chorus aviation inc.

2012
Management's Discussion and Analysis of Results of Operations and Financial Condition

February 20, 2013

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1. HIGHLIGHTS

The financial and operating highlights for Chorus are as follows:

	Three months ended December 31,			Year ended December 31,		
	2012	2011	Change %	2012	2011	Change %
Key financial information						
Operating revenue ($000)	411,693	407,742	1.0	1,710,686	1,664,467	2.8
Operating expenses ($000)	386,264	382,422	1.0	1,582,092	1,562,520	1.3
Operating income ($000)	25,429	25,320	0.4	128,594	101,947	26.1
Net income for the period ($000)	14,677	22,674	(35.3)	101,107	68,135	48.4
EBITDA[1] ($000)	40,190	37,960	5.9	185,339	146,086	26.9
Free Cash Flow[1] ($000)	30,344	29,375	3.3	139,810	106,842	30.9
Adjusted net income[1] ($000)	17,935	19,553	(8.3)	95,493	71,652	33.3
Net income per Share, basic ($)	0.12	0.18	(33.3)	0.81	0.55	47.3
Adjusted net income per Share, basic ($)	0.14	0.16	(12.5)	0.77	0.58	32.8
Key statistical information						
Departures	66,927	67,665	(1.1)	278,902	277,629	0.5
Block Hours	95,624	95,868	(0.3)	397,733	394,999	0.7
Billable Block Hours	97,249	97,108	0.1	404,101	401,477	0.7
Available Seat Miles (ASM) (000's)	1,411,938	1,459,392	(3.3)	6,382,042	6,285,922	1.5
Cost per Available Seat Mile (CASM) (¢)	27.36	26.20	4.4	24.79	24.86	(0.3)
CASM, excluding aircraft fuel (¢)	20.58	19.75	4.2	18.58	18.32	1.4
CASM, excluding aircraft fuel and Thomas Cook (¢)	20.58	20.15	2.1	19.81	19.78	0.2
Full-time equivalent (FTE) employees (end of period)	4,558	4,777	(4.6)	4,558	4,777	(4.6)
Number of Operating Aircraft (end of period)	129	139	(7.2)	129	139	(7.2)

(1) This is a non-GAAP measurement. Refer to Section 7 – Performance Indicators.

2. INTRODUCTION

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), references to Chorus or the Company refer to, as the context may require, Chorus and its subsidiaries (Jazz Aviation LP, Aviation General Partner Inc., 7503695 Canada Inc., Chorus Leasing I Inc., Chorus Leasing II Inc., Chorus Leasing III Inc., and Chorus Leasing Amalco (2012) Inc.) collectively, Chorus and one or more of its subsidiaries, one or more of Chorus' subsidiaries or Chorus itself.

The following MD&A, which presents a discussion of the financial condition and results of operations for Chorus, should be read in conjunction with the accompanying audited consolidated financial statements of Chorus and the notes therein for the years ended December 31, 2012 and December 31, 2011. All financial information has been prepared in accordance with generally accepted accounting principles in Canada ("GAAP"), as set out in the Handbook of the Canadian Institute of Chartered Accountants - Part 1 ("CICA Handbook"), except for any financial information specifically denoted otherwise. Except as otherwise noted or where the context may otherwise require, this MD&A is prepared as of February 20, 2013.

The earnings and cash flows of Chorus are affected by certain risks. For a description of those risks, please refer to Section 19 – Risk Factors.

Except where the context otherwise requires, all amounts are stated in thousands of Canadian dollars.

Caution regarding forward-looking information

Forward-looking statements are included in this MD&A. These forward-looking statements are identified by the use of terms and phrases such as “anticipate”, “believe”, “could”, “estimate”, “expect”, “intend”, “may”, “plan”, “predict”, “project”, “will”, “would”, and similar terms and phrases, including references to assumptions. Such statements may involve but are not limited to comments with respect to strategies, expectations, planned operations or future actions.

Forward-looking statements relate to analyses and other information that are based on forecasts of future results, estimates of amounts not yet determinable and other uncertain events. Forward-looking statements, by their nature, are based on assumptions, including those described below, and are subject to important risks and uncertainties. Any forecasts or forward-looking predictions or statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Such statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements to differ materially from those expressed in the forward-looking statements. Results indicated in forward-looking statements may differ materially from actual results for a number of reasons, including without limitation, risks relating to Jazz Aviation LP's relationship with Air Canada, risks relating to the airline industry, energy prices, general industry, market, credit, and economic conditions, competition, insurance issues and costs, supply issues, war, terrorist attacks, epidemic diseases, acts of God, changes in demand due to the seasonal nature of the business, the ability to reduce operating costs and employee counts, secure financing, employee relations, labour negotiations or disputes, restructuring, pension issues, currency exchange and interest rates, leverage and restructure covenants in future indebtedness, dilution of Chorus Shareholders, uncertainty of dividend payments, managing growth, changes in laws, adverse regulatory developments or proceedings, pending and future litigation and actions by third parties, as well as the factors identified throughout this MD&A. The forward-looking statements contained in this discussion represent Chorus’ expectations as of February 20, 2013, and are subject to change after such date. However, Chorus disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

3. THE CHORUS BUSINESS

Chorus was incorporated on September 27, 2010 under the laws of Canada. On November 18, 2010, Chorus incorporated Aviation General Partner Inc. to act as general partner for a newly formed partnership, Jazz Aviation LP (the "Partnership"). On January 5, 2011, substantially all of the assets of Jazz Air LP were transferred to the Partnership. The airline business previously carried on by Jazz Air LP is now carried on by the Partnership. On February 28, 2011, Chorus incorporated three wholly-owned subsidiaries under the CBCA, Chorus Leasing I Inc., Chorus Leasing II Inc., and Chorus Leasing III Inc. (collectively, the "Initial LeaseCos"). The Initial LeaseCos were established for the sole purpose of acquiring Q400 NextGen turboprop aircraft ("Q400 aircraft") and related equipment. On December 31, 2012, the Initial LeaseCos were reorganized as follows: Chorus Leasing I Inc. and Chorus Leasing II Inc. amalgamated to form Chorus Leasing Amalco (2012) Inc. ("Amalco"), and Chorus Leasing III Inc. then acquired the assets and liabilities of Amalco in exchange for preferred shares.

Chorus was established to acquire and hold, directly or indirectly, investments in the Partnership, Aviation General Partner Inc., 7503695 Canada Inc., the Initial LeaseCos and other investments that it may acquire from time to time. Chorus operates the largest regional airline, and the second largest airline, in Canada after Air Canada, based on fleet size. Chorus provides a significant part of Air Canada's domestic and transborder network. Chorus and Air Canada are parties to the Capacity Purchase Agreement ("CPA"), under which Air Canada currently purchases the greater part of Chorus' fleet capacity at pre-determined rates. Under the CPA, Chorus provides service to and from lower density markets, along with higher density markets at off-peak times, throughout Canada, and to and from certain destinations in the United States. As at December 31, 2012, Chorus operated scheduled passenger service on behalf of Air Canada with approximately 779 departures per weekday to 55 destinations in Canada and 27 destinations in the United States, using 124 Covered Aircraft. Chorus and Air Canada have linked their regional and mainline networks in order to serve connecting passengers more efficiently and provide valuable traffic feed to Air Canada's mainline routes.

Under the CPA, Chorus operates flights on behalf of Air Canada under the "Air Canada Express" tradename, formerly "Air Canada Jazz". Air Canada is responsible for scheduling, pricing, product distribution, seat inventories, marketing and advertising, and customer service at certain airports staffed or administered directly by Air Canada. Air Canada is entitled to all revenues associated with the operation of the Covered Aircraft. Chorus is paid fees based on certain variables, including Block Hours flown, flight hours, cycles (number of take-offs and landings) and passengers carried, in addition to certain variable and fixed aircraft ownership rates. Chorus is also entitled to repayment of certain pass-through costs, including fuel, navigation, landing and terminal fees and certain other costs. Chorus is also eligible to receive incentive payments each quarter if it achieves certain performance levels related to on-time performance, controllable flight completion, baggage handling performance and overall customer satisfaction.

On August 6, 2012, in accordance with the terms of the CPA, Chorus and Air Canada agreed on detailed rates on controllable costs applicable to the period commencing on January 1, 2012 and ending on December 31, 2014. These new rates were retroactive to January 1, 2012. Chorus is economically and commercially dependent upon Air Canada and certain of its subsidiaries as, in addition to being Chorus' primary source of revenue, these entities currently provide significant services to Chorus (refer to Section 14 - Economic Dependence). Chorus is directly affected by the financial and operational strength of Air Canada, its competitive position, and its ability to maintain sufficient liquidity (refer to Section 19 - Risk Factors).

On April 13, 2012, Chorus announced that it had received notification from Thomas Cook of its intention to discontinue operating dedicated charter aircraft, branded as Thomas Cook Canada, due to market conditions. As a consequence, the remaining three years of the five-year Flight Services Agreement with Chorus were terminated effective April 30, 2012. Chorus had, prior to such termination, operated Boeing 757-200 aircraft on behalf of Thomas Cook to various sun destinations from Canadian gateways. Chorus and Thomas Cook reached a commercial settlement in respect of the termination of the Flight Services Agreement, the economic terms of which reflect the original and intended expiration of the agreement, and address the recovery of certain initial start-up costs and foregone revenues. In the second quarter of 2012, approximately $9.0 million was recorded in the financial statements of Chorus as revenue in respect of this settlement.

Under the CPA, Chorus has historically experienced greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters of the calendar year. Termination of the Thomas Cook flying program is expected to return seasonality to these previous patterns. Chorus has substantial fixed costs that do not meaningfully fluctuate with passenger demand in the short-term. Chorus' revenues do not fluctuate significantly with passenger load factors.

On June 29, 2012, Chorus and Air Canada agreed to amend the CPA to support a continued fleet renewal program with the acquisition of six additional Q400 aircraft and the removal of nine CRJ aircraft (starting in December 2012) from the Chorus fleet. Pursuant to this agreement, the number of Covered Aircraft will be reduced from 125 to 122. Effective February 2013, the annual minimum capacity guarantee of 339,000 Block Hours will be reduced to approximately 331,000 Block Hours to reflect the new number of Covered Aircraft. This agreement does not change the Controllable Mark-up structure or rates, but establishes certain new metrics. The Compensating Mark-Up will now be applied based on the range between the new annual minimum targeted Block Hours of approximately 367,000 and the revised annual minimum capacity guarantee of approximately 331,000 Block Hours. The difference between the annual minimum capacity guarantee and the annual minimum targeted Block Hours remains at 36,000 Block Hours. This agreement also resolved one of the issues raised in the 2009 Benchmark Arbitration regarding the manner in which the Compensating Mark-Up formula would be applied.

On June 29, 2012, pursuant to its Q400 aircraft purchase agreement with Bombardier Inc., as represented by Bombardier Aerospace Commercial Aircraft, Chorus exercised six of 15 options to acquire additional Q400 aircraft. The agreement was conditional on Chorus making a pre-delivery lump sum payment of $13.4 million, securing financing from a third party lender, and reaching an agreement with Air Canada to amend the terms of the CPA to reflect the additional six aircraft. Based on the list price for the Q400 aircraft, these options are valued at approximately US $189.0 million. The conditions have been satisfied by Chorus and the six Q400 aircraft are scheduled to be delivered at a rate of two aircraft per month in each of February, March and April 2013.

During 2012, Chorus also entered into a separate agreement with a third party to purchase 2 additional PW150A engines by the end of 2013 with a list price of US$6.6 million.

Chorus has secured financing from EDC of US$126.1 million for the purchase of the six Q400 aircraft and the two PW150A engines. Chorus is obligated to pay EDC a non-refundable commitment fee of 0.2% per annum on the undisbursed portion of the commitment. The availability of any undrawn amount will expire on January 11, 2014. EDC financing will provide for the majority of the purchase price of the Q400 aircraft and the Q400 engines with a term to maturity of 12 years, payable in semi-annual installments and quarterly installments, respectively.

On July 12, 2012, Chorus announced that it would be consolidating its heavy maintenance activities. Chorus will consolidate its four heavy maintenance lines (two in London, Ontario and two in Halifax, Nova Scotia) to three larger lines to be based in Halifax. The transition is expected to be completed by the summer of 2013.

On July 16, 2012, Chorus announced that as a result of the consolidation of its heavy maintenance, it would be expanding its operations and facilities in Halifax, Nova Scotia. To facilitate this expansion, Chorus purchased an office building on August 31, 2012 and will be making modifications to its existing Halifax hangar and building. In connection with this increase of activity in Nova Scotia, the Province of Nova Scotia (the "Province") has agreed to provide Chorus with a $12.0 million, interest-bearing, repayable loan. The Province's financial assistance will also consist of an additional $2.5 million forgivable loan (which will be forgiven if certain employment targets are achieved) and a $2.0 million employee grant to recruit, train and develop new employees or to upgrade current employees' skills.

On February 15, 2013, Chorus took delivery of the first of the six additional Q400 aircraft. It will enter into service by March 1, 2013. As described above, Chorus has secured EDC financing for this delivery. The term loan is repayable by Chorus to EDC in semi-annual instalments of US$1.0 million, matures in February 2025 and is secured primarily by one Q400 aircraft and two PW150A engines.

The majority of Chorus' employees are unionized. Chorus reached new collective bargaining agreements with both flight dispatch employees, represented by the Canadian Air Line Dispatchers Association ("CALDA"), and maintenance and engineering employees, represented by the Canadian Auto Workers ("CAW"). The agreement with CALDA, reached in September 2012, has a six year term with an expiry in 2018, and the agreement with CAW, reached in October 2012, has a three year term with an expiry in 2015.

Chorus continues to negotiate with its crew schedulers (represented by CAW), as this collective bargaining agreement expired at the end of June 2012 and its airport employees (customer service agents, aircraft groomers, and ramp attendants), also represented by CAW, as this collective bargaining agreement expired on January 13, 2013. The terms and conditions of the expired agreements remain in force while Chorus and CAW continue to negotiate a new collective agreement in accordance with the timelines and provisions of the Canada Labour Code.

4. SELECTED ANNUAL INFORMATION

The following table provides selected annual information for Chorus for the years 2010 through to 2012.

	Year ended December 31,		
(expressed in thousands of Canadian dollars, except per Share (Unit) amounts)	2012 $	2011 $	2010 $
Revenue	1,710,686	1,664,467	1,486,166
Operating income	128,594	101,947	86,785
Net income	101,107	68,135	55,888
Total assets	812,307	773,429	523,793
Total long-term liabilities	432,333	319,155	152,006
EBITDA (1)	185,339	146,086	128,674
Dividends / distributions declared	74,408	74,408	73,776
Free Cash Flow (1)	139,810	106,842	98,056
Cash provided by operating activities	142,807	152,969	112,133
Cash and cash equivalents	118,306	108,068	65,896
Per Share (Unit)			
Operating income	1.03	0.83	0.71
Net income	0.81	0.55	0.46
Dividends / distributions declared	0.60	0.60	0.60
Free Cash Flow / distributable cash	1.13	0.87	0.80

(1) This is a non-GAAP measurement. Refer to Section 7 – Performance Indicators.

2012 Compared to 2011

Revenue increased in 2012 from 2011, as a result of the one time termination settlement amount with Thomas Cook, passenger revenue increases due to rate increases pursuant to the CPA, which captures the lease rates for the new Q400 aircraft, which are higher than the replaced CRJ aircraft, and higher incentives earned for operational performance under the CPA.

Net income increased in 2012 from 2011 due to an unrealized foreign exchange gain on long-term debt and finance leases and lower income tax.

Total assets increased in 2012 from 2011 as a result of the purchase of Q400 aircraft and engines. This increase was offset by a writedown in the long-term investment in LARAH (refer to Section 11 - Liquidity and Capital Resources).

Total long-term liabilities increased in 2012 from 2011 as a result of increased long-term debt related to the purchase of Q400 aircraft and engines.

EBITDA increased in 2012 from 2011 as a result of the underlying leasing ownership structure of the Q400 aircraft. The Q400 aircraft lease revenue under the CPA is reflected in operating revenue, and is designed to provide compensation to Chorus for both depreciation and interest expense. CRJ aircraft, previously under operating leases, are being replaced by owned Q400 aircraft. Related ownership costs are comprised of depreciation (an operating expense), and interest (a non-operating expense).

Free Cash Flow increased in 2012 from 2011 as a result of improved EBITDA being slightly offset by higher interest on the long-term debt associated with the Q400 aircraft.

Cash and cash equivalents increased as a result of a higher operating income and the timing of certain payments.

The 2012 results compared to 2011 are discussed in more detail throughout this document.

2011 Compared to 2010

Revenue increased in 2011 from 2010 as a result of increased pass-through costs, increased CPA Billable Block Hours, new revenue earned under the Thomas Cook arrangements, and higher CPA revenue pursuant to the CPA which captures the lease rates for the new Q400 aircraft which are higher than the replaced CRJ aircraft.

Net income increased in 2011 from 2010 due to the absence in 2011 of any loss on derivative liabilities; offset by unrealized foreign exchange loss on long-term debt and finance leases and higher income tax.

Total assets increased in 2011 from 2010 as a result of the purchase of Q400 aircraft and engines.

Total long-term liabilities increased in 2011 from 2010 as a result of increased long-term debt related to the purchase of Q400 aircraft and engines.

EBITDA increased in 2011 from 2010 as a result of the underlying leasing ownership structure of the Q400 aircraft and the Thomas Cook arrangement. The Q400 aircraft lease revenue under the CPA is reflected in operating revenue, and is designed to provide compensation to Chorus for both depreciation and interest expense. CRJ aircraft, previously under operating leases, are being replaced by owned Q400 aircraft. Related ownership costs are comprised of depreciation (an operating expense), and interest (a non-operating expense).

Free Cash Flow increased in 2011 from 2010 as a result of improved EBITDA; offset by increased Maintenance Capital Expenditures

Cash and cash equivalents increased in 2011 from 2010 as a result of a higher operating income and the timing of certain payments.

5. FOURTH QUARTER ANALYSIS

The following table compares the results of operations of Chorus for the three months ended December 31, 2012 to the three months ended December 31, 2011.

(expressed in thousands of Canadian dollars)	Three months ended December 31, 2012 $	2011 $	Change $	Change %
Operating revenue	411,693	407,742	3,951	1.0
Operating expenses				
Salaries, wages and benefits	99,997	102,108	(2,111)	(2.1)
Aircraft fuel	95,696	94,243	1,453	1.5
Depreciation and amortization	14,761	12,640	2,121	16.8
Food, beverage and supplies	4,137	3,993	144	3.6
Aircraft maintenance materials, supplies and service	43,055	35,112	7,943	22.6
Airport and navigation fees	48,562	49,238	(676)	(1.4)
Aircraft rent	22,774	27,199	(4,425)	(16.3)
Terminal handling services	28,438	28,318	120	0.4
Other	28,844	29,571	(727)	(2.5)
Total operating expenses	386,264	382,422	3,842	1.0
Operating income	25,429	25,320	109	0.4
Non-operating income (expenses)				
Net interest expense	(4,263)	(3,266)	(997)	30.5
Gain on disposal of property and equipment	73	143	(70)	(49.0)
Foreign exchange (loss) gain	(3,759)	5,779	(9,538)	(165.0)
Gain on Asset Backed Commercial Paper (“ABCP”)	450	—	450	100.0
	(7,499)	2,656	(10,155)	(382.3)
Net income before deferred income taxes	17,930	27,976	(10,046)	(35.9)
Income tax expense				
Current income tax	(513)	—	(513)	100.0
Deferred income tax	(2,740)	(5,302)	2,562	(48.3)
	(3,253)	(5,302)	2,049	(38.6)
Net income for the periods	14,677	22,674	(7,997)	(35.3)

Operating Revenue

Operating revenue increased from $407.7 million to $411.7 million, representing an increase of $4.0 million or 1.0%. Passenger revenue, excluding pass-through costs, increased by $4.9 million or 2.0%, primarily as a result of rate increases made pursuant to the CPA, increased CPA Billable Block Hours, increased revenue related to a newly signed engine maintenance contract for the Q400 aircraft of $5.5 million, and a $0.1 million increase in incentives earned under the CPA with Air Canada; offset by a lower US dollar exchange rate and no activity in the fourth quarter of 2012 for Thomas Cook. Pass-through costs decreased by $1.0 million or 0.7%, from $158.4 million to $157.4 million, which included an increase of $1.8 million related to fuel costs. Other revenue increased by $0.1 million.

Operating Expenses

Operating expenses increased from $382.4 million to $386.3 million, an increase of $3.8 million or 1.0%. Controllable Costs increased by $4.9 million, or 2.2%; offset by a decrease in pass-through costs of $1.0 million. Additional information regarding operating expenses is set out below.

- Salaries, wages and benefits decreased by $2.1 million primarily as a result of a reduction in the number of FTE's; offset by wage and scale increases under new collective agreements, increased incentive compensation expense, increased pension expense resulting from a revised actuarial valuation and lower capitalized salaries and wages related to major maintenance overhauls.
- Aircraft fuel costs increased by $1.5 million, primarily attributable to higher fuel prices and usage as a result of increased activity.
- Depreciation and amortization expense increased by $2.1 million primarily related to the purchase of Q400 aircraft, with the balance due to increased capital expenditures on aircraft rotable parts and other equipment; offset by decreased major maintenance overhauls and certain assets having reached full amortization.
- Aircraft maintenance expense increased by $7.9 million as a result of increased Block Hours of $0.6 million, increased maintenance cost for a newly signed maintenance contract for the Q400 aircraft of $5.5 million, increased engine overhaul on charter aircraft of $1.2 million, inventory adjustment of $1.6 million and increased other maintenance costs of $1.9 million; offset by a decrease in engine maintenance activity due to engine charges for the CRJ aircraft of $1.8 million and a decrease in the US dollar exchange rate on certain material purchases of $1.1 million.
- Airport and navigational fees decreased by $0.7 million, primarily as a result of no activity in this quarter for Thomas Cook and the removal of CRJ aircraft; offset by increased rates related to the Q400 aircraft and changes in aircraft deployment.
- Aircraft rent decreased by $4.4 million primarily as a result of no expense in this quarter for Thomas Cook aircraft, the return of aircraft of $2.1 million and a lower US dollar exchange rate of $0.9 million.
- Terminal handling costs increased by $0.1 million due to deicing costs and changes in aircraft deployment; offset by no activity in this quarter for Thomas Cook.
- Other expenses decreased by $0.7 million primarily due to decreased professional fees and general overhead expenses.

Non-Operating Income (Expenses)

Non-operating expenses increased by $10.2 million. This change was primarily attributable to a foreign exchange loss of $3.8 million (of which $3.3 million related to an unrealized foreign exchange loss on long-term debt and finance leases) arising as a result of the change in value of the Canadian dollar relative to the US dollar and increased interest expense related to Q400 aircraft financing of $1.0 million.

6. YEAR-TO-DATE ANALYSIS

The following table compares the results of operations of Chorus for the year ended December 31, 2012 to the year ended December 31, 2011.

(expressed in thousands of Canadian dollars)	Year ended December 31, 2012 $	2011 $	Change $	Change %
Operating revenue	1,710,686	1,664,467	46,219	2.8
Operating expenses				
Salaries, wages and benefits	411,455	399,606	11,849	3.0
Aircraft fuel	396,413	410,735	(14,322)	(3.5)
Depreciation and amortization	56,745	44,139	12,606	28.6
Food, beverage and supplies	18,437	15,587	2,850	18.3
Aircraft maintenance materials, supplies and service	162,361	152,301	10,060	6.6
Airport and navigation fees	204,209	198,130	6,079	3.1
Aircraft rent	100,083	106,471	(6,388)	(6.0)
Terminal handling services	112,881	116,032	(3,151)	(2.7)
Other	119,508	119,519	(11)	—
Total operating expenses	1,582,092	1,562,520	19,572	1.3
Operating income	128,594	101,947	26,647	26.1
Non-operating income (expenses)				
Net interest expense	(16,559)	(10,076)	(6,483)	64.3
Gain on disposal of property and equipment	1,232	682	550	80.6
Foreign exchange gain (loss)	5,909	(4,176)	10,085	(241.5)
Gain on Asset Backed Commercial Paper (“ABCP”)	450	547	(97)	(17.7)
	(8,968)	(13,023)	4,055	(31.1)
Net income before deferred income taxes	119,626	88,924	30,702	34.5
Income tax expense				
Current income tax	(513)	—	(513)	100.0
Deferred income tax	(18,006)	(20,789)	2,783	(13.4)
	(18,519)	(20,789)	2,270	(10.9)
Net income for the periods	101,107	68,135	32,972	48.4

Operating Revenue

Operating revenue increased from $1,664.5 million to $1,710.7 million, representing an increase of $46.2 million or 2.8%. Passenger revenue, excluding pass-through costs, increased by $56.8 million or 5.8%, primarily as a result of $9.0 million related to the early termination of the Thomas Cook Flight Services Agreement (refer to Section 3 – The Chorus Business), increased Billable Block Hours, rate increases made pursuant to the CPA (including the new Q400 aircraft ownership structure), a higher US dollar exchange rate, and a $4.4 million increase in incentives earned under the CPA with Air Canada. Pass-through costs decreased $11.3 million or 1.7% from $670.6 million to $659.3 million, which included $14.6 million related to fuel. Other revenue increased by $0.7 million.

Operating Expenses

Operating expenses increased from $1,562.5 million to $1,582.1 million, an increase of $19.6 million or 1.3%. Controllable Costs increased by $30.9 million or 3.5%; offset by a decrease in pass-through costs of $11.3 million. Additional information regarding operating expenses is set out below.

- Salaries, wages and benefits increased by $11.8 million as a result of wage and scale increases under new collective agreements, increased Block Hours, increased pension expense resulting from a revised actuarial valuation, increased incentive compensation expense and lower capitalized salaries and wages related to major maintenance overhauls; offset by a reduction in the number of FTE's.

- Aircraft fuel costs decreased by $14.3 million. As of November 1, 2011, Chorus no longer processed or recorded fuel for Thomas Cook, which resulted in a decrease in fuel costs related to flights operated on behalf of Thomas Cook. In the first six months of 2011, $25.1 million was recorded as pass-through revenue and cost related to the Thomas Cook flight program. CPA fuel costs increased by $10.8 million, primarily attributable to an increase in the price of fuel; offset by a decrease in fuel usage.

- Depreciation and amortization expense increased by $12.6 million, of which $10.9 million was related to the purchase of Q400 aircraft, and increased capital expenditures on aircraft rotable parts and other equipment; offset by certain assets having reached full amortization.

- Aircraft maintenance expense increased by $10.1 million as a result of increased Block Hours of $1.8 million, increased other maintenance costs of $8.6 million, increased maintenance cost for a newly signed maintenance contract for the Q400 aircraft of $5.5 million, increased engine overhaul on charter aircraft of $2.4 million, inventory adjustment of $1.3 million and an increase in the US dollar exchange rate on certain material purchases of $0.9 million; offset by a decrease in engine maintenance activity due to the return of CRJ aircraft of $6.8 million.

- Airport and navigational fees increased by $6.1 million, primarily as a result of increased rates related to the Q400 aircraft, a rate increase resulting from a change in the airport user fee structure and changes in aircraft deployment; offset by the removal of CRJ aircraft and no activity in the fourth quarter of 2012 for Thomas Cook.

- Aircraft rent decreased by $6.4 million primarily as a result of the return of CRJ aircraft of $6.5 million and no activity in the fourth quarter of 2012 for Thomas Cook; offset by a higher US dollar exchange rate of $0.9 million and one additional leased Q400 aircraft of $0.6 million.

- Terminal handling costs decreased by $3.2 million due to changes in aircraft deployment, a decrease in deicing costs and no activity in the fourth quarter of 2012 for Thomas Cook; offset by a rate increase related to increased departures.

Non-Operating Income (Expenses)

Non-operating expenses decreased by $4.1 million. This change was attributable to a foreign exchange gain of $5.9 million (of which $5.6 million related to an unrealized foreign exchange gain on long-term debt and finance leases) arising as a result of the change in value of the Canadian dollar relative to the US dollar; offset by increased interest expense related to Q400 aircraft financing of $6.6 million.

7. PERFORMANCE INDICATORS

Chorus uses certain non-GAAP financial measures, described below, to evaluate operating performance and in making decisions relating to dividends to Shareholders. These measures are not recognized for financial statement presentation under GAAP, do not have a standardized meaning, and are therefore not likely to be comparable to similar measures presented by other public entities.

EBITDA

EBITDA (earnings before interest, taxes, depreciation, amortization and obsolescence) is a non-GAAP financial measure commonly used throughout all industries to view operating results before interest expense, interest income, depreciation and amortization, gains and losses on property and equipment and other non-operating income and expenses. Management believes EBITDA assists investors in comparing Chorus' performance on a consistent basis without regard to depreciation and amortization, which are non-cash in nature and can vary significantly depending on accounting methods and non-operating factors such as historical cost. EBITDA should not be used as an exclusive measure of cash flow because it does not account for the impact of working capital growth, capital expenditures, debt repayments and other sources and uses of cash, which are disclosed in the statements of cash flows, forming part of Chorus' financial statements.

Free Cash Flow

Prior to Chorus' conversion from an income fund structure, distributable cash was a key performance indicator used by management to evaluate the ongoing performance of the Fund. Distributable cash is not a measure which is commonly utilized in respect of a public corporation. Management believes, however, that it is a term with which its Shareholders are familiar, and has calculated Free Cash Flow as a proxy for previously reported distributable income. Free Cash Flow is defined as EBITDA less non-operating expenses and Maintenance Capital Expenditures required to sustain the operation, and adjusted for any unrealized foreign exchange gain or loss on long-term debt and finance leases and any unusual non-operating one-time items. Other capital expenditures incurred to facilitate growth of the business are excluded from the calculation.

Standardized Free Cash Flow

Standardized Free Cash Flow is a non-GAAP measure recommended by the CICA in order to provide a consistent and comparable measurement of free cash flow across entities of cash generated from operations and is used as an indicator of financial strength and performance. Standardized Free Cash Flow is defined as cash flows from operating activities, as reported in accordance with GAAP, less total capital expenditures and dividends.

The following table provides a reconciliation of Free Cash Flow to EBITDA:

(expressed in thousands of Canadian dollars)	Three months ended December 31, 2012 $	Three months ended December 31, 2011 $	Year ended December 31, 2012 $	Year ended December 31, 2011 $
Operating income	25,429	25,320	128,594	101,947
Depreciation and amortization	11,462	8,948	43,516	30,920
Major maintenance overhauls	3,299	3,692	13,229	13,219
Total depreciation and amortization	14,761	12,640	56,745	44,139
EBITDA	40,190	37,960	185,339	146,086
EBITDA margin (%)(1)	9.8	9.3	10.8	8.8
EBITDA	40,190	37,960	185,339	146,086
Non-operating expenses(2)	(4,241)	(465)	(14,582)	(9,506)
	35,949	37,495	170,757	136,580
Capital expenditures, excluding Q400 aircraft purchases	(3,511)	(5,253)	(19,680)	(13,505)
Capitalized major maintenance overhauls	(2,094)	(2,867)	(11,267)	(16,233)
Maintenance Capital Expenditures(3)	(5,605)	(8,120)	(30,947)	(29,738)
Free Cash Flow	30,344	29,375	139,810	106,842
Dividends declared	18,602	18,602	74,408	74,408
Payout ratio – Dividends declared / Free Cash Flow (%)	61.3	63.3	53.2	69.6
Payout ratio adjusted for principal long-term debt repayments (%)	75.9	66.2	59.6	70.5

(1) EBITDA margin is calculated as EBITDA divided by operating revenues.
(2) Excludes $3.3 million loss and $5.6 million gain for the three months and year ended December 31, 2012, respectively, related to unrealized foreign exchange on long-term debt and finance leases (2011 - $3.1 million gain and $3.5 million loss, respectively on unrealized foreign exchange).
(3) Excludes all capital expenditures related to the purchase of the Q400 aircraft and Q400 engines, as these are not treated as Maintenance Capital Expenditures (refer to Section 11 – Liquidity and Capital Resources - Maintenance Capital Expenditures).

Due to the nature of the underlying associated revenue stream provided by the CPA, the unrealized foreign exchange gains or losses on long-term debt and finance leases will not affect future cash flows. Chorus has, therefore excluded the unrealized portion of foreign exchange gains or losses on long-term debt and finance leases from the Free Cash Flow calculation.

Chorus' lower payout ratio for the year ended December 31, 2012 is primarily attributable to Chorus' increased EBITDA in respect of this period. EBITDA increased primarily as a result of the Q400 aircraft ownership structure, as well as the one-time early termination settlement with Thomas Cook. Leasing revenue earned under the CPA for the Q400 aircraft is included in operating income and ownership costs (interest and depreciation) associated with the Q400 aircraft on a consolidated basis are added back to the calculation. While the Free Cash Flow calculation includes the related interest expense on the Q400 aircraft, it does not include a deduction for principal long-term debt repayments. These are captured in the financing section of the consolidated statement of cash flows. If these principal long-term debt repayments were included, Free Cash Flow for the three months and year ended December 31, 2012 would be $24.5 million and $124.9 million, respectively (2011 - $28.1 million and $105.5 million, respectively), and the payout ratio for the same periods would be 75.9% and 59.6%, respectively (2011 - 66.2% and 70.5%, respectively).

The following table provides a reconciliation of cash flows from operating activities to Standardized Free Cash Flow and Free Cash Flow:

	Three months ended December 31,		Year ended December 31,	
	2012	**2011**	**2012**	**2011**
(expressed in thousands of Canadian dollars)	**$**	**$**	**$**	**$**
Cash flows from operating activities	8,632	41,339	142,807	152,969
Maintenance Capital Expenditures, net of gain on disposal	(5,532)	(7,977)	(30,345)	(29,056)
Growth capital expenditures(1)	(4,501)	(76,274)	(139,173)	(178,278)
Dividends	(18,602)	(18,602)	(74,408)	(55,806)
Standardized Free Cash Flow	(20,003)	(61,514)	(101,119)	(110,171)
Change in non-cash operating working capital	30,412	(3,040)	34,227	(13,702)
Amortization of prepaid aircraft rent and related fees	(565)	(524)	(2,280)	(1,975)
Stock-based compensation	(613)	(498)	(2,454)	(2,206)
Accretion of debt component of convertible debentures	(425)	(400)	(1,661)	(1,567)
Aircraft maintenance materials, supplies and services	(2,090)	—	(2,090)	—
Other	525	475	1,606	2,379
Growth capital expenditures(1)	4,501	76,274	139,173	178,278
Dividends	18,602	18,602	74,408	55,806
Free Cash Flow	30,344	29,375	139,810	106,842

(1) Growth capital expenditures include expenditures related to the purchase of Q400 aircraft and Q400 engines.

Adjusted Net Income

Adjusted net income is calculated by adjusting net income by the amount of any unrealized foreign exchange gains or losses on long-term debt and finance leases, and therefore more clearly reflects earnings from an operating perspective.

(expressed in thousands of Canadian dollars)	Three months ended December 31, 2012 $	2011 $	Change %	Year ended December 31, 2012 $	2011 $	Change %
Net income for the periods	14,677	22,674	(35.3)	101,107	68,135	48.4
Unrealized foreign exchange loss (gain)	3,258	(3,121)	(204.4)	(5,614)	3,517	(259.6)
Adjusted net income	17,935	19,553	(8.3)	95,493	71,652	33.3
Adjusted net income per Share - basic	0.14	0.16	(12.5)	0.77	0.58	32.8
Adjusted net income per Share - diluted	0.14	0.15	(6.7)	0.74	0.57	29.8

8. FLEET

As at December 31, 2012, Chorus' operating fleet was made up of 129 operating aircraft, of which 50 were regional jets and 79 were turboprop aircraft.

The following table lists Chorus' operating fleet as at December 31, 2012:

	Number of Operating Aircraft December 31, 2012	Average Age of Operating Aircraft	Owned	Finance Lease	Operating Lease	Number of Operating Aircraft December 31, 2011
Canadair Regional Jet CRJ100	8	17.3	—	—	8	17
Canadair Regional Jet CRJ200	26	10.5	—	—	26	26
Canadair Regional Jet CRJ705	16	7.4	—	—	16	16
De Havilland DHC-8-300	28	22.4	19	7	2	28
De Havilland DHC-8-100	36	24.7	29	—	7	36
Bombardier Q400	15	1.1	15	—	—	10
Boeing 757-200	—	—	—	—	—	6
Total Operating Aircraft	129	16.0	63	7	59	139

Chorus operates two Dash-8-100, two Dash-8-300, and one CRJ200 aircraft for charter purposes.

9. QUARTERLY FINANCIAL DATA

The following table summarizes quarterly financial results and major operating statistics of Chorus for the previous eight quarters. All information is reported on an IFRS basis.

	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011
Operating revenue ($000)	411,693	435,646	426,274	437,073	407,742	411,660	402,046	443,019
Operating expenses ($000)	386,264	398,982	389,710	407,136	382,422	380,566	378,086	421,446
Operating income ($000)	25,429	36,664	36,564	29,937	25,320	31,094	23,960	21,573
Total non-operating income (expenses) ($000)	(7,499)	7,249	(8,735)	17	2,656	(12,564)	(925)	(2,190)
Income tax expense ($000)	(3,253)	(6,754)	(4,962)	(3,550)	(5,302)	(4,620)	(6,140)	(4,727)
Net income ($000)	14,677	37,159	22,867	26,404	22,674	13,910	16,895	14,656
Adjusted net income(1) ($000)	17,935	27,124	27,403	23,031	19,553	21,535	16,240	14,324
Billable Block Hours	97,249	104,393	98,342	104,117	97,108	102,431	97,632	104,306
Available Seat Miles (000's)	1,411,938	1,571,335	1,532,914	1,865,855	1,459,392	1,487,874	1,460,612	1,878,044
Cost per Available Seat Mile (CASM) (¢)	27.36	25.39	25.42	21.82	26.20	25.58	25.89	22.44
CASM, excluding fuel (¢)	20.58	18.76	19.03	16.54	19.75	18.68	18.83	16.54
EBITDA(1) ($000)	40,190	51,828	50,443	42,878	37,960	42,954	33,885	31,287
Free Cash Flow(1) ($000)	30,344	37,825	38,714	32,927	29,375	29,101	23,257	25,109
Free Cash Flow(1) per Share ($)	0.24	0.31	0.31	0.27	0.24	0.24	0.19	0.21
Dividends declared per Share ($)	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
Net income per Share, basic ($)	0.12	0.30	0.18	0.21	0.18	0.11	0.14	0.12
Net income per Share, diluted ($)	0.12	0.28	0.18	0.20	0.18	0.11	0.13	0.12
Adjusted net income per Share, basic(1) ($)	0.14	0.22	0.22	0.19	0.16	0.17	0.13	0.12

(1) This is a non-GAAP measurement. Refer to Section 7 – Performance Indicators.

10. PENSION PLANS

Projected pension funding obligations

The table below provides projections for Chorus' pension funding obligations from 2013 to 2017:

(expressed in thousands of Canadian dollars)	2013 $	2014 $	2015 $	2016 $	2017 $
Defined benefit pension plans, current service	16,400	16,800	17,100	17,600	17,900
Defined benefit pension plans, past service	10,100	9,700	9,700	9,700	-
Defined contribution pension plans	9,400	10,000	10,600	10,800	11,000
Projected pension funding obligations	35,900	36,500	37,400	38,100	28,900

The estimated pension funding obligations shown in the above table are in respect of the defined benefit and defined contribution pension plans sponsored by Chorus. Defined benefit pension plans include the Chorus pilots' registered defined benefit pension plan as well as an unregistered defined benefit supplemental executive retirement plan that Chorus sponsors for eligible employees. Defined contribution pension plans include a number of defined contribution pension arrangements that Chorus contributes to for its eligible employees.

The funding requirements for the Chorus pilots' registered pension plan are based on the January 1, 2012 actuarial valuation for that plan and an estimate of the pilot payroll over the projection period. The estimated funding requirements for the supplemental executive retirement plan are based on a funding policy adopted by Chorus and the January 1, 2012 actuarial valuation for that plan.

The January 1, 2012 actuarial valuation for the Chorus pilot's registered plan applies an average of the solvency ratio over a three year period.

Changes in economic conditions, mainly the investment returns generated by the plan assets and changes in interest rates, will impact the financial position of these plans and, therefore, future required contributions. These projections are updated annually, or more frequently, as required (refer to Section 2 – Introduction, "Caution regarding forward-looking information").

11. LIQUIDITY AND CAPITAL RESOURCES

Chorus continues to generate positive operating income and cash flows from operations. At December 31, 2012, Chorus had $118.3 million in cash and cash equivalents and $6.0 million of restricted cash, for a total of $124.3 million. Chorus expects to generate sufficient cash flow to fund dividends (which are declared at the discretion of the Board of Directors), planned Maintenance Capital Expenditures, long-term debt repayments, and interest costs related to its convertible debentures (refer to Section 2 – Introduction, "Caution regarding forward-looking information").

(expressed in thousands of Canadian dollars)	Three months ended December 31, 2012 $	2011 $	Year ended December 31, 2012 $	2011 $
Cash provided by operating activities	8,632	41,339	142,807	152,969
Cash (used in) provided by financing activities	(21,318)	57,156	32,608	111,320
Cash used in investing activities	(10,032)	(87,383)	(165,177)	(222,117)
Net change in cash and cash equivalents during the periods	(22,718)	11,112	10,238	42,172
Cash and cash equivalents – Beginning of periods	141,024	96,956	108,068	65,896
Cash and cash equivalents – End of periods	118,306	108,068	118,306	108,068

Operating activities

Chorus continued to generate positive cash flows from operations of $8.6 million and $142.8 million, respectively, for the three months and year ended December 31, 2012, compared to $41.3 million and $153.0 million, respectively, for the same periods in 2011. Such decrease was attributable to a decrease in accounts payable; offset by a decrease in accounts receivable and a higher net income.

Financing activities

Cash provided by financing activities for the three months and year ended December 31, 2012 included proceeds received from long-term borrowings of $3.8 million and $124.6 million, respectively, dividends to Shareholders of $18.6 million and $74.4 million, respectively, a repayment of obligations under finance leases of $0.7 million and $2.7 million, respectively, and a repayment of long-term borrowings of $5.8 million and $14.9 million, respectively.

Cash used in financing activities for the three months and year ended December 31, 2011 included dividends to Shareholders of $18.6 million and $55.8 million, respectively, a repayment of obligations under finance leases of $0.7 million and $2.8 million, respectively, a repayment of long-term borrowings of $1.3 million, and proceeds received from long-term borrowings of $77.8 million and $171.2 million, respectively.

Investing activities

Investing activities for the three months and year ended December 31, 2012 included capital expenditures of $10.1 million and $170.1 million, respectively, and for the year ended December 31, 2012 included assets held for sale of $0.3 million and a decrease in restricted cash relating to letters of credit of $4.6 million. Capital expenditures consisted of major maintenance overhauls, the purchase of aircraft spare parts, other purchases necessary to support ongoing operations, purchase of a building to expand operations and facilities, the acquisition of two PW150A engines, and the acquisition of Q400 aircraft.

Investing activities for the three months and year ended December 31, 2011 included capital expenditures of $95.8 million and $208.0 million, respectively, assets held for sale of $13.0 million for year ended December 31, 2011, and a $5.0 million and $1.8 million increase, respectively, in restricted cash relating to letters of credit. Capital expenditures consisted of major maintenance overhauls, the purchase of aircraft spare parts, other purchases necessary to support ongoing operations and the acquisition of Q400 aircraft. Assets held for sale related to Q400 spare parts acquired that were being held for sale as part of a third party provisioning contract.

Contractual obligations and other commitments

The table below summarizes Chorus' principal and interest cash debt repayments and future minimum lease payments under operating leases for flight equipment and base facilities for the years 2013 through to 2017 and thereafter.

(expressed in thousands of Canadian dollars)	Payments Due by Period						
	Total $	2013 $	2014 $	2015 $	2016 $	2017 $	After 5 years $
Convertible debentures (1)	95,450	7,620	87,830	—	—	—	—
Long-term debt	336,711	29,682	29,682	29,682	30,682	30,648	186,335
Finance leases	10,087	3,546	3,546	2,995	—	—	—
Operating leases							
Air Canada and its subsidiary (2)	683,477	80,083	77,870	75,418	68,618	62,439	319,049
Operating leases							
Other third parties	59,806	12,899	11,236	9,656	4,712	3,482	17,821
	1,185,531	133,830	210,164	117,751	104,012	96,569	523,205

(1) Refer to “Convertible debentures” below for further discussion.
(2) Certain of the aircraft lease agreements have been entered into by Air Canada Capital Ltd. or Air Canada with head lessors and subleased to Chorus. These leases are included in the above table under the heading “Air Canada and its subsidiary”. For further discussion, refer to Section 14 - Economic Dependence.
(3) A significant portion of lease payments are payable in US dollars.

On June 29, 2012, pursuant to its Q400 aircraft purchase agreement with Bombardier Inc., Chorus exercised six of the 15 options to acquire additional aircraft. Based on the list price for the Q400 aircraft, these options are valued at approximately US$189.0 million. The first of these additional Q400 aircraft was delivered on February 15, 2013 and the remainder are scheduled to be delivered by April 2013.

During 2012, Chorus also entered into a separate agreement with a third party to purchase two additional PW150A engines by the end of 2013 with a list price of US$6.6 million.

Chorus has secured financing from EDC of US$126.1 million for the purchase of the six Q400 aircraft and two PW150A engines. Chorus is obligated to pay EDC a non-refundable commitment fee of 0.2% per annum on the undisbursed portion of the commitment. The availability of any undrawn amount will expire on January 11, 2014. EDC financing will provide for the majority of the purchase price of the Q400 aircraft and the Q400 engines with a term to maturity of 12 years, payable in semi-annual installments and quarterly installments, respectively.

In 2007 and 2010, Chorus entered into common terms agreements (“CTAs”) with aircraft lessors which govern three of Chorus' aircraft leases and which will also apply to any future aircraft leases with the same lessors. As at December 31, 2012, Chorus was in compliance with the tangible asset disposal covenants contained in these CTAs.

Long-term debt

Long-term debt consists of the following:

(expressed in thousands of Canadian dollars)	December 31, 2012 $	December 31, 2011 $
Term loans - purchased aircraft (1)	267,339	173,158
Term loans - purchased engines (2)	3,807	—
Term loan - Halifax facility (3)	6,300	—
	277,446	173,158
Less: Current portion	20,281	11,853
	257,165	161,305

(1) 15 individual term loans, repayable in semi-annual instalments, ranging from $0.8 million to $1.0 million, bearing fixed interest at a weighted average rate of 3.447%, maturing between May 2023 and June 2024, each secured by one Q400 aircraft and two PW150A engines. At December 31, 2012, the total Q400 aircraft financing payable in US dollars was US$268.7 million (December 31, 2011 - US$170.3 million) and the net book value of property and equipment pledged as collateral under Q400 aircraft financing was $309.0 million (December 31, 2011 - $189.9 million).

(2) Two individual term loans, repayable in quarterly instalments of $0.1 million, including fixed interest at a rate of 4.591%, maturing December 2024, each secured by one PW150A engine. At December 31, 2012, the total Q400 engine financing payable in US dollars was US$3.9 million and the net book value of property and equipment pledged as collateral under Q400 engine financing was $5.3 million (December 31, 2011 - $nil).

(3) Nova Scotia Jobs Fund loan, with a maximum contribution of $12.0 million, bearing interest at a fixed rate of 3.33% annually. Principal repayments of $1.0 million are payable annually commencing on August 31, 2016. Maturing on August 31, 2027, the loan may be repaid in full or in part at any time without bonus or penalty and is secured by a first security interest in the land and office building located at 3 Spectacle Lake Drive, Dartmouth, Nova Scotia and the assignment of the building tenant leases. As of December 31, 2012, the amount drawn on the loan was $6.3 million (December 31, 2011 - $nil). The provincial financial assistance will also consist of an additional $2.5 million forgivable loan (which will be forgiven if certain employment targets are achieved) and a $2.0 million employee grant to recruit, train and develop new employees or to upgrade current employees' skills.

Under its financing agreement with EDC (for both aircraft and engines), the "Jazz Group" (currently comprised of Jazz and Chorus Leasing III Inc.) is required to maintain a maximum adjusted leverage ratio of 2.25:1 and a minimum adjusted interest coverage ratio of 1.66:1. As at December 31, 2012, the Jazz Group was in compliance with these covenants. Failure by the Jazz Group to satisfy either such ratio at an applicable time would constitute an event of default under the financing agreement, which could have a material adverse effect on Chorus.

The financing agreement with EDC also contains several covenants which are specific to Jazz as the lessee of the Q400 aircraft and engines, including:

- a tangible asset disposal covenant, and;
- a continuation of business under the CPA covenant.

As at December 31, 2012, Jazz was in compliance with both of these continuous covenants.

As additional security under the financing agreements, the aircraft and engine leases between Jazz and Chorus Leasing III Inc. have been assigned to EDC. Also, Chorus Aviation Inc., has provided a limited recourse guarantee to EDC and pledged the issued shares of Chorus Leasing III Inc. to EDC as security for such guarantee.

Convertible debentures

The Debentures bear interest at a rate of 9.50% per annum, payable semi-annually in arrears on June 30 and December 31 in each year commencing on June 30, 2010, and will mature on December 31, 2014 (the “Maturity Date”). The Debentures are convertible at the holder's option into Shares of Chorus at any time prior to 5:00 pm (EST) on the earlier of the Maturity Date and the date fixed for redemption at a conversion price of $5.25 per Unit (the “Conversion Price”). The Debentures are not redeemable on or before December 31, 2012, except on a change of control of Chorus or default under the terms of the Debentures. After December 31, 2012 and prior to December 31, 2013, the Debentures may be redeemed in whole or in part from time to time at Chorus' option at a price equal to their principal amount plus accrued interest, provided that the volume weighted average trading price for the Shares is not less than 125% of the Conversion Price. On and after December 31, 2013 and prior to the Maturity Date, the Debentures may be redeemed in whole or in part from time to time at Chorus' option at a price equal to their principal amount plus accrued interest. Subject to regulatory approval, Chorus may satisfy its obligation to repay the principal amount of the Debentures on redemption or at maturity, in whole or in part, by delivering that number of Shares equal to the amount due divided by 95% of the market price for the Shares at that time, plus accrued interest in cash. Upon issuance, the Debentures were separated into liability and conversion components for accounting purposes. The following table allocates the Debentures between debt and equity:

(expressed in thousands of Canadian dollars)	Cost of borrowing %	Debt $	Equity $	Total $
As at December 31, 2010	9.5	73,541	9,497	83,038
Accretion expense		1,567		1,567
As at December 31, 2011		75,108	9,497	84,605
Accretion expense		1,661		1,661
As at December 31, 2012		76,769	9,497	86,266

Transaction costs are capitalized and offset with the debt and equity portions of the debentures and amortized over the life of the debentures using the effective interest rate.

For the year ended December 31, 2012, the total interest expense was $9.3 million (2011 - $9.2 million) which included interest accretion of $1.7 million (2011 - $1.6 million).

Off balance sheet arrangements and guarantees

Chorus enters into real estate leases or operating agreements which grant a license to Chorus to use certain premises and/or operate at certain airports in the majority of the cities that it serves. It is common in such commercial lease transactions for Chorus, as the lessee, to agree to indemnify the lessor and other related third parties for tort liabilities arising out of or relating to Chorus' use or occupancy of the leased or licensed premises. In certain cases, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but generally excludes any liabilities caused by their gross negligence or willful misconduct. Chorus also typically indemnifies such parties for any environmental liability arising out of or relating to its use or occupancy of the leased or licensed premises.

In aircraft financing or leasing agreements, Chorus typically indemnifies the financing parties, trustees acting on their behalf and other related parties and/or lessors against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft and for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, except for their gross negligence or willful misconduct. In addition, in aircraft financing or leasing transactions, including those structured as leveraged leases, Chorus typically provides indemnities in respect of certain tax consequences.

When Chorus, as a customer, enters into technical service agreements with service providers, primarily service providers who operate an airline as their main business, Chorus from time to time agrees to indemnify the service provider against liabilities that arise from third party claims, whether or not these liabilities arise out of or relate to the negligence of the service provider, but excluding liabilities that arise from the service provider's gross negligence or willful misconduct.

Chorus has indemnification obligations to its directors and officers. Pursuant to such obligations, Chorus indemnifies these individuals, to the extent permitted by law, against any and all claims or losses (including amounts paid in settlement of claims) incurred as a result of their service to Chorus.

The maximum amount payable under the foregoing indemnities cannot be reasonably estimated. Chorus carries or is otherwise the beneficiary of various insurance policies in respect of various risks applicable to the business (including in respect of tort liability and certain contractual indemnities). Chorus expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities described above.

Maintenance Capital Expenditures

Maintenance Capital Expenditures represent expenditures incurred to sustain operations or Chorus' productive capacity. Chorus separates its capital expenditures into three categories: leasehold improvements (includes improvements made to leased aircraft), aircraft-related (includes aircraft, aircraft related communication, equipment and tooling, aircraft rotable parts and engines, and major maintenance overhaul expenditures), and facilities and owned buildings.

For the three months and year ended December 31, 2012, Maintenance Capital Expenditures were $5.6 million and $30.9 million, respectively (2011 - $8.1 million and $29.7 million, respectively), which included $2.1 million and $11.3 million, respectively, for capitalization of major maintenance overhauls, $0.1 million and $6.0 million, respectively for the purchase of an office building, and $3.4 million and $13.6 million, respectively, for ongoing fleet modification programs, ongoing landing gear and spare parts replacements for the DHC-8-100, DHC-8-300 and Q400 fleet, facility improvements, and technological upgrades to foster process improvements. 2012 actual maintenance capital expenditures were lower than anticipated due to less major maintenance overhauls than planned and a delay until 2013 in modifications for the new office building and the existing Halifax hangar that were planned for the fourth quarter of 2012. Management anticipates its Maintenance Capital Expenditures for the year ended December 31, 2013 to be $42.0 million (refer to Section 2 – Introduction, "Caution regarding forward-looking information").

Shares

At February 18, 2013, the issued and outstanding common Shares of Chorus, along with common Shares potentially issuable, pursuant to convertible debentures, were as follows:

Number of Shares

	February 18, 2013	December 31, 2011
Issued and outstanding common Shares		
Class A variable voting Shares	6,486,003	13,173,264
Class B voting Shares	117,529,468	110,842,207
Total issued and outstanding common Shares	124,015,471	124,015,471
Common Shares potentially issuable		
Convertible debentures(1)	15,278,095	15,278,095
Total outstanding and potentially issuable common Shares	139,293,566	139,293,566

(1) Assuming all outstanding convertible debentures are exercised.

Long-term Investment

On April 30, 2010, Chorus purchased a 33% non-voting equity interest in Latin American Regional Aviation Holding Corporation ("LARAH"). LARAH held an indirect 75% equity interest in Pluna Líneas Aéreas Uruguayas S.A. ("Pluna"). The remaining 25% equity interest in Pluna was held, indirectly, by the Government of Uruguay. In the second quarter of 2012 it was announced that Pluna was in financial difficulty and that the Uruguayan government had taken control of the airline and ceased its operations. All of the shares in Pluna held indirectly by LARAH, including the portion indirectly owned by Chorus, were transferred to the Government of Uruguay. As a result, in the second quarter of 2012 Chorus recorded a write-down of $16.4 million to the fair value of the investment through other comprehensive loss.

12. RELATED PARTY TRANSACTIONS

As at December 31, 2012, Chorus had no transactions with related parties as defined in the CICA Handbook, except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship arrangements.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Chorus' financial instruments consist of cash and cash equivalents, accounts receivable, long-term investment, ABCP, accounts payable and accrued liabilities, promissory note payable, obligations under finance leases, long-term debt and convertible debentures.

Chorus has exposure to the following risks from its use of financial instruments: interest rate risk, credit risk, liquidity risk and currency risk.

Interest rate risk

Investments included in Chorus' cash and cash equivalents earn interest at prevailing and fluctuating market rates, as Chorus' objective is to maintain these balances in highly liquid investments. As at December 31, 2012, Chorus' investments consisted of bankers acceptances and bankers deposit notes issued by three Schedule I banks.

The 17 term loans with EDC bear fixed interest rates. This debt is therefore not subject to interest rate volatility.

A 1% change in the interest rate would not have a significant impact on the net income of Chorus.

Credit risk

Credit risk arises from cash and cash equivalents, restricted cash, deposits, as well as credit exposure to customers, including outstanding receivables. Chorus manages the credit risk on cash and cash equivalents by ensuring that the counter-parties are governments, banks and corporations with high credit-ratings assigned by international credit-rating agencies. In accordance with its investment policy, Chorus invests excess cash in Government of Canada treasury bills, short-term Canadian and provincial government debt, bankers' acceptance notes, term deposits of Schedule 1 Banks and Schedule 2 Banks rated R-1 high, and commercial paper rated R-1 high.

The maximum exposure to credit risk for cash and cash equivalents, restricted cash, deposits and trade and other receivables approximate the amount recorded on the statement of financial position.

With the exception of trade receivables, Chorus has no financial assets past due. As at December 31, 2012, the total amount of trade receivables was $61.9 million (2011 - $73.1 million), net of allowances for bad debts, which has been estimated by management based on prior experience and its assessment of the current economic environment and the specific debtor. The amount of this allowance was reduced to $nil from prior year. At December 31, 2012, trade receivables of $59.8 million (2011 - $67.8 million) were not past due or impaired; $2.1 million (2011 - $5.3 million) were past due, but not impaired, and $nil million (2011 - $0.02 million) were impaired. Chorus continues to work with the entities from which it holds past due receivables to recover the full amount outstanding. Approximately $58.5 million (2011 - $63.2 million) of the total receivables are with one company, Air Canada. Accordingly, Chorus is directly affected by the financial and operational strength of Air Canada. Chorus does not believe it is subject to any significant concentration of credit risk other than with Air Canada.

Liquidity risk

Cash flow forecasting is performed in respect of each operating entity of Chorus and then aggregated. Chorus monitors rolling forecasts of Chorus' liquidity requirements. Such forecasts take into consideration Chorus' operational cash flow requirements, debt financing plans and compliance with internal balance sheet ratio targets.

Chorus' objective is to maintain sufficient liquidity to meet liabilities when due. Chorus monitors its cash balances and cash flows generated from operations to meet its liquidity requirements. Letters of credit totaling approximately $6.0 million (December 31, 2011 - $10.6 million) have been issued as security for groundhandling, charters and airport fee contracts, lease payments on rental space and aircraft, and certain employee benefits.

Currency risk

Chorus receives certain revenue and incurs certain expenses in US currency, and as a result, is subject to fluctuations as foreign exchange rates fluctuate. Chorus manages its exposure to currency risk by billing for services in the underlying currency related to the expenditure. Accordingly, the primary exposure results from balance sheet fluctuations of US denominated cash, accounts receivable, accounts payable, and, in particular, obligations under finance leases, and long-term debt, which are long-term and subject to larger unrealized gains or losses. Chorus mitigates this currency risk by maintaining a balance of US dollars which is used to pay down US denominated liabilities and replenishes the balance through US denominated revenues. The amount of US denominated assets was $48.2 million and US denominated liabilities was $337.3 million at December 31, 2012. A 1¢ change in the US exchange rate would result in a change in the unrealized gain or loss of approximately $2.9 million.

Fair value of financial instruments

The carrying amounts reported in the balance sheet for cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, dividends payable and the promissory note payable approximate fair values based on the immediate or short-term maturities of these financial instruments. The methods and assumptions used in estimating the fair value of other financial assets and liabilities are as follows:

- Asset backed commercial paper

  The ABCP classified as level three is a financial security that currently has no active trading market. Valuation is done based on limited available market information, maturity dates and expected return of capital on a discounted basis. During the year ended December 31, 2012, a valuation gain of $0.5 million (2011 - $0.5 million) was recorded.

- Long-term investment

  In 2012 all of the shares in Pluna held indirectly by LARAH, including the portion indirectly owned by Chorus, were transferred to the Government of Uruguay. As a result, in 2012 Chorus recorded a write-down of $16.4 million to the fair value of the investment through other comprehensive loss.

- Long-term debt

  At December 31, 2012, the fair value of the fixed rate term loans was $286.7 million. These fair values have been calculated by discounting the future cash flow of the respective long-term debt at the estimated yield to maturity of similar debt instruments.

- Finance leases

  The repayment terms that Chorus is committed to make have been discounted at the relevant market interest rates applicable at year end. Interest rates used to calculate fair value are based on the change in the risk-free rate at December 31, 2012, compared to the risk-free rates at the inception of the leases.

- Convertible debentures

  Chorus' convertible debentures are listed on the Toronto Stock Exchange and their fair value was determined using bid prices on the last trading day of the year.

14. ECONOMIC DEPENDENCE

The CPA

The arrangements under the CPA are based upon a number of variable components based on certain different metrics, including Block Hours flown, flight hours, cycles (number of take-offs and landings), number of passengers and number of Covered Aircraft. The rates for these metrics are fixed for annual periods and vary by aircraft type. In addition, Air Canada is required to reimburse Chorus for certain pass-through costs, including fuel, deicing, navigation, landing and terminal fees, station provisioning costs, station termination costs, passenger liability insurance and certain employee relocation costs. Since these costs are required to operate the Covered Aircraft, the reimbursement of these costs is included in Chorus' revenue. Chorus also has the ability to earn certain performance incentive payments on a quarterly basis related to on-time performance, controllable flight completion, baggage handling performance and other customer satisfaction criteria.

Amendments to the CPA

On September 22, 2009 Chorus and Air Canada executed the CPA Amending Agreement to document certain amendments to the CPA, including those amendments described below.

The CPA Amending Agreement extends the initial term of the CPA from December 31, 2015 to December 31, 2020 and provides greater certainty regarding the number of annual Block Hours to be scheduled for flying by Chorus. Under the CPA Amending Agreement, Air Canada agreed to use reasonable commercial efforts to provide a minimum of 375,000 total annual Block Hours to Chorus, as measured by the sum of the twelve monthly schedules delivered by Air Canada to Chorus for a calendar year (the “Annual Delivered Block Hours”). In addition, Air Canada and Chorus agreed that the minimum average daily utilization per aircraft, measured in Block Hours, will not result in less than 339,000 annual Block Hours (the minimum average daily utilization guarantee or “MADUG”), notwithstanding the temporary reduction in the number of Covered Aircraft to 123 aircraft and the subsequent permanent reduction in the number of Covered Aircraft to 125, subject to Air Canada's one-time right to revise the MADUG in the circumstances described below.

In addition to establishing the annual minimum number of Block Hours on which the MADUG is based, the CPA Amending Agreement provides Air Canada with the right to revise the MADUG effective in January 2016 in the event Air Canada's domestic market share for the twelve month period from October 1, 2014 to September 30, 2015 has decreased by a fixed percentage compared to its domestic market share for the twelve month period from August 1, 2008 to July 31, 2009. In the event of such a decrease, the CPA Amending Agreement requires that Air Canada and Chorus agree to a revised MADUG by November 17, 2015, failing which Air Canada shall have the right to unilaterally set a revised MADUG by sending Chorus notice by November 20, 2015. The CPA Amending Agreement provides Chorus with the right to send Air Canada notice by December 18, 2015 of its intention to either accept the revised MADUG or exercise its right to terminate the CPA as of December 31, 2016.

The CPA Amending Agreement also amended the rates established for the rate period commencing January 1, 2009 and ending on December 31, 2011 (the “2009-2011 Rate Period”). The rates previously negotiated provided a mark-up of 16.72% on Chorus' Controllable Costs. Pursuant to the terms of the CPA Amending Agreement, Air Canada and Chorus agreed that the Controllable Mark-Up of 16.72% would only apply as of and from January 1, 2009 through to July 31, 2009. Effective August 1, 2009, an agreed set of revised rates became effective, under which Chorus applies a Controllable Mark-Up of 12.50% on Chorus' Controllable Costs.

Following the expiration of the 2009-2011 Rate Period, the CPA Amending Agreement established the following three remaining rate periods during the initial term of the CPA: (i) January 1, 2012 to December 31, 2014; (ii) January 1, 2015 to December 31, 2017 and; (iii) January 1, 2018 to December 31, 2020. Prior to the commencement of each rate period Chorus and Air Canada shall determine the rates to be charged by Chorus during each period (applying a rate reset process set out in the CPA). The CPA provides that Air Canada and Chorus will review and agree in writing on the rates for the next rate period. The components of each rate to be considered in this process are set out in the schedules to the CPA and are based on costs forecasted by Chorus. If Chorus and Air Canada cannot agree on new rates, the matter is subject to the arbitration provisions in the CPA.

The CPA Amending Agreement also provides for adjustments to the Controllable Mark-Up in certain circumstances. Commencing January 1, 2010, if the Annual Delivered Block Hours are less than 375,000 Block Hours, the Controllable Mark-Up will be increased, to a maximum of 16.72%, to compensate Chorus for increased Unit costs and margin lost due to the reduction in flying. If, on the other hand, the Annual Delivered Block Hours are greater than 375,000 Block Hours, then the Controllable Mark-Up of 12.50% will only apply to Chorus' fixed controllable charges and the Controllable Mark-Up of 12.50% shall be reduced to 5% on Chorus' variable controllable charges for Block Hours in excess of 375,000.

The CPA Amending Agreement provides for changes to the long range fleet plan, reflecting the agreement of Air Canada and Chorus to renew the fleet of Covered Aircraft. Air Canada and Chorus agreed that the fleet of Covered Aircraft shall be reduced from 133 aircraft to 125 aircraft, the “Guaranteed Minimum Number of Covered Aircraft”. The reduction in Covered Aircraft to the Guaranteed Minimum Number of Covered Aircraft was completed in April 2010.

The initial Q400 aircraft was delivered on May 26, 2011, and entered into service on June 7, 2011. Effective July 1, 2011, following the entry of the second Q400 aircraft into service, the number of aircraft comprising the Covered Aircraft returned to 125, being the Guaranteed Minimum Number of Covered Aircraft. Upon the delivery of each remaining Q400 aircraft, one CRJ will be removed from the fleet of Covered Aircraft, such that the number of aircraft shall remain at the Guaranteed Minimum Number of Covered Aircraft.

On March 8, 2011, Chorus and Air Canada agreed to the “Second Amending Agreement” to facilitate acquisition and leasing of the Q400 aircraft. Under the Second Amending Agreement, Air Canada agreed that the Q400 aircraft may be acquired by one or more of Chorus' subsidiary leasing companies, which will then lease such aircraft to Jazz Aviation LP, as Covered Aircraft. The parties also agreed to the timing of scheduling of the Q400 aircraft into commercial service, based upon the anticipated delivery date of such aircraft.

On June 29, 2012, Chorus and Air Canada agreed to amend the CPA to support the continued fleet renewal program with the acquisition of six additional Q400 aircraft and the removal of nine CRJ aircraft (starting in December 2012) from the Chorus fleet. Pursuant to this agreement, the number of Covered Aircraft will be reduced from 125 to 122. Effective February 2013, the annual minimum capacity guarantee of 339,000 Block Hours will be reduced to approximately 331,000 Block Hours to reflect the new number of Covered Aircraft. This agreement does not change the the Controllable Mark-Up or rates, but establishes certain new metrics. The Compensating Mark-Up will now be applied based on the range between the new annual minimum targeted Block Hours of approximately 367,000 and the revised annual minimum capacity guarantee of approximately 331,000 Block Hours. The difference between the annual minimum capacity guarantee and the annual minimum targeted Block Hours remains at 36,000 Block Hours. This agreement also resolved one of the issues raised in the 2009 Benchmark Arbitration regarding the manner in which the Compensating Mark-Up formula would be applied.

On August 6, 2012, in accordance with the terms of the CPA, Chorus and Air Canada agreed on detailed Rates applicable to the period commencing on January 1, 2012 and ending on December 31, 2014. These new Rates were retroactive to January 1, 2012.

Pursuant to the terms of the CPA Amending Agreement, Air Canada and Chorus also agreed, effective as of August 1, 2009, to treat the rent charged to Chorus for five of the CRJ aircraft as a pass-through cost.

2009 Benchmark Process

The CPA provides that Controllable Mark-Up may be reduced as a result of benchmarking Chorus' Controllable Costs to those of a group of comparable operators (the “Comparable Operators”) using publicly available information. Under the CPA, this benchmarking was to be effected in 2010 (based on information from Chorus' 2009 calendar year - the “2009 Benchmark”) and again in 2016 (using information from Chorus' 2015 calendar year - the “2015 Benchmark”). If the 2009 Benchmark revealed that the percentage difference between Chorus' Unit Costs and the median controllable unit costs, stage length adjusted, of the Comparable Operators had increased compared to the percentage difference of these costs for the twelve-month period beginning July 1, 2006 and ending June 30, 2007, the Controllable Mark-up was to be reduced accordingly with effect as of January 1, 2010 until December 31, 2020 (unless as a result of the 2015 Benchmark it is further reduced) to the lower of 12.50% or the percentage that is equal to 16.72% minus the change in Controllable Mark-up resulting from the 2009 Benchmark. If the 2015 Benchmark indicates that percentage difference between Chorus' Unit Costs and the median controllable unit costs, stage length adjusted, of the Comparable Operators has increased compared to the percentage difference determined during the 2009 Benchmark, the Controllable Mark-Up then in effect shall be reduced based on the results of the 2015 Benchmark, with effect as of January 1, 2016 until December 31, 2020. The comparison of Chorus' Unit Costs to the median controllable unit costs of the Comparable Operators, stage length adjusted, shall be subject to adjustments required to reflect the differences between Chorus and each Comparable Operator for matters such as fleet type and size, aircraft utilization, currency, geographical deployment and growth relative to Chorus. These adjustments are necessary to facilitate a reasonable and fair comparison of unit costs.

Chorus and Air Canada were unable to reach an agreement in 2010 on the results of the 2009 Benchmark. On February 3, 2011, Chorus and Air Canada agreed to proceed to binding arbitration in respect of the 2009 Benchmark (the “Arbitration”). On October 3, 2011, Air Canada delivered its claim in the Arbitration (the “AC Claim”). In the AC Claim, Air Canada sought a declaration that the appropriate methodology for comparing Chorus' Unit Costs to the adjusted median controllable unit costs of the Comparable Operators is a “component unit cost driver methodology” or “CUCD”. The AC Claim further sought a declaration that the proper application of the CUCD for the purpose of the 2009 Benchmark results in a reduction of the Controllable Mark-Up from 12.50% to 9.54%, effective from January 2010. Air Canada claimed that, if the Controllable Mark-Up was reduced from 12.50% to 9.54%, Chorus would be required to repay Air Canada the amount of $26.0 million in respect of payments made by Air Canada to Chorus in 2010.

At the commencement of the Arbitration hearings in June 2012, Air Canada amended its claim to seek a declaration that the Controllable Mark-Up be reduced to 9.48% rather than 9.54%, and that Chorus be required to repay Air Canada the amount of $24.4 million and $24.7 million in respect of payments made by Air Canada to Chorus in 2010 and 2011, respectively. In its amended Claim, Air Canada sought an order that Chorus be required to pay Air Canada those amounts, or such other amounts as the arbitration panel (the “Panel”) may determine, as well as any other amount necessary to account for the adjustment of Controllable Mark-Up for payments made by Air Canada to Chorus in 2012 and on a going-forward basis. Such adjustment for 2012 is estimated to be approximately $25.0 million. The AC Claim also alleged that the formula for calculating the Compensating Mark-Up ought to be adjusted to take into account any reduction in the Controllable Mark-Up (the “Compensating Mark-Up Claim").

On November 7, 2011, Chorus delivered its Defence and Counterclaim in the Arbitration (the “Chorus Claim”). In the Chorus Claim, Chorus asserted that the relevant provisions of the CPA provide that the preferred methodology to be applied for comparing Chorus' Unit Costs to the stage length adjusted median controllable unit costs of the Comparable Operators is on a “cost per available seat mile” or “CASM” basis. Chorus further asserted that, if a CASM methodology is applied with the appropriate normalizations and adjustments, no adjustment to the Controllable Mark-Up would be required as a result of the 2009 Benchmark. As a result, Chorus asserted that it was not required to repay Air Canada any amounts in respect of payments made in 2010 or 2011, and that its Controllable Mark-Up will remain at 12.50% going forward until at least the 2015 Benchmark. In the alternative, Chorus asserted that, even if the Panel were to accept that CASM was not an appropriate methodology, the CUCD methodology proposed by Air Canada in the AC Claim is not an “alternate market recognized benchmark” as contemplated by the CPA. In the further alternative, the Chorus Claim asserted that, even if CUCD were to be found to be an “alternate market recognized benchmark”, a proper application of the CUCD methodology with the appropriate normalizations and adjustments would not result in the adjustment to the Controllable Mark-Up claimed by Air Canada. Finally, Chorus stated that the CPA does not provide for any adjustment to the Compensating Mark-Up formula resulting from an adjustment to the Controllable Mark-Up as a consequence of the 2009 Benchmark exercise.

During the Arbitration, Chorus and Air Canada resolved the Compensating Mark-Up Claim as part of the June 29, 2012 agreement to further amend the CPA to support a continued fleet renewal program with the acquisition of six additional Q400 aircraft and the removal of nine CRJ aircraft as described in Section 3 - The Chorus Business and Section 14 - Economic Dependence. The Compensating Mark-Up Claim was therefore removed as a dispute to be determined by the Panel.

The hearing of the arbitration occurred in June 2012. Subsequent to the hearing, the parties exchanged written submissions and then reply submissions. On October 2 and 3, 2012, the Panel released its award (the “Award”).

In the Award, two of the three member Panel concluded that the CUCD methodology put forward by Air Canada was the appropriate methodology to use in the 2009 Benchmark to compare Chorus' Unit Costs to the stage length adjusted median controllable unit costs of the Comparable Operators. However, the Panel also agreed with Chorus that a number of the additional adjustments proposed by Chorus were also required to be made (the "Adjustments") but did not provide guidance on the calculation of such Adjustments. The Panel also agreed with Chorus that fleet age impacts the rate at which maintenance costs increase. However, the Panel did not specify a methodology for the Fleet Age Adjustment and directed Air Canada and Chorus to negotiate a further adjustment that would account for the impact of fleet age on the rate at which maintenance costs increase (the “Fleet Age Adjustment”) failing which the parties will submit new proposals and analysis to the Panel on that issue.

There remain substantive disputes between the parties with respect to the interpretation and application of the Award and its impact on the Controllable Mark-Up. The parties have been unable to reach agreement on either the calculation of certain of the Adjustments or the Fleet Age Adjustment.

Chorus' position is that, applying the CUCD methodology, along with the proper application of the Adjustments required by the Panel other than the Fleet Age Adjustment, the Controllable Mark-Up should remain at 12.50%.

Air Canada previously asserted to Chorus its view that the impact of the Adjustments required by the Panel would reduce the Controllable Mark-Up to11.41%. However, this does not account for any impact that the Fleet Age Adjustment would have on the Controllable Mark-Up. Air Canada took the position at the hearing that there should be no such Fleet Age Adjustment.

Air Canada is now taking the position that a Fleet Age Adjustment ought to be made and that such adjustment should be in its favour. The effect of making the Fleet Age Adjustment, in the manner asserted by Air Canada, would be to materially reduce the Controllable Mark-Up below the 11.41% rate that Air Canada asserts should otherwise result from the application of the other Adjustments.

Chorus remains of the view that, given its older fleet relative to those of the relevant comparable operators, and consistent with the position it took at the initial hearing, any Fleet Age Adjustment would only be to the benefit of Chorus and therefore regardless of the decision on the other Adjustments, the Fleet Age Adjustment should result in the Controllable Mark-Up remaining at 12.50% going forward until at least the 2015 Benchmark and that it should not be required to repay Air Canada any amounts in respect of payments made since January 1, 2010.

Following the release of the Award, the parties had scheduled a further hearing with the Panel to occur in the last week of November 2012 to resolve the outstanding issues in dispute, including the impact of the Fleet Age Adjustment. That hearing was subsequently adjourned to the last week of January 2013 and then to the first week of April 2013 in order to provide the parties with additional time to put forward evidence on the issues which remain in dispute.

As a consequence of the issues remaining in dispute, the impact, if any, of the 2009 Benchmark and the Arbitration to the Controllable Mark-Up on Chorus' Controllable Costs cannot be stated at this time with reasonable certainty.

No amounts have been recorded in the accounts of Chorus in 2010, 2011 or 2012 related to this claim as management has determined that it is not probable that the AC claim will be successful, and it is not practicable to determine an estimate of the possible financial effect, if any, with sufficient reliability.

Master services agreement

Under a master services agreement dated September 24, 2004, between Chorus and Air Canada, Air Canada provides certain services to Chorus for a fee. These services include information technology services, french language training, insurance claims services, and environmental affairs services.

The master services agreement will continue in effect until the termination or expiration of the CPA, but individual services can be amended or terminated earlier in accordance with the terms of the master services agreement.

Other

Air Canada provides certain supplies from third parties, primarily fuel, to Chorus and subsequently collects payment from Chorus. As these transactions and balances merely represent a method of settlement for transactions in the normal course of business, they have not been separately disclosed. Air Canada ground handling services, a division of Air Canada, provides ground handling services.

Substantially all of the trade receivable from Air Canada relates to outstanding balances under the CPA.

The balances in accounts payable and accrued liabilities are payable on normal trade terms and have arisen from the services provided by the applicable party.

Chorus has a significant amount of transactions with Air Canada and its subsidiary. Air Canada and its subsidiary represented 96.2% of Chorus' operating revenues for the year ended December 31, 2012 (94.6% for the year ended December 31, 2011). Approximately 10.0% and 10.6% of Chorus' operating expenses for the years ended December 31, 2012 and 2011, respectively, were incurred with Air Canada and its subsidiary.

15. CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with GAAP requires management to make estimates, judgments and assumptions that management believes are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results can differ from those estimates (refer to Section 2 - Introduction, "Caution regarding forward-looking information"). The significant accounting policies of Chorus are described in note 3 of the December 31, 2012 consolidated financial statements of Chorus.

Employee future benefits

Chorus' significant policies related to defined benefit pension plan for its pilots, the supplemental executive retirement plan for Chorus executives, which is also a defined benefit pension plan (collectively referred to as "Pension Benefits"), and the Other Employee Benefits are as follows:

- The cost of pension benefits earned by employees is actuarially determined using the projected benefit method prorated on service, market interest rates, and management's best estimate of expected plan investment performance, salary escalation and retirement ages of employees. Obligations are attributed to the period beginning on the date the employee joins the plan and ending on the earlier of the date of termination, death or retirement. Actuarial gains and losses on the pension benefits are recognized in full in the period in which they occur in other comprehensive income and retained earnings without recycling to the statement of income in subsequent periods. Current service cost, the recognized element of any past service cost, the expected return on plan assets and the interest arising on the pension liability are included in salaries, wages and benefits in the statement of income.

- Other employee benefits consist of two categories of benefits:
  - Medical and dental benefits provided to employees while on long-term disability, and Worker's Compensation and Workers Safety Insurance Board benefits in respect of Ontario employees, are collectively referred to as other long-term benefits. The actuarial gains and losses for this component of other employee benefits are charged to operating expense in the year they occur.
  - Sick leave benefits are paid to certain employees upon or just prior to retirement. The actuarial gains and losses on this component of other employee benefits are charged to other comprehensive income in the year they occur.
- The cost of the other employee benefits is actuarially determined using the projected benefit method prorated on service (where applicable), market interest rates, and management's best estimate of retirement ages of employees, health care cost inflation, salary escalation and general inflation, as applicable to each of the categories of benefits.
- The expected return on plan assets is based on the long-term expected rate of return on plan assets and the fair value of the plan assets. It is reasonably possible that management's estimate of the long-term rate of return may change as management continues to assess future investments and strategies and as a result of changes in financial markets.
- Past service costs arising from plan amendments of the defined benefit pension plan and the supplemental executive retirement plan are recognized immediately in income unless the changes to the plan are conditional on the employee remaining in service for a specified period of time (the vesting period). In this case, the past service costs are recognized over the vesting period.
- The registered pension plan is subject to certain minimum funding requirements. The liability in respect of the minimum funding requirement is determined using the projected minimum funding requirements based on actuarial forecasts. The liability in respect of the minimum funding requirement and any subsequent re-measurement of that liability is recognized in other comprehensive income without subsequent reclassification to income.
- The measurement date of each of the plans' assets and obligations is December 31. Pension obligations are attributed to the period beginning on the employee's date of joining the plan and ending on the earlier of the date of termination, death or retirement. The obligations relating to other employee benefits plans are attributed to the period beginning on the employee's date of joining the plan or disablement (whichever applicable) and ending on the earlier of retirement or end of disablement or age 65 (whichever applicable).
- Chorus also maintains several defined contribution pension plans. The cost of defined contribution pension plans is charged to expense as the contributions become payable.

The following assumptions were used in valuing the benefit obligations under the plan and the employer's net periodic pension or benefit cost:

- The discount rate used to determine the pension and benefit obligation was determined by reference to market interest rates, as of the measurement date, on high quality debt instruments with cash flows that approximately match the timing and amount of expected benefit payments. It is reasonably possible that these rates may change in the future as a result of changes in market interest rates.

- Chorus' expected long-term rate of return on assets assumption is based on economic conditions as of the measurement date and the specific portfolio mix of plan assets. Management, in conjunction with its actuaries, reviews anticipated future long-term performance of individual asset categories and considers the asset allocation strategy adopted by Chorus. These factors are used to determine the average rate of expected return on the funds invested to provide for the pension plan benefits. While the review considers recent fund performance and historical returns, the assumption is primarily a long-term, prospective rate. This assumption may change as management continues to assess future investments and strategies and as a result of changes in financial markets.
- The health care inflation used to determine cost of other employee future benefits costs is based on recent industry experience and long-term expectations. The weighted average health care inflation assumption used for the health care plans is 6.1% per annum for 2012 and 4.5% per annum for 2030 and later years.
- Actual experience that differs from assumptions made by management will result in a net actuarial gain or loss, which is recognized each period through other comprehensive income.

The following table contains assumptions used in valuing the benefit obligations under this plan and the employer's net periodic pension or benefit cost.

	Fiscal year ended December 31,	
	2012	**2011**
Weighted average assumptions used to determine accrued benefit obligation		
- Discount rate	3.7% - 4.4%	4.3% - 5.4%
- Rate of compensation increase	4.5% - 5%	5%
- Health care inflation - Select	6.4%	6.1%
- Health care inflation - Ultimate	4.5%	4.5%
- Year ultimate trend reached	2030	2030
Weighted average assumptions used to determine pension and benefit costs		
- Discount rate	4.3% - 5.4%	4.9% - 5.7%
- Expected long-term rate of return on assets	5.8%	6.2%
- Rate of compensation increase	4.8%	4%
- Health care inflation - Select	6.1%	6.9%
- Health care inflation - Ultimate	4.5%	4.5%
- Year ultimate trend reached	2030	2030

Depreciation of long-lived assets

Management makes estimates and judgements about the expected useful life and the expected residual value of long-lived assets. Depreciation methods for long-lived assets are based on management's judgment of the most appropriate method to reflect the pattern of an asset's future economic benefit. Useful life and residual values are based on estimates of future fair values and can vary significantly from actual. Management revises depreciation estimates and patterns regularly and makes any changes on a prospective basis. A 25% reduction to the residual values of aircraft would result in an increase of $5.2 million to annual depreciation expense.

16. ACCOUNTING POLICIES

The significant accounting policies of Chorus are described in note 3 of the December 31, 2012 consolidated financial statements of Chorus.

New accounting standards adopted

Chorus has early adopted IFRS 9, Financial Instruments. The new standard requires financial assets to be classified into two measurement categories: amortized cost and fair value. Classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For investments in equity instruments which are not subject to control, joint control, or significant influence, on initial recognition IFRS allows an entity to irrevocably elect classification at "fair value through profit or loss" or "fair value through other comprehensive income". For financial liabilities, changes in fair value attributable to an entity's own credit risk are recorded through other comprehensive income rather than through net income.

Management has designated that equity investments not held for trading that were previously classified as available for sale, be classified as fair value through other comprehensive income.

The new accounting standard provides more relevant information for users to assess the amounts, timing and uncertainty of future cash flows. The new accounting standard was applied retrospectively and there were no resulting changes to opening retained earnings or the classification of comparable period fair value adjustments through the statement of income or statement of comprehensive income as a result of the adoption of IFRS 9.

The adoption of the new standard had the effect of recording the loss on revaluation of the investment in LARAH through the statement of comprehensive income as opposed to the statement of income as would have been the case under IAS 39.

Accounting standards issued but not yet applied

Chorus does not expect to early adopt the following revised standards and amendments. Accordingly, Chorus expects to adopt these standards on the effective dates listed below.

IFRS 10, Consolidated Financial Statements

The IASB issued IFRS 10, "Consolidated Financial Statements" ("IFRS 10"), effective for annual periods beginning on or after January 1, 2013. IFRS 10 replaces portions of IAS 27, "Consolidated and Separate Financial Statements" ("IAS 27") that addresses consolidation, and supersedes Standing Interpretations Committee ("SIC") SIC-12 in its entirety. The objective of IFRS 10 is to define the principles of control and establish the basis of determining when and how an entity should be included within a set of consolidated financial statements. IAS 27 has been amended to reflect the issuance of IFRS 10 and retains guidance only for separate financial statements. Chorus continues to assess the impact of IFRS 10 on its consolidated financial statements.

IFRS 11, Joint Ventures

The IASB issued IFRS 11, "Joint Ventures" ("IFRS 11"), effective for annual periods beginning on or after January 1, 2013. IFRS 11 supersedes IAS 31, "Interest in Joint Ventures" and SIC-13, "Jointly Controlled Entities - Non Monetary Contributions by Venturers". Through an assessment of the rights and obligations in an arrangement, IFRS 11 establishes principles to determine the type of joint arrangement and guidance for financial reporting activities required by the entities that have an interest in arrangements which are controlled jointly. As a result of the issuance of IFRS 10 and IFRS 11, IAS 28, "Investments in Associates and Joint Ventures" ("IAS 28") was amended to reflect the guidance provided in IFRS 10 and IFRS 11. Currently, this standard has no impact on the consolidated financial statements of Chorus.

IFRS 12, Disclosure of Interests in Other Entities

The IASB issued IFRS 12, "Disclosure of Interests in Other Entities" ("IFRS 12") effective for annual periods beginning on or after January 1, 2013. IFRS 12 requires extensive disclosures relating to a company's interests in subsidiaries, joint arrangements, associates, and unconsolidated structured entities. IFRS 12 enables users of the financial statements to evaluate the nature and risks associated with its interests in other entities and the effects of those interests on its financial position and performance. As this standard relates to disclosure, there will be no changes to the statements of income and financial position upon adoption of the new standard. Chorus continues to evaluate additional disclosures required.

IFRS 13, Fair Value measurement

The IASB issued IFRS 13, "Fair Value Measurement" ("IFRS 13") effective for annual periods beginning on or after January 1, 2013. IFRS 13 defines fair value, provides guidance in a single framework for measuring fair value and identifies the required disclosures pertaining to fair value measurement. Chorus does not anticipate any material changes to the statements of income and financial position upon adoption of the new standard.

Amendments to standards

IAS 19, *Employee Benefits*, has been amended effective for annual periods beginning on or after January 1, 2013. The revised standard requires immediate recognition of actuarial gains and losses in other comprehensive income, eliminating the previous options that were available. A number of other amendments have been made to recognition, measurement and classification. Chorus' current accounting policy for recognition of actuarial gains and losses through other comprehensive income is consistent with the revisions contained in the standard. Chorus has analyzed the impacts of the revisions to IAS 19 and expects that in 2012, upon retrospective application, restated net income will be lower than originally reported under the current standard. The decrease is expected to arise due to the projected rate of return on plan assets being higher than the discount rate, and will result in the statement of income receiving an additional pre-tax charge of $1,206 with an offsetting pre-tax reduction to the statement of comprehensive income. Chorus does not anticipate the revised standard will impact the balances of employee benefits in the statement of financial position.

IAS 1, *Presentation of Financial Statements*, has been amended to require entities to separate items presented in OCI into two groups, based on whether or not items may be recycled in the future. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately. The amendment is effective for annual periods beginning on or after July 1, 2012 with earlier application permitted. Chorus is already in compliance with the revisions to the standard.

17. CONTROLS AND PROCEDURES

Disclosure controls and procedures and internal control over financial reporting

Disclosure controls and procedures within Chorus have been designed to provide reasonable assurance that all relevant information is identified to the Disclosure Policy Committee to ensure appropriate and timely decisions are made regarding public disclosure.

An evaluation of the design and effectiveness of the operation of Chorus' disclosure controls and procedures has been conducted by management, under the supervision of the CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that, as of December 31, 2012, Chorus' disclosure controls and procedures, as defined by National Instrument 52-109 - Certification of Disclosure in Issuers' Annual and Interim Filings, are effective to ensure that information required to be disclosed in reports that are filed or submitted under Canadian securities legislation is recorded, processed, summarized and reported within the time periods specified therein.

Internal control over financial reporting has been designed, based on the framework established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”), to provide reasonable assurance regarding the reliability of Chorus' financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Management, under the supervision of the CEO and CFO, has evaluated the effectiveness of our internal control over financial reporting using the framework designed as described above. Based on this evaluation, the CEO and CFO have concluded that internal control over financial reporting was effective as of December 31, 2012.

Because of inherent limitations, internal control over financial reporting and disclosure controls can provide only reasonable assurances and may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

There has been no change in Chorus' internal control over financial reporting that occurred during the year ended 2012 that has materially affected, or is reasonably likely to materially affect, Chorus' or the Partnership's internal control over financial reporting.

The Audit, Finance and Risk Committee of the board of directors of Chorus reviewed this MD&A, and the consolidated financial statements of Chorus for December 31, 2012, and Chorus' board of directors approved these documents prior to their release.

18. OUTLOOK

The discussion that follows represents forward-looking information (refer to Section 2 – Introduction, “Caution regarding forward-looking information”). This outlook is provided for the purpose of providing information about current expectations for 2013. This information may not be appropriate for other purposes.

Based upon the 2012-2013 winter schedule, the summer 2013 schedule and planning assumptions received from Air Canada, Chorus anticipates billing between 375,000 and 390,000 Block Hours for the year ending December 31, 2013.

19. RISK FACTORS

Risks Relating to the Relationship with Air Canada

Dependence on Air Canada

Chorus is directly affected by the financial and operational strength of Air Canada and its competitive position. In the event of any decrease in its financial or operational strength, Air Canada's ability to make full payment of amounts owing to Chorus may be adversely affected. In addition, a deterioration of Air Canada's competitive position could adversely affect the utilization of the Covered Aircraft.

In the recent past, Air Canada has, like other network carriers, sustained significant operating losses and may sustain significant losses in the future. Air Canada's business, results from operations and financial condition are subject to a number of risks, including:

- Air Canada has substantial commitments for capital expenditures, including for the acquisition of new aircraft; fuel costs, which continue to fluctuate and recently reached historically high levels, constitute a significant portion of Air Canada's operating expenses;
- labour conflicts or disruptions can have a material adverse effect on Air Canada's business, results from operations and financial condition;
- the airline industry is highly competitive and subject to price discounting; and
- the risk factors described under "Risks Relating to the Industry".

Air Canada is the sole marketing agent for Chorus' Covered Aircraft capacity and is solely responsible for establishing schedule, routes, frequency and ticket prices for Chorus. To the extent Air Canada does not effectively and competitively market the routes serviced through Chorus, the utilization of the Covered Aircraft could be reduced with the result that Chorus' operating margin in dollar terms would be reduced, all of which could have a material adverse effect on Chorus' business, results from operations and financial conditions.

In addition, Air Canada is responsible for establishing Chorus' operating plans for the Covered Aircraft, including schedules, Block Hours, departures, ASMs and load factors for each aircraft type included in the Covered Aircraft, and any changes thereto. Should such operating plans not be provided to Chorus on a timely basis in accordance with the CPA, Chorus' operations could be materially adversely affected.

Liquidity

Air Canada has significant ongoing capital and liquidity requirements and has in the past, among other things, issued new equity, entered into or amended credit facilities and sought cost cutting or containment changes to its arrangements with its workforce suppliers and other stakeholders in order to improve its liquidity position. There can be no assurance that these measures will provide Air Canada with sufficient liquidity to continue operations in the longer term. The failure of Air Canada to satisfy its liquidity requirements could have a material adverse effect on Chorus' business, results from operations and financial condition. Such material adverse effect could arise as a result of any inability of Air Canada to pay the fees owing to Chorus under the CPA, any reduction in the utilization of the Covered Aircraft below the required contractual minimums or other defaults by Air Canada of its obligation under the CPA or other contracts with Chorus.

Termination of the CPA

Substantially all of Chorus' current revenues are received pursuant to the CPA which currently covers all of Chorus' existing operating fleet (except four Dash 8 aircraft and one CRJ aircraft). The CPA Amending Agreement extended the initial term of the CPA from December 31, 2015 to December 31, 2020. The CPA will be automatically renewed for two additional five year periods, unless either party gives notice to the other of its intention not to renew within one year prior to the expiry of the initial term or any renewal term. In addition, either party is entitled to terminate the CPA at any time upon the occurrence of an event of default. Events of default include, without limitation:

- bankruptcy or insolvency of the other party;
- suspension or revocation of Chorus' right to operate as a scheduled airline;
- failure by Air Canada or Chorus to pay amounts when due where such default continues for a period of 30 days after notice;
- failure by Air Canada or Chorus to comply with any of its obligations under the CPA, where such default continues for a period of 30 days after notice;
- failure to operate more than 50% of the Covered Aircraft for more than seven consecutive days or failure to operate 25% of the Covered Aircraft for more than 21 consecutive days, other than as a result of an order of a governmental authority affecting the industry generally or as a result of any action by Air Canada, any strike by Air Canada employees or any force majeure (including any cessation, slow-down, interruption of work or any other labour disturbance);
- failure by Chorus to meet certain performance criteria;
- default by Chorus with respect to any material term, if such default continues for more than the applicable period, if any;
- a default by Air Canada or Chorus with respect to a material term of any other material agreement between Chorus and Air Canada if such default continues for more than the applicable period, if any;
- failure by Chorus to maintain adequate insurance; and
- failure by Chorus to comply with Air Canada's audit and inspection rights.

If the CPA is terminated, Chorus' revenue and earnings would be significantly reduced or eliminated unless Chorus is able to enter into satisfactory substitute arrangements. There is no assurance that Chorus would be able to enter into satisfactory substitute arrangements or that such arrangements would be as favourable to Chorus as the CPA. A termination of the CPA, or any failure of Chorus to enter into significant, substitute arrangements in the event of any such termination, would have a material adverse effect on Chorus' business, results from operations and financial condition.

Under the CPA, if a change of control of Jazz occurs without the consent of Air Canada, Air Canada may terminate the CPA. The existence of this right may limit Chorus' ability to negotiate or consummate the sale of all or part of its business to another entity or otherwise participate in any consolidation in the airline industry.

The CPA provides that upon the expiry or termination of the CPA, other than termination as a result of a default by Chorus or Air Canada, all leases between Chorus and Air Canada (or any affiliate of Air Canada) in respect of Covered Aircraft and Spare Engines shall automatically be terminated and Air Canada (or any affiliate of Air Canada) shall have the right to repossess the Covered Aircraft and the Spare Engines. There can be no assurance that Chorus will be able to find replacement aircraft in these circumstances. In the event that Chorus is able to find replacement aircraft, there can be no assurance that Chorus will be able to do so on terms as favourable as the terms of its current leases with Air Canada (or any affiliate of Air Canada). Unless Chorus is able to find replacement aircraft on reasonable terms, Chorus' ability to offer scheduled and charter flights to any carrier would be materially adversely affected, which would have a material adverse effect on Chorus' business, results from operations and financial condition.

In the event that the CPA is terminated as a result of Chorus' default, all leases between Chorus and Air Canada (or any affiliate of Air Canada) in respect of Covered Aircraft and Spare Engines will not be automatically terminated. In such event, Chorus would remain liable for its obligations under the aircraft leases with no corresponding ability to earn income under the CPA to cover its aircraft lease obligations, which would have a material adverse effect on Chorus' business, results from operations and financial condition.

The CPA Amending Agreement also provides Air Canada with the right to revise the MADUG in the event Air Canada's domestic market share for the twelve month period from October 1, 2014 to September 30, 2015 has decreased by a fixed percentage compared to its domestic market share for the twelve month period from August 1, 2008 to July 31, 2009. In the event of such a decrease, the CPA Amending Agreement requires that Air Canada and Chorus agree upon a revised MADUG by November 17, 2015, failing which Air Canada shall have the right to unilaterally set a revised MADUG by sending Chorus notice by November 20, 2015. The CPA Amending Agreement provides Chorus with the right to send Air Canada notice by December 18, 2015, of Chorus' intention to either accept the revised MADUG or exercise its right to terminate the CPA as of December 31, 2016.

There can be no assurances that Chorus and Air Canada will, if required, agree to a revised MADUG or that, if the parties do not agree and Air Canada unilaterally sets a revised MADUG level, such revised MADUG level will be acceptable to Chorus. If the CPA is terminated, Chorus' revenue and earnings would be significantly reduced or eliminated unless Chorus is able to enter into satisfactory alternative business arrangements. There is no assurance that Chorus would be able to enter into satisfactory alternative business arrangements or that such arrangements would be as favourable to Chorus as the CPA. Any such termination, or failure to enter into satisfactory substitute arrangements, would have a material adverse effect on Chorus' business, results from operations and financial condition.

Upon the expiration or termination of the CPA, Chorus may lose access to airport facilities at key locations where Air Canada supplies facilities and other services to Chorus. Chorus may also lose access to such airport facilities should Air Canada not be able to secure such access to airport facilities in the future. Most of the airport facilities at Chorus' principal domestic destinations are leased by Air Canada from airport authorities. Under the CPA, Chorus is currently entitled to use these facilities to fulfill its obligations to Air Canada under the CPA. All of Chorus' airport takeoff or landing slots used for Scheduled Flights are under Air Canada's name. Upon the expiry or termination of the CPA, Chorus may lose access to those airport facilities, airport takeoff or landing slots, and Chorus may have to enter into alternative arrangements to use the same or other airport facilities and slots at higher rates. There can be no assurance that Chorus would have access to other airport facilities or slots or as to the terms upon which Chorus could do so. Chorus' inability to secure access to sufficient airport facilities or slots, or ability to do so only with a significant cost increase, would have a material adverse effect on Chorus' business, results from operations and financial condition.

Reduced utilization levels

While the CPA requires Air Canada to meet certain minimum utilization levels for Chorus' aircraft, Air Canada determines, in its sole discretion, which routes Chorus flies. If Air Canada was unable to find sufficient capacity for its own aircraft or was able to operate at a competitive cost compared to Chorus or use other suppliers at competitive cost, or for any other reason, Air Canada could reduce Chorus' flights to the minimum utilization levels or could require Chorus to fly its aircraft on routes that may under-utilize Chorus' aircraft capacity or may make it more difficult for Chorus to reach incentive targets. Any such reduction or requirement would likely result in lower revenues earned by Chorus under the CPA, which could have a material adverse effect on Chorus' business, results from operations and financial condition. Though Chorus would still be guaranteed a minimum revenue, if its aircraft were underutilized by Air Canada, Chorus would lose the ability to recover a margin on the direct operating costs of flights that would otherwise have been realized had Chorus' aircraft been more fully utilized. Chorus would also lose the opportunity to earn incentive compensation. The minimum average daily utilization guarantee will not apply in the event Chorus fails to reach the minimum number of Block Hours due to its own default or an inability to supply sufficient capacity.

Pursuant to the terms of the CPA and the June 29, 2012 agreement to amend certain provisions of the CPA, Air Canada and Chorus have agreed to a revised MADUG of approximately 331,000 annual Block Hours, subject to Air Canada's one-time right to revise the MADUG in the circumstances described above.

Force Majeure

Air Canada's and Chorus' obligations under the CPA (other than any financial obligations) will be suspended if, and for so long as, any event of force majeure prevents a party from meeting its obligations pursuant to the CPA. In addition, Air Canada and Chorus recognize that an event of force majeure may inadvertently result in one party being in default of a collective agreement to which it is a party. As a result of any event of force majeure that occurs during the term of the CPA, Air Canada and Chorus may decide to renegotiate certain terms of the CPA, including, without limitation, rates for the payment of fees by Air Canada, minimum capacity purchase guarantees, elements of the then current three-year, annual or seasonal operating plans, the long-range fleet plan, including Block Hours and departures, ASMs, airports to which Chorus will operate and the number of Covered Aircraft. Such changes to the terms of the CPA, whether temporary or long term, could have a material adverse effect on Chorus' business, results from operations and financial condition.

Replacement of services provided by Air Canada under the CPA and the Master Services Agreement ("MSA")

Air Canada provides a number of important services to Chorus, including ticket sales, reservations and call centre services, designator codes, information technology, deicing services and glycol usage, fuel purchasing services and passenger, aircraft and traffic handling services. If the CPA is not renewed beyond its original term or subsequent renewal terms, or is otherwise terminated, Chorus would either need to provide these services internally or contract with third parties for such services. There can be no assurance that Chorus would be able to replace these services on a cost effective or timely basis. In addition, pursuant to the MSA, Air Canada provides certain services to Chorus for a fee. These services include information technology services, French language training, insurance claims services and environmental affairs services. If the MSA is terminated, Chorus would either need to provide these functions internally or contract with third parties for such functions. There can be no assurance that Chorus would be able to replace these services on a cost-effective or timely basis. Chorus' inability to replace these services on a cost effective or timely basis could have a material adverse effect on Chorus' business, results from operations and financial condition.

Changes in costs and fees

Chorus is paid fees by Air Canada on a variety of different metrics based on Chorus' estimated controllable costs for each calendar year in the applicable period marked-up by a specified percentage. Such mark-up equates to a specified margin on Chorus' estimated Scheduled Flights Revenue for each calendar year in the applicable period. Air Canada is responsible for scheduling and pricing the flights, and absorbs the risk of variations in ticket prices, passenger loads and fuel prices. If such controllable costs exceed Chorus' estimates, Chorus may realize decreased profits or losses under the CPA, and may be unable to generate sufficient cash flow to pay its debts on time. If any of these events occurs, Chorus' business, results from operations and financial condition could be materially adversely affected.

For the periods commencing 2009, 2012, 2015 and 2018, Chorus and Air Canada established and will establish rates for each of the succeeding three years. There can be no assurance that the estimates of the future costs used and to be used in negotiating such rate resets is and will be accurate.

The CPA Amending Agreement amended the Rates established for the 2009-2011 Rate Period. The Rates negotiated and reflected in the Rate Amending Agreement were established to enable Chorus to achieve a Controllable Target Margin of 14.32%, corresponding to a Controllable Mark-Up of 16.72% on Chorus' Controllable Costs. However, pursuant to the terms of the CPA Amending Agreement, Air Canada and Chorus agreed that the Controllable Mark-Up of 16.72% shall only apply as of and from January 1, 2009 through to July 31, 2009. Effective commencing August 1, 2009, an agreed set of revised rates were effective, enabling Chorus to achieve a Controllable Target Margin of 11.11%, corresponding to a Controllable Mark-Up of 12.50% on Chorus' Controllable Costs. If Controllable Costs exceed Chorus' estimates, Chorus may realize decreased profits or losses under the CPA, and may be unable to generate sufficient cash flow to pay its debts on time. If any of these events occurs, Chorus' business, results from operations and financial condition could be materially adversely affected.

The CPA Amending Agreement also provides for adjustments to the Controllable Mark-Up in certain circumstances. Commencing January 1, 2010, if the Annual Delivered Block Hours are less than 375,000 Block Hours, the Controllable Mark-Up will be increased, to a maximum of 16.72%, to compensate Chorus for increased Unit costs and lost margin due to the reduction in flying. If annual Delivered Block Hours are greater than 375,000 Block Hours, the Controllable Mark-Up of 12.50% shall only apply to Chorus' fixed controllable charges and the Controllable Mark-Up of 12.50% shall be reduced to 5% on Chorus' variable controllable charges.

The Controllable Mark-Up may also be reduced as a result of the 2009 Benchmark and the 2015 Benchmark. If the 2009 Benchmark indicates that the percentage difference between Chorus' Controllable Costs and those of the Comparable Group has increased compared to the percentage difference for the twelve month period beginning July 1, 2006 and ending June 30, 2007, the Controllable Mark-Up will be reduced with effect as of January 1, 2010 until December 31, 2020, unless as a result of the 2015 Benchmark it is further reduced, to the lower of 12.50% or the percentage that is equal to 16.72% minus the amount of the increase described above. If the 2015 Benchmark indicates that the percentage difference between Chorus' Controllable Costs and those of the Comparable Group has increased compared to the percentage difference determined during the 2009 benchmarking, the Controllable Mark-Up then in effect shall be reduced by the results of the 2015 Benchmark, with effect as of January 1, 2016 until December 31,

2020. Any such reduction in the Controllable Mark-Up could have a material adverse effect on Chorus' business, results from operations and financial conditions (for a summary of the status of the ongoing arbitration proceeding between Chorus and Air Canada regarding the 2009 Benchmark (refer to Section 14 - Economic Dependence).

Air Canada Pilots Association ("ACPA") Scope Clauses and Small Jets Settlement Agreement

Air Canada's collective bargaining agreement with ACPA and the Small Jets Settlement Agreement entered into by Air Canada, Chorus, ACPA and the Air Line Pilots Association ("ALPA") limit the number of regional jet aircraft which can be operated by Chorus under the CPA. The Small Jets Settlement Agreement also prevents Chorus from operating the CRJ aircraft if configured in excess of 75 seats, inclusive of all classes, and sets out a minimum ratio of ASMs flown by Air Canada compared to the CPA ASMs flown by Chorus. These restrictions may cause Air Canada to reduce the level of capacity it purchases from Chorus under the CPA, prevent Chorus from expanding its market share, or impede Chorus' fleet development, any of which could significantly reduce Chorus' opportunities for growth, revenue and earnings. Any such event could have a material adverse affect on Chorus' business, results from operations and financial condition. Chorus cannot ensure that any future Air Canada collective bargaining agreement will not contain similar, or more severe, restrictions for Chorus.

Covered Aircraft reductions

Subject to regulatory restrictions, the CPA does not preclude Chorus from entering into capacity purchase agreements with, or providing airline services to, or making investments in, other carriers as long as Chorus' ability to perform its obligations under the CPA is not impaired as a result. However, if Chorus enters into an agreement with another carrier to provide regional airline services (other than charter flights), whether on a capacity purchase or other economic basis, Air Canada will have the right to reduce the number of Covered Aircraft, on a one-for-one basis, by the number of aircraft to be operated under such other agreement, which would reduce Chorus' revenue earned from Air Canada.

Exclusivity arrangements

Chorus does not benefit from exclusivity arrangements preventing Air Canada from allocating some or all of its regional capacity requirements internally or to another carrier under a capacity purchase agreement or other forms of contractual arrangements. Air Canada's use of other regional carriers could negatively impact opportunities for increasing Chorus' flying under the CPA.

Potential conflicts with Air Canada

Conflicts may arise between Air Canada and Chorus in a number of areas, including:

- the 2009 Benchmark and/or the 2015 Benchmark (for a summary of the status of the ongoing arbitration proceeding between Chorus and Air Canada regarding the 2009 Benchmark (refer to Section 14 - Economic Dependence);
- Chorus' and Air Canada's respective rights and obligations under the CPA or other agreements between Chorus and Air Canada, including conflicts based on differing interpretations of the contract language;
- the nature and quality of the services Air Canada provides to Chorus and the services Chorus provides to Air Canada;
- the terms of Air Canada's and Chorus' respective collective bargaining agreements;
- amendments to any of the existing agreements between Chorus and Air Canada, including the CPA; and
- reductions in the number of Covered Aircraft in accordance with the CPA.

Chorus may not be able to resolve any potential conflicts with Air Canada and, even if any such conflicts are resolved, the resolution may be on terms and conditions less favourable to Chorus. Any such result could have a material adverse effect on Chorus' business, results from operations and financial condition.

Limited ability to participate in improved market conditions

While the capacity purchase business model and target margin reflected in the CPA reduce Chorus' financial risk and exposure to fluctuations for many of its potentially volatile costs, they also limit Chorus' potential to benefit from earnings growth arising as a result of improved market conditions.

Risks Relating to Chorus

Bill C-459 and Bill C-17

On February 2, 2013, Bill C-459, An Act Respecting the Rights of Air Passengers received second reading. Previous versions of Bill C-459 died on recommendation of the Standing Committee on Transport, Infrastructure and Communities in 2009 (Bill C-310) and on the order paper when Parliament was dissolved in 2011 (Bill C-541). If enacted, Bill C-459 would impose obligations on air carriers in the event of certain flight delays, flight cancellations, denied boarding to passengers or ground delays of aircraft with passengers on board. Such legislation could lead to significant costs for air carriers, including Chorus, which could have a material adverse effect on Chorus' business, results from operations and financial condition. Management cannot predict whether such proposed legislation will be enacted, if at all, or if enacted whether its provisions will be in the form currently proposed by Bill C-459 or otherwise.

On October 17, 2011, Bill C-17, An Act to Amend the Air Canada Public Participation Act, received first reading. If passed into law, Bill C-17 would render designated carriers contracted to Air Canada, including Chorus, directly accountable to the Commissioner of Official Languages and subject to recourse in the event of non-compliance under the Official Languages Act. These provisions are not applicable to all air carriers operating in Canada and would result in increased costs to Chorus, and potentially adversely impact Chorus' competitive position. Bill C-17, if enacted, could have a material adverse affect on Chorus' business, results from operations and financial condition.

Employees

Chorus' business is labour-intensive and requires a large number of pilots, flight attendants, mechanics and other personnel. Chorus' business requires Chorus to locate, hire, train and retain new employees. There can be no assurance that Chorus will be able to locate, hire, train and retain a sufficient number of qualified employees that it needs to carry out its plans or replace departing employees. Chorus' inability to hire and retain a sufficient number of qualified employees at a reasonable cost could have a material adverse effect on its business, results from operations and financial condition.

Labour costs and labour relations

Labour costs constitute the largest percentage of Chorus' total operating costs that are borne by Chorus. There can be no assurance that the estimates of Chorus' future labour costs will be accurate. If such costs exceed Chorus' estimates, Chorus may realize decreased profits or losses under the CPA.

90 percent of Chorus employees are unionized. Currently both the pilots and flight attendants are working under collective agreements that run until their expiry in July of 2015. The collective agreements governing Chorus' maintenance and engineering employees and crew schedulers, both represented by the Canadian Auto Workers (CAW) and its flight dispatch employees, represented by the Canadian Air Line Dispatchers Association (CALDA), expired on June 30, 2012. In accordance with the Canada Labour Code provisions governing collective bargaining in the Federal sector, Chorus was successful in reaching a Collective Agreement with its Maintenance and Engineering employees represented by the CAW, which is effective until October 1, 2015. Chorus also reached agreement with CALDA in the form of a new Collective Agreement that will run until July 1, 2018.

Chorus continues to bargain with the CAW representing the crew scheduler employees to reach a new Collective Agreement and its customer service and aircraft services agents, represented by the CAW. Chorus and the CAW bargaining committee continue to meet and negotiate towards new Collective Agreements in accordance with the Canada Labour Code.

There can be no assurance that the collective agreements will be renewed in the future without labour conflict or action, or that there will not otherwise be a labour conflict or action that could lead to an interruption or stoppage in Chorus' service or otherwise adversely affect Chorus' ability to conduct its operations, all of which could have a material adverse effect on its business, results from operations and financial condition. There can be no assurance that these agreements with employees' unions will be on terms that are consistent with Chorus' expectations or comparable to agreements entered into by other regional airlines, and any future agreements may increase labour costs or otherwise adversely affect Chorus.

Leverage and restrictive covenants in current and future indebtedness

The ability of Chorus to pay dividends, or make other payments or advances, is subject to, among other things, its liquidity position, applicable laws and contractual restrictions contained in the instruments governing any indebtedness. The degree to which Chorus is leveraged has important consequences to Shareholders, including: (i) that Chorus' ability to obtain additional financing for working capital, capital expenditures or acquisitions in the future may be limited; (ii) that a significant portion of cash flow from operations may be dedicated to the payment of principal and interest in respect of its indebtedness, thereby reducing funds available for future operations; (iii) that certain borrowings will be at variable rates of interest, which exposes Chorus to the risk of increased interest rates; and (iv) that Chorus may be more vulnerable to economic downturns and be limited in its ability to withstand competitive pressures.

Current global financial conditions have been characterized by high levels of volatility and several financial institutions have faced significant liquidity and other issues in recent years. Access to new public financing has been negatively impacted by these events, which may impact the ability of Chorus to obtain financing in the future on acceptable terms. Any failure of Chorus in the future to obtain required financing on acceptable terms could have a material adverse effect on Chorus' business, results of operations and financial condition.

Dilution of Shareholders

Chorus is authorized to issue an unlimited number of Class A Variable Voting Shares and an unlimited number of Class B Voting Shares for consideration, and on terms and conditions, as shall be established by the Board. The Shareholders have no pre-emptive rights in connection with such further issues. Chorus may make future acquisitions or enter into financings or other transactions involving the issuance of securities of Chorus which may be dilutive, and materially adverse to current Shareholders.

Uncertainty of dividend payments

Payment of dividends may be impacted by factors that can have a material adverse change on Chorus' business, results from operations and financial condition and which could impact its liquidity and ability to declare and pay dividends (whether at current levels, revised levels or at all), and is also dependent on, among other things, the ability of Chorus to generate sufficient cash flows, the financial requirements of Chorus, and applicable solvency tests and contractual restrictions (whether under credit agreements or other contracts).

Level of indebtedness - refinancing risk

The level of Chorus' indebtedness from time to time could impair Chorus' ability to obtain additional financing on a timely basis to take advantage of business opportunities that may arise. Any failure of Chorus in the future to obtain required financing or acceptable terms in these circumstances could have a material adverse effect on Chorus' business, results of operations and financial condition.

Diversification and growth

Management regularly reviews potential diversification and growth opportunities and business acquisition opportunities that they believe may be complementary to Chorus. As part of any such initiative, management conducts customary due diligence and performs analysis with the goal of identifying and evaluating material risks. Notwithstanding their review, management may be unsuccessful in identifying all such risks or realizing the intended synergies of any given initiative, or in successfully executing a particular diversification or growth transaction. Any such failure could have a material adverse effect on results of operation and its financial condition could be adversely impacted. In addition, management's inability to effectively manage growth could have a material adverse impact on Chorus' business, operations and prospects.

Reliance on key personnel

The success of Chorus depends on the abilities, experience, industry knowledge and personal efforts of senior management and other key employees, and Chorus' ability to retain and attract skilled employees. As Chorus seeks to diversify and/or grow, this may put additional strain and demand on management and on Chorus' employees and produce risks in both productivity and retention levels. In addition, Chorus may not be able to attract and retain additional qualified management as needed in the future. The loss of the services of such key personnel could have a material adverse effect on the business, results from operations, financial condition or future prospects of Chorus.

Risks relating to financial instruments

For a description of the interest rate risk, credit risk, liquidity risk and currency risk associated with Chorus' financial instruments, see the discussion in Section 13 - Financial Instruments and Risk Management.

Off balance sheet arrangements and guarantees

Chorus has agreed to indemnify various third parties in connection with the entering into of leases, agreements and other arrangements. The maximum amount payable under the such indemnities cannot be reasonably estimated. Chorus carries or is otherwise the beneficiary of various insurance policies in respect of various risks applicable to the business (including in respect of tort liability and certain contractual indemnities). While Chorus expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities, in the event that such insurance coverage were not available or insufficient, any payment pursuant to Chorus' indemnification obligations could have a material adverse effect on Chorus' business, results from operations and financial condition.

Risks Relating to the Industry

Economic and geopolitical conditions

Airline operating results are sensitive to economic and geopolitical conditions, which have a significant impact on the demand for air transportation. Airline fares and passenger demand have fluctuated significantly in the past and may fluctuate significantly in the future. Air Canada is not able to predict with certainty market conditions and the fares it may be able to charge. Customer expectations can change rapidly and the demand for lower fares may limit revenue opportunities. Travel, especially leisure travel, is a discretionary consumer expense. A downturn in economic growth in North America, as well as geopolitical instability in various areas of the world, could have the effect of reducing demand for air travel. In addition, the recent increases, and any further increases, in the value of the Canadian dollar relative to the United States dollar could affect the desirability of transborder travel to Canada. Any such event could have a material adverse effect on Chorus' business, results from operations and financial condition.

Fuel costs

Fuel costs represent a major expense to air carriers. Fuel prices have increased to and have fluctuated at near historically high levels. Should fuel prices remain at such levels or further increase, demand for air travel may decrease as a result of fuel surcharges and/or Air Canada may be unable to pass on any further increases to its customers through fuel surcharges. This could have a material adverse effect on Chorus' business, results from operations and financial condition if Air Canada were to reduce its capacity usage or as a result were unable to meet its obligations under the CPA.

Impact of competition on Air Canada's need to utilize Chorus' services

The airline industry is highly competitive. Air Canada competes with other major carriers as well as low cost carriers on its routes, including routes that Chorus flies under the CPA. Competitors could rapidly enter markets Chorus serves for Air Canada, and quickly discount fares, which could lessen the economic benefit of Chorus' regional operations to Air Canada. In 2012, WestJet announced its intention to launch Encore, an affiliated low cost, short haul regional airline. On February 11, 2013, WestJet announced Encore will launch in June 2013 with two Q400 aircraft in Western Canada. In addition to traditional competition among airlines, the industry faces competition from ground transportation alternatives. Video teleconferencing and other methods of electronic communication have also added a new dimension of competition to the industry as business travelers seek substitutes to air travel. Any of the foregoing events could have a material adverse effect on Chorus' business, results from operations and financial condition.

Impact of increased competition in the regional airline industry and the tour operator industry on Chorus' diversification or growth opportunities

As well as the limitations under the CPA and the regulatory prohibition on cabotage, Chorus' ability to provide regional air service to a major United States airline is limited by existing relationships that all United States network airlines have with other regional operators. In addition, many of the network airlines are subject to scope clause restrictions under their collective bargaining agreements with employees that restrict their ability to add new regional jet capacity. New competitors may also enter the regional airline industry. Such new or existing competitors may enter into capacity purchase agreements with airlines, including Air Canada, in respect of routes currently operated by Chorus. Capacity growth by other regional airlines in the regional jet market would lead to significantly greater competition and may result in lower rates of return in the regional airline industry. Further, many of the network airlines are focused on reducing costs, which may also result in lower operating margins in the regional airline industry. Aggressive competition among tour operators and carriers providing flying services can limit Chorus' ability to expand in those markets. Any of the foregoing events could have a material adverse effect on Chorus' business, results from operations and financial condition.

Airline industry characterized by low gross profit margins and high fixed costs

The airline industry generally, and scheduled service in particular, are characterized by low gross profit margins and high fixed costs. The costs of operating any particular flight do not vary significantly with the number of passengers carried and, therefore, a relatively small change in the number of passengers or in fare pricing or traffic mix could have a significant effect on Air Canada's operating and financial results. This condition has been exacerbated by aggressive pricing by low-cost carriers, which has had the effect of driving down fares in general. A minor shortfall from Air Canada's expected revenue levels could have a material adverse effect on Chorus' business, results from operations and financial condition if Air Canada were to reduce its capacity usage or were unable to meet its obligations under the CPA.

Terrorist attacks

The occurrence of a terrorist attack (whether domestic or international and whether involving Air Canada, Chorus, another carrier or no carrier at all) and increasingly restrictive security measures, such as the restrictions on the content of carry-on baggage, could have a material adverse effect on passenger demand for air travel and on the number of passengers traveling on Air Canada's and Chorus' flights. Any such negative effect on demand could have a material adverse effect on Chorus' business, results from operations and financial condition if Air Canada were to reduce its capacity usage or were unable to meet its obligations under the CPA.

Epidemic diseases

The spread of contagious diseases could have a material adverse effect on passenger demand for air travel and the number of passengers traveling on Air Canada and Chorus flights, especially in the event travel related restrictions are imposed. Any such event could have a material adverse effect on Chorus' business, results from operations and financial condition.

Interruptions or disruptions in service

Chorus' business is significantly dependent upon its ability to operate without interruption at a number of key airports, including Toronto Pearson. An interruption or stoppage in service at a key airport could have a material adverse effect on Chorus' business, results from operations and financial condition.

Dependence on technology

Chorus relies in part on technology, including computer and telecommunications equipment and software to increase revenues, reduce costs, and operate its business. Proper implementation and operation of technology initiatives is fundamental to Chorus' ability to operate a profitable business. Chorus continuously invests in new technology initiatives to remain competitive, and its continued ability to invest sufficient amounts to enhance technology will affect Chorus' ability to operate successfully. An inability to invest in technological initiatives would have a material adverse effect on Chorus' business, results from operations and financial condition.

Chorus' technology systems may be vulnerable to a variety of sources of failure, interruption or misuse, including by reason of natural disasters, terrorist attacks, telecommunications failures, computer viruses, hackers and other security issues. While Chorus maintains and continues to invest in technology security initiatives and disaster recovery plans, these measures may not be adequate or implemented properly. Any failure in technology employed by Chorus or technology employed by Air Canada to provide services to Chorus, including by reason of power, telecommunication or Internet interruptions, could materially and adversely affect Chorus' operations and could have a material adverse effect on Chorus' business, results from operations and financial condition.

Seasonal nature of the business, other factors and prior performance

Chorus has historically experienced greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters of the calendar year. Termination of the Thomas Cook flying program is expected to return seasonality to these previous patterns. Chorus has substantial fixed costs that do not meaningfully fluctuate with passenger demand in the short-term. Chorus' revenues do not fluctuate significantly with Passenger Load Factors.

Demand for air travel is also affected by factors such as economic conditions, war or the threat of war or terrorist attacks, fare levels and weather conditions. Due to these and other factors, operating results for an interim period are not necessarily indicative of operating results for an entire year, and operating results for a historical period are not necessarily indicative of operating results for a future period.

Under the CPA, Chorus is paid fees by Air Canada on a variety of different metrics based on Chorus' estimated controllable costs in the applicable period marked-up by a specified percentage. Such mark-up equates to a specified margin on Chorus' estimated Scheduled Flights Revenue in the applicable period. However, Chorus' actual quarterly results could differ from those contemplated by the target margin based on a variety of factors, including the timing of capital expenditures and changes in operating expenses, such as personnel and maintenance costs, over the course of a fiscal year.

Regulatory matters

The airline industry is subject to extensive Canadian and foreign government regulations relating to, among other things, security, safety, licensing, competition, noise levels, the environment and, in some measure, pricing. Additional laws and regulations may be proposed, and decisions rendered, from time to time which could impose additional requirements or restrictions on airline operations. The implementation of additional regulations or decisions by Transport Canada, the Canadian Transportation Agency, the Treasury Board or other domestic or foreign governmental entities may have a material adverse effect on Chorus' business, results from operations and financial condition. Chorus cannot give any assurances that new regulations or revisions to the existing legislation, or decisions, will not be adopted or rendered. The adoption of such new laws and regulations or revisions, or the rendering of such decisions, could have a material adverse effect on Chorus' business, results from operations and financial condition.

Chorus is also subject to domestic and United States laws regarding privacy of passenger and employee data. Compliance with these regulatory regimes is expected to result in additional operating costs and could have a material adverse effect on Chorus' business, results from operations and financial condition.

Environment and greenhouse gas emissions

As a participant in the airline industry, Chorus is exposed to any future regulations concerning greenhouse gas emissions by its aircraft. Chorus would be faced with additional costs necessary to comply with any such regulations, which could have a material adverse effect on Chorus' business, results from operations and financial condition.

Third party war risk insurance

There is a risk that the Government of Canada may not continue to provide an indemnity for third party war risk liability coverage, which it is currently providing Chorus and certain other carriers in Canada. Any such discontinuance could have a material adverse effect on Chorus' business, results from operations and financial condition. In the event that the Government of Canada does not continue to provide such indemnity or amends such indemnity, Chorus and other industry participants would have to seek such coverage from commercial insurance providers. Alternative solutions, such as those proposed by International Civil Aviation Organization ("ICAO") and IATA have not developed as planned due to actions taken by other countries and the availability of supplemental insurance. The achievement of a global solution is not likely in the immediate or near future. The United States federal government has set up its own facility to provide war risk coverage to United States carriers, thus removing itself as a key component of any global plan.

London aviation insurance providers have introduced a new standard war and terrorism exclusion clause applicable to aircraft hull and spares and have announced their intention to introduce similar exclusions to airline passenger and third party liability policies. These clauses exclude claims caused by the hostile use of a dirty bomb, electromagnetic pulse device, or bio chemical materials. The Government of Canada indemnity program is designed to address these types of issues as they arise, but the Government of Canada has not yet decided to extend the existing indemnity to cover this exclusion. Unless and until the Government of Canada does so, the loss of coverage exposes Chorus to this new uninsured risk and may result in Chorus being in breach of certain regulatory requirements or contractual arrangements, which may have a material adverse effect on Chorus' business, results from operations and financial condition.

Casualty losses

Due to the nature of its core operating business, Chorus may be subject to liability claims arising out of accidents or disasters involving aircraft on which Chorus' customers are traveling or involving aircraft of other carriers maintained or repaired by Chorus, including claims for serious personal injury or death. There can be no assurance that Chorus' insurance coverage will be sufficient to cover one or more large claims and any shortfall could be material. Additionally, any accident or disaster involving one of Air Canada's or Chorus' aircraft or an aircraft of another carrier maintained or repaired by Air Canada or Chorus, could significantly harm their reputation for safety, which would have a material adverse effect on Chorus' business, results from operations and financial condition.

Risks Relating to Current Legal Proceedings

In February 2011, Chorus and Air Canada agreed to proceed to binding arbitration in respect of the 2009 Benchmark under the CPA (the "Arbitration") (refer to Section 14 - Economic Dependence). If Chorus is not successful in the Arbitration, Chorus' operating results, financial conditions and liquidity may be materially adversely affected.

In February 2006, Chorus commenced proceedings before the Ontario Superior Court of Justice ("Ontario Court") against the Toronto Port Authority ("TPA"), Porter Airlines Inc. ("Porter") and other defendants (collectively with Porter, the "Porter Defendants") after Chorus became aware that it would be excluded from operating flights from Toronto City Centre (Island) Airport (the "TCCA"). On October 26, 2007, Porter counterclaimed against Chorus and Air Canada alleging various tort claims, including conspiracy, and violations of competition law, including that Chorus and Air Canada's commercial relationship contravenes Canadian competition laws, and claiming $850.0 million in damages. Concurrently with the Ontario Court proceedings, Chorus commenced judicial review proceedings against the TPA before the Federal Court of Canada ("Federal Court") relating to Chorus' access to the TCCA. The Porter Defendants were granted intervener and party status in these proceedings. In January of 2008, in the Federal Court proceedings, Porter filed a defence and counterclaim against Chorus and Air Canada making allegations and seeking damages similar to those in the Ontario Court counterclaim. On October 16, 2009, Chorus discontinued its action in the Ontario Court against the Porter Defendants and the TPA. On the same date, the counterclaim filed by Porter in the Ontario Court against Chorus and Air Canada was stayed pending the outcome of the proceeding in Federal Court. On March 29, 2010, Chorus discontinued its action in the Federal Court against the TPA, in which the Porter Defendants intervened and were made parties. On May 14, 2010 Porter discontinued its counterclaim in the Federal Court. The counterclaim against Chorus and Air Canada brought by Porter in the Ontario Court was reinstated on February 22, 2011. Chorus maintains that Porter's counterclaim is without merit. The counterclaim will be vigorously contested by Chorus in court. If Chorus is not successful in defending the counterclaim, it could be subject to a material damages award. It is not practicable to determine an estimate of the possible financial effect, uncertainties related to the amount or timing of any outflows or the possibility of any reimbursement. Accordingly, no amounts have been recorded in the accounts of Chorus related to this claim.

Various other lawsuits and claims that have arisen in the normal course of business are pending by and against Chorus. The provisions that have been recorded are not material. It is the opinion of management that final determination of these claims will not have a material adverse effect on the financial position or the results of Chorus.

Risks Relating to the Convertible Debentures

Matters affecting trading prices for the convertible debentures

The TSX approved the listing of the Convertible Debentures and the Shares issuable upon conversion, redemption or repayment thereof. There is currently no market through which the securities may be sold and purchasers may not be able to resell securities purchased under the short form prospectus. This may affect the pricing of the securities in the secondary market, the transparency and availability of trading prices, the liquidity of securities, and the extent of issuer regulation.

No assurance can be given that an active or liquid trading market for the Convertible Debentures will develop or be sustained. If an active or liquid market for the Convertible Debentures fails to develop or be sustained, the prices at which the Convertible Debentures trade may be adversely affected. Whether or not the Convertible Debentures will trade at lower prices depends on many factors, including the liquidity of the Convertible Debentures, prevailing interest rates and the markets for similar securities, the market price of the Chorus Shares, general economic conditions and Chorus' financial condition, historic financial performance and future prospects. Further, the Shareholders will suffer dilution if Chorus decides to redeem outstanding Convertible Debentures for Shares or to repay outstanding principal amounts thereunder at maturity of the Convertible Debentures by issuing additional Shares.

Credit risk and prior ranking indebtedness; absence of covenant protection

The likelihood that purchasers of the Convertible Debentures will receive payments owing to them under the terms of the Convertible Debentures will depend on the financial health of Chorus and its creditworthiness. In addition, the

Convertible Debentures are unsecured obligations of Chorus and are subordinate in right of payment to all Chorus' existing and future senior indebtedness. Therefore, if Chorus becomes bankrupt, liquidates its assets, reorganizes or enters into certain other transactions, Chorus' assets will be available to pay its obligations with respect to the Convertible Debentures only after it has paid all of its senior and secured indebtedness in full. There may be insufficient assets remaining following such payments to pay amounts due on any or all of the Convertible Debentures then outstanding. The Convertible Debentures are also effectively and structurally subordinate to claims of creditors (including trade creditors) of Chorus' subsidiaries except to the extent Chorus is a creditor of such subsidiaries ranking at least pari passu with such other creditors.

Conversion following certain transactions

In the case of certain transactions, each Convertible Debenture will become convertible into the securities, cash or property receivable by a holder of Shares in the kind and amount of securities, cash or property into which the Convertible Debenture was convertible immediately prior to the transaction. This change could substantially lessen or eliminate the value of the conversion privilege associated with the Convertible Debentures in the future. For example, if Chorus were acquired in a cash merger, each Convertible Debenture would become convertible solely into cash and would no longer be convertible into securities whose value would vary depending on Chorus' future prospects and other factors.

20. ADDITIONAL INFORMATION

Additional information relating to Chorus, including Chorus' Annual Information Form is available on SEDAR at www.sedar.com or on Chorus' website at www.chorusaviation.ca, under Investors.

21. GLOSSARY OF TERMS

"**7503695**" means 7503695 Canada Inc., a corporation incorporated under the Canada Business Corporations Act on April 14, 2010;

"**ABCP**" means asset backed commercial paper;

"**Arbitration**" means the binding arbitration process between Chorus and Air Canada related to the 2009 Benchmark;

"**Available Seat Mile (ASMs)**" means a measure of passenger capacity calculated by multiplying the total number of seats available for passengers by the number of miles flown;

"**Aviation GP**" means Aviation General Partner Inc., a corporation incorporated under the Ontario Business Corporations Act on November 18, 2010 to act as the general partner of Jazz Aviation LP;

"**Billable Block Hours**" mean actual Block Hours flown, Block Hours related to weather and air traffic control cancellations, and commercial cancellations and commercial ferry flights;

"**Block Hours**" mean the number of minutes elapsing from the time the chocks are removed from the wheels of an aircraft until the chocks are next again returned to the wheels of the aircraft, divided by 60;

"**CBCA**" means the Canada Business Corporations Act, as amended;

"**Chorus**" references herein to Chorus or the Company in this MD&A refer to, as the context may require, Chorus Aviation Inc. and its current and former subsidiaries (the Partnership, Aviation General Partner Inc., 7503695 Canada Inc. and the LeaseCos) collectively, Chorus and one or more of its current and former subsidiaries, one or more of Chorus' current and former subsidiaries or Chorus itself;

"**CICA Handbook**" means the handbook of the Canadian Institute of Chartered Accountants – Part 1, which incorporates International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB");

"**Compensating Mark-Up**" has the meaning given in the CPA;

"**Controllable Costs**" mean for any period, all costs and expenses incurred and paid by Chorus other than Pass-through costs;

"**Controllable Mark-Up**" has the meaning given in the CPA;

"**Cost per Available Seat Mile**" or "**CASM**" means the operating expense per Available Seat Mile;

"**Covered Aircraft**" means Chorus' aircraft subject to the CPA;

"**CPA**" means the amended and restated capacity purchase agreement effective January 1, 2006, between Air Canada and the Partnership, as amended by the Rate Amending Agreement and the CPA Amending Agreement, and as may be further amended;

"**CPA Amending Agreement**" means the agreement to amend the CPA between the Partnership and Air Canada dated September 22, 2009;

"**Debentures**" mean the $86.25 million principal amount of 9.50% convertible unsecured subordinated debentures of Chorus due December 31, 2014;

"**EDC**" means Export Development Canada;

"**Flight Hours**" has the meaning given in the CPA;

"**Flight Services Agreement**" means the contractual flying agreement between Thomas Cook and Chorus;

"**FTE**" means full-time equivalents in respect of employee staffing levels;

"**GAAP**" means generally accepted accounting principles in Canada after the adoption of IFRS;

"**Guaranteed Minimum Number of Covered Aircraft**" has the meaning given in the CPA;

"**IASB**" means the International Accounting Standards Board;

"**IFRS**" means International Financial Reporting Standards;

"**Jazz**" means Jazz Aviation LP, together with its general partner, Aviation GP, and their respective subsidiaries and predecessors; and, in particular, reference to Jazz in respect of a time period prior to October 1, 2004 are references to the business of Jazz as carried on by Jazz Air Inc., which was liquidated on September 30, 2004, and references to Jazz in respect of the time period from October 1, 2004 until February 1, 2006 are references to the business of Jazz as carried on by Jazz Air Limited Partnership, and references to Jazz in respect of the time period from February 2, 2006 to January 5, 2011 are references to the business of Jazz as carried on by Jazz Air LP, unless the context requires otherwise;

"**Jazz Air LP**" means Jazz Air LP, a limited partnership established under the laws of the Province of Québec on September 12, 2005, which carried on the regional airline business from February 2, 2006 until January 5, 2011;

"**LARAH**" means Latin American Regional Aviation Holding Corporation;

"**LeaseCos**" means Chorus Leasing I Inc., Chorus Leasing II Inc., and Chorus Leasing III Inc., collectively;

"**Maintenance Capital Expenditures**" represent expenditures incurred to sustain operations or Chorus' productive capacity;

“**Management**” means management personnel of Chorus;

“**MD&A**” means Chorus’ management’s discussion and analysis of results of operations and financial condition;

“**Operating Aircraft**” means Covered Aircraft under the CPA plus charter aircraft, plus Thomas Cook aircraft, less new aircraft deliveries which have not yet entered commercial service;

“**Partnership Agreements**” mean those contracts signed by Jazz for contract flying;

“**Pass-through costs**” mean those costs that are reimbursed under Partnership Agreements;

“**Pass-through revenue**” means operating revenue derived from costs that are reimbursed under Partnership Agreements;

“**Pluna**” means Pluna Líneas Aéreas Uruguayas S.A;

“**Q400 aircraft**” means Q400 NextGen turboprop aircraft;

“**Rate Amending Agreement**” means the agreement to amend and re-set the rates between the Partnership and Air Canada dated July 28, 2009;

“**Shareholders**” mean holders of Shares;

“**Shares**” mean common shares of Chorus Aviation Inc.;

“**The Partnership**” means Jazz Aviation LP, a limited partnership established under the laws of the Province of Ontario;

“**Thomas Cook**” means Thomas Cook Canada Inc.;

“**Unit Costs**” has the meaning given in the CPA;“**Units**” or “**Fund Units**” mean units of the Fund;

“**Variable Voting Shares**” mean Class A common Variable Voting Shares of Chorus; and

“**Voting Shares**” mean Class B Common Voting Shares of Chorus.