AIR CANADA

ANNUAL REPORT 2010

1. HIGHLIGHTS

The financial and operating highlights for Air Canada for the periods indicated are as follows.

(Canadian dollars in millions, except where indicated)	Fourth Quarter			Full Year		
	2010 (1)	2009	Change $	2010 (1)	2009	Change $
Financial						
Operating revenues	2,616	2,348	268	10,786	9,739	1,047
Operating income (loss) before a provision adjustment for cargo investigations, net (1)	85	(83)	168	361	(316)	677
Operating income (loss)	131	(83)	214	407	(316)	723
Non-operating expense	(91)	(83)	(8)	(388)	(355)	(33)
Income (loss) before non-controlling interest, foreign exchange and income taxes	40	(166)	206	19	(671)	690
Income (loss) for the period	134	(56)	190	107	(24)	131
Operating margin before a provision adjustment for cargo investigations, net % (1)	3.2%	(3.5%)	6.7 pp	3.3%	(3.2%)	6.5 pp
Operating margin %	5.0%	(3.5%)	8.5 pp	3.8%	(3.2%)	7.0 pp
EBITDAR before a provision adjustment for cargo investigations, net (1) (2)	334	167	167	1,386	679	707
EBITDAR (2)	380	167	213	1,432	679	753
EBITDAR margin before a provision adjustment for cargo investigation, net % (1) (2)	12.8%	7.1%	5.7 pp	12.9%	7.0%	5.9 pp
EBITDAR margin % (2)	14.5%	7.1%	7.4 pp	13.3%	7.0%	6.3 pp
Cash, cash equivalents and short-term investments	2,192	1,407	785	2,192	1,407	785
Free cash flow (3)	122	(52)	174	746	(399)	1,145
Adjusted debt to debt plus equity ratio % (4)	74.3%	80.1%	(5.8) pp	74.3%	80.1%	(5.8) pp
Earnings (loss) per share - Diluted	$ 0.42	($0.25)	$ 0.67	$ 0.37	($0.18)	$ 0.55
Operating Statistics			Change %			Change %
Revenue passenger miles (millions) (RPM)	11,756	10,885	8.0	51,875	47,884	8.3
Available seat miles (millions) (ASM)	14,918	13,841	7.8	63,496	59,343	7.0
Passenger load factor %	78.8%	78.6%	0.2 pp	81.7%	80.7%	1.0 pp
Passenger revenue per RPM (cents) (5)	19.1	18.6	2.8	18.1	17.7	2.3
Passenger revenue per ASM (cents) (5)	15.1	14.6	3.0	14.8	14.3	3.6
Operating revenue per ASM (cents) (5)	17.3	17.0	1.8	17.0	16.4	3.5
Operating expense per ASM ("CASM") (cents)	17.0	17.6	(3.4)	16.4	16.9	(3.1)
CASM, excluding fuel expense (cents)	12.7	13.2	(4.1)	12.2	12.8	(4.5)
Average number of full-time equivalent (FTE) employees (thousands) (6)	23.3	22.5	3.4	23.2	22.9	1.2
Aircraft in operating fleet at period end (7)	328	332	(1.2)	328	332	(1.2)
Average fleet utilization (hours per day) (8)	9.4	8.6	9.0	9.8	9.2	6.5
Revenue frequencies (thousands)	131	126	4.2	537	525	2.4
Average aircraft flight length (miles) (8)	850	823	3.3	868	847	2.5
Fuel price per litre (cents) (9)	70.2	72.6	(3.3)	69.6	69.4	0.3
Fuel litres (millions)	906	825	9.8	3,791	3,510	8.0

(1) In the first quarter of 2008, Air Canada recorded a provision for cargo investigations of $125 million. In the fourth quarter of 2010, Air Canada recorded a net reduction of $46 million to this provision.

(2) EBITDAR (earnings before interest, taxes, depreciation and amortization, and aircraft rent) is a non-GAAP financial measure. See section 20 "Non-GAAP Financial Measures" of the MD&A for a reconciliation of EBITDAR before a provision adjustment for cargo investigations to operating income (loss) and EBITDAR to operating income (loss).

(3) Free cash flow (cash flows from (used for) operating activities less additions to capital assets) is a non-GAAP financial measure. See section 9.5 of the MD&A for additional information.

(4) Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is a non-GAAP financial measure. See section 9.3 of the MD&A for additional information.

(5) A favourable revenue adjustment of $40 million related to Air Canada's transatlantic joint venture, which was finalized in December 2010 but with effect as of January 1, 2010, with United Airlines and Deutsche Lufthansa AG and to other interline agreements was recorded in the fourth quarter of 2010. For comparative purposes, these measures were adjusted to exclude the impact of the $40 million favourable adjustment recorded in the fourth quarter of 2010.

(6) Reflects FTE employees at Air Canada. Excludes FTE employees at Jazz and other third party carriers operating under capacity purchase agreements with Air Canada.

(7) Includes Jazz aircraft covered under the Jazz CPA.

(8) Excludes charter operations. Also excludes third party carriers operating under capacity purchase arrangements, other than Jazz aircraft covered under the Jazz CPA.

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

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MESSAGE FROM THE PRESIDENT & CEO

We made significant progress in 2010 toward the goal of achieving long-term, sustained profitability. Although we benefited from the general upturn in the global airline industry, our strong performance in 2010 was also due to deliberate actions taken to transform and strengthen the company. The goal for 2011 and beyond is to build on these achievements and make continuous improvement part of our culture at Air Canada.

For 2010, we reported EBITDAR of approximately $1.4 billion, more than double that of 2009 and the highest in Air Canada's history. Our operating income (before a net reduction of $46 million to a provision for cargo investigations) of $361 million was an improvement of $677 million from a year earlier. We reported net income of $107 million or 37 cents per diluted share, reversing a net loss of $24 million or 18 cents per share a year earlier. In total, we carried over 32 million passengers in 2010 and – most importantly of all – we did so safely. Air Canada's stock price improved dramatically during the year from $1.26 on the first trading date of the year to $3.45 on the last trading day of the year, an improvement of 174 per cent. This was a pleasing reversal from where we were in 2009.

Accompanying these solid financial results were improvements in virtually every key operating metric. Passenger revenue rose in all market segments led by a 31 per cent increase in the Pacific, and cargo revenue climbed 30 per cent. Our all-important premium cabin revenue was up 23 per cent, reflecting a return of business traffic and our renewed focus on promoting business class services. On a system-wide basis, unit passenger revenue grew 3.6 per cent over the previous year. For 2010, we maintained an all-time high average load factor of 81.7 per cent, attesting to the company's disciplined capacity management.

At the same time, there was significant progress towards achieving long-term sustainability and stability. The company exceeded by $30 million its 2010 Cost Transformation Program ("CTP") target of $300 million in annual revenue and cost improvements. The cost savings associated with this program contributed to reducing unit costs by 4.5 per cent, excluding fuel. We also completed a high yield debt offering that raised nearly $1.1 billion of new liquidity, enabling the company to end 2010 with close to $2.2 billion in cash, cash equivalents and short term investments – another record for Air Canada.

In a service industry such as ours, success is also determined by non-financial measures, including how we are doing with our customers. In 2010, Air Canada garnered numerous awards for its customer service including Best Airline in North America from both the Skytrax World Airline Awards and Global Traveler magazine. In addition, Business Traveler magazine recognized Air Canada with five awards; the most of any carrier in the world for the second consecutive year. These included Best Flight Attendants in North America, Best In-flight Services in North America, Best North American Airline for Business Class Service, Best North American Airline for International Travel and Best Airline Web Site. Additionally, an Ipsos Reid survey found Air Canada is the preferred airline of 71 per cent of Canadian business travellers, the third consecutive year of improvement in our ratings.

Through the course of 2010, there were also important strategic developments that we expect will yield long-term benefits for the company. One of the most important was the completion of our Atlantic joint venture with Lufthansa and the merged United Airlines and Continental Airlines. Following up on that agreement is a proposed transborder joint venture with United, which we anticipate will take effect later in 2011, subject to regulatory approvals.

Commercial alliances extend Air Canada's global reach and provide us access to new markets. For example, we currently serve 59 American cities with our aircraft whereas United has a presence at 210 U.S. airports, meaning added exposure for our brand. Already, the Atlantic joint venture is yielding positive results as international connecting traffic through our main hub at Toronto's Lester B. Pearson International Airport has grown, with twice the number of U.S. originating passengers transiting through Toronto to international destinations as compared to last year. In addition, we have now secured the right to operate at Toronto Island's Billy Bishop Airport and our passengers will have access to this Toronto downtown location following our launch of service scheduled for May 2011.

The strong results of 2010 are rooted in some very clear decisions we made in 2009 to focus on specific priorities. For 2011, it is our intention to build on the success we achieved through the execution of these priorities.

Our first priority is to build on the Air Canada brand and global network while maintaining a strict capacity discipline. In 2010, we redeployed our existing fleet to expand our capacity to Asia, Europe and the U.S. by almost 10 per cent. In addition to Pacific traffic growth, we also achieved a 6.7 per cent traffic increase on the highly competitive Atlantic market, helped by the addition of services to Geneva, Rome, Brussels, Athens, Copenhagen and

Barcelona. In the transborder segment in which we compete in an Open Skies environment, we maintained our industry-leading 35 per cent market share. Additional services were launched to a number of U.S. cities, including San Diego, Portland (Oregon), Cincinnati, Memphis, Portland (Maine), Syracuse and New Orleans.

Apart from expanding our presence in the larger U.S. market, increased transborder flying also supports our growth strategy of channeling more international traffic from the United States through our main Canadian hubs to international destinations. We are well-positioned to continue attracting "sixth freedom traffic" because of our strong brand franchise and industry-leading product, featuring amenities such as lie-flat suites in long-haul Executive First cabins. We have also enhanced on-board services and airport premium products and made schedule adjustments to facilitate connections, and these improvements will position us to further leverage our network and target the higher margins historically available in international markets.

Our second priority is continuing the essential transformation of our cost structure and finding different opportunities for revenue growth. By the end of 2011, we expect our CTP will yield annualized benefits of $530 million. These benefits are being achieved primarily through operational process improvements, supplier contract renegotiations and revenue productivity gains. For example, Air Canada flew 3,700 more flights and carried 400,000 more passengers in summer 2010 over the same period in 2009, without adding a single aircraft to the fleet. With respect to increased revenue, in 2010 ancillary revenue per passenger grew 20 per cent due to initiatives with a variety of fee-based passenger services.

As we move to complete our three-year CTP goal by the end of 2011, our efforts are transitioning to focus on more complex cross-branch processes for cost savings, including through the use of technology. A new business transformation team will work with cross-functional business teams to identify new opportunities to lower our cost structure over the medium term and embed in our culture an ethos of continuous cost improvement.

We are also focused on improving our balance sheet. Our net debt to EBITDAR ratio declined from 8.3 times at the end of 2009 to 3.5 times at the end of 2010. With the completion of the fleet-wide cabin refurbishment and Boeing 777 program, we are currently in a low capital expenditure period, prior to the first deliveries of our Boeing 787 order expected in late 2013 and early 2014. We expect to further deleverage our balance sheet over the next two years.

Our third priority is around customer service. Our goal is to continuously meet and exceed customer satisfaction by delivering consistent, friendly and professional service that is best in class. The numerous awards we received in 2010 speak to our success, and our own monthly surveys support our continued improvement. For example, "overall satisfaction" increased 10 percentage points among our customers. We will continue to introduce service and process improvements at our call centres, on aircanada.com, in airports and on our aircraft. We also expect the increased use of technology and social media to facilitate customer interactions and enhance customers' experience.

The final and perhaps most important priority is culture change. A corporate culture is the foundation upon which everything stands and the company is committed to fostering a culture where leadership, entrepreneurship and ownership are valued and rewarded. Already, there has been a 20 per cent improvement in employee engagement over the last two years according to internal surveys. Our initiative of granting shares to employees through the 2010 Employee Recognition Award, along with the Sharing Our Success monthly incentive program, should further align our employees' personal interests with corporate goals, as we build a strong performance-oriented organization. We, at Air Canada, have long recognized the importance of giving back to the communities we serve and taking measurable steps to reducing our impact on the environment. In 2010, our employees' passionate involvement in Haiti relief activity served as an example of their ongoing commitment to Air Canada's social and humanitarian activities.

While 2010 was a strong year for Air Canada, the results achieved demonstrate that we have the focus to succeed in our challenge of sustained profitability. The current year will not be without challenges, notably rising fuel prices, a still uncertain global economy, competitive changes within the industry and other factors, but we believe the company has the flexibility to respond quickly to these changing circumstances.

We will be in negotiations with our unions this year as our Canadian collective agreements are up for renewal in the first half of 2011. We have been engaged in productive dialogue and have been sharing information with our unions on a regular basis for the past two years. Based on what we have achieved in 2010 by working together, it is management's belief that we have a good foundation to reach mutually satisfactory agreements that will enhance our ability to execute our priorities.

Most importantly, I want to thank Air Canada's 26,000 employees for their commitment, dedication and professionalism. Equally, I thank our customers, shareholders, suppliers and other stakeholders for their ongoing support and loyalty. The airline business is complex and impacted by many events, but we are encouraged by the many improvements of 2010. We look forward with renewed enthusiasm to the future.

Calin Rovinescu
President and Chief Executive Officer

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 2010 MD&A provides the reader with a view and analysis, from the perspective of management, of Air Canada's financial results for the fourth quarter of 2010 and for the full year 2010. This MD&A should be read in conjunction with Air Canada's audited consolidated financial statements and notes for 2010. All financial information has been prepared in accordance with generally accepted accounting principles in Canada ("GAAP"), unless indicated otherwise. 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 21 "Glossary" of this MD&A. Except as otherwise noted, this MD&A is current as of February 9, 2011.

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 risks relating to Air Canada, refer to section 18 "Risk Factors" of this MD&A.

Air Canada issued a news release dated February 10, 2011, reporting on its results for the fourth quarter of 2010 and for the full year 2010. This news release is available on Air Canada's website at aircanada.com and on SEDAR at **www.sedar.com**. For further information on Air Canada's public disclosure file, including Air Canada's Annual Information Form, consult Air Canada's website at **aircanada.com** or SEDAR at **www.sedar.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 communications, including filings with regulatory authorities and securities regulators. Forward-looking statements may be 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. 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 herein and are subject to important risks and uncertainties. Forward-looking 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, environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), 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 this MD&A. The forward-looking statements contained in this MD&A represent Air Canada's expectations as of February 9, 2011 (or as of the date they are otherwise stated to be made), and are subject to change after such date. However, Air Canada 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 continue to recover in 2011. In addition, Air Canada expects that the Canadian dollar will trade, on average, at C$1.00 per U.S. dollar in the first quarter of 2011 and C$1.02 per U.S. dollar for the full year 2011 and that the price of fuel will average 76 cents per litre for the first quarter of 2011 and 80 cents per litre for the full year 2011.

3. ABOUT AIR CANADA

Air Canada is Canada's largest domestic, U.S. transborder and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-U.S. transborder market and in the international market to and from Canada.

In 2010, Air Canada, together with Jazz Aviation LP ("Jazz") (the successor to Jazz Air LP) and other regional airlines operating flights on behalf of and under commercial agreements with Air Canada, operated, on average, 1,470 daily departures to 59 destinations in Canada, 59 destinations in the U.S. and 60 destinations in the Canada-Europe, Canada-Pacific, Canada-Caribbean/Central America and Canada-South America markets. Domestic, U.S. transborder and international departures accounted for approximately 66%, 27% and 7%, respectively, of the approximately 1,470 average daily departures. In addition, Air Canada provides certain passenger charter services under the brand name "AC Jetz". In 2010, Air Canada carried over 32 million passengers and provided passenger service to 178 direct destinations on five continents.

As at December 31, 2010, Air Canada operated a mainline fleet of 205 aircraft comprised of 89 Airbus narrow-body aircraft, 56 Boeing and Airbus wide-body aircraft and 60 Embraer regional jets. In addition, under Air Canada's capacity purchase agreement with Jazz (the "Jazz CPA"), Jazz operated, for Air Canada, 123 aircraft comprised of 63 Bombardier regional jets and 60 Dash-8 aircraft.

Air Canada enhances its network through the Jazz CPA, pursuant to which Air Canada purchases the greater part of Jazz's fleet capacity based on predetermined rates and Air Canada determines the routes and schedule which Jazz operates on Air Canada's behalf. Under the Jazz CPA, Jazz operates with smaller jet and turboprop aircraft that have lower trip costs than conventional large jet aircraft, allowing Jazz to provide service to Air Canada's customers in lower density markets as well as in higher density markets at off-peak times throughout Canada and the United States.

Air Canada is a founding member of the Star Alliance® network. The Star Alliance® network includes 27 member airlines. Through its membership in the Star Alliance® network, Air Canada is able to offer its customers access to approximately 1,160 destinations in 181 countries, as well as reciprocal participation in frequent flyer programs and use of airport lounges.

In October 2010, Air Canada announced that it had concluded a memorandum of understanding with United Airlines, Inc. setting out the principles for a comprehensive revenue-sharing joint venture on U.S. transborder flights. The joint venture is expected to come into effect in 2011, subject to the parties obtaining regulatory approvals, making the necessary filings, and finalizing the arrangements and documentation.

In December 2010, Air Canada finalized a transatlantic joint venture with United Air Lines, Inc., Continental Airlines, Inc. (United Air Lines, Inc. and Continental Airlines, Inc. are collectively "United Airlines") and Deutsche Lufthansa AG through which the carriers provide customers with more choice and streamlined service on routings between North and Central America, and Africa, India, Europe and the Middle East. This transatlantic joint venture, including its revenue share structure, was implemented effective January 1, 2010.

Through its long-term relationship with Aeroplan Canada Inc. ("Aeroplan"), Air Canada's frequent flyer program provider, Air Canada is able to build customer loyalty by offering those customers who are Aeroplan® members the opportunity to earn Aeroplan® Miles when they fly with Air Canada. Aeroplan is also Air Canada's single largest customer. The relationship with Aeroplan is designed to provide a long-term stable and recurring source of revenue from the purchase by Aeroplan of Air Canada seats to be provided to Aeroplan® members who choose to redeem their Aeroplan® Miles for air travel rewards.

Air Canada also generates revenue from Air Canada Cargo and from tour operator services provided by its wholly-owned subsidiary, Touram Limited Partnership (doing business as "Air Canada Vacations").

Air Canada Cargo provides direct cargo services to over 150 Canadian, U.S. transborder and international destinations and has sales representation in over 50 countries. Air Canada Cargo is Canada's largest provider of air cargo services as measured by cargo capacity. Air cargo services are provided on domestic and U.S. transborder flights and on international flights on routes between Canada and major markets in Europe, Asia, South America and Australia.

Air Canada Vacations is one of Canada's leading tour operators. Based in Montreal and Toronto, Air Canada Vacations operates its business in the outbound leisure travel market (Caribbean, Mexico, U.S., Europe, Central and South America, South Pacific and Asia) by developing, marketing and distributing vacation travel packages. Air Canada Vacations also offers cruise packages in North America, Europe and the Caribbean.

4. STRATEGY

In 2010, Air Canada improved its reputation as one of the world's leading international air carriers. Significant progress was made on executing and delivering on its four key priorities and this, coupled with improving economic conditions, allowed Air Canada to record operating income (before a net reduction of $46 million to a provision for cargo investigations) of $361 million in 2010, a $677 million improvement from 2009. EBITDAR (before a net reduction of $46 million to a provision for cargo investigations) of $1,386 million in 2010 was the highest EBITDAR recorded in the airline's history. See section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Air Canada's financial strategy is to continue to improve both the level and sustainability of its earnings and, in turn, maximize long-term value for its stakeholders. In 2011, Air Canada plans to build on the progress it achieved in 2010 and focus on the following four key priorities:

- Building on the Air Canada brand and global network;
- Leveraging new opportunities for revenue growth and cost transformation;
- Engaging with customers with a focus on premium passengers and premium products;
- Enhancing the corporate culture and developing a strong employee brand.

Building on the Air Canada brand and global network

In 2011, Air Canada will continue to remain disciplined in its approach to growth. Air Canada believes that Canada's multi-ethnic demographic profile provides the airline with opportunities to benefit from a growing demand for international travel. Combined with a powerful brand franchise and an industry leading international product, Air Canada plans on leveraging its network in order to benefit from the higher margins generally available in international markets. The airline will also continue leveraging its world class hub at Toronto Pearson International Airport and other Canadian hubs with the objective of increasing global connecting traffic via Canada. Toronto Pearson International Airport has a geographic advantage due to its proximity to densely populated markets and is also a destination for a large number of business and leisure travelers. The Greater Toronto Airport Authority has made terminal improvements, including improvements that enabled Air Canada and most of its Star Alliance® partners to consolidate operations in one terminal, thereby facilitating transfer traffic and improving the customer experience. These improvements have strengthened the position of Toronto Pearson International Airport as a major gateway for global flow traffic.

In 2010, Air Canada expanded its capacity to Asia, Europe and the U.S. by close to 11%. Air Canada recognizes the growing importance of the Asian travel market and, in 2010, increased Pacific traffic by over 22% from 2009. The decision to add capacity to this market was driven, in part, by Canada being granted Approved Destination Status from China, a designation that makes it easier for Chinese nationals to visit Canada. Furthermore, aided by the addition of services to Geneva, Rome, Brussels, Athens, Copenhagen and Barcelona, Air Canada also increased 2010 traffic in the Atlantic market by 6.7% from 2009 levels. These additional services are strengthening the airline's European flagship routes of London, Paris and Frankfurt. Air Canada also added service to a number of U.S. cities in 2010, including San Diego, Portland (Oregon), Cincinnati, Memphis, Portland (Maine), Syracuse (New York) and New Orleans, with the goal of growing connecting traffic from the U.S. in support of its international expansion initiatives.

An important aspect of Air Canada's international expansion program is the continued development of commercial alliances with major international carriers to extend the airline's global reach and enhance market presence. This is being achieved through Air Canada's membership in Star Alliance® which allows the airline to offer its customers a choice of 1,160 airports in 181 countries. In addition, through its transatlantic joint venture with United Airlines and Deutsche Lufthansa AG, referred to as A++, Air Canada is strengthening its market presence in North America and Europe, the Middle East as well as Africa and India. In early October 2010, Air Canada announced a joint venture in the Canada-U.S. market with United Airlines, subject to obtaining regulatory approvals, making the necessary filings, and finalizing the arrangements and documentation. This joint venture will provide Air Canada with benefits and revenue synergies allowing the airline to compete more effectively. By managing pricing, scheduling and sales, Air Canada will be better able to serve customers by offering more travel options, while reducing travel times. The Canada-U.S. transborder joint venture is expected to come into effect in 2011.

Leveraging new opportunities for revenue growth and cost transformation

Air Canada recognizes that the long term success of the airline is dependent on sustaining a competitive cost structure, and Air Canada is committed to making cost containment and reduction a permanent part of its corporate culture without compromising the customer experience. In 2011, Air Canada is focused on building on the progress it achieved in 2010 to improve unit revenue and cost productivity. The airline will continue to focus on improving business processes and leveraging technology to improve the quality of its products and services and reduce costs.

One of Air Canada's objectives is to achieve annualized revenue improvements and cost savings of $530 million by the end of 2011. Through extensive management analysis and benchmarking against other airlines, over 125 initiatives have been identified, the vast majority of which relate to cost savings such as contract renegotiation, operational process improvements and productivity gains. In 2010, Air Canada has achieved annual benefits of $330 million, $30 million more than its $300 million CTP target for 2010 (the result of having completed planned 2011 CTP initiatives earlier than expected), and has achieved $400 million of its overall CTP target of $530 million for the end of 2011, on a run-rate basis.

In 2010, the cost transformation program was a factor in lowering Air Canada's CASM, excluding fuel, by 4.5% from 2009.

Engaging with customers with a focus on premium passengers and premium products

Customer satisfaction and growth of the premium class segment are key elements to Air Canada's long term success. Air Canada's goal is to continuously meet and exceed customer expectations by delivering consistently friendly, professional and "best in class" service. In 2011, Air Canada will remain focused on premium passengers and products to build on its success in 2010, which reflected passenger revenue growth of $378 million or 23 per cent in the premium cabin when compared to 2009. The airline will continue to focus on better managing its premium class cabin to maximize revenues, seeking new opportunities to increase premium revenues, and broadening access to corporate customers.

Air Canada is one of the most respected brands in Canada, and Air Canada plans to continue to leverage this strength to attract premium revenue, particularly on its international service. Air Canada has one of the youngest fleets among North American legacy carriers, with an average age of 10.7 years at December 31, 2010. The airline's investment in Boeing 777 and Embraer aircraft and industry-leading on-board products, including personal in-flight entertainment systems and in-seat power outlets accessible at virtually every seat, showcase the advantages of flying Air Canada. In addition, customers are increasingly recognizing the value of the airline's Maple Leaf Lounges, its concierge program and its loyalty program.

In 2010, Air Canada was recognized with the following awards, reflecting the skill and professionalism of its employees as well as the quality of its product offerings:

- Five top honours in Business Traveler's "Best in Business Travel" award program, the most first place awards won by any airline in the world in the magazine's annual reader survey.
    - Best Flight Attendants in North America
    - Best In-Flight Services in North America
    - Best North American Airline for Business Class Service
    - Best North American Airline for International Travel
    - Best Airline Web Site

- "Best Airline in North America" in the annual Global Traveler Reader Survey Awards, based on the responses of more than 25,000 readers of Global Traveler magazine.

- "Best Airline for Flights to Canada" by readers of Executive Travel magazine in annual "Leading Edge Awards" readership survey of frequent international travelers, for a third consecutive year.

- "Best Airline in North America" in a worldwide survey of more than 17 million air travelers conducted by independent research firm, Skytrax, for their 2010 World Airline Awards.

Furthermore, in 2010, 71% of Canadian business travelers surveyed by Ipsos Reid in their 2010 Canadian Business Travel Study named Air Canada as their preferred airline, the third consecutive year of improvement in the airline's ratings.

The continued year-over-year improvements in monthly customer satisfaction ratings and the numerous industry awards won in late 2009 and 2010 is evidence that the airline has been successful in engaging with its customers.

Enhancing the corporate culture and developing a strong employee brand

One of Air Canada's key priorities is to improve its corporate culture to one that promotes leadership, ownership and entrepreneurship. Air Canada recognizes the need to simplify processes, give its employees the tools and training required to foster a culture of top customer care and empower employees to allow them to make decisions or solve problems quickly. The emphasis on cost containment is helping forge a more entrepreneurial culture at Air Canada in which all employees are encouraged to act as owners and ambassadors of the airline.

With internal departments working better together, Air Canada has become more efficient with the use of its fleet. This past summer, the airline flew 3,700 more flights or 12,630 more hours and carried 400,000 more customers with almost the same number of aircraft that it operated in 2009.

This positive shift in Air Canada's culture enabled the airline to better manage through major challenges, both planned, such as the Olympics, and unplanned, such as the Icelandic volcano eruption. The airline is managing irregular operations more efficiently to minimize customer inconvenience. This was demonstrated again during the flight disruptions at European airports during the Christmas holidays when the airline was praised for its customer service and the speed with which it was able to resume operations.

The recent industry honours awarded to Air Canada are an indication that employees are participating in the airline's transformation and recognize that the airline's success depends on being resolutely customer focused.

5. OVERVIEW

Air Canada's results of operations for the fourth quarter of 2010 and for the full year 2010 are discussed in sections 6 and 7, respectively, of this MD&A.

In summary, Air Canada's results of operations for 2010 compared to 2009 are as follows:

Air Canada recorded net income of $107 million or $0.37 per diluted share in 2010 compared to a net loss of $24 million or $0.18 loss per diluted share in 2009. Air Canada's net income in 2010 included foreign exchange gains of $145 million which were primarily attributable to a stronger Canadian dollar at December 31, 2010, compared to December 31, 2009. The December 31, 2010 noon day exchange rate was US$1 = C$0.9946 while the December 31, 2009 noon day exchange rate was US$1 = C$1.0466. Air Canada's net loss in 2009 included foreign exchange gains of $657 million.

In the first quarter of 2008, Air Canada recorded a provision of $125 million related to alleged anti-competitive cargo pricing activities. In the fourth quarter of 2010, Air Canada recorded a net reduction of $46 million to this provision. For additional information, refer to section 18 "Risk Factors" of this MD&A.

In 2010, Air Canada recorded operating income (before a net reduction of $46 million to the provision for cargo investigations) of $361 million, an improvement of $677 million from the operating loss of $316 million recorded in 2009. EBITDAR (before a net reduction of $46 million to the provision for cargo investigations) amounted to $1,386 million in 2010 compared to EBITDAR of $679 million in 2009, an increase of $707 million. See section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

In 2010, Air Canada recorded operating revenues of $10,786 million, an increase of $1,047 million or 11% from the operating revenues of $9,739 million recorded in 2009. The increase in operating revenues was mainly due to passenger and cargo revenue growth of $1,036 million or 12% from 2009. The year-over-year system passenger revenue growth of $928 million or 11% was due to an 8.3% increase in system passenger traffic and a 2.3% improvement in system yield. The passenger traffic growth in 2010 was greater than the capacity increase of 7.0% which resulted in a 1.0 percentage point improvement in system passenger load factor from 2009. The system yield improvement of 2.3% in 2010 was achieved despite a negative impact of $293 million relating to the stronger Canadian dollar on foreign currency denominated passenger revenues, which were approximately 29% of 2010 passenger revenues. System RASM in 2010 increased 3.6% year-over-year due to both the yield growth and the passenger load factor improvement. The stronger Canadian dollar in 2010 compared to 2009 reduced the RASM improvement by 3.2 percentage points in 2010. Excluding the unfavourable impact of foreign exchange, RASM increased 6.8% in 2010. Cargo revenue growth of $108 million or 30% from 2009 was due to a 34% increase in cargo traffic.

In 2010, Air Canada recorded operating expenses of $10,425 million, an increase of $370 million or 4% from the operating expenses of $10,055 million recorded in 2009. The increase in operating expenses in 2010 was largely driven by the capacity growth of 7.0%, higher base fuel prices year-over-year representing $517 million of the increase, and increases in wages, salaries and benefits, commissions, ownership, and communication and information technology costs from 2009. Higher credit card fees and an increase in expenses related to ground packages at Air Canada Vacations were also contributing factors to the operating expense increase year-over-year. Operating expense increases were partly offset by several factors, including the impact of a stronger Canadian dollar on foreign currency denominated expenses which reduced operating expenses by approximately $439 million from the same period in 2009, notable reductions in aircraft maintenance and capacity purchase fees paid to Jazz, as well as by the impact of Cost Transformation Program ("CTP") initiatives.

Initiatives relating to the CTP have had a favourable impact on various operating expense categories, including wages and salaries, airport user fees, capacity purchase fees with Jazz, food, beverage and supplies, information technology, terminal handling and "other" operating expenses. In mid-2009, Air Canada launched the CTP, identifying and implementing initiatives with a goal of generating annualized revenue gains and cost savings, including through contract and operating process improvements and productivity gains. As of the date of this MD&A, Air Canada has achieved annual benefits of $330 million, $30 million more than its $300 million CTP target for 2010, the result of having completed planned 2011 CTP initiatives earlier than expected. To date, Air Canada has achieved $400 million of its overall CTP target of $530 million for the end of 2011, on a run-rate basis. Air Canada views the CTP as one of its most important priorities.

CASM decreased 3.1% from 2009. Excluding fuel expense, CASM decreased 4.5% from 2009. The 4.5% decrease in CASM (excluding fuel expense) for 2010 was in line with the 4.0% to 4.5% CASM (excluding fuel expense) decrease projected in Air Canada's news release dated November 4, 2010.

6. RESULTS OF OPERATIONS – FOURTH QUARTER 2010 VERSUS FOURTH QUARTER 2009

The following table and discussion compares the results of Air Canada for the fourth quarter of 2010 versus the fourth quarter of 2009.

(Canadian dollars in millions, except per share figures)	Fourth Quarter 2010 (1)	Fourth Quarter 2009	Change $	Change %
Operating revenues				
Passenger	$ 2,296	$ 2,030	$ 266	13
Cargo	124	110	14	13
Other	196	208	(12)	(6)
	2,616	**2,348**	**268**	**11**
Operating expenses				
Aircraft fuel	640	601	39	6
Wages, salaries and benefits	470	418	52	12
Airport and navigation fees	229	228	1	-
Capacity purchase with Jazz	231	227	4	2
Depreciation and amortization	165	165	-	-
Aircraft maintenance	173	202	(29)	(14)
Food, beverages and supplies	54	69	(15)	(22)
Communications and information technology	81	64	17	27
Aircraft rent	84	85	(1)	(1)
Commissions	65	46	19	41
Other	339	326	13	4
	2,531	**2,431**	**100**	**4**
Operating income (loss) before undernoted item	**85**	**(83)**	**168**	
Provision adjustment for cargo investigations, net (1)	46	-	46	
Operating income (loss)	**131**	**(83)**	**214**	
Non-operating income (expense)				
Interest income	9	2	7	
Interest expense	(81)	(87)	6	
Interest capitalized	1	-	1	
Loss on assets	(8)	(25)	17	
Gain on financial instruments recorded at fair value	8	22	(14)	
Other	(20)	5	(25)	
	(91)	(83)	(8)	
Income (loss) before the following items	**40**	**(166)**	**206**	
Non-controlling interest	(2)	(4)	2	
Foreign exchange gain	111	108	3	
Recovery of (provision for) income taxes	(15)	6	(21)	
Income (loss) for the period	**$ 134**	**$ (56)**	**$ 190**	
EBITDAR before the provision adjustment for cargo investigations, net (1) (2)	**$ 334**	**$ 167**	**$ 167**	
EBITDAR (2)	**$ 380**	**$ 167**	**$ 213**	
Earning (loss) per share - Diluted	**$ 0.42**	**$ (0.25)**	**$ 0.67**	

(1) In the first quarter of 2008, Air Canada recorded a provision for cargo investigations of $125 million. In the fourth quarter of 2010, Air Canada recorded a net reduction of $46 million to this provision.

(2) See section 20 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR before the provision adjustment for cargo investigations to operating income (loss) and EBITDAR to operating income (loss).

System passenger revenues increased 13.1% from the fourth quarter of 2009

System passenger revenues increased $266 million or 13.1% to $2,296 million from the fourth quarter of 2009. Fourth quarter 2010 passenger revenues included a favourable annual adjustment of $40 million related to the airline's transatlantic joint venture, which was finalized in December 2010 but with effect as of January 1, 2010, with United Airlines and Deutsche Lufthansa AG and to other interline agreements. For comparative purposes, the discussion and tables below exclude the impact of the $40 million favourable adjustment recorded in the fourth quarter of 2010.

On an adjusted basis, system passenger revenues increased $226 million or 11.2% to $2,256 million from the fourth quarter of 2009. Premium cabin revenues increased $88 million or almost 21% from the same quarter in 2009, due to a 16.9% increase in traffic and a 2.2% improvement in yield.

In the fourth quarter of 2010, Air Canada's overall capacity was 7.8% higher than the fourth quarter of 2009, with capacity growth reflected in all markets. Overall capacity in the international markets, including the U.S. transborder market, increased 11.4% from the fourth quarter of 2009. This capacity growth is consistent with one of Air Canada's 2010 key priorities to expand its international operations and to leverage its hub at Toronto Pearson International Airport as a global transfer point for travelers en route to domestic, U.S. transborder and international destinations.

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

Fourth Quarter 2010 Versus Fourth Quarter 2009	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	7.5	0.2	2.0	1.4	5.3	7.1
US transborder	10.7	11.7	12.0	0.2	(1.3)	(1.0)
Atlantic	7.5	5.5	2.5	(2.8)	4.7	1.7
Pacific	31.7	23.0	22.9	(0.1)	7.2	7.0
Other	15.4	7.2	9.4	1.6	5.4	7.5
System	**11.2**	**7.8**	**8.0**	**0.2**	**2.8**	**3.0**

The table below provides year-over-year percentage changes in system passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the fourth quarter 2010 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
System	Q4'09	Q1'10	Q2'10	Q3'10	Q4'10
Passenger Revenues	(7.0)	4.2	12.4	13.4	11.2
Capacity (ASMs)	2.0	6.6	5.3	8.2	7.8
Traffic (RPMs)	0.4	6.4	8.7	9.7	8.0
Passenger Load Factor (pp Change)	(1.3)	(0.1)	2.6	1.2	0.2
Yield	(7.3)	(2.2)	3.3	3.2	2.8
RASM	(8.8)	(2.3)	6.6	4.7	3.0

Components of the year-over-year change in fourth quarter system passenger revenues included:

- A system traffic increase of 8.0% on the capacity growth of 7.8%, which resulted in a system passenger load factor improvement of 0.2 percentage points from the fourth quarter of 2009. This system capacity growth was in line with the 7.0% to 8.0% fourth quarter 2010 ASM capacity increase projected in Air Canada's news release dated November 4, 2010.

- An adjusted system yield improvement of 2.8% from the fourth quarter of 2009, which reflected an improvement in the economic environment as well as the impact of Air Canada's renewed focus on improving the quality of its revenues and promoting its business class services. The year-over-year fourth quarter yield improvement was achieved in spite of an unfavourable impact relating to the stronger Canadian dollar on foreign currency denominated passenger revenues. The stronger Canadian dollar in the fourth quarter of 2010 versus the fourth quarter of 2009 decreased the Canadian dollar value of sales in foreign countries and had a negative impact of $32 million on system passenger revenues.

- An adjusted system RASM increase of 3.0% from the fourth quarter of 2009, which was due to both the yield growth and the passenger load factor improvement. Adjusted RASM in the premium cabin increased 12.2% year-over-year while RASM in the economy cabin improved 0.4% from the fourth quarter of 2009.

Domestic passenger revenues increased 7.5% from the fourth quarter of 2009

Domestic passenger revenues of $950 million in the fourth quarter of 2010 increased $67 million or 7.5% from the fourth quarter of 2009 due to a yield improvement and traffic growth.

The table below provides year-over-year percentage changes in domestic passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the fourth quarter 2010 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Canada	Q4'09	Q1'10	Q2'10	Q3'10	Q4'10
Passenger Revenues	(7.9)	1.5	6.8	5.9	7.5
Capacity (ASMs)	(0.6)	2.6	(0.2)	0.8	0.2
Traffic (RPMs)	(1.3)	0.8	2.9	1.7	2.0
Passenger Load Factor (pp Change)	(0.5)	(1.4)	2.5	0.7	1.4
Yield	(6.7)	0.6	3.7	4.1	5.3
RASM	(7.3)	(1.1)	7.0	5.0	7.1

Components of the year-over-year change in fourth quarter domestic passenger revenues included:

- A traffic increase of 2.0% on capacity growth of 0.2%, which resulted in a 1.4 percentage point improvement in passenger load factor.

- A yield increase of 5.3% from the fourth quarter of 2009, reflecting yield improvements in both the economy cabin and the premium cabin. Yield improvements were recorded on all major domestic services with the largest improvement reflected on routes to and from western Canada (short and long haul). The yield improvement was mainly due to an increase in business traffic resulting from more favourable economic conditions assisted by targeted Executive cabin fare products, which improved both traffic and average fare performance. Air Canada's Rapidair routes, linking Toronto and Montreal/Ottawa, also reflected meaningful yield improvements over the same quarter in 2009 due to the return of higher yielding business traffic.

- The year-over-year fourth quarter domestic yield improvement was achieved in spite of a $5 million unfavourable impact of a stronger Canadian dollar on foreign currency denominated domestic passenger revenues.

- A domestic RASM increase of 7.1% from the fourth quarter of 2009, which was mainly due to the yield growth but also to the passenger load factor improvement.

U.S. transborder passenger revenues increased 10.7% from the fourth quarter of 2009

U.S. transborder passenger revenues of $448 million in the fourth quarter of 2010 increased $43 million or 10.7% from the fourth quarter of 2009 due to traffic growth. In the fourth quarter of 2010, U.S. transborder capacity increased 11.7% from the fourth quarter of 2009, largely driven by growth in connecting traffic from the U.S. in support of Air Canada's international expansion initiatives.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the fourth quarter 2010 and each of the previous four quarters.

U.S. transborder	Year-over-Year by Quarter (% Change)				
	Q4'09	Q1'10	Q2'10	Q3'10	Q4'10
Passenger Revenues	(3.7)	6.0	11.3	10.4	10.7
Capacity (ASMs)	(1.8)	2.8	7.3	13.3	11.7
Traffic (RPMs)	(5.0)	3.4	10.3	12.8	12.0
Passenger Load Factor (pp Change)	(2.5)	0.5	2.0	(0.3)	0.2
Yield	1.4	2.5	0.8	(2.3)	(1.3)
RASM	(1.9)	3.1	3.6	(2.7)	(1.0)

Components of the year-over-year change in fourth quarter U.S. transborder passenger revenues included:

- A traffic increase of 12.0% on the capacity growth of 11.7%, which resulted in a passenger load factor improvement of 0.2 percentage points from the fourth quarter of 2009. The year-over-year capacity growth included:
  - The introduction of new daily services from Toronto to San Diego, California; Memphis, Tennessee; New Orleans, Louisiana; Cincinnati, Ohio; Portland, Maine; Portland, Oregon and Syracuse, New York and new daily services from Montreal to Phoenix, Arizona;
  - An increase in capacity on routes to California between Toronto and Los Angeles through the use of larger aircraft and between Toronto and San Francisco through an increase in frequencies;
  - An increase in capacity on routes to Florida between Toronto and Fort Lauderdale, and Toronto and Miami through an increase in frequencies;
  - An earlier start-up of Air Canada's seasonal service between Calgary and Honolulu, and Calgary and Maui;
  - An increase in capacity in the eastern seaboard market (New York, Boston, Washington, Pittsburg and Philadelphia) through the combination of an increase in frequencies and the use of larger aircraft.

  The suspension of the following services partly offset this capacity growth: Edmonton-Los Angeles, Edmonton-Las Vegas, Calgary-San Diego, Calgary-Seattle and Calgary-Portland, Oregon.
- A yield decline of 1.3% from the fourth quarter of 2009, which was due to the impact of more aggressive competitive pricing in the U.S. transborder market and a higher proportion of international traffic flowing to and from the U.S. producing lower yields on the U.S. transborder segments, thereby impacting the overall U.S. transborder yield while increasing revenues in the international market. Yield improvements were achieved on all major routes with the exception of routes to Florida and California where incremental and new competitive flying resulted in lower yields. The unfavourable impact of a stronger Canadian dollar on foreign currency denominated U.S. transborder passenger revenues was also a factor in the year-over-year yield decline, accounting for a decrease of $8 million to fourth quarter 2010 U.S. transborder passenger revenues.
- A U.S. transborder RASM decrease of 1.0% from the fourth quarter of 2009, which was due to the decline in yield.

Atlantic passenger revenues increased 7.5% from the fourth quarter of 2009

On an adjusted basis, Atlantic passenger revenues of $404 million in the fourth quarter of 2010 increased $28 million or 7.5% from the fourth quarter of 2009 due to yield and traffic growth. In the fourth quarter of 2010, Atlantic capacity increased 5.5% from the fourth quarter of 2009, with capacity growth reflected on all major Atlantic services with the exception of routes to the U.K. and Germany.

The table below provides year-over-year percentage changes in Atlantic passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the fourth quarter 2010 and each of the previous four quarters.

Atlantic	Year-over-Year by Quarter (% Change)				
	Q4'09	Q1'10	Q2'10	Q3'10	Q4'10
Passenger Revenues	(4.8)	6.5	12.8	16.3	7.5
Capacity (ASMs)	6.7	6.2	2.4	12.3	5.5
Traffic (RPMs)	2.4	5.8	3.2	12.3	2.5
Passenger Load Factor (pp Change)	(3.3)	(0.3)	0.7	-	(2.2)
Yield	(7.0)	0.5	9.2	3.5	4.7
RASM	(10.8)	0.1	10.0	3.4	1.7

Components of the year-over-year change in fourth quarter Atlantic passenger revenues included:

- A traffic increase of 2.5% on the capacity growth of 5.5%, which resulted in a passenger load factor decrease of 2.2 percentage points from the fourth quarter of 2009. Despite continued traffic growth on many major Atlantic services originating from Canada, the U.S. and Europe, competitive pressure, both in terms of pricing and added capacity, had a negative impact on Air Canada's local and connecting traffic in France, Switzerland and Germany. On routes to Israel, traffic gains did not fully meet the capacity growth.

- The capacity increase in the fourth quarter of 2010 reflected the addition of new routes including the following year-round services which started in June 2010, namely: Toronto-Montreal-Brussels and Toronto-Copenhagen and the following summer seasonal services which operated into October 2010, namely: Montreal-Barcelona, Toronto-Barcelona, Toronto-Athens, Montreal-Athens, as well as additional frequencies on Toronto-Tel Aviv commencing in June 2010.

- An adjusted yield improvement of 4.7% from the fourth quarter of 2009, which reflected a greater proportion of higher-yield premium traffic, a notable return in business travel demand and the airline's strong focus on promoting premium services. The year-over-year fourth quarter Atlantic yield improvement was achieved in spite of a $13 million unfavourable impact of a stronger Canadian dollar on foreign currency denominated Atlantic passenger revenues.

- An adjusted Atlantic RASM increase of 1.7% from the fourth quarter of 2009, which was due to the yield growth.

Pacific passenger revenues increased 31.7% from the fourth quarter of 2009

Pacific passenger revenues of $261 million in the fourth quarter of 2010 increased $62 million or 31.7% from the fourth quarter of 2009 due to yield and traffic growth. In the fourth quarter of 2010, capacity increased 23.0% from the fourth quarter of 2009 with growth reflected on all major Pacific services.

The table below provides year-over-year percentage changes in Pacific passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the fourth quarter 2010 and each of the previous four quarters.

Pacific	Year-over-Year by Quarter (% Change)				
	Q4'09	Q1'10	Q2'10	Q3'10	Q4'10
Passenger Revenues	(9.7)	14.5	37.3	37.7	31.7
Capacity (ASMs)	6.5	25.6	17.5	10.9	23.0
Traffic (RPMs)	4.2	23.6	27.0	17.1	22.9
Passenger Load Factor (pp Change)	(1.8)	(1.4)	6.7	4.8	(0.1)
Yield	(13.4)	(7.4)	8.1	17.5	7.2
RASM	(15.2)	(8.8)	16.9	24.1	7.0

Components of the year-over-year change in fourth quarter Pacific passenger revenues included:

- A traffic increase of 22.9% on capacity growth of 23.0%, which resulted in a passenger load factor decline of 0.1 percentage points from the fourth quarter of 2009. Air Canada increased its capacity on the Pacific with the introduction of a Calgary-Narita non-stop service until October 2010, additional frequencies from Vancouver to Beijing and Shanghai, the use of larger aircraft on routes to Japan and additional frequencies on routes to Korea. The strong year-over-year traffic gains were driven by attracting passengers originating from Air Canada's international points of sale as well as from Canada and the U.S.

- A yield increase of 7.2% from the fourth quarter of 2009, which reflected yield improvements on all major Pacific services with the exception of China where the yield was slightly below the same quarter in 2009. The year-over-year fourth quarter Pacific yield improvement was achieved despite a $4 million unfavourable impact of a stronger Canadian dollar on foreign currency denominated Pacific passenger revenues.

- A Pacific RASM increase of 7.0% from the fourth quarter of 2009, which was due to the yield growth.

Other passenger revenues increased 15.4% from the fourth quarter of 2009
Other passenger revenues (comprised of Australia, Caribbean, Mexico, Central and South America) of $193 million in the fourth quarter of 2010 increased $26 million or 15.4% from the fourth quarter of 2009 due to traffic and yield growth. A year-over-year capacity growth of 7.2% in the fourth quarter of 2010 was largely driven by increased frequencies to the Caribbean and Mexico and, starting in June 2010, increased frequencies to Caracas and Bogotá.

The table below provides year-over-year percentage changes in Other passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the fourth quarter 2010 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Other	Q4'09	Q1'10	Q2'10	Q3'10	Q4'10
Passenger Revenues	(10.8)	(0.5)	15.3	18.2	15.4
Capacity (ASMs)	(0.1)	4.3	10.1	10.7	7.2
Traffic (RPMs)	3.3	6.6	12.7	13.8	9.4
Passenger Load Factor (pp Change)	2.6	1.7	1.8	2.3	1.6
Yield	(13.7)	(6.6)	2.2	3.7	5.4
RASM	(10.7)	(4.6)	4.5	6.7	7.5

Components of the year-over-year change in fourth quarter Other passenger revenues included:

- A traffic increase of 9.4% on the capacity growth of 7.2%, which resulted in a passenger load factor improvement of 1.6 percentage points versus the same quarter of 2009.

- A yield increase of 5.4% from the fourth quarter of 2009, which reflected a significant yield improvement on routes to South America. Yields on certain routes to traditional leisure destinations were negatively impacted by aggressive competitive pricing activities. The year-over-year fourth quarter Other yield improvement was achieved despite a $2 million unfavourable impact of a stronger Canadian dollar on foreign currency denominated Other passenger revenues.

- A RASM increase of 7.5% from the fourth quarter of 2009, which was mainly due to the yield growth but also to the passenger load factor improvement.

Cargo revenues increased 13% from the fourth quarter of 2009

Cargo revenues of $124 million in the fourth quarter of 2010 increased $14 million or 13% from the fourth quarter of 2009 due to a 10.0% increase in cargo traffic and, to a lesser extent, a 1.6% growth in cargo yield per revenue ton mile (RTM). Traffic growth was reflected in all markets, with the exception of the domestic market where traffic declined 12.8% from the fourth quarter of 2009. The system cargo yield per RTM improvement was mainly driven by growth in the Atlantic market. Excluding the unfavourable impact of foreign exchange of $6 million relating to the stronger Canadian dollar on foreign currency denominated cargo revenues, yield per RTM increased 6.3% from the fourth quarter of 2009.

The table below provides the dollar change in cargo revenues as well as year-over-year percentage changes in cargo revenues, capacity as measured by effective ton miles ("ETM"), revenue per ETM, traffic as measured by revenue ton miles ("RTM"), and yield per RTM for the fourth quarter of 2009 and the fourth quarter of 2010.

Fourth Quarter 2010 Versus Fourth Quarter 2009	Cargo Revenue $ Change (millions)	Cargo Revenue % Change	Capacity (ETMs) % Change	Rev / ETMs % Change	Traffic (RTMs) % Change	Yield / RTM % Change
Canada	1	(2.0)	(13.3)	13.0	(12.8)	12.4
U.S transborder	1	16.6	24.7	(6.5)	37.0	(14.8)
Atlantic	7	18.8	5.4	12.7	14.6	3.6
Pacific	4	8.2	21.0	(10.6)	8.7	(0.5)
Other	1	18.3	4.0	13.8	8.9	8.6
System	**14**	**13.0**	**7.7**	**3.9**	**10.0**	**1.6**

Other revenues decreased 6% from the fourth quarter of 2009

Other revenues consist primarily of revenues from the sale of the ground portion of vacation packages, ground handling services, and other airline-related services, as well as revenues related to the lease or sublease of aircraft to third parties.

Other revenues of $196 million in the fourth quarter of 2010 declined $12 million or 6% from the fourth quarter of 2009, primarily due to a decrease in aircraft sublease revenues and lower third party revenues at Air Canada Vacations. The decrease in aircraft sublease revenues was mainly due to the impact of a fewer number of aircraft subleased to third parties compared to the fourth quarter of 2009. The reduction in third party revenues at Air Canada Vacations was largely driven by a lower selling price of tour packages compared to the same quarter of 2009, due to competitive pressures from other tour operators.

CASM decreased 3.4% from the fourth quarter of 2009. Excluding fuel expense, CASM decreased 4.1% from the fourth quarter of 2009

In the fourth quarter of 2010, operating expenses of $2,531 million increased $100 million or 4% from the fourth quarter of 2009. The increase in operating expenses in the fourth quarter of 2010 was mainly driven by the capacity growth of 7.8%, higher base fuel prices year-over-year, as well as increases in wages, salaries and benefits, commissions, and communications and information technology expenses. Operating expense increases were partly offset by several factors, including the impact of a stronger Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) compared to the fourth quarter of 2009 which reduced operating expenses by approximately $56 million from the same period in 2009, a reduction in aircraft maintenance expense, the favourable impact of CTP initiatives and, to a lesser extent, a decrease in food, beverages and supplies expense.

Unit cost in the fourth quarter of 2010, as measured by operating expense per available seat mile (CASM), decreased 3.4% from the fourth quarter of 2009. Excluding fuel expense, CASM decreased 4.1% year-over-year. The 4.1% decrease in CASM (excluding fuel expense) for the fourth quarter of 2010 was better than the 2.5% to 3.5% CASM (excluding fuel expense) decrease projected in Air Canada's news release dated November 4, 2010. This improvement was mainly driven by lower than forecasted pension expense and food, beverages and supplies expense.

The favourable impact of a stronger Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars), the capacity growth, which results in the airline's fixed costs being allocated over a greater number of ASMs, the impact of CTP initiatives, as well as increases in aircraft utilization and average stage length from the fourth quarter of 2009 were all contributing factors to the year-over-year CASM decrease.

The following table compares Air Canada's operating expenses per ASM for the fourth quarter of 2010 to Air Canada's operating expenses per ASM for the corresponding period in 2009.

(cents per ASM)	Fourth Quarter		Change	
	2010	2009	cents	%
Wages and salaries	2.69	2.61	0.08	3.1
Benefits	0.47	0.41	0.06	14.6
Ownership (DAR) [1]	1.67	1.81	(0.14)	(7.7)
Airport user fees	1.54	1.65	(0.11)	(6.7)
Capacity purchase with Jazz	1.55	1.64	(0.09)	(5.5)
Aircraft maintenance	1.16	1.46	(0.30)	(20.5)
Food, beverages and supplies	0.37	0.49	(0.12)	(24.5)
Communications and information technology	0.55	0.46	0.09	19.6
Commissions	0.44	0.33	0.11	33.3
Other	2.24	2.36	(0.12)	(5.1)
Operating expense, excluding fuel expense [2]	**12.68**	**13.22**	**(0.54)**	**(4.1)**
Aircraft fuel	4.28	4.34	(0.06)	(1.4)
Total operating expense	**16.96**	**17.56**	**(0.60)**	**(3.4)**

(1) DAR refers to the combination of depreciation and amortization and aircraft rent expenses.

(2) Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Fuel expense increased 6% from the fourth quarter of 2009

Fuel expense amounted to $640 million in the fourth quarter of 2010, an increase of $39 million or 6% from the fourth quarter of 2009. Factors contributing to the year-over-year change in fourth quarter fuel expense included:

- A higher base fuel price, which accounted for a fuel expense increase of $71 million.
- A higher volume of fuel consumed, which accounted for a fuel expense increase of $52 million.

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

- The favourable impact of a stronger Canadian dollar versus the U.S. dollar, which accounted for a decrease of $30 million to fuel expense.
- Fuel hedging losses of $31 million, which represented a decrease of $54 million from the fourth 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)	Fourth Quarter		Change	
	2010	2009	$	%
Aircraft fuel expense - GAAP (1)	$ 636	$ 599	$ 37	6
Remove: Fuel hedging gains (losses) reclassified from AOCL into fuel expense	(31)	(85)	54	64
Add: Net cash payment on fuel derivatives (2)	7	12	(5)	(42)
Economic cost of fuel - Non-GAAP (3)	**$ 612**	**$ 526**	**$ 86**	**16**
Fuel consumption (thousands of litres)	905,519	824,911	80,608	10
Fuel cost per litre (cents) - GAAP	70.2	72.6	(2.4)	(3)
Fuel cost per litre (cents) - excluding fuel hedging gains (losses)	66.8	62.3	4.5	7
Economic fuel cost per litre (cents) - Non-GAAP	67.5	63.7	3.8	6

(1) Excludes fuel expense related to third party carriers, other than Jazz, operating under capacity purchase agreements.

(2) Excludes early terminated hedging contracts of $20 million in the fourth quarter of 2009 covering 2010 fuel consumption. Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives.

(3) The economic cost of fuel is a non-GAAP measure used by Air Canada and may not be comparable to measures presented by other public companies. Air Canada uses this measure to calculate its cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period and premium costs associated with those derivatives. It excludes non-cash accounting gains and losses from fuel derivative instruments.

Wages, salaries and benefits expense amounted to $470 million in the fourth quarter of 2010, an increase of $52 million or 12% from the fourth quarter of 2009

Wages and salaries expense amounted to $401 million in the fourth quarter of 2010, an increase of $39 million or 11% from the fourth quarter of 2009. This increase was mainly due to higher expenses related to incentive compensation programs linked to Air Canada's financial and operational performance.

Employee benefits expense amounted to $69 million in the fourth quarter of 2010, an increase of $13 million or 23% from the fourth quarter of 2009. The increase in employee benefits expense was mainly due to higher pension expense as a result of changes in actuarial assumptions. For information on Air Canada's pension funding obligations, refer to section 9.8 of this MD&A.

Airport and navigation fees increased $1 million from the fourth quarter of 2009

Airport and navigation fees amounted to $229 million in the fourth quarter of 2010, an increase of $1 million. The impact of a 4.2% increase in aircraft departures was mostly offset by lower rates for landing and general terminal fees, mainly at Toronto Pearson International Airport, and the favourable impact of a stronger Canadian dollar versus the U.S. dollar compared to the fourth quarter of 2009 on U.S. and other foreign currency denominated airport and navigation fee expenses.

Capacity purchase costs with Jazz increased $4 million from the fourth quarter of 2009

Capacity purchase costs with Jazz, pursuant to the Jazz CPA, amounted to $231 million in the fourth quarter of 2010 compared to $227 million in the fourth quarter of 2009, an increase of $4 million or 2%. This year-over-year increase in capacity purchase costs was mainly due to an increase in Jazz CPA rates of $10 million, including $3 million related to additional maintenance costs due to the aging of Jazz's fleet, and $7 million as a result of increased flying. Largely offsetting these increases was the impact of the CTP-related amendment to the Jazz CPA effective August 1, 2009, which accounted for a decrease of $5 million, the favourable impact of foreign exchange on U.S. currency denominated Jazz CPA charges paid by Air Canada, which accounted for a decrease of $3 million and other factors which accounted for a net decrease of $5 million.

Ownership costs decreased $1 million from the fourth quarter of 2009

Ownership costs, comprised of depreciation and amortization, and aircraft rent expense, of $249 million in the fourth quarter of 2010 decreased $1 million from the fourth quarter of 2009. The decrease included the favourable impact of a stronger Canadian dollar versus the U.S. dollar, which accounted for a decrease of $4 million to aircraft rent expense.

Aircraft maintenance expense decreased 14% from the fourth quarter of 2009

In the fourth quarter of 2010, aircraft maintenance expense of $173 million decreased $29 million or 14% from the fourth quarter of 2009. Factors contributing to the year-over-year change in fourth quarter aircraft maintenance expense included:

- A decrease of $26 million in engine maintenance, which was mainly due to maintenance cycle timing, particularly on Airbus A320 aircraft.
- A decrease of $19 million in airframe maintenance, which was largely due to a deferral of heavy maintenance events on Airbus A320 aircraft. Air Canada expects to complete this airframe maintenance activity in the next 12 months.
- The impact of a stronger Canadian dollar versus the U.S. dollar on U.S. currency denominated maintenance expenses, mainly engine and component maintenance, which accounted for a decrease of $5 million to aircraft maintenance expense compared to the fourth quarter of 2009.

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

- An increase of $7 million in component maintenance, which was largely due to the year-over-year growth in flying.
- Other various factors, which amounted to a net increase of $14 million.

Food, beverages and supplies expense decreased 22% from the fourth quarter of 2009

In the fourth quarter of 2010, food, beverages and supplies expense of $54 million decreased $15 million or 22% from the fourth quarter of 2009. The impact of an 8.0% growth in passenger traffic growth was more than offset by a favourable adjustment of $7 million related to previous quarters in 2010, the impact of cost reduction initiatives, as well as the impact of a stronger Canadian dollar versus the U.S. dollar which reduced food, beverages and supplies expense in the fourth quarter of 2010 when compared to the same quarter in 2009.

Communications and information technology expense increased 27% from the fourth quarter of 2009

In the fourth quarter of 2010, communications and information technology expense of $81 million increased $17 million or 27% from the fourth quarter of 2009. The increase in these costs was the result of a higher volume of transactions, an increase in information technology project spend, as well as rate increases relating to distribution services.

Commission expense increased 41% from the fourth quarter of 2009

On passenger and cargo revenue growth of 13%, commission expense increased $19 million from the same quarter in 2009. This increase was largely driven by Air Canada's international expansion strategy as a higher proportion of sales to international destinations are made through travel agencies which increased Air Canada's cost of sale. A higher proportion of premium cabin revenue, which typically generates a higher commission rate, was also a contributing factor to the year-over-year increase.

Other operating expenses increased 4% from the fourth quarter of 2009

Other operating expenses amounted to $339 million in the fourth quarter of 2010, an increase of $13 million or 4% from the fourth quarter of 2009. The increase in other operating expenses included the impact of the capacity growth, an increase in credit card fees, resulting from higher passenger volumes, and an increase in expenses related to a greater volume of ground packages at Air Canada Vacations. Other operating expense increases were partly offset by the favourable impact of CTP initiatives.

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

(Canadian dollars in millions)	Fourth Quarter 2010	Fourth Quarter 2009	Change $	Change %
Credit card fees	$ 50	$ 45	$ 5	11
Air Canada Vacations' land costs	49	47	2	4
Terminal handling	45	45	-	-
Miscellaneous fees and services	33	33	-	-
Building rent and maintenance	31	35	(4)	(11)
Crew cycle	28	29	(1)	(3)
Remaining other expenses	103	92	11	12
	$ 339	**$ 326**	**$ 13**	**4**

Non-operating expense amounted to $91 million in the fourth quarter of 2010
Non-operating expense amounted to $91 million in the fourth quarter of 2010 compared to non-operating expense of $83 million in the fourth quarter of 2009. Factors contributing to the year-over-year change in fourth quarter non-operating expense included:

- In the fourth quarter of 2010, net interest expense decreased $14 million from the fourth quarter of 2009. The net impact of higher debt balances in the last twelve months was more than offset by a year-over-year increase in interest income, mainly the result of higher rates of interest and higher cash balances, coupled with the favourable impact of a stronger Canadian dollar on U.S. currency denominated interest expense. In addition, in the fourth quarter of 2009, Air Canada recorded a charge of $8 million in interest expense related to the sale and leaseback of three Boeing 777 aircraft. There was no such charge recorded in the fourth quarter of 2010.

- In the fourth quarter of 2010, Air Canada recorded an impairment charge of $7 million on its fleet of retired Boeing 767-200 aircraft. In the fourth quarter of 2009, Air Canada recorded a loss on assets of $24 million pertaining to the sale and leaseback of three Boeing 777 aircraft.

- Gains related to fair value adjustments on derivative instruments amounted to $8 million in the fourth quarter of 2010 versus gains of $22 million in the fourth quarter of 2009. Refer to section 12 of this MD&A for additional information on Air Canada's derivative instruments.

Gains on foreign exchange amounted to $111 million in the fourth quarter of 2010
Gains on foreign exchange, which were mainly related to U.S. currency denominated long-term debt, amounted to $111 million in the fourth quarter of 2010 compared to gains of $108 million in the fourth quarter of 2009. The gains in the fourth quarter of 2010 were mainly attributable to a stronger Canadian dollar at December 31, 2010, compared to September 30, 2010. The December 31, 2010 noon day exchange rate was US$1 = C$0.9946 while the September 30, 2010 noon day exchange rate was US$1 = C$1.0298.

Provision for income taxes of $15 million in the fourth quarter of 2010
Air Canada recorded a provision for income taxes of $15 million on pre-tax income of $149 million in the fourth quarter of 2010, representing an effective income tax rate of 10%. The effective income tax rate is affected by the reclassification of losses on fuel derivatives from Accumulated Other Comprehensive Loss ("AOCL") to income of $31 million, which does not attract any net tax recovery due to the reversal of valuation allowance from prior years. The effective income tax rate is also impacted by certain non-taxable items as well as the reversal of valuation allowance on future income tax assets arising from fresh start reporting on September 30, 2004.

7. RESULTS OF OPERATIONS – FULL YEAR 2010 VERSUS FULL YEAR 2009

The following table and discussion compares the results of Air Canada for the full year of 2010 versus the full year of 2009.

(Canadian dollars in millions, except per share figures)	Full Year		Change	
	2010[(1)]	2009	$	%
Operating revenues				
Passenger	$ 9,427	$ 8,499	$ 928	11
Cargo	466	358	108	30
Other	893	882	11	1
	10,786	**9,739**	**1,047**	**11**
Operating expenses				
Aircraft fuel	2,652	2,448	204	8
Wages, salaries and benefits	1,885	1,751	134	8
Airport and navigation fees	961	971	(10)	(1)
Capacity purchase with Jazz	934	973	(39)	(4)
Depreciation and amortization	679	660	19	3
Aircraft maintenance	677	759	(82)	(11)
Food, beverages and supplies	280	291	(11)	(4)
Communications and information technology	316	293	23	8
Aircraft rent	346	335	11	3
Commissions	259	186	73	39
Other	1,436	1,388	48	3
	10,425	**10,055**	**370**	**4**
Operating income (loss) before the undernoted item	**361**	**(316)**	**677**	
Provision adjustment for cargo investigations, net [(1)]	46	-	46	
Operating income (loss)	**407**	**(316)**	**723**	
Non-operating income (expense)				
Interest income	19	14	5	
Interest expense	(378)	(373)	(5)	
Interest capitalized	1	4	(3)	
Loss on assets	(7)	(95)	88	
Gain (loss) on financial instruments recorded at fair value	(3)	95	(98)	
Other	(20)	-	(20)	
	(388)	(355)	(33)	
Income (loss) before the following items	**19**	**(671)**	**690**	
Non-controlling interest	(9)	(15)	6	
Foreign exchange gain	145	657	(512)	
Recovery of (provision for) income taxes	(48)	5	(53)	
Income (loss) for the period	**$ 107**	**$ (24)**	**$ 131**	
EBITDAR before the provision adjustment for cargo investigations, net [(1) (2)]	**$ 1,386**	**$ 679**	**$ 707**	
EBITDAR [(2)]	**$ 1,432**	**$ 679**	**$ 753**	
Earnings (loss) per share - Diluted	**$ 0.37**	**$ (0.18)**	**$ 0.55**	

(1) In the first quarter of 2008, Air Canada recorded a provision for cargo investigations of $125 million. In the fourth quarter of 2010, Air Canada recorded a net reduction of $46 million to this provision.

(2) See section 20 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR before the provision adjustment for cargo investigations to operating income (loss) and EBITDAR to operating income (loss).

System passenger revenues increased 10.9% from 2009

Compared to 2009, system passenger revenues increased $928 million or 10.9% to $9,427 million in 2010 due to traffic and yield growth. In 2010, premium cabin revenues increased $378 million or 23.3% due to a 14.3% increase in premium cabin traffic and a 7.9% improvement in premium cabin yield.

In 2010, Air Canada's overall capacity was 7.0% higher than in 2009, with capacity growth reflected in all markets. Domestic capacity increased 0.8% while, on a combined basis, capacity in the international and U.S. transborder markets increased 10.0% from 2009.

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

Year 2010 Versus Year 2009	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	5.5	0.8	1.9	0.8	3.5	4.6
US transborder	9.5	8.5	9.3	0.6	-	0.8
Atlantic	14.0	7.1	6.7	(0.3)	6.7	6.3
Pacific	31.1	18.4	22.3	2.8	7.2	10.7
Other	10.4	7.6	10.1	1.8	0.2	2.5
System	**10.9**	**7.0**	**8.3**	**1.0**	**2.3**	**3.6**

Components of the year-over-year change in system passenger revenues included:

- A system traffic increase of 8.3% on capacity growth of 7.0%, which resulted in a system passenger load factor improvement of 1.0 percentage points from 2009. The system capacity growth of 7.0% in 2010 compared to 2009 was in line with the 6.5% to 7.0% ASM capacity increase projected in Air Canada's news release dated November 4, 2010.

- A system yield improvement of 2.3% from 2009, which reflected an improvement in the economic environment as well as the impact of Air Canada's renewed focus on improving the quality of its revenues and promoting its business class services. The year-over-year yield improvement was achieved in spite of an unfavourable impact relating to the stronger Canadian dollar on foreign currency denominated passenger revenues. The stronger Canadian dollar in 2010 versus 2009 decreased the Canadian dollar value of sales in foreign countries and had a negative impact of $293 million on system passenger revenues.

- A system RASM increase of 3.6% from 2009, which was due to both the yield growth and the passenger load factor improvement.

Domestic passenger revenues increased 5.5% from 2009

Domestic passenger revenues of $3,790 million in 2010 increased $199 million or 5.5% from 2009 due to yield and traffic growth. Components of the year-over-year change in domestic passenger revenues included:

- A traffic increase of 1.9% on capacity growth of 0.8%, which resulted in a 0.8 percentage point improvement in passenger load factor.

- A yield increase of 3.5% from 2009, which reflected yield improvements in both the economy cabin and the premium cabin. Yield improvements were recorded on all major domestic services with the largest improvements reflected on routes to and from western Canada (short and long haul) and on Rapidair routes, linking Toronto and Montreal/Ottawa. An increase in business traffic resulting from more favourable economic conditions and assisted by targeted Executive cabin fare products, which improved both traffic and average fare performance, and the impact of higher-yielding traffic driven by the Vancouver 2010 Winter Olympic Games were contributing factors to the year-over-year yield improvement. The domestic yield improvement was achieved in spite of a $48 million unfavourable impact of a stronger Canadian dollar on foreign currency denominated domestic passenger revenues.

- Domestic RASM increased 4.6% from 2009, which was mainly due to the yield growth but also to the passenger load factor improvement.

U.S. transborder passenger revenues increased 9.5% from 2009

U.S. transborder passenger revenues of $1,797 million in 2010 increased $156 million or 9.5% from 2009 due to traffic growth. Components of the year-over-year change in U.S. transborder passenger revenues included:

- A traffic increase of 9.3% on the capacity growth of 8.5%, which resulted in a passenger load factor improvement of 0.6 percentage points from 2009. The capacity growth in 2010 is consistent with one of Air Canada's key priorities of increasing connecting traffic from the U.S. in support of the airline's international expansion strategy.

- U.S. transborder yield was unchanged from 2009 despite the unfavourable impact of a stronger Canadian dollar on foreign currency denominated U.S. transborder passenger revenues, which accounted for a decrease of $72 million to 2010 U.S. transborder passenger revenues. Yield improvements were reflected on routes from Canada to Las Vegas, Western Canada to Western U.S. and in other U.S. long-haul markets, while capacity increases as well as increased competition on key U.S. transborder routes such as Boston, New York (LaGuardia) and Newark, New Jersey, and on routes to California and Hawaii resulted in lower yields.

- A RASM increase of 0.8% from 2009, which was due to the passenger load factor improvement of 0.6 percentage points.

Atlantic passenger revenues increased 14.0% from 2009

Atlantic passenger revenues of $1,962 million in 2010 increased $241 million or 14.0% from 2009 due to traffic growth and yield improvement. In 2010, Atlantic capacity increased 7.1% from 2009, with capacity increases reflected on all major Atlantic services with the exception of routes to France and the U.K. The capacity increases in 2010 were partly offset by capacity decreases caused by the airport closures associated with the Icelandic volcano eruption in April 2010. Components of the year-over-year change in Atlantic passenger revenues included:

- A traffic increase of 6.7% on the capacity growth of 7.1%, which resulted in a 0.3 percentage point decrease in passenger load factor. Traffic growth was driven by an increase in Canadian and U.S. originating traffic to Europe, Africa and Tel Aviv, as well as an increase in European originating traffic traveling both to Canada and the U.S., a result of Air Canada's international growth strategy and the airline's participation in the A++ transatlantic joint venture.

- A yield improvement of 6.7% from 2009, which reflected a greater proportion of higher-yielding traffic, a notable return in business travel demand and the airline's strong focus on promoting premium services. The year-over-year Atlantic yield improvement was achieved in spite of a $106 million unfavourable impact of a stronger Canadian dollar on foreign currency denominated Atlantic passenger revenues.

- A RASM increase of 6.3% from 2009, which was due to the yield growth.

Pacific passenger revenues increased 31.1% from 2009

Pacific passenger revenues of $1,087 million in 2010 increased $258 million or 31.1% from 2009 due to traffic and yield growth. In 2010, capacity increased 18.4% from 2009 with growth reflected on all major Pacific services. Components of the year-over-year change in Pacific passenger revenues included:

- A traffic increase of 22.3% on capacity growth of 18.4%, which resulted in a passenger load factor improvement of 2.8 percentage points from 2009. Air Canada increased its capacity in the Pacific with the introduction of a Calgary-Narita non-stop service in March 2010, the use of larger aircraft on routes from Toronto and Vancouver to Narita, and additional frequencies from Vancouver to Beijing and Shanghai. The strong year-over-year traffic gains were driven by attracting passengers originating from Air Canada's international points of sale as well as from Canada and the U.S.

- A yield increase of 7.2% from 2009, which reflected yield improvements on all major Pacific services. The year-over-year Pacific yield improvement was achieved despite a $48 million unfavourable impact of a stronger Canadian dollar on foreign currency denominated Pacific passenger revenues.

- A RASM increase of 10.7% from 2009, which was due to both the yield growth and the passenger load factor improvement.

Other passenger revenues increased 10.4% from 2009

Other passenger revenues (comprised of Australia, Caribbean, Mexico and Central and South America) of $791 million in 2010 increased $74 million or 10.4% from 2009, mainly due to traffic growth. In 2010, a year-over-year capacity increase of 7.6% was largely driven by increased frequencies to the Caribbean and Mexico and, starting in June 2010, increased frequencies to Caracas and Bogotá. In 2009, capacity to and from Mexico was significantly impacted by reduced flying caused by concerns over the H1N1 influenza virus. Components of the year-over-year increase in Other passenger revenues included:

- A traffic increase of 10.1% on the capacity growth of 7.6%, which resulted in a passenger load factor improvement of 1.8 percentage points versus 2009.

- A yield increase of 0.2% from 2009, which reflected a significant yield improvement on routes to South America. Yields on certain routes to traditional leisure destinations were negatively impacted by competitive pricing activities. The year-over-year Other yield improvement was achieved despite a $19 million unfavourable impact of a stronger Canadian dollar on foreign currency denominated Other passenger revenues.

- A RASM increase of 2.5% from 2009, which was mainly due to the passenger load factor improvement.

Cargo revenues increased 29.9% from 2009

In 2010, fueled by traffic growth of 34.0%, cargo revenues amounted to $466 million, a $108 million or 29.9% increase from 2009. Traffic growth was recorded in all markets. System cargo yield per RTM declined 3.1% from 2009, mainly due to continued competitive pressure on rates and the unfavourable impact of a stronger Canadian dollar on foreign currency denominated revenues. Excluding the unfavourable impact of foreign exchange of $35 million relating to the stronger Canadian dollar on foreign currency denominated cargo revenues, yield per RTM increased 3.9% from 2009.

The table below provides the dollar change in cargo revenues as well as year-over-year percentage changes in cargo revenues, capacity as measured by ETM, revenue per ETM, traffic as measured by RTM, and yield per RTM for 2009 and 2010.

Year 2010 Versus Year 2009	Cargo Revenue $ Change (millions)	Cargo Revenue % Change	Capacity (ETMs) % Change	Rev / ETMs % Change	Traffic (RTMs) % Change	Yield / RTM % Change
Canada	6	9.4	(4.5)	14.6	11.9	(3.1)
U.S transborder	3	18.4	13.2	4.6	30.1	(9.0)
Atlantic	37	29.0	5.8	21.9	35.6	(4.9)
Pacific	52	45.6	17.4	24.1	38.8	5.0
Other	10	25.0	4.4	19.8	29.8	(3.7)
System	**108**	**29.9**	**7.5**	**20.9**	**34.0**	**(3.1)**

Other revenues increased 1% from 2009

Other revenues of $893 million in 2010 increased $11 million or 1% from 2009 due to a $50 million or 14% increase in third party revenues at Air Canada Vacations, largely driven by an increase in passenger volumes reflecting increased capacity year-over-year. This increase was partly offset by a decrease in aircraft sublease revenues which was mainly due to less aircraft being subleased to third parties compared to 2009, as well as the unfavourable impact of a stronger Canadian dollar on U.S. currency denominated aircraft lease and sublease revenues.

CASM decreased 3.1% from 2009. Excluding fuel expense, CASM decreased 4.5% from 2009

In 2010, operating expenses of $10,425 million increased $370 million or 4% from 2009. The increase in operating expenses in 2010 was largely driven by the capacity growth of 7.0%, higher base fuel prices year-over-year, and increases in wages, salaries and benefits, commissions, ownership, and communication and information technology costs from 2009. Higher credit card fees and an increase in expenses related to ground packages at Air Canada Vacations were also contributing factors to the operating expense increase year-over-year.

Operating expense increases were partly offset by several factors, including the impact of a stronger Canadian dollar on foreign currency denominated expenses which reduced operating expenses by approximately $439 million from the same period in 2009, notable reductions in capacity purchase fees paid to Jazz and aircraft maintenance expenses, as well as the favourable impact of CTP initiatives.

Unit cost in 2010, as measured by operating expense per available seat mile (CASM), decreased 3.1% over 2009. Excluding fuel expense, CASM decreased 4.5% year-over-year.

The favourable impact of a stronger Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars), the capacity growth, which results in the airline's fixed costs being allocated over a greater number of ASMs, the impact of CTP initiatives, as well as increases in aircraft utilization and average stage length from 2009 were all contributing factors to the year-over-year CASM decrease.

The following table compares Air Canada's operating expenses per ASM for 2010 to Air Canada's operating expenses per ASM for the corresponding period in 2009.

	Full Year		Change	
(cents per ASM)	**2010**	**2009**	**cents**	**%**
Wages and salaries	2.39	2.51	(0.12)	(4.8)
Benefits	0.57	0.44	0.13	29.5
Ownership (DAR) (1)	1.61	1.68	(0.07)	(4.2)
Airport user fees	1.51	1.64	(0.13)	(7.9)
Capacity purchase with Jazz	1.47	1.64	(0.17)	(10.4)
Aircraft maintenance	1.07	1.28	(0.21)	(16.4)
Food, beverages and supplies	0.44	0.49	(0.05)	(10.2)
Communications and information technology	0.50	0.49	0.01	2.0
Commissions	0.41	0.31	0.10	32.3
Other	2.27	2.34	(0.07)	(3.0)
Operating expense, excluding fuel expense (2)	**12.24**	**12.82**	**(0.58)**	**(4.5)**
Aircraft fuel	4.18	4.12	0.06	1.5
Total operating expense	**16.42**	**16.94**	**(0.52)**	**(3.1)**

(1) DAR refers to the combination of depreciation and amortization and aircraft rent expenses.

(2) Refer to section 20 "Non-GAAP Financial Measures" of this MD&A for additional information.

Fuel expense increased 8% from 2009

Fuel expense amounted to $2,652 million in 2010, an increase of $204 million or 8% from 2009. Factors contributing to the year-over-year change in fuel expense included:

- A higher base fuel price, which accounted for a fuel expense increase of $517 million.
- A higher volume of fuel consumed, which accounted for a fuel expense increase of $163 million.

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

- The favourable impact of a stronger Canadian dollar versus the U.S. dollar, which accounted for a fuel expense decrease of $240 million.
- Fuel hedging losses of $183 million, which represented a decrease of $236 million from 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)	Full Year		Change	
	2010	2009	$	%
Aircraft fuel expense - GAAP [1]	$ 2,638	$ 2,437	$ 201	8
Remove: Fuel hedging gains (losses) reclassified from AOCL into fuel expense	(183)	(419)	236	56
Add: Net cash payments on fuel derivatives [2]	60	88	(28)	(32)
Economic cost of fuel - Non-GAAP [3]	**$ 2,515**	**$ 2,106**	**$ 409**	**19**
Fuel consumption (thousands of litres)	3,790,911	3,509,918	280,993	8
Fuel cost per litre (cents) - GAAP	69.6	69.4	0.2	-
Fuel cost per litre (cents) - excluding fuel hedging gains (losses)	64.8	57.5	7.3	13
Economic fuel cost per litre (cents) - Non-GAAP	66.4	60.0	6.4	11

(1) Excludes fuel expense related to third party carriers, other than Jazz, operating under capacity purchase agreements.

(2) Excludes early terminated hedging contracts of $172 million in the first quarter of 2009 and $20 million in the fourth quarter of 2009 covering 2009 and 2010 fuel consumption. Includes early terminated hedging contracts of $5 million in the second quarter of 2010 covering 2010 fuel consumption. Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives.

(3) The economic cost of fuel is a non-GAAP measure used by Air Canada and may not be comparable to measures presented by other public companies. Air Canada uses this measure to calculate its cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period and premium costs associated with those derivatives. It excludes non-cash accounting gains and losses from fuel derivative instruments.

Wages, salaries and benefits expense amounted to $1,885 million in 2010, an increase of $134 million or 8% from 2009

Wages and salaries expense totaled $1,520 million in 2010, an increase of $28 million or 2% from 2009.

- In 2010, Air Canada recorded expenses of $84 million relating to incentive compensation programs linked to Air Canada's financial and operational performance. In 2009, expenses related to these programs amounted to $29 million.

- In 2009, Air Canada recorded expenses related to staff reduction programs of $30 million. No such expenses were recorded in 2010.

Employee benefits expense amounted to $365 million in 2010, an increase of $106 million or 41% from 2009. The increase in employee benefits expense was mainly due to higher pension expense as a result of changes in actuarial assumptions.

Capacity purchase costs with Jazz decreased 4% from 2009

Capacity purchase costs with Jazz, pursuant to the Jazz CPA, amounted to $934 million in 2010 compared to $973 million in 2009, a decrease of $39 million or 4%. This year-over-year decrease in capacity purchase costs was mainly due to the favourable foreign exchange impact on U.S. currency denominated Jazz CPA charges paid by Air Canada, which accounted for a decrease of $33 million. In addition, the impact of the CTP-related amendment to the Jazz CPA effective August 1, 2009, accounted for a net decrease of $22 million, comprised of a decrease related to the reduction to the mark-up on Jazz CPA rates and an increase in charges relating to the return of aircraft. Furthermore, the impact of reduced flying, accounted for a decrease of $8 million. Partly offsetting these decreases was a year-over-year increase in Jazz CPA rates of $29 million, including $13 million related to maintenance costs for Jazz's fleet.

Ownership costs increased 3% from 2009

Ownership costs, comprised of depreciation and amortization, and aircraft rent expense, of $1,025 million in 2010 increased $30 million or 3% from 2009. Factors contributing to the year-over-year change in ownership costs included:

- Decreases in aircraft residual values, which accounted for an increase of $51 million to depreciation expense.
- The impact of the sale and leaseback of three Boeing 777 aircraft and the addition of one Boeing 777 aircraft in July 2009 to Air Canada's operating fleet, which together accounted for an increase of $27 million.

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

- The impact of a stronger Canadian dollar versus the U.S. dollar, which accounted for a decrease of $34 million to aircraft rent expense.

Aircraft maintenance expense decreased 11% from 2009

In 2010, aircraft maintenance expense of $677 million decreased $82 million or 11% from 2009. Factors contributing to the year-over-year change in aircraft maintenance expense included:

- A decrease of $55 million in airframe maintenance, which was largely due to the deferral of heavy maintenance events on Airbus A320 aircraft. Air Canada expects to complete this airframe maintenance activity in the next 12 months.
- The favourable impact of a stronger Canadian dollar versus the U.S. dollar on U.S. currency denominated maintenance expenses, mainly engine and component maintenance, which accounted for a decrease of $48 million to aircraft maintenance expense compared to 2009.
- A decrease of $14 million, which related to maintenance cost obligations on aircraft and engines leased to third parties.

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

- An increase of $36 million in component maintenance, which was mainly due to the year-over-year growth in flying and the expiration of certain component warranties.

Commission expense increased 39% from 2009

On passenger and cargo revenue growth of 12%, commission expense of $259 million increased $73 million or 39% from 2009. This increase was largely driven by the introduction of a 7% commission for Canadian travel agents to sell Tango fares for flights within Canada and Air Canada's international expansion strategy as a higher proportion of sales to international destinations are made through travel agencies which increased Air Canada's cost of sale. A higher proportion of premium cabin revenue, which typically generates a higher commission rate, was also a contributing factor to the year-over-year increase.

Other operating expenses increased 3% from 2009

Other operating expenses amounted to $1,436 million in 2010, an increase of $48 million or 3% from 2009. The increase in Other operating expenses included the impact of the capacity growth, an increase in credit card fees resulting from higher passenger volumes, and an increase in expenses related to a greater volume of ground packages at Air Canada Vacations. Additionally, in 2010, Air Canada recorded a favourable translation rate adjustment on foreign currency transactions of $13 million compared to a favourable translation rate adjustment on foreign currency transactions of $30 million in 2009. These amounts are reflected in "remaining other expenses" in the table below. Other operating expenses increases were partly offset by the favourable impact of CTP initiatives.

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

	Full Year		Change	
(Canadian dollars in millions)	2010	2009	$	%
Credit card fees	$ 201	$ 175	$ 26	15
Air Canada Vacations' land costs	272	250	22	9
Miscellaneous fees and services	110	117	(7)	(6)
Building rent and maintenance	126	131	(5)	(4)
Crew cycle	117	118	(1)	(1)
Terminal handling	187	188	(1)	(1)
Remaining other expenses	423	409	14	3
	$ 1,436	**$ 1,388**	**$ 48**	**3**

Non-operating expense amounted to $388 million in 2010

Non-operating expense amounted to $388 million in 2010 compared to non-operating expense of $355 million in 2009. Factors contributing to the year-over-year increase in non-operating expense included:

- In 2010, interest expense increased $5 million from 2009. Factors contributing to the year-over-year change in interest expense in 2010 included:

  - A 2010 charge of $54 million in interest expense related to Air Canada's secured term credit facility concluded in the third quarter of 2009, comprised of early payment fees of $29 million and $25 million for adjustments related to the unamortized portion of transaction costs and debt discounts. There was no such charge recorded in 2009.

  - The net impact of financing transactions completed in 2010. In the third quarter of 2010, Air Canada completed a private offering of two series of senior secured notes, consisting of US$600 million senior secured first lien notes due 2015 and $300 million senior secured first lien notes due 2015. At that time, Air Canada also completed a private offering of US$200 million senior secured second lien notes due 2016. Air Canada used approximately $729 million of the net proceeds of the offerings ($1,075 million after deduction of fees, expenses and discounts) to repay all of the outstanding debt under the secured term credit facility it entered into in 2009.

  These increases were largely offset by the following:

  - Charges of $25 million in 2009 related to the sale and leaseback of four Boeing 777 aircraft. There were no such charges recorded in 2010.

  - A charge of $9 million in 2009 related to the termination of the capital leases of two Airbus A340 aircraft and the subsequent sale of these aircraft. There was no such charge recorded in 2010.

  - The favourable impact of a stronger Canadian dollar on U.S. currency denominated interest expense.

  - Lower average interest rates year-over-year.

- In 2010, interest income improved $5 million from 2009, due to both higher cash balances and higher rates of interest.

- In 2010, Air Canada recorded an impairment charge of $7 million on its fleet of retired Boeing 767-200 aircraft. In 2009, Air Canada recorded an impairment charge of $68 million related to previously capitalized costs incurred in the development of a new reservation system and a loss on assets of $24 million related to the sale and leaseback of three Boeing 777 aircraft. There were no significant disposals during 2010.

- Losses related to fair value adjustments on derivative instruments amounted to $3 million in 2010 versus gains of $95 million in 2009. Refer to section 12 of this MD&A for additional information on Air Canada's derivative instruments.

Gains on foreign exchange amounted to $145 million in 2010
Gains on foreign exchange, which were mainly related to U.S. currency denominated long-term debt, amounted to $145 million in 2010 compared to gains of $657 million in 2009. The gains in 2010 were mainly attributable to a stronger Canadian dollar at December 31, 2010, compared to December 31, 2009. The December 31, 2010 noon day exchange rate was US$1 = C$0.9946 while the December 31, 2009 noon day exchange rate was US$1 = C$1.0466.

Provision for income taxes of $48 million in 2010
Air Canada recorded a provision for income taxes of $48 million on pre-tax income of $155 million in 2010. The effective income tax rate of 31% is affected by the reclassification of losses on fuel derivatives from AOCL to income of $183 million, which does not attract any net tax recovery due to the reversal of valuation allowance from prior years. The effective income tax rate is also impacted by certain non-taxable items as well as the reversal of valuation allowance on future income tax assets arising from fresh start reporting on September 30, 2004.

8. FLEET

The following table provides Air Canada's operating fleet as at December 31, 2010 (excluding aircraft operated by Jazz under the Jazz CPA).

	Total Seats	Number of Operating Aircraft (1)	Average Age	Owned (1)	Capital Lease (2)	Owned - Special Purpose Entities (2)	Operating Lease
Widebody Aircraft							
Boeing 777-300	349	12	2.8	3	1	-	8
Boeing 777-200	270	6	3.1	4	-	-	2
Boeing 767-300	191-213	30	17.3	1	8	6	15
Airbus A330-300	265	8	10.2	-	8	-	-
Narrowbody Aircraft							
Airbus A321	174	10	8.8	-	-	5	5
Airbus A320	146	41	17.7	-	-	-	41
Airbus A319	120	38	12.6	-	17	15	6
EMBRAER 190	93	45	3.8	45	-	-	-
EMBRAER 175	73	15	5.3	15	-	-	-
Total		**205**	**10.7**	**68**	**34**	**26**	**77**

(1) Excludes aircraft which have been removed from service.

(2) Owned aircraft, aircraft under capital lease, and other aircraft under lease from special purpose entities which are consolidated by Air Canada and are carried on Air Canada's statement of financial position. Owned aircraft include aircraft financed under conditional sales agreements.

The following table provides the number of aircraft in Air Canada's operating fleet as at December 31, 2009, and December 31, 2010, as well as planned changes to its operating fleet (excluding aircraft operated by Jazz under the Jazz CPA).

	Actual			Planned			
Fleet Plan	December 31, 2009	2010 Fleet Changes	December 31, 2010	2011 Fleet Changes	December 31, 2011	2012 Fleet Changes	December 31, 2012
Boeing 777-300	12	-	12	-	12	-	12
Boeing 777-200	6	-	6	-	6	-	6
Boeing 767-300	30	-	30	1	31	(1)	30
Airbus A330-300	8	-	8	-	8	-	8
Airbus A321	10	-	10	-	10	-	10
Airbus A320	41	-	41	-	41	-	41
Airbus A319	35	3	38	-	38	-	38
EMBRAER 190	45	-	45	-	45	-	45
EMBRAER 175	15	-	15	-	15	-	15
Total	202	3	205	1	206	(1)	205
Average age (years)	9.7		10.7		11.6		12.6

On October 4, 2010, Air Canada announced that it settled the terms of a long term commercial carrier operating agreement with the Toronto Port Authority, the operator of Billy Bishop Toronto City Airport. The conclusion of that agreement is subject to certain conditions not yet completed, including entering into an agreement with the operator of the terminal, City Centre Terminal Corp., for lease of terminal space at the airport. Also, on October 4, 2010, Air Canada announced that it entered into a capacity purchase agreement with Sky Regional Airlines Inc., an associated company of Skyservice Business Aviation, to operate, on behalf of Air Canada, flights to and from Billy Bishop Toronto City Airport. The date on which Air Canada will resume operations at this airport remains to be determined.

Finally, Air Canada entered into lease agreements with a lessor for five Bombardier Dash 8-400 aircraft. Sky Regional Airlines Inc. will sublease and operate these Dash 8-400 aircraft on behalf of Air Canada pursuant to the terms of the capacity purchase agreement.

At December 31, 2010, Jazz's operating fleet was comprised of 123 aircraft operating under the Jazz CPA, a decrease of 7 aircraft from December 31, 2009. Jazz's covered fleet had an average age of 15.8 years at December 31, 2010, comprised of the following aircraft:

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

During 2011, seven Dash 8-400 aircraft, to be purchased by Jazz, will be introduced into the Jazz fleet and five Bombardier CRJ-100 aircraft, owned by Air Canada, will be removed, increasing Jazz's covered fleet to 125 aircraft.

9. FINANCIAL AND CAPITAL MANAGEMENT

9.1 LIQUIDITY

Liquidity risk is the risk that Air Canada will encounter difficulty in meeting obligations associated with its financial liabilities and other contractual obligations. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. Air Canada's principal objective in managing liquidity risk is to maintain a minimum unrestricted cash balance in excess of a target liquidity level of 15% of annual operating revenues.

At December 31, 2010, cash, cash equivalents and short-term investments amounted to approximately $2,192 million, or 20% of 2010 operating revenues, exceeding Air Canada's minimum target liquidity level of 15% of 12-month trailing operating revenues.

Managing Air Canada's liquidity position was a particular focus in 2010 and remains a significant priority going forward. In 2010, Air Canada's unrestricted cash balance increased $785 million due mainly to positive cash from operations of $864 million. Air Canada manages its liquidity through a variety of strategies, including by seeking to achieve positive cash from operations, sourcing committed financing for new and existing aircraft and through other financing activities.

Covenants in credit card agreements
Air Canada has various agreements with companies that process customer credit card transactions. Approximately 85% of Air Canada's sales are processed using credit cards, with remaining sales processed through cash-based transactions. Air Canada receives payment for a credit card sale generally in advance of when the passenger transportation is provided.

Air Canada's principal credit card processing agreements for card processing services requirements in North America are scheduled to terminate at the end of May 2011. Air Canada's obligation to provide a deposit to the credit card processor under these agreements, as well as the amount of such deposit, are determined pursuant to a matrix measuring, on a quarterly basis, both a fixed charge coverage ratio for Air Canada and the unrestricted cash of Air Canada. Air Canada also has agreements with this processor for the provision of certain credit card processing services requirements for markets other than North America and for its cargo operations worldwide and such agreements contain deposit obligations similar to the obligations set forth above.

Air Canada has accepted a proposal from a new service provider for the provision of its principal credit card processing services requirements in North America for Visa and MasterCard for a five-year term beginning at the expiry of the current agreements being replaced. Air Canada and the credit card processor have agreed to triggering events upon which Air Canada would be required to provide the credit card processor with deposits. The obligation to provide, and the amount of, deposits required would be based upon a matrix measuring, on a quarterly basis, both a fixed charge coverage ratio and unrestricted cash of Air Canada. The agreement between Air Canada and the credit card processor is subject to certain conditions, including conclusion of formal documentation.

9.2 FINANCIAL POSITION

The following table provides a condensed statement of financial position of Air Canada as at December 31, 2010, and as at December 31, 2009.

(Canadian dollars in millions)	December 31, 2010	December 31, 2009	Change $
Assets			
Cash, cash equivalents and short-term investments	$ 2,192	$ 1,407	$ 785
Other current assets	1,253	1,244	9
Current assets	3,445	2,651	794
Property and equipment	5,747	6,369	(622)
Intangible assets	840	916	(76)
Deposits and other assets	512	470	42
	$ 10,544	**$ 10,406**	**$ 138**
Liabilities			
Current liabilities	$ 3,062	$ 3,002	$ 60
Long-term debt and capital leases	3,952	4,054	(102)
Pension and other benefits liabilities	1,059	1,163	(104)
Other long-term liabilities	562	540	22
	8,635	**8,759**	**(124)**
Non-controlling interest	**169**	**201**	**(32)**
Shareholders' equity	**1,740**	**1,446**	**294**
	$ 10,544	**$ 10,406**	**$ 138**

Movements in current assets and liabilities are described in section 9.4 of this MD&A.

Property and equipment amounted to $5,747 million at December 31, 2010, a reduction of $622 million from December 31, 2009. The reduction was mainly due to the impact of depreciation expense of $627 million in 2010 and the impact of the remaining part of a sale and leaseback transaction completed in the first quarter of 2010 partly offset by additions to capital assets of $118 million.

Refer to section 9.3 for a summary of changes impacting debt during 2010.

9.3 ADJUSTED NET DEBT

The following table reflects Air Canada's adjusted net debt balances and net debt to net debt plus equity ratio as at December 31, 2010, and as at December 31, 2009.

(Canadian dollars in millions)	December 31, 2010	December 31, 2009	Change $
Total long-term debt and capital leases	$ 3,952	$ 4,054	$ (102)
Current portion of long-term debt and capital leases	505	468	37
Total long-term debt and capital leases, including current portion	4,457	4,522	(65)
Less cash, cash equivalents and short-term investments	(2,192)	(1,407)	(785)
Net debt	**$ 2,265**	**$ 3,115**	**$ (850)**
Capitalized operating leases (1)	2,595	2,513	82
Adjusted net debt	**$ 4,860**	**$ 5,628**	**$ (768)**
Non-controlling interest	169	201	(32)
Adjusted net debt and non-controlling interest	**$ 5,029**	**$ 5,829**	**$ (800)**
Shareholders' equity	**$ 1,740**	**$ 1,446**	**$ 294**
Adjusted net debt and non-controlling interest to adjusted net debt and non-controlling interest plus equity ratio	**74.3 %**	**80.1 %**	**(5.8) pp**

(1) Adjusted net debt is a non-GAAP measure used by Air Canada and may not be comparable to measures presented by other public companies. Air Canada 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 capitalized operating leases is used by Air Canada and may not be comparable to similar measures presented by other public companies. Aircraft rent was $346 million in 2010, and $335 million in 2009. Aircraft rent expense includes aircraft rent associated with aircraft subleased to third parties. The sublease revenue associated with these aircraft subleases is included in Other revenues on Air Canada's Consolidated Statement of Operations.

Total debt and capital leases amounted to $4,457 million at December 31, 2010, a decrease of $65 million from December 31, 2009. The decrease in long-term debt and capital leases from December 31, 2009 was mainly due to long-term debt and capital lease repayments of $1,135 million and the favourable impact of a stronger Canadian dollar on Air Canada's foreign currency denominated debt (mainly U.S. dollars) and capital leases which accounted for a decrease of $160 million. These decreases were largely offset by proceeds from borrowings of $1,175 million.

During 2010, the following key financing activities were completed:

- In the first quarter of 2010, Air Canada entered into arrangements with a new lender, comprised of a group of entities that are related to each other, to obtain a $100 million increase to its $600 million secured term credit facility concluded in July 2009.

- On August 3, 2010, Air Canada completed a private offering of two series of senior secured notes, consisting of US$600 million senior secured first lien notes due 2015 (the "U.S. Dollar First Lien Notes") and $300 million senior secured first lien notes due 2015 (the "Canadian Dollar First Lien Notes" and, collectively with the U.S. Dollar First Lien Notes, the "First Lien Notes"). On August 3, 2010, Air Canada also completed a private offering of US$200 million senior secured second lien notes due 2016 (the "Second Lien Notes" and, together with the First Lien Notes, the "Notes"). Air Canada received net proceeds of $1,075 million after deduction of fees, expenses and discounts. Air Canada used approximately $729 million of the net proceeds of the offerings to repay all of the outstanding debt under the above-referenced secured term credit facility, including $29 million for early payment fees.

- On August 20, 2010, Air Canada concluded a credit agreement with GE Japan Corporation, PK Airfinance Japan ("GE Japan") for a senior secured term loan facility in the amount of up to approximately US$171 million to refinance amounts due in 2011 and 2012 related to 16 aircraft currently operated by Air Canada and leased from special purpose leasing entities which are consolidated by Air Canada. As of this date, four of the 16 aircraft have been refinanced in part using the proceeds of this loan facility.

At December 31, 2010, adjusted net debt and non-controlling interest decreased $800 million from December 31, 2009, mainly due to positive free cash flow of $746 million recorded in 2010, resulting in an increase in unrestricted cash balances of $785 million during 2010. Refer to section 9.5 of this MD&A for additional information on Air Canada's cash flow movements. The adjusted net debt and non-controlling interest to adjusted net debt and non-controlling interest plus equity ratio for Air Canada at December 31, 2010, was 74.3%, an improvement of 5.8 percentage points from December 31, 2009.

9.4 WORKING CAPITAL

The following table provides information on Air Canada's working capital balances at December 31, 2010 and at December 31, 2009.

(Canadian dollars in millions)	December 31, 2010	December 31, 2009	Change $
Cash and short-term investments	$ 2,192	$ 1,407	$ 785
Accounts receivable	641	701	(60)
Other current assets	612	543	69
Accounts payable and accrued liabilities	(1,182)	(1,246)	64
Advance ticket sales	(1,375)	(1,288)	(87)
Current portion of long-term debt and capital leases	(505)	(468)	(37)
Net working capital (deficiency)	**$ 383**	**$ (351)**	**$ 734**

The net positive working capital of $383 million at December 31, 2010, represented an improvement of $734 million from December 31, 2009, mainly due to positive net cash from operating activities of $864 million, partially offset by capital expenditures of $118 million in 2010. In 2010, Air Canada also received net proceeds of $1,075 million related to the private notes offerings as described in section 9.3 of this MD&A. This financing inflow was offset by scheduled repayments of long-term debt and capital lease obligations of $1,135 million, including the repayment of Air Canada's secured term credit facility as described in section 9.3 of this MD&A.

9.5 CONSOLIDATED CASH FLOW MOVEMENTS

The following table provides the cash flow movements for Air Canada for the periods indicated.

(Canadian dollars in millions)	Fourth Quarter			Full Year		
	2010	2009	Change $	2010	2009	Change $
Net cash from operating activities, before the under noted items	$ 167	$ 54	$ 113	$ 873	$ 442	$ 431
Cash used for fuel hedge settlements, terminations and premiums	(18)	(18)	-	(80)	(275)	195
Fuel hedge collateral deposits, net	2	62	(60)	43	268	(225)
Excess of employee future benefit funding over expense	(43)	(53)	10	(126)	(368)	242
Changes in non-cash working capital	40	(55)	95	154	(234)	388
Cash flows from (used for) operating activities	148	(10)	158	864	(167)	1,031
Additions to capital assets	(26)	(42)	16	(118)	(232)	114
Free cash flow (1)	**122**	**(52)**	**174**	**746**	**(399)**	**1,145**
Proceeds from sale and leaseback transactions	-	380	(380)	20	552	(532)
Proceeds from contractual commitments	-	-	-	-	230	(230)
Reduction to Aveos letter of credit	-	-	-	23	-	23
Short-term investments	(440)	(125)	(315)	(810)	214	(1,024)
Other	(5)	(1)	(4)	(11)	74	(85)
Cash flows from (used for) investing activities (excluding additions to capital assets)	**(445)**	**254**	**(699)**	**(778)**	**1,070**	**(1,848)**
Proceeds from borrowings	-	3	(3)	1,175	926	249
Issue of common shares and warrants	2	249	(247)	2	256	(254)
Repayment of long-term debt and capital lease obligations	(100)	(381)	281	(1,135)	(1,237)	102
Other	-	-	-	(35)	-	(35)
Cash flows from (used for) financing activities	**(98)**	**(129)**	**31**	**7**	**(55)**	**62**
Net increase (decrease) in cash and cash equivalents	(421)	73	(494)	(25)	616	(641)
Net increase (decrease) in short-term investments	440	125	315	810	(214)	1,024
Net increase in cash, cash equivalents and short-term investments	**$ 19**	**$ 198**	**$ (179)**	**$ 785**	**$ 402**	**$ 383**

(1) Free cash flow is a non-GAAP measure used by Air Canada and may not 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, including repaying debt, meeting ongoing financial obligations and reinvesting in Air Canada.

An increase in free cash flow in the fourth quarter of 2010 of $174 million was largely due to an improvement in Air Canada's cash operating results year-over-year of $113 million. The improvement in non-cash working capital of $95 million also factored in to the free cash flow improvement. Similar factors supported the improvement in free cash flow in 2010 of $1,145 million versus 2009. The impact of not making pension past service cost contributions in 2010 as a result of the adoption of the Air Canada 2009 Pension Plan Funding Regulations, versus contributions of $140 million in 2009, also contributed to the improvement.

9.6 CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS

Air Canada has 37 firm orders for Boeing 787 aircraft with The Boeing Company ("Boeing"). Air Canada also holds purchase options for 13 Boeing 787 aircraft and purchase rights for 10 Boeing 787 aircraft and 18 Boeing 777 aircraft.

In January 2011, Boeing announced that it had delayed the first delivery of the Boeing 787 aircraft from the first quarter of 2011 to the third quarter of 2011. Air Canada's first Boeing 787 aircraft is currently scheduled for delivery in the second half of 2013. The potential impact of Boeing's January 2011 announcement on Air Canada's Boeing 787 aircraft deliveries, if any, has not yet been determined.

Air Canada has financing commitments from Boeing and the engine manufacturer covering 31 of the 37 Boeing 787 firm aircraft orders. The financing terms for 28 out of the 31 covered aircraft are for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments. For the remaining three out of the 31 covered aircraft, the financing under the commitment covers up to 90% of the capital expenditure and the term to maturity is 15 years with principal payments made on a mortgage style basis resulting in equal installment payments of principal and interest over the term to maturity.

The table below provides Air Canada's current projected, planned and committed capital expenditures for 2011, for the next four years and after 2015.

(Canadian dollars in millions)	2011	2012	2013	2014	2015	Thereafter
Projected committed expenditures	$ 86	$ 112	$ 700	$ 932	$ 624	$ 2,050
Projected planned but uncommitted expenditures	89	119	113	95	88	n/a
Total projected expenditures [(1)]	175	231	813	1,027	712	n/a
Projected financing on committed expenditures	-	-	(538)	(736)	(473)	(1,215)
Total projected expenditures, net of financing	**$ 175**	**$ 231**	**$ 275**	**$ 291**	**$ 239**	**n/a**

(1) U.S. dollar amounts are converted using the December 31, 2010 noon day exchange rate of US$1 = C$0.9946. Final aircraft delivery prices include estimated escalation and interest on deferred delivery payments.

Certain maintenance events will be capitalized under International Financial Reporting Standards ("IFRS") beginning on January 1, 2011, as opposed to being recorded in maintenance expense under existing Canadian GAAP. As a result, actual additions to capital assets on Air Canada's consolidated statement of cash flow under IFRS will reflect these capitalized maintenance costs. This reflects a change in accounting practice only and will not change the underlying cash flows. The table above does not reflect this change in accounting practice. Refer to section 16.1 of this MD&A for additional information on the expected impact of IFRS reporting on Air Canada's statement of financial position as at January 1, 2010.

9.7 CONTRACTUAL OBLIGATIONS

The table below provides Air Canada's current contractual obligations for 2011, for the next four years and after 2015. The table also includes the impact of the loan facility from GE Japan assuming the full commitment will be drawn upon. As of this date, the loan facility was drawn upon in respect of the refinancing of four of the 16 aircraft. Refer to section 9.3 of this MD&A for additional information.

(Canadian dollars in millions)	2011	2012	2013	2014	2015	Thereafter	Total
Principal							
Long-term debt obligations	$ 514	$ 293	$ 363	$ 200	$ 1,103	$ 1,307	$ 3,780
Capital lease obligations	96	105	94	90	144	226	755
	610	**398**	**457**	**290**	**1,247**	**1,533**	**4,535**
Interest							
Long-term debt obligations	218	199	186	171	126	103	1,003
Capital lease obligations	68	59	49	39	29	85	329
	286	**258**	**235**	**210**	**155**	**188**	**1,332**
Total long-term debt, capital leases and interest repayment obligations (1)	**896**	**656**	**692**	**500**	**1,402**	**1,721**	**5,867**
Operating lease obligations (2)	**382**	**355**	**333**	**266**	**210**	**671**	**2,217**
Committed capital expenditures (3)	**86**	**112**	**700**	**932**	**624**	**2,050**	**4,504**
Total contractual obligations (4)(5)	**1,364**	**1,123**	**1,725**	**1,698**	**2,236**	**4,442**	**12,588**
Net impact of GE Japan loan facility	(100)	(9)	34	33	26	57	41
Total obligations, including net impact of GE Japan loan facility (4)(5)	**$ 1,264**	**$ 1,114**	**$ 1,759**	**$ 1,731**	**$ 2,262**	**$ 4,499**	**$ 12,629**

(1) The interest repayment obligations relate to long-term debt, variable interest entities' debt consolidated under AcG-15 and capital leases.

(2) The operating lease obligations above mainly relate to U.S. dollar aircraft operating leases.

(3) The committed capital expenditures above mainly relate to U.S. dollar aircraft-related expenditures. These expenditures also include purchases relating to system development costs, facilities and leasehold improvements.

(4) Total contractual obligations exclude commitments for goods and services required in the ordinary course of business. Also excluded are other long-term liabilities mainly due to reasons of uncertainty of timing of cash flows and items which are non-cash in nature.

(5) The table above excludes the future minimum non-cancelable commitment under the Jazz CPA of $749 million for 2011, the future minimum non-cancelable commitment under capacity purchase agreements with other regional carriers of $29 million for 2011 and the minimum annual commitment to purchase Aeroplan® Miles from Aeroplan of $216 million for 2011. Future commitments for 2012 and beyond are not yet determinable.

9.8 PENSION FUNDING OBLIGATIONS

Air Canada maintains several pension plans including defined benefit and defined contribution pension plans and plans providing other retirement and post-employment benefits to its employees. As at January 1, 2010, based on actuarial valuations completed in the second quarter of 2010 and which were used to determine certain pension funding requirements in 2010, the aggregate solvency deficit in the registered pension plans was $2,728 million. The next required valuations are as of January 1, 2011, and will be completed in the first half of 2011, but as described below, they will not increase pension past service cost funding obligations projected for 2011 to 2013 and identified in the table below.

In July 2009, the Government of Canada adopted the Air Canada 2009 Pension Regulations. The Air Canada 2009 Pension Regulations relieve Air Canada from making any past service contributions (i.e. special payments to amortize the plan solvency deficits) to its ten domestic defined benefit registered pension plans in respect of the period beginning April 1, 2009, and ending December 31, 2010. Thereafter, in respect of the period from January 1, 2011 to December 31, 2013, the aggregate annual past service contribution shall equal the lesser of (i) $150 million, $175 million, and $225 million in 2011, 2012, and 2013, respectively, on an accrued basis, and (ii) the maximum past service contribution permitted under the Canadian Income Tax Act.

The Air Canada 2009 Pension Regulations were adopted during the third quarter of 2009 in coordination with pension funding agreements reached with all of Air Canada's Canadian-based unions ("the Pension MOUs"). Pursuant to the Pension MOUs, on October 26, 2009, Air Canada issued to a trust, 17,647,059 Class B voting shares. This number of shares represented 15% of the shares of Air Canada issued and outstanding as at the date of the Pension MOUs and the date of issuance (in both cases after taking into account such issuance). All net proceeds of sale of such shares by the trust are to be contributed to the pension plans. On October 26, 2009, upon the issuance of the shares to the trust, Air Canada recorded a decrease to its net pension and other benefit liabilities in the amount of $28 million and an increase to share capital in the amount of $28 million. For so long as the trust continues to hold at least 2% of the issued and outstanding shares of Air Canada, the trustee will have the right to designate one nominee (who shall not be a member or officer of any of Air Canada's Canadian-based unions) to Air Canada's board of directors, subject to completion of Air Canada's usual governance process for selection and confirmation of director nominees. Current service contributions will continue to be made in the normal course while the Air Canada 2009 Pension Regulations are in effect.

After consideration of the effect of the Air Canada 2009 Pension Regulations, as outlined above, Air Canada's pension funding contributions amounted to $243 million in 2010.

(Canadian dollars in millions)	2010	2009
Past service cost for registered pension plans	$ -	$ 140
Current service cost for registered pension plans	169	185
Other pension arrangements (1)	74	64
Total contributions	**$ 243**	**$ 389**

(1) Includes retirement compensation arrangements, supplemental plans and international plans.

Funding obligations are generally dependent on a number of factors, including the assumptions used in the most recently filed actuarial valuation reports for current service (including the applicable discount rate used or assumed in the actuarial valuation), the plan demographics at the valuation date, the existing plan provisions, existing pension legislation and changes in economic conditions (mainly the return on fund assets and changes in interest rates). Actual contributions that are determined on the basis of future valuation reports filed annually may vary significantly from projections. In addition to changes in plan demographics and experience, actuarial assumptions and methods may be changed from one valuation to the next, including by reason of changes in plan experience, financial markets, future expectations, and changes in legislation and other factors. Until 2013, Air Canada's past service pension funding obligations are also limited by the Air Canada 2009 Pension Plan Funding Regulations.

Air Canada's projected pension funding obligations, on a cash basis, for 2011 and for the next two years, are provided in the table below. As of 2014, the Air Canada 2009 Pension Regulations will cease to have effect and Air Canada's pension funding obligations may vary significantly based on a wide variety of factors, including those identified above.

(Canadian dollars in millions)	2011	2012	2013
Past service domestic registered plans	$ 138	$ 173	$ 221
Current service domestic registered plans	180	186	191
Other pension arrangements (1)	79	81	83
Projected pension funding obligations	**$ 397**	**$ 440**	**$ 495**

(1) Includes retirement compensation arrangements, supplemental plans and international plans.

The net deficit, on an accounting basis, at December 31, 2010, for pension benefits was $2,077 million (2009 - $1,186 million). The increase in the accounting deficit is mainly the result of the increase to the accrued benefit obligation resulting from the decrease in the discount rate and, to some extent, offset by the higher than expected returns on plan assets.

9.9 SHARE INFORMATION

As at January 31, 2011, an aggregate of 278,972,384 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 of the dates indicated below, as follows:

	Number of Shares at	
	January 31, 2011	January 31, 2010
Issued and outstanding shares		
Class A variable voting shares	48,424,211	59,341,968
Class B voting shares	230,548,173	218,805,091
Total issued and outstanding shares	**278,972,384**	**278,147,059**
Class A variable voting and Class B voting shares potentially issuable		
Warrants	89,430,300	90,250,000
Stock options (1)	3,460,027	3,963,474
Performance share units	2,500	561,846
Total shares potentially issuable	**92,892,827**	**94,775,320**
Total outstanding and potentially issuable shares	**371,865,211**	**372,922,379**

(1) Issued as at February 9, 2011.

During 2009, a total of 90,250,000 warrants were issued, of which 10,000,000 were issued in conjunction with Air Canada's secured term credit facility completed in July 2009 (this facility was repaid on August 3, 2010) and 80,250,000 were issued in conjunction with the share and warrant public offering completed on October 27, 2009. As at January 31, 2011, 89,430,300 warrants remained outstanding.

10. QUARTERLY FINANCIAL DATA

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

(Canadian dollars in millions, except where indicated)	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010
Operating revenues	**$ 2,391**	**$ 2,330**	**$ 2,670**	**$ 2,348**	**$ 2,519**	**$ 2,625**	**$ 3,026**	**$ 2,616**
Aircraft fuel	593	572	682	601	619	660	733	640
Ownership (DAR) (1)	245	248	252	250	264	258	254	249
Other operating expenses	1,741	1,623	1,668	1,580	1,762	1,632	1,712	1,642
Operating expenses	**2,579**	**2,443**	**2,602**	**2,431**	**2,645**	**2,550**	**2,699**	**2,531**
Operating income before the undernoted item	**(188)**	**(113)**	**68**	**(83)**	**(126)**	**75**	**327**	**85**
Provision adjustment for cargo investigations, net (2)	-	-	-	-	-	-	-	**46**
Operating income (loss)	**(188)**	**(113)**	**68**	**(83)**	**(126)**	**75**	**327**	**131**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(212)	268	209	27	41	(278)	(66)	3
Net income (loss)	**$ (400)**	**$ 155**	**$ 277**	**$ (56)**	**$ (85)**	**$ (203)**	**$ 261**	**$ 134**
Revenue passenger miles (millions)	10,984	11,862	14,153	10,885	11,692	12,896	15,531	11,756
Available seat miles (millions)	13,821	14,735	16,946	13,841	14,727	15,523	18,328	14,918
Passenger load factor (%)	79.5	80.5	83.5	78.6	79.4	83.1	84.7	78.8
RASM (cents) (3)	14.5	13.9	14.1	14.6	14.2	14.8	14.8	15.1
CASM (cents)	18.7	16.6	15.4	17.6	18.0	16.4	14.7	17.0
CASM, excluding fuel expense (cents)	14.4	12.7	11.3	13.2	13.8	12.2	10.7	12.7
Fuel price per litres (cents) (4)	71.4	65.4	68.6	72.6	70.7	71.1	66.9	70.2
EBITDAR before the provision for cargo investigations (2) (5)	**$ 57**	**$ 135**	**$ 320**	**$ 167**	**$ 138**	**$ 333**	**$ 581**	**$ 334**
EBITDAR (5)	**$ 57**	**$ 135**	**$ 320**	**$ 167**	**$ 138**	**$ 333**	**$ 581**	**$ 380**
Earning (loss) per share - Basic	**$ (4.00)**	**$ 1.55**	**$ 2.77**	**$ (0.25)**	**$ (0.31)**	**$ (0.72)**	**$ 0.94**	**$ 0.48**
Earning (loss) per share - Diluted	**$ (4.00)**	**$ 1.55**	**$ 2.44**	**$ (0.25)**	**$ (0.31)**	**$ (0.72)**	**$ 0.91**	**$ 0.42**

(1) DAR refers to the combination of depreciation and amortization and aircraft rent expenses.

(2) In the first quarter of 2008, Air Canada recorded a provision for cargo investigations of $125 million. In the fourth quarter of 2010, Air Canada recorded a net reduction of $46 million to this provision.

(3) System RASM excludes the impact of a $40 million favourable adjustment recorded in the fourth quarter of 2010.

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

(5) See section 20 "Non-GAAP Financial Measures" in this MD&A for additional information.

11. SELECTED ANNUAL INFORMATION

The following table provides selected annual information for Air Canada for the years 2008 through to 2010.

(Canadian dollars in millions, except per share figures)	2010	2009	2008
Operating revenues	$ 10,786	$ 9,739	$ 11,082
Operating expenses	10,425	10,055	11,121
Operating income (loss) before the undernoted item	**361**	**(316)**	**(39)**
Provision for cargo investigations, net (1)	46	-	(125)
Operating income (loss)	**407**	**(316)**	**(164)**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(300)	292	(861)
Net income (loss)	**$ 107**	**$ (24)**	**$ (1,025)**
EBITDAR before a provision adjustment for cargo investigations, net (1) (2)	$ 1,386	$ 679	$ 934
EBITDAR (2)	$ 1,432	$ 679	$ 809
Earning (loss) per share - Basic	$ 0.38	$ (0.18)	$ (10.25)
Earning (loss) per share - Diluted	$ 0.37	$ (0.18)	$ (10.25)
Cash, cash equivalents and short-term investments	$ 2,192	$ 1,407	$ 1,005
Total assets	$ 10,544	$ 10,406	$ 11,364
Total long-term liabilities (3)	$ 5,998	$ 6,140	$ 7,309
Total liabilities	$ 8,635	$ 8,759	$ 10,412
Shareholders' equity	$ 1,740	$ 1,446	$ 762

(1) In the first quarter of 2008, Air Canada recorded a provision for cargo investigations of $125 million. In the fourth quarter of 2010, Air Canada recorded a net reduction of $46 million to this provision.

(2) See section 20 "Non-GAAP Financial Measures" in this MD&A for additional information.

(3) Total long-term liabilities include long-term debt (including current portion) and capital leases, pension and other benefit liabilities and other long-term liabilities.

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of gain (loss) on financial instruments recorded at fair value

The following is a summary of gain (loss) 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:

(Canadian dollars in millions)	Fourth Quarter		Full Year	
	2010	2009	2010	2009
Fuel derivatives not under hedge accounting	$ 11	$ 24	$ (11)	$ 102
Other	(3)	(2)	8	(7)
Gain (loss) on financial instruments recorded at fair value	**$ 8**	**$ 22**	**$ (3)**	**$ 95**

Risk Management

Under its risk management policy, Air Canada manages its interest rate risk, foreign exchange risk, share based compensation risk and market risk through the use of various interest rate, foreign exchange, fuel and other derivative financial instruments. Air Canada uses derivative financial instruments only for risk management purposes, not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be offset by changes in cash flows related to the risk being hedged.

As noted below, Air Canada engages in derivative hedging in an effort to mitigate various risks. The derivative fair values represent the amount of the consideration that could be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. Fair value of these derivatives is determined using active markets, where available. When no such market is available, valuation techniques are applied such as discounted cash flow analysis. Where practical, the valuation technique incorporates all factors that would be considered in setting a price, including Air Canada's own credit risk and the credit risk of the counterparty.

Interest Rate Risk

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

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

The ratio of fixed to floating rate obligations outstanding is designed to maintain flexibility in Air Canada's capital structure and is based upon a long term objective of 60% fixed and 40% floating but allows the flexibility in the short term to adjust to prevailing market conditions. The ratio at December 31, 2010, was 69% fixed and 31% floating, including the effects of interest rate swap positions (59% and 41%, respectively, as at December 31, 2009).

The following are the current derivatives employed in interest rate risk management activities and the adjustments recorded during 2010:

- During 2010, the interest rate swap agreement relating to Air Canada's term credit facility was terminated. The fair value of this contract at termination was nil ($1 million in favour of the counterparty at December 31, 2009). During 2010, a gain of $1 million (a loss of $1 million in 2009) was recorded in gain on financial instruments recorded at fair value related to this derivative.

- As at December 31, 2010, Air Canada had two interest rate swap agreements in place with terms to July 2022 and January 2024 relating to two Boeing 767 aircraft financing agreements with an aggregate notional value of $80 million (US$80 million) (2009 - $92 million (US$88 million)). These swaps convert the lease payments on the two aircraft leases from fixed to floating rates. The fair value of these contracts as at December 31, 2010, was $13 million in favour of Air Canada ($12 million in favour of Air Canada in 2009). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2010, a gain of $6 million was recorded in gain on financial instruments recorded at fair value related to these derivatives (a loss of $9 million in 2009).

Interest income includes $15 million (2009 - $10 million) related to cash and cash equivalents, short-term investments, and collateral deposits for fuel derivatives, which are classified as held for trading. Interest expense reflected on Air Canada's Consolidated Statement of Operations relates to financial liabilities recorded at amortized cost.

Foreign Exchange Risk

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

Air Canada's risk management objective is to reduce cash flow risk related to foreign currency denominated cash flows.

Air Canada's cash inflows are primarily in Canadian dollars, while a large portion of its outflows are in U.S. dollars. This unbalanced mix results in an annual U.S. dollar shortfall from operations. In order to mitigate this imbalance, Air Canada has adopted the practice of converting excess revenues from offshore currencies into U.S. dollars. In 2010, this conversion generated coverage of approximately 32% of the imbalance. The remaining 68% was covered through the use of a variety of foreign exchange derivatives, including spot transactions and U.S. dollar investments, which had maturity dates corresponding to the forecasted shortfall dates. The level of foreign exchange derivatives expiring at any one point in time is dependent upon a number of factors, which include the amount of foreign revenue conversion available, U.S. dollar net cash flows, as well as the amount attributed to aircraft and debt payments.

The following are the current derivatives employed in foreign exchange risk management activities and the adjustments recorded during 2010:

- As at December 31, 2010, Air Canada had outstanding foreign currency option agreements to purchase U.S. dollars against Canadian dollars on $223 million (US$224 million) and Euro dollars against Canadian dollars on $15 million (EUR 11 million) which mature in 2011 (2009 - $99 million (US$95 million)). The fair value of these foreign currency contracts as at December 31, 2010, was $3 million in favour of the counterparties (2009 - $4 million in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2010, a gain of $2 million was recorded in foreign exchange gain (loss) related to these derivatives (2009 - $7 million loss).

Fuel Price Risk

Fuel price risk is the risk that future cash flows relating to jet fuel purchases will fluctuate because of changes in jet fuel prices. In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries. Air Canada uses derivative contracts on jet fuel and other crude oil-based commodities, heating oil and crude oil. Heating oil and crude oil commodities are used due to the relative limited liquidity of jet fuel derivative instruments on a medium to long-term horizon since jet fuel is not traded on an organized futures exchange. Air Canada's policy permits hedging of up to 75% of the projected jet fuel purchases for the next 12 months, 50% for the next 13 to 24 months and 25% for the next 25 to 36 months. These are maximum (but not mandated) limits. There is no minimum monthly hedging requirement. Air Canada performs regular reviews and, if necessary, adjusts the strategy in light of market conditions. Air Canada does not purchase or hold any derivative financial instrument for speculative purposes.

During 2010:

- Air Canada recorded a loss of $11 million in "gain (loss) on financial instruments recorded at fair value", related to fuel derivatives (a gain of $102 million in 2009).

- Air Canada purchased crude-oil call options and collars covering 2010 and 2011 fuel exposure, for which the cash premium related to these contracts was $43 million.

- Fuel derivative contracts cash settled with a net fair value of $27 million in favour of the counterparties ($88 million in favour of the counterparties in 2009).

As of January 31, 2011, approximately 24% of Air Canada's anticipated purchases of jet fuel for the remainder of 2011 are hedged at an average West Texas Intermediate ("WTI") capped price of US$94 per barrel and approximately 4% is subject to an average floor price of US$82 per barrel. Air Canada's contracts to hedge anticipated jet fuel purchases over the 2011 period are comprised of crude-oil based contracts.

The following table outlines the notional volumes per barrel along with the WTI weighted average floor and capped price for each year currently hedged by type of derivative instruments as at January 31, 2011.

Derivative Instruments	Term	Volume (bbls)	WTI Weighted Average Floor Price (US$/bbl)	WTI Weighted Average Capped Price (US$/bbl)
Call options	2011	4,580,000	n/a	$ 94
Collars	2011	910,000	$ 82	$ 93

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.

From time to time, Air Canada may choose to adjust or restructure its hedging portfolio in light of market conditions. In 2010, Air Canada modified its fuel hedge portfolio with the termination of swap and collar contracts for $5 million, in favour of the counterparty. The collateral held by the counterparty was in excess of the settlement amount, and such excess was returned, resulting in a cash inflow for Air Canada. During 2009, Air Canada modified its fuel hedge portfolio with the termination of swap and put contracts for $192 million, in favour of the counterparties.

Below is a table summarizing the impact of fuel derivatives on Air Canada's Consolidated Statement of Operations, Consolidated Statement of Comprehensive Loss and Consolidated Statement of Financial Position.

		Fourth Quarter		Full Year	
(Canadian dollars in millions)		2010	2009	2010	2009
Consolidated Statement of Operations					
Operating expense					
Aircraft fuel	Realized effective loss on derivatives designated under hedge accounting	$ (31)	$ (85)	$ (183)	$ (419)
Non-operating income (expense)					
Gain (loss) on financial instruments recorded at fair value	Fair market value gain (loss) – economic hedges	$ 11	$ 24	$ (11)	$ 102
Consolidated Other Comprehensive Income (Loss)					
	Effective loss on derivatives designated under hedge accounting	n/a	n/a	n/a	$ (1)
	Reclassification of net realized loss on fuel derivatives designated under hedge accounting to aircraft fuel expense	$ 31	$ 85	$ 183	$ 419
	Tax on reclassification	$ 1	$ -	$ 1	$ 4

(Canadian dollars in millions)		December 31, 2010	December 31, 2009
Consolidated Statement of Financial Position			
Prepaid expenses and other current assets	Collateral deposits for fuel derivatives	$ -	$ 43
	Fair market vaiue of fuel derivatives	$ 33	$ -
Accounts payable and accrued liabilities	Fair market value of fuel derivatives	$ -	$ (31)
Shareholders' equity (AOCL)	Net loss from fuel derivatives designated under hedge accounting (net of tax in 2010 - $nil and 2009 - $1 million)	$ -	$ (184)

13. OFF-BALANCE SHEET ARRANGEMENTS

The following is a summary of Air Canada's more significant off-balance sheet arrangements.

Guarantees

Performance Obligations Relating to Aircraft Leasing Agreements

With respect to 44 Air Canada aircraft leases, the difference between the reduced rents as a result of the implementation of the Plan of Reorganization, Compromise and Arrangement under the Companies' Creditors Arrangement Act ("CCAA") on September 30, 2004, and amounts which would have been due under the original lease contracts will be forgiven at the expiry date of the leases if no material default has occurred by such date. In the event of a material default, which does not include any cross defaults to other unrelated agreements (including agreements with the counterparties of these aircraft leases), this difference plus interest will become due and payable and all future rent will be based on the original contracted rates. Rent expense is being recorded on the renegotiated lease agreements, and any additional liability would be recorded only at the time management believes the amount is likely to be incurred.

Guarantees in Fuel Facilities Arrangements

Air Canada participates in fuel facility arrangements operated through fuel facility corporations (the "Fuel Facility Corporations"), along with other airlines that contract for fuel services at various major airports in Canada. The Fuel Facility Corporations operate on a cost recovery basis. The purpose of the Fuel Facility Corporations is to own and finance the system that distributes the fuel to the contracting airlines, including leasing the land rights under the land lease. The aggregate debt of the five Fuel Facility Corporations in Canada that have not been consolidated by Air Canada under Accounting Guideline 15 – Consolidated of Variable Interest Entities ("AcG-15") was approximately $171 million as at December 31, 2010 ($162 million as at December 31, 2009), which is Air Canada's maximum exposure to loss without taking into consideration any cost sharing that would occur amongst the other contracting airlines. Air Canada views this loss potential as remote. Each contracting airline participating in a Fuel Facility Corporation shares pro-rata, based on system usage, in the guarantee of this debt.

Indemnification Agreements

In the ordinary course of Air Canada's business, Air Canada enters into a variety of agreements, some of which may provide for indemnifications to counterparties that may require Air Canada to pay for costs and/or losses incurred by such counterparties. Air Canada cannot reasonably estimate the potential amount, if any, it could be required to pay under such indemnifications. Such amount would also depend on the outcome of future events and conditions, which cannot be predicted. While certain agreements specify a maximum potential exposure, certain others do not specify a maximum amount or a limited period. Historically, Air Canada has not made any significant payments under these indemnifications.

Air Canada enters into real estate leases or operating agreements, which grant a license to Air Canada to use certain premises, in substantially all cities that it serves. It is common in such commercial lease transactions for Air Canada, as the lessee, to agree to indemnify the lessor and other related third parties for tort or similar extra-contractual liabilities that arise out of or relate to Air Canada's use or occupancy of the leased or licensed premises. Exceptionally, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by their gross negligence or willful misconduct. Additionally, Air Canada typically indemnifies such parties for any environmental liability that arises out of or relates to its use or occupancy of the leased or licensed premises.

In aircraft financing or leasing agreements, Air Canada typically indemnifies the financing parties, trustees acting on their behalf and other related parties and/or lessors against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft and for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, except for their gross negligence or willful misconduct. In addition, in aircraft financing or leasing transactions, including those structured as leveraged leases, Air Canada typically provides indemnities in respect of various tax consequences including in relation to the leased or financed aircraft, the use, possession, operation, maintenance, leasing, subleasing, repair, insurance, delivery, import, export of such aircraft, the lease or finance arrangements entered in connection therewith, changes of law and certain income, commodity and withholding tax consequences.

When Air Canada, as a customer, enters into technical service agreements with service providers, primarily service providers who operate an airline as their main business, Air Canada has from time to time agreed to indemnify the service provider against certain liabilities that arise from third party claims, which may relate to the services performed by the service provider.

Under its general by-laws and pursuant to contractual agreements between Air Canada and each of its officers and directors, Air Canada has indemnification obligations to its directors and officers. Pursuant to such obligations, Air Canada indemnifies these individuals, to the extent permitted by law, against any and all claims or losses (including amounts paid in settlement of claims) incurred as a result of their service to Air Canada.

The maximum amount payable under the foregoing indemnities cannot be reasonably estimated. Air Canada expects that it would be covered by insurance for most tort and similar extra-contractual liabilities and certain related contractual indemnities described above.

14. RELATED PARTY TRANSACTIONS

In 2010, ACE Aviation Holdings Inc. ("ACE") announced that it had concluded a public secondary offering on a bought deal basis of 44,000,000 Class B voting shares of Air Canada for aggregate gross proceeds to ACE of $162 million. Air Canada did not receive any of the proceeds from this offering. In accordance with the Registration Rights Agreement between Air Canada and ACE, the expenses of the offering of less than $1 million were paid by Air Canada. After giving effect to this offering and ACE's resulting ownership interest in Air Canada of approximately 11%, ACE and Air Canada are no longer related parties. ACE was a participant lender in the secured term credit facility. ACE's pro-rata share of interest expense to the time the secured term credit facility was repaid was $13 million.

As a result of the Aveos Fleet Performance Inc. ("Aveos") Restructuring Plan described below and the change in equity interests in Aveos, Air Canada and Aveos are no longer related parties.

Aveos Restructuring Plan

In the first quarter of 2010, Aveos reached an agreement with its lenders and equity holders on the terms of a consensual restructuring plan to recapitalize the company. As part of this recapitalization, Air Canada and Aveos entered into agreements to settle certain issues and modify the terms of certain contractual arrangements in exchange for Air Canada receiving a minority equity interest in Aveos. This restructuring modified the terms of certain commercial agreements between Air Canada and Aveos, including terms of the Pension and Benefits Agreement and repayment terms on $22 million of receivables. The modified terms relating to maintenance agreements are not expected to have a material impact on maintenance expense over their terms.

As part of these agreements, Air Canada also agreed to extend repayment terms on $22 million of receivables, due in 2010, over six years with annual repayments on a non-interest bearing basis, with such payments subject to satisfaction of certain conditions. This agreement is now referred to as the Term Note.

The terms of the Pension and Benefits Agreement, relating to pension and benefits arrangements pertaining to (i) the non-unionized employees of Air Canada who were previously assigned to the Aveos operation and who became employees of Aveos on October 16, 2007, and (ii) those unionized employees of Air Canada who were assigned to the Aveos operation pursuant to general services agreements between Air Canada and Aveos for the assignment of unionized employees from Air Canada to Aveos, were also modified to defer the determination of pension assets and related solvency deficiencies of transferring unionized employees performing airframe maintenance services to April 2011. This has the result of Air Canada assuming changes in the solvency deficiency for those affected employees from October 16, 2007, being the date of the Pension and Benefits Agreement, to April 1, 2011. As part of the amendment, all letters of credit issued under the Pension and Benefits Agreement were cancelled and a new letter of credit in the amount of $20 million was issued by Air Canada in favour of Aveos to secure the payment of all compensation payments owing by Air Canada to Aveos in respect of pension, disability, and retiree liabilities for which Air Canada would be liable under the Pension and Benefits Agreement. This modification resulted in a reduction to the outstanding deposit under Air Canada's letter of credit facility of $23 million during the first quarter of 2010. Until such future time as the assets and obligations under the Air Canada pension and other employee and retiree benefit arrangements pertaining to unionized employees may be transferred to Aveos, the current service pension cost and the current service and interest costs for other employee benefits in respect of Air Canada employees providing services to Aveos are charged by Air Canada to Aveos, and as such, the modifications to the Pension and Benefits Agreement have no accounting consequence in the current period.

As a result of the above agreements, Air Canada's equity investment in Aveos was recorded at $49 million, based upon its estimated fair value. The Term Note of $22 million was recorded at its estimated fair value of $11 million, based on the present value of expected cash flows on a discounted basis. Other trade receivables from Aveos of $4 million were settled. For accounting purposes, $34 million for consideration of agreement amendments is deferred and will be amortized over the terms of the amended agreements with Aveos of four years, on average. The accounting treatment recorded in the first quarter of 2010 is summarized as follows:

Share consideration received	$49 million
Allocated to:	
Term Note	*$11 million*
Trade receivables settled	*$4 million*
Agreements and contract amendments	*$34 million*
	$49 million

The investment in Aveos common shares is recorded in deposits and other assets and is carried at cost. The Term Note is also recorded in deposits and other assets and is carried at amortized cost.

Aveos Certification Order

On January 31, 2011, the Canada Industrial Relations Board issued an order determining that the sale of Air Canada's former aircraft, engine and component maintenance and repair business had occurred within the meaning of the Canada Labour Code, and establishing Aveos as a distinct employer, bound by separate collective agreements. The issuance of this order triggers the commencement of the process by which certain employees will transition from Air Canada to employment with Aveos.

Pursuant to this order and a related separation program, Air Canada may be required to provide up to a maximum of 1,500 separation packages to IAMAW-represented Aveos employees employed as of the date of the order (with each package including up to a maximum of 52 weeks of pay), in the event that such employees are permanently laid off or terminated as a direct result of Aveos ceasing to be the exclusive provider of airframe maintenance services to Air Canada prior to June 30, 2015. These packages will also be made available at any time up to June 30, 2013, in the event of an insolvency, liquidation or bankruptcy involving Aveos resulting in the cancellation of Air Canada-Aveos contracts and in the termination or permanent layoff of IAMAW-represented employees. The airframe maintenance services agreement may be terminated, as of June 30, 2013, by either party. The accounting for the separation program will be determined in the first quarter of 2011.

15. CRITICAL ACCOUNTING ESTIMATES

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

Air Canada has identified the following areas that contain critical accounting estimates utilized in the preparation of its consolidated financial statements.

Passenger and Cargo Revenues

Airline passenger and cargo advance sales are deferred and included in current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aeroplan, a corporation that provides loyalty program services to Air Canada and purchases seats from Air Canada pursuant to the Aeroplan Commercial Participation and Services Agreement between Aeroplan and Air Canada (the "CPSA"). Passenger and cargo revenues are recognized when the transportation is provided, except for revenue on unlimited flight passes which is recognized on a straight-line basis over the period during which the travel pass is valid. Air Canada has formed alliances with other airlines encompassing loyalty program participation, code sharing and coordination of services including reservations, baggage handling and flight schedules. Revenues are allocated based upon formulas specified in the agreements and are recognized as transportation is provided. Passenger revenue also includes revenues from passenger-related services such as ticket changes, seat selection, and excess baggage which are recognized as the services are provided.

Air Canada performs regular evaluations on the deferred revenue liability which may result in adjustments being recognized as revenue. Due to the complex pricing structures, the complex nature of interline, and other commercial agreements used throughout the industry, historical experience over a period of many years, and other factors including refunds, exchanges and unused tickets, certain amounts are recognized as revenue based on estimates. Events and circumstances may result in actual results that are different from estimates.

Employee Future Benefits

Air Canada maintains several defined benefit plans providing pension, other retirement and post-employment benefits to its employees. Management makes a number of assumptions in the calculation of both the accrued benefit obligation as well as the pension costs.

	December 31, 2010	December 31, 2009
Weighted average assumptions used to determine the accrued benefit liability		
Discount rate	5.50 %	6.40 %
Rate of compensation increase (1)	2.50 %	2.50 %
Weighted average assumptions used to determine the accrued benefit cost		
Discount rate	6.40 %	7.35 %
Expected long-term rate	7.00 %	7.15 %
Rate of compensation increase (2)	2.50 %	2.50 %

(1) A rate of compensation increase of 0% plus merit was used for 2010 in determining the net benefit obligation for the pension plan and 2.5% plus merit for the remaining years.

(2) A rate of compensation increase of 0% plus merit was used for 2010 in determining the net benefit pension expense and 2.5% plus merit for the remaining years.

Discount Rate

The discount rate used to determine the pension obligation was determined by reference to market interest rates on corporate bonds rated "AA" or better with cash flows that approximately match the timing and amount of expected benefit payments. An increase or decrease in the discount rate of 0.25% results in a decrease or increase of $411 million to the pension obligation, respectively. A sensitivity analysis on pension expense assuming a change in the discount rate on plan obligations is provided below.

Expected Return on Assets Assumption

Air Canada's expected long-term rate of return on assets assumption is selected based on the facts and circumstances that existed as of the measurement date and the specific portfolio mix of plan assets. Air Canada's management, in conjunction with its actuaries, reviews anticipated future long-term performance of individual asset categories and considers the asset allocation strategy adopted by Air Canada, including the longer duration in its bond portfolio in comparison to other pension plans. These factors are used to determine the average rate of expected return on the funds invested to provide for the pension plan benefits. The determination of the long-term rate considers recent fund performance and historical returns, to the extent that the past is indicative of the expected long-term, prospective rate. There can be no assurance that any of the plans will earn the expected rate of return. A sensitivity analysis on pension expense assuming a change in the expected return on plan assets is provided below.

U.S. Health Care Reform

Air Canada is a sponsor of certain U.S. post-retirement health-care plans that were impacted by U.S. health care reform legislation enacted in March 2010. Under this legislation, changes include the removal of lifetime benefit maximums. This legislation has the impact of increasing Air Canada's post-retirement benefit obligation by $55 million. The full amount is recognized as an actuarial loss and will be recognized in pension expense over the expected average remaining service life commencing in 2011.

Composition of Pension Plan Assets

The composition of the domestic registered plan assets and the target allocation are the following:

	2010	2009	Target allocation (1)
Non-matched assets (mainly equities)	54.0 %	55.9 %	54.4 %
Matched assets (mainly Canadian bonds)	46.0 %	43.4 %	45.6 %
Cash and temporary investments	0.0 %	0.7 %	0.0 %
Total	**100.0 %**	**100.0 %**	**100.0 %**

(1) Weighted average of the Master Trust Fund target allocation (99% of Domestic Registered Plan assets) and the Bond Fund target allocation. The Bond Fund serves the purpose of altering the asset mix of some of the participating plans. These plans exhibit characteristics that differ from the majority of the participating plans, which are solely invested in the Master Trust.

Domestic Registered Plans

For the domestic registered plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Funds as amended during 2010. The investment return objective of the Fund is to achieve a total annualized rate of return that exceeds by a minimum of 1.0% before investment fees on average over the long term (i.e.10 years) the total annualized return that could have been earned by passively managing the Liability Benchmark. The Liability Benchmark, which is referenced to widely used Canadian fixed income performance benchmarks (DEX), is composed of a mix of the DEX Universe Provincial Bond Index, DEX Long Term Provincial Bond Index and DEX Real Return Bond Index that closely matches the characteristics of the pension liabilities.

In addition to the broad asset allocation, as summarized in the asset allocation section above, the following policies apply to individual asset classes:

- Non-matched assets are mainly equities, and are required to be diversified among industries and economic sectors. Foreign equities can comprise 31% to 37% of the total market value of the Master Trust Fund. Limitations are placed on the overall allocation to any individual security at both cost and market value. Investments in non-publicly traded securities and in non-traditional asset classes are allowed up to 10% of the total market value of the Master Trust Fund.

- Matched assets are mainly Canadian bonds, oriented toward long term investment grade securities rated "BBB" or higher. With the exception of Government of Canada securities or a province thereof, in which the plan may invest the entire fixed income allocation, these investments are required to be diversified among individual securities and sectors.

Derivatives are permitted provided that they are used for hedging a particular risk (including interest rate risk related to pension liabilities) or to create exposures to given markets and currencies and that counterparties have a minimum credit rating of "A". As of December 31, 2010, a 15% derivative exposure to matched assets is in place to hedge interest rate risk related to pension liabilities.

Similar investment policies are established for the other pension plans sponsored by Air Canada.

Air Canada's expected long-term rate of return on assets assumption is selected based on the facts and circumstances that exist as of the measurement date, and the specific portfolio mix of plan assets. Management reviewed anticipated future long-term performance of individual asset categories and considered the asset allocation strategy adopted by Air Canada, including the longer duration in its bond portfolio in comparison to other pension plans. These factors are used to determine the average rate of expected return on the funds invested to provide for the pension plan benefits. While the review considers recent fund performance and historical returns, the assumption is primarily a long-term, prospective rate.

Sensitivity Analysis

Sensitivity analysis on the 2010 pension expense based on different actuarial assumptions with respect to discount rate and expected return on plan assets is as follows:

	0.25 percentage point	
Impact on 2010 pension expense (Canadian dollars in millions)	**Decrease**	**Increase**
Discount rate on obligation assumption	$ 8	$ (9)
Long-term rate of return on plan assets assumption	$ 29	$ (29)

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. An 8.25% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2010 (8.25% was assumed for 2009). The rate is assumed to decrease gradually to 5% by 2015. A one percentage point increase in assumed health care trend rates would have increased the service and interest costs by $2 million and the obligation by $47 million. A one percentage point decrease in assumed health care trend rates would have decreased the service and interest costs by $2 million and the obligation by $46 million.

Income Taxes

Air Canada utilizes the assets and liability method of accounting for income taxes under which future income tax assets and liabilities are recognized for the estimated future income tax consequences attributable to differences between the financial statement carrying value amount and the tax basis of assets and liabilities. Management uses judgment and estimates in determining the appropriate rates and amounts in recording future taxes, giving consideration to timing and probability. Actual taxes could significantly vary from these estimates as a result of future events, including changes in income tax law or the outcome of reviews by tax authorities and related appeals. The resolution of these uncertainties and the associated final taxes may result in adjustments to Air Canada's tax assets and tax liabilities.

Future income tax assets are recognized to the extent that realization is considered more likely than not. Air Canada considers past results, current trends and outlooks for future years in assessing realization of income tax assets.

As at December 31, 2010, Air Canada has substantial tax attributes largely in the form of loss carry forwards and other tax attributes to shelter future taxable income. Air Canada does not forecast having any significant current taxes payable within the foreseeable future.

Impairment of Long-Lived Assets

Long-lived assets are tested for impairment whenever circumstances indicate that the carrying value may not be recoverable. When events or circumstances indicate that the carrying value of long-lived assets, other than indefinite life intangibles, are not recoverable, the long-lived assets are tested for impairment by comparing the estimate of future expected undiscounted cash flows to the carrying amount of the assets or groups of assets. Indefinite-life intangible assets are subject to impairment tests under Canadian GAAP on an annual basis or when events or circumstances indicate a potential impairment. If the carrying value of long-lived assets is not recoverable from future expected undiscounted cash flows, any loss is measured as the amount by which the asset's carrying value exceeds fair value and recorded in the period. Recoverability is assessed relative to undiscounted cash flows from the direct use and disposition of the asset or group of assets.

Fair value under Canadian GAAP is defined as "the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act". Assessing the fair value of intangible assets requires significant management estimates on discount rates to be applied in the analysis and future cash flows to be generated by the assets, including the estimated useful life of the assets. Discount rates are determined with reference to estimated risk adjusted market rates of return for similar cash flows. Air Canada performs sensitivity analysis on the discount rates applied. The discount rates used are subject to measurement uncertainty.

Property and Equipment

Property and equipment is originally recorded at cost. Property under capital leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments.

Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Property and equipment under capital leases within variable interest entities are depreciated to estimated residual values over the life of the lease. Air Canada's aircraft and flight equipment, including spare engines and related parts ("rotables"), are depreciated over 20 to 25 years, with 10 to 20% estimated residual values. Aircraft reconfiguration costs are amortized over three to five years. Betterments to owned aircraft are capitalized and amortized over the remaining service life of the aircraft. Betterments to aircraft on operating leases are amortized over the term of the lease.

Buildings are depreciated over their useful lives not exceeding 50 years on a straight-line basis. An exception to this is where the useful life of the building is greater than the term of the land lease. In these circumstances, the building is depreciated over the life of the lease. Leasehold improvements are amortized over the lesser of the lease term or five years. Ground and other equipment is depreciated over three to 25 years.

Aircraft depreciable life is determined through economic analysis, a review of existing fleet plans and comparisons to other airlines operating similar fleet types. Residual values are estimated based on Air Canada's historical experience with regard to the sale of aircraft and spare parts, as well as forward-looking valuations prepared by independent third parties.

16. ACCOUNTING POLICIES

16.1 UPDATE ON THE PROGRESS OF THE INTERNATIONAL FINANCIAL REPORTING STANDARDS CONVERSION PLAN

The following information is provided solely for the purpose of allowing investors and others to obtain a better understanding of the Corporation's IFRS changeover plan and the resulting expected effects on the Corporation's financial statements and operating performance measures. Readers are cautioned that it may not be appropriate to use such information for any other purpose. The accounting policy differences identified in this MD&A should not be considered as complete or final as further changes, or other effects and other policy differences may be identified. In addition, the information provided reflects the Corporation's current assumptions, estimates and expectations, all of which are subject to change. Circumstances may arise, including changes in IFRS, regulations or economic conditions, which could change these assumptions, estimates or expectations or the information provided.

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. Commencing with the first quarter of 2011, Air Canada's financial results will be presented in accordance with IFRS. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosures.

The Corporation has developed a plan to convert its consolidated financial statements to IFRS and has established 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.

Summary of the IFRS changeover plan

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 as follows:

	Key Activities	Status
Accounting policies and implementation decisions	Identification of differences in Canadian GAAP and IFRS accounting policies; Selection of the Corporation's ongoing IFRS policies; Selection of the Corporation's IFRS 1 First-time Adoption of International Financial Reporting Standards ("IFRS 1") choices; Development of financial statement format; Quantification of effects of change in accounting policies and application of IFRS 1 exemptions.	As further described below, the Corporation has identified and quantified the significant differences between accounting policies under Canadian GAAP and accounting policy choices under IFRS, both on an ongoing basis and with respect to certain choices available on conversion, made in accordance with IFRS 1.
Infrastructure Financial reporting expertise	Development of IFRS expertise.	The Corporation has provided training for key employees and stakeholders. Additional training will be ongoing until full adoption in 2011.
Infrastructure Information technology and data systems	Development of systems solution for transition period and post-convergence period.	The Corporation has determined system requirements and solutions. The impact with respect to Information technology and data systems is due to the change in accounting for property, plant and equipment. These changes have largely been implemented at nominal cost.
Business activities Financial covenants	Identification of impact on financial covenants and business practices.	The Corporation is in the process of finalizing its analysis on the contractual implications of IFRS on any financing relationships and other arrangements, including discussions with 3rd parties.

	Key Activities	Status
Business activities Compensation arrangements	Identification of impact on compensation arrangements.	The Corporation has analyzed its compensation policies that rely on indicators derived from the financial statements and has implemented the appropriate changes.
Control activities Internal control over financial reporting	For all accounting policy changes identified, assessment of Internal Controls over Financial Reporting ("ICFR") design and effectiveness implications.	The Corporation is in the process of finalizing its analysis of any issues with respect to ICFR, including the implementation of appropriate changes in internal controls as required to handle changes in accounting policies and practices as described below.
Control activities Disclosure controls and procedures	For all accounting policy changes identified, assessment of Disclosure Controls and Procedures ("DC&P") design and effectiveness implications.	The Corporation is in the process of finalizing its analysis of any issues with respect to DC&P and has not identified any areas where substantive changes to procedures are required.

First time adoption of IFRS

With regard to IFRS transition, the Corporation has largely completed its analysis on the optional exemptions available under IFRS 1. IFRS 1 provides entities adopting IFRS for the first time with a number of optional exemptions and mandatory exceptions, in certain areas, to the general requirement for full retrospective application of IFRSs. The decisions about the optional exemptions available under IFRS 1 may be subject to change based on changes in circumstances.

The most significant IFRS 1 exemptions that are expected to apply to the Corporation upon adoption are summarized in the following table:

Optional Exemption under IFRS 1	Summary of Exemption Available	Policy Selection
Business Combinations	The Corporation may elect not to apply IFRS 3 (as amended in 2008) retrospectively to past business combinations prior to the date of transition to IFRS. Such election has the effect of leaving past business combinations as previously reported.	The Corporation expects to elect not to apply IFRS 3 (as amended in 2008) retrospectively to business combinations that occurred before January 1, 2010, the date of transition to IFRS.
Fair value or revaluation as deemed cost	The Corporation may elect to use any one of the following amounts at the date of transition for any item within the scope of the exemption: a) fair value at date of transition to IFRS; or b) a revaluation under previous GAAP that meets specified criteria; or c) a deemed cost measurement recognized under previous GAAP based on fair value at the date of an event such as a privatization or an initial public offering (an 'event-driven' value).	The Corporation expects to elect to measure owned and finance leased aircraft and engines at January 1, 2010 at fair value and use that fair value as deemed cost at that date. Under existing Canadian GAAP, the Corporation applied fresh start reporting on September 30, 2004. As a result, all consolidated assets and liabilities of Air Canada were reported at fair values, except for future income taxes. As permitted under IFRS 1, the Corporation expects to elect to apply those fair values as deemed cost for IFRS as at the date of the revaluation, with the exception of owned and finance leased aircraft and engines, which are being measured at fair value as at January 1, 2010 as described above and intangible assets and goodwill, which, in such case, would be measured at historical cost without the application of the fresh start fair values. Refer to "Fresh Start Reporting" below for additional information.
Employee Benefits	The Corporation may elect to recognize in retained earnings all cumulative actuarial gains and losses at the date of transition to IFRSs.	The Corporation expects to elect to recognize all cumulative actuarial gains and losses on pension and other post-retirement benefit plans as at January 1, 2010 directly in Deficit.
Borrowing Costs	The Corporation may elect to designate any date before the date of transition to IFRSs to capitalize borrowing costs relating to all qualifying assets for which the commencement date for capitalization is on or after that date of transition to IFRS.	The Corporation expects to apply IAS 23R for annual periods beginning on or after January 1, 2010, the date of transition to IFRS. Under existing Canadian GAAP, the Corporation had an accounting policy of capitalizing interest.

Summary of significant accounting policy changes under IFRS

The Corporation has identified the following significant differences between its current accounting policies and those required or expected to apply in preparing IFRS financial statements which are summarized in the following table:

Accounting Policy	Significant Accounting Policy Changes under IFRS and Expected Impact
Principles of Consolidation	Under IAS 27 "Consolidated and separate financial statements", consolidation is based on a control model. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. This control model also applies to interests in special purpose entities. Non-controlling interest is initially measured at the minority's interest in the fair value of the subsidiary's net assets. At subsequent periods, it is measured at the minority's interest in the equity of the subsidiary. Non-controlling interest is presented as a component of equity separately from the equity from the owners of the parent on the balance sheet and net income and comprehensive income attributable to the owners of the parent and to the non-controlling interests below net income and comprehensive income. **Policy choices:** Under IFRS 3R, an entity can elect on an acquisition by acquisition basis the use of either the proportionate or full goodwill method. The Corporation expects to apply the proportionate goodwill method for all non-controlling interests. **Differences from existing Canadian GAAP:** Under existing Canadian GAAP, consolidation is based on a controlling financial interest model. For variable interest entities, consolidation is based on an analysis of the primary beneficiary. For non-variable interest entities, consolidation of an entity is based on the continuing power to govern the financial and operating policies of an entity so as to obtain benefits from its activities and be exposed to related risks. Non-controlling interest is initially measured at the minority's interest in the historical cost of the subsidiary's net assets. Non-controlling interest is presented outside of liabilities and equity on the balance sheet and as a reduction to net income on the income statement. **Expected impact to the opening balance sheet:** Non-controlling interest on the balance sheet as at January 1, 2010 amounting to $201 million is expected to be reported in Equity. Certain special purpose entities ("SPEs") that were not consolidated under existing Canadian GAAP, as the Corporation was determined not to be the primary beneficiary, will be consolidated under IFRS. This relates to aircraft leasing entities covering seven A319 aircraft, six A340 aircraft and eight A330 aircraft. This adjustment is expected to result in an increase to Property and equipment of $212 million (based upon the fair value of the aircraft as at January 1, 2010 and included in the IFRS 1 Property and equipment impacts further discussed below), an increase to Long-term debt of $259 million, a decrease to non-controlling interest of $53 million and a credit to the Deficit of $6 million. The additional debt consolidated in the SPEs relates to third party guarantees in the SPE leasing entities. **Expected impact subsequent to transition:** Interest expense will increase related to the non-cash accretion on the debt consolidated from the SPEs at an average effective interest rate of approximately 8% per year. Refer to Property and Equipment section below for a discussion of changes to depreciation expense.

<table>
<tr><th>Accounting Policy</th><th>Significant Accounting Policy Changes under IFRS and Expected Impact</th></tr>
<tr><td>Employee Benefits</td><td>Actuarial gains and losses of Post Employment and Post Retirement Benefits

Policy choices:
Under IAS 19 "Employee benefits" ("IAS19"), actuarial gains and losses may either be:

• recognized in profit or loss under the corridor approach (excess amounts amortized when they exceed either 10% of the greater of the obligation and market-related value of plan assets at the beginning of the period) (the 'corridor approach');

• recognized in any systematic method that results in faster recognition of actuarial gains or losses, provided that the same basis is applied consistently from period to period;

• recognized immediately in other comprehensive income without subsequent recycling to income, however with reclassifications to retained earnings.

Policy selection: The Corporation expects to recognize actuarial gains and losses in other comprehensive income and retained earnings.

Differences from existing Canadian GAAP: Under existing Canadian GAAP, the corridor approach was used and cumulative actuarial gains and losses in excess of 10% of the greater of the obligation and market-related value of plan assets at the beginning of the period is amortized in profit or loss.

Fair value of plan assets versus market-related value of plan assets

Policy choices: There are no policy choices available under IFRS. The expected return on plan assets is based on actual plan assets.

Differences from existing Canadian GAAP: Under existing Canadian GAAP, a market-related value of assets was used whereby the difference between actual and expected return was gradually recognized over four years.

The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

IFRIC 14 "IAS 19 - The Limit of a Defined Benefit Asset, Minimum Funding Requirements and their Interaction" ("IFRIC 14") addresses the application of paragraph 58 of IAS 19 which limits the measurement of a defined benefit asset to "the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan" plus cumulative unrecognized net losses and past service cost.

IFRIC 14 provides guidance regarding (a) when refunds or reductions in future contributions should be regarded as available in accordance with paragraph 58 of IAS 19, (b) how a minimum funding requirement might affect the availability of reductions in future contributions and (c) when a minimum funding requirement might give rise to a liability.

Policy choices: There are no policy choices available under IFRS.

Differences from existing Canadian GAAP: There is Canadian GAAP guidance related to the limit on the carrying amount of an accrued benefit asset and recognition of a related valuation allowance. However, IFRS and Canadian GAAP had different methods of calculating the defined benefit asset limit. Furthermore, Canadian GAAP did not address accounting for an additional liability due to minimum funding requirements.</td></tr>
</table>

Accounting Policy	Significant Accounting Policy Changes under IFRS and Expected Impact
Employee Benefits	*Presentation of employee benefits expense* **Policy choices:** IAS19 does not specify the presentation of current service cost, interest cost and the expected return on plan assets as components or a single item of income or expense. Accordingly, the Corporation can elect to present the components of pension cost (current service cost, interest cost and the expected return on plan assets) either net or separately on the income statement. **Policy selection:** The Corporation expects to elect to separately present the components of pension expense on the income statement. Current service costs are expected to continue to be recorded in operating expenses. Interest cost and the expected return on plan assets are expected to be presented in non-operating expenses - financing costs. **Expected impact to the opening balance sheet:** Pension and other benefit liabilities are expected to increase by $2,776 million, offset by a charge to the Deficit. This includes the impact of IFRIC 14 and the IFRS 1 employee benefits optional exemption described above. The additional minimum funding requirement liability under IFRIC 14 included in the adjustment is expected to amount to approximately $1,937 million. **Expected impact subsequent to transition:** The effect of actuarial gains and losses are no longer expected to affect net income under the Corporation's accounting policy choice; however, the pension and other employee benefit liabilities and shareholders' equity are expected to be subject to greater variability as the effects of actuarial gains and losses will be recognized immediately, rather than being deferred and amortized over a period of time. The income related to the market return on plan assets is expected to be subject to more volatility as it is based on actual plan assets as opposed to a smoothed value and based on the current value of plan assets, the income may be lower than comparable values under Canadian GAAP.
Property and Equipment	*Capitalization of major engine and airframe overhaul* IAS 16 provides guidance that would require major engine and airframe overhaul costs be treated as separate components of an aircraft if they meet a significant part of the asset's cost. The actual cost of the overhaul or inspection is then capitalized provided that it meets the recognition criteria, that it is probable that future economic benefits will flow to the entity and that the cost can be measured reliably. This inspection/overhaul cost is then depreciated over the period to the next inspection/overhaul. *Cost/Revaluation Model* **Policy choices:** Either a cost model or a revaluation model can be used to value classes of property, plant and equipment. **Policy selection:** The Corporation expects to utilize the cost model. **Expected impact to the opening balance sheet:** Property and equipment is expected to be reduced by $301 million, offset by a charge to the Deficit, which includes (1) the impact of the fair value adjustment to aircraft and spare engines as at January 1, 2010 as described above and (2) the impact of componentizing the aircraft and adjusting the fair values based upon the estimated remaining life of each component, including capitalized engine and airframe overhaul costs. The amount of $301 million excludes the impact of the consolidation of special purpose entities ("SPEs") as described above, which has the effect of increasing property and equipment by $212 million for a net decrease of $89 million to property and equipment. **Expected impact subsequent to transition:** Depreciation and aircraft maintenance expense will be different under IFRS on owned and finance leased aircraft. Major engine and airframe overhaul costs that were charged to aircraft maintenance expense under Canadian GAAP on owned and finance leased aircraft will be capitalized and depreciated over their estimated useful lives under IFRS. Major engine and airframe overhaul costs that were charged to aircraft maintenance expense under Canadian GAAP on operating lease aircraft will continue to be expensed as incurred, except for end of lease return obligations which will be accrued during the term of the operating lease.

Accounting Policy	Significant Accounting Policy Changes under IFRS and Expected Impact
Lease	Under IAS 17 "Leases" ("IAS17"), a lease is classified as either a finance lease or an operating lease. Lease classification depends on whether substantially all of the risks and rewards incidental to ownership of a leased asset have been transferred from the lessor to the lessee, and is made at inception of the lease. A number of indicators are used to assist in lease classification however, quantitative thresholds are not offered as an indicator as under current Canadian GAAP. In addition, under IAS 17, immediate gain recognition from the sale and leaseback of an asset depends on whether or not the sale takes place at fair value, and whether the leaseback is classified as an operating lease or a finance lease. Under existing Canadian GAAP, immediate gain recognition from the sale and leaseback of an asset does not occur unless the leaseback is classified as an operating lease and the seller-lessee retains the rights to use only a minor portion of the asset sold. **Policy choices:** There are no policy choices available under IFRS. **Expected impact to the opening balance sheet:** As described under Principles of consolidation, 21 capital leases are expected to be treated as owned aircraft financings upon the consolidation of the special purpose leasing entities. Other long-term liabilities are expected to decrease by $69 million offset by a decrease to the Deficit for the reversal of deferred gains on sale leasebacks. **Expected impact subsequent to transition:** Aircraft rent is expected to increase due to the elimination of the deferred gains on sale leasebacks, which were amortizing to 2018 – 2020.
Borrowing Costs	Under IAS 23R "Borrowing costs" ("IAS 23"), borrowing costs related to "qualifying" assets are capitalized. Interest on both general borrowing and borrowings specific to the asset under construction are eligible for capitalization. The capitalization of interest commences when borrowing costs are incurred, expenditures for the asset are being incurred, and activities to prepare the asset for its intended use or sale are in progress. Capitalization ceases when the activities necessary to prepare the asset for its intended use or sale are substantially complete. Borrowing costs are capitalized at the weighted average rate of both general borrowings and borrowings specific to the asset under construction, as applicable. **Policy choices:** There are no policy choices available under IFRS. **Differences from existing Canadian GAAP:** Under existing Canadian GAAP, borrowing costs directly attributable to property and equipment may be capitalized if certain conditions are met. There is no specific standard however for the capitalization of interest and differences may arise with respect to the identification of qualifying assets, the amount of interest that can be capitalized on general or specific borrowings, the treatment of investment income on the temporary investment of specific borrowings and when the capitalization of interest should commence or be suspended. Borrowing costs were capitalized by the Corporation at the weighted average cost of all outstanding borrowings. **Expected impact to the opening balance sheet:** No expected impact as previously capitalized interest is not expected to be reversed. **Expected impact subsequent to transition:** It is expected that there will be an ongoing difference based on the difference in capitalization rates.

Accounting Policy	Significant Accounting Policy Changes under IFRS and Expected Impact
Fresh Start Reporting	Under IFRS, there are no explicit standards related to fresh start reporting or when an entity undertakes a financial reorganization. **Differences from existing Canadian GAAP:** Under Canadian GAAP, the Corporation applied fresh start reporting on September 30, 2004. As a result, all consolidated assets and liabilities of Air Canada were reported at fair values, except for future income taxes. Goodwill is not recognized upon adoption of fresh start reporting. Under fresh start reporting, retained earnings and contributed surplus were reset to zero. **Expected impact to the opening balance sheet:** Goodwill, which was reported by Air Canada prior to the application of fresh start reporting under Canadian GAAP of $311 million, is expected to be reinstated with an offsetting credit to Deficit. Adjustments to Deficit and Contributed surplus related to the impact of fresh start reporting are expected to be undone with the offset to Share capital. As outlined under IFRS 1 exemptions above, the majority of the Corporation's intangible assets under Canadian GAAP were carried in the balance sheet on the basis of valuations performed on September 30, 2004 following the application of fresh start reporting. In accordance with IFRS 1, the Corporation is expected to elect to reverse the intangible assets that were established in accordance with Section 1625 of the CICA Handbook, Comprehensive Revaluation of Assets and Liabilities ("CICA 1625"). As a result, Intangible assets are expected to decrease by $587 million, representing the derecognition of existing Canadian GAAP intangible assets that were established in accordance with fresh start reporting. The associated future income tax liability on the intangibles with indefinite lives is expected to decrease $40 million, for a net charge to the Deficit of $547 million.
Impairment of Long-lived Assets	Under IAS 36 Impairment of Assets ("IAS 36"), impairment testing of assets is based on comparing the carrying amount of the asset or group of assets to their recoverable amount. Recoverable amount is calculated as the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use. Value in use is calculated based upon a discounted cash flow analysis. In addition, IAS 36 requires, under certain circumstances, the reversal of impairment losses. **Policy choices:** There are no policy choices available under IFRS. **Differences from existing Canadian GAAP:** Under Canadian GAAP, recoverable amount is initially based on undiscounted cash flows. If the recoverable amount is less than the carrying value then the asset or asset group is written down to fair value. Impairment losses cannot be reversed under current Canadian GAAP. **Expected impact to the opening balance sheet:** The opening impairment test on transition to IFRS has been completed. As at the date of the opening IFRS balance sheet, no impairment issues have been identified. **Expected impact subsequent to transition:** Impairments may be recognized more frequently under IFRS, which may be reversed in future periods.

Accounting Policy	Significant Accounting Policy Changes under IFRS and Expected Impact
Provisions and contingent liabilities (including Asset Retirement Obligations)	*Provisions* IAS 37 "Provisions, Contingent Liabilities and Contingent Assets", requires a provision to be recognized when: there is a present obligation as a result of a past transaction or event; it is probable that an outflow of resources will be required to settle the obligation; and a reliable estimate can be made of the obligation. "Probable" in this context means more likely than not. Under IAS 37, there are a number of different estimation techniques to arrive at the best estimate, including the single most likely outcome, the weighted average of all possible outcomes or the midpoint where there is a range of equally possible outcomes. *Asset Retirement Obligations* Measurement of Asset Retirement Obligations under IFRS is based on management's best estimate of future cash flows, discounted to present value using a discount rate specific to the liability. *Lease return conditions* Under IFRS, it is expected that a provision will be recorded over the term of the lease for the end of lease maintenance return condition obligations within the Corporation's operating leases, offset by a prepaid maintenance asset to the extent of any related power by the hour maintenance service agreements or any recoveries under aircraft subleasing arrangements. The provision is recorded using a discount rate specific to the liability, which approximates the risk free rate over the remaining term of the lease. Interest accretion on the provision is recorded in other non-operating expense. For aircraft under operating leases which are subleased to third parties, the provision expense on the income statement is recorded net of the recovery under the sublease, as applicable. **Policy choices:** There are no policy choices available under IFRS. **Differences from existing Canadian GAAP:** *Provisions* Under Canadian GAAP, the criterion for recognition in the financial statements is "likely", which is a higher threshold than "probable". Where there is a range of equally possible outcomes, the provision is recorded at the low point of the range. *Asset Retirement Obligations* Measurement of an Asset Retirement Obligation under Canadian GAAP is based on the fair value of the obligation (which takes market assumptions into account). Cash flow estimates are discounted to present value using a credit adjusted discount rate. *Lease return conditions* Maintenance costs for lease return conditions are booked only for short term leases under the Corporation's accounting policies under existing Canadian GAAP.

Accounting Policy	Significant Accounting Policy Changes under IFRS and Expected Impact
	Expected impact to the opening balance sheet: *Asset Retirement Obligations* Property & Equipment is expected to increase by $7 million, Other long-term liabilities are expected to increase by $12 million and equity is expected to be reduced by $5 million relating to asset retirement obligations associated with the various property leases and the fuel facilities arrangements. *Lease return conditions* Deposits and other assets are expected to increase by $77 million relating to prepayments under power by the hour arrangements, Other long-term liabilities are expected to increase by $447 million relating to provisions for lease return conditions and equity is expected to be reduced by approximately $370 million. **Expected impact subsequent to transition:** Provisions may be recognized more frequently under IFRS. Maintenance expense will include the accrual for maintenance provisions associated with lease return conditions, while interest expense will include the accretion of the obligation over the life of the lease. Actual maintenance costs related to the end of lease return conditions will be charged against the provision, thereby reducing some of the income statement volatility relating to the timing of lease returns.

Estimated Adjustments to the Consolidated Statement of Financial Position on Adoption of IFRS

The following table provides the Canadian GAAP Consolidated Statement of Financial Position as at January 1, 2010 and the IFRS adjustments as described above to arrive at the opening position under IFRS. As described above, circumstances may arise, including changes in IFRS, regulations or economic conditions, which could change these adjustments. The main impacts on the Consolidated Statement of Financial Position are summarized as follows:

- No change to current assets or current liabilities;
- A decrease to Property and equipment of $82 million mainly reflecting fair value adjustments as at the date of transition;
- A decrease to the value of Intangible assets of $587 million partially offset by the recording of Goodwill of $311 million due to the recognition of these assets at historical cost;
- An increase to Long-term debt of $259 million as a result of consolidating additional special purpose leasing entities covering third party guarantees under 21 aircraft leases;
- An increase to Pension and other benefit liabilities of $2,776 million reflecting the recognition of cumulative actuarial losses and an additional minimum funding liabilities;
- An increase to Other long-term liabilities of $390 million mainly related to the recognition of maintenance provisions associated with lease return conditions; and
- A resulting shareholders' deficit of $2,019 million.

Estimated Adjustments to the Consolidated Statement of Operations on Adoption of IFRS
Following the opening IFRS Consolidated Statement of Financial Position below is the 2010 Canadian GAAP Consolidated Statement of Operations as compared to the estimated statement of operations under IFRS. The main impacts on the Consolidated Statement of Operations for the year 2010 are summarized as follows:

- No change to operating revenues;

- An increase to wages, salaries and benefits of $26 million due to the impact of the revised accounting policies for Employee Benefits as described above;

- An increase to Depreciation and amortization expense of $122 million mainly due to the capitalization and amortization of certain maintenance events as well as shortened amortization periods for certain aircraft components. In addition, under IFRS impairment charges are recorded in depreciation expense; impairment charges under IFRS of $49 million were recognized on A340-300 and 767-200 aircraft in 2010;

- A decrease to Aircraft maintenance expense of $28 million due to the capitalization of major engine and airframe overhaul costs, partially offset by the provision for future lease return conditions over the term of the lease; and

- An increase to Non-operating expense of $101 million mainly due to the revised presentation of interest costs on pensions and other employee benefits.

As a result of the adjustments, revised EBITDAR (before a provision adjustment for cargo investigations, net) under IFRS for the year 2010 is expected to increase by $2 million to $1,388 million.

The Corporation is continuing to assess the impact of IFRS on accounting for income taxes.

Estimated Adjustments to the Consolidated Statement of Financial Position on Adoption of IFRS

Unaudited **As at January 1, 2010** **(Canadian dollars in millions)**	Canadian GAAP January 1, 2010	Property & equipment (IAS 16)	Leases (IAS 17)	Pension benefits (IAS 19)	Other employee future benefits (IAS 19)	Fresh Start Reporting (IFRS 1)	Provisions (IAS 37)	Other	IFRS January 1, 2010
ASSETS									
Current assets	$ 2,651								$ 2,651
Property and equipment	6,369	(89)					7		6,287
Intangible assets	916					(587)			329
Goodwill	-					311			311
Deposits and other assets	470						77		547
	$ 10,406	**(89)**	-	-		**(276)**	**84**	-	**10,125**
LIABILITIES									
Current liabilities	$ 3,002								$ 3,002
Long-term debt and capital leases	4,054	259							4,313
Future income taxes	85					(40)			45
Pension and other benefit liabilities	1,163			3,034	(258)				3,939
Other long-term liabilities	455		(69)				459		845
	8,759	259	(69)	3,034	(258)	(40)	459	-	12,144
Non-controlling interest	201							(201)	-
SHAREHOLDER'S EQUITY									
Non-controlling interest		(53)						201	148
Share capital	532							314	846
Contributed surplus	1,825							(1,773)	52
Deficit	(727)	(295)	69	(3,034)	258	(236)	(375)	1,459	(2,881)
Accumulated other comprehensive loss	(184)								(184)
	1,446	(348)	69	(3,034)	258	(236)	(375)	201	(2,019)
	$ 10,406	**(89)**	-	-	-	**(276)**	**84**	-	**$ 10,125**

* The estimated adjustments to Shareholders' Equity on adoption of IFRS are intended to highlight areas which the Corporation believes to be most significant. It should not be regarded as final.

Estimated Annual Adjustments to the Consolidated Statement of Operations on Adoption of IFRS (Tax adjustments are excluded)

Unaudited For the year ended December 31 (Canadian dollars in millions)	Canadian GAAP 2010	Property & equipment (IAS 16)	Leases (IAS 17)	Consolidation of SPEs	Pension benefits (IAS 19)	Other employee future benefits (IAS 19)	Provisions (IAS 37)	Intangible assets (IAS 38)	IFRS 2010
Operating revenues									
Passenger	$ 9,427								$ 9,427
Cargo	466								466
Other	893								893
	10,786	-	-	-	-	-	-	-	**10,786**
Operating expenses									
Aircraft fuel	2,652								2,652
Wages, salaries and benefits	1,885				63	(37)			1,911
Airport and navigation fees	961								961
Capacity purchase with Jazz	934								934
Depreciation and amortization	679	128						(6)	801
Aircraft maintenance	677	(84)					56		649
Food, beverages and supplies	280								280
Communications and information technology	316								316
Aircraft rent	346		7						353
Commissions	259								259
Other	1,436								1,436
	10,425	**44**	**7**	-	**63**	**(37)**	**56**	**(6)**	**10,552**
Operating income before under noted item	**361**	**(44)**	**(7)**		**(63)**	**37**	**(56)**	**6**	**234**
Provision adjustment for cargo investigations, net	46								46
Operating income	**407**	**(44)**	**(7)**	-	**(63)**	**37**	**(56)**	**6**	**280**
Non-operating income (expense)									
Net interest expense	(358)			(19)					(377)
Other	(30)	6			(23)	(53)	(12)		(112)
	(388)	6	-	(19)	(23)	(53)	(12)	-	(489)
Income (loss) before the following items	**19**	**(38)**	**(7)**	**(19)**	**(86)**	**(16)**	**(68)**	**6**	**(209)**
Non-controlling interest	(9)			9					-
Foreign exchange gain	145			15			22		182
Income (loss) before income taxes	**155**	**(38)**	**(7)**	**5**	**(86)**	**(16)**	**(46)**	**6**	**(27)**

The estimated adjustments to Net Income on adoption of IFRS are intended to highlight areas which the Corporation believes to be most significant. It should not be regarded as final.

Estimated Quarterly Adjustments to the Consolidated Statement of Operations on Adoption of IFRS (Tax adjustments are excluded)

Unaudited (Canadian dollars in millions)	Q1 2010		Q2 2010		Q3 2010		Q4 2010		2010	
	CGAAP	IFRS	CGAAP	IFRS	CGAAP	IFRS	CGAAP	IFRS	CGAAP	IFRS
Operating revenues										
Passenger	$ 2,095	$ 2,095	$ 2,314	$ 2,314	$ 2,722	$ 2,722	$ 2,296	$ 2,296	$ 9,427	$ 9,427
Cargo	104	104	115	115	123	123	124	124	466	466
Other	320	320	196	196	181	181	196	196	893	893
	2,519	**2,519**	**2,625**	**2,625**	**3,026**	**3,026**	**2,616**	**2,616**	**10,786**	**10,786**
Operating expenses										
Aircraft fuel	619	619	660	660	733	733	640	640	2,652	2,652
Wages, salaries and benefits	470	474	474	479	471	473	470	485	1,885	1,911
Airport and navigation fees	226	226	236	236	270	270	229	229	961	961
Capacity purchase with Jazz	226	226	230	230	247	247	231	231	934	934
Depreciation and amortization	176	196	172	193	166	185	165	227	679	801
Aircraft maintenance	200	179	146	150	158	141	173	179	677	649
Food, beverages and supplies	74	74	75	75	77	77	54	54	280	280
Communications and information technology	80	80	79	79	76	76	81	81	316	316
Aircraft rent	88	90	86	88	88	89	84	86	346	353
Commissions	60	60	62	62	72	72	65	65	259	259
Other	426	426	330	330	341	341	339	339	1,436	1,436
	2,645	**2,650**	**2,550**	**2,582**	**2,699**	**2,704**	**2,531**	**2,616**	**10,425**	**10,552**
Operating income (loss) before under noted item	**(126)**	**(131)**	**75**	**43**	**327**	**322**	**85**	**-**	**361**	**234**
Provision adjustment for cargo investigations, net	-	-	-	-	-	-	46	46	46	46
Operating income (loss)	**(126)**	**(131)**	**75**	**43**	**327**	**322**	**131**	**46**	**407**	**280**
Non-operating income (expense)										
Interest income	2	2	4	4	4	4	9	9	19	19
Interest expense	(78)	(83)	(133)	(138)	(86)	(90)	(81)	(86)	(378)	(397)
Interest capitalized	-	-	-	-	-	-	1	1	1	1
Gain (loss) on assets	(1)	-	-	(1)	2	1	(8)	(1)	(7)	(1)
Gain (loss) on financial instruments recorded at fair value	2	2	(18)	(18)	5	5	8	8	(3)	(3)
Other	-	(22)	-	(22)	-	(23)	(20)	(41)	(20)	(108)
	(75)	(101)	(147)	(175)	(75)	(103)	(91)	(110)	(388)	(489)
Income (loss) before the following items	**(201)**	**(232)**	**(72)**	**(132)**	**252**	**219**	**40**	**(64)**	**19**	**(209)**
Non-controlling interest	(3)	-	(3)	-	(1)	-	(2)	-	(9)	-
Foreign exchange gain (loss)	100	123	(156)	(189)	90	115	111	133	145	182
Net income (loss) for the period before income taxes	**$ (104)**	**$ (109)**	**$ (231)**	**$ (321)**	**$ 341**	**$ 334**	**$ 149**	**$ 69**	**$ 155**	**$ (27)**

*The estimated adjustments to Net Income on adoption of IFRS are intended to highlight areas which the Corporation believes to be most significant. It should not be regarded as final.

17. SENSITIVITY OF RESULTS

Air Canada's financial results are subject to many different internal and external factors which can have a significant impact on operating results. The following table describes, on an indicative basis, the financial impact that changes in certain assumptions would generally have had on Air Canada's operating results. These guidelines were derived from 2010 levels of activity and make use of management estimates. The impacts are not additive, do not reflect the interdependent relationship of the elements and actual results may vary significantly due to a wide range of factors many of which are beyond the control of Air Canada.

(Canadian dollars in millions, except where indicated) Key Variable	2010 Measure		Sensitivity Factor	Favourable / (Unfavourable) Estimated Operating Income Impact
Revenue Measures				
Passenger yield (cents)	System	18.1	1% increase in yield	$ 88
	Canada	23.8		$ 35
Traffic (RPMs) (millions)	System	51,875	1% increase in traffic	$ 83
	Canada	15,834		$ 34
Passenger load factor (%)	System	81.7	1 percentage point increase	$ 102
RASM (cents)	System	14.8	1% increase in RASM	$ 86
Cost Measures				
Fuel – WTI price (US$/barrel) (1)		78.3	US$1/barrel increase to WTI	$ (25)
Fuel – jet fuel price (CAD cents/litre) (1)		64.5	1% increase	$ (24)
Cost per ASM (cents)		16.4	1% increase in CASM	$ (104)
Currency Exchange				
C$ to US$	C$1 = US$1.00		1 cent increase in exchange rate (i.e., $1.01 to $1.00 per US dollar)	$ 24

(1) Excludes the impact of fuel surcharges and fuel hedging. Refer to section 12 of this MD&A for information on Air Canada's fuel derivative instruments.

(Canadian dollars in millions) Key Variable	2010 Measure	Sensitivity Factor	Favourable / (Unfavourable) Estimated Pre-Tax Income Impact(1)
Currency Exchange			
C$ to US$	C$1 = US$1.00	1 cent increase in exchange rate (i.e., $1.01 to $1.00 per US dollar)	$ 61

(1) Excludes the impact of foreign exchange, forward contracts and currency swaps.

18. RISK FACTORS

The risks described herein may not be the only risks faced by Air Canada. Other risks of which Air Canada is not aware or which Air Canada currently deems to be immaterial may surface and have a material adverse impact on Air Canada, its business, results from operations and financial condition.

Risks Relating to Air Canada

Operating Results

Prior to emergence, on September 30, 2004, from its restructuring under the Companies Creditors Arrangement Act, as amended ("CCAA"), Air Canada had sustained significant losses and Air Canada may sustain significant losses in the future. Since emergence from CCAA to December 31, 2010, Air Canada has accumulated losses of $620 million. A variety of factors, including economic conditions and other factors described in this Risk Factors section, may result in Air Canada incurring significant losses. Despite ongoing strategic and business initiatives, including efforts at securing cost reductions and revenue improvements, Air Canada may not be able to successfully achieve positive net profitability or realize the objectives of any or all of its initiatives, including those which seek to improve yield or offset or mitigate risks facing Air Canada, including those relating to economic conditions, liquidity, pension funding, unexpected volatility in fuel costs and other expenses.

Leverage

Air Canada has, and is expected to continue to have and incur, a significant amount of indebtedness, including substantial fixed obligations under aircraft leases and financings (including under the private offering of senior secured notes described in section 9.3 of this MD&A), and as a result of challenging economic or other conditions affecting Air Canada, Air Canada may incur greater levels of indebtedness than currently exist. The amount of indebtedness that Air Canada currently has and which it may incur in the future could have a material adverse effect on Air Canada, for example, by (i) limiting Air Canada's ability to obtain additional financing, (ii) requiring Air Canada to dedicate a substantial portion of its cash flow from operations to payments on its indebtedness and fixed cost obligations, thereby reducing the funds available for other purposes, (iii) making Air Canada more vulnerable to economic downturns, and (iv) limiting Air Canada's flexibility in planning for, or reacting to, competitive pressures or changes in its business environment.

The ability of Air Canada to make scheduled payments under its indebtedness will depend on, among other things, its future operating performance and its ability to refinance its indebtedness, if necessary. In addition, as Air Canada incurs indebtedness which bears interest at fluctuating interest rates, to the extent these interest rates increase, its interest expense will increase. There can be no assurance that Air Canada will be able to generate sufficient cash from its operations to pay its debts and lease obligations. Each of these factors is, to a large extent, subject to economic, financial, competitive, regulatory, operational and other factors, many of which are beyond Air Canada's control.

Need for Additional Capital and Liquidity

Air Canada faces a number of challenges in its business, including in relation to economic conditions, pension plan funding, volatile fuel prices, contractual covenants which could require Air Canada to deposit cash collateral with third parties, foreign exchange rates and increased competition from international, U.S. transborder and low-cost domestic carriers. Air Canada's liquidity levels may be adversely impacted by these as well as by other factors and risks identified in this MD&A. As part of Air Canada's efforts to meet such challenges and to support Air Canada's business strategy, significant liquidity and significant operating and capital expenditures are, and will in the future be, required. There can be no assurance that Air Canada will continue to be able to obtain on a timely basis sufficient funds on terms acceptable to Air Canada to provide adequate liquidity and to finance the operating and capital expenditures necessary to overcome challenges and support its business strategy if cash flows from operations and cash on hand are insufficient.

Failure to generate additional funds, whether from operations or additional debt or equity financings, could require Air Canada to delay or abandon some or all of its anticipated expenditures or to modify its business strategy and could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Furthermore, competitors with greater liquidity or their ability to raise money more easily and on less onerous terms could create a competitive disadvantage for Air Canada.

Air Canada's credit ratings influence its ability to access capital markets and its liquidity. There can be no assurance that Air Canada's credit ratings will not be downgraded, which would add to Air Canada's borrowing and insurance costs, hamper its ability to attract capital, adversely impact its liquidity, and limit its ability to operate its business, all of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Economic and Geopolitical Conditions
Airline operating results are sensitive to economic and geopolitical conditions which can have a significant impact on Air Canada. For example, economic and geopolitical conditions may impact demand for air transportation in general or to or from certain destinations, and may also impact Air Canada's operating costs, future pension plan contributions, fuel costs, and costs and availability of capital and supplies required by Air Canada. Especially in light of Air Canada's substantial fixed cost structure, any prolonged or significant impact arising from economic and geopolitical conditions, including weakness of the Canadian, U.S. or world economies could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Airline fares and passenger demand have fluctuated significantly in the past and may fluctuate significantly in the future. Air Canada is not able to predict with certainty market conditions and the fares that Air Canada may be able to charge. Customer expectations can change rapidly and the demand for lower fares may limit revenue opportunities. Travel, especially leisure travel, is a discretionary consumer expense. Demand travel for business and premium travel are also impacted by economic conditions. Depressed economic conditions in North America and other areas served by Air Canada, as well as geopolitical instability in various areas of the world, concerns about the environmental impacts of air travel and tendencies towards "green" travel initiatives where consumers reduce their travel activities, could have the effect of reducing demand for air travel in Canada and abroad and could materially adversely impact Air Canada's profitability.

Pension Plans
Canadian federal pension legislation requires that the funded status of registered pension plans be determined periodically, on both a going concern basis (essentially assuming indefinite plan continuation) and a solvency basis (essentially assuming immediate plan termination).

Pension plan solvency valuations are influenced primarily by long-term interest rates and by the investment return on plan assets, which in turn may be dependent on a variety of factors, including economic conditions. The interest rate used to calculate benefit obligations for solvency purposes is a prescribed rate derived from the interest rates on long-term Government of Canada bonds. Deteriorating economic conditions may result in significant increases in Air Canada's funding obligations, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Refer to section 9.8 of this MD&A for additional information relating to Air Canada's pension funding obligations. In particular, as of 2014, the Air Canada 2009 Pension Regulations will cease to have effect and Air Canada's pension funding obligations may vary significantly based on several factors, including regulatory developments, assumptions and methods used and changes in the economic conditions (mainly the return on fund assets and changes in interest rates). Underfunded pension plans or a failure or inability by Air Canada to make required cash contributions to its registered pension plans could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Fuel Costs
Fuel costs constituted the largest percentage of the total operating costs of Air Canada in 2010. Fuel prices fluctuate widely depending on many factors including international market conditions, geopolitical events and the Canada/U.S. dollar exchange rate. Air Canada cannot accurately predict fuel prices. During the last five years, fuel prices increased and fluctuated near or at historically high levels. Should fuel prices fluctuate significantly or increase significantly above current levels, fuel costs could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Due to the competitive nature of the airline industry, Air Canada may not be able to pass on increases in fuel prices to its customers by increasing its fares. Based on 2010 volumes, management estimates that a US$1 per barrel movement in the average price of West Texas Intermediate ("WTI") crude oil would have resulted in an approximate $25 million change in 2010 fuel expense for Air Canada (excluding any impact of fuel surcharges, foreign exchange rates and fuel hedging), assuming flying capacity remained unchanged and that refining spreads between WTI crude oil and jet fuel as well as foreign exchange rates remained constant.

Foreign Exchange

Air Canada's financial results are sensitive to the fluctuating value of the Canadian dollar. In particular, Air Canada has a significant annual net outflow of U.S. dollars and is affected by fluctuations in the U.S./Canada dollar exchange rate. Management estimates that during 2010, a $0.01 strengthening of the Canadian dollar versus the U.S. dollar (i.e., $1.01 to $1.00 per U.S. dollar) would have had an estimated $24 million favourable impact on operating income and a $61 million favourable impact on pre-tax income. Conversely, an opposite change in the exchange rate would have had the opposite effect. Air Canada incurs significant expenses in U.S. dollars for such items as fuel, aircraft rental and maintenance charges, interest payments, debt servicing and computerized reservations system fees, while a substantial portion of its revenues are generated in Canadian dollars. A significant deterioration of the Canadian dollar relative to the U.S. dollar would increase the costs of Air Canada relative to its U.S. competitors and could have a material adverse effect on Air Canada, its business, results from operations and financial condition. In addition, Air Canada may be unable to appropriately hedge the risks associated with fluctuations in exchange rates.

Labour Costs and Labour Relations

Labour costs constitute one of Air Canada's largest operating cost items. There can be no assurance that Air Canada will be able to maintain such costs at levels which do not negatively affect its business, results from operations and financial condition. There can be no assurance that future agreements with employees' unions or the outcome of arbitrations will be on terms consistent with Air Canada's expectations or comparable to agreements entered into by Air Canada's competitors. Any future agreements or outcome of negotiations, mediations or arbitrations including in relation to wages or other labour costs or work rules may result in increased labour costs or other charges which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Most of Air Canada's employees are unionized. The collective agreements representing the majority of the unionized workforce were renewed or extended in 2009 and will expire in 2011. No strikes or lock-outs may lawfully occur during the term of the collective agreements, nor during the negotiations of their renewal until a number of pre-conditions, in respect of the unions for Canadian-based employees, prescribed by the Canada Labour Code, have been satisfied. There can be no assurance that collective agreements will be further renewed without labour conflict or action or that there will not otherwise be any labour conflict or action that could also lead to an interruption or stoppage in Air Canada's service or otherwise adversely affect the ability of Air Canada to conduct its operations, any of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Any labour disruption or work stoppage by any of the unionized work groups of Jazz or other parties, with whom Air Canada conducts business could have a material adverse effect on Air Canada, its business, results from operations and financial condition. In addition, labour conflicts at Star Alliance® partners could result in lower demand for connecting traffic with Air Canada and, ultimately, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Airline Industry Characterized by Low Gross Profit Margins and High Fixed Costs

The airline industry is characterized by low gross profit margins and high fixed costs. The costs of operating any particular flight do not vary significantly with the number of passengers carried and, therefore, a relatively small change in the number of passengers or in fare pricing or traffic mix would have a significant effect on Air Canada's operating and financial results. This condition has been exacerbated by aggressive pricing by low-cost carriers, which has had the effect of driving down fares in general. Accordingly, a shortfall from expected revenue levels could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Air Canada incurs substantial fixed costs which do not meaningfully fluctuate with overall capacity. As a result, should Air Canada be required to reduce its overall capacity or the number of flights operated, it may not be able to successfully reduce certain fixed costs in the short term and may be required to incur important termination or other restructuring costs, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Competition

Air Canada operates within a highly competitive industry. Over the past few years, several carriers have entered or announced their intention to enter or expand into the domestic, the U.S. transborder and international markets in which Air Canada operates.

Canadian low-cost and other carriers have entered and/or expanded or announced their intention to compete in many of Air Canada's key domestic markets and, along with some U.S. carriers have also entered and/or expanded their operations in the U.S. transborder and leisure-oriented markets. Carriers against which Air Canada may compete, including U.S. carriers, may undergo (and some have undergone) substantial reorganizations (including by way of merger with or acquisition by another carrier), creating reduced levels of indebtedness and lower operating costs and may be in a position to more effectively compete with Air Canada. Air Canada is also facing increasing competition in international markets as carriers increase their international capacity, both by expansion and by shifting existing domestic capacity to international operations to avoid low-cost domestic competition.

If Canadian low-cost and other carriers are successful in entering or expanding into Air Canada's domestic and the U.S. transborder markets, if additional U.S. or other carriers against which Air Canada competes are successful in entering Air Canada's U.S. transborder market or if carriers are successful in their expansion in international markets of Air Canada, Air Canada's business results from operations and financial condition could be materially adversely affected.

Air Canada also encounters substantial price competition. The prevalence of low-cost carriers, along with the advent of Internet travel websites and other travel products distribution channels, has resulted in a substantial increase in discounted and promotional fares initiated by Air Canada's competitors. The decision to match competitors' fares to maintain passenger traffic results in reduced yields which, in turn, could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Furthermore, Air Canada's ability to reduce its fares in order to effectively compete with other carriers is dependent on Air Canada's ability to achieve acceptable operating margins and may also be limited by government policies to encourage competition. Likewise, competitors continue to pursue commissions/incentive actions and, in many cases, increase these payments. The decision to modify Air Canada's current programs in order to remain competitive and maintain passenger traffic could result in increased costs to Air Canada's business.

In addition, consolidation in the airline industry could result in increased competition as some airlines emerging from such consolidations may be able to compete more effectively against Air Canada which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Limitations Due to Restrictive Covenants

Some of the financing and other major agreements to which Air Canada is a party contain restrictive, financial (including in relation to liquidity, minimum EBITDAR, fixed charge coverage ratio and debt coverage ratios) and other covenants which affect and, in some cases, significantly limit or prohibit, among other things, the manner in which Air Canada may structure or operate its business, including by reducing Air Canada's liquidity, limiting Air Canada's ability to incur indebtedness, create liens, sell assets, pay dividends, make capital expenditures, and engage in acquisitions, mergers or restructurings or a change of control. Future financing and other major agreements may also be subject to similar covenants which limit Air Canada's operating and financial flexibility, which could materially and adversely affect Air Canada's ability to operate its business and its profitability.

A failure by Air Canada to comply with its contractual obligations (including restrictive, financial and other covenants), or to pay its indebtedness and fixed costs could result in a variety of material adverse consequences, including the acceleration of its indebtedness, the withholding of credit card proceeds by the credit card service providers and the exercise of remedies by its creditors, lessors or other co-contracting parties, and such defaults could trigger additional defaults under other indebtedness or agreements. In such a situation, Air Canada may not be able to repay the accelerated indebtedness or fulfill its obligations under certain contracts, make required aircraft lease payments or otherwise cover its fixed costs. Also, the lenders under the financing arrangements could foreclose upon all or substantially all of the assets of Air Canada which secure Air Canada's obligations.

Refer to section 9.1 of this MD&A for information on Air Canada's credit card processing agreements.

Airport User Fees and Air Navigation Fees
With the privatization of airports and air navigation authorities over the last decade in Canada, new airport and air navigation authorities have imposed significant increases in their fees. Though certain authorities have implemented some fee reductions, if authorities in Canada or elsewhere were to increase their fees, Air Canada, its business, results from operations and financial condition could be materially adversely affected.

Strategic, Business, Technology and Other Important Initiatives
In order to operate its business, achieve its goals and remain competitive, Air Canada continuously seeks to identify and devise, invest in, implement and pursue strategic, business, technology and other important initiatives, such as those relating to the aircraft fleet restructuring, business processes, information technology, revenue management, cost transformation, improving premium passenger revenues, expansion of flying capacity (including in respect of new routes), corporate culture transformation, initiatives seeking to ensure a consistently high quality customer service experience and others. These initiatives, including activities relating to their development and implementation, may be adversely impacted by a wide range of factors, many of which are beyond Air Canada's control. Such factors include the performance of third parties, including suppliers, the implementation and integration of such initiatives into Air Canada's other activities and processes as well as the adoption and acceptance of initiatives by Air Canada's customers, suppliers and personnel. A delay or failure to sufficiently and successfully identify and devise, invest in or implement these initiatives could adversely affect Air Canada's ability to operate its business, achieve its goals and remain competitive and could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

For instance, a key component of Air Canada's business plan is the completion of Air Canada's fleet restructuring program through the acquisition of new and more efficient Boeing 787 aircraft. A delay or failure in the completion of Air Canada's fleet restructuring, including further delays by the manufacturers in the delivery of the wide-body aircraft, or an inability to remove, as planned, certain aircraft from the fleet in coordination with the planned entry into service of new aircraft, could adversely affect the implementation of Air Canada's business plan which may, in turn, have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Dependence on Technology
Air Canada relies heavily on technology, including computer and telecommunications equipment and software and Internet-based systems, to operate its business, increase its revenues and reduce its costs. These systems include those relating to Air Canada's telecommunications, websites, computerized airline reservations and airport customer services and flight operations.

These technology systems may be vulnerable to a variety of sources of failure, interruption or misuse, including by reason of third party suppliers' acts or omissions, natural disasters, terrorist attacks, telecommunications failures, power failures, computer viruses, unauthorized or fraudulent users, and other operational and security issues. While Air Canada continues to invest in initiatives, including security initiatives and disaster recovery plans, these measures may not be adequate or implemented properly. Any such technology systems failure, interruption or misuse could materially and adversely affect Air Canada's operations and could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Key Supplies and Suppliers
Air Canada is dependent upon its ability to source, on favourable terms and costs, sufficient quantities of goods and services in a timely manner, including those available at airports or from airport authorities or otherwise required for Air Canada's operations such as fuel, aircraft and related parts and aircraft maintenance services (including maintenance services obtained from Aveos). In certain cases, Air Canada may only be able to access goods and services from a limited number of suppliers and transition to new suppliers may take significant amounts of time and require significant resources. A failure, refusal or inability of a supplier may arise as a result of a wide range of causes, many of which are beyond Air Canada's control. In addition, there can be no assurance as to the continued viability of any of Air Canada's suppliers. Any failure or inability of Air Canada to successfully source goods and services, including by reason of a failure, refusal or inability of a supplier, or to source goods and services on terms and pricing and within the timeframes acceptable to Air Canada, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Aeroplan
Through its commercial agreement with Aeroplan, Air Canada is able to offer its customers who are Aeroplan® members the opportunity to earn Aeroplan® Miles. Based on customer surveys, management believes that rewarding customers with Aeroplan® Miles is a significant factor in customers' decision to travel with Air Canada and Jazz and contributes to building customer loyalty. The failure by Aeroplan to adequately fulfill its obligations towards Air Canada under the Aeroplan Commercial Participation and Services Agreement and in connection with the Aeroplan program®, or other unexpected interruptions of Aeroplan services which are beyond Air Canada's control, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Jazz
Under the Jazz CPA, Jazz provides Air Canada's customers service in lower density markets and higher density markets at off-peak times throughout Canada and to and from certain destinations in the United States and also provides valuable traffic feed to Air Canada's mainline routes. Pursuant to the terms of the Jazz CPA, Air Canada pays Jazz a number of fees which are determined based upon certain costs incurred by Jazz. Air Canada also reimburses Jazz, without mark-up, for certain pass-through costs incurred directly by Jazz, such as fuel, navigation, landing and terminal fees and certain other costs. Significant increases in such pass-through costs, the failure by Jazz to adequately fulfill its obligations towards Air Canada under the Jazz CPA, or other unexpected interruptions or cessation of Jazz's services which are beyond Air Canada's control could have a material adverse effect on Air Canada, its business, results from operations and financial condition. In addition, the Jazz CPA requires that Jazz maintain a minimum fleet size and contain a minimum average daily utilization guarantee which requires that Air Canada make certain minimum payments to Jazz regardless of the amount of flying done on its behalf by Jazz.

Star Alliance®
The strategic and commercial arrangements with Star Alliance® members provide Air Canada with important benefits, including codesharing, efficient connections and transfers, reciprocal participation in frequent flyer programs and use of airport lounges from the other members. Should a key member leave Star Alliance® or otherwise fail to meet its obligations thereunder, Air Canada, its business, results from operations and financial condition could be materially adversely affected.

Interruptions or Disruptions in Service
Air Canada's business is significantly dependent upon its ability to operate without interruption at a number of hub airports, including Toronto Pearson International Airport. Delays or disruptions in service, including those due to security or other incidents, weather conditions, labour conflicts with airport workers, baggage handlers, air traffic controllers and other workers not employed by Air Canada or other causes beyond the control of Air Canada could have a material adverse impact on Air Canada, its business, results from operations and financial condition.

Interruptions and disruptions in service may be caused by, and the demand and cost of air travel may be adversely impacted by, environmental conditions and factors in addition to those relating to the weather. Environmental conditions and factors, such as those arising from volcanic eruptions or other natural phenomena, as well as those arising from man-made sources, could cause interruptions and disruptions in service, increase Air Canada's costs or adversely impact demand for air travel, any of which could have a material adverse impact on Air Canada, its business, results from operations and financial condition.

Current Legal Proceedings
The European Commission, the United States Department of Justice and the Competition Bureau in Canada have investigated or are investigating alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including Air Canada. Competition authorities have sought or requested information from Air Canada as part of their investigations. Air Canada has been cooperating with these investigations, which are likely to lead, or have led, to proceedings against Air Canada and a number of airlines and other cargo operators in certain jurisdictions. Air Canada is named as a defendant in a number of class action lawsuits that have been filed before the United States District Court and in Canada and in Europe in connection with these allegations. Air Canada has been or may be named as a defendant or may otherwise be implicated in these or other lawsuits or proceedings in connection with these allegations.

During 2008, Air Canada recorded a provision of $125 million as a preliminary estimate. This was only an estimate based upon the status of the investigations and proceedings at that time and Air Canada's assessment as to the potential outcome for certain of them. This provision did not address the proceedings and investigations in all jurisdictions, but only where there was sufficient information to do so. On November 9, 2010, Air Canada announced that the European Commissions issued a decision finding that 12 air cargo carriers (including groups of related carriers) had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006. Air Canada was among the carriers subject to the decision and a fine of 21,037,500 Euros (approximately $29.4 million at an exchange rate of $1.3970) was imposed on Air Canada. The amount of the fine was included in the $125 million provision taken by Air Canada in 2008. Air Canada is appealing this decision and filed an application for appeal before the European General Court. In the first quarter of 2011, Air Canada will be paying the fine, as required, pending the outcome of its appeal.

As a result of the decision by the European Commission and a further review of proceedings and investigations in other jurisdictions, Air Canada recorded a net reduction to the provision for cargo investigations of $46 million in 2010. The revised provision does not address the proceedings and investigations in all jurisdictions, but only where there is sufficient information to do so. Air Canada has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings and investigations. As stated above, Air Canada is appealing the decision issued by the European Commission and, if and as appropriate, based on the outcome of any updates regarding this appeal as well as developments regarding proceedings and investigations in other jurisdictions, may adjust the provision in its results for subsequent periods as required.

In February 2006, Jazz commenced proceedings before the Ontario Superior Court of Justice against Porter Airlines Inc. ("Porter") and other defendants (collectively the "Porter Defendants") after Jazz became aware that it would be excluded from operating flights from Billy Bishop Toronto City Airport. On October 26, 2007, the Porter Defendants counter-claimed against Jazz and Air Canada alleging various violations of competition law, including that Jazz and Air Canada's commercial relationship contravenes Canadian competition laws, and claiming $850 million in damages. On October 16, 2009, Jazz discontinued its suit in the Ontario Superior Court against Porter.

Concurrently with the Ontario Superior Court of Justice proceedings, Jazz commenced judicial review proceedings against the Toronto Port Authority ("TPA") before the Federal Court of Canada relating to Jazz's access to the Billy Bishop Toronto City Airport. The Porter Defendants were granted intervener and party status in these proceedings. In January of 2008, Porter filed a defence and counterclaim against Jazz and Air Canada making allegations and seeking conclusions similar to those in the Ontario Superior Court counterclaim. In March 2010, Jazz discontinued its proceedings in the Federal Court of Canada against the TPA. On May 14, 2010, Porter filed a discontinuance of its counterclaim before the Federal Court of Canada.

The counterclaim filed by Porter in the Ontario Superior Court of Justice against Jazz and Air Canada was stayed pending the outcome of the mirror counterclaim in the Federal Court but, in January 2011, Porter filed proceedings to have the stay lifted to reactivate the counterclaim. Management views Porter's counterclaim as being without merit.

In the first quarter of 2010, Air Canada filed legal proceedings with the Federal Court of Canada seeking to challenge the process announced by the TPA to allocate flight capacity or slots at the Billy Bishop Toronto City Airport. On July 21, 2010, the Federal Court of Canada dismissed Air Canada's challenge and Air Canada is appealing this decision before the Federal Court of Appeal.

The Canadian Union of Public Employees ("CUPE"), which represents Air Canada's flight attendants, filed a complaint before the Canadian Human Rights Commissions where it alleges gender-based wage discrimination. CUPE claims the predominantly female flight attendant group should be paid the same as the predominantly male pilot and mechanics groups because their work is of equal value. The complaint dates from 1991 but has not been investigated on the merits because of a legal dispute over whether the three groups work in the same "establishment" within the meaning of the Canadian Human Rights Act. On January 26, 2006, the Supreme Court of Canada ruled that they do work in the same "establishment" and sent the case back to the Canadian Human Rights Commissions, which may now proceed to assess the merits of CUPE's complaint. On March 16, 2007, the Canadian Human Rights Commissions referred the complaint against Air Canada for investigation and an investigation is proceeding. Air Canada considers that any investigation will show that it is complying with the equal pay provisions of the Canadian Human Rights Act, however, management has determined that it is not possible at this time to predict with any degree of certainty the final outcome of the Commissions' investigation.

Air Canada is engaged in a number of proceedings involving challenges to the mandatory retirement provisions of certain of its collective agreements, including the Air Canada-Air Canada Pilots Association collective agreement which incorporate provisions of the pension plan terms and conditions applicable to pilots requiring them to retire at age 60. Air Canada is defending these challenges. At this time, it is not possible to determine with any degree of certainty the extent of any financial liability that may arise from Air Canada being unsuccessful in its defense of these proceedings, though any such financial liability, if imposed, would not be expected to be material.

Future Legal Proceedings

Airlines are susceptible to various claims and litigation, including class action claims, in the course of operating their business or with respect to the interpretation of existing agreements. Any future claims or litigation could also have a material adverse effect on Air Canada, its business and results from operations.

Key Personnel

Air Canada is dependent on the experience and industry knowledge of its executive officers and other key employees to execute its business plan. If Air Canada were to experience a substantial turnover in its leadership or other key employees, Air Canada's business, results from operations and financial condition could be materially adversely affected. Additionally, Air Canada may be unable to attract and retain additional qualified key personnel as needed in the future.

Risks Relating to the Airline Industry

Terrorist Attacks and Security Measures

The September 11, 2001 terrorist attacks and subsequent terrorist activity, notably in the Middle East, Southeast Asia, Europe and the U.S., causes uncertainty in the minds of the traveling public. The occurrence of a terrorist attack (or attempted attacks) (whether domestic or international and whether involving Air Canada or another carrier or no carrier at all) and increasingly restrictive security measures, such as those relating to the content of carry-on baggage, passenger identification document requirements, and passenger screening procedures could have a material adverse effect on passenger demand for air travel and on the number of passengers traveling on Air Canada's flights. It could also lead to a substantial increase in insurance, airport security and other costs. Any resulting reduction in passenger revenues and/or increases in costs, including insurance, security or other costs could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Epidemic Diseases (Severe Acute Respiratory Syndrome (SARS), H1N1 Influenza or Other Epidemic Diseases)

The international outbreaks of Severe Acute Respiratory Syndrome (SARS) in 2003, and the resulting actions tabled by the World Health Organization (the "WHO"), including a travel advisory against non-essential travel to Toronto, Canada had a significant adverse effect on passenger demand for air travel in Air Canada's markets and resulted in a major negative impact on traffic on the entire network. An outbreak of influenza, SARS, H1N1 influenza virus or of another epidemic disease (whether domestic or international) or any WHO or similar travel advisories (whether relating to Canadian cities or regions or other cities, regions or countries) could have a material adverse effect on passenger demand for air travel. Any resulting reduction in traffic in the markets served by Air Canada could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Casualty Losses

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

Seasonal Nature of the Business, Other Factors and Prior Performance

Air Canada has historically experienced considerably greater demand for its services in the second and third quarters of the calendar year and significantly lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the preference of a high number of leisure travelers to travel during the spring and summer months. Air Canada has substantial fixed costs that do not meaningfully fluctuate with passenger demand in the short term.

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

Regulatory Matters

The airline industry is subject to extensive Canadian and foreign government regulations relating to, among other things, security, safety, privacy, licensing, competition, environment (including noise levels and carbon emissions) and, in some measure, pricing. For example, new and proposed legislation have been considered or adopted concerning carbon emissions emanating from the aviation industry. Such legislative initiatives include, for example, market-based mechanisms called emissions trading systems which are being proposed and implemented to reduce the amount carbon emissions through the setting of emissions allowances and charging aircraft operators for a certain percentage of theses allowances. The implementation of additional regulations or decisions, including those relating to carbon emissions, and others, whether by Transport Canada, the Competition Bureau and/or the Competition Tribunal, the Canadian Transportation Agency or other domestic or foreign governmental entities, may have a material adverse effect on Air Canada, its business, results from operations and financial condition.

The European Union passed legislation for an Emissions Trading System which will include carbon emissions from aviation commencing in January 2012, including for flights operated between Canada and countries within the European Union. The legislation would require aircraft operators to monitor and report on fuel use and emissions data. While this legislation would be expected to result in increased costs relating to the purchase of emissions allowances, the net financial impact would, in part, depend upon how much of such cost, if any, would be recoverable, including in the form of higher passenger fares and cargo rates.

The availability of international routes to Canadian air carriers is regulated by agreements between Canada and foreign governments. Changes in Canadian or foreign government aviation policy could result in the alteration or termination of these agreements and could adversely affect Air Canada and its international operations.

Air Canada is subject to domestic and foreign laws regarding privacy of passenger and employee data, including advance passenger information and access to airline reservation systems, which are not consistent in all countries in which Air Canada operates. The need to comply with these regulatory regimes is expected to result in additional operating costs and could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

There can be no assurances that new laws, regulations or revisions to same, or decisions, will not be adopted or rendered, from time to time, and these could impose additional requirements or restrictions, which may adversely impact Air Canada's business, results form operations and financial condition.

Increased Insurance Costs

Since September 11, 2001 the aviation insurance industry has been continually reevaluating the terrorism risks that it covers, and this activity may adversely affect some of Air Canada's existing insurance carriers or Air Canada's ability to obtain future insurance coverage. To the extent that Air Canada's existing insurance carriers are unable or unwilling to provide it with insurance coverage, and in the absence of measures by the Government of Canada to provide the required coverage, Air Canada's insurance costs may increase further and may result in Air Canada being in breach of regulatory requirements or contractual arrangements requiring that specific insurance be maintained, which may have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Third Party War Risk Insurance

There is a risk that the Government of Canada may not continue to provide an indemnity for third party war risk liability coverage, which it currently provides to Air Canada and certain other carriers in Canada. In the event that the Government of Canada does not continue to provide such indemnity or amends such indemnity, Air Canada and other industry participants would have to turn to the commercial insurance market to seek such coverage. Air Canada estimates that such coverage would cost Air Canada approximately US$5 million per year. Alternative solutions, such as those envisioned by the International Civil Aviation Organization ("ICAO") and the International Air Transport Association ("IATA"), have not developed as planned, due to actions taken by other countries and the recent availability of supplemental insurance products. ICAO and IATA are continuing their efforts in this area; however, the achievement of a global solution is not likely in the immediate or near future. The U.S. federal government has set up its own facility to provide war risk coverage to U.S. carriers, thus removing itself as a key component of any global plan.

19. 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 President and Chief Executive Officer ("CEO"), its Executive Vice President and Chief Financial Officer ("CFO") and 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, under the supervision of and with the participation of the Corporation's CEO and 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.

The Corporation will file certifications, signed by the Corporation's CEO and CFO, with the Canadian Securities Administrators ("CSA") upon filing of the Corporation's Annual Information Form. In those filings, the Corporation's CEO and CFO will certify, 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. The Corporation's CEO and CFO also certify the appropriateness of the financial disclosures in the Corporation's interim filings with securities regulators. In those interim filings, the Corporation's CEO and CFO also certify 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 audited 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, under the supervision of and with the participation of the Corporation's CEO and CFO, evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined under National Instrument 52-109) and concluded, as at December 31, 2010, that such disclosure controls and procedures were effective.

Management's report on internal controls over financial reporting

Management, under the supervision of and with the participation of the Corporation's CEO and CFO, evaluated the effectiveness of the Corporation's internal controls over financial reporting (as defined under National Instrument 52-109). In making this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commissions ("COSO") in Internal Control - Integrated Framework. Based on that evaluation, management and the CEO and CFO have concluded that, as at December 31, 2010, the Corporation's internal controls over financial reporting were effective. This evaluation took into consideration the Corporation's Corporate Disclosure Policy and the functioning of its Disclosure Policy Committee.

Changes in internal controls over financial reporting

There have been no changes to the Corporation's internal controls over financial reporting during the year ended December 31, 2010 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

20. NON-GAAP FINANCIAL MEASURES

EBITDAR

EBITDAR (earnings before interest, taxes, depreciation and amortization, and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before depreciation and amortization, and aircraft rent as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. EBITDAR is not a recognized measure for financial statement presentation under Canadian GAAP and does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies.

EBITDAR (before a net reduction of $46 million to a provision for cargo investigations) and EBITDAR for Air Canada are reconciled to operating income (loss) as follows:

(Canadian dollars in millions)	Fourth Quarter			Full Year		
	2010	2009	Change $	2010	2009	Change $
GAAP operating income (loss) before a provision adjustment for cargo investigations, net	$ 85	$ (83)	$ 168	$ 361	$ (316)	$ 677
Add back:						
Aircraft rent	84	85	(1)	346	335	11
Depreciation and amortization	165	165	-	679	660	19
EBITDAR before a provision adjustment for cargo investigations, net (1)	**$ 334**	**$ 167**	**$ 167**	**$ 1,386**	**$ 679**	**$ 707**
Add back:						
Provision adjustment for cargo investigations, net	46	-	46	46	-	46
EBITDAR	**$ 380**	**$ 167**	**$ 213**	**$ 1,432**	**$ 679**	**$ 753**

(1) In the first quarter of 2008, Air Canada recorded a provision for cargo investigations of $125 million. In the fourth quarter of 2010, Air Canada recorded a net reduction of $46 million to this provision.

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 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/U.S. exchange rate, and excluding this expense from GAAP results analysis 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)	Fourth Quarter			Full Year		
	2010	2009	Change $	2010	2009	Change $
GAAP operating expense	$ 2,531	$ 2,431	$ 100	$ 10,425	$ 10,055	$ 370
Remove:						
Aircraft fuel	(640)	(601)	(39)	(2,652)	(2,448)	(204)
Operating expense, excluding fuel expense	**$ 1,891**	**$ 1,830**	**$ 61**	**$ 7,773**	**$ 7,607**	**$ 166**

21. GLOSSARY

Atlantic passenger and cargo revenues — Refers to revenues from flights that cross the Atlantic Ocean with origins and destinations principally in Europe.

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 depreciation and amortization, and aircraft rent as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. Refer to section 20 of this MD&A for additional information.

Effective Ton Miles or ETMs — Refers to the mathematical product of tonnage capacity times distance hauled.

Other passenger and cargo revenues — Refers to revenues from flights with origins and destinations principally in Central and South America, Australia, the Caribbean and Mexico.

Pacific passenger and cargo revenues — Refers to revenues from flights that cross the Pacific Ocean with origins and destinations principally in Asia.

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.

Percentage point (pp) — A measure for the arithmetic difference of two percentages.

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.

Revenue Ton Miles or RTMs — Refers to the mathematical product of weight in tons of a shipment being transported by the number of miles that it is transported.

Yield — Average passenger revenue per RPM.

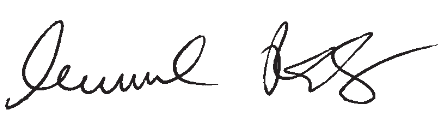
MANAGEMENT'S REPORT

The consolidated financial statements have been prepared by management. Management is responsible for the fair presentation of the consolidated financial statements in conformity with generally accepted accounting principles. Management is responsible for the selection of accounting policies and making significant accounting judgements and estimates. Management is also responsible for all other financial information included in the annual report and for ensuring that this information is consistent, where appropriate, with the information contained in the consolidated financial statements.

Management is responsible for establishing and maintaining adequate internal control over financial reporting which includes those policies and procedures that provide reasonable assurance over the safeguarding of assets and over the completeness, fairness and accuracy of the consolidated financial statements and other financial information.

The Audit, Finance and Risk Committee reviews the quality and integrity of the Corporation's financial reporting and recommends approval to the Board of Directors; oversees management's responsibilities as to the adequacy of the supporting systems of internal controls; provides oversight of the independence, qualifications and appointment of the external auditor; and, pre-approves audit and audit-related fees and expenses. The Board of Directors approves the Corporation's consolidated financial statements, management's discussion and analysis and annual report disclosures prior to their release. The Audit, Finance and Risk Committee meets with management, the internal auditors and external auditors at least four times each year to review and discuss financial reporting issues and disclosures, auditing and other matters.

The external auditors, PricewaterhouseCoopers LLP, conduct an independent audit of the consolidated financial statements in accordance with Canadian generally accepted auditing standards and express their opinion thereon. Those standards require that the audit is planned and performed to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The external auditors have unlimited access to the Audit, Finance and Risk Committee and meet with the Committee on a regular basis.



Michael Rousseau
Executive Vice President &
Chief Financial Officer

Calin Rovinescu
President &
Chief Executive Officer

AUDITORS' REPORT

TO THE SHAREHOLDERS OF AIR CANADA

We have audited the accompanying consolidated financial statements of Air Canada and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of operations, changes in shareholders' equity, comprehensive income and cash flow for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Air Canada and its subsidiaries as at December 31, 2010 and 2009 and the results of their operations and their cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants [1]
Montreal, Quebec
February 9, 2011

[1] Chartered accountant auditor permit No. 18144

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate legal entity.

CONSOLIDATED STATEMENT OF OPERATIONS

For the year ended December 31 (Canadian dollars in millions except per share figures)		2010	2009
Operating revenues			
Passenger		$ 9,427	$ 8,499
Cargo		466	358
Other		893	882
		10,786	9,739
Operating expenses			
Aircraft fuel		2,652	2,448
Wages, salaries and benefits		1,885	1,751
Airport and navigation fees		961	971
Capacity purchase with Jazz	Note 2D	934	973
Depreciation and amortization	Notes 3 & 4	679	660
Aircraft maintenance		677	759
Food, beverages and supplies		280	291
Communications and information technology		316	293
Aircraft rent		346	335
Commissions		259	186
Other		1,436	1,388
		10,425	10,055
Operating income (loss) before under noted item		**361**	**(316)**
Provision adjustment for cargo investigations, net	Note 17	46	-
Operating income (loss)		**407**	**(316)**
Non-operating income (expense)			
Interest income		19	14
Interest expense		(378)	(373)
Interest capitalized		1	4
Loss on assets	Notes 3 & 4	(7)	(95)
Gain (loss) on financial instruments recorded at fair value	Note 15	(3)	95
Other		(20)	-
		(388)	(355)
Income (loss) before the following items		**19**	**(671)**
Non-controlling interest		(9)	(15)
Foreign exchange gain		145	657
Recovery of (provision for) income taxes	Note 7		
Current		4	7
Future		(52)	(2)
Net income (loss) for the year		**$ 107**	**$ (24)**
Net income (loss) per share			
Basic	Note 12	$ 0.38	$ (0.18)
Diluted	Note 12	$ 0.37	$ (0.18)

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at December 31 (Canadian dollars in millions)		2010	2009
ASSETS			
Current			
Cash and cash equivalents	Note 2O	$ 1,090	$ 1,115
Short-term investments	Note 2P	1,102	292
		2,192	1,407
Restricted cash	Note 2Q	80	78
Accounts receivable		641	701
Aircraft fuel inventory		67	63
Spare parts and supplies inventory	Note 2R	88	64
Prepaid expenses and other current assets		377	338
		3,445	2,651
Property and equipment	Note 3	5,747	6,369
Intangible assets	Note 4	840	916
Deposits and other assets	Note 5	512	470
		$ 10,544	**$ 10,406**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		$ 1,182	$ 1,246
Advance ticket sales		1,375	1,288
Current portion of long-term debt and capital leases	Note 6	505	468
		3,062	3,002
Long-term debt and capital leases	Note 6	3,952	4,054
Future income taxes	Note 7	80	85
Pension and other benefit liabilities	Note 8	1,059	1,163
Other long-term liabilities	Note 9	482	455
		8,635	8,759
Non-controlling interest		169	201
SHAREHOLDERS' EQUITY			
Share capital	Note 11	534	532
Contributed surplus		1,826	1,825
Deficit		(620)	(727)
Accumulated other comprehensive loss	Notes 2L &15	-	(184)
		1,740	1,446
		$ 10,544	**$ 10,406**

The accompanying notes are an integral part of the consolidated financial statements.

Commitments (Note 14); Contingencies, Guarantees, and Indemnities (Note 17).

On behalf of the Board of Directors:

Signed
David I. Richardson
Chairman

Signed
Michael M. Green
Chair of the Audit, Finance and Risk Committee

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

For the year ended December 31 (Canadian dollars in millions)		2010	2009
Share Capital			
Common shares, beginning of year		$ 532	$ 274
Shares issued	Notes 8 & 11	2	258
Total share capital		534	532
Contributed surplus			
Balance, beginning of year		1,825	1,797
Fair value of stock options issued to Corporation employees recognized as compensation expense	Note 10	1	2
Warrants issued under the credit facility	Note 6	-	7
Warrants issued under the public offering	Note 11	-	19
Total contributed surplus		1,826	1,825
Deficit			
Balance, beginning of year		(727)	(703)
Net income (loss) for the year		107	(24)
Deficit		(620)	(727)
Accumulated other comprehensive income (loss)			
Balance, beginning of year		(184)	(606)
Other comprehensive income		184	422
Total accumulated other comprehensive loss		-	(184)
Total deficit and accumulated other comprehensive loss		(620)	(911)
Total shareholders' equity		**$ 1,740**	**$ 1,446**

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31 (Canadian dollars in millions)		2010	2009
Comprehensive income (loss)			
Net income (loss) for the year		$ 107	$ (24)
Other comprehensive income (loss), net of taxes:			
Net losses on fuel derivatives under hedge accounting, net of taxes	Note 15	-	(1)
Reclassification of net realized losses on fuel derivatives to income, net of taxes	Note 15	184	423
		184	422
Total comprehensive income		**$ 291**	**$ 398**

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOW

For the year ended December 31 (Canadian dollars in millions)		2010	2009
Cash flows from (used for)			
Operating			
Net income (loss) for the year		$ 107	$ (24)
Adjustments to reconcile to net cash from operations			
Depreciation and amortization		679	660
Loss on assets	Notes 3 & 4	7	95
Foreign exchange gain		(172)	(633)
Future income taxes		52	2
Excess of employee future benefit funding over expense		(126)	(368)
Non-controlling interest		9	15
Fuel and other derivatives	Note 15	102	41
Fuel hedge collateral deposits, net	Note 15	43	268
Provision adjustment for cargo investigations, net	Note 17	(46)	-
Changes in non-cash working capital balances		154	(234)
Other		55	11
		864	**(167)**
Financing			
Proceeds from borrowings	Note 6	1,175	926
Shares issued	Note 11	2	230
Warrants issued under the public offering and credit facility	Notes 6 & 11	–	26
Reduction of long-term debt and capital lease obligations		(1,135)	(1,237)
Other		(35)	-
		7	**(55)**
Investing			
Short-term investments		(810)	214
Additions to capital assets		(118)	(232)
Proceeds from contractual commitments	Note 9	-	230
Proceeds from sale of assets	Note 3	29	103
Proceeds from sale-leaseback transactions	Note 3	20	552
Reduction to Aveos letter of credit	Note 18	23	-
Other		(40)	(29)
		(896)	**838**
Increase (decrease) in cash and cash equivalents		**(25)**	**616**
Cash and cash equivalents, beginning of year		1,115	499
Cash and cash equivalents, end of year		**$ 1,090**	**$ 1,115**

The accompanying notes are an integral part of the consolidated financial statements.

For the Years Ended December 31, 2010 and 2009 (Canadian dollars in millions –except per share amounts)

1. BASIS OF PRESENTATION AND NATURE OF OPERATIONS

A) BASIS OF PRESENTATION

The accompanying consolidated financial statements are of Air Canada (the "Corporation"). The term "Corporation" refers to, as the context may require, Air Canada and/or one or more of Air Canada's subsidiaries.

These consolidated financial statements are expressed in millions of Canadian dollars and are prepared in accordance with generally accepted accounting principles in Canada ("GAAP").

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

B) NATURE OF OPERATIONS

The consolidated financial statements of Air Canada include wholly-owned subsidiaries of Air Canada, including Air Canada Cargo Limited Partnership ("Air Canada Cargo") up to and including November 30, 2009, ACGHS Limited Partnership ("Air Canada Ground Handling Services" or "ACGHS") up to and including November 30, 2009 and Touram Limited Partnership ("Air Canada Vacations"). These consolidated financial statements also include certain aircraft and engine leasing entities and fuel facility corporations, which are consolidated under Accounting Guideline 15 – Consolidation of Variable Interest Entities (Note 2Z).

Effective December 1, 2009, the operations of Air Canada Cargo and Air Canada Ground Handling Services, previously operated by wholly-owned subsidiaries of Air Canada, were wound up into Air Canada. These wind-ups had no impact on the consolidated financial statements.

Air Canada is Canada's largest domestic, US transborder and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-US transborder market as well as the international markets to and from Canada. Certain of the scheduled passenger services offered on domestic and Canada-US transborder routes are provided by Jazz Aviation LP ("Jazz") (the successor to Jazz Air LP) through a capacity purchase agreement between Air Canada and Jazz (the "Jazz CPA"). Through Air Canada's global route network, virtually every major market throughout the world is served either directly or through the Star Alliance network. In addition, Air Canada provides certain passenger charter services under the brand name "AC Jetz".

Air Canada offers air cargo services on domestic and US transborder routes using cargo capacity on aircraft operated by Air Canada and Jazz. Prior to December 1, 2009, these services were provided by Air Canada Cargo. Air Canada offers international cargo services on routes between Canada and major markets in Europe, Asia, South America and Australia using cargo capacity on Boeing 777 and other wide body aircraft operated by Air Canada.

Air Canada Ground Handling Services provided passenger handling services to Air Canada, Jazz and other airlines with a primary focus on Canadian stations. Services covered included passenger check-in, gate management, baggage and cargo handling and processing, cabin cleaning, de-icing as well as aircraft ramp services. Effective December 1, 2009 with the wind-up of ACGHS, Air Canada offers these services directly.

Air Canada Vacations is one of Canada's leading tour operators. Based in Montreal and Toronto, Air Canada Vacations operates its business in the outbound leisure travel market (Caribbean, Mexico, U.S., Europe, Central and South America, South Pacific and Asia) by developing, marketing and distributing vacation travel packages. Air Canada Vacations also offers cruise packages in North America, Europe and the Caribbean.

Air Canada is managed as one operating segment based on how financial information is produced internally for the purposes of making operating decisions.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) PRINCIPLES OF CONSOLIDATION

These consolidated financial statements include the accounts of all entities controlled by Air Canada, with adjustments for non-controlling interests. The consolidated financial statements of the Corporation include the accounts of variable interest entities for which the Corporation is the primary beneficiary. All inter-company balances and transactions are eliminated.

B) USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Significant estimates made in the preparation of the consolidated financial statements include those used in accounting for employee future benefits, accounting for income taxes, the determination of passenger revenues, the determination of amortization period for long-lived assets, the impairment considerations on long-lived assets, the carrying value of financial instruments recorded at fair value and provisions for investigations and proceedings related to alleged anti-competitive cargo pricing activities.

C) PASSENGER AND CARGO REVENUES

Airline passenger and cargo advance sales are deferred and included in Current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aeroplan Canada Inc. ("Aeroplan"), a corporation that provides loyalty program services to Air Canada and purchases seats from Air Canada pursuant to the Commercial Participation and Services Agreement between Aeroplan and Air Canada (the "CPSA") (Note 14). Passenger and cargo revenues are recognized when the transportation is provided, except for revenue on unlimited flight passes which is recognized on a straight-line basis over the period during which the travel pass is valid. The Corporation has formed alliances with other airlines encompassing loyalty program participation, code sharing and coordination of services including reservations, baggage handling and flight schedules. Revenues are allocated based upon formulas specified in the agreements and are recognized as transportation is provided. Passenger revenue also includes revenues from passenger-related services such as ticket changes, seat selection, and excess baggage which are recognized as the services are provided.

The Corporation performs regular evaluations on the deferred revenue liability which may result in adjustments being recognized as revenue. Due to the complex pricing structures; the complex nature of interline and other commercial agreements used throughout the industry; historical experience over a period of many years; and other factors including refunds, exchanges and unused tickets, certain relatively small amounts are recognized as revenue based on estimates. Events and circumstances may result in actual results that are different from estimates.

D) CAPACITY PURCHASE AGREEMENTS – JAZZ & TIER III CARRIERS

Air Canada has capacity purchase agreements with Jazz and certain other regional carriers, some of which are referred to as Tier III carriers, operating aircraft of 18 seats or less. Under these agreements, Air Canada markets, tickets and enters into other commercial arrangements relating to these flights and records the revenue it earns under Passenger revenue. Operating expenses under capacity purchase agreements include the capacity purchase fees, which, under the Jazz CPA, are based on variable and fixed rates ("CPA Rates") plus mark-up and pass-through costs. The CPA Rates are periodically set by the parties for rate periods of three years. The parties set the rates through negotiations based on Jazz's forecasted costs for the applicable rate period and an operating plan for the applicable rate period provided by Air Canada. Pass-through costs are non-marked-up costs charged to the Corporation and include fuel, airport and user fees and other costs. These expenses are recorded in the applicable category within Operating expenses.

The following table outlines expenses and pass-through costs under the Jazz CPA for 2009 and 2010:

	2010	2009
Expenses from Jazz CPA	$ 934	$ 973
Pass-through fuel expense from Jazz CPA	292	253
Pass-through airport expense from Jazz CPA	193	196
Pass-through other expense from Jazz CPA	39	35
	$ 1,458	**$ 1,457**

Due to terms of the Jazz CPA, Jazz is deemed to be a variable interest entity. Notwithstanding that Air Canada is not the primary beneficiary of Jazz, Air Canada holds a significant variable interest in Jazz through the contractual arrangements with Jazz as described in Note 14.

The Corporation entered into an agreement amending the terms of the Jazz CPA effective August 1, 2009. This amending agreement includes among other items (i) a reduction to fees paid under the Jazz CPA based on a reduction in the mark-up paid to Jazz from 16.72% to 12.5%; (ii) a reduction in Air Canada's commitment to Jazz's covered fleet from 133 to 125 aircraft; (iii) a contract term extension of five years (from December 31, 2015 to December 31, 2020), during which a second benchmarking review will be performed; and (iv) agreement on Jazz's turboprop fleet renewal strategy relating to the introduction of 15 Dash-8-400 aircraft which will replace 13 CRJ-100 aircraft.

E) AEROPLAN LOYALTY PROGRAM

Air Canada is an Aeroplan partner providing certain of Air Canada's customers with Aeroplan Miles®, which can be redeemed by customers for air travel or other rewards acquired by Aeroplan.

Under the CPSA, Aeroplan purchases passenger tickets from Air Canada to meet its obligation for the redemption of Aeroplan Miles® for air travel. The proceeds from the sale of passenger tickets to Aeroplan are included in Advance ticket sales. Revenue related to these passenger tickets is recorded in passenger revenues when transportation is provided.

For Aeroplan Miles® earned by Air Canada customers, Air Canada purchases Aeroplan Miles® from Aeroplan in accordance with the terms of the CPSA. The cost of purchasing Aeroplan Miles® from Aeroplan is accounted for as a sales incentive and charged against passenger revenues when the points are issued, which occurs upon the qualifying air travel being provided to the customer.

F) OTHER REVENUES

Other revenue includes revenues from the sale of the ground portion of vacation packages, ground handling services and other airline related services. Vacation package revenue is recognized as services are provided over the period of the vacation. Other airline related service revenues are recognized as the products are sold to passengers or the services are provided.

Other revenue also includes revenue related to the lease or sublease of aircraft to third parties. Lease or sublease revenues are recognized on a straight line basis over the term of the lease or sublease. Rental revenue from operating leases and subleases amounted to $101 in 2010 (2009 - $126).

In certain subleases of aircraft to Jazz, the Corporation reports the sublease revenues net against aircraft rent expense as the terms of the sublease match the terms of the Corporation's lease. The Corporation acts as lessee and sublessor in these matters. Refer to Note 14 for the lease commitments under these arrangements.

The Corporation provides certain services to former related parties consisting principally of administrative services in relation to information technology, human resources, finance and accounting, treasury and tax services, corporate real estate, and environmental affairs. Administrative service revenues are recognized as services are provided. Real estate rental revenues are recognized on a straight line basis over the term of the lease.

G) EMPLOYEE FUTURE BENEFITS

The cost of pensions, other post-retirement and post-employment benefits earned by employees is actuarially determined annually as at December 31. The cost is determined using the projected benefit method prorated on service, market interest rates, and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and health care costs.

A market-related valuation method is used to value plan assets for the purpose of calculating the expected return on plan assets. Under the selected method, the differences between investment returns during a given year and the expected investment returns are amortized on a straight line basis over four years.

Past service costs arising from plan amendments are amortized on a straight-line basis over the expected average remaining service period of employees active at the date of amendment. This period does not exceed the expected average remaining service period of such employees up to the full eligibility date. The expected average remaining service period of active employees (or expected average remaining life expectancy of retired members for a plan with no active members) is between 7 and 15 years for pension plans and between 5 and 11 years for post-retirement and post-employment benefit plans.

Cumulative unrecognized net actuarial gains and losses in excess of 10% of the greater of the projected benefit obligation or market-related value of plan assets at the beginning of the year are amortized over the expected remaining service life of active employees.

As described in Note 8, certain Corporation employees perform work for a former related party, namely Aveos Fleet Performance Inc. ("Aveos"), and are members of Corporation-sponsored defined benefit pension plans and also participate in Corporation-sponsored health, life and disability benefit plans. Other Corporation employees performed work for Aeroplan until June 1, 2009, the date of transition to employment at Aeroplan and then ceased to accrue benefits under the Corporation-sponsored defined benefit pension plans and under the Corporation-sponsored health, life and disability benefit plans. These consolidated financial statements include all of the assets and liabilities of all sponsored plans of the Corporation. Pension and other employee benefits expenses are recorded net of costs recovered from these entities pertaining to employees contractually assigned by the Corporation to these entities based on an agreed upon formula. The cost recovery reduces the Corporation's benefit cost.

H) EMPLOYEE PROFIT SHARING PLAN

The Corporation has an employee profit sharing plan. Expenses are calculated annually on full calendar year results and recorded throughout the year as a charge to salary and wage expense based on the estimated annual payment under the plan.

I) STOCK-BASED COMPENSATION PLANS

Certain employees of the Corporation participate in Air Canada's Long-Term Incentive Plan, which provides for the grant of stock options and performance share units ("PSUs"), as further described in Note 10.

The fair value of stock options with a graded vesting schedule is determined based on different expected lives for the options that vest each year, as it would be if the award were viewed as several separate awards, each with a different vesting date, and it is accounted for on that basis. For a stock option award attributable to an employee who is eligible to retire at the grant date, the fair value of the stock option award is expensed on the grant date. For a stock option award attributable to an employee who will become eligible to retire during the vesting period, the fair value of the stock option award is recognized over the period from the grant date to the date the employee becomes eligible to retire. The amount of compensation cost recognized at any date at least equals the value of the vested options at that date.

For grants of PSUs that are accounted for as equity settled instruments, the Corporation recognizes Compensation expense offset by Contributed surplus equal to the market value of an Air Canada common share at the date of grant on a straight line basis over the applicable vesting period. Compensation expense is adjusted for subsequent changes in management's estimate of the number of PSUs that are expected to vest. For grants of PSUs that are accounted for as cash settled instruments, the Corporation recognizes Compensation expense offset by Other long-term liabilities equal to the market value of an Air Canada common share at the date of grant on a straight line basis over the applicable vesting period. Compensation expense is adjusted for subsequent changes in the market value of Air Canada common shares and management's estimate of the number of PSUs that are expected to vest. Refer to Note 15 for a description of derivative instruments used by the Corporation to hedge the cash flow exposure to PSUs.

Air Canada also maintains an employee share purchase plan. Under this plan, contributions by the Corporation's employees are matched to a specific percentage by the Corporation. Employees must remain with the Corporation until March 31 of the subsequent year for vesting of the Corporation's contributions. These contributions are included in Wages, salaries, and benefits expense as earned.

J) MAINTENANCE AND REPAIRS

Maintenance and repair costs for both leased and owned aircraft, including line maintenance, component overhaul and repair, and maintenance checks, are charged to Operating expenses as incurred, with the exception of maintenance and repair costs related to return conditions on short-term aircraft leases, which are accrued over the term of the lease. Line maintenance consists of routine daily and weekly scheduled maintenance inspections and checks, overhaul and repair involves the inspection or replacements of major parts, and maintenance checks consist of more complex inspections and servicing of the aircraft.

K) OTHER OPERATING EXPENSES

Included in Other operating expenses are expenses related to building rent and maintenance, terminal handling, professional fees and services, crew meals and hotels, advertising and promotion, insurance costs, credit card fees, ground costs for Air Canada Vacations packages, and other expenses. Expenses are recognized as incurred.

L) FINANCIAL INSTRUMENTS

Under the Corporation's risk management policy, derivative financial instruments are used only for risk management purposes and not for generating trading profits.

Financial assets and financial liabilities, including derivatives, are recognized on the Consolidated Statement of Financial Position when the Corporation becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. All financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods is dependent upon the classification of the financial instrument as held-for-trading, held-to-maturity, available-for-sale, loans and receivables, or other financial liabilities. The held-for-trading classification is applied when an entity is "trading" in an instrument or alternatively, the standard permits that any financial instrument be irrevocably designated as held-for-trading. The held-to-maturity classification is applied only if the asset has specified characteristics and the entity has the ability and intent to hold the asset until maturity. For financial instruments classified as other than held-for-trading, transaction costs are added to the initial fair value of the related financial instrument.

Financial assets and financial liabilities classified as held-for-trading are measured at fair value with changes in those fair values recognized in Non-operating income (expense). Financial assets classified as held-to-maturity, loans and receivables, or other financial liabilities are measured at amortized cost using the effective interest rate method. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost.

The Corporation enters into interest rate, foreign currency, and fuel derivatives and share forward contracts to manage the associated risks. Derivative instruments are recorded on the Consolidated Statement of Financial Position at fair value, including those derivatives that are embedded in financial or non-financial contracts. Changes in the fair value of derivative instruments are recognized in Non-operating income (expense) with the exception of foreign exchange risk management contracts, which are recorded in Foreign exchange gain (loss), and fuel derivatives designated as effective cash flow hedges, as further described below. These contracts are included in the Consolidated Statement of Financial Position at fair value in Prepaid expenses and other current assets, Deposits and other assets, Accounts payable and accrued liabilities, or Other long-term liabilities based on the terms of the contractual agreements. All cash flows associated with purchasing and selling derivatives are classified as operating cash flows in the Consolidated Statement of Cash Flow.

For financial instruments measured at amortized cost, transaction costs or fees, premiums or discounts earned or incurred are recorded, at inception, net against the fair value of the financial instrument. Interest expense is recorded using the effective interest rate method. For any guarantee issued that meets the definition of a guarantee pursuant to Accounting Guideline 14, Disclosure of Guarantees, the inception fair value of the obligation relating to the guarantee is recognized and amortized over the term of the guarantee. It is the Corporation's policy to not re-measure the fair value of the financial guarantee unless it qualifies as a derivative.

The Corporation has implemented the following classifications:

- Cash and cash equivalents and Short-term investments are classified as held-for-trading and any period change in fair value is recorded through interest income.
- Restricted cash is classified as held-for-trading and any period change in fair value is recorded through interest income.
- Aircraft related and other deposits are classified as held-to-maturity investments and are measured at amortized cost using the effective interest rate method. Interest income is recorded in the Consolidated Statement of Operations, as applicable.
- Accounts receivable are classified as loans and receivables and are measured at amortized cost using the effective interest rate method. Interest income is recorded in the Consolidated Statement of Operations, as applicable.
- Accounts payable, credit facilities, and bank loans are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method. Interest expense is recorded in the Consolidated Statement of Operations, as applicable.

Fuel Derivatives

Prior to the Corporation discontinuing hedge accounting for all fuel derivatives effective the third quarter of 2009 as described below, it had designated certain of its fuel derivatives as cash flow hedges. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative is recognized in Other comprehensive income ("OCI") while the ineffective portion is recognized in Non-operating income (expense). The effective gains and losses previously recognized in Accumulated OCI ("AOCI") are recorded in fuel expense when the forecasted hedge transaction occurs.

Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the derivative is terminated or sold, or upon the sale or early termination of the hedged item. The amounts previously recognized in AOCI are reclassified to fuel expense during the periods when the previously forecasted hedge transaction occurs. Refer to Note 15 for the impact of fuel derivatives during the year.

After considering the costs and benefits specific to the application of cash flow hedge accounting, the Corporation elected to discontinue hedge accounting for all fuel derivatives effective the third quarter of 2009. The derivative instruments continue to be recorded at fair value in each period with both realized and unrealized changes in fair value recognized immediately in earnings in non-operating income (expense). Amounts deferred to AOCI for derivatives previously designated under hedge accounting were taken into fuel expense in the period in which the previously forecasted hedge transaction occurred. As at December 31, 2010, there is no remaining balance in AOCI related to fuel hedging contracts.

M) FOREIGN CURRENCY TRANSLATION

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the Consolidated Statement of Financial Position. Non-monetary assets and liabilities, revenues and expenses arising from transactions denominated in foreign currencies, are translated at the historical exchange rate or the average exchange rate during the period, as applicable. Adjustments to the Canadian dollar equivalent of foreign denominated monetary assets and liabilities due to the impact of exchange rate changes are recognized in Foreign exchange gain (loss).

N) INCOME TAXES

The Corporation utilizes the asset and liability method of accounting for income taxes under which future income tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amount and the tax basis of assets and liabilities. Future income tax assets and liabilities are measured using substantively enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. Income taxes are recognized in the income statement except to the extent that it relates to items charged or credited to Shareholders' equity, in which case the taxes are netted with such items. The effect on future income tax assets and liabilities of a change in tax rates is recognized in earnings in the period when the change is substantively enacted. Future income tax assets are recognized to the extent that realization is considered more likely than not. The Corporation applied fresh start reporting on September 30, 2004 under which the assets and liabilities of the Corporation were comprehensively revalued, excluding goodwill ("fresh start"). The benefit of future income tax assets that existed at fresh start, and for which a valuation allowance is recorded, will be recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to Shareholders' equity. The benefit of future income tax assets that arise after fresh start will be recognized in the Consolidated Statement of Operations.

O) CASH AND CASH EQUIVALENTS

Cash and cash equivalents include $497 pertaining to investments with original maturities of three months or less at December 31, 2010 (2009 - $323). Investments include bankers' acceptances and bankers' discount notes, which may be liquidated promptly and have original maturities of three months or less. The weighted average interest rate on investments as at December 31, 2010 is 1.37% (2009 - 0.29%).

P) SHORT-TERM INVESTMENTS

Short-term investments, comprised of bankers' acceptances and bankers' discount notes, have original maturities over three months, but not more than one year. The weighted average interest rate on Short-term investments as at December 31, 2010 is 1.13% (2009 - 0.53%).

Q) RESTRICTED CASH

The Corporation has recorded $80 (2009 - $78) in Restricted cash, under Current assets, representing funds held in trust by Air Canada Vacations in accordance with regulatory requirements governing advance ticket sales, recorded under Current liabilities, for certain travel related activities.

Restricted cash with maturities greater than one year from the balance sheet date is recorded in Deposits and other assets. This restricted cash relates to funds on deposit with various financial institutions as collateral for letters of credit and other items.

R) AIRCRAFT FUEL INVENTORY AND SPARE PARTS AND SUPPLIES INVENTORY

Inventories of aircraft fuel and spare parts and supplies are measured at the lower of cost and net realizable value, with cost being determined using a weighted average formula.

The Corporation did not recognize any write-downs on inventories or reversals of any previous write-downs during the periods presented. Included in aircraft maintenance is $36 related to spare parts and supplies consumed during the year (2009 - $74).

S) PROPERTY AND EQUIPMENT

Property and equipment is initially recorded at cost. Property under capital leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments.

Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Property and equipment under capital leases and within variable interest entities are depreciated to estimated residual values over the life of the lease. Aircraft and flight equipment, including spare engines and related parts ("rotables") are depreciated over 20 to 25 years, with 10% to 20% estimated residual values. Aircraft reconfiguration costs are amortized over 3 to 5 years. Betterments to owned aircraft are capitalized and amortized over the remaining service life of the aircraft. Betterments to aircraft on operating leases are amortized over the term of the lease.

Buildings are depreciated over their useful lives not exceeding 50 years on a straight line basis. An exception to this is where the useful life of the building is greater than the term of the land lease. In these circumstances, the building is depreciated over the life of the lease. Leasehold improvements are amortized over the lesser of the lease term or 5 years. Ground and other equipment is depreciated over 3 to 25 years.

T) INTEREST CAPITALIZED

Interest on funds used to finance the acquisition of new flight equipment and other property and equipment is capitalized for periods preceding the dates that the assets are available for service. Capitalized interest related to the acquisition of new flight equipment and other property and equipment is included in purchase deposits within Property and equipment (Note 3) based on the effective interest rate. Capitalized interest also includes financing costs charged by the manufacturer on capital commitments as described in Note 14.

U) INTANGIBLE ASSETS

As a result of the application of fresh start reporting, intangible assets were recorded at their estimated fair values at September 30, 2004. For periods subsequent to September 30, 2004, intangible assets are initially recorded at cost. Indefinite life assets are not amortized while assets with finite lives are amortized on a straight line basis to nil over their estimated useful lives.

	Estimated Useful Life
International route rights and slots	Indefinite
Air Canada trade name	Indefinite
Other marketing based trade names	Indefinite
Star Alliance membership	25 years
Other contract and customer based intangible assets	10 to 15 years
Technology based intangible assets	5 years

V) IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets are tested for impairment whenever circumstances indicate that the carrying value may not be recoverable. When events or circumstances indicate that the carrying amount of long-lived assets, other than indefinite life intangibles, are not recoverable, the long-lived assets are tested for impairment by comparing the estimate of future expected undiscounted cash flows to the carrying amount of the assets or groups of assets. If the carrying value is not recoverable from future expected undiscounted cash flows, any loss is measured as the amount by which the asset's carrying value exceeds fair value and recorded in the period. Recoverability is assessed relative to undiscounted cash flows from the direct use and disposition of the asset or group of assets.

Indefinite life intangible assets are subjected to impairment tests on an annual basis or when events or circumstances indicate a potential impairment. If the carrying value of such assets exceeds the fair values, the assets are written down to fair value.

W) AIRCRAFT LEASE PAYMENTS IN EXCESS OF OR LESS THAN RENT EXPENSE

Total aircraft operating lease rentals over the lease term are amortized to operating expense on a straight-line basis. Included in Deposits and other assets and Other long-term liabilities are the differences between the straight line aircraft rent expense and the payments as stipulated under the lease agreement.

X) ASSET RETIREMENT OBLIGATIONS

The Corporation records an asset and related liability for the costs associated with the retirement of long-lived tangible assets when a legal liability to retire such assets exists. The fair value of a liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and then amortized over its estimated useful life. In subsequent periods, the asset retirement obligation is adjusted for the passage of time through charges to income and any changes in the amount of the underlying cash flows through increases or decreases to the asset retirement obligation and related asset. A gain or loss may be incurred upon settlement of the liability.

Y) RELATED PARTY TRANSACTIONS

Related party transactions not in the normal course of operations are measured at the exchange amount when the change in ownership interest in the item transferred is substantive and the exchange amount is supported by independent evidence; otherwise it is recorded at the carrying amount. Related party transactions in the normal course of operations are measured at the exchange amount.

Z) VARIABLE INTEREST ENTITIES

Aircraft Leasing Transactions

The Corporation has aircraft leasing transactions with a number of special purpose entities that are variable interest entities (a "VIE") under Accounting Guideline 15 of the CICA Handbook, Consolidation of Variable Interest Entities ("AcG-15"). As a result of the Corporation being the primary beneficiary of these VIEs, the Corporation consolidates leasing entities covering 37 aircraft.

Fuel Facilities Arrangements

The Corporation participates in fuel facilities arrangements operated through fuel facility corporations (the "Fuel Facility Corporations"), along with other airlines to contract for fuel services at various major Canadian airports. The Fuel Facility Corporations are organizations incorporated under federal or provincial business corporations acts in order to acquire, finance and lease assets used in connection with the fuelling of aircraft and ground support equipment. The Fuel Facilities Corporations operate on a cost recovery basis.

Under AcG-15, the Corporation is the primary beneficiary of three of the Fuel Facility Corporations in Canada. Five of the Fuel Facility Corporations in which Air Canada participates in Canada that have not been consolidated have assets of approximately $190 and debt of approximately $171, which is the Corporation's maximum exposure to loss without taking into consideration any cost sharing and asset retirement obligations that would occur amongst the other contracting airlines. The Corporation considers this loss potential as remote.

3. PROPERTY AND EQUIPMENT

	2010	2009
Cost		
Flight equipment, including spare engines (a)	$ 5,797	$ 5,866
Assets under capital leases (b)	1,959	1,959
Buildings, including leasehold improvements	702	688
Ground and other equipment	170	157
	8,628	8,670
Accumulated depreciation and amortization		
Flight equipment, including spare engines (a)	1,758	1,407
Assets under capital leases (b)	853	683
Buildings, including leasehold improvements	228	187
Ground and other equipment	76	62
	2,915	2,339
	5,713	**6,331**
Purchase deposits, including capitalized interest (c)	34	38
Property and equipment at net book value (d)	**$ 5,747**	**$ 6,369**

(a) Included in flight equipment as at December 31, 2010 are rotable parts, including spare engines with a cost of $786 (2009 - $821) less accumulated depreciation of $355 (2009 - $327) for a net book value of $431(2009 - $494). Also included in flight equipment are 24 aircraft and 1 spare engine (2009 –24 aircraft and 1 spare engine) which are leased to Jazz (Note 14) and third parties with a cost of $591 (2009 - $591) less accumulated depreciation of $282 (2009 - $237) for a net book value of $309 (2009 - $354).

(b) Included in capital leases as at December 31, 2010 are 40 aircraft (2009 - 40) with a cost of $1,893 (2009 - $1,893) less accumulated depreciation of $840 (2009 - $672) for a net book value of $1,053 (2009 - $1,221) and facilities with a cost of $66 (2009 - $66) less accumulated depreciation $13 (2009 - $11) for a net book value of $53 (2009 - $55).

(c) Includes $17 (2009 - $17) for Boeing B777/787 aircraft and $17 (2009 - $21) for equipment purchases and internal projects.

(d) Net book value of Property and equipment includes $698 (2009 - $798) consolidated for aircraft leasing entities and $155 (2009 - $165) consolidated for fuel facility corporations, both of which are consolidated under AcG-15.

As at December 31, 2010, flight equipment included 17 aircraft (2009 - 17) that are retired from active service with a net carrying value of $4 (2009 - $22). In 2010, the Corporation recorded an impairment charge of $7 on its fleet of retired B767-200 aircraft.

Interest capitalized during 2010 amounted to $1 at an interest rate of 6.68% (2009 - $4 at an interest rate of 7.38%).

Depreciation of property and equipment in 2010 amounted to $627 (2009 - $602).

During 2010:

- The Corporation received additional net proceeds of $20 upon completion of the remaining part of the sale-leaseback transaction of three Boeing 777 aircraft which was substantially completed in the fourth quarter of 2009. The Corporation recorded a loss on assets of $1 in 2010 for this remaining part of the transaction.

- The Corporation sold a spare engine for proceeds of $25 with a book value of $24, resulting in a gain on sale of $1.

During 2009:

- The Corporation took delivery of one Boeing 777 aircraft. The aircraft was financed with guarantee support from the Export-Import Bank of the United States ("EXIM").

- The Corporation entered into a sale lease-back transaction for a Boeing 777 aircraft, which was originally delivered in 2007 and debt financed. The proceeds from the transaction of $172 were used to repay the outstanding loan of $114. The Corporation recorded a charge of $17 in interest expense for this transaction including a prepayment fee of $14. The gain on sale of the aircraft of $26 has been deferred and will be recognized in Depreciation and amortization over the term of the lease. The lease is accounted for as a capital lease with a 12 year term, with monthly lease payments.

- The Corporation sold two A340 aircraft for proceeds of $91 with a book value of $93, resulting in a loss on sale of $2. The Corporation made a repayment of $82 for the associated debt.

- The Corporation entered into a sale lease-back transaction for three Boeing 777 aircraft, which were originally delivered in 2007 and debt financed. The proceeds from the transaction of $380 were used to repay the outstanding principal of $273. The Corporation recorded a charge of $8 in interest expense for this transaction and a loss on sale of the aircraft of $24. The leases are accounted for as operating leases with a 12 year term, with monthly lease payments.

4. INTANGIBLE ASSETS

	2010	2009
Indefinite life assets		
International route rights and slots	$ 310	$ 329
Air Canada trade name	276	298
Other marketing based trade names	29	31
	615	**658**
Finite life assets		
Star Alliance membership	125	131
Other contract and customer based	141	144
Technology based	277	254
	543	529
Accumulated depreciation and amortization		
Star Alliance membership	(42)	(37)
Other contract and customer based	(116)	(110)
Technology based	(160)	(124)
	(318)	(271)
Finite life assets, net	**225**	**258**
	$ 840	**$ 916**

The amortization of intangible assets in 2010 amounted to $47 (2009 - $58).

As a result of recognizing the benefit during the year ended December 31, 2010 of future income tax assets that existed at fresh start, and for which a valuation allowance was recorded, intangible assets were reduced on a pro-rata basis by $56 (2009 – nil).

During 2009, the Corporation recorded an impairment charge of $68 related to previously capitalized costs incurred pertaining to the development of a new reservation system, referred to as POLARIS, which was recorded in Technology based intangible assets.

5. DEPOSITS AND OTHER ASSETS

		2010	2009
Aircraft related deposits (a)		$ 131	$ 189
Restricted cash		130	121
Investment in Aveos	Note 18	51	-
Accrued pension benefit asset	Note 8	28	-
Aircraft lease payments in excess of rent expense	Note 2W	52	51
Deposit related to the Pension and Benefits Agreement	Note 18	20	43
Asset backed commercial paper	Note 15	29	29
Other deposits		34	24
Other		37	13
		$ 512	**$ 470**

(a) Represents the amount of deposits with lessors for the lease of aircraft and flight simulators.

6. LONG-TERM DEBT AND CAPITAL LEASES

		Base Currency	Final Maturity	Actual Interest Rate (%)	2010	2009
Embraer aircraft financing (a)		USD	2017 - 2021	2.18 - 8.49	$ 1,041	$ 1,164
Boeing aircraft financing (b)		USD	2019 - 2021	0.29 - 5.69	386	450
Boeing aircraft financing (c)		JPY	2020	0.33	207	210
Senior secured first lien notes (d)		USD	2015	9.25	597	-
Senior secured first lien notes (d)		CDN	2015	10.13	300	-
Senior secured second lien notes (d)		USD	2016	12.00	199	-
Term credit facility (e)		CDN	2014		-	593
Aircraft leasing entities - debt (f)	Note 2Z				533	662
Term loan due 2013 (g)		USD	2013	6.25	75	78
Conditional sales agreements (h)		USD	2019	3.20 - 3.29	123	140
Fuel facility corporations - debt (i)	Note 2Z				134	136
Spare parts financing (j)		USD	2014	5.74	100	138
Spare engine financing (k)		USD	2013	3.70	62	74
Canadian Regional Jet financing (l)		CDN	2012	2.98	10	17
GE flight simulator financing (m)		USD	2015	3.50	13	17
Long-term debt					**3,780**	**3,679**
Capital lease obligations (n)					755	904
Total debt and capital leases					**4,535**	**4,583**
Unamortized discount					(16)	-
Unamortized debt issuance costs					(62)	(61)
Current portion					(505)	(468)
Long-term debt and capital leases					**$ 3,952**	**$ 4,054**

The Interest Rate in the table above is the actual rate as of December 31, 2010

Amounts reported below are before any transaction costs or fees recorded net against the carrying value of the debt.

Refer to note (f) for a description of a loan facility entered into on August 20, 2010 to refinance certain borrowings due in 2011 and 2012.

(a) Embraer aircraft financing amounts to US$1,046 as at December 31, 2010 (US$1,112 as at December 31, 2009). Principal and interest is repaid quarterly until maturity and the financing has both fixed and variable interest rates. The fixed rate financing of US$796 bears interest at rates ranging from 6.39% to 8.49% (6.39% to 8.49% as at December 31, 2009) and the variable rate financing of US$250 bears interest at a three month US LIBOR plus 1.9% (2.18% to 2.20% as at December 31, 2010 and 2.15% to 2.18% as at December 31, 2009). The financing can be repaid at any time, in whole or in part, with the payment of applicable fees. The financing is secured by the 60 delivered Embraer aircraft, with a carrying value of $1,527.

(b) Boeing aircraft financing amounts to US$388 as at December 31, 2010 (US$430 as at December 31, 2009), which is financed under loan guarantee support provided by the Export-Import Bank of the United States ("EXIM"). Principal and interest is repaid quarterly until maturity and the financing has both fixed and variable interest rates. The fixed rate financing of US$139 bears interest at rates ranging from 5.41% to 5.69% (5.41% to 5.69% as at December 31, 2009) and the variable rate financing of US$249 bears interest at a three month US LIBOR (0.29% to 0.31% as at December 31, 2010 and 0.25% to 0.28% as at December 31, 2009). The financing can be repaid at any time, in whole, with the payment of applicable fees. The financing is secured primarily by 5 delivered aircraft with a carrying value of $607.

(c) Boeing aircraft financing amounts to JPY16,872 as at December 31, 2010 (JPY18,671 as at December 31, 2009), which is financed under loan guarantee support provided by EXIM. Principal and interest is repaid quarterly until maturity and the financing bears interest at a three month JPY LIBOR (0.33% as at December 31, 2010 and 0.46% to 0.47% as at December 31, 2009). The financing can be repaid at any time, in whole, with the payment of applicable fees. The financing is secured primarily by 2 delivered aircraft with a carrying value of $225.

(d) In August 2010, the Corporation completed a private offering of two series of senior secured notes, consisting of US$600 senior secured first lien notes due 2015 (the "U.S. Dollar First Lien Notes") and $300 senior secured first lien notes due 2015 (the "Canadian Dollar First Lien Notes" and, collectively with the U.S. Dollar First Lien Notes, the "First Lien Notes"). In August 2010, the Corporation also completed a private offering of US$200 senior secured second lien notes due 2016 (the "Second Lien Notes" and, together with the First Lien Notes, the "Notes"). The Corporation received net proceeds of $1,075, after deduction of fees, expenses and discounts. The Corporation used approximately $729 of the net proceeds of the offerings to repay all of the outstanding debt under the Credit Facility described in note (e) below, including $29 for early payment fees.

The U.S. Dollar First Lien Notes bear interest at a rate of 9.250% per annum, the Canadian Dollar First Lien Notes bear interest at a rate of 10.125% per annum, and the Second Lien Notes bear interest at a rate of 12.000% per annum, in each case payable February 1 and August 1 of each year, beginning on February 1, 2011. The Corporation is required to pay additional special interest of 2% per annum on the Notes if (i) the priority lien debt value ratio (appraised value of collateral / priority lien debt) is less than 1.7:1.0, or (ii) the total appraised value ratio (total appraised value of collateral / secured debt) is less than 1.25:1.0.

The Corporation may redeem some or all of the First Lien Notes at any time on or after August 1, 2012 at certain established redemption prices, plus accrued and unpaid interest. At any time prior to August 1, 2012, Air Canada may redeem some or all of the First Lien Notes at a price equal to 100% of their principal amount plus a "make-whole" premium, and accrued and unpaid interest. At any time prior to August 1, 2012, Air Canada may redeem up to 35% of the aggregate principal amount of each issue of First Lien Notes with the proceeds of certain equity offerings, at established redemption prices, plus accrued and unpaid interest. In addition, at any time and from time to time prior to August 1, 2014, the Corporation may redeem, during any twelve-month period, up to 10% of the original aggregate principal amount of each issue of First Lien Notes at a redemption price of 103% of the principal amount, plus accrued and unpaid interest.

The Corporation may redeem some or all of the Second Lien Notes at any time on or after February 1, 2013 at certain established redemption prices, plus accrued and unpaid interest. At any time prior to February 1, 2013, Air Canada may redeem some or all of the Second Lien Notes at a price equal to 100% of their principal amount plus a "make-whole" premium, and accrued and unpaid interest. At any time prior to February 1, 2013, Air Canada may redeem up to 35% of the aggregate principal amount of the Second Lien Notes with the proceeds of certain equity offerings and by paying a redemption price equal to 112% of the principal amount of the Second Lien Notes being redeemed, plus accrued and unpaid interest thereon.

The prepayment options within the First Lien Notes and Second Lien Notes are considered embedded derivatives. The value of these embedded derivatives at December 31, 2010 is negligible. Upon specified change of control events or upon certain sales of assets, the Corporation must offer to repurchase the Notes.

The Notes are senior secured obligations of the Corporation, (i) secured on a first-lien basis (in the case of the First Lien Notes) or on a junior lien basis (in the case of the Second Lien Notes), subject to certain permitted liens, by accounts receivable, certain real estate interests, certain spare engines, ground equipment, certain airport slots and gate leaseholds, and the Corporation's licenses to operate its Pacific routes and the airport slots and gate leaseholds utilized in connection with these Pacific routes and (ii) guaranteed on a senior secured basis by a subsidiary of the Corporation, subject to certain thresholds and exclusions.

(e) In July 2009, the Corporation received financing proceeds of $600, less financing fees of $20, under a secured term credit facility (the "Credit Facility") pursuant to which the Corporation also issued warrants for the purchase of Air Canada's Class A Variable Voting Shares or Class B Voting Shares as further described below. During the first quarter of 2010, the Corporation entered into arrangements with a new lender, comprised of a group of entities that are related to each other, to obtain a $100 increase to the facility. The addition to the facility increased, on a pro rata basis, the scheduled repayments, including the final payment. The Corporation received financing proceeds of $100, less financing fees of $2 in February 2010. No additional warrants were issued as a result of the increase to the credit facility. The Credit Facility was repayable in 16 consecutive quarterly instalments commencing in August 2010 of $30 with the final instalment of $120 due in July 2014.

As described above under (d), total outstanding debt under this facility of $700 was repaid upon the issuance of the Notes in August 2010. Based on the change in cash flows under the Credit Facility due to its repayment, the Corporation recorded a charge of $54 in interest expense in 2010, including early payment fees of $29 and $25 for the adjustment related to the unamortized portion of transaction costs and debt discounts.

Interest under the Credit Facility was charged at a rate based upon the greater of the bankers' acceptance rate or 3.00% plus 9.75% (12.75% as at December 31, 2009).

Under the Credit Facility, Air Canada issued to the lenders, concurrently with the first drawdown of $600, warrants for the purchase of Air Canada's Class A Variable Voting Shares or Class B Voting Shares representing an aggregate of 5% or 5 million of the total issued and outstanding shares as at the closing date of the Credit Facility, allocated among the lenders based on their pro rata lending commitments under the Credit Facility. These initial 5% warrants have an exercise price of $1.51 per share, are exercisable at any time and expire four years after the date of issuance. In the event that Air Canada did not grant additional security over certain assets within 90 days of closing, Air Canada was required to issue to the lenders additional warrants representing up to an additional 5% or 5 million of the total issued and outstanding shares (determined at the time of issuance of such additional warrants) with an average exercise price established based on a volume weighted average price over the 5 days before issuance, exercisable at any time and expiring four years after the date of issuance. These additional warrants were issued on October 19, 2009 and have an exercise price of $1.44 per share. The ascribed value of both the initial and additional warrants, totalling 10 million warrants, were included in Contributed surplus on the Consolidated Statement of Financial Position as at December 31, 2009 in the amount of $7.

(f) The Corporation has aircraft lease transactions with several special purpose entities that qualify as VIEs. The debt has a weighted average effective interest rate of approximately 8% (2009 - 8%). These aircraft have a carrying value of $698 (2009 - $798) and are charged as collateral against the debt by the owners thereof. The creditors under these leasing arrangements have recourse to the Corporation, as lessee, in the event of default or early termination of the lease. Aircraft related debt amounting to US$535 ($533) (US$633 ($662) as at December 31, 2009) is summarized as follows (in Canadian dollars):

	Final Maturity	2010	2009
Canadian Regional Jet	2011	$ 138	$ 211
Boeing 767-300	2011 - 2016	123	141
Airbus 319	2011 - 2014	170	192
Airbus 321	2017	102	118
Total		**$ 533**	**$ 662**

In August 2010, the Corporation concluded a credit agreement with GE Japan Corporation, PK Airfinance Japan ("GE Japan") for a senior secured term loan facility in the amount of up to approximately US$171 (the "Facility") to refinance amounts related to sixteen aircraft currently operated by Air Canada and leased from special purpose leasing entities which are consolidated by Air Canada. The credit agreement bears interest at a rate of one month US LIBOR plus 5.50%. On a consolidated basis, the draws on the Facility will be accounted for as a settlement of the special purpose leasing entities' debt related to these aircraft. Draw-downs under the facility are subject to certain customary terms and conditions.

The Facility will be available in 2011 to refinance up to US$129 of the amount related to eight Airbus A319 aircraft and four Boeing B767-300ER aircraft, with terms of seven and four years respectively. The Facility will also be available in 2012 to refinance up to US$42 of the amount related to four Airbus A319 aircraft, with a term of five years. As a result of this Facility, the amounts due under the existing debt maturities within the next 12 months that will be refinanced by the commitment on a long-term basis have been classified as long-term at December 31, 2010.

(g) The term loan financing amounts to US$75 principal outstanding at December 21, 2010 (US$75 as at December 31, 2009). The financing bears interest at one month LIBOR plus 5.98% (6.25% as at December 31, 2010 and 6.21% as at December 31, 2009) and is secured by a security interest and a movable hypothec in the principal amount of $400. The financing can be repaid at any time prior to maturity, in whole or in part, without the payment of applicable fees.

(h) Conditional sales agreements amount to US$124 principal outstanding at December 31, 2010 (US$133 as at December 31, 2009) on acquisitions of two A340-500 aircraft financed through conditional sales agreements. Principal and interest are paid quarterly until maturity in 2019. The purchase price instalments bear interest at a three month LIBOR rate plus 2.9% (3.20% - 3.29% as at December 31, 2010 and 3.15% - 3.31% as at December 31, 2009). The financing can be repaid at any time, in whole, with the payment of applicable fees. The carrying value of the two A340-500 aircraft provided as security under the conditional sales agreements is $185 as at December 31, 2010.

(i) The Corporation is the primary beneficiary of certain Fuel Facility Corporations in Canada. The debts bear interest at rates ranging from 2.93% to 5.09%. Of the total debts of $134, $101 relates to a bond payable at a fixed rate of interest of 5.09% which matures in 2032 with equal semi-annual payments of principal and interest. The remaining debts have varying maturities. The debts are secured by a general security agreement covering all assets of the Fuel Facility Corporations. The carrying value of the assets of the fuel facilities is $155 as at December 31, 2010.

(j) Spare parts financing amounts to US$101 as at December 31, 2010 (US$132 as at December 31, 2009). Principal and interest are repaid quarterly until maturity in 2014, at a floating interest rate equal to the three month LIBOR rate plus the lender's incremental cost of funds rate and a margin of 3.00% (5.74% at December 31, 2010 and 5.73% at December 31, 2009). The financing can be repaid subsequent to the 36th monthly anniversary of the initial funding date, in whole or in part, with the payment of applicable fees. The loan is secured by spare parts and other assets with a carrying value of $214. The related financing agreements contain certain collateral value tests, performed on a monthly basis. These tests relate to all inventory collateral and the Corporation may be required to provide additional inventory collateral, cash collateral, letters of credit, prepay some of the loan or any combination of the above based on appraised values, as of the date of the test. Any amounts prepaid would be recorded as a reduction of the loan. There has not been a prepayment or additional collateral required as part of the collateral value test. This amount declines over time to nil upon the loan expiry.

(k) Spare engine financing amounts to US$63 as at December 31, 2010 (US$70 as at December 31, 2009). Principal and interest are paid quarterly until maturity in 2013, with a final payment at maturity of 50% of the original principal, at a floating interest rate equal to the three month LIBOR rate plus 3.40% (3.70% at December 31, 2010 and 3.65% at December 31, 2009). The financing can be repaid at any time, in whole, with the payment of applicable fees. The loan is secured by 10 spare engines with a carrying value of $110.

The loan agreement contains a current market value test, beginning on the first anniversary of the facility, and annually thereafter until expiry. This test relates to 10 engines and under the test, the Corporation may be required to provide additional collateral or prepay certain facility amounts, based on engine current market values, as of the date of the test. Any amounts prepaid would be recorded as a reduction of the loan. The maximum amount payable in December 2011 on the next anniversary, assuming the engines are worth nil and no additional collateral has been provided, is $54 (US$54). There has not been a prepayment or additional collateral required as part of the current market value test. This amount declines over time to fifty percent of the original principal upon the loan expiry.

(l) Canadian Regional Jet financing amounts to $10 as at December 31, 2010 ($17 as at December 31, 2009). Principal and interest are paid quarterly to maturity in 2012. The financing bears interest at a floating rate of the 3 month Canadian bankers' acceptance rate plus 1.70% (2.98% at December 31, 2010 and 2.13% at December 31, 2009). The financing can be repaid at any time, in whole or in part, with the payment of applicable fees. The loan is secured by four aircraft with a carrying value of $21.

(m) GE flight simulator financing amounts to US$13 as at December 31, 2010 (US$16 as at December 31, 2009). Principal and interest are repaid quarterly until maturity in 2015 at a floating interest rate equal to the six month LIBOR rate plus 2.75% (3.50% as at December 31, 2010 and 3.19% at December 31, 2009). The financing is pre-payable on any interest payment date after September 21, 2009, without the payment of applicable fees. The debt is secured primarily by certain flight training equipment with a current carrying value of $26.

(n) Capital leases, related to facilities and 40 aircraft, total $755 ($82 and US$670 ($904 ($83 and US$784) as at December 31, 2009). The debt has a weighted average effective interest rate of approximately 8% and final maturities range from 2013 to 2033. During 2010, the Corporation recorded interest expense on capital lease obligations of $75 (2009 - $102).

Certain aircraft lease agreements contain a fair value test, beginning on July 1, 2009, and annually thereafter until lease expiry. This test relates to 24 aircraft under lease of which 21 are accounted for as capital leases and the remainder relates to leasing entities that are consolidated under AcG-15. Under the test, the Corporation may be required to prepay certain lease amounts or to provide additional collateral, based on aircraft fair values, as of the date of the test. The Corporation contracts with certain third parties to provide residual value support for certain aircraft. If the Corporation is required under the loan to value test to prepay lease obligations, these amounts are recoverable from the third party residual value support provider upon lease expiry to the extent that the adjusted obligation taking into account prepayments is less than the residual value support. The maximum amount payable on July 1, 2011, assuming the related aircraft are worth nil, is $457 (US$459). The maximum payable amount declines over time to nil upon lease expiry. In September 2010 additional collateral of $48 in the form of cash deposits were made under the fair value test for certain aircraft leases pertaining to A340 and A330 aircraft. This cash outflow is reported in Investing on the consolidated statement of cash flow.

Interest paid on Long-term debt and capital leases in 2010 by the Corporation was $276 (2009 - $326).

Refer to Note 14 for the Corporation's principal and interest repayment requirements as at December 31, 2010.

7. FUTURE INCOME TAXES

The following income tax related amounts appear in the Corporation's Consolidated Statement of Financial Position:

	2010	2009
Liability		
Tax payable (a)	$ (5)	$ (10)
Future income tax liability (b)	(80)	(85)
	$ (85)	**$ (95)**

(a) Taxes Payable

Air Canada has a cash tax payable of $5 of which $2 is included in Accounts payable and accrued liabilities and the remainder is recorded in Other long-term liabilities.

(b) Future Income Tax Liability

It has been assumed that certain intangibles and other assets with no tax cost and a carrying value of approximately $615, have indefinite lives and accordingly, the associated future income tax liability is not expected to reverse until the assets are disposed of or become amortizable, resulting in the reporting of a future income tax liability of $80.

The future income tax assets and liabilities are as follows:

	2010	2009
Future tax assets		
Loss carryforwards	$ 496	$ 689
Post-employment obligations	287	322
Accounting provisions not currently deductible for tax	101	144
Tax basis of property and equipment over book basis	41	-
Deferred gains	35	24
Other	111	91
Total future tax assets	**1,071**	**1,270**
Future tax liabilities		
Book basis of property and equipment over tax basis	-	153
Intangible assets	110	120
Other	53	39
Total future tax liabilities	**163**	**312**
Net future tax assets	**908**	**958**
Less valuation allowance (c)	988	1,043
Net recorded future income tax liability	**$ (80)**	**$ (85)**

(c) Valuation Allowance

The Corporation has determined that it is more likely than not that future income tax assets of $988 are not recoverable and have been offset by a valuation allowance. However, the future tax deductions underlying the future tax assets remain available for use in the future to reduce taxable income.

The provision for (recovery of) income taxes differs from the amount that would have resulted from applying the statutory income tax rate to income before income tax expense as follows:

	2010	2009
Provision (recovery) based on combined federal and provincial rates	$ 47	$ (9)
Non-taxable portion of capital gains	(23)	(105)
Non-deductible expenses (non-taxable income)	(11)	7
Effect of tax rate changes on future income taxes	7	76
Other	(18)	(15)
	2	(46)
Valuation allowance (refer to (c) above)	46	41
Provision for (recovery of) income taxes	**$ 48**	**$ (5)**

Significant components of the Provision for (recovery of) income taxes are as follows:

	2010	2009
Current tax recovery	$ (4)	$ (7)
Future income tax recovery relating to temporary differences	(1)	(115)
Future income tax expense from tax rate changes	7	76
Future income tax expense related to the valuation allowance	46	41
Provision for (recovery of) income taxes	**$ 48**	**$ (5)**

Refer to Note 15 for future income taxes recorded in other comprehensive income related to fuel derivatives designated under fuel hedge accounting.

Income taxes paid in 2010 by the Corporation were $4 (2009 – recovery of $5).

The balances of tax attributes as at December 31, 2010, namely the balances of non-capital loss carryforwards, vary amongst different taxing jurisdictions. The following are the Federal non-capital tax loss expiry dates:

	Tax Losses
2026	2
2027	524
2028	904
2029	431
2030	11
	$ 1,872

There are no net capital losses as at December 31, 2010 (2009 - nil).

8. PENSION AND OTHER BENEFIT LIABILITIES

The Corporation maintains several defined benefit and defined contribution plans providing pension, other post-retirement and post-employment benefits to its employees, including those employees of the Corporation who are contractually assigned to Aveos as well as employees of the Corporation who were contractually assigned to Aeroplan until June 1, 2009.

The Corporation is the administrator and sponsoring employer of ten Domestic Registered Plans ("Domestic Registered Plans") under the Pension Benefits Standard Act, 1985 (Canada). The US plan, UK plan and Japan plan are international plans covering employees in those countries. In addition, the Corporation maintains a number of supplementary pension plans which are not registered. The defined benefit pension plans provide benefits upon retirement, termination or death based on the member's years of service and final average earnings for a specified period.

The other employee benefits consist of health, life and disability. These benefits consist of both post-employment and post-retirement benefits. The post-employment benefits relate to disability benefits available to eligible active employees, while the post-retirement benefits are comprised of health care and life insurance benefits available to eligible retired employees.

Certain Corporation employees perform work for Aveos and are members of Corporation-sponsored defined benefit pension plans and also participate in Corporation-sponsored health, life and disability benefit plans. Other Corporation employees performed work for Aeroplan until June 1, 2009, the date of transition to employment at Aeroplan and then ceased to accrue benefits under the Corporation-sponsored defined benefit pension plans and under the Corporation-sponsored health, life and disability benefit plans. These consolidated financial statements include all of the assets and liabilities of all Corporation-sponsored plans. The employee benefit expense in these consolidated financial statements includes the expenses for all employees participating in the plans less a cost recovery which is charged to Aveos and Aeroplan for those employees contractually assigned. The cost recovery includes current service costs for pensions for Aveos, past service cost to Aeroplan for pensions and a portion of post-employment and post-retirement benefits to Aveos, based on actuarial calculation for their specific employee group. This cost recovery amounted to $27 for the year ended December 31, 2010 (2009 - $32).

In May 2009, Air Canada and Aeroplan reached an agreement with the Canadian Auto Workers (CAW) Local 2002 providing for a process for the approximately 750 Air Canada employees then assigned to and working in the Aeroplan contact centres to choose to transition to employment at Aeroplan, effective June 1, 2009, or to remain employees of Air Canada. Employees at Air Canada work locations who became surplus to Air Canada's needs due to employees who were senior to them and then working at Aeroplan contact centres choosing to remain employees of Air Canada were given the option to transition to employment at Aeroplan. Effective October 4, 2009, all affected employees had completed the transition to Aeroplan. For those employees who transferred to Aeroplan, their service, which largely determines benefit levels under the Air Canada pension and other employee benefit plans, ceased to accrue as of the date of employment with Aeroplan. Air Canada and Aeroplan continue to discuss the terms surrounding the transfer of pension benefits and certain implications relating to same remain to be resolved. Air Canada continues to retain plan assets and report liabilities for services accrued for the transferred Aeroplan employees as at December 31, 2010, pending final determination of this matter. Post transition, Aeroplan is contributing current service costs in their pension plan for service accruing with Aeroplan.

As described in Note 18, Air Canada and Aveos are parties to a Pension and Benefits Agreement covering the future transfer of certain pension and benefit assets and obligations to Aveos. In 2010, the Office of the Superintendent of Financial Institutions ("OSFI") provided its approval for the transfer of pension assets and liabilities from the Air Canada pension plans to the Aveos pension plan for certain non-unionized employees of Air Canada who became employees of Aveos effective October 16, 2007. The amount of the asset transfer was established as a pro-rata share, based on solvency liabilities, of assets in the Air Canada pension plans as at October 16, 2007. The resulting amount was adjusted by investment returns and benefit payments until the actual date funds were transferred. The transaction, completed in the second quarter of 2010, included an asset transfer of $43, as well as a reduction of $43 to the benefit obligation, in addition to transferring cash payments previously made under the Pension and Benefits Agreement of $2. An amount of $1 has also been accrued relating to the Pension and Benefits Agreement. The settlement was recognized in the unamortized actuarial gains (losses) upon the annual remeasurement at December 31, 2010 and will be amortized over the expected average remaining service life as appropriate.

As described in Note 2B, the accounting for pensions requires management to make significant estimates including estimates as to the discount rate applicable to the benefit obligation and the expected rate of return on plan assets.

Pension Plan Cash Funding Obligations

As at January 1, 2010, based on the actuarial valuations which were used to determine certain pension funding requirements in 2010, the aggregate solvency deficit in the registered pension plans was $2,728. The next required valuations are as of January 1, 2011, and will be completed in the first half of 2011, but as described below, they will not increase the 2011 pension past service cost funding obligations.

In July 2009, the Government of Canada adopted the Air Canada 2009 Pension Regulations. The Air Canada 2009 Pension Regulations relieve Air Canada from making any past service contributions (i.e. special payments to amortize the plan deficits) to its ten domestic defined benefit registered pension plans in respect of the period beginning April 1, 2009 and ending December 31, 2010. Thereafter, in respect of the period from January 1, 2011 to December 31, 2013, the aggregate annual past service contribution shall equal the lesser of (i) $150, $175, and $225 in respect of 2011, 2012, and 2013, respectively, on an accrued basis, and (ii) the maximum past service contribution permitted under the Canadian Income Tax Act.

The Air Canada 2009 Pension Regulations were adopted during the third quarter of 2009 in coordination with pension funding agreements reached with all of the Corporation's Canadian-based unions ("the Pension MOUs"). Pursuant to the Pension MOUs, on October 26, 2009, Air Canada issued to a trust, 17,647,059 Class B Voting Shares. This number of shares represented 15% of the shares of Air Canada issued and outstanding as at the date of the Pension MOUs and the date of issuance (in both cases after taking into account such issuance). All net proceeds of sale of such shares by the trust are to be contributed to the pension plans. On October 26, 2009, upon the issuance of the shares to the trust, the Corporation recorded a decrease to its Pension and other benefit liabilities in the amount of $28 and an increase to Share capital in the amount of $28. For so long as the trust continues to hold at least 2% of the issued and outstanding shares of Air Canada, the trustee will have the right to designate one nominee (who shall not be a member or officer of any of Air Canada's Canadian-based unions) to Air Canada's board of directors, subject to completion of Air Canada's usual governance process for selection and confirmation of director nominees. Current service contributions will continue to be made in the normal course while the Air Canada 2009 Pension Regulations are in effect.

After consideration of the effect of the Air Canada 2009 Pension Regulations as outlined above, employer pension funding contributions during 2010 amounted to $243.

Discount Rate

The discount rate used to determine the pension obligation was determined by reference to market interest rates on corporate bonds rated "AA" or better with cash flows that approximately match the timing and amount of expected benefit payments. An increase in the discount rate of 0.25% results in a decrease of $411 to the pension obligation and $9 to the pension expense. A decrease in the discount rate of 0.25% results in an increase of $411 to the pension obligation and $8 to the pension expense.

Expected Return on Assets Assumption

The expected long-term rate of return on assets assumption is selected based on the facts and circumstances that exist as of the measurement date and the specific portfolio mix of plan assets. Air Canada's management, in conjunction with its actuaries, reviews anticipated future long-term performance of individual asset categories and considers the asset allocation strategy adopted by Air Canada, including the longer duration in its bond portfolio in comparison to other pension plans. These factors are used to determine the average rate of expected return on the funds invested to provide for the pension plan benefits. The determination of the long-term rate considers recent fund performance, and historical returns, to the extent that the past is indicative of the expected long-term, prospective rate. There can be no assurance that any of the plans will earn the expected rate of return.

US Health Care Reform

The Corporation is a sponsor of certain US post-retirement health-care plans that were impacted by US health care reform legislation enacted in March 2010. Under this legislation, changes include the removal of lifetime benefit maximums. This legislation has the impact of increasing the Corporation's post-retirement benefit obligation by $55. The full amount is recognized as an actuarial loss and will be recognized in pension expense over the expected average remaining service life commencing in 2011.

Benefit Obligation and Plan Assets

The following table presents financial information related to the changes in the pension and other post-employment benefits plans:

	Pension Benefits		Other Employee Future Benefits	
	2010	2009	2010	2009
Change in benefit obligation				
Benefit obligation at beginning of year	$ 11,937	$ 10,729	$ 851	$ 790
Current service cost	160	123	53	50
Interest cost	748	760	53	54
Employees' contributions	76	78	-	-
Benefits paid	(770)	(724)	(59)	(58)
Actuarial loss	1,501	1,015	110	33
Foreign exchange gain	(33)	(44)	(8)	(18)
	13,619	11,937	1,000	851
Change in plan assets				
Fair value of plan assets at beginning of year	10,751	9,717	-	-
Actual return on plan assets	1,270	1,296	-	-
Employer contributions	243	389	59	58
Employees' contributions	76	78	-	-
Pension MOUs share contribution	-	28	-	-
Benefits paid	(770)	(724)	(59)	(58)
Foreign exchange loss	(28)	(33)	-	-
	11,542	10,751	-	-
Deficit at end of year	**2,077**	**1,186**	**1,000**	**851**
Unrecognized past service costs	(2)	(2)	-	-
Unrecognized net actuarial gain (loss)	(2,104)	(1,079)	129	258
Valuation allowance against accrued benefit	1	15	-	-
Net benefit obligation (asset)	**$ (28)**	**$ 120**	**$ 1,129**	**$ 1,109**
Weighted average assumptions used to determine the accrued benefit liability				
Discount rate	5.50 %	6.40 %	4.25 - 5.50 %	4.75 - 6.40 %
Rate of compensation increase (1)	2.50 %	2.50 %		

(1) A rate of compensation increase of 0% plus merit was used for 2010 in determining the net benefit obligation for the pension plan and 2.5% plus merit for the remaining years.

Under the terms of the domestic registered and supplementary plans, there is no indexation provided after January 1, 2007.

The pension benefit deficit of only those plans that are not fully funded at the end of the year is as follows:

	2010	2009
Domestic registered plans	$ 1,238	$ 496
US, UK, and Japan	98	78
Supplementary plans	755	653
	$ 2,091	**$ 1,227**

The net deficit, on an accounting basis, at December 31, 2010 for pension benefits was $2,077 (2009 - $1,186). The increase in the accounting deficit is mainly the result of the increase to the accrued benefit obligation resulting from the decrease in the discount rate and to some extent offset by the higher than expected returns on plan assets.

The net benefit obligation is recorded in the statement of financial position as follows:

	2010	2009
Accrued pension benefit asset in Deposits and other assets	$ 28	$ -
Accrued benefit liabilities in		
Pension benefits obligation	$ -	$ 120
Other employee future benefits	1,129	1,109
Net benefit obligation	**1,129**	**1,229**
Current portion	(70)	(66)
Pension and other benefit liabilities	**$ 1,059**	**$ 1,163**

The current portion of the net benefit obligation represents an estimate of other employee future benefits claims to be paid during 2011. The current portion is included in Accounts payable and accrued liabilities.

Pension and Other Employee Future Benefit Expense

The Corporation has recorded net defined benefit pension and other employee future benefits expense as follows:

	Pension Benefits		Other Employee Future Benefits	
	2010	2009	2010	2009
Components of net periodic pension cost				
Current service cost	$ 160	$ 123	$ 53	$ 50
Interest cost	748	760	53	54
Actual return on plan assets	(1,270)	(1,296)	-	-
Actuarial loss on benefit obligation	1,501	1,015	110	33
Costs arising in the year	**1,139**	**602**	**216**	**137**
Differences between costs arising in the year and costs recognized in the year in respect of:				
Return on plan assets	469	460	-	-
Actuarial gain	(1,499)	(1,068)	(132)	(62)
Increase (decrease) in valuation allowance provided against accrued benefit asset	(14)	6	-	-
Net periodic benefit cost of plans	**95**	**-**	**84**	**75**
Amount charged to Aveos and Aeroplan	(16)	(20)	(11)	(12)
Net defined benefit pension and other employee benefits expense	**$ 79**	**$ (20)**	**$ 73**	**$ 63**
Weighted average assumptions used to determine the accrued benefit cost				
Discount rate	6.40 %	7.35 %	5.75 - 6.40 %	6.25 - 7.35 %
Expected long-term rate of return on plan assets	7.00 %	7.15 %	n/a	n/a
Rate of compensation increase (1)	2.50 %	2.50 %		

(1) A rate of compensation increase of 0% plus merit in 2010 was used in determining the net benefit pension expense and 2.5% plus merit for the remaining years.

Other Benefits — Sensitivity Analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. An 8.25% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2010 (2009 - 8.25%). The rate is assumed to decrease gradually to 5% by 2015. A one percentage point increase in assumed health care trend rates would have increased the service and interest costs by $2 and the obligation by $47. A one percentage point decrease in assumed health care trend rates would have decreased the service and interest costs by $2 and the obligation by $46.

Composition of Pension Plan Assets

The composition of the Domestic Registered Plan assets and the target allocation are the following:

	2010	2009	Target Allocation (1)
Non-matched assets (mainly equities)	54.0%	55.9%	54.4 %
Matched assets (mainly Canadian bonds)	46.0 %	43.4 %	45.6 %
Cash and temporary investments	0.0 %	0.7 %	0.0 %
	100.0 %	**100.0 %**	**100.0 %**

(1) Weighted average of the Master Trust Fund target allocation (99% of Domestic Registered Plan assets) and the Bond Fund target allocation. The Bond Fund serves the purpose of altering the asset mix of some of the participating plans. These plans exhibit characteristics that differ from the majority of the participating plans, which are solely invested in the Master Trust.

Domestic Registered Plans

For the Domestic Registered Plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Funds, as amended during 2010. The investment return objective is to achieve a total annualized rate of return that exceeds by a minimum of 1.0% before investment fees on average over the long term (i.e. 10 years) the total annualized return that could have been earned by passively managing the Liability Benchmark. The Liability Benchmark, which is referenced to widely used Canadian fixed income performance benchmarks (DEX), is composed of a mix of the DEX Universe Provincial Bond Index, DEX Long Term Provincial Bond Index and DEX Real Return Bond Index that closely matches the characteristics of the pension liabilities.

In addition to the broad asset allocation, as summarized in the asset allocation section above, the following policies apply to individual asset classes:

- Non-matched assets are mainly equities, and are required to be diversified among industries and economic sectors. Foreign equities can comprise 31% to 37% of the total market value of the Master Trust Fund. Limitations are placed on the overall allocation to any individual security at both cost and market value. Investments in non-publicly traded securities and in non-traditional asset classes are allowed up to 10% of the total market value of the Master Trust Fund.

- Matched assets are mainly Canadian bonds, oriented toward long term investment grade securities rated “BBB” or higher. With the exception of Government of Canada securities or a province thereof, in which the plan may invest the entire fixed income allocation, these investments are required to be diversified among individual securities and sectors.

Derivatives are permitted provided that they are used for hedging a particular risk (including interest rate risk related to pension liabilities) or to create exposures to given markets and currencies and that counterparties have a minimum credit rating of A. As of December 31, 2010, a 15% derivatives exposure to matched assets is in place to hedge interest rate risk related to pension liabilities.

Defined Contribution Plans

The Corporation's management, administrative and certain unionized employees may participate in defined contribution plans. Contributions range from 3% to 6% of annual pay for those employees in Canada and 3% to 7% of annual pay for those participants in the United Kingdom. The Corporation contributes an equal amount. The Corporation's expense for defined contribution plans amounted to $2 for the year ended December 31, 2010 (2009 - $1).

9. OTHER LONG-TERM LIABILITIES

		2010	2009
Unfavourable contract liability on aircraft leases (a)		$ 25	$ 31
Proceeds from contractual commitments (b)		107	107
Aircraft rent in excess of lease payments	Note 2W	32	41
Long-term employee liabilities (c)		25	33
Workplace safety and insurance board liabilities		42	40
Deferred gains on aircraft sale leasebacks		62	69
Collateral held in leasing arrangements and other deposits		46	33
Other (d)		143	101
		$ 482	**$ 455**

(a) The unfavourable contract liability on aircraft leases represents the net present value of lease payments in excess of estimated market rents related to lease arrangements that existed on fresh start reporting.

(b) Proceeds from contractual commitments represent non-refundable proceeds received, net of related costs and deposits, in consideration of various contractual commitments and will be recognized as reductions in the cost of those contractual commitments when incurred.

(c) The following table outlines the changes to labour related provisions which are included in long-term employee liabilities:

	2010	2009
Beginning of year	$ 61	$ 54
Interest accretion	2	3
Charges (credits) recorded in wages, salaries and benefits	(2)	30
Amounts disbursed	(21)	(26)
End of year	40	61
Current portion in Accounts payable and accrued liabilities	(15)	(28)
	$ 25	**$ 33**

The Corporation offers certain severance programs to certain employees from time to time. The cost of these programs is recorded within Operating expenses. As a result of a review of the outstanding provisions, it was determined that a portion of the provision amounting to $3 was no longer required and was adjusted in 2010.

(d) "Other" includes asset retirement obligations of the Corporation. Under the terms of their respective land leases, each Fuel Facility Corporation has an obligation to restore the land to vacant condition at the end of the lease and to rectify any environmental damage for which it is responsible. If it were found that the Fuel Facility Corporations had to contribute to any remediation costs, each contracting airline would share pro rata, based on system usage, in the costs. For all asset retirement obligations including all Fuel Facility Corporations in Canada in which the Corporation participates, the Corporation has recorded an obligation of $10 ($40 undiscounted) (2009 - $9 ($40 undiscounted)) representing the present value of the estimated decommissioning and remediation obligations at the end of the lease using an 8% (2009 - 8%) discount rate, with lease term expiry dates ranging from 2032 to 2039. This estimate is based on numerous assumptions including the overall cost of decommissioning and remediation and the selection of alternative decommissioning and remediation approaches.

10. STOCK-BASED COMPENSATION

Air Canada Long-Term Incentive Plan

Certain of the Corporation's employees participate in the Air Canada Long-term Incentive Plan (the "Long-term Incentive Plan"). The Long-term Incentive Plan provides for the grant of options and performance share units to senior management and officers of Air Canada. 19,470,294 shares are authorized for issuance under the Long-term Incentive Plan in respect of either of stock options or performance share units.

The options to purchase shares granted under the Long-term Incentive Plan have a maximum term of 10 years and an exercise price based on the fair market value of the shares at the time of the grant of the options. Fifty percent of all options vest over four years. The remaining options will vest based upon performance conditions. The performance vesting conditions are based on operating margin (operating income over operating revenues) and net income targets established by the Air Canada Board over the same time period. The terms of the Long-term Incentive Plan specify that upon the retirement of the employee, options granted may be exercised as the rights to exercise accrue within three years from the retirement date.

The number of Air Canada stock options granted to employees, the related compensation expense recorded and the assumptions used to determine stock-based compensation expense, using the Black-Scholes option valuation model are as follows:

	2010	2009
Compensation expense ($ millions)	$ 1	$ 2
Number of stock options granted to Air Canada employees	50,000	2,330,000
Weighted average fair value per option granted ($)	$ 1.06	$ 1.06
Aggregated fair value of options granted ($ millions)	$ -	$ 2
Weighted average assumptions:		
Risk-free interest rate	2.55 - 3.23 %	1.73 - 3.14 %
Expected volatility	80.0 - 83.6 %	83.0 - 84.7 %
Dividend yield	0 %	0 %
Expected option life (years)	4.50	4.50

A summary of the Long-term Incentive Plan option activity is as follows:

	2010		2009	
	Options	Weighted Average Exercise Price/Share	Options	Weighted Average Exercise Price/Share
Beginning of year	3,963,474	$ 8.66	1,701,447	$ 19.14
Granted	50,000	1.85	2,330,000	1.32
Exercised	(5,625)	1.59	-	-
Forfeited	(719,918)	19.63	(67,973)	19.44
Outstanding options, end of year	**3,287,931**	**$ 6.17**	**3,963,474**	**$ 8.66**
Options exercisable, end of year	**1,038,986**	**$ 14.42**	**551,544**	**$ 19.60**

Range of Exercise Prices	Expiry Dates	2010 Outstanding Options			2010 Exercisable Options	
		Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$ 21.00	2013	566,457	3	$ 21.00	566,457	$ 21.00
$ 11.08 - $ 18.60	2014	345,474	4	14.89	180,404	14.89
$ 8.51	2015	11,000	5	8.51	2,750	8.51
$ 0.97 - $ 1.59	2016	2,315,000	6	1.32	289,375	1.32
$ 1.78 - $ 1.91	2017	50,000	7	1.85	-	-
		3,287,931		**$ 6.17**	**1,038,986**	**$ 14.42**

Range of Exercise Prices	Expiry Dates	2009 Outstanding Options			2009 Exercisable Options	
		Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$ 21.00	2013	1,146,400	4	$ 21.00	429,900	$ 21.00
$ 11.08 - $ 18.60	2014	481,074	5	14.73	120,269	14.73
$ 8.51	2015	11,000	6	8.51	1,375	8.51
$ 0.97 - $ 1.59	2016	2,325,000	7	1.32	-	-
		3,963,474		**$ 8.66**	**551,544**	**$ 19.60**

Performance Share Units

The Long-term Incentive Plan also includes performance share units ("PSUs"). The vesting term of PSUs is three years and generally incorporates performance vesting features based upon achievement of earnings targets established over the vesting period. Subject to vesting and other conditions, each PSU entitles the employee to receive a payment in the form of one common share, cash in the amount equal to market value of one common share, or a combination thereof, at the discretion of the Board of Directors. The terms of the plan specify that upon the retirement of an employee, the number of PSUs that vest are prorated based on the total number of completed months of active service during the PSU vesting term. Certain PSUs granted may only be redeemed for Air Canada shares purchased on the secondary market and/or equivalent cash at the discretion of the Board of Directors. The remaining PSUs may be redeemed for Air Canada shares issued from treasury or purchased on the secondary market and/or equivalent cash at the discretion of the Board of Directors.

The compensation expense related to PSUs in 2010 was $4 (2009 was less than $1).

A summary of the Long-term Incentive Plan performance share unit activity is as follows:

	2010	2009
Beginning of year	1,653,064	1,671,068
Granted	2,532,337	11,591
Forfeited	(595,952)	(29,595)
Outstanding PSUs, end of year (1)	**3,589,449**	**1,653,064**

(1) As at December 31, 2010, all PSUs remain non-vested. Included in the total number of PSUs outstanding, 3,586,949 PSUs will entitle the employee to receive, at the discretion of the Board of Directors, Air Canada shares purchased on the secondary market and/or equivalent cash (2009 – 1,091,218). As at December 31, 2010, the liability related to these PSUs is $5.

Refer to Note 15 for a description of derivative instruments used by the Corporation to hedge the cash flow exposure to the PSUs granted.

Employee Share Purchase Plans

Eligible employees can participate in the employee share purchase plan under which employees can invest up to 6% of their base salary for the purchase of shares on the secondary market. Air Canada will match 33.3% of the investments made by the employee. During 2010, the Corporation recorded compensation expense of less than $1 (2009 – less than $1).

11. SHAREHOLDERS' EQUITY

The issued and outstanding common shares of Air Canada, along with the potential common shares, were as follows:

As at December 31		2010	2009
Issued and outstanding			
Class A variable voting shares		64,275,209	56,586,112
Class B voting shares		214,697,175	221,560,947
Total issued and outstanding		**278,972,384**	**278,147,059**
Potential common shares			
Warrants (refer to note below)		89,430,300	90,250,000
Stock options	Note 10	3,287,931	3,963,474
Performance share units	Note 10	2,500	561,846
Total potential common shares		**92,720,731**	**94,775,320**

The changes during 2010 in the number of issued and outstanding shares and their recorded value, net of issue costs, were as follows:

For the year ended December 31, 2010	Number of shares	Value
Issued, beginning of year	278,147,059	$ 532
Shares issued on the exercise of stock options	5,625	-
Shares issued on the exercise of warrants	819,700	2
Issued, end of year	**278,972,384**	**$ 534**

Common Shares

As at December 31, 2010, the common shares issuable by Air Canada consist of an unlimited number of Class A Variable Voting Shares ("Variable Voting Shares") and an unlimited number of Class B Voting Shares ("Voting Shares"). The two classes of common shares have equivalent rights as common shareholders except for voting rights. Holders of Variable Voting Shares are entitled to one vote per share unless (i) the number of Variable Voting Shares outstanding, as a percentage of the total number of voting shares of Air Canada exceeds 25% or (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting exceeds 25% of the total number of votes that may be cast at such meeting. If either of the above noted thresholds would otherwise be surpassed at any time, the vote attached to each Variable Voting Share will decrease proportionately such that (i) the Variable Voting Shares as a class do not carry more than 25% of the aggregate votes attached to all issued and outstanding voting shares of Air Canada and (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting do not exceed 25% of the votes that may be cast at such meeting.

Variable Voting Shares may only be held, beneficially owned or controlled, directly or indirectly, by persons who are not Canadians (within the meaning of the Canada Transportation Act). An issued and outstanding Variable Voting Share shall be converted into one Voting Share automatically and without any further act of Air Canada or the holder, if such Variable Voting Share becomes held, beneficially owned and controlled, directly or indirectly, otherwise than by way of security only, by a Canadian, as defined in the *Canada Transportation Act*.

Voting Shares may only be held, beneficially owned and controlled, directly or indirectly, by Canadians. An issued and outstanding Voting Share shall be converted into one Variable Voting Share automatically and without any further act of Air Canada or the holder, if such Voting Share becomes held, beneficially owned or controlled, directly or indirectly, otherwise than by way of security only, by a person who is not a Canadian.

Warrants

A summary of warrants outstanding as at December 31, 2010 is as follows:

Grant date	Number of Warrants Outstanding	Exercise Prices	Expiry Dates	Remaining Life (Years)
30-Jul-09	5,000,000	$ 1.51	30-Jul-13	2.6
19-Oct-09	5,000,000	$ 1.44	19-Oct-13	2.8
27-Oct-09	79,430,300	$ 2.20	27-Oct-12	1.8
	89,430,300			

During 2009, a total of 90,250,000 warrants were issued, of which 10,000,000 were issued in conjunction with the Credit Facility as described in Note 6(e) and 80,250,000 were issued in conjunction with the Share and Warrant Public Offering as described below. During 2010, a total of 819,700 warrants were exercised for cash consideration of $2.

Share and Warrant Public Offering

On October 27, 2009 Air Canada completed a bought deal public offering pursuant to which it sold to an underwriting syndicate 160,500,000 units (the "Units") of Air Canada at a price of $1.62 per Unit for aggregate gross proceeds to Air Canada of $260 (net proceeds of $249 after expenses and underwriter fees).

Each Unit is comprised of one Class A variable voting share (the "Variable Voting Shares") or one Class B voting share (the "Voting Shares", and, together with the Variable Voting Shares, the "Shares") of Air Canada, and one half of one share purchase warrant. Each whole share purchase warrant is defined as a "Warrant". Each Warrant will entitle the holder thereof to acquire one Variable Voting Share or one Voting Share (each, a "Warrant Share") at an exercise price of $2.20 per Warrant Share, at any time prior to 36 months following October 27, 2009. In the event that, prior to the time of expiry of the Warrants, the 20-day volume weighted average trading price of the Variable Voting Shares on the Toronto Stock Exchange ("TSX") is equal to or greater than $4.00 or the 20-day volume weighted average trading price of the Voting Shares on the TSX is equal to or greater than $4.00 (each, an "Acceleration Event"), Air Canada shall have the right, at its option, within 10 business days after the Acceleration Event, to accelerate the time of expiry of the Warrants.

The recorded values related to the Shares and Warrants were split based on their relative fair values. The value ascribed to Share capital was $230 and the value ascribed to Contributed surplus related to the Warrants was $19.

12. EARNINGS PER SHARE

The following table outlines the calculation of basic and diluted earnings per share:

(in millions, except per share amounts)	2010	2009
Numerator:		
Numerator for basic and diluted earnings per share:		
Net income (loss)	$ 107	$ (24)
Denominator:		
Weighted-average shares	278	132
Effect of potential dilutive securities:		
Contingently issuable shares	-	5
Warrants	13	-
Stock options	1	-
Performance share units	-	-
	14	5
Add back anti-dilutive impact	-	(5)
Adjusted denominator for diluted earnings per share	292	132
Basic earnings (loss) per share	**$ 0.38**	**$ (0.18)**
Diluted earnings (loss) per share	**$ 0.37**	**$ (0.18)**

The calculation of earnings per share is based on whole dollars and not on rounded millions.
As a result, the above amounts may not be recalculated to the per share amount disclosed above.

The dilutive effect of outstanding stock options on earnings per share is based on the application of the treasury stock method. Under this method, the proceeds from the exercise of such securities are assumed to be used to purchase Class B Voting Shares. Contingently issuable shares relate to the dilutive impact of the shares issued under the Pension MOUs, as described in Note 8, from the date of the agreement in July 2009 to the date of their issuance on October 26, 2009.

Excluded from the 2010 calculation of diluted earnings per share were 2,368,152 (2009 – 3,724,659) outstanding options where the options' exercise prices were greater than the average market price of the common shares for the year. The 2,500 equity settled performance share units outstanding at December 31, 2010 (2009 – 561,846) were also excluded as management determined that the performance vesting criteria will not be met. All outstanding warrants were included in the 2010 calculation of diluted earnings per share. In 2009 there were 90,001,652 warrants excluded from the calculation of diluted earnings per share as the warrants' exercise prices were greater than the average market price of the common shares for the year.

13. SEGMENT INFORMATION

A reconciliation of the total amounts reported by geographic region for Passenger revenue and Cargo revenue on the Consolidated Statement of Operations is as follows:

Passenger revenues	2010	2009
Canada	$ 3,790	$ 3,591
US Transborder	1,797	1,641
Atlantic	1,962	1,721
Pacific	1,087	829
Other	791	717
	$ 9,427	**$ 8,499**

Cargo revenues	2010	2009
Canada	$ 69	$ 63
US Transborder	17	14
Atlantic	164	127
Pacific	164	112
Other	52	42
	$ 466	**$ 358**

Passenger and cargo revenues are based on the actual flown revenue for flights with an origin and destination in a specific country or region. Atlantic refers to flights that cross the Atlantic Ocean with origins and destinations principally in Europe. Pacific refers to flights that cross the Pacific Ocean with origins and destinations principally in Asia. Other passenger and cargo revenues refer to flights with origins and destinations principally in South America, South Pacific, and the Caribbean. Other operating revenues are principally derived from customers located in Canada.

14. COMMITMENTS

Boeing

As at December 31, 2010, the Corporation has outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of 37 Boeing 787 aircraft. The Corporation also has purchase rights for 18 Boeing 777, purchase options for 13 Boeing 787 aircraft and purchase rights for 10 Boeing 787 aircraft. In January 2011, Boeing announced that it had delayed the first delivery of the Boeing 787 aircraft from the first quarter of 2011 to the third quarter 2011. The Corporation's first Boeing 787 aircraft is currently scheduled for delivery in the second half of 2013. The potential impact of Boeing's January 2011 announcement on the Corporation's Boeing 787 aircraft deliveries, if any, has not yet been determined.

For the firm aircraft orders, the Corporation has financing commitments from Boeing and the engine manufacturer covering 31 of the 37 Boeing 787 aircraft. The financing terms for 28 out of the 31 covered aircraft is for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments. For the remaining three out of the 31 covered aircraft, the financing under the commitment covers up to 90% of the capital expenditure and the term to maturity is 15 years with principal payments made on a mortgage style basis resulting in equal instalment payments of principal and interest over the term to maturity.

Capital Commitments

The estimated aggregate cost of the future firm Boeing 787 aircraft deliveries and other capital purchase commitments as at December 31, 2010 approximates $4,504 (of which $2,962 is subject to committed financing, subject to the fulfillment of certain terms and conditions). US dollar amounts are converted using the December 31, 2010 noon day rate of CDN$0.9946. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day US LIBOR rate at December 31, 2010. Other capital purchase commitments relate principally to building and leasehold improvement projects.

	2011	2012	2013	2014	2015	Thereafter	Total
Capital Commitments	$ 86	$ 112	$ 700	$ 932	$ 624	$ 2,050	$ 4,504

Operating Lease Commitments

As at December 31, 2010 the future minimum lease payments under existing operating leases of aircraft and other property amount to $2,217 using year end exchange rates.

	2011	2012	2013	2014	2015	Thereafter	Total
Aircraft	$ 335	$ 316	$ 295	$ 230	$ 178	$ 554	$ 1,908
Other property	47	39	38	36	32	117	309
Total	**$ 382**	**$ 355**	**$ 333**	**$ 266**	**$ 210**	**$ 671**	**$ 2,217**

The above minimum lease payments include residual value guarantees, except for those for which the Corporation has obtained residual value support.

The Corporation subleases certain aircraft to Jazz on a flow-through basis, which are reported net on the statement of operations. These subleases relate to 25 Bombardier CRJ-200 aircraft and 15 Bombardier CRJ-705 aircraft. The operating lease commitments under these aircraft, which are recovered from Jazz, are not included in the aircraft operating lease commitments table above but are summarized as follows:

	2011	2012	2013	2014	2015	Thereafter	Total
Jazz flow-through leases	$ 76	$ 76	$ 76	$ 76	$ 74	$ 449	$ 827

The subleases with Jazz have the same terms and maturity as the Corporation's corresponding lease commitments to the lessors.

The future minimum non-cancellable commitment for the next 12 months under the Jazz CPA is approximately $749 (2009 - $732) and under the capacity purchase agreements with other regional carriers is $29 (2009 - $29). Based upon amended terms as described in Note 2D, the Jazz CPA expires December 31, 2020. The rates under the Jazz CPA are subject to change based upon, amongst other things, changes in Jazz's costs and the results of benchmarking exercises, which compare Jazz costs to other regional carriers, one of which is currently underway. The results of this benchmarking will be implemented with retroactive effect to January 1, 2010.

Maturity Analysis

Principal and interest repayment requirements as at December 31, 2010 on Long-term debt and capital lease obligations are as follows:

Principal	2011	2012	2013	2014	2015	Thereafter	Total
Long-term debt obligations	$ 514	$ 293	$ 363	$ 200	$ 1,103	$ 1,307	$ 3,780
Capital lease obligations	96	105	94	90	144	226	755
	$ 610	**$ 398**	**$ 457**	**$ 290**	**$ 1,247**	**$ 1,533**	**$ 4,535**

Interest	2011	2012	2013	2014	2015	Thereafter	Total
Long-term debt obligations	$ 218	$ 199	$ 186	$ 171	$ 126	$ 103	$ 1,003
Capital lease obligations	68	59	49	39	29	85	329
	$ 286	**$ 258**	**$ 235**	**$ 210**	**$ 155**	**$ 188**	**$ 1,332**

Principal repayments in the table above exclude transaction costs and discounts of $78 which are offset against Long-term debt and capital leases in the Consolidated Statement of Financial Position.

The following is a maturity analysis, based on contractual undiscounted cash flows, for selected financial liabilities. The analysis includes both the principal and interest component of the payment obligations on long-term debt and is based on interest rates and the applicable foreign exchange rate effective as at December 31, 2010 and does not include the impact of the loan facility with GE Japan as described in Note 6. If drawn upon, this loan facility will reduce the net cash flows by the amount of the related debt maturities refinanced in 2011 and 2012 of $125 and $43, respectively, offset by the principal and interest repayments under the loan facility.

	2011	2012	2013	2014	2015	Thereafter	Total
Long-term debt obligations	$ 732	$ 492	$ 549	$ 371	$ 1,229	$ 1,410	$ 4,783
Capital lease obligations	164	164	143	129	173	311	1,084
Accounts payable and accrued liabilities	1,182	-	-	-	-	-	1,182
	$ 2,078	**$ 656**	**$ 692**	**$ 500**	**$ 1,402**	**$ 1,721**	**$ 7,049**

Minimum Committed Purchase of Aeroplan Miles

The CPSA between the Corporation and Aeroplan outlines a requirement for the Corporation to purchase a minimum number of Aeroplan Miles® from Aeroplan. The estimated minimum requirement for 2011 is $216. The annual commitment is based on 85% of the average total Aeroplan Miles® actually issued in respect of Air Canada flights or Air Canada airline affiliate products and services in the three preceding calendar years. During 2010, the Corporation purchased $262 from Aeroplan.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Financial Instruments

	Carrying Amounts					
	December 31, 2010					December 31, 2009
	Financial instruments classification					
	Held for trading	Held to maturity	Loans and receivables	Liabilities at amortized cost	Total	
Financial Assets						
Cash and cash equivalents	$ 1,090	$ -	$ -	$ -	$ 1,090	$ 1,115
Short-term investments	1,102	-	-	-	1,102	292
Restricted cash	80	-	-	-	80	78
Accounts receivable	-	-	641	-	641	701
Collateral deposits for fuel derivatives	-	-	-	-	-	43
Deposits and other assets						
Restricted cash	130	-	-	-	130	121
Asset backed commercial paper	29	-	-	-	29	29
Aircraft related and other deposits	-	185	-	-	185	256
Derivative instruments						
Fuel derivatives	33	-	-	-	33	-
Share forward contracts	9	-	-	-	9	-
Interest rate swaps	13	-	-	-	13	11
	$ 2,486	**$ 185**	**$ 641**	**$ -**	**$ 3,312**	**$ 2,646**
Financial Liabilities						
Accounts payable	$ -	$ -	$ -	$ 1,179	$ 1,179	$ 1,215
Current portion of long-term debt and capital leases	-	-	-	505	505	468
Long-term debt and capital leases	-	-	-	3,952	3,952	4,054
Derivative instruments						
Fuel derivatives	-	-	-	-	-	31
Foreign exchange derivatives	3	-	-	-	3	4
	$ 3	**$ -**	**$ -**	**$ 5,636**	**$ 5,639**	**$ 5,772**

There have been no changes in classification of financial instruments since December 31, 2009.

For cash flow purposes, the Corporation may settle, from time to time, certain short-term investments prior to their original maturity. For this reason, these financial instruments do not meet the criteria of held to maturity and are therefore designated as held for trading. They are recorded at fair value with changes in fair value recorded in Interest income.

Collateral Held in Leasing Arrangements

The Corporation holds security deposits with a carrying value of $11 (2009 - $10), which approximates fair value, as security for certain aircraft leased and sub-leased to third parties. These deposits do not pay interest to the lessee or sub-lessee. Of these deposits, $7 (2009 - $7) have been assigned as collateral to secure the Corporation's obligations to the lessors and financiers of the aircraft, with the remaining cash held by Air Canada being unrestricted during the term of the lease. Any collateral held by the Corporation is returned to the lessee or sub-lessee, as the case may be, at the end of the lease or sub-lease term provided there have been no events of default under the leases or sub-leases.

Summary of Gain on Financial Instruments Recorded at Fair Value

	2010	2009
Fuel derivatives not under hedge accounting	(11)	102
Other	8	(7)
Gain (loss) on financial instruments recorded at fair value (1)	**$ (3)**	**$ 95**

(1) See Fuel Price Risk for a discussion of losses on fuel derivatives recorded in Other comprehensive income ("OCI").

Risk Management

Under its risk management policy, the Corporation manages its interest rate risk, foreign exchange risk, share-based compensation risk and market risk through the use of various interest rate, foreign exchange, fuel and other derivative financial instruments. The Corporation uses derivative financial instruments only for risk management purposes, not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be offset by changes in cash flows related to the risk being hedged.

As noted below, the Corporation engages in derivative hedging to mitigate various risks. The derivative fair values represent the amount of the consideration that could be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. Fair value of these derivatives is determined using active markets, where available. When no such market is available, valuation techniques are applied such as discounted cash flow analysis. Where practical, the valuation technique incorporates all factors that would be considered in setting a price, including the Corporation's own credit risk and the credit risk of the counterparty.

Interest Rate Risk

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

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

The ratio of fixed to floating rate obligations outstanding is designed to maintain flexibility in the Corporation's capital structure and is based upon a long term objective of 60% fixed and 40% floating but allows flexibility in the short-term to adjust to prevailing market conditions. The ratio at December 31, 2010 is 69% fixed and 31% floating, including the effects of interest rate swap positions (59% and 41%, respectively as at December 31, 2009).

The following are the current derivatives employed in interest rate risk management activities and the adjustments recorded during 2010:

- During 2010, the interest rate swap agreement relating to the Credit Facility as described in Note 6(e) was terminated. The fair value of this contract at termination was nil ($1 in favour of the counterparty at December 31, 2009). During 2010, a gain of $1 (2009 – loss of $1) was recorded in Gain on financial instruments recorded at fair value related to this derivative.

- As at December 31, 2010, the Corporation had two interest rate swap agreements in place with terms to July 2022 and January 2024 relating to two B767 aircraft financing agreements with an aggregate notional value of $80 (US$80) (2009 - $92 (US$88)). These swaps convert the lease payments on the two aircraft leases from fixed to floating rates. The fair value of these contracts as at December 31, 2010 was $13 in favour of the Corporation (2009 - $12 in favour of the Corporation). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2010, a gain of $6 was recorded in Gain on financial instruments recorded at fair value related to these derivatives (2009 - $9 loss).

Interest income includes $15 (2009 - $10) related to Cash and cash equivalents, Short-term investments, and Collateral deposits for fuel derivatives, which are classified as held for trading. Interest expense reflected on the Consolidated Statement of Operations relates to financial liabilities recorded at amortized cost.

Foreign Exchange Risk

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

The Corporation's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

The Corporation's cash inflows are primarily in Canadian dollars, while a large portion of its outflows are in US dollars. This unbalanced mix results in an annual US dollar shortfall from operations. In order to mitigate this imbalance, the Corporation has adopted the practice of converting excess revenues from offshore currencies into US dollars. In 2010, this conversion generated coverage of approximately 32% of the imbalance. The remaining 68% was covered through the use of a variety of foreign exchange derivatives, including spot transactions and US dollar investments, which had maturity dates corresponding to the forecasted shortfall dates. The level of foreign exchange derivatives expiring at any one point in time is dependent upon a number of factors, which include the amount of foreign revenue conversion available, US dollar net cash flows, as well as the amount attributed to aircraft and debt payments.

The following are the current derivatives employed in foreign exchange risk management activities and the adjustments recorded during 2010:

- As at December 31, 2010, the Corporation had outstanding foreign currency option agreements to purchase US dollars against Canadian dollars on $223 (US$224) and Euro dollars against Canadian dollars on $15(EUR 11) which mature in 2011 (2009 - $99 (US$95)). The fair value of these foreign currency contracts as at December 31, 2010 was $3 in favour of the counterparties (2009 - $4 in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2010, a gain of $2 was recorded in Foreign exchange gain (loss) related to these derivatives (2009 - $7 loss).

Stock-based Compensation Risk

The Corporation issues stock-based compensation to its employees in the form of stock options and PSUs as described in Note 10. Each PSU entitles the employees to receive a payment in the form of one Air Canada common share, cash in the amount equal to market value of one common share, or a combination thereof, at the discretion of the Board of Directors.

Stock-based compensation risk refers to the risk that future cash flows to settle the PSUs will fluctuate because of changes in the Corporation's share price. To hedge the exposure to the PSU plan, the Corporation entered into share forward contracts during 2010 to hedge 75% of the PSUs that may vest in 2011 and 2012, subject to the performance vesting criteria. The contracts were prepaid by the Corporation for $5, representing the initial price of $1.785 per share for 2,700,000 Air

Canada common shares. The forward dates for the share forward contracts coincide with the vesting term of 825,000 PSUs in 2011 and 1,875,000 PSUs in 2012 and will be cash settled. These contracts were not designated as hedging instruments for accounting purposes. Accordingly, changes in the fair value of these contracts are recorded in Gain (loss) on financial instruments recorded at fair value in the period in which they arise. During 2010, a gain of $4 was recorded. As at December 31, 2010, the fair value of the share forward contracts is $9 in favour of Air Canada and is recorded in Deposits and other assets.

Liquidity Risk

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 well as those assets being 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 unrestricted cash balance in excess of a target liquidity level of 15% of annual operating revenues. At December 31, 2010, Air Canada had Cash and cash equivalents and Short-term investments of $2,192, which represents 20% of 2010 operating revenues.

A maturity analysis of the Corporation's financial liabilities, other fixed operating commitments and capital commitments is set out in Note 14.

Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: foreign exchange risk; interest rate risk; and other price risk, which includes commodity price risk.

Refer to the Asset Backed Commercial Paper section below for information regarding these instruments held by the Corporation and the associated market risks.

Sensitivity Analysis

The following table is a sensitivity analysis for each type of market risk relevant to the significant financial instruments recorded by the Corporation as at December 31, 2010. The sensitivity analysis is based on a reasonably possible movement in the relevant risk factor. These assumptions may not be representative of actual movements in these risks and should not be relied upon. Given the recent volatility in the financial and commodity markets, the actual percentage changes may differ significantly from the percentage changes outlined below. Each risk is contemplated independent of other risks.

	Interest rate risk (1)	Foreign exchange rate risk (2)		Other price risk (3)	
	Income	Income		Income	
	1% increase	5% increase	5% decrease	10% increase	10% decrease
Cash and cash equivalents	$ 11	$ (13)	$ 13	$ -	$ -
Short-term investments	$ 11	$ (6)	$ 6	$ -	$ -
Aircraft related deposits	$ -	$ (5)	$ 5	$ -	$ -
Long-term debt and capital leases	$ (13)	$ 207	$ (207)	$ -	$ -
Fuel derivatives	$ -	$ -	$ -	$ 35	$ (22)
Foreign exchange derivatives	$ -	$ (19)	$ 8	$ -	$ -

(1) Due to currently low market rates of interest, a 1% decrease in interest rates was not considered a reasonable scenario within the forecast period, being one year.

(2) Increase (decrease) in foreign exchange relates to a strengthening (weakening) of the Canadian dollar.

(3) Other price risk relates to the Corporation's fuel derivatives. The sensitivity analysis is based upon a 10% increase or decrease in the price of the underlying commodity.

Covenants in Credit Card Agreements

The Corporation has various agreements with companies that process customer credit card transactions. Approximately 85% of the Corporation's sales are processed using credit cards, with remaining sales processed through cash based transactions. The Corporation receives payment for a credit card sale generally in advance of when the passenger transportation is provided.

The Corporation's principal credit card processing agreements for card processing services requirements in North America are scheduled to terminate at the end of May 2011. The Corporation's obligation to provide a deposit to the credit card processor under these agreements, as well as the amount of such deposit, are determined pursuant to a matrix measuring, on a quarterly basis, both a fixed charge coverage ratio for the Corporation and the unrestricted cash of the Corporation. The Corporation also has agreements with this processor for the provision of certain credit card processing services requirements for markets other than North America and for its cargo operations worldwide and such agreements contain deposit obligations similar to the obligations set forth above.

The Corporation has accepted a proposal from a new service provider for the provision of its principal credit card processing services requirements in North America for Visa and MasterCard for a five year term beginning at the expiry of the current agreements being replaced. The Corporation and the credit card processor have agreed to triggering events upon which the Corporation would be required to provide the credit card processor with deposits. The obligation to provide, and the amount of, deposits required would be based upon a matrix measuring, on a quarterly basis, both a fixed charge coverage ratio and unrestricted cash of the Corporation. The agreement between the Corporation and the credit card processor is subject to certain conditions, including conclusion of formal documentation.

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. As at December 31, 2010, the Corporation's credit risk exposure consists mainly of the carrying amounts of Cash and cash equivalents, Short-term investments and Accounts receivable. Cash and cash equivalents and Short-term investments are in place with major financial institutions, the Canadian government, and major corporations. Accounts receivable are generally the result of sales of tickets to individuals, often through the use of major credit cards, through geographically dispersed travel agents, corporate outlets, or other airlines. Credit rating guidelines are used in determining counterparties for fuel hedging. In order to manage its exposure to credit risk and assess credit quality, the Corporation reviews counterparty credit ratings on a regular basis and sets credit limits when deemed necessary.

Refer to the Asset Backed Commercial Paper section below for further credit risk information.

Fuel Price Risk

Fuel price risk is the risk that future cash flows arising from jet fuel purchases will fluctuate because of changes in jet fuel prices. In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, the Corporation enters into derivative contracts with financial intermediaries. The Corporation uses derivative contracts based on jet fuel, heating oil and crude oil. Heating oil and crude oil commodities are used due to the relative limited liquidity of jet fuel derivative instruments on a medium to long-term horizon since jet fuel is not traded on an organized futures exchange. The Corporation's policy permits hedging of up to 75% of the projected jet fuel purchases for the next 12 months, 50% for the next 13 to 24 months and 25% for the next 25 to 36 months. These are maximum (but not mandated) limits. There is no minimum monthly hedging requirement. There are regular reviews to adjust the strategy in light of market conditions. The Corporation does not purchase or hold any derivative financial instrument for speculative purposes.

During 2010:

- The Corporation recorded a loss of $11 in Gain (loss) on financial instruments recorded at fair value related to fuel derivatives ($102 gain in 2009).
- The Corporation purchased crude-oil call options and collars covering 2010 and 2011 fuel exposure. The cash premium related to these contracts was $43.
- Fuel derivative contracts cash settled with a net fair value of $27 in favour of the counterparties ($88 in favour of the counterparties in 2009).

As of December 31, 2010, approximately 20% of the Corporation's anticipated purchases of jet fuel for 2011 are hedged at an average West Texas Intermediate ("WTI") capped price of US$92 per barrel. The Corporation's contracts to hedge anticipated jet fuel purchases over the 2011 period are comprised of crude-oil based contracts. The fair value of the fuel derivatives portfolio at December 31, 2010 is $33 in favor of the Corporation ($31 in favour of the counterparties in 2009). The Corporation had no outstanding collateral deposits with its counterparties at December 31, 2010 ($43 in 2009).

The following table outlines the notional volumes per barrel along with the WTI weighted average floor and capped price for each year currently hedged by type of derivative instruments as at December 31, 2010.

Derivative Instruments	Term	Volume (bbls)	WTI Weighted Average Floor Price (US$/bbl)	WTI Weighted Average Capped Price (US$/bbl)
Call options	2011	4,400,000	$ n/a	$ 92
Collars	2011	705,000	$ 80	$ 92

The Corporation is expected to generate fuel hedging gains if oil prices increase above the average capped price and is exposed to fuel hedging losses if prices decrease below the average floor price. The types of derivative instruments used by the Corporation within its hedging program, such as put options within collar structures, expose the Corporation to the potential of providing collateral deposits to its counterparties. When fuel prices decrease causing the Corporation's derivative position to be in a liability position below the set credit thresholds with counterparties, the Corporation is responsible for extending collateral to the counterparties.

From time to time, the Corporation may choose to adjust or restructure its hedging portfolio in light of market conditions. In 2010, the Corporation modified its fuel hedge portfolio with the termination of swap and collar contracts for $5, in favour of the counterparty. The collateral held by the counterparty was in excess of the settlement amount, and such excess was returned, resulting in a cash inflow for the Corporation. During 2009, the Corporation modified its fuel hedge portfolio with the termination of swap and put contracts for $192, in favour of the counterparties.

The Corporation discontinued applying hedge accounting effective the third quarter of 2009. Amounts that were deferred to Accumulated Other Comprehensive Loss ("AOCL") for derivatives previously designated under hedge accounting were taken into fuel expense in the period when the previously forecasted hedge transaction occurred. During 2010, $183 was reclassified from AOCL to Aircraft fuel expense ($419 in 2009). As at December 31, 2010, there are no amounts remaining in AOCL.

The following information summarizes the financial statement impact of fuel derivatives:

		2010	2009
Consolidated Statement of Operations			
Operating expenses			
Aircraft fuel	Realized effective loss on derivatives designated under hedge accounting	$ (183)	$ (419)
Non-operating income (expense)			
Gain (loss) on financial instruments recorded at fair value	Fair market value gain (loss) on economic hedges	$ (11)	$ 102
Consolidated Other Comprehensive Income (Loss)			
	Effective loss on derivatives designated under hedge accounting	n/a	$ (1)
	Reclassification of net realized loss on fuel derivatives designated under hedge accounting to Aircraft fuel expense	$ 183	$ 419
	Tax on reclassification	$ 1	$ 4

		2010	2009
Consolidated Statement of Financial Position			
Prepaid expenses and other current assets	Collateral deposits for fuel derivatives	$ -	$ 43
	Fair market value of fuel derivatives	$ 33	$ -
Accounts payable and accrued liabilities	Fair market value of fuel derivatives	$ -	$ (31)
Shareholders' equity (AOCL)	Net loss from fuel derivatives designated under hedge accounting (net of tax of 2010 - $nil and 2009 - $1)	$ -	$ (184)

Financial Instrument Fair Values in the Consolidated Statement of Financial Position

The carrying amounts reported in the Consolidated Statement of Financial Position for short term financial assets and liabilities, which includes Accounts receivable and Accounts payable, approximate fair values due to the immediate or short-term maturities of these financial instruments. Cash equivalents and Short-term investments are classified as held for trading and therefore are recorded at fair value.

The carrying amounts of interest rate swaps, share forward contracts, foreign exchange, and fuel derivatives are equal to fair value, which is based on the amount at which they could be settled based on estimated current market rates.

Management estimated the fair value of its long-term debt based on valuation techniques taking into account market rates of interest, the condition of any related collateral, the current conditions in credit markets and the current estimated credit margins applicable to the Corporation based on recent transactions. The estimated fair value of debt is approximately $4,400 as compared to its carrying value of $4,457.

Following is a classification of fair value measurements recognized in the Consolidated Statement of Financial Position using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

		Fair value measurements at reporting date using:		
	December 31 2010	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Assets				
Held-for-trading securities				
Cash equivalents	$ 497	$ -	$ 497	$ -
Short-term investments	1,102	-	1,102	-
Deposits and other assets				
Asset backed commercial paper	29	-	-	29
Derivative instruments				
Fuel deriatives	33	-	33	-
Share forward contracts	9	-	9	-
Interest rate swaps	13	-	13	-
Total	**$ 1,683**	**$ -**	**$ 1,654**	**$ 29**

		Fair value measurements at reporting date using:		
	December 31 2010	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Liabilities				
Derivative instruments				
Foreign exchange derivatives	$ 3	$ -	$ 3	$ -
Total	**$ 3**	**$ -**	**$ 3**	**$ -**

Financial assets held by financial institutions in the form of cash and restricted cash have been excluded from the fair value measurement classification table above as they are not valued using a valuation technique.

Asset Backed Commercial Paper ("ABCP")

The Corporation has $37 ($29 net of a fair value adjustment) in non-bank sponsored ABCP which has been recorded in Deposits and other assets. There is a limited private market to sell certain of these investments however management does not believe that this market qualifies as an active market and therefore has estimated the fair value of these investments using valuation techniques. The carrying value as at December 31, 2010 is based on a number of assumptions as to the fair value of the investments including factors such as estimated cash flow scenarios and risk adjusted discount rates. The assumptions used in estimating the fair value of the investments are subject to change, which may result in further adjustments to non-operating results in the future. No adjustments to the carrying value were recorded during 2010.

16. CAPITAL DISCLOSURES

The Corporation views capital as the sum of Long-term debt and capital leases, Non-controlling interest, capitalized operating leases, and Shareholders' equity. The Company includes capitalized operating leases, which is a measure commonly used in the industry ascribing a value to obligations under operating leases. The value is based on annualized aircraft rent expense multiplied by 7.5, which is a factor commonly used in the airline industry. The measure used may not necessarily reflect the fair value or net present value related to the future minimum lease payments as the measure is not based on the remaining contractual payments and the factor may not recognize discount rates implicit in the actual leases or current rates for similar obligations with similar terms and risks. This definition of capital is used by management and may not be comparable to measures presented by other public companies.

The Corporation also monitors its ratio of adjusted net debt to net debt plus shareholders' equity. Adjusted net debt is calculated as the sum of Long-term debt and capital lease obligations, Non-controlling interest, capitalized operating leases, and Shareholders' equity less Cash and cash equivalents and Short-term investments.

The Corporation's main objectives when managing capital are:

- to structure repayment obligations in line with the expected life of the Corporation's principal revenue generating assets;
- to ensure the Corporation has access to capital to fund contractual obligations as they become due and to ensure adequate cash levels to withstand deteriorating economic conditions;
- to maintain an appropriate balance between debt supplied capital versus investor supplied capital as measured by the adjusted net debt to net debt plus equity ratio; and
- to monitor the Corporation's credit ratings to facilitate access to capital markets at competitive interest rates.

In order to maintain or adjust the capital structure, the Corporation may adjust the type of capital utilized, including purchase versus lease decisions, defer or cancel aircraft expenditures by not exercising available options or selling current aircraft options, and issuing debt or equity securities, all subject to market conditions and the terms of the underlying agreements.

The total capital as at December 31 is calculated as follows:

	2010	2009
Long-term debt and capital leases	$ 3,952	$ 4,054
Current portion of long-term debt and capital leases	505	468
	4,457	4,522
Non-controlling interest	169	201
Capitalized operating leases	2,595	2,513
Adjusted debt and non-controlling interest	7,221	7,236
Shareholders' equity	1,740	1,446
Total Capital	**$ 8,961**	**$ 8,682**
Adjusted debt and non-controlling interest	**$ 7,221**	**$ 7,236**
Less Cash and cash equivalents and Short-term investments	(2,192)	(1,407)
Adjusted net debt and non-controlling interest	**$ 5,029**	**$ 5,829**
Adjusted net debt to adjusted net debt plus shareholders' equity ratio	**74.3%**	**80.1%**

The adjusted net debt and non-controlling interest amount has decreased by $800 in 2010 largely attributable to cash flow from operations.

17. CONTINGENCIES, GUARANTEES AND INDEMNITIES

Contingencies

Investigations by Competition Authorities Relating to Cargo

The European Commission, the United States Department of Justice and the Competition Bureau in Canada have investigated or are investigating alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including Air Canada. Competition authorities have sought or requested information from Air Canada as part of their investigations. Air Canada has been cooperating with these investigations, which are likely to lead, or have led, to proceedings against Air Canada and a number of airlines and other cargo operators in certain jurisdictions. Air Canada is named as a defendant in a number of class action lawsuits that have been filed before the United States District Court and in Canada in connection with these allegations. Air Canada has been or may be named as a defendant or may otherwise be implicated in these or other lawsuits or proceedings in connection with these allegations.

During 2008, Air Canada recorded a provision of $125 as a preliminary estimate. This was only an estimate based upon the status of the investigations and proceedings at that time and Air Canada's assessment as to the potential outcome for certain of them. This provision did not address the proceedings and investigations in all jurisdictions, but only where there was sufficient information to do so. On November 9, 2010, Air Canada announced that the European Commission issued a decision finding that 12 air cargo carriers (including groups of related carriers) had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006. Air Canada was among the carriers subject to the decision and a fine of 21 Euros (approximately C$29 at an exchange rate of $1.3970) was imposed on Air Canada. The amount of the fine is covered by the $125 provision taken by Air Canada in 2008. Air Canada is appealing this decision and filed an application for annulment of the decision before the European General Court. In the first quarter of 2011, Air Canada will pay the fine, as required, pending the outcome of the appeal.

As a result of the decision by the European Commission and a further review of proceedings and investigations in other jurisdictions, Air Canada recorded a net reduction to the provision for cargo investigations of $46 in 2010. The revised provision does not address the proceedings and investigations in all jurisdictions, but only where there is sufficient information to do so. Air Canada has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings and investigations. As stated above, Air Canada is appealing the decision issued by the European Commission and, if and as appropriate, based on the outcome of any updates regarding this appeal as well as developments regarding proceedings and investigations in other jurisdictions, may adjust the provision in its results for subsequent periods as required.

Billy Bishop Toronto City Airport

In February 2006, Jazz commenced proceedings before the Ontario Superior Court of Justice against Porter Airlines Inc. ("Porter") and other defendants (collectively the "Porter Defendants") after Jazz became aware that it would be excluded from operating flights from Billy Bishop Toronto City Airport. On October 26, 2007, the Porter Defendants counter-claimed against Jazz and Air Canada alleging various violations of competition law, including that Jazz and Air Canada's commercial relationship contravenes Canadian competition laws, and claiming $850 in damages. On October 16, 2009, Jazz discontinued its suit in the Ontario Superior Court against Porter.

Concurrently with the Ontario Superior Court of Justice proceedings, Jazz commenced judicial review proceedings against the Toronto Port Authority ("TPA") before the Federal Court of Canada relating to Jazz's access to the Billy Bishop Toronto City Airport. The Porter Defendants were granted intervenor and party status in these proceedings. In January of 2008, Porter filed a defence and counterclaim against Jazz and Air Canada making allegations and seeking conclusions similar to those in the Ontario Superior Court counterclaim. In March 2010, Jazz discontinued its proceedings in the Federal Court of Canada against the TPA. On May 14, 2010, Porter filed a discontinuance of its counterclaim before the Federal Court of Canada.

The counterclaim filed by Porter in the Ontario Superior Court of Justice against Jazz and Air Canada was stayed pending the outcome of the mirror counterclaim in the Federal Court but in January 2011 Porter filed proceedings to have the stay lifted to reactivate the counterclaim. Management views Porter's counterclaim as being without merit.

In the first quarter of 2010, Air Canada filed legal proceedings with the Federal Court of Canada seeking to challenge the process announced by the TPA to allocate flight capacity or slots at the TCCA. On July 21, 2010, the Federal Court of Canada dismissed Air Canada's challenge and Air Canada is appealing this decision before the Federal Court of Appeal.

Pay Equity

The Canadian Union of Public Employees ("CUPE"), which represents Air Canada's flight attendants, filed a complaint before the Canadian Human Rights Commission where it alleges gender-based wage discrimination. CUPE claims the predominantly female flight attendant group should be paid the same as the predominantly male pilot and mechanics groups because their work is of equal value. The complaint dates from 1991 but has not been investigated on the merits because of a legal dispute over whether the three groups work in the same "establishment" within the meaning of the Canadian Human Rights Act. On January 26, 2006, the Supreme Court of Canada ruled that they do work in the same "establishment" and sent the case back to the Canadian Human Rights Commission, which may now proceed to assess the merits of CUPE's complaint. On March 16, 2007, the Canadian Human Rights Commission referred the complaint against Air Canada for investigation and an investigation is proceeding. Air Canada considers that any investigation will show that it is complying with the equal pay provisions of the Canadian Human Rights Act, however, management has determined that it is not possible at this time to predict with any degree of certainty the final outcome of the Commission's investigation.

Mandatory Retirement

Air Canada is engaged in a number of proceedings involving challenges to the mandatory retirement provisions of certain of its collective agreements, including the Air Canada-Air Canada Pilots Association collective agreement which incorporate provisions of the pension plan terms and conditions applicable to pilots requiring them to retire at age 60. Air Canada is defending these challenges. At this time, it is not possible to determine with any degree of certainty the extent of any financial liability that may arise from Air Canada being unsuccessful in its defense of these proceedings, though any such financial liability, if imposed, would not be expected to be material.

Other Contingencies

Various other lawsuits and claims, including claims filed by various labour groups of Air Canada are pending by and against the Corporation and provisions have been recorded where appropriate. It is the opinion of management that final determination of these claims will not have a material adverse effect on the financial position or the results of the Corporation.

With respect to 44 aircraft leases, the difference between the reduced rents as a result of the implementation of the Plan of Reorganization, Compromise and Arrangement under the Companies' Creditors Arrangement Act ("CCAA") on September 30, 2004 and amounts which would have been due under the original lease contracts will be forgiven at the expiry date of the leases if no material default has occurred by such date. In the event of a material default which does not include any cross defaults to other unrelated agreements (including unrelated agreements with the counterparties to these aircraft leases), this difference plus interest will become due and payable and all future rent will be based on the original contracted rates. Rent expense is being recorded on the renegotiated lease agreements and any additional liability would be recorded only at the time management believes the amount is likely to be incurred.

Guarantees

Guarantees in Fuel Facilities Arrangements

The Corporation participates in fuel facility arrangements operated through Fuel Facility Corporations, along with other airlines that contract for fuel services at various major airports in Canada. The Fuel Facility Corporations operate on a cost recovery basis. The purpose of the Fuel Facility Corporations is to own and finance the system that distributes the fuel to the contracting airlines, including leasing the Land Rights under the land lease. The aggregate debt of the five Fuel Facility Corporations in Canada that have not been consolidated by the Corporation under AcG-15 is approximately $171 as at December 31, 2010 (2009 - $162), which is the Corporation's maximum exposure to loss without taking into consideration any cost sharing that would occur amongst the other contracting airlines. The Corporation views this loss potential as remote. Each contracting airline participating in a Fuel Facility Corporation shares pro rata, based on system usage, in the guarantee of this debt.

Indemnification Agreements

In the ordinary course of the Corporation's business, the Corporation enters into a variety of agreements, some of which may provide for indemnifications to counterparties that may require the Corporation to pay for costs and/or losses incurred by such counterparties. The Corporation cannot reasonably estimate the potential amount, if any, it could be required to pay under such indemnifications. Such amount would also depend on the outcome of future events and conditions, which cannot be predicted. While certain agreements specify a maximum potential exposure, certain others do not specify a maximum amount or a limited period. Historically, the Corporation has not made any significant payments under these indemnifications.

The Corporation enters into real estate leases or operating agreements, which grant a license to the Corporation to use certain premises, in substantially all cities that it serves. It is common in such commercial lease transactions for the Corporation, as the lessee, to agree to indemnify the lessor and other related third parties for tort liabilities that arise out of or relate to the Corporation's use or occupancy of the leased or licensed premises. Exceptionally, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by their gross negligence or willful misconduct. Additionally, the Corporation typically indemnifies such parties for any environmental liability that arises out of or relates to its use or occupancy of the leased or licensed premises.

In aircraft financing or leasing agreements, the Corporation typically indemnifies the financing parties, trustees acting on their behalf and other related parties and/or lessors against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft and for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, except for their gross negligence or willful misconduct. In addition, in aircraft financing or leasing transactions, including those structured as leveraged leases, the Corporation typically provides indemnities in respect of various tax consequences including in relation to the leased or financed aircraft, the use, possession, operation maintenance, leasing, subleasing, repair, insurance, delivery, import, export of such aircraft, the lease or finance arrangements entered in connection therewith, changes of law and certain income, commodity and withholding tax consequences.

When the Corporation, as a customer, enters into technical service agreements with service providers, primarily service providers who operate an airline as their main business, the Corporation has from time to time agreed to indemnify the service provider against certain liabilities that arise from third party claims, which may relate to services performed by the service provider.

Under its general by-laws and pursuant to contractual agreements between the Corporation and each of its officers and directors, the Corporation has indemnification obligations to its directors and officers. Pursuant to such obligations, the Corporation indemnifies these individuals, to the extent permitted by law, against any and all claims or losses (including amounts paid in settlement of claims) incurred as a result of their service to the Corporation.

The maximum amount payable under the foregoing indemnities cannot be reasonably estimated. The Corporation expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities described above.

18. RELATED PARTY TRANSACTIONS

During 2010, ACE announced that it had concluded a public secondary offering on a bought deal basis of 44,000,000 Class B voting shares of Air Canada for aggregate gross proceeds to ACE of $162. Air Canada did not receive any of the proceeds from this offering. In accordance with the Registration Rights Agreement between Air Canada and ACE, the expenses of the offering of less than $1 were paid by Air Canada. After giving effect to this offering and ACE's resulting ownership interest in Air Canada of approximately 11%, ACE and Air Canada are no longer related parties. ACE was a participant lender in the Credit Facility as described in Note 6. ACE's pro-rata share of interest expense to the time the facility was repaid was $13.

As a result of the Aveos Restructuring Plan described below and the change in equity interests in Aveos, Air Canada and Aveos are no longer related parties.

Aveos Restructuring Plan

During the first quarter of 2010, Aveos reached an agreement with its lenders and equity holders on the terms of a consensual restructuring plan to recapitalize the company. As part of this recapitalization, Air Canada and Aveos entered into agreements to settle certain issues and modify the terms of certain contractual arrangements in exchange for Air Canada receiving a minority equity interest in Aveos. This restructuring modified the terms of certain commercial agreements between Air Canada and Aveos, including terms of the Pension and Benefits Agreement and an agreement with Aveos on revised payment terms. The modified terms relating to maintenance agreements are not expected to have a material impact on maintenance expense over their terms.

As part of these agreements, the Corporation also agreed to extend repayment terms on $22 of receivables, due in 2010, over six years with annual repayments on a non-interest bearing basis, with such payments subject to satisfaction of certain conditions. This agreement is now referred to as the Term Note.

The terms of the Pension and Benefits Agreement, relating to pension and benefits arrangements pertaining to (i) the non-unionized employees of Air Canada who were previously assigned to the Aveos operation and who became employees of Aveos on October 16, 2007 and (ii) those unionized employees of Air Canada who were assigned to the Aveos operation pursuant to general services agreements between Air Canada and Aveos for the assignment of unionized employees from Air Canada to Aveos were also modified to defer the determination of pension assets and related solvency deficiencies of transferring unionized employees performing airframe maintenance services to April 2011. This has the result of Air Canada assuming changes in the solvency deficiency for those affected employees from October 16, 2007, being the date of the Pension and Benefits Agreement, to April 1, 2011. As part of the amendment, all letters of credit issued under the Pension and Benefits Agreement were cancelled and a new letter of credit in the amount of $20 was issued by Air Canada in favour of Aveos to secure the payment of all compensation payments owing by Air Canada to Aveos in respect of pension, disability, and retiree liabilities for which Air Canada would be liable under the Pension and Benefits Agreement. This modification resulted in a reduction to the outstanding deposit under Air Canada's letter of credit facility of $23 in 2010. Until such future time as the assets and obligations under the Air Canada pension and other employee and retiree benefit arrangements pertaining to unionized employees may be transferred to Aveos, the current service pension cost and the current service and interest costs for other employee benefits in respect of Air Canada employees providing services to Aveos are charged by Air Canada to Aveos, and as such, the modifications to the Pension and Benefits Agreement have no accounting consequence in the current period.

As a result of the above agreements, Air Canada's equity investment in Aveos was recorded at $49, based upon its estimated fair value. The Term Note of $22 was recorded at its estimated fair value of $11, based on the present value of expected cash flows on a discounted basis. Other trade receivables from Aveos of $4 were settled. For accounting purposes, $34 for consideration of agreement amendments is deferred and will be amortized over the terms of the amended agreements with Aveos of four years, on average. This accounting treatment recorded in the first quarter of 2010 is summarized as follows:

Share consideration received	$ 49
Allocated to:	
Term Note	11
Trade receivables settled	4
Agreements and contract amendments	34
	$ 49

The investment in Aveos common shares is recorded in Deposits and other assets and is carried at cost. The Term Note is also recorded in Deposits and other assets and is carried at amortized cost.

Aveos Certification Order

On January 31, 2011, the Canada Industrial Relations Board issued an order determining that the sale of Air Canada's former aircraft, engine and component maintenance and repair business had occurred within the meaning of the Canada Labour Code, and establishing Aveos as a distinct employer, bound by separate collective agreements. The issuance of this order triggers the commencement of the process by which certain employees will transition from Air Canada to employment with Aveos.

Pursuant to this order and a related separation program, Air Canada may be required to provide up to a maximum of 1,500 separation packages to IAMAW-represented Aveos employees employed as of the date of the order (with each package including up to a maximum of 52 weeks of pay), in the event that such employees are permanently laid off or terminated as a direct result of Aveos ceasing to be the exclusive provider of airframe maintenance services to Air Canada prior to June 30, 2015. These packages will also be made available at any time up to June 30, 2013, in the event of an insolvency, liquidation or bankruptcy involving Aveos resulting in the cancellation of Air Canada-Aveos contracts and in the termination or permanent layoff of IAMAW-represented employees. The current expiry date of the airframe maintenance services agreement is June 30, 2013. The accounting for the separation program will be determined in the first quarter of 2011.

OFFICERS

David I. Richardson	Chairman of the Board
Calin Rovinescu	President and Chief Executive Officer
Duncan Dee	Executive Vice President and Chief Operating Officer
Michael Rousseau	Executive Vice President and Chief Financial Officer
Benjamin M. Smith	Executive Vice President and Chief Commercial Officer
Lise Fournel	Senior Vice President, E-Commerce and Chief Information Officer
Kevin C. Howlett	Senior Vice President, Employee Relations
David Legge	Senior Vice President, Operations
Susan Welscheid	Senior Vice President, Customer Service
Alan D. Butterfield	Vice President, Air Canada Maintenance and Engineering
Nick Careen	Vice President, Airports
Yves Dufresne	Vice President, Alliances, International Operations and Regulatory Affairs
Marcel Forget	Vice President, Network Planning
Lucie Guillemette	Vice President, Revenue Management
Carolyn M. Hadrovic	Corporate Secretary
Chris Isford	Vice President and Controller
Amos Kazzaz	Vice President, Financial Planning and Analysis
Craig Landry	Vice President, Marketing
Priscille LeBlanc	Vice President, Corporate Communications
Scott Morey	Vice President, Labour Relations
Claude Morin	Vice President, Global Sales
David J. Shapiro	Vice President and General Counsel

DIRECTORS

David I. Richardson	Corporate Director and Chairman of the Board, Air Canada, Grafton, Ontario
Bernard Attali	Senior Advisor, TPG Capital, Paris, France
Michael M. Green	Chief Executive Officer and Managing Director, Tenex Capital Management, Radnor, Pennsylvania
Jean Marc Huot	Partner, Stikeman Elliott LLP, Montreal, Quebec
Pierre Marc Johnson	Counsel, Heenan Blaikie LLP, Montreal, Quebec
Joseph B. Leonard	Interim Chief Executive Officer, Walter Energy, Inc., Minneapolis, Minnesota
Arthur T. Porter	Director General and Chief Executive Officer, McGill University Health Centre, Montreal, Quebec
Roy J. Romanow	Senior Fellow, Public Policy, University of Saskatchewan, Saskatoon, Saskatchewan
Calin Rovinescu	President and Chief Executive Officer, Air Canada, Montreal, Quebec
Vagn Sørensen	Senior Industrial Advisor, EQT Partners, Holte, Denmark

Investor and Shareholder Information

Price Range and Trading Volume of Air Canada Variable Voting Shares (AC.A)

2010	High	Low	Volume Traded
1st Quarter	$ 2.43	$ 1.25	9,716,700
2nd Quarter	$ 2.75	$ 1.51	12,110,394
3rd Quarter	$ 3.26	$ 1.58	24,114,944
4th Quarter	$ 4.11	$ 2.72	11,669,264
			57,611,302

Price Range and Trading Volume of Air Canada Voting Shares (AC.B)

2010	High	Low	Volume Traded
1st Quarter	$ 2.29	$ 1.24	63,240,015
2nd Quarter	$ 2.67	$ 1.40	55,606,738
3rd Quarter	$ 3.05	$ 1.60	73,871,011
4th Quarter	$ 4.09	$ 2.76	148,813,896
			341,531,660

Price Range and Trading Volume of Air Canada Warrants (AC.WT)

2010	High	Low	Volume Traded
1st Quarter	$ 0.70	$ 0.27	19,482,307
2nd Quarter	$ 0.85	$ 0.34	5,461,505
3rd Quarter	$ 1.08	$ 0.34	19,882,235
4th Quarter	$ 1.88	$ 0.91	25,764,915
			70,590,962

Restrictions on Voting Securities

Currently, the ***Air Canada Public Participation Act*** (ACPPA) limits ownership of Air Canada's voting interests by non-residents of Canada to a maximum of 25%. The ***Canada Transportation Act*** (CTA) also requires that Canadians own and control at least 75% of the voting interests of licensed Canadian carriers. Accordingly, Air Canada's articles contain restrictions to ensure that it remains "Canadian" as defined under the CTA. The restrictions provide that non-Canadians can only hold variable voting shares of Air Canada, that such variable voting shares will not carry more than 25% (or any higher percentage that the Governor in Council may by regulation specify) of the aggregate votes attached to all issued and outstanding voting shares and that the total number of votes cast by the holders of such variable voting shares at any meeting of shareholders will not exceed 25% (or any such higher percentage) of the votes that may be cast at such meeting.

The Government of Canada's Bill C-10, the ***Budget Implementation Act 2009***, contains provisions whereby the restrictions on voting securities in the ACPPA would be repealed and the CTA would be amended to provide the Governor in Council with flexibility to increase the foreign ownership limit from the existing 25% level to a maximum of 49%. These provisions will come into force on a date to be fixed by order of the Governor in Council made on the recommendation of the Minister of Finance, in the case of the ACPPA, and on the recommendation of the Minister of Transport, in the case of the CTA.

For Further Information

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Air Canada complies with the guidelines adopted by the Toronto Stock Exchange.

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CIBC Mellon Trust Company
Telephone: 1-800-387-0825
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Duplicate Communication
Shareholders receiving more than one copy are requested to call 1-800-387-0825 or write to the Transfer Agent and Registrar, CIBC Mellon Trust Company at the following address:
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Montreal, Quebec H3A 2A6

Inquiries may be submitted by electronic mail to inquiries@cibcmellon.com

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ENGLISH OR FRENCH, IT'S THE CLIENT'S CHOICE

Official Languages at Air Canada

For Air Canada, offering service in the language chosen by its customers is essential. Verbal exchanges with clients, public-address announcements at the airport and on board as well as briefing of passengers with special needs all constitute the very heart of customer service and call upon our employees linguistic skills at all times. Our consideration to bilingualism not only makes good sense customer-wise, but also supports our legal obligations to serve the public in the two official languages of Canada.

Air Canada puts great efforts to better serve clients in the language of their choice. It is through reach-out activities with the minority language communities as well as ongoing employee awareness and training that we can face the daily challenges, whether it is the growing difficulty to recruit bilingual candidates outside the province of Quebec and the national capital region, or for our employees to maintain their language skills with very little opportunities to practice the acquired language in some regions of the country.

Corporate Profile

Air Canada is Canada's largest domestic, U.S. transborder and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-U.S. transborder market and in the international market to and from Canada.

In 2010, Air Canada, together with Jazz and other regional airlines operating flights on behalf of and under commercial agreements with Air Canada, operated, on average, 1,470 daily departures to 59 destinations in Canada, 59 destinations in the U.S. and 60 destinations in the Canada-Europe, Canada-Pacific, Canada-Caribbean/Central America and Canada-South America markets. In 2010, Air Canada carried over 32 million passengers and provided passenger service to 178 destinations on five continents.

Air Canada is a founding member of the Star Alliance® network. The Star Alliance® network includes 27 member airlines. Through its membership in the Star Alliance® network, Air Canada is able to offer its customers access to approximately 1,160 destinations in 181 countries, as well as reciprocal participation in frequent flyer programs and use of airport lounges.

Air Canada also operates a domestic and international cargo division, Air Canada Cargo, and a tour operator, Air Canada Vacations.

aircanada.com

AIR CANADA

A STAR ALLIANCE MEMBER

Left to Right:
Raynald Hallé, Licensed Aircraft Technician – Maintenance
Ingrid Young, Manager, Strategic Purchasing – Finance
Francis Bell, First Officer, A319 / 320 – Flight Operations
Pascale Godet, Service Director – In-Flight Service
Graham Kerr, Cargo Rating Specialist – Cargo
Gisele Labelle, Customer Sales & Service Agent – Airports
David Bouchard, Station Attendant – Airports