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Air Canada reports second quarter 2011 results - Operating income improvement of \$26 million to \$73 million

MONTREAL, Aug. 4, 2011 /CNW Telbec/ - Air Canada today reported second quarter operating income of \$73 million compared to operating income of \$47 million in the second quarter of 2010, an improvement of \$26 million. Earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent (EBITDAR) of \$338 million increased \$10 million from the same quarter in 2010.

"I am very pleased to report continued improvements in our financial performance for the second quarter," said Calin Rovinescu, President and Chief Executive Officer. "Despite significant increases in fuel prices year-over-year and the effects of a three-day work stoppage by our call centre and airport customer service agents represented by the CAW, the second quarter's operating profit reflects our disciplined approach to capacity management which, combined with our industry leading product, drove strong revenue performance and yield growth in the quarter. Our Cost Transformation Program is on track, having achieved \$475 million in annual benefits of the \$530 million targeted for the end of 2011 on a run-rate basis. In addition, adjusted net debt of \$4,362 million at June 30, 2011 decreased \$890 million when compared to June 30, 2010.

"However, fuel prices remain volatile and at historically high levels. We estimate that these higher fuel prices will add approximately \$800 million to operating costs in 2011, based on 2010 capacity and net of the impact of foreign exchange. In an attempt to mitigate the impact on Air Canada's 2011 results, we continue to explore additional cost reduction opportunities beyond those identified through our Cost Transformation Program, to increase fares and fuel surcharges where competitively feasible, and to make adjustments to capacity as required.

"I want to thank our employees for their commitment to the priorities that support Air Canada's transformation. Their hard work has been recognized by our customers who ranked Air Canada as Best International Airline in North America, the second consecutive year we have achieved top honours in the annual Skytrax World Airline Awards survey of international air travellers."

Revenue Highlights

System passenger revenues increased \$272 million or 11.7 per cent from the second quarter of 2010 on a 6.1 per cent growth in traffic and a 5.2 per cent improvement in yield.

System capacity grew 6.4 per cent from the second quarter of 2010, the result of capacity increases implemented after the second quarter of 2010 which continued into the second quarter of 2011, and which were supported by increased aircraft utilization.

A system yield improvement of 5.2 per cent reflected yield growth in all markets. The improvement was driven by higher fares and fuel surcharges to partly offset higher fuel prices and, to a lesser extent, traffic gains in the premium cabin. Premium cabin revenues grew \$54 million or almost 11 per cent from the same quarter in 2010 due to traffic growth of 13 per cent.

Passenger revenue per available seat mile (RASM) increased 4.9 per cent from the second quarter of 2010 as a result of the yield improvement.

Operating Expense Highlights

Operating expenses increased \$267 million or 10 per cent from the second quarter of 2010, mainly on a 46 per cent increase in base fuel prices year-over-year, and on the system capacity growth of 6.4 per cent. Partially offsetting these increases was the favourable impact of a stronger Canadian dollar on foreign currency denominated expenses (which reduced operating expenses by \$64 million when compared to the second quarter of 2010). Cost Transformation Program (CTP) initiatives also contributed to reducing various operating expenses.

Unit cost in the second quarter of 2011, as measured by operating expense per available seat mile (CASM), increased 3.8 per cent from the second quarter of 2010. Excluding fuel expense, CASM decreased 3.7 per cent year-over-year. The favourable impact of a stronger Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars), the capacity growth, the impact of CTP initiatives, as well as increases in aircraft utilization and average stage length compared to the second quarter of 2010 contributed to the year-over-year CASM, excluding fuel expense, decrease. The 3.7 per cent year-over-year

decrease in CASM, excluding fuel expense, for the second quarter of 2011 was above the 0.5 to 1.5 per cent decrease projected in Air Canada news release dated May 5, 2011. The improvement was largely due to lower than forecasted aircraft maintenance expense and wages, salaries and benefits expense.

Air Canada reported a net loss of \$46 million in the second quarter of 2011 compared to a net loss of \$318 million in the second quarter of 2010, an improvement of \$272 million. The net loss in the second quarter of 2011 includes foreign exchange gains of \$9 million, while the net loss in the second quarter of 2010 included foreign exchange losses of \$190 million.

Air Canada reported a loss per diluted share of (\$0.17) in the second quarter of 2011 on an unadjusted basis. The airline reported a loss per diluted share, on an adjusted basis, of (\$0.20) in the second quarter of 2011 compared to a loss per diluted share, on an adjusted basis, of (\$0.27) in the second quarter of 2010. Loss per diluted share for the second quarter of 2011 was adjusted to remove Air Canada's gains on foreign exchange of \$9 million and a gain on disposal of assets of \$1 million. The loss per diluted share for the second quarter of 2010 was adjusted to remove Air Canada's loss on foreign exchange of \$190 million, an interest charge related to the prepayment of the airline's secured credit facility of \$54 million, and a loss on disposal of assets of \$1 million.

Liquidity Highlights

At June 30, 2011, Air Canada's cash, cash equivalents and short-term investments totalled \$2.259 billion which represented 20 per cent of 12-month trailing operating revenues.

In the second quarter of 2011, free cash flow of \$241 million decreased \$56 million from the second quarter of 2010, largely due to Air Canada having resumed making past service contributions to its domestic registered pension plans pursuant to the terms of the Air Canada 2009 Pension Regulations.

Total debt and finance lease obligations, including current portion, amounted to \$4,213 million at June 30, 2011, a decrease of \$382 million from December 31, 2010. The decrease in long-term debt and finance lease obligations from December 31, 2010 was mainly due to repayments of \$411 million, including balloon maturities totaling \$221 million, as well as the favourable impact of a stronger Canadian dollar on Air Canada's foreign currency denominated debt (mainly U.S. dollars), which accounted for a decrease of \$119 million. These decreases were partially offset by proceeds from borrowings of \$125 million.

At June 30, 2011, adjusted net debt of \$4,362 million decreased \$281 million from March 31, 2011, due to debt repayments of \$144 million made during the quarter and the impact of higher balances of cash, cash equivalents and short-term investments.

Labour Update

Terms were tentatively concluded on August 1, 2011 for a new five-year collective agreement with the Canadian Union of Public Employees (CUPE) representing the airline's approximately 6,800 flight attendants. The agreement is subject to ratification by the union membership. A new four-year collective agreement was ratified on June 27, 2011 with the Canadian Auto Workers (CAW) union representing the airline's approximately 3,800 call centre and airport customer service agents in Canada following a three-day labour disruption during which the airline maintained full operations. Air Canada expects to resume negotiations in the coming weeks with the International Association of Machinists and Aerospace Workers (IAMAW) which represents the airline's mechanics and baggage handlers. Negotiations with the Canadian Airline Dispatchers Association (CALDA) are ongoing. As the tentative agreement reached in March 2011 by the company and the AirCanada Pilots Association (ACPA) was not ratified by the membership, Air Canada continues to discuss with ACPA next steps towards finalizing a new collective agreement over the coming months.

Current Outlook

Air Canada plans to increase its full year 2011 system capacity, as measured by available seat miles (ASMs), by 3.5 to 4.5 per cent from the full year 2010 level, unchanged from what was projected in its May 5, 2011 news release. The system capacity increase would be achieved primarily through the use of Air Canada's current aircraft fleet.

Due to some minor flight schedule changes, Air Canada now expects its full year 2011 domestic capacity to range between a 0.5 per cent decrease and a 0.5 per cent increase from the full year 2010 (as opposed to the full year 2011 domestic capacity decrease of up to 0.5 per cent projected in Air Canada's news release dated May 5, 2011). As a result of Air Canada recording better than expected CASM, excluding fuel expense, in the second quarter of 2011, Air Canada now expects its full year 2011 CASM, excluding fuel expense, to decrease by 1.0 to 3.0 per cent from the full year 2010 level (as opposed to the full year 2011 CASM, excluding fuel expense, decrease of up to 2.0 per cent from the full year 2010 level projected in Air Canada's news release dated May 5, 2011).

For the third quarter of 2011, Air Canada plans to increase its system ASM capacity by 1.5 to 2.5 per cent compared to the third

quarter of 2010 and expects CASM, excluding fuel expense, to increase from the third quarter of 2010 by 1.0 to 2.0 per cent.

In its May 5, 2011 news release, AirCanada projected that EBITDAR for the first half of 2011 would exceed first half 2010 EBITDAR by up to 5 per cent. Due to a number of factors, including lower than forecasted aircraft maintenance expense of \$16 million and fuel expense of \$6 million, net favourable adjustments in wages, salaries and benefits of \$12 million and reversals of various tax-related accruals of \$ 7 million, EBITDAR of \$545 million for the first half of 2011 reflected a year-over-year improvement of 14 per cent.

In its February 10, 2011 news release, AirCanada had projected that aircraft maintenance expense for the full year 2011 would increase by 8 to 12 per cent from the full year 2010. Due to a number of factors, including the impact of a stronger Canadian dollar versus the U.S. dollar and lower than forecasted airframe and engine maintenance activity, Air Canada now expects full year 2011 aircraft maintenance expense to range between a 1.0 per cent decrease and a 3.0 per cent increase from the full year 2010. Air Canada had also projected that depreciation, amortization and impairment expense for the full year 2010 would decrease by approximately \$60 million from the full year 2010. Due to Air Canada recording lower than expected depreciation, amortization and impairment expense in the first six months of 2011 (mainly lower depreciation and amortization of rotatable inventory and systems development and software costs), Air Canada now expects full year 2011 depreciation, amortization and impairment expense to decrease by \$75 million from the full year 2010. Air Canada's projection on pension and other employee future benefits expense which projected an increase of approximately \$60 million for the full year 2011 compared to the full year 2010 remains essentially unchanged from what was disclosed in Air Canada's news release dated February 10, 2011.

In mid-2009, Air Canada launched the CTP, identifying and implementing initiatives with a goal of generating annualized revenue gains and cost savings, including through contract and operating process improvements and productivity gains. In 2010, Air Canada achieved and delivered annual benefits of \$330 million. To date, Air Canada has achieved \$475 million of its overall CTP target of \$530 million for the end of 2011, on a run-rate basis. Air Canada views continuous cost transformation and improvement as one of its most important priorities, and a critical objective going forward to support ongoing CASM improvements.

Air Canada's outlook assumes that the Canadian economy will continue to recover in 2011. In addition, Air Canada expects that the Canadian dollar will trade, on average, at C\$0.97 per U.S. dollar in the third quarter of 2011 and C\$0.98 per U.S. dollar for the full year 2011 and that the price of jet fuel will average 86 cents per litre for the third quarter of 2011 and 85 cents per litre for the full year 2011.

The following table summarizes Air Canada's above-mentioned outlook and related major assumptions for the third quarter of 2011 and for the full year 2011:

	Third Quarter 2011 versus Third Quarter 2010	Full Year 2011 versus Full Year 2010
<u>Current Outlook</u>		
Available seat miles (System)	Increase 1.5 to 2.5%	Increase 3.5 to 4.5%
Available seat miles (Canada)	n/a	Decrease 0.5% to an increase of 0.5%
CASM, excluding fuel expense	Increase 1.0 to 2.0%	Decrease 1.0 to 3.0%
Aircraft maintenance expense		Decrease 1.0% to an increase of 3.0%
Depreciation, amortization and impairment expense		Decrease \$75 million
Employee benefits expense		Increase \$60 million
	Major Assumptions - Third Quarter 2011	Major Assumptions - Full Year 2011
<u>Major Assumptions</u>		
Canadian dollar per U.S. dollar	0.97	0.98
Jet fuel price - Cents per litre (net of fuel hedging)	86 cents	85 cents
Canadian economy	Will continue to recover	Will continue to recover

The outlook provided constitutes forward-looking statements within the meaning of applicable securities laws and is based on a number of additional assumptions and subject to a number of risks. Please see section below entitled "Caution Regarding Forward-Looking Information."

(1) Non-GAAP Measures

Air Canada uses adjusted earnings (loss) per diluted share to assess share performance without the effects of foreign exchange gains (losses). This measure is not a recognized measure for financial statement presentation under Canadian GAAP and does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies.

EBITDAR is a non-GAAP financial measure commonly used in the airline industry to assess earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent. EBITDAR is used to view operating results before aircraft rent, depreciation, amortization and impairment as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. EBITDAR is not a recognized measure for financial statement presentation under GAAP and does not have a standardized meaning and is therefore not comparable to similar measures presented by other public companies.

Air Canada's Second Quarter 2011 Interim Unaudited Condensed Consolidated Financial Statements and Notes and its Second Quarter 2011 Management's Discussion and Analysis (MD&A) are available on Air Canada's website at aircanada.com, and will be filed on SEDAR at www.sedar.com. Readers should refer to Air Canada's Second Quarter 2011 MD&A for a reconciliation of EBITDAR to operating income (loss).

For further information on Air Canada's public disclosure file, including Air Canada's Annual Information Form dated March 30, 2011, refer to Air Canada's website at aircanada.com or consult SEDAR at www.sedar.com.

CAUTION REGARDING FORWARD-LOOKING INFORMATION

This press release includes forward-looking statements within the meaning of applicable securities laws. Forward-looking statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to preliminary results, guidance, strategies, expectations, planned operations or future actions. Forward-looking statements are identified by the use of terms and phrases such as "preliminary", "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "predict", "project", "will", "would", and similar terms and phrases, including references to assumptions.

Forward-looking statements, by their nature, are based on assumptions, including those described herein and are subject to important risks and uncertainties. Forward-looking statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including without limitation, industry, market, credit and economic conditions, the ability to reduce operating costs and secure financing, pension issues, energy prices, currency exchange and interest rates, employee and labour relations, competition, war, terrorist acts, epidemic diseases, environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), insurance issues and costs, changes in demand due to the seasonal nature of the business, supply issues, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this news release and those identified in section 18 "Risk Factors" of Air Canada's 2010 MD&A and section 14 "Risk Factors" of Air Canada's Second Quarter 2011 MD&A. The forward-looking statements contained in this news release represent Air Canada's expectations as of the date of this news release (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 as a result of new information, future events or otherwise, except as required under applicable securities regulations.

Highlights

Effective January 1, 2011, Air Canada began reporting its financial results in accordance with IFRS, including comparative figures for 2010. The financial and operating highlights for Air Canada for the periods indicated are as follows.

(Canadian dollars in millions, except where indicated)	Second Quarter			First Six Months		
	2011	2010	Change \$	2011	2010	Change \$
Financial Performance Metrics						
Operating revenues	2,918	2,625	293	5,671	5,144	527
Operating income (loss)	73	47	26	7	(89)	96
Non-operating expense	(120)	(365)	245	(73)	(342)	269
Loss before income taxes	(47)	(318)	271	(66)	(431)	365
Loss for the period	(46)	(318)	272	(65)	(430)	365
Operating margin %	2.5 %	1.8 %	0.7 pp	0.1 %	(1.7) %	1.8 pp
EBITDAR ⁽¹⁾	338	328	10	545	478	67
EBITDAR margin % ⁽¹⁾	11.6 %	12.5 %	(0.9) pp	9.6 %	9.3 %	0.3 pp
Cash, cash equivalents and short-term investments	2,259	1,815	444	2,259	1,815	444
Free cash flow ⁽²⁾	241	297	(56)	431	512	(81)
Adjusted net debt ⁽³⁾	4,362	5,252	(890)	4,362	5,252	(890)
Loss per share - Diluted	\$(0.17)	\$(1.14)	\$0.97	\$(1.56)	\$1.31	\$(0.25)
Operating Statistics						
	Change %			Change %		
Revenue passenger miles (millions) (RPM)	13,677	12,896	6.1	26,032	24,588	5.9
Available seat miles (millions) (ASM)	16,512	15,523	6.4	32,371	30,250	7.0
Passenger load factor %	82.8 %	83.1 %	(0.2) pp	80.4 %	81.3 %	(0.9) pp

Passenger revenue per RPM ("Yield") (cents)	18.8	17.9	5.2	18.7	17.9	4.7
Passenger revenue per ASM ("RASM") (cents)	15.6	14.8	4.9	15.0	14.5	3.6
Operating revenue per ASM (cents)	17.7	16.9	4.5	17.5	17.0	3.0
Operating expense per ASM ("CASM") (cents)	17.2	16.6	3.8	17.5	17.3	1.1
CASM, excluding fuel expense (cents)	11.9	12.3	(3.7)	12.5	13.1	(4.5)
Average number of full-time equivalent (FTE) employees (thousands) ⁽⁴⁾	23.5	23.1	2.0	23.6	23.0	2.6
Aircraft in operating fleet at period end ⁽⁵⁾	330	328	0.6	330	328	0.6
Average fleet utilization (hours per day) ⁽⁶⁾	10.0	9.7	3.3	10.1	9.6	5.2
Revenue frequencies (thousands)	138	135	2.9	271	262	3.5
Average aircraft flight length (miles) ⁽⁶⁾	886	853	3.9	888	855	3.9
Economic fuel price per litre (cents) ⁽⁷⁾	87.9	66.8	31.6	83.2	66.5	25.1
Fuel litres (millions)	984	924	6.5	1,922	1,796	7.0

- (1) *EBITDAR (earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent) is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of Air Canada's Second Quarter 2011 MD&A for a reconciliation of EBITDAR to operating income (loss).*
- (2) *Free cash flow (cash flows from operating activities less additions to property, equipment and intangible assets) is a non-GAAP financial measure. Refer to section 7.4 of Air Canada's Second Quarter 2011 MD&A for additional information.*
- (3) *Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is a non-GAAP financial measure. Refer to section 7.2 of Air Canada's Second Quarter 2011 MD&A for additional information.*
- (4) *Reflects FTE employees at Air Canada. Excludes FTE employees at Jazz and other third party carriers operating under capacity purchase agreements with Air Canada.*
- (5) *Includes Jazz aircraft covered under the Jazz CPA. Excludes aircraft operated by other third party carriers pursuant to capacity purchase agreements with Air Canada. Refer to section 6 of Air Canada's Second Quarter 2011 MD&A for additional information.*
- (6) *Excludes charter operations. Also excludes third party carriers operating under capacity purchase arrangements, other than Jazz aircraft covered under the Jazz CPA.*
- (7) *Includes fuel handling and is net of fuel hedging results. Economic fuel price per litre is a non-GAAP financial measure. Refer to sections 4 and 5 of Air Canada's Second Quarter 2011 MD&A for additional information.*

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