AIR CANADA

First Quarter 2008
Management's Discussion and Analysis of Results of Operations and Financial Condition

May 8, 2008

TABLE OF CONTENTS

1. **Highlights** 1
2. **Introduction** 2
3. **Results of Operations – First Quarter 2008 versus First Quarter 2007** 4
4. **Our Fleet** 13
5. **Financial and Capital Management** 14
   - 5.1 Financial Position 14
   - 5.2 Adjusted Net Debt 14
   - 5.3 Liquidity 15
   - 5.4 Consolidated Cash Flow Movements 16
   - 5.5 Contractual Obligations 17
   - 5.6 Capital Expenditures and Related Financing Arrangements 17
   - 5.7 Share Information 19
6. **Quarterly Financial Data** 20
7. **Financial Instruments and Risk Management** 22
8. **Related Party Transactions** 26
9. **Changes in Accounting Policies** 27
10. **Off-Balance Sheet Arrangements** 28
11. **Critical Accounting Estimates** 28
12. **Risk Factors** 28
13. **Controls and Procedures** 29
14. **Non-GAAP Financial Measures** 30
15. **Glossary** 31

1. Highlights

Prior to May 24, 2007, Air Canada had two reportable segments: Air Canada Services (which is now referred to as Air Canada) and Jazz Air LP ("Jazz"). The following table provides the reader with financial and operating highlights for Air Canada for the first quarter of 2008, which no longer includes the consolidation of Jazz, and for the Air Canada Services segment, which excluded the consolidation of Jazz, for the first quarter of 2007. Refer to section 2 of this MD&A for additional information.

	First Quarter		
(Canadian dollars in millions except per share figures)	**2008**	**2007**	**Change $**
Financial			
Operating revenues	2,727	2,540	187
Operating loss before the provision for cargo investigations [(1)]	(12)	(78)	66
Operating loss	(137)	(78)	(59)
Non-operating income (expenses)	(107)	8	(115)
Loss before non-controlling interest, foreign exchange and income taxes	(244)	(70)	(174)
Loss for the period	(288)	(34)	(254)
Operating margin before the provision for cargo investigations % [(1)]	-0.4%	-3.1%	2.7 pp
Operating margin %	-5.0%	-3.1%	(1.9) pp
EBITDAR before the provision for cargo investigations [(1)(2)]	222	129	93
EBITDAR [(2)]	97	129	(32)
EBITDAR margin before the provision for cargo investigations % [(1)(2)]	8.1%	5.1%	3.0 pp
EBITDAR margin % [(2)]	3.6%	5.1%	(1.5) pp
Cash, cash equivalents and short-term investments	1,394	1,969	(575)
Free cash flow	(173)	(183)	10
Adjusted debt/equity ratio	68.8%	68.6%	0.2 pp
Loss per share - basic and diluted [(3)]	($2.88)	($0.34)	($2.54)
Operating Statistics			**Change %**
Revenue passenger miles (millions) (RPM)	12,331	11,814	4.4
Available seat miles (millions) (ASM)	15,407	14,735	4.6
Passenger load factor	80.0%	80.2%	(0.2) pp
Passenger revenue per RPM (cents) [(4)]	18.7	18.3	2.2
Passenger revenue per ASM (cents) [(4)]	15.0	14.7	2.0
Operating revenue per ASM (cents) [(4)]	17.7	17.4	1.5
Operating expense per ASM ("CASM") (cents)	17.8	17.8	-
CASM, excluding fuel expense (cents)	13.1	13.8	(4.8)
Average number of full-time equivalent (FTE) employees (thousands)	24.0	23.4	2.8
Aircraft in operating fleet at period end [(5)]	341	332	2.7
Average fleet utilization (hours per day) [(6)]	9.9	9.6	3.5
Average aircraft flight length (miles) [(6)]	876	875	0.1
Fuel price per litre (cents) [(7)]	75.2	62.9	19.5
Fuel litres (millions)	947	925	2.4

(1) A provision for cargo investigations of $125 million was recorded in the first quarter of 2008.
(2) See section 14 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR before the provision for cargo investigations to operating income (loss) and EBITDAR to operating income (loss).
(3) Earnings (losses) per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.
(4) A revenue adjustment of $26 million relating to a change in accounting estimates was recorded in the fourth quarter of 2007 of which $29 million pertained to the first quarter of 2007. For comparative purposes, yield and RASM percentage changes were adjusted to include the impact of adding back $29 million to the first quarter of 2007.
(5) Excludes chartered freighters in 2008 and 2007. Includes Jazz aircraft covered under the Jazz CPA.
(6) Excludes third party carriers operating under capacity purchase arrangements other than Jazz aircraft covered under the Jazz CPA (which are included).
(7) Includes fuel handling and is net of fuel hedging results.

2. Introduction

In this MD&A, "we", "us", "our", "Air Canada" and "Corporation" refer to Air Canada and/or one or more of Air Canada's subsidiaries, unless indicated otherwise.

This Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A") for the first quarter of 2008 provides the reader with a view of Air Canada through the eyes of management and includes an analysis of our financial results for the first quarter of 2008 and a discussion on our controls and procedures. This MD&A should be read in conjunction with Air Canada's first quarter 2008 interim unaudited consolidated financial statements and notes. All financial information has been prepared in accordance with Generally Accepted Accounting Principles in Canada ("GAAP"), unless indicated otherwise. Air Canada's unaudited consolidated financial statements are based on accounting policies consistent with those disclosed in Note 2 to the Corporation's annual audited consolidated financial statements for 2007, with the exception of the changes in accounting policies described in section 9 of this MD&A.

Prior to May 24, 2007, Air Canada's consolidated financial statements included the financial position, results of operations and cash flows of Jazz as Air Canada was deemed to be the primary beneficiary of Jazz under Accounting Guideline 15 "Consolidation of Variable Interest Entities" ("AcG-15"). ACE's distribution of units of Jazz Air Income Fund on May 24, 2007 gave rise to a reconsideration of which entity should consolidate Jazz and, as a result, Jazz Air Income Fund was deemed to be the primary beneficiary of Jazz under AcG-15. Although Jazz is still considered to be a variable interest entity, Air Canada is no longer the primary beneficiary under AcG-15. Effective May 24, 2007, the results and financial position of Jazz are no longer consolidated within Air Canada.

Prior to May 24, 2007, Air Canada had two reportable segments: Air Canada Services (which is now referred to as Air Canada), the passenger and cargo transportation services business operated by Air Canada and related ancillary services, and Jazz, Air Canada's regional capacity provider. Segment information provided useful information to shareholders as it enabled them to distinguish between the results of operations, cash and other assets and liabilities of the two segments. Refer to Note 6 "Segment Information" to Air Canada's interim unaudited consolidated financial statements for the first quarter of 2008 for additional information.

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current period.

Except where the context otherwise requires, all monetary amounts are stated in 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 May 7, 2008.

The Corporation issued a news release dated May 8, 2008 reporting on its results for the first quarter of 2008. In this news release, the Corporation reported and updated guidance previously provided for 2008. This news release is available on www.sedar.com and on www.aircanada.com.

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

CAUTION REGARDING FORWARD-LOOKING INFORMATION

Air Canada's public communications may include written or oral forward looking statements within the meaning of applicable securities laws. Such statements are included in this MD&A and may be included in other filings with regulatory authorities and securities regulators. Forward-looking statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to 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, including those described below, and are subject to important risks and uncertainties. Any forecasts or forward-looking predictions or statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. 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, currency exchange and interest rates, competition, war, terrorist acts, epidemic diseases, insurance issues and costs, changes in demand due to the seasonal nature of the business, the ability to reduce operating costs, employee and labour relations, pension issues, supply issues, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in the "Risk Factors" section of Air Canada's 2007 MD&A dated February 6, 2008 and section 12 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.

Assumptions were made by Air Canada in preparing and making forward-looking statements. In addition to other assumptions contained in this MD&A, Air Canada has assumed that growth in North America and globally will slow in 2008 and that a mild economic recession will take place in the United States. Air Canada has also assumed that the Canadian dollar will trade, on average, at Cdn $1.01 per US dollar in the second quarter of 2008 and for the full year 2008 and that the price of fuel will average 91 cents per litre in the second quarter of 2008 and 89 cents per litre for the full year 2008 (both net of current hedging positions).

3. Results of Operations – First Quarter 2008 versus First Quarter 2007

Air Canada recorded an operating loss of $12 million, before the provision for cargo investigations, and a net loss of $288 million in the first quarter of 2008. In the same period of 2007, Air Canada, including the consolidation of Jazz's operations, reported a consolidated operating loss of $42 million and a net loss of $34 million. Air Canada recorded a provision for cargo investigations of $125 million in the first quarter of 2008 relating to alleged anti-competitive cargo pricing activities. Management does not consider this provision to be reflective of the underlying financial performance of Air Canada from ongoing operations. **For comparative purposes, the following table and discussion provides the reader with the results of Air Canada for the first quarter of 2008, which no longer includes the consolidation of Jazz, and the results of the Air Canada Services segment, which excluded the consolidation of Jazz, for the first quarter of 2007.**

Unaudited (Canadian dollars in millions except per share figures)	First Quarter 2008	 2007(3)	Change $	 %
Operating revenues				
Passenger	$ 2,311	$ 2,137	$ 174	8
Cargo	124	141	(17)	(12)
Other	292	262	30	11
	2,727	**2,540**	**187**	**7**
Operating expenses				
Wages, salaries and benefits	481	499	(18)	(4)
Aircraft fuel	715	585	130	22
Aircraft rent	63	79	(16)	(20)
Airport and navigation fees	241	243	(2)	(1)
Aircraft maintenance, materials and supplies	203	224	(21)	(9)
Communications and information technology	73	71	2	3
Food, beverages and supplies	77	80	(3)	(4)
Depreciation and amortization	171	128	43	34
Commissions	53	59	(6)	(10)
Capacity purchase with Jazz	235	230	5	2
Other	427	420	7	2
	2,739	**2,618**	**121**	**5**
Operating loss before the under-noted item	**(12)**	**(78)**	**66**	
Provision for cargo investigations	**(125)**	**-**	**(125)**	
Operating loss	**(137)**	**(78)**	**(59)**	
Non-operating income (expense)				
Interest income	18	26	(8)	
Interest expense	(81)	(91)	10	
Interest capitalized	17	36	(19)	
Gain (loss) on capital assets	(36)	7	(43)	
Gain (loss) on financial instruments recorded at fair value	(23)	34	(57)	
Other	(2)	(4)	2	
	(107)	8	(115)	
Loss before the following items	**(244)**	**(70)**	**(174)**	
Non-controlling interest	(3)	(2)	(1)	
Foreign exchange gain (loss)	(89)	33	(122)	
Recovery of income taxes	48	5	43	
Loss for the period	**$ (288)**	**$ (34)**	**$ (254)**	
EBITDAR before the provision for cargo investigations (1)	**$ 222**	**$ 129**	**$ 93**	
EBITDAR (1)	**$ 97**	**$ 129**	**$ (32)**	
Loss per share, basic and diluted (2)	**$ (2.88)**	**$ (0.34)**	**$ (2.54)**	

(1) See section 14 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR before the provision for cargo investigations to operating income (loss) and EBITDAR to operating income (loss).
(2) Earnings (losses) per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.
(3) Reflects the results of the Air Canada Services segment, which excluded the consolidation of Jazz, for the first quarter of 2007. Refer to section 2 of this MD&A for additional information on Air Canada's reportable segments prior to May 24, 2007.

For comparative purposes, the following discussion provides the reader with an analysis of the results of Air Canada for the first quarter of 2008, which no longer includes the consolidation of Jazz, in relation to the results of the Air Canada Services segment, which excluded the consolidation of Jazz, for the first quarter of 2007.

In the first quarter of 2008, Air Canada reported an operating loss of $12 million, before the provision for cargo investigations discussed above, compared to an operating loss of $78 million in the first quarter of 2007, an improvement of $66 million.

In the first quarter of 2008, EBITDAR amounted to $222 million, before the provision for cargo investigations, compared to EBITDAR of $129 million in the same period in 2007, an improvement of $93 million, despite an increase in fuel expense of $130 million.

System passenger revenues increased 8.1% over the first quarter of 2007

Passenger revenues increased $174 million or 8.1% to $2,311 million in the first quarter of 2008 due to growth in both system traffic and yield. The following factors contributed to the year-over-year change in first quarter system passenger revenues:

- An adjusted system yield improvement of 2.2% reflecting higher fares in the Canada and US transborder markets and increased fuel surcharges to partially offset higher fuel prices in the international markets.
- An adjusted RASM increase of 2.0% due to the growth in yield.
- Traffic growth of 4.4% on a capacity increase of 4.6%, resulting in a 0.2 percentage point decrease in passenger load factor from the first quarter of 2007.
- A stronger Canadian dollar in the first quarter of 2008, which lowers the Canadian dollar value of sales in foreign countries, had a negative impact on foreign currency denominated revenues, accounting for a decrease of $62 million to first quarter 2008 passenger revenues.

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

First Quarter 2008 Versus First Quarter 2007	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	8.7	5.5	4.9	(0.4)	3.6	3.1
US transborder	8.4	(1.9)	(0.6)	1.0	9.1	10.5
Atlantic	3.4	6.6	2.9	(2.9)	0.5	(3.0)
Pacific	(3.1)	1.9	0.8	(0.9)	(3.9)	(5.0)
Other	23.1	13.2	17.9	3.3	4.4	8.8
Other(1)	9.2	13.2	17.9	3.3	(7.4)	(3.5)
System	**8.1**	**4.6**	**4.4**	**(0.2)**	**3.6**	**3.4**
System(1)	**6.7**	**4.6**	**4.4**	**(0.2)**	**2.2**	**2.0**

(1) System and Other passenger revenue, yield and RASM percentage changes include the impact of adding back a $29 million adjustment, relating to a change in accounting estimates, to the first quarter of 2007.

Domestic passenger revenues increased 8.7% from the first quarter of 2007

Domestic passenger revenues of $922 million in the first quarter of 2008 increased $74 million or 8.7% from the first quarter of 2007, due to both yield and traffic growth. The following factors contributed to the year-over-year change in first quarter domestic passenger revenues:

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- A yield increase of 3.6% mainly due to fare increases to partially offset higher fuel prices.
- RASM growth of 3.1% due to the higher yield.
- Traffic growth of 4.9% on a capacity increase of 5.5% resulting in a decrease in passenger load factor of 0.4 percentage points from the first quarter of 2007. Capacity increases were largely reflected on the transcontinental services between central and western Canada and also on the Atlantic Canada services.

US transborder passenger revenues increased 8.4% from the first quarter of 2007

US transborder passenger revenues were $530 million in the first quarter of 2008, an increase of $41 million or 8.4% from the first quarter of 2007, due to a growth in yield. The following factors contributed to the year-over-year change in first quarter US transborder passenger revenues:

- A yield improvement of 9.1% due to fare increases to partially offset higher fuel prices.
- A passenger load factor improvement of 1.0 percentage point as the capacity reduction was greater than the decrease in traffic.
- The stronger Canadian dollar which had a negative impact on foreign currency denominated revenues. The impact accounted for a decrease of $20 million to first quarter 2008 passenger revenues.
- RASM growth of 10.5% due primarily to the yield improvement but also reflecting the higher passenger load factor.

Atlantic passenger revenues increased 3.4% from the first quarter of 2007

Atlantic passenger revenues of $370 million in the first quarter of 2008 increased $12 million or 3.4% from the first quarter of 2007, due primarily to traffic and, to a lesser extent, yield growth. The following factors contributed to the year-over-year change in first quarter Atlantic passenger revenues:

- A yield increase of 0.5% largely due to increased fuel surcharges to partially offset higher fuel prices. An increase in the proportion of higher-yielding business travelers was also a factor in the yield growth reflecting in part the attractiveness of Air Canada's new Executive First product.
- The stronger Canadian dollar which had a negative impact on foreign currency denominated revenues. The impact accounted for a decrease of $14 million to first quarter 2008 passenger revenues.
- Traffic growth of 2.9% on a capacity increase of 6.6% resulting in a decrease in passenger load factor of 2.9 percentage points. The increase in fuel surcharges to partially offset higher fuel prices and increased UK departure taxes passed onto customers have had an adverse impact on market demand in the United Kingdom. Traffic growth was reflected in the France and German markets as a result of capacity growth driven by the addition of the Boeing 777 aircraft in these markets.
- A RASM decrease of 3.0%, the result of the decrease in passenger load factor.

Pacific passenger revenues decreased 3.1% from the first quarter of 2007

Pacific passenger revenues of $205 million in the first quarter of 2008 decreased $7 million or 3.1% from the first quarter of 2007, due to a decline in yield. The following factors contributed to the year-over-year change in first quarter Pacific passenger revenues:

- A yield decrease of 3.9% reflecting in part the growth in longer-haul flying. The average stage length increased 12.5% from the same period in 2007. Long-haul flights generally have a lower yield than short-haul flights. When measured on a per mile basis, the average fare paid on long-haul flights is relatively lower than short-haul flights. An increase in the proportion of higher-yielding business travelers partly offset the yield decrease.
- The stronger Canadian dollar which had a negative impact on foreign currency denominated revenues. The impact accounted for a decrease of $9 million to first quarter 2008 passenger revenues.

- A traffic increase of 0.8% on a capacity increase of 1.9% resulting in a decline in passenger load factor of 0.9 percentage points. A 56.5% increase in Canada – China capacity was largely offset by the impact of a capacity reduction in the Japan market and the suspension of service to India. The traffic from Japan to Canada is being challenged by other global destinations as alternative places to travel for the Japanese. The rising Canadian dollar versus the declining Japanese Yen has also had an adverse impact on market demand in Japan. Although the China market has had strong traffic growth, the traffic growth has not yet surpassed the significant capacity increase in that market. With the Olympics scheduled for August, the demand has been rising continuously since the capacity additions.
- A decrease in RASM of 5.0% due to both the yield decrease and the decline in passenger load factor.

Other passenger revenues increased 23.1% from the first quarter of 2007

Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of $284 million in the first quarter of 2008 increased $54 million or 23.1% from the first quarter of 2007 or $25 million or 9.2%, after including a change in an accounting estimate applicable to the first quarter of 2007. The following factors contributed to the year-over-year change in first quarter other passenger revenues:

- Traffic growth of 17.9% on a capacity increase of 13.2% resulting in a passenger load factor improvement of 3.3 percentage points. Traffic growth in these markets mainly reflected higher capacity to traditional leisure destinations and the addition of a new non-stop service from Vancouver to Sydney, Australia. The more intense Canadian winter, combined with the factor that the Easter holiday was in March, resulted in additional traffic to traditional leisure destinations.
- An adjusted yield decline of 7.4% reflecting large capacity increases to sun destinations and, to a lesser extent, to South America. These capacity increases necessitated pricing actions to be taken to stimulate traffic which adversely impacted the yield performance. The average stage length increased 3.3% from the same period in 2007 and long-haul flights generally have a lower yield than short-haul flights.
- The stronger Canadian dollar which had a negative impact on foreign currency denominated revenues. The impact accounted for a decrease of $7 million to first quarter 2008 passenger revenues.
- An adjusted RASM decrease of 3.5% due to the decline in yield.

Cargo revenues declined 12% from the first quarter of 2007

First quarter 2008 cargo revenues amounted to $124 million and were $17 million or 12% below the first quarter of 2007, primarily due to reduced freighter revenues of $14 million arising from the termination of Asian freighter operations in mid-2007 and, to a lesser extent, from reduced Atlantic freighter flying in 2008. Non-freighter revenues were down $3 million or 3%. System cargo yield per revenue ton mile improved 5%. The following factors contributed to the year-over-year change in first quarter cargo revenues:

- System traffic declined 16% versus the 2007 quarter. Of this, reduced MD-11 freighter operations accounted for over three quarters of the reduction. Severe winter weather also had a negative impact in the quarter.
- MD-11 freighter operations to Asia were terminated in mid-2007 due to inadequate financial returns. Air Canada continues to operate one chartered MD-11 freighter to Europe, which will cease on June 30, 2008. This Atlantic freighter termination coincides with increased cargo capacity being offered in Europe through greater use of new Boeing 777 passenger aircraft which have a greater cargo capacity than the Airbus aircraft they are replacing.
- During the first quarter of 2008, a stronger Canadian dollar (with corresponding weaker foreign currencies) had a negative impact on the value of foreign currency denominated revenues.

Other revenues were up 11% from the first quarter of 2007

Other revenues of $292 million in the first quarter of 2008 increased $30 million or 11% from the first quarter of 2007. The following factors contributed to the year-over-year change in first quarter other revenues:

- A $12 million increase in aircraft sublease revenues.
- An $8 million increase in third party revenues at Air Canada Vacations.
- Other factors amounting to a net increase of $10 million.

Operating expenses increased 5% from the first quarter of 2007

Operating expenses were $2,739 million in the first quarter of 2008, an increase of $121 million or 5% over the first quarter of 2007. CASM in the first quarter of 2008 was unchanged from the first quarter of 2007. Excluding fuel expense, CASM declined 4.8% which was better than the projected CASM, which was provided in our news release dated February 7, 2008, where we projected CASM, excluding fuel expense, for the first quarter of 2008 to improve between 2% and 3% from the same period in 2007.

The following table compares Air Canada's operating expenses per ASM for the first quarter of 2008 to Air Canada's operating expenses per ASM for the corresponding period in 2007. Unit cost reductions were recorded in all major categories with the exception of fuel and ownership costs. A stronger Canadian dollar versus the US dollar and unit cost savings related to the Boeing 777 aircraft were among the more important factors in the unit cost decrease, excluding fuel expense, from the first quarter of 2007. During the first quarter of 2008, our Boeing 777 fleet produced 12.9% of our total ASM capacity and accounted for 1.8 percentage points in the unit cost improvement, including fuel expense. The higher unit cost of ownership reflects Air Canada's investment in new aircraft and the aircraft interior refurbishment program.

	First Quarter		Change	
(cents per ASM)	**2008**	**2007**	**cents**	**%**
Wages and salaries	2.49	2.58	(0.09)	(3.5)
Benefits	0.63	0.80	(0.17)	(21.3)
Ownership (DAR) (1)	1.51	1.40	0.11	7.9
Airport and navigation fees	1.57	1.65	(0.08)	(4.8)
Aircraft maintenance, materials and supplies	1.31	1.52	(0.21)	(13.8)
Communications and information technology	0.47	0.48	(0.01)	(2.1)
Food, beverages and supplies	0.50	0.54	(0.04)	(7.4)
Commissions	0.34	0.40	(0.06)	(15.0)
Capacity purchase with Jazz	1.52	1.56	(0.04)	(2.6)
Other	2.79	2.87	(0.08)	(2.8)
Operating expense, excluding fuel expense (2)	**13.13**	**13.80**	**(0.67)**	**(4.8)**
Aircraft fuel	4.64	3.97	0.67	16.9
Total operating expense	**17.77**	**17.77**	**-**	**-**

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

Wages, salaries and benefits amounted to $481 million in the first quarter of 2008, a decrease of $18 million or 4% from the first quarter of 2007.

Wages and salaries expense totaled $384 million in the first quarter of 2008, an increase of $3 million or 1% from the first quarter of 2007. Factors contributing to the year-over-year first quarter change in wages and salaries expense included:

- A quarter-over-quarter increase in 663 full-time equivalent ("FTE") employees or 2.8%, mainly reflecting growth in ground handling personnel, pilots and flight attendants. The increase was required to support the 4.6% growth in ASM capacity. Traffic increased 4.4% over the first quarter of 2007.
- Higher average wage rates established during the wage review process with the Corporation's unionized employees. The average wage increase over the first quarter of 2007 was less than 1%.
- Reduced overtime expenses of $3 million largely as a result of the growth in FTE employees and an increased focus on reducing overtime costs.
- Other factors, including a decrease in stock-based compensation expense and provisions related to voluntary separation packages recorded in the first quarter of 2007 but not recorded in the first quarter of 2008, amounting to a net decrease of $6 million.

Employee benefits expense amounted to $97 million in the first quarter of 2008, a decrease of $21 million or 18% from the first quarter of 2007. Factors contributing to the year-over-year first quarter change in benefits expense included:

- Revised pension actuarial estimates accounting for a decrease of $17 million to pension expense. The reduction in pension expense was mainly related to an increase from 5.00% to 5.75% in the discount rate used in calculating the present value of pension payments to be made in future years.

  Accounting for defined benefit pension plans requires the Corporation to make estimates. These include estimates of future salary increases for employees covered by defined benefit pension plans, employee turnover, life expectancy and the determination of the discount rate to be used in calculating the present value of pension payments to be made in future years. Specific components in the determination of annual pension expense include service cost, interest on pension obligations, actual returns on plan assets, amortization of unrecognized prior service costs, and amortization of a gain/loss component.

- A decrease of $4 million in post-retirement and post-employment benefit expense as a result of revised actuarial assumptions.

Fuel expense increased 22% from the first quarter of 2007

Fuel expense amounted to $715 million in the first quarter of 2008, an increase of $130 million or 22% from the first quarter of 2007. Factors contributing to the year-over-year first quarter change in fuel expense included:

- A higher base fuel price which accounted for an increase of $276 million.
- A volume-related increase of $13 million. The impact of an increase in ASM capacity was partly offset by the replacement of the Airbus A340 aircraft with more fuel efficient Boeing 777 aircraft and a reduction in flying from MD-11 freighter aircraft.
- The favourable impact of a stronger Canadian dollar versus the US dollar which accounted for a decrease of $117 million.
- Net fuel hedging gains of $32 million in the first quarter of 2008 versus net fuel hedging losses of $10 million in the first quarter of 2007, a favourable variance of $42 million.

Ownership costs increased 13% from the first quarter of 2007

Ownership costs, comprised of aircraft rent, depreciation and amortization expenses, of $234 million in the first quarter of 2008 increased $27 million or 13% from the first quarter of 2007. Factors contributing to the year-over-year first quarter change in ownership costs included:

- The addition of aircraft to Air Canada's operating fleet which accounted for an increase of $23 million.
- An increase in depreciation expenses of $20 million related to Air Canada's aircraft interior refurbishment program.
- Other factors amounting to a net increase of $8 million.

The above-noted increases were partially offset by the following:

- The impact of a stronger Canadian dollar versus the US dollar which accounted for a decrease of $9 million to aircraft rent expense.
- The removal of aircraft from Air Canada's fleet which accounted for a decrease of $9 million in aircraft rent expense and depreciation and amortization expenses.
- The impact of reduced MD-11 freighter flying versus 2007 which accounted for a decrease of $6 million to aircraft rent.

Airport and navigation fees decreased 1% from the first quarter of 2007

Airport and navigation fees of $241 million decreased $2 million or 1% from the first quarter of 2007 on a 4% increase to aircraft frequencies. Factors contributing to the year-over-year first quarter change in these fees included:

- Lower rates for landing and general terminal fees. Landing fees at Pearson Airport were reduced by 3.1% and terminal charges were reduced by 4.7% effective January 1, 2008.
- Navigation fees in Canada were reduced by 4% effective August 2007.

Aircraft maintenance, materials and supplies decreased 9% from the first quarter of 2007

Aircraft maintenance, materials and supplies of $203 million in the first quarter of 2008 decreased $21 million or 9% from the first quarter of 2007. Factors contributing to the year-over-year first quarter change in aircraft maintenance, materials and supplies expense included:

- The impact of a stronger Canadian dollar versus the US dollar accounted for a decrease of $19 million to aircraft maintenance, materials and supplies expense.
- A net reduction of $13 million in airframe and engine maintenance expenses. A decrease in maintenance expenses for the Airbus A319/A320/A340 aircraft and the Boeing 767-200 aircraft due to fewer events compared to the first quarter of 2007 was partially offset by an increase in maintenance expenses for the Airbus A321 and Boeing 767-300 aircraft. The reduction in maintenance events for the Airbus A319/A320/A340 aircraft was in large part due to the sale, sublease to third parties or lease return of aircraft previously in Air Canada's operating fleet. The increase in maintenance expenses for the Airbus A321 and Boeing 767-300 aircraft was due to timing of maintenance activities versus the first quarter of 2007.
- Other factors amounting to a net decrease of $6 million.

The above-noted decreases were partly offset by the following:

- A $12 million increase in expenses related to the preparation of aircraft to return to lessor or for sublease to third parties.
- Maintenance expenses for the Boeing 777 and Embraer ERJ-190 aircraft in the first quarter of 2008 amounting to $5 million versus nil in the first quarter of 2007.

Food, beverages and supplies decreased 4% from the first quarter of 2007

Food, beverages and supplies of $77 million in the first quarter of 2008 decreased $3 million or 4% from the first quarter of 2007, despite a passenger traffic growth of 4.4%. Certain cost saving initiatives implemented by Air Canada contributed to the quarter-over-quarter decrease.

Commission expense decreased 10% from the first quarter of 2007

Despite a combined passenger and cargo revenue growth of 7% over the first quarter of 2007, commission expense of $53 million in the first quarter of 2008 decreased $6 million or 10% from the first quarter of 2007. Factors contributing to the year-over-year first quarter change in commission expense included:

- The favourable impact of a new commission structure at Air Canada Vacations in 2007.
- Commercial initiatives implemented by Air Canada to lower commission costs.
- An increase in web penetration which lowers distribution and commission costs. Web penetration for domestic sales in the first quarter of 2008 was 65% while web penetration for combined Canada and US transborder sales was 54%. 75% of Canada and US sales in the first quarter of 2008 were made directly with Air Canada, either on-line or through call centres.

Capacity purchase fees paid to Jazz increased 2% from the first quarter of 2007

Capacity purchase fees paid to Jazz, pursuant to the capacity purchase agreement between Jazz and Air Canada ("Jazz CPA"), amounted to $235 million in the first quarter of 2008 compared to capacity fees paid to Jazz of $230 million in the first quarter of 2007, an increase of $5 million. The 2% increase in these fees was largely related to a 5% increase in hours flown by Jazz when compared to the first quarter of 2007. Air Canada and Jazz are parties to the Jazz CPA pursuant to which Air Canada purchases substantially all of Jazz's fleet capacity based on predetermined rates, in addition to reimbursing Jazz, without mark-up, for certain pass-through costs as defined in the Jazz CPA which include fuel, airport and user fees and other expenses. The fees include both a variable component that is dependent on Jazz aircraft utilization and a fixed component. The pass-through costs recorded by Air Canada pursuant to the Jazz CPA are reflected in Air Canada's respective income statement line categories.

Other operating expenses increased 2% from the first quarter of 2007

Other operating expenses amounted to $427 million in the first quarter of 2008, an increase of $7 million or 2% from the first quarter of 2007. The following table provides a breakdown of the more significant items included in other expenses.

Unaudited	First Quarter		Change	
(Canadian dollars in millions)	2008	2007	$	%
Other expenses				
Air Canada Vacations' land costs	$ 110	$ 106	$ 4	4
Credit card fees	49	45	4	9
Terminal handling	45	49	(4)	(8)
Building rent and maintenance	35	32	3	9
Crew expenses (meals, transportation and hotels)	28	28	-	-
Miscellaneous fees and services	26	27	(1)	(4)
Remaining other expenses	134	133	1	1
	$ 427	**$ 420**	**$ 7**	**2**

Non-operating expense amounted to $107 million in the first quarter of 2008

Non-operating expense amounted to $107 million in the first quarter of 2008 compared to non-operating income of $8 million in the first quarter of 2007. Factors contributing to the year-over-year first quarter change in non-operating expense included:

- An increase in net interest expense of $17 million. A lower amount of capitalized interest related to new aircraft and a decrease in interest income due to lower cash balances more than offset the $10 million decrease in interest expense. Although there was an increase in interest expense driven by the financing of additional aircraft in the quarter, this increase was more than offset by the impact of lower aircraft financing rates versus the first quarter of 2007 and the favourable impact of a stronger Canadian dollar versus the US dollar in the first quarter of 2008 compared to the first quarter of 2007.
- In the first quarter of 2008, Air Canada recorded an impairment charge of $38 million ($26 million net of tax) on its fleet of Boeing 767-200 aircraft due to the revised retirement date of the aircraft.
- In the first quarter of 2007, Air Canada recorded gains amounting to $7 million pertaining to the sale of one real estate property and to the sale of parked aircraft.
- Losses relating to fair value adjustment on certain derivatives instruments amounted to $23 million in the first quarter of 2008 versus gains of $34 million in the same quarter of 2007. Losses recorded in the first quarter of 2008 related to derivatives are described in section 7 of this MD&A.

Net losses on foreign currency monetary items amounted to $89 million in the first quarter of 2008

Net losses on foreign currency monetary items amounted to $89 million in the first quarter of 2008 versus a gain of $33 million in the first quarter of 2007. The loss in the first quarter of 2008 was largely attributable to a weaker Canadian dollar at March 31, 2008 compared to December 31, 2007, partially offset by gains of $79 million related to foreign currency derivatives. The March 31, 2008 noon date rate was $1US = Cdn $1.0279 while the December 31, 2007 noon date rate was $1US = Cdn $0.9881.

Recovery of income tax of $48 million in the first quarter of 2008

Income tax recovery was $48 million in the first quarter of 2008, representing an effective income tax rate of 14%, as compared to $5 million at an effective income tax rate of 13% for the same period in 2007. The effective income tax rate was impacted by the capital portion of certain foreign exchange losses reported in the first quarter of 2008 which were tax-effected at 50% of the income tax rate. In addition, no tax recovery was recorded on the provision for cargo investigations, which has the effect of reducing the effective tax rate.

Net loss amounted to $288 million in the first quarter of 2008

A net loss of $288 million was recorded in the first quarter of 2008 compared to a net loss of $34 million in the first quarter of 2007. The net loss in the first quarter of 2008 included a provision of $125 million related to alleged anti-competitive cargo pricing activities. Refer to section 12 of this MD&A for additional information.

4. Our Fleet

We are implementing our network redesign in the North American market through the increased use of large regional jet aircraft which have lower trip costs than conventional narrowbody aircraft. Air Canada had taken delivery of all 15 Embraer ERJ-175 aircraft by the end of 2006 and had taken delivery of all 45 Embraer ERJ-190 aircraft by the end of February 2008. In order to support the expansion of our international operations and reduce unit costs, we are progressively introducing Boeing 777 aircraft into our fleet. In the first quarter of 2008, three Boeing 777-200LR aircraft and one Boeing 777-300ER aircraft were added to our fleet. On April 22, 2008, Air Canada took delivery of one Boeing 777-300 aircraft for a total of 13 Boeing 777 aircraft delivered to date. At the same time as the new aircraft are being added to our fleet, Air Canada is removing older and less efficient aircraft. In the first quarter of 2008, Air Canada took the decision to retire its fleet of Boeing 767-200 aircraft, consisting of 10 aircraft, by the end of 2008. These older aircraft are high unit cost aircraft from both a fuel consumption and maintenance perspective.

The following table provides the existing and planned fleet changes to our fleet (excluding aircraft operated by Jazz):

	Actual							Planned							
Fleet Plan	**Year End 2007**	**New Deliveries**	**Sublease to Third Party**	**Lease returns**	**Sales**	**Parked**	**March 31, 2008**	**New Deliveries**	**Sublease/lease to Third Party / Sale by Air Canada**	**Lease returns**	**Sales**	**Parked**	**Year End 2008**	**2009 fleet changes**	**Year End 2009**
B777-300	5	1	-	-	-	-	6	5	-	-	-	-	**11**	**1**	**12**
B777-200	3	3	-	-	-	-	6	-	-	-	-	-	**6**	**-**	**6**
B767-300	31	-	-	-	-	-	31	-	-	(1)	-	-	**30**	**-**	**30**
B767-200	10	-	-	-	-	(1)	9	-	-	-	-	(9)	**-**	**-**	**-**
A340-300[(1)]	5	-	(1)	-	-	(2)	2	-	(2)	-	-	-	**-**	**-**	**-**
A330-300	8	-	-	-	-	-	8	-	-	-	-	-	**8**	**-**	**8**
A321	10	-	-	-	-	-	10	-	-	-	-	-	**10**	**-**	**10**
A320	41	-	-	-	-	-	41	-	-	-	-	-	**41**	**-**	**41**
A319[(2)]	37	-	-	-	-	(2)	35	-	-	-	-	-	**35**	**-**	**35**
ERJ-190	42	3	-	-	-	-	45	-	-	-	-	-	**45**	**-**	**45**
ERJ-175	15	-	-	-	-	-	15	-	-	-	-	-	**15**	**-**	**15**
Total	207	7	(1)	-	-	(5)	208	5	(2)	(1)	-	(9)	**201**	**1**	**202**
Average age (years)	**9.0**						**8.8**						**8.8**		**9.8**

(1) Two Airbus A340-300 aircraft were parked in the first quarter of 2008 pending their sublease to third parties.
(2) Two Airbus A319 aircraft were parked in the first quarter of 2008 pending their return to lessors.

Pursuant to the Jazz CPA, Jazz operates an operating fleet of 133 aircraft comprised of the following aircraft:

- 24 Bombardier CRJ-100 aircraft;
- 33 Bombardier CRJ-200 aircraft;
- 16 Bombardier CRJ-705 aircraft;
- 26 Dash 8-300 aircraft; and
- 34 Dash 8-100 aircraft.

Aircraft Interior Refurbishment Program

Air Canada commenced a refurbishment of the interior of its existing aircraft in 2006 in order to offer its customers a world class product. As at May 7, 2008, Air Canada has completed the refurbishment of 35 Airbus A319 aircraft, 34 Airbus A320 aircraft, 10 Airbus A321 aircraft and 23 Boeing 767-300 aircraft to date, for a total of 102 aircraft. Air Canada plans to refurbish an additional 15 aircraft by the end of 2008.

5. Financial and Capital Management

5.1 Financial Position

The following table provides the financial position of Air Canada as at March 31, 2008 and as at December 31, 2007.

Condensed Statement of Financial Position (Canadian dollars in millions)	March 31, 2008	December 31, 2007
Assets		
Cash, cash equivalents and short-term investments	$ 1,394	$ 1,239
Other current assets	1,262	1,239
Current assets	2,656	2,478
Property and equipment	7,737	7,919
Intangible assets	954	952
Other assets	514	488
	$ 11,861	**$ 11,837**
Liabilities		
Current liabilities	$ 3,065	$ 2,956
Long-term debt and capital leases	4,035	4,006
Pension and other benefits liabilities	1,773	1,824
Other long-term liabilities	568	424
	9,441	**9,210**
Non-controlling interest	**187**	**184**
Shareholders' equity	**2,233**	**2,443**
	$ 11,861	**$ 11,837**

5.2 Adjusted Net Debt

The following table reflects Air Canada's net debt balances and net debt to net debt plus equity ratio as at March 31, 2008 and as at December 31, 2007.

(Canadian dollars in millions)	March 31, 2008	December 31, 2007	Change
Total long-term debt and capital lease obligations	$ 4,035	$ 4,006	$ 29
Current portion of long debt and capital lease obligations	424	413	11
	4,459	4,419	40
Non-controlling interest	187	184	3
Less cash, cash equivalents and short-term investments	(1,394)	(1,239)	(155)
Net debt and non-controlling interest	**3,252**	**3,364**	**(112)**
Capitalized operating leases (1)	1,995	2,115	(120)
Adjusted net debt and non-controlling interest	**5,247**	**5,479**	**(232)**
Less pre-delivery (PDP) financing included in long-term debt	(324)	(521)	197
Adjusted net debt and non-controlling interest, excluding PDP financing	**$ 4,923**	**$ 4,958**	**$ (35)**
Shareholders' equity	**$ 2,233**	**$ 2,443**	**$ (210)**
Adjusted net debt to net debt plus equity ratio, excluding PDP financing	**68.8%**	**67.0%**	**1.8 pp**

(1) The Corporation includes capitalized operating leases which is a measure commonly used in the industry to ascribe a value to obligations under operating leases. Common industry practice is to multiply annualized aircraft rent expense by 7.5 as an estimate of the present value of operating lease obligations. This definition of capital is used by management and may not be comparable to similar measures presented by other public companies. Aircraft rent was $266 million for the twelve months ended March 31, 2008 and $282 million for the twelve months ended December 31, 2007. Aircraft rent expense 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.

At March 31, 2008, adjusted net debt and non-controlling interest, including capitalized operating leases, and excluding the pre-delivery payment ("PDP") financing, decreased $35 million from December 31, 2007. The adjusted net debt to net debt plus equity ratio for Air Canada increased to 68.8% at March 31, 2008 from 67.0% at December 31, 2007. The deterioration from December 31, 2007 in the ratio was attributable, in part, to the net loss recorded in the first quarter of 2008.

5.3 Liquidity

The Corporation's principal source of liquidity is cash generated from operations. Such cash generation fluctuates within any given year based on seasonal demand patterns. Positive cash from operations would generally take place in the second and third quarters while negligible or negative cash from operations would generally take place in the other quarters. There were no significant changes to how Air Canada monitors or manages liquidity from what was disclosed in Air Canada's 2007 MD&A dated February 6, 2008.

At March 31, 2008, Air Canada had cash, cash equivalents and short-term investments of $1,394 million. Cash, cash equivalents and short-term investments increased $155 million from December 31, 2007, primarily due to positive cash flows from operations of $230 million and the sale and leaseback of three Boeing 777 aircraft in the first quarter of 2008 offset by additions to capital assets.

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.

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 March 31, 2008 as compared to December 31, 2007.

(Canadian dollars in millions)	March 31, 2008	December 31, 2007	Change in working capital
Cash and short-term investments	$ 1,394	$ 1,239	$ 155
Accounts receivable	835	750	85
Other current assets	427	489	(62)
Accounts payable and accrued liabilities	(1,149)	(1,243)	94
Other current liabilities	(1,916)	(1,713)	(203)
	$ (409)	**$ (478)**	**$ 69**

The improvement in working capital was largely attributable to cash from operations. In addition, cash was favourably impacted by net proceeds of $85 million from the sale and leaseback of three Boeing 777 aircraft. During the quarter, additions to capital assets, net of the related financing and excluding the sale and leaseback transactions, amounted to $81 million and included three Embraer ERJ-190 aircraft, one Boeing 777 aircraft, expenditures related to the aircraft interior refurbishment program and inventory and spare engines.

5.4 Consolidated Cash Flow Movements

The following table provides Air Canada's consolidated cash flow movements for the periods indicated. Prior to May 24, 2007, Air Canada had two reportable segments: Air Canada Services (now referred to as Air Canada) and Jazz. Segment information provided useful information to shareholders as it enabled them to distinguish between the results of operations, cash and other assets and liabilities of the two segments. Effective May 24, 2007, Air Canada no longer consolidates the operations of Jazz.

	Three months ended March 31			
	2008	2007		
(Canadian dollars in millions)	Air Canada	Air Canada	Jazz	Total
Net cash provided by (used for) operating activities	$ (22)	$ (92)	$ 39	$ (53)
Changes in non-cash working capital	252	335	(2)	333
Cash flows from operating activities	230	243	37	280
Additions to capital assets	(403)	(426)	(7)	(433)
Free cash flow[1]	(173)	(183)	30	(153)
Proceeds from sale and leaseback transactions	411	-	-	-
Other	151	-	-	-
Cash flows from (used for) investing activities (excluding additions to capital assets)	562	(83)	-	(83)
Aircraft and facility related borrowings	187	112	-	112
Reduction of long-term debt and capital lease obligations	(322)	(78)	-	(78)
Other	-	(36)	(33)	(69)
Cash flows used for financing activities	(135)	(2)	(33)	(35)
Net increase (decrease) in cash and cash equivalents	254	(268)	(3)	(271)
Net increase (decrease) in short-term investments	(99)	127	-	127
Net increase (decrease) in cash, cash equivalents and short term investments	$ 155	$ (141)	$ (3)	$ (144)

(1) Free cash flow is a non-GAAP measure used by management and is not likely to be comparable to measures presented by other public companies. Air Canada considers free cash flow to be an indicator of the financial strength and performance of its business because it shows how much cash is available to repay debt, meet ongoing financial obligations and reinvest in the Corporation.

Air Canada's free cash flow for the first quarter of 2008 improved $10 million from the first quarter of 2007, excluding the consolidation of Jazz operations. The improvement in free cash flow was largely related to an improvement in operating results compared to the first quarter of 2007 partially offset by an unfavourable change in non-cash working capital items. The unfavourable change in non-cash working capital items was mainly attributable to growth in accounts receivable due to the timing of passenger sales.

5.5 Contractual Obligations

The table below provides Air Canada's current contractual obligations as at March 31, 2008 for the remainder of 2008, for the next four years and after 2012. Air Canada's capital expenditure projections, including the pre-delivery payments, have been amended to reflect a delay in the deliveries of the Boeing 787 aircraft. Refer to section 5.6 for additional information.

Contractual Obligations (Canadian dollars in millions)	**Remainder of 2008**	**2009**	**2010**	**2011**	**2012**	**Thereafter**	**Total**
Long-term debt obligations (1)	$ 228	$ 293	$ 272	$ 278	$ 281	$ 2,155	$ 3,507
Debt consolidated under AcG-15 (1)	122	105	153	340	93	193	1,006
Capital lease obligations (1)	204	152	147	142	184	588	1,417
Operating lease obligations (2)	220	290	278	214	196	624	1,822
Committed capital expenditures (3)	291	29	53	84	457	3,779	4,693
Foreign exchange derivatives	22	-	-	-	-	-	22
Total contractual obligations (4)	**$ 1,087**	**$ 869**	**$ 903**	**$ 1,058**	**$ 1,211**	**$ 7,339**	**$ 12,467**
Pension funding obligations (5)	$ 266	$ 328	$ 338	$ 348	$ 358	N/A	N/A

(1) Includes both the principal and the interest component of the payment obligations on long-term debt and capital leases and is based on interest rates and the applicable foreign exchange rate effective as at March 31, 2008.
(2) Mainly relate to US dollar aircraft operating leases.
(3) Mainly relate to US dollar aircraft-related expenditures. Also include purchases relating to system development costs, facilities and leasehold improvements.
(4) Excludes commitments for goods and services required in the ordinary course of business. Also excluded are future income taxes and other long-term liabilities mainly due to reasons of uncertainty of timing of cash flows and items which are non-cash in nature.
(5) There were no changes to Air Canada's pension plan funding obligations from those disclosed in Air Canada's 2007 MD&A dated February 6, 2008.

5.6 Capital Expenditures and Related Financing Arrangements

In 2004, Air Canada signed a definitive purchase agreement with Empresa Brasileira de Aeronautica S.A. ("Embraer") for the acquisition of regional jet aircraft. In November 2005, Air Canada also concluded agreements with The Boeing Company ("Boeing") for the acquisition of Boeing 777 and Boeing 787 aircraft.

Boeing

As at March 31, 2008, 11 of the 16 Boeing 777 firm aircraft under the purchase agreement with Boeing had been delivered, with the remaining five firm deliveries expected to be delivered by November 2008. The seven aircraft delivered in 2007 were financed under a loan guarantee facility with the Export-Import Bank of the United States ("EXIM"). In January 2008, the Corporation received a commitment for loan guarantee support from EXIM for all nine 2008 Boeing 777 firm aircraft deliveries. The loan guarantee, subject to certain conditions, covers a 12-year loan term for 85% of the capital expenditure at an interest rate based on a floating rate. The table below assumes that Air Canada will use the EXIM guarantee facility for five of the nine aircraft in 2008. Air Canada is currently reviewing its financing alternatives and may not utilize EXIM financing on all remaining 2008 deliveries. As at May 7, 2008, five of the nine 2008 Boeing 777 aircraft had been delivered, one of these aircraft was financed using the EXIM facility and the other four aircraft were, concurrently with the purchase, sold and leased back to Air Canada.

As at March 31, 2008, Air Canada had completed the sale and leaseback of three of these Boeing 777 aircraft and the sale and leaseback of a fourth aircraft was completed in April 2008. The four leases are accounted for as operating leases with 12-year terms. All leases are at market rates. These sale and leaseback transactions replace an equivalent number of aircraft loan guarantee commitments provided by EXIM.

Boeing has notified Air Canada that its first Boeing 787 aircraft originally scheduled for delivery in 2010 is now scheduled for delivery in 2012, with additional deliveries, originally scheduled for completion between 2010 and 2014, being delayed by approximately two to two and a half years. Air Canada will be seeking compensation from Boeing and evaluating alternatives to mitigate any potential impact of this delay on Air Canada's international growth strategy. Air Canada's capital expenditure projections, including the pre-delivery payments, have been amended to reflect this delay. Refer to the table below for Air Canada's current projected planned and committed capital expenditures.

Embraer

By the end of February 2008, the last three ERJ-190 aircraft had been delivered, with a total of 15 Embraer ERJ-175 aircraft and 45 Embraer ERJ-190 aircraft currently in Air Canada's fleet. As at March 31, 2008, 25 options for Embraer ERJ-190 series aircraft remained exercisable. The three firm ERJ-190 aircraft delivered in the first quarter of 2008 were financed through loan commitments from third parties covering approximately 80% of the capital expenditure to be repaid in quarterly instalments for a 12-year term. The loan commitments for two of the three aircraft are based on floating rates at the 90-day US LIBOR plus 1.90% and the loan commitment for one of the three aircraft is based at the fixed rate equivalent of the 90-day US LIBOR plus 1.70%.

Projected Planned and Committed Capital Expenditures

The table below provides Air Canada's current projected planned and committed capital expenditures for the full year 2008 (including first quarter of 2008 capital expenditures), for the next four years and after 2012. Air Canada's capital expenditure projections, including the pre-delivery payments, have been amended to reflect the delay in the deliveries of the Boeing 787 aircraft.

Air Canada Projected planned and committed Capital expenditures ($ millions) (1)(2)	**2008**	**2009**	**2010**	**2011**	**2012**	**Thereafter**
Projected committed expenditures	$ 513	$ 29	$ 53	$ 84	$ 457	$ 3,779
Projected planned but uncommitted expenditures	245	175	169	134	85	
Total projected expenditures	758	204	222	218	542	
Projected financing on committed expenditures	(614)	-	-	-	(404)	
Total projected expenditures, net of financing	**$ 144**	**$ 204**	**$ 222**	**$ 218**	**$ 138**	

(1) US dollar amounts are converted using the March 31, 2008 noon day rate of 1US$ = Cdn$1.0279. 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 March 31, 2008.

(2) The dollar amounts reflected above do not include obligations pertaining to day-to-day operations.

5.7 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 April 30, 2008	**At December 31, 2007**
Issued and outstanding shares		
Class A variable voting shares	15,932,399	16,476,999
Class B voting shares	84,067,601	83,523,001
Total issued and outstanding shares	**100,000,000**	**100,000,000**
Class A variable voting and Class B voting shares potentially issuable		
Stock options	1,731,092	1,695,035
Total shares potentially issuable	**1,731,092**	**1,695,035**
Total outstanding and potentially issuable shares	**101,731,092**	**101,695,035**

6. Quarterly Financial Data

Prior to May 24, 2007, Air Canada had two reportable segments: Air Canada Services (now referred to as Air Canada) and Jazz. Segment information provided useful information to shareholders as it enabled them to distinguish between the results of operations, cash and other assets and liabilities of the two segments. Effective May 24, 2007, Air Canada no longer consolidates the operations of Jazz. The table below summarizes quarterly financial results and major operating statistics for Air Canada, excluding the consolidation of Jazz operations, for the last eight quarters. The amounts in the table below include inter-segment revenues and expenses between Air Canada and Jazz for the applicable periods.

($ millions, except per share figures)	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008
Air Canada								
Operating revenues	$ 2,583	$ 2,861	$ 2,423	$ 2,540	$ 2,639	$ 2,954	$ 2,513	$ 2,727
Special charge for Aeroplan miles (1)	-	(102)	-	-	-	-	-	-
Operating revenues	**2,583**	**2,759**	**2,423**	**2,540**	**2,639**	**2,954**	**2,513**	**2,727**
Ownership (DAR) (2)	(208)	(205)	(218)	(207)	(211)	(210)	(202)	(234)
Other operating expenses	(2,262)	(2,424)	(2,210)	(2,411)	(2,340)	(2,393)	(2,239)	(2,505)
Operating expenses	**(2,470)**	**(2,629)**	**(2,428)**	**(2,618)**	**(2,551)**	**(2,603)**	**(2,441)**	**(2,739)**
Operating income (loss) before the under-noted item	**113**	**130**	**(5)**	**(78)**	**88**	**351**	**72**	**(12)**
Provision for cargo investigations (3)	-	-	-	-	-	-	-	(125)
Operating income (loss)	**113**	**130**	**(5)**	**(78)**	**88**	**351**	**72**	**(137)**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	39	(86)	(139)	44	67	(78)	(37)	(151)
Net income (loss)	**$ 152**	**$ 44**	**$ (144)**	**$ (34)**	**$ 155**	**$ 273**	**$ 35**	**$ (288)**
Revenue passenger miles (millions)	12,248	14,345	11,160	11,814	12,580	14,789	11,446	12,331
Available seat miles (millions)	14,925	17,528	14,343	14,735	15,220	18,144	14,715	15,407
Passenger load factor (%)	82.1	81.8	77.8	80.2	82.7	81.5	77.8	80.0
Operating expense per available seat mile (CASM) (cents)	16.5	15.0	16.9	17.7	16.7	14.3	16.6	17.8
CASM, excluding fuel expense (cents) (4)	12.3	10.7	12.9	13.8	12.6	10.4	12.4	13.1
EBITDAR before the provision for cargo investigations (4)	**$ 321**	**$ 335**	**$ 213**	**$ 129**	**$ 299**	**$ 561**	**$ 274**	**$ 222**
EBITDAR (4), excluding the special charges for Aeroplan miles and labour restructuring	**$ 321**	**$ 437**	**$ 205**	**$ 129**	**$ 299**	**$ 561**	**$ 274**	**$ 97**
EBITDAR (4)	**$ 321**	**$ 335**	**$ 213**	**$ 129**	**$ 299**	**$ 561**	**$ 274**	**$ 97**
Earning (loss) per share - Basic and diluted (5)	**$ 1.72**	**$ 0.50**	**$ (1.55)**	**$ (0.34)**	**$ 1.55**	**$ 2.73**	**$ 0.35**	**$ (2.88)**

(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 and amortization expenses.
(3) A provision for cargo investigations of $125 million was recorded in the first quarter of 2008.
(4) See section 14 "Non-GAAP Financial Measures" in this MD&A for additional information.
(5) Earnings (losses) per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.

The table below summarizes quarterly financial results for Jazz for the second quarter of 2006 to the second quarter of 2007. Jazz results were not consolidated within Air Canada effective May 24, 2007.

($ millions)	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 2007
Jazz					
Operating revenues	**$ 340**	**$ 369**	**$ 352**	**$ 364**	**$ 249**
Ownership (DAR) [(1)]	(40)	(40)	(39)	(40)	(26)
Other operating expenses	(263)	(290)	(280)	(288)	(197)
Operating expenses	**(303)**	**(330)**	**(319)**	**(328)**	**(223)**
Operating income	**37**	**39**	**33**	**36**	**26**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	-	-	(1)	(1)	1
Net income	**$ 36**	**$ 39**	**$ 32**	**$ 35**	**$ 27**

(1) DAR refers to the combination of Aircraft rent and Depreciation and amortization expenses.

The table below summarizes quarterly consolidated financial results for the Corporation and Jazz for the last eight quarters. The results below reflect the consolidation of Jazz only up to May 24, 2007.

($ millions, except per share figures)	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008
Consolidated Total								
Operating revenues	$ 2,559	$ 2,837	$ 2,395	$ 2,510	$ 2,622	$ 2,954	$ 2,513	$ 2,727
Special charge for Aeroplan miles [(1)]	-	(102)	-	-	-	-	-	-
Operating revenues	**2,559**	**2,735**	**2,395**	**2,510**	**2,622**	**2,954**	**2,513**	**2,727**
Ownership (DAR) [(2)]	(239)	(237)	(247)	(237)	(231)	(210)	(202)	(234)
Other operating expenses	(2,171)	(2,329)	(2,119)	(2,315)	(2,277)	(2,393)	(2,239)	(2,505)
Operating expenses	**(2,410)**	**(2,566)**	**(2,366)**	**(2,552)**	**(2,508)**	**(2,603)**	**(2,441)**	**(2,739)**
Operating income (loss) before the under-noted item	**149**	**169**	**29**	**(42)**	**114**	**351**	**72**	**(12)**
Provision for cargo investigations [(3)]	-	-	-	-	-	-	-	(125)
Operating income (loss)	**149**	**169**	**29**	**(42)**	**114**	**351**	**72**	**(137)**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	3	(125)	(173)	8	41	(78)	(37)	(151)
Net income (loss)	**$ 152**	**$ 44**	**$ (144)**	**$ (34)**	**$ 155**	**$ 273**	**$ 35**	**$ (288)**
Earning (loss) per share - Basic and diluted [(4)]	**$ 1.72**	**$ 0.50**	**$ (1.55)**	**$ (0.34)**	**$ 1.55**	**$ 2.73**	**$ 0.35**	**$ (2.88)**

(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 and amortization expenses.
(3) A provision for cargo investigations of $125 million was recorded in the first quarter of 2008.
(4) Earnings (losses) per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.

7. Financial Instruments and Risk Management

As described in section 9 of this MD&A, the Corporation adopted CICA sections 3862 and 3863 effective January 1, 2008. These new standards enhance disclosures with respect to financial instruments.

Risk Management

The Corporation is exposed to the following risks as a result of holding financial instruments: interest rate risk, foreign exchange risk, liquidity risk, market risk and fuel risk. The following is a description of these risks and how they are managed.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Corporation enters into both fixed and floating rate debt and also leases certain assets where the rental amount fluctuates based on changes in short-term interest rates. The Corporation manages interest rate risk on a portfolio basis and seeks financing terms in individual arrangements that are most advantageous taking into account all relevant factors, including credit margin, term and basis. The risk management objective is to minimize the potential for changes in interest rates causing adverse changes in cash flows to the Corporation. The temporary investment portfolio which earns a floating rate of return is an economic hedge for a portion of the floating rate debt.

The ratio of fixed to floating rate debt outstanding is designed to maintain flexibility in the Corporation's capital structure and is based upon a long-term objective of 60% fixed and 40% floating. The current ratio is 66% fixed and 34% floating, including the effects of interest rate swap positions.

The following are the current derivatives employed in interest rate risk management activities and the adjustments recorded in the first quarter of 2008:

- The Corporation's one remaining Embraer ERJ-190 aircraft interest swap contract matured with a fair value of $2 million in favour of the counterparty. No gain or loss was recorded during the period.

- The Corporation recorded a gain of $5 million on interest rate swaps relating to two Boeing 767 aircraft. These interest rate swaps convert the lease payments on the two aircraft leases from fixed to floating rates.

- The Corporation entered into two cross-currency interest rate swap agreements with terms of March 2019 and May 2019, respectively, relating to Boeing 777 aircraft financing, with an aggregate notional value of $202 million (USD$197 million). These swaps convert US denominated debt principal and interest payments into Canadian denominated debt at a foreign exchange rate of par (US$1/CAD$1) and convert from a fixed rate of 5.208% to a floating rate. These derivative instruments have not been designated as hedges for accounting purposes and are fair-valued on a quarterly basis. As at March 31, 2008, the fair value of these contracts was $6 million in favour of the Corporation.

Foreign Exchange Risk

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The majority of the Corporation's outstanding debt is denominated in US dollars. The US dollar debt acts as an economic hedge against the related aircraft, which is routinely purchased and sold by Air Canada in US dollars.

The Corporation is also exposed to foreign exchange risk on foreign currency denominated trade receivables and foreign currency denominated net cash flows.

The Corporation's risk management objective is to reduce cash flow risk related to foreign denominated cash flows. To help manage this risk, the Corporation enters into certain foreign exchange forward contracts or currency swaps to manage the risks associated with foreign currency exchange rates. At March 31, 2008, the Corporation had entered into foreign currency forward contracts and option agreements converting US dollars and Euros into Canadian dollars on $1,632 million (US$1,588 million) and $24 million (EUR 15 million) which mature in 2008 and 2009. The fair value of these foreign currency contracts as at March 31, 2008 was $22 million in favour of third parties (December 31, 2007 - $124 million in favour of third parties on $2,132 million (US$2,158 million) and $26 million (EUR 18 million) which mature in 2008 and 2009). During the first quarter of 2008, a gain of $79 million was recorded in foreign exchange gain (loss) related to these derivatives. These derivative instruments have not been designated as hedges for accounting purposes.

The cross-currency swap as described above under interest rate risk acts as an economic hedge of the foreign exchange risk on the financing related to two Boeing 777 aircraft with a principal amount of $202 million (US$197 million) as at March 31, 2008.

The Corporation had also entered into currency swap agreements for 11 CRJ aircraft. These agreements matured in January 2008 with a nominal fair value. No gain or loss was recorded during the period.

Liquidity risk

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities. The long-term debt issued by the Corporation generally has fixed principal and interest repayment requirements over the term of the instrument.

The Corporation monitors and manages liquidity risk by preparing rolling cash flow forecasts, maintaining flexibility in financing arrangements and having available its $400 million revolving credit facility.

Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: foreign exchange risk, interest rate risk and other price risk, which includes commodity price risk. Refer to the section "Asset-Backed Commercial Paper" below for information regarding these instruments held by the Corporation.

The Corporation is exposed to market risks through the derivative instruments entered into. The Corporation uses derivative instruments only for risk management purposes and not for generating trading profit. As such, any change in cash flows associated with derivative instruments due to their exposure to market risks is designed to be offset by changes in cash flows related to the risk being hedged.

Fuel Price Risk

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 March 31, 2008, Air Canada had hedged 33% of its projected fuel requirement for 2008, 11% of its projected fuel requirement for 2009 and 4% of its fuel requirement for 2010. The remainder of 2008 was hedged at prices that fluctuated between an average of US$103 to US$110 per barrel for jet-fuel based contracts, an average of US$95 to US$98 per barrel for heating oil-based contracts and an average of US$86 to US$95 per barrel for West Texas Intermediate ("WTI") crude-oil based contracts.

Since March 31, 2008, Air Canada has entered into new hedging positions, using swap and costless collar option structures, which have added 4% coverage to the remainder of 2008, 3% coverage to 2009 and 2% coverage to 2010. With these new hedging positions, the remainder of 2008 is hedged at prices that can fluctuate between an average of US$108 to US$116 per barrel for jet-fuel based contracts, an average of US$95 to US$99 per barrel for heating oil-based contracts and an average of US$88 to US$97 per barrel for WTI crude-oil based contracts.

The following information summarizes the financial statement impact of derivatives designated under fuel hedge accounting, before the impact of tax:

- The fair value of outstanding fuel derivatives under hedge accounting at March 31, 2008 was $147 million in favour of the Corporation. At April 30, 2008, the fair value of the outstanding fuel derivatives was $216 million.

- The change in fair value of derivatives during the period was $112 million:

    - The unrealized effective change in the fair value of derivatives recorded in other comprehensive income ("OCI") during the first quarter of 2008 was $134 million before tax expense of $42 million. The realized effective change in the fair value of derivatives recorded in OCI during the first quarter of 2008 was $12 million before tax expense of $4 million. OCI amounts for the three months ended March 31, 2008 are presented net of this tax expense on Air Canada's consolidated statement of comprehensive income.

    - The ineffective change in the fair value of derivative recorded in non-operating income (expense) for the first quarter of 2008 was ($38) million. The ineffective portion is calculated as the difference between the intrinsic value and fair market value of the derivatives as well as the difference between the Air Canada proxy derivative and the counterparty derivative. The increasing amount being recorded in non-operating income (expense) is due to the intrinsic value of the derivatives being higher than the fair market value caused by the rising market price of fuel in comparison to the exercise prices of Air Canada derivatives.

    - The depreciation of the Canadian dollar during the first quarter of 2008 resulted in a foreign exchange gain on fuel derivative contracts of $4 million on USD denominated fuel derivative contracts, which was recorded in foreign exchange gain (loss) on Air Canada's consolidated statement of operations.

- During the first quarter of 2008, hedge accounting was discontinued for certain fuel hedge contracts, with a fair value of $8 million, where the hedging relationship ceased to satisfy the conditions for hedge accounting. The fair value of the contracts that have not settled are now included in derivatives not under hedge accounting. The Corporation continues to hold these derivatives as it believes they continue to be good economic hedges in managing its exposure to jet fuel prices. The value of the accumulated other comprehensive income ("AOCI") balance recognized in connection with these derivatives will be taken into fuel expense upon the maturity of the contracts.

- During the first quarter of 2008, fuel derivative contracts matured with fair values in favour of the Corporation for $32 million. This maturity amount includes $8 million for de-designated contracts.

- During the first quarter of 2008, the benefit to fuel expense was $34 million before tax expense of $11 million. This benefit was recognized through the removal of the amount from AOCI. Included in this amount was $7 million related to the de-designated contracts.

- During the first quarter of 2008, the net impact to AOCI was an increase of $112 million before tax expense of $35 million. As at March 31, 2008, the balance in AOCI was $196 million before tax. The estimated net amount of existing gain and losses reported in AOCI that is expected to be reclassified to net income (loss) during the following 12 months is $172 million before tax.

The following information summarizes the financial statement impact of derivatives not designated under fuel hedge accounting, but held as economic hedges, before the impact of tax:

- During the first quarter of 2008, fuel derivative contracts matured in favour of the Corporation for $7 million.

- The fair value of outstanding fuel derivatives not under hedge accounting at March 31, 2008 was $9 million in favour of the Corporation.

- The change in fair value of the derivative contracts for the period was $6 million and was recorded in non-operating income (expense).

Asset-Backed Commercial Paper ("ABCP")

The Corporation has $37 million ($29 million, net of a fair value adjustment) in non-bank sponsored ABCP which has been recorded in deposits and other assets. These investments were scheduled to mature during the third quarter 2007. An agreement in principle to restructure the ABCP investments was approved by the Pan-Canadian Committee for Third Party Structured ABCP ("Committee") on December 23, 2007 and approved by vote, which occurred on April 25, 2008. The process is subject to a court hearing as to whether the plan is fair, which is expected in early May 2008. Under the terms of the restructuring, all of the ABCP would be exchanged for longer-term notes that will match the maturity of the underlying assets in the proposed structure. Air Canada is not accruing interest on these investments.

The carrying value as at March 31, 2008 is 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 discount 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. No adjustment to the carrying value was recorded during the first quarter of 2008.

8. Related Party Transactions

At March 31, 2008, ACE had a 75% ownership interest in Air Canada. Air Canada has various related party transactions with ACE and other ACE-related entities, including Aeroplan Limited Partnership ("Aeroplan"), ACTS Aero Technical Support & Services Inc. ("ACTS Aero") and Jazz. During the first quarter of 2008, ACE's ownership interest in Jazz was reduced to 9.5%. The relationships between Air Canada, Aeroplan, Jazz, ACTS Aero and ACE are described in Air Canada's 2007 MD&A dated February 6, 2008. There have been no material changes to related party agreements, including the commercial agreements between Air Canada and Jazz, from what was disclosed at that time.

The related party balances resulting from the payment obligations in respect of the application of the related party agreements were as follows:

(Canadian dollars in millions)	March 31, 2008	December 31, 2007
Accounts receivable		
ACE	$ 4	$ 9
Aeroplan	43	20
ACTS LP / ACTS Aero	104	75
	$ 151	**$ 104**
Prepaid Maintenance		
ACTS Aero	$ 15	$ 24
	$ 15	**$ 24**
Accounts payable and accrued liabilities		
ACTS LP / ACTS Aero	$ 94	$ 88
	$ 94	**$ 88**

Revenues and expenses with related parties are summarized as follows:

	First Quarter	
(Canadian dollars in millions)	**2008**	**2007**
Revenues		
Passenger revenues from Aeroplan related to Aeroplan rewards, net of purchases of Aeroplan miles	$ 40	$ 33
Property rental revenues from related parties	9	10
Revenues from information technology services to related parties	6	6
Revenues from corporate services and other	14	6
Cargo revenues from related parties	-	1
	$ 69	**$ 56**
Expenses		
Maintenance expense for services from ACTS LP / ACTS Aero	$ 140	$ 188
Other expenses	4	4
Recovery of wages, salary and benefit expense for employees assigned to related parties	(96)	(99)
	$ 48	**$ 93**

9. Changes in Accounting Policies

Capital Disclosures and Financial Instruments – Presentation and Disclosure

Effective January 1, 2008 the Corporation adopted three new CICA accounting standards: section 1535, *Capital Disclosures*, section 3862, *Financial Instruments – Disclosures* and section 3863, *Financial Instruments – Presentation*.

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

Sections 3862 and 3863 replace section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements in certain areas, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. Refer to section 7 of this MD&A for information on the Corporation's financial instruments.

For additional information on these new accounting standards, refer to Note 5 to Air Canada's interim unaudited consolidated financial statements for the first quarter of 2008.

Inventories

Effective January 1, 2008, the Corporation adopted CICA section 3031, *Inventories*, which replaced section 3030, *Inventories.* Section 3031 provides more extensive guidance on measurement, and expands disclosure requirements to increase transparency. The Corporation's accounting policy for aircraft fuel inventory is consistent with the measurement requirements in the new standard and, as a result, no adjustment was recorded on the transition, however, additional disclosures have been included in Air Canada's interim unaudited consolidated financial statements for the first quarter of 2008.

Future Accounting Standard Changes

In February 2008, the CICA issued section 3064, *Goodwill and Intangible Assets,* which provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. The standard is effective for fiscal years beginning on or after October 1, 2008, and requires retroactive application to prior period financial statements. The Corporation is in the process of evaluating the impact of this new standard for adoption on January 1, 2009.

10. Off-Balance Sheet Arrangements

There were no significant changes to Air Canada's off-balance sheet arrangements from what was disclosed in Air Canada's 2007 MD&A dated February 6, 2008.

11. Critical Accounting Estimates

Critical accounting estimates are those that are most important to the portrayal of the Corporation's financial condition and results of operations. They require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Actual results could differ from those estimates under different assumptions or conditions.

There were no significant changes to Air Canada's critical accounting estimates from what was disclosed in Air Canada's 2007 MD&A dated February 6, 2008.

12. 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 2007 MD&A dated February 6, 2008. 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 Air Canada's 2007 MD&A are revised to provide for the following updates:

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 the Corporation, a number of whom, including the Corporation, have received a statement of objections from the European Commission that sets out the European Commission's preliminary assessment in relation to such matter. The Corporation has provided its reply to the statement of objections. Competition authorities have sought or requested information from the Corporation as part of their investigations. The Corporation is cooperating with these investigations, which are likely to lead to proceedings against the Corporation and a number of airlines and other cargo operators in certain jurisdictions. The Corporation 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.

During the first quarter of 2008, the Corporation recorded a provision of $125 million as a preliminary estimate. This estimate is based upon the current status of the investigations and proceedings and the Corporation's assessment as to the potential outcome for certain of them. This provision does not address the proceedings in all jurisdictions, but only where there is sufficient information to do so. Management has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings. Additional material provisions may be required.

The risk factor describing the Air Canada Pilots Association ("ACPA") claim under Current Legal Proceedings is amended to reflect the revised date for the hearing of ACPA's appeal to the Ontario Court of Appeal, now scheduled to be heard on June 27, 2008.

The description of the risk factor related to Regulatory Matters is expanded to reference legislation being considered or enacted by governments (and which may apply to the airline industry), including in relation to carbon emission trading schemes, aimed at reducing carbon emissions.

13. Controls and Procedures

Disclosure Controls and Procedures

Air Canada's Audit, Finance and Risk Committee reviewed the first quarter 2008 MD&A and the first quarter 2008 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 2007 Annual Report contains a statement that the President and Chief Executive Officer and the Executive Vice President and Chief Financial Officer 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, 2007.

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 March 31, 2008 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

14. Non-GAAP Financial Measures

EBITDAR

EBITDAR (earnings before interest, taxes, depreciation, amortization and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before aircraft rent and depreciation and amortization as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. Management considers that the provision for cargo investigations is not reflective of the underlying financial performance of Air Canada from ongoing operations. Air Canada excludes this item as it could potentially distort the analysis of trends in business performance.

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 before the provision for cargo investigations and EBITDAR for Air Canada (previously "Air Canada Services") are reconciled to operating income (loss) as follows:

	First Quarter		
(Canadian dollars in millions)	**2008**	**2007**	**$ Change**
Air Canada			
GAAP operating loss before the provision for cargo investigations	$ (12)	$ (78)	$ 66
Add back:			
Aircraft rent	63	79	(16)
Depreciation and amortization	171	128	43
EBITDAR before the provision for cargo investigations	**222**	**129**	**93**
Add back:			
Provision for cargo investigations	(125)	-	(125)
EBITDAR	**$ 97**	**$ 129**	**$ (32)**

Operating Expense excluding Fuel Expense

Air Canada uses operating expense excluding fuel expense to assess the operating performance of its ongoing business without the effects of fuel expense. This item is excluded from Air Canada's results as it could potentially distort the analysis of trends in business performance. Fuel expense fluctuate widely depending on many factors including international market conditions, geopolitical events and the Canada/US exchange rate and excluding this expense from GAAP results allows Air Canada to compare its operating performance on a consistent basis.

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 for Air Canada (previously "Air Canada Services") is reconciled to operating expense as follows:

	First Quarter		
(Canadian dollars in millions)	**2008**	**2007**	**$ Change**
Air Canada			
GAAP operating expense	$ 2,739	$ 2,618	$ 121
Remove:			
Aircraft fuel	(715)	(585)	(130)
Operating expense, excluding fuel expense	**$ 2,024**	**$ 2,033**	**$ (9)**

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 and amortization and aircraft rent and 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;

Subsidiary or subsidiaries — refers to, in relation to Air Canada, to any entity, including a corporation or a limited partnership, which is controlled, directly or indirectly, by Air Canada.

Yield — Average passenger revenue per RPM.