First Quarter 2021

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

May 7, 2021

AIR CANADA

A STAR ALLIANCE MEMBER

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1. HIGHLIGHTS

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

(Canadian dollars in millions, except per share data or where indicated)	**First Quarter**		
Financial Performance Metrics	**2021**	**2020**	**$ Change**
Operating revenues	729	3,722	(2,993)
Operating loss	(1,049)	(433)	(616)
Loss before income taxes	(1,387)	(1,276)	(111)
Net loss	(1,304)	(1,049)	(255)
Adjusted pre-tax loss (1)	(1,335)	(520)	(815)
EBITDA (excluding special items) (1)	(763)	71	(834)
Unrestricted liquidity (2)	6,582	6,523	59
Diluted loss per share	$(3.90)	$(4.00)	$0.10
Operating Statistics (3)	**2021**	**2020**	**% Change**
Revenue passenger miles ("RPMs") (millions)	1,831	17,507	(89.5)
Available seat miles ("ASMs") (millions)	4,211	23,511	(82.1)
Passenger load factor %	43.5%	74.5%	(31 pp)(6)
Passenger revenue per RPM ("Yield") (cents)	21.6	18.2	18.2
Passenger revenue per ASM ("PRASM") (cents)	9.4	13.6	(31.0)
Operating revenue per ASM (cents)	17.3	15.8	9.4
Operating expense per ASM ("CASM") (cents)	42.2	17.7	NM(7)
Adjusted CASM (cents) (1)	40.4	13.1	NM
Average number of full-time-equivalent ("FTE") employees (thousands) (4)	16.1	33.0	(51.0)
Fuel cost per litre (cents)	62.7	69.2	(9.3)
Fuel litres (thousands)	318,358	1,208,119	(73.6)
Revenue passengers carried (thousands) (5)	1,124	9,927	(88.7)

(1) Adjusted pre-tax income (loss), EBITDA (excluding special items) (earnings before interest, taxes, depreciation, and amortization), and adjusted CASM are each non-GAAP financial measures. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for descriptions of Air Canada's non-GAAP financial measures.

(2) Unrestricted liquidity refers to the sum of cash, cash equivalents and short and long-term investments, and the amount of available credit under Air Canada's revolving credit facilities. At March 31, 2021, unrestricted liquidity comprised cash, cash equivalents and short-term investments of $5,969 million, and long-term investments of $613 million. At March 31, 2020, unrestricted liquidity consisted of cash, cash equivalents and short-term investments of $6,128 million, and long-term investments of $395 million.

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

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

(5) 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.

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

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

2. INTRODUCTION

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), the "Corporation" refers, as the context may require, to Air Canada and/or one or more of Air Canada's subsidiaries, including its wholly owned operating subsidiaries, Touram Limited Partnership, doing business under the brand name Air Canada Vacations® ("Air Canada Vacations"), Air Canada Rouge LP, doing business under the brand name Air Canada Rouge® ("Air Canada Rouge") and Aeroplan Inc. ("Aeroplan"). This MD&A provides the reader with a review and analysis, from the perspective of management, of Air Canada's financial results for the first quarter of 2021. This MD&A should be read in conjunction with Air Canada's interim unaudited condensed consolidated financial statements and notes for the first quarter of 2021, as well as Air Canada's 2020 annual audited consolidated financial statements and notes and Air Canada's 2020 MD&A each dated February 12, 2021. All financial information has been prepared in accordance with generally accepted accounting principles in Canada ("GAAP"), as set out in the CPA Canada Handbook – Accounting ("CPA Handbook"), which incorporates International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"), except for any non-GAAP measures and any financial information specifically denoted otherwise.

Except as otherwise noted, monetary amounts are stated in Canadian dollars. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of May 6, 2021.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 14 "Risk Factors" of this MD&A. Air Canada issued a news release dated May 7, 2021 reporting on its results for the first quarter 2021. This news release is available on Air Canada's website at **aircanada.com** and on SEDAR's website at **www.sedar.com**. For further information on Air Canada's public disclosures, including Air Canada's Annual Information Form, consult SEDAR at **www.sedar.com**.

Caution Regarding Forward-Looking Information

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

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

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

Other factors that may cause results to differ materially from results indicated in forward-looking statements include economic and geopolitical conditions, Air Canada's ability to successfully achieve or sustain positive net profitability, industry and market conditions and the demand environment, Air Canada's ability to pay its indebtedness and maintain or increase liquidity, competition, energy prices, Air Canada's dependence on technology, cybersecurity risks, Air Canada's ability to successfully implement appropriate strategic and other important initiatives (including Air Canada's ability to reduce operating costs), other epidemic diseases, terrorist acts, war, Air Canada's dependence on key suppliers, casualty losses, changes in laws, regulatory developments or proceedings, Air Canada's ability to successfully operate its new loyalty program, climate change and environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), interruptions of service, Air Canada's dependence on regional and other carriers, Air Canada's ability to preserve and grow its brand, employee and labour relations and costs, Air Canada's dependence on Star Alliance® and joint ventures, limitations due to restrictive covenants, pending and future litigation and actions by third parties, currency exchange, risks generally relating to the grounding of aircraft fleet types, pension plans, Air Canada's ability to attract and retain required personnel, insurance issues and costs, as well as the factors identified in Air Canada's public disclosure file available at **www.sedar.com** and, in particular, those identified in section 17 "Risk Factors" in Air Canada's 2020 MD&A and in section 14 "Risk Factors" of this MD&A. The forward-looking statements contained or incorporated by reference in this MD&A represent Air Canada's expectations as of the date of this MD&A (or as of the date they are otherwise stated to be made) and are subject to change after such date. However, Air Canada disclaims any intention or obligation to update or revise any forward-looking statements whether because of new information, future events or otherwise, except as required under applicable securities regulations.

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, as applicable. Air Canada also owns or has the rights to copyrights that also protect the content of its products and/or services. Solely for convenience, the trademarks, service marks, trade names and copyrights referred to in this MD&A may be listed without the ©, ® and TM symbols, but Air Canada reserves all rights to assert, to the fullest extent under applicable law, its rights, or the rights of the applicable licensors to these trademarks, service marks, trade names and copyrights. This MD&A may also include trademarks, service marks or trade names of other parties. Air Canada's use or display of other parties' trademarks, service marks, trade names or products is not intended to, and does not imply a relationship with, or endorsement or sponsorship of Air Canada by, the trademark, service mark or trade name owners or licensees.

3. ABOUT AIR CANADA

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

Air Canada enhances its domestic and transborder network 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.

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

Air Canada Cargo, a division of Air Canada, is a global cargo service provider, offering cargo services on passenger flights and on all-cargo flights. In 2021, Air Canada Cargo expects to continue using Air Canada's mainline wide-body aircraft, including certain converted Boeing 777 and Airbus A330 aircraft with increased cargo space generated by the removal of seats from the passenger cabin. In 2021, Air Canada also expects to generate incremental cargo revenue from the e-commerce business and by converting several of its owned Boeing 767 aircraft into dedicated freighters to leverage the growth of e-commerce.

4. RECENT DEVELOPMENTS

Debt and Equity Financing Agreements with the Government of Canada

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

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

- Gross proceeds of $500 million for 21,570,942 Air Canada shares at a price of $23.17933 per share (net proceeds of approximately $480 million).
- $1.5 billion in the form of a secured revolving credit facility maturing in April 2026 and bearing interest at the Canadian Dollar Offered Rate (CDOR) plus 1.5%; the facility is secured on a first lien basis by the assets of Aeroplan, Air Canada's shares in Aeroplan as well as certain assets of Air Canada, including certain intellectual property relating to the Aeroplan loyalty program.

- $2.475 billion in the form of three unsecured non-revolving credit facilities of $825 million each with: the first, five-year tranche maturing in April 2026, at CDOR plus 1.75% per annum; the second, six-year tranche maturing in April 2027, at 6.5% per annum (increasing to 7.5% after 5 years); and the third, seven-year tranche maturing in April 2028, at 8.5% per annum (increasing to 9.5% after 5 years).

- As consideration for the Government making the above secured and unsecured credit facilities available to Air Canada, Air Canada issued an aggregate of 14,576,564 warrants initially exercisable for the purchase of an equal number of Air Canada shares, subject to customary adjustments, at an exercise price of $27.2698 per share during a 10-year term, representing an aggregate exercise price equal to 10% of the total commitment available under the above secured and unsecured credit facilities; 50% of the warrants vested concurrently with the implementation of the credit facilities and the remaining 50% of the warrants will vest on a proportional basis to the amounts that Air Canada draws, if any, under the above unsecured credit facilities; the warrants are subject to a one-time call right in favour of Air Canada, pursuant to which Air Canada may, upon repayment of all indebtedness outstanding under the above secured and unsecured credit facilities and termination thereof, repurchase for cancellation all outstanding warrants at a price per warrant equal to its fair market value determined by third-party valuators.

- Up to $1.404 billion in the form of an unsecured credit facility tranche to support customer refunds of non-refundable tickets. The facility will have a seven-year term maturing in April 2028 and carry an annual interest rate of 1.211%. Draws under this facility will be made monthly based on the amount of refunds processed and paid during the period.

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

- Using the proceeds from the financial package (other than the $1.404 billion ticket refund facility) only for the payment of operating expenses and ordinary course business obligations of Air Canada as they become due in accordance with past practices.

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

- The resumption of service or access to Air Canada's network for nearly all regional communities where service was suspended because of COVID-19's impact on travel, through direct services or new interline agreements with third party regional carriers.

- Restricting certain expenditures and senior executive compensation.

- Restricting dividends or payments of distributions on Air Canada's equity interests, or any purchases, redemptions or other acquisitions or retirements for value of any equity interests or convertible indebtedness of Air Canada while any indebtedness is outstanding under any of the secured and unsecured credit facilities (excluding the unsecured credit facility tranche to support customer refunds of non-refundable tickets) and for a period of 12 months following the termination of such facilities.

- Obligations to maintain employment at levels which are no lower than those at April 1, 2021.

- The completion of the airline's acquisition of 33 Airbus A220 aircraft, manufactured at Airbus' Mirabel, Québec facility. Air Canada has also agreed to complete its existing firm order of 40 Boeing

737 Max aircraft. Completion of these orders remains subject to the terms and conditions of the applicable purchase agreements.

In connection with the Government's equity investment, Air Canada has agreed to provide the Government with customary registration rights. The Air Canada shares and warrants issued to the Government are subject to certain transfer restrictions, namely (i) restrictions on any transfer, other than to affiliates of the Government, for a period commencing on the date of issuance and ending, in the case of the shares, on the date that is one year from the date of issuance and, in respect of the warrants, the date on which Air Canada's previously described call right has expired pursuant to the terms of the warrants, (ii) restrictions on transfers to competitors and securityholders of Air Canada that beneficially own or control 5% or more of Air Canada's issued and outstanding shares, including any convertible securities, on an as converted basis, subject to customary exceptions, and (iii) in respect of the warrants, once the transfer restriction described in (i) has expired, minimum block sizes for transfers. The warrants are also subject to an exercise cap which limits the Government's aggregate ownership of Air Canada shares. The exercise cap prohibits the Government from exercising any warrants if the voting rights attached to the Air Canada shares held by the Government (including those issued upon any exercise of the warrants) would exceed 19.99% of the aggregate votes attached to all of Air Canada's voting securities outstanding immediately after giving effect to such exercise.

Termination of the Transat A.T. Inc. Arrangement Agreement

On April 2, 2021, Air Canada announced, together with Transat A.T. Inc. ("Transat"), that it had mutually agreed to terminate the previously disclosed Arrangement Agreement for the proposed acquisition of Transat by Air Canada. The two parties had originally agreed in June 2019 on the acquisition with subsequent amendments in August 2019 and October 2020. The Canadian regulatory authorities approved the transaction on February 11, 2021. However, following discussions with the European Commission ("EC") it became evident that the EC would not approve the transaction based on the offered remedy package. After a careful consideration, Air Canada concluded that providing additional, onerous remedies, which may still not have secured an EC approval, would significantly compromise Air Canada's ability to compete internationally, negatively impacting customers, other stakeholders and future prospects as it recovers and rebuilds from the impacts of the COVID-19 pandemic. As a result, Air Canada and Transat agreed to terminate the Arrangement Agreement with Air Canada paying Transat a termination fee of $12.5 million and Transat no longer under any obligation to pay Air Canada any fee should Transat be involved in another acquisition or similar transaction in the future. Air Canada recorded the termination fee as a special item in the first quarter of 2021.

Consolidation of Air Canada Express flying with Jazz

On March 1, 2021, Air Canada announced an agreement to revise its capacity purchase agreement ("CPA") with Jazz Aviation LP ("Jazz"), a wholly owned subsidiary of Chorus Aviation Inc., and consolidated all its regional flying with Jazz. As a result of the CPA revisions and consolidation of regional flying, Air Canada expects to realize $400 million in cost reductions over the 15-year term of the agreement ($43 million per year until 2026 and $18 million per year thereafter). In addition, the revised CPA will lower future contractual capital expenditures and leasing costs through a restructured CPA fleet, avoiding an estimated $193 million in future capital expenditures. The amended CPA is effective on a retroactive basis to January 1, 2021. In the first quarter of 2021, Air Canada recorded a net expense of $2 million under special items related to the CPA revisions and consolidation of regional flying.

5. RESULTS OF OPERATIONS – FIRST QUARTER 2021 VS. FIRST QUARTER 2020

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

(Canadian dollars in millions, except where indicated)	First Quarter			
	2021	2020	$ Change	% Change
Operating revenues				
Passenger	$ 395	$ 3,193	$ (2,798)	(88)
Cargo	281	149	132	89
Other	53	380	(327)	(86)
Total operating revenues	**729**	**3,722**	**(2,993)**	(80)
Operating expenses				
Aircraft fuel	200	836	(636)	(76)
Wages, salaries, and benefits	528	796	(268)	(34)
Regional airlines expense, excluding fuel	195	471	(276)	(59)
Depreciation and amortization	413	504	(91)	(18)
Aircraft maintenance	150	270	(120)	(44)
Airport and navigation fees	98	228	(130)	(57)
Sales and distribution costs	24	183	(159)	(87)
Ground package costs	5	234	(229)	(98)
Catering and onboard services	21	97	(76)	(78)
Communications and information technology	105	135	(30)	(22)
Special items	(127)	-	(127)	NM(2)
Other	166	401	(235)	(59)
Total operating expenses	**1,778**	**4,155**	**(2,377)**	**(57)**
Operating loss	**(1,049)**	**(433)**	**(616)**	
Non-operating income (expense)				
Foreign exchange gain (loss)	67	(711)	778	
Interest income	21	42	(21)	
Interest expense	(177)	(129)	(48)	
Interest capitalized	4	8	(4)	
Net financing expense relating to employee benefits	(4)	(11)	7	
Loss on financial instruments	(242)	(34)	(208)	
Other	(7)	(8)	1	
Total non-operating expense	**(338)**	**(843)**	**505**	
Loss before income taxes	**(1,387)**	**(1,276)**	**(111)**	
Income tax recovery	83	227	(144)	
Net loss	**$ (1,304)**	$ **(1,049)**	**$ (255)**	
Diluted loss per share	**$ (3.90)**	$ **(4.00)**	**$ 0.10**	
EBITDA (excluding special items) (1)	**$ (763)**	$ **71**	**$ (834)**	
Adjusted pre-tax loss (1)	**$ (1,335)**	$ **(520)**	**$ (815)**	

(1) EBITDA (excluding special items) and adjusted pre-tax income (loss) are non-GAAP financial measures. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

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

System Passenger Revenues

The system-wide impacts of the COVID-19 pandemic, including government-regulated travel restrictions, started being felt in early March 2020 which continued throughout 2020, and then throughout the first quarter of 2021. As a result, Air Canada reduced its ASM capacity by 82.1% compared to the first quarter of 2020, consistent with the capacity decrease of 83% projected in Air Canada's news release dated February 12, 2021. In the first quarter of 2021, passenger revenues of $395 million decreased $2,798 million or 87.6% from the first quarter of 2020.

In the first quarter of 2021, traffic at the system level declined 89.5% while yield increased 18.2% compared to the first quarter of 2020. This yield increase was mainly the result of the significant change in traffic mix towards domestic Canada travel and, given the low revenue base, is not a meaningful indicator.

In the first quarter of 2021, PRASM decreased 31.0% compared to the first quarter of 2020. This PRASM decrease reflected a passenger load factor decline of 31 percentage points compared to the first quarter of 2020, partly offset by the yield increase discussed above.

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

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

	First Quarter			
(Canadian dollars in millions)	**2021**	**2020**	**$ Change**	**% Change**
Canada	$ 237	$ 944	$ (707)	(74.9)
U.S. transborder	29	755	(726)	(96.2)
Atlantic	87	659	(572)	(86.8)
Pacific	16	392	(376)	(95.8)
Other	26	443	(417)	(94.1)
System	**$ 395**	**$ 3,193**	**$ (2,798)**	**(87.6)**

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

	First Quarter 2021 vs First Quarter 2020					
	Passenger Revenue % Change	**Capacity (ASMs) % Change**	**Traffic (RPMs) % Change**	**Passenger Load Factor pp Change**	**Yield % Change**	**PRASM % Change**
Canada	(74.9)	(65.9)	(78.7)	(27.6)	17.8	(26.6)
U.S. transborder	(96.2)	(94.9)	(97.1)	(29.8)	30.6	(25.0)
Atlantic	(86.8)	(73.8)	(84.0)	(28.7)	(17.5)	(49.8)
Pacific	(95.8)	(90.1)	(96.5)	(49.2)	18.5	(57.8)
Other	(94.1)	(91.5)	(94.9)	(32.3)	15.2	(30.6)
System	**(87.6)**	**(82.1)**	**(89.5)**	**(31.0)**	**18.2**	**(31.0)**

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

	First Quarter			
	2021		2020	
(in millions)	RPMs	ASMs	RPMs	ASMs
Domestic	767	1,683	3,603	4,928
U.S. transborder	97	240	3,323	4,743
Atlantic	698	1,565	4,369	5,964
Pacific	106	391	3,026	3,957
Other	163	332	3,186	3,919
System	**1,831**	**4,211**	**17,507**	**23,511**

Cargo Revenues

In the first quarter of 2021, cargo revenues of $281 million increased $132 million or 88.6% from the first quarter of 2020. All-cargo flights represented 59% of the cargo revenues in the first quarter of 2021. In the first quarter of 2021, yield increased 129.5% while traffic declined 17.9% compared to the first quarter of 2020. The yield increase was driven by the continued strength in demand for cargo space to support global trade, with a strong performance in the freighter activities in the transpacific and transatlantic markets. The decline in traffic was a result of the significant decline in passenger flying, which reduced the space available for cargo, and was partially offset by the impact of the all-cargo operations discussed above.

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

	First Quarter			
(Canadian dollars in millions)	2021	2020	$ Change	% Change
Canada	$ 24	$ 19	$ 5	26.3
U.S. transborder	11	9	2	22.2
Atlantic	119	69	50	72.5
Pacific	108	38	70	184.2
Other	19	14	5	35.7
System	**$ 281**	**$ 149**	**$ 132**	**88.6**

Other Revenues

In the first quarter of 2021, other revenues of $53 million decreased $327 million or 86% from the same quarter in 2020. This decrease represented, in large part, a significant reduction in ground package revenues at Air Canada Vacations. The reduction in passenger and airline-related fees, due to lower passenger volumes resulting from the COVID-19 pandemic also contributed to the decrease in other revenues year-over-year. These declines were partially offset by growth in non-air revenues related to the Aeroplan program.

Operating Expenses

In the first quarter of 2021, on a capacity reduction of 82.1%, operating expenses of $1,778 million decreased $2,377 million or 57% from the first quarter of 2020. The decrease reflected a lower volume of flying resulting from the COVID-19 pandemic and the significant progress made on both managing variable costs and reducing fixed expenses since the pandemic began.

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

Aircraft Fuel

In the first quarter of 2021, fuel expense of $200 million declined $636 million or 76% from the first quarter of 2020. The decline was driven by a reduction of 74% in fuel litres consumed versus the first quarter of 2020 as a result of the COVID-19 pandemic, and to a lesser extent, a reduction of 9% in the cost of jet fuel per litre (before the impact of foreign exchange).

Wages, Salaries and Benefits

In the first quarter of 2021, wages, salaries and benefits of $528 million declined $268 million or 34% from the same quarter in 2020. Compared to the first quarter of 2020, wages and salaries decreased $212 million or 37% mainly on a decrease of 51% or 16,822 in average full-time equivalent employees (FTEs), partially offset by higher average salaries and by the impact of stock-based compensation which reflected a higher share price year-over-year. Employee benefits expense declined $56 million or 25% versus the first quarter of 2020, primarily due to the decrease in FTE employees, partially offset by higher rates on Canadian payroll taxes.

Regional Airlines Expense

In the first quarter of 2021, regional airlines expense (excluding fuel) of $195 million declined $276 million or 59% from the same quarter in 2020, reflecting the impact of reduced flying primarily by Jazz as a result of the COVID-19 pandemic.

Depreciation and Amortization

In the first quarter of 2021, depreciation and amortization expense of $413 million decreased $91 million or 18% from the first quarter of 2020, reflecting the retirement of certain older aircraft from the fleet, partially offset by the impact of new aircraft deliveries.

Aircraft Maintenance

In the first quarter of 2021, aircraft maintenance expense of $150 million decreased $120 million or 44% from the first quarter of 2020. The decline reflected a lower volume of maintenance activity due to reduced flying year-over-year and the retirement of certain aircraft from the fleet as well as a decrease in maintenance provisions as a result of updated end-of-lease cost estimates in anticipation of returning aircraft (primarily Airbus A319) to lessors upon lease expiry (over the next 12 months).

Ground Package Costs

In the first quarter of 2021, ground package costs of $5 million decreased $229 million or 98% from the first quarter of 2020. The decline reflected the drastic decline in passenger volumes year-over-year as a result of the COVID-19 pandemic and related travel restrictions, including the ongoing suspension of flights to Mexico and the Caribbean effective January 31, 2021.

Special Items

In the first quarter of 2021, Air Canada recorded special items amounting to a net operating expense reduction of $127 million. The table below provides a breakdown of these special items.

	First Quarter
(Canadian dollars in millions)	**2021**
Impairments	$ 20
Canada Emergency Wage Subsidy, net	(163)
Workforce reduction provisions	2
Other	14
Special Items	**$ (127)**

Impairments

In response to the capacity reductions implemented as a result of the COVID-19 pandemic, Air Canada accelerated the retirement of certain older aircraft from its fleet and recorded a non-cash impairment charge of $283 million in 2020. In the first quarter of 2021, an additional impairment charge of $20 million was recorded as a result of reductions to the estimates around the expected disposal proceeds of certain owned aircraft partly offset by lower costs expected to meet contractual return conditions on lease returns.

Canada Emergency Wage Subsidy

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

Air Canada recorded a total gross subsidy under the CEWS program of $166 million in the first quarter of 2021. Cash payments of $156 million were received in the first quarter of 2021. The amount of the CEWS recorded in special items is net of the cost for inactive employees who were eligible for the wage subsidy under the program. There are no unfulfilled conditions or other contingencies attached to the current CEWS program.

Air Canada intends to continue its participation in the CEWS program, which is available to June 2021, subject to meeting the eligibility requirements. In the April 19, 2021 Federal Budget, the Government of Canada announced the program would be extended to September 2021.

Termination of the Transat Arrangement Agreement

On April 2, 2021, Air Canada announced that the Arrangement Agreement for the proposed acquisition of Transat was terminated. Air Canada and Transat had originally agreed in June 2019 on the acquisition, the terms of which were subsequently amended in August 2019 and then revised in October 2020 as a result of the severe economic impact of the COVID-19 pandemic.

Both Air Canada and Transat agreed to terminate the Arrangement Agreement with Air Canada paying Transat a termination fee of $12.5 million, and with Transat no longer under any obligation to pay Air Canada any fee should Transat be involved in another acquisition or similar transaction in the future. The termination fee was recorded as a special item in the first quarter of 2021.

Amendments to Capacity Purchase Agreements

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

Subsequent Events Related to Employee Benefit Programs

Pension Plan Amendment

In April 2021, Air Canada received the decision of the arbitrator in relation to the determination of the cap on pensionable earnings recognized in the defined benefit pension plan for IAMAW-represented employees. The decision has resulted in an increase to the maximum pensionable earnings cap used for purposes of calculating pension income, which change is effective in the second quarter of 2021, however the period of retroactivity is not yet determined since the arbitrator left it to Air Canada and the IAMAW to negotiate the period of retroactivity. Subject to resolving the period of retroactivity, Air Canada will record a one-time pension past service cost, which will be reported as a special item, estimated to be in the range of $100 million to $130 million in the second quarter of 2021. This amendment does not impact the Air Canada's liquidity position as it is funded out of the surplus in the domestic registered pension plans.

Early Retirement Incentive Programs

As a result of the COVID-19 pandemic, and to mitigate the number of employees who remain on layoff status, during the second quarter of 2021, Air Canada is offering early retirement incentive programs to its unionized workforce. These programs provide for pension improvements payable from the defined benefit pension plan for eligible employees, and as such do not impact the Corporation's liquidity position. The charge for this program will be recorded during the second quarter of 2021 as a termination benefit, which will be reported as a special item. The amount of the charge is not yet determinable as the number of employees participating in this program is not yet known.

Non-operating Expense

In the first quarter of 2021, non-operating expense amounted to $338 million compared to non-operating expense of $843 million in the first quarter of 2020.

Air Canada recorded a gain on foreign exchange of $67 million for the first quarter of 2021 compared to a loss on foreign exchange of $711 million in the first quarter of 2020. The improvement reflected the effect of a stronger Canadian dollar versus the US dollar in the first quarter of 2021 compared to the first quarter of 2020. The foreign exchange gain included a remeasurement gain of $145 million on long-term debt and lease liabilities offset by a $73 million loss on foreign exchange derivatives. The March 31, 2021 closing exchange rate was US$1=$1.2562 compared to a closing exchange rate of US$1=$1.2725 on December 31, 2020.

Interest expense for the first quarter of 2021 was $177 million compared to $129 million in the first quarter of 2020. The increase in interest expense was due to a higher level of debt as a result of financings concluded in 2020, partially offset by a favourable foreign exchange rate, and lower interest rates.

Loss on financial instruments of $242 million in the first quarter of 2021 included a fair value adjustment of $187 million on Air Canada's convertible notes mainly due to the increase in the Air Canada share price during the period, which increased the value of the cash conversion settlement option. Fair value adjustments on financial assets and a loss of $19 million on the extension and repricing of Air Canada's revolving credit facilities were also recorded in the first quarter of 2021. The debt repricing transaction is further described in section 7.1 "Liquidity" of this MD&A.

Income Taxes

Air Canada recorded an income tax recovery of $83 million in the first quarter of 2021 compared to an income tax recovery of $227 million in the first quarter of 2020. In the first quarter of 2021, a deferred income tax expense recorded in other comprehensive income (loss) related to remeasurements on employee benefit liabilities is offset by a deferred income tax recovery recorded through Air Canada's consolidated statement of operations.

6. FLEET

In response to the COVID-19 pandemic, capacity was reduced through the temporary grounding of aircraft. These grounded aircraft are included in the table below. Air Canada continues to assess its fleet and capacity and will continue to adjust its schedule and take other measures as developments warrant.

As a response to the surge in demand for air cargo space, Air Canada has been operating all-cargo flights using its passenger aircraft as well as some temporarily converted Boeing 777-300ER and Airbus A330 aircraft. The converted aircraft have increased available cargo space by removing the seats from the passenger cabin. Air Canada plans to introduce two dedicated Boeing 767 freighters to its fleet by the end of 2021. These aircraft are reflected in the table below.

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

AIR CANADA	Actual			Planned	
	December 31, 2020	**Q1 2021 Changes**	**March 31, 2021**	**Remainder of 2021 Fleet Changes**	**December 31, 2021**
Wide-body aircraft					
Boeing 777-300ER	15	(1)	14	(1)	13
Boeing 777-300ER (cargo)	4	1	5	-	5
Boeing 777-200LR	6	-	6	-	6
Boeing 787-8	8	-	8	-	8
Boeing 787-9	29	-	29	-	29
Boeing 767-300 freighters	-	-	-	2	2
Airbus A330-300	13	(1)	12	1	13
Airbus A330-300 (cargo)	3	1	4	(1)	3
Narrow-body aircraft					
Boeing 737 MAX 8	24	-	24	3	27
Airbus A321	15	-	15	-	15
Airbus A320	21	(2)	19	(1)	18
Airbus A319	16	(3)	13	(7)	6
Airbus A220-300	15	4	19	8	27
Total Mainline	**169**	**(1)**	**168**	**4**	**172**

AIR CANADA rouge	Actual			Planned	
	December 31, 2020	Q1 2021 Changes	March 31, 2021	Remainder of 2021 Fleet Changes	December 31, 2021
Narrow-body aircraft					
Airbus A321	14	-	14	-	14
Airbus A320	5	-	5	-	5
Airbus A319	20	-	20	-	20
Total Air Canada Rouge	**39**	**-**	**39**	**-**	**39**
Total Mainline & Rouge	**208**	**(1)**	**207**	**4**	**211**

Air Canada Express

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

On March 1, 2021, Air Canada announced it consolidated its Air Canada Express services with Jazz. Through the revised agreement, Air Canada transferred the operation of its Embraer 175 fleet from Sky Regional to Jazz. The amended CPA, which is effective on a retroactive basis to January 1, 2021, also provides for the removal of 19 De Havilland Dash 8-300 from the Air Canada Express fleet in 2021.

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

AIR CANADA EXPRESS	Actual			Planned	
	December 31, 2020	Q1 2021 Changes	March 31, 2021	Remainder of 2021 Fleet Changes	December 31, 2021
Embraer 175	25	-	25	-	25
Mitsubishi CRJ-200	15	-	15	-	15
Mitsubishi CRJ-900	34	1	35	-	35
De Havilland Dash 8-300	19	(8)	11	(11)	-
De Havilland Dash 8-400	43	(4)	39	-	39
Total Air Canada Express	**136**	**(11)**	**125**	**(11)**	**114**

7. FINANCIAL AND CAPITAL MANAGEMENT

7.1 LIQUIDITY

Impacts of the COVID-19 Pandemic

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

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

Air Canada concluded a number of financing transactions in 2020, as described in section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of Air Canada's 2020 MD&A, increasing Air Canada's cash position, thereby allowing for additional flexibility operationally and to support the implementation of its planned mitigation and recovery measures in response to the COVID-19 pandemic. During the first quarter of 2021, Air Canada announced the partial exercise of the over-allotment option in connection with the offering of shares completed on December 30, 2020 (the "Offering".) The sale of these additional shares resulted in gross proceeds of $62 million, bringing the total amount for the Offering to $912 million. In addition, Air Canada extended its US$600 million and $200 million revolving credit facilities, by one year, to April 2024 and to December 2023, respectively.

As further described in section 4 "Recent Developments" of this MD&A, in April 2021, Air Canada substantially increased its available liquidity through a series of debt and equity financing agreements with the Government of Canada, which will allow Air Canada to access up to $5.379 billion in debt financing through fully repayable loans that Air Canada would only draw down if and as required, as well as an equity investment for gross proceeds of $500 million (net proceeds of approximately $480 million).

As of the date of this MD&A, unrestricted liquidity available under credit facilities with the Government of Canada amounted to $3.975 billion. This excludes $1.404 billion related to a refunds credit facility which is only available upon processing of eligible customer refunds and is cash neutral to Air Canada's liquidity position as the related refunds are processed.

The additional liquidity available through these debt and equity financing agreements achieves several aligned objectives as it provides a significant layer of insurance for Air Canada, it enables Air Canada to better resolve customer refunds of non-refundable tickets, maintain its workforce and re-enter regional markets. Most importantly, this program provides additional liquidity, if required, to rebuild Air Canada's business to the benefit of all stakeholders and to remain a significant contributor to the Canadian economy through its recovery and for the long term.

Air Canada's unencumbered asset pool (excluding the value of Aeroplan, Air Canada Vacations, and Air Canada Cargo) amounted to approximately $1.7 billion at March 31, 2021. Refer to section 4 "Recent Developments" of this MD&A for a description of the debt financing activities recently completed, which included granting security over the assets of Aeroplan and Air Canada's shares in Aeroplan. As part of Air Canada's ongoing efforts to maintain adequate liquidity levels, additional financing arrangements continue to be assessed and may be pursued.

Liquidity Risk Management

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

Liquidity needs are primarily related to meeting obligations associated with financial liabilities, capital commitments, ongoing operations, contractual and other obligations, which are further discussed in sections 7.6, 7.7, and 7.8 of this MD&A. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts for minimum periods of 12 months, including under various scenarios and assumptions, monitoring the condition and value of assets available for use as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements.

At March 31, 2021, unrestricted liquidity amounted to $6,582 million (comprising cash, cash equivalents and short-term investments of $5,969 million and long-term investments of $613 million). This compared to unrestricted liquidity of $8,013 million at December 31, 2020 (comprising cash, cash equivalents and short-term investments of $7,501 million, and long-term investments of $512 million).

7.2 FINANCIAL POSITION

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

(Canadian dollars in millions)	March 31, 2021	December 31, 2020	$ Change
Assets			
Cash, cash equivalents and short-term investments	$ 5,969	$ 7,501	$ (1,532)
Other current assets	1,154	1,170	(16)
Current assets	**$ 7,123**	**$ 8,671**	**$ (1,548)**
Investments, deposits, and other assets	942	833	109
Property and equipment	12,099	12,137	(38)
Pension assets	2,869	2,840	29
Deferred income tax	29	25	4
Intangible assets	1,129	1,134	(5)
Goodwill	3,273	3,273	-
Total assets	**$ 27,464**	**$ 28,913**	**$ (1,449)**
Liabilities			
Current liabilities	$ 6,900	$ 7,139	$ (239)
Long-term debt and lease liabilities	11,122	11,201	(79)
Aeroplan and other deferred revenues	3,975	4,032	(57)
Pension and other benefit liabilities	2,628	3,015	(387)
Maintenance provisions	968	1,040	(72)
Other long-term liabilities	892	696	196
Deferred income tax	75	75	-
Total liabilities	**$ 26,560**	**$ 27,198**	**$ (638)**
Total shareholders' equity	**$ 904**	**$ 1,715**	**$ (811)**
Total liabilities and shareholders' equity	**$ 27,464**	**$ 28,913**	**$ (1,449)**

Movements in current assets and current liabilities are described in section 7.4 "Working Capital" of this MD&A. Long-term debt and lease liabilities are discussed in sections 7.3 "Net Debt" and 7.5 "Cash Flow Movements" of this MD&A.

At March 31, 2021, net pension assets of $241 million (comprising pension assets of $2,869 million net of pension and other benefit liabilities of $2,628 million) increased $416 million from December 31, 2020. This increase was mainly due to a net actuarial gain on remeasurements of employee liabilities of $488 million ($404 million, net of tax) recorded on Air Canada's consolidated statement of comprehensive income, partially offset by pension and other employee benefits expense recorded during the quarter. The actuarial gain included the impact of an 81-basis point increase in the discount rate used to value the liabilities, partially offset by a lower return on plan assets.

The long-term portion of the Aeroplan and other deferred revenue liability decreased $57 million from December 31, 2020. This decrease included a reclassification of $101 million from long-term to current liabilities for Aeroplan Point redemptions expected to occur over the next 12 months, partially offset by the sale of Aeroplan Points to program partners exceeding redemptions.

7.3 NET DEBT

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

(Canadian dollars in millions)	**March 31, 2021**	**December 31, 2020**	**$ Change**
Total long-term debt and lease liabilities	$ 11,122	$ 11,201	$ (79)
Current portion of long-term debt and lease liabilities	1,630	1,788	(158)
Total long-term debt and lease liabilities (including current portion)	**$ 12,752**	**$ 12,989**	**$ (237)**
Less cash, cash equivalents and short and long-term investments	(6,582)	(8,013)	1,431
Net debt (1)	**$ 6,170**	**$ 4,976**	**$ 1,194**

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

As at March 31, 2021, net debt of $6,170 million increased $1,194 million from December 31, 2020, reflecting the impact of net cash used for operating and investing activities in the first quarter of 2021, partially offset by proceeds from the partial exercise of the over-allotment option of the December 2020 equity offering. Refer to section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of Air Canada's 2020 MD&A for a description of the debt financing activities completed during 2020. The impact of a stronger Canadian dollar, at March 31, 2021 compared to December 31, 2020, decreased foreign currency denominated debt (mainly U.S. dollars) by $145 million.

7.4 WORKING CAPITAL

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

(Canadian dollars in millions)	March 31, 2021	December 31, 2020	$ Change
Cash, cash equivalents and short-term investments	$ 5,969	$ 7,501	$ (1,532)
Accounts receivable	667	644	23
Other current assets	487	526	(39)
Total current assets	**$ 7,123**	**$ 8,671**	**$ (1,548)**
Accounts payable and accrued liabilities	2,269	2,465	(196)
Advance ticket sales	2,337	2,314	23
Aeroplan and other deferred revenues	664	572	92
Current portion of long-term debt and lease liabilities	1,630	1,788	(158)
Total current liabilities	**$ 6,900**	**$ 7,139**	**$ (239)**
Net working capital	**$ 223**	**$ 1,532**	**$ (1,309)**

Net working capital of $223 million as at March 31, 2021 decreased $1,309 million from December 31, 2020. Working capital was unfavourably impacted by negative cash flows from operating activities, and capital expenditure spending, excluding the Airbus A220-300 aircraft deliveries which were financed. Advance ticket sales generally increase in the first and second quarters prior to the summer peak travel season, however, the ongoing COVID-19 pandemic and the government-imposed travel restrictions continue to negatively impact travel demand and advance ticket sales. Under the debt and equity financing agreements with the Government of Canada described in section 4 "Recent Developments" of this MD&A, eligible customer refunds may further decrease advance ticket sales in future periods. Such customer refunds will be neutral to liquidity and will improve net working capital with proceeds drawn under the refunds credit facility.

7.5 CASH FLOW MOVEMENTS

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

	First Quarter		
(Canadian dollars in millions)	**2021**	**2020**	**$ Change**
Net cash flows used in operating activities	**$ (888)**	**$ (20)**	**$ (868)**
Proceeds from borrowings	128	1,027	(899)
Reduction of long-term debt and lease liabilities	(404)	(509)	105
Shares purchased for cancellation	-	(132)	132
Issue of shares	74	1	73
Financing fees	(3)	-	(3)
Net cash flows from (used in) financing activities	**$ (205)**	**$ 387**	**$ (592)**
Investments, short-term and long-term	994	408	586
Additions to property, equipment, and intangible assets	(280)	(373)	93
Proceeds from sale of assets	5	2	3
Proceeds from sale and leaseback of assets	6	-	6
Other	6	31	(25)
Net cash flows from investing activities	**$ 731**	**$ 68**	**$ 663**
Effect of exchange rate changes on cash and cash equivalents	**$ (18)**	**$ 63**	**$ (81)**
Increase (decrease) in cash and cash equivalents	**$ (380)**	**$ 498**	**$ (878)**

Net Cash Flows used in Operating Activities

In the first quarter of 2021, net cash flows used in operating activities of $888 million deteriorated by $868 million from the same quarter in 2020 on lower operating results, reflecting the impact of the COVID-19 pandemic which first presented in traffic and sales figures in early March 2020.

Net Cash Flows from (used in) Financing Activities

In the first quarter of 2021, net cash flows used in financing activities of $205 million decreased $592 million from the first quarter of 2020. The decline was due to lower proceeds from borrowings partially offset by lower debt repayments, issuance of shares, and the suspension of share purchases under the normal course issuer bid in March 2020. Proceeds from borrowings of $128 million in the first quarter of 2021 were related to the financing of three Airbus A220-300 aircraft, these being the last three aircraft covered by the secured financing concluded in September 2020. In the first quarter of 2021, Air Canada recorded net proceeds of $60 million from the partial exercise of the over-allotment option of the equity offering completed in December 2020, and recorded proceeds of $14 million from the exercise of Air Canada stock options. Proceeds from borrowings of $1,027 million in the first quarter of 2020 reflected the drawdown of Air Canada's US$600 million and $200 million revolving credit facilities in March 2020.

Net Cash Flows from Investing Activities

In the first quarter of 2021, net cash flows from investing activities of $731 million increased $663 million from the first quarter of 2020, reflecting, in large part, movements between cash and short and long-term investments, as well as a lower level of capital expenditures year-over-year.

Refer to sections 7.2 "Financial Position", 7.3 "Net Debt", 7.4 "Working Capital", and 7.9 "Share Information" of this MD&A for additional information.

Free Cash Flow

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

	First Quarter		
(Canadian dollars in millions)	**2021**	**2020**	**$ Change**
Net cash flows used in operating activities	**$ (888)**	**$ (20)**	**$ (868)**
Additions to property, equipment, and intangible assets, net of proceeds from sale and leaseback transactions	(274)	(373)	99
Free cash flow [(1)]	**$ (1,162)**	**$ (393)**	**$ (769)**

(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. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

In the first quarter of 2021, negative free cash flow of $1,162 million deteriorated by $769 million from the first quarter of 2020, reflecting lower cash flows from operating activities due to the impact of the COVID-19 pandemic, partially offset by a lower level of net capital expenditures.

Net Cash Burn

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

	First Quarter
(Canadian dollars in millions)	**2021**
Net cash flows used in operating activities	**$ (888)**
Net cash flows used in financing activities	**(205)**
Net cash flows from investing activities	**731**
Remove:	
Net proceeds from new non-aircraft related financings	(71)
Lump-sum debt repayments	159
Proceeds from sale and leaseback transactions	(6)
Investments, short-term and long-term	(994)
Net cash burn [(1)]	**$ (1,274)**

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

In the first quarter of 2021, net cash burn of $1,274 million (or approximately $14 million per day, on average) was lower than management's net cash burn expectations of an average of $15 million to $17 million per day, discussed in Air Canada's February 12, 2021 news release. The lower net cash burn versus what was previously anticipated was attributable to a combination of higher than anticipated operating earnings, favourable timing on working capital, and deferred settlement of aircraft lease returns.

7.6 CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS

Air Canada's capital expenditures and related financial arrangements are discussed in section 8.6 "Capital Expenditures and Related Financing Arrangements" of Air Canada's 2020 MD&A. There have been no material changes to Air Canada's capital expenditures and related financial arrangements from what was disclosed at that time except for the following:

In March 2021, Air Canada concluded a committed secured facility totaling US$475 million to finance the purchase of the next 15 Airbus A220 aircraft scheduled for delivery in 2021 and 2022.

Refer to section 7.8 "Contractual Obligations" for further details on the yearly committed capital expenditures for the period 2021 to 2025.

7.7 PENSION FUNDING OBLIGATIONS

Based on final actuarial valuations as at January 1, 2021, the aggregate solvency surplus in Air Canada's domestic registered pension plans was $3 billion.

Air Canada's pension funding obligations are discussed in section 8.7 "Pension Funding Obligations" of Air Canada's 2020 MD&A. There have been no material changes to Air Canada's pension funding obligations from what was disclosed at that time.

7.8 CONTRACTUAL OBLIGATIONS

The table below provides Air Canada's contractual obligations as at March 31, 2021, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and lease liabilities and committed capital expenditures.

(Canadian dollars in millions)	Remainder of 2021[2]	2022	2023	2024	2025	Thereafter	Total
Principal							
Long-term debt [1]	$ 978	$ 475	$ 1,713	$ 2,016	$ 1,612	$ 2,836	$ 9,630
Lease liabilities	427	486	480	442	414	1,305	3,554
Total principal obligations	**$ 1,405**	**$ 961**	**$ 2,193**	**$ 2,458**	**$ 2,026**	**$ 4,141**	**$ 13,184**
Interest							
Long-term debt	$ 305	$ 352	$ 328	$ 235	$ 173	$ 260	$ 1,653
Lease liabilities	129	146	121	97	75	355	923
Total interest obligations	**$ 434**	**$ 498**	**$ 449**	**$ 332**	**$ 248**	**$ 615**	**$ 2,576**
Total long-term debt and lease liabilities	**$ 1,839**	**$ 1,459**	**$ 2,642**	**$ 2,790**	**$ 2,274**	**$ 4,756**	**$ 15,760**
Committed capital expenditures	**$ 747**	**$ 992**	**$ 492**	**$ 198**	**$ -**	**$ -**	**$ 2,429**
Total contractual obligations [2]	**$ 2,586**	**$ 2,451**	**$ 3,134**	**$ 2,988**	**$ 2,274**	**$ 4,756**	**$ 18,189**

(1) Assumes the principal balance of the convertible notes remains unconverted and includes estimated interest payable until maturity in 2025.

(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.

7.9 SHARE INFORMATION

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

	March 31, 2021	December 31, 2020
Issued and outstanding shares		
Class A variable voting shares	123,522,400	111,926,060
Class B voting shares	212,616,705	220,246,228
Total issued and outstanding shares	**336,139,105**	**332,172,288**
Class A variable voting and Class B voting shares potentially issuable		
Convertible notes	48,687,441	48,687,441
Stock options	4,862,157	5,903,174
Total shares potentially issuable	**53,549,598**	**54,590,615**
Total outstanding and potentially issuable shares	**389,688,703**	**386,762,903**

Share Offerings

In connection with Air Canada's December 2020 share offering, Air Canada granted the underwriters an option to purchase up to an additional 15% of the shares in the offering, exercisable in whole or in part at any time until 30 days after closing of the offering on December 30, 2020. In January 2021, the underwriters partially exercised their over-allotment option to purchase an additional 2,587,000 Air Canada shares for gross proceeds of $62 million. After deduction of the underwriters' fees and expenses, net proceeds from the exercise of this over-allotment option were $60 million.

As further described in section 4 "Recent Developments" of this MD&A, in April 2021, Air Canada entered into a series of debt and equity financing agreements with the Government of Canada, including the issuance of shares and warrants. These shares and warrants are not included in the table above.

8. QUARTERLY FINANCIAL DATA

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

(Canadian dollars in millions, except per share figures)	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1
Operating revenues	$ 4,738	$ 5,529	$ 4,429	$ 3,722	$ 527	$ 757	$ 827	$ 729
Operating expenses	4,316	4,573	4,284	4,155	2,082	1,542	1,830	1,778
Operating income (loss)	**422**	**956**	**145**	**(433)**	**(1,555)**	**(785)**	**(1,003)**	**(1,049)**
Non-operating income (expense)	**18**	**(78)**	**27**	**(843)**	**74**	**(36)**	**(272)**	**(338)**
Income (loss) before income taxes	**440**	**878**	**172**	**(1,276)**	**(1,481)**	**(821)**	**(1,275)**	**(1,387)**
Income tax recovery (expense)	(97)	(242)	(20)	227	(271)	136	114	83
Net income (loss)	**$ 343**	**$ 636**	**$ 152**	**$ (1,049)**	**$ (1,752)**	**$ (685)**	**$ (1,161)**	**$ (1,304)**
Diluted earnings (loss) per share	**$ 1.26**	**$ 2.35**	**$ 0.56**	**$ (4.00)**	**$ (6.44)**	**$ (2.31)**	**$ (3.91)**	**$ (3.90)**
Adjusted pre-tax income (loss)(1)	**$ 326**	**$ 857**	**$ 66**	**$ (520)**	**$ (1,438)**	**$ (1,141)**	**$ (1,326)**	**$ (1,335)**

(1) Adjusted pre-tax income (loss) is a non-GAAP financial measure. A reconciliation of this measure to a comparable GAAP measure can be found in section 15 "Non-GAAP Financial Measures" of this MD&A.

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Air Canada's financial instruments and risk management practices are summarized in section 11 "Financial Instruments and Risk Management" of Air Canada's 2020 MD&A. There have been no material changes to Air Canada's financial instruments and risk management practices from what was disclosed at that time. Additional information on Air Canada's risk management practices and financial instruments is provided in Note 9 of Air Canada's interim unaudited condensed consolidated financial statements for the first quarter of 2021.

10. ACCOUNTING POLICIES AND CONTROLS

Air Canada's accounting policies are summarized in section 12 "Accounting Policies" of Air Canada's 2020 MD&A. There have been no material changes to Air Canada's accounting policies from what was disclosed at that time. Additional information on Air Canada's accounting policies is provided in Note 2 of Air Canada's interim unaudited condensed consolidated financial statements for the first quarter of 2021.

Changes in Internal Controls over Financial Reporting

There have been no changes to Air Canada's internal controls over financial reporting during the quarter ended March 31, 2021 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

11. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Air Canada's critical accounting estimates and judgments are summarized in section 13 "Critical Accounting Estimates and Judgments" of Air Canada's 2020 MD&A. There have been no material changes to critical accounting estimates and judgments from what was disclosed at that time.

12. OFF-BALANCE SHEET ARRANGEMENTS

Air Canada's off-balance sheet arrangements are summarized in section 14 "Off-Balance Sheet Arrangements" of Air Canada's 2020 MD&A. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

13. RELATED PARTY TRANSACTIONS

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

14. RISK FACTORS

For a description of risk factors associated with Air Canada and its business, refer to section 17 "Risk Factors" of Air Canada's 2020 MD&A. Except as otherwise discussed in this MD&A and the following update, there have been no material changes to Air Canada's risk factors from what was disclosed at that time.

As further described in section 4 "Recent Developments" of this MD&A, on April 12, 2021, Air Canada entered into a series of debt and equity financing agreements with the Government of Canada, which will allow Air Canada to access up to $5.879 billion in liquidity through the Large Employer Emergency Financing Facility (LEEFF) program. As part of the financial package, (i) Air Canada agreed to offer eligible customers who purchased non-refundable fares but did not travel due to COVID-19 since February 2020, the option of a refund to the original form of payment and (ii) an unsecured credit facility tranche of up to $1.404 billion was made available to support customer refunds of these non-refundable tickets.

15. NON-GAAP FINANCIAL MEASURES

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

EBITDA

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

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

	First Quarter		
(Canadian dollars in millions)	**2021**	**2020**	**$ Changes**
Operating loss – GAAP	**$ (1,049)**	**$ (433)**	**$ (616)**
Add back:			
Depreciation and amortization	413	504	(91)
EBITDA (including special items)	**$ (636)**	**$ 71**	**$ (707)**
Remove:			
Special items	(127)	-	(127)
EBITDA (excluding special items)	**$ (763)**	**$ 71**	**$ (834)**

Adjusted CASM

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

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

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

Adjusted CASM is reconciled to GAAP operating expense as follows:

(Canadian dollars in millions, except where indicated)	First Quarter 2021	2020	Change
Operating expense – GAAP	**$ 1,778**	**$ 4,155**	**$ (2,377)**
Adjusted for:			
Aircraft fuel expense	(200)	(836)	636
Ground package costs	(5)	(234)	229
Special items	127	-	127
Operating expense, adjusted for the above-noted items	**$ 1,700**	**$ 3,085**	**$ (1,385)**
ASMs (millions)	**4,211**	**23,511**	**(82.1)%**
Adjusted CASM (cents)	**¢ 40.37**	**¢ 13.12**	**¢ 27.25**

Adjusted Pre-tax Income (Loss)

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

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

(Canadian dollars in millions)	First Quarter 2021	2020	$ Change
Loss before income taxes – GAAP	**$ (1,387)**	**$ (1,276)**	**$ (111)**
Adjusted for:			
Special items	(127)	-	(127)
Foreign exchange (gain) loss	(67)	711	(778)
Net financing expense relating to employee benefits	4	11	(7)
Loss on financial instruments	242	34	208
Adjusted pre-tax loss	**$ (1,335)**	**$ (520)**	**$ (815)**

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

Net Cash Burn

Air Canada uses net cash burn as a measure of cash used to maintain operations, support capital expenditures, and settle normal debt repayments, all before the net impact of new financing proceeds. Net cash burn is defined as net cash flows from operating, financing for aircraft deliveries, and investing activities. Excluded are proceeds from non-aircraft financings, lump sum debt maturities made where Air Canada has refinanced or replaced the amount, and proceeds from sale and leaseback transactions. Net cash burn also excludes movements between cash and short and long-term investments. Refer to section 7.5 "Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.