Air Canada's well-publicised financial problems started with the merger with Canadian Airlines in 2000. This was followed by unprecedented levels of competition. Air Canada has used bankruptcy protection to restructure its business and expects to eliminate $2 billion of annual cost by 2006.

How Air Canada has transformed under CCAA protection

Since 11th September 2001, most North American legacy airlines have been on the brink of or under bankruptcy protection. The future of Air Canada, however, which emerged from Company's Credit Arrangement Act (CCAA), Canada's equivalent of US Chapter 11 bankruptcy protection, on September 30 2004 seems encouraging. This carrier filed for bankruptcy protection on 1st April 2003 and remained under protection for 18 months while it restructured and reorganised. What led Air Canada to bankruptcy protection, how did it emerge from protection, and what future is it facing?

Seeds of disaster

Air Canada's principal domestic competitor was Canadian Airlines during the 1990s. Canadian Airlines suffered several severe financial crises in the late 1990s, and by mid-1999 it was becoming unable to sustain its day-to-day operations, losing about $2 million per day. In mid-August 1999 the Canadian Ministers of Transport and Industry of Canada issued an order suspending operation of the Competition Act with respect to Air Canada and Canadian Airlines, due to the impending national emergency in the air transport sector caused by the imminent failure of Canadian Airlines.

The Canadian government approved the proposed acquisition and combination of the two airlines, but imposed numerous undertakings on Air Canada regarding the combination of the companies, the treatment of employees and the fostering of competition in the Canadian airline industry. In particular, Air Canada undertook the following obligations:

- Not to lay-off any non-unionised employees of either airline as a result of the merger.
- Not to involuntarily relocate any unionised employees of either airline.
- Not to start up a planned 'low-cost' air carrier in Eastern Canada before September 2001, even if this would reduce costs.
- To guarantee continued service for three years to all communities in Canada that already had services from Air Canada, Canadian Airlines or any of their regional carriers.

In March 2000 Canadian Airlines was granted protection from its creditors under CCAA protection to allow it to restructure its debt and other obligations. Air Canada provided financing, debt and loan guarantees to Canadian Airlines during the debt restructuring process, and so took assignment aircraft leases.

After the merger, Air Canada started to integrate the airlines' schedules. The elimination of flights and reorganisation of the schedule resulted in an overall reduction of Air Canada's domestic capacity by about 15%. The freed-up capacity allowed this carrier to introduce new routes to the US and overseas destinations. Also, the economic boom of the late 1990s continued through the summer of 2000, and there was significant demand for Air Canada's services. Things seemed encouraging.

Air Canada was suffering from numerous constraints related to its acquisition of Canadian Airlines, however. Even though the two airlines' schedules had been integrated by the summer of 2000, they continued to operate separately as a result of union refusals to allow their labour forces to merge. This meant Air Canada employees were not permitted to service 'Canadian Airlines flights', and vice versa.

Combined with Air Canada's undertakings not to lay off or involuntarily relocate workers, these employment constraints required Air Canada to hire hundreds of new employees in several locations, despite the fact that it already had an overall surplus of several thousand employees as a result of acquiring Canadian Airlines.

Air Canada reached agreements with its key unions in late 2000 to allow it to begin intermingling Canadian Airlines and Air Canada ground employees (in-flight employees did not agree to intermingling until 2001 and 2002). While this relieved some pressure from an operational perspective, Air Canada continued to have a significant employee surplus. In several cases, the unions demanded that Air Canada commit to job protection provisions (that is, no lay-off clauses) in exchange for their agreement about intermingling and other items. As labour costs accounted for about 30% of Air Canada's operating costs, such concessions became a severe obstacle to its ability to reduce costs.

Low-cost carriers

From 2000, Air Canada faced increased competition from domestic low-cost airlines. By 2003, low-cost airlines were competing with Air Canada on 74% of its domestic network. Westjet, Air Canada's primary competitor in western Canada, commenced operations in Eastern Canada in April 2000 using Hamilton, Ontario as its eastern hub.

The undertakings in the merger with Canadian Airlines meant that Air Canada

Air Canada's problems started with the merger with Canadian Airlines in 2000. With the merger Air Canada had to agree to not lay-off non-unionised employees or start-up a low-cost airline in eastern Canada before September 2001.

was forbidden from responding to this competitive threat by establishing a low-cost airline in this region.

In August 2000, Royal Airlines converted from a charter operator into a scheduled, low-fare domestic airline. In September 2000, Canjet commenced operations serving eastern and central Canada using Halifax as its hub. In early 2001, Canada 3000, a successful charter carrier that was converted into a scheduled, low-fare domestic airline, acquired both Canjet and Royal Airlines, thereby becoming Canada's largest domestic airline.

Although Canada 3000 went bankrupt shortly after 11th September 2001, the low-fare segment of the Canadian air travel market has continued to grow. WestJet grew to the size of Canadian Airlines' domestic operations prior to its integration with Air Canada, and ordered 14 737-700s in 2003. CanJet restarted in spring 2002 utilising Halifax as a hub, and JetsGo, another low-cost airline, commenced service between major Canadian cities in 2002.

Consequently, Air Canada's domestic market share fell to 72% in December 2002 from about 90% at the time of its acquisition of Canadian Airlines in 2000. Jazz, Air Canada's regional carrier, was negatively affected by the competition. The dramatic decline in passenger demand on short-haul routes, coupled with escalating costs, resulted in massive revenue shortfalls. Jazz, for example, lost $90 million in operating income in 2002.

Furthermore, after 11th September 2001, US carriers added significant new capacity to the transborder US-Canada market using regional jets (RJs). These RJs were operated by feeder carriers, which had lower operating costs and more flexible labour rules than Air Canada and Jazz. Air Canada's revenue from its trans-border services continued to decline: $2.245 billion in 2000; $2.118 in 2001; and $1.945 billion in 2002.

Struggles before CCAA

Air Canada responded to competition by introducing a sub-brand, Tango by Air Canada, in November 2001. Tango operated in the domestic marketplace as a form of low-cost, point-to-point carrier, mainly on long-haul routes. Tango's lower cost structure was due principally to the underlying product design: it operated in all-economy configuration, and offered 'all extras are optional' in-flight service, where food/beverages and amenities are an additional cost to passengers. Tango was operated as a self-contained network, so it did not provide any connecting traffic to the mainline operation. This allowed tango to generate a higher fleet utilisation than Air Canada's. Tango's fares are priced as one-way and did not require a minimum stay or advance purchase.

Air Canada launched another low-cost airline in September 2002, named Zip Air and based in Western Canada. Zip Air contracted some services from Air Canada such as pilots and maintenance, but operated independently of Air Canada form many other functions. Zip Air's labour costs were lower than Air Canada's, due to special agreements with Air Canada's unions. Zip Air's size was restricted, however, to 20 737s by the collective agreement between Air Canada and its pilots' unions.

Financial distress

Despite the efforts to adapt to market change, Air Canada's capital base was steadily eroded from 1999 onwards because of the integration with Canadian Airlines and the economic downturn after 2000.

In 2000, Air Canada reported a net loss of $82 million. It was forced to fund its operating losses after 11th September 2001 by selling assets. In 2001, its net loss increased to $1.315 billion, and in 2002 had decreased to $428 million. The operating loss continued at a rate of $2 million per day in the first quarter of 2003.

As of 31st December 2002, Air Canada had $4.223 billion of long-term debt. It also had mandatory principal and interest repayments of debt: $277 million in 2003; $591 million in 2004; $300 million in 2005; $563 million in 2006; and $306 million in 2007.

Fleet and leases

Air Canada's fleet became complex after the merger with Canadian Airlines, and prevented it from gaining the advantages of economies of scale. Even worse was that over-capacity became more prominent from late 2001. In the months after 11th September 2001, Air Canada grounded its DC9 fleet, as well as several of its 767s, 737s and CRJs because they were surplus to requirements.

The market values of these aircraft also plummeted, and some were only half of what they were on 10th September 2001. A financial analysis was completed by Seabury Advisors LLC to estimate the extent to which Air Canada's obligations to General Electric Capital Corporation (GECC) with respect to 22 cross-collateralized aircraft exceeded their fair market value. The analysis indicated that Air Canada's obligation to GECC exceeded the estimated fair market value by $400 million.

Management's initiative

Without the initiative, determination and tactics of Air Canada's management, these facts and numbers would not have been enough to lead this carrier to file for CCAA. Robert Milton, Air Canada's ex-president and chief executive officer, had been trying to transform it into a low-

Following the merger with Canadian Airlines, Air Canada had a complex fleet with a large number of aircraft types. Under bankruptcy protection, Air Canada reduced its fleet by 61 aircraft. It also renegotiated aircraft leases, which has reduced annual lease rentals by at least $600 million.

cost airline. His speech on 13th February 2003 expressed his intention clearly. "The days when our competitors shared our cost structures and inefficiencies are over. The competition today is more nimble and more flexible than ever before and we have no choice but to confront this reality and adjust accordingly. The next step is essentially to transform Air Canada into a low-cost carrier in its own right," said Milton. "If we had our low-cost competitor's work rules, pay scales, and so on we could improve our bottom line by $1.3 billion. If you stop and reflect on this, if we had our competitors' labour cost structure we would have made an operating profit of $900 million last year. So, we have cut these cost reductions down the middle to arrive at a saving of $650 million." Now what Air Canada needed was enough time to commit the transformation in a legal and smooth way.

From March 2003, the SARS crisis, the war in Iraq, which caused fuel prices to soar, and drastic declining traffic in Air Canada's market, dragged the airline into an abyss, where it reported a loss of $2 million per day. Air Canada's management managed to capitalise on the fear of the interested parties, such as unions and lessors, and filed for CCAA protection to get them to negotiate for an expected cost structure.

Under bankruptcy protection

In October 2004, the month following Air Canada's emergence from CCAA protection, Milton disclosed the intention and purpose of filing for CCAA protection. It was to:

- Isolate airline profitability from other businesses through corporate restructuring;
- Restore viability to domestic and transborder US services through innovative pricing structure;
- Radically cut costs and introduce a new fleet;
- Grow highly profitable international services; and
- Expand high margin businesses like Aeroplan and cargo.

The restructuring program is designed to materially reduce costs with most gains being made between 2004 and 2006. The key components of this cost reduction plan include the following:

- Air Canada has renegotiated labour contracts that eliminate lay-off prohibitions while allowing for some wage reductions, lower entry-level salaries, reduction in holidays and vacation time, greater use of part-time employment, and greater work-rule flexibility. The net effect is expected to reduce Air Canada's average salary by 11% in 2006 in comparison to 2002 levels and to increase employee productivity (as measured by available seat-miles per employee) by about 28%.
- Air Canada has returned less efficient and surplus aircraft, such as older model 737s and 747s, and BAE 146 regional aircraft. Lease rent reductions have also been negotiated for a portion of the core fleet.

The company identified a number of other expense reductions, such as in-flight costs, reduced hotel rates, reduced IT costs, maintenance efficiencies, and distribution costs.

Fleet lease amendments

In late May 2003, Air Canada convened meetings in New York and Frankfurt with its aircraft lessors. Air Canada advised attendees about its fleet reconfiguration which must be completed for it to be competitive in the harder business environment. It also gave details of the leasing concessions it would be seeking from lessors, and its intention to extend the 60-day moratorium on aircraft leasing payments that would preserve cash resources and allow it to complete a review of its existing fleet and assess future fleet requirements.

The projected aircraft lease payments over the 60-day moratorium period were estimated at $203 million with respect to both financing ($15 million) and operating leases ($188 million). Payment terms for the aircraft leases were not standardised, and ranged from payments on a monthly, quarterly or semi-annual basis.

Aircraft lessors were also advised that concessions would be required to reduce lease rates to market level. Lessors were also advised that Air Canada might also terminate leases early to lessors who were unwilling to renegotiate appropriate lease arrangements. Air Canada also advised lessors that it intended to resume lease rentals at restructured rates from the date the lessor executed a revised lease.

In September 2003 Air Canada repudiated leases covering 18 of its own aircraft and five Jazz aircraft. Annualised cash savings resulting from these repudiations were estimated at $66 million. Since initiating its fleet lease restructuring process, Air Canada has entered into memoranda of understanding with eight lessors concerning the amended lease terms covering 170 aircraft (including 10 which are governed by both GECAS and ECA agreements). The restructured leases were for: GATX, three aircraft; GECAS, 106 aircraft; ILFC, 12 aircraft; Debis, nine aircraft; Oasis, 4 aircraft; Marubeni, one aircraft; Pegasus, seven aircraft; and Europe Credit Agencies (ECAS), for 38 aircraft.

Air Canada launched a low-cost subsidiary airline Zip Air based in western Canada in September 2002. Zip Air contracts some services from Air Canada, but Zip Air has lower labour costs. Zip Air is limited to a fleet of 20 737s. Air Canada's other low-cost airline, Tango, was launched in November 2001.

Including the negotiated agreements, agreements in principle and repudiated aircraft leases noted above, the applicants completed the restructuring of 244 aircraft, representing approximately 68% of its aircraft leases.

In September 2003, Air Canada announced a tentative restructure agreement related to 38 Airbus aircraft consisting of 22 A319s, eight A330s and eight A340s involving syndicates of lenders supported by the Export Credit Agencies of the UK, France and Germany. Under the terms of the tentative agreement, rental payments for each aircraft will be restructured in a manner consistent with Air Canada's restructuring plan, which meant the lease rates were much lower than original rentals.

By December 2003, Air Canada had reduced its fleet by 61 aircraft, including repudiated and returned aircraft.

Under the agreement with GECAS, Air Canada accepted delivery of three new aircraft since filing for bankruptcy protection. However, the rental rates on these new aircraft were lower than those on existing aircraft, reflecting Air Canada's demand for new rental rates. In total, in the eight months of CCAA protection, this carrier has made a net reduction in its operating fleet of 35 aircraft. Based on 2002 cost data, the net reduction in annual aircraft payments, offset by the cost of the newly delivered aircraft, was estimated to be $140 million.

GECAS agreement

On 1st April 2003, GECC leased Air Canada 108 aircraft and 15 spare engines and financed seven flight simulators. These aircraft represent about one third of Air Canada's fleet, making GECC the single most significant lessor to Air Canada. On 3rd July 2003, Air Canada reached a tentative agreement with GECAS on the restructuring of owned and managed aircraft leases, new exit financing for use upon emergence from CCAA and aircraft financing to be used for the future acquisition of new regional aircraft. A Global Restructuring Agreement (GRA) was executed on 11th September 2003. The GRA mainly provides the following benefits for Air Canada:

- The restructuring of 106 of 107 aircraft leased by Air Canada and Jazz Air, including lease rate reductions on 51 aircraft (of which 3 aircraft have been returned as of the current date), cashflow relief for 29 aircraft, termination of Air Canada's obligations with respect to 20 parked F.28s (effective immediately), the cancellation of four future aircraft lease commitments and the restructuring of the overall obligations with respect to two 747s.
- Exit financing of about $425 million to be provided by GECC upon the carrier's emergence from CCAA.
- Aircraft financing up to a maximum of $540 million to be provided by GECC and to be used by Air Canada to finance the future purchase of about 43 RJ aircraft.

Since the execution of the GRA, Air Canada has returned two 767-300ERs. The GRA provides for amended lease rates for the remaining 10 aircraft leases managed by GECC (two 767-300ERs and eight A320-200s). The GECC-owned aircraft subject to lease or other agreements with Air Canada as at 1st April 2003 comprised: seven undelivered aircraft; 20 parked and unused aircraft, 22 aircraft cross-collateralized under the CCAA Credit Facility; and 47 other owned aircraft. One 767 was returned to GECC by Air Canada prior to execution of the GRA, leaving a total of 95 aircraft to be restructured pursuant to GRA.

With regard to the seven undelivered aircraft (five A320s, one A319 and one 767), the lease agreements covering the three A320s and 767 have been terminated pursuant to the GRA. The GRA further provides that Air Canada will take delivery of the remaining three undelivered aircraft subject to modified leases with shorter lease terms and lower lease rates. The first two A320s were delivered in July 2003 and the third in December 2003. The GRA also provides that GECC may retain the deposits of about $9 million held in respect of all seven undelivered aircraft.

The 20 F.28s were previously subject to an agreement obligating Air Canada to transfer title to these aircraft to GECC. Pursuant to the GRA, this obligation has been terminated, allowing Air Canada to retain the aircraft, to which General Electric ascribed a value of $10 million.

The GRA provides for cashflow relief covering 20 of the 22 aircraft (14 A319s and six 767-300s) cross-collateralized under the CCAA Credit Facility. This cashflow relief is provided by deferring a portion of the lease rentals due on each payment date, such portion being calculated as the difference between the contract lease rates and Air Canada's target lease rates.

With respect to the remaining two

SUMMARY OF AIR CANADA'S OPERATING PERFORMANCE AND TARGET COST REDUCTIONS

YEAR	2001	2002	2003	2004 (Est)	2005 (Est)	2006 (Est)
Operating revenues-$m	9,611	9,826	8,368			
Operating expenses-$m	10,342	10,018	9,052			
Operating profit/(loss)-$m	(731)	(192)	(684)			
Costs reductions:						
Labour-$m			300	500	900	900
Lease rentals-$m			600	600	600	700
Other-$m			200	400	400	400
Total			1,100	1,500	1,900	2,000

747-400s, the aggregate termination value pursuant to the lease contract was about $246 million. Air Canada estimated that the aggregate fair market value of the two aircraft did not exceed $50 million. These leases are settled as follows:

- Air Canada will pay GECC rent at current contractual rates for the period 1st April 2003 to 30th September 2004.

- Air Canada will purchase both the aircraft from GECC for an aggregate amount equal to the sum of: (i) $246 million; (ii) interest for the period 29th June 2003 to the date of issuance of the convertible note to GECC, at a rate of LIBOR +4%, compounded monthly; (iii) a breakage amount of about $5.5 million per aircraft; and (iv) rent for the period 1st July 2003 to 30th September 2004 at the rate of $700,000 per month.

Of the 46 other owned aircraft, a 747-400 was returned to GECC with a return payment of about $13 million. The GRA provides for lease rate deferrals in respect of nine of the 46 owned aircraft (eight A319-100s and one A320-200) which provide Air Canada with cashflow relief by deferring payment obligations. Additional lease amendments are provided for with respect to a further 35 aircraft (one A319-100, 10 CRJ-200s, two 767-300s and 22 A320-200s) which provide for rent reductions for all or a portion of the remaining lease term. All of the lease amendments took effect on 30th September 2004.

Pursuant to GRA, GECC agreed to provide Air Canada with a commitment for up to $540 million of financing to be used to fund new RJs, which are a cornerstone of Air Canada's restructuring plan. The RJ financing may be used in connection with up to 25 operating leases, provided the aircraft model and selection type are acceptable to GECC, with the remainder to be provided in the form of debt financing.

In September 2004 Air Canada confirmed a firm order for 15 50-seat CRJ200s, 15 75-seat CRJ705s and 'conditional orders' for an additional 15 CRJ200s. The airline also firmed up its agreement with Embraer for RJs. The deal comprises a firm order for 45 of the General Electric CF34-powered, 100-seat twinjets and options for another 45.

In a speech in October 2004 Milton summarised Air Canada's position with respect to regional jets. "Over the years, low-cost carriers have used smaller aircraft to undercut legacy carriers in their traditional markets. With smaller aircraft containing fewer seats, low-cost airlines have fragmented traditional airline markets, requiring fewer passengers to make a profit. We will more effectively challenge low-cost players with the new Embraer 75- to 95-seat jets, by offering more non-stop flights to smaller markets. Just as with the low-cost carriers, we will need to fill fewer seats to make a route work. In other words, Air Canada will do to the low-cost carriers what they have done to legacy carriers."

Pursuant to the GRA, GECC will provide the reorganized Air Canada with exit financing of $585 million. The Exit Facility is to be comprised of a $425 million non-revolving term loan facility and a $160 million non-revolving credit facility. The Exit Facility is to be used for general working capital purposes.

In return, the GRA provides that, upon emergence from CCAA, the reorganized Air Canada will issue stock purchase warrants to GECC as follows:

- The Warrants will be for the right to purchase up to 4% of the non-voting common shares of the reorganized Air Canada on a fully diluted basis.

- The Warrants will have a term of five years from the date of issuance.

- The exercise price for the warrants will be set on a per-share basis equivalent to the buy in price of the equity plan sponsor.

Benefits of CCAA protection

In October 2004, Milton summarised the basic benefits gained from CCAA Protection.

These were $2 billion in cost reductions, including: $1 billion labour and benefits; $0.6 billion in aircraft lease rentals (49% cut in cash rent from 2003 to 2009); and $0.4 billion in supplier contracts and other. Labour costs were cut by 35%, and 10,000 employees were laid off. ASMs per employee were increased by 25%, and a 10-11% reduction in average salaries was achieved. Embraer flight crew costs are almost identical to jetBlue's and all CRJs are operated by Jazz.

Following emergence from bankruptcy, Air Canada will have negative equity, but its debt burden will have been reduced significantly. Lease-adjusted debt (net of cash) will be about 67% of revenue as of 30th September 2004. This is lower in comparison to many of its US-based peers, but is still considered high. Adjusted debt levels will increase further when Air Canada's defined benefit pension plan deficits are included. The combined current deficit is about C$1.2 billion. Funding obligations related to these deficits over the next few years will constrain operating cashflows.

Post-CCAA protection

Although Air Canada is still the dominant carrier in Canada, it faces strong competitive challenges from low-cost carriers in most of its domestic markets and increasingly in the transborder markets.

Maintaining yields at a premium to low-cost carriers will be challenging. A large part of Air Canada's strategy is essentially based on maintaining higher unit revenues relative to its competitors

After emerging from bankruptcy protection in September 2004, Air Canada had managed to reduce its annual costs by at least $1.5 billion. This compares to annual costs of $10 billion in 2002. Annual cost savings are expected to amount to $2.0 billion by 2006, taking annual expenditure down to about $8 billion.

through higher frequency of service, higher load factors, auxiliary revenues (such as cargo), and a simplified pricing strategy. Core to achieving these goals is a higher utilisation of RJs. The carrier is slated to increase its use of RJs in the next three years as a means of offering higher frequency service, while not expanding its capacity.

Financial profile

Air Canada will have debt maturities as follows:

2005: C$292 million;
2006: C$287 million;
2007: C$489 million;
2008: C$635 million; and
2009: C$558 million;

On 1st October 2004, Air Canada had total liquidity of about C$1.9 billion. A secured credit facility totalling $425 million had been provided by GECC and has been fully drawn. This facility matures in 2011, gradually amortising from 2007.

The facility contains financial covenants including minimum cash balances, minimum collateral values, and minimum EBITDAR levels. It is expected the airline must generate at least C$600 million in operating cashflow per year to maintain liquidity at current levels. Debt maturities (which include payments under capital leases) are substantial in the next few years. This carrier is not expected to be cashflow positive in the near term, since it will incur significant expenditures to acquire a further 75 RJs by 2009.

It has secured financing commitments from the manufacturers and GECC to acquire these aircraft. The financing commitments are subject to material change clauses (Air Canada is not required to take the aircraft if this clause has been tripped) and, in the case of the GECC regional jet financing, that Air Canada maintains a rating from Standard & Poor's of 'B-' or better to continue to draw on this financing. Outside of aircraft capital expenditures, the company is expected to incur other capital expenditures, including inventory and aircraft betterments, of about C$300 million a year.

Air Canada's ability to generate these levels of operating cashflow is uncertain. The company would require a significant improvement in operating profitability from current levels. Cuts and productivity savings achieved in bankruptcy should result in a material improvement in operating results, but the airline could be hampered by high fuel costs, should fuel prices stay at current levels, and by the many other economic uncertainties to which airlines are hypersensitive.

The airline has few alternative sources of liquidity. The company has essentially no unsecured assets. Air Canada might be able to sell all or a portion of its most marketable subsidiary, the Aeroplan frequent flyer program, and retain all or a portion of the proceeds for working capital usage subject to the provisions of its bank agreement. As a public company, with an expected market capitalisation of about C$3 billion on emergence from bankruptcy, it might also issue equity to support its operations. Nevertheless, in cases of severe financial distress, issuing equity could be untenable due to severe dilution.

Air Canada did achieve meaningful debt reductions in bankruptcy protection, but its financial profile is still weak. The carrier has negative equity (as generated under Canadian GAAP) and it could take several years of profitability to restore a positive equity balance. Yield erosion appears to have subsided in most markets and the airline has demonstrated strong trends in traffic as evidenced by record load factors through the summer of 2004. Nevertheless, operating profitability is only likely to be modestly positive in 2004 and restoration to positive net profitability will be reliant on a continuation of strong passenger traffic, maintaining yields, and, most critically, achieving planned cost reductions.

Risks

The key risks that Air Canada is facing are:

- Although wage reductions have been achieved, it is more difficult to rely on Air Canada's ability to achieve the levels of productivity it has assumed. Air Canada has a poor history of achieving planned cost reductions, most notably those projected after its merger with Canadian Airlines in 1999.
- Some of the improvement in Air Canada's profitability is reliant on a reduction in fuel costs beyond 2004. If current prices persist or escalate, there is little pricing power to compensate in the short term.
- Air Canada has dramatically simplified its fare structure in an effort to regain customer confidence-particularly in the domestic market. This is a marked departure from the complicated yield management systems typically used by network carriers, and it is unclear if Air Canada can maintain yields at current levels with this type of fare structure. AC