



Second Quarter 2023

INTERIM UNAUDITED
Condensed Consolidated
Financial Statements and Notes



August 11, 2023

 **AIR CANADA**

A STAR ALLIANCE MEMBER 

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

Unaudited (Canadian dollars in millions)	June 30, 2023	December 31, 2022
ASSETS		
Current		
Cash and cash equivalents	\$ 2,926	\$ 2,693
Short-term investments	5,721	5,295
Total cash, cash equivalents and short-term investments	8,647	7,988
Accounts receivable	1,192	1,037
Aircraft fuel inventory	161	200
Spare parts and supplies inventory	137	118
Prepaid expenses and other current assets	368	322
Total current assets	10,505	9,665
Investments, deposits and other assets	1,167	1,073
Property and equipment	12,094	11,950
Pension assets	2,627	2,444
Deferred income tax	56	48
Intangible assets	1,061	1,054
Goodwill	3,273	3,273
Total assets	\$ 30,783	\$ 29,507
LIABILITIES		
Current		
Accounts payable and accrued liabilities	\$ 2,802	\$ 2,691
Advance ticket sales	5,709	4,104
Aeroplan and other deferred revenue	1,197	1,295
Current portion of long-term debt and lease liabilities	1,024	1,263
Total current liabilities	10,732	9,353
Long-term debt and lease liabilities	13,862	15,043
Aeroplan and other deferred revenue	3,208	3,160
Pension and other benefit liabilities	1,822	1,770
Maintenance provisions	1,287	1,352
Other long-term liabilities	380	311
Deferred income tax	73	73
Total liabilities	\$ 31,364	\$ 31,062
SHAREHOLDERS' EQUITY (DEFICIENCY)		
Share capital	2,744	2,743
Contributed surplus	127	118
Hedging reserve	(3)	-
Accumulated other comprehensive loss	(49)	(46)
Deficit	(3,400)	(4,370)
Total shareholders' equity (deficiency)	(581)	(1,555)
Total liabilities and shareholders' equity (deficiency)	\$ 30,783	\$ 29,507

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

CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited (Canadian dollars in millions except per share figures)	Three months ended June 30		Six months ended June 30		
	2023	2022 Restated Note 2	2023	2022 Restated Note 2	
Operating revenues					
Passenger	Note 8	\$ 4,901	\$ 3,441	\$ 8,989	\$ 5,358
Cargo	Note 8	227	299	465	697
Other		299	241	860	499
Total revenues		5,427	3,981	10,314	6,554
Operating expenses					
Aircraft fuel		1,187	1,450	2,562	2,200
Wages, salaries and benefits		971	781	1,885	1,518
Depreciation, amortization, and impairment		418	407	846	814
Airport and navigation fees		364	299	676	527
Sales and distribution costs		264	197	537	319
Capacity purchase fees		201	188	417	355
Aircraft maintenance	Note 2	275	209	536	253
Ground package costs		126	102	444	231
Communications and information technology		128	107	274	226
Catering and onboard services		158	101	286	171
Other		533	393	1,066	743
Total operating expenses		4,625	4,234	9,529	7,357
Operating income (loss)		802	(253)	785	(803)
Non-operating income (expense)					
Foreign exchange gain (loss)		251	(196)	378	(97)
Interest income		106	31	189	51
Interest expense	Note 3	(241)	(216)	(486)	(425)
Interest capitalized		6	2	11	5
Financial instruments recorded at fair value	Note 7	(115)	287	(77)	114
Loss on debt settlement	Note 3	(2)	-	(2)	-
Other		(11)	(7)	(25)	(11)
Total non-operating expense		(6)	(99)	(12)	(363)
Income (loss) before income taxes		796	(352)	773	(1,166)
Income tax recovery (expense)	Note 4	42	(34)	69	(194)
Net income (loss) for the period		\$ 838	\$ (386)	\$ 842	\$ (1,360)
Net income (loss) per share	Note 5				
Basic earnings (loss) per share		\$ 2.34	\$ (1.08)	\$ 2.35	\$ (3.80)
Diluted earnings (loss) per share		\$ 2.34	\$ (1.60)	\$ 2.35	\$ (3.80)

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

Unaudited (Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2023	2022	2023	2022
Comprehensive income (loss)				
Net income (loss) for the period	\$ 838	\$ (386)	\$ 842	\$ (1,360)
Other comprehensive income (loss), net of tax expense: <u>Note 4</u>				
Items that will not be reclassified to net income				
Remeasurements on employee benefit liabilities	97	93	128	(118)
Remeasurements on equity investments	(2)	(15)	(3)	(1)
Items that will be reclassified to net income				
Fuel derivatives designated as cash flow hedges	(3)	–	(3)	–
Total comprehensive income (loss)	\$ 930	\$ (308)	\$ 964	\$ (1,479)

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (DEFICIENCY)

Unaudited (Canadian dollars in millions)	Share capital	Contributed surplus	Hedging reserve	Accumulated OCI	Deficit	Total shareholders' equity (deficiency)
January 1, 2022	\$ 2,735	\$ 104	–	\$ (45)	\$ (2,785)	\$ 9
Net income (loss)	–	–	–	–	(1,360)	(1,360)
Remeasurements on employee benefit liabilities	–	–	–	–	(118)	(118)
Remeasurements on equity investments	–	–	–	(1)	–	(1)
Total comprehensive income (loss)	–	–	–	(1)	(1,478)	(1,479)
Share-based compensation	–	10	–	–	–	10
Shares issued	3	(1)	–	–	–	2
June 30, 2022	\$ 2,738	\$ 113	–	\$ (46)	\$ (4,263)	\$ (1,458)
January 1, 2023	\$ 2,743	\$ 118	–	\$ (46)	\$ (4,370)	\$ (1,555)
Net income	–	–	–	–	842	842
Remeasurements on employee benefit liabilities	–	–	–	–	128	128
Remeasurements on equity investments	–	–	–	(3)	–	(3)
Fuel derivatives designated as cash flow hedges	–	–	(3)	–	–	(3)
Total comprehensive income (loss)	–	–	(3)	(3)	970	964
Share-based compensation	–	9	–	–	–	9
Shares issued	1	–	–	–	–	1
June 30, 2023	\$ 2,744	\$ 127	(3)	\$ (49)	\$ (3,400)	\$ (581)

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

CONSOLIDATED STATEMENTS OF CASH FLOW

Unaudited (Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2023	2022	2023	2022
Cash flows from (used in)				
Operating				
Net income (loss) for the period	\$ 838	\$ (386)	\$ 842	\$ (1,360)
Adjustments to reconcile to net cash from operations				
Deferred income tax	Note 4	(34)	23	(63)
Depreciation, amortization, and impairment		418	407	846
Foreign exchange (gain) loss		(228)	180	(301)
Employee benefit funding less than expense		15	57	35
Financial instruments recorded at fair value	Note 7	93	(287)	55
Loss on debt settlements	Note 3	2	-	2
Change in maintenance provisions		(69)	12	(25)
Changes in non-cash working capital balances		458	998	1,556
Other		(3)	60	(20)
Net cash flows from operating activities	1,490	1,064	2,927	1,431
Financing				
Proceeds from borrowings	Note 3	-	123	84
Reduction of long-term debt and lease liabilities	Note 3	(935)	(270)	(1,312)
Issue of shares		-	1	2
Financing fees	Note 3	-	(1)	-
Net cash flows used in financing activities	(935)	(147)	(1,227)	(339)
Investing				
Investments, short-term and long-term		(193)	(698)	(489)
Additions to property, equipment and intangible assets		(525)	(636)	(975)
Proceeds from sale of assets		2	2	3
Other		(2)	9	(6)
Net cash flows used in investing activities	(718)	(1,323)	(1,467)	(2,579)
Effect of exchange rate changes on cash and cash equivalents	(1)	7	-	18
Increase (decrease) in cash and cash equivalents	(164)	(399)	233	(1,469)
Cash and cash equivalents, beginning of period	3,090	3,345	2,693	4,415
Cash and cash equivalents, end of period	\$ 2,926	\$ 2,946	\$ 2,926	\$ 2,946
Cash payments of interest	Note 3	\$ 177	\$ 130	\$ 442
Cash payments of income taxes		\$ 14	\$ 14	\$ 49

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

Notes to the interim condensed consolidated financial statements (unaudited)
(Canadian dollars except where otherwise indicated)

1. GENERAL INFORMATION

The accompanying unaudited interim condensed consolidated financial statements (the “financial statements”) are of Air Canada (the “Corporation”). The term “Corporation” also refers to, as the context may require, Air Canada and/or one or more of its subsidiaries, including its principal wholly-owned operating subsidiaries, Aeroplan Inc. (“Aeroplan”), Touram Limited Partnership doing business under the brand name Air Canada Vacations® (“Air Canada Vacations”), and Air Canada Rouge LP doing business under the brand name Air Canada Rouge® (“Air Canada Rouge”).

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

The Corporation has historically experienced greater demand for its services in the second and third quarters of the calendar year, primarily due to the high number of leisure travellers and their preference for travel during the spring and summer months. The financial results for the six months ended June 30, 2023 are not necessarily indicative of financial results for the entire year.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation prepares its financial statements in accordance with generally accepted accounting principles in Canada (“GAAP”) as set out in the CPA Canada Handbook – Accounting (“CPA Handbook”) which incorporates International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). These financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 “Interim Financial Reporting”. In accordance with GAAP, these financial statements do not include all the financial statement disclosures required for annual financial statements and should be read in conjunction with the Corporation’s annual consolidated financial statements for the year ended December 31, 2022. In management’s opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim period presented.

These financial statements were approved for issue by the Board of Directors of the Corporation on August 10, 2023.

These financial statements are based on the accounting policies consistent with those disclosed in Note 2 to the 2022 annual consolidated financial statements.

Reclassification of certain operating expenses – 2022 comparative figures

Prior to the fourth quarter of 2022, operating expenses under capacity purchase agreements were aggregated in a separate line item in the consolidated statement of operations titled Regional airlines expense, and included the capacity purchase fees, pass-through costs, and other costs incurred by Air Canada which were directly related to regional carrier operations, excluding fuel. For the year ended December 31, 2022, these costs are no longer allocated to regional airline expense on the consolidated statement of operations. Capacity purchase fees are now presented as a separate line item and continue to exclude the component of fees related to aircraft costs which are accounted for as lease liabilities in accordance with IFRS 16. Refer to Note 2D and Note 2AA to the 2022 annual consolidated financial statements for additional details.

The tables below present the operating expenses for the second quarter and first half of 2022 as previously reported and on this reclassified basis.

(Canadian dollars in millions)	For the three months ended June 30, 2022 as previously reported	Reclassification for Regional airlines expense	For the three months ended June 30, 2022 as restated
Operating expenses			
Aircraft fuel	\$ 1,450	\$ -	\$ 1,450
Wages, salaries and benefits	749	32	781
Depreciation, amortization and impairment	407	-	407
Regional airlines expense, excluding fuel	367	(367)	-
Airport and navigation fees	241	58	299
Sales and distribution costs	171	26	197
Capacity purchase fees	-	188	188
Aircraft maintenance	195	14	209
Ground package costs	102	-	102
Communications and information technology	103	4	107
Catering and onboard services	94	7	101
Other	355	38	393
Total operating expenses	\$ 4,234	\$ -	\$ 4,234

(Canadian dollars in millions)	For the six months ended June 30, 2022 as previously reported	Reclassification for Regional airlines expense	For the six months ended June 30, 2022 as restated
Operating expenses			
Aircraft fuel	\$ 2,200	\$ -	\$ 2,200
Wages, salaries and benefits	1,456	62	1,518
Depreciation, amortization and impairment	814	-	814
Regional airlines expense, excluding fuel	683	(683)	-
Airport and navigation fees	424	103	527
Sales and distribution costs	279	40	319
Capacity purchase fees	-	355	355
Aircraft maintenance	221	32	253
Ground package costs	231	-	231
Communications and information technology	219	7	226
Catering and onboard services	158	13	171
Other	672	71	743
Total operating expenses	\$ 7,357	\$ -	\$ 7,357

Aircraft maintenance

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

3. LONG-TERM DEBT AND LEASE LIABILITIES

	Final Maturity	Weighted Average Interest Rate (%)	June 30, 2023 (Canadian dollars in millions)	December 31, 2022 (Canadian dollars in millions)
Aircraft financing				
Fixed rate U.S. dollar financing	2023 – 2030	4.97	\$ 3,069	\$ 3,408
Floating rate U.S. dollar financing	2026 – 2027	7.29	358	399
Fixed rate CDN dollar financing	2026 – 2030	3.78	173	182
Floating rate CDN dollar financing	2026 – 2033	6.75	605	1,240
Fixed rate Japanese yen financing	2027	1.84	108	121
Convertible notes	2025	4.00	316	313
Credit facility – CDN dollar	2028	1.21	1,072	1,054
Senior secured notes – CDN dollar	2029	4.63	2,000	2,000
Senior secured notes – U.S. dollar	2026	3.88	1,589	1,626
Senior secured credit facility – U.S. dollar	2028	8.84	3,015	3,102
Long-term debt		5.48	12,305	13,445
Lease liabilities				
Air Canada aircraft	2023 – 2031	5.11	1,506	1,667
Regional aircraft	2025 – 2035	5.76	779	917
Land and buildings	2023 – 2078	5.43	451	454
Lease liabilities		5.35	2,736	3,038
Total debt and lease liabilities		5.46	15,041	16,483
Unamortized debt issuance costs and discounts			(155)	(177)
Current portion – Long-term debt			(518)	(713)
Current portion – Air Canada aircraft			(340)	(337)
Current portion – Regional aircraft			(141)	(187)
Current portion – Land and buildings			(25)	(26)
Long-term debt and lease liabilities			\$ 13,862	\$ 15,043

The above table provides terms of instruments disclosed in Note 9 to the 2022 annual consolidated financial statements of the Corporation as well as borrowings concluded during the six months ended June 30, 2023 and described below.

In the first quarter of 2023, Air Canada drew on financing for the final two Airbus A220 aircraft under the secured facility described in Note 9(a) to its 2022 annual consolidated financial statements and the amount of such draw is included in Aircraft financing in the above table. The financing on these two aircraft was prepaid in June 2023 as described below.

In June 2023, the Corporation prepaid loans of \$650 million which had been used to finance the acquisition of 19 Airbus A220-300 aircraft. As a result of the prepayment, these aircraft have been added to the Corporation's unencumbered asset pool. A loss of \$2 million was recorded on debt settlement.

Under Interbank Offered Rate ("IBOR") reform, IBORs are replaced with alternative benchmark rates. In the second quarter of 2023, debt and aircraft leases referencing \$2,399 million USD LIBOR were transitioned to term SOFR (Secured Overnight Financing Rate). There was no significant impact to the financial statements as the change in contractual cash flows was on an economically equivalent basis, and therefore the change is accounted for by updating the effective interest rate with no gain or loss recognized.

The Corporation has recorded Interest expense as follows:

(Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2023	2022	2023	2022
Interest on debt	\$ 202	\$ 177	\$ 407	\$ 346
Interest on lease liabilities				
Air Canada aircraft	21	20	43	41
Regional aircraft	11	14	24	28
Land and buildings	7	5	12	10
Interest expense	\$ 241	\$ 216	\$ 486	\$ 425

The consolidated statement of operations includes the following amounts related to leases which have not been recorded as right-of-use assets and lease liabilities.

(Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2023	2022	2023	2022
Short-term leases	\$ 7	\$ 4	\$ 10	\$ 9
Variable lease payments not included in lease liabilities	11	10	21	18
Expense related to leases (included in Other operating expenses)	\$ 18	\$ 14	\$ 31	\$ 27

Total cash outflows for payments on lease liabilities was \$171 million for the three months ended June 30, 2023 (\$350 million for the six months ended June 30, 2023; \$168 million and \$329 million respectively for the three- and six-month periods ended June 30, 2022), of which \$132 million was for principal repayments (\$271 million for the six months ended June 30, 2023; \$129 million and \$250 million for the three- and six-month periods ended June 30, 2022).

Maturity Analysis

Principal and interest repayment requirements as at June 30, 2023 on Long-term debt and lease liabilities are as follows. U.S. dollar amounts are converted using the June 30, 2023 closing rate of CDN\$1.3242.

Principal (Canadian dollars in millions)	Remainder of 2023	2024	2025	2026	2027	Thereafter	Total
Long-term debt obligations ⁽¹⁾	\$ 290	\$ 456	\$ 1,190	\$ 2,432	\$ 1,082	\$ 7,103	\$ 12,553
Air Canada aircraft	173	331	317	252	202	231	1,506
Regional aircraft	71	141	138	50	40	339	779
Land and buildings	13	26	26	26	26	334	451
Lease liabilities	\$ 257	\$ 498	\$ 481	\$ 328	\$ 268	\$ 904	\$ 2,736
Total long-term debt and lease liabilities	\$ 547	\$ 954	\$ 1,671	\$ 2,760	\$ 1,350	\$ 8,007	\$ 15,289

Interest (Canadian dollars in millions)	Remainder of 2023	2024	2025	2026	2027	Thereafter	Total
Long-term debt obligations ⁽¹⁾	\$ 343	\$ 658	\$ 625	\$ 561	\$ 462	\$ 480	\$ 3,129
Air Canada aircraft	40	67	51	36	24	21	239
Regional aircraft	21	35	26	20	18	71	191
Land and buildings	12	23	21	20	19	231	326
Lease liabilities	\$ 73	\$ 125	\$ 98	\$ 76	\$ 61	\$ 323	\$ 756
Total long-term debt and lease liabilities	\$ 416	\$ 783	\$ 723	\$ 637	\$ 523	\$ 803	\$ 3,885

(1) Assumes the principal balance of the convertible notes, \$363 million (US\$274 million) remains unconverted and includes estimated interest payable until maturity in 2025. The full principal balance of \$1,273 million for the unsecured credit facility accessed in 2021 to support customers refunds of non-refundable tickets is included.

Principal repayments in the table above exclude discounts and transaction costs of \$155 million, which are offset against Long-term debt and lease liabilities in the consolidated statement of financial position.

Cash flows from financing activities

Information on the change in liabilities for which cash flows have been classified as financing activities in the statement of cash flows is presented below.

(Canadian dollars in millions)	Mar 31, 2023	Cash Flows			Non-Cash Changes			Jun. 30, 2023
		Borrowings	Repayments	Financing fees	Foreign exchange adjustments	Amortization of financing fees and other adjustments	New lease liabilities (new and modified contracts)	
Long-term debt	\$ 13,281	\$ -	\$ (803)	\$ -	\$ (187)	\$ 14	\$ -	\$ 12,305
Air Canada aircraft	1,617	-	(87)	-	(31)	-	7	1,506
Regional aircraft	877	-	(39)	-	(17)	-	(42)	779
Land and buildings	456	-	(6)	-	-	-	1	451
Lease liabilities	2,950	-	(132)	-	(48)	-	(34)	2,736
Unamortized debt issuance costs	(167)	-	-	-	-	12	-	(155)
Total liabilities from financing activities	\$ 16,064	\$ -	\$ (935)	\$ -	\$ (235)	\$ 26	\$ (34)	\$ 14,886

(Canadian dollars in millions)	Jan. 1, 2023	Cash Flows			Non-Cash Changes			Jun. 30, 2023
		Borrowings	Repayments	Financing fees	Foreign exchange adjustments	Amortization of financing fees and other adjustments	New lease liabilities (new and modified contracts)	
Long-term debt	\$ 13,445	\$ 84	\$ (1,041)	\$ -	\$ (212)	\$ 29	\$ -	\$ 12,305
Air Canada aircraft	1,667	-	(171)	-	(36)	-	46	1,506
Regional aircraft	917	-	(84)	-	(19)	-	(35)	779
Land and buildings	454	-	(16)	-	-	-	13	451
Lease liabilities	3,038	-	(271)	-	(55)	-	24	2,736
Unamortized debt issuance costs	(177)	-	-	-	-	22	-	(155)
Total liabilities from financing activities	\$ 16,306	\$ 84	\$ (1,312)	\$ -	\$ (267)	\$ 51	\$ 24	\$ 14,886

4. INCOME TAXES

Income Tax Recovery (Expense)

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

(Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2023	2022	2023	2022
Current income tax (expense) recovery	\$ 8	\$ (11)	\$ 6	\$ (24)
Deferred income tax (expense) recovery	34	(23)	63	(170)
Income tax recovery (expense)	\$ 42	\$ (34)	\$ 69	\$ (194)

The Corporation's statutory tax rate for the six months ended June 30, 2023 was 26.46% (26.47% for the six months ended June 30, 2022).

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

(Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2023	2022	2023	2022
Remeasurements on employee benefit liabilities				
- current income tax (expense) recovery	\$ (1)	\$ (1)	\$ (2)	\$ (3)
- deferred income tax (expense) recovery	(34)	25	(55)	178
Income tax recovery (expense)	\$ (35)	\$ 24	\$ (57)	\$ 175

5. EARNINGS (LOSS) PER SHARE

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

(in millions, except per share amounts)	Three months ended June 30		Six months ended June 30	
	2023	2022	2023	2022
Numerator:				
Net income (loss) for the period:	\$ 838	\$ (386)	\$ 842	\$ (1,360)
Effect of assumed conversion of convertible notes	102	(266)	87	(125)
Remove anti-dilutive impact	(102)	-	(87)	125
Adjusted numerator for diluted loss per share:	838	(652)	842	(1,360)
Denominator:				
Weighted-average shares	358	358	358	358
Effect of potential dilutive securities:				
Stock options	-	-	-	-
Convertible notes	18	49	18	49
Remove anti-dilutive impact	(18)	-	(18)	(49)
Adjusted denominator for diluted loss per share	358	407	358	358
Basic earnings (loss) per share	\$ 2.34	\$ (1.08)	\$ 2.35	\$ (3.80)
Diluted earnings (loss) per share	\$ 2.34	\$ (1.60)	\$ 2.35	\$ (3.80)

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

6. CAPITAL COMMITMENTS

Capital commitments consist of the future firm aircraft deliveries and commitments related to acquisition of other property and equipment. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation. U.S. dollar amounts are converted using the June 30, 2023 closing rate of CDN\$1.3242. Minimum future commitments under these contractual arrangements are shown below.

(Canadian dollars in millions)	Remainder of 2023	2024	2025	2026	2027	Thereafter	Total
Capital commitments	\$ 671	\$ 1,142	\$ 799	\$ 1,130	\$ 699	\$ 2,510	\$ 6,951

7. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Refer also to Note 17 to the 2022 annual consolidated financial statements for information on the Corporation's risk management strategy.

Summary of Gain (loss) on financial instruments recorded at fair value

(Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2023	2022	2023	2022
Embedded derivative on convertible notes	\$ (100)	\$ 321	\$ (76)	\$ 196
Short-term investments	(15)	(32)	(1)	(81)
Share forward contracts	-	(2)	-	(1)
Gain (loss) on financial instruments recorded at fair value	\$ (115)	\$ 287	\$ (77)	\$ 114

Liquidity Risk Management

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

Liquidity needs are primarily related to meeting obligations associated with financial liabilities, capital commitments, ongoing operations, contractual and other obligations. The Corporation monitors and manages liquidity risk by preparing rolling cash flow forecasts for a minimum period of at least twelve months after each reporting period, monitoring the condition and value of assets available to be used as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing processes to monitor and maintain compliance with terms of financing agreements. At June 30, 2023, total liquidity was \$10,551 million comprised of cash and cash equivalents, short-term and long-term investments of \$9,556 million, and \$995 million available under undrawn credit facilities. Cash and cash equivalents include \$189 million related to funds held in trust by Air Canada Vacations in accordance with regulatory requirements governing advance sales for tour operators.

Foreign Exchange Risk Management

Based on the notional amount of currency derivatives outstanding at June 30, 2023, as further described below, approximately 65% of net U.S. cash outflows are hedged for the remainder of 2023 and 49% for 2024, resulting in derivative coverage of 54% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 60% coverage over the next 18 months.

As at June 30, 2023, the Corporation had outstanding foreign currency options and swap agreements, settling in 2023 and 2024, to purchase at maturity \$6,287 million (US\$4,749 million) of U.S. dollars at a weighted average rate of \$1.2995 per \$1.00 U.S. dollar (as at December 31, 2022 – \$5,798 million (US\$4,310 million) with settlements in 2023 and 2024 at a weighted average rate of \$1.2986 per \$1.00 U.S. dollar). The Corporation also has protection in place to sell a portion of its excess Euros, Sterling, YEN, YUAN, and AUD (EUR €177 million, GBP £309 million, JPY ¥6,004 million, CNH ¥153 million, and AUD \$134 million) which settle in 2023 and 2024 at weighted average rates of €1.0980, £1.2512, ¥0.0083, ¥0.6982 and \$0.1439 per \$1.00 U.S. dollar respectively (as at December 31, 2022 - EUR €198 million, GBP £244 million, JPY ¥17,405 million, CNH ¥355 million and AUD \$126 million with settlement in 2023 and 2024 at weighted average rates of €1.0828, £1.2467, ¥0.0082, ¥0.1419, and AUD \$0.7072 respectively per \$1.00 U.S. dollar).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations, and based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at June 30, 2023 was \$120 million in favour of the counterparties (as at December 31, 2022 – \$140 million in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During the second quarter of 2023, foreign exchange gain related to these derivatives was \$21 million (\$101 million gain for the six month period ended June 30, 2023; \$177 million gain and \$138 million gain respectively for the three- and six-month periods ended June 30, 2022). In the second quarter of 2023, foreign exchange derivative contracts cash settled with a net fair value of \$37 million in favour of the Corporation (\$80 million in favour of the Corporation for the six month period ended June 30, 2023; \$6 million in favour of the Corporation and \$4 million in favour of the counterparties respectively for the three- and six-month periods ended June 30, 2022).

The Corporation also holds U.S. cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash and short-term investment balances as at June 30, 2023 amounted to \$1,378 million (US\$1,037 million) (\$693 million (US\$511 million) as at December 31, 2022). During the three months ended June 30, 2023, a loss of \$18 million (\$17 million loss for the six month period ended June 30, 2023; \$28 million gain and \$30 million gain respectively for the three- and six-month periods ended June 30, 2022) was recorded in foreign exchange gain reflecting the change in Canadian equivalent market value of the U.S. dollar cash, short-term and long-term investment balances held.

Financial Instrument Fair Values in the Consolidated Statement of Financial Position

The carrying amounts reported in the consolidated statement of financial position for short-term financial assets and liabilities, which includes Accounts receivable and Accounts payable and accrued liabilities, approximate fair values due to the immediate or short-term maturities of these financial instruments. Cash equivalents and Short and Long-term investments are classified as held for trading and therefore are recorded at fair value.

The carrying amounts of derivatives are equal to their fair value, which is based on the amount at which they could be settled based on estimated market rates as at June 30, 2023.

Management estimated the fair value of its long-term debt based on valuation techniques including discounted cash flows, taking into account market information and traded values where available, market rates of interest, the condition of any related collateral, the current conditions in credit markets and the current estimated credit margins applicable to the Corporation based on recent transactions. Based on significant unobservable inputs (Level 3 in the fair value hierarchy), the estimated fair value of debt is \$11,675 million compared to its carrying value of \$12,305 million.

The following is a classification of fair value measurements recognized in the consolidated statement of financial position using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. There are no changes in classifications or methods of measuring fair value from those disclosed in Note 17 to the 2022 annual consolidated financial statements. There were no transfers within the fair value hierarchy during the six months ended June 30, 2023.

As at June 30, 2023, approximately 30% of the Corporation's anticipated purchases of jet fuel for the third quarter of 2023 are hedged with derivative contracts comprised of jet fuel call options with a fair value of \$19 million.

(Canadian dollars in millions)	June 30, 2023	Fair value measurements at reporting date using:		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Assets				
Held-for-trading securities				
Cash equivalents	\$ 307	\$ -	\$ 307	\$ -
Short-term investments	5,721	-	5,721	-
Long-term investments	909	-	909	-
Equity investment in Chorus	47	47	-	-
Derivative instruments				
Foreign exchange derivatives	23	-	23	-
Fuel derivatives	19	-	19	-
Total	\$ 7,026	\$ 47	\$ 6,979	\$ -
Financial Liabilities				
Derivative instruments				
Foreign exchange derivatives	143	-	143	-
Embedded derivative on convertible notes	196	-	196	-
Total	\$ 339	\$ -	\$ 339	\$ -

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

8. GEOGRAPHIC INFORMATION

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

Passenger Revenues (Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2023	2022	2023	2022
Canada	\$ 1,282	\$ 1,115	\$ 2,346	\$ 1,763
U.S. Transborder	1,037	761	2,003	1,186
Atlantic	1,665	1,051	2,589	1,515
Pacific	573	226	1,065	324
Other	344	288	986	570
	\$ 4,901	\$ 3,441	\$ 8,989	\$ 5,358

Cargo Revenues (Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2023	2022	2023	2022
Canada	\$ 23	\$ 28	\$ 47	\$ 58
U.S. Transborder	11	10	22	23
Atlantic	109	146	228	270
Pacific	54	79	103	273
Other	30	36	65	73
	\$ 227	\$ 299	\$ 465	\$ 697

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