
# 2022

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

February 17, 2023

AIR CANADA

A STAR ALLIANCE MEMBER

**TABLE OF CONTENTS**

1. SELECTED FINANCIAL METRICS AND STATISTICS ..... 1
2. INTRODUCTION AND KEY ASSUMPTIONS ..... 3
3. ABOUT AIR CANADA ..... 5
4. OVERVIEW ..... 6
5. RESULTS OF OPERATIONS – 2022 VERSUS 2021 ..... 12
6. RESULTS OF OPERATIONS – Q4 2022 VERSUS Q4 2021 ..... 21
7. FLEET ..... 29
8. FINANCIAL AND CAPITAL MANAGEMENT ..... 32
 8.1 LIQUIDITY ..... 32
 8.2 FINANCIAL POSITION ..... 33
 8.3 NET DEBT ..... 34
 8.4 WORKING CAPITAL ..... 35
 8.5 CASH FLOW MOVEMENTS ..... 36
 8.6 CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS ..... 38
 8.7 PENSION FUNDING OBLIGATIONS ..... 39
 8.8 CONTRACTUAL OBLIGATIONS ..... 41
 8.9 SHARE INFORMATION ..... 42
9. QUARTERLY FINANCIAL DATA ..... 43
10. SELECTED ANNUAL INFORMATION ..... 44
11. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT ..... 45
12. ACCOUNTING POLICIES ..... 47
13. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS ..... 48
14. OFF-BALANCE SHEET ARRANGEMENTS ..... 52
15. RELATED PARTY TRANSACTIONS ..... 52
16. SENSITIVITY OF RESULTS ..... 53
17. ENTERPRISE RISK MANAGEMENT AND GOVERNANCE ..... 54
18. RISK FACTORS ..... 56
19. CONTROLS AND PROCEDURES ..... 64
20. NON-GAAP FINANCIAL MEASURES ..... 66
21. GLOSSARY ..... 72

# 1. SELECTED FINANCIAL METRICS AND STATISTICS

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

| (Canadian dollars in millions, except per share data or where indicated) | Fourth Quarter | | | Full Year | | |
|---|---|---|---|---|---|---|
| **Financial Performance Metrics** | **2022** | **2021** | **$ Change** | **2022** | **2021** | **$ Change** |
| Operating revenues | 4,680 | 2,731 | 1,949 | 16,556 | 6,400 | 10,156 |
| Operating loss | (28) | (503) | 475 | (187) | (3,049) | 2,862 |
| Operating margin (1) (%) | (0.6) | (18.4) | 17.8 pp (10) | (1.1) | (47.6) | 46.5 pp |
| Adjusted EBITDA (2) | 389 | 22 | 367 | 1,457 | (1,464) | 2,921 |
| Adjusted EBITDA margin (2) (%) | 8.3 | 0.8 | 7.5 pp | 8.8 | (22.9) | 31.7 pp |
| Income (loss) before income taxes | 146 | (617) | 763 | (1,524) | (3,981) | 2,457 |
| Net income (loss) | 168 | (493) | 661 | (1,700) | (3,602) | 1,902 |
| Adjusted pre-tax loss (2) | (211) | (574) | 363 | (952) | (3,768) | 2,816 |
| Adjusted net loss (2) | (217) | (577) | 360 | (988) | (3,768) | 2,780 |
| Total liquidity (3) | 9,824 | 10,528 | (704) | 9,824 | 10,528 | (704) |
| Net cash flows from (used in) operating activities (4) | 647 | 508 | 139 | 2,368 | (1,502) | 3,870 |
| Free cash flow (2) | 320 | 130 | 190 | 796 | (2,564) | 3,360 |
| Net debt (2) | 7,495 | 6,953 | 542 | 7,495 | 6,953 | 542 |
| Diluted earnings (loss) per share | 0.41 | (1.38) | 1.79 | (4.75) | (10.25) | 5.50 |
| Adjusted loss per share (2) | (0.61) | (1.61) | 1.00 | (2.76) | (10.74) | 7.98 |
| **Operating Statistics (5)** | **2022** | **2021** | **Change %** | **2022** | **2021** | **Change %** |
| Revenue passenger miles (RPMs) (millions) | 18,525 | 9,612 | 92.7 | 66,495 | 21,045 | 216.0 |
| Available seat miles (ASMs) (millions) | 22,368 | 14,057 | 59.1 | 82,558 | 33,384 | 147.3 |
| Passenger load factor % | 82.8% | 68.4% | 14.4 pp | 80.5% | 63.0% | 17.5 pp |
| Passenger revenue per RPM (Yield) (cents) | 21.9 | 21.2 | 3.3 | 21.4 | 21.4 | - |
| Passenger revenue per ASM (PRASM) (cents) | 18.2 | 14.5 | 25.1 | 17.2 | 13.5 | 28.0 |
| Operating revenue per ASM (cents) | 20.9 | 19.4 | 7.7 | 20.1 | 19.2 | 4.6 |
| Operating expense per ASM (CASM) (cents) | 21.1 | 23.0 | (8.5) | 20.3 | 28.3 | (28.3) |
| Adjusted CASM (cents) (2) | 13.7 | 16.7 | (18.3) | 13.2 | 23.3 | (43.4) |
| Average number of full-time-equivalent (FTE) employees (thousands) (6) | 33.2 | 25.2 | 32.0 | 30.5 | 19.8 | 54.2 |
| Aircraft in operating fleet at period-end (7) | 345 | 337 | 2.4 | 345 | 337 | 2.4 |
| Seats dispatched (thousands) | 12,690 | 8,772 | 44.7 | 47,038 | 21,105 | 122.9 |
| Aircraft frequencies (thousands) | 89.9 | 71.5 | 25.6 | 340.5 | 175.3 | 94.2 |
| Average stage length (miles) (8) | 1,763 | 1,602 | 10.0 | 1,755 | 1,582 | 11.0 |
| Fuel cost per litre (cents) | 134.3 | 83.9 | 60.1 | 130.1 | 74.7 | 74.0 |
| Fuel litres (thousands) | 1,084,569 | 791,581 | 37.0 | 4,056,788 | 2,108,144 | 92.4 |
| Revenue passengers carried (thousands) (9) | 10,098 | 5,836 | 73.0 | 36,144 | 13,192 | 174.0 |

*(1) Operating margin is a supplementary financial measure and is defined as operating income (loss) as a percentage of operating revenues.*

*(2) Adjusted EBITDA (earnings before interest, taxes, depreciation, and amortization), adjusted EBITDA margin, adjusted pre-tax income (loss), adjusted net income (loss), free cash flow, net debt, adjusted earnings (loss) per share, and adjusted CASM are non-GAAP financial measures, capital management measures, non-GAAP ratios or supplementary financial measures. Such measures are not recognized measures for financial statement presentation under GAAP, do not have standardized meanings, may not be comparable to similar measures presented by other entities and should not be considered a substitute for or superior to GAAP results. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for descriptions of Air Canada's non-GAAP financial measures and for a quantitative reconciliation of Air Canada's non-GAAP financial measures to the most comparable GAAP measure.*

*(3) Total liquidity refers to the sum of cash, cash equivalents, short and long-term investments, and the amounts available under Air Canada's credit facilities. Total liquidity, as at December 31, 2022, of $9,824 million consisted of $8,811 million in cash, cash equivalents, short and long-term investments and $1,013 million available under undrawn credit facilities. As at December 31, 2021, total liquidity of $10,528 million consisted of $9,570 million in cash and cash equivalents, short and long-term investments, and $958 million available under undrawn credit facilities. These amounts also include funds ($386 million as at December 31, 2022 and $167 million as at December 31, 2021) held in trust by Air Canada Vacations in accordance with regulatory requirements governing advance sales for tour operators. Refer to section 12 "Accounting Policies" of this MD&A for a description of the change in presentation related to restricted cash and pursuant to which certain amounts have been reclassified to cash and cash equivalents with the 2021 comparative figures also reclassified.*

*(4) Refer to section 12 "Accounting Policies" of this MD&A for a description of the change in presentation related to restricted cash and pursuant to which certain amounts have been reclassified to cash and cash equivalents with the 2021 comparative figures also reclassified.*

*(5) 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.*

*(6) Reflects FTE employees at Air Canada and its subsidiaries. Excludes FTE employees at third party carriers operating under capacity purchase agreements with Air Canada. As of December 31, 2022, there were 35,600 employees based in Canada.*

*(7) The number of aircraft in Air Canada's operating fleet at December 31, 2022 and at December 31, 2021 includes certain aircraft that were grounded due to the impact of the COVID-19 pandemic. As at December 31, 2022, two aircraft remained grounded pending return to service maintenance.*

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

*(9) 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.*

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

## 2. INTRODUCTION AND KEY ASSUMPTIONS

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), the Corporation refers, as the context may require, to Air Canada and/or one or more of Air Canada's subsidiaries, including its wholly owned operating subsidiaries, Aeroplan Inc. (Aeroplan), Touram Limited Partnership, doing business under the brand name Air Canada Vacations® (Air Canada Vacations), and Air Canada Rouge LP, doing business under the brand name Air Canada Rouge® (Air Canada Rouge). This MD&A provides the reader with a review and analysis, from the perspective of management, of Air Canada's financial results for the fourth quarter and full year 2022. This MD&A should be read in conjunction with Air Canada's 2022 annual audited consolidated financial statements and notes dated February 17, 2023. All financial information has been prepared in accordance with generally accepted accounting principles in Canada (GAAP), as set out in the CPA Canada Handbook – Accounting (CPA Handbook), which incorporates International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB), except for any non-GAAP measures and any financial information specifically denoted otherwise.

Except as otherwise noted, monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 21 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of February 16, 2023.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 18 "Risk Factors" of this MD&A. Air Canada issued a news release dated February 17, 2023 reporting on its results for the fourth quarter and full year 2022. 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. Forward-looking statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to guidance, strategies, expectations, planned operations or future actions. Forward-looking statements are identified using terms and phrases such as "preliminary", "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "predict", "project", "will", "would", and similar terms and phrases, including references to assumptions.

Forward-looking statements, by their nature, are based on assumptions including those described herein and 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.

Factors that may cause results to differ materially from results indicated in forward-looking statements include economic and geopolitical conditions such as the military conflict between Russia and Ukraine, Air Canada's ability to successfully achieve or sustain positive net profitability, industry and market conditions and the demand environment, competition, the remaining effects from the COVID-19 pandemic, 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 manage operating costs), energy prices, Air Canada's ability to pay its indebtedness and maintain or increase liquidity, interruptions of service, climate change and environmental factors (including weather systems and other natural phenomena and factors arising from anthropogenic sources), Air Canada's dependence on key suppliers (including government agencies and other stakeholders supporting airport and airline operations), Air Canada's dependence on regional and other carriers, Air Canada's ability to attract and retain required personnel, the availability and onboarding of Air Canada's workforce, other epidemic diseases, changes in laws, regulatory developments or proceedings, employee and labour relations and costs, terrorist acts, war, Air Canada's ability to successfully operate its loyalty program, casualty losses, Air Canada's dependence on Star Alliance® and joint ventures, Air Canada's ability to preserve and grow its brand, pending and future litigation and actions by third parties, currency exchange fluctuations, limitations due to restrictive covenants, insurance issues and costs, and pension plan obligations, as well as the factors identified in Air Canada's public disclosure file available at www.sedar.com and, in particular, those identified in section 18 "Risk Factors" of this MD&A.

Air Canada has and continues to establish targets, make commitments, and assess the impact regarding climate change, and related initiatives, plans and proposals that Air Canada and other stakeholders (including government, regulatory and other bodies) are pursuing in relation to climate change and carbon emissions. The achievement of our commitments and targets depends on many factors, including the combined actions and efforts of governments, industry, suppliers and other stakeholders and actors, as well as the development and implementation of new technologies. Air Canada has incurred, and expects to continue to incur, costs to achieve its goal of net-zero carbon emissions and to comply with environmental sustainability legislation and regulation and other standards and accords. The precise nature of future binding or non-binding legislation, regulation, standards and accords, which is receiving increased focus of multiple stakeholders locally and internationally, cannot be predicted with any degree of certainty nor can their financial, operational or other impact. There can be no assurance of the extent to which any of our climate goals will be achieved or that any future investments that we make in furtherance of achieving our climate goals will produce the expected results or meet increasing stakeholder environmental, social and governance expectations. Moreover, future events could lead Air Canada to prioritize other nearer-term interests over progressing toward our current climate goals based on business strategy, economic, regulatory and social factors, potential pressure from investors, activist groups or other stakeholders. If we are unable to meet or properly report on our progress toward achieving our climate change goals and commitments, we could face adverse publicity and reactions from other investors, customers, advocacy groups, or other stakeholders, which could result in reputational harm or other adverse effects to Air Canada.

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**

Assumptions were made by Air Canada in preparing and making forward-looking statements. As part of its assumptions, Air Canada assumes moderate Canadian GDP growth for 2023. Air Canada also assumes that the Canadian dollar will trade, on average, at C$1.34 per U.S. dollar for the full year 2023 and that the price of jet fuel will average C$1.30 per litre for the full year 2023.

**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.

**Incorporation of Other Information**

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

## 3. ABOUT AIR CANADA

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

Air Canada enhances its domestic and transborder network through a capacity purchase agreement (CPA) with Jazz Aviation LP (Jazz), a wholly owned subsidiary of Chorus Aviation Inc., with regional flights operated on behalf of Air Canada under the Air Canada Express banner. Regional flying forms an integral part of the airline's international network strategy, providing valuable traffic feed to Air Canada and Air Canada Rouge routes.

In 2022, Air Canada together with its regional partners operated, on average, 945 daily scheduled flights to 185 direct destinations on six continents. In comparison, in 2019, Air Canada, together with its regional partners, operated, on average, 1,531 daily scheduled flights to 217 direct destinations on six continents.

At December 31, 2022, Air Canada mainline had 192 aircraft in its operating fleet, which consisted of 110 Boeing and Airbus narrow-body aircraft and 82 Boeing and Airbus wide-body aircraft, including five Boeing 767 freighter aircraft (of which, at December 31, 2022, three were in service and two pending Transport Canada certification), while Air Canada Rouge had an operating fleet of 39 Airbus narrow-body aircraft. At December 31, 2022, the Air Canada Express fleet comprised 50 Mitsubishi regional jets, 39 De Havilland Dash-8 turboprop aircraft and 25 Embraer 175 aircraft for a total of 114 aircraft.

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

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

Air Canada Cargo, a division of Air Canada, is a global cargo service provider, offering cargo services on passenger flights and on all-cargo flights, including on dedicated freighter aircraft. Air Canada Cargo uses cargo space available in Air Canada's mainline wide-body aircraft and on dedicated Boeing 767 freighters. Air Canada Cargo operated three Boeing 767 freighters at December 31, 2022 and expects to have seven Boeing 767 freighters in service by the end of 2023.

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

## 4. OVERVIEW

Throughout the COVID-19 pandemic, Air Canada and the rest of the global airline industry faced significantly lower traffic than in 2019. Demand for travel services was impacted by varying health measures, travel restrictions coupled with vaccination requirements introduced by numerous countries, as well as by concerns related to the pandemic and its economic impact. This translated into a decline in revenue and cash flows. During the pandemic, Air Canada actively managed its available capacity based on prevailing market trends and travel demand.

The effects of the pandemic continued to be felt in early 2022, including with the emergence of the Omicron variant. Despite the challenges faced in the first half of 2022, Air Canada continued with its ramp up plans in anticipation of an expected rise in demand. The situation started to improve in the second quarter of 2022, and the lifting of most travel restrictions allowed for a significant resumption of operations during 2022. In 2022, Air Canada's total operated capacity recovered to 73% of 2019 levels.

The summer of 2022 marked a pivotal point in Air Canada's path to recovery from the effects of the COVID-19 pandemic. In Canada, most of the remaining travel restrictions for fully vaccinated travellers were eased leading into the summer period. Effective October 1, 2022, all remaining Government of Canada COVID-19 travel health restrictions and measures were lifted, including requirements for wearing masks on aircraft, testing and quarantine, and the mandatory use of the ArriveCan declaration application. As a result, in Canada, similar to many countries around the world, upon the lifting of travel restrictions and health measures, travel recovered at an accelerated pace, primarily led by leisure and visiting friends and relatives (VFR) traffic. However, the impact of the pandemic impeded Air Canada's and the global airline industry's restart efforts and affected the ability of some of its participants, on which Air Canada's operations are dependent, to support the surge in traffic, which resulted in a meaningful increase in flight delays and cancellations, and other operational disruptions and challenges from June to mid-July 2022.

**Full Year 2022 Financial Summary**

The following is an overview of Air Canada's results of operations and financial position for the full year 2022 compared to the full year 2021, with selected comparisons to 2019, being the pre-pandemic comparison period.

- Operating revenues of $16,556 million compared to operating revenues of $6,400 million in 2021, an increase of $10,156 million. Compared to 2019, operating revenues recovered to about 87%.
- Operating expenses of $16,743 million versus operating expenses of $9,449 million in 2021, an increase of $7,294 million or 77% on an operated capacity increase of about 59%, and a 74% increase in fuel prices. Compared to 2019, operating expenses declined 4% on a capacity decline of about 27% and a 70% increase in fuel prices. Refer to section 5 "Results of operations – 2022 versus 2021" of this MD&A for additional details on operating costs.
- Operating loss of $187 million, an improvement from an operating loss of $3,049 million in 2021.
- Adjusted CASM of 13.2 cents compared to 23.3 cents in 2021. Adjusted CASM increased 19% from 2019, one percentage point above the high point of the range projected in Air Canada's third quarter 2022 earnings release, dated October 28, 2022. This increase was due to the impact of higher passenger traffic and yield (which increased sales and distribution costs), general inflationary pressures, including but not limited to higher catering and service costs, customer disruption costs greater than expected (largely due to weather-related disruptions in the fourth quarter of 2022), and higher employee benefits expense.
- Adjusted EBITDA of $1,457 million, with an adjusted EBITDA margin of 8.8%, improved $2,921 million from 2021. The adjusted EBITDA margin was within the projection provided in Air Canada's news release dated October 28, 2022.
- Net cash flows from operating activities of $2,368 million compared to cash used in operating activities of $1,502 million in 2021. Refer to section 8.5 "Cash Flow Movements" of this MD&A for additional information.

- In 2022, Air Canada repurchased and cancelled $635 million (US$473 million) aggregate principal amount of its outstanding 4.000% Convertible Notes due 2025 for an aggregate cash repurchase price of approximately $778 million (US$579 million), including accrued interest. A total of $372 million (US$274 million) aggregate principal amount of Convertible Notes remains outstanding.

**Fourth Quarter 2022 Financial Summary**

The following is an overview of Air Canada's results of operations and financial position for the fourth quarter 2022 compared to the fourth quarter 2021, with selected comparisons to the fourth quarter 2019, being the pre-pandemic comparison period.

- Record fourth quarter operating revenues of $4,680 million compared to fourth quarter 2021 operating revenues of $2,731 million, an increase of $1,949 million. Compared to the fourth quarter of 2019, operating revenues increased 6% while operated capacity recovered to 85%.

- Operating expenses of $4,708 million versus operating expenses of $3,234 million in the fourth quarter of 2021, an increase of $1,474 million or 46%. Compared to the same period in 2021, operated capacity and fuel price increased 59% and 60%, respectively.

- Operating loss of $28 million, improved from an operating loss of $503 million in the fourth quarter of 2021.

- Adjusted CASM of 13.7 cents compared to 16.7 cents in the fourth quarter of 2021. Adjusted CASM increased 15% from 2019. Refer to section 6 "Results of operations – Q4 2022 versus Q4 2021" of this MD&A for additional details on factors affecting adjusted CASM.

- Adjusted EBITDA of $389 million, with an adjusted EBITDA margin of 8.3%, improved $367 million from the fourth quarter of 2021.

- Net cash flows from operating activities of $647 million increased $139 million from the fourth quarter of 2021. Refer to section 8.5 "Cash Flow Movements" of this MD&A for additional information.

**Corporate Strategy**

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

Air Canada is evolving its business for the future. "Rise Higher", Air Canada's business imperatives strategy is intended to elevate everything about its business. In pursuing this strategy, Air Canada is working to:

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

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

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

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

In pursuit of this strategy, in 2023, Air Canada will continue to build upon and leverage its key assets and numerous competitive advantages, including:

- Its talented people, and award-winning culture.
- A streamlined, modern, fuel efficient and versatile fleet, with market-leading aircraft configurations.
- A global network, well positioned to meet demand from various customer segments, and enhanced by the airline's membership in Star Alliance® and by numerous commercial arrangements.
- A widely recognized and powerful brand.
- A customer experience enhanced by competitive products and services, including the fully transformed Aeroplan program.
- Air Canada Rouge, a lower-cost leisure carrier and Air Canada Vacations, a leading Canadian tour operator.
- A growing cargo offering.
- New core technologies and other technological improvements.
- A commitment to sustainability.

**2022 Highlights**

*Funding the future*

Notwithstanding the impact of the COVID-19 pandemic, Air Canada has continued to make strategic and innovative investments in technology and other assets to fund its future.

In 2022, Air Canada announced it is acquiring 30 extra-long range (XLR) versions of the Airbus A321neo aircraft and converted options for 15 Airbus A220-300 aircraft into firm orders. Air Canada also agreed to purchase 30 ES-30 electric-hybrid regional aircraft under development by Heart Aerospace of Sweden (expected to enter service in 2028), and to invest $7 million in Heart Aerospace.

Air Canada also announced an equity investment/loan of $6.75 million into Canadian climate solutions company Carbon Engineering (CE), supporting the advancement of CE's Direct Air Capture (DAC) technology that aims to extract carbon dioxide directly out of the air at large, industrial scale.

*Reaching New Frontiers*

In 2022, Air Canada continued to restore its North American and International network, doing so prudently and proportionally with the air transportation's system ability to absorb new capacity. This included:

- An expansion of its North American network for the Summer of 2022 that included the launch of new service on four transborder and three domestic routes, as well as the restoration of 41 North American routes. Air Canada operated to 51 Canadian and 46 U.S. airports in the summer of 2022 and offered customers the largest network and the most travel options of any Canadian carrier.
- An expanded Summer 2022 international schedule with 34 routes relaunched across the Atlantic and Pacific.
- The strategic expansion of its South Pacific schedule with the return of daily service to Sydney and resumption of services to both Brisbane and Auckland.

- The launch of a service to Bangkok and restoration of service to Mumbai.
- New, transborder flights between Halifax-and-Newark and Vancouver-and-Houston.

In 2022, Air Canada also announced network updates for its 2023 schedule which included:

- New service between Montréal and Fort McMurray, and increased frequencies on certain routes. Air Canada's plans for its summer 2023 schedule include over 600 daily flights on 97 domestic routes to 51 Canadian airports.
- New transborder services including JFK airport-Toronto/Montréal, Toronto-Sacramento. Services restored on 13 U.S. routes beginning May 1, and increased frequency on more than a dozen other transborder routes for Summer 2023.
- Strategic expansion of its international network for summer 2023, with the addition of new European services to Brussels, Toulouse and Copenhagen, resumption of key Asia services and to leading destinations in the Atlantic, Pacific and South America regions.

*Cargo*

In response to the surge in demand for air cargo space, Air Canada operated all-cargo flights using passenger aircraft as well as some temporarily converted Boeing 777-300ER and Airbus A330 aircraft. As at December 31, 2022, all temporarily converted aircraft have been returned to a passenger configuration. As at December 31, 2022, three Boeing 767 dedicated freighters were in service and seven are expected to be in service by the end of 2023. In 2022, Air Canada Cargo operated over 3,600 cargo-only flights (including those operated with dedicated freighter aircraft) to over a dozen destinations, including Toronto, Halifax, St. John's, Miami, Atlanta, Dallas, Quito, Lima, Bogota, San Juan, Mexico City, Guadalajara, Madrid and Frankfurt.

*Elevating the Customer*

Air Canada has been named the Best Airline in North America for the fourth consecutive year by the readers of Global Traveler. The airline also won for Best Airline Cabin Cleanliness for the third consecutive year in the 19th edition of the GT Tested Reader Survey of the magazine's readership of frequent business and luxury travelers.

*On board*

In November 2022, Air Canada launched Live TV on select aircraft and domestic routes, becoming the only Canadian carrier to offer six Canadian English and French channels as part of the airline's complimentary and extensive inflight entertainment programming. The inflight dining experience has also been enhanced, with a restored Premium Cabin Experience, elevated bistro offering with more seasonal variety, hot casserole options, new tray components and a new dessert service. Additionally, new amenity kits for International Signature Class and Premium Economy and North America Signature Class were introduced.

*On the ground*

Air Canada has further invested in its Maple Leaf Lounge experience, including a contemporary buffet service, expanded Café offering and new Priority Access Lanes for Signature Class, Business Class, and Aeroplan Super Elite customers. Air Canada has also expanded its Porsche-powered tarmac chauffeur service, now offering the service in Toronto and in Vancouver.

*Aeroplan*

Aeroplan launched HotelSavers, allowing members to book stays with Aeroplan points at preferential rates at a broad range of acclaimed hotels worldwide and since May 30, 2022, Aeroplan members can earn points for select LCBO purchases. In 2022, Aeroplan was recognized as the Top Airline Loyalty Program by Canada's Choice travel rewards and

Best Earning and Redemption Ability (Americas) in a survey of global frequent flyers by the Frequent Traveler (FT) People's Awards. It was rewarded for Best Redemption Ability and, for a third time, as the top trending program in delivering value to members in the Americas in a survey of global frequent flyers by the Freddie Awards, which celebrate the world's leading loyalty programs.

*Inclusive Workplace and Impact on Society*

Air Canada has been recognized as one of "Montréal's Top Employers" for 2022 in Mediacorp Canada's annual employer survey, marking the ninth consecutive year that the airline has received this award. Air Canada was selected for its employee recognition and wellness programs, and its commitment to advancing opportunities for women. Air Canada was also named to the Forbes list of Canada's Best Employers 2023 and recognized as one of Canada's Best Diversity Employers.

In 2022, lost time due to injuries decreased and Air Canada launched its bi-annual safety culture and pulse survey. Air Canada enhanced its diversity and inclusion practices, including through the formalization of employee resource groups providing representation and a conduit for employee feedback for diverse identity groups. The airline promoted bilingualism through strengthened official languages programs and practices. In the Fall of 2022, Air Canada was recognized at the annual Canadian HR Awards with the Payworks Award for Best Corporate Social Responsibility Strategy.

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

- 20 per cent GHG net reductions from air operations by 2030 compared to our 2019 baseline.
- 30 per cent GHG net reductions from ground operations by 2030 compared to our 2019 baseline.
- $50-million investment in sustainable aviation fuels (SAF) and in carbon reductions and removals.

In pursuit if this goal, in addition to the announcements related to the A321XLR and A220s, the purchase agreement and equity investment with Heart Aerospace of Sweden as well as the investment with Carbon Engineering (CE), in 2022 Air Canada:

- Introduced CHOOOSE, a global climate technology company, as the airline's new carbon offset program provider. The option to purchase verified carbon offsets is now seamlessly integrated into the airline's Canadian and U.S. booking websites.
- Continued electrifying the Corporation's ground fleet by purchasing 50 electric ground service vehicles to support the operations.
- Announced it is working alongside Rheinmetall Canada to type trial the eMSU; the world's first, zero-emission, all-electric air start unit.
- Welcomed eight customers (corporate and cargo) onto the Leave Less Travel Program, designed for corporate and cargo customers and offering effective options to offset or reduce greenhouse gas (GHG) emissions related to business travel and reduce their carbon footprint.
- Launched an electric shuttle service for its employees at Vancouver airport. The daily service, which operates more than 150 itineraries, is now operated by fully electric vehicles instead of conventional gasoline-powered ones.

In addition, Air Canada has joined the Canadian Council for Sustainable Aviation Fuels (C-SAF), a not-for-profit organization that aims to accelerate the commercial production and deployment of SAF in Canada.

Air Canada's climate governance, strategy, risks and performance are also reported through its report aligned with the Task Force on Climate-related Financial Disclosures (TCFD), as well as through the CDP (formerly known as the carbon disclosure project). The CDP has aligned its approach with the TCFD framework.

Additional details on Air Canada's social impact and advancements on its sustainability strategy will be communicated through Air Canada's upcoming 2022 Annual Report, the Air Canada Foundation 2022 Impact Report, the 2022 TCFD Report and its 2022 Corporate Sustainability Report.

## 5. RESULTS OF OPERATIONS – 2022 VERSUS 2021

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

| (Canadian dollars in millions, except where indicated) | Full Year | | | |
|---|---|---|---|---|
| | 2022 | 2021 (1), (2) | $ Change | % Change |
| **Operating revenues** | | | | |
| Passenger | $ 14,238 | $ 4,498 | 9,740 | 217 |
| Cargo | 1,266 | 1,495 | (229) | (15) |
| Other | 1,052 | 407 | 645 | 158 |
| **Total operating revenues** | **16,556** | **6,400** | **10,156** | **159** |
| **Operating expenses** | | | | |
| Aircraft fuel | 5,276 | 1,576 | 3,700 | 235 |
| Wages, salaries and benefits | 3,260 | 2,143 | 1,117 | 52 |
| Depreciation and amortization | 1,640 | 1,616 | 24 | 1 |
| Airport and navigation fees | 1,213 | 723 | 490 | 68 |
| Sales and distribution costs | 797 | 286 | 511 | 179 |
| Capacity purchase fees | 763 | 558 | 205 | 37 |
| Aircraft maintenance | 706 | 711 | (5) | (1) |
| Ground package costs | 474 | 120 | 354 | 295 |
| Communications and information technology | 468 | 373 | 95 | 25 |
| Catering and onboard services | 425 | 184 | 241 | 131 |
| Impairment of assets | 4 | 38 | (34) | (89) |
| Restructuring and transaction costs | - | 175 | (175) | (100) |
| Other | 1,717 | 946 | 771 | 82 |
| **Total operating expenses** | **16,743** | **9,449** | **7,294** | **77** |
| **Operating loss** | **(187)** | **(3,049)** | **2,862** | |
| **Non-operating income (expense)** | | | | |
| Foreign exchange loss | (732) | (52) | (680) | |
| Interest income | 168 | 72 | 96 | |
| Interest expense | (909) | (749) | (160) | |
| Interest capitalized | 13 | 17 | (4) | |
| Net interest relating to employee benefits | 24 | (8) | 32 | |
| Gain (loss) on financial instruments recorded at fair value | 133 | (55) | 188 | |
| Loss on debt settlements and modifications | (14) | (129) | 115 | |
| Other | (20) | (28) | 8 | |
| **Total non-operating expense** | **(1,337)** | **(932)** | **(405)** | |
| **Loss before income taxes** | **(1,524)** | **(3,981)** | **2,457** | |
| Income tax recovery (expense) | (176) | 379 | (555) | |
| **Net loss** | **$ (1,700)** | **$ (3,602)** | **$ 1,902** | |
| **Diluted loss per share** | **$ (4.75)** | **$ (10.25)** | **$ 5.50** | |
| **Adjusted EBITDA** (3) | **$ 1,457** | **$ (1,464)** | **$ 2,921** | |
| **Adjusted pre-tax loss** (3) | **$ (952)** | **$ (3,768)** | **$ 2,816** | |
| **Adjusted net loss** (3) | **$ (988)** | **$ (3,768)** | **$ 2,780** | |
| **Adjusted loss per share** (3) | **$ (2.76)** | **$ (10.74)** | **$ 7.98** | |

*(1) Previously, operating expenses under capacity purchase agreements, were aggregated in a separate line item in the consolidated statement of operations titled "Regional airlines expense", and included the capacity purchase fees, pass-through costs, which are direct costs incurred by the regional carrier and charged to Air Canada and other costs incurred by Air Canada which are directly related to regional carrier operations, excluding fuel. For the year ended December 31, 2022, these costs are no longer allocated to regional airline expenses on the consolidated statement of operations. Capacity purchase fees are now presented as a separate line item in the consolidated statement of operations and continue to exclude the component of fees related to aircraft costs which are accounted for as lease liabilities in accordance with IFRS 16. This reclassification provides improved presentation of the total cost by nature of each expense associated with the Corporation's operations. This presentation change has no impact on total operating expenses. Comparative figures for 2021 have been reclassified to conform to the financial statement presentation adopted for the current year. Refer to Section 12 "Accounting Policies" of this MD&A for information on the reclassifications on the consolidated statement of operations.*

*(2) Figures previously classified as Special items in the consolidated statement of operations have been reclassified to Wages, salaries and benefits, Restructuring and transaction costs, and Impairment of assets. The nature of transactions included in these items are further described in Notes 2Z and 10, 4, and 6, respectively of Air Canada's 2022 annual audited consolidated financial statements and notes dated February 17, 2023. Refer to Section 12 "Accounting Policies" of this MD&A for information on the reclassifications on the consolidated statement of operations.*

*(3) Adjusted EBITDA, adjusted pre-tax income (loss), adjusted net income (loss), and adjusted earnings (loss) per share are non-GAAP financial measures or non-GAAP financial ratios. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.*

**System Passenger Revenues**

In 2022, passenger revenues of $14,238 million increased $9,740 million or more than triple from 2021. Traffic at the system level more than tripled while total operated capacity more than doubled from 2021, resulting in a passenger load factor increase of 18 percentage points. As a result of COVID-19 pandemic-related travel restrictions in place at that time, travel demand in 2021, most notably in the first half of the year, was primarily for essential purposes, booked close to departure date and on shorter stage-length journeys than prior to the pandemic. This demand environment favoured higher yields with low passenger load factors, as such, certain comparisons versus 2021 may not be meaningful. Air Canada believes that a comparison to 2019 allows for a better understanding of passenger revenues and the development of Air Canada's recovery.

Compared to 2019, 2022 passenger revenues and operated capacity recovered to 83% and 73%, respectively. The 2022 operated capacity was in line with the projection provided in Air Canada's news release dated October 28, 2022. The decline in passenger revenues versus 2019 levels was due to a combination of lower capacity and lower traffic, particularly in the first half of 2022, partially offset by higher yields in all markets. At the system level, 2022 passenger load factor declined about 3 percentage points from 2019, primarily due to the impact of the COVID-related travel restrictions in place during the first half of 2022, most notably in the first quarter of 2022. Average fares in 2022 were 19% higher versus 2019.

At the cabin level, 2022 passenger revenues increased three-and-a-half times for business, four times for premium economy, and three times for economy from 2021. When compared to 2019, 2022 passenger revenues in premium cabins and in economy recovered to about 92% and 79%, respectively. The change versus 2019 was primarily due to lower capacity and lower traffic with stronger yields, in all cabins for most of the markets, partially offsetting the decline.

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

| (Canadian dollars in millions) | Full Year | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2022 | 2021 | $ Change | % Change | 2019 | $ Change | % Change |
| Canada | $ 4,424 | $ 2,050 | $ 2,374 | 116 | $ 5,233 | $ (809) | (15) |
| U.S. transborder | 3,017 | 770 | 2,247 | 292 | 3,795 | (778) | (21) |
| Atlantic | 4,381 | 1,100 | 3,281 | 298 | 4,468 | (87) | (2) |
| Pacific | 1,118 | 245 | 873 | 356 | 2,449 | (1,331) | (54) |
| Other | 1,298 | 333 | 965 | 289 | 1,287 | 11 | 1 |
| **System** | **$ 14,238** | **$ 4,498** | **$ 9,740** | **217** | **$ 17,232** | **$ (2,994)** | **(17)** |

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

| | Full Year 2022 versus Full Year 2021 | | | | | |
|---|---|---|---|---|---|---|
| | Passenger Revenue % Change | Capacity (ASMs) % Change | Traffic (RPMs) % Change | Passenger Load Factor pp Change | Yield % Change | PRASM % Change |
| Canada | 116 | 69 | 104 | 14 | 6 | 28 |
| U.S. transborder | 292 | 265 | 336 | 12 | (10) | 7 |
| Atlantic | 298 | 165 | 252 | 21 | 13 | 50 |
| Pacific | 356 | 153 | 353 | 36 | 1 | 80 |
| Other | 289 | 233 | 286 | 11 | 1 | 17 |
| **System** | **217** | **147** | **216** | **18** | **-** | **28** |

| | Full Year 2022 versus Full Year 2019 | | | | | |
|---|---|---|---|---|---|---|
| | Passenger Revenue % Change | Capacity (ASMs) % Change | Traffic (RPMs) % Change | Passenger Load Factor pp Change | Yield % Change | PRASM % Change |
| Canada | (15) | (17) | (20) | (2) | 5 | 2 |
| U.S. transborder | (21) | (22) | (26) | (4) | 7 | 1 |
| Atlantic | (2) | (13) | (14) | (1) | 15 | 13 |
| Pacific | (54) | (67) | (68) | (3) | 45 | 40 |
| Other | 1 | (15) | (22) | (8) | 30 | 18 |
| **System** | **(17)** | **(27)** | **(29)** | **(3)** | **17** | **13** |

Domestic Passenger Revenues

In 2022, domestic passenger revenues of $4,424 million increased $2,374 million more than doubling from 2021 on a year-over-year capacity growth of 69%. The increase was driven by traffic doubling in all major domestic services and resulted in a 14-percentage-point increase in passenger load factor. These results largely reflect the increased demand for air services and greater availability of routes and frequencies across the domestic network. In 2021, as a result of the COVID-19 pandemic and travel restrictions in place at that time, travel demand, most notably in the first half of 2021, was primarily for essential purposes, booked close-in to departure date and on shorter stage-length journeys than prior to the pandemic. This noncomparable environment, in 2021, generated statistically high yields.

When compared to 2019, domestic passenger revenues, in 2022, recovered to 85% on an operated capacity representing 83% of 2019 levels. Traffic and passenger load factor declined 20% and 2 percentage points, respectively. Average domestic fares were about 20% higher from 2019 and yield increased 5%, with yield gains in almost all major domestic services despite an unfavourable impact due to higher average stage length.

U.S. Transborder Passenger Revenues

In 2022, U.S. transborder passenger revenues of $3,017 million increased $2,247 million or about four times from 2021 on an operated capacity that more than tripled year-over-year. These results largely reflect the increased demand for air services and greater availability of routes and frequencies across our U.S. transborder network. In 2021, as a result of the COVID-19 pandemic and travel restrictions in place at that time, travel demand, most notably in the first half of 2021, was primarily for essential purposes, booked close-in to departure date and on shorter stage-length journeys than prior to the pandemic. This noncomparable environment, in 2021, generated statistically high yields.

When compared to 2019, U.S. transborder revenues, in 2022, recovered to 79% on an operated capacity representing 78% of 2019 levels. Traffic recovered to 74% while passenger load factor declined four percentage-points. Yield increased 7% reflecting yield gains in nearly all major U.S. transborder services. Average fares in 2022 were 15% higher than 2019, however, strong leisure demand and changes in stage length resulted in an unfavourable impact on yields due to the network makeup.

<u>Atlantic Passenger Revenues</u>

In 2022, Atlantic passenger revenues of $4,381 million increased $3,281 million or nearly four times from 2021 on a capacity representing 2.6 times that of 2021. Traffic increased about 3.5 times and load factor increased 21 percentage points year-over-year. These results largely reflect the increased demand for air services, in all cabins, and greater availability of routes and frequencies across our Atlantic network derived from a more normalized network and the return to a more stable demand environment following the easing of travel restrictions, most notably in the second half of 2022.

When compared to 2019, Atlantic passenger revenues, in 2022, recovered to 98% on an operated capacity representing 87% of 2019 levels. Traffic recovered to 86% while passenger load factor declined one percentage point compared to 2019 levels. Yield increased 15% with yield gains in almost all major Atlantic services, most notably India, with Atlantic average fares being about 22% higher than 2019 levels.

<u>Pacific Passenger Revenues</u>

In 2022, Pacific revenues of $1,118 million increased $873 million or about four-and-a-half times from 2021 on a capacity representing two-and-a-half times that of 2021. Traffic increased 4.5 times from 2021, which resulted in a 36-percentage-point increase in passenger load factor. These results reflect a better operating environment following the easing of some travel restrictions in certain destinations in the Pacific market, most notably Japan, Korea, and Australia.

When compared to 2019, Pacific passenger revenues, in 2022, were 46% of those in 2019 on an operated capacity that represented 33% of 2019 levels led by significantly lower capacity to China and to Hong Kong. Yield and average fares increased 45% and 44%, respectively, with higher yields driven by fare mix changes due the ongoing impact of COVID-19-related travel restrictions in certain markets.

<u>Other Passenger Revenues</u>

In 2022, Other passenger revenues of $1,298 million were $965 million or almost four times higher than 2021 on a capacity representing over three times that of 2021. Traffic increased almost four times year-over-year. This resulted in an 11-percentage-point increase in passenger load factor. These results reflect the increased demand for air services, in all cabins, and greater availability of routes and frequencies across our Caribbean, Central and South American network derived from a more normalized network and the return to a more stable demand environment following the easing of travel restrictions, most notably in the second half of 2022.

When compared to 2019, Other passenger revenues, in 2022, were 1% higher on a capacity that represented about 85% of 2019 levels. Yield, average fares, and PRASM increased 30%, 29%, and 18%, respectively, with gains in all markets served. These results reflect the strong demand, including in the premium cabins, for Caribbean, Central and South American destinations derived from a robust demand recovery following the easing of travel restrictions.

**Cargo Revenues**

In 2022, Cargo revenues of $1,266 million declined $229 million or about 15% from 2021. The year-over-year decline was primarily due to lower year-over-year traffic in the Pacific market reflecting reduced cargo-only flights as the temporarily converted passenger aircraft gradually returned to passenger operations. To a lesser extent, yield normalization, mainly in the U.S. transborder, Domestic and Atlantic markets, also contributed to the decline. The decline was partially offset by increased capacity and higher traffic in the Atlantic and Central and South American markets, as well as, strong yields from the Pacific market. In 2022, Air Canada operated over 3,600 cargo-only flights (including those operated with dedicated freighter aircraft) compared to over 10,200 cargo-only flights in 2021.

Demand for air cargo services remained healthy through the end of 2022, despite coming down from the elevated levels in 2020 and 2021. In 2021, the global supply of air cargo capacity was negatively impacted by the COVID-19 pandemic due to reduced capacity as a result of fewer flights operated worldwide, in particular by commercial airlines. This resulted in abnormally high yields. Compared to 2019, 2022 Cargo revenues increased $549 million or about 77% mainly due to increased cargo-only flying. In 2019, Air Canada did not operate cargo-only flights and did not have dedicated freighters in the fleet.

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

| (Canadian dollars in millions) | Full Year | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2022 | 2021 | $ Change | % Change | 2019 | $ Change | % Change |
| Canada | $ 114 | $ 124 | $ (10) | (8) | $ 113 | $ 1 | 1 |
| U.S. transborder | 51 | 62 | (11) | (18) | 48 | 3 | 6 |
| Atlantic | 556 | 538 | 18 | 3 | 258 | 298 | 115 |
| Pacific | 409 | 667 | (258) | (39) | 241 | 168 | 70 |
| Other | 136 | 104 | 32 | 31 | 57 | 79 | 136 |
| **System** | **$ 1,266** | **$ 1,495** | **$ (229)** | **(15)** | **$ 717** | **$ 549** | **77** |

### Other Revenues

In 2022, other revenues of $1,052 million increased $645 million or about 2.5 times from 2021. The increase was primarily due to a higher volume of ground package revenues at Air Canada Vacations compared to 2021, reflecting the increased demand for vacation packages and the impact of the suspension of flights to Mexico and the Caribbean between January 31 and June 26, 2021. To a lesser extent, higher onboard and Maple Leaf Lounge revenues driven by the return of traffic, higher non-air revenues related to the Aeroplan program, and higher passenger-related fees also contributed to the increase.

### Operating Expenses

In 2022, operating expenses of $16,743 million increased $7,294 million or about 77% from 2021. The year-over-year variance is primarily explained by increases in nearly all line items reflecting increases in traffic and operated capacity of about 3.2 times and about 2.5 times, respectively, and by a 74% year-over-year increase in fuel prices. Compared to 2019, on a capacity that represented 73% of 2019, operating expenses decreased $738 million or about 4% largely reflecting higher fuel prices and higher passenger service costs.

The more notable components of the year-over-year change in operating expenses are described below.

<u>Aircraft Fuel</u>

In 2022, aircraft fuel expense of $5,276 million increased $3,700 million or more than triple from 2021. The increase was a result of jet fuel prices increasing 74% and 92% higher volume of litres used reflecting increased flying year-over-year. To a lesser extent, the depreciation of the Canadian dollar also contributed to the increase.

<u>Wages, Salaries and Benefits</u>

In 2022, wages, salaries and benefits of $3,260 million increased $1,117 million or about 52% from 2021. The year-over-year increase is largely due to a 54% increase in full-time equivalent employees as Air Canada significantly increased its staffing levels from 2021 to support the increase in flying volume. In 2021, a charge of $125 million for a benefit plan settlement, a charge of $82 million for benefit plan amendments, and a credit of $451 million were recorded related to the government wage subsidy. The items amounted to a net credit of $244 million which also contributed to the 2022 year-over-year increase. Information on the 2021 charges related to the benefit plan settlement and benefit plan amendments is provided in Note 10 Pension and Other Benefit Liabilities of Air Canada's 2022 annual audited consolidated financial statements and notes dated February 17, 2023. Refer to section 12 "Accounting Policies" of this MD&A for additional information on how these costs were previously classified.

Depreciation and Amortization

In 2022, depreciation and amortization of $1,640 million increased $24 million or about 1% from 2021. The increase was due to the addition of several new aircraft to the operating fleet during the year and an increase in amortization of intangible assets. The increase was partially offset by assets that were fully depreciated during 2022.

Airport and Navigation Fees

In 2022, airport and navigation fees of $1,213 million increased $490 million or 68%. The increase was due to a higher volume of flying compared to 2021.

Sales and Distribution Costs

In 2022, sales and distribution costs of $797 million increased $511 million or about 2.8 times from 2021.The increase was largely due to the year-over-year increase in passenger revenues.

Capacity Purchase Fees

In 2022, capacity purchase fees of $763 million increased $205 million or 37%. The increase was mainly due to a higher volume of flying compared to 2021 and higher CPA rates year-over-year due to higher costs incurred by Jazz for operating flights on behalf of Air Canada.

Aircraft Maintenance

In 2022, aircraft maintenance expense of $706 million declined $5 million or about 1% from 2021. The variance was mainly due to savings from an amended agreement with a third-party maintenance provider, as further described below, and was partially offset by increased maintenance activity to support higher volume of flying compared to 2021. To a lesser extent, a year-over-year increase in maintenance provisions reflecting updated end-of-lease cost estimates, in anticipation of returning aircraft to lessors upon lease expiries over the next 12 months, and an unfavourable currency impact partially offset the decrease.

In the first quarter of 2022, Air Canada and a third-party maintenance provider completed an amended agreement. In connection with this, a favourable adjustment of $159 million was recorded in Aircraft maintenance expense arising from the adjustment to maintenance accruals and recognition of future credits that will be available under the amended agreement. Given the significantly reduced aircraft operations and fleet reductions during the COVID-19 pandemic, this agreement was amended by the parties to convert the nature of the services from a power-by-the-hour basis to a time and materials contract and reduced the number of items covered under the agreement.

Ground Package Costs

In 2022, ground package costs of $474 million increased $354 million or about four times from 2021. The increase was largely due to a higher volume of ground package revenues at Air Canada Vacations reflecting a higher volume of passengers year-over-year. Air Canada suspended its flights to Mexico and Caribbean destinations between January 31, 2021 and June 26, 2021.

Restructuring and Transaction Costs

In 2022, Air Canada did not record restructuring and transaction costs compared to an operating expense of $175 million in 2021.

The table below provides the breakdown of the restructuring and transaction costs recorded for the periods identified.

| (Canadian dollars in millions) | Full Year | |
|---|---|---|
| | 2022 | 2021 |
| Workforce reduction provisions | - | 161 |
| Other | - | 14 |
| **Restructuring and transaction costs** (1) | **$ -** | **$ 175** |

*(1) Refer to section 12 "Accounting Policies" of this MD&A for additional information on how these costs were previously classified.*

*Workforce Reduction Provisions*

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

*Other*

*Termination of the Transat Arrangement Agreement*

In April 2021, Air Canada announced that the arrangement agreement for the proposed acquisition by Air Canada of Transat A.T. Inc (Transat) was terminated, including the payment of a $12.5 million termination fee to Transat.

*Amendments to Capacity Purchase Agreements*

In March 2021, Air Canada announced an agreement to amend the capacity purchase agreement (Jazz CPA) with Jazz, under which Jazz currently operates regional flights under the Air Canada Express brand. Through the revised agreement, Air Canada transferred the operation of its Embraer E175 fleet to Jazz from Sky Regional and Jazz became the sole operator of flights under the Air Canada Express brand. The capacity purchase agreement with Sky Regional was terminated. Air Canada recorded a net expense of $2 million, related to the CPA revisions and consolidation of regional flying.

Other operating expenses

In 2022, other operating expenses of $1,717 million increased $771 million or 82% from 2021. The year-over-year increase was mainly due to a higher volume of flying compared to 2021 and, to a lesser extent, the impact of cost inflation.

The following table provides a breakdown of other expenses for the periods indicated.

| (Canadian dollars in millions) | Full Year | | | |
|---|---|---|---|---|
| | 2022 | 2021 | $ Change | % Change |
| Terminal handling | $ 367 | $ 192 | $ 175 | 91 |
| Crew cycle | 207 | 92 | 115 | 125 |
| Building rent and maintenance | 229 | 164 | 65 | 40 |
| Miscellaneous fees and services | 213 | 137 | 76 | 55 |
| Remaining other expenses | 701 | 361 | 340 | 94 |
| **Total other expenses** | **$ 1,717** | **$ 946** | **$ 771** | **82** |

### CASM and Adjusted CASM

In 2022, CASM decreased 28% and adjusted CASM declined 43% from 2021. Compared to 2019, CASM and adjusted CASM increased 31% and 19%, respectively. The declines versus 2021 are primarily due the year-over-year ASM increase which resulted in a more efficient use of assets. CASM was unfavourably impacted by significantly higher aircraft fuel expense compared to 2021 and to 2019, and by increased ground package costs year-over-year. Higher traffic and yields resulted in higher passenger service and selling costs also impacted CASM and adjusted CASM negatively. In addition, inflationary pressures and the cost of restoring Maple Leaf lounge and onboard passenger service levels unfavourably impacted CASM and adjusted CASM.

The following table reconciles CASM to adjusted CASM for the periods indicated.

| (cents per ASM) | Full Year | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2022 | 2021 | $ Change | % Change | 2019 | $ Change | % Change |
| **CASM** | **¢ 20.28** | **¢ 28.30** | **¢ (8.02)** | **(28.3)** | **¢ 15.50** | **¢ 4.78** | **30.9** |
| **Remove:** | | | | | | | |
| Aircraft fuel expense, ground package costs, net government wage subsidy, benefit plan amendments, benefit plan settlement, impairment of assets, restructuring and transaction costs, freighter costs | (7.07) | (4.98) | (2.09) | 41.7 | (4.41) | (2.66) | 60.3 |
| **Adjusted CASM** | **¢ 13.21** | **¢ 23.32** | **¢ (10.11)** | **(43.4)** | **¢ 11.09** | **¢ 2.12** | **19.1** |

**Non-Operating Expense**

In 2022, non-operating expense was $1,337 million compared to a non-operating expense of $932 million in 2021.

Losses on foreign exchange of $732 million in 2022 compared to losses of $52 million in 2021. The December 31, 2022 closing exchange rate was US$1=$1.3554 compared to US$1=1.2637 at December 31, 2021. The increase in losses year-over-year was mainly due to foreign exchange remeasurement on long-term debt and lease obligations.

Interest expense of $909 million in 2022 compared to $749 million in 2021. The increase was mainly due to higher levels of debt as a result of the financing transactions concluded during 2021, and to a lesser extent, unfavourable changes in interest and foreign exchange rates. The year-over-year increase was partially offset by debt repayments in 2022, including the partial repurchase of Air Canada's Convertible Notes, as described in section 4 "Overview" of this MD&A.

In 2022, Air Canada recorded a gain of $133 million on financial instruments recorded at fair value compared to a loss of $55 million in 2021. The fluctuation in the fair value of Air Canada's Convertible Notes resulted in a gain of $219 million partially offset by a loss of $86 million due to a change in the fair value of Air Canada's short-term investments driven by higher interest rates.

In 2022, Air Canada recorded a loss of $14 million on debt settlement and modifications related to the repurchase of $635 million (US$473 million) aggregate principal amount of its outstanding Convertible Notes for an aggregate cash repurchase price of approximately $778 million (US$579 million), including accrued interest. This compared to a loss on debt settlements and modifications of $129 million, in 2021, which included the write-off of amortized costs and prepayment fees in a series of refinancing transactions completed during that year.

**Income Tax**

In 2022, Air Canada recorded an income tax expense of $176 million compared to an income tax recovery of $379 million in 2021 as shown below. Deferred income tax expense in the statement of operations partially offset the deferred income tax recovery recorded in other comprehensive income related to remeasurements on employee benefit liabilities.

| (Canadian dollars in millions) | Full Year | |
|---|---|---|
| | 2022 | 2021 |
| Current income tax (expense) | $ (47) | $ (16) |
| Deferred income tax (expense) recovery | (129) | 395 |
| **Income tax (expense) recovery** | **$ (176)** | **$ 379** |

## 6. RESULTS OF OPERATIONS – Q4 2022 VERSUS Q4 2021

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

| (Canadian dollars in millions, except where indicated) | Fourth Quarter 2022 | 2021 (1), (2) | $ Change | % Change |
|---|---|---|---|---|
| **Operating revenues** | | | | |
| Passenger | $ 4,062 | $ 2,041 | 2,021 | 99 |
| Cargo | 288 | 490 | (202) | (41) |
| Other | 330 | 200 | 130 | 65 |
| **Total operating revenues** | **4,680** | **2,731** | **1,949** | **71** |
| **Operating expenses** | | | | |
| Aircraft fuel | 1,459 | 665 | 794 | 119 |
| Wages, salaries and benefits | 892 | 804 | 88 | 11 |
| Depreciation and amortization | 417 | 399 | 18 | 5 |
| Airport and navigation fees | 320 | 255 | 65 | 25 |
| Sales and distribution costs | 228 | 120 | 108 | 90 |
| Capacity purchase fees | 214 | 164 | 50 | 30 |
| Aircraft maintenance | 248 | 242 | 6 | 2 |
| Ground package costs | 163 | 91 | 72 | 79 |
| Communications and information technology | 127 | 96 | 31 | 32 |
| Catering and onboard services | 127 | 79 | 48 | 61 |
| Impairment of assets | - | 24 | (24) | (100) |
| Restructuring and transaction costs | - | (2) | 2 | (100) |
| Other | 513 | 297 | 216 | 73 |
| **Total operating expenses** | **4,708** | **3,234** | **1,474** | **46** |
| **Operating loss** | **(28)** | **(503)** | **475** | |
| **Non-operating income (expense)** | | | | |
| Foreign exchange gain | 316 | 22 | 294 | |
| Interest income | 71 | 18 | 53 | |
| Interest expense | (245) | (211) | (34) | |
| Interest capitalized | 5 | 4 | 1 | |
| Net interest relating to employee benefits | 7 | 2 | 5 | |
| Gain on financial instruments recorded at fair value | 44 | 59 | (15) | |
| Loss on debt settlements and modifications | (31) | - | (31) | |
| Other | 7 | (8) | 15 | |
| **Total non-operating income (expense)** | **174** | **(114)** | **288** | |
| **Income (loss) before income taxes** | **146** | **(617)** | **763** | |
| Income tax recovery | 22 | 124 | (102) | |
| **Net income (loss)** | **$ 168** | **$ (493)** | **$ 661** | |
| **Diluted earnings (loss) per share** | **$ 0.41** | **$ (1.38)** | **$ 1.79** | |
| **Adjusted EBITDA** (2) | **$ 389** | **$ 22** | **$ 367** | |
| **Adjusted pre-tax loss** (2) | **$ (211)** | **$ (574)** | **$ 363** | |
| **Adjusted net loss** (2) | **$ (217)** | **$ (577)** | **$ 360** | |
| **Adjusted loss per share** (2) | **$ (0.61)** | **$ (1.61)** | **$ 1.00** | |

*(1) Previously, operating expenses under capacity purchase agreements, were aggregated in a separate line item in the consolidated statement of operations titled Regional airlines expense, and included the capacity purchase fees, pass-through costs, which are direct costs incurred by the regional carrier and charged to Air Canada and other costs incurred by Air Canada which are directly related to regional carrier operations, excluding fuel. For the year ended December 31, 2022, these costs are no longer allocated to regional airline expenses on the consolidated statement of operations. Capacity purchase fees are now presented as a separate line item in the consolidated statement of operations and continue to exclude the component of fees related to aircraft costs which are accounted for as lease liabilities in accordance with IFRS 16. This reclassification provides improved presentation of the total cost by nature of each expense associated with the Corporation's operations. This presentation change has no impact on total operating expenses. Comparative figures for 2021 have been reclassified to conform to the financial statement presentation adopted for the current year.*

*(2) Figures previously classified as special items in the consolidated statement of operations have been reclassified to Wages, salaries and benefits, Restructuring and transaction costs, and Impairment of assets. The nature of transactions included in these items are further described in Notes 2Z and 10, 4, and 6, respectively of Air Canada's 2022 annual audited consolidated financial statements and notes dated February 17, 2023.*

*(3) Adjusted EBITDA, adjusted pre-tax income (loss), adjusted net income (loss), and adjusted earnings (loss) per share are non-GAAP financial measures or non-GAAP financial ratios. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.*

### System Passenger Revenues

Record fourth quarter 2022 passenger revenues of $4,062 million increased $2,021 million or nearly double from the fourth quarter of 2021. Year-over-year, traffic and capacity increased 93% and 59%, respectively, which resulted in a 14-percentage-point increase in passenger load factor.

In the fourth quarter of 2022, passenger revenues increased about 2% from the fourth quarter of 2019 on an operated capacity that represented 85% of the same period in 2019. Traffic recovered to 87% of fourth quarter 2019 levels, which resulted in a two-percentage-point increase in passenger load factor. The increase was driven by an 18% increase in system yield. Yield gains in all markets resulted from the continuation of the strong recovery in demand for air travel following the further easing of travel restrictions in Canada and in many countries Air Canada operates to, despite certain restrictions remaining in particular Pacific destinations.

In the fourth quarter of 2022, passenger revenues in the premium cabins increased 13% while those in the economy cabin reached 98% of fourth quarter 2019 levels. These results were driven by yield gains across all cabins, in all markets, reflecting the strong demand for air passenger services and higher fares during the quarter. Better fare mix in premium and economy cabins and higher average fare levels contributed to the strong yield performance compared to the fourth quarter of 2019, despite the unfavourable impact of stage length on yields.

Record fourth quarter revenues were a result of the continuation of the strong recovery in demand for air travel, building upon the third quarter 2022 strength, following the further easing of travel restrictions in Canada and in many countries Air Canada operates to, despite certain restrictions remaining in particular Pacific destinations.

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

| (Canadian dollars in millions) | Fourth Quarter | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2022 | 2021 | $ Change | % Change | 2019 | $ Change | % Change |
| Canada | $ 1,195 | $ 774 | $ 421 | 54 | $ 1,258 | $ (63) | (5) |
| U.S. transborder | 916 | 418 | 498 | 119 | 903 | 13 | 1 |
| Atlantic | 1,096 | 554 | 542 | 98 | 942 | 154 | 16 |
| Pacific | 412 | 82 | 330 | 401 | 555 | (143) | (26) |
| Other | 443 | 213 | 230 | 108 | 317 | 126 | 40 |
| **System** | **$ 4,062** | **$ 2,041** | **$ 2,021** | **99** | **$ 3,975** | **$ 87** | **2** |

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

| | Fourth Quarter 2022 versus Fourth Quarter 2021 | | | | | |
|---|---|---|---|---|---|---|
| | Passenger Revenue % Change | Capacity (ASMs) % Change | Traffic (RPMs) % Change | Passenger Load Factor pp Change | Yield % Change | PRASM % Change |
| Canada | 54 | 27 | 43 | 9 | 8 | 22 |
| U.S. transborder | 119 | 84 | 127 | 15 | (3) | 19 |
| Atlantic | 98 | 49 | 82 | 16 | 8 | 33 |
| Pacific | 401 | 178 | 334 | 31 | 15 | 80 |
| Other | 108 | 61 | 90 | 12 | 10 | 29 |
| **System** | **99** | **59** | **93** | **14** | **3** | **25** |

| | Fourth Quarter 2022 versus Fourth Quarter 2019 | | | | | |
|---|---|---|---|---|---|---|
| | Passenger Revenue % Change | Capacity (ASMs) % Change | Traffic (RPMs) % Change | Passenger Load Factor pp Change | Yield % Change | PRASM % Change |
| Canada | (5) | (12) | (10) | 2 | 5 | 7 |
| U.S. transborder | 1 | (7) | (5) | 2 | 7 | 9 |
| Atlantic | 16 | (6) | (2) | 3 | 19 | 24 |
| Pacific | (26) | (49) | (48) | 3 | 42 | 47 |
| Other | 40 | 5 | 3 | (2) | 36 | 33 |
| **System** | **2** | **(15)** | **(13)** | **2** | **18** | **21** |

Domestic Passenger Revenues

In the fourth quarter of 2022, Domestic passenger revenues of $1,195 million increased $421 million or 54% from the fourth quarter of 2021. Traffic and capacity increased 43% and 27% year-over-year. This resulted in a nine-percentage-point increase in domestic passenger load factor. Yield increased 8% from the same period in 2021. These results largely reflect the increased demand for air services and greater availability of routes and frequencies across our domestic network.

Compared to the fourth quarter of 2019, Domestic passenger revenues, traffic, and capacity recovered to 95%, 90%, and 88%, respectively. Yield and passenger load factor increased 5% and two percentage points, respectively. Yield gains in all major domestic services resulted in a 7% gain in PRASM. Domestic average fares increased about 21% from 2019 due to fare mix in both premium and economy cabins. Average stage length also increased as a result of higher demand for our long-haul service. These results are largely explained by the continued strength in demand and pricing for domestic passenger services and also reflect changes in traffic mix, with premium cabins representing a larger share of Domestic passenger revenues than in the fourth quarter of 2019.

U.S. Transborder Passenger Revenues

In the fourth quarter of 2022, U.S. transborder passenger revenues of $916 million increased $498 million or more than doubled from the fourth quarter of 2021. Traffic more than doubled while capacity increased 84% year-over-year. This resulted in a 15-percentage-point increase in passenger load factor and a 19% increase in PRASM. These results reflect the increased demand for air services and greater availability of routes and frequencies across our U.S. transborder network.

Compared to the fourth quarter of 2019, U.S. transborder passenger revenues increased 1%, with traffic and capacity recovering to 95% and to 93%, respectively, resulting in a two-percentage-point increase in passenger load factor. PRASM and yield increased 9% and 7%, respectively, with yield gains in all major U.S. markets. These results reflect strong demand and pricing for our U.S. transborder services, including a favourable foreign exchange variance, as well as changes in traffic mix with premium cabins representing a larger share of U.S. transborder passenger revenues than in the fourth quarter of 2019. U.S. transborder average fares increased about 15% from 2019.

Atlantic Passenger Revenues

In the fourth quarter of 2022, Atlantic passenger revenues of $1,096 million increased $542 million or nearly doubling year-over-year. Traffic and capacity increased 82% and 49% from the fourth quarter of 2021, which resulted in a 16-percentage-point increase in passenger load factor. PRASM and yield increased 33% and 8%, respectively, from the fourth quarter of 2021, with yield gains in all major Atlantic markets. These results reflect the increased demand for air services, in all cabins, and greater availability of routes and frequencies across our Atlantic network derived from a more normalized network and the return to a more stable demand environment following the easing of travel restrictions, most notably in the second half of 2022.

Compared to the fourth quarter of 2019, Atlantic passenger revenues increased 16%, with traffic and capacity recovering to 98% and 94%, respectively, resulting in a three-percentage-point increase in passenger load factor. PRASM and yield increased 24% and 19%, respectively, with yield gains in all major Atlantic markets. These results reflect strong demand and pricing for our Atlantic services as well as changes in traffic mix with premium cabins representing a larger share of Atlantic passenger revenues than in the fourth quarter of 2019. Atlantic average fares increased about 24% from 2019.

Pacific Passenger Revenues

In the fourth quarter of 2022, Pacific passenger revenues of $412 million increased $330 million or about five times from the fourth quarter of 2021. Traffic and capacity increased 4.3 times and 2.8 times year-over-year, resulting in a 31-percentage-point increase in passenger load factor. These results reflect a better operating environment following the easing of certain travel restrictions in certain destinations in the Pacific market, most notably Australia, Japan, and Korea.

Fourth quarter 2022 Pacific passenger revenues, traffic and capacity recovered to 74%, 52%, and 51% of fourth quarter of 2019 levels. These results reflect the significantly reduced capacity in all major Pacific markets, most notably China and Hong Kong, as a result of the COVID-19-related travel restrictions that remained in place. This constrained capacity environment, paired with increased average fares, resulted in PRASM, average fares, and yield increasing 47%, 45% and 42%, respectively, from the fourth quarter of 2019.

Other Passenger Revenues

In the fourth quarter of 2022, Other passenger revenues of $443 million increased $230 million or more than double from the fourth quarter of 2021. Traffic and capacity increased 90% and 61%, year-over-year. This resulted in a 12-percentage-point increase in passenger load factor. PRASM and yield increased 29% and 10%, respectively, from the fourth quarter of 2021. These results reflect the increased demand for air services, in all major markets across all cabins, and a greater availability of routes and frequencies across our Caribbean, Central and South American network derived from a more normalized network and the return to a more stable demand environment following the easing of travel restrictions, most notably in the second half of 2022.

Compared to the fourth quarter of 2019, Other passenger revenues, operated capacity, and traffic increased 40%, 5%, and 3%, respectively. Despite a two-percentage-point decrease in passenger load factor; yield, average fares, and PRASM increased 36%, 33% and 33%, respectively. These results reflect strong demand and pricing for our Caribbean, Central and South American services, as well as changes in traffic mix with premium cabins representing a larger share of Other passenger revenues than in the fourth quarter of 2019.

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

| | Fourth Quarter | | | | Full Year | | | |
|---|---|---|---|---|---|---|---|---|
| | 2022 | | 2021 | | 2022 | | 2021 | |
| (millions) | RPMs | ASMs | RPMs | ASMs | RPMs | ASMs | RPMs | ASMs |
| Canada | 4,233 | 5,184 | 2,952 | 4,081 | 16,336 | 20,373 | 8,002 | 12,072 |
| U.S. transborder | 3,495 | 4,356 | 1,542 | 2,366 | 11,781 | 15,290 | 2,705 | 4,190 |
| Atlantic | 6,111 | 7,226 | 3,350 | 4,855 | 25,072 | 30,188 | 7,126 | 11,396 |
| Pacific | 2,364 | 2,765 | 545 | 995 | 6,128 | 7,484 | 1,353 | 2,956 |
| Other | 2,322 | 2,837 | 1,223 | 1,760 | 7,178 | 9,223 | 1,859 | 2,770 |
| **System** | **18,525** | **22,368** | **9,612** | **14,057** | **66,495** | **82,558** | **21,045** | **33,384** |

### Cargo Revenues

In the fourth quarter of 2022, cargo revenues of $288 million declined $202 million or 41% from the fourth quarter of 2021. Compared to the same period in 2019, cargo revenues increased $102 million or 55%. The decline from 2021 was primarily due to lower traffic in the Pacific market due to fewer cargo-only flights as the temporarily converted passenger aircraft no longer flew cargo-only flights and, to a lesser extent, to yield normalization in all markets. The decline was partially offset by higher traffic in the U.S. and Atlantic markets.

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

| (Canadian dollars in millions) | Fourth Quarter | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2022 | 2021 | $ Change | % Change | 2019 | $ Change | % Change |
| Canada | $ 30 | $ 45 | $ (15) | (33) | $ 27 | $ 3 | 9 |
| U.S. transborder | 13 | 18 | (5) | (24) | 11 | 2 | 26 |
| Atlantic | 145 | 151 | (6) | (4) | 69 | 76 | 109 |
| Pacific | 66 | 241 | (175) | (72) | 64 | 2 | 4 |
| Other | 34 | 35 | (1) | (4) | 15 | 19 | 122 |
| **System** | **$ 288** | **$ 490** | **$ (202)** | **(41)** | **$ 186** | **$ 102** | **55** |

### Other Revenues

In the fourth quarter of 2022, other revenues of $330 million increased $130 million or 65% from the fourth quarter of 2021. The increase was primarily due to a higher volume of ground package revenues at Air Canada Vacations. To a lesser extent, higher non-air revenues related to the Aeroplan program, onboard purchases and miscellaneous passenger fees contributed to the increase.

### Operating Expenses

In the fourth quarter of 2022, total operating expenses of $4,708 million increased $1,474 million of 46% from the fourth quarter of 2021. The year-over-year variance is primarily due to increases in nearly all line items reflecting increases in traffic and operated capacity of about 93% and about 59%, respectively, and by a 60% year-over-year increase in fuel prices. Compared to the fourth quarter of 2019, operating expenses increased $424 million or 10% mainly driven by higher aircraft fuel expense and higher passenger service costs.

The more notable components of the year-over-year change in operating expenses are described below.

Aircraft Fuel

In the fourth quarter of 2022, aircraft fuel expense of $1,459 million increased $794 million or more than double from the fourth quarter of 2021. The year-over-year increase is largely due to a 60% increase in jet fuel prices. To a lesser extent, 37% higher volume of litres used as a result of the year-over-year increase in flying, and an unfavourable foreign exchange variance also contributed to the year-over-year increase.

Wages, Salaries and Benefits

In the fourth quarter of 2022, wages, salaries and benefits of $892 million increased $88 million or about 11%. The year-over-year increase is largely due to a 32% increase in full-time equivalent employees as Air Canada significantly increased its staffing levels, from the fourth quarter of 2021, to support the increase in flying volume. In the fourth quarter of 2021, a charge of $125 million for a benefit plan amendment, a charge of $6 million for benefit plan settlement, and a credit of $27 million related to the government wage subsidy were recorded. In aggregate, these items totalled $104 million which partially offset the year-over-year increase. Information on the 2021 charges related to the benefit plan settlement and benefit plan amendments is provided in Note 10 Pension and Other Benefit Liabilities of Air Canada's 2022 annual audited consolidated financial statements and notes dated February 17, 2023. Refer to section 12 "Accounting Policies" of this MD&A for additional information on how these costs were previously classified.

Depreciation and amortization

In the fourth quarter of 2022, depreciation and amortization expense of $417 million increased $18 million or 5% from the fourth quarter of 2021. The increase was due to the addition of several new aircraft to the operating fleet in 2022 and an increase in amortization of intangible assets. The increase was partially offset by assets that were fully depreciated during 2022.

Sales and Distribution Costs

In the fourth quarter of 2022, sales and distribution costs of $228 million increased $108 million or 90% from the fourth quarter of 2021. The increase was largely due to the year-over-year increase in passenger revenues.

Capacity purchase fees

In the fourth quarter of 2022, capacity purchase fees of $214 million increased $50 million or 30% from the fourth quarter of 2021. The increase was mainly due to higher CPA rates year-over-year due to higher costs incurred by Jazz for operating flights on behalf of Air Canada.

Aircraft Maintenance

In the fourth quarter of 2022, aircraft maintenance expense of $248 million increased $6 million or 2% from the fourth quarter of 2021. The increase was mainly due to increased maintenance activity to support higher volume of flying compared to the fourth quarter of 2021. The increase was partially offset by savings from an amended agreement with a third-party maintenance provider, as described in section 5 "Results of Operations – 2022 versus 2021", and by a year-over-year decrease in maintenance provisions reflecting updated end-of-lease cost estimates, in anticipation of returning aircraft to lessors upon lease expiries over the next 12 months.

Ground Package Costs

In the fourth quarter of 2022, ground package costs of $163 million increased $72 million or 79% from the fourth quarter of 2021. The increase was largely due to a higher volume of ground package revenues at Air Canada Vacations reflecting a higher volume of passengers year-over-year.

Restructuring and Transaction costs

In the fourth quarter of 2022, Air Canada did not record restructuring and transaction costs compared to a net operating expense reduction of $2 million in the fourth quarter of 2021.

The table below provides the breakdown of the restructuring and transaction costs recorded for the periods identified.

| (Canadian dollars in millions) | Fourth Quarter | |
|---|---|---|
| | 2022 | 2021 |
| Workforce reduction provisions | - | (2) |
| **Restructuring and transaction costs** (1) | **$ -** | **$ (2)** |

*(1) Refer to section 12 "Accounting Policies" of this MD&A for additional information on how these costs were previously classified.*

Other operating expenses

In the fourth quarter of 2022, other operating expenses of $513 million increased $216 million or 73% from the fourth quarter of 2021. The year-over-year increase was mainly due to a higher volume of flying compared to the fourth quarter of 2021.

The following table provides a breakdown of other expenses for the periods indicated.

| (Canadian dollars in millions) | Fourth Quarter | | | |
|---|---|---|---|---|
| | 2022 | 2021 | $ Change | % Change |
| Terminal handling | $ 106 | $ 72 | $ 34 | 47 |
| Crew cycle | 59 | 35 | 24 | 69 |
| Building rent and maintenance | 67 | 46 | 21 | 46 |
| Miscellaneous fees and services | 67 | 30 | 37 | 123 |
| Remaining other expenses | 214 | 114 | 100 | 88 |
| **Total other expenses** | **$ 513** | **$ 297** | **$ 216** | **73** |

**CASM and Adjusted CASM**

In the fourth quarter of 2022, CASM decreased about 8% and adjusted CASM declined 18% from the same period in 2021. Compared to the fourth quarter of 2019, CASM and adjusted CASM increased 30% and 15%, respectively. The declines versus 2021 are primarily due to the year-over-year ASM increase which resulted in a more efficient use of assets. CASM was unfavourably impacted by aircraft fuel expense increasing from both the fourth quarter of 2021 and of 2019. Higher traffic and yields that resulted in higher passenger service and selling costs also impacted CASM and adjusted CASM negatively. In addition, inflationary pressures and the cost of restoring Maple Leaf lounge and onboard passenger service levels unfavourably impacted CASM and adjusted CASM.

The following table reconciles CASM to adjusted CASM for the periods indicated.

| (cents per ASM) | Fourth Quarter | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2022 | 2021 | $ Change | % Change | 2019 | $ Change | % Change |
| **CASM** | **¢ 21.05** | **¢ 23.01** | **¢ (1.96)** | **(8.5)** | **¢ 16.21** | **¢ 4.84** | **29.8** |
| **Remove:** | | | | | | | |
| Aircraft fuel expense, ground package costs, net government wage subsidy, benefit plan amendments, benefit plan settlement, impairment of assets, restructuring and transaction costs, freighter costs | (7.37) | (6.27) | (1.10) | 17.5 | (4.33) | (3.04) | 70.2 |
| **Adjusted CASM** | **¢ 13.68** | **¢ 16.74** | **¢ (3.06)** | **(18.3)** | **¢ 11.88** | **¢ 1.80** | **15.1** |

**Non-Operating Income (Expense)**

In the fourth quarter of 2022, non-operating income was $174 million compared to a non-operating expense of $114 million in the fourth quarter of 2021.

Gains on foreign exchange of $316 million in the fourth quarter of 2022 compared to $22 million in the same period of 2021. The December 31, 2022 closing exchange rate was US$1=$1.3554 compared to US$1=1.3829 at September 30, 2022. The variance was mainly due to foreign exchange remeasurement on long-term debt and lease obligations.

Interest income of $71 million in the fourth quarter of 2022 compared to $18 million in the fourth quarter of 2021.

Interest expense of $245 million in the fourth quarter of 2022 compared to $211 million in the fourth quarter of 2021. The variance was primarily due to higher interest rates year-over-year as well as to an unfavourable foreign exchange variance. The increase was partially offset by lower levels of debt reflecting principal repayments made during 2022, including the partial repurchase of Air Canada's Convertible Notes.

In the fourth quarter of 2022, Air Canada recorded a $31 million loss on debt settlement related to the repurchase of $362 million (US$266 million) aggregate principal amount of its outstanding Convertible Notes for an aggregate cash repurchase price of $449 million (US$330 million), including accrued interest.

# 7. FLEET

**Mainline and Air Canada Rouge**

The tables below provide the number of aircraft in Air Canada's and Air Canada Rouge's operating fleet as at December 31, 2022. Refer to the Air Canada Express section below for information on the fleet of aircraft operated by Jazz under its capacity purchase agreement with Air Canada.

The tables below include certain aircraft that were grounded in response to the COVID-19 pandemic. As at December 31, 2022, two aircraft remained grounded pending return to service maintenance. The table below includes two new Boeing 767 freighter aircraft which were delivered in 2022 that are expected to enter service in 2023.

| AIR CANADA | At December 31, 2022 | | | | |
|---|---|---|---|---|---|
| | Number of Operating Aircraft | Total Seats | Average Age | Owned | Leased |
| **Wide-body aircraft** | | | | | |
| Boeing 777-300ER | 18 | 419 | 12.6 | 10 | 8 |
| Boeing 777-200LR | 6 | 300 | 15.4 | 4 | 2 |
| Boeing 787-8 | 8 | 255 | 8.6 | 8 | - |
| Boeing 787-9 | 29 | 298 | 6.3 | 23 | 6 |
| Boeing 767-300 freighters | 5 | - | 18.0 | 3 | 2 |
| Airbus A330-300 | 16 | 295 | 17.9 | 8 | 8 |
| **Total wide-body aircraft** | 82 | 321 | 11.6 | 56 | 26 |
| **Narrow-body aircraft** | | | | | |
| Boeing 737 MAX 8 | 40 | 169 | 3.3 | 31 | 9 |
| Airbus A321 | 15 | 190 | 20.0 | 5 | 10 |
| Airbus A320 | 18 | 142 | 26.3 | 10 | 8 |
| Airbus A319 | 5 | 83 | 25.5 | 5 | - |
| Airbus A220-300 | 32 | 137 | 1.8 | 32 | - |
| **Total narrow-body aircraft** | 110 | 154 | 9.9 | 83 | 27 |
| **Total Mainline** | **192** | **223** | **10.6** | **139** | **53** |

| AIR CANADA rouge | At December 31, 2022 | | | | |
|---|---|---|---|---|---|
| | Number of Operating Aircraft | Total Seats | Average Age | Owned | Leased |
| **Narrow-body aircraft** | | | | | |
| Airbus A321 | 14 | 197 | 7.6 | 4 | 10 |
| Airbus A320 | 5 | 168 | 15.7 | - | 5 |
| Airbus A319 | 20 | 136 | 24.8 | 17 | 3 |
| **Total Air Canada Rouge** | **39** | **162** | **17.5** | **21** | **18** |

| | | | | | |
|---|---|---|---|---|---|
| **Total Mainline & Rouge** | **231** | **213** | **11.8** | **160** | **71** |

The tables below provide the number of aircraft in Air Canada's operating fleet as at December 31, 2021 and December 31, 2022 as well as Air Canada's planned operating fleet for the future periods indicated.

| AIR CANADA | Actual | | | Planned | | | |
|---|---|---|---|---|---|---|---|
| | Dec. 31, 2021 | 2022 Fleet Changes | Dec. 31, 2022 | 2023 Fleet Changes | Dec. 31, 2023 | 2024 Fleet Changes | Dec. 31, 2024 |
| **Wide-body aircraft** | | | | | | | |
| Boeing 777-300ER | 18 | - | 18 | 1 | 19 | - | 19 |
| Boeing 777-200LR | 6 | - | 6 | - | 6 | - | 6 |
| Boeing 777-300 freighters | - | - | - | - | - | 2 | 2 |
| Boeing 787-8 | 8 | - | 8 | - | 8 | - | 8 |
| Boeing 787-9 | 29 | - | 29 | 2 | 31 | 1 | 32 |
| Boeing 767-300 freighters | 1 | 4 | 5 | 2 | 7 | 2 | 9 |
| Airbus A330-300 | 16 | - | 16 | 2 | 18 | - | 18 |
| **Total wide-body aircraft** | 78 | 4 | 82 | 7 | 89 | 5 | 94 |
| **Narrow-body aircraft** | | | | | | | |
| Boeing 737 MAX 8 | 31 | 9 | 40 | - | 40 | - | 40 |
| Airbus A321 | 15 | - | 15 | - | 15 | - | 15 |
| Airbus A320 | 18 | - | 18 | (2) | 16 | - | 16 |
| Airbus A319 | 6 | (1) | 5 | (2) | 3 | - | 3 |
| Airbus A220-300 | 27 | 5 | 32 | 1 | 33 | 6 | 39 |
| **Total narrow-body aircraft** | 97 | 13 | 110 | (3) | 107 | 6 | 113 |
| **Total Mainline** | **175** | **17** | **192** | **4** | **196** | **11** | **207** |

| AIR CANADA rouge | Actual | | | Planned | | | |
|---|---|---|---|---|---|---|---|
| | Dec. 31, 2021 | 2022 Fleet Changes | Dec. 31, 2022 | 2023 Fleet Changes | Dec. 31, 2023 | 2024 Fleet Changes | Dec. 31, 2024 |
| **Narrow-body aircraft** | | | | | | | |
| Airbus A321 | 14 | - | 14 | 3 | 17 | - | 17 |
| Airbus A320 | 5 | - | 5 | - | 5 | - | 5 |
| Airbus A319 | 20 | - | 20 | - | 20 | - | 20 |
| **Total Air Canada Rouge** | **39** | **-** | **39** | **3** | **42** | **-** | **42** |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Total Mainline & Rouge** | **214** | **17** | **231** | **7** | **238** | **11** | **249** |

**Air Canada Express**

The table below provides the number of aircraft operated as at December 31, 2021 and as at December 31, 2022, on behalf of Air Canada, by its regional carrier operating flights under the Air Canada Express banner pursuant to a capacity purchase agreement with Air Canada. The table also provides the planned fleet for the future periods indicated.

| AIR CANADA EXPRESS | Actual | | | Planned | | | |
|---|---|---|---|---|---|---|---|
| | Dec. 31, 2021 | 2022 Fleet Changes | Dec. 31, 2022 | 2023 Fleet Changes | Dec. 31, 2023 | 2024 Fleet Changes | Dec. 31, 2024 |
| Embraer 175 | 25 | - | 25 | - | 25 | - | 25 |
| Mitsubishi CRJ-200 | 15 | - | 15 | - | 15 | - | 15 |
| Mitsubishi CRJ-900 | 35 | - | 35 | - | 35 | - | 35 |
| De Havilland Dash 8-300 | 9 | (9) | - | - | - | - | - |
| De Havilland Dash 8-400 | 39 | - | 39 | - | 39 | - | 39 |
| **Total Air Canada Express** | **123** | **(9)** | **114** | **-** | **114** | **-** | **114** |

# 8. FINANCIAL AND CAPITAL MANAGEMENT

## 8.1 LIQUIDITY

**Liquidity Risk Management**

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

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

At December 31, 2022 total liquidity was $9,824 million comprised of cash and cash equivalents, short-term and long-term investments of $8,811 million, and $1,013 million available under undrawn credit facilities. Over the next 12 months, Air Canada expects to meet its liquidity needs with cash from operations as well as with available cash and cash equivalents, short-term and long-term investments. Liquidity needs related to obligations associated with financial liabilities and capital commitments may also be supported through new financing arrangements.

## 8.2 FINANCIAL POSITION

The table below provides a condensed consolidated statement of financial position of Air Canada as at December 31, 2022, and as at December 31, 2021.

| (Canadian dollars in millions) | December 31, 2022 | December 31, 2021 (1) Restated | $ Change |
|---|---|---|---|
| **Assets** | | | |
| Cash, cash equivalents and short-term investments | $ 7,988 | $ 8,969 | $ (981) |
| Other current assets | 1,677 | 1,084 | 593 |
| **Current assets** | **$ 9,665** | **$ 10,053** | **$ (388)** |
| Investments, deposits, and other assets | 1,073 | 858 | 215 |
| Property and equipment | 11,950 | 11,740 | 210 |
| Pension assets | 2,444 | 3,571 | (1,127) |
| Deferred income tax | 48 | 39 | 9 |
| Intangible assets | 1,054 | 1,080 | (26) |
| Goodwill | 3,273 | 3,273 | - |
| **Total assets** | **$ 29,507** | **$ 30,614** | **$ (1,107)** |
| **Liabilities** | | | |
| Current liabilities | $ 9,353 | $ 6,924 | $ 2,429 |
| Long-term debt and lease liabilities | 15,043 | 15,511 | (468) |
| Aeroplan and other deferred revenues | 3,160 | 3,656 | (496) |
| Pension and other benefit liabilities | 1,770 | 2,588 | (818) |
| Maintenance provisions | 1,352 | 1,032 | 320 |
| Other long-term liabilities | 311 | 821 | (510) |
| Deferred income tax | 73 | 73 | - |
| **Total liabilities** | **$ 31,062** | **$ 30,605** | **$ 457** |
| **Total shareholders' equity (deficiency)** | **$ (1,555)** | **$ 9** | **$ (1,564)** |
| **Total liabilities and shareholders' equity (deficiency)** | **$ 29,507** | **$ 30,614** | **$ (1,107)** |

*(1) Refer to section 12 "Accounting Policies" of this MD&A for a description of the change in presentation related to restricted cash and pursuant to which certain amounts have been reclassified to cash and cash equivalents with the 2021 comparative figures also reclassified.*

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 "Cash Flow Movements" of this MD&A.

At December 31, 2022, net long-term benefit assets of $674 million (comprising pension assets of $2,444 million net of pension and other benefit liabilities of $1,770 million) decreased $309 million from December 31, 2021. This decrease was mainly due to a net actuarial loss on remeasurements of employee liabilities of $31 million recorded on Air Canada's consolidated statement of comprehensive income, as well as pension and other employee benefits expense recorded during the year. The actuarial loss reflects the limit on the amount of pension assets that can be recognized under the accounting rules. While the actuarial gain on the 208-basis point increase in discount rate used to value the liabilities offset a lower return on plan assets, the net asset that could be recognized was capped to the amount of surplus available to reduce future funding requirements.

The long-term portion of the Aeroplan and other deferred revenue liability decreased $496 million from December 31, 2021. This decrease included a reclassification of $312 million from long-term to current liabilities for Aeroplan point redemptions expected to occur over the next 12 months, as well as Aeroplan point redemptions exceeding the value of points issued given the strong rebound in travel demand in 2022. The decrease to Other long-term liabilities included a $459 million decrease in the liability of the embedded derivative on Air Canada's Convertible Notes of which $240 million was recognized on the repurchase of the Convertible Notes.

## 8.3 NET DEBT

The table below reflects Air Canada's net debt balances as at December 31, 2022, and as at December 31, 2021.

| (Canadian dollars in millions) | December 31, 2022 | December 31, 2021 (1) Restated | Change |
|---|---|---|---|
| Total long-term debt and lease liabilities | $ 15,043 | $ 15,511 | $ (468) |
| Current portion of long-term debt and lease liabilities | 1,263 | 1,012 | 251 |
| **Total long-term debt and lease liabilities (including current portion)** | **16,306** | **16,523** | **(217)** |
| Less cash, cash equivalents and short and long-term investments | (8,811) | (9,570) | 759 |
| **Net debt (2)** | **$ 7,495** | **$ 6,953** | **$ 542** |
| **Adjusted EBITDA (trailing 12 months)** | **$ 1,457** | **(1,464)** | **2,921** |
| **Net debt to adjusted EBITDA ratio (2)** | **5.1** | **NM (3)** | **NM** |

*(1) Refer to section 12 "Accounting Policies" of this MD&A for a description of the change in presentation related to restricted cash and pursuant to which certain amounts have been reclassified to cash and cash equivalents with the 2021 comparative figures also reclassified.*

*(2) Net debt is a capital management measure and a key component of the capital managed by Air Canada and provides management with a measure of its net indebtedness. Net debt to adjusted EBITDA ratio (also referred to as "leverage ratio" in this MD&A) is a non-GAAP financial ratio and is used by Air Canada to measure financial leverage. For additional information on net debt, refer to section 20 "Non-GAAP Financial Measures" of this MD&A.*

*(3) NM denotes "not meaningful".*

As at December 31, 2022, net debt of $7,495 million increased $542 million from December 31, 2021. The unfavourable impact of a weaker Canadian dollar at December 31, 2022 compared to December 31, 2021, increased foreign currency denominated debt (mainly U.S. dollars) by $835 million. The change in long-term debt and lease liabilities also included $1,814 million of repayments, comprised of regularly scheduled repayments and $778 million for the repurchase of Convertible Notes.

## 8.4 WORKING CAPITAL

The table below provides information on Air Canada's working capital balances as at December 31, 2022 and as at December 31, 2021.

| (Canadian dollars in millions) | December 31, 2022 | December 31, 2021 (1) Restated | $ Change |
|---|---|---|---|
| Cash, cash equivalents and short-term investments | $ 7,988 | $ 8,969 | $ (981) |
| Accounts receivable | 1,037 | 691 | 346 |
| Other current assets | 640 | 393 | 247 |
| **Total current assets** | **$ 9,665** | **$ 10,053** | **$ (388)** |
| Accounts payable and accrued liabilities | 2,691 | 2,603 | 88 |
| Advance ticket sales | 4,104 | 2,326 | 1,778 |
| Aeroplan and other deferred revenues | 1,295 | 983 | 312 |
| Current portion of long-term debt and lease liabilities | 1,263 | 1,012 | 251 |
| **Total current liabilities** | **$ 9,353** | **$ 6,924** | **$ 2,429** |
| **Net working capital** | **$ 312** | **$ 3,129** | **$ (2,817)** |

*(1) Refer to section 12 "Accounting Policies" of this MD&A for a description of the change in presentation related to restricted cash and pursuant to which certain amounts have been reclassified to cash and cash equivalents with the 2021 comparative figures also reclassified.*

Net working capital of $312 million as at December 31, 2022 decreased $2,817 million from December 31, 2021. This decrease was mainly due to a combination of net cash outflows relating to capital expenditures and debt repayments in 2022, partially offset by positive operating cash results. The increases in accounts receivable, other current assets and advance ticket sales are mainly driven by the passenger sales demand which is supported by the increased capacity.

## 8.5 CASH FLOW MOVEMENTS

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

| | Fourth Quarter | | | Full Year | | |
|---|---|---|---|---|---|---|
| **(Canadian dollars in millions)** | **2022** | **2021(1) Restated** | **$ Change** | **2022** | **2021(1) Restated** | **$ Change** |
| **Net cash flows from (used in) operating activities** | **$ 647** | **$ 508** | **$ 139** | **$ 2,368** | **$ (1,502)** | **$ 3,870** |
| Proceeds from borrowings | - | 144 | (144) | 202 | 8,171 | (7,969) |
| Reduction of long-term debt and lease liabilities | (740) | (276) | (464) | (1,814) | (4,510) | 2,696 |
| Issue of shares | 2 | 1 | 1 | 6 | 555 | (549) |
| Financing fees | (1) | (2) | 1 | (6) | (205) | 199 |
| **Net cash flows from (used in) financing activities** | **$ (739)** | **$ (133)** | **$ (606)** | **$ (1,612)** | **$ 4,011** | **$ (5,623)** |
| Investments, short-term and long-term | 435 | (913) | 1,348 | (959) | (862) | (97) |
| Additions to property, equipment and intangible assets | (327) | (378) | 51 | (1,572) | (1,073) | (499) |
| Proceeds from sale of assets | 27 | 3 | 24 | 36 | 19 | 17 |
| Proceeds from sale and leaseback of assets | - | - | - | - | 11 | (11) |
| Other | 2 | 21 | (19) | (3) | 36 | (39) |
| **Net cash flows from (used in) investing activities** | **$ 137** | **$ (1,267)** | **$ 1,404** | **$ (2,498)** | **$ (1,869)** | **$ (629)** |
| **Effect of exchange rate changes on cash and cash equivalents** | **$ 2** | **$ (5)** | **$ 7** | **$ 20** | **$ 11** | **$ 9** |
| **Increase (decrease) in cash and cash equivalents** | **$ 47** | **$ (897)** | **$ 944** | **$ (1,722)** | **$ 651** | **$ (2,373)** |

*(1) Refer to section 12 "Accounting Policies" of this MD&A for a description of the change in presentation related to restricted cash and pursuant to which certain amounts have been reclassified to cash and cash equivalents with the 2021 comparative figures also reclassified.*

### Net Cash Flows from (used in) Operating Activities

In 2022, net cash flows from operating activities of $2,368 million improved by $3,870 million from 2021. The improvement was due to a significant improvement in operating results and strong advance ticket sales results when compared to 2021. Additionally, 2021 included cash outflows from operating activities of $1,273 million related to the refund of non-refundable fares.

### Net Cash Flows from (used in) Financing Activities

In September 2022, Air Canada repurchased $273 million (US$207 million) aggregate principal amount of its outstanding 4.000% Convertible Senior Notes due 2025 for an aggregate cash repurchase price of approximately $329 million (US$249 million), including accrued interest. In December 2022, Air Canada repurchased an additional $362 million (US$266 million) aggregate principal amount of the outstanding Convertible Notes for an aggregate cash repurchase price of $449 million (US$330 million), including accrued interest. The 2021 financing activities included net proceeds of $3.7 billion related to refinancing transactions completed in August 2021.

**Net Cash Flows from (used in) Investing Activities**

Net movements between cash and short and long-term investments amounted to $435 million and ($959) million during the fourth quarter of 2022 and the twelve months ended December 31, 2022, respectively. Additions to property, equipment and intangible assets of $1,572 million in 2022 increased $499 million from 2021. These additions relate mainly to aircraft acquisitions and related pre-delivery payments, capitalized maintenance, and technology projects.

Refer to sections 8.2 "Financial Position", 8.3 "Net Debt", and 8.4 "Working Capital" 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)** | **2022** | **2021 Restated** | **$ Change** | **2022** | **2021 Restated** | **$ Change** |
| **Net cash flows from (used in) operating activities** | **$ 647** | **$ 508** | **$ 139** | **$ 2,368** | **$ (1,502)** | **$ 3,870** |
| Additions to property, equipment, and intangible assets, net of proceeds from sale and leaseback transactions | (327) | (378) | 51 | (1,572) | (1,062) | (510) |
| **Free cash flow** [(1)] | **$ 320** | **$ 130** | **$ 190** | **$ 796** | **$ (2,564)** | **$ 3,360** |

*(1) Free cash flow is a non-GAAP financial measure used by Air Canada as an indicator of the financial strength and performance of its business, indicating how much cash it can generate from operations after capital expenditures. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment, and intangible assets, net of proceeds from sale and leaseback transactions. Such measure is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, may not be comparable to similar measures presented by other entities and should not be considered a substitute for or superior to GAAP results. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.*

Free cash flow of $320 million in the fourth quarter of 2022 increased by $190 million from the same period in 2021 mainly due to increased net cash from earnings. Free cash flow of $796 million in 2022 improved $3,360 million from 2021, reflecting higher net cash flows from operations as a result of an improved operating environment and strong advance ticket sales.

## 8.6 CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS

**Airbus A321XLR Aircraft**

Air Canada is acquiring 30 extra-long range (XLR) versions of the Airbus A321neo aircraft (Airbus A321XLR). Deliveries are now scheduled to begin in 2025 with the final aircraft scheduled to arrive in 2028. Of the 30 total aircraft, 20 aircraft will be leased and 10 are being acquired under a purchase agreement with Airbus S.A.S. that includes purchase rights to acquire up to an additional 15 aircraft between 2027 and 2030.

**Airbus A220-300 Aircraft**

Air Canada has an agreement with Airbus Canada for the purchase of Airbus A220-300 aircraft which provides for:

- Firm orders for 60 Airbus A220-300 aircraft.
- Purchase options for an additional 15 Airbus A220-300 aircraft.

Of the above mentioned 60 firm orders, 32 had been delivered as at December 31, 2022 with an additional aircraft delivered in January 2023. The 27 remaining firm orders (which arise from commitments in 2021 for two aircraft, in 2022 for 10 aircraft and the exercise of 15 options in the third quarter of 2022), planned deliveries are: six in 2024, six in 2025, and 15 in 2026.

**Boeing 737 MAX**

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

- Firm orders for 40 Boeing 737 MAX 8 aircraft, which have all been delivered as at December 31, 2022.
- Purchase options for an additional 10 Boeing 737 MAX aircraft.

**Boeing 787-9 Aircraft**

Air Canada exercised options for the purchase of three Boeing 787-9 aircraft which are scheduled to be delivered in 2023 and 2024. Air Canada has no additional purchase options for Boeing 787 aircraft.

**Boeing 767 Freighter Aircraft**

Air Canada finalized an agreement for the purchase of two new Boeing 767 freighter aircraft which were delivered in the second quarter of 2022 and are expected to enter service in 2023. Air Canada expects to have a fleet of seven Boeing 767 freighters by the end of 2023, including the two aircraft delivered in 2022, and expects to add a further three Boeing 767 freighters between 2024 and 2025.

**Boeing 777 Freighter Aircraft**

Air Canada finalized an agreement for the purchase of two new Boeing 777 freighter aircraft with deliveries expected in 2024.

**Heart Aerospace ES-30 Electric Aircraft**

In the third quarter of 2022, Air Canada finalized a purchase agreement for 30 ES-30 electric-hybrid aircraft under development by Heart Aerospace. Due to the developing design and specifications of the aircraft, the final cost is not yet determinable and are not included in the table below, however the agreement provides for a price cap. The regional aircraft are expected to enter service in 2028. In addition to the purchase agreement, Air Canada has entered into an agreement providing for a $7 million (US$5 million) investment by Air Canada in Heart Aerospace.

**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, 2022 amounted to $7,789 million.

| (Canadian dollars in millions) | 2023 | 2024 | 2025 | 2026 | 2027 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Committed expenditures | $ 1,334 | $ 1,048 | $ 660 | $ 1,193 | $ 743 | $ 2,811 | $ 7,789 |
| Projected planned but uncommitted expenditures | 292 | 445 | 557 | 540 | 540 | not available | Not available |
| Projected planned but uncommitted capitalized maintenance (1) | 388 | 514 | 485 | 450 | 450 | not available | Not available |
| **Total projected expenditures (2)** | **$ 2,014** | **$ 2,007** | **$ 1,702** | **$ 2,183** | **$ 1,733** | **Not available** | **Not available** |

(1) *Future capitalized maintenance amounts for 2026 and beyond are not yet determinable, however estimates of $450 million have been made for each of 2026 and 2027.*

(2) *U.S. dollar amounts are converted using the December 31, 2022 closing exchange rate of US$1=C$1.3554. 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, 2022.*

## 8.7 PENSION FUNDING OBLIGATIONS

Air Canada maintains several defined benefit pension plans, including domestic registered pension plans and supplemental pension plans. Air Canada also sponsors several defined contribution pension plans and pension plans for foreign employees and contributes to some multi-employer pension plans. In addition, Air Canada has plans providing other retirement and post-employment benefits to its employees.

On a preliminary basis, at January 1, 2023, the aggregate solvency surplus in Air Canada's domestic registered pension plans was estimated at $4.4 billion. The final valuations will be completed in the first half of 2023. As permitted by legislation and subject to applicable plan rules, amounts in excess of 105% on a solvency basis may be used to reduce current service contributions under the defined benefit component or to fund the employer contribution to a defined contribution component within the same pension plan.

Total employer defined benefit pension funding contributions (including international and supplemental plans) amounted to $89 million in 2022 and are forecasted to be $88 million in 2023.

Net of the surplus in the defined benefit components which was used to fund the employer contribution to a defined contribution component within the same pension plan, total employer contributions for the defined contribution plans and multi-employer plans amounted to $42 million in 2022 and are forecasted to be $60 million in 2023.

At December 31, 2022, approximately 75% of Air Canada's pension assets in the domestic defined benefit plans were invested in fixed income instruments to mitigate a significant portion of the interest rate (discount rate) risk. Air Canada seeks to maintain a high percentage of long-term fixed income products to hedge pension liabilities.

Pension plan assets

Included in plan assets, for determining the net benefit obligation for accounting purposes, are 17,646,765 (2021 – 17,646,765) Class B voting shares of Air Canada which were issued to a trust in 2009 in connection with pension funding agreements reached with all of Air Canada's Canadian-based unions. The trust arrangement provides that proceeds of the sale of the trust shares will be retained and applied to reduce future pension solvency deficits, if any should materialize. In addition, for so long as the trust continues to hold at least 2% of Air Canada's issued and outstanding shares, the trustee will have the right to designate one nominee to the Board of Directors of Air Canada (who shall not be a member or officer of any of Air Canada's Canadian-based unions), subject to completion by Air Canada of its usual governance process for selection and confirmation of director nominees.

With Air Canada's domestic registered plans in a surplus position on a solvency basis, the accounting rules prevent the recognition of the value of the shares held in trust as part of the pension assets. The shares held in trust had a fair value of $342 million at December 31, 2022 (2021 – $373 million), however after giving effect to the asset ceiling, the recognized accounting value of the trust asset is nil.

In November 2021, Air Canada announced that its Canadian unions and the Air Canada Pionairs agreed in principle to permit certain other uses of the proceeds of the shares discussed above. If all conditions are met, shares in the trust will be gradually sold over a period of up to 15 years with the net proceeds from the sales used to make lump sum payments to Canadian pensioners and to fund voluntary separation packages for senior unionized employees and non-executive employees. Pursuant to the agreement in principle, the above-described right to designate one nominee for election to the Board of Directors of Air Canada would continue until the earlier of (i) January 1, 2030, or (ii) the date that Air Canada shares in trust represent 2% or less of Air Canada's issued and outstanding shares. There are several conditions to the completion of the agreement in principle and effecting such sales and payments. These include the conclusion of definitive documentation, and the receipt of all required regulatory and other approvals which remain outstanding. While the satisfaction of the conditions is being pursued, there can be no assurance that these or any other conditions will be satisfied.

## 8.8 CONTRACTUAL OBLIGATIONS

The table below provides Air Canada's projected contractual obligations as at December 31, 2022, 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) | 2023 | 2024 | 2025 | 2026 | 2027 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| **Principal** | | | | | | | |
| Long-term debt [1] | $ 713 | $ 525 | $ 1,276 | $ 2,548 | $ 1,182 | $ 7,479 | $ 13,723 |
| Lease liabilities | 550 | 501 | 471 | 331 | 273 | 912 | 3,038 |
| **Total principal obligations** | **$ 1,263** | **$ 1,026** | **$ 1,747** | **$ 2,879** | **$ 1,455** | **$ 8,391** | **$ 16,761** |
| **Interest** | | | | | | | |
| Long-term debt | $ 711 | $ 680 | $ 643 | $ 574 | $ 472 | $ 514 | $ 3,594 |
| Lease liabilities | 152 | 123 | 98 | 76 | 59 | 321 | 829 |
| **Total interest obligations** | **$ 863** | **$ 803** | **$ 741** | **$ 650** | **$ 531** | **$ 835** | **$ 4,423** |
| **Total long-term debt and lease liabilities** | **$ 2,126** | **$ 1,829** | **$ 2,488** | **$ 3,529** | **$ 1,986** | **$ 9,226** | **$ 21,184** |
| **Committed capital expenditures** | **$ 1,334** | **$ 1,048** | **$ 660** | **$ 1,193** | **$ 743** | **$ 2,811** | **$ 7,789** |
| **Total contractual obligations [2]** | **$ 3,460** | **$ 2,877** | **$ 3,148** | **$ 4,722** | **$ 2,729** | **$ 12,037** | **$ 28,973** |

*(1) Assumes the principal balance of the convertible notes, $372 million (US$274 million), remains unconverted and includes estimated interest payable until maturity in 2025. The full principal balance of $1,273 million for the unsecured credit facility in connection with the Government of Canada financing to support customer refunds is included.*

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

## 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, 2022 | December 31, 2021 |
|---|---|---|
| **Issued and outstanding shares** | | |
| Class A variable voting shares | 72,431,001 | 82,897,507 |
| Class B voting shares | 285,931,257 | 274,944,350 |
| **Total issued and outstanding shares** | **358,362,258** | **357,841,857** |
| **Class A variable voting and Class B voting shares potentially issuable** | | |
| Convertible notes | 17,856,599 | 48,687,441 |
| Warrants | - | 7,288,282 |
| Stock options | 5,304,745 | 4,420,051 |
| **Total shares potentially issuable** | **23,161,344** | **60,395,774** |
| **Total outstanding and potentially issuable shares** | **381,523,602** | **418,237,631** |

### Warrants

In April 2021, Air Canada entered into a series of debt and equity financing agreements with the Government of Canada (acting through Canada Enterprise Emergency Funding Corporation), including the issuance of shares and warrants. Air Canada exercised its call right to purchase and cancel the 7,288,282 vested warrants at fair market value of $82 million, with settlement completed in January 2022.

### Convertible Notes

In June 2020, Air Canada closed US$748 million ($1,011 million) of convertible unsecured notes (Convertible Notes), for net proceeds of $986 million. The Convertible Notes bear interest semi-annually in arrears at a rate of 4.0% per annum and will mature on July 1, 2025, unless earlier repurchased, redeemed or converted. The initial conversion rate of the Convertible Notes is 65.1337 shares per US$1,000 principal amount of Convertible Notes, or an initial conversion price of approximately US$15.35 per share. The Convertible Notes are convertible at the Corporation's election, into cash, or into Class A Variable Voting shares and/or Class B Voting shares of the Corporation, or a combination of cash and shares. The Convertible Notes are convertible prior to the close of business on the business day immediately preceding March 1, 2025 only under the circumstances and subject to satisfaction of the conversion conditions set out in the indenture for the Convertible Notes, and at any time on or after March 1, 2025 until the close of business on the second scheduled trading day immediately preceding July 1, 2025, the maturity date of the Notes, regardless of the foregoing conditions, in each case at the option of the noteholders.

In 2022, Air Canada repurchased and cancelled $635 million (US$473 million) aggregate principal amount of its outstanding Convertible Notes. As at December 31, 2022, a total of $372 million (US$274 million) aggregate principal amount of Convertible Notes remains outstanding.

## 9. QUARTERLY FINANCIAL DATA

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

| | 2021 | | | | 2022 | | | |
|---|---|---|---|---|---|---|---|---|
| (Canadian dollars in millions, except per share figures) | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Operating revenues | $ 729 | $ 837 | $ 2,103 | $ 2,731 | $ 2,573 | $ 3,981 | 5,322 | $ 4,680 |
| Operating expenses | 1,778 | 1,970 | 2,467 | 3,234 | 3,123 | 4,234 | 4,678 | 4,708 |
| **Operating income (loss)** | **(1,049)** | **(1,133)** | **(364)** | **(503)** | **(550)** | **(253)** | **644** | **(28)** |
| **Non-operating income (expense)** | **(338)** | **(165)** | **(315)** | **(114)** | **(264)** | **(99)** | **(1,148)** | **174** |
| **Income (loss) before income taxes** | **(1,387)** | **(1,298)** | **(679)** | **(617)** | **(814)** | **(352)** | **(504)** | **146** |
| Income tax recovery (expense) | 83 | 133 | 39 | 124 | (160) | (34) | (4) | 22 |
| **Net income (loss)** | **$ (1,304)** | **$ (1,165)** | **$ (640)** | **$ (493)** | **$ (974)** | **$ (386)** | **$ (508)** | **$ 168** |
| **Diluted earnings (loss) per share** | **$ (3.90)** | **$ (3.31)** | **$ (1.79)** | **$ (1.38)** | **$ (2.72)** | **$ (1.60)** | **$ (1.42)** | **$ 0.41** |
| **Adjusted EBITDA (1)** | **$ (763)** | **$ (656)** | **$ (67)** | **$ 22** | **$ (143)** | **$ 154** | **$ 1,057** | **$ 389** |
| **Adjusted pre-tax income (loss) (1)** | **$ (1,335)** | **$ (1,210)** | **$ (649)** | **$ (574)** | **$ (740)** | **$ (447)** | **$ 446** | **$ (211)** |
| **Adjusted net income (loss) (1)** | **$ (1,332)** | **$ (1,207)** | **$ (652)** | **$ (577)** | **$ (747)** | **$ (455)** | **$ 431** | **$ (217)** |
| **Adjusted earnings (loss) per share – diluted (1)** | **$ (3.98)** | **$ (3.40)** | **$ (1.82)** | **$ (1.61)** | **$ (2.09)** | **$ (1.12)** | **$ 1.07** | **$ (0.61)** |

*(1) Adjusted EBITDA, adjusted pre-tax income (loss) and adjusted net income (loss) are non-GAAP financial measures. Adjusted earnings (loss) per share is a non-GAAP financial ratio. For additional information, refer to section 20 "Non-GAAP Financial Measures" of this MD&A.*

## 10. SELECTED ANNUAL INFORMATION

| (Canadian dollars in millions, except per share figures) | Full Year 2022 | Full Year 2021 | Full Year 2020 |
|---|---|---|---|
| Operating revenues | $ 16,556 | $ 6,400 | $ 5,833 |
| Operating expenses | 16,743 | 9,449 | 9,609 |
| **Operating loss** | **(187)** | **(3,049)** | **(3,776)** |
| Loss before income taxes | (1,524) | (3,981) | (4,853) |
| Income tax recovery (expense) | (176) | 379 | 206 |
| **Net loss** | **$ (1,700)** | **$ (3,602)** | **$ (4,647)** |
| **Basic loss per share** | **$ (4.75)** | **$ (10.25)** | **$ (16.47)** |
| **Diluted loss per share** | **$ (4.75)** | **$ (10.25)** | **$ (16.47)** |
| **Adjusted EBITDA** (1) | **$ 1,457** | **$ (1,464)** | **$ (2,043)** |
| **Adjusted pre-tax loss** (1) | **$ (952)** | **$ (3,768)** | **$ (4,425)** |
| **Adjusted net loss** (1) | **$ (988)** | **$ (3,768)** | **$ (4,389)** |
| **Adjusted loss per share – diluted** (1) | **$ (2.76)** | **$ (10.74)** | **$ (15.56)** |
| **Cash, cash equivalents and short-term investments** (2) | **$ 7,988** | **$ 8,969** | **$ 7,607** |
| **Total assets** | **$ 29,507** | **$ 30,614** | **$ 28,913** |
| **Total long-term liabilities** | **$ 21,709** | **$ 23,681** | **$ 20,059** |
| **Total liabilities** | **$ 31,062** | **$ 30,605** | **$ 27,198** |

*(1) Adjusted EBITDA, adjusted pre-tax income (loss) and adjusted net income (loss) are non-GAAP financial measures. Adjusted earnings (loss) per share is a non-GAAP financial ratio. For additional information, refer to section 20 "Non-GAAP Financial Measures" of this MD&A.*

*(2) Refer to section 12 "Accounting Policies" of this MD&A for a description of the change in presentation related to restricted cash and pursuant to which certain amounts have been reclassified to cash and cash equivalents with the 2021 and 2020 comparative figures also reclassified.*

## 11. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

### Gain (Loss) on Financial Instruments Recorded at Fair Value

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

| | Fourth Quarter | | Full Year | |
|---|---|---|---|---|
| **(Canadian dollars in millions)** | **2022** | **2021** | **2022** | **2021** |
| Embedded derivative on convertible notes | $ 45 | $ 64 | $ 219 | $ (45) |
| Short-term investments | (2) | (5) | (86) | (36) |
| Warrants | - | 2 | - | 27 |
| Share forward contracts | 1 | (2) | - | (1) |
| **Gain (loss) on financial instruments recorded at fair value** | **$ 44** | **$ 59** | **$ 133** | **$ (55)** |

As described in section 8.9 "Share Information" of this MD&A, Air Canada exercised its call right to purchase and cancel the 7,288,282 vested warrants at fair market value of $82 million, with settlement completed in January 2022.

### Risk Management

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

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

### Fuel Price Risk Management

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

There was no fuel hedging activity during 2022 or 2021.

### 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 2022, these net operating cash inflows totalled approximately US$3.8 billion and U.S. denominated operating costs amounted to approximately US$7.4 billion. Non-operating cash outflows in U.S. dollars, primarily related to interest payments on U.S. dollar denominated debt and net financing outflows, amounted to approximately US$2.4 billion. In 2022, this resulted in a U.S. dollar net cash flow exposure of approximately US$6.0 billion.

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

- Holding U.S. dollar cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash, short and long-term investment balances as at December 31, 2022 amounted to $693 million (US$511 million) ($1,403 million (US$1,110 million) as at December 31, 2021). A portion of the cash and investment reserves are an economic hedge against long-term U.S. dollar debt while the remainder of the cash is operational cash and investment reserves which are applied against the rolling 18-month net U.S. dollar cash flow exposure. In 2022, a gain of $72 million (gain of $10 million in 2021) was recorded in Foreign exchange gain (loss) reflecting the change in Canadian equivalent market value of the U.S. dollar cash, short and long-term investment balances held.

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

The level of foreign exchange derivatives entered into and their related maturity dates are dependent upon a number of factors, which include the amount of foreign revenue conversion available, U.S. dollar net cash outflows, as well as the amount attributed to aircraft and debt payments. Based on the notional amount of currency derivatives outstanding at December 31, 2022, as further described below, approximately 69% of net U.S. cash outflows are hedged for 2023 and 43% for 2024, resulting in derivative coverage of 60% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 60% coverage.

As at December 31, 2022, Air Canada had outstanding foreign currency options and swap agreements, settling in 2023 and 2024, to purchase at maturity $5,798 million (US$4,310 million) of U.S. dollars at a weighted average rate of $1.2986 per US$1.00 (2021 – $2,423 million (US$1,925 million) with settlements in 2022 and 2023 at a weighted average rate of $1.2742 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 €198 million, GBP £244 million, JPY ¥17,405 million, CNH ¥355 million and AUD $126 million) which settle in 2023 and 2024 at weighted average rates of €1.0828, £1.2467, ¥0.0082, ¥0.1419, and AUD $0.7072 per $1.00 U.S. dollar, respectively (as at December 31, 2021 – EUR €260 million, GBP £56 million, JPY ¥4,577 million, CNH ¥31 million and AUD $36 million with settlement in 2022 and 2023 at weighted average rates of €1.1704, £1.4125, ¥0.0092, ¥0.1471, and AUD $0.7300 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, 2022 was $140 million in favour of the counterparties (2021 – $268 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 2022, a gain of $174 million was recorded in Foreign exchange gain (loss) related to these derivatives (2021 – $114 million loss). In 2022, foreign exchange derivative contracts cash settled with a net fair value of $46 million in favour of Air Canada (2021 – $437 million in favour of the counterparties).

**Interest Rate Risk**

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

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

The ratio of fixed to floating rate obligations outstanding is designed to maintain flexibility in the Corporation's capital structure and is based upon a long-term objective of 60% fixed and 40% floating but allows flexibility to adjust to prevailing market conditions. The ratio at December 31, 2022 is 71% fixed and 29% floating (73% and 27%, respectively as at December 31, 2021).

## 12. ACCOUNTING POLICIES

Information on Air Canada's accounting policies is provided in Note 2 of Air Canada's audited consolidated financial statements and notes for 2022, including future changes in accounting policies for amendments to standards not yet effective. Information on the initial application of an interpretation on IAS 7 Statement of Cash Flows is provided below. Presentation changes made in the consolidated statement of operations for costs related to capacity purchase agreements and figures previously classified as special items is described below. Comparative figures have been reclassified to conform to the financial presentation adopted for the current year.

<u>IAS 7 Statement of Cash Flows</u>

In 2022, the IFRS Interpretations Committee finalized its decision on IAS 7 Statement of Cash Flows that restrictions on the use of demand deposits arising from a contract with a third party do not preclude those deposits from being classified as cash and cash equivalents when they are available to the company on demand. Such deposits should therefore be included in cash and cash equivalents in the statements of cash flows and financial position, with disclosure provided on significant cash and cash equivalents balances with restrictions on use.

Previously, Air Canada recorded restricted cash under current assets representing funds held in trust by Air Canada Vacations in accordance with regulatory requirements governing advance sales for tour operators. While these funds are in trust pursuant to the applicable regulations, Air Canada may access these funds as services are rendered or as disbursements are made on behalf of the customer. As a result of this guidance on application of IAS 7 Statement of Cash Flows, Air Canada has reclassified these amounts to Cash and cash equivalents with the 2021 comparative figures also reclassified. The presentation change impacted cash flows from operating activities, with an increase of $61 million for the year ended December 31, 2021. Cash and cash equivalents include $386 million related to these funds at December 31, 2022 ($167 million at December 31, 2021).

<u>Capacity purchase agreements</u>

Previously, operating expenses under capacity purchase agreements, were aggregated in a separate line item in the consolidated statement of operations titled Regional airlines expense, and included the capacity purchase fees, pass-through costs, which are direct costs incurred by the regional carrier and charged to Air Canada and other costs incurred by Air Canada which are directly related to regional carrier operations, excluding fuel.

For the year ended December 31, 2022, these costs are no longer allocated to regional airline expenses on the consolidated statement of operations. Capacity purchase fees are now presented as a separate line item in the consolidated statement of operations and continue to exclude the component of fees related to aircraft costs which are accounted for as lease liabilities in accordance with IFRS 16. This reclassification provides improved presentation of the total cost by nature of each expense associated with Air Canada's operations. This presentation change has no impact on total operating expenses.

<u>Reclassification of certain operating expenses</u>

Figures previously classified as special items in the consolidated statement of operations have been reclassified to Wages, salaries and benefits, Restructuring and transaction costs, and Impairment of assets. The nature of transactions included in these items are further described in Sections 5 and 6 "Results of Operations". This change in presentation did not change any subtotals within the consolidated statement of operations, nor any other line items presented.

These presentation changes impacted Air Canada's previously reported consolidated statement of operations as presented in the following table. Line items that were not affected by the presentation change have not been included in the table below. As a result, the total operating expenses cannot be recalculated from the table provided.

| (Canadian dollars in millions) | For the year ended Dec. 31, 2021 as previously reported | Reclassification for Regional airlines expense | Reclassification for Special items | For the year ended Dec. 31, 2021 as restated |
|---|---|---|---|---|
| **Operating expenses** | | | | |
| Wages, salaries and benefits | $ 2,283 | $ 104 | $ (244) | $ 2,143 |
| Regional airlines expense, excluding fuel | 1,042 | (1,042) | | - |
| Airport and navigation fees | 562 | 161 | | 723 |
| Sales and distribution costs | 244 | 42 | | 286 |
| Capacity purchase fees | - | 558 | | 558 |
| Aircraft maintenance | 656 | 55 | | 711 |
| Communications and information technology | 362 | 11 | | 373 |
| Catering and onboard services | 165 | 19 | | 184 |
| Special items | (31) | | 31 | - |
| Impairment of assets | - | | 38 | 38 |
| Restructuring and transaction costs | - | | 175 | 175 |
| Other | 854 | 92 | | 946 |
| **Total operating expenses** | **$ 9,449** | **$ -** | **$ -** | **$ 9,449** |

The $244 million reclassification to Wages, salaries and benefit is comprised of a credit of $451 million government wage subsidy offset by $82 million for benefit plan amendments and $125 million for a benefit plan settlement. These items are further described in Notes 2Z and 10 to Air Canada's 2022 annual consolidated financial statements dated February 17, 2023.

## 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 materially from those estimates and judgments.

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

**Impairment Considerations on Long-lived Assets**

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

**Aeroplan Loyalty Program**

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

Breakage represents the estimated Points that are not expected to be redeemed. Breakage is estimated by management based on the terms and conditions of membership and historical accumulation and redemption patterns, as adjusted for changes to any terms and conditions or other circumstances that may affect future redemptions. Management uses statistical and simulation models to estimate breakage. A change in assumptions as to the number of Points expected to be redeemed could have a significant impact on revenue in the year in which the change occurs. Given the unique impact of the COVID-19 pandemic on travel demand and consumer spending patterns, and considering the launch of the new Aeroplan program in 2020 and the special benefits and accommodations for Aeroplan members in response to the COVID-19 pandemic, the breakage estimate is unchanged in 2022 and is based on a qualitative update of the prior assessment. In addition, the estimate is based on management's long-term expectations of breakage over the life of the program.

As at December 31, 2022, the Aeroplan points deferred revenue balance was $3,409 million. For illustrative purposes, a hypothetical 1% change in the number of outstanding points estimated to be redeemed would result in an approximate impact of $34 million on revenue with a corresponding adjustment to Aeroplan deferred revenue.

**Breakage**

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

**Depreciation and Amortization Period for Long-lived Assets**

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

**Maintenance Provisions**

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

**Employee Future Benefits**

The cost and related liabilities of the Corporation's pension, other post-retirement and post-employment benefit programs are determined using actuarial valuations. The actuarial valuations involve assumptions and estimates including discount rates 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 estimates about actuarial and financial assumptions to determine the cost and related liabilities of Air Canada's employee future benefits.

Discount Rate

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

Future Increases in Compensation

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

Mortality Assumptions

Mortality tables and improvement scales issued by the Canadian Institute of Actuaries (revised in 2014) were taken into account in selecting management's best estimate mortality assumption used to calculate the accrued benefit obligation as at December 31, 2022 and 2021.

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

| | Pension Benefits | | Other Employee Future Benefits | |
|---|---|---|---|---|
| | 2022 | 2021 | 2022 | 2021 |
| **Discount rate used to determine:** | | | | |
| Net interest on the net defined benefit obligation for the year ended December 31 | 3.20% | 2.82% (1) | 3.20% | 2.59% |
| Service cost for the year ended December 31 | 3.37% | 3.10% (1) | 3.37% | 3.16% (1) |
| Accrued benefit obligation as at December 31 | 5.28% | 3.20% | 5.28% | 3.20% |
| **Rate of future increases in compensation used to determine:** | | | | |
| Accrued benefit cost and service cost for the year ended December 31 | 2.50% | 2.50% | Not applicable | Not applicable |
| Accrued benefit obligation as at December 31 | 2.75% | 2.50% | Not applicable | Not applicable |

*(1) Weighted average reflecting re-measurements during the year due to items related to early retirement incentive programs.*

**Sensitivity Analysis**

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

Sensitivity analysis on 2022 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 | $ 15 | $ (15) |
| Net interest relating to pension benefit liabilities | 10 | (10) |
| **Total** | **$ 25** | **$ (25)** |
| | | |
| **Increase (decrease) in pension obligation** | **$ 536** | **$ (520)** |

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, 2022, approximately 75% of Air Canada's pension assets were invested in fixed income instruments to mitigate a significant portion of the interest rate (discount rate) risk.

An increase of one year in life expectancy would increase the pension benefit obligation by $399 million.

Assumed health care cost trend rates impact the amounts reported for the health care plans. A 4.75% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2022 (2021 – 5%). The rate is assumed to decrease to 4.5% in 2023 and thereafter (2021 – assumed to decrease gradually to 4.5% by 2023). A one-percentage-point increase in assumed health care trend rates would have increased the total of current service and interest costs by $7 million and the obligation by $56 million. A one-percentage-point decrease in assumed health care trend rates would have decreased the total of current service and interest costs by $6 million and the obligation by $58 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 $32 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 $30 million.

## 14. OFF-BALANCE SHEET ARRANGEMENTS

**Guarantees**

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 the Corporation under IFRS 10 Consolidated Financial Statements is approximately $1,181 million as at December 31, 2022 (December 31, 2021 – $1,038 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 among 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, 2022, 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. SENSITIVITY OF RESULTS

Air Canada's financial results are subject to many different internal and external factors which can have a significant impact on operating results. The following table describes, on an indicative basis, the financial impact that changes in fuel prices and the value of the Canadian dollar would generally have had on Air Canada's past operating results. An equivalent but opposite movement of the sensitivity factor in the table below would have generally resulted in a similar but opposite impact. These guidelines were derived from 2022 levels of activity and are based on management estimates. The impacts are not additive, do not reflect the interdependent relationship of the elements and may not be indicative of future trends or results which may vary significantly due to a wide range of factors many of which are beyond the control of Air Canada.

| Key Variable | 2022 Measure | Sensitivity Factor | Favourable/ (Unfavourable) Estimated Operating Income Impact/Pre-tax Income (Canadian dollars in millions) | |
|---|---|---|---|---|
| **Fuel** | | | | |
| Fuel – Jet fuel price (US$/barrel) (1) | $154.3 | US$1/barrel increase | $ | (42) |
| Fuel – Jet fuel price (C$/litre) (1) | $1.30 | 1% increase | $ | (65) |
| **Currency Exchange** | | | | |
| C$ to US$ | US$1=C$1.33 | 1 cent appreciation (i.e. from $1.34 to $1.33 per US$) | | |
| | | Operating income (2) | $ | 36 |
| | | Net interest expense | | 5 |
| | | Revaluation of long-term debt and lease liabilities, U.S. dollar cash, cash equivalents and short-term investments, and other long-term monetary items, net | | 89 |
| | | Remeasurement of outstanding currency derivatives | | (43) |
| | | **Pre-tax income impact** | **$** | **87** |

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

## 17. ENTERPRISE RISK MANAGEMENT AND GOVERNANCE

**Overview**

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

**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 Air Canada's most important strategic risks and is aligned to the ISO 31000 standard and COSO ERM 2017 framework.

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

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

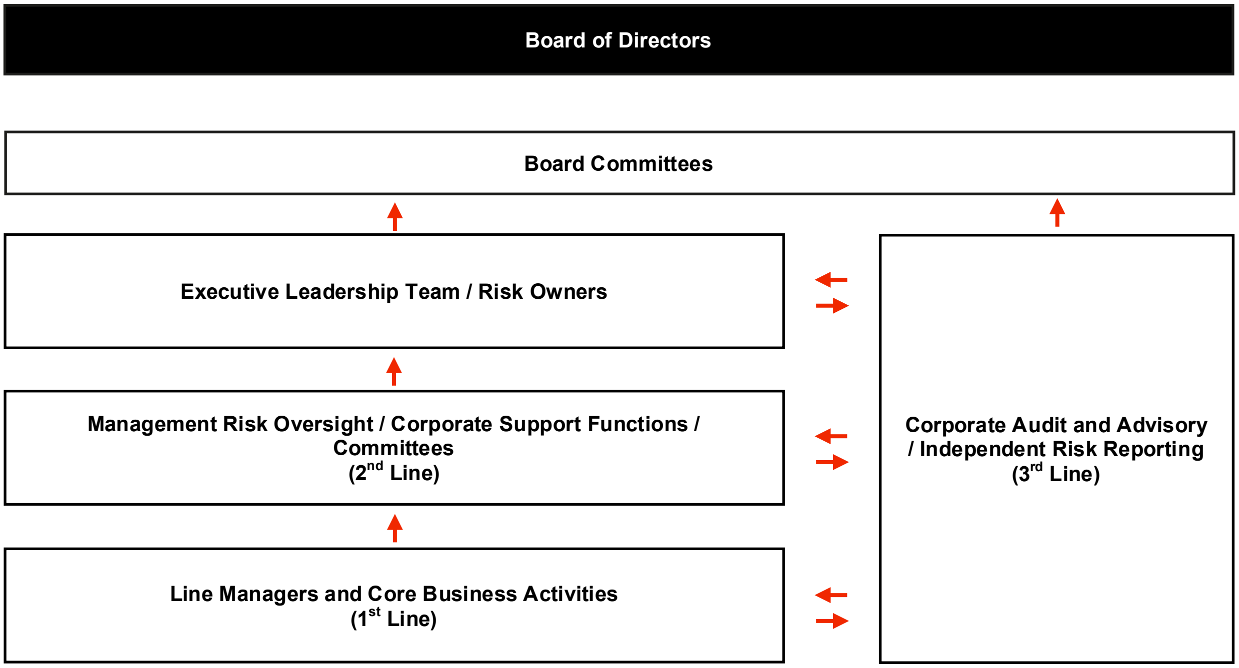
Air Canada's risk management structure is aligned with the "Three Lines Model" approach to risk management:

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

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

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

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




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

## 18. RISK FACTORS

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

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

Air Canada's results from operations, like those of other airlines, are sensitive to and may be significantly impacted by economic and geopolitical conditions, which may impact demand for air transportation in general or to or from certain destinations, operating costs, operating revenues, costs and availability of fuel, foreign exchange costs, tax costs and costs and availability of capital and supplies. Any prolonged or significant impact arising from economic and geopolitical conditions, including in relation to the COVID-19 pandemic (or emergence of a new pandemic), the military conflict between Russia and Ukraine (which is also causing overflight restrictions and impacting Air Canada's ability to operate certain routes optimally or at all), ongoing geopolitical conflicts and civil unrest, and the related response and restrictions imposed by various governments and authorities (or lack thereof), weakness of the Canadian, U.S. or world economies, inflation, changes to political, economic, fiscal or trade relationships within or between jurisdictions where Air Canada operates flights or does business, or threatened or actual outbreaks of hostilities in or adjacent to regions Air Canada serves or over which it operates flights or does business could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

**Operating results** - Air Canada may sustain significant losses and not be able to successfully achieve and/or sustain positive net profitability or realize the objectives of any or all 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 change in the number of passengers, fare pricing, margins or traffic mix, or increased costs, could have a significant impact on Air Canada's operating and financial results. Due to the competitive nature of the airline industry and customer sensitivity to travel costs, Air Canada may not be able to pass on cost increases to its customers. Despite a focus on improving resiliency to downturns in its business as well as ongoing and planned strategic and business initiatives, Air Canada may not be able to successfully achieve and/or sustain positive net profitability or realize all of its objectives, including those that seek to increase revenues, decrease costs, improve margins, profitably deploy additional capacity, generate sufficient returns on its capital expenditures or offset or mitigate risks facing Air Canada, including those described in this MD&A.

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

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

**Competition** - Air Canada operates in a highly competitive environment and faces increasing competition in Canada, North America and internationally

Air Canada operates within a highly competitive industry and continuously encounters substantial price competition. Carriers, including low-cost, ultra-low-cost, domestic, U.S. and foreign carriers, have entered, announced their intention to enter or continue to enter or expand into markets Air Canada operates in or plans to operate in, including domestic, U.S. transborder, international and leisure-oriented markets, as well as cargo transportation markets, including and more recently as a result of potential and changing opportunities created by the COVID-19 pandemic.

Certain carriers against which Air Canada competes have received airline sector-specific government aid in relation to the COVID-19 pandemic that may strengthen their ability to compete, including against airlines that have not received, or that have not made use of, such (or as much) 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 co-operation 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 its ability to achieve acceptable operating margins and may be limited by applicable laws or government policies to encourage competition.

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

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

During the period from March 2020 until early- to mid-2022, Air Canada and the rest of the global airline industry faced significantly lower traffic than in 2019, and a corresponding decline in revenue and cash flows, as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world including in Canada. Conditions have improved significantly, and travel restrictions have been lifted in many countries, including in Canada, however, there can be no assurance that there will not be further impacts from the COVID-19 pandemic or that the recovery will continue as expected, including as a result of further waves, supply chain disruptions and inflationary pressures.

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

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

Air Canada's business requires the secure collection, processing and storage of sensitive data, including personal information of its passengers, Aeroplan members, employees business partners and others. The effective, reliable and secure operation of the networks and systems (including third party systems) on which sensitive information is stored, transmitted, processed and maintained is critical to Air Canada's business.

Technology systems may be vulnerable to a variety sources of failure, interruption or misuse, including by reason of human error, third-party suppliers' acts or omissions, natural disasters, terrorist attacks, telecommunications failures, power failures, unauthorized or fraudulent users (including cyber-attacks, malware, ransomware, computer viruses and the like), and other operational and security issues. Like other entities operating in today's digital business environment, we are subject to threats to the security of our networks, systems and data. These threats continue to increase as the frequency, intensity and sophistication of attempted attacks and intrusions increase around the world. We have been the target of cybersecurity attacks in the past and expect that we will continue to be in the future.

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

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

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

In order to operate its business, achieve its goals and remain competitive, Air Canada continually seeks to identify and devise, invest in, implement and pursue strategic, business, technology and other important initiatives, including those relating to the expansion of its cargo business (including operating dedicated cargo freighter aircraft), the renewal of its aircraft fleet, participation in the leisure or lower-cost market (including through Air Canada Rouge), initiatives to address climate change, expansion of joint venture arrangements, enhancement of revenues, reduction of costs, improvement of business processes, implementation of new technologies, expansion of flying capacity (including in respect of new aircraft and routes), and corporate culture transformation initiatives seeking to ensure a consistently high-quality customer service experience and others. These initiatives, including activities relating to their development and implementation, may be adversely impacted by a wide range of factors, many of which are beyond Air Canada's control. Such factors include the need to seek legal or regulatory approvals, the performance of third parties (including suppliers), their services and their products, the implementation and integration of such initiatives into Air Canada's other activities and processes as well as the adoption and acceptance of these initiatives by Air Canada's customers, suppliers and personnel. A delay or a failure to sufficiently and successfully identify and devise, invest in or implement any of these or other significant initiatives could adversely affect Air Canada's ability to operate its business, achieve its goals and remain competitive and could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

Fuel costs constitute one of Air Canada's largest operating cost items. Fuel prices fluctuate widely depending on many factors, including international market conditions, geopolitical events, jet fuel supply and refining costs, carbon pricing, as further described below, or other climate change related regulations, taxes, levies or other measures, and the Canada/U.S. dollar exchange rate. Air Canada cannot accurately predict the future price of fuel and it may not be able to sufficiently, or may not, hedge the risk associated with fluctuations in fuel prices. Due to the competitive nature of the airline industry, Air Canada may not be able to pass on increases in fuel prices to its customers by increasing its pricing. Significant fluctuations (including increases) in fuel prices could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

**Financial Leverage** - Air Canada has a significant amount of financial leverage. Air Canada may also not be able to obtain sufficient funds in a timely manner and on acceptable terms to provide adequate liquidity and to finance necessary operating and capital expenditures

Air Canada has a significant amount of financial leverage from fixed obligations, including substantial obligations under aircraft leases, aircraft purchases and other financings, and 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 ratio. Air Canada was required to significantly increase its level of indebtedness as a result of the COVID-19 pandemic. The amount of indebtedness that Air Canada has and which it may incur in the future could have a material adverse effect on Air Canada. The ability of Air Canada to make scheduled payments under its indebtedness may depend on, among other things, its future operating performance and its ability to refinance its indebtedness, if necessary. Air Canada incurs a significant proportion of its indebtedness in foreign currencies, primarily in U.S. dollars, and as a result, future debt servicing repayments are subject to foreign exchange risk. There can be no assurance that Air Canada will at all times be able to generate sufficient cash from its operations to satisfy its debts, lease and other obligations and continue to pursue capital expenditures, and other business initiatives or strategic plans. Each of these factors is, to a large extent, subject to economic, financial, competitive, regulatory, operational and other factors, many of which are beyond Air Canada's control.

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

Air Canada's liquidity levels may be adversely impacted by risks identified in this MD&A, including the effects of the COVID-19 pandemic, geopolitical, economic and public health conditions, foreign exchange rates, increased competition, volatile fuel prices, labour issues, and contractual covenants. As part of Air Canada's efforts to manage risk and to support its business strategy, significant liquidity and significant ongoing operating and capital expenditures are required.

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

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 its business or operating environment, may negatively impact Air Canada's ability to raise capital, issue debt, borrow on acceptable terms, attract and/or retain key employees, make strategic acquisitions, enter into business arrangements or operate its business, and such factors may contribute to volatility in the market price of Air Canada's securities.

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

Air Canada's business is significantly dependent upon its ability to operate without interruption to or from a number of airports, including its main hubs at Toronto, Montréal, and Vancouver. Delays or disruptions in service, including those due to a variety of factors, such as the inability of airline industry participants on which Air Canada's operations are dependent (including airports, security, customs, air navigation and other participants or services), security issues, computer malfunctions or other incidents, weather conditions, labour shortages or conflicts in respect of personnel not employed by Air Canada such as airport workers, baggage handlers, air traffic controllers, security personnel and others supporting airport-related operations, epidemics, pandemics and public health restrictions (including in relation to the COVID-19 pandemic) or other causes beyond the control of Air Canada could have a material adverse impact on Air Canada, its business, results from operations and financial condition.

Interruptions and disruptions in service may be caused by, and the demand and cost of air travel may also be adversely impacted by, environmental conditions, technology issues and factors in addition to those relating to the weather, including those identified in this MD&A. Environmental conditions and factors, such as climate change, volcanic eruptions or other natural phenomena, as well as those arising from man-made sources, may also increase the frequency, duration and intensity of severe weather events, including on the ground and at altitude (including turbulence events). Such events, including at airports or destinations served or flight routes used by Air Canada may impact the viability or cost of flying to such destinations, 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.

**Key supplies and suppliers** - Air Canada's failure or inability to source certain goods and services from key suppliers, including on favourable terms and on a timely basis 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, and without disruption, 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, catering, airport services (including customs and security services and infrastructure to support demand), de-icing services, airport slots, aircraft maintenance services, cargo handling services and facilities, and information technology systems and services. In certain cases, Air Canada may only be able to source goods and services from a limited number of suppliers (or from sole source suppliers) and the transition to new or alternative suppliers, which may be necessitated by reason of such suppliers increasing their rates or by their failure, refusal or inability to deliver or perform, may not be possible or may take a significant amount of time or require significant resources. A failure, refusal, delay or inability of a supplier to supply Air Canada with goods and services of desirable quality on terms and pricing and within timeframes acceptable to Air Canada may arise as a result of a wide range of causes, many of which are beyond Air Canada's control, including as a result of the COVID 19 pandemic and related disruptions in supply chains or labour shortages. Any failure or the inability of Air Canada to successfully source goods and services of desirable quality on terms and pricing and within the timeframes acceptable to Air Canada could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

Air Canada enhances its network through a capacity purchase agreement with Jazz that operates 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 that are determined based upon certain costs incurred by Jazz. Air Canada also reimburses Jazz for certain pass-through costs incurred by Jazz (or arranges to provide the related supplies to Jazz), such as fuel costs, navigation fees, landing fees and terminal fees. In addition, the Jazz CPA requires that Jazz maintain a minimum fleet size and contains a minimum average daily utilization guarantee, which requires Air Canada to use 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 that may reduce the utilization of the Jazz fleet, including economic or market downturns or the effects of the COVID-19 pandemic, and unexpected interruptions or cessation of Jazz's services, as well as similar circumstances relating to other airlines from whom Air Canada may source regional capacity, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

Air Canada is dependent on its ability to attract and retain a variety of employees, including senior leadership, managers, airline flight, technology and operations personnel and other key employees having the necessary industry experience, qualifications and knowledge in order to execute its business plan and operate its business. If Air Canada were to experience a shortfall or a substantial turnover in its key employees (including as a result of the more competitive labour market), Air Canada, its business, results from operations and financial condition could be materially adversely affected.

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

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

**Regulatory matters** - Air Canada is subject to extensive and continually evolving domestic and international legal, regulatory and administrative controls and oversight

Air Canada and the airline industry are subject to extensive and continually evolving domestic and international legal, regulatory and administrative controls and oversight, including in relation to taxes, airport fees and operations, route rights, airport slots, aircraft operations and maintenance, security, passenger and consumer rights, public health and safety, accessibility of transportation, flight crew and other labour rules, privacy, data security, marketing and advertising, licensing, competition, joint ventures, pensions, environment (including in relation to fuel management, pollution, climate change, greenhouse gas emissions and noise levels), customs, immigration, foreign exchange controls and, in some measure, pricing.

Air Canada is subject to significant and continually evolving tax laws, regulations and interpretations, which apply to its operations in various jurisdictions throughout the world. A significant majority of countries in the Organisation for Economic Co-operation and Development's (OECD) Inclusive Framework have agreed, in principle, to proposed changes to long-standing tax principles. Such changes focus on nexus, profit reallocation to market jurisdictions and a global minimum tax. As these changes are subject to further negotiation and implementation by each member country, the final rules, timing and ultimate impact of any such changes on Air Canada's tax obligations are uncertain.

Air Canada cannot predict whether, or the manner in which, proposed domestic and international laws, regulations and administrative requirements or similar initiatives will ultimately be implemented or their impact on Air Canada. While Air Canada seeks to comply with all applicable laws, regulations and administrative requirements, compliance may involve significant judgment in interpreting them. Furthermore, interpretations as well as the application and enforcement of such requirements may evolve due to numerous factors, including decisions by courts, regulators, administrative and other bodies. Compliance (including failure to comply) with current or future domestic and international laws, regulations and administrative requirements, including potentially inconsistent or conflicting laws or regulations, or laws or regulations that disproportionally apply to Canadian airlines or Air Canada specifically, may impose significant costs (including taxes, fines, penalties and/or levies), impediments and/or competitive disadvantages. There cannot be any assurance that current or future laws, regulations and administrative requirements will not materially adversely affect Air Canada, its business, results from operations and financial condition.

**Labour costs and labour relations** - Air Canada may not be able to maintain labour costs at appropriate levels or secure labour agreements that permit it to successfully pursue its strategic initiatives. There can be no assurance that collective bargaining agreements will be 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 had established long-term arrangements with unions representing a significant portion of its unionized employees, these agreements are scheduled to reach the end of their term over the next few years. Further, due to the impact of the COVID-19 pandemic, Air Canada is not expected to meet a wide body benchmark under the long-term arrangement it concluded in 2014 with the Air Canada Pilots Association, which may result in ACPA and Air Canada engaging in collective bargaining as early as mid-2023. 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, including on terms consistent with Air Canada's expectations or comparable to its competitors' labour agreements, 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 lockouts 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 which 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.

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

The potential for terrorist attacks and terrorist activity causes concern and uncertainty in the minds of the travelling public. The occurrence of a terrorist attack, an attempted attack or the perceived threat of one (whether or not involving Air Canada or another carrier, or involving Air Canada's destinations, or other destinations or regions) and restrictive security measures, such as those relating to the content of carry-on baggage, passenger identification document requirements and passenger screening procedures, could have a material adverse effect on passenger demand for air travel and on the number of passengers travelling on Air Canada's flights. It could also lead to a substantial increase in insurance, security and other costs. Any resulting reduction in revenues and/or increases in costs could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

In 2020, Air Canada implemented a new, redesigned Aeroplan loyalty program. Air Canada offers its customers who are Aeroplan Members the opportunity to earn Aeroplan points, which management believes is a significant factor in many customers' decision to travel with Air Canada and contributes to building customer loyalty. The success of the Aeroplan program is dependent on attracting new and retaining current members and on maintaining sufficient accumulation and redemption partners. Increases in redemption rates for outstanding Aeroplan points, failures to adequately operate the Aeroplan program, reductions in the prevailing interchange rates in Canada, or interruptions or disruptions of Aeroplan program services, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

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

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

**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 joint venture counterparties, Lufthansa AG, United Airlines and Air China, 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 toward Air Canada, Air Canada, its business, results from operations and financial condition could be materially adversely affected.

**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 they are exposed to significant adverse publicity including through social media. Adverse publicity, whether justified or not, can rapidly spread through social or digital media. To the extent we are subject to, or unable to respond timely and appropriately to adverse publicity, our brand and reputation may be damaged. Any failure to preserve or grow Air Canada's brand, including by reason of the conduct of Air Canada or any of its business partners or other external parties, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

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

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

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

**Limitations due to restrictive covenants** - Covenants in agreements that Air Canada has entered into or may enter into may affect or limit the manner in which Air Canada operates its business

Some of the financing and other major agreements to which Air Canada is a party contain, and in the future may contain, restrictive, financial (including in relation to asset valuations, liquidity, fixed charge coverage ratio) and other covenants that 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 that limit Air Canada's operating and financial flexibility, which could materially and adversely affect Air Canada's ability to operate its business and its profitability.

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

Also, the lenders under the financing arrangements could foreclose upon all or substantially all of the assets of Air Canada that secure Air Canada's obligations.

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

The insurance industry in general, including the aviation insurance industry, has been experiencing increasing losses and decreased insurer profitability in recent years, resulting in reduced capacity levels and premium increases. These conditions may adversely affect some of Air Canada's existing insurance carriers or Air Canada's ability to obtain future insurance coverage (including war risk 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 (and in the absence of measures by the Government of Canada to provide the required coverage), Air Canada's insurance costs may increase further and may result in Air Canada being in breach of regulatory requirements or contractual arrangements requiring that specific insurance be maintained, which 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 and supplemental pension plans.

Canadian federal pension legislation requires that the funded status of defined benefit 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). Canadian federal pension legislation prescribes the minimum contributions that plan sponsors must make to their defined benefit registered pension plans. Current service contributions are required to be paid monthly, except to the extent they are funded through the surplus in such plan (subject to applicable plan rules and legislation). Air Canada's pension funding obligations (including projected funding obligations) may vary significantly based on a wide variety of factors, including the plan's solvency financial position, regulatory developments, plan demographics, changes to plan provisions, the success of its pension asset investment strategies, assumptions and methods used and changes in economic conditions (mainly the return on fund assets and changes in interest rates) and other factors. Air Canada has taken significant steps to reduce its pension plan risk, and its domestic defined benefit registered pension plans are in a surplus position, but there can be no assurance that such a risk will not materialize and adversely impact Air Canada's ability to meet its funding obligations, which in turn could have a material adverse effect on Air Canada, its business, results from operations and financial condition. See section 8.7 "Pension Funding Obligations" of this MD&A for additional information.

## 19. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures and Internal Controls over Financial Reporting

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

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

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

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

**Management's Report on Disclosure Controls and Procedures**

Management, under the supervision of and with the participation of Air Canada's CEO and CFO, evaluated the effectiveness of Air Canada's disclosure controls and procedures (as defined under National Instrument 52-109) and concluded, as at December 31, 2022, that such disclosure controls and procedures were effective.

**Management's Report on Internal Controls over Financial Reporting**

Management, under the supervision of and with the participation of Air Canada's CEO and CFO, evaluated the effectiveness of Air Canada's internal controls over financial reporting (as defined under National Instrument 52-109). In making this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commissions (COSO) in Internal Control - Integrated Framework (2013). Based on that evaluation, management and the CEO and CFO have concluded that, as at December 31, 2022, Air Canada's internal controls over financial reporting were effective. This evaluation took into consideration Air Canada's Corporate Disclosure Policy and the functioning of its Disclosure Policy Committee.

**Changes in Internal Controls over Financial Reporting**

There have been no changes to Air Canada's internal controls over financial reporting during 2022 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

## 20. NON-GAAP FINANCIAL MEASURES

Below is a description of certain non-GAAP financial measures and ratios 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.

When calculating adjusted EBITDA, adjusted EBITDA margin, adjusted CASM, adjusted pre-tax income (loss), adjusted net income (loss), and adjusted earnings (loss) per share – diluted, Air Canada excludes the effects of the government wage subsidy, benefit plan amendments, benefit plan settlement, impairment of assets, restructuring and transaction costs as these items may distort the analysis of certain business trends and render comparative analysis across periods or to other airlines less meaningful. As described in notes 2Z, 4, 6 and 10 of Air Canada's 2022 annual audited consolidated financial statements and notes dated February 17, 2023, these items, which were previously classified as special items in the consolidated statement of operations, have now been reclassified as follows:

- Government wage subsidy, benefit plan amendment and benefit plan settlement are now classified in wages, salaries and benefits.
- Impairments is now classified as a separate line item called impairment of assets.
- Workforce reduction provisions and other items are now classified in restructuring and transaction costs.

Refer to Section 12 "Accounting Policies" of this MD&A for information on the reclassifications on the consolidated statement of operations.

**EBITDA and Adjusted 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. In adjusted EBITDA, Air Canada excludes the effects of the government wage subsidy, benefit plan amendments, benefit plan settlement, impairment of assets, restructuring and transaction costs as these items may distort the analysis of certain business trends and render comparative analysis across periods or to other airlines less meaningful.

**Adjusted EBITDA Margin**

Adjusted EBITDA margin (adjusted EBITDA as a percentage of operating revenues) is commonly used in the airline industry and is used by Air Canada as a means to measure the operating margin 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. Further, the effects of the government wage subsidy, benefit plan amendments, benefit plan settlement, impairment of assets, restructuring and transaction costs are also removed in computing adjusted EBITDA margin as these items may distort the analysis of certain business trends and render comparative analysis across periods or to other airlines less meaningful.

EBITDA, adjusted EBITDA and adjusted EBITDA margin are reconciled to GAAP operating income (loss) as follows:

| (Canadian dollars in millions, except where indicated) | Fourth Quarter | | | Full Year | | |
|---|---|---|---|---|---|---|
| | 2022 | 2021 | Change | 2022 | 2021 | Change |
| **Operating loss – GAAP** | **$ (28)** | **$ (503)** | **$ 475** | **$ (187)** | **$ (3,049)** | **$ 2,862** |
| **Add back:** | | | | | | |
| Depreciation and amortization | 417 | 399 | 18 | 1,640 | 1,616 | 24 |
| **EBITDA** | **$ 389** | **$ (104)** | **$ 493** | **$ 1,453** | **$ (1,433)** | **$ 2,886** |
| **Remove:** | | | | | | |
| Government wage subsidy, net | - | (27) | 27 | - | (451) | 451 |
| Benefit plan amendments | - | 6 | (6) | - | 82 | (82) |
| Benefit plan settlement | - | 125 | (125) | - | 125 | (125) |
| Impairment of assets | - | 24 | (24) | 4 | 38 | (34) |
| Restructuring and transaction costs | - | (2) | 2 | - | 175 | (175) |
| **Adjusted EBITDA** | **$ 389** | **$ 22** | **$ 367** | **$ 1,457** | **$ (1,464)** | **$ 2,921** |
| **Operating revenues** | **$ 4,680** | **$ 2,731** | **$ 1,949** | **$ 16,556** | **$ 6,400** | **$ 10,156** |
| **Operating margin (%)** | **(0.6)** | **(18.4)** | **17.8 pp** | **(1.1)** | **(47.6)** | **46.5 pp** |
| **Adjusted EBITDA margin (%)** | **8.3** | **0.8** | **7.5 pp** | **8.8** | **(22.9)** | **31.7 pp** |

### 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, government wage subsidy, benefit plan amendments, benefit plan settlement, impairment of assets, restructuring and transaction costs, and freighter costs as these items may distort the analysis of certain business trends and render comparative analysis across periods less meaningful and generally allows for a more meaningful analysis of Air Canada's operating expense performance and a more meaningful comparison to that of other airlines.

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.

Air Canada also incurs expenses related to the operation of freighter aircraft which some airlines, without comparable cargo businesses, may not incur. Air Canada introduced one Boeing 767 dedicated freighter to its operating fleet in December 2021, and had three dedicated freighter aircraft in service as at December 31, 2022. Prior to 2021, Air Canada did not incur any costs related to the operation of dedicated freighter aircraft. These costs do not generate ASMs and therefore excluding these costs from operating expense results provides for a more meaningful comparison of the passenger airline business across periods.

Adjusted CASM is reconciled to GAAP operating expense as follows:

| (Canadian dollars in millions, except where indicated) | Fourth Quarter | | | Full Year | | |
|---|---|---|---|---|---|---|
| | 2022 | 2021 | Change | 2022 | 2021 | Change |
| **Operating expense – GAAP** | **$ 4,708** | **$ 3,234** | **$ 1,474** | **$ 16,743** | **$ 9,449** | **$ 7,294** |
| **Adjusted for:** | | | | | | |
| Aircraft fuel | (1,459) | (665) | (794) | (5,276) | (1,576) | (3,700) |
| Ground package costs | (163) | (91) | (72) | (474) | (120) | (354) |
| Government wage subsidy, net | - | 27 | (27) | - | 451 | (451) |
| Benefit plan amendments | - | (6) | 6 | - | (82) | 82 |
| Benefit plan settlement | - | (125) | 125 | - | (125) | 125 |
| Impairment of assets | - | (24) | 24 | (4) | (38) | 34 |
| Restructuring and transaction costs | - | 2 | (2) | - | (175) | 175 |
| Freighter costs (excluding fuel) | (27) | - | (27) | (86) | - | (86) |
| **Operating expense, adjusted for the above-noted items** | **$ 3,059** | **$ 2,352** | **$ 707** | **10,903** | **7,784** | **3,119** |
| **ASMs (millions)** | **22,368** | **14,057** | **59.1%** | **82,558** | **33,384** | **147.3%** |
| **Adjusted CASM (cents)** | **¢ 13.68** | **¢ 16.74** | **¢ (3.06)** | **¢ 13.21** | **¢ 23.32** | **¢ (10.11)** |

**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 government wage subsidy, benefit plan amendments, benefit plan settlement, impairment of assets, restructuring and transaction costs, foreign exchange gains or losses, net interest 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 disposal of assets, gains or losses on debt settlements and modifications, as these items may distort the analysis of certain business trends and render comparative analysis across periods or to other airlines less meaningful.

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

| | Fourth Quarter | | | Full Year | | |
|---|---|---|---|---|---|---|
| **(Canadian dollars in millions)** | **2022** | **2021** | **$ Change** | **2022** | **2021** | **$ Change** |
| **Income (loss) before income taxes – GAAP** | **$ 146** | **$ (617)** | **$ 763** | **$ (1,524)** | **$ (3,981)** | **$ 2,457** |
| **Adjusted for:** | | | | | | |
| Government wage subsidy, net | - | (27) | 27 | - | (451) | 451 |
| Benefit plan amendments | - | 6 | (6) | - | 82 | (82) |
| Benefit plan settlement | - | 125 | (125) | - | 125 | (125) |
| Impairment of assets | - | 24 | (24) | 4 | 38 | (34) |
| Restructuring and transaction costs | - | (2) | 2 | - | 175 | (175) |
| Foreign exchange (gain) loss | (316) | (22) | (294) | 732 | 52 | 680 |
| Net interest relating to employee benefits | (7) | (2) | (5) | (24) | 8 | (32) |
| (Gain) loss on financial instruments recorded at fair value | (44) | (59) | 15 | (133) | 55 | (188) |
| Loss on debt settlements and modifications | 31 | - | 31 | 14 | 129 | (115) |
| Gain on disposal of assets | (21) | - | (21) | (21) | - | (21) |
| **Adjusted pre-tax loss** | **$ (211)** | **$ (574)** | **$ 363** | **$ (952)** | **$ (3,768)** | **$ 2,816** |

**Adjusted Net Income (loss) and Adjusted Earnings (Loss) per Share – Diluted**

Air Canada uses adjusted net income (loss) and adjusted earnings (loss) per share – diluted as a means to assess the overall financial performance of its business without the after-tax effects of government wage subsidy, benefit plan amendments, benefit plan settlement, impairment of assets, restructuring and transaction costs, 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 as these items may distort the analysis of certain business trends and render comparative analysis to other airlines less meaningful.

Adjusted net income (loss) and adjusted earnings (loss) per shares are reconciled to GAAP net income as follows:

| | Fourth Quarter | | | Full Year | | |
|---|---|---|---|---|---|---|
| **(Canadian dollars in millions)** | **2022** | **2021** | **$ Change** | **2022** | **2021** | **$ Change** |
| **Net income (loss) – GAAP** | **$ 168** | **$ (493)** | **$ 661** | **$ (1,700)** | **$ (3,602)** | **$ 1,902** |
| **Adjusted for:** | | | | | | |
| Government wage subsidy, net | - | (27) | 27 | - | (451) | 451 |
| Benefit plan amendments | - | 6 | (6) | - | 82 | (82) |
| Benefit plan settlement | - | 125 | (125) | - | 125 | (125) |
| Impairment of assets | - | 24 | (24) | 4 | 38 | (34) |
| Restructuring and transaction costs | - | (2) | 2 | - | 175 | (175) |
| Foreign exchange (gain) loss | (316) | (22) | (294) | 732 | 52 | 680 |
| Net interest relating to employee benefits | (7) | (2) | (5) | (24) | 8 | (32) |
| (Gain) loss on financial instruments recorded at fair value | (44) | (59) | 15 | (133) | 55 | (188) |
| Loss on debt settlements and modifications | 31 | - | 31 | 14 | 129 | (115) |
| Gain on disposal of assets | (21) | - | (21) | (21) | - | (21) |
| Income tax, including for the above reconciling items (1) | (28) | (127) | 99 | 140 | (379) | 519 |
| **Adjusted net loss** | **$ (217)** | **$ (577)** | **$ 360** | **$ (988)** | **$ (3,768)** | **$ 2,780** |
| Weighted average number of outstanding shares used in computing diluted income per share (in millions) | 358 | 358 | - | 358 | 351 | 7 |
| **Adjusted loss per share – diluted** | **$ (0.61)** | **$ (1.61)** | **$ 1.00** | **$ (2.76)** | **$ (10.74)** | **$ 7.98** |

*(1) In 2022, the deferred income tax recovery recorded in other comprehensive income related to remeasurements on employee benefit liabilities is offset by a deferred income tax expense which was recorded through Air Canada's consolidated statement of operations. This expense is removed from adjusted net income (loss). In comparison, a deferred income tax recovery was removed from adjusted net income (loss) for the year 2021.*

The table below reflects the share amounts used in the computation of basic and diluted earnings per share on an adjusted earnings per share basis.

| (In millions) | Fourth Quarter | | Full Year | |
|---|---|---|---|---|
| | 2022 | 2021 | 2022 | 2021 |
| **Weighted average number of shares outstanding – basic** | **358** | **358** | **358** | **351** |
| Effect of dilution | - | - | - | - |
| **Weighted average number of shares outstanding – diluted** | **358** | **358** | **358** | **351** |

### Free Cash Flow

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

### Net Debt

Net debt is a capital management measure and a key component of the capital managed by Air Canada and provides management with a measure of its net indebtedness. Refer to section 8.3 "Net Debt" of this MD&A for a reconciliation of this non-GAAP measure to the nearest measure under GAAP.

## 21. GLOSSARY

**Adjusted CASM** – Refers to operating expense per ASM adjusted to remove the effects of aircraft fuel expense, ground packages costs at Air Canada Vacations, government wage subsidy, benefit plan amendments, benefit plan settlement, impairment of assets, restructuring and transaction costs, and freighter costs. Adjusted CASM is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

**Adjusted EBITDA** – Refers to earnings before interest, taxes, depreciation and amortization excluding government wage subsidy, benefit plan amendments, benefit plan settlement, impairment of assets, restructuring and transaction costs. Adjusted EBITDA is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

**Adjusted EBITDA margin** – Refers to adjusted EBITDA as a percentage of operating revenue. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

**Adjusted net income (loss) –** Refers to the consolidated net income (loss) of Air Canada adjusted to remove the after-tax effects of government wage subsidy, benefit plan amendments, benefit plan settlement, impairment of assets, restructuring and transaction costs, foreign exchange gains or losses, net interest 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. Adjusted net income (loss) is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

**Adjusted pre-tax income (loss)** – Refers to the consolidated income (loss) of Air Canada before income taxes and adjusted to remove the effects of government wage subsidy, benefit plan amendments, benefit plan settlement, impairment of assets, restructuring and transaction costs, foreign exchange gains or losses, net interest 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. Adjusted pre-tax income (loss) is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

**Aeroplan –** Refers to Aeroplan Inc.

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

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

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

**CASM** – Refers to operating expense per ASM.

**Domestic –** In reference to passenger and cargo revenues, means revenues from flights within Canada.

**Free cash flow** – Refers to net cash flows from operating activities minus additions to property, equipment, and intangible assets, and is net of proceeds from sale and leaseback transactions. Free cash flow is a non-GAAP financial measure. Refer to sections 8.5 "Cash Flow Movements" and 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

**Jazz** – Refers to Jazz Aviation LP.

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

**Leverage ratio** – Also known as Net debt to adjusted EBITDA ratio. Refers to the ratio of net debt to trailing 12-month adjusted EBITDA (calculated by dividing net debt by trailing 12-month adjusted EBITDA). Leverage ratio is a non-GAAP financial measure. Refer to sections 8.3 "Net Debt" and 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

**Net debt** – Refers to total long-term debt liabilities (including current portion) less cash, cash equivalents. and short- and long-term investment. Refer to section 8.3 "Net Debt" of this MD&A for a reconciliation of this capital management measure to the nearest measure under GAAP.

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

**Pacific –** In reference to passenger and cargo revenues, means 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 available seat mile.

**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** – Refers to a measure of passenger traffic calculated by multiplying the total number of revenue passengers carried by the miles they are carried.

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

**Yield** – Refers to average passenger revenue per RPM.