Third Quarter 2017

INTERIM UNAUDITED
Condensed Consolidated
Financial Statements and Notes

October 25, 2017

AIR CANADA

A STAR ALLIANCE MEMBER

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Unaudited (Canadian dollars in millions)		**September 30, 2017**	**December 31, 2016**
ASSETS			
Current			
Cash and cash equivalents		$ 1,146	$ 787
Short-term investments		2,989	2,192
Total cash, cash equivalents and short-term investments		4,135	2,979
Restricted cash		108	126
Accounts receivable		789	707
Aircraft fuel inventory		75	79
Spare parts and supplies inventory		107	107
Prepaid expenses and other current assets		272	349
Total current assets		5,486	4,347
Property and equipment		9,072	8,520
Pension assets	Note 5	1,179	1,153
Deposits and other assets		450	468
Deferred income tax	Note 3	610	-
Intangible assets		313	315
Goodwill		311	311
Total assets		**$ 17,421**	**$ 15,114**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		$ 1,898	$ 1,644
Advance ticket sales		2,350	2,073
Current portion of long-term debt and finance leases	Note 4	769	707
Total current liabilities		5,017	4,424
Long-term debt and finance leases	Note 4	5,560	5,911
Pension and other benefit liabilities	Note 5	2,595	2,436
Maintenance provisions		968	922
Other long-term liabilities		214	202
Total liabilities		**$ 14,354**	**$ 13,895**
SHAREHOLDERS' EQUITY			
Share capital		801	797
Contributed surplus		68	83
Hedging reserve		-	3
Retained earnings		2,198	336
Total shareholders' equity		3,067	1,219
Total liabilities and shareholders' equity		**$ 17,421**	**$ 15,114**

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

CONSOLIDATED STATEMENT OF OPERATIONS

Unaudited		**Three months ended September 30**		**Nine months ended September 30**	
(Canadian dollars in millions except per share figures)		**2017**	**2016**	**2017**	**2016**
Operating revenues					
Passenger		$ 4,478	$ 4,106	$ 11,090	$ 10,113
Cargo		179	130	467	357
Other		223	215	875	782
Total revenues		**4,880**	**4,451**	**12,432**	**11,252**
Operating expenses					
Aircraft fuel		832	708	2,192	1,681
Regional airlines expense		662	639	1,942	1,786
Wages, salaries and benefits	Note 5	690	658	1,997	1,877
Airport and navigation fees		264	247	704	656
Aircraft maintenance		241	230	695	694
Depreciation, amortization and impairment		241	220	711	604
Sales and distribution costs		204	179	608	531
Ground package costs		73	72	432	388
Aircraft rent		125	118	377	342
Food, beverages and supplies		112	104	294	267
Communications and information technology		63	56	192	182
Special items	Note 10	-	-	30	-
Other		369	324	1,027	917
Total operating expenses		**3,876**	**3,555**	**11,201**	**9,925**
Operating income		**1,004**	**896**	**1,231**	**1,327**
Non-operating income (expense)					
Foreign exchange gain (loss)	Note 9	44	(42)	182	(9)
Interest income		16	12	42	35
Interest expense		(73)	(97)	(232)	(291)
Interest capitalized		9	12	27	50
Net financing expense relating to employee benefits	Note 5	(15)	(17)	(47)	(52)
Gain (loss) on financial instruments recorded at fair value	Note 9	17	6	24	(5)
Gain on sale and leaseback of assets	Note 11	-	-	52	19
Loss on debt settlements	Note 4	(3)	-	(3)	(7)
Other		(6)	(2)	(17)	(12)
Total non-operating income (expense)		**(11)**	**(128)**	**28**	**(272)**
Income before income taxes		**993**	**768**	**1,259**	**1,055**
Recovery of income taxes	Note 3	793	-	790	-
Net income for the period		**$ 1,786**	**$ 768**	**$ 2,049**	**$ 1,055**
Net income per share	Note 7				
Basic earnings per share		$ 6.56	$ 2.79	$ 7.53	$ 3.79
Diluted earnings per share		$ 6.44	$ 2.74	$ 7.39	$ 3.72

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Unaudited **(Canadian dollars in millions)**		**Three months ended September 30** **2017**	**Three months ended September 30** **2016**	**Nine months ended September 30** **2017**	**Nine months ended September 30** **2016**
Comprehensive income					
Net income for the period		$ 1,786	$ 768	$ 2,049	$ 1,055
Other comprehensive income (loss), net of tax expense:	Note 3				
Items that will not be reclassified to net income					
Remeasurements on employee benefit liabilities	Note 5	78	111	(148)	(816)
Items that will be reclassified to net income					
Fuel derivatives designated as cash flow hedges, net	Note 9	1	(17)	(3)	4
Total comprehensive income		**$ 1,865**	**$ 862**	**$ 1,898**	**$ 243**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Unaudited (Canadian dollars in millions)	**Share capital**	**Contributed surplus**	**Hedging reserve**	**Retained earnings (deficit)**	**Total shareholders' equity**	**Non-controlling interests**	**Total equity**
January 1, 2016	$ 825	$ 76	$ (11)	$ (877)	$ 13	$ 27	$ 40
Net income	–	–	–	1,055	1,055	–	1,055
Remeasurements on employee benefit liabilities	–	–	–	(816)	(816)	–	(816)
Fuel derivatives designated as cash flow hedges, net	–	–	4	–	4	–	4
Total comprehensive income	–	–	4	239	243	–	243
Share-based compensation	–	5	–	(12)	(7)	–	(7)
Shares issued	1	–	–	–	1	–	1
Shares purchased and cancelled under issuer bid	(30)	–	–	(59)	(89)	–	(89)
Distributions	–	–	–	–	–	(27)	(27)
September 30, 2016	$ 796	$ 81	$ (7)	$ (709)	$ 161	$ –	$ 161
January 1, 2017	$ 797	$ 83	$ 3	$ 336	$ 1,219	$ –	$ 1,219
Net income	–	–	–	2,049	2,049	–	2,049
Remeasurements on employee benefit liabilities	–	–	–	(148)	(148)	–	(148)
Fuel derivatives designated as cash flow hedges, net	–	–	(3)	–	(3)	–	(3)
Total comprehensive income	–	–	(3)	1,901	1,898	–	1,898
Share-based compensation	–	(2)	–	(9)	(11)	–	(11)
Shares issued	12	(4)	–	–	8	–	8
Shares purchased and cancelled under issuer bid	(8)	–	–	(28)	(36)	–	(36)
Reclassification of equity settled award to cash settled award (Note 2)	–	(9)	–	(2)	(11)	–	(11)
September 30, 2017	$ 801	$ 68	$ –	$ 2,198	$ 3,067	$ –	$ 3,067

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

CONSOLIDATED STATEMENT OF CASH FLOW

Unaudited		**Three months ended September 30**		**Nine months ended September 30**	
(Canadian dollars in millions)		**2017**	**2016**	**2017**	**2016**
Cash flows from (used for)					
Operating					
Net income for the period		$ 1,786	$ 768	$ 2,049	$ 1,055
Adjustments to reconcile to net cash from operations					
Deferred income tax	Note 3	(806)	-	(806)	-
Depreciation, amortization and impairment		248	226	732	621
Foreign exchange loss (gain)		(123)	29	(224)	(82)
Gain on sale and leaseback of assets	Note 11	-	-	(52)	(19)
Loss on debt settlements	Note 4	3	-	3	7
Employee benefit funding less than expense	Note 5	62	59	181	131
Financial instruments recorded at fair value	Note 9	(14)	(4)	(23)	7
Change in maintenance provisions		34	37	83	112
Changes in non-cash working capital balances		(724)	(679)	358	227
Other		27	2	48	11
Net cash flows from operating activities		**493**	**438**	**2,349**	**2,070**
Financing					
Proceeds from borrowings		-	-	733	1,308
Reduction of long-term debt and finance lease obligations		(203)	(80)	(574)	(468)
Shares purchased for cancellation	Note 6	-	(31)	(36)	(89)
Distributions related to aircraft special purpose leasing entities		-	-	-	(32)
Issue of shares		4	1	7	1
Financing fees		(3)	-	(15)	(2)
Net cash flows from (used in) financing activities		**(202)**	**(110)**	**115**	**718**
Investing					
Short-term investments		(256)	(144)	(831)	(337)
Additions to property, equipment and intangible assets		(169)	(123)	(1,990)	(2,691)
Proceeds from sale of assets		1	55	3	349
Proceeds from sale and leaseback of assets	Note 11	-	-	740	351
Other		9	15	8	7
Net cash flows used in investing activities		**(415)**	**(197)**	**(2,070)**	**(2,321)**
Effect of exchange rate changes on cash and cash equivalents		**(29)**	**4**	**(35)**	**(22)**
Increase (decrease) in cash and cash equivalents		**(153)**	**135**	**359**	**445**
Cash and cash equivalents, beginning of period		1,299	882	787	572
Cash and cash equivalents, end of period		**$ 1,146**	**$ 1,017**	**$ 1,146**	**$ 1,017**
Cash payments of interest	Note 4	**$ 49**	**$ 51**	**$ 198**	**$ 209**
Cash payments of income taxes		**$ -**	**$ -**	**$ 1**	**$ -**

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

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

1. GENERAL INFORMATION

The accompanying unaudited interim condensed consolidated financial statements (the "financial statements") are of Air Canada (the "Corporation"). The term "Corporation" also refers to, as the context may require, Air Canada and/or one or more of its subsidiaries, including its principal wholly-owned operating subsidiaries, Touram Limited Partnership doing business under the brand name Air Canada Vacations® ("Air Canada Vacations") and Air Canada rouge LP doing business under the brand name Air Canada Rouge® ("Air Canada Rouge"). These financial statements also include certain aircraft leasing entities, which are consolidated under IFRS 10 Consolidated Financial Statements.

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

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

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation prepares its financial statements in accordance with generally accepted accounting principles in Canada ("GAAP") as set out in the CPA Canada Handbook – Accounting ("CPA Handbook") which incorporates International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). These financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 "Interim Financial Reporting". In accordance with GAAP, these financial statements do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the Corporation's annual consolidated financial statements for the year ended December 31, 2016. In management's opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim period presented.

These financial statements were approved for issue by the Board of Directors of the Corporation on October 24, 2017.

These financial statements are based on the accounting policies consistent with those disclosed in Note 2 to the 2016 annual consolidated financial statements.

As described in Note 2I to the 2016 annual consolidated financial statements, performance share units ("PSUs") and restricted share units ("RSUs") were accounted for as equity settled instruments. A prospective change in accounting was made in 2017 from equity settled to cash settled instruments based on settlement experience. In accounting for cash settled instruments, compensation expense is adjusted for subsequent changes in the fair value of the PSUs and RSUs taking into account forfeiture estimates. The liability related to cash settled PSUs and RSUs is recorded in Other long-term liabilities.

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted for the current year.

Critical Accounting Estimates and Judgments

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect certain of the amounts reported in these financial statements and accompanying notes. The underlying assumptions are reviewed on an ongoing basis. Actual results could differ materially from those estimates.

As described in Note 10 to the 2016 annual consolidated financial statements, the Corporation has temporary differences and tax loss carryforwards for which no deferred income tax assets had previously been recognized. Refer to Note 3 Income taxes for information on the recognition of deferred income tax assets at September 30, 2017.

IFRS 15 – Revenue from Contracts with Customers

As described in Note 2BB to the 2016 annual consolidated financial statements, the Corporation will apply IFRS 15 effective January 1, 2018. The standard will be applied retrospectively with adjustment to the opening consolidated statement of financial position as at January 1, 2017. Under IFRS 15, incremental costs of obtaining passenger revenues, such as credit card fees and global distribution system charges, will be capitalized at the time the flight ticket is sold and expensed at the time of passenger revenue recognition. Currently, these costs are expensed as incurred at the time the flight ticket is sold. The anticipated impact on the consolidated statement of financial position as at January 1, 2017 is an increase to Prepaid expenses and other current assets of $61 and an equivalent increase to opening retained earnings. In addition, deferred commission costs in the amount of $40 as at December 31, 2016, currently recorded net against the Advance ticket sales liability, will be reclassified to Prepaid expenses and other current assets. The amount of the deferred contract cost asset will fluctuate on a quarterly basis in line with changes in the Advance ticket sales liability.

In addition, certain passenger and cargo related fees and surcharges will be reclassified from Other to Passenger revenue and to Cargo revenue on the consolidated statement of operations.

The Corporation continues to evaluate other possible impacts of this standard on its consolidated financial statements, including the impact of changes to the disclosure requirements, however no further financial statement impacts are expected at this time.

3. INCOME TAXES

Deferred income tax assets are recognized only to the extent that it is probable that future taxable income will be available to realize them. In making this assessment, consideration is given to available positive and negative evidence and relevant assumptions, including, among other aspects, historical financial results, and expectations relating to future taxable income, the overall business environment, and industry-wide trends.

In this regard and in connection with the preparation of the financial statements for the period ended September 30, 2017, Air Canada determined that it was probable that substantially all of the deferred income tax assets, which include non-capital losses, would be realized. Accordingly, a deferred income tax asset of $610 was recognized as at September 30, 2017, which resulted in a non-cash tax recovery recorded in the consolidated statement of operations of $806 and non-cash tax expense recorded in the consolidated statement of comprehensive income of $196 related to remeasurements on employee benefit liabilities.

Deferred tax assets and liabilities of $610 are recorded net as a noncurrent deferred income tax asset on the consolidated statement of financial position. Certain intangible assets with nominal tax cost and a carrying value of $185 have indefinite lives and accordingly, the associated deferred income tax liability of $49 (2016 - $49) is not expected to reverse until the assets are disposed of, become impaired or amortizable. As a result, this recognized net deferred income tax liability of $49 is included in Other long-term liabilities.

At September 30, 2017, the Corporation has net capital losses of approximately $87 available for income tax purposes, for which no deferred income tax asset has been recognized at this time as the ability to utilize these tax attributes is limited to future taxable capital gains. While the net capital losses remain available for use, the recognition criteria for accounting is not met at this time.

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

	Three months ended September 30		Nine months ended September 30	
	2017	**2016**	**2017**	**2016**
Current income tax	$ 13	$ -	$ 16	$ -
Deferred income tax	(806)	-	(806)	-
Income tax expense (recovery)	**$ (793)**	**$ -**	**$ (790)**	**$ -**

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

	Three months ended September 30		Nine months ended September 30	
	2017	**2016**	**2017**	**2016**
Remeasurements on employee benefit liabilities - deferred income tax	$ 196	$ -	$ 196	$ -
Fuel derivatives designated as cash flow hedges - deferred income tax	-	-	-	-
Income tax expense	**$ 196**	**$ -**	**$ 196**	**$ -**

4. LONG-TERM DEBT AND FINANCE LEASES

	Final Maturity	Weighted Average Interest Rate (%)	September 30, 2017	December 31, 2016
Aircraft financing				
Fixed rate U.S. dollar financing	2017 – 2027	4.38	$ 2,985	$ 3,598
Floating rate U.S. dollar financing	2018 – 2027	3.07	892	457
Floating rate CDN dollar financing	2026 – 2027	1.98	341	366
Fixed rate Japanese yen financing	2027	1.85	130	-
Floating rate Japanese yen financing	2020 - 2027	0.71	65	70
Senior secured notes – CDN dollar	2023	4.75	200	200
Senior unsecured notes – U.S. dollar	2021	7.75	499	537
Other secured financing – U.S. dollar	2018 – 2023	3.88	1,092	1,175
Other secured financing – CDN dollar	–	8.15	-	44
Long-term debt		**4.16**	**6,204**	**6,447**
Finance lease obligations	2018 – 2033	9.49	231	275
Total debt and finance leases		**4.36**	**6,435**	**6,722**
Unamortized debt issuance costs			(106)	(104)
Current portion			(769)	(707)
Long-term debt and finance leases			**$ 5,560**	**$ 5,911**

The above table provides terms of instruments disclosed in Note 7 to the 2016 annual consolidated financial statements of the Corporation as well as terms of instruments concluded during the nine months ended September 30, 2017 and described below.

In June 2017, Air Canada completed the repricing of its US$1.1 billion senior secured credit facility, reducing the interest rate by 50 basis points, to an interest rate of 225 basis points over LIBOR (subject to a LIBOR floor of 75 basis points). The credit facility is comprised of a US$800 term loan maturing in 2023, and a US$300 revolving credit facility (undrawn) expiring in 2021.

In connection with the acquisition of four Boeing 787 aircraft in the nine months ended September 30, 2017, the Corporation completed a financing, maturing in 2027 and comprised of a principal of US$439 subject to a floating rate, JPY¥11,743 subject to a fixed rate and JPY¥1,247 subject to a floating rate. These financings were secured using Japanese Operating Leases with a Call Option ("JOLCO") structures with the transactions recorded as loans and the aircraft as owned for accounting purposes in the Corporation's consolidated financial statements.

During the third quarter of 2017, principal of US$27 was prepaid relating to the financing of one A330 aircraft. An amount of $3 is included in Loss on debt settlements related to the prepayment of such fixed rate debt. During the nine months ended September 30, 2016, principal of US$49 was prepaid relating to the financing of six Embraer 190 aircraft. An amount of $7 is included in Loss on debt settlements related to the prepayment of such fixed rate debt.

Maturity Analysis

Principal and interest repayment requirements as at September 30, 2017 on Long-term debt and finance lease obligations are as follows. U.S. dollar amounts are converted using the September 30, 2017 closing rate of CDN$1.2472.

Principal	Remainder of 2017	2018	2019	2020	2021	Thereafter	Total
Long-term debt obligations	$ 192	$ 628	$ 496	$ 531	$ 857	$ 3,500	**$ 6,204**
Finance lease obligations	10	46	43	46	16	70	**231**
	$ 202	**$ 674**	**$ 539**	**$ 577**	**$ 873**	**$ 3,570**	**$ 6,435**

Interest	Remainder of 2017	2018	2019	2020	2021	Thereafter	Total
Long-term debt obligations	$ 63	$ 227	$ 207	$ 184	$ 141	$ 383	**$ 1,205**
Finance lease obligations	5	18	14	9	6	18	**70**
	$ 68	**$ 245**	**$ 221**	**$ 193**	**$ 147**	**$ 401**	**$ 1,275**

5. PENSIONS AND OTHER BENEFIT LIABILITIES

Pension and Other Employee Future Benefit Expense

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Consolidated Statement of Operations				
Operating expenses				
Wages, salaries and benefits				
Pension benefits	$ 75	$ 71	$ 211	$ 195
Other employee benefits	6	4	18	2
	$ 81	**$ 75**	**$ 229**	**$ 197**
Non-operating income (expense)				
Net financing expense relating to employee benefit liabilities				
Pension benefits	$ (2)	$ (3)	$ (9)	$ (12)
Other employee benefits	(13)	(14)	(38)	(40)
	$ (15)	**$ (17)**	**$ (47)**	**$ (52)**
Consolidated Other Comprehensive Income (Loss)				
Remeasurements on employee benefit liabilities before income taxes				
Pension benefits	$ 226	$ 145	$ 83	$ (660)
Other employee benefits	48	(34)	(35)	(156)
	$ 274	**$ 111**	**$ 48**	**$ (816)**

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Net defined pension and other future employee benefits expense recorded in the consolidated statement of operations				
Wages, salaries and benefits	$ 81	$ 75	$ 229	$ 197
Net financing expense relating to employee benefit liabilities	15	17	47	52
	$ 96	**$ 92**	**$ 276**	**$ 249**
Employee benefit funding by Air Canada				
Pension benefits	$ 21	$ 19	$ 60	$ 82
Other employee benefits	13	14	35	36
	$ 34	**$ 33**	**$ 95**	**$ 118**
Employee benefit funding less than expense	**$ 62**	**$ 59**	**$ 181**	**$ 131**

6. SHARE CAPITAL

Issuer Bid

In May 2017, Air Canada received approval from the Toronto Stock Exchange ("TSX") for the renewal of its normal course issuer bid for its Class A variable voting shares and Class B voting shares (collectively the "Shares"), authorizing, between May 31, 2017 and May 30, 2018, the purchase of up to 22,364,183 Shares, representing 10% of the public float as at May 17, 2017. The renewal followed the conclusion of the 2016 normal course issuer bid which expired on May 29, 2017.

In the nine months ended September 30, 2017, the Corporation purchased, for cancellation, 2,597,200 Shares at an average cost of $13.88 per Share for aggregate consideration of $36. The excess of the cost over the average book value of $28 was charged to retained earnings. No shares were purchased during the three months ended September 30, 2017. At September 30, 2017, a total of 22,164,183 Shares remain available for repurchase under the existing issuer bid.

In the third quarter of 2016, the Corporation purchased, for cancellation, 3,454,400 Shares at an average cost of $8.97 per Share for aggregate consideration of $31 (10,368,465 Shares at an average cost of $8.60 per Share for aggregate consideration of $89 for the nine months ended September 30, 2016). The excess of the cost over the average book value of $21 ($59 for the nine months ended September 30, 2016) was charged to retained earnings.

7. EARNINGS PER SHARE

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

	Three months ended September 30		Nine months ended September 30	
(in millions, except per share amounts)	**2017**	**2016**	**2017**	**2016**
Numerator:				
Numerator for basic and diluted earnings per share:				
Net income	$ 1,786	$ 768	$ 2,049	$ 1,055
Denominator:				
Weighted-average shares - basic	272	275	272	278
Effect of potential dilutive securities:				
Stock options	5	5	5	5
Total potential dilutive securities	5	5	5	5
Adjusted denominator for diluted earnings per share	277	280	277	283
Basic earnings per share	**$ 6.56**	**$ 2.79**	**$ 7.53**	**$ 3.79**
Diluted earnings per share	**$ 6.44**	**$ 2.74**	**$ 7.39**	**$ 3.72**

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

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

8. COMMITMENTS

Capital Commitments

Capital commitments consist of the future firm aircraft deliveries and commitments related to acquisition of other property and equipment. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at September 30, 2017. U.S. dollar amounts are converted using the September 30, 2017 closing rate of CDN$1.2472. Minimum future commitments under these contractual arrangements are shown below.

	Remainder of 2017	2018	2019	2020	2021	Thereafter	Total
Capital commitments	$ 364	$ 1,666	$ 1,329	$ 1,324	$ 1,008	$ 560	**$ 6,251**

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Refer also to Note 15 to the 2016 annual consolidated financial statements for information on the Corporation's risk management strategy.

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

	Three months ended September 30		Nine months ended September 30	
	2017	**2016**	**2017**	**2016**
Share forward contracts	$ 19	$ 6	$ 26	$ -
Fuel derivatives	(2)	-	(2)	-
Prepayment option on senior secured notes	-	-	-	(5)
Gain (loss) on financial instruments recorded at fair value	**$ 17**	**$ 6**	**$ 24**	**$ (5)**

Fuel Price Risk Management

During the third quarter of 2017:

- Hedging gain of $3 was reclassified from other comprehensive income to Aircraft fuel expense ($5 loss for the nine months ended September 30, 2017; loss of $3 and $13 reclassified from other comprehensive income to Aircraft fuel expense for the three and nine-month period ended September 30, 2016, respectively). No hedging ineffectiveness was recorded.
- The Corporation did not purchase any call options during the third quarter. The cash premium related to crude-oil call option contracts was $14 for the nine months ended September 30, 2017 covering a portion of its 2017 fuel exposure ($9 and $33 respectively for the three and nine-month periods ended September 30, 2016, respectively, for 2016 and 2017 exposures).
- Fuel derivative contracts cash settled with a fair value of $15 in favour of the Corporation ($19 in favour of the Corporation for the nine months ended September 30, 2017; $10 and $22 in favour of the Corporation, respectively, for the three and nine-month periods ended September 30, 2016).

As of September 30, 2017, there are no outstanding fuel derivatives. The fair value of the fuel derivatives portfolio was $14 in favour of the Corporation as at December 31, 2016 and recorded within Prepaid expenses and other current assets.

Foreign Exchange Risk Management

Based on the notional amount of currency derivatives outstanding at September 30, 2017, as further described below, approximately 57% of net U.S. cash outflows are hedged for the remainder of 2017 and 61% for 2018, and 20% for 2019 resulting in derivative coverage of 56% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 68% coverage over the next 18 months.

As at September 30, 2017, the Corporation had outstanding foreign currency options and swap agreements, settling in 2017 and 2018, to purchase at maturity $2,515 (US$2,016) of U.S. dollars at a weighted average rate of $1.3010 per US$1.00 (as at December 31, 2016 – $2,612 (US$1,946) with settlements in 2017 and 2018 at a weighted average rate of $1.2898 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 €88, GBP £47, JPY ¥1,636, CNY ¥102, and AUD $37) which settle in 2017 and 2018 at weighted average rates of €1.1149, £1.2830, ¥0.0092, ¥0.1468, and $0.7555 per $1.00 U.S. dollar respectively (as at December 31, 2016 - EUR €82, GBP £69, JPY ¥2,334, CNY ¥53, and AUD $33 with settlement in 2017 at weighted average rates of €1.1059, £1.2589, ¥0.0096, ¥0.1522 and $0.7500 respectively per $1.00 U.S. dollar).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations, and based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at September 30, 2017 was $233 in favour of the counterparties (as at December 31, 2016 – $5 in favour of the Corporation). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During the third quarter of 2017, a loss of $198 was recorded in Foreign exchange gain (loss) related to these derivatives ($272 loss for the nine-month period ended September 30, 2017; gain of $52 and loss of $251 for the three and nine-month periods ended September 30, 2016). In the third quarter of 2017, foreign exchange derivative contracts cash settled with a net fair value of $81 in favour of the counterparties ($35 for the nine-month period ended September 30, 2017 in favour of the counterparties; $25 and $52 for the three and nine-month periods ended September 30, 2016 in favour of the counterparties).

The Corporation also holds U.S. currency reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash and short-term investment balances as at September 30, 2017 amounted to $910 (US$730) ($560 (US$416) as at December 31, 2016). During the three months ended September 30, 2017, a loss of $49 ($72 loss for the nine-month period ended September 30, 2017; gain of $13 and loss of $40 for the three and nine-month periods ended September 30, 2016) was recorded in Foreign exchange gain (loss) reflecting the change in Canadian equivalent market value of the U.S. dollar cash and short-term investment balances held.

Financial Instrument Fair Values in the Consolidated Statement of Financial Position

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

The carrying amounts of derivatives are equal to their fair value, which is based on the amount at which they could be settled based on estimated market rates at September 30, 2017.

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 and finance leases is $6,403 compared to its carrying value of $6,329.

The following is a classification of fair value measurements recognized in the consolidated statement of financial position using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. There are no changes in classifications or methods of measuring fair value from those disclosed in Note 15 to the 2016 annual consolidated financial statements. There were no transfers within the fair value hierarchy during the nine months ended September 30, 2017.

	September 30, 2017	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	$ 202	$ –	$ 202	$ –
Short–term investments	2,989	–	2,989	–
Derivative instruments				
Fuel derivatives	-	–	-	–
Share forward contracts	56	–	56	–
Foreign exchange derivatives	-	–	-	–
Total	**$ 3,247**	**$ –**	**$ 3,247**	**$ –**
Financial Liabilities				
Derivative instruments				
Foreign exchange derivatives	233	–	233	–
Total	**$ 233**	**$ –**	**$ 233**	**$** –

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.

10. CONTINGENCIES AND LITIGATION PROVISIONS

Investigations by Competition Authorities Relating to Cargo

As described in Note 16 to the 2016 annual consolidated financial statements, in 2010, the European Commission rendered a decision finding that 12 air cargo carriers (including groups of related carriers) had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006. Air Canada was among the carriers subject to the decision and a fine of 21 Euros (approximately $29 at that time) was imposed on Air Canada. Air Canada appealed the decision and paid the fine, as required, pending the outcome of its appeal. On December 16, 2015, the European General Court granted Air Canada's appeal and annulled the decision of the European Union with regard to Air Canada and certain other airlines. As a result of the European General Court's decision, the European Commission was required to refund to Air Canada the fine of 21 Euros ($30).

In March 2017, the European Commission issued a new decision imposing the same fine of 21 Euros ($30) initially levied against Air Canada in 2010. Air Canada has appealed the decision. Air Canada recorded the charge as a Special item in the first quarter of 2017, and paid the fine as required in the second quarter of 2017, pending the outcome of its appeal. While Air Canada cannot predict with certainty the outcome of its appeal or any related proceedings, Air Canada believes it has reasonable grounds to challenge the European Commission's ruling.

11. SALE-LEASEBACK

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

In the nine months ended September 30, 2016, the Corporation took delivery of two 787 aircraft that were financed under sale-leaseback transactions with proceeds of $351 and a gain on sale of $19 was recognized in non-operating income.