



Third Quarter 2018
INTERIM UNAUDITED
Condensed Consolidated
Financial Statements and Notes
October 31, 2018



A STAR ALLIANCE MEMBER 

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Unaudited (Canadian dollars in millions)	September 30, 2018	December 31, 2017 Restated - note 2	January 1, 2017 Restated - note 2
ASSETS			
Current			
Cash and cash equivalents	\$ 852	\$ 642	\$ 787
Short-term investments	4,070	3,162	2,192
Total cash, cash equivalents and short-term investments	4,922	3,804	2,979
Restricted cash	116	148	126
Accounts receivable	960	814	707
Aircraft fuel inventory	117	91	79
Spare parts and supplies inventory	109	115	107
Prepaid expenses and other current assets Note 3	370	425	447
Total current assets	6,594	5,397	4,445
Deposits and other assets	416	465	468
Property and equipment	9,810	9,252	8,520
Pension assets Note 5	2,243	1,583	1,153
Deferred income tax	32	456	-
Intangible assets	371	318	315
Goodwill	311	311	311
Total assets	\$ 19,777	\$ 17,782	\$ 15,212
LIABILITIES			
Current			
Accounts payable and accrued liabilities Note 3	\$ 2,030	\$ 1,961	\$ 1,644
Advance ticket sales Note 3	2,759	2,469	2,119
Current portion of long-term debt and finance leases Note 4	432	671	707
Total current liabilities	5,221	5,101	4,470
Long-term debt and finance leases Note 4	6,246	5,448	5,911
Pension and other benefit liabilities Note 5	2,447	2,592	2,436
Maintenance provisions	1,058	1,003	922
Other long-term liabilities	145	167	153
Deferred income tax	110	49	49
Total liabilities	\$ 15,227	\$ 14,360	\$ 13,941
SHAREHOLDERS' EQUITY			
Share capital	803	799	797
Contributed surplus	73	69	83
Hedging reserve	4	-	3
Retained earnings	3,670	2,554	388
Total shareholders' equity	4,550	3,422	1,271
Total liabilities and shareholders' equity	\$ 19,777	\$ 17,782	\$ 15,212

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

CONSOLIDATED STATEMENT OF OPERATIONS

Unaudited (Canadian dollars in millions except per share figures)	Three months ended September 30		Nine months ended September 30	
	2018	2017 Restated - note 2	2018	2017 Restated - note 2
Operating revenues				
Passenger Note 12	\$ 5,018	\$ 4,514	\$ 12,428	\$ 11,184
Cargo Note 12	218	194	586	510
Other	179	172	805	738
Total revenues	5,415	4,880	13,819	12,432
Operating expenses				
Aircraft fuel	1,222	832	3,011	2,192
Regional airlines expense	717	662	2,134	1,942
Wages, salaries and benefits Note 5	743	690	2,154	1,997
Airport and navigation fees	281	264	739	704
Aircraft maintenance	277	241	753	695
Depreciation, amortization and impairment	268	241	813	711
Sales and distribution costs	237	232	625	601
Ground package costs	86	73	476	432
Aircraft rent	137	125	385	377
Catering and onboard services	125	112	329	294
Communications and information technology	79	63	225	192
Special items Note 11	-	-	-	30
Other	403	369	1,123	1,027
Total operating expenses	4,575	3,904	12,767	11,194
Operating income	840	976	1,052	1,238
Non-operating income (expense)				
Foreign exchange gain (loss)	89	44	(48)	182
Interest income	32	16	76	42
Interest expense	(80)	(73)	(247)	(232)
Interest capitalized	7	9	27	27
Net financing expense relating to employee benefits Note 5	(13)	(15)	(38)	(47)
Gain on financial instruments recorded at fair value Note 10	10	17	2	24
Gain on sale and leaseback of assets Note 13	-	-	-	52
Gain (loss) on debt settlements and modifications Note 4	(1)	(3)	9	(3)
Loss on disposal of assets Note 13	(2)	-	(188)	-
Other	(6)	(6)	(24)	(17)
Total non-operating income (expense)	36	(11)	(431)	28
Income before income taxes	876	965	621	1,266
Income tax (expense) recovery Note 6	(231)	758	(223)	755
Net income for the period	\$ 645	\$ 1,723	\$ 398	\$ 2,021
Net income per share Note 8				
Basic earnings per share	\$ 2.37	\$ 6.33	\$ 1.46	\$ 7.43
Diluted earnings per share	\$ 2.34	\$ 6.22	\$ 1.44	\$ 7.29

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

Unaudited (Canadian dollars in millions)	Three months ended September 30		Nine months ended September 30	
	2018	2017 Restated - note 2	2018	2017 Restated - note 2
Comprehensive income (loss)				
Net income for the period	\$ 645	\$ 1,723	\$ 398	\$ 2,021
Other comprehensive income (loss), net of tax expense:				
Items that will not be reclassified to net income				
Remeasurements on employee benefit liabilities	(13)	78	738	(148)
Notes 5 & 6				
Items that will be reclassified to net income				
Fuel derivatives designated as cash flow hedges, net	6	1	4	(3)
Note 10				
Total comprehensive income (loss)	\$ 638	\$ 1,802	\$ 1,140	\$ 1,870

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Unaudited (Canadian dollars in millions)	Share capital	Contributed surplus	Hedging reserve	Retained earnings⁽¹⁾	Total shareholders' equity⁽¹⁾
January 1, 2017	\$ 797	\$ 83	\$ 3	\$ 388	\$ 1,271
Net income	-	-	-	2,021	2,021
Remeasurements on employee benefit liabilities	-	-	-	(148)	(148)
Fuel derivatives designated as cash flow hedges, net	-	-	(3)	-	(3)
Total comprehensive income (loss)	-	-	(3)	1,873	1,870
Share-based compensation (note 6)	-	(2)	-	10	8
Shares issued	12	(4)	-	-	8
Shares purchased and cancelled under issuer bid	(8)	-	-	(28)	(36)
Reclassification of equity settled award to cash settled award	-	(9)	-	(2)	(11)
September 30, 2017	\$ 801	\$ 68	\$ -	\$ 2,241	\$ 3,110
January 1, 2018	\$ 799	\$ 69	\$ -	\$ 2,554	\$ 3,422
Net income	-	-	-	398	398
Remeasurements on employee benefit liabilities	-	-	-	738	738
Fuel derivatives designated as cash flow hedges, net	-	-	4	-	4
Total comprehensive income	-	-	4	1,136	1,140
Share-based compensation	-	6	-	-	6
Shares issued	7	(2)	-	-	5
Shares purchased and cancelled under issuer bid	(3)	-	-	(20)	(23)
September 30, 2018	\$ 803	\$ 73	\$ 4	\$ 3,670	\$ 4,550

(1) Amounts for prior periods as restated – Refer to note 2

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

CONSOLIDATED STATEMENT OF CASH FLOW

Unaudited (Canadian dollars in millions)	Three months ended September 30		Nine months ended September 30	
	2018	2017 Restated - note 2	2018	2017 Restated - note 2
Cash flows from (used for)				
Operating				
Net income for the period	\$ 645	\$ 1,723	\$ 398	\$ 2,021
Adjustments to reconcile to net cash from operations				
Deferred income tax	Note 6	222	(771)	214
Depreciation, amortization and impairment		278	248	840
Foreign exchange (gain) loss		(78)	(123)	26
Gain on sale and leaseback of assets	Note 13	-	-	(52)
Loss (gain) on debt settlements and modifications		1	3	(9)
Loss on disposal of assets	Note 13	2	-	188
Employee benefit funding less than expense	Note 5	67	62	204
Financial instruments recorded at fair value	Note 10	(5)	(14)	(5)
Change in maintenance provisions		39	34	59
Changes in non-cash working capital balances		(823)	(696)	388
Other		23	27	32
Net cash flows from operating activities		371	493	2,335
Financing				
Proceeds from borrowings		-	-	1,210
Reduction of long-term debt and finance lease obligations		(225)	(203)	(809)
Shares purchased for cancellation	Note 7	-	-	(23)
Issue of shares		3	4	5
Financing fees		-	(3)	(8)
Net cash flows from (used in) financing activities		(222)	(202)	375
Investing				
Short-term investments		(259)	(256)	(884)
Additions to property, equipment and intangible assets		(194)	(169)	(1,978)
Proceeds from sale of assets		4	1	10
Proceeds from sale and leaseback of assets	Note 13	293	-	293
Other		3	9	48
Net cash flows used in investing activities		(153)	(415)	(2,511)
Effect of exchange rate changes on cash and cash equivalents		-	(29)	11
Increase (decrease) in cash and cash equivalents		(4)	(153)	210
Cash and cash equivalents, beginning of period		856	1,299	642
Cash and cash equivalents, end of period		\$ 852	\$ 1,146	\$ 852
Cash payments of interest	Note 4	\$ 64	\$ 49	\$ 201
Cash payments of income taxes		\$ 5	\$ -	\$ 32

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



Notes to the interim condensed consolidated financial statements (unaudited)
(Canadian dollars in millions – except per share amounts)

1. GENERAL INFORMATION

The accompanying unaudited interim condensed consolidated financial statements (the “financial statements”) are of Air Canada (the “Corporation”). The term “Corporation” also refers to, as the context may require, Air Canada and/or one or more of its subsidiaries, including its principal wholly-owned operating subsidiaries, 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”). These financial statements also include, for the relevant periods, certain aircraft leasing entities, which are consolidated under IFRS 10 Consolidated Financial Statements. During 2017, all related aircraft were purchased by the Corporation and the structured entities were collapsed.

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

The Corporation historically experiences greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the spring and summer months. The Corporation has substantial fixed costs in its cost structure that do not meaningfully fluctuate with passenger demand in the short term.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation prepares its financial statements in accordance with generally accepted accounting principles in Canada ("GAAP") as set out in the CPA Canada Handbook – Accounting ("CPA Handbook") which incorporates International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). These financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 "Interim Financial Reporting". In accordance with GAAP, these financial statements do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the Corporation's annual consolidated financial statements for the year ended December 31, 2017. In management's opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim period presented.

These financial statements were approved for issue by the Board of Directors of the Corporation on October 30, 2018.

These financial statements are based on the accounting policies consistent with those disclosed in Note 2 to the 2017 annual consolidated financial statements, except as described below under IFRS 15.

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 replaces IAS 18 Revenue and related interpretations. The core principle of the new standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard is intended to enhance disclosures about revenue, provide more comprehensive guidance for transactions that were not previously addressed and improve guidance for multiple-element arrangements.

The Corporation adopted the standard effective January 1, 2018 using the full retrospective method, which requires each prior reporting period presented to be restated. The main changes are explained below.

Accounting for costs to obtain a contract

Under IFRS 15, incremental costs of obtaining passenger revenues, such as credit card fees and global distribution system charges, are capitalized at time of sale and expensed at the time of passenger revenue recognition. Prior to adoption of IFRS 15, these costs were expensed as incurred at the time the flight ticket was sold. With this change in accounting policy for contract costs, the timing of expense recognition is impacted.

The impact on the consolidated statement of financial position as at January 1, 2017 is an increase to Prepaid expenses and other current assets of \$58 and an equivalent increase to opening Retained earnings (\$65 as at December 31, 2017). In addition, deferred commission costs in the amount of \$40 as at December 31, 2016, previously recorded net against the Advance ticket sales liability, were reclassified to Prepaid expenses and other current assets (\$35 as at December 31, 2017).

Accounting for change fees

Revenue arising from change fees which are collected by travel agents on Air Canada's behalf will be deferred and recognized in passenger revenue at the time of the related flight, rather than at time of collection. The impact on the consolidated statement of financial position as at January 1, 2017 is an increase to Advance ticket sales of \$6 and an equivalent decrease to opening Retained earnings (\$6 as at December 31, 2017).

Presentation

Certain passenger and cargo related fees and surcharges were reclassified from Other to Passenger revenue and to Cargo revenue on the consolidated statement of operations to better reflect the nature and aggregation of similar revenue items. This reclassification has no impact on total operating revenues.

Impact to previously reported results

Selected adjusted financial statement information, which reflect the adoption of IFRS 15, is presented below. Line items that were not affected by the change in accounting policy have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided. In summary, the following adjustments were made to the amounts recognized in the consolidated statement of financial position for the date of initial application on January 1, 2017 and at the end of the comparative period, December 31, 2017.

(Canadian dollars in millions)	December 31, 2016 as previously reported	Reclassification	Remeasurements	January 1, 2017 as restated
Prepaid expenses and other current assets	\$ 349	\$ 40	\$ 58	\$ 447
Deferred income tax	-	-	-	-
Total assets	\$ 15,114	\$ 40	\$ 58	\$ 15,212
Advance ticket sales	2,073	40	6	2,119
Total current liabilities	\$ 4,424	\$ 40	\$ 6	\$ 4,470
Retained earnings	336	-	52	388
Total shareholders' equity	\$ 1,219	\$ -	\$ 52	\$ 1,271
Total liabilities and shareholders' equity	\$ 15,114	\$ 40	\$ 58	\$ 15,212

(Canadian dollars in millions)	December 31, 2017 as previously reported	Reclassification	Remeasurements	December 31, 2017 as restated
Prepaid expenses and other current assets	\$ 325	\$ 35	\$ 65	\$ 425
Deferred income tax	472	-	(16)	456
Total assets	\$ 17,698	\$ 35	\$ 49	\$ 17,782
Advance ticket sales	2,428	35	6	2,469
Total current liabilities	\$ 5,060	\$ 35	\$ 6	\$ 5,101
Retained earnings	2,511	-	43	2,554
Total shareholders' equity	\$ 3,379	\$ -	\$ 43	\$ 3,422
Total liabilities and shareholders' equity	\$ 17,698	\$ 35	\$ 49	\$ 17,782

No deferred income tax was recorded on the restatement as of January 1, 2017 due to deferred income tax assets not being recognized at that time. Starting in the third quarter of 2017, the adjustments include their corresponding income tax effect resulting in a \$16 decrease of the tax recovery recorded in the consolidated statement of operations.

Adoption of the standard impacted the Corporation's previously reported consolidated statement of operations as follows.

	Three months ended September 30, 2017 as previously reported	Reclassification	Remeasurements	Three months ended September 30, 2017 as restated
(Canadian dollars in millions)				
Operating revenues				
Passenger	\$ 4,478	\$ 36	\$ -	\$ 4,514
Cargo	179	15	-	194
Other	223	(51)	-	172
Total revenues	4,880	-	-	4,880
Operating expenses				
Sales and distribution costs	204	-	28	232
Total operating expenses	3,876	-	28	3,904
Operating income	1,004	-	(28)	976
Income tax (expense) recovery	774	-	(16)	758
Net income for the period	\$ 1,767	\$ -	\$ (44)	\$ 1,723
Basic earnings per share	\$ 6.49	\$ -	\$ (0.16)	\$ 6.33
Diluted earnings per share	\$ 6.37	\$ -	\$ (0.15)	\$ 6.22

	Nine months ended September 30, 2017 as previously reported	Reclassification	Remeasurements	Nine months ended September 30, 2017 as restated
(Canadian dollars in millions)				
Operating revenues				
Passenger	\$ 11,090	\$ 94	\$ -	\$ 11,184
Cargo	467	43	-	510
Other	875	(137)	-	738
Total revenues	12,432	-	-	12,432
Operating expenses				
Sales and distribution costs	608	-	(7)	601
Total operating expenses	11,201	-	(7)	11,194
Operating income	1,231	-	7	1,238
Income tax (expense) recovery	771	-	(16)	755
Net income for the period	\$ 2,030	\$ -	\$ (9)	\$ 2,021
Basic earnings per share	\$ 7.46	\$ -	\$ (0.03)	\$ 7.43
Diluted earnings per share	\$ 7.32	\$ -	\$ (0.03)	\$ 7.29

(Canadian dollars in millions)	Twelve months ended December 31, 2017 as previously reported	Reclassification	Remeasurements	Twelve months ended December 31, 2017 as restated
Operating revenues				
Passenger	\$ 14,471	\$ 122	\$ -	\$ 14,593
Cargo	650	58	-	708
Other	1,131	(180)	-	951
Total revenues	16,252	-	-	16,252
Operating expenses				
Sales and distribution costs	777	-	(7)	770
Total operating expenses	14,888	-	(7)	14,881
Operating income	1,364	-	7	1,371
Income tax (expense) recovery	759	-	(16)	743
Net income	\$ 2,038	\$ -	\$ (9)	\$ 2,029
Basic earnings per share	\$ 7.48	\$ -	\$ (0.04)	\$ 7.44
Diluted earnings per share	\$ 7.34	\$ -	\$ (0.03)	\$ 7.31

Adoption of IFRS 15 does not have any net impact on the consolidated statement of cash flows.

IFRS 16 – Leases

IFRS 16 replaces IAS 17 Leases and related interpretations. The core principle is that a lessee recognizes assets and liabilities for all leases with a lease term of more than 12 months. A lessee is required to recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. Assets and liabilities arising from a lease are initially measured on a present value basis. The measurement of the lease liability includes non-cancellable lease payments (including inflation-linked payments), and also includes payments to be made in optional periods if the lessee is reasonably certain to exercise an option to extend the lease, or not to exercise an option to terminate the lease. Purchase options which are reasonably certain of being exercised are also included in the measurement of the lease liability. Lease payments will not include variable lease payments other than those that depend on an index or rate. The right-of-use asset will be derived from the calculation of the lease liability and will also include any provisions the lessee will owe for return conditions on leased assets.

The new standard is intended to provide an improved representation of leasing transactions, in particular those that do not currently require the lessee to recognize an asset and liability arising from an operating lease. IFRS 16 is effective for annual periods beginning on January 1, 2019. Entities have the option of adopting a full retrospective approach or a modified retrospective approach on transition to IFRS 16.

The Corporation will apply the standard effective January 1, 2019 and plans to transition with a full retrospective approach with restatement to each prior reporting period presented. The Corporation expects to elect the package of practical expedients to not reassess prior conclusions related to contracts containing leases and apply the recognition exemption for short term leases. Other practical expedients available under the guidance are still being evaluated.

The Corporation continues to assess the impacts the adoption of this standard will have on its consolidated financial statements but expects this standard will have a significant impact on its consolidated balance sheet, along with a change to the recognition, measurement and presentation of lease expenses in the consolidated statement of operations. Based on a review of current contracts and the requirements of the standard, Air Canada has largely concluded the accounting policy determination and scoping exercise for IFRS 16, with additional information provided below. Measurement of the related right-of-use assets and lease liabilities is in progress.

Aircraft Leases

As of December 31, 2017, the Corporation had 111 aircraft under operating leases, and Air Canada expects to record such aircraft as right-of-use assets and lease liabilities of Air Canada in accordance with the requirements of the new standard. Additionally, the Corporation has identified that, under IFRS 16, Air Canada has leases as lessee in respect of aircraft used by regional carriers providing services under the respective capacity purchase agreements ("CPA"), and also expects to record such aircraft as right-of-use assets and lease liabilities of Air Canada. As at December 31, 2017, there were 151 aircraft operating under these arrangements on behalf of Air Canada.

Property Leases

The Corporation has leases related to airport terminal operations space and other real estate leases. For leases related to terminal operations space, there are generally effective substitution rights in the hands of the lessor and therefore these are not considered lease contracts under the standard. Leases with reciprocal termination rights with a notice period of less than 12 months would be considered short-term leases and therefore would be excluded from balance sheet recognition under the practical expedient. Finally, those airport terminal contracts with variable lease payments will also be excluded since variable lease payments, other than those based on an index or rate, are excluded from the measurement of the lease liability. This results in a portfolio of property leases that are expected to be recorded as right-of-use assets and lease liabilities under the standard which relate to dedicated space in Air Canada's hub locations of Toronto, Montreal and Vancouver, lease contracts on building space dedicated to Air Canada for offices, airport and maintenance operations, Maple Leaf Lounges and land leases.

Accounting for Right-of-Use Assets

Right-of-use assets will be accounted for under IAS 16 Property, Plant and Equipment. Aircraft recorded as right-of-use assets will have the same accounting policies as directly owned aircraft, meaning the right-of-use assets will be componentized and depreciated over the lease term. Consistent with owned aircraft, any qualifying maintenance events will be capitalized and depreciated over the lesser of the lease term and expected maintenance life. Maintenance provisions will be recorded, as applicable, on aircraft leases as a maintenance expense over the term of the lease. Any changes to the provision for end-of-lease conditions will be recognized as an adjustment to the right-of-use asset and subsequently amortized to the income statement over the remaining term of the lease.

Income Statement Impacts

The impacts on the income statement will be an elimination of aircraft rent and building rent, which is recorded in other operating expenses, for those contracts which are recognized as leases, and instead will be replaced by an amortization of the right-of-use asset and interest costs on the lease liability. Maintenance expense is expected to decrease under the standard as qualifying maintenance events for the former operating leases will be capitalized and amortized over their expected maintenance life. This will be partially offset by higher maintenance provision expense recorded on all aircraft right-of-use assets which contain end of lease maintenance return conditions. Since all the aircraft lease contracts are denominated in US dollars, there will be additional volatility in the foreign exchange recognized in the income statement due to the revaluation of the lease liabilities and maintenance provisions to the rate of exchange in effect at the date of the balance sheet.

3. REVENUE

Passenger and cargo revenues are recognized when the transportation is provided, except for revenue on unlimited flight passes which is recognized on a straight-line basis over the period during which the travel pass is valid. The Corporation has formed alliances with other airlines encompassing loyalty program participation, interline agreements and code sharing and coordination of services including reservations, baggage handling and flight schedules. Revenues are allocated based upon formulas specified in the agreements and are recognized as transportation is provided. Passenger revenue also includes certain fees and surcharges and revenues from passenger-related services such as seat selection and excess baggage which are recognized when the transportation is provided.

Air Canada has capacity purchase agreements with Jazz, Sky Regional and certain other regional carriers. Under these agreements, Air Canada markets, tickets and enters into other commercial arrangements relating to these flights and records the revenue it earns under Passenger revenue when transportation is provided.

Air Canada purchases Aeroplan Miles[®] from Aimia Canada Inc. ("Aeroplan"), an unrelated party that provides loyalty program services to Air Canada and purchases seats from Air Canada pursuant to the Commercial Participation and Services Agreement between Aeroplan and Air Canada. Air Canada is an Aeroplan partner providing certain of Air Canada's customers with Aeroplan Miles[®], which they can redeem as Aeroplan customers for air travel or other rewards offered by Aeroplan pursuant to its program. The cost of purchasing Aeroplan Miles[®] from Aeroplan is accounted for as a sales incentive and charged against passenger revenues when the points are issued, which occurs upon the qualifying air travel being provided to the customer. Aeroplan purchases passenger tickets from Air Canada, which are accounted for as passenger revenues by Air Canada when transportation is provided.

Other revenue is primarily comprised of revenues from the sale of the ground portion of vacation packages, ground handling services, on-board sales, lounge pass sales and loyalty program marketing fees. Vacation package revenue is recognized as services are provided over the period of the vacation. Other airline related service revenues are recognized as the products are sold to passengers or the services are provided.

Disaggregation of revenue

The Corporation disaggregates revenue from contracts with customers according to the nature of the air transportation services. The nature of services is presented as passenger, cargo and other revenue on its consolidated statement of operations. The Corporation further disaggregates air transportation service revenue according to geographic market segments, as presented in Note 12 Geographic information.

Contract balances

The following table provides information about receivables, contract assets, and contract liabilities from contracts with customers.

	September 30, 2018	December 31, 2017 Restated – note 2	January 1, 2017 Restated – note 2
Receivables, which are included in Accounts receivable	\$ 764	\$ 587	\$ 540
Contract costs which are included in Prepaid expenses and other current assets	115	100	98
Contract liabilities – Advance ticket sales	2,759	2,469	2,119

Receivables include passenger, cargo and other receivables from contracts with customers. The Corporation sells passenger ticket and related ancillary services via cash, credit card or other card-based forms of payment with payment generally collected in advance of the performance of related transportation services. Passenger ticket and ancillary receivables are amounts due from other airlines for interline travel, travel agency payment processing intermediaries or credit card processors associated with sales for future travel, and are included in Accounts receivable on the consolidated statement of



financial position. Cargo and other accounts receivable relate to amounts owing from customers, including from freight forwarders and interline partners for cargo and other services provided.

Contract costs include credit card fees, commissions and global distribution system charges on passenger tickets. These costs are capitalized at time of sale and expensed at the time of passenger revenue recognition.

Airline passenger advance sales and the ground portion of vacation packages are deferred and included in Current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aeroplan. The deferred revenue is recognized when the related flight occurs or over the period of the vacation. The Corporation performs regular evaluations on the advance ticket sales liability. The Corporation records an estimate of breakage revenue for tickets that will expire unused. These estimates are based on historical experience.

Depending on the fare class, passengers may exchange their tickets up to the time of the flight or obtain a refund, generally in exchange for the payment of a fee. For non-refundable tickets, the Corporation recognizes the full amount into revenue at time when transportation is provided. For refundable tickets that remain unused at the time of the flight, the Corporation recognizes the net revenue after any refund amount is issued to the passenger.

The practical expedient in IFRS 15 allows entities not to disclose the amount of the remaining transaction prices and its expected timing of recognition for performance obligations if the contract has an original expected duration of one year or less. The Corporation elects to use this practical expedient for the passenger travel performance obligation as passenger tickets expire within a year if unused.

4. LONG-TERM DEBT AND FINANCE LEASES

	Final Maturity	Weighted Average Interest Rate (%)	September 30, 2018	December 31, 2017
Aircraft financing				
Fixed rate U.S. dollar financing	2020 – 2030	3.84	\$ 3,447	\$ 2,828
Floating rate U.S. dollar financing	2020 – 2027	4.16	656	871
Fixed rate CDN dollar financing	2026 – 2030	3.76	301	-
Floating rate CDN dollar financing	2026 – 2027	2.62	307	332
Fixed rate Japanese yen financing	2027	1.84	133	131
Floating rate Japanese yen financing	2020 – 2027	0.82	44	61
Senior secured notes – CDN dollar	2023	4.75	200	200
Senior unsecured notes – U.S. dollar	2021	7.75	516	503
Other secured financing – U.S. dollar	2023	4.24	991	1,073
Long-term debt		4.15	6,595	5,999
Finance lease obligations	2020 – 2033	9.30	191	223
Total debt and finance leases		4.29	6,786	6,222
Unamortized debt issuance costs			(108)	(103)
Current portion			(432)	(671)
Long-term debt and finance leases			\$ 6,246	\$ 5,448

The above table provides terms of instruments disclosed in Note 7 to the 2017 annual consolidated financial statements of the Corporation as well as terms of instruments concluded during the nine months ended September 30, 2018 and described below.

In connection with the acquisition of four Boeing 787-9 and nine Boeing 737 MAX-8 aircraft in the nine months ended September 30, 2018, a principal amount of US\$719 is included in fixed rate U.S. dollar financing in the table above. The acquisition of these aircraft was financed with proceeds from the sale of the enhanced equipment trust certificates that were issued through a private offering in 2017 as described in Note 7 to the 2017 annual consolidated financial statements of the Corporation.

In March 2018, in connection with the financing of the acquisition of one new Boeing 787-9 aircraft and four new Boeing 737 MAX-8 aircraft, Air Canada entered into a certificate purchase agreement for a private offering of two tranches of enhanced equipment trust certificates with a combined aggregate face amount of \$301 and a weighted average interest rate of 3.76% per annum, and a final expected maturity date of 2030. Proceeds from the offering were disbursed in the second quarter of 2018 following delivery of the aircraft. These proceeds are included in fixed rate CDN dollar financing in the table above.

In February 2018, Air Canada completed the repricing of its US\$1.1 billion senior secured facility, reducing the interest rate by 25 basis points, to an interest rate of 200 basis points over LIBOR (subject to a LIBOR floor of 75 basis points). The Corporation recorded an \$11 Gain on debt settlements and modifications related to this transaction.

In connection with the sales transaction described in Note 13, long-term debt of \$144 (US\$109) related to the Embraer 190 aircraft was repaid in the third quarter of 2018 (principal of US\$167 for the nine months ended September 30, 2018). The loss recorded in Gain (loss) on debt settlements and modifications in respect of the prepayment of such debt was \$1 for the third quarter of 2018 (loss of \$2 for the nine month period ended September 30, 2018).

During the nine months ended September 30, 2018, principal of US\$35 was prepaid relating to the financing of three Boeing 777 aircraft. The loss recorded in Gain (loss) on debt settlements and modifications in respect of the prepayment of such debt was less than \$1 for the nine month period ended September 30, 2018.

Maturity Analysis

Principal and interest repayment requirements as at September 30, 2018 on Long-term debt and finance lease obligations are as follows. U.S. dollar amounts are converted using the September 30, 2018 closing rate of CDN\$1.2908.

Principal	Remainder of 2018	2019	2020	2021	2022	Thereafter	Total
Long-term debt obligations	\$ 92	\$ 383	\$ 608	\$ 952	\$ 327	\$ 4,233	\$ 6,595
Finance lease obligations	11	45	48	17	14	56	191
	\$ 103	\$ 428	\$ 656	\$ 969	\$ 341	\$ 4,289	\$ 6,786

Interest	Remainder of 2018	2019	2020	2021	2022	Thereafter	Total
Long-term debt obligations	\$ 76	\$ 273	\$ 253	\$ 211	\$ 176	\$ 471	\$ 1,460
Finance lease obligations	3	14	9	6	5	14	51
	\$ 79	\$ 287	\$ 262	\$ 217	\$ 181	\$ 485	\$ 1,511

5. PENSIONS AND OTHER BENEFIT LIABILITIES

Pension and Other Employee Future Benefit Expense

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2018	2017	2018	2017
Consolidated Statement of Operations				
Operating expenses				
Wages, salaries and benefits				
Pension benefits	\$ 81	\$ 75	\$ 239	\$ 211
Other employee benefits	10	6	21	18
	\$ 91	\$ 81	\$ 260	\$ 229
Non-operating income (expense)				
Net financing expense relating to employee benefit liabilities				
Pension benefits	\$ (1)	\$ (2)	\$ (2)	\$ (9)
Other employee benefits	(12)	(13)	(36)	(38)
	\$ (13)	\$ (15)	\$ (38)	\$ (47)
Consolidated Other Comprehensive Income (Loss)				
Remeasurements on employee benefit liabilities				
Pension benefits	\$ (55)	\$ 226	\$ 920	\$ 83
Other employee benefits	38	48	89	(35)
	\$ (17)	\$ 274	\$ 1,009	\$ 48

The funding of employee benefits as compared to the expense recorded in the consolidated statement of operations is summarized in the table below.

	Three Months Ended September 30		Nine Months Ended September 30	
	2018	2017	2018	2017
Net defined pension and other future employee benefits expense recorded in the consolidated statement of operations				
Wages, salaries and benefits	\$ 91	\$ 81	\$ 260	\$ 229
Net financing expense relating to employee benefit liabilities	13	15	38	47
	\$ 104	\$ 96	\$ 298	\$ 276
Employee benefit funding by Air Canada				
Pension benefits	\$ 22	\$ 21	\$ 59	\$ 60
Other employee benefits	15	13	35	35
	\$ 37	\$ 34	\$ 94	\$ 95
Employee benefit funding less than expense	\$ 67	\$ 62	\$ 204	\$ 181

6. INCOME TAXES

Income Tax Expense

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

	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
Current income tax	\$ (9)	\$ (13)	\$ (9)	\$ (16)
Deferred income tax	(222)	771	(214)	771
Income tax (expense) recovery	\$ (231)	\$ 758	\$ (223)	\$ 755

During the third quarter of 2017, the Corporation determined that it was probable that substantially all of the deferred income tax assets would be realized. Accordingly, Air Canada recorded a tax recovery of \$790, which was revised to \$771 with \$19 related to share-based compensation reclassified to Retained earnings in the fourth quarter of 2017.

Income tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full year. The Corporation's effective tax rate for the three months ended September 30, 2018 was 26.4% (35.9% for the nine month period ended September 30, 2018). The income tax expense differs from the amounts computed by applying the statutory tax rate, principally due to the impact of unrecognized tax benefits on foreign exchange capital losses and the effect of non-deductible expenses.

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

	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
Remeasurements on employee benefit liabilities - deferred income tax	\$ 4	\$ (196)	\$ (271)	\$ (196)
Fuel derivatives designated as cash flow hedges - deferred income tax	(2)	-	(1)	-
Income tax (expense) recovery	\$ 2	\$ (196)	\$ (272)	\$ (196)

7. SHARE CAPITAL

Issuer Bid

In May 2018, Air Canada received approval from the Toronto Stock Exchange for the renewal of its normal course issuer bid for its Class A variable voting shares and Class B voting shares (collectively the "shares"), authorizing, between May 31, 2018 and May 30, 2019, the purchase of up to 24,040,243 shares, representing 10% of Air Canada's public float as at May 17, 2018. The renewal followed the conclusion of the 2017 normal course issuer bid which expired on May 30, 2018.

In the nine months ended September 30, 2018, the Corporation purchased, for cancellation 914,218 shares at an average cost of \$24.78 per share for aggregate consideration of \$23. The excess of the cost over the average book value of \$20 was charged to Retained earnings. No shares were purchased during the three months ended September 30, 2018. At September 30, 2018, a total of 24,040,243 shares remained available for repurchase under the existing issuer bid.

In the nine months ended September 30, 2017, the Corporation purchased, for cancellation, 2,597,200 shares at an average cost of \$13.88 per share for aggregate consideration of \$36. The excess of the cost over the average book value of \$28 was charged to Retained earnings. No shares were purchased during the three months ended September 30, 2017.

8. EARNINGS PER SHARE

The following table outlines the calculation of basic and diluted earnings per share.

(in millions, except per share amounts)	Three months ended September 30		Nine months ended September 30	
	2018	2017 Restated - note 2	2018	2017 Restated - note 2
Numerator:				
Numerator for basic and diluted earnings per share:				
Net income	\$ 645	\$ 1,723	\$ 398	\$ 2,021
Denominator:				
Weighted-average shares	273	272	273	272
Effect of potential dilutive securities:				
Stock options	3	5	4	5
Total potential dilutive securities	3	5	4	5
Adjusted denominator for diluted earnings per share	276	277	277	277
Basic earnings per share	\$ 2.37	\$ 6.33	\$ 1.46	\$ 7.43
Diluted earnings per share	\$ 2.34	\$ 6.22	\$ 1.44	\$ 7.29

The calculation of earnings per share is based on whole numbers and not on rounded millions. As a result, the above amounts may not be recalculated to the per share amount disclosed above.

Excluded from the calculation of diluted earnings per share were outstanding options where the options' exercise prices were greater than the average market price of the shares for the period.

9. COMMITMENTS

Capital Commitments

Capital commitments consist of the future firm aircraft deliveries and commitments related to acquisition of other property and equipment. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at September 30, 2018. U.S. dollar amounts are converted using the September 30, 2018 closing rate of CDN\$1.2908. Minimum future commitments under these contractual arrangements are shown below.

	Remainder of 2018	2019	2020	2021	2022	Thereafter	Total
Capital commitments	\$ 176	\$ 1,623	\$ 1,422	\$ 775	\$ 716	\$ 539	\$ 5,251

10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Refer also to Note 15 to the 2017 annual consolidated financial statements for information on the Corporation's risk management strategy.

Summary of gain on financial instruments recorded at fair value

	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
Share forward contracts	\$ 11	\$ 19	\$ 3	\$ 26
Fuel derivatives	(1)	(2)	(1)	(2)
Gain on financial instruments recorded at fair value	\$ 10	\$ 17	\$ 2	\$ 24

Fuel Price Risk Management

During the third quarter of 2018:

- A hedging loss of \$8 was reclassified from other comprehensive income to Aircraft fuel expense (\$10 for the nine months ended September 30, 2018; gain of \$3 and loss of \$5 reclassified from other comprehensive income to Aircraft fuel expense for the three and nine month periods ended September 30, 2017, respectively). No hedging ineffectiveness was recorded.
- The Corporation purchased crude-oil call options covering a portion of its 2018 fuel exposure. The cash premium related to these contracts was \$2 (\$12 for the nine months ended September 30, 2018; nil and \$14 for the three and nine month periods ended September 30, 2017, respectively, for 2017 exposures).
- Fuel derivative contracts cash settled with a fair value of nil (nil for the nine months ended September 30, 2018; \$15 and \$19 in favour of the Corporation for the three and nine month periods ended September 30, 2017, respectively).

As of September 30, 2018, approximately 7% of the Corporation's anticipated purchases of jet fuel for the fourth quarter of 2018 are hedged at an average West Texas Intermediate equivalent capped price of US\$64 per barrel. The Corporation's contracts to hedge anticipated jet fuel purchases are comprised of call options with notional volumes of 600,000 barrels. The fair value of the fuel derivatives portfolio at September 30, 2018 is \$8 in favour of the Corporation and is recorded within Prepaid expenses and other current assets. There were no outstanding fuel derivatives as at December 31, 2017.

Foreign Exchange Risk Management

Based on the notional amount of currency derivatives outstanding at September 30, 2018, as further described below, approximately 75% of net U.S. cash outflows are hedged for the remainder of 2018, 73% for 2019, and 16% for 2020 resulting in derivative coverage of 65% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 73% coverage over the next 18 months.

As at September 30, 2018, the Corporation had outstanding foreign currency options and swap agreements, settling in 2018, 2019, and 2020 to purchase at maturity \$4,873 (US\$3,776) of U.S. dollars at a weighted average rate of \$1.2586 per US\$1.00 (as at December 31, 2017 – \$3,400 (US\$2,704) with settlements in 2018 and 2019 at a weighted average rate of \$1.2703 per \$1.00 U.S. dollar). The Corporation also has protection in place to sell a portion of its excess Euros, Sterling, YEN, and AUD (EUR €180, GBP £180, JPY ¥19,244, and AUD \$61) which settle in 2018, 2019, and 2020 at weighted average rates of €1.2008, £1.3584, ¥0.0091, and AUD \$0.7723 per \$1.00 U.S. dollar respectively (as at December 31, 2017 - EUR €101, GBP £105, JPY ¥8,623, CNY ¥41, and AUD \$32 with settlement in 2018 at weighted average rates of €1.1664, £1.3259, ¥0.0090, ¥0.1468 and AUD \$0.7576 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 September 30, 2018 was \$66 in favour of the counterparties (as at December 31, 2017 – \$215 in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During the third quarter of 2018, a loss of \$5 was recorded in Foreign exchange gain (loss) related to these derivatives (\$169 gain for the nine month period ended September 30, 2018; loss of \$198 and \$272 for the three and nine month periods ended September 30, 2017). In the third quarter of 2018, foreign exchange derivative contracts cash settled with a net fair value of \$33 in favour of the Corporation (\$20 for the nine month period ended September 30, 2018 in favour of the Corporation; \$81 and \$35 for the three and nine month periods ended September 30, 2017 in favour of the counterparties).

The Corporation also holds U.S. cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash and short-term investment balances as at September 30, 2018 amounted to \$959 (US\$743) (\$686 (US\$542) as at December 31, 2017). During the three months ended September 30, 2018, a loss of \$13 (\$15 gain for the nine month period ended September 30, 2018; loss of \$49 and \$72 for the three and nine month periods ended September 30, 2017) 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.

Financial Instrument Fair Values in the Consolidated Statement of Financial Position

The carrying amounts reported in the consolidated statement of financial position for short term financial assets and liabilities, which includes Accounts receivable and Accounts payable and accrued liabilities, approximate fair values due to the immediate or short-term maturities of these financial instruments.

The carrying amounts of derivatives are equal to their fair value, which is based on the amount at which they could be settled based on estimated market rates at September 30, 2018.

Management estimated the fair value of its long-term debt based on valuation techniques including discounted cash flows, taking into account market information and traded values where available, market rates of interest, the condition of any related collateral, the current conditions in credit markets and the current estimated credit margins applicable to the Corporation based on recent transactions. Based on significant unobservable inputs (Level 3 in the fair value hierarchy), the estimated fair value of long term debt approximates its carrying value.

The following is a classification of fair value measurements recognized in the consolidated statement of financial position using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. There are no changes in classifications or methods of measuring fair value from those disclosed in Note 15 to the 2017 annual consolidated financial statements. There were no transfers within the fair value hierarchy during the nine months ended September 30, 2018.

	September 30, 2018	Fair value measurements at reporting date using:		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Assets				
Held-for-trading securities				
Cash equivalents	\$ 249	\$ -	\$ 249	\$ -
Short-term investments	4,070	-	4,070	-
Derivative instruments				
Fuel derivatives	8	-	8	-
Share forward contracts	46	-	46	-
Foreign exchange derivatives	5	-	5	-
Total	\$ 4,378	\$ -	\$ 4,378	\$ -
Financial Liabilities				
Derivative instruments				
Foreign exchange derivatives	71	-	71	-
Total	\$ 71	\$ -	\$ 71	\$ -

Financial assets held by financial institutions in the form of cash and restricted cash have been excluded from the fair value measurement classification table above as they are not valued using a valuation technique.

11. CONTINGENCIES AND LITIGATION PROVISIONS

Investigations by Competition Authorities Relating to Cargo

As described in Note 16 to the 2017 annual consolidated financial statements, in 2010, the European Commission rendered a decision finding that 12 air cargo carriers (including groups of related carriers) had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006. Air Canada was among the carriers subject to the decision and a fine of 21 Euros (approximately \$29 at that time) was imposed on Air Canada in 2010. Air Canada appealed the decision and the European General Court granted Air Canada's appeal in 2015 and annulled the decision of the European Commission with regard to Air Canada and certain other airlines, following which the European Commission refunded Air Canada the fine of 21 Euros (\$30).

In March 2017, the Commission issued a new decision, based on the same allegations and imposed the same fine (21 Euros; approximately \$30) on Air Canada as it had in 2010. Air Canada recorded the charge as a Special item in the first quarter of 2017, and paid the fine, as required, in the second quarter of 2017, pending the outcome of an appeal it made in 2017 to the European General Court. While Air Canada cannot predict with certainty the outcome of its appeal or any related proceedings, Air Canada believes it has reasonable grounds to challenge the European Commission's ruling.

12. GEOGRAPHIC INFORMATION

A reconciliation of the total amounts reported by geographic region for Passenger revenues and Cargo revenues on the consolidated statement of operations is as follows:

	Three months ended September 30		Nine months ended September 30	
	2018	2017 Restated - note 2	2018	2017 Restated - note 2
Passenger Revenues				
Canada	\$ 1,427	\$ 1,368	\$ 3,678	\$ 3,486
U.S. Transborder	946	862	2,658	2,449
Atlantic	1,617	1,344	3,338	2,776
Pacific	787	717	1,880	1,694
Other	241	223	874	779
	\$ 5,018	\$ 4,514	\$ 12,428	\$ 11,184

	Three months ended September 30		Nine months ended September 30	
	2018	2017 Restated - note 2	2018	2017 Restated - note 2
Cargo Revenues				
Canada	\$ 25	\$ 23	\$ 68	\$ 61
U.S. Transborder	12	11	31	29
Atlantic	74	68	206	179
Pacific	91	78	237	199
Other	16	14	44	42
	\$ 218	\$ 194	\$ 586	\$ 510

Passenger and cargo revenues are based on the actual flown revenue for flights with an origin and destination in a specific country or region. Atlantic refers to flights that cross the Atlantic Ocean with origins and destinations principally in Europe, India, the Middle East and North Africa. Pacific refers to flights that cross the Pacific Ocean with origins and destinations principally in Asia and Australia. Other passenger and cargo revenues refer to flights with origins and destinations principally in Central and South America and the Caribbean and Mexico.

13. SALE-LEASEBACK

In July 2018, the Corporation entered into final negotiations for the sale of 25 Embraer 190 aircraft. As such, these aircraft were presented as Assets held for sale and measured at fair value less costs to sell as at June 30, 2018. In connection with this measurement, a loss on disposal of \$186 was recorded in the second quarter of 2018. In August 2018, the Corporation finalized the sale of the aircraft with net proceeds of \$293. At the time of the sale, the loss on disposal was adjusted by \$2 for a total loss of \$188 related to the disposal of the aircraft. There are no Assets held for sale that remain as at September 30, 2018. The aircraft will continue to be operated under sale-leaseback agreements until they fully exit the fleet progressively through 2018 to 2020, in line with the Corporation's current fleet plans. The leases are accounted for as operating leases.

In the nine months ended September 30, 2017, the Corporation took delivery of four 787 aircraft that were financed under sale-leaseback transactions with proceeds of \$740. The sales were at fair value and accordingly the resulting gain on sale of \$52 was recognized in non-operating income. The leases are accounted for as operating leases with 12 year terms, paid monthly.

14. AGREEMENT IN PRINCIPLE FOR THE ACQUISITION OF AIMIA'S AEROPLAN LOYALTY BUSINESS

On August 21, 2018, Air Canada, The Toronto-Dominion Bank, Canadian Imperial Bank of Commerce, Visa Canada Corporation (collectively, "the Consortium") and Aimia Inc. ("Aimia") announced that they had entered into an agreement in principle for the acquisition of Aimia's Aeroplan loyalty business.

The aggregate purchase price consists of \$450 in cash and is on a cash-free, debt-free basis and includes the assumption of approximately \$1.9 billion of Aeroplan Miles liability.

The transaction is subject to the satisfactory conclusion of definitive transaction documents, Aimia shareholder approval, and certain other conditions, including due diligence, receipt of customary regulatory approvals and completion by the Consortium of credit card loyalty program and network agreements for future participation in Air Canada's new loyalty program. Completion of the transaction is expected by the end of 2018.