AIR CANADA

Third Quarter 2007
Management's Discussion and Analysis of Results of Operations and Financial Condition

November 8, 2007

Financial and Operating Highlights

Effective May 24, 2007, Air Canada no longer consolidates the operations of Jazz Air LP ("Jazz"). The following table provides the reader with financial and operating highlights for Air Canada, excluding the consolidation of Jazz operations (previously "Air Canada Services") for the periods indicated.

	Third Quarter			YTD		
($ millions, except per share figures)	**2007**	**2006**	**Change $**	**2007**	**2006**	**Change $**
Financial						
Operating revenues	2,954	2,759	195	8,133	7,741	392
Operating income	351	130	221	361	119	242
Operating income, excluding special charges (1)	351	232	119	361	249	112
Non-operating expenses	(45)	(53)	8	(70)	(139)	69
Income (loss) before non-controlling interest, foreign exchange and provision for income taxes	306	77	229	291	(20)	311
Income for the period	273	44	229	394	70	324
Operating margin %	11.9%	4.7%	7.2 pp	4.4%	1.5%	2.9 pp
Operating margin %, excluding special charges (1)	11.9%	8.1%	3.8 pp	4.4%	3.2%	1.2 pp
EBITDAR (2)	561	335	226	989	735	254
EBITDAR, excluding special charges (1) (2)	561	437	124	989	865	124
EBITDAR margin %	19.0%	12.1%	6.9 pp	12.2%	9.5%	2.7 pp
EBITDAR margin %, excluding special charges (1)	19.0%	15.3%	3.7 pp	12.2%	11.0%	1.2 pp
Cash, cash equivalents and short-term investments	1,502	1,422	80	1,502	1,422	80
Cash flows from operating activities	54	2	52	347	371	(24)
Earnings per share - basic and diluted (3)	$ 2.73	$ 0.50	$ 2.23	$ 3.94	$ 0.79	$ 3.15
			Change %			**Change %**
Operating Statistics						
Revenue passenger miles (millions) (RPM)	14,789	14,345	3.1	39,183	37,833	3.6
Available seat miles (millions) (ASM)	18,144	17,528	3.5	48,099	46,740	4.7
Passenger load factor	81.5%	81.8%	(0.3) pp	81.5%	80.9%	0.6 pp
Passenger revenue yield per RPM (cents)	17.9	17.7	1.1	18.1	18.0	1.0
Passenger revenue per ASM (cents)	14.6	14.5	0.7	14.8	14.5	1.7
Operating revenue per ASM (cents)	16.3	15.7	3.4	16.9	16.6	2.1
Operating expense per ASM ("CASM") (cents)	14.3	15.0	(4.4)	16.2	16.3	(0.9)
CASM, excluding fuel expense (cents)	10.4	10.7	(2.4)	12.1	12.1	-
CASM, excluding fuel expense and the special charge for labour restructuring (cents) (1)	10.4	10.7	(2.4)	12.1	12.1	0.7
Average number of full-time equivalent (FTE) employees (thousands)	24.1	23.5	2.8	23.9	23.7	0.9
Aircraft in operating fleet at period end (4)	338	333	1.5	338	333	1.5
Average fleet utilization (hours per day) (5)	10.7	10.4	2.9	10.0	9.6	4.2
Average aircraft flight length (miles) (5)	911	920	(1.0)	881	882	(0.1)
Fuel price per litre (cents) (6)	64.7	69.9	(7.4)	65.0	67.0	(3.0)
Fuel litres (millions)	1,102	1,085	1.6	2,968	2,907	2.1

1. *A special charge for labour restructuring of $28 million was recorded in the first quarter of 2006. The fourth quarter of 2006 includes a favourable adjustment of $8 million relating to the special charge for labour restructuring recorded in the first quarter of 2006. A special charge of $102 million was recorded to operating revenues in the third quarter of 2006 in connection with Air Canada's obligation for the redemption of pre-2002 Aeroplan miles.*
2. *See section 14 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income.*
3. *Earnings per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.*
4. *Operating fleet excludes chartered freighters in 2007 and 2006. Includes Jazz aircraft covered under the Jazz CPA.*
5. *Excludes third party carriers operating under capacity purchase arrangements other than Jazz aircraft covered under the Jazz CPA (which are included).*
6. *Includes fuel handling and fuel hedging expenses.*

Table of Contents

1. Preface

Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A") for the third quarter 2007 provides an overview of Air Canada's results of operations and financial condition and discusses how Air Canada is performing relative to its strategic objectives. The MD&A should be read in conjunction with Air Canada's third quarter 2007 interim unaudited consolidated financial statements and notes and Air Canada's annual audited combined consolidated financial statements and notes and its annual MD&A for 2006. Management prepared the interim unaudited consolidated financial statements in accordance with Generally Accepted Accounting Principles in Canada ("GAAP"). Air Canada's interim unaudited consolidated financial statements are based on accounting policies consistent with those disclosed in Note 2 to Air Canada's annual audited combined consolidated financial statements for 2006. Significant exceptions are the deconsolidation of Jazz Air LP ("Jazz") effective May 24, 2007, which is described in Note 1 to Air Canada's third quarter 2007 interim unaudited financial statements, and the adoption, on January 1, 2007, of certain accounting policies relating to financial instruments, hedging derivatives and comprehensive income, which are described in section 7 of this MD&A.

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current period. In particular, Air Canada has reclassified the presentation of certain aircraft sublease revenues from Jazz. The revised presentation relates to aircraft that are accounted for as owned aircraft by Air Canada but are operating leases in Jazz. This revised presentation does not impact the consolidated results for any period presented however, it results in an increase in Air Canada's inter-segment revenue and aircraft rent of $7 million for the three months ended September 30, 2007 ($17 million for the nine months ended September 30, 2007) and $7 million for the three months ended September 30, 2006 ($19 million for the nine months ended September 30, 2006).

In this MD&A, the term "Corporation" refers to, as the context may require, Air Canada and/or one or more of Air Canada's subsidiaries.

Except where the context otherwise requires, all monetary amounts are stated in millions of Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 15 "Glossary". Except as otherwise noted, this MD&A is current as of November 8, 2007.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward Looking Statements" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a detailed description of the risks relating to Air Canada, refer to the "Risk Factors" section in Air Canada's 2006 annual MD&A dated February 14, 2007 and section 11 of this MD&A.

For further information on Air Canada's public disclosure file, including Air Canada's Initial Annual Information Form dated March 27, 2007, consult SEDAR at www.sedar.com or Air Canada's website at www.aircanada.com.

Caution Regarding Forward-Looking Information

This MD&A includes forward-looking statements within the meaning of applicable securities laws. These statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to strategies, expectations, planned operations or future actions. 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.

Forward-looking statements, by their nature, are based on assumptions 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. Results indicated in forward-looking statements may differ materially from actual results due to a number of factors, including without limitation, energy prices, general industry, market and economic conditions, war, terrorist attacks, changes in demand due to the seasonal nature of the business, the ability to reduce operating costs and employee counts, employee relations, labour negotiations or disputes, pension issues, currency exchange and interest rates, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in the "Risk Factors" section of Air Canada's 2006 annual MD&A dated February 14, 2007 and section 11 of this MD&A. The forward-looking statements contained in this MD&A represent the Corporation's expectations as of the date of this MD&A and are subject to change after such date. However, the Corporation 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.

2. Results of Operations – Third Quarter 2007 versus Third Quarter 2006

Air Canada recorded operating income of $351 million and net income of $273 million in the third quarter of 2007. In the same period of 2006, Air Canada reported consolidated operating income of $169 million and net income of $44 million. The 2006 results included the consolidation of Jazz's operations.

As further described in Note 1 to Air Canada's third quarter 2007 interim unaudited consolidated financial statements, effective May 24, 2007, Air Canada no longer consolidates the operations of Jazz. As a result of this change, Air Canada's consolidated results for the third quarter of 2007 are not directly comparable to its consolidated results for the third quarter of 2006. For comparative purposes, the following table and discussion provides the reader with the results of Air Canada (previously "Air Canada Services"), excluding the consolidation of Jazz operations for both periods.

Unaudited	**Third Quarter**		**Change**	
($ millions)	**2007**	**2006**	**$**	**%**
Operating revenues				
Passenger	$ 2,660	$ 2,552	$ 108	4
Cargo	132	158	(26)	(16)
Other	162	151	11	7
	2,954	**2,861**	**93**	**3**
Special charge for Aeroplan Miles	-	(102)	102	(100)
	2,954	**2,759**	**195**	**7**
Operating expenses				
Wages, salaries and benefits	478	461	17	4
Aircraft fuel	716	761	(45)	(6)
Aircraft rent	66	80	(14)	(18)
Airport and navigation fees	284	275	9	3
Aircraft maintenance, materials and supplies	155	167	(12)	(7)
Communications and information technology	70	67	3	4
Food, beverages and supplies	88	91	(3)	(3)
Depreciation, amortization and obsolescence	144	125	19	15
Commissions	54	61	(7)	(11)
Capacity purchase with Jazz	234	226	8	4
Other	314	315	(1)	-
	2,603	**2,629**	**(26)**	**(1)**
Operating income	**351**	**130**	**221**	
Non-operating income (expense)				
Interest income	21	21	-	
Interest expense	(82)	(78)	(4)	
Interest capitalized	24	17	7	
Gain (loss) on disposal of assets	(2)	1	(3)	
Loss on financial instruments recorded at fair value	(4)	(16)	12	
Other	(2)	2	(4)	
	(45)	(53)	8	
Income before the following items	**306**	**77**	**229**	
Non-controlling interest	-	(1)	1	
Foreign exchange gain (loss)	104	(3)	107	
Provision for income taxes	(137)	(29)	(108)	
Income for the period	**$ 273**	**$ 44**	**$ 229**	
EBITDAR[1]	**561**	**335**	**226**	
EBITDAR[1], excluding special charge	**561**	**437**	**124**	
Earnings per share - Basic and diluted[2]	**$ 2.73**	**$ 0.50**	**$ 2.23**	

1. *See section 14 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income.*
2. *Earnings per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.*

Air Canada reported operating income of $351 million in the third quarter of 2007 compared to operating income of $130 million in the third quarter of 2006, an increase of $221 million. EBITDAR of $561 million in the third quarter of 2007 reflected an improvement of $226 million over the third quarter of 2006.

Included in third quarter of 2006 was a special charge of $102 million recorded in operating revenues in connection with Air Canada's obligations for the redemption of pre-2002 Aeroplan miles. Refer to Note 10 of Air Canada's third quarter 2007 interim unaudited financial statements for additional information.

Excluding the special charge for Aeroplan miles, third quarter 2007, operating income and EBITDAR increased $119 million and $124 million, respectively, over the same period in 2006.

Passenger Revenues

Passenger revenues increased $108 million or 4.2% to $2,660 million in the third quarter of 2007, mainly reflecting traffic growth. In addition, ancillary passenger fees amounted to $24 million in the third quarter of 2007. These ancillary passenger fees, which are included in passenger revenues in 2007, were included in other revenues in 2006. A partly offsetting factor to these increases was the adverse impact of a stronger Canadian dollar on foreign currency denominated revenues versus the third quarter of 2006. This impact accounted for a decrease of approximately $20 million to passenger revenues.

The domestic market delivered a strong performance in the third quarter of 2007, equally on both traffic and yield growth. Air Canada has been shifting capacity from the US transborder market back to Canada to take advantage of the strong domestic market. In the US transborder market, a stronger market demand and tighter capacity management resulted in both yield and passenger load factor improvements. The Atlantic market continues to be adversely impacted by competitive pressures resulting from both the new British Airways service from Calgary to London as well as a substantial increase in capacity by charter carriers in the Canada – United Kingdom market. Significant capacity additions made by Middle East carriers have also reduced volume and average fares of traffic traveling to the Middle East via Air Canada's Atlantic services.

System yield improved 1.1% over the third quarter of 2006. In the third quarter of 2007, traffic grew 3.1% on a capacity increase of 3.5% over the third quarter of 2006, resulting in a passenger load factor decrease of 0.3 percentage points (pp). RASM rose 0.7% over the third quarter of 2006 due to the growth in yield. The domestic and US transborder markets reflected strong yield growth.

The table below describes year-over-year percentage changes in third quarter passenger revenues, capacity, traffic, passenger load factor, yield and RASM.

Third Quarter 2007 Versus Third Quarter 2006	**Passenger Revenue % Change**	**Capacity (ASMs) % Change**	**Traffic (RPMs) % Change**	**Passenger Load Factor pp Change**	**Yield % Change**	**RASM % Change**
Canada	9.5	5.9	5.4	(0.4)	4.0	3.5
US transborder	3.3	(3.2)	(2.4)	0.6	5.9	6.7
Atlantic	(2.6)	4.2	3.0	(0.9)	(5.5)	(6.5)
Pacific	0.7	3.1	2.2	(0.8)	(1.5)	(2.4)
Other	6.0	6.8	7.6	0.6	(1.5)	(0.8)
System	**4.2**	**3.5**	**3.1**	**(0.3)**	**1.1**	**0.7**

Domestic passenger revenues of $1,139 million in the third quarter of 2007 increased $99 million or 9.5% from the third quarter of 2006, almost equally on both traffic and yield growth. Traffic grew 5.4% on a capacity increase of 5.9% resulting in a decrease in passenger load factor of 0.4 percentage points. Domestic RASM increased 3.5% compared to the third quarter of 2006 due to the higher yield. Capacity increases were largely reflected on the Transcontinental and Atlantic Canada services. Yield increased 4.0% from the same period in 2006 largely as a result of stronger market demand and tighter capacity management on Western Canada services. The inclusion of certain ancillary passenger fees effective January 1, 2007 contributed 1.7 percentage points to the yield growth.

US transborder passenger revenues were $470 million in the third quarter of 2007, an increase of $15 million or 3.3% from the third quarter of 2006. Capacity decreased 3.2% as Air Canada shifted capacity from the US transborder market to the Canadian domestic market. Traffic declined 2.4% resulting in a passenger load factor improvement of 0.6 percentage points. Despite the negative effect of a stronger Canadian dollar on US currency denominated revenues, yield increased 5.9% mainly due to stronger market demand combined with capacity reductions allowing for tighter inventory management. In addition, the third quarter of 2006 was adversely impacted by the temporary removal of content by one of the airline's product global distribution providers in response to distribution model changes made by Air Canada. The strong US transborder RASM growth of 6.7% over the third quarter of 2006 was due to the yield improvement combined with the capacity reduction.

Atlantic passenger revenues of $597 million in the third quarter of 2007 decreased $16 million or 2.6% from the third quarter of 2006. Traffic grew 3.0% on a capacity increase of 4.2% resulting in a decrease in passenger load factor of 0.9 percentage points. Traffic growth was mainly reflected in the United Kingdom market as a result of the newly launched Edmonton – London service and increased capacity on the Vancouver – London and Atlantic Canada services to London. Yield decreased 5.5% due to increased competitive pressures resulting from both the new British Airways service from Calgary to London as well as a substantial increase in capacity by charter carriers in the Canada – United Kingdom market. Significant capacity additions made by Middle East carriers, in particular Etihad and Emirates, in the Middle East – North America market, have reduced volume and average fares of traffic traveling to the Middle East on Air Canada's Atlantic services. In addition, Air Canada has been actively seeking to attract, on its routes, traffic between Europe and the United States to compensate for the reduction in both connecting traffic beyond London and Paris and local traffic given the higher competitive capacity levels due to the factors described above. While Air Canada is increasing its penetration in this market, the yields are lower than that of Canada – Europe traffic. Atlantic RASM decreased 6.5% primarily as a result of the decline in yield.

Pacific passenger revenues of $310 million in the third quarter of 2007 increased $2 million or 0.7% from the third quarter of 2006 due to traffic growth. Pacific traffic increased 2.2% on a capacity increase of 3.1% resulting in a decline in passenger load factor of 0.8 percentage points. A 41% increase in Canada – China capacity was largely offset by the impact of capacity decreases in the Japan and Korea markets and the cancellation of service to India. Air Canada plans to increase operations to China from 17 weekly frequencies last winter to 21 weekly non-stop flights for the winter 2007-2008 season. The additional service comprises the operation of Toronto – Shanghai service throughout the winter for the first time with three weekly flights and by increasing Toronto – Beijing from three to four weekly frequencies. Yield decreased 1.5% in large part due to the negative effect of a stronger Canadian dollar versus the Japanese Yen. The overall market from Japan to Canada has weakened somewhat over the last year due to the increasing popularity of alternative destinations. To a much lesser extent, growth in longer-haul flying, which generally provides for a lower yield than short-haul flights, was also a factor in the overall Pacific yield decrease over the third quarter of 2006. The Pacific average stage length increased 14% over the third quarter of 2006. While China capacity grew significantly in the third quarter of 2007, the China yield was essentially unchanged from the third quarter of 2006. China RASM fell 6% as the traffic growth was less than the capacity increase resulting in a decrease in passenger load factor over the third quarter of 2006. Overall Pacific RASM decreased 2.4% due to both the yield decrease and the decline in passenger load factor.

Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of $144 million in the third quarter of 2007 increased $8 million or 6.0% from the third quarter of 2006 due to traffic growth. Traffic grew 7.6% on a capacity increase of 6.8% resulting in a passenger load factor improvement of 0.6 percentage points. Traffic growth in these markets mainly reflected higher capacity to South America and to traditional leisure destinations. In the third quarter of 2007, Air Canada continued its expansion in the South Pacific, Caribbean, Mexico and South America market where total non-stop flights increased 5% in comparison to the third quarter of 2006. In particular, Air Canada operated 66% more flights to Chile/Argentina and 28% more flights to the Caribbean/Mexico region through Air Canada Vacations' flying compared to the third quarter of 2006. Yield declined 1.5% as a result of the large capacity increases driven by Air Canada Vacations where pricing actions were taken to stimulate traffic on the extra capacity. RASM decreased 0.8% as the increase in passenger load factor was more than offset by the yield decline.

In the drive for innovation, Air Canada continues to expand the offering of "passes", "subscriptions" and "à la carte" pricing options tailored to different segments of the marketplace. In the third quarter of 2007, revenues from pass products increased 90% over the third quarter of 2006 and represented close to 4% of North American revenues.

Cargo Revenues

In the third quarter of 2007, dedicated freighter revenues declined $19 million and non-freighter cargo revenues declined $7 million for a total cargo revenue decrease of $26 million from the third quarter of 2006. System cargo traffic was down 11% on a 4% reduction to available cargo capacity. Cargo yield per revenue ton mile declined 7% from the 2006 quarter.

In late 2006, the Corporation decided to terminate MD11 freighter operations to Asia due to inadequate financial returns. One MD11 freighter was removed in November 2006 and a second freighter was removed at the end of June 2007, bringing an end to Asia freighter operations. As a result, freighter revenues declined $19 million or 61% during the quarter from the third quarter of 2006. However, freighter operating expenses were down by a greater amount resulting in an improved financial result for freighter aircraft. Freighter revenues per unit of available capacity improved 10% from the 2006 quarter. Air Canada continues to operate one chartered MD11 freighter to Europe.

In the third quarter of 2007, non-freighter revenues declined $7 million or 6% on 3% higher traffic offset by a 9% yield decline. Most of the revenue decline was in the North American and the Atlantic markets primarily on reduced yield.

Other Revenues

Other revenues of $162 million in the third quarter of 2007 grew $11 million or 7% from the same period in 2006 and included third party aircraft sublease revenues of $8 million in 2007 and growth in third party revenues from Air Canada Vacations and Air Canada Ground Handling Services. Partly offsetting this increase was the impact of the reclassification of certain ancillary passenger fees to passenger revenues effective January 1, 2007.

Operating Expenses

Operating expenses were $2,603 million in the third quarter of 2007, a decrease $26 million or 1% over the third quarter of 2006. The stronger Canadian dollar was a factor in the quarter's overall unit cost decrease, particularly in aircraft fuel. Unit cost, as measured by operating expense per ASM, decreased 4.4% over the third quarter of 2006. Excluding fuel expense, unit cost decreased 2.4% over the same period in 2006.

The following table compares Air Canada's operating expenses per ASM for the third quarter of 2007 to Air Canada's operating expenses per ASM for the corresponding period in 2006.

	Third Quarter		Change	
(cents per ASM)	**2007**	**2006**	**cents**	**%**
Wages and salaries	2.13	2.09	0.04	1.9
Benefits	0.50	0.54	(0.04)	(7.4)
Ownership (DAR) [(1)]	1.15	1.18	(0.03)	(2.5)
Airport and navigation fees	1.57	1.57	-	-
Aircraft maintenance, materials and supplies	0.85	0.95	(0.10)	(10.5)
Communications and information technology	0.38	0.38	-	-
Food, beverages and supplies	0.48	0.52	(0.04)	(7.7)
Commissions	0.30	0.35	(0.05)	(14.3)
Capacity purchase with Jazz	1.29	1.29	-	-
Other	1.74	1.78	(0.04)	(2.2)
Operating expense, excluding fuel expense [(2)]	**10.39**	**10.65**	**(0.26)**	**(2.4)**
Aircraft fuel	3.95	4.35	(0.40)	(9.2)
Total operating expense	**14.34**	**15.00**	**(0.66)**	**(4.4)**

1. *DAR refers to the combination of Aircraft rent and Depreciation, amortization and obsolescence.*
2. *Refer to section 14 "Non-GAAP Financial Measures" in this MD&A for additional information.*

Wages, salaries and benefits amounted to $478 million in the third quarter of 2007, an increase of $17 million or 4% from the third quarter of 2006.

Wages and salaries expense totaled $386 million in the third quarter of 2007, an increase of $19 million or 5% from the third quarter of 2006 mainly due to an addition of 662 full-time equivalent ("FTE") employees or 3% over the third quarter of 2006 and, to a much lesser extent, to higher average wage rates established during the wage review process with the Corporation's unionized employees. The increase in FTE employees was mainly related to pilots, flight attendants and ground handling personnel required to support the 3.5% growth in ASM capacity. In addition, the increase in ground handling personnel also reflected growth in third party ground handling contracts. Other factors included a $2 million increase in provisions for voluntary separation packages and net favorable adjustments in the third quarter of 2006 of $4 million. These increases were partly offset by reduced overtime expenses, which was $3 million lower due to fewer delays and cancellations when compared to the third quarter of 2006.

Employee benefits expense amounted to $92 million in the third quarter of 2007, a decrease of $2 million or 2% from the third quarter of 2006, largely attributable to a decline in pension and post-employment benefit expenses as a result of revised actuarial valuations. A partially offsetting factor was increased expense relating to health benefits for active employees.

Air Canada has continued to reduce its fuel burden by negotiating competitive fuel rates from its suppliers and is focusing on its structured fuel hedging program. Air Canada's jet fuel cost per litre for the third quarter of 2007 stood at 64.7 cents versus 69.9 cents for the third quarter of 2006 (65.0 cents for the first nine months of 2007 versus 67.0 cents for the first nine months of 2006). Despite an ASM capacity increase of 3.5% over the third quarter of 2006, fuel expense of $716 million in the third quarter of 2007 decreased $45 million or 6% from the third quarter of 2006. The volume-related increase of $22 million and the unfavourable impact of a higher average base fuel price of $6 million was more than offset by the favourable impact of a stronger Canadian dollar in 2007 versus the US dollar which accounted for a decrease of $46 million, hedging gains of $8 million in 2007 compared to hedging losses of $9 million in 2006 and a $10 million decrease due to a reduction in MD-11 freighter operations. Refer to section 7 of this MD&A for information on Air Canada's fuel hedging program.

Ownership costs, comprised of aircraft rent, depreciation, amortization and obsolescence expenses, of $210 million in the third quarter of 2007 increased $5 million over the third quarter of 2006. The increase reflected the addition of aircraft to Air Canada's operating fleet (19 Embraer 190 and seven Boeing 777 aircraft) and depreciation expense related to the aircraft interior refurbishment program. Largely offsetting these increases were ownership cost decreases relating to reduced MD-11 freighter flying versus 2006, the effect of aircraft returns and lease terminations, the favourable impact of a stronger Canadian dollar for leases denominated in US dollars and a decrease in amortization expense for intangible assets.

Airport and navigation fees of $284 million in the third quarter of 2007 increased $9 million or 3% over the third quarter of 2006, mainly due to a 5% increase in aircraft frequencies and higher rates for landing and general terminal fees, primarily at Toronto's Pearson International Airport ("Pearson Airport"). These increases were partly offset by 4% and 1.7% rate reductions for navigation fees in Canada which became effective in August 2007 and in September 2006, respectively. On October 16, 2007, the Greater Toronto Airports Authority ("GTAA") announced a reduction in fees charged to airlines for all services as of January 1, 2008. Landing fees at Pearson Airport will be reduced by 3.1% and terminal charges will be reduced by 4.7%.

Aircraft maintenance, materials and supplies of $155 million in the third quarter of 2007 decreased $12 million or 7% from the third quarter of 2006 mainly as a result of reduced engine maintenance for Airbus A340 and Boeing 767-300 aircraft largely due to a reduction of four aircraft and a planned delay in previously scheduled Boeing 767-200 engine events which, combined, accounted for a decrease of $25 million. This decrease was largely offset by higher airframe maintenance expenses of $11 million for the Airbus A320 and Boeing 767 aircraft as these aircraft are in a work cycle which requires additional maintenance. In addition, the third quarter of 2007 reflected an increase in expense of $5 million related to the preparation of aircraft for return to lessors.

Commission expense of $54 million in the third quarter of 2007 decreased $7 million or 11% from the third quarter of 2006, on combined passenger and cargo revenue growth of 3% over the third quarter of 2006. The decrease in commission expense was largely driven by the impact of a new commission structure at Air Canada Vacations in 2007 and by commercial initiatives implemented by Air Canada to lower commission costs. These decreases more than offset the volume-related increase. Commissions, as a percent of passenger and cargo revenues, declined to 1.9% in the third quarter of 2007 from 2.3% in the third quarter of 2006. Web penetration in Canada reached 64% in the third quarter of 2007, a 9 percentage point increase from the third quarter of 2006. Web penetration for combined domestic Canada and US transborder sales was 50%, a 7 percentage point increase over the previous year's quarter. System-wide web penetration of 32% represented an increase of 5 percentage points from the third quarter of 2006. These figures do not include sales from Air Canada call centres that employ the Air Canada host platform. Including sales from call centres, Air Canada's direct penetration for Canada was 74% for the third quarter of 2007 versus 67% for the third quarter of 2006.

Capacity purchase fees paid to Jazz, pursuant to the capacity purchase agreement between Jazz and Air Canada ("Jazz CPA"), amounted to $234 million in the third quarter of 2007 compared to capacity fees paid to Jazz of $226 million in the third quarter of 2006, an increase of $8 million. The 4% increase was mainly driven by a 5% increase in block hours over the third quarter of 2006. ASM capacity for flights operated by Jazz increased 5% over the third quarter of 2006.

Other operating expenses, largely comprised of terminal handling expenses, credit card fees, building rent and maintenance, costs of ground packages at Air Canada Vacations and miscellaneous fees and services, amounted to $314 million in the third quarter of 2007, a decrease of $1 million from the third quarter of 2006. The more significant decreases were recorded in miscellaneous fees and services, terminal handling, customer inconvenience and insurance. Offsetting these decreases were increases recorded in credit card fees, crew cycle, engine rental costs and expenses related to Air Canada Vacations ground packages as a result of higher passenger volumes.

Air Canada is continuously focused on evaluating and seeking ways to improve its cost structure to remain highly competitive. For instance, Air Canada's fleet renewal program is providing cost savings particularly with the efficiencies of the Boeing 777 aircraft. In addition, POLARIS, the new web-enabled computer system that will be replacing Air Canada's legacy systems for passenger and reservation and airport customer service, is being designed to provide for lower operating costs while enhancing Air Canada's capability to bring new, innovative products to market faster. As part of Air Canada's objective to provide passengers with their desired self-service products, Air Canada has increased the availability of mobile check-in, web-check-in and baggage self-tagging from airport kiosks. Air Canada believes these self-service products offer passengers improved customer satisfaction and generate cost savings for Air Canada. Furthermore, the continued growth in web penetration continues to allow Air Canada to reduce its costs of distribution.

Non-operating expense amounted to $45 million in the third quarter of 2007, a decrease of $8 million compared to the third quarter of 2006. In the third quarter of 2007, net interest expense of $37 million decreased $3 million from the third quarter of 2006. A $4 million increase in interest expense, largely driven by the financing of additional aircraft, was more than offset by a higher amount of capitalized interest relating to new aircraft. The impact of a stronger Canadian dollar versus the US dollar in the third quarter of 2007 versus the same period in 2006 also favourably impacted net interest expense. In the third quarter of 2007, Air Canada recorded a loss of $4 million relating to fair value adjustments on certain derivative instruments entered into by Air Canada. In the third quarter of 2006, Air Canada recorded an expense of $12 million relating to interest rate swaps pertaining to the financing of Embraer 190 aircraft.

Net gains on foreign currency monetary items amounted to $104 million in the third quarter of 2007, attributable to a stronger Canadian dollar at September 30, 2007 compared to June 30, 2007. This compared to losses of $3 million in the third quarter of 2006. The net gains recorded in the third quarter of 2007 were comprised of gains of $221 million relating to the mark-to-market of US denominated long-term monetary items partially offset by losses of $117 million relating to the mark-to-market of foreign currency forward contracts and currency swaps. Refer to section 7 of this MD&A for additional information.

The income tax provision was $137 million in the third quarter of 2007 and represented an effective tax rate of 33% as compared to $29 million at an effective tax rate of 40% in the third quarter of 2006. The decrease in the effective tax rate this quarter is largely attributable to the capital portion of certain foreign exchange gains reported in the third quarter, which are tax affected at 50% of the income tax rate. The Corporation also recorded a current tax expense of $10 million in the third quarter of 2007 related to the harmonization of Ontario and federal tax balances. This change in tax law results in a tax liability of $10 million payable over a period of 5 years, beginning with the 2009 taxation year.

Net income of $273 million was recorded in the third quarter of 2007 compared to net income of $44 million in the third quarter of 2006, which included the special charge for Aeroplan miles of $102 million.

3. Results of Operations – YTD September 30, 2007 and YTD September 30, 2006

Air Canada recorded consolidated operating income of $423 million and net income of $394 million in the nine months ended September 30, 2007. The 2007 results included the consolidation of Jazz's operations only up to May 24, 2007. In the same period of 2006, Air Canada reported consolidated operating income of $230 million and net income of $70 million. The 2006 results included the consolidation of Jazz's operations. As a result of the Jazz deconsolidation, Air Canada's consolidated results for the first nine months of 2007 are not directly comparable to its consolidated results for the first nine months of 2006. For comparative purposes, the following table and discussion provides the reader with the results of Air Canada, excluding the consolidation of Jazz operations (previously "Air Canada Services") for both periods.

Unaudited, excluding the consolidation of Jazz operations	**Nine months ended September 30**		**Change**	
($ millions)	**2007**	**2006**	**$**	**%**
Operating revenues				
Passenger	$ 7,133	$ 6,816	$ 317	5
Cargo	408	463	(55)	(12)
Other	592	564	28	5
	8,133	**7,843**	**290**	**4**
Special charge for Aeroplan miles	-	(102)	102	(100)
	8,133	**7,741**	**392**	**5**
Operating expenses				
Wages, salaries and benefits	1,452	1,373	79	6
Aircraft fuel	1,937	1,961	(24)	(1)
Aircraft rent	220	258	(38)	(15)
Airport and navigation fees	784	750	34	5
Aircraft maintenance, materials and supplies	584	563	21	4
Communications and information technology	208	205	3	1
Food, beverages and supplies	246	246	-	-
Depreciation, amortization and obsolescence	408	358	50	14
Commissions	164	188	(24)	(13)
Capacity purchase with Jazz	696	647	49	8
Special charge for labour restructuring	-	28	(28)	(100)
Other	1,073	1,045	28	3
	7,772	**7,622**	**150**	**2**
Operating income	**361**	**119**	**242**	
Non-operating income (expense)				
Interest income	70	58	12	
Interest expense	(259)	(225)	(34)	
Interest capitalized	88	40	48	
Gain on disposal of assets	19	4	15	
Gain (loss) on financial instruments recorded at fair value	24	(19)	43	
Other	(12)	3	(15)	
	(70)	(139)	69	
Income (loss) before the following items	**291**	**(20)**	**311**	
Non-controlling interest	(6)	(9)	3	
Foreign exchange gain	297	119	178	
Provision for income taxes	(188)	(20)	(168)	
Income for the period	**394**	**70**	**324**	
EBITDAR[(1)]	**989**	**735**	**254**	
EBITDAR[(1)], excluding special charges	**989**	**865**	**124**	
Earnings per share - Basic and diluted[(2)]	**$ 3.94**	**$ 0.79**	**$ 3.15**	

1. *See section 14 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income (loss) and EBITDAR, excluding special charges to operating income (loss).*
2. *Earnings per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.*

Air Canada reported operating income of $361 million in the nine months ended September 30, 2007 compared to operating income of $119 million in the nine months ended September 30, 2006, an improvement of $242 million. EBITDAR of $989 million increased $254 million over the first nine months of 2006.

Included in the first nine months of 2006 was a special charge of $102 million recorded in operating revenues in connection with Air Canada's obligations for the redemption of pre-2002 Aeroplan miles. Also included in the first nine months of 2006 was a special charge for labour restructuring of $28 million relating to a non-unionized workforce reduction program. This charge was reduced by $8 million in the fourth quarter of 2006, with the total for the year 2006 amounting to $20 million. Excluding the special charges for Aeroplan miles and labour restructuring in 2006, operating income and EBITDAR for the first nine months of 2007 increased $112 million and $124 million, respectively, over the first nine months of 2006.

Passenger Revenues

Passenger revenues of $7,133 million in the first nine months of 2007 increased $317 million or 4.7% over the same period in 2006, reflecting a growth in traffic. In addition, ancillary passenger fees amounted to $54 million in the first nine months of 2007. These ancillary passenger fees, which are included in passenger revenues in 2007, were recorded in other revenues in 2006.

The system yield improvement of 1.0% in the first nine months of 2007 over the same period in 2006 was principally due to the inclusion in passenger revenues of the ancillary passenger fees. In the nine months ended September 30, 2007, traffic grew 3.6% on a capacity increase of 2.9% over the same period in 2006, resulting in a passenger load factor increase of 0.6 percentage points (pp). RASM rose 1.7% due to both the growth in yield and the improvement in system passenger load factor.

The table below describes year-over-year percentage changes in passenger revenues, capacity, traffic, passenger load factor, yield and RASM for the nine month periods ending September 30.

Nine months ended September 30, 2007, versus nine months ended September 30, 2006	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	7.9	3.8	6.2	1.8	1.6	4.0
US transborder	2.5	2.0	1.6	(0.3)	0.9	0.5
Atlantic	0.7	3.3	2.8	(0.5)	(2.1)	(2.6)
Pacific	4.0	0.9	1.5	0.5	2.5	3.1
Other	4.9	4.4	4.5	0.1	0.4	0.5
System	**4.7**	**2.9**	**3.6**	**0.6**	**1.0**	**1.7**

Domestic passenger revenues of $2,998 million in the first nine months of 2007 increased $218 million or 7.9% from the same period in 2006 largely due to traffic growth on a stronger market demand. Traffic grew 6.2% on a capacity increase of 3.8% resulting in a passenger load factor improvement of 1.8 percentage points. Capacity increases were largely reflected on the Transcontinental and Atlantic Canada services. Yield increased 1.6% over the same period in 2006 due to the inclusion of certain ancillary passenger fees in the first nine months of 2007. Domestic RASM increased 4.0% compared to the first nine months of 2006 due to the improvement in domestic passenger load factor and the growth in yield.

US transborder passenger revenues of $1,428 million in the nine months ended September 30, 2007 increased $35 million or 2.5% from the same period in 2006 due to a 1.6% growth in traffic. Yield increased 0.9% in the first nine months of 2007 reflecting the inclusion of certain ancillary passenger fees effective January 1, 2007. US transborder RASM increased 0.5% over the same period in 2006 due to the yield growth as the passenger load factor was only slightly below the same period in 2006.

Atlantic passenger revenues of $1,432 million in the nine months ended September 30, 2007 increased $10 million or 0.7% from the same period in 2006 due to traffic growth of 2.8%. The traffic growth was largely reflected in the United Kingdom market as a result of increased capacity on the Vancouver – London route, the newly launched Edmonton – London service and additional capacity from Atlantic Canada to London. Yield decreased 2.1% due to increased competition, particularly in the second and the third quarter of 2007, as a result of the new service on British Airways from Calgary to London as well as a substantial increase in competitive fare actions due to a significant capacity increase by low-cost carriers in the Canada – United Kingdom market. Atlantic RASM decreased 2.6% primarily as a result of the decline in yield.

Pacific passenger revenues of $758 million in the nine months ended September 30, 2007 increased $30 million or 4.0% from the same period in 2006 due to a 2.5% yield improvement and a 0.9% increase in traffic. A 24% increase in China capacity was almost fully offset by capacity decreases in the Japan, Korea and India markets. Yield improved 2.5% largely due to increased fuel surcharges implemented in 2006. The overall Pacific yield increase was partly offset by the negative impact of a stronger Canadian dollar, in particular versus the Japanese Yen in the third quarter of 2007. Pacific RASM increased 3.1% primarily due to higher yield and to a 0.5 percentage point improvement in passenger load factor.

Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of $517 million in the nine months ended September 30, 2007 increased $24 million or 4.9% from the same period in 2006 primarily due to a growth in traffic. The traffic growth of 4.5% was mainly due to an increase in capacity to traditional leisure destinations and to South America. Yield did not significantly change from the nine months of 2006. In the first nine months of 2007, RASM increased 0.5% principally due to the growth in yield.

In the first nine months of 2007 in comparison with the first nine months of 2006, Air Canada has added 4% more flights on international routes, which are mainly composed of new non-stop and expanded services on the Atlantic from western Canada/Maritimes to London and seasonal Montreal – Rome, and by an 11% increase in flights to sun markets such as the Dominican Republic and Mexico. Air Canada's strategy for the Pacific market is to operate its new and larger Boeing 777 aircraft on the key routes from Toronto to Japan, Hong Kong and China. Air Canada added a second frequency out of Vancouver to Beijing and increased the Toronto-Shanghai/Beijing services both to daily products, for a total of five daily flights to China in the summer of 2007.

Cargo Revenues

For the nine months ended September 30, 2007, cargo revenues decreased $55 million or 12% from the same period in 2006. System cargo traffic was down 12% on a 6% reduction in available cargo capacity. Cargo yield per revenue ton mile was unchanged from the first nine months of 2006.

In late 2006, the Corporation decided to terminate MD11 freighter operations to Asia due to inadequate financial returns. One MD11 freighter was removed in November 2006 and a second freighter was removed at the end of June 2007, bringing an end to Asia freighter operations. As a result, freighter revenues declined $35 million or 34% from the same period in 2006. However, freighter operating expenses were down by a greater amount resulting in an improved financial result for freighter aircraft. Freighter revenues per unit of available capacity improved 11% from the first nine months of 2006. Air Canada continues to operate one chartered MD11 freighter to Europe.

Non-freighter revenues declined $20 million or 5% on a 5% reduction in traffic and a 1% decline in yield. Most of the revenue decline was in North American and Pacific markets due to soft market demand.

Other Revenues

Other revenues of $592 million in the first nine months of 2007 increased $28 million or 5% over the same period in 2006. Increases included third-party revenue growth at Air Canada Vacations of $16 million, third-party aircraft sublease revenues of $15 million in 2007, higher third-party revenues at Air Canada Ground Handling Services of $6 million as well as various other increases. A partially offsetting factor was the impact of the reclassification of certain ancillary passenger fees to passenger revenues effective January 1, 2007.

Operating Expenses

Operating expenses of $7,772 million in the first nine months of 2007 increased $150 million or 2% over the corresponding period in 2006. Air Canada recorded a special charge for labour restructuring of $28 million in the first nine months of 2006 related to a non-unionized workforce reduction program. Unit cost, as measured by operating expense per ASM, decreased 0.9% over the first nine months of 2006. Excluding fuel expense and the special charge for labour restructuring, unit cost increased 0.7%.

The following table compares Air Canada's operating expenses per ASM for the nine months ended September 30, 2007 to Air Canada's operating expenses per ASM for the corresponding period in 2006.

	Nine months ended September 30		Change	
(cents per ASM)	**2007**	**2006**	**cents**	**%**
Wages and salaries	2.39	2.28	0.11	4.8
Benefits	0.63	0.66	(0.03)	(4.5)
Ownership (DAR) (1)	1.30	1.32	(0.02)	(1.5)
Airport and navigation fees	1.63	1.61	0.02	1.2
Aircraft maintenance, materials and supplies	1.21	1.21	-	-
Communications and information technology	0.43	0.44	(0.01)	(2.3)
Food, beverages and supplies	0.51	0.53	(0.02)	(3.8)
Commissions	0.34	0.40	(0.06)	(15.0)
Capacity purchase with Jazz	1.45	1.38	0.07	5.1
Other	2.24	2.22	0.02	0.9
Operating expense, excluding fuel expense and the special charge for labour restructuring (2)	**12.13**	**12.05**	**0.08**	**0.7**
Aircraft fuel	4.03	4.20	(0.17)	(4.0)
Special charge for labour restructuring	-	0.06	(0.06)	(100.0)
Total operating expense	**16.16**	**16.31**	**(0.15)**	**(0.9)**

1. *DAR refers to the combination of Aircraft rent and Depreciation, amortization and obsolescence.*
2. *Refer to section 14 "Non-GAAP Financial Measures" in this MD&A for additional information.*

Wages, salaries and benefits of $1,452 million reflected an increase of $79 million or 6% from the same period in 2006. Wages and salaries expense totaled $1,148 million in the first nine months of 2007, an increase of $84 million or 8% over the corresponding period in 2006 due to higher average wages, a growth of 1% in the average number of FTEs, net favorable adjustments of $18 million in the 2006 period, increased provisions for voluntary separation packages of $9 million and increased overtime expenses of $5 million. The higher average wages were largely attributable to arbitrated and negotiated average wage increases of approximately 1.5% and salary progression based on additional seniority. The total average number of FTEs in the period increased by 203 FTEs or 1%, which included an increase of 210 pilots, comparatively at a higher average wage than other groups, driving the overall average salary up.

Employee benefits expense amounted to $304 million in the first nine months of 2007, a decrease of $5 million or 2% from the same period in 2006, largely attributable to a decline in pension and post-employment benefit expenses as a result of revised actuarial valuations. A partially offsetting factor was increased expense related to health benefits for active employees.

Despite an ASM capacity increase of 2.9%, fuel expense of $1,937 million in the first nine months of 2007 decreased $24 million or 1% over the same period in 2006. The volume-related increase of $61 million was more than offset by the favourable impact of a stronger Canadian dollar in 2007 versus the US dollar which accounted for a decrease of $50 million in fuel expense, hedging losses of $1 million in 2007 compared to hedging losses of $11 million in 2006, a $22 million decrease due to a reduction in MD-11 freighter operations and a decrease in the average base fuel price which accounted for $3 million.

Ownership costs, comprised of aircraft rent, depreciation, amortization and obsolescence expenses, of $628 million in the first nine months of 2007 increased $12 million over the first nine months of 2006. Factors in the increase were the addition of aircraft to Air Canada's operating fleet and depreciation expense related to the aircraft interior refurbishment program. Largely offsetting these increases were the reduction to MD-11 freighter aircraft rent due to reduced flying, the effect of aircraft returns and lease terminations, the favourable impact of a stronger Canadian dollar on leases denominated in US dollars and a decrease in amortization expense for intangible assets.

Airport and navigation fees of $784 million in the first nine months of 2007 increased $34 million or 5% over the same period in 2006, mainly due to a 6% increase in aircraft departures and higher rates for landing and general terminal fees, primarily at Pearson Airport. These increases were partly offset by 4% and 1.7% rate reductions for navigation fees in Canada which became effective in August 2007 and in September 2006, respectively.

Aircraft maintenance, materials and supplies of $584 million in the first nine months of 2007 increased $21 million or 4% over the same period in 2006. Higher maintenance expenses related to satisfying minimum return conditions on aircraft leases returns and maintenance expense related to preparing aircraft to be subleased to third party operators accounted for an increase of $34 million. However, this expense was largely offset by a reduction in component and engine maintenance expenses.

Commission expense of $164 million in the first nine months of 2007 decreased $24 million or 13% over the same period in 2006, on combined passenger and cargo revenue growth of 4% over the first nine months of 2006. The decrease in commission expense was mainly driven by the impact of a new commission structure at Air Canada Vacations in 2007 and by commercial initiatives implemented by Air Canada to lower commission costs. These decreases more than offset the volume-related increase.

Capacity purchase fees paid to Jazz of $696 million in the first nine months of 2007 increased $49 million or 8% over the same period in 2006, largely driven by a 10% growth in block hours. ASM capacity for flights operated by Jazz increased 11% over the first nine months of 2006.

Other operating expenses, largely comprised of terminal handling expenses, credit card fees, building rent and maintenance, ground packages costs for Air Canada Vacations and miscellaneous fees and services, amounted to $1,073 million in the first nine months of 2007. Other operating expense grew $28 million or 3% over the same period in 2006 largely due to a growth in expenses, mainly in the first quarter of 2007, related to ground packages as a result of higher passenger volumes at Air Canada Vacations. Increases were also recorded in credit card fees, crew cycle expense, engine rental costs, training and other expense areas. Offsetting these increases were reductions recorded in miscellaneous fees and services, advertising and promotion expense, terminal handling, insurance and other expense areas.

Non-operating expense amounted to $70 million in the nine months ended September 30, 2007 compared to non-operating expense of $139 million in the nine months ended September 30, 2006. In the first nine months of 2007, net interest expense of $101 million decreased $26 million from 2006. A $34 million increase in interest expense, largely driven by the financing of additional aircraft, was more than offset by a higher amount of capitalized interest relating to the acquisition of new aircraft and growth in interest income due to higher cash balances and higher average interest rates during the first quarter of 2007. For the nine months ended September 30, 2007, Air Canada recorded gains of $7 million pertaining to the sale of one real estate property and the sale of parked aircraft. In addition, in the second quarter of 2007, Air Canada recorded a gain on disposal of $14 million relating to a damaged aircraft. Included in non-operating income was a gain of $24 million in the first nine months of 2007 and a loss of $19 million in the same period in 2006 relating to fair value adjustments on certain derivative instruments entered into by Air Canada. In the third quarter of 2006, Air Canada recorded an expense of $12 million relating to interest rate swaps pertaining to the financing of Embraer 190 aircraft.

Net gains from foreign currency monetary items amounted to $297 million in the first nine months of 2007, attributable to a stronger Canadian dollar at September 30, 2007 compared to December 31, 2006. This compared to gains of $119 million in the first nine months of 2006.

The income tax provision was $188 million for the nine months ended September 30, 2007 and represented an effective tax rate of 32% as compared to $20 million at an effective rate of 22% in the nine months ended September 30, 2006. The effective tax rate in the nine months ended September 30, 2007 was favourably impacted by the capital portion of certain foreign exchange gains reported during the period, which are tax affected at 50% of the income tax rate. The Corporation also recorded a current tax expense of $10 million in the third quarter of 2007 related to the harmonization of Ontario and federal tax balances. The tax provision for the nine months ended September 30, 2006 was favourably impacted by a credit of $17 million related to changes in federal tax rates during the period.

Net income of $394 million was recorded in the nine months ended September 30, 2007 compared to net income of $70 million in the nine months ended September 30, 2006.

4. Fleet Strategy

Air Canada is achieving its network redesign in the North American market through the increased use of large regional jet aircraft which have lower trip costs than conventional narrow-body aircraft. In North America, Air Canada has increased the number of its 93 seat Embraer 190 aircraft by eight in the third quarter of 2007, bringing the total Embraer 190 aircraft deliveries in 2007 to 16. Since September 30, 2007, an additional four Embraer 190 aircraft have been added to Air Canada's fleet for a total of 38 aircraft.

In the third quarter of 2007, Air Canada took delivery of one Boeing 777-200 aircraft and one Boeing 777-300 aircraft. Since the start of 2007, Air Canada has taken delivery of five Boeing 777-300 aircraft and two Boeing 777-200 aircraft. Air Canada continued the planned refurbishment of the interior of its aircraft fleet initiated in 2006 and has now completed the refurbishment of 24 Airbus A319 aircraft, 30 Airbus A320 aircraft, one Airbus A321 aircraft and eight Boeing 767-300 aircraft. Initial customer responses based on internal customer satisfaction surveys are favourable.

In the first nine months of 2007, Air Canada removed 14 aircraft from its fleet comprised of two Boeing 767-300 aircraft and five Airbus A320 aircraft which were returned to lessors, one Boeing 767-200 aircraft which was retired from service, two Airbus A340-300 aircraft and four Airbus A319 aircraft which were subleased to other airlines. Letters of intent were executed for the disposition of four Airbus A319 aircraft to another airline, which are scheduled for delivery in the remainder of 2007. Letters of intent were also executed for the lease of two Airbus A340-500 and the sublease of one Airbus A340-300 aircraft planned for delivery in the remainder of 2007 to other airlines. Since October 1, 2007, final agreements have been signed with respect to the disposition of such four Airbus A319 aircraft, with one such aircraft having been delivered to the sublessee under the sublease, the lease of two of the Airbus A340-500 aircraft, both of which have been delivered to the lessee under the lease, and the sublease of one Airbus A340-300. In addition, two Airbus A340-300 will be returned to lessors and one Airbus A320 aircraft has been returned to the lessor. One Boeing 767-200 aircraft is expected to be retired from regular service in 2007. In addition, five Airbus A340-300 aircraft are expected to be subleased in 2008. The following table provides the actual and planned fleet changes to Air Canada's fleet (excluding aircraft operated by Jazz):

		Actual					Planned						
Fleet Plan	**Year End 2006**	**New Deliveries**	**Sublease to Third Party**	**Lease returns**	**Parked**	**YTD September 2007**	**New Deliveries**	**Sublease / lease to Third Party / Sale by Air Canada**	**Lease returns**	**Parked**	**Year End 2007**	**Planned 2008 fleet changes**	**Year End 2008**
B777-300	-	5	-	-	-	5	-	-	-	-	**5**	**6**	**11**
B777-200	-	2	-	-	-	2	1	-	-	-	**3**	**3**	**6**
B767-300	33	-	-	(2)	-	31	-	-	-	-	**31**	**(2)**	**29**
B767-200	11	-	-	-	(1)	10	-	-	-	(1)	**9**	**(1)**	**8**
A340-500	2	-	-	-	-	2	-	(2)	-	-	**-**	**-**	**-**
A340-300	10	-	(2)	-	-	8	-	(1)	(2)	-	**5**	**(5)**	**-**
A330-300	8	-	-	-	-	8	-	-	-	-	**8**	**-**	**8**
A321	10	-	-	-	-	10	-	-	-	-	**10**	**-**	**10**
A320	47	-	-	(5)	-	42	-	-	(1)	-	**41**	**-**	**41**
A319	45	-	(4)	-	-	41	-	(4)	-	-	**37**	**(2)**	**35**
EMB 190	18	16	-	-	-	34	8	-	-	-	**42**	**3**	**45**
EMB 175	15	-	-	-	-	15	-	-	-	-	**15**	**-**	**15**
Total	199	23	(6)	(7)	(1)	208	9	(7)	(3)	(1)	**206**	**2**	**208**
Average age (years)	**9.6**					**9.2**					**8.9**	**0.3**	**9.2**

5. Financial and Capital Management

5.1. Financial Position

As a result of the deconsolidation of Jazz effective May 24, 2007, Air Canada's consolidated statement of financial position as at September 30, 2007 does not include the financial position of Jazz. The comparative December 31, 2006 consolidated statement of financial position included the following items of Jazz:

- Cash and cash equivalents of $135 million and other current assets of $109 million;
- Long-lived assets of $239 million;
- Current liabilities of $213 million;
- Long-term debt of $115 million;
- Non-controlling interest of $162 million; and
- Other long-term liabilities of $71 million

For comparative purposes, the following table and discussion provides the financial position of Air Canada as at September 30, 2007 and the financial position of Air Canada (previously "Air Canada Services"), excluding the consolidation of Jazz as at December 31, 2006.

Condensed Statement of Financial Position ($ millions)	**September 30, 2007**	**December 31, 2006**
Assets		
Cash, cash equivalents and short-term investments	$ 1,502	$ 2,110
Other current assets	1,317	1,962
Current assets	2,819	4,072
Property and equipment	7,155	5,747
Intangible assets	994	1,185
Other assets	376	384
	$ 11,344	**$ 11,388**
Liabilities		
Current liabilities	$ 3,074	$ 3,754
Long-term debt and capital leases obligations	3,425	3,081
Pension and other benefits liabilities	1,855	1,867
Other long-term liabilities	469	544
	8,823	**9,246**
Non-controlling interest	**181**	**212**
Shareholders' equity	**2,340**	**1,930**
	$ 11,344	**$ 11,388**

5.2. Cash, Cash Equivalents and Short-term Investments

At September 30, 2007, Air Canada had cash, cash equivalents and short-term investments of $1,502 million. Compared to December 31, 2006, cash, cash equivalents and short-term investments have decreased by $608 million primarily due to aircraft acquisitions, net of financing.

Air Canada has a secured syndicated revolving credit facility of $400 million. As of the date hereof, no amounts have been drawn on this credit facility.

5.3. Working Capital

Actively managing working capital is key to ensuring cash is available to partially support funding of the Corporation's fleet renewal and refurbishment. The following table provides additional information on Air Canada's working capital balances at September 30, 2007 as compared to December 31, 2006 excluding the consolidation of Jazz operations (previously "Air Canada Services").

	September 30, 2007	December 31, 2006	Change in working capital
Cash and short-term investments	$ 1,502	$ 2,110	$ (608)
Accounts receivable	994	739	255
Other current assets	323	1,223	(900)
Accounts payable and accrued liabilities	(1,435)	(1,430)	(5)
Other current liabilities	(1,639)	(2,324)	685
	$ (255)	**$ 318**	**$ (573)**

The September 30, 2007 working capital deficiency of $255 million has deteriorated by $573 million over December 31, 2006 largely reflecting the utilization of cash to fund the additions to capital assets, net of aircraft-related borrowings received. The change in other current assets and other current liabilities is largely attributable to the settlement of the future income tax asset and related tax payable of $345 million that arose from the Air Canada Initial Public Offering ("IPO") tax loss utilization strategy. These balances are also impacted by the drawdown of the prepaid maintenance to ACTS and related note payable to ACTS.

5.4. Debt and Lease Obligations

Additional information on Air Canada's debt and lease obligations is provided in section 9.5 of Air Canada's 2006 annual MD&A dated February 14, 2007 and in Note 3 to Air Canada's 2006 annual combined consolidated financial statements. In the first nine months of 2007, Air Canada received financing for six Boeing 777 aircraft and 16 Embraer aircraft. In addition, one Boeing 777 aircraft was delivered pursuant to an operating lease. Refer to section 5.7 of this MD&A for additional information.

The following table reflects Air Canada's net debt balances and net debt to net debt plus equity ratio as at September 30, 2007 and as at December 31, 2006.

($ millions)	September 30, 2007	December 31, 2006	Change
Total long term debt and capital lease obligations	$ 3,425	$ 3,081	$ 344
Current portion of long debt and capital lease obligations	367	367	-
	$ 3,792	$ 3,448	$ 344
Non-controlling interest	181	212	(31)
Cash, cash equivalents and short-term investments	(1,502)	(2,110)	608
Net debt and non-controlling interest	**$ 2,471**	**$ 1,550**	**$ 921**
Capitalized operating leases [1]	2,258	2,648	(390)
Adjusted Net Debt and non-controlling interest	**$ 4,729**	**$ 4,198**	$ 531
Shareholders' equity and non-controlling interest	**$ 2,521**	**$ 2,142**	**$ 379**
Adjusted net debt to net debt plus equity ratio	**65.2%**	**66.2%**	

1. *Financial and credit analysts regularly derive a present value debt equivalent from the future stream of aircraft operating lease payments. Common industry practice is to multiply annualized aircraft rent expense by 7.5. Aircraft rent in the last twelve months was $301 million for the period ended September 30, 2007 and $353 million for the period ended September 30, 2006. Aircraft rent expense for the period ended September 30, 2007 includes aircraft rent associated with aircraft subleased to third parties. The sublease revenue associated with these aircraft leases is included in "other" revenues on Air Canada's statement of operations. Sublease revenues amounted to $15 million in the nine months ended September 30, 2007.*

At September 30, 2007, adjusted net debt and non-controlling interest, including capitalized operating leases, increased $531 million from December 31, 2006. The increase was largely the result of aircraft acquisitions in the first nine months of 2007 partly offset by the appreciation of the Canadian dollar against the US dollar on Air Canada's US denominated debt. Refer to section 4 of this MD&A for additional information on Air Canada's fleet strategy. The adjusted net debt to net debt plus equity ratio for Air Canada decreased to 65.2% at September 30, 2007 from 66.2% at December 31, 2006.

Information on Air Canada's off-balance sheet arrangements is provided in Air Canada's 2006 annual MD&A dated February 14, 2007.

5.5. Consolidated Cash Flow Movements

The following tables provide Air Canada's consolidated cash flow movements for the periods indicated.

	Three months ended September 30 2007[(1)]			Three months ended September 30, 2006		
($ millions)	**Air Canada**	**Jazz**	**Total**	**Air Canada**	**Jazz**	**Total**
Net cash provided by operating activities	$ 361	$ -	**$ 361**	$ 168	$ 49	**$ 217**
Changes in working capital	(307)	-	**(307)**	(166)	1	**(165)**
Cash flows from operating activities	54	-	**54**	2	50	**52**
Additions to capital assets	(580)	-	**(580)**	(199)	(10)	**(209)**
Free cash flow	(526)	-	**(526)**	(197)	40	**(157)**
Cash flows from (used for) investing activities (excluding additions to capital assets)	136	-	**136**	74	(26)	**48**
Aircraft and facility related borrowings	449	-	**449**	99	-	**99**
Reduction of long-term debt and capital lease obligations	(138)	-	**(138)**	(58)	-	**(58)**
Other	-	-	**-**	(1)	-	**(1)**
Cash flows from financing activities	311	-	**311**	40	-	**40**
Net increase (decrease) in cash and cash equivalents	(79)	-	**(79)**	(83)	14	**(69)**
Net decrease in short term investments	(171)	-	**(171)**	(52)	-	**(52)**
Net increase (decrease) in cash and cash equivalents and short term investments	**$ (250)**	**$ -**	**$ (250)**	**$ (135)**	**$ 14**	**$ (121)**

1. *There was no consolidation of Jazz in the third quarter of 2007.*

($ millions)	Nine months ended September 30 2007[1] Air Canada	Jazz	Total	Nine months ended September 30, 2006 Air Canada	Jazz	Total
Net cash provided by operating activities	$ 337	$ 69	**$ 406**	$ 161	$ 146	**$ 307**
Changes in working capital	10	(2)	**8**	210	2	**212**
Cash flows from operating activities	347	67	**414**	371	148	**519**
Additions to capital assets	(1,673)	(11)	**(1,684)**	(657)	(18)	**(675)**
Free cash flow	(1,326)	56	**(1,270)**	(286)	130	**(156)**
Cash flows from (used for) investing activities (excluding additions to capital assets)	54	(137)	**(83)**	(235)	138	**(97)**
Aircraft and facility related borrowings	1,093	-	**1,093**	321	-	**321**
Reduction of long-term debt and capital lease obligations	(305)	-	**(305)**	(193)	(14)	**(207)**
Other	(36)	(54)	**(90)**	399	(164)	**235**
Cash flows from (used for) financing activities	752	(54)	**698**	527	(178)	**349**
Net increase (decrease) in cash and cash equivalents	(520)	(135)	**(655)**	6	90	**96**
Net increase (decrease) in short term investments	(88)	-	**(88)**	114	-	**114**
Net increase (decrease) in cash and cash equivalents and short term investments	**$ (608)**	**$ (135)**	**$ (743)**	**$ 120**	**$ 90**	**$ 210**

1. *The second quarter 2007 results reflect the change in accounting for Jazz whereby the Jazz's results from operations and financial condition were consolidated by the Corporation only up to May 24, 2007. There was no consolidation of Jazz in the third quarter of 2007.*

Air Canada's free cash flow, excluding the consolidation of Jazz operations, decreased $329 million from the third quarter of 2006 and decreased $1,040 million from the first nine months of 2006. The decrease in free cash flow was largely related to negative movements in working capital items and to additions to capital assets mainly related to aircraft partly offset by an increase in net cash provided by operating activities. The negative movements in working capital items include the timing of collection of certain passenger sales receivables which have been collected in the fourth quarter of 2007 and to the timing of certain remittances of passenger related taxes and fees. In addition, fuel inventory levels increased during the third quarter 2007 versus a decrease in the comparable 2006 period causing a negative cash flow variance of $26 million.

5.6. Share Information

An aggregate of 100 million Class A variable voting shares and Class B voting shares in the capital of Air Canada are issued and outstanding.

The issued and outstanding shares of Air Canada, along with shares potentially issuable, are as follows:

	Number of shares At September 30, 2007	At June 30, 2007
Issued and outstanding shares		
Class A variable voting shares	18,625,199	20,199,243
Class B voting shares	81,374,801	79,800,757
Total issued and outstanding shares	**100,000,000**	**100,000,000**
Class A variable voting and Class B voting shares potentially issuable		
Stock options	1,704,416	1,792,638
Total shares potentially issuable	**1,704,416**	**1,792,638**
Total outstanding and potentially issuable shares	**101,704,416**	**101,792,638**

5.7. Capital Resources and Capital Expenditures

On April 23, 2007, Air Canada amended agreements with The Boeing Company ("Boeing") to increase its firm orders for Boeing 787 aircraft from 14 to 37. In addition, the parties agreed to reduce the firm orders of Boeing 777 aircraft by two scheduled for delivery in 2009. The deliveries of the 37 firm aircraft are scheduled to commence in 2010 and be completed by 2014. In addition, these amendments also provide for an additional 23 Boeing 787 option aircraft, for a total of up to 60 Boeing 787 aircraft.

In conjunction with the amended agreements with Boeing, Air Canada received additional financing commitments from Boeing for an additional seven Boeing 787 aircraft (21 Boeing 787 aircraft in total) on the same terms and conditions as previously disclosed. Should Air Canada not utilize any of the previously disclosed financing commitments on the Boeing 777 aircraft, the financing commitments for the Boeing 787 aircraft will be increased to 31 of which the terms of 28 would be revised such that 80% of the aircraft delivery price would be covered and the term to maturity would be reduced to 12 years from 15 years, with straight-line principal repayments over the term to maturity.

On April 19, 2007, Air Canada received a final commitment for loan guarantee support, subject to the fulfillment of certain terms and conditions, from the Export-Import Bank of the United States ("EXIM") covering the first seven Boeing 777 aircraft under the Corporation's purchase agreement with Boeing (the "Boeing Purchase Agreement") to be delivered in 2007. In the nine months ended September 30, 2007, Air Canada took delivery of seven Boeing 777 aircraft, six of which were purchased under the Boeing Purchase Agreement and financed under the loan guarantee support provided by EXIM, the other one being subject to an operating lease agreement with International Lease Finance Corporation ("ILFC"). An eighth Boeing 777 aircraft is expected for delivery in the fourth quarter of 2007; it will be the final of the seven Boeing 777 aircraft purchased under the Boeing Purchase Agreement and financed under the loan guarantee support provided by EXIM.

The EXIM commitment for loan guarantee support covers a 12-year loan term for approximately 80% of the aircraft delivery price at an interest rate of approximately 5.23% based on interest rates as at September 30, 2007. Air Canada has also received a preliminary commitment from EXIM for the remaining Boeing 777 aircraft which are scheduled to be delivered in 2008 and 14 Boeing 787 aircraft which are scheduled to be delivered in 2010 and 2011. Air Canada is currently in discussions with EXIM to convert the preliminary commitment on the 2008 deliveries into a final commitment.

The total committed capital expenditures relating to the amended Boeing agreements beyond 2011 amount to $2.5 billion. As at September 30, 2007, total committed capital expenditures, including the expenditures related to the amended Boeing agreements, amounted to $6.3 billion.

In addition to the changes discussed above, the timing of certain planned and committed capital expenditures has changed from that which was disclosed in Air Canada's 2006 annual MD&A dated February 14, 2007. Air Canada continues to evaluate whether certain aircraft acquisitions will be financed by debt or operating lease arrangements. However, based on an assumption that all aircraft acquisitions will be financed under debt, the current planned and committed capital expenditures are as follows:

Air Canada Projected planned and committed Capital expenditures ($ millions) (1)(2)	**Remainder of 2007**	**2007(3)**	**2008**	**2009**	**2010**	**2011**
Projected committed expenditures	$ 430	$ 2,115	$ 1,359	$ 123	$ 853	$ 947
Projected planned but uncommitted expenditures	83	83	412	148	136	141
Total projected expenditures	513	2,198	1,771	271	989	1,088
Projected financing on committed expenditures	(288)	(1,381)	(1,028)	-	(690)	(810)
Total projected expenditures, net of financing	$ 225	$ 817	$ 743	$ 271	$ 299	$ 278

1. *US dollar amounts are converted using the September 30, 2007 noon day rate of $0.9963. Final aircraft delivery prices include estimated escalation and interest on deferred delivery payments, which is calculated based on the 90-day USD LIBOR rate at September 30, 2007.*
2. *The dollar amounts reflected above do not include obligations pertaining to day-to-day operations.*
3. *Total year projections for 2007 include year-to-date actuals through to September 30, 2007.*

Projected Cash Payments for Committed Aircraft Deliveries

The following table provides Air Canada's cash principal payments for the future firm aircraft deliveries for the remainder of 2007 through to 2011.

The principal repayments disclosed below are based on the assumption that all aircraft acquisitions will be financed under debt.

($ millions)	Remainder of 2007	2008	2009	2010	2011
Principal repayment on aircraft-related long-term debt(1)(2)	$ -	$ 36	$ 57	$ 70	$ 103

1. *US dollar amounts are converted using the September 30, 2007 noon day rate of $0.9963. Final aircraft delivery prices include estimated escalation and interest on deferred delivery payments, which is calculated based on the 90-day USD LIBOR rate at September 30, 2007.*
2. *The projected principal repayment amounts reflect certain loan commitments received and management's best estimate as to market terms available.*

5.8. Pension Plan Cash Funding Obligations

Air Canada's pension plan cash funding obligations have been updated from those disclosed in Air Canada's 2006 annual MD&A dated February 14, 2007.

As at January 1, 2007, the solvency deficit in the domestic registered plans was $542 million compared to $1,655 million at January 1, 2006. This reduction in the solvency deficit of the plans represents a significant improvement in the financial position of the plans with the solvency ratio for all plans on a combined basis increasing from 86% to 95%. This improvement resulted from the combination of the following factors in 2006:

- A 13.6% return on plan assets, net of expenses;
- Significant company contributions to the plans including $261 million for past service;
- A stable interest rate environment.

This improvement causes the financial position of the plans as at January 1, 2007 to be ahead of schedule compared to the projected financial position assuming no experience gains or losses and using the initial repayment schedule agreed to with the Office of the Superintendent of Financial Institutions ("OSFI") in 2004.

The schedule of required past service contributions required to be made by Air Canada to domestic registered plans, based on the January 1, 2007 actuarial valuations, is reduced compared to the schedule of past service contributions that would have been required based on the January 1, 2006 valuations. The reductions are approximately $115 million in 2007 and $150 million per annum for the years 2008 to 2013, assuming no change in economic conditions.

The table below provides revised projections for Air Canada's pension funding obligations for the remainder of 2007 and for the full years 2007 through to 2011, assuming no change in economic conditions. Changes in the economic conditions, mainly the return on fund assets and changes in interest rates will impact projected required contributions. The required contributions and solvency deficit disclosed below assume no future gains and losses on plan assets and liabilities over the projection period and do not reflect the economic experience of 2007 to date.

Air Canada ($ millions)	**Remainder of 2007**	**Full year 2007**	**2008**	**2009**	**2010**	**2011**
Past service domestic registered plans	$ 24	$ 134	$ 91	$ 92	$ 93	$ 93
Current service domestic registered plans	44	164	166	171	176	181
Other pension arrangements	13	86	86	65	69	74
Projected pension funding obligations	**$ 81**	**$ 384**	**$ 343**	**$ 328**	**$ 338**	**$ 348**

The above pension funding requirements are in respect of the Corporation's pension arrangements. For domestic registered pension plans, the funding requirements are based on the minimum past service contributions disclosed in the January 1, 2007 actuarial valuation plus a projection of the current service contributions.

6. Quarterly Financial Data

The table below summarizes quarterly financial results and major operating statistics for Air Canada, excluding the consolidation of Jazz operations (previously "Air Canada Services") for the last eight quarters. The amounts in the table below include inter-segment revenues and expenses.

($ millions, except per share figures)	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 2007	Q3 2007
Air Canada								
Operating revenues	$ 2,276	$ 2,399	$ 2,583	$ 2,861	$ 2,423	$ 2,540	$ 2,639	$ 2,954
Special charge for Aeroplan miles [1]	-	-	-	(102)	-	-	-	-
Operating revenues	**2,276**	**2,399**	**2,583**	**2,759**	**2,423**	**2,540**	**2,639**	**2,954**
Ownership (DAR) [2]	(201)	(203)	(208)	(205)	(218)	(207)	(211)	(210)
Other operating expenses	(2,166)	(2,320)	(2,262)	(2,424)	(2,210)	(2,411)	(2,340)	(2,393)
Operating expenses [3]	**(2,367)**	**(2,523)**	**(2,470)**	**(2,629)**	**(2,428)**	**(2,618)**	**(2,551)**	**(2,603)**
Operating income (loss)	**(91)**	**(124)**	**113**	**130**	**(5)**	**(78)**	**88**	**351**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(44)	(2)	39	(86)	(139)	44	67	(78)
Segment income (loss)	**$ (135)**	**$ (126)**	**$ 152**	**$ 44**	**$ (144)**	**$ (34)**	**$ 155**	**$ 273**
Revenue passenger miles (millions)	10,584	11,240	12,248	14,345	11,160	11,814	12,580	14,789
Available seat miles (millions)	13,807	14,287	14,925	17,528	14,343	14,735	15,220	18,144
Passenger load factor (%)	76.7	78.7	82.1	81.8	77.8	80.2	82.7	81.5
Operating expense per available seat mile (CASM) (cents)	17.1	17.6	16.5	15.0	16.9	17.7	16.7	14.3
CASM, excluding fuel expense (cents) [4]	12.9	13.7	12.3	10.7	12.8	13.8	12.6	10.4
CASM, excluding fuel expense and the special charge for labour restructuring (cents) [4]	12.9	13.5	12.3	10.7	12.9	13.8	12.6	10.4
EBITDAR [4]	**$ 110**	**$ 79**	**$ 321**	**$ 335**	**$ 213**	**$ 129**	**$ 299**	**$ 561**
EBITDAR [4], excluding special charges	**$ 110**	**$ 107**	**$ 321**	**$ 437**	**$ 205**	**$ 129**	**$ 299**	**$ 561**
Earning (loss) per share - Basic and diluted [5]	**$ (1.53)**	**$ (1.43)**	**$ 1.72**	**$ 0.50**	**$ (1.55)**	**$ (0.34)**	**$ 1.55**	**$ 2.73**

1. *The third quarter of 2006 includes a special charge of $102 million in connection with Air Canada's obligation for the redemption of pre-2002 Aeroplan miles.*
2. *DAR refers to the combination of Aircraft rent and Depreciation, amortization and obsolescence expenses.*
3. *The first quarter of 2006 includes a special charge for labour restructuring of $28 million. The fourth quarter of 2006 includes a favourable adjustment of $8 million relating to the special charge for labour restructuring recorded in the first quarter of 2006.*
4. *See section 14 "Non-GAAP Financial Measures" in this MD&A for additional information.*
5. *Earnings per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.*

Seasonality

Air Canada 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. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the spring and summer months. The cost structure of the Corporation is such that its fixed costs do not fluctuate proportionately with passenger demand in the short-term.

The table below summarizes quarterly financial results and major operating statistics for Jazz for the last eight quarters. The second quarter of 2007 shows the consolidation of Jazz only up to May 24, 2007. There was no consolidation of Jazz in the third quarter of 2007.

($ millions)	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 2007[(1)]	Q3 2007[(1)]
Jazz								
Operating revenues	**304**	**320**	**340**	**369**	**352**	**364**	**249**	**-**
Ownership (DAR) [(2)]	(32)	(36)	(40)	(40)	(39)	(40)	(26)	-
Other operating expenses	(238)	(249)	(264)	(290)	(280)	(288)	(197)	-
Operating expenses	**(270)**	**(285)**	**(304)**	**(330)**	**(319)**	**(328)**	**(223)**	**-**
Operating income	**34**	**35**	**36**	**39**	**33**	**36**	**26**	**-**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(2)	(2)	-	-	(1)	44	67	-
Segment income	**$32**	**$33**	**$36**	**$39**	**$32**	**$35**	**$27**	**-**

1. *The second quarter 2007 results reflect the change in accounting for Jazz whereby the Jazz's results from operations and financial condition were consolidated by the Corporation only up to May 24, 2007. There was no consolidation of Jazz in the third quarter of 2007.*
2. *DAR refers to the combination of Aircraft rent and Depreciation, amortization and obsolescence expenses.*

The table below summarizes quarterly consolidated financial results and major operating statistics for the Corporation and Jazz for the last eight quarters. The second quarter of 2007 shows the consolidation of Jazz only up to May 24, 2007. There was no consolidation of Jazz in the third quarter of 2007.

($ millions, except per share figures)	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 2007[(1)]	Q3 2007[(1)]
Consolidated Total								
Operating revenues	$ 2,256	$ 2,376	$ 2,559	$ 2,837	$ 2,395	$ 2,510	$ 2,622	$ 2,954
Special charge for Aeroplan miles [(2)]	-	-	-	(102)	-	-	-	-
Operating revenues	**2,256**	**2,376**	**2,559**	**2,735**	**2,395**	**2,510**	**2,622**	**2,954**
Ownership (DAR) [(32)]	(227)	(239)	(239)	(237)	(247)	(237)	(231)	(210)
Other operating expenses	(2,086)	(2,225)	(2,171)	(2,329)	(2,119)	(2,315)	(2,340)	(2,393)
Operating expenses [(4)]	**(2,313)**	**(2,464)**	**(2,410)**	**(2,566)**	**(2,366)**	**(2,552)**	**(2,508)**	**(2,603)**
Operating income (loss)	**(57)**	**(88)**	**149**	**169**	**29**	**(42)**	**114**	**351**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(78)	(38)	3	(125)	(173)	44	67	(78)
Segment income (loss)	**$ (135)**	**$ (126)**	**$ 152**	**$ 44**	**$ (144)**	**$ (34)**	**$ 155**	**$ 273**
Earning (loss) per share - Basic and diluted [(5)]	**$ (1.53)**	**$ (1.43)**	**$ 1.72**	**$ 0.50**	**$ (1.55)**	**$ (0.34)**	**$ 1.55**	**$ 2.73**

1. *The second quarter 2007 results reflect the change in accounting for Jazz whereby the Jazz's results from operations and financial condition were consolidated by the Corporation only up to May 24, 2007. There was no consolidation of Jazz in the third quarter of 2007.*
2. *The third quarter of 2006 includes a special charge of $102 million in connection with Air Canada's obligation for the redemption of pre-2002 Aeroplan miles.*
3. *DAR refers to the combination of Aircraft rent and Depreciation, amortization and obsolescence expenses.*
4. *The first quarter of 2006 includes a special charge for labour restructuring of $28 million. The fourth quarter of 2006 includes a favourable adjustment of $8 million relating to the special charge for labour restructuring recorded in the first quarter of 2006.*
5. *Earnings per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.*

7. Derivatives and Financial Instruments

Air Canada manages its exposure to changes in interest rates, foreign exchange rates and jet fuel prices through the use of various derivative financial instruments.

Fuel Price Risk Management
To manage its exposure to jet fuel prices and minimize volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries. As at September 30, 2007, Air Canada had mainly collar options and swap structures in place to hedge a portion of its anticipated jet fuel requirement over the remainder of 2007 and 2008 periods. Since jet fuel is not traded on an organized futures exchange, liquidity for hedging this commodity is relatively limited in the long-term. Air Canada uses crude oil and heating oil for hedging its exposure to jet fuel price volatility. Air Canada does not purchase or hold any derivative financial instruments for trading purposes. Refer to Note 1 and 6 to Air Canada's third quarter 2007 interim unaudited consolidated financial statements for additional information.

In the third quarter of 2007, maturing fuel derivative contracts were cash settled for $20 million in favour of Air Canada, of which $10 million related to contracts designated under hedge accounting and $10 million related to contracts classified as economic hedges.

As at September 30, 2007, Air Canada had hedged 44% of the remainder of its projected fuel requirement for 2007 and 3% of its projected fuel requirement for 2008. The total fair market value of the derivative contracts recognized under prepaid expenses and other current assets amounted to $37 million in favour of Air Canada, of which $23 million was classified as hedges under hedge accounting and $14 million was classified under economic hedges.

Air Canada designates its fuel derivatives as cash flow hedges and applies hedge accounting as prescribed under CICA section 3865, Hedges. Air Canada also holds certain fuel derivatives instruments that do not qualify for hedge accounting; management believes these derivatives constitute good economic hedges in managing its exposure to jet fuel prices. These contracts, classified as economic hedges, are recorded at fair value at each balance sheet date and the change in fair value is recognized in non-operating income (expense).

Fuel derivative instruments designated under hedge accounting result in all period changes in the fair value of the hedging items that are considered effective being recorded in Accumulated Other Comprehensive Income ("AOCI") until the underlying jet fuel is consumed. Upon maturity of the hedging item, the effective gains and losses are recorded in fuel expense. The ineffective component of the change in fair value is recorded in non-operating income (expense). Air Canada is exposed to the risk that periodic changes in fair value will not be perfectly effective. As defined by Air Canada's fuel hedging policy, ineffectiveness results when the change in the derivative's fair value does not perfectly offset the change in the intrinsic value of the anticipated jet fuel purchase. The ineffective portion relating to the change in a derivative's intrinsic value is calculated by comparing it to the change in intrinsic value of a proxy perfect hedge based on Air Canada's jet fuel weighted average price. As Air Canada's current policy does not take into account variables affecting fair value such as volatility and time value of money, a significant component of the change in fair value of outstanding fuel derivatives may be recorded as ineffective under the current policy.

Ineffectiveness is inherent in hedging diversified jet fuel purchases with derivative positions in crude oil and related commodities and in the differences between intrinsic values and fair values of the derivative instruments, especially given the magnitude of volatility observed in oil market prices. Air Canada is unable to predict the amount of ineffectiveness that could be recorded for each period. This may result, and has resulted, in increased volatility in the accounting results of Air Canada but has no impact on the underlying cash flows. Refer to Note 6 to Air Canada's third quarter 2007 interim unaudited consolidated financial statements for additional information.

Since September 30, 2007, Air Canada has entered into new hedging positions, using collar option structures, which have added 5% coverage to the fourth quarter of 2007, 10% coverage to 2008 and 2% coverage to 2009, increasing the total hedged volume for the remainder of 2007 to 50% and the total hedged volume for 2008 to 13%. The fourth quarter of 2007 is hedged at prices that can fluctuate between an average of US$85 to US$90 per barrel for jet-fuel based contracts, an average of US$72 to US$78 per barrel for heating oil-based contracts and an average of US$60 to US$69 per barrel for WTI crude-oil based contracts. 2008 is hedged at prices that can fluctuate between an average of US$90 to US$97 per barrel for jet-fuel based contracts, an average of US$86 to US$93 per barrel for heating oil-based contracts and an average of US$61 to US$68 per barrel for WTI crude-oil based contracts.

Foreign Exchange Risk Management

In the first quarter of 2007, currency swaps for five CRJ aircraft leases with third parties were settled at their fair value of $10 million (which was equal to the carrying value) upon the expiry of the lease term.

Air Canada enters into certain foreign exchange forward contracts or currency swaps to manage the risks associated with foreign currency exchange rates. As at September 30, 2007, Air Canada had entered into foreign currency forward contracts and option agreements on US$2.3 billion of future purchases in 2007, 2008 and 2009. The fair value of these foreign currency contracts as at September 30, 2007 was $159 million in favour of the counterparties (December 31, 2006 - $25 million in favour of Air Canada on $503 million of future purchases in 2007). These derivative instruments have not been designated as hedges for accounting purposes. The unrealized loss has been recorded in foreign exchange.

Asset-Backed Commercial Paper (ABCP)

Air Canada has $37 million ($32 million net of a fair value adjustment) in a non-bank sponsored ABCP which has been recorded in deposits and other assets on Air Canada's consolidated statement of financial position. These investments, which were scheduled to mature during the third quarter of 2007, were previously recorded in cash and cash equivalents and the transfer to deposits and other assets was reflected as an investing activity on Air Canada's third quarter 2007 consolidated statement of cash flows. The restructuring deadline for the ABCP has been extended to December 2007. There is uncertainty as to when these investments will settle and the amount of the settlement.

In the third quarter of 2007, Air Canada recorded a charge of $5 million ($3 million after tax) in non-operating income (expense). The charge was based on a number of assumptions as to the fair value of the investments including factors such as estimated cash flow scenarios and risk-adjusted discounted rates. The assumptions used in estimating the fair value of the investments are subject to change, which may result in further adjustments to non-operating results in the future.

8. Related Party Transactions

At September 30, 2007, ACE had a 75% ownership interest in the Corporation. The Corporation has various related party transactions with ACE and other ACE-related entities, including Aeroplan, Jazz and ACTS LP ("ACTS"). Refer to Note 8 to Air Canada's third quarter 2007 interim unaudited consolidated financial statements for additional information. Also refer to Note 12 to Air Canada's third quarter 2007 interim unaudited consolidated financial statements for a summary of transactions arising upon ACE's sale of ACTS during the fourth quarter of 2007.

Related party trade balances arise from the provision of services, as outlined in the table below, the allocation of employee-related costs and centralized cash management activities as described below.

In the third quarter of 2007, Air Canada purchased from ACE its 49% interest in Air Canada Vacations causing Air Canada Vacations to be wholly owned by Air Canada. Consideration for the units was $10 million which reflected the consideration paid by ACE upon the transfer of the investment from Air Canada to ACE in 2005. The consideration is accounted for on Air Canada's statement of financial position in contributed surplus. Air Canada Vacations remains consolidated within the result of the Corporation.

The related party balances resulting from the application of the commercial and contractual practices were as follows:

($ millions)	**September 30, 2007**	**December 31, 2006**
Accounts receivable		
ACE	$ 4	$ -
Aeroplan	35	6
ACTS	124	97
Jazz [1]	92	-
	$ 255	**$ 103**
Accounts payable and accrued liabilities		
ACE	$ -	$ 12
ACTS	80	111
Jazz [1]	70	-
	$ 150	**$ 123**

1. Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada.

Revenues and expenses with related parties are summarized as follows:

	Three months ended September 30		Nine months ended September 30	
($ millions)	**2007**	**2006**	**2007 (1)**	**2006**
Revenues				
Revenues from Aeroplan related to Aeroplan rewards	$ 117	$ 114	$ 305	$ 274
Revenues offset from purchase of Aeroplan miles	(56)	(57)	(182)	(181)
Property rental revenues from related parties	12	12	35	37
Revenues from information technology services to related parties	7	6	21	19
Revenues from corporate services and other	10	5	22	12
Aircraft sublease revenues from Jazz	7	-	8	-
Air Canada Ground Handling revenues from related parties	13	-	17	-
Cargo revenues from related parties	2	1	3	3
	112	**81**	**229**	**164**
Expenses				
Maintenance expense for services from ACTS	$ 129	$ 136	$ 504	$ 456
Expense from CPA with Jazz	234	-	310	-
Pass-through fuel expense from Jazz(2)	84	-	113	-
Pass-through airport expense from Jazz(2)	54	-	71	-
Pass-through other expense from Jazz(2)	5	-	7	-
Call centre management and marketing fees for services from Aeroplan	2	2	7	7
Other expenses	2	7	2	29
Recovery of wages, salary and benefit expense for employees assigned to Aeroplan and ACTS	(93)	(100)	(315)	(307)
	$ 417	**$ 45**	**$ 699**	**$ 185**
Net interest expense (income) from related parties	**$ (1)**	**$ 1**	**$ (1)**	**$ 5**

1. *Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada. The related party transactions above with Jazz are for the period from May 24, 2007.*
2. *Pass-through costs (which are not marked up) charged to Air Canada from Jazz include fuel, airport and user fees and other costs. These expenses are recorded in the applicable category within operating expenses in the results of Air Canada.*

In addition to the above revenues and expenses with Jazz, Air Canada transfers fuel inventory and subleases certain aircraft to Jazz on a flow through basis, which are reported net on Air Canada's consolidated statement of operations.

9. Changes in Accounting Policies

Critical accounting estimates are those that are most important to the portrayal of Air Canada's financial condition and results of operations. These critical accounting estimates require management to make certain judgments and estimates, some of which may relate to matters that are uncertain. Actual results could differ from those estimates under different assumptions and conditions.

Information on Air Canada's critical accounting estimates, including assumptions made for pension and other benefit plans, is provided in Air Canada's 2006 annual MD&A dated February 14, 2007. There have been no material changes to critical accounting estimates since that time.

Refer to section 5.8 of this MD&A for an update on Air Canada's pension plan cash funding obligations.

Financial Instruments

On January 1, 2007, Air Canada adopted CICA accounting handbook section 3855, *Financial Instruments – Recognition and Measurement*, section 3861, *Financial Instruments and Presentation*, section 3865, *Hedges*, section 1530, *Comprehensive Income* and section 3251*, Equity*. Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. The purpose of the section is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows.

The changes to Air Canada's consolidated financial statements are described in Note 1 to Air Canada's third quarter of 2007 interim unaudited consolidated financial statements.

The adopted sections establish standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. Under this standard, all financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods is dependent upon the classification of the financial instrument as held-for-trading, available-for-sale, held-to-maturity, loans and receivables, or other financial liabilities.

With the exception of investment securities classified as available-for-sale and derivatives designated as cash flow hedges, changes in the fair values over the reporting period are reported in net income. The changes in fair values of investment securities classified as available-for-sale and derivatives designated as cash flow hedges are reported in other comprehensive income.

The standards also provide guidance on accounting for derivatives in hedging relationships. In addition to requiring all derivatives to be fair valued on the consolidated statement of financial position, the standards require the effectiveness of the hedging relationships for the reporting period to be quantified. The effective portion of the change in the fair value of the hedging derivative is recognized in other comprehensive income ("OCI") while the ineffective portion is recognized in non-operating income. Upon maturity of fuel derivatives, the effective gains and losses previously recognized in Accumulated OCI ("AOCI") are recorded in fuel expense.

Impact upon Adoption

In accordance with the transitional provisions of the standards, prior periods have not been restated for the adoption of these new accounting standards.

The transition adjustments attributable to the remeasurement of financial assets and financial liabilities at fair value, other than financial assets classified as available-for-sale and hedging instruments designated as cash flow hedges, were recognized in the opening deficit of the Corporation as at January 1, 2007.

For the Corporation's fuel hedging relationship classified as cash flow hedges, which qualify for hedge accounting under the new standards, the effective portion of any gain or loss on the hedging instruments was recognized in AOCI and the cumulative ineffective portion was included in the opening deficit of the Corporation as at January 1, 2007.

Upon adoption, the Corporation recorded the following adjustments to the consolidated statement of financial position:

Increase (decrease) ($ millions)		
Deferred charges	$	(14)
Future income taxes ($6 million, net of a valuation allowance of $6 million)	$	-
Accounts payable and accrued liabilities	$	18
Long-term debt and capital leases	$	(14)
Deficit, net of nil tax	$	(8)
Accumulated other comprehensive income (loss), net of nil tax	$	(26)

Future Accounting Changes

The CICA issued four new accounting standards: section 1535, Capital Disclosures, section 3862, Financial Instruments – Disclosures, section 3863, Financial Instruments – Presentation and section 3031, Inventories. These new standards will be effective for fiscal years beginning on or after October 1, 2007 and the Corporation will adopt them on January 1, 2008. The Corporation is in the process of evaluating the disclosure and presentation requirements of the new standards, however, it is not anticipated that the results of the Corporation will be affected.

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose will be to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Sections 3862 and 3863 will replace section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections will place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

Section 3031 will replace section 3030, Inventories, providing more extensive guidance on measurement and expanding disclosure requirements to increase transparency.

10. Controls and Procedures

Disclosure Controls and Procedures

Air Canada's Audit, Finance and Risk Committee reviewed the third quarter 2007 MD&A and the interim unaudited consolidated financial statements and Air Canada's Board of Directors reviewed and approved these documents prior to their release.

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

Air Canada's 2006 Annual Report contains a statement that the President and Chief Executive Officer ("CEO") and the Executive Vice President and Chief Financial Officer ("CFO") have concluded that Air Canada's disclosure controls and procedures are effective based upon an evaluation of these controls and procedures conducted at December 31, 2006.

Changes in Internal Controls over Financial Reporting

There were no changes to Air Canada's internal controls over financial reporting during the three months ended September 30, 2007 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

11. Risk Factors

For a detailed description of the risk factors associated with the Corporation, refer to the section entitled "Risk Factors" in Air Canada's 2006 annual MD&A dated February 14, 2007 (the "2006 MD&A"). The Corporation is not aware of any significant changes to the Corporation's risk factors from those disclosed at that time. However, the risk factors under Current Legal Proceedings in the 2006 MD&A are revised to provide for the following updates relating to investigations of alleged anti-competitive cargo pricing activities and to include the following proceedings between Air Canada and Porter Airlines Inc.

Current Legal Proceedings

The European Commission, the United States Department of Justice and the Competition Bureau in Canada, among other competition authorities, are investigating alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including Air Canada. Competition authorities have sought or requested information from Air Canada as part of their investigations. Air Canada is cooperating with these investigations, which are likely to lead to proceedings against Air Canada and a number of airlines and other cargo operators in certain jurisdictions. Air Canada is also named as a defendant in a number of class action lawsuits that have been filed before the United States District Court and in Canada in connection with these allegations. It is not possible at this time to predict with any degree of certainty the outcome of these proceedings, but these proceedings may result in liability to Air Canada, which may be material. It is Air Canada's policy to conduct its business in full compliance with all applicable competition laws.

In February 2006, Jazz commenced proceedings before the Ontario Superior Court of Justice against certain defendants including Porter Airlines Inc. after Jazz became aware that it would be excluded from operating flights from Toronto City Centre (Island) Airport. On October 26, 2007, the defendants counter-claimed against Jazz and Air Canada alleging various violations of competition law, including that Jazz and Air Canada's commercial relationship contravenes Canadian competition laws, and claiming $850 million in damages. Air Canada views the defendants' counterclaim as frivolous and without merit.

12. Subsequent Events

On October 16, 2007, ACE announced that it had completed the monetization of ACTS, its wholly-owned maintenance, repair and overhaul subsidiary, pursuant to which ACTS sold substantially all its assets to a new ACTS entity established to purchase the assets ("New ACTS") with ACE retaining a 23% interest in the New ACTS.

On closing of the ACTS Monetization, the following transactions were recorded by Air Canada:

- Proceeds of $28 million for the sale of a building to the New ACTS, successor in interest to ACTS.
- Proceeds of $17 million for the settlement of a related party receivable with ACTS.
- Proceeds of $20 million pursuant to the Repair Schemes and Non-Compete Agreement as described below.
- The funding of a letter of credit in the amount of $102 million related to the Pension and Benefits Agreement as described below.

The above transactions will be recorded by the Corporation during the fourth quarter of 2007.

The ACTS Maintenance Agreements, the ACTS Master Services Agreement, the ACTS Trademark License Agreement, and the General Services Agreements, all between Air Canada and ACTS and previously identified in Note 18 to the 2006 annual combined consolidated financial statements of the Corporation, and the Repair Schemes and Non-Compete Agreement described below were assigned from ACTS to the New ACTS upon closing of the ACTS Monetization.

Pension and Benefits Agreement

The Corporation, ACTS and the New ACTS entered into a Pension and Benefits Agreement effective as of October 16, 2007 ("Pension and Benefits Agreement"), relating to pension and benefits arrangements pertaining to non-unionized and unionized employees of Air Canada who were assigned to the New ACTS operation pursuant to general services agreements between Air Canada and ACTS for the assignment of unionized and non-unionized employees from Air Canada to ACTS (these agreements were assigned to the New ACTS upon closing of the ACTS Monetization). On October 16, 2007, non-unionized employees of Air Canada who were previously assigned to the ACTS operation became employees of the New ACTS. New defined benefit and defined contribution pension plans as well as other employee and retiree benefit arrangements (including health, life and disability) are to be established by the New ACTS (the "ACTS Benefit Arrangements"). Subject to regulatory approval where required and based upon valuations of the relevant pension and benefit arrangements of Air Canada (the "Air Canada Benefit Arrangements") as at October 16, 2007, the assets and obligations under the Air Canada Benefit Arrangements pertaining to the transferring non-unionized employees will be transferred to the New ACTS or the ACTS Benefit Arrangements, as applicable. Any solvency deficiency in the defined benefit pension plans as at October 16, 2007 related to transferring non-unionized employees will be funded by Air Canada through quarterly payments to the New ACTS until 2014. The accounting liability as at October 16, 2007 in respect of retiree and disability benefits related to transferring non-unionized employees will be funded by Air Canada through quarterly payments to the New ACTS until 2012.

In addition, the Pension and Benefits Agreement contemplates similar asset and liability transfer and compensation arrangements in respect of unionized employees, which arrangements would take effect at such future time as those unionized employees may be transferred from Air Canada to the New ACTS. However, the solvency deficiencies in respect of transferring unionized employees for which the future quarterly compensation payments would be made are determined as at October 16, 2007, subject to certain adjustments, and the discount rate used to compute the accounting liability for the unionized employees' retiree and disability benefits is fixed as at October 16, 2007. The compensation payments in respect of these solvency deficiencies and accounting liabilities would be made quarterly during the five years beginning after the unionized employees are transferred to the New ACTS, but only if such transfer occurs. Until such future time as the unionized employees may be transferred to the New ACTS, the current service pension cost and the current service and interest costs for other employee benefits in respect of Air Canada employees providing services to the New ACTS are charged to the New ACTS.

The Pension and Benefits Agreement also required that Air Canada provide letters of credit to the New ACTS on October 16, 2007, to secure the above-described payment obligations in respect of the solvency deficiencies of the defined benefit pension plans and accounting liabilities for other retiree and disability benefit arrangements. The letters of credit total $102 million, subject to adjustment once the exact amounts of the relevant solvency deficiencies and accounting liabilities as at October 16, 2007 are determined by actuarial valuations. The face amounts of the letters of credit decrease as the related quarterly funding payments described above are made. The New ACTS may call the letters of credit in whole or in part, in the event of a default as defined in the Pension and Benefits Agreement.

Non-Compete and Repair Schemes Transfer Agreement

Generally described, repair schemes are processes and methods which may be used in the maintenance and repair of aircraft and related equipment. Effective October 16, 2007 the Corporation entered into a non-compete and repair schemes transfer agreement (the "Repair Schemes and Non-Compete Agreement"). The agreement provides for the sale from Air Canada to ACTS of an undivided joint ownership interest in repair schemes owned by Air Canada or approved under Air Canada's airworthiness engineering organization as well as the sale from ACTS to Air Canada of an undivided joint ownership interest in the repair schemes owned or developed by ACTS and applicable to airframe heavy maintenance services provided by ACTS to Air Canada under the parties' airframe heavy maintenance services agreement.

This agreement also restricts Air Canada's ability to own any equity interest in an entity (other than entities in which Air Canada may currently have interests), or to carry on a business activity, related to the following commercial maintenance, repair and overhaul services in the airline industry, namely, airframe heavy maintenance and paint services, engine and auxiliary power unit ("APU") overhaul maintenance services, and component maintenance services. The applicable non-compete periods are as follows:

- With respect to airframe heavy maintenance services and paint services, the non-compete period ends one year after the current heavy maintenance services agreement is terminated or expires (the current term of the heavy maintenance services agreement expires October 2011);
- With respect to engine and APU overhaul maintenance services, the non-compete period ends on September 30, 2015;
- With respect to component maintenance services, the non-compete period ends on September 30, 2016;

The non-compete agreement does not restrict Air Canada from holding interests in any entities in which it held interests at the time of concluding the agreement nor does it limit Air Canada's line maintenance activities which it continues to operate.

In consideration for entering into this agreement, Air Canada will receive $20 million during the fourth quarter of 2007.

The Repair Schemes and Non-Compete Agreement was assigned to the New ACTS upon closing of the ACTS Monetization.

ACTS Trademark License Agreement

In addition to the above transactions, the ACTS Trademark License Agreement described above was amended on closing of the ACTS Monetization October 16, 2007 to provide for the termination of the agreement on October 16, 2008.

13. Outlook

For the fourth quarter of 2007, capacity is expected to increase by approximately 2.5% versus the comparable period in 2006. CASM, excluding fuel expense, is expected to decrease at a slightly lower rate year-over-year than experienced in the third quarter of 2007.

For the full year 2007, capacity is expected to increase by 3% versus the full year 2006. Full year 2007 CASM, excluding fuel expense, is expected to decrease by less than 1% from 2006.

In 2008, Air Canada expects its system ASM capacity to increase by 2.5% to 4%, reflecting growth in each of its markets.

With crude oil prices trading in the range of US$85 to US$95 per barrel, fuel expense remains a major risk in 2008. Air Canada has partially mitigated these record high fuel prices through its fuel hedging program.

14. Non-GAAP Financial Measures

EBITDAR

EBITDAR (earnings before interest, taxes, depreciation, amortization, obsolescence and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before aircraft rent and depreciation, amortization and obsolescence as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets.

EBITDAR is not a recognized measure for financial statement presentation under Canadian GAAP and does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies.

EBITDAR is reconciled to operating income as follows:

	Third Quarter			Nine months ended September 30		
($ millions)	**2007**	**2006**	**$ Change**	**2007**	**2006**	**$ Change**
Air Canada						
GAAP operating income	$ 351	$ 130	$ 221	$ 361	$ 119	$ 242
Add back:						
Aircraft rent	66	80	(14)	220	258	(38)
Depreciation, amortization and obsolescence	144	125	19	408	358	50
EBITDAR	**$ 561**	**$ 335**	**$ 226**	**$ 989**	**$ 735**	**$ 254**
Add back:						
Special charge for Aeroplan Miles	-	102	(102)	-	102	(102)
Special charge for labour restructuring	-	-	-	-	28	(28)
EBITDAR excluding special charges	**$ 561**	**$ 437**	**$ 124**	**$ 989**	**$ 865**	**$ 124**

Operating Income excluding Special Charges

Air Canada uses operating income excluding the special charge for Aeroplan miles and labour restructuring to assess the operating performance of its ongoing business without the effects of these special charges taken in 2006. These items were excluded from Air Canada's 2006 results as they could potentially distort the analysis of trends in business performance. The special charge for Aeroplan miles was for the full and final settlement between the parties in connection with Air Canada's obligations for the redemption of pre-2002 miles. The special charge for labour restructuring was for the total cost of the 20% non-unionized workforce reduction plan announced in February 2006.

The following measure is not a recognized measure for financial statement presentation under Canadian GAAP and does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies.

Operating income excluding the special charge for Aeroplan miles and the special charge for labour restructuring is reconciled to operating income as follows:

($ millions)	Third Quarter 2007	Third Quarter 2006	Third Quarter $ Change	Nine months ended September 30 2007	Nine months ended September 30 2006	Nine months ended September 30 $ Change
Air Canada						
GAAP operating income	$ 351	$ 130	$ 221	$ 361	$ 119	$ 242
Add back:						
Special charge for Aeroplan Miles	-	102	(102)	-	102	(102)
Special charge for labour restructuring	-	-	-	-	28	(28)
Operating income, excluding special charges	**$ 351**	**$ 232**	**$ 119**	**$ 361**	**$ 249**	**$ 112**

Operating Expense excluding Fuel Expense and the Special Charge for Labour Restructuring

Air Canada uses operating expense excluding fuel expense and the special charge for labour restructuring to assess the operating performance of its ongoing business without the effects of fuel expense and the special charge for labour restructuring. These items are excluded from Air Canada's results as they could potentially distort the analysis of trends in business performance. Fuel expense is highly volatile and excluding this expense from GAAP results allows Air Canada to compare its operating performance on a consistent basis. The special charge for labour restructuring is not reflective of the underlying financial performance of Air Canada from ongoing operations.

The following measure is not a recognized measure for financial statement presentation under Canadian GAAP and does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies.

Operating expense excluding fuel expense and the special charge for labour restructuring is reconciled to operating expense as follows:

($ millions)	Third Quarter 2007	Third Quarter 2006	Third Quarter $ Change	Nine months ended September 30 2007	Nine months ended September 30 2006	Nine months ended September 30 $ Change
Air Canada						
GAAP operating expense	$ 2,603	$ 2,629	$ (26)	$ 7,772	$ 7,622	$ 150
Remove:						
Aircraft fuel	(716)	(761)	45	(1,937)	(1,961)	24
Operating expense, excluding fuel expense	**$ 1,887**	**$ 1,868**	**$ 19**	**$ 5,835**	**$ 5,661**	**$ 174**
Remove:						
Special charge for labour restructuring	-	-	-	-	(28)	28
Operating expense, excluding fuel expense and the special charge for labour restructuring	**$ 1,887**	**$ 1,868**	**$ 19**	**$ 5,835**	**$ 5,633**	**$ 202**

15. Glossary

Available Seat Miles or ASMs — A measure of passenger capacity calculated by multiplying the total number of seats available for passengers by the miles flown;

CASM — Operating expense per ASM;

EBITDAR — EBITDAR is earnings before interest, taxes, depreciation, amortization, obsolescence and aircraft rent. EBITDAR is a non-GAAP financial measure commonly used in the airline industry to view operating results before aircraft rent and depreciation, amortization and obsolescence as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets;

Passenger Load Factor — A measure of passenger capacity utilization derived by expressing Revenue Passenger Miles as a percentage of Available Seat Miles;

Passenger Revenue per Available Seat Mile or RASM — Average passenger revenue per ASM;

Revenue Passenger Miles or RPMs — A measure of passenger traffic calculated by multiplying the total number of revenue passengers carried by the miles they are carried;

Yield — Average passenger revenue per RPM.