2020

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

February 12, 2021

AIR CANADA

A STAR ALLIANCE MEMBER

TABLE OF CONTENTS

1. HIGHLIGHTS

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

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

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

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

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

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

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

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

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

2. INTRODUCTION AND KEY ASSUMPTIONS

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), the "Corporation" refers, as the context may require, to Air Canada and/or one or more of Air Canada's subsidiaries, including its wholly owned operating subsidiaries, Touram Limited Partnership, doing business under the brand name Air Canada Vacations® ("Air Canada Vacations"), Air Canada Rouge LP, doing business under the brand name Air Canada Rouge® ("Air Canada Rouge") and Aeroplan Inc. ("Aeroplan"). This MD&A provides the reader with a review and analysis, from the perspective of management, of Air Canada's financial results for the fourth quarter and full year 2020. This MD&A should be read in conjunction with Air Canada's audited consolidated financial statements and notes for 2020. All financial information has been prepared in accordance with generally accepted accounting principles in Canada ("GAAP"), as set out in the CPA Canada Handbook – Accounting ("CPA Handbook"), which incorporates International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"), except for any non-GAAP measures and any financial information specifically denoted otherwise.

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

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 17 "Risk Factors" of this MD&A. Air Canada issued a news release dated February 12, 2021 reporting on its results for the fourth quarter and full year 2020. This news release is available on Air Canada's website at **aircanada.com** and on SEDAR's website at **www.sedar.com**. For further information on Air Canada's public disclosures, including Air Canada's Annual Information Form, consult SEDAR at **www.sedar.com**.

CAUTION REGARDING FORWARD-LOOKING INFORMATION

Air Canada's public communications may include forward-looking statements within the meaning of applicable securities laws. Such forward-looking statements are included in this MD&A and may be included in other communications, including filings with regulatory authorities and securities regulators. Forward-looking statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to guidance, strategies, expectations, planned operations or future actions. Forward-looking statements are identified using terms and phrases such as "preliminary", "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "predict", "project", "will", "would", and similar terms and phrases, including references to assumptions.

Forward-looking statements, by their nature, are based on assumptions, including those described in this MD&A and the documents incorporated by reference herein and are subject to important risks and uncertainties. Forward-looking statements cannot be relied upon due to, among other things, changing external events and general uncertainties of the business of Air Canada. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including those discussed below.

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

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

KEY ASSUMPTIONS

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

INTELLECTUAL PROPERTY

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

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

3. ABOUT AIR CANADA

Air Canada is the largest provider of scheduled passenger services in the Canadian market, the Canada-U.S. transborder market and in the international market to and from Canada. Its mission is connecting Canada and the World.

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

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

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

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

Air Canada's Aeroplan program is Canada's premier travel loyalty program. The Aeroplan program allows individuals to 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 card, and other rewards provided directly by participating partners, or made available through Aeroplan's suppliers. Aeroplan Elite Status recognizes Air Canada's frequent flyers, as well as Aeroplan's most engaged members, with a range of priority travel services and membership benefits.

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

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

4. STRATEGY AND COVID-19 MITIGATION AND RECOVERY PLAN

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

Covid-19 Mitigation and Recovery Plan

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

Customer Service and Safety

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

- To underscore its commitment to customer and employee safety, Air Canada introduced Air Canada CleanCare+. This program is designed to reduce the risk of exposure to COVID-19 through such measures as enhanced aircraft grooming, mandatory preflight customer temperature checks and facial coverings, in addition to required health questionnaires and providing all customers with care kits for hand cleaning and hygiene. In January 2021, Air Canada received the Diamond certification from the Airline Passenger Experience Association (APEX) Health Safety powered by SimpliFlying. The Diamond Certification recognized the airline for achieving hospital-grade levels of biosecurity across multiple passenger touchpoints. The certification program aims to create a global standard for health and safety measures focused on airline customers.

- Air Canada has introduced numerous touchless processes throughout the customer journey, including: TouchFree Bag Check for flights departing from Canadian airports, the ability to order food directly in Maple Leaf Lounges from smartphones and tablets, touchless self-entry to the Air Canada Café for when it reopens, and provisioning of all newspapers and magazines in digital format via PressReader.

- Air Canada has undertaken several medical collaborations to continue advancing biosafety across its business, including with Cleveland Clinic Canada in Toronto, a renowned global healthcare leader, to provide additional science-based evidence in our ongoing COVID-19 response; with Ottawa-based Spartan Bioscience to explore rapid COVID-19 testing in an aviation environment; and, since early 2019, with Toronto-based BlueDot, a company that monitors infectious diseases globally in real time to provide accurate, relevant information to make business and safety decisions quickly.

- Air Canada partnered with McMaster HealthLabs and the Greater Toronto Airports Authority in a study of international travellers arriving at Toronto Pearson International Airport. Preliminary results have indicated that testing can provide an effective, responsible alternative to facilitate the safe relaxation of quarantines. Final results are currently being analyzed and are expected to be published by McMaster HealthLabs and the University of Toronto during the first quarter of 2021.

- Air Canada is finalizing an initial order of Abbott's ID NOW COVID-19 rapid response tests as part of its ongoing evaluation of COVID-19 testing technology and protocols, one of the first private sector companies to do so.

- Air Canada recently conducted a trial with the application of COVID-19 contact tracing technology in its workplace using the Bluetooth enabled TraceSCAN app and wearable technology developed by Canadian-based Facedrive Inc. Following an initial pilot, the use of this technology is being further expanded on a trial basis in other Air Canada workplaces.

- Air Canada is collaborating with Shoppers Drug Mart to provide Air Canada customers with the opportunity to take a pre-departure COVID-19 PCR test to support compliance with international travel requirements. The test is now available to travellers in Ontario, Alberta, and British Columbia.

- Air Canada is working with the Creative Destruction Labs rapid testing consortium on rapid antigen screening in the workplace starting with pilots in Toronto and Montreal.

- Air Canada is the first Canadian airline to offer its customers the safety and convenience of a new boarding option utilizing facial biometrics. The technology is now available for customers departing from San Francisco International Airport. The airline plans to expand biometric boarding options to other U.S. airports in the near future and is currently exploring options which could be viable at Canadian airports.

Capacity and Route Network

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

Canadian travel and quarantine restrictions include the following:

- Travel bans prohibiting all foreign nationals from entering Canada by air under provisions of the Aeronautics Act and Quarantine Act under two different orders (one for United States arrivals and one for all other international arrivals), subject to limited exceptions (for example, for family members, compassionate reasons, and international students).

- 14-day quarantine requirements under the Quarantine Act for all travellers entering Canada, including Canadians.

- Interprovincial restrictions on travel and/or quarantines in numerous provinces, including Nova Scotia, New Brunswick, Prince Edward Island, Newfoundland, Manitoba, and in the three territories – for all persons including Canadians.

- The Government of Canada also has a global travel advisory in place advising Canadians to avoid all nonessential travel outside of Canada.

- Effective January 7, 2021, the Government of Canada requires airline passengers five years of age or older entering Canada from an international destination to provide, prior to boarding a flight, a negative COVID-19 PCR test, subject to limited exceptions (for example, airline crews re-entering Canada and aircraft maintenance engineers). Despite a negative COVID-19 PCR test, all customers entering Canada are required to complete the full mandatory 14-day quarantine.

- On January 29, 2021, the Canadian Government announced the following additional restrictions and measures:

    - Effective February 4, 2021, all scheduled international passenger flights into Canada must land at the following four airports: Montréal-Trudeau International Airport, Toronto Pearson International Airport, Calgary International Airport, and Vancouver International Airport.
    - All Canadian airlines have suspended flight to Mexico and the Caribbean between February 1 and April 30, 2021.
    - All air travellers arriving in Canada, with limited exceptions, will shortly be required to take a COVID-19 PCR test upon arrival and quarantine at a Government of Canada-approved hotel at their own expense while they await their results. If the result of the COVID-19 PCR test is negative, travellers will be able to complete the 14-day mandatory quarantine at a suitable location of their choice that allows them to observe their quarantine. If the COVID-19 PCR result is positive, travellers will have to complete the mandatory 14-day quarantine at a Government of Canada-supervised facility.

Financing and Liquidity

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

- In March 2020, Air Canada drew down its US$600 million and $200 million revolving credit facilities for aggregate net proceeds of $1,027 million.

- In June 2020, Air Canada concluded an underwritten public offering of 35,420,000 Class A variable voting shares and/or Class B voting shares of Air Canada at a price of $16.25 per share, for aggregate proceeds of $576 million, and a concurrent private placement of convertible senior unsecured notes due 2025 for aggregate proceeds of US$748 million ($1,011 million).

- In June 2020, Air Canada completed a private offering of $840 million aggregate principal amount of 9.00% Second Lien Secured Notes due 2024, which were sold at 98% of par.

- In June 2020, Air Canada completed a private offering of one tranche of Class C Enhanced Equipment Trust Certificates ("EETCs") with a combined aggregate face amount of approximately US$316 million ($426 million), which were sold at 95.002% of par.

- In September 2020, Air Canada concluded a private offering of two tranches of EETCs, the proceeds of which were used to purchase equipment notes issued by Air Canada and secured by three Boeing 787-9 aircraft, three Boeing 777-300ER aircraft, one Boeing 777-200LR and nine Airbus A321-200 aircraft. The two tranches of certificates have a combined aggregate face amount of US$553 million ($740 million) and a weighted average interest rate of 5.73%. Air Canada used the proceeds from this financing together with cash on hand to repay in full the US$600 million ($803 million) 364-day term loan originally put in place in April 2020 and discussed in Air Canada's second quarter 2020 MD&A.

- In September 2020, Air Canada concluded a committed secured facility totaling $788 million to finance the purchase of the first 18 Airbus A220 aircraft. As aircraft are financed under this facility, the bridge financing of $788 million put in place in April 2020 (and discussed in Air Canada's second quarter 2020 MD&A) will be repaid concurrently. At December 31, 2020, there were 15 Airbus A220 aircraft financed under this facility with the corresponding bridge financing repaid.

- In October 2020, Air Canada completed sale and leaseback transactions for nine Boeing 737 MAX 8 aircraft for total proceeds of US$365 million ($485 million). The nine aircraft were delivered to Air Canada in the past three years.

- In December 2020, Air Canada concluded an underwritten public offering of 35,420,000 Class A variable voting shares and/or Class B voting shares of Air Canada at a price of $24 per share, for aggregate proceeds of $850 million. In January 2021, the underwriters exercised their over-allotment option to purchase an additional 2,587,000 shares at a price of $24 per share, for gross proceeds of $62 million.

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

- Air Canada suspended share purchases under its Normal Course Issuer Bid in early March 2020 and did not renew its issuer bid upon its expiry in the second quarter of 2020.

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

Cost Reduction and Capital Reduction and Deferral Program

- Air Canada completed a company-wide cost reduction and capital reduction and deferral program for 2020 which reached $1.7 billion. On a capacity reduction of 67%, 2020 operating expenses decreased $7,872 million or 45% from 2019, reflecting the significant progress made on both managing variable costs and reducing fixed expenses. Air Canada continues to seek additional opportunities for cost reduction and cash preservation.

- Air Canada completed a workforce reduction of approximately 20,000 employees, representing more than 50% of its workforce. This was achieved through layoffs, terminations of employment, voluntary separations, early retirements, and special leaves. In January 2021, Air Canada announced another workforce reduction of approximately 1,700 employees. The airline is working with its unions on mitigation programs.

- Air Canada adopted the Canada Emergency Wage Subsidy (CEWS) for most of its workforce effective March 15, 2020. The net benefit for employee wages under this program in 2020 was $554 million. In September 2020, the Government of Canada announced an extension of the program to June 2021. Air Canada intends to continue its participation in the CEWS program, subject to meeting the eligibility requirements.

- Air Canada is permanently retiring certain older aircraft from its fleet – consisting of its less efficient Boeing 767, Airbus A319 and Embraer 190 aircraft. Their retirement will reduce Air Canada's cost structure, simplify the airline's overall fleet, and lower its carbon footprint.

- Air Canada concluded an amendment to the purchase agreement for Airbus A220-300 aircraft which became effective in early November 2020 and pursuant to which Air Canada has deferred 18 aircraft deliveries over 2021 and 2022. Also, Air Canada will not be purchasing the last 12 Airbus A220 aircraft from its original order of 45 aircraft.

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

Strategy

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

Air Canada has a modern and efficient fleet, including the Boeing 777 aircraft with its competitive cost per available seat mile particularly adapted to service high-volume leisure markets and the Boeing 787 aircraft with its lower operating costs, mid-size capacity and range flexibility. The airline has also renewed its narrow-body fleet. At December 31, 2020, Air Canada had taken delivery of 15 Airbus A220 aircraft. The Airbus A220 aircraft replaces the Embraer 190 aircraft and, with its longer range and better efficiency, offers greater deployment opportunities, enabling Air Canada to serve new markets not as well suited to Air Canada's larger Boeing 737 MAX or Airbus A321 aircraft. Air Canada also has 24 Boeing 737 MAX 8 aircraft in its fleet (of a firm order of 40). The Boeing 737 MAX aircraft has a longer range and offers greater maintenance and fuel efficiencies than the aging mainline narrow-body Airbus aircraft it replaces.

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

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

Air Canada's hubs of Toronto, Vancouver and 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.

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

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

Air Canada leverages its suite of branded fare products, allowing it to further segment its customer base and offer a variety of fare options and a customized 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.

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

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

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

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

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

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

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

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

Proposed Acquisition of Transat

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

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

5. RESULTS OF OPERATIONS – FULL YEAR 2020 VERSUS FULL YEAR 2019

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

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

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

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

System Passenger Revenues

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

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

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

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

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

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

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

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

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

Cargo Revenues

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

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

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

Other Revenues

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

Operating Expenses

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

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

Aircraft Fuel

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

Wages, Salaries and Benefits

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

Regional Airlines

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

Depreciation and Amortization

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

Aircraft Maintenance

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

Special Items

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

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

Impairments

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

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

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

Workforce Reduction Provisions

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

Canada Emergency Wage Subsidy

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

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

Non-operating Income (Expense)

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

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

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

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

Income Taxes

Income taxes recorded in 2020 and 2019 are summarized below.

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

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

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

6. RESULTS OF OPERATIONS – FOURTH QUARTER 2020 VERSUS FOURTH QUARTER 2019

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

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

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

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

System Passenger Revenues

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

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

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

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

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

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

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

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

Cargo Revenues

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

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

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

Other Revenues

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

Operating Expenses

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

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

Aircraft Fuel

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

Wages, Salaries and Benefits

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

Regional Airlines

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

Depreciation and Amortization

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

Aircraft Maintenance

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

Special Items

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

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

Non-operating Income (Expense)

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

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

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

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

7. FLEET

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

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

	Actual	**Planned**	
Mainline	**December 31, 2020**	**2021 Fleet Changes**	**December 31, 2021**
Wide-body aircraft			
Boeing 787-8	8	-	8
Boeing 787-9	29	-	29
Boeing 777-300ER	19	(1)	18
Boeing 777-200LR	6	-	6
Airbus A330-300	16	-	16
Narrow-body aircraft			
Boeing 737 MAX 8	24	3	27
Airbus A321	15	-	15
Airbus A320	21	(6)	15
Airbus A319	16	(10)	6
Airbus A220-300	15	12	27
Total Mainline	**169**	**(2)**	**167**

	Actual	**Planned**	
Air Canada Rouge	**December 31, 2020**	**2021 Fleet Changes**	**December 31, 2021**
Narrow-body aircraft			
Airbus A321	14	-	14
Airbus A320	5	-	5
Airbus A319	20	-	20
Total Air Canada Rouge	**39**	**-**	**39**

Total Mainline and Air Canada Rouge	**208**	**(2)**	**206**

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

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

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

Air Canada Express

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

	Actual	Planned	
	December 31, 2020	**2021 Fleet Changes**	**December 31, 2021**
Embraer 175	25	-	25
Bombardier CRJ-100/200	15	-	15
Bombardier CRJ-900	34	1	35
De Havilland Dash 8-300	19	-	19
De Havilland Dash 8-400	43	(4)	39
Total Air Canada Express	**136**	**(3)**	**133**

8. FINANCIAL AND CAPITAL MANAGEMENT

8.1 LIQUIDITY

Impact of the COVID-19 Pandemic

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

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

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

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

Liquidity Risk Management

Air Canada manages its liquidity needs through a variety of strategies, including by seeking to sustain and improve cash from operations and free cash flow, sourcing committed financing, as necessary, for new and existing aircraft, and through other financing activities.

Liquidity needs are primarily related to meeting obligations associated with financial liabilities, capital commitments, ongoing operations, contractual and other obligations, which are further discussed in sections 8.6, 8.7 and 8.8 of this MD&A. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts for a minimum period of at least 12 months, including under various scenarios and assumptions, monitoring the condition and value of assets available for use as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements.

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

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

8.2 FINANCIAL POSITION

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

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

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

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

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

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

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

8.3 NET DEBT

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

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

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

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

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

8.4 WORKING CAPITAL

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

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

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

8.5 CONSOLIDATED CASH FLOW MOVEMENTS

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

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

Net Cash Flows from (used in) Operating Activities

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

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

Net Cash Flows from (used in) Financing Activities

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

Net Cash Flows from (used in) Investing Activities

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

In 2020, net cash flows used in investing activities of $733 million reflected a reduction of $2,062 million from 2019, mainly due to a lower level of capital expenditures year-over-year, proceeds from the sale and leaseback of nine Boeing 737 MAX 8 aircraft, and movements between short and long-term investments. In 2020, Air Canada took delivery of 15 Airbus A220 aircraft. Additions to property and equipment is net of additional settlement payments received from Boeing related to the grounding of the 737 MAX fleet. The first quarter of 2019 included the impact of Air Canada's acquisition of Aeroplan on January 10, 2019.

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

Free Cash Flow

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

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

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

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

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

Net Cash Burn

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

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

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

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

8.6 CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS

Boeing 737 MAX Aircraft

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

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

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

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

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

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

Airbus A220-300 Aircraft

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

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

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

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

Capital Commitments

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

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

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

(2) U.S. dollar amounts are converted using the December 31, 2020 closing exchange rate of US$1=C$1.2725. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at December 31, 2020.

8.7 PENSION FUNDING OBLIGATIONS

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

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

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

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

8.8 CONTRACTUAL OBLIGATIONS

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

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

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

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

8.9 SHARE INFORMATION

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

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

Issuer Bid

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

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

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

Share Offerings

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

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

Proposed Acquisition of Transat

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

9. QUARTERLY FINANCIAL DATA

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

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

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

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

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

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

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

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

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

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

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

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

10. SELECTED ANNUAL INFORMATION

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

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

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

11. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

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

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

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

Risk Management

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

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

Fuel Price Risk Management

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

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

Foreign Exchange Risk

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

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

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

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

- Locking in the foreign exchange rate through the use of a variety of foreign exchange derivatives which have maturity dates corresponding to the forecasted dates of U.S. dollar net outflows.

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

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

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

Interest Rate Risk

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

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

The ratio of fixed to floating rate obligations outstanding is designed to maintain flexibility in Air Canada's capital structure and is based upon a long-term objective of 60% fixed and 40% floating but allows flexibility to adjust to prevailing market conditions. The ratio at December 31, 2020 is 74% fixed and 26% floating (83% and 17%, respectively as at December 31, 2019).

12. ACCOUNTING POLICIES

Interbank Offered Rate ("IBOR") Reform

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

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

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

13. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

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

Impairment Considerations on Long-lived Assets

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

Income Taxes

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

Aeroplan Loyalty Program

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

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

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

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

Depreciation and Amortization Period for Long-lived assets

Air Canada makes estimates about the expected useful lives of long-lived assets and the expected residual value of the assets based on the estimated current and future fair values of the assets, the Corporation's fleet plans, and the cash flows they generate. Changes to these estimates, which can be significant, could be caused by a variety of factors, including changes to maintenance programs, changes in jet fuel prices and other operating costs, changes in utilization of the aircraft, and changing market prices for new and used aircraft of the same or similar types. Estimates and assumptions are evaluated at least annually. Generally, these adjustments are accounted for on a prospective basis, through depreciation and amortization expense. For the purposes of sensitivity analysis on these estimates, a 50% reduction to residual values on aircraft with remaining useful lives greater than five years results in an increase of $14 million to annual depreciation expense. For aircraft with shorter remaining useful lives, the residual values are not expected to change significantly.

Maintenance Provisions

The recording of maintenance provisions related to return conditions on aircraft leases requires management to make estimates of the future costs associated with the maintenance events required under the lease return condition and estimates of the expected future maintenance condition of the aircraft at the time of lease expiry. These estimates consider current costs of these maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Any difference in the actual maintenance cost incurred at the end of the lease and the amount of the provision is recorded in aircraft maintenance expense in the period. The effect of any changes in estimates, including changes in discount rates, inflation assumptions, cost estimates or lease expiries, is recognized as an adjustment to the right-of-use asset.

Employee Future Benefits

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

Assumptions

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

Discount Rate

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

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

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

	Pension Benefits		Other Employee Future Benefits	
	2020	2019	2020	2019
Discount rate used to determine:				
Net interest on the net benefit obligation for the year ended December 31	3.13%	3.81%	3.13%	3.81%
Service cost for the year ended December 31	3.20%	3.93%	3.20%	3.93%
Accrued benefit obligation as at December 31	2.59%	3.13%	2.59%	3.13%
Rate of future increases in compensation used to determine:				
Accrued benefit cost for the year ended December 31	2.50%	2.50%	Not applicable	Not applicable
Accrued benefit obligation as at December 31	2.50%	2.50%	Not applicable	Not applicable

Sensitivity Analysis

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

Sensitivity analysis on 2020 pension expense and net financing expense relating to pension benefit liabilities, based on different actuarial assumptions with respect to discount rate is set out below. The effects on each pension plan of a change in an assumption are weighted proportionately to the total plan obligation to determine the total impact for each assumption presented.

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

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

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

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

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

14. OFF-BALANCE SHEET ARRANGEMENTS

Guarantees

Guarantees in Fuel and De-icing Arrangements

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

Indemnification Agreements

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

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

15. RELATED PARTY TRANSACTIONS

At December 31, 2020, Air Canada had no transactions with related parties as defined in the CPA Handbook, except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship agreements.

16. ENTERPRISE RISK MANAGEMENT AND GOVERNANCE

Overview

The management of opportunities and risks is an integral part of Air Canada's business processes. Strategic decisions are made by the executive team with consideration of risk implications to the business and its stakeholders. Risks which may be material to Air Canada are identified and monitored on an 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 2020, Air Canada has remained vigilant to continue to maintain the integrity and resiliency of its key governance, oversight and risk management processes as outlined below. Processes have been adjusted as necessary to reflect changes to Air Canada's business and working environments; ensuring important risks continue to be managed appropriately.

Board Oversight

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

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

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

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

Risk Management Framework and Structure

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

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

Sound business practices and ethical behaviour are also fundamental to Air Canada's risk governance culture. Air Canada has in place (and updates, as required) a Corporate Policy and Guidelines on Business

Conduct ("Code of Conduct"), which sets out guiding principles and ethical standards that apply to all Air Canada's corporate activities. A confidential, anonymous reporting process and ethics committee are also in place to oversee adherence to the Code of Conduct.

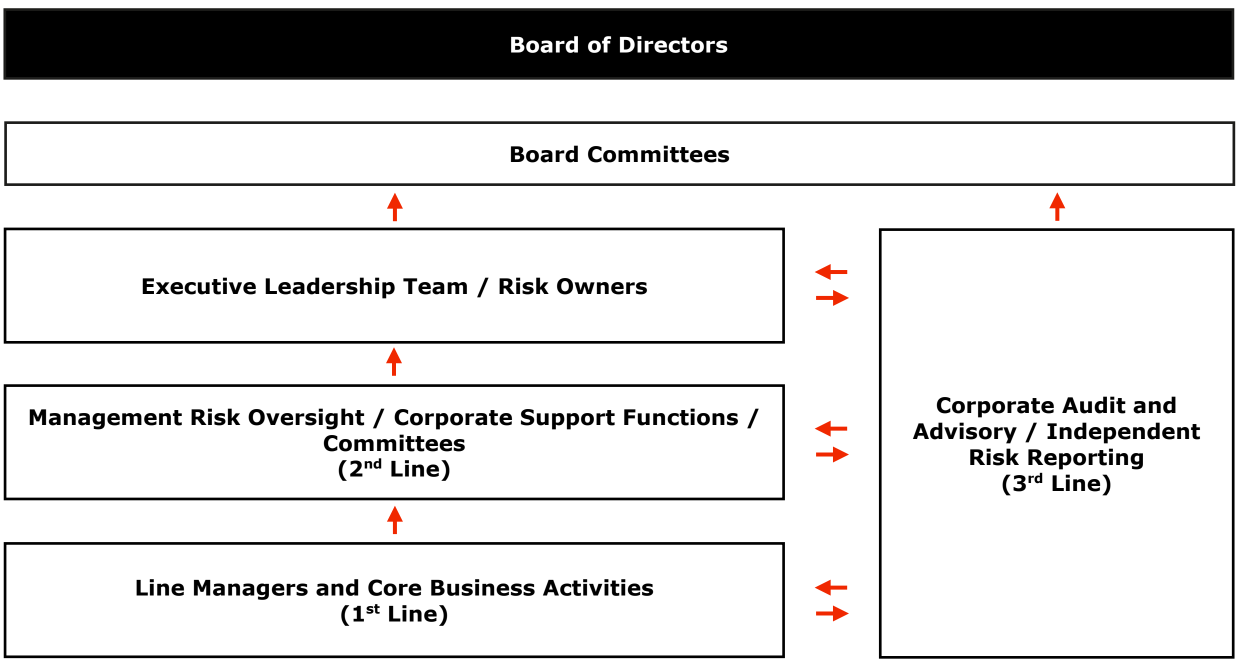
Air Canada's risk management structure is aligned with the "Three Lines of Defence" approach to risk management:

1st line - Business functions are expected to integrate risk management when performing their day-to-day core commercial and operational activities.

2nd line - Support functions establish policies, provide guidance and expertise, and risk oversight (e.g. Safety, Security, Legal and Compliance, Finance/Treasury/Tax, Sourcing and Procurement, Government Affairs, People, Environment, IT Operations and IT Security).

3rd line - Corporate Audit and Advisory department provides an independent and objective perspective on Air Canada's governance, risk management practices and controls.

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



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

17. RISK FACTORS

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

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

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

Air Canada has taken and implemented a number of safety measures in light of the COVID-19 pandemic, including the Air Canada CleanCare+ program and has publicly appealed to governments and other parties in an effort to recognize the efficacy of such safety measures and to allow for a measured and responsible reduction of travel restrictions. Air Canada continues to be adversely impacted to the extent that travel restrictions and advisories remain in place over time. Air Canada as well as its brand and reputation may also be adversely impacted to the extent that safety measures introduced are not perceived to adequately address the risks of transmission of COVID-19 or justify relaxing the travel restrictions and advisories issued by governments or by perceptions that any efforts Air Canada makes to mitigate the risk of transmission of COVID 19 during the course of a journey or otherwise to support or promote travel are designed to induce travel and are inconsistent with public health interests.

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

Air Canada is providing customers who booked with Air Canada and who are affected by COVID-19 related cancellations with the option to convert their ticket to an Air Canada travel voucher that has no expiry date and is fully transferable. Alternatively, customers may convert the unused value of their ticket into Aeroplan

Points and receive additional bonus Aeroplan Points. Air Canada is refunding refundable fares according to the terms and conditions that govern them. Air Canada may be required to refund non-refundable fares depending on the laws of the jurisdictions applicable to such flights. Not refunding non-refundable tickets exposes Air Canada to litigation, as well as enforcement action by regulators in certain jurisdictions, and may also adversely impact Air Canada's brand and reputation. Class actions claiming the refund of non-refundable tickets or tour packages have been filed against Air Canada, and other carriers, in Canada and in the United States, and additional class actions or other proceedings may be instituted in these or other jurisdictions. In countries where refund requirements are or will be enhanced, maintained or enforced, ensuing refunds may adversely impact Air Canada's liquidity and the impact of all these risks could be material.

COVID-19 has also materially disrupted Air Canada's strategic operating plans in the near-term, and there are risks to it and Air Canada's business, operating results and financial condition associated with executing Air Canada's strategic operating plans in the long-term. In recent years, Air Canada developed several strategic operating plans, including several revenue-generating initiatives and plans to optimize Air Canada's revenue, such as plans to add capacity, including international expansion, initiatives and plans to optimize and control Air Canada's costs and opportunities to enhance segmentation and improve the customer experience at all points in air travel. In developing strategic operating plans, Air Canada makes certain assumptions, including, but not limited to, those related to customer demand, competition, market consolidation, the availability of aircraft and the global economy. Actual economic, market and other conditions have been and may continue to be different from Air Canada's assumptions. In 2020, demand was, and is expected to continue to be in 2021, significantly impacted by COVID-19, which has materially disrupted the timely execution of Air Canada's strategic operating plans, including plans to add capacity in 2020. If Air Canada does not successfully develop, execute or adjust Air Canada's strategic operating plans in the long-term, or if actual conditions and results continue to vary significantly from the assumptions on which they are based, Air Canada's business, operating results and financial condition could be materially and adversely impacted.

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

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

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

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

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

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

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

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

Although prior to the COVID-19 pandemic Air Canada had been focusing on reducing its level of indebtedness and improving its leverage ratios, the amount of indebtedness that Air Canada has and which it may incur in the future could have a material adverse effect on Air Canada. The ability of Air Canada to make scheduled payments under its indebtedness will depend on, among other things, its future operating performance and its ability to refinance its indebtedness, if necessary. Air Canada incurs a significant proportion of its indebtedness in foreign currencies, primarily in U.S. dollars, and as a result, future debt servicing repayments are subject to foreign exchange risk. There can be no assurance that Air Canada will at all times be able to generate sufficient cash from its operations to satisfy its debts, lease and other obligations. Each of these factors is, to a large extent, subject to economic, financial, competitive, regulatory, operational and other factors, many of which are beyond Air Canada's control.

Need for capital and liquidity - Air Canada may not be able to obtain sufficient funds in a timely way and on acceptable terms to provide adequate liquidity and to finance necessary operating and capital expenditures

Air Canada's liquidity levels may be adversely impacted by risks identified in this MD&A, including the effects of the COVID-19 pandemic, geopolitical, economic and public health conditions, foreign exchange rates, increased competition, volatile fuel prices, labour issues, and contractual covenants (which require Air Canada to maintain minimum cash reserves and which could require Air Canada to deposit cash collateral with third parties). As part of Air Canada's efforts to manage such challenges and to support Air Canada's business strategy, significant liquidity and significant 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 items. There can be no assurance as to the timing of any such issuance, or that any such additional financing will be completed on favorable terms, or at all.

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

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

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

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

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

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

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

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

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

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

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

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

As indicated under 4 "Strategy and COVID-19 Mitigation and Recovery Plan", as part of its ongoing efforts to increase liquidity levels, Air Canada continues to pursue additional financing arrangements. Such financings may include secured or unsecured credit agreements or debt securities, as well as the issuance of additional Shares or equity-linked instruments. If Air Canada determines to pursue government funding under a government financial assistance program but is unable to secure it, or if such program or other assistance is not made available to Air Canada on terms acceptable to it, the amount of financing that Air

Canada would be required to seek from other third parties would be increased accordingly. However, no assurance can be made that any such replacement financing will be available on acceptable terms or at all. See 4 "Strategy and COVID-19 Mitigation and Recovery Plan" for additional information.

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

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

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

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

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

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

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

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

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

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

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

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

The potential for terrorist attacks and terrorist activity causes concern and uncertainty in the minds of the traveling 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 traveling on Air Canada's flights. It could also lead to a substantial increase in insurance, security and other costs, including higher operating costs to avoid flying over airspace near conflict zones. Any resulting reduction in passenger revenues and/or increases in costs, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

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

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

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

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

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

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

Compliance with current or future Canadian and international laws, regulations and administrative requirements, including potentially inconsistent or conflicting laws or regulations, or laws or regulations which 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 adversely affect Air Canada, its business, results from operations and financial condition.

The ability of Air Canada to operate flights or otherwise offer air services on international routes between airports in Canada and other countries may be subject to change, including as a result of the COVID-19 pandemic. Applicable arrangements between Canada and foreign governments, which govern many areas including traffic rights, may be amended from time to time, rules and policies with respect to airport operations may be revised, and the availability of appropriate airport slots or facilities may change. Air Canada currently operates a number of flights on international routes under government arrangements, regulations or policies that designate the number of carriers permitted to operate on such routes, the capacity of the carriers providing services on such routes, the airports at which carriers may operate international flights, or the number of carriers allowed access to particular airports. Any further limitations, additions or modifications to such arrangements, regulations or policies could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Additionally, if Canada were to adopt a more liberalized approach in relation to air services arrangements with foreign countries, such an approach could have a material adverse impact on Air Canada, its business, results from operations and financial condition and could result in the impairment of material amounts of related tangible and intangible assets.

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

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

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

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

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

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

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

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

After completing the acquisition of Aeroplan Inc. (formerly Aimia Canada Inc.), owner and operator of the Aeroplan loyalty business and program in January 2019, Air Canada implemented, in November 2020 a new, redesigned Aeroplan loyalty program. Air Canada offers its customers who are Aeroplan members the opportunity to earn Aeroplan Points, which management believes is a significant factor in many customers' decision to travel with Air Canada and contributes to building customer loyalty. The success of the Aeroplan program is dependent on attracting new and retaining current members and on maintaining sufficient accumulation and redemption partners. Increases in redemption rates for outstanding Aeroplan Points, any failures to adequately operate the Aeroplan program or interruptions or disruptions of Aeroplan program services, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

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

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

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

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

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

Air Canada seeks to enhance its network through capacity purchase agreements with certain airlines and regional airlines such as Jazz and Sky Regional operating flights on behalf of Air Canada. Pursuant to the terms of the Jazz CPA, Air Canada pays Jazz a number of fees, some of which are fixed and others which are determined based upon certain costs incurred by Jazz. Air Canada also reimburses Jazz for certain pass-through costs incurred by Jazz (or arranges to provide the related supplies to Jazz), such as fuel, navigation, landing and terminal fees. In addition, the Jazz CPA requires that Jazz maintain a minimum fleet size and contains a minimum average daily utilization guarantee which requires Air Canada to utilize Jazz for that amount of flying. Significant increases in Jazz's costs, the failure by Jazz to adequately fulfill its obligations under the Jazz CPA, factors which may reduce the utilization of the Jazz fleet, including economic or market downturns, and unexpected interruptions or cessation of Jazz's services, as well as similar circumstances relating to other airlines from whom Air Canada sources capacity, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

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

Air Canada believes that its success is dependent on the value of its brand and on Air Canada's ability to preserve, grow and leverage that value. The Air Canada brand is recognized throughout the world, and Air Canada has received high ratings in external brand value studies, based in part on consumer perceptions on a variety of subjective qualities. Air Canada believes it has and continues to build an excellent reputation globally for the safety and quality of its services, and for the delivery of a consistently positive passenger experience. Air Canada's reputation and brand could be damaged if exposed to significant adverse publicity through social media. Adverse publicity, whether justified or not, can rapidly spread through social or digital media. To the extent we are unable to respond timely and appropriately to adverse publicity, our brand and reputation may be damaged. Any failure to preserve or grow Air Canada's brand, including by reason of the conduct of Air Canada or any of its business partners or other external parties, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

18. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures and Internal Controls over Financial Reporting

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

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

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

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

Management's Report on Disclosure Controls and Procedures

Management, under the supervision of and with the participation of the Corporation's CEO and CFO, evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined under National Instrument 52-109) and concluded, as at December 31, 2020, that such disclosure controls and procedures were effective.

Management's Report on Internal Controls over Financial Reporting

Management, under the supervision of and with the participation of the Corporation's CEO and CFO, evaluated the effectiveness of the Corporation's internal controls over financial reporting (as defined under National Instrument 52-109). In making this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commissions ("COSO") in Internal Control - Integrated Framework (2013). Based on that evaluation, management and the CEO and CFO have concluded that, as at December 31, 2020, the Corporation's internal controls over financial reporting were effective. This evaluation took into consideration the Corporation's Corporate Disclosure Policy and the functioning of its Disclosure Policy Committee.

Changes in Internal Controls over Financial Reporting

There have been no changes to the Corporation's internal controls over financial reporting during 2020 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

19. NON-GAAP FINANCIAL MEASURES

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

EBITDA

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

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

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

Adjusted CASM

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

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

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

Adjusted CASM is reconciled to GAAP operating expense as follows:

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

Adjusted Pre-tax Income (Loss)

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

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

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

Free Cash Flow

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

Net Cash Burn

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

20. GLOSSARY

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

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

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

Aeroplan – Refers to Aeroplan Inc.

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

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

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

Boeing – Refers to The Boeing Company.

Bombardier – Refers to Bombardier Inc.

CASM – Refers to operating expense per ASM.

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

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

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

Jazz – Refers to Jazz Aviation LP.

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

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

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

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

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

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

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

Passenger revenue per available seat mile or PRASM – Refers to average passenger revenue per ASM.

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

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

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

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

Sky Regional – Refers to Sky Regional Airlines Inc.

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

Yield – Refers to average passenger revenue per RPM.