2021

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

February 18, 2022

AIR CANADA

A STAR ALLIANCE MEMBER

TABLE OF CONTENTS

1. SELECTED FINANCIAL METRICS AND STATISTICS

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

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

(1) Adjusted pre-tax income (loss), EBITDA (excluding special items) (earnings before interest, taxes, depreciation, and amortization), and adjusted CASM are each non-GAAP financial measures. Such measures are not recognized measures for financial statement presentation under GAAP, do not have standardized meanings, may not be comparable to similar measures presented by other entities and should not be considered a substitute for or superior to GAAP results. Refer to section 20 "Non-GAAP Financial Measures" of this 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 amounts available under Air Canada's credit facilities. At December 31, 2021, unrestricted liquidity amounted to $10,361 million and consisted of $9,403 million in cash and cash equivalents, short-term and long-term investments, and $958 million available under undrawn credit facilities. At December 31, 2020, unrestricted liquidity of $8,013 million consisted of cash, cash equivalents and short-term and long-term investments.

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

(4) Reflects FTE employees at Air Canada and its subsidiaries. Excludes FTE employees at third party carriers operating under capacity purchase agreements with Air Canada. As of December 31, 2021, there were 25,775 employees based in Canada.

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

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

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

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

2. INTRODUCTION AND KEY ASSUMPTIONS

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

Except as otherwise noted, monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 21 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of February 17, 2022.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 18 "Risk Factors" of this MD&A. Air Canada issued a news release dated February 18, 2022 reporting on its results for the fourth quarter and full year 2021. This news release is available on Air Canada's website at **aircanada.com** and on SEDAR's website at **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 the documents incorporated by reference herein and are subject to important risks and uncertainties. Forward-looking statements cannot be relied upon due to, among other things, changing external events and general uncertainties of the business of Air Canada. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including those discussed below.

Air Canada, along with the rest of the global airline industry, continued to face significantly lower traffic in 2021, as compared to the year 2019, and a corresponding decline in revenue and cash flows as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world, including in Canada. While there are signs of improvement, there is limited visibility on future demand trends given changing government restrictions. Air Canada cannot predict the full impact or the timing for when conditions may improve. The COVID-19 pandemic is also having and may continue to have significant economic impacts, including on business and consumer spending and behaviour, which may in turn significantly impact demand for travel. The return of business travel to pre-pandemic levels may be challenged by the evolving nature of business models and remote-work practices in light of the impacts of the COVID-19 pandemic, including the growth and continued use of videoconferencing and other remote-work technologies as well as tendencies towards less environmentally impactful business and consumer behaviour. Air Canada is actively monitoring the situation and will respond as the impact of the COVID-19 pandemic evolves, which will depend on a number of factors including the course of the virus including its variants, availability of rapid, effective testing, vaccinations and treatments for the virus, government actions including health measures and other restrictions, and passenger reaction, the complexities of restarting an industry whose many stakeholders must act in coordination with each other as well as timing and extent of recovery in international and business travel which are important segments of Air Canada's market, none of which can be predicted with certainty.

Other factors that may cause results to differ materially from results indicated in forward-looking statements include economic and geopolitical conditions, Air Canada's ability to successfully achieve or sustain positive net profitability, industry and market conditions and the demand environment, Air Canada's ability to pay its indebtedness and maintain or increase liquidity, competition, Air Canada's dependence on technology, cybersecurity risks, energy prices, Air Canada's ability to successfully implement appropriate strategic and other important initiatives (including Air Canada's ability to manage operating costs), other epidemic diseases, terrorist acts, war, Air Canada's dependence on key suppliers, Air Canada's ability to successfully operate its loyalty program, interruptions of service, Air Canada's ability to attract and retain required personnel, the availability of Air Canada's workforce, casualty losses, changes in laws, regulatory developments or proceedings, climate change and environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), Air Canada's dependence on regional and other carriers, Air Canada's ability to preserve and grow its brand, employee and labour relations and costs, Air Canada's dependence on Star Alliance® and joint ventures, pending and future litigation and actions by third parties, currency exchange, limitations due to restrictive covenants, insurance issues and costs, pension plans, as well as the factors identified in Air Canada's public disclosure file available at **www.sedar.com** and, in particular, those identified in section 18 "Risk Factors" of this MD&A. The forward-looking statements contained or incorporated by reference in this MD&A represent Air Canada's expectations as of the date of this MD&A (or as of the date they are otherwise stated to be made) and are subject to change after such date. However, Air Canada disclaims any intention or obligation to update or revise any forward-looking statements whether because of new information, future events or otherwise, except as required under applicable securities regulations.

Key Assumptions

In light of the impact of the COVID-19 pandemic, as well as the economic environment and the recent significant volatility in fuel price and foreign exchange rates, Air Canada is not providing any assumptions relating to GDP, fuel prices or foreign exchange rates.

Intellectual Property

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

Incorporation of Other Information

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

3. ABOUT AIR CANADA

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

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

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

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

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

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

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

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

4. 2021 HIGHLIGHTS

Air Canada, along with the rest of the global airline industry, continued to face a significant decrease in traffic in 2021, as compared to the year 2019, and a corresponding decline in revenue and cash flows, as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world, including Canada.

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

Financing and Liquidity

Debt and Equity Financing Agreements with the Government of Canada

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

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

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

- Up to $1.404 billion in the form of an unsecured credit facility tranche to support customer refunds of non-refundable tickets. The facility has a seven-year term maturing April 2028 and carries an annual interest rate of 1.211%. Draws under this facility were available and made monthly based on the amount of refunds processed and paid until November 30, 2021. As at December 31, 2021, $1.273 billion was drawn under this facility to support customer refunds of non-refundable tickets. No further amounts can be drawn under this facility.

- Gross proceeds of $500 million for 21,570,942 Air Canada shares, at a price of $23.17933 per share (net proceeds of $480 million), which the government continues to hold.

- $1.5 billion in the form of a secured revolving credit facility maturing in April 2026 and bearing interest at the Canadian Dollar Offered Rate (CDOR) plus 1.5%. The facility was secured on a first lien basis by the assets of Aeroplan, Air Canada's shares in Aeroplan as well as certain assets of Air Canada. No amount was drawn by Air Canada under this facility, which as stated above has since been terminated by Air Canada.

- $2.475 billion in the form of three unsecured non-revolving credit facilities of $825 million each, with: the first, five-year tranche maturing in April 2026, at CDOR plus 1.75% per annum; the second, six-year tranche maturing in April 2027, at 6.5% per annum (increasing to 7.5% after 5 years); and the third, seven-year tranche maturing in April 2028, at 8.5% per annum (increasing to 9.5% after 5 years). No amount was drawn under these facilities, which as stated above have since been terminated by Air Canada.

- Air Canada issued 14,576,564 warrants initially exercisable during a 10-year term for the purchase of an equal number of Air Canada shares, to the Government of Canada, at an exercise price of $27.2698 per share. Half of the warrants vested upon the implementation of the above secured and unsecured credit facilities, while the remaining half would have vested on a proportional basis to the amounts that Air Canada may have drawn under the now terminated unsecured credit facilities. The warrants were subject to a one-time call right in favour of Air Canada, pursuant to which Air Canada on certain conditions could repurchase for cancellation all outstanding warrants at a price per warrant equal to their fair market value. The vested warrants were exercisable by the holder either by paying the exercise price or by using a cashless exercise option. With the termination of the operating credit facilities, the unvested warrants were cancelled. In addition, Air Canada exercised its call right on the vested warrants repurchasing and cancelling the warrants in January 2022 at a price of $82 million which is equivalent to the carrying value of the vested warrants as at December 31, 2021.

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

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

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

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

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

- The completion of the airline's acquisition of 33 Airbus A220 aircraft, manufactured at Airbus' Mirabel, Québec facility. Air Canada also agreed to complete its existing firm order of 40 Boeing 737 MAX aircraft. Completion of these orders remains subject to the terms and conditions of the applicable purchase agreements.

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

Refinancing Transactions

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

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

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

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

Navigating through the COVID-19 Pandemic

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

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

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

- Since September 7, 2021, fully vaccinated foreign nationals have been allowed to enter Canada for non-essential travel. Foreign nationals who do not meet the requirements to be considered fully vaccinated are not able to enter Canada unless they meet an exemption set out in the Orders made under the *Quarantine Act*. Unvaccinated children under the age of 12, later adjusted to children under the age of five, who enter Canada with their fully vaccinated parents, stepparents, guardians or tutors, are not required to quarantine upon entering Canada, but must adhere to strict public health measures including testing rules (save for certain exceptions) and limit contact with others for 14 days.

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

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

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

Until February 28, 2022, all travellers, regardless of vaccination status, will be required to provide a negative pre-entry COVID-19 PCR test result taken within 72 hours of departure or a proof of a positive test result received in the previous 11 to 180 days. On February 15, 2022, the Government of Canada announced further easing of certain travel restrictions for fully vaccinated travellers. These changes, which are effective February 28, 2022, included:

- Fully vaccinated travellers arriving to Canada will be subject to a random selection process for COVID-19 testing upon arrival with no need to quarantine while waiting for their result.

- Children under 12 years old travelling with fully vaccinated adults will continue to be exempt from the quarantine requirement but they will no longer need to avoid school, camp or daycare or other public spaces.

- Travellers will have the option to present a COVID-19 rapid antigen test result (taken the day prior to their scheduled flight), or a molecular test result (taken no more than 72 hours before their scheduled flight.)

- Travel Health advisory will change from a Level 3 to a Level 2, meaning that the Government will no longer recommend that Canadians avoid travel for non-essential purposes.

- International flights carrying passengers will be permitted to land at all remaining Canadian airports that are designated by the Canada Border Services Agency to receive international passenger flights.

<u>Route Network and Schedule</u>

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

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

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

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

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

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

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

- Two new seasonal routes connecting Québec City with Vancouver and with Calgary. These routes are scheduled to begin in May 2022.

- Increase in service to several key South American destinations. Year-round service to São Paulo, Brazil from Montreal resumed in December 2021. Direct service from Montreal to Bogota, Colombia started in early December 2021. Flights from Toronto to Bogota increased to four per week in November 2021. Service between Toronto and Santiago, Chile resumed in January 2022. Air Canada now serves Buenos Aires, Argentina, with flights offered from both Toronto and Montreal via São Paulo.

- New seasonal service between Toronto and Santo Domingo in the Dominican Republic, which began in December 2021.

- Planned summer 2022 schedule for Europe, Africa, the Middle East and India. In addition to its established year-round services, Air Canada announced its return to key summer seasonal destinations such as Barcelona, Venice, Nice, Manchester, Edinburgh, and Reykjavik.

- Since October 2021, expansion of services to India with increased frequency to Delhi from Toronto, and a new year-round non-stop route to Delhi from Montreal.

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

<u>People and Culture</u>

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

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

Customer Experience

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

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

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

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

Aeroplan

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

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

Cargo

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

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

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

Consolidation of Air Canada Express flying with Jazz

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

Termination of Transat A.T. Inc. Arrangement Agreement

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

5. STRATEGY

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

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

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

- Fund its future by staying vigilant on costs, seizing on opportunities, and making the right strategic investments
- Reach new frontiers, by embracing its competitive strengths to grow the business by expanding its international reach, and continually exploring new opportunities
- Elevate its customers, and support the creation of meaningful customer experiences and human connections by leveraging innovations in technology, loyalty and products
- Foster a collaborative workplace that respects diverse cultures and languages, while making impactful contributions to society

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

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

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

Air Canada has a modern and efficient fleet, including the Boeing 777 aircraft with its competitive cost per ASM particularly adapted to service high-volume leisure markets and the Boeing 787 aircraft with its lower operating costs, mid-size capacity and range flexibility. The airline has also continued renewing its narrow-body fleet. As of December 31, 2021, Air Canada had 31 Boeing 737 MAX 8 aircraft in its fleet. The Boeing 737 MAX 8 resumed commercial operations on February 1, 2021. At December 31, 2021, Air Canada had taken delivery of 27 Airbus A220-300 aircraft. The Airbus A220-300 aircraft replaced the Embraer 190 aircraft and, with its longer range and better efficiency, offers greater deployment opportunities, enabling Air Canada to serve new markets not as well suited to Air Canada's larger Boeing 737 MAX or Airbus A320 family aircraft. Through its fleet investments, Air Canada is well positioned to retain its leadership in the various markets served. The narrow-body fleet is being transformed to modern, cost- and fuel-efficient Airbus A220 and Boeing 737 MAX aircraft types.

As the impact of the COVID-19 pandemic softened, the leisure and Visiting Friends & Relatives ("VFR") markets have led the recovery, as expected, while business travel has remained depressed. Air Canada's hubs of Toronto, Vancouver, and Montreal each offer complementary geography and demographics. Not only are these hubs well positioned to capture global traffic flows, but they also have the benefit of a strong local multicultural population base which offers Air Canada a variety of opportunities globally. Air Canada's wide-body aircraft are not only more fuel efficient, but also offer best-in-class seating density which lowers the CASM and thereby reduces the overall dependence on premium business travel during the recovery. With regards to corporate travel, certain business sectors and small-medium enterprises have shown signs of resiliency throughout the pandemic as they have continued to travel for business, Air Canada expects this trend to continue into 2022. As the pandemic subsides and return to office policies evolve, Air Canada expects corporate customers to return to the skies, as there is a desire to travel again.

Air Canada Rouge, Air Canada's leisure carrier, leverages the strengths of Air Canada, including its extensive network with enhanced connection options, operational expertise, and frequent flyer program. Air Canada Rouge seeks to maintain a cost structure consistent with that of its leisure market competitors, effectively lowering CASM on leisure routes through increased seat density, lower wage rates, more efficient work standards, and reduced overhead costs. Over the last several years, Air Canada Rouge, had been deployed to Caribbean destinations and leisure destinations in the United States and in Canada, as well as to international leisure markets. As a result of the COVID-19 pandemic, Air Canada Rouge suspended operations in the spring of 2021, and resumed service on September 7, 2021. In addition, with the retirement of all the Boeing 767 aircraft from its fleet, Air Canada Rouge now only operates narrow-body aircraft. In 2022, the Air Canada Rouge fleet will be operated primarily to leisure destinations in the U.S., the Caribbean and to select destinations in Canada.

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

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

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

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

Air Canada has been investing in technology and transforming core operational process. In 2021, after concluding the last phase of its implementation, Air Canada's new passenger service system - the Amadeus Altéa Suite was fully operational. Altéa, as a shared infrastructure solution, enables simplification and lowers costs in Air Canada's technology environments while improving operational efficiency, including automation of functions. The new system also enables revenue enhancements and growth opportunities as well as significant customer service improvements. Air Canada also has a multi-year distribution agreement in place with Amadeus, supporting its focus on delivering a consistent brand and customer experience across all channels. Amadeus users worldwide can access Air Canada's industry-leading customizable fare products and availability via the Amadeus Global Distribution System, as well as Air Canada's ancillary offerings. Leveraging artificial intelligence ("AI") has also become a key part of Air Canada's strategy as it moves forward on a series of technology driven initiatives that will help shape its future, mainly focused on improving operations, customer experience, and enhancing the revenue management practice.

<u>Commitment to Sustainability</u>

Being a global champion involves being a responsible corporate citizen and doing what is right for the longer-term interest of its shareholders, employees, customers, communities, and other stakeholders; it includes supporting research and development of innovative ways to reduce its environmental footprint and governing its business responsibly, safely, and ethically. Environment, social and governance (ESG) practices are integrated in Air Canada's business and inform decision-making. ESG achievements are reported through its Corporate Sustainability Report "Citizens of the World" in accordance with the Global Reporting Initiative ("GRI") standards. Internationally recognized as a leader in sustainability reporting standards, GRI standards help maintain transparency in corporate reporting related to performance on governance, environmental, and social matters. Continuously maintaining transparency and accountability, seven performance indicators, including Scope 1 and 2 emissions are verified by an independent external party, following internationally recognized standards.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

System Passenger Revenues

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

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

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

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

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

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

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

Domestic Passenger Revenues

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

U.S. Transborder Passenger Revenues

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

Atlantic Passenger Revenues

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

Pacific Passenger Revenues

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

Other Passenger Revenues

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

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

Cargo Revenues

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

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

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

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

Other Revenues

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

Operating Expenses

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

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

Aircraft Fuel

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

Wages, Salaries and Benefits

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

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

Regional Airlines Expense

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

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

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

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

Depreciation and Amortization

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

Aircraft Maintenance

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

Ground package costs

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

Special Items

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

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

Impairments

In response to COVID-19 related capacity reductions, Air Canada accelerated the retirement of certain older aircraft from its fleet. As a result, a non-cash impairment charge of $283 million was recorded in 2020, reflecting the write-down of right-of-use assets for leased aircraft and the reduction of carrying values of owned aircraft to expected disposal proceeds.

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

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

Canada Emergency Wage Subsidy

In 2020, in response to challenges posed by the COVID-19 pandemic, the Government of Canada announced the Canada Emergency Wage Subsidy ("CEWS") in order to help employers retain and/or return Canadian-based employees to payrolls. Air Canada continued its participation in the CEWS program until the program ended in October 2021. In October 2021, the Government of Canada announced two new programs designed to support businesses that are still facing challenges due to the COVID-19 pandemic: the Hardest Hit Business Recovery Program ("HHBRP") and the Tourism and Hospitality Recovery Program ("THRP").

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

Workforce reduction provisions

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

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

Benefit Plan Amendments

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

Benefit Plan Settlement

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

Other

Termination of the Transat Arrangement Agreement

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

Amendments to Capacity Purchase Agreements

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

Other operating expenses

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

Non-operating Expense

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

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

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

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

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

Income Taxes

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

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

As a result of the COVID-19 pandemic, there is negative evidence relating to losses incurred in the current and prior year and uncertainty exists as to when conditions will improve. Such negative evidence currently outweighs the positive historical evidence and, accordingly, net deferred tax assets are not being recognized. The future tax deductions underlying the unrecognized deferred income tax assets of $1,719 million remain available for use in the future to reduce taxable income. The deferred income tax expense recorded in Other comprehensive income (loss) related to remeasurements on employee benefit liabilities is offset by a deferred income tax recovery which was recorded through the statement of operations. As such, a deferred income tax recovery of $395 million was recorded for the year, which is partially offsetting the deferred income tax expense of $379 million recorded in Other comprehensive income (loss).

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

7. RESULTS OF OPERATIONS – Q4 2021 VERSUS Q4 2020

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

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

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

System Passenger Revenues

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

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

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

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

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

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

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

Domestic Passenger Revenues

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

U.S. Transborder Passenger Revenues

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

Atlantic Passenger Revenues

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

Pacific Passenger Revenues

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

Other Passenger Revenues

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

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

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

Cargo Revenues

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

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

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

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

Other Revenues

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

Operating Expenses

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

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

Aircraft Fuel

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

Wages, Salaries and Benefits

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

Regional Airlines Expense

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

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

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

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

Depreciation and Amortization

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

Aircraft Maintenance

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

Special Items

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

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

Non-operating Expense

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

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

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

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

8. FLEET

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

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

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

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

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

AIR CANADA rouge	Actual			Planned			
	Dec. 31, 2020	2021 Fleet Changes	Dec. 31, 2021	2022 Fleet Changes	Dec. 31, 2022	2023 Fleet Changes	Dec. 31, 2023
Narrow-body aircraft							
Airbus A321	14	-	14	-	14	-	14
Airbus A320	5	-	5	-	5	-	5
Airbus A319	20	-	20	-	20	-	20
Total Air Canada Rouge	**39**	**-**	**39**	**-**	**39**	**-**	**39**
Total Mainline & Rouge	**208**	**6**	**214**	**14**	**228**	**6**	**234**

Air Canada Express

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

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

AIR CANADA EXPRESS	Actual			Planned			
	Dec. 31, 2020	2021 Fleet Changes	Dec. 31, 2021	2022 Fleet Changes	Dec. 31, 2022	2023 Fleet Changes	Dec. 31, 2023
Embraer 175	25	-	25	-	25	-	25
Mitsubishi CRJ-200	15	-	15	-	15	-	15
Mitsubishi CRJ-900	34	1	35	-	35	-	35
De Havilland Dash 8-300	19	(10)	9	(9)	-	-	-
De Havilland Dash 8-400	43	(4)	39	-	39	-	39
Total Air Canada Express	**136**	**(13)**	**123**	**(9)**	**114**	**-**	**114**

9. FINANCIAL AND CAPITAL MANAGEMENT

9.1 LIQUIDITY

Impact of the COVID-19 Pandemic

Air Canada, along with the global airline industry, continued to face a significant decrease in traffic in 2021, as compared to the year 2019, and a corresponding decline in revenue and cash flows as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world, including Canada.

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

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

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

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

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

Liquidity Risk Management

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

Liquidity needs are primarily related to meeting obligations associated with financial liabilities, capital commitments, ongoing operations, contractual and other obligations, which are further discussed in sections 9.6 "Capital Expenditures and Related Financing Arrangements", 9.7 "Pension Funding Obligations", and 9.8 "Contractual Obligations" of this MD&A. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts for a minimum period of at least twelve months after each reporting period, including under various scenarios and assumptions, monitoring the condition and value of assets available to be used as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. At December 31, 2021, unrestricted liquidity was $10,361 million consisting of $9,403 million in cash and cash equivalents, short-term and long-term investments, and $958 million available under undrawn credit facilities.

Air Canada estimates that it requires a minimum unrestricted liquidity balance of $2,400 million to support ongoing business operations. This minimum cash estimate considers Air Canada's various financial covenants, provides adequate coverage for advance ticket sales, and supports Air Canada's liquidity needs, as described above. Given the uncertainty that has characterized the COVID-19 pandemic, Air Canada's current unrestricted liquidity position permits it to better support ongoing investments, including in fleet and technology, as Air Canada continues to navigate through the recovery phase and build back the airline.

9.2 FINANCIAL POSITION

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

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

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

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

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

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

9.3 NET DEBT

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

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

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

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

9.4 WORKING CAPITAL

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

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

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

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

9.5 CASH FLOW MOVEMENTS

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

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

Net Cash Flows from (used in) Operating Activities

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

Net Cash Flows from (used in) Financing Activities

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

Net Cash Flows from (used) in Investing Activities

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

Refer to sections 9.2 "Financial Position", 9.3 "Net Debt", 9.4 "Working Capital", and 9.9 "Share Information" of this MD&A for additional information.

Free Cash Flow

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

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

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

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

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

Net Cash Flow (Burn)

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

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

(1) Net cash flow (burn) is a non-GAAP financial measure used by Air Canada as a measure of cash used to maintain operations, support capital expenditures, and settle normal debt repayments, all before the net impact of new financing proceeds. Net cash burn is defined as net cash flows from operating, financing for aircraft deliveries, and investing activities. Excluded are proceeds from non-aircraft financings, lump sum debt maturities made where Air Canada has refinanced or replaced the amount, and proceeds from sale and leaseback transactions. Net cash burn also excludes movements between cash and short and long-term investments, and refunds for non-refundable fares being processed for flights impacted by the COVID-19 pandemic. Such refunds were eligible for draws under the Government of Canada refunds credit facility and, therefore, were generally cash neutral to Air Canada's liquidity position. Draws under this facility were made monthly based on the amount of refunds processed and paid until November 30, 2021. Net cash flow (burn) is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, may not be comparable to similar measures presented by other entities and should not be considered a substitute for or superior to GAAP results.

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

9.6 CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS

Airbus A220-300 Aircraft

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

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

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

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

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

Boeing 737 MAX

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

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

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

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

Boeing 787-9 Aircraft

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

Capital Commitments

As outlined in the table below, the estimated aggregate cost of all aircraft expected to be delivered and other capital purchase commitments at December 31, 2021 amounted to about $2,499 million.

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

(1) Future capitalized maintenance amounts for 2025 and beyond are not yet determinable, however estimates of $262 million and $340 million have been made for 2025 and 2026, respectively.

(2) U.S. dollar amounts are converted using the December 31, 2021 closing exchange rate of US$1=C$1.2637. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at December 31, 2021.

9.7 PENSION FUNDING OBLIGATIONS

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

On a preliminary basis, at January 1, 2022, the aggregate solvency surplus in Air Canada's domestic registered pension plans was estimated at $4.7 billion. The final valuations will be completed in the first half of 2022. As permitted by legislation and subject to applicable plan rules, amounts in excess of 105% on a solvency basis may be used to reduce current service contributions under the defined benefit component or to fund the employer contribution to a defined contribution component within the same pension plan.

Total employer defined benefit pension funding contributions (including international and supplemental plans) amounted to $91 million in 2021 and are forecasted to be $90 million in 2022.

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

At December 31, 2021, approximately 75% of Air Canada's pension assets were invested in fixed income instruments to mitigate a significant portion of the interest rate (discount rate) risk. Air Canada seeks to maintain a high percentage of long-term fixed income products to hedge pension liabilities.

Pension plan assets

Included in plan assets, for determining the net benefit obligation for accounting purposes, are 17,646,765 (2020 – 17,646,765) shares of Air Canada which were issued to a trust in 2009 in connection with pension funding agreements reached with all of Air Canada's Canadian-based unions. The trust arrangement provides that proceeds of the sale of the trust shares will be retained and applied to reduce future pension solvency deficits, if any should materialize. With Air Canada's domestic registered plans in a surplus position on a solvency basis, the accounting rules prevent the recognition of the value of the shares held in trust as part of the pension assets. The shares held in trust had a fair value of $373 million at December 31, 2021 (2020 – $402 million), however after giving effect to the asset ceiling, the recognized accounting value of the trust asset is nil.

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

9.8 CONTRACTUAL OBLIGATIONS

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

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

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

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

9.9 SHARE INFORMATION

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

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

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

Issuer Bid

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

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

Share Offerings

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

In December 2020, Air Canada completed an underwritten public offering of 35,420,000 shares at a price of $24.00 per share, for aggregate proceeds of $850 million. After deduction of the underwriters' fees and expenses of the offering, net proceeds were $815 million. Air Canada granted the underwriters an option to purchase up to an additional 15% of the shares in the offering, exercisable in whole or in part at any time until 30 days after closing of the offering on December 30, 2020. On January 18, 2021, Air Canada announced that the underwriters exercised their over-allotment option to purchase an additional 2,587,000 shares for net proceeds of $60 million.

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

10. QUARTERLY FINANCIAL DATA

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

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

(1) Adjusted pre-tax income (loss) is a non-GAAP financial measure. A reconciliation of this measure to a comparable GAAP measure can be found in section 20 "Non-GAAP Financial Measures" of this MD&A.

11. SELECTED ANNUAL INFORMATION

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

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

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

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Gain (Loss) on Financial Instruments Recorded at Fair Value

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

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

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

Risk Management

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

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

Fuel Price Risk Management

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

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

Foreign Exchange Risk

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

Air Canada generates certain sales in U.S. dollars and in other foreign currencies which are converted to U.S. dollars under Air Canada's risk management program. In 2021, these net operating cash inflows totalled approximately US$1.6 billion and U.S. denominated operating costs amounted to approximately US$3.2 billion. Non-operating cash outflows in U.S. dollars, primarily related to interest payments on U.S. dollar denominated debt and net financing outflows, amounted to approximately US$2.0 billion. In 2021, this resulted in a U.S. dollar net cash flow exposure of approximately US$3.6 billion.

In 2021, mainly due to a lower relative risk exposure to international operations, Air Canada updated its target coverage to 60% on a rolling 18-month basis (from 70% on a 24-month basis) to manage the net U.S. dollar cash flow exposure described above utilizing the following risk management strategies:

- Holding U.S. dollar cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash, short and long-term investment balances as at December 31, 2021 amounted to $1,403 million (US$1,110 million) ($1,747 million (US$1,371 million) as at December 31, 2020). A portion of the cash and investment reserves are an economic hedge against long-term U.S. dollar debt while the remainder of the cash is operational cash and investment reserves which are applied against the rolling 18-month net U.S. dollar cash flow exposure. In 2021, a gain of $10 million (loss of $69 million in 2020) was recorded in foreign exchange gain (loss) reflecting the change in Canadian equivalent market value of the U.S. dollar cash and short-term investment balances held.

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

The level of foreign exchange derivatives entered into and their related maturity dates are dependent upon a number of factors, which include the amount of foreign revenue conversion available, U.S. dollar net cash outflows, as well as the amount attributed to aircraft and debt payments. Based on the notional amount of currency derivatives outstanding at December 31, 2021, as further described below, approximately 52% of net U.S. cash outflows are hedged for 2022 and 30% for 2023, resulting in derivative coverage of 45% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage result in 60% coverage.

As at December 31, 2021, Air Canada had outstanding foreign currency options and swap agreements, settling in 2022 and 2023, to purchase at maturity $2,423 million (US$1,925 million) of U.S. dollars at a weighted average rate of $1.2742 per US$1.00 (2020 – $5,730 million (US$4,499 million) with settlements in 2021 and 2022 at a weighted average rate of $1.3586 per $1.00 U.S. dollar). Air Canada also has protection in place to sell a portion of its excess Euros, Sterling, YEN, YUAN, and AUD (EUR €260 million, GBP £56 million, JPY ¥4,577 million, CNH ¥31 million and AUD $36 million) which settle in 2022 and 2023 at weighted average rates of €1.1704, £1.4125, ¥0.0092, ¥0.1471, and AUD $0.7300 per $1.00 U.S. dollar, respectively (as at December 31, 2020 – EUR €464 million, GBP £64 million, JPY ¥4,963 million, CNH ¥415 million and AUD $88 million with settlement in 2021 and 2022 at weighted average rates of €1.1414, £1.3277, ¥0.0094, ¥0.1463, and AUD $0.6942 respectively per $1.00 U.S. dollar).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations, and based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at December 31, 2021 was $268 million in favour of the counterparties (2020 – $591 million in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. In 2021, a loss of $114 million was recorded in foreign exchange gain (loss) related to these derivatives (2020 – $583 million loss). In 2021, foreign exchange derivative contracts cash settled with a net fair value of $437 million in favour of the counterparties (2020 – $106 million in favour of the counterparties).

Interest Rate Risk

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

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

The ratio of fixed to floating rate obligations outstanding is designed to maintain flexibility in Air Canada's capital structure and is based upon a long-term objective of 60% fixed and 40% floating but allows flexibility to adjust to prevailing market conditions. The ratio at December 31, 2021 is 73% fixed and 27% floating (74% and 26%, respectively as at December 31, 2020).

13. ACCOUNTING POLICIES

Information on Air Canada's accounting policies is provided in Note 2 of Air Canada's audited consolidated financial statements and notes for 2021.

14. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

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

Impairment Considerations on Long-lived Assets

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

Aeroplan Loyalty Program

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

Breakage represents the estimated Points that are not expected to be redeemed. Breakage is estimated by management based on the terms and conditions of membership and historical accumulation and redemption patterns, as adjusted for changes to any terms and conditions or other circumstances that may affect future redemptions. Management uses statistical and simulation models to estimate breakage. A change in assumptions as to the number of Points expected to be redeemed could have a significant impact on revenue in the year in which the change occurs. Given the impact of the COVID-19 pandemic on travel demand and consumer spending patterns, and considering the launch of the new Aeroplan program in 2020 and the special benefits and accommodations for Aeroplan members in response to the COVID-19 pandemic, the breakage estimate is unchanged in 2021 and is based on a qualitative update of the prior assessment. In addition, the estimate is based on management's long-term expectations of breakage over the life of the program.

As at December 31, 2021, the Aeroplan Points deferred revenue balance was $3,452 million. For illustrative purposes, a hypothetical 1% change in the number of outstanding Points estimated to be redeemed would result in an approximate impact of $35 million on revenue with a corresponding adjustment to Aeroplan deferred revenue.

Breakage

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

Depreciation and Amortization Period for Long-lived Assets

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

Maintenance Provisions

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

Employee Future Benefits

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

<u>Assumptions</u>

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

Discount Rate

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

Future Increases in Compensation

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

Mortality Assumptions

In 2014, the Canadian Institute of Actuaries ("CIA") published a report on Canadian Pensioners' Mortality ("Report"). The Report contained Canadian pensioners' mortality tables and improvement scales based on experience studies conducted by the CIA. The CIA's conclusions were taken into account in selecting management's best estimate mortality assumption used to calculate the projected benefit obligation as at December 31, 2021 and 2020.

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

	Pension Benefits		**Other Employee Future Benefits**	
	2021	**2020**	**2021**	**2020**
Discount rate used to determine:				
Net interest on the net benefit obligation for the year ended December 31	2.82%[1]	3.13%	2.59%	3.13%
Service cost for the year ended December 31	3.10%[1]	3.20%	3.16%[1]	3.20%
Accrued benefit obligation as at December 31	3.20%	2.59%	3.20%	2.59%
Rate of future increases in compensation used to determine:				
Accrued benefit cost and service cost for the year ended December 31	2.50%	2.50%	Not applicable	Not applicable
Accrued benefit obligation as at December 31	2.50%	2.50%	Not applicable	Not applicable

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

Sensitivity Analysis

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

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

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

The increase (decrease) in the pension obligation for a 0.25 percentage point change in the discount rate relates to the gross amount of the pension liabilities and is before the impact of any change in plan assets. As at December 31, 2021, approximately 75% of Air Canada's pension assets were invested in fixed income instruments to mitigate a significant portion of the interest rate (discount rate) risk.

An increase of one year in life expectancy would increase the pension benefit obligation by $519 million.

Assumed health care cost trend rates impact the amounts reported for the health care plans. A 5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2021 (2020 – 5%). The rate is assumed to decrease gradually to 4.5% by 2023 (2020 – assumed to decrease gradually to 4.5% by 2023). A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by $7 million and the obligation by $81 million. A one percentage point decrease in assumed health care trend rates would have decreased the total of current service and interest costs by $5 million and the obligation by $79 million.

A 0.25 percentage point decrease in discount rate for other employee future benefits would have increased the total of current and interest costs by less than $1 million and the obligation by $56 million. A 0.25 percentage point increase in discount rate would have decreased the total of current and interest costs by less than $1 million and the obligation by $53 million.

15. OFF-BALANCE SHEET ARRANGEMENTS

Guarantees

Guarantees in Fuel Facilities and De-Icing Arrangements

The Corporation participates in fuel facility arrangements operated through nine Fuel Facility Corporations, and three aircraft de-icing service facilities, along with other airlines that contract for fuel and de-icing services at various major airports in Canada. These entities operate on a cost recovery basis. The aggregate debt of these entities that has not been consolidated by the Corporation under IFRS 10 Consolidated Financial Statements is approximately $1,038 million as at December 31, 2021 (December 31, 2020 – $1,047 million), which is Air Canada's maximum exposure to loss before taking into consideration the value of the assets that secure the obligations and any cost sharing that would occur amongst the other contracting airlines. Air Canada views this loss potential as remote. Each contracting airline participating in these entities shares pro rata, based on system usage, in the guarantee of this debt. The maturities of these debt arrangements vary but generally extend beyond five years.

Indemnification Agreements

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

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

16. RELATED PARTY TRANSACTIONS

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

17. ENTERPRISE RISK MANAGEMENT AND GOVERNANCE

Overview

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

Implications of COVID-19

While confronting the challenges that the COVID-19 pandemic has had and its major impact on Air Canada's business in 2021, Air Canada has remained vigilant to continue to maintain the integrity and resiliency of its key governance, oversight and risk management processes as outlined below. Processes have been adjusted as necessary to reflect changes to Air Canada's business and working environments; ensuring important risks continue to be managed appropriately.

Board Oversight

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

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

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

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

Risk Management Framework and Structure

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

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

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

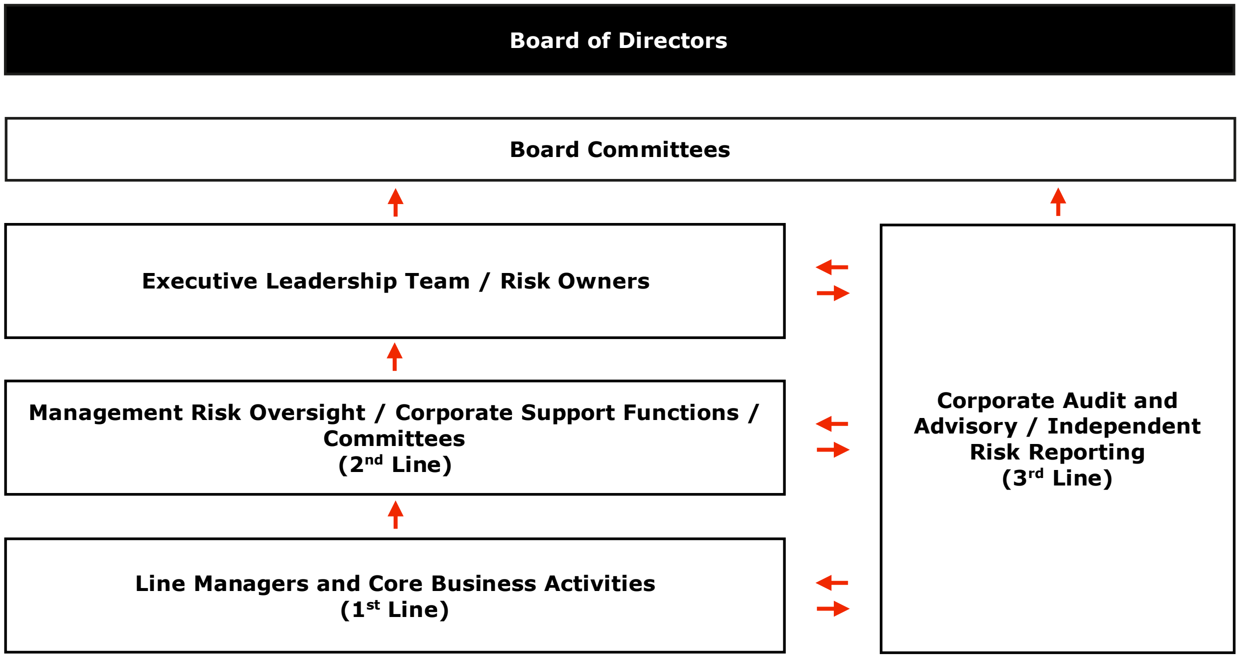
Air Canada's risk management structure is aligned with the "Three Lines Model" approach to risk management:

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

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

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

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



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

18. RISK FACTORS

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

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

Air Canada, along with the rest of the global airline industry, continued to face significantly lower traffic in 2021, as compared to the year 2019, and a corresponding decline in revenue and cash flows as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world, including in Canada. While there are signs of improvement, there is limited visibility on future demand trends given changing government restrictions in place around the world and in Canada. Air Canada cannot predict the full impact or the timing for when conditions may recover due to a number of factors, including changing government restrictions, requirements and advisories, concerns about travel and expectations about the need for certain precautions due to the COVID-19 pandemic, the risk of waning vaccine efficacy and the accessibility and timeliness of roll out of booster doses and treatments, the threat of and uncertainty surrounding known and new COVID-19 variants, the availability and acceptance of specific vaccine programs by various governments as well as passengers, the acceptance of certificates evidencing vaccination by various governments, the cost and efficiency of testing requirements, quarantine requirements in various jurisdictions (including in Pacific route jurisdictions which may significantly impact the recovery of those markets). The COVID-19 pandemic is also having and may continue to have significant economic impacts, including on business and consumer spending and behaviour, which may in turn significantly impact demand for travel. The return of business travel to pre-pandemic levels may be challenged by the evolving nature of business models and remote-work practices in light of the impacts of the COVID-19 pandemic, including the growth and continued use of videoconferencing and other remote-work technologies as well as tendencies towards less environmentally impactful business and consumer behaviour. Air Canada is actively monitoring the situation and will respond as the impact of the COVID-19 pandemic evolves, which will depend on a number of factors including the course of the virus including its variants, availability of rapid, effective testing, vaccinations and treatments for the virus, government actions including health measures and other restrictions, and passenger reaction, the complexities of restarting an industry whose many stakeholders must act in coordination with each other as well as timing and extent of recovery in international and business travel which are important segments of Air Canada's market, none of which can be predicted with certainty.

Air Canada has taken and implemented a number of safety measures in light of the COVID-19 pandemic, including the Air Canada CleanCare+ program and a health and safety policy that makes it mandatory for all employees of Air Canada, and anyone accessing Air Canada's facilities, to be fully vaccinated against COVID-19 (subject to certain limited exceptions required by law). Air Canada continues to appeal to governments and other parties in an effort to recognize the efficacy of such safety measures and to allow for a measured and responsible reduction of travel restrictions and requirements. Air Canada's business, results from operations and financial condition will continue to be adversely impacted to the extent that travel restrictions, requirements and advisories remain in place or are expanded upon over time.

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

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

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

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

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

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

A variety of factors, including economic conditions and other factors described in this MD&A, may result in Air Canada incurring significant losses. The airline industry has historically been characterized by low profit margins and high fixed costs and the costs of operating a flight do not vary significantly with the number of passengers carried. Therefore, a relatively small change in the number of passengers, fare pricing or traffic mix, or increased costs, could have a significant impact on Air Canada's operating and financial results. Due to the competitive nature of the airline industry and customer sensitivity to travel costs, Air Canada may not be able to pass on cost increases to its customers. Despite a focus on improving resiliency to downturns in its business as well as on-going and planned strategic and business initiatives, Air Canada may not be able to successfully achieve and/or sustain positive net profitability or realize all of its objectives, including those which seek to increase revenues, decrease costs, improve margins, profitably deploy additional capacity, generate sufficient returns on its capital expenditures or offset or mitigate risks facing Air Canada, including those described in this MD&A.

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

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

Financial Leverage - Air Canada has a significant amount of financial leverage

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The airline industry is subject to extensive legal, regulatory and administrative controls and oversight, including in relation to taxes, airport fees and operations, route rights, airport slots, security, passenger and consumer rights, public health and safety (including in light of the COVID-19 pandemic), accessibility of transportation, flight crew and other labour rules, privacy, data security, marketing and advertising, licensing, competition, pensions, environment (including noise levels and carbon emissions), customs, immigration, foreign exchange controls and, in some measure, pricing.

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

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

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

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

The International Civil Aviation Organization ("ICAO") global market-based measure known as the Carbon Offsetting Reduction Scheme for International Aviation ("CORSIA"), adopted in 2016, includes emissions from applicable international flights. CORSIA is being implemented in three phases, with the first two phases (occurring from 2021 to 2023, and 2024 to 2026, respectively) to be voluntary and with the third phase (from 2027 to 2035) to be mandatory. Canada voluntarily adopted the first phase. Given the COVID-19 pandemic's impact on the airline industry and its emissions in 2020, ICAO recognized that calculating offsetting requirements based on the average of 2019 and 2020 emissions would lead to a substantial unexpected increase in offsetting requirements. Instead, it was agreed to use 2019 emissions for CORSIA's baseline during the pilot phase (2021-2023). Baseline calculation for subsequent phases of CORSIA are scheduled to be discussed by the ICAO Council in 2022. On the basis of CORSIA, the European Parliament and Council has continued exempting flights between Europe and third countries from the European Union ("EU") greenhouse gas ("GHG") emissions trading system ("ETS"). In 2021, the European Commission published the "Fit for 55 Package" consisting of regulatory proposals aimed at delivering a reduction of net GHG emissions of 55% by 2030 as compared to 1990 levels. The proposal includes an amendment to the EU ETS that would make non-EU airlines flying intra-EU routes subject to both EU ETS and CORSIA. In addition, the European Commission is proposing to cease exempting international flights between Europe and third countries from EU ETS as of 2027 if ICAO decides to exclude 2020 emissions from CORSIA's baseline for CORSIA's mandatory third phase (2027-2035). The European Commission has also proposed a ReFuelEU Aviation regulation with a stated aim of increasing, in the EU, the supply and demand for sustainable aviation fuels ("SAF"), which costs significantly more than conventional jet fuel. If adopted, it would require aviation fuel suppliers to supply all airports in the EU with a minimum volume share of 2% SAF as of 2025, increasing to 63% by 2050. This requirement would impact all aircraft operators uplifting fuel at EU airports.

In Canada, since 2018, the federal pan-Canadian benchmark for carbon pricing has been in effect with pricing based on GHG emissions from all fossil fuel sources, including jet fuel and other fuels used by Air Canada in ground operations and stationary combustion equipment. Canadian provinces may either apply an explicit price-based system, such as a carbon tax or levy, or a cap-and-trade system. Certain provinces, such as British Columbia and Québec have implemented a carbon pricing system; others have had the federal carbon pricing backstop system applied. Air Canada and regional carriers operating flights on behalf of Air Canada have been subject to a carbon tax for flights operating on an intra-provincial basis. In December 2020, the government of Canada published its proposed Clean Fuel Regulations for liquid fossil fuels which would set carbon intensity targets that would decline over time in order to drive the development of sustainable and low carbon fuels in Canada. Conventional jet fuel is not currently on the list of liquid fossil fuels that would be required to achieve a carbon intensity target, however, the production of SAF may be eligible to generate compliance credits that would create a financial incentive for the production of SAF in Canada. The government of Canada is expected to publish the final Clean Fuel Regulations in the spring of 2022. In 2021, the province of British Columbia published its CleanBC Roadmap to 2030, which includes proposed amendments to its Low Carbon Fuel Standard (LCFS) to expand coverage to marine and aviation fuels beginning 2023. The BC LCFS requires fuel suppliers to progressively decrease the average carbon intensity of the fuels they supply to users in the province.

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

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

Air Canada's business requires the secure processing and storage of sensitive information relating to our customers, employees, business partners and others. There has been a heightened legislative and regulatory focus on data privacy and cybersecurity in Canada, the EU and elsewhere. As a result, Air Canada is subject to proliferating and increasingly stringent domestic and foreign laws and regulations regarding privacy and cybersecurity, including in relation to passenger, employee and other data, advance passenger information, access to airline reservation systems, and requirements for notifying regulators and affected individuals in the event of a data security incident, which may not be consistent across all countries which may assert jurisdiction over Air Canada, including in countries where Air Canada operates, conducts business or processes or stores data. These laws and regulatory regimes are increasingly challenging, result in additional complexities, operating costs and potential exposure to fines and penalties, and further regulation in this area or non-compliance, could have a material adverse effect on Air Canada, its business (including by impacting Air Canada's goodwill and reputation), results from operations and financial condition.

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

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

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

Air Canada, like other airlines, is subject to climate change-related risks, including in relation to other factors described in this MD&A. The airline industry is a source of carbon dioxide and other greenhouse gases and faces extensive related laws and regulations, including those described in this MD&A. Carbon emissions by the aviation industry and their impact on climate change have become a particular focus of regulators (including securities regulators), businesses and consumers.

Climate change may also increase the frequency and intensity of severe weather on the ground and at altitude (including turbulence events) which could impact many aspects of airline operations including by increasing operating costs. Severe weather events at airports or destinations served by Air Canada may impact the viability or cost of flying to such destinations.

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

Concerns about carbon emissions from flights and efforts to effectively address climate change may result in additional regulation, expanded aviation fuel taxes and levies, reduced demand for air travel and may adversely impact public perception of Air Canada and its brand. Climate change as well as a failure to adapt to and address evolving related regulations, or changes in public opinion, failure to implement initiatives which adequately reduce climate or environmental impacts (including those already announced by Air Canada), or which improve sustainability of its operations or otherwise respond to climate change-related challenges, in a timely manner, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

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

Air Canada enhances its network through capacity purchase agreements with regional airlines who operate flights on behalf of Air Canada. In 2021, Air Canada consolidated its regional flying with Jazz. Pursuant to the terms of the Jazz CPA, Air Canada pays Jazz a number of fees, some of which are fixed and others which are determined based upon certain costs incurred by Jazz. Air Canada also reimburses Jazz for certain pass-through costs incurred by Jazz (or arranges to provide the related supplies to Jazz), such as fuel costs, navigation fees, landing fees and terminal fees. In addition, the Jazz CPA requires that Jazz maintain a minimum fleet size and contains a minimum average daily utilization guarantee which requires Air Canada to utilize Jazz for that amount of flying. Significant increases in Jazz's costs, the failure by Jazz to adequately fulfill its obligations under the Jazz CPA, factors which may reduce the utilization of the Jazz fleet, including economic or market downturns or the effects of the COVID-19 pandemic, and unexpected interruptions or cessation of Jazz's services, as well as similar circumstances relating to other airlines from whom Air Canada may source regional capacity, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

The decline in demand for air travel services resulting from the COVID-19 pandemic continues to impact demand for regional carrier services and, as a result, Air Canada's utilization of its regional network is reduced and adapting to better support the airline. Air Canada expects the disruption to services resulting from the COVID-19 pandemic to continue to adversely affect its regional carrier. If, as a result of the COVID-19 pandemic or another significant disruption to the Air Canada's regional network, Jazz or other airlines from whom Air Canada may source regional capacity are unable to perform their obligations over an extended period of time, there could be a material adverse effect on Air Canada's business, results from operations and financial condition.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Pension plans

Air Canada maintains several defined benefit pension plans, including domestic registered pension plans, supplemental pension plans and international pension plans. Canadian federal pension legislation requires that the funded status of registered pension plans be determined periodically, on both a going concern basis (essentially assuming indefinite plan continuation) and a solvency basis (essentially assuming immediate plan termination). In addition, current service contributions in respect of a domestic registered plan are required except to the extent they are funded (and if permitted subject to applicable plan rules and legislation) through a sufficient surplus in such plan. Air Canada's pension funding obligations (including projected funding obligations) may vary significantly based on a wide variety of factors, including pension plan solvency valuations, regulatory developments, plan demographics, changes to plan provisions, the success of its pension asset investment strategies, assumptions and methods used and changes in economic conditions (mainly the return on fund assets and changes in interest rates) and other factors. While Air Canada has taken significant steps to reduce its pension plan risk, and its plans are in surplus position, there can be no assurance that such risk will not materialize and adversely impact Air Canada's ability to meet its funding obligations, which in turn could have a material adverse effect on Air Canada, its business, results from operations and financial condition. See section 9.7 "Pension Funding Obligations" of this MD&A for additional information.

19. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures and Internal Controls over Financial Reporting

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

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

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

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

Management's Report on Disclosure Controls and Procedures

Management, under the supervision of and with the participation of Air Canada's CEO and CFO, evaluated the effectiveness of Air Canada's disclosure controls and procedures (as defined under National Instrument 52-109) and concluded, as at December 31, 2021, that such disclosure controls and procedures were effective.

Management's Report on Internal Controls over Financial Reporting

Management, under the supervision of and with the participation of Air Canada's CEO and CFO, evaluated the effectiveness of Air Canada's internal controls over financial reporting (as defined under National Instrument 52-109). In making this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commissions ("COSO") in Internal Control - Integrated Framework (2013). Based on that evaluation, management and the CEO and CFO have concluded that, as at December 31, 2021, Air Canada's internal controls over financial reporting were effective. This evaluation took into consideration Air Canada's Corporate Disclosure Policy and the functioning of its Disclosure Policy Committee.

Changes in Internal Controls over Financial Reporting

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

20. NON-GAAP FINANCIAL MEASURES

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

EBITDA

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

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

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

Adjusted CASM

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

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

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

Adjusted CASM is reconciled to GAAP operating expense as follows:

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

Adjusted Pre-tax Income (Loss)

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

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

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

Free Cash Flow

Air Canada uses free cash flow as an indicator of the financial strength and performance of its business, indicating the amount of cash Air Canada can generate from operations and after capital expenditures. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment, and intangible assets, and is net of proceeds from sale and leaseback transactions. Refer to section 9.5

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

Net Cash Flow (Burn)

Air Canada uses net cash flow (burn) as a measure of cash used to maintain operations, support capital expenditures, and settle normal debt repayments, all before the net impact of new financing proceeds. Net cash burn is defined as net cash flows from operating, financing for aircraft deliveries, and investing activities. Excluded are proceeds from non-aircraft financings, lump sum debt maturities made where Air Canada has refinanced or replaced the amount, and proceeds from sale and leaseback transactions. Net cash burn also excludes movements between cash and short and long-term investments, and refunds for non-refundable fares processed for flights impacted by the COVID-19 pandemic. Such refunds were eligible for draws under the Government of Canada refunds credit facility and, therefore, are generally cash neutral to Air Canada's liquidity position, up to the $1.404 billion limit of the facility. Refer to section 9.5 "Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

21. GLOSSARY

Adjusted CASM – Refers to operating expense per ASM adjusted to remove the effects of aircraft fuel expense, ground packages costs at Air Canada Vacations and special items. Adjusted CASM is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Adjusted pre-tax income (loss) – Refers to the consolidated income (loss) of Air Canada before income taxes and adjusted to remove the effects of foreign exchange gains or losses, net financing expense relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items. Adjusted pre-tax income (loss) is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Aeroplan – Refers to Aeroplan Inc.

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

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

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

CASM – Refers to operating expense per ASM.

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

EBITDA – Refers to earnings before interest, taxes, depreciation and amortization. EBITDA is a non-GAAP financial measure. Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information. Air Canada excludes special items from EBITDA.

Free cash flow – Refers to net cash flows from operating activities minus additions to property, equipment, and intangible assets, and is net of proceeds from sale and leaseback transactions. Free cash flow is a non-GAAP financial measure. Refer to sections 9.5 "Cash Flow Movements" and 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Jazz – Refers to Jazz Aviation LP.

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

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

Net cash burn – Refers to net cash flows from operating, financing, and investing activities, and excludes proceeds from new financings, lump sum debt maturities made where the Corporation has refinanced or replaced the amount, and proceeds from sale and leaseback transactions. Net cash burn also excludes movements between cash and short and long-term investments. Net cash burn is a non-GAAP financial measure. Refer to sections 9.5 "Cash Flow Movements" and 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

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

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

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

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

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

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

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

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

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

Yield – Refers to average passenger revenue per RPM.