities	**$ 1,012**	**$ 1,147**	**$ 929**	**$ 2,200**	**$ 2,660**	**$ 9,276**	**$ 17,224**

(Canadian dollars in millions)	2022	2023	2024	2025	2026	Thereafter	Total
Interest							
Long-term debt obligations (1)	$ 540	$ 517	$ 495	$ 471	$ 393	$ 668	$ 3,084
Air Canada aircraft	76	62	48	35	24	23	268
Regional aircraft	51	41	32	24	19	84	251
Land and buildings	20	20	20	20	20	20	120
Lease liabilities	147	123	100	79	63	127	639
Total long-term debt and lease liabilities	**$ 687**	**$ 640**	**$ 595**	**$ 550**	**$ 456**	**$ 795**	**$ 3,723**

(1) Assumes the principal balance of the convertible notes, $945 million (US$748 million), remains unconverted and includes estimated interest payable until maturity in 2025. The full principal balance of $1,273 million for the unsecured credit facility described in (c) above is included.

Principal repayments in the table above exclude discounts and transaction costs of $224 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.

(Canadian dollars in millions)	January 1, 2021	Cash Flows			Non-Cash Changes			
		Borrowings	Repayments	Financing fees	Foreign exchange adjustments	Amortization of financing fees and other adjustments	New lease liabilities (new and modified contracts)	December 31, 2021
Long-term debt	$ 9,561	$ 8,171	$ (3,952)	$ -	$ (40)	$ (172)	$ -	$ 13,568
Air Canada aircraft	1,996	-	(366)	-	(16)	-	178	1,792
Regional aircraft	1,171	-	(167)	-	(9)	-	(14)	981
Land and buildings	429	-	(25)	-	(1)	-	3	406
Lease liabilities	3,596	-	(558)	-	(26)	-	167	3,179
Unamortized debt issuance costs and other adjustments	(168)	-	-	(205)	-	149	-	(224)
Total liabilities from financing activities	**$ 12,989**	**$ 8,171**	**$ (4,510)**	**$ (205)**	**$ (66)**	**$ (23)**	**$ 167**	**$ 16,523**

(Canadian dollars in millions)	January 1, 2020	Cash Flows			Non-Cash Changes			
		Borrowings	Repayments	Financing fees	Foreign exchange adjustments	Amortization of financing fees and other adjustments	New lease liabilities (new and modified contracts)	December 31, 2020
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 and other adjustments	(90)	(38)	-	(78)	-	38	-	(168)
Total liabilities from financing activities	**$ 9,242**	**$ 6,262**	**$ (2,719)**	**$ (78)**	**$ (346)**	**$ (238)**	**$ 866**	**$ 12,989**

11. 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 defined benefit 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, 2021, the aggregate solvency surplus in the Domestic Registered Plans was $2.9 billion. The next required valuation to be made as at January 1, 2022 will be completed in the first half of 2022. With the Corporation's Domestic Registered Plans in a solvency surplus position as at January 1, 2021, past service contributions were not required in 2021. 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 2021 amounted to $79 million ($91 million employer contribution net of $12 million used to fund employer contribution in defined contribution components of the same plans). Pension funding obligations for 2022 are expected to be $90 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:

	Pension Benefits		Other Employee Future Benefits		Total	
(Canadian dollars in millions)	2021	2020	2021	2020	2021	2020
Non-current assets						
Pension assets	$ 3,571	$ 2,840	$ -	$ -	$ 3,571	$ 2,840
Current liabilities						
Accounts payable and accrued liabilities	-	-	67	62	67	62
Non-current liabilities						
Pension and other benefit liabilities	1,192	1,515	1,396	1,500	2,588	3,015
Net benefit obligation (asset)	**$ (2,379)**	**$ (1,325)**	**$ 1,463**	**$ 1,562**	**$ (916)**	**$ 237**

The current portion of the net benefit obligation represents an estimate of other employee future benefits claims to be paid during 2022.

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	
	2021	2020	2021	2020
Change in benefit obligation				
Benefit obligation at beginning of year	$ 23,720	$ 21,931	$ 1,562	$ 1,518
Current service cost	262	275	53	45
Past service cost (note 4)	240	46	4	(3)
Plan settlements (note 4)	125	-	-	-
Interest cost	641	664	42	45
Employees' contributions	60	66	-	-
Benefits paid	(1,071)	(936)	(42)	(42)
Settlement payments	(125)	-	-	-
Remeasurements:				
Experience loss (gain)	88	(48)	(19)	(56)
Loss (gain) from change in demographic assumptions	(1)	(51)	(3)	3
Loss (gain) from change in financial assumptions	(1,875)	1,774	(133)	56
Foreign exchange loss (gain)	(13)	(1)	(1)	(4)
Total benefit obligation	22,051	23,720	1,463	1,562
Change in plan assets				
Fair value of plan assets at beginning of year	25,887	23,424	-	-
Return on plan assets, excluding amounts included in Net financing expense	1,149	2,537	-	-
Interest income	710	711	-	-
Employer contributions	79	90	42	42
Employees' contributions	60	66	-	-
Benefits paid	(1,071)	(936)	(42)	(42)
Settlements (note 4)	(125)	-	-	-
Administrative expenses paid from plan assets	(9)	(9)	-	-
Foreign exchange gain (loss)	(14)	4	-	-
Total plan assets	26,666	25,887	-	-
(Surplus) deficit at end of year	**(4,615)**	**(2,167)**	**1,463**	**1,562**
Asset ceiling / additional minimum funding liability	2,236	842	-	-
Net benefit obligation (asset)	**$ (2,379)**	**$ (1,325)**	**$ 1,463**	**$ 1,562**

The actual return on plan assets was $1,859 million (2020 – $3,248 million).

Plan assets include an annuity contract for the UK plan defined benefit pension obligation which has been accounted for on a settlement basis. Refer to Note 4 Special items.

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

(Canadian dollars in millions)	2021	2020
Domestic Registered Plans	$ 8	$ 8
International plans	62	99
Supplementary plans	1,122	1,408
	$ 1,192	**$ 1,515**

The weighted average duration of the defined benefit obligation is 14.0 years (2020 – 14.4 years).

Pension and Other Employee Future Benefit Expense

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

	Pension Benefits		Other Employee Future Benefits	
(Canadian dollars in millions)	2021	2020	2021	2020
Consolidated Statement of Operations				
Components of cost				
Current service cost	$ 262	$ 275	$ 53	$ 45
Past service cost	-	-	(1)	(6)
Administrative and other expenses	9	9	-	-
Actuarial losses (gains), including foreign exchange	-	-	(9)	(7)
Total cost recognized in Wages, salaries and benefits	**$ 271**	**$ 284**	**$ 43**	**$ 32**
Total cost recognized in Special items (note 4)	**$ 365**	**$ 46**	**$ 5**	**$ 3**
Net financing expense relating to employee benefits	**$ (34)**	**$ (18)**	**$ 42**	**$ 45**
Total cost recognized in statement of operations	**$ 602**	**$ 312**	**$ 90**	**$ 80**
Consolidated Other Comprehensive (Income) Loss				
Remeasurements:				
Experience loss (gain), including foreign exchange	89	(53)	(14)	(48)
Loss (gain) from change in demographic assumptions	(1)	(51)	(3)	-
Loss (gain) from change in financial assumptions	(1,875)	1,774	(130)	54
Return on plan assets	(1,157)	(2,660)	-	-
Change in asset ceiling	1,360	(93)	-	-
Total cost (income) recognized in OCI	**$ (1,584)**	**$ (1,083)**	**$ (147)**	**$ 6**

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)	2021	2020
Net defined pension and other future employee benefits expense recorded in the consolidated statement of operations		
Wages, salaries and benefits	$ 314	$ 316
Special items	370	49
Net financing expense relating to employee benefit liabilities	8	27
	$ 692	**$ 392**
Employee benefit funding by Air Canada		
Pension benefits	$ 79	$ 90
Other employee benefits	42	42
	$ 121	**$ 132**
Employee benefit funding less than expense	**$ 571**	**$ 260**

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:

	2021	2020	Target Allocation
Bonds	60%	65%	60%
Canadian equities	3%	3%	3%
Foreign equities	7%	7%	7%
Alternative investments	30%	25%	30%
	100%	100%	100%

For the Domestic Registered Plan assets, approximately 77% of assets as of December 31, 2021 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 (2020 – 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 $373 million at December 31, 2021 (2020 – $402 million), although after giving effect to the asset ceiling, the recognized accounting value of the trust asset is nil.

In November 2021, Air Canada announced that its Canadian unions and the Air Canada Pionairs agreed in principle to permit certain other uses of the proceeds of the shares discussed above. If all conditions are met, shares in the trust will be gradually sold over a period of up to 15 years with the net proceeds from the sales used to make lump sum payments to Canadian pensioners and to fund voluntary separation packages for senior unionized employees and non-executive employees. There are several conditions to the completion of the agreement and effecting such sales and payments. These include the conclusion of definitive documentation, and the receipt of all required regulatory and other approvals. There can be no assurance that these or any other conditions will be satisfied. The financial statements do not reflect any accounting consequences related to this, as these would only be determined upon the conditions and required approvals being met.

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 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, 2021, 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. Due to unrealized gains and losses on invested assets, the market value of assets could deviate from this allocation from time to time.

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, 2021, 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, 2021 and 2020.

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	
	2021	**2020**	**2021**	**2020**
Discount rate used to determine:				
Net interest on the net defined benefit obligation for the year ended December 31	2.82% (1)	3.13%	2.59%	3.13%
Service cost for the year ended December 31	3.10% (1)	3.20%	3.16% (1)	3.20%
Accrued benefit obligation as at December 31	3.20%	2.59%	3.20%	2.59%
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

(1) Weighted average reflecting remeasurements during the year due to special items as described in Note 4 related to early retirement incentive programs.

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 2021 pension expense and net financing expense relating to pension benefit liabilities, based on different actuarial assumptions with respect to discount rate is set out below. The effects on each pension plan of a change in an assumption are weighted proportionately to the total plan obligation to determine the total impact for each assumption presented.

	0.25 Percentage Point	
(Canadian dollars in millions)	**Decrease**	**Increase**
Discount rate on obligation assumption		
Pension expense	$ 26	$ (24)
Net financing expense relating to pension benefit liabilities	15	(17)
	$ 41	**$ (41)**
Increase (decrease) in pension obligation	**$ 775**	**$ (748)**

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, 2021, 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 $519 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 2021 (2020 – 5%). The rate is assumed to decrease gradually to 4.5% by 2023 (2020 – assumed to decrease gradually to 4.5% by 2023). A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by $7 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 $79 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 $56 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 $53 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, $12 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 2021 (2020 – $13 million).

The Corporation's expense for these pension plans amounted to $35 million for the year ended December 31, 2021 (2020 – $33 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 2022 are $36 million.

12. PROVISIONS FOR OTHER LIABILITIES

The following table provides a continuity schedule of all recorded 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, 2020				
Current	$ 313	$ -	$ 38	$ 351
Non-current	1,040	35	-	1,075
	$ 1,353	**$ 35**	**$ 38**	**$ 1,426**
Provisions arising during the year	$ 155	$ -	$ 8	$ 163
Amounts utilized	(288)	-	(8)	(296)
Changes in estimated costs	(43)	(1)	-	(44)
Accretion expense	6	1	-	7
Foreign exchange gain	(12)	-	-	(12)
At December 31, 2021	**$ 1,171**	**$ 35**	**$ 38**	**$ 1,244**
Current	$ 139	$ -	$ 38	$ 177
Non-current	1,032	35	-	1,067
	$ 1,171	**$ 35**	**$ 38**	**$ 1,244**

(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 2022 to 2035 with the average remaining lease term of approximately four years. The maintenance provisions take into account current costs of maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Assuming the aggregate cost for return conditions increases by 5%, holding all other factors constant, there would be a cumulative balance sheet adjustment to increase the provision by $51 million at December 31, 2021 and an increase to maintenance expense in 2022 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 $25 million at December 31, 2021. An equivalent but opposite movement in the discount rate would result in a similar impact in the opposite direction.

(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 2022 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.

13. INCOME TAXES

Income Tax Recovery

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

(Canadian dollars in millions)	2021	2020
Current income tax recovery (expense)	$ (16)	$ 42
Deferred income tax recovery	395	164
Income tax recovery	**$ 379**	**$ 206**

The income tax recovery 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)	2021	2020
Loss before income taxes	$ (3,981)	$ (4,853)
Statutory income tax rate based on combined federal and provincial rates	26.47%	26.54%
Income tax recovery based on statutory tax rates	**1,054**	**1,288**
Effects of:		
Non-taxable portion of capital gains	4	20
Unrecognized deferred income tax assets	(628)	(1,018)
Non-deductible items	(45)	(82)
Other	(6)	(2)
Income tax recovery	**$ 379**	**$ 206**

The applicable statutory tax rate is 26.47% (2020 – 26.54%). 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 in the consolidated statement of operations differs from the amount that would have resulted from applying the statutory income tax rate to the loss 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)	2021		2020	
Remeasurements on employee benefit liabilities				
– current income tax expense	$	(41)	$	(33)
– deferred income tax expense		(379)		(279)
Remeasurements on equity investments				
– deferred income tax recovery		-		4
Income tax expense	**$**	**(420)**	**$**	**(308)**

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)	2021		2020	
Other comprehensive income before income taxes	$	1,725	$	1,009
Statutory income tax rate based on combined federal and provincial rates		26.47%		26.54%
Income tax expense based on statutory tax rates		**(457)**		**(268)**
Non-deductible portion of capital loss		(1)		(9)
Recognition of (unrecognized) deferred income tax assets		38		(28)
Tax rate changes on deferred income taxes		-		1
Other		-		(4)
Income tax expense	**$**	**(420)**	**$**	**(308)**

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 and prior 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. The future tax deductions underlying the unrecognized deferred income tax assets of $1,719 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 $395 million was recorded for the year, which is partially offsetting the deferred income tax expense of $379 million recorded in Other comprehensive income (loss).

Deferred tax assets and liabilities of $39 million are recorded net as a non-current deferred income tax asset and deferred tax liabilities of $73 million are recorded as a non-current 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 (2020 – $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 non-current deferred income tax liability.

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

(Canadian dollars in millions)	2021	2020
Deferred income tax assets		
Non-capital losses	$ 1,502	$ 1,126
Accounting provisions not currently deductible for tax	6	9
Lease liabilities	978	1,110
Maintenance provisions	215	215
	2,701	2,460
Deferred income tax liabilities		
Post-employment obligations – pension	(593)	(353)
Property, equipment, technology-based and other intangible assets	(2,030)	(2,023)
Indefinite-lived intangible assets	(73)	(73)
Other	(39)	(61)
	(2,735)	(2,510)
Net recognized deferred income tax liabilities	**$ (34)**	**$ (50)**
Balance sheet presentation		
Deferred income tax assets	39	25
Deferred income tax liabilities	(73)	(75)
Net recognized deferred income tax liabilities	**$ (34)**	**$ (50)**

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

(Canadian dollars in millions)	January 1, 2021	2021 income statement movement	2021 OCI movement	December 31, 2021
Non-capital losses	$ 1,126	$ 376	$ -	$ 1,502
Accounting provisions not currently deductible for tax	9	(3)	-	6
Lease liabilities	1,110	(132)	-	978
Maintenance provisions	215	-	-	215
Post-employment obligations – pension	(353)	139	(379)	(593)
Property, equipment, technology-based and other intangible assets	(2,023)	(7)	-	(2,030)
Indefinite-lived intangible assets	(73)	-	-	(73)
Other deferred tax liabilities	(61)	22	-	(39)
Total recognized deferred income tax assets (liabilities)	**$ (50)**	**$ 395**	**$ (379)**	**$ (34)**

(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)**

At December 31, 2021, 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)	2021	2020
Unrecognized non-capital losses carryforwards	$ 2,956	$ 30
Post-employment obligations - other employee future benefits	1,472	1,562
Accounting provisions not currently deductible for tax	286	323
Maintenance provision	358	542
Deferred revenue	1,161	1,461
Unrecognized net capital losses carryforwards	124	154
Unrealized foreign exchange gains	(1)	(18)
Other	1	8
Total unrecognized net temporary differences	**$ 6,357**	**$ 4,062**
Deferred income tax rate based on combined federal and provincial rates	26.46%	26.51%
	$ 1,682	**$ 1,077**
Unrecognized recoverable taxes	37	37
Total unrecognized net deferred income tax assets	**$ 1,719**	**$ 1,114**

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

(Canadian dollars in millions)	Tax Losses
2030	$ 2
2031	6
2032	2
2033	1
2034	3
2036	3
2037	2
2038	2
2040	4,300
2041	4,228
Non-capital losses carryforwards	$ 8,549

Cash income taxes paid in 2021 by the Corporation were $2 million (2020 – $8 million).

14. SHARE CAPITAL

		Number of shares	Value (Canadian dollars in millions)
At January 1, 2020		**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**
Shares issued on the exercise of stock options		1,507,355	21
Shares issued on settlement of restricted share units		4,272	-
Shares issued in public offering		2,587,000	60
Shares issued to government	Note 5	21,570,942	504
At December 31, 2021		**357,841,857**	**$ 2,735**

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

		2021	2020
Issued and outstanding			
Class A variable voting shares		82,897,507	111,926,060
Class B voting shares		274,944,350	220,246,228
Total issued and outstanding		**357,841,857**	**332,172,288**
Potential shares			
Convertible notes	Note 10	48,687,441	48,687,441
Warrants	Note 5	7,288,282	-
Stock options	Note 15	4,330,993	5,903,174
Total outstanding and potentially issuable shares		**418,148,573**	**386,762,903**

Shares

As at December 31, 2021, 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.

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. In January 2021, the underwriters partially exercised their over-allotment option to purchase an additional 2,587,000 Air Canada shares for gross proceeds of $62 million. After deduction of the underwriters' fees and expenses, net proceeds from the exercise of this over-allotment option were $60 million.

As further described in Note 5, in April 2021, Air Canada entered into a series of debt and equity financing agreements with the Government of Canada, including the issuance of shares and warrants. Air Canada issued 21,570,942 shares to the Government of Canada for net proceeds of $480 million. Air Canada exercised its call right on the vested warrants as per their terms at fair market value, purchasing and cancelling the warrants, with settlement completed in January 2022.

15. 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 6,868,598 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 ten 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:

	2021	2020
Compensation expense ($ millions)	$ 12	$ 16
Number of stock options granted to Air Canada employees	988,997	1,428,322
Weighted average fair value per option granted ($)	$ 11.56	$ 8.95
Aggregated fair value of options granted ($ millions)	$ 11	$ 13
Weighted average assumptions:		
Share price	$ 25.36	$ 31.08
Risk-free interest rate	0.29%-1.35%	0.22%-0.62%
Expected volatility	55.04%	33.35%
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:

	2021		2020	
	Options	Weighted Average Exercise Price/Share	Options	Weighted Average Exercise Price/Share
Beginning of year	5,903,174	$ 22.06	4,890,095	$ 18.80
Granted	988,997	25.36	1,428,322	31.08
Exercised	(1,507,355)	9.97	(285,138)	8.78
Expired	-	-	-	-
Forfeited	(1,053,823)	27.52	(130,105)	28.66
Outstanding options, end of year	**4,330,993**	**$ 25.84**	**5,903,174**	**$ 22.06**
Options exercisable, end of year	**2,074,173**	**$ 22.10**	**2,414,643**	**$ 13.05**

The weighted average share price on the date of exercise for options exercised in 2021 was $24.16 (2020 – $26.22).

		2021 Outstanding Options			2021 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$12.64	2022	126,316	1	$ 12.64	126,316	$ 12.64
$9.23 – $9.61	2023	378,126	2	9.29	378,126	9.29
$12.83 – $26.40	2027	405,867	6	14.88	395,867	14.59
$22.53 – $27.75	2028	810,216	7	26.53	508,808	26.55
$33.11 – $43.22	2029	837,189	8	33.28	325,391	33.24
$15.35 – $32.42	2030	1,183,930	9	30.80	339,665	31.31
$23.80 – $26.93	2031	589,349	10	25.34	-	-
		4,330,993		**$ 25.84**	**2,074,173**	**$ 22.10**

		2020 Outstanding Options			2020 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$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**

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 are generally 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 2021 was $12 million (2020 – $(23) 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:

	2021	2020
Beginning of year	2,374,006	2,085,811
Granted	1,106,028	1,124,146
Settled	(646,964)	(724,539)
Forfeited	(635,087)	(111,412)
Outstanding share units, end of year	**2,197,983**	**2,374,006**

Refer to Note 18 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 matched 33.33% of the contributions made by employees. During 2021, the Corporation recorded compensation expense of nil (2020 – $5 million) related to the Employee Share Purchase Plan.

16. LOSS PER SHARE

The following table outlines the calculation of basic and diluted loss per share:

(in millions, except per share amounts)	2021	2020
Numerator:		
Net loss	**$ (3,602)**	**$ (4,647)**
Effect of assumed conversion of convertible notes	143	216
Effect of assumed conversion of warrants	(27)	-
Remove anti-dilutive impact	(116)	(216)
Adjusted numerator for diluted loss per share	**$ (3,602)**	**$ (4,647)**
Denominator:		
Weighted-average shares	**351**	**282**
Effect of potential dilutive securities:		
Stock options	1	1
Warrants	-	-
Convertible notes	49	28
Remove anti-dilutive impact	(50)	(29)
Adjusted denominator for diluted loss per share	**351**	**282**
Basic and diluted loss per share	**$ (10.25)**	**$ (16.47)**

The calculation of loss 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 2021 calculation of diluted loss per share were 2,930,000 (2020 – 2,817,000) outstanding options where the options' exercise prices were greater than the average market price of the shares for the year.

The potential dilutive securities related to the vested and unvested warrants described in Note 5 are included in the calculation of dilutive loss per share only for the portion of the period during which they were outstanding. All warrants were excluded from the calculation since their exercise price was greater than the average market price of the shares for the period.

17. 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, 2021. U.S. dollar amounts are converted using the December 31, 2021 closing rate of CDN$1.2637. Minimum future commitments under these contractual arrangements are shown below.

(Canadian dollars in millions)	2022	2023	2024	2025	2026	Thereafter	Total
Committed expenditures	$ 1,154	$ 611	$ 356	$ 338	$ 40	$ -	**$ 2,499**

The Corporation leases and subleases certain aircraft and spare engines to its regional carriers, which as of April 2021 is solely Jazz, 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 nine De Havilland Dash 8 aircraft, 15 Mitsubishi CRJ-200 aircraft, 20 Mitsubishi CRJ-705/900 aircraft, 25 Embraer E175 aircraft, and 15 spare engines. The lease and sublease revenue and expense related to these aircraft and engines each amount to $152 million in 2021 (2020 – $183 million).

Other Contractual Commitments

The future minimum non-cancellable commitment for the next 12 months under the capacity purchase agreement is approximately $1,178 million.

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Financial Instruments

(Canadian dollars in millions)	Carrying Amounts					
	December 31, 2021					Dec. 31, 2020
	Financial instruments classification					
	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	$ 4,248	$ -	$ -	$ -	$ 4,248	$ 3,658
Short-term investments	4,554	-	-	-	4,554	3,843
Restricted cash	167	-	-	-	167	106
Accounts receivable	-	-	691	-	691	644
Investments, deposits and other assets						
Long-term investments	601	-	-	-	601	512
Equity investment in Chorus	-	52	-	-	52	58
Restricted cash	75	-	-	-	75	87
Aircraft related and other deposits	-	-	71	-	71	90
Derivative instruments						
Share forward contracts	13	-	-	-	13	20
Foreign exchange derivatives	5	-	-	-	5	-
	$ 9,663	$ 52	$ 762	$ -	$ 10,477	$ 9,018
Financial Liabilities						
Accounts payable	$ -	$ -	$ -	$ 2,051	$ 2,051	$ 1,775
Foreign exchange derivatives	273	-	-	-	273	591
Embedded derivative on convertible notes	579	-	-	-	579	534
Warrants	82	-	-	-	82	-
Current portion of long-term debt and lease liabilities	-	-	-	1,012	1,012	1,788
Long-term debt and lease liabilities	-	-	-	15,511	15,511	11,201
	$ 934	$ -	$ -	$ 18,574	$ 19,508	$ 15,889

Summary of Loss on Financial Instruments Recorded at Fair Value

(Canadian dollars in millions)		2021	2020
Share forward contracts		$ (1)	$ (28)
Embedded derivative on convertible notes	Note 10	(45)	(214)
Warrants	Note 10	27	-
Short-term investments		(36)	-
Loss on financial instruments recorded at fair value		**$ (55)**	**$ (242)**

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 values 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 twelve 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, 2021, unrestricted liquidity was $10,361 million comprised of $9,403 million in Cash and cash equivalents, Short-term and Long-term investments, and $958 million available under undrawn credit facilities.

Cash and cash equivalents include $407 million pertaining to investments with original maturities of three months or less at December 31, 2021 ($667 million as at December 31, 2020).

In response to the COVID-19 pandemic, Air Canada has taken the following actions in 2021 to support its liquidity position:

- As described in Note 10, Air Canada entered into a series of debt and equity financing agreements with the Government of Canada, which allowed Air Canada to access up to $5.379 billion in debt financing through fully repayable loans that Air Canada would only draw down if and as required, as well as an equity investment for gross proceeds of $500 million (net proceeds of $480 million). As at December 31, 2021, $1,273 million was drawn under the unsecured credit facility solely to support customer refunds of non-refundable tickets. No amount was ever drawn on any of the other facilities with the Government of Canada, which were terminated by Air Canada in November 2021.
- As described in Note 10, Air Canada received aggregate gross proceeds of approximately $7.1 billion comprised of $2.0 billion of senior secured notes due 2029, US$1.2 billion of senior secured notes due 2026, a US$2.3 billion new term loan B maturing in 2028, and a new undrawn US$600 million revolving credit facility maturing in 2025.
- Air Canada revised the terms of its CPA with Jazz. Through the revised agreement, Jazz became the sole operator of flights under the Air Canada Express brand. This realignment of regional services will provide cost certainty, achieve efficiencies and reduce operating costs and cash burn by combining the regional fleet under a single operator, creating related operational cost savings, and reducing Air Canada's overall regional flying compensation. In addition, the revised CPA will lower future contractual capital expenditure and leasing costs through a restructured CPA fleet.
- As described in Note 10, the Corporation extended its $200 million revolving credit facility by one year to 2024.
- As described in Note 10, the Corporation refinanced the Series B Certificates of its 2013-1 EETC with a final expected distribution date of May 2025.

A maturity analysis of the Corporation's principal and interest repayment requirements on long-term debt and lease liabilities is set out in Note 10, and fixed operating commitments and capital commitments are set out in Note 17.

Market Risks

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk can be further divided into the following sub-classifications related to the Corporation: 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 2021 and there were no outstanding fuel derivatives as at December 31, 2021 and December 31, 2020.

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 2021, these net operating cash inflows totalled approximately US$1.6 billion and U.S. denominated operating costs amounted to approximately US$3.2 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$2.0 billion. For 2021, this resulted in a U.S. dollar net cash flow exposure of approximately US$3.6 billion.

The Corporation has a target coverage of 60% on a rolling 18 month basis to manage the net U.S. dollar cash flow exposure described above utilizing the following risk management strategies:

- Holding U.S. dollar cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash, short and long-term investment balances as at December 31, 2021 amounted to $1,403 million (US$1,110 million) ($1,747 million (US$1,371 million) as at December 31, 2020). 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 18 month net U.S. dollar cash flow exposure. In 2021, a gain of $10 million (loss of $69 million in 2020) was recorded in Foreign exchange gain (loss) reflecting the change in Canadian equivalent market value of the U.S. dollar cash, short and long-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, 2021, as further described below, approximately 52% of net U.S. cash outflows are hedged for 2022 and 30% for 2023, resulting in derivative coverage of 45% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 60% coverage.

As at December 31, 2021, the Corporation had outstanding foreign currency options and swap agreements, settling in 2022 and 2023, to purchase at maturity $2,423 million (US$1,925 million) of U.S. dollars at a weighted average rate of $1.2742 per US$1.00 (2020 – $5,730 million (US$4,499 million) with settlements in 2021 and 2022 at a weighted average rate of $1.3586 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 €260 million, GBP £56 million, JPY ¥4,577 million, CNH ¥31 million and AUD $36 million) which settle in 2022 and 2023 at weighted average rates of €1.1704, £1.4125, ¥0.0092, ¥0.1471, and AUD $0.7300 per $1.00 U.S. dollar, respectively (as at December 31, 2020 – EUR €464 million, GBP £64 million, JPY ¥4,963 million, CNH ¥415 million and AUD $88 million with settlement in 2021 and 2022 at weighted average rates of €1.1414, £1.3277, ¥0.0094, ¥0.1463, and AUD $0.6942 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, 2021 was $268 million in favour of the counterparties (2020 – $591 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 2021, a loss of $114 million was recorded in Foreign exchange gain (loss) related to these derivatives (2020 – $583 million loss). In 2021, foreign exchange derivative contracts cash settled with a net fair value of $437 million in favour of the counterparties (2020 – $106 million in favour of the counterparties).

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, 2021 is 73% fixed and 27% floating (74% and 26%, respectively as at December 31, 2020).

Share-based Compensation Risk

The Corporation issues RSUs and PSUs to certain of its employees, as described in Note 15, 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 2022 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 625,000 PSUs and RSUs from 2022 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 2021, a loss of $1 million was recorded (2020 – loss of $28 million). Share forward contracts cash settled with a fair value of $6 million in favour of the Corporation in 2021 (2020 – $9 million). As at December 31, 2021, the fair value of the share forward contracts is $13 million in favour of the Corporation (2020 – $20 million in favour of the Corporation), with those contracts maturing in 2022 valued at $6 million recorded in Prepaid expenses and other current assets and the remainder of $7 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, 2021, 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, 2021. 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 any 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, 2021 considering a number of variables including the remaining term to maturity and does not consider the fair value change that would be applicable to the derivative assuming the market risk change was applicable to the maturity date of the derivative contract.

	Interest rate risk		Foreign exchange rate risk (1)		Other price risk (2),(3)	
	Income		Income		Income	
(Canadian dollars in millions)	1% increase	1% decrease	5% increase	5% decrease	10% increase	10% decrease
Cash and cash equivalents	$ 42	$ (42)	$ (39)	$ 39	$ -	$ -
Short–term investments	$ 46	$ (46)	$ (28)	$ 28	$ -	$ -
Long-term investments	$ 6	$ (6)	$ (3)	$ 3	$ -	$ -
Aircraft related deposits	$ -	$ -	$ (3)	$ 3	$ -	$ -
Long-term debt and lease liabilities	$ (45)	$ 28	$ 610	$ (610)	$ -	$ -
Share forward contracts	$ -	$ -	$ -	$ -	$ 1	$ (1)
Foreign exchange derivatives	$ -	$ -	$ (13)	$ 13	$ -	$ -
Embedded derivative on convertible notes	$ -	$ -	$ -	$ -	$ (58)	$ 58

(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 $7 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 $5 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 2021, the Corporation made no cash deposits under these agreements (nil in 2020).

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 is $13,688 million compared to its carrying value of $13,568 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.

		Fair value measurements at reporting date using:		
Recurring measurements (Canadian dollars in millions)	December 31, 2021	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Assets				
Held–for–trading securities				
Cash equivalents	$ 407	$ -	$ 407	$ -
Short-term investments	4,554	-	4,554	-
Long-term investments	601	-	601	-
Equity investment in Chorus	52	52	-	-
Derivative instruments				
Share forward contracts	13	-	13	-
Foreign exchange derivatives	5	-	5	-
Total	**$ 5,632**	**$ 52**	**$ 5,580**	**$ -**
Financial Liabilities				
Derivative instruments				
Foreign exchange derivatives	273	-	273	-
Embedded derivative on convertible notes	579	-	579	-
Warrants	82	-	82	-
Total	**$ 934**	**$ -**	**$ 934**	**$ -**

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 2021.

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 $46 million as at December 31, 2021 ($9 million as at December 31, 2020). 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, 2021 and 2020, 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.

Financial assets	**Amounts offset**			**Amounts not offset**	**Net**
(Canadian dollars in millions)	Gross assets	Gross liabilities offset	Net amounts presented	Financial instruments	
December 31, 2021					
Derivative assets	$ 22	$ (17)	$ 5	$ 13	$ 18
	$ 22	**$ (17)**	**$ 5**	**$ 13**	**$ 18**
December 31, 2020					
Derivative assets	$ -	$ -	$ -	$ 20	$ 20
	$ -	**$ -**	**$ -**	**$ 20**	**$ 20**

Financial liabilities	**Amounts offset**			**Amounts not offset**	**Net**
(Canadian dollars in millions)	Gross liabilities	Gross assets offset	Net amounts presented	Financial instruments	
December 31, 2021					
Derivative liabilities	$ 317	$ (44)	$ 273	$ -	$ 273
	$ 317	**$ (44)**	**$ 273**	**$ -**	**$ 273**
December 31, 2020					
Derivative liabilities	$ 646	$ (55)	$ 591	$ -	$ 591
	$ 646	**$ (55)**	**$ 591**	**$ -**	**$ 591**

19. 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 $1,038 million as at December 31, 2021 (December 31, 2020 – $1,047 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.

20. 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. The Corporation also monitors its net debt which is calculated as the sum of Long-term debt and lease liabilities less Cash and cash equivalents, and Short-term 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, 2021	December 31, 2020
Long-term debt and lease liabilities	$ 15,511	$ 11,201
Current portion of long-term debt and lease liabilities	1,012	1,788
Total long-term debt and lease liabilities	16,523	12,989
Embedded derivative on convertible notes	579	534
Shareholders' equity	9	1,715
Total Capital	**$ 17,111**	**$ 15,238**
Total long-term debt and lease liabilities	$ 16,523	$ 12,989
Less Cash and cash equivalents, and Short-term and Long-term investments	(9,403)	(8,013)
Net debt	**$ 7,120**	**$ 4,976**

21. 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)	2021	2020
Passenger Revenues		
Canada	$ 2,050	$ 1,640
U.S. Transborder	770	840
Atlantic	1,100	909
Pacific	245	468
Other	333	525
	$ 4,498	**$ 4,382**

(Canadian dollars in millions)	2021	2020
Cargo Revenues		
Canada	$ 124	$ 90
U.S. Transborder	62	35
Atlantic	538	387
Pacific	667	354
Other	104	54
	$ 1,495	**$ 920**

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, 2021	December 31, 2020
Receivables, which are included in Accounts receivable	$ 513	$ 332
Contract costs which are included in Prepaid expenses and other current assets	80	68
Contract liabilities – Advance ticket sales	2,326	2,314
Contract liabilities – Aeroplan deferred revenue (current and long-term)	3,452	3,256
Contract liabilities – Other deferred revenue (current and long-term)	1,187	1,348

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, 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 as at December 31, 2021 of $250 million related to these vouchers has been recorded in current liabilities even though some could be used after the next 12 months.

The following table presents financial information related to the changes in Aeroplan deferred revenue:

(Canadian dollars in millions)	2021	2020
Aeroplan deferred revenue, beginning of year	$ 3,256	$ 2,825
Proceeds from Aeroplan Points issued to program partners	822	687
Equivalent ticket value of Aeroplan Points issued	65	63
Aeroplan Points redeemed	(691)	(319)
Aeroplan deferred revenue, end of year	**$ 3,452**	**$ 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 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.

22. REGIONAL AIRLINES EXPENSE

In March 2021, Air Canada amended the capacity purchase agreement with Jazz. Through the revised agreement, Jazz became the sole regional carrier for flights under the Air Canada Express brand. Prior to this, regional services were also provided by Sky Regional. 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)	2021	2020
Capacity purchase fees	$ 558	$ 636
Airport and navigation fees	161	127
Sales and distribution costs	42	51
Other operating expenses	281	272
Regional airlines expense, excluding fuel	**$ 1,042**	**$ 1,086**

23. SALE-LEASEBACK

In 2021, the Corporation completed sale and leaseback transactions for two Boeing 767 aircraft for total proceeds of $11 million. The aircraft are being converted from passenger to freighter configuration and will continue to be operated under lease agreements.

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.

24. RELATED PARTY TRANSACTIONS

Compensation of Key Management

Key management includes Air Canada's Board of Directors, President and Chief Executive Officer, Executive Vice President and Chief Financial Officer, Executive Vice President and Chief Commercial Officer, Executive Vice President and Chief Operations Officer, Executive Vice President - Chief Human Resources Officer and Public Affairs, and Executive Vice President and Chief Legal Officer. Amounts reported are based upon the expense as reported in the consolidated financial statements, which in the case of Pension and post-employment benefits, includes actuarial gains or losses, as applicable. The share-based compensation credit in 2020 reflected the decrease in the Air Canada share price during 2020. Compensation to key management is summarized as follows:

(Canadian dollars in millions)	2021	2020
Salaries and other benefits	$ 4	$ 7
Pension and post-employment benefits	(2)	6
Share-based compensation	11	(9)
	$ 13	$ 4

About Air Canada

Air Canada is Canada's largest domestic and international airline, the country'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 from the independent U.K. research firm Skytrax, which in 2021 also named Air Canada as having the Best Airline Staff in North America, Best Airline Staff in Canada, Best Business Class Lounge in North America, as well as an Excellence award for its handling of COVID-19. Also in 2021, Air Canada was named *Global Traveler*'s Best Airline in North America for the third straight year. In January 2021, Air Canada received APEX's Diamond Status Certification for the Air Canada CleanCare+ biosafety program for managing COVID-19, the only airline in Canada to attain the highest APEX ranking. Air Canada has also committed to a net-zero emissions goal from all global operations by 2050.

Air Canada's predecessor, Trans-Canada Air Lines (TCA), inaugurated its first flight on September 1, 1937. The 50-minute flight aboard a Lockheed L-10A carried two passengers and mail between Vancouver and Seattle. By 1964, TCA had grown to become Canada's national airline; it changed its name to Air Canada. The airline became fully privatized in 1989.

Air Canada's Class A variable voting shares and Class B voting shares are traded on the Toronto Stock Exchange under the single ticker symbol "AC" and on the OTCQX International Premier in the U.S. under the single ticker symbol "ACDVF".

Its corporate headquarters are located in Montréal.