1994 Annual Report

Taking off for New Horizons

AIR CANADA

Corporate Profile

Air Canada is a Canadian-based international air carrier providing scheduled and charter air transportation for passengers and for cargo. The airline's passenger route network offers scheduled service to 25 North American cities.

Through its domestic connector carriers, another 50 Canadian communities and five cities in the United States are linked to the Air Canada network. The Corporation serves 26 cities in Europe, Asia and the Caribbean. Charter passenger services are provided to 15 international destinations.

The airline's cargo division serves 51 destinations in Canada and internationally, with sales representatives in some 80 countries.

Air Canada provides aircraft and engine maintenance, technical, flight attendant and pilot training, and computer and ground handling services to airlines and other customers. The Corporation owns outright or holds majority interest in the following: five Canadian regional airlines – AirBC, Air Ontario, Air Alliance, Air Nova and NWT Air; Galileo Canada, a computerized reservation service used by travel agents; and a major Canadian tour operator, Air Canada Vacations (Touram Inc.). It also holds minority interest in Continental Airlines, Inc. and in other travel- and transportation-related businesses.

Shareholder Base

Air Canada's shareholder base is comprised of the following: Institutional, 78 per cent; Retail, 16 per cent; and Employees, six per cent. Approximately 87 per cent of the shares are held by Canadian residents, and 13 per cent by non-residents (as defined in the Air Canada Public Participation Act and Air Canada's Articles of Continuance).

The Annual General Meeting of Shareholders of Air Canada will be held at 10:00 a.m. on Wednesday, May 10, 1995, at The Holiday Inn Crowne Plaza Hotel, 350 St. Mary Avenue, Winnipeg, Manitoba.

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Year at a Glance

Financial	1994	1993	Change
(Millions except per share figures)			
Operating revenues	$ 4,024	$ 3,598	12%
Operating expenses	$ 3,780	$ 3,521	7%
Operating income before provision for staff reduction and retirement costs	$ 244	$ 77	
Income (loss) for the year	$ 129	$ (326)	
Operating margin before provision for staff reduction and retirement costs	6%	2%	
Cash flow from operations	$ 44	$ (34)	
Average common shares outstanding (basic)	117.9	77.1	
Average common shares outstanding (fully diluted)	143.5	80.7	
Income (loss) for the year per common share (basic)*	$ 1.09	$ (4.23)	
Income (loss) for the year per common share (fully diluted)*	$ 0.97	$ (4.23)	
Cash flow from operations per common share (basic)*	$ 0.37	$ (0.44)	
Cash flow from operations per common share (fully diluted)*	$ 0.31	$ (0.44)	
Return on equity	47%	(238)%	

* Per share amounts have been calculated using the weighted average number of common shares outstanding during the year.

Operating Statistics	1994	1993	Change
(Scheduled and Charter – not consolidated)			
Revenue passengers carried (millions)	9.9	9.5	4%
Revenue passenger miles (millions)	14,995	13,768	9%
Available seat miles (millions)	23,730	21,157	12%
Passenger load factor	63.2%	65.1%	
Yield per revenue passenger mile	17.7¢	17.1¢	3%
Average number of employees	18,422	18,152	1%

The Air Canada fleet

	A319	A320	A340	Boeing 747	Boeing 767	CL-65	DC-9	L-1011	Total
Owned	0	21	0	5	11	0	26	5*	68
Op. Lease	0	13	0	4	11	4	9	0	41
In service	0	34	0	9	22	4	35	3	107
Orders	25	6	6**	0	5	6	0	0	48
Options	10	0	3	0	5	38	0	0	56

* One L-1011 has been leased to a third party. One is being used for replacement parts.
** Two additional Airbus A340 aircraft will be delivered in mid-1995 under 3-year operating leases.

The Connector Airline Fleets – In Service

	BAe 146	BAe J-31	Boeing 737 combi	DHC-8-100	DHC-8-300	Hercules Cargo	Twin Otter	Total
Air Nova	5	0	0	12	0	0	0	17
Air Alliance	0	0	0	9	0	0	0	9
Air Ontario	0	0	0	16	6	0	0	22
NWT Air	0	0	3	0	0	1	0	4
AirBC	5	5	0	11	6	0	4	31

1994 Highlights

A traditional Japanese sake jar, wrapped in rice straw and hand decorated.

January

Gemini settlement
Air Canada and PWA Corporation reach an out-of-court settlement of their 14 month legal battle over PWA's campaign to force dissolution of The Gemini Group Partnership. That deal precipitates a sweeping realignment of competitive forces in the business of providing Canadian travel agents with computerized reservations services.

Osaka route award
The Canadian government designates Air Canada to operate a new route to Osaka. That represents Air Canada's long awaited breakthrough into the lucrative Japanese market.

Still the best
For the second year in a row, Business Traveller International magazine selects Air Canada as Best Airline to fly to Canada. (Twelve months later, it will bestow the award on Air Canada yet again.)

February

A340 deal signed
Air Canada signs a contract acquiring six Airbus A340-300 long-range jetliners for delivery starting in late 1996. The four engine A340-300, capable of carrying 284 passengers and 15 tonnes of cargo for up to 13,000 kilometres, is the airline's aircraft of choice to launch future expansion in Pacific markets. The A340s will replace older Boeing 747s in the fleet.

March

Galileo Canada created
Galileo Canada, a wholly owned Air Canada subsidiary, is created to take over the travel services previously offered by Gemini. Galileo Canada uses the leading-edge travel product of Galileo International, the world's largest computer reservations network.

Freighter network disbanded
Air Canada Cargo disbands its money losing DC-8 domestic freighter network and makes international traffic its principal marketing focus, with the result that Cargo immediately enhances its contribution to Air Canada's profitability.

April

RESIII launched
The airline switches to a new reservations and inventory management system called RESIII. The change from 25 year-old technology represents one of the largest, one time system upgrades ever undertaken by a Canadian corporation. It provides Air Canada with an advanced IBM based platform capable of accommodating the many revenue and productivity enhancing features being developed by the airline industry worldwide.

ACV restructured
Air Canada Vacations is restructured. The downsizing gives the airline's tour operator division lower costs and a new business focus. By year-end, ACV is turning in its best performance in years, meeting or exceeding its financial targets.

Seoul ironwork featuring the yin and yang, symbolizing the opposites in nature.

May

Seoul route launched
It took 57 years, but on May 16, Air Canada's first transpacific route is inaugurated with the startup of service to Seoul, South Korea. Air Canada operates three weekly flights from Toronto via Vancouver, code-shared with marketing partner Korean Air. The two carriers also offer three flights on the same route on KAL equipment.

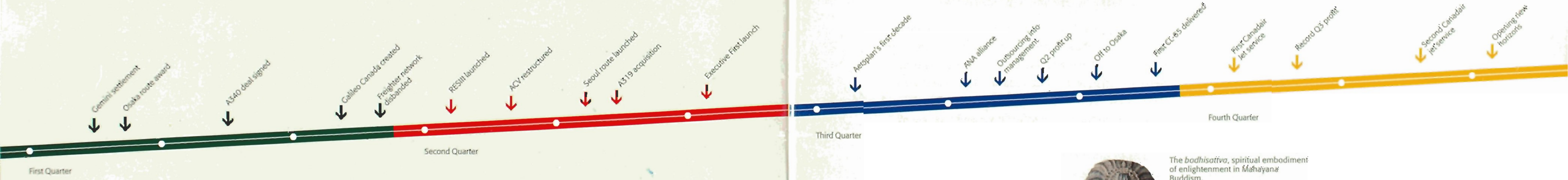
A319 acquisition
After an intense competition, Air Canada announces plans to acquire up to 35 Airbus A319 jetliners rather than update its fleet of aging DC-9 aircraft.

June

Executive First debuts
Executive First, the airline's new intercontinental business class product, makes its formal debut. Promoted as a first class product for a business class fare, it wins rave reviews from customers and media and sells strongly from Day 1.

British Midland alliance
Striking an alliance with British Midland, Air Canada adds UK cities, including Edinburgh and Belfast, to its global network.

Using hand held scanners to track time sensitive cargo shipments.



July

Aeroplan's first decade
Aeroplan, Canada's most prestigious frequent flyer program with the strongest worldwide partner network of any Canadian loyalty reward plan, celebrates its 10th anniversary.

The CL-65 regional jet, Air Canada's newest addition to the fleet.

August

ANA alliance
Air Canada and All Nippon Airways strike a comprehensive strategic alliance involving marketing, sales and operational services. The carriers agree to exchange frequent flyer benefits, facilitate interlining of passengers and cargo, and coordinate connections at Osaka's new $20 billion Kansai International Airport when Air Canada begins operating there in September.

Outsourcing info management
Advantis Canada, an IBM Canada subsidiary, is created to manage Air Canada's information systems and data centre as well as the airline's voice and data networks. For Air Canada, the outsourcing of these management services generates an immediate $55 million cash benefit and offers the prospect of future annual savings in the order of 10 percent.

Q2 profit up
The airline reports second quarter profit of $27 million, a $40 million improvement in consolidated operating income. When certain one time items are excluded from the year over year comparison, net results for the first six months of 1994 are up $169 million.

September

Off to Osaka
With the departure of Flight 891 from Toronto on September 20, Osaka becomes the airline's second Pacific destination and first in Japan. Air Canada begins serving Osaka with four weekly round trips via Vancouver. When the first flight lands on September 21 in Japan, chairman Hollis Harris announces that Air Canada will accelerate delivery of two A340 jetliners to enable the upgrading of the Osaka service to daily in July 1995.

First Canadair Jet delivered
Air Canada's first Canadair CL-65 jet is delivered to the airline at the Farnborough Air Show in England. The 50-seat regional jet, first of 24, will help launch a network of new transborder routes that call for a smaller aircraft than a DC-9 or A320.

October

One stop check-in expands
United Airlines becomes the latest Air Canada partner to offer connecting Air Canada passengers one stop check-in with advance boarding cards. The new service covers all legs of a journey originating or terminating with an Air Canada flight. Air Canada already offers a similar service with Continental Airlines.

Daytripper debuts
Daytripper, a new daylight service to London, England, offers business travelers the chance to arrive in the British capital by early evening, just in time for a normal bedtime, the ideal cure for jetlag. Operating six days a week from Toronto, Daytripper complements Air Canada's existing overnight flight on the same route and further confirms Air Canada's leadership in the Canada-United Kingdom market.

The *bodhisattva*, spiritual embodiment of enlightenment in Mahayana Buddism.

Toronto-New Delhi service
After a full year of success serving New Delhi from Vancouver via London, the airline increases its commitment to the Canada-India market by adding a weekly Toronto-Frankfurt-New Delhi service. The winter schedule includes a total of five Canada-Delhi services.

First Canadair Jet service
The CL-65 jet enters revenue service on October 10 on Ottawa-New York, providing travelers from the National Capital Region with the fastest service yet to the Big Apple.

November

Record Q3 profit
The Corporation reports third-quarter profit of $130 million, the best quarterly performance in the airline's 57 year history, the sixth consecutive quarter of year over year improvement in net earnings and the eighth straight quarter of improved operating results.

Second Canadair service
The second CL-65 service begins with three daily round trips on Halifax-Boston. Plans are announced to operate the aircraft on Montreal-Boston (December '94), Toronto-Fredericton (January '95) and Toronto-Saint John (February '95).

December

Opening new horizons
Canada liberalizes access to unserved and underserved international air routes. Air Canada states its desire to launch service to Manila and Tel Aviv and renews its four year campaign to be designated to serve Hong Kong, one of Canada's fastest growing overseas air travel markets. Separately, Canada and the United States announce agreement on the main points that will comprise the long-awaited Open Skies agreement between the two countries.

To the Shareholders

Asked how they measure success, many would say that the greater the obstacles one has overcome, the greater the achievement.

By that standard, two of Air Canada's many accomplishments last year were formidable indeed: the airline completed an arduous recovery from the worst recession in this half century and finally became a full-fledged Pacific carrier.

The net profit for 1994 was $129 million. That's a profit exceeded only once before in Air Canada's 57 year history, and it represents a $455 million improvement over 1993.

Just two years ago, Air Canada lost an almost inconceivable $454 million. Since then, by dint of great sacrifice and perseverance, this airline has been re-engineered and transformed into a winner.

Last year, having anticipated the global recovery in both the passenger and cargo markets, the Corporation turned from retrenchment to prudent expansion, employing a relatively low cost growth strategy based on working the fleet harder.
Air Canada did more flying than ever. Capacity grew by 11 percent, revenues by 12 percent, and costs by just over seven percent, resulting in a record operating profit of $244 million.

Most of that growth occurred internationally, marked by our long-awaited debut as a Pacific carrier serving Seoul and Osaka and a full year of operating to New Delhi.

Complementing expansion was our adherence to a disciplined pricing policy of rarely matching the non-compensatory fares of competitors. As a consequence, our yields rose while passenger load factor – the percentage of seats filled – declined by 1.4 points to 62.1 percent. That means Air Canada's core network has ample capacity to generate additional revenue as demand builds.

Domestically, recovery brought a trend towards more rational pricing for the industry – but not stability. Even after the billion dollar bailout and restructuring of Canadian Airlines International Ltd., doubts persisted about that carrier's viability. Those doubts continue to mesmerize policymakers, frustrating the development of pro-competitive policies for international routes consistent with our deregulated, domestic market and Canada-US Open Skies.

Protectionism of the kind now preventing Air Canada from serving Hong Kong penalizes consumers and acts like a ball and chain hobbling Canada's economic progress.

For six years, Canadian Airlines lobbied furiously against Air Canada's application to serve Japan, claiming that having to share this enormously prosperous market with Air Canada would cause it great harm. That both Air Canada and Canadian are doing well in Japan today proves what we were saying all along: That market was being underserved. The same applies to Hong Kong and other markets.

If Air Canada is to survive as an independent entity, and not become a branch plant of a foreign airline, growth must be our destiny – not unbridled or unfocussed growth, but sustainable growth which enhances the security of all Air Canada stakeholders.

Despite Air Canada's return to profitability last year at near record levels, I challenge the notion that we have accomplished our mission.

Our $129 million profit offsets only 12 percent of our aggregate losses for 1990-93. Our expansion last year was relatively risk free. For Air Canada to attain a higher plateau of sustainable profit – sufficient to reduce our debt, pay for fleet renewal and build up reserves for future contingencies – the Corporation must be prepared to assume a moderate degree of additional risk. In 1995, our plan is to add 13 percent more capacity, which will necessitate some expansion of the fleet.

The timing is right; the current growth cycle is far from spent. Our dollar is attracting record numbers of foreign visitors and boosting cargo sales. Canada-US Open Skies represents a new frontier for growth.

As you read about our strategic initiatives in this report I think you will agree: This is the most competitive Air Canada ever, more entrepreneurial and customer-focussed, employing leading edge technology and investing aggressively in a state of the art fleet to deliver a world-beating product. Our unit costs are among the lowest of the major North American carriers, our aircraft utilization rate among the highest. We have a worldwide network of strong alliance partners. With sleeper seats and 55 inch seat pitch, our new intercontinental business class – Executive First – continues to win rave reviews.

At the start of 1994, efforts by PWA Corporation to force dissolution of the Gemini Group partnership led us to create Galileo Canada as a wholly owned Air Canada subsidiary, providing an exceptional computer reservations product to Canadian travel agents.

I have left perhaps the best for last: Air Canada's over 18,000 employees. Their skill, resilience and dedication were instrumental in our turnaround.

Time and again last year, I marvelled at how our staff rose to meet a challenge: how the reservations and airport staff coped heroically with the stressful switchover to our new RESIII reservations system; how our flight attendants, by their sensitivity and dedication to customers' needs, established Executive First as a bestseller; how our technical crews strained under impossible deadlines to reconfigure the fleet for Executive First; how pilots and ground crews once again made Air Canada a North American leader for on-time arrival performance.

Exploring new horizons and open skies means more than publishing a larger timetable. It means challenging ourselves to expand the limits of our capabilities. The next few years won't be easy. Then again, neither were the last few. That's why I am convinced Team Air Canada has the mettle to achieve even greater success.

Hollis L. Harris

Hollis L. Harris
Chairman, President and
Chief Executive Officer

Year in Review:
Taking off for new horizons

The airline industry is notoriously unforgiving of those who sit on their laurels. The pace of change is accelerating. New frontiers are opening up. Competitive forces are realigning. Tomorrow's survivors, Air Canada among them, must display a chameleon like ability to adapt to this environment by anticipating and even pre-empting new challenges.

Even as Air Canada was turning the corner to profitability last year, there was hardly time for Team Air Canada to take a breather. The unprecedented volume of change, the sheer enormity of many developments, snatched one's breath away. New destinations were launched, new alliances struck, new aircraft ordered, new aircraft delivered, new products and services introduced and new technology brought on line. While almost every aspect of the Corporation's activities in 1994 was a good news story, hardly any came about by happenstance. Together, these good news stories form an anthology: Year 1 of Air Canada's global strategy for long-term security and prosperity.

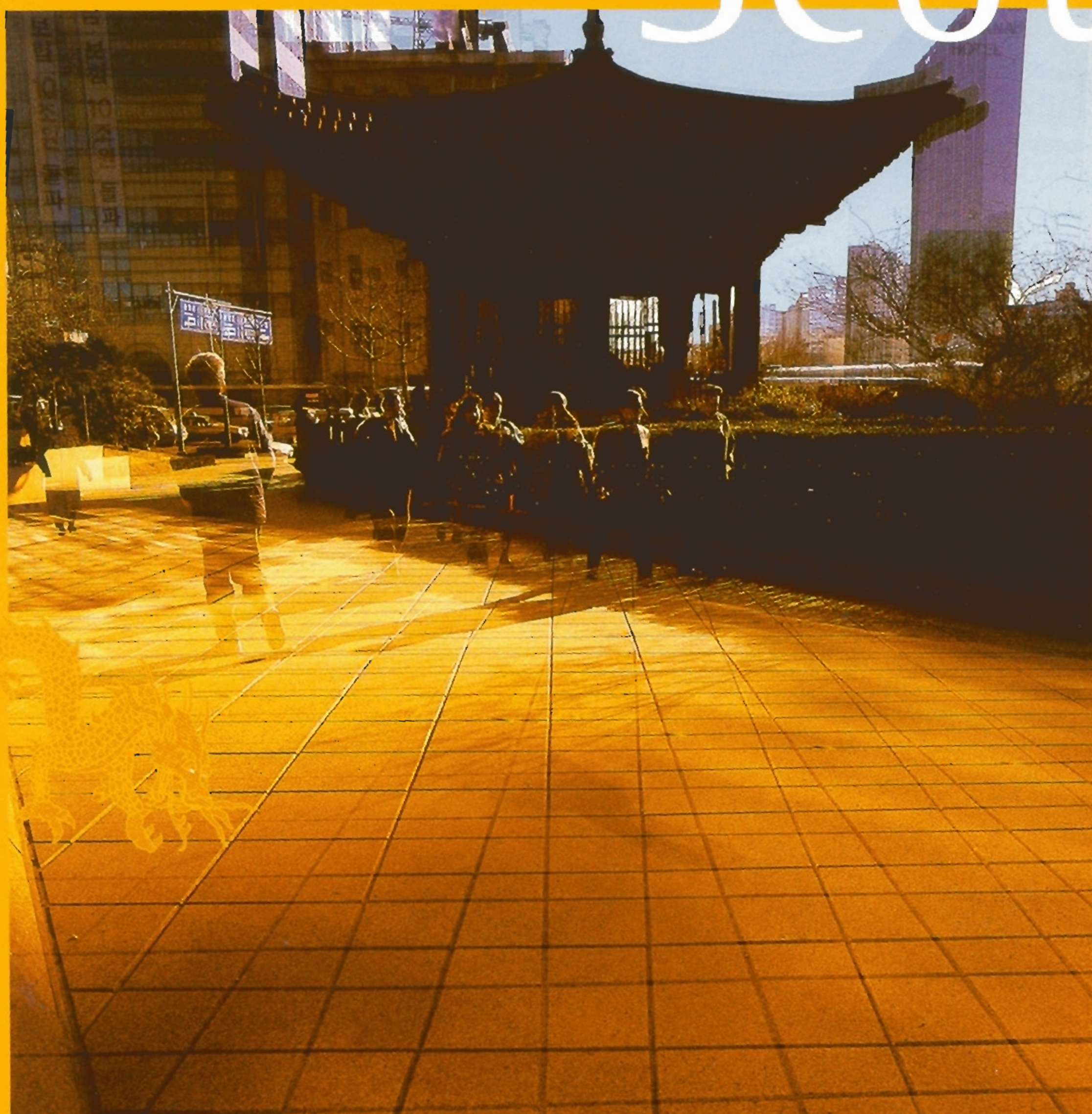
1. The network strategy

September 21, 1994... Touchdown of Flight 891 at Osaka. Air Canada had made it to Japan. Arriving at Kansai International Airport was a banzai occasion... banzai, the Japanese greeting that means "May you live ten thousand years."

It had been a summer for feeling immortal. By reaching Osaka, Air Canada's 35 year ambition to serve the Japanese market finally was fulfilled. Only four months earlier, by inaugurating service to Seoul, Air Canada had become a Pacific carrier.

As historic as these events seemed at the moment, they are even more significant for where they are taking the airline strategically. As international air travel becomes less regulated and more competitive, the search for profitable, new horizons assumes new urgency. Seoul and Osaka were logical candidates. These two cities, both prosperous industrial/financial centres, are destined to be major Asian aviation hubs and preferred gateways to all of central and eastern Asia.

Seoul



Although it traces its history back 603 years,
Seoul is the thoroughly modern capital of
one of Asia's most dynamic societies.

The burgeoning economies of Asia's Pacific Rim – tigers and dragons all – offer a cornucopia of expansion opportunities for Air Canada. At the same time, the Corporation's international strategy also seeks to improve the geographic balance of the network – to never be overdependent on the fortunes of any one region. The re-launch of service to India, via Europe, in November 1993 exceeded all expectations, prompting last year's addition of a Toronto-New Delhi same-plane service to the existing Vancouver-New Delhi routing. Over the next two years, Air Canada plans to begin serving the Middle East, Africa and Latin America, starting with Tel Aviv this June. Nor are good opportunities in Europe being ignored. The airline is preparing to resume flying to Brussels and Madrid.

While international expansion was front and centre last year, another front in Air Canada's network strategy is about to open in earnest. Canada-US Open Skies, the greatest growth opportunity and competitive challenge ever presented Air Canada, is a reality. With the dawn of this new deregulated era for transborder travel, Air Canada plans to offer as many as 20 new services in the first 18 months of Open Skies. Some will be operated with our own fleet – like the 50 seat CL-65 – and others by code-sharing new services launched by partners Continental Airlines and United Airlines.

Team Air Canada in Seoul: Customer service agent E.J. Choi, station manager Don Hur and Korean Air mechanic Kim Seung Ryeol inside an Air Canada Boeing 747-400 at Kimpo Airport. Seoul became Air Canada's first trans-Pacific destination in May 1994.

The quality that mechanic Martin Loiselle and his colleagues in Tech Ops' are renowned for has helped Air Canada earn major maintenance contracts from other airlines.

Separately, these two growth fronts promote travel between Canada and the rest of the world. Superimposed on the existing network, they create a new dimension for Air Canada: new international connections that tap into the far larger US market for overseas travel.

Friends in high places

Negotiating new and improved alliances with foreign carriers is another way Air Canada is building network appeal. Last year, Air Canada implemented an alliance with British Midland and negotiated another with Japan's All Nippon Airways. Air Canada also joined United in implementing one stop check-in for interline journeys, a service also offered with Continental.

2. Winning for customers

The easiest way to succeed in new markets is to make sure a good reputation precedes you.

In June, Air Canada discontinued First Class and launched Executive First, a new intercontinental business class earning plaudits as the new standard of excellence for intercontinental business class travel. With extra wide sleeper seats, a 55 inch seat pitch, personal entertainment systems and a global phone-fax capability at each seat, Executive First provides the personal space and amenities other airlines reserve for their First Class.

The success of Executive First – it often sells out on major routes – spurred Air Canada to launch Daytripper, an early morning service between Toronto and London designed for business travelers in

Osaka

Osaka, metropolis of Western Japan, anchors a region of 23 million people that generates as much economic activity as all of Canada.

particular. Daytripper, which complements Air Canada's regular overnight service, is timed to arrive in the British capital by mid-evening so that travelers can beat jetlag by going right to bed, then rise bright eyed the next morning ready for business.

Air Canada also went to great lengths to assure that our Asian guests feel welcome aboard our new Asian services. Japanese, Korean, Hindi- and Punjabi-speaking flight attendants staff Osaka, Seoul and New Delhi flights. For Osaka, cabin staff receive extensive training in Japanese culture and customs. Customers are offered Japanese language video soundtracks and reading material, as well as Japanese menu, bar and beverage selections in both Executive First and Hospitality cabins.

More smoke free horizons

Air Canada was the first major airline to ban smoking on all flights, a much applauded policy that was extended voluntarily to the carrier's new Seoul and Osaka routes. That made Air Canada the first carrier on the Pacific offering a totally smoke free environment on all flights. Customers tell us that traveling in a smoke free environment helps reduce jetlag. Now, as the rest of the world follows Air Canada's lead with smoke free flights, the airline is going a step further: All of our Maple Leaf lounges around the world have been made totally smoke free.

3. Cargo's comeback

There were more than a few damp eyes in the hangar when employees gathered to bid farewell to Air Canada's last DC-8 freighter – bringing to a close a 34 year association with DC-8 flying. Few at the wake could have guessed that the party was only beginning for Cargo. On March 31, Cargo grounded its domestic freighter network to refocus on international growth. The timing proved serendipitous. By the summer, the international air freight business, depressed for years, was in the midst of a strong recovery. New international business made up for lost domestic traffic, with the result that Cargo's 1994 revenues – $334 million – were virtually the same as the year before. Costs fell dramatically with the termination of the freighter operation. Cargo increased its contribution to Air Canada's bottom line by over $40 million, making 1994 one of its most profitable years ever.

Air Canada's new Asian services are having a dramatic impact on Cargo's performance. Seoul became Air Canada's East Asia cargo gateway. Loads there have stabilized at very high levels. In Western Asia, New Delhi has become Cargo's second best revenue generating station worldwide, with tariffs more than double the system average. The almost immediate success of New Delhi and Seoul and the resurgence of the global air freight sector have assured Cargo a full partnership in determining Air Canada's growth agenda.

ACV rebuilds, too

Cargo wasn't the only division successfully restructured last year. A rationalization of Air Canada Vacations' global operations resulted in a 27 percent reduction in operating expenditures. That, combined with a new business focus emphasizing value added tour packages, put the Corporation's tour operator division back into the black, assuring it a prominent role in developing Air Canada's expanded network.

Naoki Hashimoto, assistant manager at Osaka's Kansai International Airport, helps keep things running smoothly at Air Canada's newest international station.

4. Fleet usage – flying harder

An airplane costs the same to own or lease whether it is parked or flying. Scheduling it to fly more each day, thereby carrying more passengers and generating more revenue, is a cost effective way to expand. Most of Air Canada's 11 percent capacity increase last year was generated by extracting an average of 30 minutes more daily flying time per aircraft, including maintenance down-time.

This year's planned expansion is even more ambitious: 13 percent. And the fleet is being worked harder still: an average of 15 minutes more per day on top of last year's increase. That's a gain of 45 minutes per aircraft in two years.

Forty five minutes may not sound like a lot, but it translates into 80 hours of additional daily flying by the fleet. That's equivalent to all the flying Air Canada does daily in the Toronto-Ottawa-Montreal triangle, Canada's busiest travel corridor. Adding 80 hours is like adding nine new aircraft to the fleet at no additional cost.

With this year's increase, average daily flying per aircraft will reach 10 hours. That Air Canada is extracting so much more from the fleet while leading North American carriers in on-time arrival performance is a tribute to the care lavished on each aircraft by Air Canada's maintenance professionals.

With expansion on the front burner, more aircraft are required to help build capacity. The fleet, 107 aircraft at the end of 1994, will grow to a record 124 units by year end. Nineteen aircraft are being added, while two older Boeing 747s are scheduled to be retired.

In with the old

When the Lockheed L-1011s went into storage in Arizona in 1990, some pundits bet they would never fly again. What they neglected to consider is that reactivating the fully depreciated "L-10s" would be a quick, inexpensive way to rebuild transcontinental capacity after the recession. Last spring, the three remaining "L-10s" were brought north for a three year encore and given a roomy 238 seat configuration that quickly re-established them as customer favorites.

Coming into the fleet this year are 12 more Canadian made CL-65 regional jets to develop new transborder routes up to 1,500 kilometres; two intercontinental Boeing 767-200s coming in on two to three year leases; three new Boeing 767-300ERs, also for international growth; and two Airbus A340-300s. These A340s are being leased for three years from a third party – an interim measure so Air Canada can start daily Osaka service this July without waiting for delivery of six A340s in 1996-97.

With all of these comings and goings, the fleet is not only getting larger, it's getting younger. The average age is projected to drop from 13.2 years per aircraft to five by 1998.

5. Fleet renewal – in with the new

This next story sounds like a high stakes version of Let's Make a Deal. It began in the winter of 1993-94. First, Fokker came knocking at Air Canada's door. Then came Airbus and Boeing, along with McDonnell Douglas and British Aerospace, all saying "Have we got a deal for you!"

Each wanted to persuade Air Canada to drop plans to lead a program to refurbish the world's aging DC-9 fleet. Given the buyer's market for new aircraft that existed at the time, the manufacturers saw the DC-9X program – the X stands for service life extension – as further competition. If they could persuade Air Canada to give up the DC-9X, it might never get off the ground.

"Make us an offer we can't refuse," the manufacturers were told.

That they did. They wooed Air Canada with great new planes, great pricing and attractive financing. The result was Air Canada's decision last May to order 25 A319s from Airbus, with options for 10 more.

Factoring in various operational savings and potential revenue gains, flying new A319s will not cost much more than refurbishing and operating the 35 DC-9s for another 10 years.

The A319 prevailed over the DC-9X because of longer range (almost twice that of a DC-9), larger capacity (22 more seats than a DC-9) and much greater fuel efficiency (29 percent less fuel burned per seat mile). Since the A319 is a smaller sister ship to Air Canada's A320s, the two fleet types can be used almost interchangeably. Over 15 years, that promises accrued savings of $130 million in pilot training and maintenance scheduling, as well as in simulators and spare parts.

Yet, the concept behind DC-9X was sound. With the introduction of Open Skies, Air Canada is keeping its options open. Known as reliable performers, the DC-9s are eliciting great interest in the re-sale market. Air Canada's "Nines" could be sold as is, or refurbished and then sold at a higher margin. Alternatively, some or all may continue to fly for Air Canada beyond 1997 to accelerate the carrier's transborder expansion.

Earning kudos and revenues

Despite ordering the A319, Air Canada is still performing DC-9 upgrades for other carriers, along with engine overhauls and other heavy maintenance work for customers like Continental Airlines and Northwest Airlines. Air Canada's total revenues from third party maintenance work soared to $126 million, a 43 percent increase. Total third party revenues, which also take in the provision of ground handling and sales representation for other carriers in Canada and abroad, jumped 25 percent.

6. RESIII: the biggest technology update ever

RESERVEC is dead. Long Live RESIII! Now, that can be said with some conviction, but when the switchover to a new Reservations and Departure Control System occurred last April, the potential benefits were hard to appreciate amid the tumult. RESERVEC was user friendly for the reservations and airport staff, but not for many other departments, including Inventory and Yield Management. In the fast changing world of information technology, RESERVEC's once formidable capabilities paled against what today's leading edge systems can do to maximize revenue. RESERVEC could handle only 7-8 fare types. The system was expensive to maintain and couldn't be upgraded in a cost-effective manner to match the kind of enhancements developed for the more than 30 airlines using systems like RESIII that are based on the same British Airways system design.

RESIII can handle 26 fare types. That gives Yield Management enormous leeway to adjust the seat allocations for each category of consumer demand based on current and historical trends. It also permits introduction of customer service enhancements Air Canada must make to remain competitive – like issuing bar-coded baggage tags, or identifying frequent travelers for special treatment.

All of that is fine, but changing in-house reservations systems is like learning a new language overnight. Ripping out what had been the daily operational tool for 12,000 people for a quarter century and replacing it with a totally different system became one of the single, biggest information technology changeovers ever attempted in Canada. The fact that RESIII came in on time – in fact, six months earlier than initial forecasts – caught some departments unprepared. Weeks after RESIII was running, many employees continued to struggle with it. Customers faced busy signals at reservations centres and some flight delays. By summer, operations were back to normal. From here on in, RESIII will be a revenue enhancer and customer pleaser, good reasons why even die-hard RESERVEC fans have gotten used to it and have come to like it.

Technology to sell
Air Canada is not only a buyer of new technology like RESIII, it is a vendor, too. After evaluating competing systems, both Air France and Ansett Airlines of Australia purchased Aeroplan's highly respected Aeroplan Direct Marketing System to enable their own frequent flyer programs to track the activity of their best customers.

7. Galileo – donning the halo

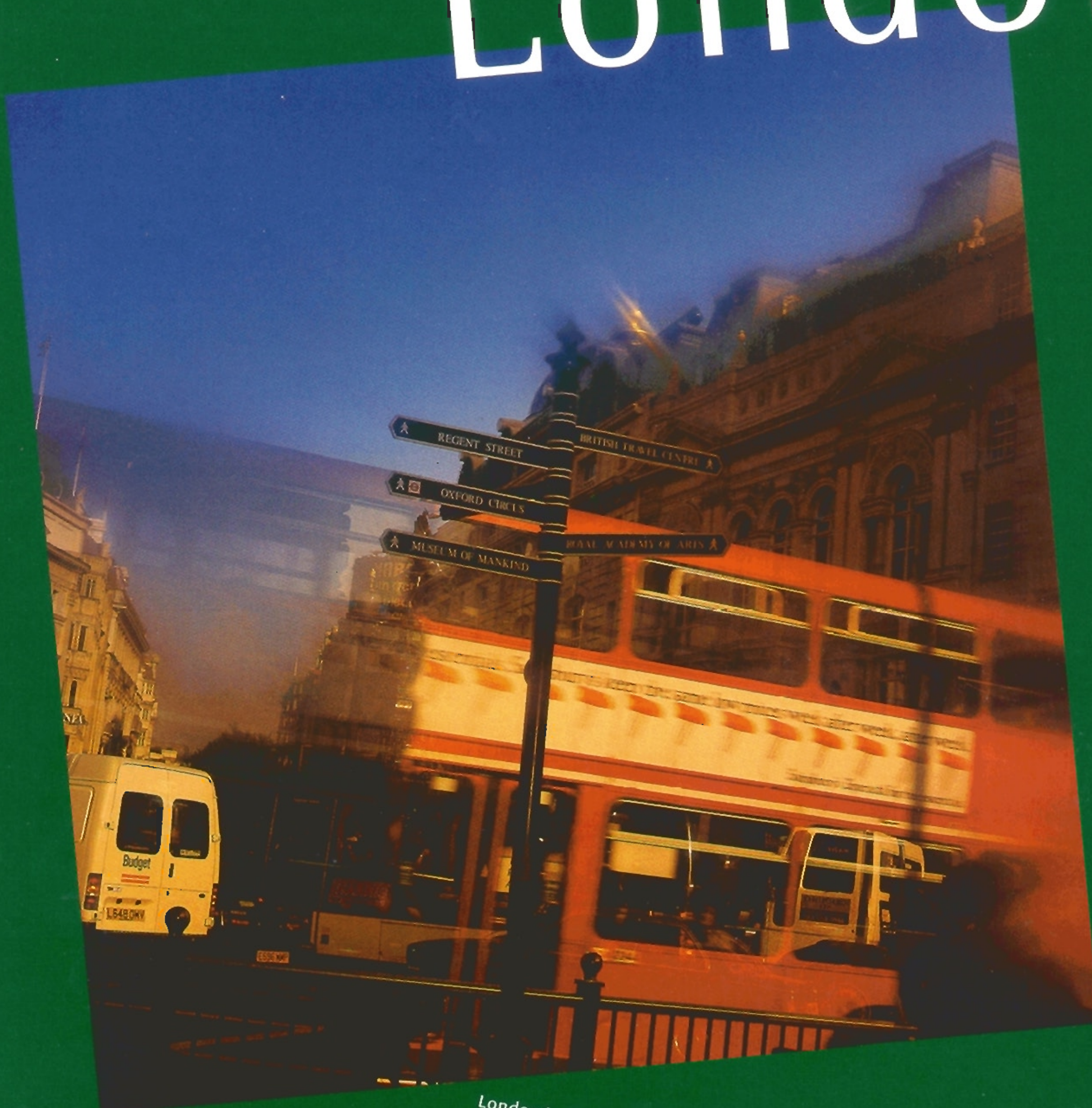
Four out of five airline bookings are made by travel agents, and travel agents make bookings through a commercial computer reservations system – or CRS.

Canada's CRS leader had been the Gemini Group, a partnership formed by Air Canada and PWA Corporation in 1987. By January 1994, Gemini had been subjected to two years of harassment and relentless litigation by PWA in their effort to dissolve the partnership so they could satisfy conditions set by AMR Corporation for bailing out Canadian Airlines International. AMR owns SABRE, Gemini's major competitor.

For Air Canada, taking over a weakened and demoralized Gemini – network and all – would have entailed enormous, on-going cost and difficulty.

Yet, Gemini's failure would have given SABRE a virtual monopoly in the CRS field. That raised a different dilemma. Studies in the United States have demonstrated that when an airline owns a CRS, travel agents

London



London is Air Canada's busiest overseas passenger and cargo station.

An Air Canada destination since 1947, London also became the airline's gateway to New Delhi.

using that CRS tend to favor that airline when booking customers. That's called the halo effect. Had Gemini disappeared, SABRE's greater halo could have promoted CAIL and American Airlines to Air Canada's detriment.

It was a perplexing problem requiring an inspired solution. In the end, two separate companies were created to take over Gemini's operations: Galileo Canada, a wholly owned Air Canada subsidiary, now provides the former Gemini customer base with a leading edge CRS product. Advantis Canada, a subsidiary of IBM Canada Ltd., became the network provider for Galileo Canada and in a related transaction, took over management of Air Canada's information technology systems, including voice and data networks. The latter contract will result in substantial future savings for Air Canada.

By affiliating with Galileo International, the world's largest CRS, Galileo Canada gained instant credibility. Almost as soon as it was up and running last July, Galileo Canada began to reverse the damage done to Gemini and regain market share from SABRE.

Traveling ticketless

The paper trail in air travel is coming to an end. Echoing initiatives of major US carriers like United and Continental, Air Canada plans to start phasing in ticketless travel. Traveling without a ticket is a lot like renting a car. Customers get a confirmation number for their booking, and use that number to get a boarding pass at the airport. That means no tickets to pick up, no tickets to lose and no unused tickets to return for refunds.

Barry Kent, station attendant at London's Heathrow Airport, loading cargo on Flight 896 to New Delhi. Cargo is a major reason for the success of new Asian destinations like Delhi, Seoul and Osaka.

Team Air Canada at 35,000 feet: Flight attendant Suzanne Duffy and her colleagues helped make Executive First one of the top-rated and best-selling intercontinental business class services.

8. Aeroplan keeps on growing and growing

Those who assume that frequent flyer programs must be losing their appeal should consider this: Last year, in Aeroplan's 10th year of operation, membership grew by 23 percent, topping two million. Since 1991, membership in Canada's premier frequent flyer program has grown by 125 percent, as has the mileage earned by members through their travel on Air Canada, on partner airlines, or through car rentals, hotel stays and from purchases charged to a CIBC Aerogold Visa or Diners Club/enRoute card.

Frequent flyer programs have evolved into much more than brand loyalty builders. Aeroplan is an integral part of Air Canada's product and a direct mail vehicle that helps the airline keep close to its major customers. As well, it is a major revenue generator. Revenues from the sale of Aeroplan mileage to Aeroplan partners rose 40 percent last year continuing a pattern of double digit growth as the membership base continues to expand.

Much of Aeroplan's success is attributable to the quality and diversity of its partners – brand names of quality with global appeal. It's hard to imagine traveling anywhere in the world without being able to collect Aeroplan points.

The extra mile

Air Canada also figures prominently in Canada's Air Miles program, which rewards members in some four million Canadian households with free travel for frequenting participating retailers. Air Canada is the only Canadian carrier on which Air Miles travel rewards can be used, and each reward trip is a ticket purchased by Loyalty Management Group Canada Inc.

9. People and productivity

Once you tighten your belt in the airline industry, there is no letting it out. Air Canada's recovery was based on stringent cost management and building a strong, private sector work ethic. These virtues are being carried over to the carrier's expansion.

Quite simply, this company has learned to get the most from the least. Air Canada is operating more capacity today than it did five years ago, but with 5,000 fewer employees. One reason is that front line employees are being empowered to make more

Houston

on, deep in the heart of Texas, is
ndustry capital of the United States
nd a major gateway to Latin America.

Customer service agent Desna Francis is part of the Air Canada team at Houston Intercontinental Airport. Air Canada has been serving Houston, a major hub of partner Continental Airlines, since May 1993.

decisions. Today, nine stations across the route system, including Boston and Regina, are operated by employees without the presence of on site supervisory staff.

With last year's expansion, Air Canada unit costs declined a further six percent while employee productivity rose by 11 percent. What really counts, is that Air Canada operated 550 more flights per month on average, significantly increased its work for third parties in the maintenance area and implemented a major technological change in RESIII with a mere one percent increase in overall employment.

However, Air Canada's future lies not in statistics but in people – our staff and our customers. In today's marketplace, an employee's extra effort is often the one thing the customer remembers about a trip. Air Canada's employees have a vested interest in continuing to provide exceptional service. While the customer is always boss at Air Canada, chances are the employee serving our customers also is a part owner of the airline. A majority of Air Canada employees are shareholders with lengthy service and extensive experience in meeting our customers' needs. Those are enormous, intangible assets that Air Canada will rely on more than ever as it takes off for new horizons.

As it expands to Asia, the Middle East and more of Europe and the United States, Air Canada is relying even harder on its people to be courteous and motivated service providers. An employee's extra effort is often the one thing a customer remembers from a travel experience.

Management Discussion and Analysis of Results

Air Canada recorded a consolidated net income of $129 million or $1.09 per share ($0.97 per share on a fully diluted basis) in 1994. This represents an improvement of $455 million compared to a net loss of $326 million or $4.23 per share in 1993. The 1994 results include favorable one time non-operating credits totalling $79 million related to the reorganization of The Gemini Group Limited Partnership ("Gemini"), the realization on the distribution of Gemini assets and the outsourcing of the Corporation's computer and network services functions. The prior year's results were adversely impacted by $187 million of one time charges relating to provisions for staff reduction and retirement costs and provisions for investments, partially offset by a favorable $46 million fuel excise tax rebate. Excluding these one time items, net income improved by $235 million.

Operating income was $244 million, the best in the Corporation's 57 year history and an improvement of $167 million from the previous year (before 1993 provisions for staff reduction). Excluding the impact of the 1993 fuel excise tax rebate, the improvement was $213 million.

Operating revenues grew by $426 million or 12 per cent while operating expenses rose $259 million or seven per cent. System capacity increased 11 per cent as measured by available seat miles (ASMs). Operating margin increased to six per cent from two per cent a year earlier (before 1993 staff reduction provisions). Earnings before interest, taxes, depreciation, amortization and aircraft rent (EBITDAR), a measure of normal operating income performance, improved to $680 million, 16.9 per cent of operating revenues.

In 1994, Air Canada pursued a growth strategy in selected domestic and international markets. With global economies recovering and with business and leisure travel increasing, the Corporation generated significantly improved operating results by improving market share and yields, by selectively adding passenger capacity at relatively low cost and by maintaining tight control on operating expenses. This growth was achieved without a significant addition to capital assets. Air Canada improved the daily utilization of its existing aircraft fleet, re-activated three Lockheed L-1011 aircraft from storage and added one Boeing 767-300, returned from a sublease.

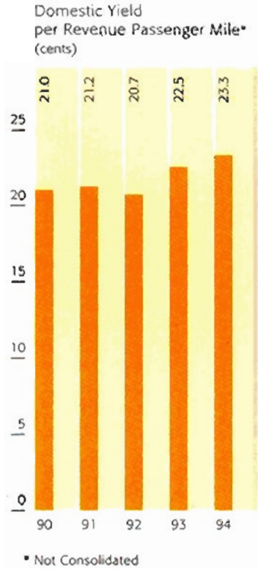
Non-operating expense was $87 million, a decrease of $230 million from 1993 due primarily to the previously noted 1994 credits with the prior year affected by provisions for investments of $111 million.

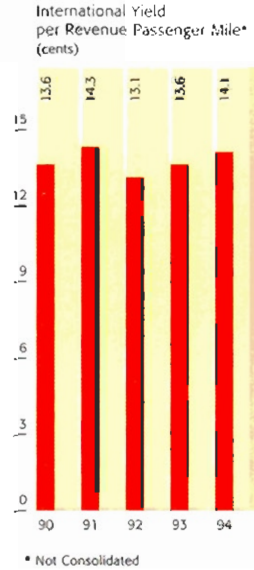
In 1994, a $67 million income tax provision was recorded in relation to the current year's earnings. This was reduced by $42 million by applying a portion of unrecognized income tax benefits from losses of past years.

Operating Revenues

(in millions)

Year ended December 31	**1994**	1993	1992	1991	1990	1989	1988
Domestic Routes							
Passenger	**$ 1,814**	$ 1,691	$ 1,677	$ 1,711	$ 1,793	$ 1,699	$ 1,512
Cargo	**151**	191	205	216	229	231	317
Total	**1,965**	1,882	1,882	1,927	2,022	1,930	1,829
International Routes							
Passenger	**1,358**	1,158	1,136	1,104	1,310	1,185	1,090
Cargo	**183**	144	137	138	184	167	186
Total	**1,541**	1,302	1,273	1,242	1,494	1,352	1,276
Other	**518**	414	346	316	383	336	299
Total	**$ 4,024**	$ 3,598	$ 3,501	$ 3,485	$ 3,899	$ 3,618	$ 3,404





1994 Income Results

Operating Revenues

Consolidated operating revenues of $4,024 million rose $426 million or 12 per cent over 1993.

Passenger Revenue

Consolidated passenger revenues increased 11 per cent to $3,172 million. For the year, consolidated system traffic, as measured by revenue passenger miles (RPMs), increased nine per cent while system yields improved two per cent to 19.6 cents per RPM. The system consolidated passenger load factor (a measure of capacity utilization) declined 1.4 percentage points to 62.1 per cent. This was due to the major expansion in new international flights and Air Canada's continuing yield improvement strategy which reduced the availability of discount fares.

The Corporation's passenger revenue on domestic routes grew by seven per cent. Overall domestic traffic rose five per cent on a capacity growth of four per cent. The Corporation's share of the domestic market, as measured by tickets sold by Canadian travel agents for travel within Canada, rose to 56.5 per cent, up one percentage point from 1993. Domestic yields improved two per cent reflecting less fare discounting and growth in higher yielding traffic.

Revenue on the Canadian transcontinental routes, which accounted for more than one third of total domestic revenues, increased eight per cent primarily as a result of traffic growth. Capacity was expanded in 1994 with new Boeing 747 Pacific services via Vancouver and with the addition of two Lockheed L-1011 aircraft on transcontinental routes.

Representing approximately one quarter of domestic revenues, the Corporation's commuter service revenues (including flights within Ontario and Quebec and the Rapidair routes on the Montreal, Toronto and Ottawa corridor) increased 11 per cent on the basis of higher yields and traffic.

The regional routes, which include service within Western Canada and Atlantic Canada flights recorded a six per cent revenue improvement primarily due to increased traffic.

International routes recorded a 17 per cent growth in revenue. International passenger traffic increased 12 per cent on a capacity growth of 18 per cent while yields rose five per cent.

In the transborder market between Canada and the USA, the Corporation continued to increase flights to the major hubs of its strategic alliance partners, United Airlines and Continental Airlines. Additional services were offered to Newark, California and Boston. Revenues on the transborder service, excluding Florida, rose 21 per cent on the basis of traffic growth of 14 per cent and seven per cent higher yields. Yield improved primarily due to fare increases and stronger growth in higher yielding fare categories. Florida revenues declined one per cent mainly due to reduced charter activity.

Transatlantic routes, excluding routes to India, recorded a 12 per cent increase in revenue compared to 1993. Passenger traffic grew by nine per cent with a three per cent increase in yields. Premium revenues, including Executive First, rose 15 per cent over 1993.

In the UK market, Air Canada's largest transatlantic service, revenues grew 14 per cent as a result of additional capacity and the full year impact of the Canada-London portion of service to India. Revenues from passenger services to Germany and Switzerland recorded a 32 per cent growth on higher traffic while France revenues were slightly over 1993 levels.

The Asian routes, which include services from London to New Delhi, India (started in November 1993) and service to Seoul, South Korea (May 1994) and Osaka, Japan (September 1994), generated incremental passenger revenues of $48 million over 1993. These Asian routes represent approximately one quarter of the growth in international passenger revenues over 1993.

Cargo Revenue

Consolidated cargo revenue of $334 million declined $1 million from 1993.

In March 1994, Air Canada completed the phase-out of its DC-8 all-cargo aircraft operations. As a result, the Corporation's domestic cargo revenues decreased 21 per cent.

Offsetting this, the international air cargo market experienced significant growth as a result of improving world economies. The Corporation's international cargo revenues increased 27 per cent due to growth from Atlantic, India and new Pacific services.

System cargo traffic, excluding subsidiaries, increased eight per cent while yield declined nine per cent.

Other Revenue

Other revenue of $518 million rose $104 million or 25 per cent. Of this increase, approximately 40 per cent came from the consolidation of Gemini and Galileo Canada Distribution Systems Inc. ("Galileo Canada") revenues, not previously consolidated. Additional third party aircraft maintenance revenues, including work for Continental, and Aeroplan partner revenues were the other significant factors.

Operating Expenses

Consolidated operating expenses of $3,780 million rose $259 million or seven per cent compared to 1993, before 1993 staff reduction provisions. Operating expenses increased primarily as a result of an 11 per cent growth in ASM capacity, the consolidation of Gemini and Galileo Canada (not previously consolidated) and higher aircraft maintenance expense.

Salaries and wages expense increased $28 million or three per cent. Approximately half of this increase resulted from the consolidation of Gemini and Galileo Canada. Other factors were additional manpower for increased maintenance services to third party airlines and the introduction of the new RESIII computer reservations system as well as higher salaries and wages expense for the Regional Airlines.

The average number of employees during the year increased by 270 or one per cent, excluding subsidiaries. Employee productivity, measured as available seat miles per employee, increased by eleven per cent over 1993. In 1994, average management and clerical employment declined 13 per cent while contract employees increased five per cent. Average salaries declined three per cent, partly as a result of salary reduction programs. A non-cash amount of $20 million has been included in salaries and wages expense due to an increase in the value of Share Appreciation Rights granted to certain Air Canada employee groups in return for salary reductions.

Benefits expense increased by $17 million to $160 million. Major factors were higher pension costs, government mandated increases, higher employee levels and the consolidation of Gemini and Galileo Canada benefit expenses.

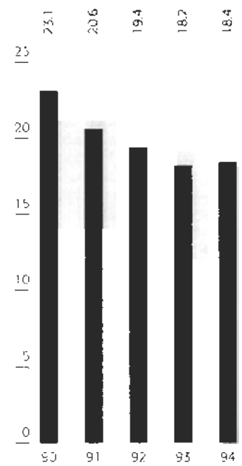
Fuel expense rose $31 million or seven per cent, excluding the 1993 fuel excise tax rebate. This reflected additional flying, partially offset by lower average fuel prices.

Depreciation, amortization and obsolescence expense declined by $13 million or six per cent in 1994. This was primarily due to the completion of amortization of Airbus A320 start-up costs, partially offset by higher expenses due to the inclusion of Gemini and Galileo Canada expenses.

The 11 per cent growth in passenger revenue was the key element in the $28 million or 10 per cent increase in commissions expense.

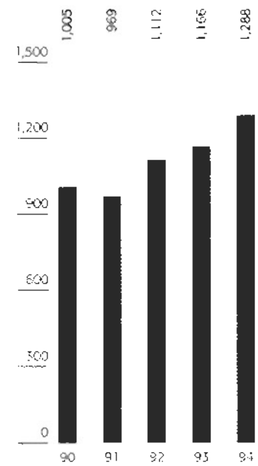
Food, beverages and supplies expense was unchanged from 1993. Increases due to additional traffic were essentially offset by changes to the on-board product and other expense reductions.

Average Number of Employees*
(thousands)



* Not Consolidated

Available Seat Miles per Employee*
(thousands)



* Not Consolidated

Aircraft maintenance materials and supplies expense increased by $31 million. This was due to additional flying, higher repair costs for older aircraft types, expenses related to Air Canada's new aircraft livery as well as increased maintenance expense for the Regional Airlines.

Increased flight frequencies and higher passenger volumes, particularly on Atlantic and Asian routes, as well as rate increases in Canada, Europe and on India flights accounted for most of the $22 million or 16 per cent increase in airport user fees.

Aircraft rent expense rose $16 million or seven per cent due primarily to the full year impact of 1993 operating leases for two Boeing 747-400 and five Airbus A320 aircraft and the lease of one Boeing 767-300 aircraft in early 1994. This was partially offset by reduced aircraft lease expense for the Regional Airlines and for Air Canada's all-cargo operations, discontinued in March 1994.

Other operating expense of $906 million was $53 million or six per cent higher than 1993. The consolidation of Galileo Canada and Gemini as well as volume-related expense increases in third party maintenance materials consumed, airport terminal services, computer reservations charges, credit card fees, flight/cabin crew lodging expenses, insurance and the Regional Airlines were the primary reasons for the increase. Expense reductions were recorded in Aeroplan liability, legal fees, advertising and promotion and from the restructuring of Air Canada Vacations.

As a result of continuing cost disciplines and productivity improvements, operating expense per available seat mile (ASM), excluding subsidiaries, declined six per cent compared to 1993, excluding the fuel excise tax rebate.

The Corporation's operating expense includes those of a number of non-passenger transportation businesses which do not produce passenger available seat miles. These businesses include cargo operations, third party maintenance and ground handling services, Gemini and Galileo Canada as well as Air Canada Vacations' packages. In 1994 non-ASM producing businesses generated consolidated revenues of $852 million. Excluding subsidiaries, the 1994 net operating cost per ASM of the passenger transportation business, after deducting the revenue impact of non-ASM generating businesses, amounted to 10.5 cents per ASM, a decline of seven per cent from 1993, excluding the fuel excise tax rebate.

Non-operating Expense

Consolidated non-operating expense was $87 million, a decrease of $230 million from 1993. Non-operating expense in 1994 was favourably affected by $79 million from the reorganization of Gemini and the restructuring of the Corporation's computer and network services functions. Non-operating expense in 1993 was adversely affected by $111 million in provisions for investments in GPA Group plc and Gemini.

Net interest expense decreased $6 million. Interest income grew due to higher average cash balances during the year and higher interest rates. Interest expense increased due to the weaker Canadian dollar. Higher interest rates on floating rate US dollar debt were offset by lower average debt balances in 1994. Capitalized interest of $11 million was related to future aircraft deliveries.

The gain on sale of assets of $67 million mainly reflected the sale of the last three DC-8 all-cargo aircraft and a $13 million gain related to the sale of the Corporation's computer service assets.

Other non-operating expense of $35 million represented an improvement of $13 million from 1993. The largest elements were related to gains on prepayment of debt and higher income from investments recorded on an equity basis. These were partially offset by a $33 million increase in amortization of deferred foreign exchange losses on long-term debt resulting from the weaker Canadian dollar.

Income Taxes

In 1994, Air Canada recorded a $67 million income tax provision in relation to the current year's earnings. This was reduced by $42 million by applying a portion of unrecognized income tax benefits from losses of past years. As at December 31, 1994, the remaining unrecognized potential benefit of future income tax savings amounted to $81 million. In 1993, as in 1992, management considered it inappropriate to record potential tax recoveries as generally accepted accounting principles restrict the recording of tax recoveries to circumstances in which there is virtual certainty that future profitability will absorb accumulated losses within the period as prescribed by the tax regulations.

Cash Position

At year-end 1994, Air Canada maintained a strong cash position with cash and short term investments at $599 million. Cash balances declined $246 million from 1993 as Air Canada reduced debt balances and made progress payments on future aircraft deliveries.

In 1994, cash from operations generated inflows of $44 million, an improvement of $78 million from the prior year. Excluding changes to major non-cash working capital items (accounts receivable, spare parts and supplies, accounts payable and advance ticket sales), operating cash flow was $164 million, an improvement of $243 million over 1993.

Other cash inflows included proceeds of $259 million from the sale and leaseback of assets including one Boeing 767-300 aircraft and one Boeing 747-400 aircraft which was converted from a conditional sale agreement to an operating lease. Proceeds from the sale of assets were $145 million primarily from the sale of three DC-8 all-cargo aircraft and the Corporation's information services assets. Cash from the consolidation of Gemini included Gemini cash balances at the time of acquisition. Investment in and advances to other companies reflected a net inflow of $32 million. This was due to the reclassification to cash and short term investments of a $60 million interest bearing deposit, maturing in 1995, which was partially offset by the $25 million cost of acquiring the minority interest in Air Ontario and Air Alliance.

Major uses of cash were for reduction of long-term debt and for additions to property and equipment.

In 1994, long term debt was reduced by $355 million. Air Canada retired US $100 million of long term debt at a discount to face value, 40 million of UK sterling bonds which matured in 1994 and US $76 million of obligations related to a conditional sale agreement for one Boeing 747-400 aircraft, which was refinanced under an operating lease.

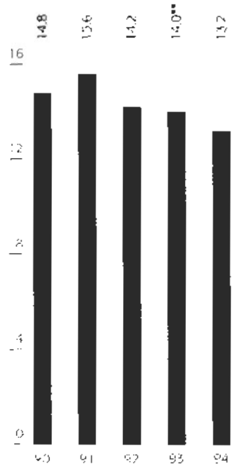
Additions to property and equipment of $410 million included $269 million in progress payments on future deliveries of Airbus A340, Airbus A319 and Boeing 767-300 aircraft as well as the exercise of purchase options on three previously leased DC-9 aircraft. Expenditures for spare engines, inventory, aircraft betterments, ground equipment, facilities and computer project development costs, including RESIII, accounted for most of the remaining expenditures.

Planned Capital Expenditures and Financing

The following summarizes the Corporation's committed US dollar capital expenditures on aircraft, net of committed aircraft financing for the 1995 to 1997 period:

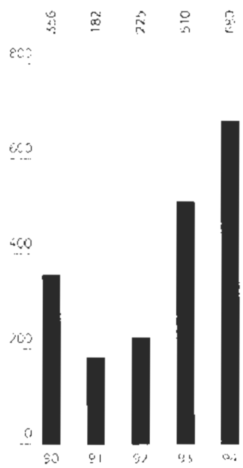
(US$ millions)	1995	1996	1997	Total
Committed US$ aircraft and spare engine expenditures before financing	374	380	714	1,468
Committed US$ aircraft financing	(195)	(397)	(913)	(1,505)
Net committed US$ aircraft and spare engine expenditures (proceeds) after financing	179	(17)	(199)	(37)

Operating Expense
per Available Seat Mile*
(cents)



* Not Consolidated
** Excludes Fuel Excise Tax Rebate

Ebitdar*
($ millions)



* Consolidated
Earnings before interest, taxes, depreciation, amortization and aircraft rent

The 1995-1997 committed amount of US $1,468 million for aircraft and spare engines represents primarily progress and final payments for five Boeing 767-300 aircraft to be delivered in 1995 and 1996, six Airbus A340 aircraft to be delivered in 1996 and 1997, 15 Airbus A319 aircraft for delivery in late 1996 and in 1997 as well as progress payments on 10 firmly ordered Airbus A319 aircraft for delivery in 1998.

The 1995-1997 committed aircraft financing amount of US $1,505 million represents committed financing on the above aircraft on the basis that Air Canada fully utilizes the financing facilities. Air Canada has arranged commitments for 100 per cent financing at delivery for all firm Airbus A340 and Airbus A319 aircraft orders. The Corporation is currently in the process of negotiating a separate financing facility covering approximately one half of the progress payments on these aircraft.

In addition, Air Canada has received a preliminary commitment from the Export-Import Bank of the United States to provide financing guarantees covering up to 80 per cent of the acquisition cost of the five Boeing 767-300 aircraft to be delivered in 1995 and 1996.

Not included in the above aircraft deliveries are the following:

- commitments under operating leases for 10 Canadair Jets, of which four were delivered in 1994 and six are to be delivered in 1995. The 10 aircraft are included in future lease commitments under Note 11 of the Notes to the Consolidated Statements. The remaining 14 Canadair Jets are to be delivered in 1995 and 1996, subject to certain conditions including the provision of 100% lease financing.
- commitments under operating leases for two Airbus A340 aircraft to be delivered in mid-1995. These aircraft are being leased under three year operating leases. Committed lease payments for these aircraft are also included under Note 11 of the Notes to the Consolidated Statements.
- operating leases, currently being negotiated, for two used Boeing 767-200 aircraft to be delivered in 1995. These aircraft would be leased for a period of up to three years and are not included under Note 11 of the Notes to the Consolidated Statements.

The following summarizes the Corporation's planned and committed US dollar aircraft expenditures, net of US dollar financing for the 1995 to 1997 period:

(US$ millions)	1995	1996	1997	Total
Net committed US$ aircraft and spare engine expenditures (proceeds) after financing	179	(17)	(199)	(37)
Planned US$ aircraft and spare engine expenditures	53	39	206	298
Planned US$ inventory, spare parts, modifications and refurbishments	40	22	23	85
Total net US$ planned and committed aircraft expenditures	272	44	30	346

The 1995-1997 planned aircraft expenditure amount of US $298 million represents primarily the potential exercise of certain options to purchase additional Airbus A319 aircraft. Air Canada currently has 10 options for Airbus A319 aircraft for delivery in 1997 and 1998. These options have not been exercised and represent an uncommitted but planned capital expenditure.

The following summarizes the remaining planned capital expenditures for the 1995 to 1997 period, expressed in Canadian dollars:

(Cdn$ millions)	1995	1996	1997	Total
Planned aircraft expenditures		33		33
Planned inventory, spare parts, modifications and refurbishments	11	12	9	32
Planned other property and equipment	133	60	43	236
Balance of planned capital expenditures	144	105	52	301

The amount of $33 million relates to the planned exercise of purchase options on leased DC-9 aircraft.

The amount of $32 million relates to three year planned expenditures for aircraft inventory, spare parts, modifications and refurbishments. The last three-year component of $236 million relates to planned spending on facilities, ground equipment and computer development projects to improve customer services.

All uncommitted capital expenditures will be subject to management's assessment of future market and financial conditions prior to commitment.

A significant financing reserve is the year-end 1994 cash and short-term investment position of $599 million. Other sources of funds remain available to the Corporation. At year-end 1994, Air Canada had the following financing facility established on an unsecured basis, against which there were drawings in the amount of US $100 million:

- up to US $300 million or the Canadian dollar equivalent from a group of financial institutions in Canada.

After the above-noted drawing, the net amount available was US $200 million. Drawn amounts may be repaid and redrawn subject to a reducing revolving availability period.

The sale and leaseback of existing owned and unencumbered aircraft represents a potential source of financing. At year-end 1994, 51 per cent of the Corporation's fleet by number or 44 per cent by fair market value was owned and unencumbered. As new aircraft are delivered, Air Canada plans to offer for sale, subject to operational requirements, surplus aircraft such as Boeing 747-100/200 and Lockheed L-1011 aircraft. The market for certain used aircraft has improved over the past year and the potential sale of these assets is expected to provide additional cash inflows in the 1996 to 1998 period.

Financing Strategy

With the financial performance of the North American airline industry showing signs of improvement in 1994, access to credit is improving.

Over the past years, Air Canada has pursued a strategy of holding a significant cash and liquidity position through the difficult environment affecting the airline industry.

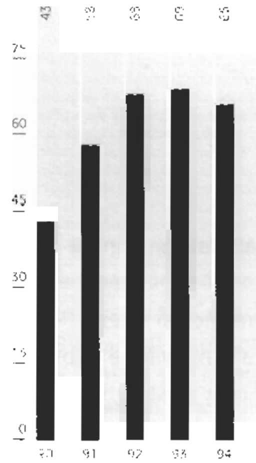
The Corporation's debt repayment schedule for 1995 is relatively low at $55 million. In 1996, scheduled debt repayments are $709 million (of which US $400 million is due in December 1996). In 1997, scheduled debt repayments are $194 million and less than $75 million in each of 1998 and 1999.

Although the Corporation's overall financial leverage remains high, committed aircraft acquisitions have been substantially financed and debt repayments for 1995 are low. The Corporation is currently in the final stages of concluding a new financing facility for up to US $250 million to be available by December 1996 which will provide partial funding for 1996 debt repayments.

Since 1990, most of Air Canada's debt facilities have been drawn on a floating rate basis in US dollars. As a result, the Corporation benefited from falling interest rates in the period from 1991 to early 1994. As at December 31, 1994, approximately 41% of the Corporation's total debt was on a floating rate basis. Approximately one tenth of the 1995 interest rate exposure on this floating rate debt was hedged by short term forward interest rate agreements. Depending upon market conditions and the Corporation's view of interest rate movements, a portion or all of the floating rate debt could be fixed in the short term or swapped to fixed rate for terms up to maturity.

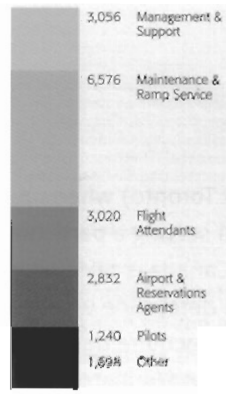
The weighted average cost of Air Canada's long-term debt and subordinated perpetual debt was 7.9 per cent in 1994 up from 6.9 per cent in 1993. The higher weighted average cost of debt reflects primarily increased interest expense caused by the weakening of the Canadian dollar.

Percentage of Debt to Debt Plus Fixed Capital*
(%)



* Consolidated

The Work Force*



* Average Full-time Equivalents

Air Canada has borrowed in a number of lower interest rate currencies such as the Swiss franc and Japanese yen. As at December 31, 1994, 15 billion of Japanese yen notes and 300 million of Swiss franc debt were exposed to foreign exchange fluctuations.

The subordinated perpetual debt of $931 million is not considered to be subject to foreign exchange risk since there is no requirement to repay the principal.

Interest obligations in Swiss francs and Deutsche marks are covered to a large extent by European currency surpluses from operations. With the start-up of operations to Japan, yen denominated revenues are expected to provide a natural hedge to cover a portion of the yen interest expense.

The largest part of Air Canada's existing debt, capital expenditures for aircraft and interest expense is denominated in US dollars. On an ongoing basis, the Corporation manages its US dollar and foreign currency exposure through hedging, which may be adjusted from time to time depending on its view of the foreign currency markets. As at December 31, 1994, less than five per cent of the US dollar debt was covered by foreign exchange hedging instruments. However, aircraft assets, which are recorded on the balance sheet at historical foreign exchange rates at the time of acquisition, are viewed as US dollar assets providing a longer term economic hedge against currency movements.

Outlook

In December 1994, the governments of Canada and the United States announced a framework for a new air services agreement between the two countries. A formal agreement was implemented in February 1995. The agreement provides for Canadian air carriers to have unlimited route rights from any point in Canada to any point in the US. Canadian air carriers were allocated additional take-off and landing rights (slots) at certain slot-restricted airports in the US. Carriers from the US will gain unlimited route rights from any point in the US to any point in Canada, except to Toronto, Montreal and Vancouver, where new passenger services are being phased in over a two to three year period.

Air Canada is reviewing its transborder operations with the aim of introducing a number of new services between Canada and the US to take advantage of the limited "head start" provided to Canadian carriers. Competitive pressure will be heightened on transborder services as a result of this agreement. In the first year, a number of new routes will be operated by US carriers including a limited number of routes to Montreal, Vancouver and Toronto. Air Canada's main domestic competitor will also be granted unrestricted access to the US market. The Corporation, however, is well positioned to compete under the new air services regime. From the base of an established transborder network, recognized high quality product and strategic US carrier alliances, Air Canada plans to expand significantly its transborder presence. Additionally, the acquisition of Airbus A319 and Canadair Jets coupled with options and the flexibility to retain aircraft such as the DC-9s will enhance Air Canada's ability to offer new "point to point" services and increased frequencies to the hubs of its US strategic alliance partners.

In December 1994, the Government of Canada announced a new international air transportation policy applicable to Canadian air carriers (excluding transborder services). The new policy established a "Use It or Lose It" allocation process for underutilized route designations and a process which would allow increased foreign carrier service to Canada (except Toronto) when no Canadian carrier is interested in serving a particular route.

Air Canada is reviewing its international operations to determine whether applications will be submitted to acquire designations for new destinations or to expand/initiate services on routes which are currently "underserved" or not served by the Corporation. While the new international air policy is expected to heighten competition on international routes, it will also provide Air Canada with opportunities for expansion. Air Canada will expand to new routes which are projected to generate necessary financial returns. Service to Israel starting in June and to Brussels and Madrid in late 1995 are examples. Other opportunities under consideration include the Philippines and Singapore.

The Corporation estimates that 1995 system capacity will increase by approximately 13 per cent.

Two major labour agreements covering pilots and IAMAW maintenance and ramp service personnel, are up for renewal in April and June 1995 respectively. Air Canada expects that, through the collective bargaining process, new labour agreements will be concluded.

While many analysts are forecasting higher crude oil prices for 1995, it is uncertain whether fuel prices will increase given modest anticipated increases in industry demand and normal levels of crude and finished fuel stocks. As at February 14, 1995, Air Canada had hedged approximately three quarters of its anticipated 1995 fuel consumption through fixed price purchase agreements with suppliers or financial hedges in the form of swap agreements. For the unhedged portion of Air Canada's fuel expense, every one US dollar per barrel movement in the price of crude oil could result in an approximate Cdn $4 million change in annual operating expense.

Air Canada also has an exposure to movements in foreign exchange rates. Including currency hedging, a one cent improvement in the value of the Canadian dollar (compared to one US dollar) could positively impact operating income by approximately $3 million and non-operating expense by $5 million in 1995. A weakening Canadian dollar can stimulate additional foreign currency sales, further mitigating currency impacts on operating results. The Corporation manages its foreign currency exposure on an ongoing basis with the objective of minimizing currency impacts on a long term basis.

Air Canada has an exposure to movements in short term interest rates due to its significant floating rate debt position and short term investment portfolio. Including interest rate hedging, as at February 14, 1995, a one percentage point increase in short term interest rates could negatively impact net interest expense by $9 million in 1995.

One of the Corporation's major priorities is to improve unit cost performance to a level fully competitive with US air carriers. By adding new capacity at relatively low cost and through continued focus on expense reductions, Air Canada does not expect its average unit cost to increase in 1995.

The global airline industry is expected to remain highly competitive in 1995. Passenger traffic and yields will continue to be under pressure as a result of consumers demanding greater value for money. Air Canada has completed major structural changes over the past several years in order to improve its market position, operational efficiency and cost profile for sustained profitability. The Corporation will continue to review all aspects of its business including its ongoing operational processes, labor policies, fleet composition, network, products and investments with the objective of improving operating profitability and cash flows in 1995 and subsequent years.

Management Report

The consolidated financial statements contained in this annual report have been prepared by management in accordance with generally accepted accounting principles and the integrity and objectivity of the data in these financial statements are management's responsibility. Management is also responsible for all other information in the annual report and for ensuring that this information is consistent, where appropriate, with the information and data contained in the financial statements.

In support of its responsibility, management maintains a system of internal control to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets. The Corporation has an internal audit department whose functions include reviewing internal controls and their application, on an ongoing basis.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control and exercises this responsibility through the Audit Committee of the Board, which is composed of directors who are not employees of the Corporation. The Audit Committee meets with management, the internal auditors and the external auditors at least four times each year.

The external auditors, Price Waterhouse, conduct an independent audit, in accordance with generally accepted auditing standards, and express their opinion on the financial statements. Their audit includes a review and evaluation of the Corporation's system of internal control and appropriate tests and procedures to provide reasonable assurance that, in all material respects, the financial statements are presented fairly. The external auditors have full and free access to the Audit Committee of the Board and meet with it on a regular basis.

R Pete

M. Robert Peterson
Senior Vice President, Finance
and Chief Financial Officer

Hollis L. Harris

Hollis L. Harris
Chairman, President and
Chief Executive Office

Auditors' Report

To the Shareholders of Air Canada:

We have audited the consolidated statement of financial position of Air Canada as at December 31, 1994 and 1993 and the consolidated statements of operations and deficit and changes in cash position for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1994 and 1993 and the results of its operations and the changes in its cash position for the years then ended in accordance with generally accepted accounting principles.

Price Waterhouse

Chartered Accountants
Montréal, Québec
February 21, 1995

Consolidated Statement of Operations and Deficit

(in millions except per share figures)

Year ended December 31	1994	1993
Operating revenues		
Passenger	$ 3,172	$ 2,849
Cargo	334	335
Other	518	414
	4,024	3,598
Operating expenses		
Salaries and wages	1,007	979
Benefits	160	143
Aircraft fuel (note 10)	474	397
Depreciation, amortization and obsolescence	206	219
Commissions	313	285
Food, beverages and supplies	158	158
Aircraft maintenance, materials and supplies	165	134
Airport user fees	161	139
Aircraft rent	230	214
Other (note 1 h)	906	853
	3,780	3,521
Operating income before the undernoted item	244	77
Staff reduction and retirement costs	-	(76)
Operating income	244	1
Non-operating income (expense)		
Interest income	53	37
Interest expense	(249)	(228)
Interest capitalized	11	–
Gain on sale of assets	67	33
Gemini Group asset realization (note 9)	66	–
Provision for investments	-	(111)
Other	(35)	(48)
	(87)	(317)
Income (loss) before income taxes and minority interest	157	(316)
Income tax provision (note 10)	(67)	(9)
Recovery of prior years income taxes previously not recorded	42	–
Minority interest	(3)	(1)
Income (loss) for the year	129	(326)
Deficit, beginning of year	(573)	(247)
Deficit, end of year	$ (444)	$ (573)
Earnings (loss) per share		
Basic	$ 1.09	$ (4.23)
Fully diluted	$ 0.97	$ (4.23)

See accompanying notes.

Consolidated Statement of Financial Position

(in millions)

December 31	1994	1993
Assets		
Current		
Cash and short-term investments	**$ 599**	$ 845
Accounts receivable	**424**	352
Spare parts, materials and supplies	**159**	150
Prepaid expenses	**24**	26
	1,206	1,373
Property and equipment (note 2)	**2,617**	2,687
Deferred charges (note 3)	**863**	693
Investments and other assets (note 4)	**311**	286
	$ 4,997	$ 5,039
Liabilities		
Current		
Accounts payable and accrued liabilities	**$ 640**	$ 662
Advance ticket sales	**202**	209
Current portion of long-term debt	**55**	136
	897	1,007
Long-term debt (note 5)	**2,409**	2,504
Other long-term liabilities	**85**	82
Deferred credits (note 6)	**306**	277
	3,697	3,870
Minority interest	**4**	8
Subordinated perpetual debt (note 7)	**931**	931
Shareholders' Equity		
Share capital – common (note 8)	**809**	803
Deficit	**(444)**	(573)
	365	230
	$ 4,997	$ 5,039

See accompanying notes.

On behalf of the Board:

Hollis L. Harris
Chairman, President and Chief Executive Officer

William James
Chairman, Audit Committee

Consolidated Statement of Changes in Cash Position

(in millions except per share figures)

Year ended December 31		1994		1993
Cash provided by (used for)				
Operating				
Income (loss) for the year	$	129	$	(326)
Adjustments to reconcile to net cash provided by operations				
Depreciation, amortization and obsolescence		206		219
Gain on sale of assets		(67)		(33)
Provision for investments		-		111
Deferred pension expense		(25)		(20)
Amortization of deferred charges		74		42
Amortization of deferred gains		(31)		(37)
Increase in accounts receivable		(75)		(37)
(Increase) decrease in spare parts, materials and supplies		(16)		17
Increase (decrease) in accounts payable and accrued liabilities		(22)		47
Increase (decrease) in advance ticket sales		(7)		18
Other		(122)		(35)
		44		(34)
Financing				
Issue of common shares and warrants		6		240
Conversion to subordinated perpetual debt		-		48
Long-term borrowings		7		283
Reduction of long-term debt		(355)		(227)
Other		(17)		(9)
		(359)		335
Investing				
Proceeds from sale and leaseback of assets		259		545
Proceeds from sale of assets		145		119
Additions to property and equipment		(410)		(395)
Cash from consolidation of Gemini Group Limited Partnership		43		–
Investment in and advances to other companies		32		(172)
Proceeds from disposal of enRoute		-		29
		69		126
Increase (decrease) in cash position		(246)		427
Cash position, beginning of year		845		418
Cash position, end of year	$	599	$	845
Cash flow per share from operations				
Basic	$	0.37	$	(0.44)
Fully diluted	$	0.31	$	(0.44)

See accompanying notes.

(currencies in millions)

1. Significant Accounting Policies

a) Consolidated Subsidiaries and Investments in Other Companies

(i) The consolidated financial statements of the Corporation include the accounts of Air Canada and the following operating subsidiaries:

	Level of Ownership	
	1994	1993
Consolidated Subsidiaries		
Air Canada Vacations (Touram Inc.)	**100%**	100%
Northwest Territorial Airways Ltd.	**100%**	100%
Dynamex Express Inc.	**100%**	100%
Air Nova Inc.	**100%**	100%
AirBC Ltd. (undiluted)	**85%**	85%
(fully diluted)	**80%**	80%
Air Ontario Inc.	**100%**	75%
Air Alliance Inc.	**100%**	75%
Wingco Leasing Inc.	**100%**	75%
The Gemini Group Limited Partnership	**100%**	33%
Galileo Canada Distribution Systems, Inc.	**100%**	–

In 1994, the Corporation increased its ownership of The Gemini Group Limited Partnership to 100% (1993 33%) and transferred the Gemini computer reservations system business to Galileo Canada Distribution Systems, Inc., a newly incorporated wholly-owned subsidiary of the Corporation.

In 1994, the Corporation acquired the remaining 25% interest in Air Ontario Inc., Air Alliance Inc., and Wingco Leasing Inc. for cash consideration of $25.

In December 1994, the Corporation signed a Letter of Intent to sell Northwest Territorial Airways Ltd. in 1995.

In February 1995, the Corporation acquired the remaining 15% interest in AirBC Ltd.

The Corporation's investments in other operating entities are recorded using the following bases of accounting:

	1994	1993
Entities Accounted for on the Equity Basis		
Partnership interests in international computer reservations systems	**< 2%**	< 2%
Continental Airlines, Inc. (Note 4)	**-**	19.6%
Companies Accounted for on the Cost Basis		
GPA Group plc (undiluted)	**10.2%**	10.2%
(fully diluted)	**1.0%**	1.0%
Continental Airlines, Inc. (Note 4)	**19.6%**	–

(ii) The excess of the acquisition cost of investment in subsidiaries and other companies accounted for on the equity basis over the Corporation's proportionate share of the underlying value of the net assets at the dates of acquisition represents goodwill, and is amortized over periods not exceeding 20 years.

b) **Foreign Currency Translation**

Monetary assets and liabilities denominated in foreign currencies, with the exception of subordinated perpetual debt, are translated into Canadian dollars at rates of exchange in effect at the date of the consolidated statement of financial position. Gains or losses are included in income of the year, except gains or losses relating to long-term debt which are deferred and amortized over the remaining term of the debt.

In 1988, the Corporation acquired zero coupon bond investments to fund the foreign currency exchange loss on certain Swiss franc and Japanese yen debt. Accordingly, deferred foreign exchange losses equalling the amount of future interest on these investments have been segregated and are being amortized to income at amounts equal to the interest earned on the bonds. The maturity dates of the investments closely match the repayment dates of the related debt.

Other assets and liabilities, subordinated perpetual debt and items affecting income are converted at rates of exchange in effect at the date of the transaction.

c) **Spare Parts, Materials and Supplies**

Spare parts, materials and supplies are valued at average cost. A provision for the obsolescence of flight equipment spare parts is accumulated over the estimated service lives of the related flight equipment to a 30% residual value.

d) **Airline Revenue**

Airline passenger and cargo sales are recognized as operating revenues when the transportation is provided. The value of unused transportation is included in current liabilities.

e) **Post Employment Benefits**

Pension expense, based on management's assumptions, consists of the actuarially computed costs of the pension benefits in respect of current year's service; imputed interest on plan assets and pension obligations; and straight-line amortization of experience gains or losses, assumption changes and plan amendments over the expected average remaining service life of the employee group.

Costs associated with post employment health care and life insurance benefits are recognized as incurred.

f) **Depreciation and Amortization**

Operating property and equipment are depreciated or amortized to estimated residual values based on the straight-line method over their estimated service lives. Estimated service lives for flight equipment range from 12 to 20 years, except when extended by significant modifications. Estimated service lives for other property and equipment range from 3 to 40 years.

	Estimated Residual Values		Estimated Service Lives
	Aircraft	Engines/Rotable Inventory	
Air Canada			
Boeing 747-133/233B	15%	10%	16 years
Boeing 767-233/333ER	15%	15%	20 years
A320-211	15%	15%	20 years
L-1011-100	15%	10%	Depreciated to residual value
DC-9-32	15%	10%	Depreciated to residual value
Subsidiaries			
Various	15-20%	15-20%	12-20 years

Significant aircraft reconfiguration costs are amortized over 3 years.

g) **Maintenance and Repairs**
Maintenance and repair costs are charged to operating expenses as incurred. Significant modification costs are capitalized and amortized over the remaining service lives of the assets.

h) **Other Operating Expenses**
Included in other operating expenses are expenses related to building rent and maintenance, advertising and promotion, computer reservation service charges, professional fees and services, terminal handling, crew meals and hotels, insurance costs and other expenses.

i) **Aeroplan**
The incremental cost of providing travel awards under the Corporation's frequent flyer program is charged to expense when entitlements to such awards are earned.

j) **Interest Capitalized**
Interest on funds used to finance the acquisition of new flight equipment and other property and equipment is capitalized for periods preceding the dates the assets are available for service.

k) **Gains on Sale and Leaseback of Assets**
Gains on sale and leaseback of assets are deferred and amortized to income over the terms of the leases as a reduction in rental expense.

l) **Comparative Figures**
Certain comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year.

2. Property and Equipment

	1994	1993
Cost:		
Flight equipment	$ 2,759	$ 3,055
Other property and equipment	1,035	1,038
	3,794	4,093
Accumulated depreciation and amortization:		
Flight equipment	872	835
Other property and equipment	601	606
	1,473	1,441
	2,321	2,652
Progress payments	296	35
Property and equipment at net book value	**$ 2,617**	$ 2,687

Flight equipment includes aircraft retired from active service with a net book value of $5 (1993 $22).

Interest capitalized during the year amounted to $11 using an average interest rate of 7.5%. No interest was capitalized in 1993.

3. Deferred Charges

	1994	1993
Employer pension plan funding in excess of pension expense	$ 338	$ 313
Foreign currency exchange on long-term debt	384	270
Financing costs	45	45
Scheduled lease payments in excess of lease expense	75	51
Other	21	14
Deferred charges	**$ 863**	$ 693

Amortization of deferred foreign currency exchange on long-term debt amounted to $67 (1993 $34).

4. Investments and Other Assets

	1994	1993
Investments in entities accounted for on the equity basis	$ 15	$ 115
Investments in companies accounted for on the cost basis	120	–
Notes receivable	30	79
Portfolio investments	79	47
Goodwill, net of amortization	37	19
Other	30	26
Investments and Other Assets	**$ 311**	$ 286

In December 1993, the Corporation's interest in the common shares of Continental was diluted from 28.7% to 19.6% as a result of the Continental Initial Public Offering. Arising from this change in circumstances and effective January 1, 1994, the investment in Continental, which includes preferred shares, is accounted for by the cost method.

The $73 carrying value of the common share investment includes the Corporation's share of 1993 fourth quarter operating results of Continental and the dilution gain. These items were recorded one quarter in arrears during the first quarter of 1994 as non-operating income. The quoted market value of the common share investment was $65 as at December 31, 1994.

Other non-operating income includes the Corporation's share of the earnings of entities accounted for on the equity basis totalling $12 (1993 losses of $3).

5. Long-Term Debt

	Final Maturity	Interest Rate (%)	1994	1993
U.S. dollar debt (a)	1996-2008	various	$ 1,674	$ 1,852
Canadian dollar debt (b)	1995-2004	8.26 – 12.10	276	297
Swiss franc debt (c)	1996-2002	5.125 – 5.625	303	243
Japanese yen notes (d)	2007	5.8	211	178
U.K. sterling bonds (e)			-	70
			2,464	2,640
Current portion			(55)	(136)
Long-term debt			**$ 2,409**	$ 2,504

All debt is unsecured by the assets of the Corporation with the exception of the subsidiaries' debt totalling $281 (1993 $298) which is secured by certain of their assets.

Principal repayment requirements for the next five years are as follows:

1995	1996	1997	1998	1999
$ 55	$ 709	$ 194	$ 71	$ 74

At December 31, 1994 , the Corporation has the following financing facility:

- up to U.S. $300 or the Canadian dollar equivalent on an unsecured basis from a group of financial institutions in Canada with a remaining term of two and one-half years with a reducing revolving availability period.

After drawings of U.S. $100, the net amount available at December 31, 1994 was U.S. $200 or the Canadian dollar equivalent. Drawn amounts may be repaid and redrawn subject to the reducing revolving availability period. Funds available under this U.S. $300 facility will be reduced by U.S. $100 in June 1995 and on each of the two subsequent anniversaries until June 1997.

Subsidiaries have financing arrangements totalling $24 against which there were no drawings as at December 31, 1994.

a) As at December 31, 1994, U.S. dollar debt totalled U.S. $1,192, the majority of which is at floating interest rates based on U.S. dollar LIBOR. Approximately 10% of the interest rate exposure on the floating rate U.S. dollar debt is hedged by short-term forward interest rate agreements. Of the U.S. dollar debt:

- a U.S. $400 borrowing has a final maturity in 1996 and may be repaid at par in whole or in part on any interest payment date.
- a U.S. $100 borrowing has a final maturity in 1997 and may be repaid at par and redrawn subject to a reducing revolving availability period.
- a U.S. $300 borrowing has a final maturity in 2005 and may be repaid at par any time until the year 2000 and on any interest payment date thereafter.
- a U.S. $265 borrowing has a final maturity in 2006 and may be repaid at par in whole or in part on any interest payment date, with an indemnity.
- a U.S. $96 borrowing has a final maturity in 2008 and may be repaid at par in whole or in part any time prior to maturity, with an indemnity.
- a U.S. $31 conditional sale agreement has a final maturity in 1996 related to twelve DC-9-32 aircraft included in property and equipment. The obligation may be discharged at par in whole or in part on any payment date.

In January and March 1994 a U.S. $100 borrowing with a final maturity in 1997 was repurchased at a discount and fully discharged.

In December 1994, the Corporation discharged a U.S. $76 obligation related to a conditional sale agreement of a Boeing 747-433 aircraft, which was refinanced under a sale leaseback transaction.

In January 1994, the Corporation's contingent obligations relating to $334 of debt defeased in March 1989 were fully discharged.

b) In 1990 and 1989, the Corporation concluded agreements with a substantial U.S. financial institution where, upon payment by the Corporation, the financial institution assumed liability for scheduled payments relating to certain long-term obligations in amounts of $98 in 1990 and $107 in 1989 and interest thereon. These obligations (which amount to $88 and $96 respectively at December 31, 1994) are considered extinguished for financial reporting purposes and have been removed from the Corporation's statement of financial position. Until the assumed liabilities have been fully discharged by the financial institution, the Corporation remains contingently liable for such obligations in the remote event that the counter party fails to perform.

c) Swiss franc debt is comprised of 100 Swiss francs maturing in 1996 and 200 Swiss francs maturing in 2002.

The 100 Swiss franc debt may be called by the Corporation at a premium on April 28, 1995. A Swiss franc to U.S. dollar swap agreement covering this debt and interest thereon was terminated in 1994.

The 200 Swiss franc debt may be called by the Corporation at a premium until 1997 and at par thereafter.

The Corporation has repurchased but not cancelled 17 Swiss franc debt securities.

d) The interest rate on the 15,000 Japanese yen notes will be reset in 2002 based on an interest rate index. These notes may be called by the Corporation at a premium until 1997 and at par thereafter.

e) In May 1994, the Corporation repaid in full at maturity 40 U.K. sterling bonds.

6. Deferred Credits

	1994	1993
Gain on sale and leaseback of assets	$ 205	$ 205
Lease expense in excess of scheduled lease payments	60	49
Income taxes	20	–
Other	21	23
Deferred credits	**$ 306**	$ 277

7. Subordinated Perpetual Debt

	1994	1993
60,000 Japanese yen at 5.30% (1993 6.55%) until 1999 Callable in 1999 and every fifth year thereafter at par (a)	$ 498	$ 498
300 Swiss francs at 6.25% Callable in 2001 and every fifth year thereafter at 102% of par	202	202
200 Swiss francs at 5.75% Callable at 101.5% of par in 1999 and every fifth year thereafter at 102% of par	134	134
200 Deutsche marks at 6.25% until 1997 Callable in 1997 and every third year thereafter at par (b)	97	97
Subordinated perpetual debt	**$ 931**	$ 931

The maturity of this subordinated perpetual debt is only upon the liquidation, if ever, of the Corporation. Principal and interest payments on the debt are unsecured and are subordinated to the prior payment in full of all indebtedness for borrowed money. Since it is not probable that circumstances will arise requiring redemption of the debt and since, under present circumstances, it is not probable that the Corporation will call the debt, it is valued at the historical exchange rate and no provision is made for foreign exchange fluctuations. Based on foreign exchange rates as at December 31, 1994, the Canadian dollar equivalent of 60,000 Japanese yen is $845 (1993 $712), 500 Swiss francs is $536 (1993 $445), and 200 Deutsche marks is $181 (1993 $152).

a) The interest rate on the yen subordinated perpetual debt is 5.30% until 1999 and will be reset for each subsequent five-year reset period based upon a capped spread over the Japanese long-term prime lending rate. The Corporation has entered into certain swap agreements which have the effect of converting one-half of the yen fixed interest rates to three month Canadian bankers' acceptance floating interest rates, less a margin until November 1999.

b) The interest rate on the Deutsche mark subordinated perpetual bonds is 6.25% until 1997 and will be reset for each subsequent three-year reset period based upon an interest rate index.

8. Share Capital

The authorized capital of the Corporation consists of an unlimited number of common shares, Class A non-voting common shares, Class A preferred shares issuable in series and Class B preferred shares issuable in series. The Corporation's Articles of Continuance under provisions of the Canada Business Corporations Act include limits on individual and aggregate non-resident public ownership of shares of 10 per cent and 25 per cent respectively, including associates of such shareholders.

The issued capital consists of common shares, and the changes during 1993 and 1994 in the outstanding number of shares and their aggregate stated value during the year are as follows:

	Number of Shares	Amount
December 31, 1992	74,033,677	$ 563
Public offering	43,500,000	240
December 31, 1993	117,533,677	803
Share purchase options exercised	101,585	–
Share Appreciation Rights Plan	833,211	6
Share purchase warrants exercised	500	–
December 31, 1994	118,468,973	$ 809

The details of the Corporation's share option plan, under which eligible employees are granted options to purchase common shares at a price not less than the market value of the shares at the date of granting, are as follows:

	Options Outstanding December 31, 1994	Option Price Per Share
1988	450,245	$ 8.00
1990	66,585	$ 8.37-$ 10.00
1991	98,796	$ 9.125
1992	35,538	$ 5.55
1993	440,782	$ 2.79-$ 3.35
1994	487,367	$ 6.42-$ 6.70
	1,579,313	

The options granted in 1988 are exercisable in the amount of 33⅓% of the shares per year on a cumulative basis. All other options are exercisable on the basis of 25% of the options per year on a cumulative basis, beginning after one year and expiring after ten years.

On February 19, 1993, the Board of Directors approved a Share Appreciation Plan, effective May 1, 1993, which authorizes the granting of Share Appreciation Rights (SARs) to employees affected by a salary reduction. Payment of the share appreciation shall be in the form of treasury shares and be distributed over a three-year cycle commencing one year after the initial salary reduction. The number of treasury shares issued will be based on the common share market value at the end of each period of the three-year cycle. During the year, 1,555,565 SARs were issued and the appreciation on 1,812,227 SARs was converted to 833,211 common shares. As at December 31, 1994, there are 4,722,706 SARs outstanding with appreciation equal to 2,258,574 common shares based on the share price at that date. Share appreciation related to the outstanding SARs will be paid in the form of treasury shares over the next two years.

There are 43,499,000 one-half common share purchase warrants outstanding. Each whole warrant entitles the holder to purchase one common share at a price of $6.25 until December 6, 1995 after which the warrant will become null and void.

9. Gemini Group Asset Realization

In 1994, the Corporation restructured its computer and network services functions by transferring the functions to Advantis Canada. The restructuring also involved reorganizing The Gemini Group Limited Partnership which resulted in the realization of $66 on the distribution of partnership assets and $13 on the gain on sale of assets.

10. Income Taxes

Income taxes differ from the amount which would be obtained based on the combined basic Canadian federal and provincial income tax rate. The difference results from the following items:

		1994		1993
Provision (recovery) based on combined federal and provincial tax rates	**$**	**63**	$	(117)
Benefit of losses which has not been recognized		**–**		102
Non-taxable portion of capital gains		**(9)**		16
Tax exempt earnings		**(9)**		(4)
Non-deductible expenses		**21**		4
Large corporations tax		**5**		6
Other		**(4)**		2
	$	**67**	$	9
Current	**$**	**47**	$	6
Deferred		**20**		3
Income tax provision	**$**	**67**	$	9

In 1993, the Corporation received a Federal excise tax rebate of $46 (applied to reduce fuel expense) in exchange for a reduction of unrecorded income tax benefits of $175. In 1994, the Corporation repaid $2 of the Federal excise tax rebate which resulted in the reinstatement of unrecorded income tax benefits of $7.

As at December 31, 1994, accumulated unrecognized income tax benefits amount to $81.

11. Commitments

The Corporation has commitments to purchase aircraft and spare engines for U.S. $1,703 and CDN $33 which are payable as follows:

	U.S.	CDN
1995	$ 374	$ –
1996	$ 380	$ 33
1997	$ 714	$ –
1998	$ 235	$ –
1999	$ –	$ –

Included in the aircraft commitments are the following:

- an amount of U.S. $1,330 for the purchase of six Airbus A340 and twenty five A319 aircraft to be delivered in 1996 through 1998 for which the Corporation has received a commitment for a 100 per cent financing package of U.S. $1,497.
- an amount of U.S. $355 for five Boeing 767-300ER aircraft to be delivered in 1995 and 1996 for which the Corporation has received a financing commitment representing 80 per cent of the aircraft value.

Other commitments for property, ground equipment and spare parts amount to approximately $39.

Future minimum lease payments under operating leases of aircraft and other property total $3,189 and are payable as follows:

	Operating Leases of Aircraft	Operating Leases of Other Property
1995	$ 300	$ 47
1996	302	37
1997	268	33
1998	241	31
1999	232	29
Remaining years	1,382	287
	$ 2,725	$ 464

Operating lease commitments include the following hedge:
an option with a major Canadian bank, exercisable in January 1996, to swap the floating rate payments on a Boeing 767-333ER aircraft to fixed rate payments for the remaining life of the lease which terminates in 2005.

12. Pension Plans

Air Canada and its subsidiaries maintain several defined benefit pension plans. Based on the latest actuarial reports prepared as at December 31, 1993 using management's assumptions, the estimated present value of the accrued pension benefits as at December 31, 1994 amounted to $3,250 and the net assets available to provide these benefits were $3,435 calculated on a four year moving average market value basis.

13. Contingencies

Various lawsuits and claims are pending by and against the Corporation. It is the opinion of management supported by counsel that final determination of these claims will not have a material adverse effect on the financial position or the results of the Corporation.

Under aircraft sale and leaseback agreements, the Corporation may be required to provide residual value support not exceeding $118. Independent appraisals as at December 31, 1994 have indicated it is unlikely the Corporation will be required to provide this support. The Corporation retains a residual value interest in these leased aircraft through purchase options.

The residual value support described above excludes support on nine DC-9-32 aircraft as the Corporation intends to purchase these aircraft on termination of leases in 1996.

14. Segmented Information

The Corporation's primary business is the transportation of passengers and cargo on scheduled airline services over routes authorized by the National Transportation Agency of Canada. Principal assets are located in Canada with substantially all of the operations involving flights within, to or from Canada.

Seven Year Comparative Review

	1994	1993	1992	1991	1990	1989	1988
Financial data – consolidated ($ millions)							
Operating revenues:							
Passenger	**3,172**	2,849	2,813	2,815	3,103	2,884	2,602
Cargo	**334**	335	342	354	413	398	503
Other	**518**	414	346	316	383	336	299
	4,024	3,598	3,501	3,485	3,899	3,618	3,404
Operating expenses:							
Salaries, wages and benefits	**1,167**	1,122	1,188	1,199	1,230	1,131	1,096
Aircraft fuel [1]	**474**	397	472	515	637	539	494
Depreciation, amortization and obsolescence	**206**	219	206	190	170	150	148
Aircraft rent	**230**	214	164	156	136	120	63
Other	**1,703**	1,569	1,616	1,589	1,676	1,559	1,499
	3,780	3,521	3,646	3,649	3,849	3,499	3,300
Operating income (loss) before the undernoted item	**244**	77	(145)	(164)	50	119	104
Staff reduction and retirement costs	**–**	(76)	(52)	(36)	(61)	(16)	(6)
Operating income (loss)	**244**	1	(197)	(200)	(11)	103	98
Non-operating income (expense):							
Net interest expense	**(185)**	(191)	(190)	(126)	(49)	(52)	(87)
Gain (loss) on sale of assets	**67**	33	(29)	(5)	22	220	79
Gemini Group asset realization	**66**	–	–	–	–	–	–
Provision for investments and writedown of goodwill	**–**	(111)	(15)	(17)	(11)	(57)	–
Other	**(35)**	(48)	(17)	(6)	6	24	25
Total non-operating income (expense)	**(87)**	(317)	(251)	(154)	(32)	135	17
Income (loss) before income taxes and minority interest	**157**	(316)	(448)	(354)	(43)	238	115
(Provision for) recovery of income taxes	**(25)**	(9)	(4)	142	18	(85)	(29)
Minority interest	**(3)**	(1)	(2)	1	(1)	–	1
Income (loss) from continuing operations	**129**	(326)	(454)	(211)	(26)	153	87
enRoute Card discontinued operations	**–**	–	–	(7)	(48)	(4)	2
Income (loss) for the year	**129**	(326)	(454)	(218)	(74)	149	89
Cash provided by (used for):							
Operating	**44**	(34)	(243)	(221)	60	149	6
Financing	**(359)**	335	246	742	402	427	133
Investing	**69**	126	287	(829)	(583)	(375)	(6)
Increase (decrease) in cash position	**(246)**	427	290	(308)	(121)	201	133
Cash position, end of year	**599**	845	418	128	436	557	356
Operating margin before provision for staff reduction and retirement costs	**6.1%**	2.1%	(4.1)%	(4.7)%	1.3%	3.3%	3.1%
Ebitdar [1][2]	**680**	510	225	182	356	389	315
Ebitdar margin	**16.9%**	14.2%	6.4%	5.2%	9.1%	10.8%	9.3%
Current ratio	**1.34**	1.36	1.09	1.15	1.47	1.79	1.56
Total assets	**4,997**	5,039	4,810	4,921	4,579	4,121	3,437
Long-term debt and capital leases (including current portion)	**2,464**	2,640	2,492	2,183	1,384	973	1,100
Subordinated perpetual debt	**931**	931	883	834	834	834	336
Shareholders' equity	**365**	230	316	770	988	1,062	913
Percentage of debt to debt plus fixed capital	**66%**	69%	68%	58%	43%	34%	47%
Earnings (loss) per share [3]	**$ 0.97**	$ (4.23)	$ (6.13)	$ (2.94)	$ (1.01)	$ 1.99	$ 1.64
Cash flow from operations per share [3]	**$ 0.31**	$ (0.44)	$ (3.28)	$ (2.99)	$ 0.80	$ 1.99	$ 0.12
Book value per share	**$ 3.08**	$ 1.96	$ 4.27	$ 10.40	$ 13.35	$ 14.55	$ 12.70
Average common shares outstanding (millions) [3]	**143.5**	80.7	75.9	75.1	74.9	74.8	48.5
Return on equity	**46.7%**	(237.6)%	(86.2)%	(25.0)%	(7.0)%	15.4%	13.5%

(1) Includes a fuel excise tax rebate in 1993 of $46 million (consolidated).
(2) Earnings before interest, taxes, depreciation, amortization and aircraft rent; a measure of normal operating income performance.
(3) Fully diluted.

	1994	1993	1992	1991	1990	1989	1988
Operating statistics – not consolidated							
Passenger – scheduled and charter:							
Revenue passengers carried (millions)	**9.9**	9.5	9.9	9.9	11.8	12.0	11.9
Revenue passenger miles (millions)	**14,995**	13,768	14,391	13,658	16,577	16,278	15,553
Available seat miles (millions)	**23,730**	21,157	21,628	19,953	23,233	23,348	21,778
Passenger load factor	**63.2%**	65.1%	66.5%	68.4%	71.4%	69.7%	71.4%
Yield per revenue passenger mile	**17.7¢**	17.1¢	16.3¢	17.3¢	16.7¢	16.3¢	15.7¢
Yield per available seat mile	**11.2¢**	11.1¢	10.8¢	11.9¢	11.9¢	11.4¢	11.2¢
Cargo – scheduled and charter:							
Revenue ton miles (millions)	**633**	586	532	549	645	595	605
Yield per revenue ton mile	**43.5¢**	47.6¢	53.1¢	53.1¢	53.2¢	53.5¢	56.6¢
All operations:							
Operating expense per available seat mile(1)	**13.2¢**	14.0¢	14.2¢	15.6¢	14.8¢	13.4¢	13.3¢
Operating expense (net of non-ASM producing revenue) per available seat mile(1)(2)	**10.5¢**	11.3¢	11.7¢	12.9¢	12.1¢	10.9¢	10.7¢
Average number of employees (thousands)	**18.4**	18.2	19.4	20.6	23.1	23.2	22.6
Available seat miles per employee (thousands)	**1,288**	1,166	1,112	969	1,005	1,005	962
Revenue per employee (thousands)	**$ 178**	$ 161	$ 148	$ 141	$ 148	$ 139	$ 134
Average aircraft utilization (hours per day)(3)	**10.3**	9.6	9.6	9.8	9.5	9.3	9.7
Average aircraft flight length (miles)	**946**	907	925	898	900	850	814
Fuel price per litre(4)	**23.8¢**	24.4¢	24.6¢	26.6¢	28.9¢	24.3¢	23.6¢
Fuel litres (millions)	**1,707**	1,529	1,609	1,627	1,965	1,991	1,905
Operating statistics – consolidated							
Revenue passenger miles (millions)	**16,143**	14,820	15,519	14,642	17,271	16,868	15,938
Available seat miles (millions)	**25,991**	23,341	23,886	22,031	24,630	24,562	22,525
Yield per revenue passenger mile	**19.6¢**	19.2¢	18.1¢	19.2¢	18.0¢	17.1¢	16.3¢

Quarterly financial and operating data (unaudited)

	1994				1993			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Financial data – consolidated ($ millions)								
Operating revenues	**991**	1,165	966	902	865	1,027	905	801
Operating income (loss) before staff reduction and retirement costs(5)	**29**	166	61	(12)	(5)	94	67	(79)
Earnings (loss) for the period(5)	**4**	130	27	(32)	(90)	43	14	(293)
Cash flow from operations(6)	**(21)**	55	47	(37)	–	18	7	(59)
Operating statistics – not consolidated								
Revenue passenger miles (millions)	**3,398**	4,827	3,509	3,261	2,996	4,402	3,386	2,984
Available seat miles (millions)	**5,931**	7,025	5,529	5,245	5,114	6,126	5,182	4,735
Passenger load factor	**57.3%**	68.7%	63.5%	62.2%	58.6%	71.9%	65.4%	63.0%
Yield per revenue passenger mile	**18.7¢**	16.8¢	18.3¢	17.2¢	18.7¢	15.9¢	17.6¢	16.7¢

(1) Excludes a fuel excise tax rebate in 1993 of $45 million (not consolidated).
(2) Represents the net cost of the passenger transportation business, after deducting the revenue impact of non-ASM producing businesses.
(3) Excludes maintenance down-time.
(4) If fuel excise tax rebate were included, fuel price per litre would be 21.5¢ in 1993.
(5) Includes a fuel excise tax rebate in 1993 of $46 million (consolidated)
(6) 1994 Q1 and Q2 are restated.

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Montréal, Québec

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Vice President,
Corporate Strategy

B. Wayne MacLellan
Vice President,
Flight Operations

Donna Price
Vice President,
Airports

H. Alan Thompson
Vice President, Corporate Affairs
and Passenger Sales – B.C.,
Alberta and Pacific Rim

Allen B. Graham, formerly Vice President Customer Service, is seconded to AirBC effective March 1, 1995 as President and Chief Executive Officer.

R. A. (Sandy) Morrison, Vice President, Corporate Communications, Government and Industry Relations, is leaving the Corporation to pursue other interests at the end of February 1995.

Glossary of Terms

Operating Margin
Operating income (loss) as a percentage of total operating revenues.

Current Ratio
Current assets divided by current liabilities.

Fixed Capital
The aggregate of shareholders' equity and subordinated perpetual debt.

Return on Equity
The average rate of return on shareholders' equity.

Revenue Passenger Miles
Total number of revenue passengers carried multiplied by the miles they are carried.

Available Seat Miles
A measure of passenger capacity calculated by multiplying the total number of seats available for revenue traffic by the miles flown.

Passenger Load Factor
A measure of passenger capacity utilization derived by expressing revenue passenger miles as a percentage of available seat miles.

Revenue Ton Miles
Total number of cargo tons carried multiplied by the miles they are carried.

Yield
Average revenue per revenue passenger mile or revenue ton mile.

Investor and Shareholder Information

Head Office
P.O. Box 14000,
Saint-Laurent, Québec
Canada H4Y 1H4
(514) 422-5000

Stock Exchange Listings
Montréal, Toronto, Winnipeg, Alberta and Vancouver Stock Exchanges.

Transfer Agent and Registrar
The R-M Trust Company, Halifax, Montréal, Toronto, Winnipeg, Regina, Calgary and Vancouver.

Duplicate Communication
Some registered holders of Air Canada shares might receive more than one copy of shareholder information mailings such as this Annual Report. While every effort is made to avoid duplication, if securities are registered in different names and/or addresses, multiple copies are forwarded.

Shareholders receiving more than one copy are requested to write to the Assistant Secretary and Shareholder Relations Director.

Restraints on Air Canada Shares
The Air Canada Public Participation Act and Air Canada's Articles of Continuance limit ownership of the airline's voting shares by all non-residents of Canada to a maximum of 25 per cent. The National Transportation Act, 1987 (NTA, 1987) requires inter alia that at least 75 per cent of the voting shares of Air Canada be owned or controlled by Canadians, as defined in section 67 of the NTA, 1987. In addition, no person or group of associated persons may own more than ten per cent of the airline's voting shares.

For Further Information
Shareholder Relations:
Assistant Secretary and
Shareholder Relations Director
Telephone: (514) 422-5787
Faxcom: (514) 422-5789

Investor Relations:
Manager,
Investor Relations
Telephone: (514) 422-5724
Faxcom: (514) 422-5739

Price Range and Trading Volume of Air Canada Common Shares

1994	High	Low	Volume
1st Quarter	$8.13	$5.00	45,042,052
2ndQuarter	$7.38	$5.63	20,336,328
3rdQuarter	$8.13	$5.88	36,929,112
4thQuarter	$8.63	$7.25	29,239,331

Price ranges and combined trading volumes on the Montréal, Toronto, Winnipeg, Alberta and Vancouver Stock Exchanges.

Ce rapport annuel est publié dans les deux langues officielles du Canada. Pour en recevoir un exemplaire en français, écrire à la Secrétaire adjointe et Directrice – Relations avec les actionnaires.

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