



QUARTER 1 2009
Management's Discussion and Analysis of Results of
Operations and Financial Condition



MAY 8, 2009

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1. Highlights

The financial and operating highlights for the Corporation for the periods indicated are as follows. Refer to section 2 of this MD&A for additional information.

(Canadian dollars in millions except per share figures)	First Quarter		
	2009	2008	Change \$
Financial			
Operating revenues	2,391	2,727	(336)
Operating loss before a special provision ⁽¹⁾	(188)	(12)	(176)
Operating loss	(188)	(137)	(51)
Non-operating expense	(109)	(107)	(2)
Loss before non-controlling interest, foreign exchange and income taxes	(297)	(244)	(53)
Loss for the period	(400)	(288)	(112)
Operating margin before a special provision % ⁽¹⁾	(7.9%)	(0.4%)	(7.5) pp
Operating margin %	(7.9%)	(5.0%)	(2.9) pp
EBITDAR before a special provision ⁽¹⁾⁽²⁾	57	222	(165)
EBITDAR ⁽²⁾	57	97	(40)
EBITDAR margin before a special provision % ⁽¹⁾⁽²⁾	2.4%	8.1%	(5.7) pp
EBITDAR margin % ⁽²⁾	2.4%	3.6%	(1.2) pp
Cash, cash equivalents and short-term investments	1,087	1,394	(307)
Free cash flow	61	(173)	234
Adjusted debt/equity ratio	93.3%	68.8%	24.5 pp
Loss per share - basic and diluted	(\$4.00)	(\$2.88)	(\$1.12)
Operating Statistics			Change %
Revenue passenger miles (millions) (RPM)	10,984	12,331	(10.9)
Available seat miles (millions) (ASM)	13,821	15,407	(10.3)
Passenger load factor	79.5%	80.0%	(0.5) pp
Passenger revenue per RPM (cents)	18.2	18.7	(2.3)
Passenger revenue per ASM (cents)	14.5	15.0	(3.0)
Operating revenue per ASM (cents)	17.3	17.7	(2.3)
Operating expense per ASM ("CASM") (cents)	18.7	17.8	5.0
CASM, excluding fuel expense (cents)	14.4	13.1	9.4
Average number of full-time equivalent (FTE) employees (thousands) ⁽³⁾	22.7	24.0	(5.4)
Aircraft in operating fleet at period end ⁽⁴⁾	334	341	(2.1)
Average fleet utilization (hours per day) ⁽⁵⁾	9.1	9.9	(8.2)
Average aircraft flight length (miles) ⁽⁵⁾	841	876	(4.0)
Fuel price per litre (cents) ⁽⁶⁾	71.4	75.2	(5.1)
Fuel litres (millions)	827	947	(12.7)

(1) A provision related to investigations of alleged anti-competitive cargo pricing activities of \$125 million was recorded in the first quarter of 2008.

(2) See section 15 "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) Reflects FTE employees at Air Canada. Excludes FTE employees at Jazz.

(4) 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.

(6) Includes fuel handling and is net of fuel hedging results.

2. Introduction

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), the "Corporation" refers to, as the context may require, Air Canada and/or one or more of Air Canada's subsidiaries.

Air Canada's First Quarter 2009 MD&A provides the reader with a view of Air Canada from the perspective of management as well as an analysis of Air Canada's financial results for the first quarter of 2009 and includes a discussion on Air Canada's controls and procedures. This MD&A should be read in conjunction with Air Canada's interim unaudited consolidated financial statements and notes for the first quarter of 2009 and its annual audited consolidated financial statements and notes and its annual MD&A for 2008. 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 for the first quarter of 2009 are based on accounting policies consistent with those disclosed in Note 2 to the Corporation's annual audited consolidated financial statements for 2008 with the exception of the adoption, on January 1, 2009, of new Canadian Institute of Chartered Accountants ("CICA") accounting standard section 3064, *Goodwill and Intangible Assets*, and the adoption, on January 1, 2009, of the recommendations of the Emerging Issues Committee ("EIC") related to Abstract EIC-173 *Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*. Refer to section 9 of this MD&A for additional information.

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

Except as otherwise noted, all monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 16 "Glossary". Except as otherwise noted, this MD&A is current as of May 7, 2009.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of the risks relating to the Corporation, see section 18 "Risk Factors" of Air Canada's 2008 MD&A dated February 13, 2009 which can be found on SEDAR at www.sedar.com and on www.aircanada.com.

The Corporation issued a news release dated May 8, 2009 reporting on its results for the first quarter of 2009. 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. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including without limitation, industry, market, credit and economic conditions, the ability to reduce operating costs and secure financing, pension issues, energy prices, currency exchange and interest rates, employee and labour relations, competition, war, terrorist acts, epidemic diseases, insurance issues and costs, changes in demand due to the seasonal nature of the business, 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 section 18 "Risk Factors" of Air Canada's 2008 MD&A dated February 13, 2009. 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. Air Canada assumes that the North American economy will remain weak for the second quarter and remainder of 2009. In addition, Air Canada expects that the Canadian dollar will trade, on average, at Cdn \$1.23 per US dollar in the second quarter of 2009 and Cdn \$1.21 per US dollar for the full year 2009 and that the price of fuel will average 64 cents per litre in the second quarter of 2009 and will average 65 cents per litre for the full year 2009 (both net of fuel hedging positions).

3. Overview

Air Canada's results of operations for the first quarter of 2009 are discussed in section 4 of this MD&A and summarized below:

Air Canada recorded a loss of \$400 million or \$4.00 per diluted share in the first quarter of 2009 compared to a loss of \$288 million or \$2.88 per diluted share in the first quarter of 2008. The loss in the first quarter of 2009 included net foreign exchange losses of \$101 million. The foreign exchange losses were attributable to a weaker Canadian dollar at March 31, 2009 versus December 31, 2008 partly offset by gains of \$25 million related to foreign currency derivatives. The loss in the first quarter of 2008 included a provision related to cargo investigations and proceedings of \$125 million and losses on foreign exchange of \$89 million.

In the first quarter of 2009, Air Canada recorded an operating loss of \$188 million, a deterioration of \$176 million from the operating loss (before the provision for cargo investigations) of \$12 million recorded in the first quarter of 2008. EBITDAR amounted to \$57 million in the first quarter of 2009 compared to EBITDAR (before the provision for cargo investigations) of \$222 million in the same period in 2008, a decrease of \$165 million.

In the first quarter of 2009, operating revenues of \$2,391 million decreased \$336 million or 12% from the operating revenues of \$2,727 million recorded in the first quarter of 2008. The decrease in operating revenues was mainly due to a passenger revenue decline of \$300 million or 13% over the same period in 2008. The passenger revenue decline was due to both reduced traffic and lower yield. Traffic decreased 10.9% on a capacity reduction of 10.3%, resulting in a passenger load factor deterioration of 0.5 percentage points. Yield declined 2.3% from the first quarter of 2008. RASM decreased 3.0% over the same period in 2008, mainly due to the yield decline but also to the deterioration in passenger load factor. A weaker Canadian dollar in the first quarter of 2009, which increases the Canadian dollar value of sales in foreign countries, had a positive impact on foreign currency denominated revenues, accounting for an increase of \$67 million to first quarter 2009 passenger revenues compared to the first quarter of 2008.

In the first quarter of 2009, operating expenses of \$2,579 million decreased \$160 million or 6% from the operating expenses of \$2,739 million recorded the first quarter of 2008. The decrease in operating expenses was achieved in spite of \$170 million in additional expenses related to the weaker Canadian dollar versus the US dollar. Reduced fuel expense of \$122 million versus the same period in 2008 was the main factor in the decrease in operating expenses. All major expense categories reflected decreases over the first quarter of 2008 with the exception of ownership costs, comprised of aircraft rent and depreciation and amortization expense, capacity purchase fees paid to Jazz Air LP ("Jazz") pursuant to a capacity purchase agreement ("Jazz CPA") and communications and information technology expenses.

In the first quarter of 2009, CASM increased 5.0% from the first quarter of 2008. Excluding fuel expense, CASM increased 9.4% from the first quarter of 2008. The unfavourable impact of a weaker Canadian dollar versus the US dollar in the first quarter of 2009 was an important factor in the CASM growth over the first quarter of 2008. The capacity reduction of 10.3% over the first quarter of 2008 was also a factor in the year-over-year growth in CASM as Air Canada's cost structure is such that its fixed costs do not fluctuate proportionately with changes in capacity in the short term. In addition, certain variable costs are progressively being reduced, however, not at the same rate as the capacity reduction. Another factor in the increase in CASM over the first quarter of 2008 was the higher unit cost of ownership reflecting Air Canada's investment in new aircraft.

Air Canada is faced with significant challenges in 2009, including its ongoing liquidity requirements and lower demand for air travel. In addition to the risks related to a contracting economy, Air Canada faces and is monitoring various risks, including risks relating to fuel price and foreign exchange rates, pension funding obligations, covenants in credit card processing agreements, and a potential exposure to liabilities related to the investigations and proceedings surrounding alleged anti-competitive cargo pricing activities. These risks may have an impact on Air Canada's business, results from operations and financing condition, including its liquidity. For a discussion on Air Canada's liquidity risks, refer to section 9.3 of Air Canada's 2008 MD&A dated February 13, 2009 and section 6.3 of this MD&A.

4. Results of Operations – First Quarter 2009 versus First Quarter 2008

The following table and discussion compares the results of Air Canada for the first quarter of 2009 to its results for the first quarter of 2008.

(Canadian dollars in millions except per share figures)	First Quarter		Change	
	2009	2008	\$	%
Operating revenues				
Passenger	\$ 2,011	\$ 2,311	\$ (300)	(13)
Cargo	80	124	(44)	(35)
Other	300	292	8	3
	2,391	2,727	(336)	(12)
Operating expenses				
Aircraft fuel	593	715	(122)	(17)
Wages, salaries, and benefits	458	481	(23)	(5)
Airport and navigation fees	230	241	(11)	(5)
Capacity purchase with Jazz	246	235	11	5
Depreciation and amortization	159	171	(12)	(7)
Aircraft maintenance	189	203	(14)	(7)
Food, beverages and supplies	67	77	(10)	(13)
Communications and information technology	79	73	6	8
Aircraft rent	86	63	23	37
Commissions	49	53	(4)	(8)
Other	423	427	(4)	(1)
	2,579	2,739	(160)	(6)
Operating loss before the undernoted item	(188)	(12)	(176)	
Provision for cargo investigations	-	(125)	125	
Operating loss	(188)	(137)	(51)	
Non-operating income (expense)				
Interest income	6	18	(12)	
Interest expense	(105)	(81)	(24)	
Interest capitalized	1	17	(16)	
Loss on capital assets	-	(36)	36	
Loss on financial instruments recorded at fair value	(10)	(23)	13	
Other	(1)	(2)	1	
	(109)	(107)	(2)	
Loss before the following items	(297)	(244)	(53)	
Non-controlling interest	(4)	(3)	(1)	
Foreign exchange loss	(101)	(89)	(12)	
Recovery of income taxes	2	48	(46)	
Loss for the period	\$ (400)	\$ (288)	\$ (112)	
EBITDAR before the provision for cargo investigations ⁽¹⁾	\$ 57	\$ 222	\$ (165)	
EBITDAR ⁽¹⁾	\$ 57	\$ 97	\$ (40)	
Loss per share - Basic and diluted	\$ (4.00)	\$ (2.88)	\$ (1.12)	

(1) See section 15 "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).

System passenger revenues decreased 13.0% from the first quarter of 2008

Compared to the first quarter of 2008, passenger revenues decreased \$300 million or 13.0% to \$2,011 million in the first quarter of 2009 due to a decrease in traffic and, to a lesser extent, a decline in yield. A weak economy, a significant reduction in high-yield business travel, mainly the result of corporations reducing their business travel expenses, and competitive pricing activities were factors in the decrease in system passenger revenues. In the first quarter of 2009, Air Canada reduced its overall capacity by 10.3% from the first quarter of 2008. Capacity in the North American markets was reduced by 9.9% from the first quarter of 2008 while capacity in the international markets was reduced by 10.7% from the same period in 2008. Components of the year-over-year change in first quarter system passenger revenues included:

- In the first quarter of 2009, a traffic decline of 10.9% surpassed the capacity decrease of 10.3% resulting in a decline in passenger load factor of 0.5 percentage points from the first quarter of 2008. Passenger load factor declines were recorded in all markets with the exception of the Pacific market.
- In the first quarter of 2009, system yield decreased 2.3% from the first quarter of 2008, reflecting yield declines in all markets with the exception of the Atlantic and Pacific markets. The system yield decline reflected a weak economy, reduced high-yield business travel and increased competitive pricing activities. To retain premium cabin traffic, pricing actions were taken to offer additional discounted Executive and Executive First fares.
- A weaker Canadian dollar in the first quarter of 2009, which increases the Canadian dollar value of sales in foreign countries, had a positive impact on foreign currency denominated revenues, accounting for an increase of \$67 million to first quarter 2009 passenger revenues compared to the first quarter of 2008.
- In the first quarter of 2009, RASM decreased 3.0% from the first quarter of 2008 primarily due to the yield decline but also due to the passenger load factor decrease. RASM decreases were reflected in all markets with the exception of the Pacific market.

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

First Quarter 2009 Versus First Quarter 2008	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	(11.4)	(7.3)	(8.3)	(1.0)	(3.3)	(4.4)
US transborder	(17.2)	(13.7)	(14.4)	(0.7)	(3.4)	(4.1)
Atlantic	(12.7)	(9.7)	(12.9)	(2.7)	0.1	(3.4)
Pacific	(12.3)	(26.0)	(20.5)	6.2	10.2	18.5
Other	(11.2)	4.2	1.4	(2.2)	(12.4)	(14.8)
System	(13.0)	(10.3)	(10.9)	(0.5)	(2.3)	(3.0)

The system ASM capacity reduction of 10.3% in the first quarter of 2009 compared to the first quarter of 2008 was consistent with the 9.5% to 10.5% ASM capacity reduction projected in the Corporation's news release dated February 13, 2009.

Domestic passenger revenues decreased 11.4% from the first quarter of 2008

Domestic passenger revenues of \$817 million in the first quarter of 2009 decreased \$105 million or 11.4% from the first quarter of 2008 due to a reduction in traffic and, to a lesser extent, a decline in yield. A weak economy, a significant reduction in high-yield business travel, mainly the result of corporations reducing their business travel expenses, and competitive pricing activities were factors in the decrease in domestic passenger revenues. In the first quarter of 2009, Air Canada reduced its domestic capacity by 7.3% from the first quarter of 2008, reflecting capacity decreases on all services. Components of the year-over-year change in first quarter domestic passenger revenues included:

- In the first quarter of 2009, a traffic decline of 8.3% surpassed a capacity decrease of 7.3% resulting in a reduction in passenger load factor of 1.0 percentage point from the first quarter of 2008. Passenger load factor declines were recorded on all domestic services with the exception of services to the Maritimes.

- In the first quarter of 2009, domestic yield decreased 3.3% from the first quarter of 2008, reflecting a weak economic environment, a lower proportion of high-yield business traffic and increased fare discounting, particularly on transcontinental services within Canada.
- A weaker Canadian dollar in the first quarter of 2009 had a positive impact on foreign currency denominated revenues of \$14 million in the first quarter 2009.
- In the first quarter of 2009, RASM declined 4.4% from the first quarter of 2008 due to the yield decrease and, to a lesser extent, the passenger load factor decline.

US transborder passenger revenues decreased 17.2% from the first quarter of 2008

US transborder passenger revenues of \$439 million in the first quarter of 2009 decreased \$91 million or 17.2% from the first quarter of 2008 due to a decrease in traffic and, to a lesser extent, a decline in yield. A weak economy, a significant reduction in high-yield business travel and competitive pricing activities, mainly in the Chicago and New York services were factors in the decrease in US transborder passenger revenues. In the first quarter of 2009, US transborder capacity was reduced by 13.7% from the first quarter of 2008, reflecting capacity decreases on most services but particularly to the west coast of the US. Components of the year-over-year change in first quarter US transborder passenger revenues included:

- In the first quarter of 2009, a traffic decrease of 14.4% surpassed the capacity reduction of 13.7% resulting in a passenger load factor decrease of 0.7 percentage points from the first quarter of 2008. The contracting economy and reduced business travel demand adversely impacted US transborder traffic.
- In the first quarter of 2009, yield decreased 3.4% from the first quarter of 2008, reflecting a weak economic environment, a lower proportion of high-yield business traffic and increased fare discounting. Although most carriers reduced capacity overall on US transborder services, there was increased competitive capacity on the Chicago and New York services which contributed to the yield decline.
- In addition to the capacity reduction discussed above, there was a capacity reduction on the Hawaii service as a result of the introduction of a non-stop service from Vancouver to Sydney which was previously operated as a one-stop via Hawaii. The Vancouver – Sydney route is recorded in other passenger revenues.
- A weaker Canadian dollar in the first quarter of 2009 had a positive impact on foreign currency denominated revenue of \$23 million in first quarter 2009.
- In the first quarter of 2009, RASM decreased 4.1% from the first quarter of 2008 due to the yield decline and, to a lesser extent, the decrease in passenger load factor.

Atlantic passenger revenues decreased 12.7% from the first quarter of 2008

Atlantic passenger revenues of \$323 million in the first quarter of 2009 decreased \$47 million or 12.7% from the first quarter of 2008 due to a decrease in traffic. A weak economy, a significant reduction in high-yield business travel and competitive pricing activities were factors in the decrease in Atlantic passenger revenues. In the first quarter of 2009, capacity was reduced by 9.7% from the first quarter of 2008, reflecting capacity decreases on all Atlantic services, with the exception of Eastern Canada – Germany. Components of the year-over-year change in first quarter Atlantic passenger revenues included:

- In the first quarter of 2009, traffic decreased 12.9% on a capacity reduction of 9.7% resulting in a passenger load factor decrease of 2.7 percentage points from the first quarter of 2008.
- In the first quarter of 2009, yield improved 0.1% from the first quarter of 2008 in part due to increased fuel surcharges. In the first quarter of 2009, fuel surcharges were reduced from the peak levels experienced in 2008. Beginning in the second quarter of 2009, fuel surcharges will be lower than the corresponding period in 2008. Although an overall yield improvement was achieved in the economy cabin as a result of a more favourable fare mix, this yield improvement was offset by a yield decline in the premium cabin, the result of pricing pressures to maintain premium traffic. While yields on most Atlantic services showed growth year-over-year, yield on the U.K. services, with a higher proportion of business traffic, was adversely impacted by the weaker demand, which also resulted in additional seats being offered at discounted Executive First cabin fares to retain this traffic.
- A weaker Canadian dollar in the first quarter of 2009 had a positive impact on foreign currency denominated revenues of \$10 million in first quarter 2009.

- In the first quarter of 2009, RASM decreased 3.4% from the first quarter of 2008 due to the decrease in passenger load factor.

Pacific passenger revenues decreased 12.3% from the first quarter of 2008

Pacific passenger revenues of \$180 million in the first quarter of 2009 decreased \$25 million or 12.3% from the first quarter of 2008 due to a decrease in traffic resulting from reducing capacity. This decrease was partly offset by a yield improvement. In the first quarter of 2009, capacity was reduced by 26.0% from the first quarter of 2008, reflecting capacity decreases on all Pacific services. Components of the year-over-year change in first quarter Pacific passenger revenues included:

- In the first quarter of 2009, yield improved 10.2% from the first quarter of 2008, reflecting yield growth on all Pacific services, with the exception of Korea. A higher average fare in the economy cabin, as a result of an improvement in fare mix, and increased fuel surcharges versus the same period in 2008 more than offset a decline in yield in the premium cabin. The devaluation of the currency in Korea adversely impacted yield on the Pacific service.
- In the first quarter of 2009, traffic decreased 20.5% on a capacity reduction of 26.0% resulting in passenger load factor improvement of 6.2 percentage points from the first quarter of 2008. Passenger load factor improvements were reflected on all services.
- A weaker Canadian dollar in the first quarter of 2009, which increases the Canadian dollar value of sales in foreign countries, had a positive impact on foreign currency denominated revenues, accounting for an increase of \$12 million to first quarter 2009 Pacific passenger revenues compared to the first quarter of 2008.
- In the first quarter of 2009, RASM increased 18.5% from the first quarter of 2008 due to both the growth in yield and the passenger load factor improvement.

Other passenger revenues decreased 11.2% from the first quarter of 2008

Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of \$252 million in the first quarter of 2009 decreased \$32 million or 11.2% from the first quarter of 2008 due to a decline in yield. In the first quarter of 2009, capacity was increased by 4.2% from the first quarter of 2008, reflecting capacity increases in all markets, with the exception of the Caribbean and the South Pacific. Components of the year-over-year change in first quarter other passenger revenues included:

- In the first quarter of 2009, traffic increased 1.4% on a capacity growth of 4.2%, resulting in a decrease of 2.2 percentage points in passenger load factor compared to the first quarter of 2008. The capacity growth on the South America market and to traditional leisure destinations was not matched by the traffic growth on these services. Additional capacity to Brazil (caused by an upgauge from a Boeing 767 aircraft to the larger capacity Boeing 777 aircraft), and the seasonal non-stop service to Buenos Aires did not generate the expected additional traffic, while strong competition in Chile and Peru further impacted these markets.
- In the first quarter of 2009, yield decreased 12.4% from the first quarter of 2008. The weak economic conditions, reduced high-yield business travel, decreased fuel surcharges and competitive pricing pressures were factors in the yield decrease from the first quarter of 2008, particularly in the premium cabin. Increased competition and the additional capacity on the South America market and to the traditional leisure destinations also adversely impacted overall yield.
- A weaker Canadian dollar in the first quarter of 2009, which increases the Canadian dollar value of sales in foreign countries, had a positive impact on foreign currency denominated revenues, accounting for an increase of \$8 million to first quarter 2009 other passenger revenues compared to the first quarter of 2008.
- In the first quarter of 2009, RASM decreased 14.8% from the first quarter of 2008 due primarily to the decline in yield but also to the decrease in passenger load factor.

Cargo revenues decreased 35% from the first quarter of 2008

First quarter 2009 cargo revenues amounted to \$80 million and were \$44 million or 35% below the first quarter of 2008 on a 23% reduction to cargo capacity. The revenue reduction was mainly due to the current economic slowdown with reduced air cargo demand in most markets, the termination of the freighter operations in June 2008, and lower fuel surcharges in the first quarter of 2009 compared to the first quarter of 2008.

Freighter revenues declined \$16 million as no MD-11 freighter aircraft were operated in the first quarter of 2009 versus one MD-11 freighter operated to Europe in the same period in 2008.

Non-freighter revenues decreased \$28 million or 26%, reflecting reduced traffic in all markets. System cargo yield per revenue ton mile decreased 7% due to significantly reduced fuel surcharges and increased competitive pressure on rates only partly offset by positive currency.

Factors contributing to the year-over-year change in first quarter cargo revenues included:

- Traffic on non-freighter aircraft decreased by 20% compared to the first quarter of 2008, mainly due to the economic slowdown. Reduced cargo volumes in the domestic market with the termination of the Canada Post contract in mid-September 2008 and reduced capacity mainly on the Pacific and Atlantic markets were also contributing factors.
- System traffic, including 2008 freighter operations, declined 31% from the first quarter of 2008.
- In the first quarter of 2009, a weaker Canadian dollar (with corresponding stronger foreign currencies) had a positive impact of approximately \$7 million on the value of foreign currency denominated revenues.

Other revenues increased 3% from the first quarter of 2008

Other revenues of \$300 million in the first quarter of 2009 increased \$8 million or 3% from the first quarter of 2008. A \$14 million increase in aircraft sublease revenues, of which \$5 million was due to the favourable impact of foreign exchange on US denominated sublease revenues, was partly offset by other factors which contributed to a net decrease of \$6 million.

Excluding fuel expense, CASM increased 9.4% from the first quarter of 2008

Operating expenses were \$2,579 million in the first quarter of 2009, a decrease of \$160 million or 6% from the first quarter of 2008. This decrease was achieved in spite of \$170 million in additional expenses related to the weaker Canadian dollar versus the US dollar.

Unit cost in the first quarter of 2009, as measured by operating expense per available seat mile (CASM), increased 5.0% over the first quarter of 2008. Excluding fuel expense, CASM increased 9.4% year-over-year.

Factors contributing to the year-over-year change in first quarter CASM included:

- A weaker Canadian dollar versus the US dollar compared to the first quarter of 2008 increased operating expenses by \$170 million in the first quarter of 2009.
- Higher ownership costs reflecting Air Canada's investment in new aircraft.
- The capacity reduction was a factor in the year-over-year growth in CASM as Air Canada's cost structure is such that its fixed costs do not fluctuate proportionately with changes in capacity in the short term. For example, an 8.2% decrease in aircraft utilization in the first quarter of 2009 resulted in the spreading of aircraft ownership costs over fewer ASMs. In addition, certain variable costs are progressively being reduced, however, not at the same rate as the capacity reduction.
- A reduction of 4.0% in average stage length was also a contributing factor in the year-over-year increase in CASM compared to the first quarter of 2008.

The 9.4% increase in CASM for the first quarter of 2009, excluding fuel expense, was less than the projected CASM increase, excluding fuel expense, provided in the Corporation's news release dated February 13, 2009 in which CASM, excluding fuel expense, was projected to increase between 13.5% and 14.5% compared to the same period in 2008. The difference is primarily attributable to the fact that certain operating expenses recorded in the first quarter of 2009 were lower than anticipated. These expenses included pension and post-retirement benefits, aircraft maintenance, aircraft rent, capacity purchase fees paid to Jazz and commissions and expenses related to ground packages at Air Canada Vacations.

The following table compares Air Canada's operating expenses per ASM for the first quarter of 2009 to Air Canada's operating expenses per ASM for the corresponding period in 2008.

(cents per ASM)	First Quarter		Change	
	2009	2008	cents	%
Wages and salaries	2.73	2.49	0.24	9.6
Benefits	0.58	0.63	(0.05)	(7.9)
Ownership (DAR) ⁽¹⁾	1.77	1.51	0.26	17.2
Airport user fees	1.66	1.57	0.09	5.7
Capacity purchase with Jazz	1.78	1.52	0.26	17.1
Aircraft maintenance	1.36	1.31	0.05	3.8
Food, beverages and supplies	0.49	0.50	(0.01)	(2.0)
Communications and information technology	0.57	0.47	0.10	21.3
Commissions	0.36	0.34	0.02	5.9
Other	3.07	2.79	0.28	10.0
Operating expense, excluding fuel expense ⁽²⁾	14.37	13.13	1.24	9.4
Aircraft fuel	4.29	4.64	(0.35)	(7.5)
Total operating expense	18.66	17.77	0.89	5.0

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

(2) Refer to section 15 "Non-GAAP Financial Measures" in this MD&A for additional information.

Fuel expense decreased 17% from the first quarter of 2008

Fuel expense amounted to \$593 million in the first quarter of 2009, a decrease of \$122 million or 17% from the first quarter of 2008. Factors contributing to the year-over-year change in first quarter fuel expense included:

- A lower base fuel price which accounted for a decrease of \$270 million.
- A volume-related decrease of \$94 million, including the termination of freighter flying.

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

- Fuel hedging losses of \$127 million in the first quarter of 2009 versus fuel hedging gains of \$34 million in the first quarter of 2008, an unfavourable variance of \$161 million compared to the first quarter of 2008.
- The unfavourable impact of a weaker Canadian dollar versus the US dollar which accounted for an increase of \$81 million to fuel expense in the first quarter of 2009.

The table below provides Air Canada's fuel cost per litre, excluding and including hedging, for the periods indicated.

(Canadian dollars in millions except where indicated)	First Quarter		Change	
	2009	2008	\$	%
Aircraft fuel expense – GAAP ⁽¹⁾	\$ 591	\$ 712	\$ (121)	(17)
Less Fuel hedging accounting losses (gains) included in Aircraft fuel expense	127	(34)	161	(474)
Add Realized losses (gains) on fuel derivatives settled during the period (designated or not under hedge accounting)	44	(40)	84	(212)
Economic cost of fuel – non-GAAP ⁽²⁾	\$ 508	\$ 706	\$ (198)	(28)
Fuel consumption (thousands of litres)	827,290	946,807	(119,516)	(13)
Fuel cost per litre (cents) – GAAP	71.4	75.2	(3.7)	(5)
Fuel cost per litre (cents) – excluding fuel hedging	56.1	78.7	(22.6)	(29)
Economic fuel cost per litre (cents) – non-GAAP ⁽²⁾	61.5	74.6	(13.1)	(18)

(1) Fuel expense excludes fuel related to third party carriers operating under capacity purchase agreement, other than Jazz

(2) Economic cost of fuel is Air Canada's best estimate of the cash cost of fuel, net of the impact of fuel hedges settled in the period. It includes the actual net cash settlements from maturing hedge contracts during the period for both fuel hedges designated under hedge accounting and economic hedges. It excludes early terminated hedging contracts in Q1 2009 of \$172 million as these contracts relate to 2009 and 2010 fuel consumption.

Wages, salaries and benefits expense amounted to \$458 million in the first quarter of 2009, a decrease of \$23 million or 5% from the first quarter of 2008.

Wages and salaries expense totaled \$377 million in the first quarter of 2009, a decrease of \$7 million or 2% from the first quarter of 2008. Factors contributing to the year-over-year change in first quarter wages and salaries expense included:

- A decrease of an average of 1,300 full-time equivalent ("FTE") employees or 5.4%, primarily the result of the 10.3% reduction in ASM capacity.
- Provisions related to employee profit sharing plans of \$8 million in the first quarter of 2009 versus provisions of \$12 million in the first quarter of 2008, a decrease of \$4 million. The expense in 2009 is related to the "Sharing Our Success" plan which provides employees with financial rewards on a monthly basis when operational performance levels are achieved.
- Reduced overtime expenses in airport operations of \$3 million versus the same period in 2008, largely due to reduced weather-related events in the first quarter of 2009 versus the same period in 2008.

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

- A year-over-year increase in average wages of approximately 2.7% over the first quarter of 2008.
- Provisions relating to employee reduction programs amounted to \$11 million in the first quarter of 2009 versus nil in the first quarter of 2008.

Employee benefits expense amounted to \$81 million in the first quarter of 2009, a decrease of \$16 million or 16% from the first quarter of 2008, mainly due to reduced pension and post-employment benefits expenses as a result of revised actuarial assumptions. The actuarial assumptions used for recording pension expense under GAAP differ from those used in determining the solvency deficit and, as such, the change in pension expense does not bear any relationship to estimated pension funding in 2009. Refer to section 9.6 of Air Canada's 2008 MD&A dated February 13, 2009 and section 6.7 of this MD&A for a discussion on Air Canada's pension funding obligations.

Airport and navigation fees decreased 5% from the first quarter of 2008

Airport and navigation fees of \$230 million decreased \$11 million or 5% from the first quarter of 2008, mainly due to reduced frequencies. Factors contributing to the year-over-year change in first quarter airport and navigation fees included:

- An overall frequency reduction of 7% from the first quarter of 2008, combined with changes in schedule and aircraft types being operated to certain destinations, resulted in a net decrease to airport user fees.
- The impact of a weaker Canadian dollar versus the US dollar compared to the first quarter of 2008 partly offset these reductions, accounting for an increase of \$2 million to airport user fees.

Capacity purchase costs with Jazz increased 5% from the first quarter of 2008

Capacity purchase costs with Jazz, pursuant to the Jazz CPA, amounted to \$246 million in the first quarter of 2009 compared to \$235 million in the first quarter of 2008, an increase of \$11 million or 5%. This year-over-year increase in capacity purchase costs was mainly due to the unfavourable impact of foreign exchange on US denominated Jazz CPA expenses which accounted for an increase of \$16 million and a contractual increase in Jazz CPA rates of \$8 million compared to the same period in 2008. Partially offsetting these increases was the impact of reduced flying which accounted for a decrease of \$13 million to capacity purchase costs compared to the first quarter of 2008. Jazz ASM capacity was reduced by 10% in the first quarter of 2009 compared to the first quarter of 2008.

Ownership costs increased 5% from the first quarter of 2008

Ownership costs, comprised of aircraft rent, depreciation and amortization expenses, of \$245 million in the first quarter of 2009 increased \$11 million or 5% from the first quarter of 2008. Factors contributing to the year-over-year change in first quarter ownership costs included:

- The addition of new Boeing 777 aircraft to Air Canada's operating fleet which accounted for an increase of \$20 million. At March 31, 2009, Air Canada had 17 Boeing 777 aircraft in its operating fleet versus 12 Boeing 777 aircraft at March 31, 2008.
- The impact of a weaker Canadian dollar versus the US dollar which accounted for an increase of \$13 million to aircraft rent expense.

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

- A decrease in depreciation expense related to changes in aircraft residual values, the result of a weaker Canadian dollar versus the US dollar, which accounted for a decrease of \$11 million.
- A decrease of \$5 million to aircraft rent expense as a result of reduced MD-11 freighter flying as no MD-11 freighter aircraft were operated in the first quarter of 2009 versus one MD-11 freighter operated in the first quarter of 2008. Freight operations were terminated in June 2008.
- Expenses of \$4 million related to returning one Boeing 767-300 and two Airbus A319 aircraft to lessors in the first quarter of 2008. No such expenses were recorded in the first quarter of 2009.
- Other factors which contributed to a net decrease of \$2 million.

Aircraft maintenance expense decreased 7% from the first quarter of 2008

In the first quarter of 2009, aircraft maintenance expense of \$189 million decreased \$14 million or 7% from the first quarter of 2008. Factors contributing to the year-over-year change in first quarter aircraft maintenance expense included:

- A net decrease of \$20 million due to a lower volume of engine maintenance activities related to the Airbus A320 and Airbus A340 aircraft partly offset by additional engine maintenance activities relating to the Boeing 777 aircraft.
- A decrease of \$15 million in expenses related to the preparation of aircraft to be returned to lessors or subleased to third parties.

- A decrease of \$4 million relating to the insourcing of supply chain management. The positive impact of insourcing supply chain management into the aircraft maintenance division was partly offset by the addition of approximately 200 FTE employees, the impact of which is included in wages and salaries.
- A decrease of \$3 million primarily due to less flying year-over-year.

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

- The impact of a weaker Canadian dollar versus the US dollar which accounted for an increase of \$20 million to aircraft maintenance expense compared to the first quarter of 2008.
- An increase of \$8 million in airframe maintenance expenses mainly due to timing of maintenance activities.

Food, beverages and supplies expense decreased 13% from the first quarter of 2008

In the first quarter of 2009, food, beverages and supplies expense of \$67 million decreased \$10 million or 13% from the first quarter of 2008 on a 10.9% decrease in passenger traffic.

Communications and information technology expense increased 8% from the first quarter of 2008

In the first quarter of 2009, communications and information technology expense of \$79 million increased \$6 million or 8% from the first quarter of 2008 and included the unfavourable impact of a weaker Canadian dollar versus the US dollar which accounted for an increase of \$5 million.

Commission expense decreased 8% from the first quarter of 2008

In the first quarter of 2009, commission expense of \$49 million decreased \$4 million or 8% from the first quarter of 2008 on a passenger revenue decrease of 13%.

Other operating expenses decreased \$4 million from the first quarter of 2008

Other operating expenses amounted to \$423 million in the first quarter of 2009, a decrease of \$4 million from the first quarter of 2008. Factors contributing to the year-over-year change in first quarter other expenses included:

- The increase in expenses related to ground packages at Air Canada Vacations of \$17 million was mainly due higher passenger volumes compared to the first quarter of 2008 and the impact of a weakening Canadian dollar versus the US dollar on Air Canada Vacations' land costs.
- The remaining variances in other expenses represented the results of various initiatives and included the impact of the capacity reduction.

The following table provides a breakdown of the significant items included in other expenses:

(Canadian dollars in millions)	First Quarter		Change	
	2009	2008	\$	%
Air Canada Vacations' land costs	\$ 127	\$ 110	\$ 17	15
Terminal handling	47	45	2	4
Credit card fees	45	49	(4)	(8)
Building rent and maintenance	33	35	(2)	(6)
Crew expenses (meals, transportation and hotels)	28	28	-	-
Miscellaneous fees and services	25	26	(1)	(5)
Remaining other expenses	118	134	(16)	(12)
	\$ 423	\$ 427	\$ (4)	(1)

Non-operating expense amounted to \$109 million in the first quarter of 2009

Non-operating expense amounted to \$109 million in the first quarter of 2009 compared to non-operating expense of \$107 million in the first quarter of 2008. Factors contributing to the year-over-year change in first quarter non-operating expense included:

- Losses related to fair value adjustments on derivatives instruments amounted to \$10 million in the first quarter of 2009 versus losses of \$23 million in the same quarter of 2008. The non-cash mark-to-market loss on financial instruments recorded in the first quarter of 2009 was mainly related to the fair value of fuel derivatives. Refer to section 12 of Air Canada's 2008 MD&A dated February 13, 2009 and section 8 of this MD&A for additional information on Air Canada's derivative instruments.
- Net interest expense increased \$52 million from the first quarter of 2008 due to:
 - A lower amount of capitalized interest of \$16 million reflecting a reduction in the number of aircraft remaining to be delivered;
 - A decrease in interest income of \$12 million due to both lower cash balances and lower rates of return;
 - An increase in interest expense of \$24 million, in part due to new financing transactions completed since the first quarter of 2008 and the unfavourable impact of foreign exchange on interest expense. In addition, the Corporation recorded a charge of \$17 million related to a sale-leaseback transaction completed in the first quarter of 2009. These increases were partly offset by a reduction of interest expense on aircraft pre-delivery payments related to Boeing 777 aircraft versus the same period in 2008.
- In the first quarter of 2008, Air Canada recorded an impairment charge of \$38 million relating to the retirement of its fleet of Boeing 767-200 aircraft, consisting of 10 aircraft.

Losses on foreign exchange amounted to \$101 million in the first quarter of 2009

Losses on foreign exchange amounted to \$101 million in the first quarter of 2009 compared to losses of \$89 million in the first quarter of 2008. The losses in the first quarter of 2009 were attributable to a weaker Canadian dollar at March 31, 2009 compared to December 31, 2008 partly offset by gains of \$25 million related to foreign currency derivatives. The March 31, 2009 noon day exchange rate was \$1US = Cdn \$1.2602 while the December 31, 2008 noon day exchange rate was \$1US = Cdn \$1.2246.

Recovery of income taxes of \$2 million in the first quarter of 2009

Air Canada recorded a recovery of income taxes of \$2 million in the first quarter of 2009. The benefit of future income tax assets arising on the current quarter loss have been offset by a valuation allowance. A recovery of income taxes of \$48 million was recorded in the first quarter of 2008, representing an effective income tax rate of 14%. 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.

5. Fleet

The following table provides the existing and planned fleet changes to Air Canada's operating fleet (excluding aircraft operated by Jazz):

Fleet Plan	Actual						Planned						
	December 31, 2008	New Deliveries	Sublease to Third Party	Lease Returns	Parked	March 31, 2009	New Deliveries	Sublease to Third Party	Lease Returns	Parked	December 31, 2009	2010 Fleet Changes	December 31, 2010
B777-300	10	1	-	-	-	11	1	-	-	-	12	-	12
B777-200	6	-	-	-	-	6	-	-	-	-	6	-	6
B767-300	30	-	-	-	-	30	-	-	-	-	30	-	30
A330-300	8	-	-	-	-	8	-	-	-	-	8	-	8
A321	10	-	-	-	-	10	-	-	-	-	10	-	10
A320	41	-	-	-	-	41	-	-	-	-	41	-	41
A319	35	-	-	-	-	35	-	-	-	-	35	-	35
Embraer E-190	45	-	-	-	-	45	-	-	-	-	45	-	45
Embraer E-175	15	-	-	-	-	15	-	-	-	-	15	-	15
Total	200	1	-	-	-	201	1	-	-	-	202	-	202
Average age (years)	8.8					9.0					9.5		10.5

Aircraft Interior Refurbishment Program

Air Canada commenced a refurbishment program of the interiors of its existing aircraft (Boeing 767-300, Airbus A330-300, A321, A320 and A319 aircraft) in 2006 in order to offer its customers a world class product. Air Canada has completed the refurbishment of all its planned operating aircraft with the exception of one Airbus A330 and three Boeing 767-300ER aircraft. The Embraer and Boeing 777 aircraft are delivered with the new seats and entertainment systems already installed.

6. Financial and Capital Management

6.1 Financial Position

The following table provides a condensed statement financial position of Air Canada as at March 31, 2009 and as at December 31, 2008.

(Canadian dollars in millions)	March 31, 2009	December 31, 2008
Assets		
Cash, cash equivalents and short-term investments	\$ 1,087	\$ 1,005
Other current assets	1,261	1,398
Current assets	2,348	2,403
Property and equipment	7,394	7,469
Intangible assets	993	997
Deposits and other assets	507	495
	\$ 11,242	\$ 11,364
Liabilities		
Current liabilities	\$ 3,913	\$ 3,856
Long-term debt and capital leases	4,889	4,691
Pension and other benefit liabilities	1,296	1,407
Other long-term liabilities	462	458
	10,560	10,412
Non-controlling interest	192	190
Shareholders' equity	490	762
	\$ 11,242	\$ 11,364

Movements in current assets and liabilities are described below under "Working Capital".

Property and equipment amounted to \$7,394 million at March 31, 2009, a reduction of \$75 million from December 31, 2008. The reduction was mainly due to the impact of depreciation expense of \$145 million recorded in the first quarter of 2009 offset by additions to capital assets.

Long-term debt and capital leases, including the current portion, amounted to \$5,506 million at March 31, 2009, an increase of \$152 million from December 31, 2008. The increase was mainly due to a depreciation of the Canadian dollar and the resulting impact on Air Canada's foreign denominated debt and capital leases, which amounted to \$121 million. In the first quarter of 2009, the impact of additional borrowings of \$267 million was more than offset by long-term debt and capital lease repayments of \$423 million. The sale-leaseback transaction completed in the first quarter of 2009 was accounted for as a capital lease, resulting in an increase to long-term debt of \$158 million.

The decline in pension and other benefits liabilities of \$111 million from December 31, 2008 was primarily due to pension funding of \$103 million in excess of pension expense. Refer to section 9.6 of Air Canada's 2008 MD&A dated February 13, 2009 and section 6.7 of this MD&A for a discussion on Air Canada's pension funding obligations.

6.2 Adjusted Net Debt

The table reflects Air Canada's adjusted net debt balances and net debt to net debt plus equity ratio as at March 31, 2009 and as at December 31, 2008.

(Canadian dollars in millions)	March 31, 2009	December 31, 2008	Change \$
Total long-term debt and capital leases	\$ 4,889	\$ 4,691	\$ 198
Current portion of long-term debt and capital leases	617	663	(46)
Total long-term debt and capital leases, including current portion	5,506	5,354	152
Non-controlling interest	192	190	2
Less cash, cash equivalents and short-term investments	(1,087)	(1,005)	(82)
Net debt and non-controlling interest	4,611	4,539	72
Capitalized operating leases ⁽¹⁾	2,265	2,093	172
Adjusted net debt and non-controlling interest	6,876	6,632	244
Less pre-delivery (PDP) financing included in long-term debt	-	(81)	81
Adjusted net debt and non-controlling interest, excluding PDP financing	\$ 6,876	\$ 6,551	\$ 325
Shareholders' equity	\$ 490	\$ 762	\$ (272)
Adjusted net debt to net debt plus equity ratio, excluding PDP financing	93.3%	89.6%	3.7 pp

(1) Adjusted net debt is a non-GAAP measure used by the Corporation and is not likely to be comparable to measures presented by other public companies. 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. This definition of capital is used by the Corporation and may not be comparable to similar measures presented by other public companies. Aircraft rent was \$302 million for the twelve months ended March 31, 2009 and \$279 million for the twelve months ended December 31, 2008. 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 consolidated statement of operations.

At March 31, 2009, adjusted net debt and non-controlling interest, including capitalized operating leases, and excluding the pre-delivery payment ("PDP") financing, increased \$325 million from December 31, 2008. This increase in adjusted net debt was in part due to the depreciation of the Canadian dollar and the resulting impact on Air Canada's foreign denominated debt and capital leases, which amounted to \$121 million. The increase in long-term debt and capital leases was also the result of financing transactions concluded in the first quarter of 2009 and an increase in capitalized operating leases. The increase in capitalized operating leases was due to the unfavourable impact of foreign exchange on aircraft rent, as aircraft leases are primarily denominated in US dollars, and the sale-leaseback transactions of Boeing 777 aircraft completed in 2008 and in the first quarter of 2009.

The adjusted net debt to net debt plus equity ratio for Air Canada increased to 93.3 % at March 31, 2009 from 89.6% at December 31, 2008. The 3.7 percentage point deterioration from December 31, 2008 was the result of both an increase in net debt and a decrease in shareholders' equity in the first quarter of 2009.

6.3 Liquidity

The challenges that the Corporation faced in 2008 and which continue in 2009 are described in section 9.3 of Air Canada's 2008 MD&A dated February 13, 2009. The challenges include the weakened demand for air travel as a result of the recession, continuing interest payments and debt payments and the funding of the Corporation's pension plans. During the first quarter of 2009, demand for the Corporation's air travel and cargo services continued to weaken in both domestic and international markets, and the Corporation expects demand to continue to be a challenge for the remainder of the year. The H1N1 virus is a new factor that may affect demand for air travel. To date, the impact on the Corporation's operations has been minimal. The Corporation is monitoring this risk however, it is unable to predict if the impact on its operations will be significant. In addition, the Corporation's major collective agreements expire in 2009 and uncertainties exist with respect to the

outcome of these negotiations. The credit markets also continue to be constrained raising concerns about available funding for a number of companies, including Air Canada. These factors have had an impact on the liquidity risk of Air Canada. Section 6.3 of this MD&A should be read in conjunction with section 9.3 of Air Canada's 2008 MD&A as this section updates the disclosures provided at that time.

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities and other contractual obligations. The Corporation monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. The Corporation's principal objective in managing liquidity risk is to maintain a minimum of cash and cash equivalents and short-term investments ("unrestricted cash") balance in excess of a target liquidity level of 15% of annual operating revenues. However, given the risks identified herein, management expects there may be significant challenges to achieving its target unrestricted cash to operating revenue ratio of 15% in 2009.

At March 31, 2009, Air Canada had cash and cash equivalents and short-term investments of \$1,087 million (\$1,005 million as at December 31, 2008), which represents approximately 10% of 2008 annual operating revenues. Management continues to closely monitor the cash flows to ensure the Corporation has adequate cash resources to meet its obligations and commitments when they become due. Unless sufficient new financing is secured, pension relief is obtained and the credit card processing company and Air Canada agree to revised triggers, the Corporation expects that the cash and cash equivalents and short-term investments would be substantially reduced over the next 12 months as a result of required deposits with the credit card processing company.

At April 30, 2009, Air Canada had cash and cash equivalents and short-term investments of approximately \$1,005 million.

During the first quarter of 2009, management continued to undertake various initiatives and develop plans to manage its operating and liquidity risks taking into account the prevailing economic conditions, including cost containment initiatives and capacity adjustments with the objective of matching capacity to passenger demand. However, given the unfavourable impact of the deterioration in the Canadian dollar versus the US dollar and the nature of the Corporation's cost structure such that fixed costs do not fluctuate proportionately with changes in capacity in the short term, it is expected that unit costs excluding fuel expense, measured as total operating expense less fuel expense over the number of available seat miles, will be a challenge for the remainder of the year.

The Corporation plans to enter into additional financing arrangements and other transactions designed to improve its cash flows and liquidity position. During the first quarter of 2009, the following arrangements were concluded and events occurred:

- Financing arrangements secured by spare parts, spare engines and a Boeing 777 aircraft for aggregate proceeds of \$267 million, net of fees of \$5 million;
- Sale-leaseback of a Boeing 777 aircraft for aggregate proceeds of \$172 million and the required repayment of a debt obligation related to the aircraft of \$128 million, which included a prepayment fee of \$14 million;
- Inventory financing arrangement under which the Corporation acquired certain spare parts inventories expected to be consumed over the next 12 months for a cash payment of \$12 million and final payment of \$115 million in 2010 based upon the foreign exchange rate as at March 31, 2009;
- Repayment of pre-delivery financing of \$83 million on the Boeing 777 aircraft received during the quarter; and
- Net return of collateral deposits on fuel derivatives in the amount of \$147 million offset by the settlement of fuel derivative contracts in favour of counterparties in the amount of \$217 million.

At April 30, 2009, the Corporation had \$43 million outstanding under a secured revolving credit facility with the Canadian Imperial Bank of Commerce (\$47 million outstanding as at March 31, 2009). This credit facility is described in section 9.3 of Air Canada's 2008 MD&A dated February 13, 2009.

The Corporation has certain assets including aircraft such as its Boeing 777 aircraft and Embraer aircraft, real estate, airport slots and accounts receivable, certain of which have estimated fair values in excess of the respective loan values, and which may be available to support additional financings or other similar transactions. Management has commenced discussions with certain suppliers, financial institutions, leasing companies, government agencies and other stakeholders on alternatives for obtaining additional financing.

Given the current and continuing instability of credit markets and economic conditions, there can be no assurance that the Corporation will be able to conclude further financing or other similar transactions, including on acceptable terms or that the Corporation's assets will generate the expected proceeds. The Corporation may be required to obtain consent from current lenders and/or other third parties for certain such transactions.

In addition to the risks related to current economic and other conditions referenced and described herein, the following are key risks that the Corporation monitors and which may materially impact operating results and liquidity.

Market Risks

Market risk includes the risk that future cash flows will fluctuate because of changes in market prices, including foreign exchange rates, interest rates, and commodity prices. While management is able to mitigate certain of these risks through certain hedging activities, the price of fuel, foreign exchange rates and interest rates are beyond the control of management and market volatility in the future may adversely impact operating results and cash flows. Refer to section 8 of this MD&A for the status of fuel price risk management as at March 31, 2009 and to section 9.3 of Air Canada's 2008 MD&A dated February 13, 2009 for information on market risks.

Pension Funding Obligations

Refer to section 9.6 of Air Canada's 2008 MD&A dated February 13, 2009 and section 6.7 of this MD&A for a discussion on Air Canada's pension funding obligations.

Covenants in Credit Card Agreements

The Corporation has various agreements for the processing of customer credit card transactions, as further described in section 9.3 of Air Canada's 2008 MD&A dated February 13, 2009. Under the terms of credit card processing agreements with one of its principal credit card processors, the credit card processing company may withhold payment of funds to Air Canada ("the deposit") upon the occurrence of certain events ("triggering events"). Under these triggering events, beginning at the end of the second quarter 2009, the unrestricted cash required in order to avoid a deposit could be as much as \$1.3 billion. Unless sufficient new financing is secured, pension relief is obtained and the credit card processing company and Air Canada agree to revised triggers, the Corporation expects that the cash and cash equivalents and short-term investments would be substantially reduced over the next 12 months as a result of required deposits under the current terms of the agreement with the credit card processing company. The Corporation is currently renegotiating certain terms and conditions, including relating to triggering events, with the credit card processing company. There can be no assurance that an agreement will be reached between the Corporation and the credit card processing company, including in a timely manner.

Cargo Investigations

The Corporation is exposed to potential liabilities related to the investigations of alleged anti-competitive cargo pricing activities, as described in section 18 of Air Canada's 2008 MD&A dated February 13, 2009. This preliminary estimate recorded by the Corporation during 2008 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. Amounts could become payable within the year and may be materially different than management's preliminary estimate.

Management believes it has developed planned courses of action and identified other opportunities to mitigate the operating and liquidity risks facing the Corporation. However, the Corporation's plans are based on assumptions (including requirements to obtain government and regulatory approval and third party consents) and are subject to important risks and uncertainties described herein and in this MD&A. As a result, there is no assurance that management will be able to successfully execute on its plans or achieve any or all of the

opportunities it has identified or obtain sufficient liquidity, including if assumptions are not met or events or conditions develop that are not consistent with management's expectations and planned courses of actions.

Working Capital

Actively managing working capital is a key element in ensuring cash is available to support liquidity growth objectives. The following table provides additional information on Air Canada's working capital balances at March 31, 2009 as compared to December 31, 2008.

(Canadian dollars in millions)	March 31, 2009	December 31, 2008	Change in working capital
Cash and short-term investments	\$ 1,087	\$ 1,005	\$ 82
Accounts receivable	714	702	12
Collateral deposits for fuel derivatives	181	328	(147)
Other current assets	366	368	(2)
Accounts payable and accrued liabilities	(1,577)	(1,440)	(137)
Fuel derivatives in current liabilities	(212)	(420)	208
Advance ticket sales	(1,507)	(1,333)	(174)
Current portion of long-term debt and capital leases	(617)	(663)	46
	\$ (1,565)	\$ (1,453)	\$ (112)

The working capital deficiency of \$1,565 million has deteriorated by \$112 million from December 31, 2008. The change in working capital reflected:

- Pension funding payments made during the quarter amounting to \$112 million;
- Repayments of long-term debt of \$309 million, which included \$83 million related to the final repayment on the pre-delivery financing of a Boeing 777 aircraft;
- The impact of capital expenditures of \$107 million in the quarter;
- Net financing proceeds of \$267 million, which included financing related to the delivery of one Boeing 777 aircraft, spare parts and spare engines financing agreements; and
- Net proceeds of \$44 million from a sale-leaseback transaction related to one Boeing 777 aircraft, derived from \$172 million in proceeds from the sale-leaseback transaction, less the repayment of the debt obligation related to the aircraft of \$128 million, which included a prepayment fee of \$14 million.

Collateral Deposits for Fuel Derivatives

The types of derivative instruments used by Air Canada within its hedging program, such as swaps and the put options within collar structures, expose the Corporation to the potential of posting cash collateral deposits. The drastic decrease in fuel prices observed in the fourth quarter of 2008 resulted in a significant negative fair value for the Corporation's portfolio of fuel hedges. Once the fair value in favour of the counterparty of certain fuel derivatives exceeds the credit thresholds with those counterparties, the Corporation is responsible for extending collateral to the counterparties. As at April 30, 2009, the total cash collateral deposits held by counterparties amounted to \$172 million (\$181 million at March 31, 2009 and \$328 million at December 31, 2008). This collateral requirement has put additional pressure on liquidity in the short term. If fuel prices remain at the current levels throughout 2009, the lower fuel prices will provide significant cash savings to the Corporation.

Refer to section 12 of Air Canada's 2008 MD&A dated February 13, 2009 and section 8 of this MD&A for a discussion on fuel price risk.

6.4 Consolidated Cash Flow Movements

The following table provides the cash flow movements for the Corporation for the periods indicated:

(Canadian dollars in millions)	First Quarter		Change \$
	2009	2008	
Net cash used for operating activities	\$ (121)	\$ (6)	\$ (115)
Changes in non-cash working capital	289	236	53
Cash flows from operating activities	168	230	(62)
Additions to capital assets	(107)	(403)	296
Free cash flow ⁽¹⁾	61	(173)	234
Proceeds from sale leaseback transactions	172	411	(239)
Short-term investments	19	99	(80)
Other	5	52	(47)
Cash flows from investing activities (excluding additions to capital assets)	196	562	(366)
Borrowings	267	187	80
Reduction of long-term debt and capital lease obligations	(423)	(322)	(101)
Cash flows used for financing activities	(156)	(135)	(21)
Net increase in cash and cash equivalents	101	254	(153)
Net decrease in short-term investments	(19)	(99)	80
Net increase in cash, cash equivalents and short-term investments	\$ 82	\$ 155	\$ (73)

(1) Free cash flow is a non-GAAP measure used by the Corporation 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 2009 improved \$234 million from the first quarter of 2008. The improvement in free cash flow was related to a reduction in capital expenditures, due to fewer aircraft deliveries and in the first quarter of 2009 when compared to the first quarter of 2008. The decrease in operating cash flows versus the same period in 2008 was primarily driven by the impact of higher past service cost contributions under the Corporation's pension plans and the settlement of fuel derivatives in favour of counterparties of \$217 million partly offset by a net return of collateral deposits on fuel derivatives of \$147 million.

6.5 Capital Expenditures and Related Financing Arrangements

Information on the Corporation's planned and committed capital expenditures and related financing arrangements is disclosed in section 9.7 of Air Canada's 2008 MD&A dated February 13, 2009. There have been no material changes to the Corporation's planned and committed capital expenditures and related financing arrangements from what was disclosed at that time.

6.6 Contractual Obligations

Information on the Corporation's contractual obligations is disclosed in section 9.5 of Air Canada's 2008 MD&A dated February 13, 2009. There have been no material changes to the Corporation's contractual obligations from what was disclosed at that time.

6.7 Pension Funding Obligations

Information on the Corporation's pension funding obligations is disclosed in section 9.6 of Air Canada's 2008 MD&A dated February 13, 2009.

As at December 31, 2008, the Corporation reported that the solvency deficit as at January 1, 2009 in the registered pension plans, which is used to determine funding requirements, was estimated to be approximately \$3,200 million. During the first quarter of 2009, as a result of updated information regarding the annuity rate to be applied in discounting the pension obligations, this estimate has been revised to \$2,850 million.

The Pension Benefits Standards Act and Regulations allow the use of an asset smoothing method over five years, limited to 110% of the market value of plan assets, to determine minimum funding requirements on a solvency basis. In order to apply this funding method, which is available to companies with federally regulated defined benefit pension plans, Air Canada opted out of the Air Canada Pension Plan Solvency Deficiency Funding Regulations. Opting out of the Air Canada Pension Plan Solvency Deficiency Funding Regulations provides the Corporation with the ability to apply the asset smoothing method over five years, limited to 110% of the market value of plan assets and results in the Corporation being required to fund its solvency deficiency in accordance with the generally applicable funding provisions of the Pension Benefits Standards Act and its Regulations. Management has determined that overall this approach (rather than remaining under the Air Canada Pension Plan Solvency Deficiency Funding Regulations) provides a more favourable impact with respect to the Corporation's current pension funding obligations.

In March 2009, the Government of Canada proposed regulations to implement pension measures for the purpose of providing temporary solvency funding relief for federally regulated defined benefit pension plans. The proposals as currently drafted include increasing the current limit of 110% for smoothing asset valuation fluctuations over five years to 115% for 2009 and increasing the period for funding a solvency deficiency from five years to ten years, subject to certain conditions, including the imposition of deemed trusts over deferred funding provided through such temporary relief. The increase in the period for funding a solvency deficiency from five years to ten years is conditional upon less than one third of both members and retirees objecting to the extended schedule or the provision of a letter of credit to secure the difference between the five and ten year payment schedules. One of these two conditions would need to be met by December 31, 2009. If one third or more of plan members or retirees object or a letter of credit is not provided by the end of 2009, the Corporation would be required to fund the deficiency over the following five years. Funding reductions in subsequent years would be dependent upon satisfying one of the two conditions as noted above.

Based upon the revised estimated solvency deficit, the use of an asset smoothing method at the current 110% limit and the implementation of the ten year payment schedule, the estimated aggregate pension funding payments during 2009 would be approximately \$570 million, an increase of \$114 million versus 2008. If the temporary solvency funding relief is not implemented or not implemented in a manner which permits the Corporation to benefit from temporary solvency funding relief, the pension funding payments in 2009 would increase by a further \$75 million.

The Corporation continues to assess the impact of these measures which are expected to be adopted through final regulations not yet in place. However, there can be no assurance that the proposed relief will be implemented at all or in a manner which would permit the Corporation to benefit from temporary solvency funding relief. The Corporation continues to monitor the government's actions and dialogue with government officials on this matter. Until the government finalizes and implements its proposal and the funding valuation is completed during the second quarter of 2009, uncertainty as to the amount and timing of additional pension funding continues to exist. Any increase in funding obligations for 2009 would be paid in the second half of the year as the funding in the first half of the year is based on the January 1, 2008 actuarial valuation reports.

In addition, management is in ongoing discussions with its Canadian-based unions to consider certain funding alternatives including a moratorium and other conditions on funding the pension deficits. These may require government and/or regulatory approval and there can be no assurance that an agreement will be reached between the Corporation and the unions on this matter or that government and/or regulatory approval would be obtained, including in a timely manner so as to provide the Corporation with required funding relief.

6.8 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, 2009	At December 31, 2008
Issued and outstanding shares		
Class A variable voting shares	13,382,299	15,475,659
Class B voting shares	86,617,701	84,524,341
Total issued and outstanding shares	100,000,000	100,000,000
Class A variable voting and Class B voting shares potentially issuable		
Stock options	1,701,447	1,701,447
Performance share units	1,680,159	1,671,068
Total shares potentially issuable	3,381,606	3,372,515
Total outstanding and potentially issuable shares	103,381,606	103,372,515

7. Quarterly Financial Data

The following table summarizes quarterly financial results and major operating statistics for Air Canada for the last eight quarters.

(\$ millions, except per share figures)	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009
Operating revenues	\$ 2,639	\$ 2,954	\$ 2,513	\$ 2,727	\$ 2,782	\$ 3,075	\$ 2,498	\$ 2,391
Aircraft fuel	(636)	(716)	(615)	(715)	(848)	(1,064)	(792)	(593)
Ownership (DAR) ⁽¹⁾	(211)	(210)	(202)	(234)	(242)	(243)	(254)	(245)
Other operating expenses	(1,704)	(1,677)	(1,624)	(1,790)	(1,685)	(1,656)	(1,598)	(1,741)
Operating expenses	(2,551)	(2,603)	(2,441)	(2,739)	(2,775)	(2,963)	(2,644)	(2,579)
Operating income (loss) before the undernoted item	88	351	72	(12)	7	112	(146)	(188)
Provision for cargo investigations ⁽²⁾	-	-	-	(125)	-	-	-	-
Operating income (loss)	88	351	72	(137)	7	112	(146)	(188)
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	67	(78)	(37)	(151)	115	(244)	(581)	(212)
Net income (loss)	\$ 155	\$ 273	\$ 35	\$ (288)	\$ 122	\$ (132)	\$ (727)	\$ (400)
Revenue passenger miles (millions)	12,580	14,789	11,446	12,331	12,884	14,458	10,845	10,984
Available seat miles (millions)	15,220	18,144	14,715	15,407	15,581	17,515	13,571	13,821
Passenger load factor (%)	82.7	81.5	77.8	80.0	82.7	82.5	79.9	79.5
RASM (cents)	15.3	14.6	14.7	15.0	15.7	15.7	16.0	14.5
CASM (cents)	16.8	14.3	16.6	17.8	17.8	16.9	19.5	18.7
CASM, excluding fuel expense (cents)	12.6	10.4	12.4	13.1	12.4	10.8	13.6	14.4
Fuel price per litres (cents) ⁽³⁾	67.2	64.7	67.5	75.2	89.2	101.0	95.8	71.4
EBITDAR before the provision for cargo investigations ⁽⁴⁾	\$ 299	\$ 561	\$ 274	\$ 222	\$ 249	\$ 355	\$ 108	\$ 57
EBITDAR ⁽⁴⁾	\$ 299	\$ 561	\$ 274	\$ 97	\$ 249	\$ 355	\$ 108	\$ 57
Earnings (loss) per share - Basic and diluted	\$ 1.55	\$ 2.73	\$ 0.35	\$(2.88)	\$ 1.22	\$(1.32)	\$ (7.27)	\$ (4.00)

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

(2) A provision for cargo investigations of \$125 million was recorded in the first quarter of 2008.

(3) Includes fuel handling and is net of fuel hedging results.

(4) See section 15 "Non-GAAP Financial Measures" in this MD&A for additional information.

8. Financial Instruments and Risk Management

Summary of Losses on Financial Instruments Recorded at Fair Value

The following is a summary of losses on financial instruments recorded at fair value included in non-operating income (expense) on Air Canada's consolidated statement of operations for the periods indicated:

(\$ millions)	First Quarter	
	2009	2008
Ineffective portion of fuel hedges	\$ -	\$ (38)
Fuel derivatives not under hedge accounting	(9)	6
Cross-currency interest rate swaps	-	6
Other	(1)	3
Loss on financial instruments recorded at fair value	\$ (10)	\$ (23)

Fuel Price Risk

As of March 31, 2009, approximately 31% of Air Canada's anticipated purchases of jet fuel for the remainder of 2009 are hedged at an average West Texas Intermediate ("WTI")-equivalent capped price of US\$104 per barrel, of which 46% is subject to an average WTI-equivalent floor price of US\$82 per barrel. Air Canada has also hedged approximately 13% of its 2010 anticipated jet fuel purchases in crude oil-based contracts hedged at an average capped price of US\$110 per barrel, of which 87% is subject to an average floor price of US\$101 per barrel.

The following table outlines the notional volumes per barrel outstanding at March 31, 2009, along with the weighted average floor and capped price for each year currently hedged by type of derivative instruments. These average contract prices represent the equivalent price in WTI using the forward prices for WTI, heating oil, and jet fuel as at March 31, 2009.

Outstanding at March 31, 2009				
Derivative Instruments	Term	Volume (BBLs)	WTI-equivalent Average Floor Price (US\$ per barrel)	WTI-equivalent Average Capped Price (US\$ per barrel)
Call Options ⁽¹⁾	2009	2,830,000	n/a	116
	2010	400,000	n/a	134
Swaps ⁽¹⁾	2009	855,000	99	99
	2010	1,070,000	99	99
Collars ⁽¹⁾	2009	1,600,000	73	84
	2010	1,560,000	102	112
Put options ⁽²⁾	2009	600,000	40	n/a

(1) Air Canada is expected to generate fuel hedging gains if oil prices increase above the average capped price and is exposed to fuel hedging losses if oil prices decrease below the average floor price.

(2) The significant decrease in oil prices in the last quarter of 2008 led the Corporation to purchase crude oil put options in late 2008. The Corporation is expected to generate fuel hedging gains if oil prices decrease below the average floor prices. Their objective is to protect against potential additional collateral requirements caused from further price decreases. The fair value of these derivative instruments increases as crude oil price decreases, therefore offsetting in part the exposure on the total portfolio and limiting the collateral requirements.

In the first quarter of 2009, fuel derivative contracts cash settled with a fair value of \$45 million in favour of the counterparties (\$39 million in favour of the Corporation in the first quarter of 2008). Of the \$45 million, \$1 million related to derivatives designated under hedge accounting and \$44 million related to economic hedges (\$32 million and \$7 million, respectively, in the first quarter of 2008).

In the first quarter of 2009, hedge accounting was discontinued for certain fuel hedge contracts where the hedging relationship ceased to satisfy the conditions for 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 Loss ("AOCI") balance recognized in connection with these derivatives will be reclassified to fuel expense upon the maturity of the contracts.

In the first quarter of 2009, in order to further reduce its exposure to declining oil prices, the Corporation terminated fuel derivative contracts with a fair market value of \$172 million (US\$146 million) in favour of the counterparties. The collateral held by the counterparties covered the majority of the settlement amount, therefore minimal additional cash outflows resulted.

As fuel hedging contracts with unfavourable fair values are settled, the Corporation can recall excess cash collateral deposits from counterparties. The fuel hedging losses recorded under fuel expense was \$127 million in the first quarter of 2009 (fuel hedging gains of \$34 million in the first quarter of 2008), mainly due to the reallocation to fuel expense of the hedging losses accumulated in Other Comprehensive Income ("OCI") in previous periods upon consumption of the hedged fuel.

The estimated net amount of existing losses reported in AOCI that are expected to be reclassified to net income (loss) during the following 12 months is \$350 million (before tax).

As of April 30, 2009, approximately 30% of Air Canada's anticipated purchases of jet fuel for the remainder of 2009 are hedged at an average WTI-equivalent capped price of US\$104 per barrel, of which 48% is subject to an average WTI-equivalent floor price of US\$82 per barrel. Air Canada has also hedged approximately 13% of its 2010 anticipated jet fuel purchases in crude oil-based contracts hedged at an average capped price of US\$110 per barrel, of which 87% is subject to an average floor price of US\$101 per barrel.

Below is a table summarizing the impact of fuel derivatives on the Corporation's consolidated statement of operations, consolidated statement of comprehensive loss and consolidated statement of financial position.

(Canadian dollars in millions)		First Quarter	
		2009	2008
Consolidated Statement of Operations			
<u>Operating expense</u>			
Aircraft fuel	Realized effective gain (loss) – derivatives designated under hedge accounting	\$ (127)	\$ 34
<u>Non-operating income (expense)</u>			
Gain (loss) on financial instruments recorded at fair value	Ineffective gain (loss) – derivatives designated under hedge accounting	-	\$ (38)
	Fair market value gain (loss) – economic hedges	\$ (9)	\$ 6
Consolidated Statement of Comprehensive Loss			
	Effective gain (loss) – derivatives designated under hedge accounting	\$ (1)	\$ 146
	Tax expense on effective gain	-	\$ (46)
	Reclassification of net realized (gain) loss on fuel derivatives designated under hedge accounting to aircraft fuel expense	\$ 127	\$ (34)
	Tax on reclassification	\$ 2	\$ 11
		March 31, 2009	December 31, 2008
Consolidated Statement of Financial Position			
<u>Current assets</u>	Collateral deposits for fuel derivatives	\$ 181	\$ 328
<u>Current liabilities*</u>	Fair market value of fuel derivatives designated under hedge accounting	\$ 1	\$ (405)
	Fair market value of fuel derivatives – economic hedges	\$ (213)	\$ (15)
<u>Shareholders' equity (AOCI)</u>	Net loss from fuel derivatives designated under hedge accounting	\$ (478)	\$ (606)

*The balance is reflected within current liabilities on Air Canada's consolidated statement of financial position due to the counterparties' ability to terminate the derivatives at fair value at any time prior to maturity.

Fuel and other derivatives on Air Canada's consolidated statement of cash flow includes adjustments for non-cash items impacting fuel expense as well as adjustments for cash items not affecting net income during the period as a result of timing differences.

9. Accounting Policies

Changes in Accounting Policies

Goodwill and Intangible Assets

Effective January 1, 2009, the Corporation adopted new Canadian Institute of Chartered Accountants ("CICA") accounting standard 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 Corporation's accounting policy for goodwill and intangibles is consistent with the new standard and as a result, no adjustment was recorded on transition.

Credit Risk and the Fair Value of Financial Assets and Financial Liabilities

Effective January 1, 2009, the Corporation adopted the recommendations of the Emerging Issues Committee ("EIC") of the CICA relating to Abstract EIC-173 *Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*. This Abstract confirms that an entity's own credit risk and the credit risk of the counterparty should be taken into consideration in determining the fair value of financial assets and liabilities, including derivative instruments. The adoption of this guidance had no significant effect on the Corporation's consolidated financial statements as collateral deposits with fuel derivative counterparties and master netting arrangements were considered in determining that no credit risk adjustment was required on the valuation of the derivatives.

Future Accounting Standard Changes

Business Combinations, Consolidated Financial Statements and Non-controlling Interests

The CICA issued three new accounting standards in January 2009: section 1582, *Business Combinations*, section 1601, *Consolidated Financial Statements*, and section 1602, *Non-controlling interests*. These new standards will be effective for fiscal years beginning on or after January 1, 2011. The Corporation is in the process of evaluating the requirements of the new standards.

Section 1582 replaces section 1581, and establishes standards for the accounting for a business combination. It provides the Canadian equivalent to International Financial Reporting Standard IFRS 3 – *Business Combinations*. The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011.

Sections 1601 and 1602 together replace section 1600 – *Consolidated Financial Statements*. Section 1601, establishes standards for the preparation of consolidated financial statements. Section 1601 applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of International Financial Reporting Standard IAS 27 - Consolidated and Separate Financial Statements and applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011.

Update on the Progress of the International Financial Reporting Standards Conversion Plan

The Canadian Accounting Standards Board has confirmed January 1, 2011 as the changeover date for Canadian publicly accountable enterprises to start using International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosures.

As a result, the Corporation has developed a plan to convert its consolidated financial statements to IFRS establishing a cross-functional IFRS team represented by managers in the areas of Accounting, Taxation, IT and Data Systems, Internal Control and Processes, Planning, Compensation, Treasury, Investor Relations and Legal. Updates regarding the progress of the conversion plan are provided to the Corporation's Audit, Finance and Risk Committee on a quarterly basis.

The plan addresses the impact of IFRS on Accounting policies and implementation decisions, Infrastructure, Business activities and Control activities. A summary status of the key elements of the changeover plan is included in section 16 "Changes in Accounting Policies" of Air Canada's 2008 MD&A dated February 13, 2009. The IFRS changeover plan is progressing as outlined and no significant changes to the plan have been made.

10. Off-Balance Sheet Arrangements

Information on the Corporation's off-balance sheet arrangements is disclosed in section 13 of Air Canada's 2008 MD&A dated February 13, 2009. There have been no material changes to the Corporation's off-balance sheet arrangements from what was disclosed at that time.

11. Related Party Transactions

At March 31, 2009, ACE held a 75% ownership interest in Air Canada. Air Canada has various related party transactions with Aveos Fleet Performance Inc. ("Aveos") and ACE Aviation Holdings Inc. ("ACE")

The agreements between Air Canada and Aveos and between Air Canada and ACE are summarized in section 14 of Air Canada's 2008 MD&A dated February 13, 2009. There have been no material changes to the Corporation's related party agreements from what was disclosed at that time.

12. Critical Accounting Estimates

Information on Air Canada's critical accounting estimates is disclosed in section 15 of Air Canada's 2008 MD&A dated February 13, 2009. There have been no material changes to the Corporation's critical accounting estimates from what was disclosed at that time.

13. Risk Factors

For a detailed description of risk factors associated with the Corporation, refer to the section entitled "Risk Factors" in Air Canada's 2008 MD&A dated February 13, 2009. Except as disclosed herein, there have been no material changes to the Corporation's risk factors from what was disclosed at that time.

14. Controls and Procedures

Disclosure Controls and Procedures and Internal Controls over Financial Reporting

Disclosure controls and procedures within the Corporation have been 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.

Internal controls over financial reporting have been designed by management, with the participation of the Corporation's President and Chief Executive Officer ("CEO") and the Executive Vice President and Chief Financial Officer ("CFO"), to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and its preparation of financial statements for external purposes in accordance with GAAP.

In the Corporation's 2008 filings, the Corporation's CEO and CFO certified, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design and effectiveness of the Corporation's disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting.

In the Corporation's first quarter 2009 filings, the Corporation's CEO and CFO certify, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design of the Corporation's disclosure controls and procedures and the design of internal controls over financial reporting.

The Corporation's Audit, Finance and Risk Committee reviewed this MD&A, and the interim consolidated financial statements, and the Corporation's Board of Directors approved these documents prior to their release.

Management's Report on Disclosure Controls and Procedures

Management, with the participation of the Corporation's CEO and CFO, concluded, as at March 31, 2009, that such disclosure controls and processes were designed to provide reasonable assurance that:

- (i) material information relating to the Corporation was made known to its Disclosure Policy Committee by others; and
- (ii) information required to be disclosed by the Corporation in its annual filings, interim filings and other reports filed or submitted by the Corporation under securities legislation was recorded, processed, summarized and reported within the time periods specified in securities legislation.

Management's Report on Internal Controls over Financial Reporting

Management, with the participation of the Corporation's CEO and CFO, concluded, as at March 31, 2009, that the Corporation's internal controls over financial reporting were designed to provide reasonable assurance regarding the reliability of financial reporting and its preparation of financial statements for external purposes in accordance with GAAP.

Management and the CEO and CFO use the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control - Integrated Framework to design the Corporation's control framework.

Changes in Internal Controls over Financial Reporting

There have been no changes to the Corporation's internal controls over financial reporting during the first quarter of 2009 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

15. 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. Air Canada presents EBITDAR before and after the provision for cargo investigations as this item 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 are reconciled to operating income (loss) as follows:

(Canadian dollars in millions)	First Quarter		Change \$
	2009	2008	
GAAP operating loss before the provision for cargo investigations	\$ (188)	\$ (12)	\$ (176)
Add back:			
Aircraft rent	86	63	23
Depreciation and amortization	159	171	(12)
EBITDAR before the provision for cargo investigations	\$ 57	\$ 222	\$ (165)
Add back:			
Provision for cargo investigations	-	(125)	125
EBITDAR	\$ 57	\$ 97	\$ (40)

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 fluctuates 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 is reconciled to operating expense as follows:

(Canadian dollars in millions)	First Quarter		Change \$
	2009	2008	
GAAP operating expense	\$ 2,579	\$ 2,739	\$ (160)
Remove:			
Aircraft fuel	(593)	(715)	122
Operating expense, excluding fuel expense	\$ 1,986	\$ 2,024	\$ (38)

16. 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 and amortization as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. Refer to section 15 of this MD&A for additional information.

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.