Second Quarter 2021

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

July 23, 2021

AIR CANADA

A STAR ALLIANCE MEMBER

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1. HIGHLIGHTS

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

(Canadian dollars in millions, except per share data or where indicated)	**Second Quarter**			**First Six Months**		
Financial Performance Metrics	**2021**	**2020**	**$ Change**	**2021**	**2020**	**$ Change**
Operating revenues	837	527	310	1,566	4,249	(2,683)
Operating loss	(1,133)	(1,555)	422	(2,182)	(1,988)	(194)
Loss before income taxes	(1,298)	(1,481)	183	(2,685)	(2,757)	72
Net loss	(1,165)	(1,752)	587	(2,469)	(2,801)	332
Adjusted pre-tax loss (1)	(1,210)	(1,438)	228	(2,545)	(1,958)	(587)
EBITDA (excluding special items) (1)	(656)	(832)	176	(1,419)	(761)	(658)
Unrestricted liquidity (2)	9,775	9,120	655	9,775	9,120	655
Diluted loss per share	(3.31)	(6.44)	3.13	(7.19)	(10.48)	3.29
Operating Statistics (3)	**2021**	**2020**	**% Change**	**2021**	**2020**	**% Change**
Revenue passenger miles ("RPMs") (millions)	1,687	783	115.4	3,518	18,290	(80.8)
Available seat miles ("ASMs") (millions)	4,000	2,243	78.4	8,211	25,754	(68.1)
Passenger load factor %	42.2%	34.9%	7.3 pp (6)	42.8%	71.0%	(28.2 pp)
Passenger revenue per RPM ("Yield") (cents)	25.3	26.4	(4.2)	23.3	18.6	25.5
Passenger revenue per ASM ("PRASM") (cents)	10.7	9.2	15.7	10.0	13.2	(24.3)
Operating revenue per ASM (cents)	20.9	23.5	(10.9)	19.1	16.5	15.6
Operating expense per ASM ("CASM") (cents)	49.3	92.9	NM (7)	45.7	24.2	NM
Adjusted CASM (cents) (1)	41.5	76.9	NM	40.9	18.7	NM
Average number of full-time-equivalent ("FTE") employees (thousands) (4)	16.5	16.4	0.7	16.3	24.7	(33.8)
Fuel cost per litre (cents)	68.3	51.8	32.0	65.6	66.3	(0.9)
Fuel litres (thousands)	349,690	240,783	45.2	668,048	1,448,902	(53.9)
Revenue passengers carried (thousands) (5)	1,165	480	142.7	2,289	10,407	(78.0)

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

(2) Unrestricted liquidity refers to the sum of cash, cash equivalents and short and long-term investments, and the amount of available credit under Air Canada's revolving and other credit facilities. At June 30, 2021, unrestricted liquidity amounted to $9,775 million comprised of $5,661 million in Cash and cash equivalents, Short-term investments, and Long-term investments and $3,975 million available under undrawn credit facilities with the Government of Canada and $139 million available to be drawn under the refunds credit facility. At June 30, 2020, unrestricted liquidity of $9,120 million consisted of cash, cash equivalents and short-term investments of $8,644 million, and long-term investments of $476 million.

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

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

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

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

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

2. INTRODUCTION

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

Except as otherwise noted, monetary amounts are stated in Canadian dollars. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of July 22, 2021.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 14 "Risk Factors" of this MD&A. Air Canada issued a news release dated July 23, 2021 reporting on its results for the second quarter of 2021. This news release is available on Air Canada's website at **aircanada.com** and on SEDAR's website at **www.sedar.com**. For further information on Air Canada's public disclosures, including Air Canada's Annual Information Form, consult SEDAR at **www.sedar.com**.

Caution Regarding Forward-Looking Information

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

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

Air Canada, along with the global airline industry, continues to face a severe drop in traffic and a corresponding decline in revenue and cash flows as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world, and particularly in Canada. There is limited visibility on travel demand given changing government restrictions in place around the world and the severity of the restrictions which have only recently begun to ease in Canada. Air Canada cannot predict the full impact or the timing for when conditions may improve. Air Canada is actively monitoring the situation and will respond as the impact of the COVID-19 pandemic evolves, which will depend on a number of factors including the course of the virus, availability of rapid, effective testing, vaccinations and treatments for the virus, government actions, and passenger reaction, as well as timing of a recovery in international and business travel which are important segments of Air Canada's markets, none of which can be predicted with certainty.

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

Intellectual Property

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

3. ABOUT AIR CANADA

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

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

In the first six months of 2021, Air Canada together with its regional partners operating flights on behalf of Air Canada under CPAs, operated, on average, 221 daily scheduled flights to 112 direct destinations on five continents. In 2020, Air Canada, together with Jazz, Sky Regional, and other regional airlines operating flights on behalf of Air Canada under CPAs, operated, on average, 544 daily scheduled flights to 192 direct destinations on six continents (though, as a result of the COVID-19 pandemic, operations to many destinations were suspended or did not operate continually).

At June 30, 2021, Air Canada mainline had an operating fleet composed of 168 aircraft, comprised of 90 Boeing and Airbus narrow-body aircraft and 78 Boeing and Airbus wide-body aircraft, while Air Canada Rouge had an operating fleet of 39 Airbus narrow-body aircraft. At June 30, 2021, the Air Canada Express fleet comprised 50 Mitsubishi regional jets, 54 De Havilland Dash-8 turboprop aircraft and 25 Embraer 175 aircraft for a total of 129 aircraft. In comparison, at December 31, 2020, Air Canada mainline had an operating fleet of 169 aircraft, comprised of 91 Boeing and Airbus narrow-body aircraft (including 24 Boeing 737 MAX aircraft which were grounded in 2020 and some of which resumed commercial flying on February 1, 2021), 78 Boeing and Airbus wide-body aircraft, while Air Canada Rouge had an operating fleet of 39 Airbus narrow-body aircraft, and the Air Canada Express fleet consisted of 49 Mitsubishi regional jets, 62 De Havilland Dash-8 turboprop aircraft and 25 Embraer 175 aircraft for a total of 136 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 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.

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

4. OVERVIEW

Air Canada, along with the global airline industry, continues to face a significant drop in traffic and a corresponding decline in revenue and cash flow due to the COVID-19 pandemic and the travel restrictions imposed in many countries around the world, including in Canada. During the second quarter of 2021, Canada continued to impose or maintain some of the most stringent travel restrictions and quarantine requirements in the world. These measures included:

- Travel restrictions on discretionary (non-essential) international travel including the United States.
- A ban on foreign nationals entering Canada, with limited exceptions.
- A mandatory, 14-day quarantine for travellers entering Canada, with limited exceptions.
- A mandatory pre-departure, upon arrival, and day eight COVID-19 PCR test for international travellers five years of age or older entering Canada.
- A quarantine for up to three nights at a government-approved hotel, at the travellers' expense, while travellers await the results of the PCR test taken upon arrival. If the result is negative, travellers must complete the remainder quarantine period at a location of choice. For travellers with a positive COVID-19 test, the remaining quarantine period must be in a government-designated facility.
- Notice to Airmen (NOTAM) restricting all direct commercial and private passenger flights to Canada from India, as well as requiring air passengers who depart from India or Pakistan to Canada via an indirect route to obtain a COVID-19 pre-departure test from a third country before continuing their journey to Canada.

On June 21, 2021, the Government of Canada extended these measures until July 21, 2021, with the exceptions included in Phase I of easing border measures, which is described below. Pakistan was also removed from the NOTAM, on June 21, 2021.

On June 21, 2021, the Government of Canada announced the initial phase of easing border measures for eligible travellers entering Canada. As of July 5, 2021, fully vaccinated travellers who are permitted to enter Canada are not subject to the federal requirement to quarantine or take a COVID-19 test on day eight after arrival. Unvaccinated or partially vaccinated travellers allowed to enter Canada remain subject to the previously mentioned measures, except for dependent children under the age of five accompanied by fully vaccinated travellers. People travelling with unvaccinated or partially vaccinated dependent children five years of age or older, or with unvaccinated or partially vaccinated dependent adults, must adhere to the measures mentioned above except for the three-day stay at a government-approved hotel.

Based on the Government of Canada announcement, travellers who are eligible to enter Canada include Canadian citizens, permanent residents and persons registered under a Canadian federal law cited as the *Indian Act*, as well as some foreign nationals who are allowed to enter Canada under certain entry measures. The existing international flight restrictions that funnel scheduled international commercial passenger flights into four Canadian airports (Montréal-Trudeau International Airport, Toronto Pearson International Airport, Calgary International Airport, and Vancouver International Airport) are being maintained in the first phase of re-opening. but these are being expanded under the Government of Canada's recent announcement discussed below.

On July 19, 2021, the Government of Canada announced an update to easing border measures for eligible travellers entering Canada. The announced measures include:

- Starting on August 9, 2021, fully vaccinated United States ("U.S.") citizens and permanent residents, residing in the U.S., will be permitted to enter Canada for non-essential travel. Entry to Canada will continue to be prohibited for U.S. travellers who are not fully vaccinated and for all other foreign nationals, unless they already meet an exemption set out in the Orders made under the *Quarantine Act*.

- Unvaccinated children under the age of 12 years of age or unvaccinated dependent children travelling with fully vaccinated travellers who are permitted to enter Canada are not required to quarantine but must adhere to strict public health measures including avoiding the attendance to group settings such as schools, day camps or daycares for 14 days after entry into Canada. Unvaccinated children will remain subject to the day one and day eight testing requirements. Further details on the requirements for unvaccinated children under 12 years of age or unvaccinated dependent children will be available in the coming days.

- Provided Canada's COVID-19 epidemiology remains favourable, the Government of Canada plans to open Canada's borders on September 7, 2021 for non-essential travel by travellers from any country who have been fully vaccinated with Government of Canada-accepted vaccines at least 14 days prior to entering Canada and who meet specific entry requirements. All travellers, regardless of vaccination status, will still require a pre-entry COVID-19 PCR test taken within 72 hours prior to arriving in Canada.

- The obligation to quarantine at a government-approved hotel will cease for all travellers starting on August 9, 2021.

- Effective August 9, 2021, five Canadian airports (Halifax Stanfield International Airport, Québec City Jean Lesage International Airport, Ottawa Macdonald–Cartier International Airport, Winnipeg James Armstrong Richardson International Airport, and Edmonton International Airport) will be allowed to receive scheduled international commercial passenger flights in addition to the four Canadian airports that are currently open for international commercial passenger operations.

- Relaxed testing restrictions will be implemented for short-term trips, a fully completed ArriveCan form will become mandatory prior to boarding any flight to Canada, and fully vaccinated travellers will not require a COVID-19 test upon arrival unless they have been randomly selected to complete one. Mandatory testing for unvaccinated travellers remains unchanged.

This recent announcement from the Government of Canada is expected to have a positive impact for international and transborder air travel. However, the government has not issued a comprehensive and structured reopening timeline for the aviation and tourism industries which continues to impact demand for air travel, including from travellers with children under 12 years of age or unvaccinated dependents.

Air Canada's vision for 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. This involves rebuilding a strong global network with a focus on hub-to-hub flying providing seamless connectivity with Air Canada's partners, delivering consistent and superior customer service, and diversifying its revenue base, including through Aeroplan and Air Canada Cargo. For additional information on Air Canada's strategy and measures it has deployed in response to the pandemic, refer to section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of Air Canada's 2020 Annual MD&A.

Recent Developments

Passenger Refunds

On April 13, 2021, Air Canada announced it was offering refunds for 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 request for a refund online or with their travel agent. On June 10, 2021, Air Canada extended the deadline for customers to submit their refund requests to July 12, 2021. Eligible refunds processed and paid during the second quarter of 2021 amounted to $997 million and based on Air Canada's projections, additional $200 million, approximately, will be processed during the third quarter of 2021 to finalize the processing of the COVID-19 refund claims. In support of its travel agency partners, Air Canada has decided that it will not retract agency sales commissions on refunded fares.

Route Network & Schedule

On May 12, 2021, Air Canada announced it would launch more non-stop services from Canada to Hawaii this winter, including the first Montreal-Honolulu and Toronto-Maui services. These new flights complement the airline's long-standing services from Calgary and Vancouver to the Hawaiian Islands and will enable convenient connections across Canada as well as from Europe.

On June 14, 2021, Air Canada and Air Canada Cargo announced the initial list of planned routes for the Boeing 767-300ER freighters scheduled to enter service in late 2021. The first Boeing 767 freighters will fly primarily out of Toronto Pearson International Airport, and will operate on routes linking Toronto to Miami, Quito, Lima, Mexico City and Guadalajara. Additional destinations to be served in early 2022, include Halifax, St. John's, Madrid and Frankfurt as more freighters join the fleet. Since March 2020, Air Canada has operated more than 10,000 all-cargo flights using its wide-body passenger aircraft as well as certain temporarily modified Boeing 777 and Airbus A330 aircraft, which have additional available cargo space due to the removal of seats from the passenger cabin.

On June 15, 2021, Air Canada announced its peak domestic summer schedule serving a total of 50 Canadian destinations from coast to coast. It includes 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 July 6, 2021, Air Canada unveiled new details for its international flight schedule for the Summer of 2021 which, in addition to the current schedule, includes the resumption of 17 routes and 11 destinations across the world from its hubs.

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 current U.S. Transborder summer schedule which includes 55 routes and 34 destinations in the U.S., with up to 220 daily flights between the U.S. and Canada.

In anticipation of an expected rebound in travel demand for the summer 2021 period, in early June 2021, Air Canada communicated it would recall approximately 2,600 employees in various roles, including flight attendants, commencing in June 2021.

As travel restrictions ease around the world, Air Canada remains committed to rebuilding its international network and to continue as a global carrier to connect Canada to the world, while also developing additional markets and targeting new opportunities.

Financing and Liquidity

On April 15, 2021, Air Canada repaid U.S. $400 million dollars of the 7.750% Senior (Unsecured) Notes, upon maturity.

On July 19, 2021, Air Canada announced that it had launched the syndication of a new senior secured term loan B expected to mature in 2028 (the "Term Loan"), and completed the syndication in respect of a new senior secured revolving facility expected to mature in 2025 (the "Revolving Facility", together with the Term Loan, the "Senior Secured Credit Facilities"). Subject to market and other conditions, Air Canada intends to complete refinancing transactions seeking total gross proceeds of approximately US$5.35 billion, and which will include the entering into of the Senior Secured Credit Facilities. The proceeds of the Term Loan are intended to fund (i) the refinancing of the Air Canada's $200 million principal amount of its 4.75% senior secured notes due 2023 and $840 million principal amount of its 9.00% second lien notes due 2024, (ii) the refinancing of the Air Canada's indebtedness under the loan agreement dated as of October 6, 2016 and comprised of a syndicated secured US dollar term loan B facility of US$578 million and a syndicated secured US dollar revolving credit facility of US$600 million and (iii) working capital and other general corporate purposes of Air Canada and its subsidiaries. The proceeds of the Revolving Facility are intended to fund working capital and other general corporate purposes of Air Canada and its subsidiaries. Air Canada will review multiple funding sources when assessing the aforementioned refinancing transactions. Closing of the Senior Secured Credit Facilities is expected to occur in the second or third week of August 2021, subject to obtaining lender commitments, market conditions and customary closing conditions.

Debt and Equity Financing Agreements with the Government of Canada

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

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

- Gross proceeds of $500 million for 21,570,942 Air Canada shares at a price of $23.17933 per share (net proceeds of approximately $480 million).

- $1.5 billion in the form of a secured revolving credit facility maturing in April 2026 and bearing interest at the Canadian Dollar Offered Rate (CDOR) plus 1.5%; the facility is secured on a first lien basis by the assets of Aeroplan, Air Canada's shares in Aeroplan as well as certain assets of Air Canada, including certain intellectual property relating to the Aeroplan loyalty program. No amount has been drawn by Air Canada under this facility.

- $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 has been drawn by Air Canada under these facilities.

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

- 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 in April 2028 and carries an annual interest rate of 1.211%. Draws under this facility are made monthly based on the amount of refunds processed and paid during the period. As at June 30, 2021, $858 million have been drawn under this facility to support customer refunds of non-refundable tickets, and a further $139 million are being drawn under the facility for refunds paid up until June 30, 2021. Draws under this facility may continue up until November 30, 2021 as eligible refunds are paid.

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

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

- Offering eligible customers who purchased non-refundable fares but did not travel due to COVID-19 since February 2020 up to April 13, 2021, the option of a refund to the original form of payment.

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

- Restricting certain expenditures and senior executive compensation in respect of any financial year during which the secured and unsecured facilities are outstanding (other than the unsecured credit facility tranche to support customer refunds of non-refundable tickets).

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

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

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

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

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

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

5. RESULTS OF OPERATIONS

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

(Canadian dollars in millions, except where indicated)	**Second Quarter**				**First Six Months**			
	2021	**2020**	**$ Change**	**% Change**	**2021**	**2020**	**$ Change**	**% Change**
Operating revenues								
Passenger	$ 426	$ 207	$ 219	106	$ 821	$ 3,400	$ (2,579)	(76)
Cargo	358	269	89	33	639	418	221	53
Other	53	51	2	4	106	431	(325)	(75)
Total operating revenues	**837**	**527**	**310**	**59**	**1,566**	**4,249**	**(2,683)**	**(63)**
Operating expenses								
Aircraft fuel	239	124	115	93	439	960	(521)	(54)
Wages, salaries, and benefits	497	464	33	7	1,025	1,260	(235)	(19)
Regional airlines expense, excluding fuel	193	172	21	12	388	643	(255)	(40)
Depreciation and amortization	404	487	(83)	(17)	817	991	(174)	(18)
Aircraft maintenance	127	181	(54)	(30)	277	451	(174)	(39)
Airport and navigation fees	109	113	(4)	(4)	207	341	(134)	(39)
Sales and distribution costs	44	13	31	238	68	196	(128)	(65)
Ground package costs	1	(3)	4	NM[(2)]	6	231	(225)	(97)
Catering and onboard services	21	23	(2)	(9)	42	120	(78)	(65)
Communications and information technology	81	91	(10)	(11)	186	226	(40)	(18)
Special items	73	236	(163)	(69)	(54)	236	(290)	(123)
Other	181	181	-	-	347	582	(235)	(40)
Total operating expenses	**1,970**	**2,082**	**(112)**	**(5)**	**3,748**	**6,237**	**(2,489)**	**(40)**
Operating loss	**(1,133)**	**(1,555)**	**422**		**(2,182)**	**(1,988)**	**(194)**	
Non-operating income (expense)								
Foreign exchange gain (loss)	(5)	242	(247)		62	(469)	531	
Interest income	16	32	(16)		37	74	(37)	
Interest expense	(164)	(149)	(15)		(341)	(278)	(63)	
Interest capitalized	5	6	(1)		9	14	(5)	
Net financing expense relating to employee benefits	(5)	(9)	4		(9)	(20)	11	
Loss on financial instruments	(5)	(40)	35		(247)	(74)	(173)	
Other	(7)	(8)	1		(14)	(16)	2	
Total non-operating income (expense)	**(165)**	**74**	**(239)**		**(503)**	**(769)**	**266**	
Loss before income taxes	**(1,298)**	**(1,481)**	**183**		**(2,685)**	**(2,757)**	**72**	
Income tax recovery (expense)	133	(271)	404		216	(44)	260	
Net loss	**$ (1,165)**	**$ (1,752)**	**$ 587**		**$ (2,469)**	**$ (2,801)**	**$ 332**	
Diluted loss per share	**$ (3.31)**	**$ (6.44)**	**$ 3.13**		**$ (7.19)**	**$ (10.48)**	**$ 3.29**	
EBITDA (excluding special items) [(1)]	**$ (656)**	**$ (832)**	**$ 176**		**$ (1,419)**	**$ (761)**	**$ (658)**	
Adjusted pre-tax loss [(1)]	**$ (1,210)**	**$ (1,438)**	**$ 228**		**$ (2,545)**	**$ (1,958)**	**$ (587)**	

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

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

System Passenger Revenues

The system-wide impact of the COVID-19 pandemic, including government-regulated travel restrictions, began to be felt in early March 2020, with the commercial aviation sector coming to a near standstill in the second quarter of 2020. Since the onset of the pandemic, Air Canada has actively managed its ASM capacity based on prevailing market trends and travel demand and, as a result, in the second quarter of 2021, Air Canada increased its ASM capacity by approximately 78.4% compared to the second quarter of 2020. When compared to the second quarter of 2019, ASM capacity in the second quarter of 2021 decreased by 85.7%. In the first six months of 2021, ASM capacity decreased by 68.1% compared to the same period in 2020 as the full impact of the COVID-19 pandemic only began to be felt, as discussed above, in March 2020.

In the second quarter of 2021, passenger revenues of $426 million increased $219 million or more than double compared to the second quarter of 2020. The second quarter 2021 year-over-year passenger revenue improvement is primarily explained, as discussed above, by the increase in ASM capacity of 78.4% versus the same period last year. To put this in perspective, the second quarter of 2020 was the hardest hit by the COVID-19 pandemic as the aviation sector came to a near standstill. Airlines around the world were suddenly forced to significantly reduce their capacity and ground the majority of their fleet in the absence of passengers and in the face of government public health measures and travel restrictions. In the second quarter of 2021, despite the continued impact of the government-imposed travel restrictions and COVID-19's third wave in Canada, which peaked in mid-April 2021, demand for air travel showed more resilience and ended the quarter in an upward trend, most notably in the domestic market.

In the first six months of 2021, passenger revenues of $821 million decreased $2,579 million or 75.9% from the same period in 2020. A detailed year-over-year comparison is not meaningful because the full impact of the COVID-19 pandemic began to be felt in March 2020 and is therefore not provided.

In the second quarter of 2021, system traffic more than doubled while yield remained flat compared to the second quarter of 2020. The traffic increase was a result of the ASM growth and the upward trend in travel demand, particularly in the domestic market. In Canada, various provinces and territories began to gradually lift COVID-19 related restrictions toward the latter half of the second quarter of 2021, allowing more of the population to travel domestically with less restrictions. While Air Canada grew its capacity and traffic in the international markets and U.S. Transborder, government-imposed travel restrictions continued to impact demand by limiting travel to what is considered essential. A further discussion on yield, given the low revenue base, is not meaningful, and is therefore not provided.

In the second quarter of 2021, PRASM increased 15.7% compared to the second quarter of 2020. This PRASM increase reflected a passenger load factor increase of 7.3 percentage points compared to the second quarter of 2020. In the first six months of 2021, PRASM decreased 24.3% compared to the first six months of 2020 reflecting a passenger load factor decrease of 28.2 percentage points.

Due to the continued impact of the COVID-19 pandemic, a more in-depth discussion of passenger revenues and of factors influencing year-over-year changes in traffic and yield by geographic region would not be meaningful and is therefore not provided. While Air Canada saw progress on revenues and advance ticket sales during the quarter, and most notably in June, strong and sustained demand in the second quarter of 2021 remained impacted by the lack of a clear plan and timeline for the reopening of the borders and the easing of the travel restrictions.

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

	Second Quarter			
(Canadian dollars in millions)	**2021**	**2020**	**$ Change**	**% Change**
Canada	$ 268	$ 118	$ 150	128.1
U.S. transborder	32	10	22	231.2
Atlantic	75	49	26	53.4
Pacific	35	18	17	84.4
Other	16	12	4	38.1
System	**$ 426**	**$ 207**	**$ 219**	**106.3**

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

	Second Quarter 2021 vs Second Quarter 2020					
	Passenger Revenue % Change	**Capacity (ASMs) % Change**	**Traffic (RPMs) % Change**	**Passenger Load Factor pp Change**	**Yield % Change**	**PRASM % Change**
Canada	128.1	108.4	130.0	4.5	(0.8)	9.5
U.S. transborder	231.2	134.4	270.2	13.8	(10.5)	41.3
Atlantic	53.4	49.7	135.2	13.7	(34.8)	2.4
Pacific	84.4	70.1	41.9	(6.5)	29.9	8.4
Other	38.1	24.9	19.4	(2.9)	15.6	10.6
System	**106.3**	**78.4**	**115.4**	**7.3**	**(4.2)**	**15.7**

The table below provides passenger revenue by geographic region for the first six months of 2021 versus the first six months of 2020.

	First Six Months			
(Canadian dollars in millions)	**2021**	**2020**	**$ Change**	**% Change**
Canada	$ 505	$ 1,062	$ (557)	(52.5)
U.S. transborder	61	765	(704)	(92.0)
Atlantic	162	708	(546)	(77.1)
Pacific	51	410	(359)	(87.7)
Other	42	455	(413)	(90.7)
System	**$ 821**	**$ 3,400**	**$ (2,579)**	**(75.9)**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics by geographic region for the first six months of 2021 versus the first six months of 2020.

	First Six Months 2021 vs First Six Months 2020					
	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	(52.5)	(39.6)	(59.0)	(22.0)	15.9	(21.3)
U.S. transborder	(92.0)	(89.9)	(94.3)	(30.1)	41.5	(20.3)
Atlantic	(77.1)	(57.8)	(73.8)	(25.4)	(12.7)	(45.9)
Pacific	(87.7)	(79.2)	(91.5)	(43.7)	44.9	(40.9)
Other	(90.7)	(89.1)	(92.9)	(28.6)	31.9	(14.7)
System	**(75.9)**	**(68.1)**	**(80.8)**	**(28.2)**	**25.5**	**(24.3)**

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

	Second Quarter				First Six Months			
	2021		2020		2021		2020	
(millions)	RPMs	ASMs	RPMs	ASMs	RPMs	ASMs	RPMs	ASMs
Canada	866	1,825	376	876	1,633	3,508	3,980	5,803
U.S. transborder	93	248	25	106	190	488	3,348	4,849
Atlantic	502	1,329	214	888	1,200	2,895	4,583	6,852
Pacific	160	494	113	291	267	885	3,139	4,247
Other	66	104	55	82	228	435	3,240	4,003
System	**1,687**	**4,000**	**783**	**2,243**	**3,518**	**8,211**	**18,290**	**25,754**

Cargo Revenues

In the second quarter of 2021, cargo revenues of $358 million increased $89 million or 33.1% from the second quarter of 2020. A total of 3,257 all-cargo flights were operated in the second quarter of 2021 with all-cargo flights revenue representing 67% of total cargo revenues for the quarter. On a system basis, in the second quarter of 2021, traffic increased 80.2% and yield decreased 26.1% compared to the second quarter of 2020. In the second quarter of 2021, all markets saw traffic gains compared to the same period last year. This increase in traffic is mainly due to the all-cargo flights Air Canada operated during the quarter, including operations of temporarily converted passenger aircraft, which have additional cargo space available following the removal of the seats from the cabin. The yield decrease was as expected and reflected the normalization of yields versus yield levels in the second quarter of 2020 which resulted from the spike in urgent global demand in air-cargo space for transporting protective equipment and critical goods in the early days of the pandemic.

In the first six months of 2021, cargo revenues of $639 million increased $221 million or 52.8% from the first six months of 2020 mainly a result of the freighter activities, combined with strong airfreight demand, especially from China, including operations of all-cargo flights on temporarily converted passenger aircraft. In the first six months of 2021, Air Canada operated a total of 5,619 all-cargo flights, which represented 63% of total cargo revenues for the period.

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

	Second Quarter				First Six Months			
(Canadian dollars in millions)	**2021**	**2020**	**$ Change**	**% Change**	**2021**	**2020**	**$ Change**	**% Change**
Canada	$ 25	$ 18	$ 7	35.9	$ 49	$ 37	$ 12	30.8
U.S. transborder	17	12	5	46.0	28	21	7	36.6
Atlantic	144	84	60	70.9	263	153	110	71.5
Pacific	150	145	5	3.5	258	183	75	40.8
Other	22	10	12	130.1	41	24	17	73.9
System	**$ 358**	**$ 269**	**$ 89**	**33.1**	**$ 639**	**$ 418**	**$ 221**	**52.8**

Other Revenues

In the second quarter of 2021, other revenues of $53 million increased $2 million or 4% from the same quarter in 2020.

In the first six months of 2021, other revenues of $106 million decreased $325 million or 75% from the same period in 2020. This decrease is explained by 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 and, to a lesser extent, a reduction in passenger and airline-related fees, both due to lower passenger volumes.

Operating Expenses

In the second quarter of 2021, operating expenses of $1,970 million decreased $112 million or 5% from the second quarter of 2020. In the second quarter of 2021, Air Canada recorded a charge of $73 million in special items ($236 million in the second quarter of 2020); refer to the Special items section below for further details. As such, total operating expenses in the second quarter of 2021 are not directly comparable to those in the same period of last year.

In the first six months of 2021, operating expenses of $3,748 million decreased $2,489 million or 40% compared to the first six months of 2020. A direct year-over-year comparison is not meaningful as Air Canada operated much of its regular schedule for the first two months of 2020 and given the impact of Special items recorded.

The more notable year-over-year variances in operating expenses in the second quarter of 2021 and in the first six months of 2021 compared to the second quarter of 2020 and to the first six months of 2020, respectively, are summarized below.

Aircraft Fuel

In the second quarter of 2021, fuel expense of $239 million increased $115 million or 93% from the second quarter of 2020. The increase reflected a higher volume of fuel litres consumed, accounting for an increase of $57 million, as a result of an increased volume of flying year-over-year. In addition, the impact of a 32% increase in fuel cost per litre accounted for a variance of $56 million when compared to the second quarter of 2020, net of a favourable foreign exchange variance due to the strengthening of the Canadian dollar year-over-year.

In the first six months of 2021, fuel expense of $439 million decreased $521 million or 54% from the first six months of 2020, due to the lower volume of flying compared to the first six months of 2020 as the impact of the COVID-19 pandemic, as previously mentioned, began to be felt in March 2020.

Wages, Salaries and Benefits

In the second quarter of 2021, wages, salaries and benefits of $497 million increased $33 million or 7% from the same quarter in 2020. Compared to the second quarter of 2020, wages and salaries increased $44 million or 14% primarily on higher average salaries. This higher average salary is the result of the change in employee mix and years of service given the impact of the layoffs completed in June 2020. In the second quarter of 2021, benefits declined $11 million or 7% compared to the second quarter of 2020. The decline was driven by lower pension and post-employment benefits expense, partially offset by higher volume of claims for active health benefits. In the first six months of 2021, wages, salaries, and benefits of $1,025 million decreased $235 million or 19% from the first six months of 2020. Wages and salaries of $708 million declined $167 million or 19% from the same period last year. Benefits of $317 million declined $68 million or 18% from the first six months of 2020. The decline in both line items was primarily driven by the decline in full-time equivalent ("FTEs") employees compared to the first six months of 2020 as a result of the impact of the COVID-19 pandemic.

Regional Airlines Expense

In the second quarter of 2021, regional airlines expense (excluding fuel) of $193 million increased $21 million or 12% from the same quarter in 2020. The increase was primarily driven by higher expenses across various line items as a result of higher volume of flying compared to the second quarter of 2020.

In the first six months of 2021, regional airlines expense (excluding fuel) of $388 million decreased $255 million or 40% from the same period in 2020, due to the lower volume of flying compared to the first six months of 2020 due to the impact of the COVID-19 pandemic which began to be felt in March 2020.

Depreciation and Amortization

Depreciation and amortization expense of $404 million in the second quarter of 2021, and of $817 million in the first six months of 2021, decreased $83 million or 17%, and $174 million or 18%, respectively, from the same period in 2020. The decline reflected the retirement of certain older aircraft from the fleet, partially offset by the addition of new Airbus A220 aircraft to the fleet.

Aircraft Maintenance

In the second quarter of 2021, aircraft maintenance expense of $127 million declined $54 million or 30% from the second quarter of 2020. The decline reflected a lower volume of maintenance activities due to the reduction of the fleet size compared to the second quarter of 2020. A decrease in maintenance provisions as a result of updated end-of-lease cost estimates in anticipation of returning aircraft to lessors upon lease expiry (over the next 12 months), and a favourable currency impact were also contributing factors to the year-over-year decline.

In the first six months of 2021, aircraft maintenance expense of $277 million decreased $174 million or 39% from the same period in 2020. The decline is mainly due to the lower volume of maintenance activities as a consequence of reduced flying compared to the first six months of 2020 in response to the impact of the COVID-19 pandemic, as well as to the retirement of several aircraft from the operating fleet. A decrease in maintenance provisions, primarily in the first quarter of 2021, resulting from updated end-of-lease cost estimates in anticipation of returning aircraft to lessors upon lease expiry (over the next 12 months) also contributed to the decline.

Special Items

In the second quarter of 2021, Air Canada recorded special items amounting to a net operating expense of $73 million. The table below provides a breakdown of these special items.

	Second Quarter		First Six Months	
(Canadian dollars in millions)	**2021**	**2020**	**2021**	**2020**
Impairments	$ 6	$ 330	$ 26	$ 330
Canada Emergency Wage Subsidy, net	(158)	(202)	(321)	(202)
Workforce reduction provisions	157	112	159	112
Benefit plan amendments	68	-	68	-
Other	-	(4)	14	(4)
Special Items	**$ 73**	**$ 236**	**$ (54)**	**$ 236**

Impairments

In response to capacity reductions related to the impact of the COVID-19 pandemic, 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 ($295 million in the second quarter of 2020), reflecting the write-down of right-of-use assets for leased aircraft and reduction of carrying values of owned aircraft to expected disposal proceeds.

In addition, Air Canada recorded an impairment charge of $35 million in the second quarter of 2020 related to previously capitalized costs incurred for the development of technology based intangible assets which are now cancelled.

In the first six months of 2021, an additional impairment charge of $26 million was recorded as a result of reductions to the estimates around the expected disposal proceeds on owned aircraft 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, the Government of Canada announced the Canada Emergency Wage Subsidy ("CEWS") in order to help employers retain and/or return Canadian-based employees to payrolls in response to challenges posed by the COVID-19 pandemic.

Air Canada recorded a total gross subsidy under the CEWS program of $160 million in the second quarter of 2021 compared to $295 million in the second quarter of 2020. Cash payments of $146 million have been received in the second quarter of 2021 compared to $180 million in the second quarter of 2020. In the first six months of 2021, Air Canada recorded a total gross subsidy under the CEWS program of $326 million and cash payments received in the same period amounted to $302 million. The amount of the CEWS recorded in Special items is net of the cost for inactive employees who were eligible for the wage subsidy under the program. There are no unfulfilled conditions or other contingencies attaching to the current CEWS program.

Subject to meeting the eligibility requirements, Air Canada intends to continue its participation in the CEWS program which the Government of Canada announced is extended to September 2021.

Workforce reduction provisions

As a result of the COVID-19 pandemic and to mitigate the number of employees who remain on layoff status, during the second quarter of 2021, Air Canada offered early retirement incentive programs to its unionized workforce. These programs provide for pension improvements payable from the defined benefit pension plan for eligible employees, and as such do not impact Air Canada's liquidity position. Termination benefits and a curtailment loss of $157 million was recorded during the second quarter of 2021 as a special item.

In the second quarter of 2020, as a result of the COVID-19 pandemic, Air Canada undertook a workforce reduction of approximately 20,000 employees, representing more than 50% of its staff, achieved through layoffs, terminations of employment, early retirements, and special leaves. A workforce reduction provision of $76 million was recorded in the second quarter of 2020 related to these measures ($78 million for the year ended December 31, 2020). In addition to the provision, termination benefits and curtailments of $36 million related to the pension and benefit obligations were recorded in the second quarter of 2020.

Benefit Plan Amendments

In April 2021, Air Canada received the decision of the arbitrator in relation to the determination of the cap on pensionable earnings recognized in the defined benefit pension plan for IAMAW-represented technical employees. The decision resulted in an increase to the maximum pensionable earnings, effective from 2021. The period of retroactivity, if any, is not yet resolved. Air Canada recorded a one-time pension past service cost of $68 million as a special item in the second quarter of 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.

Other

Termination of the Transat Arrangement Agreement

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

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

Amendments to Capacity Purchase Agreements

In March 2021, Air Canada announced an agreement to amend the CPA with Jazz Aviation LP ("Jazz"), a wholly owned subsidiary of Chorus Aviation Inc., under which Jazz currently operates certain regional Air Canada Express flights. Through the revised agreement, Air Canada has transferred operation of its Embraer E175 fleet to Jazz from Sky Regional Airlines Inc. ("Sky Regional") and, as of April 1, 2021, Jazz became the sole operator of Air Canada Express services. The capacity purchase agreement with Sky Regional was terminated on March 31, 2021. The Corporation recorded a net expense of $2 million, related to the CPA revisions and consolidation of regional flying. The expense includes a net provision of $12 million in estimated termination costs to be paid, offset by the retirement of lease liabilities and inventory costs associated with exiting aircraft.

Non-operating Expense

In the second quarter of 2021, non-operating expense amounted to $165 million compared to non-operating income of $74 million in the second quarter of 2020. In the first six months of 2021, non-operating expense amounted to $503 million compared to non-operating expense of $769 million in the first six months of 2020.

Air Canada recorded a loss on foreign exchange of $5 million for the second quarter of 2021 compared to a gain on foreign exchange of $242 million in the second quarter of 2020. The loss reflected a stronger Canadian dollar and included losses on derivatives of $120 million and gains on long-term debt and lease liabilities of $129 million. The June 30, 2021, closing exchange rate was US$1=$1.2398 compared to a closing exchange rate of US$1=$1.2562 on March 31, 2021.

In the first six months of 2021, Air Canada recorded a gain on foreign exchange of $62 million compared to a loss on foreign exchange of $469 million in the first six months of 2020. The gain in the first six months of 2021 included gains on long-term debt and lease liabilities of $274 million and losses on derivatives of $193 million. The June 30, 2021, closing exchange rate was US$1=$1.2398 compared to a closing exchange rate of US$1=$1.2725 on December 31, 2020.

Interest expense for the second quarter of 2021 and for the first six months of 2021 was $164 million and $341 million, respectively. This compared to interest expense of $149 million in the second quarter of 2020 and $278 million in the first six months of 2020. The variance for both periods is primarily driven by higher debt levels as a result of financings concluded in 2020.

Loss on financial instruments of $5 million included a fair value adjustment loss of $23 million on Air Canada's convertible notes cash conversion settlement option. A fair value adjustment gain of $9 million on the warrants which were issued in April 2021 was recorded in the second quarter of 2021. The loss on financial instruments in the first six months of 2021 of $247 included a fair value adjustment loss of $210 million on Air Canada's convertible notes cash conversion settlement option, and a loss of $19 million on the extension and repricing of Air Canada's revolving credit facilities were also recorded in 2021.

6. FLEET

In response to the COVID-19 pandemic, capacity has been actively managed through temporary grounding of aircraft and the permanent retirement of older less efficient aircraft. The temporarily grounded aircraft are included in the table 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 introduce two dedicated Boeing 767 freighters to its fleet by the end of 2021. These aircraft are reflected in the table below.

The tables below provide the number of aircraft in Air Canada's and Air Canada Rouge's operating fleet as at December 31, 2020 and as at June 30, 2021 as well as the planned fleet at December 31, 2021.

AIR CANADA	Actual			Planned	
	December 31, 2020	**First Six Months 2021 Fleet Changes**	**June 30, 2021**	**Remainder of 2021 Fleet Changes**	**December 31, 2021**
Wide-body aircraft					
Boeing 777-300ER	15	(3)	12	1	13
Boeing 777-300ER (cargo)	4	3	7	(2)	5
Boeing 777-200LR	6	-	6	-	6
Boeing 787-8	8	-	8	-	8
Boeing 787-9	29	-	29	-	29
Boeing 767-300 freighters	-	-	-	2	2
Airbus A330-300	13	(1)	12	2	14
Airbus A330-300 (cargo)	3	1	4	(2)	2
Narrow-body aircraft					
Boeing 737 MAX 8	24	-	24	3	27
Airbus A321	15	-	15	-	15
Airbus A320	21	(2)	19	(1)	18
Airbus A319	16	(8)	8	(2)	6
Airbus A220-300	15	9	24	3	27
Total Mainline	**169**	**(1)**	**168**	**4**	**172**

AIR CANADA rouge	Actual			Planned	
	December 31, 2020	First Six Months 2021 Fleet Changes	June 30, 2021	Remainder of 2021 Fleet Changes	December 31, 2021
Narrow-body aircraft					
Airbus A321	14	-	14	-	14
Airbus A320	5	-	5	-	5
Airbus A319	20	-	20	-	20
Total Air Canada Rouge	**39**	**-**	**39**	**-**	**39**
Total Mainline & Rouge	**208**	**(1)**	**207**	**4**	**211**

Air Canada Express

The table below provides the number of aircraft operated as at December 31, 2020 and as at June 30, 2021, on behalf of Air Canada, by 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, 2021.

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

AIR CANADA EXPRESS	Actual			Planned	
	December 31, 2020	First Six Months 2021 Fleet Changes	June 30, 2021	Remainder of 2021 Fleet Changes	December 31, 2021
Embraer 175	25	-	25	-	25
Mitsubishi CRJ-200	15	-	15	-	15
Mitsubishi CRJ-900	34	1	35	-	35
De Havilland Dash 8-300	19	(4)	15	(15)	-
De Havilland Dash 8-400	43	(4)	39	-	39
Total Air Canada Express	**136**	**(7)**	**129**	**(15)**	**114**

7. FINANCIAL AND CAPITAL MANAGEMENT

7.1 LIQUIDITY

Impact of the COVID-19 Pandemic

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

The expectation is for a progressive improvement of cash flows and Air Canada's liquidity position as travel restrictions are gradually lifted. Considering the uncertainty that has characterized the COVID-19 pandemic, the duration of the recovery phase remains difficult to predict.

Since March 2020, Air Canada has increased its cash position through a series of debt and equity transactions. This additional liquidity allows for operational flexibility and to support 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 "Overview" of this MD&A.

In April 2021, Air Canada substantially increased its available liquidity through a series of debt and equity financing agreements with the Government of Canada, which allows Air Canada to access up to $5.379 billion in debt financing through fully repayable loans which Air Canada will only draw down if and as required, as well as an equity investment for gross proceeds of $500 million (net proceeds of approximately $480 million). As at June 30, 2021, $858 million had been drawn on the ticket refund facility and no amount has been drawn on any of the other facilities. Air Canada is entitled to repay and terminate these facilities at any time without penalty. Refer to section 4 "Overview" of this MD&A for additional details on the government's financial package.

Air Canada's unencumbered asset pool (excluding the value of Aeroplan, Air Canada Vacations, and Air Canada Cargo) amounted to approximately $1.6 billion at June 30, 2021. Refer to section 4 "Overview" of this MD&A for a description of the debt financing activities recently completed, which included granting security over the assets of Aeroplan and Air Canada's shares in Aeroplan. As part of Air Canada's ongoing efforts to maintain adequate liquidity levels, additional financing arrangements continue to be assessed and may be pursued.

Liquidity Risk Management

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

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

At June 30, 2021, unrestricted liquidity was $9,775 million comprised of $5,661 million in Cash and cash equivalents, Short-term investments, and Long-term investments and $3,975 million available under undrawn credit facilities with the Government of Canada and $139 million available to be drawn under the refunds credit facility. This compared to unrestricted liquidity of $8,013 million as at December 31, 2020 (comprising cash, cash equivalents and short-term investments, and long-term investments).

7.2 FINANCIAL POSITION

The table below provides a condensed consolidated statement of financial position of Air Canada as at June 30, 2021 and as at December 31, 2020.

(Canadian dollars in millions)	**June 30, 2021**	**December 31, 2020**	**$ Change**
Assets			
Cash, cash equivalents and short-term investments	$ 5,093	$ 7,501	$ (2,408)
Other current assets	1,059	1,170	(111)
Current assets	**$ 6,152**	**8,671**	**(2,519)**
Investments, deposits, and other assets	913	833	80
Property and equipment	11,977	12,137	(160)
Pension assets	3,045	2,840	205
Deferred income tax	34	25	9
Intangible assets	1,110	1,134	(24)
Goodwill	3,273	3,273	-
Total assets	**$ 26,504**	**$ 28,913**	**$ (2,409)**
Liabilities			
Current liabilities	$ 5,646	7,139	(1,493)
Long-term debt and lease liabilities	11,734	11,201	533
Aeroplan and other deferred revenues	3,830	4,032	(202)
Pension and other benefit liabilities	2,636	3,015	(379)
Maintenance provisions	961	1,040	(79)
Other long-term liabilities	1,045	696	349
Deferred income tax	75	75	-
Total liabilities	**$ 25,927**	**27,198**	**(1,271)**
Total shareholders' equity	**$ 577**	**1,715**	**(1,138)**
Total liabilities and shareholders' equity	**$ 26,504**	**$ 28,913**	**$ (2,409)**

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

At June 30, 2021, net pension assets of $409 million (comprising pension assets of $3,045 million net of pension and other benefit liabilities of $2,636 million) increased $584 million from December 31, 2020. This increase was mainly due to a net actuarial gain on remeasurements of employee liabilities of $947 million ($730 million, net of tax) recorded on Air Canada's consolidated statement of comprehensive income, partially offset by pension and other employee benefits expense recorded during the year. The actuarial gain included the impact of a 66-basis point increase in the discount rate used to value the liabilities, partially offset by a lower return on plan assets.

The long-term portion of the Aeroplan and other deferred revenue liability decreased $202 million from December 31, 2020. This decrease included a reclassification of $258 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 to Other long-term liabilities includes a $210 million increase in the fair value of the embedded derivative on Air Canada's convertible notes. The increase also includes $30 million for deferred grant income as well as $100 million for the fair value of the vested warrants as at June 30, 2021 related to the debt and equity financing agreements with the Government of Canada as described in section 4 "Overview" of this MD&A.

7.3 NET DEBT

The table below reflects Air Canada's net debt balances as at June 30, 2021 and as at December 31, 2020.

(Canadian dollars in millions)	June 30, 2021	December 31, 2020	$ Change
Total long-term debt and lease liabilities	$ 11,734	$ 11,201	$ 533
Current portion of long-term debt and lease liabilities	1,012	1,788	(776)
Total long-term debt and lease liabilities (including current portion)	**$ 12,746**	**12,989**	**(243)**
Less cash, cash equivalents and short and long-term investments	(5,661)	(8,013)	2,352
Net debt (1)	**$ 7,085**	**$ 4,976**	**$ 2,109**

(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 June 30, 2021, net debt of $7,085 million increased $2,109 million from December 31, 2020, reflecting the impact of net cash used for operating and investing activities in the first half of 2021, partially offset by proceeds from the partial exercise of the over-allotment option of the December 2020 equity offering and the equity financing agreement concluded in April 2021. Repayments on long term debt in the first half of 2021 were offset with proceeds from new borrowings including proceeds from Government of Canada financing agreements relating to customer refunds of non-refundable tickets, as described in section 4 "Overview" of this MD&A, as well as proceeds from aircraft related financing. In the first half of 2021, Air Canada received financing for eight Airbus A220-300 aircraft deliveries and refinanced the 2013-1 EETC Class B equipment notes. Refer to section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of Air Canada's 2020 MD&A for a description of the debt financing activities completed during 2020. The impact of a stronger Canadian dollar at June 30, 2021 compared to December 31, 2020, decreased foreign currency denominated debt (mainly U.S. dollars) by $274 million.

7.4 WORKING CAPITAL

The table below provides information on Air Canada's working capital balances as at June 30, 2021 and as at December 31, 2020.

(Canadian dollars in millions)	June 30, 2021	December 31, 2020	$ Change
Cash, cash equivalents and short-term investments	$ 5,093	$ 7,501	$ (2,408)
Accounts receivable	617	644	(27)
Other current assets	442	526	(84)
Total current assets	**$ 6,152**	**$ 8,671**	**$ (2,519)**
Accounts payable and accrued liabilities	2,101	2,465	(364)
Advance ticket sales	1,719	2,314	(595)
Aeroplan and other deferred revenues	814	572	242
Current portion of long-term debt and lease liabilities	1,012	1,788	(776)
Total current liabilities	**$ 5,646**	**$ 7,139**	**$ (1,493)**
Net working capital	**$ 506**	**$ 1,532**	**$ (1,026)**

Net working capital of $506 million as at June 30, 2021 decreased $1,026 million from December 31, 2020. Working capital was unfavourably impacted by the cash portion of the net loss recorded during the six months ended June 30, and capital expenditures, net of financing. Advance ticket sales declined during the second quarter of 2021 as Air Canada processed and paid $997 million of eligible refunds under the refunds policy change announced on April 13, 2021 and as further described under Recent Developments in section 4 "Overview" of this MD&A. Such customer refunds are generally neutral to liquidity and improve net working capital, with $858 million in proceeds drawn under the refunds credit facility as at June 30, 2021 and $139 million to be drawn down under the facility in July 2021 in respect of refunds already paid by Air Canada.

7.5 CASH FLOW MOVEMENTS

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

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2021**	**2020**	**$ Change**	**2021**	**2020**	**$ Change**
Net cash flows used in operating activities	**$ (1,377)**	**$ (1,251)**	**$ (126)**	**$ (2,265)**	**$ (1,271)**	**$ (994)**
Proceeds from borrowings	1,139	3,867	(2,728)	1,267	4,894	(3,627)
Reduction of long-term debt and lease liabilities	(877)	(269)	(608)	(1,281)	(778)	(503)
Shares purchased for cancellation	-	-	-	-	(132)	132
Issue of shares	480	553	(73)	554	554	-
Financing fees	(4)	(62)	58	(7)	(62)	55
Net cash flows from financing activities	**$ 738**	**$ 4,089**	**$ (3,351)**	**$ 533**	**$ 4,476**	**$ (3,943)**
Investments, short-term and long-term	356	(112)	468	1,350	296	1,054
Additions to property, equipment, and intangible assets	(266)	(212)	(54)	(546)	(585)	39
Proceeds from sale of assets	6	2	4	11	4	7
Proceeds from sale and leaseback of assets	5	-	5	11	-	11
Other	(11)	6	(17)	(5)	37	(42)
Net cash flows from (used in) investing activities	**$ 90**	**$ (316)**	**$ 406**	**$ 821**	**$ (248)**	**$ 1,069**
Effect of exchange rate changes on cash and cash equivalents	**$ (19)**	**$ (21)**	**$ 2**	**$ (37)**	**$ 42**	**$ (79)**
Increase (decrease) in cash and cash equivalents	**$ (568)**	**$ 2,501**	**$ (3,069)**	**$ (948)**	**$ 2,999**	**$ (3,947)**

Net Cash Flows used in Operating Activities

In the second quarter of 2021, net cash flows used in operating activities of $1,377 million deteriorated by $126 million from the same quarter in 2020 due to a deterioration of working capital mainly attributable to ticket refunds of $997 million which was partially offset by an improvement in advance ticket sales. Additionally, an increase in end of lease return costs, as a result of retirement of older aircraft, as compared to the same quarter in 2020 were a contributing factor to the deterioration of cash flows used in operating activities.

In the first six months of 2021, net cash flows used in operating activities of $2,265 million deteriorated by $994 million from the same period in 2020 on lower operating results, reflecting the impact of the COVID-19 pandemic which first presented in traffic and sales figures in early March 2020, and the ticket refunds as described above.

Net Cash Flows from Financing Activities

In the second quarter of 2021, net cash flows from financing activities of $738 million decreased $3,351 million from the second quarter of 2020. The decline was due to lower proceeds from borrowings and issuance of shares as well as higher debt repayments. Proceeds from borrowings of $1,139 million in the second quarter of 2021 were mainly related to $858 million in proceeds from the Government of Canada unsecured credit facility supporting customer refunds of non-refundable tickets as well as $180 million in aircraft financing relating to the delivery of five Airbus A220-300 aircraft. Proceeds from share issuance in the second quarter of 2021 relate to the Government of Canada equity financing. Refer section 4 "Overview" of this MD&A, for a description of the debt and equity financing transactions with the Government of Canada. Debt repayments in the second quarter of 2021 reflected the repayment of the $400M senior unsecured U.S. dollar notes as well as the refinancing of the 2013-1 EETC Class B equipment notes. Refer to section 4 "Strategy and COVID-19 Mitigation and Recovery Plan" of Air Canada's 2020 MD&A for a description of the debt financing activities completed in 2020.

In the first six months of 2021, net cash flows from financing activities of $533 million decreased by $3,943 million from the same period in 2020. The decline was due to lower proceeds from borrowing and higher debt repayments offset by the suspension of share purchases under normal course issuer bid in March 2020. In addition to proceeds from financings in the second quarter of 2021, $128 million in proceeds related to the financing of three Airbus A220-300 aircraft were received in the first quarter of 2021, concluding the last three aircraft covered by the secured financing concluded in September 2020.

Net Cash Flows from (used in) Investing Activities

Net cash flows from investing activities of $90 million in the second quarter of 2021 and $821 million in the first six months of 2021 increased $406 million and $1,069 million, respectively, from the same periods in 2020. This increase in cash flows from investing activities reflected, in large part, movements between cash and short and long-term investments.

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

Free Cash Flow

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

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2021**	**2020**	**$ Change**	**2021**	**2020**	**$ Change**
Net cash flows used in operating activities	**$ (1,377)**	**$ (1,251)**	**$ (126)**	**$ (2,265)**	**$ (1,271)**	**$ (994)**
Additions to property, equipment, and intangible assets, net of proceeds from sale and leaseback transactions	(261)	(212)	(49)	(535)	(585)	50
Free cash flow (1)	**$ (1,638)**	**$ (1,463)**	**$ (175)**	**$ (2,800)**	**$ (1,856)**	**$ (944)**

(1) Free cash flow is a non-GAAP financial measure used by Air Canada as an indicator of the financial strength and performance of its business, indicating how much cash it can generate from operations after capital expenditures. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment, and intangible assets, net of proceeds from sale and leaseback transactions. Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

Negative free cash flow of $1,638 million in the second quarter of 2021 and $2,800 in the first six months of 2021 deteriorated by $175 million and $944 million, respectively, from the same periods in 2020, reflecting lower cash flows from operating activities due to the impact of the COVID-19 pandemic, in particular ticket refunds of $997 million in the second quarter of 2021 which reduce cash flows from operating activities without affecting liquidity as the refunds of non-refundable tickets are funded with the Government of Canada unsecured credit facility described in section 4 "Overview" of this MD&A.

Net Cash Burn

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

	Second Quarter		First Six Months	
(Canadian dollars in millions)		**2021**		**2021**
Net cash flows used in operating activities	**$**	**(1,377)**	**$**	**(2,265)**
Net cash flows from financing activities		**738**		**533**
Net cash flows from investing activities		**90**		**821**
Remove:				
Net proceeds from new non-aircraft related financings		(1,334)		(1,405)
Refund of non-refundable fares		997		997
Lump-sum debt repayments		502		661
Proceeds from sale and leaseback transactions		(5)		(11)
Investments, short-term and long-term		(356)		(1,350)
Net cash burn (1)	**$**	**(745)**	**$**	**(2,019)**

(1) Net cash burn is a non-GAAP financial measure used by Air Canada as a measure of cash used to maintain operations, support capital expenditures, and settle normal debt repayments, all before the net impact of new financing proceeds. Net cash burn is defined as net cash flows from operating, financing for aircraft deliveries, and investing activities. Excluded are proceeds from non-aircraft financings, lump sum debt maturities made where Air Canada has refinanced or replaced the amount, and proceeds from sale and leaseback transactions. Net cash burn also excludes movements between cash and short and long-term investments, and refunds for non-refundable fares being processed for flights impacted by the COVID-19 pandemic. Such refunds are eligible for draws under the Government of Canada $1.404 billion 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.

In the second quarter of 2021, net cash burn of $745 million (or approximately $8 million per day, on average) was lower than management's net cash burn expectations of $13 million to $15 million per day, on average, discussed in Air Canada's May 7, 2021 news release. EBITDA in the second quarter was better than expected mainly due to continued very strong cost control and rapid adjustments of capacity to adjust to market demand. The EBITDA variance accounted for $2 million per day of the favourable variance in net cash burn. Working capital contributed $2 million per day to the favourable variance and is mainly due to stronger advance ticket sales than forecast and ongoing management of trade receivables and other working capital items. In June 2021, following the recent announcements on the easing of certain travel restrictions, and Air Canada's updated schedule and recent service announcements, advance sales began to rebound strongly. Capital expenditures were also lower than forecast in the quarter, in part, due to the strengthening Canadian dollar.

7.6 CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS

Air Canada's capital expenditures and related financial arrangements are discussed in section 8.6 "Capital Expenditures and Related Financing Arrangements" of Air Canada's 2020 MD&A. There have been no material changes to Air Canada's capital expenditures and related financial arrangements from what was disclosed at that time except that in March 2021, Air Canada concluded a committed secured facility totaling US$475 million to finance the purchase of the next 15 Airbus A220 aircraft scheduled for delivery in 2021 and 2022.

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

7.7 PENSION FUNDING OBLIGATIONS

Air Canada's pension funding obligations are discussed in sections 8.7 "Pension Funding Obligations" of Air Canada's 2020 MD&A. There have been no material changes to Air Canada's pension funding obligations for 2021 from what was disclosed at that time.

As described in section 5 "Results of Operations" of this MD&A, Air Canada recorded under special items charges of $68 million and $157 million related to the pension plan amendment for IAMAW-represented technical employees and to the early retirement incentive programs ("ERIP") respectively. The pension plan amendment and the ERIP will be funded out of the surplus in the domestic registered pension plans. Based on final actuarial valuation results as at January 1, 2021, which take into account the pension plan amendment for IAMAW-represented technical employees and the ERIP, the aggregate solvency surplus in Air Canada's domestic registered pension plans was $2.9 billion.

7.8 CONTRACTUAL OBLIGATIONS

The table below provides Air Canada's contractual obligations as at June 30, 2021, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and lease liabilities and committed capital expenditures.

(Canadian dollars in millions)	**Remainder of 2021(2)**	**2022**	**2023**	**2024**	**2025**	**Thereafter**	**Total**
Principal							
Long-term debt (1)	$ 243	$ 488	$ 1,715	$ 2,021	$ 1,710	$ 3,768	$ 9,945
Lease liabilities	281	485	478	439	411	1,301	3,395
Total principal obligations	**524**	**973**	**2,193**	**2,460**	**2,121**	**5,069**	**13,340**
Interest							
Long-term debt	$ 186	$ 368	$ 344	$ 251	$ 187	$ 287	1,623
Lease liabilities	83	146	120	96	75	354	874
Total interest obligations	**$ 269**	**$ 514**	**$ 464**	**$ 347**	**$ 262**	**$ 641**	**$ 2,497**
Total long-term debt and lease liabilities	**$ 793**	**$ 1,487**	**$ 2,657**	**$ 2,807**	**$ 2,383**	**$ 5,710**	**$ 15,837**
Committed capital expenditures	**$ 464**	**$ 1,001**	**$ 495**	**$ 196**	**$ -**	**$ -**	**$ 2,156**
Total contractual obligations (2)	**$ 1,257**	**$ 2,488**	**$ 3,152**	**$ 3,003**	**$ 2,383**	**$ 5,710**	**$ 17,993**

(1) Assumes the principal balance of the convertible notes, $928 million (US$748 million), remains unconverted and includes estimated interest payable until maturity in 2025. The full principal balance of $858 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.

7.9 SHARE INFORMATION

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

	June 30, 2021	December 31, 2020
Issued and outstanding shares		
Class A variable voting shares	96,311,248	111,926,060
Class B voting shares	261,419,231	220,246,228
Total issued and outstanding shares	**357,730,479**	**332,172,288**
Class A variable voting and Class B voting shares potentially issuable		
Convertible notes	48,687,441	48,687,441
Warrants	14,576,564	-
Stock options	4,402,975	5,903,174
Total shares potentially issuable	**67,666,980**	**54,590,615**
Total outstanding and potentially issuable shares	**425,397,459**	**386,762,903**

Share Offerings

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

As further described in section 4 "Overview" 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.

8. QUARTERLY FINANCIAL DATA

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

(Canadian dollars in millions, except per share figures)	2019		2020				2021	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Operating revenues	$ 5,529	$ 4,429	$ 3,722	$ 527	$ 757	$ 827	$ 729	$ 837
Operating expenses	4,573	4,284	4,155	2,082	1,542	1,830	1,778	1,970
Operating income (loss)	**956**	**145**	**(433)**	**(1,555)**	**(785)**	**(1,003)**	**(1,049)**	**(1,133)**
Non-operating income (expense)	**(78)**	**27**	**(843)**	**74**	**(36)**	**(272)**	**(338)**	**(165)**
Income (loss) before income taxes	**878**	**172**	**(1,276)**	**(1,481)**	**(821)**	**(1,275)**	**(1,387)**	**(1,298)**
Income tax recovery (expense)	(242)	(20)	227	(271)	136	114	83	133
Net income (loss)	**$ 636**	**$ 152**	**$ (1,049)**	**$ (1,752)**	**$ (685)**	**$ (1,161)**	**$ (1,304)**	**$ (1,165)**
Diluted earnings (loss) per share	**$ 2.35**	**$ 0.56**	**$ (4.00)**	**$ (6.44)**	**$ (2.31)**	**$ (3.91)**	**$ (3.90)**	**$ (3.31)**
Adjusted pre-tax income (loss)[1]	**$ 857**	**$ 66**	**$ (520)**	**$ (1,438)**	**$ (1,141)**	**$ (1,326)**	**$ (1,335)**	**$ (1,210)**

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

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Air Canada's financial instruments and risk management practices are summarized in section 11 "Financial Instruments and Risk Management" of Air Canada's 2020 MD&A. There have been no material changes to Air Canada's financial instruments and risk management practices from what was disclosed at that time except for the recognition of the warrants issued to the Government of Canada which are accounted for as a financial liability. Additional information on Air Canada's risk management practices and financial instruments is provided in Note 10 of Air Canada's interim unaudited condensed consolidated financial statements for the second quarter of 2021.

10. ACCOUNTING POLICIES AND CONTROLS

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

Changes in Internal Controls over Financial Reporting

There have been no changes to Air Canada's internal controls over financial reporting during the quarter ended June 30, 2021, that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

11. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

12. OFF-BALANCE SHEET ARRANGEMENTS

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

13. RELATED PARTY TRANSACTIONS

At June 30, 2021, Air Canada had no transactions with related parties as defined in the CPA Handbook, except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship agreements.

14. RISK FACTORS

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

As further described in section 4 "Overview" of this MD&A, on April 12, 2021, Air Canada entered into debt and equity financing agreements with the Government of Canada. As part of the financial package, (i) Air Canada agreed to offer eligible customers who purchased non-refundable fares but did not travel due to COVID-19 since February 2020 up to April 13, 2021, the option of a refund to the original form of payment and (ii) an unsecured credit facility tranche of up to $1.404 billion was made available to support customer refunds of these non-refundable tickets.

15. NON-GAAP FINANCIAL MEASURES

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

EBITDA

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

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

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2021**	**2020**	**$ Change**	**2021**	**2020**	**$ Change**
Operating loss – GAAP	**$ (1,133)**	**$ (1,555)**	**$ 422**	**$ (2,182)**	**$ (1,988)**	**$ (194)**
Add back:						
Depreciation and amortization	404	487	(83)	817	991	(174)
EBITDA (including special items)	**$ (729)**	**$ (1,068)**	**$ 339**	**$ (1,365)**	**$ (997)**	**$ (368)**
Remove:						
Special items	73	236	(163)	(54)	236	(290)
EBITDA (excluding special items)	**$ (656)**	**$ (832)**	**$ 176**	**$ (1,419)**	**$ (761)**	**$ (658)**

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)	Second Quarter			First Six Months		
	2021	2020	$ Change	2021	2020	$ Change
Operating expense – GAAP	**$ 1,970**	**$ 2,082**	**$ (112)**	**$ 3,748**	**$ 6,237**	**$ (2,489)**
Adjusted for:						
Aircraft fuel expense	(239)	(124)	(115)	(439)	(960)	521
Ground package costs	(1)	3	(4)	(6)	(231)	225
Special items	(73)	(236)	163	54	(236)	290
Operating expense, adjusted for the above-noted items	**$ 1,657**	**$ 1,725**	**$ (68)**	**$ 3,357**	**$ 4,810**	**$ (1,453)**
ASMs (millions)	**4,000**	**2,243**	**78.4%**	**8,211**	**25,754**	**(68.1)%**
Adjusted CASM (cents)	**¢ 41.45**	**¢ 76.91**	**¢ (35.46)**	**¢ 40.89**	**¢ 18.68**	**¢ 22.21**

Adjusted Pre-tax Income (Loss)

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

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

(Canadian dollars in millions)	Second Quarter			First Six Months		
	2021	2020	$ Change	2021	2020	$ Change
Loss before income taxes – GAAP	**$ (1,298)**	**$ (1,481)**	**$ 183**	**$ (2,685)**	**$ (2,757)**	**$ 72**
Adjusted for:						
Special items	73	236	(163)	(54)	236	(290)
Foreign exchange (gain) loss	5	(242)	247	(62)	469	(531)
Net financing expense relating to employee benefits	5	9	(4)	9	20	(11)
Loss on financial instruments	5	40	(35)	247	74	173
Adjusted pre-tax loss	**$ (1,210)**	**$ (1,438)**	**$ 228**	**$ (2,545)**	**$ (1,958)**	**$ (587)**

Free Cash Flow

Air Canada uses free cash flow as an indicator of the financial strength and performance of its business, indicating the amount of cash Air Canada can generate from operations and after capital expenditures. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment, and intangible assets, and is net of proceeds from sale and leaseback transactions. Refer to section 7.5 "Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

Net Cash Burn

Air Canada uses net cash burn as a measure of cash used to maintain operations, support capital expenditures, and settle normal debt repayments, all before the net impact of new financing proceeds. Net cash burn is defined as net cash flows from operating, financing for aircraft deliveries, and investing activities. Excluded are proceeds from non-aircraft financings, lump sum debt maturities made where Air Canada has refinanced or replaced the amount, and proceeds from sale and leaseback transactions. Net cash burn also excludes movements between cash and short and long-term investments, and refunds for non-refundable fares being processed for flights impacted by the COVID-19 pandemic. Such refunds are eligible for draws under the Government of Canada $1.404 billion 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 7.5 "Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.