AIR CANADA

Quarter 1 2007
Interim Unaudited
Consolidated Financial Statements and Notes

May 10, 2007

Consolidated Statement of Operations

Unaudited (Canadian dollars in millions except per share figures)		Three Months Ended March 31 2007	 March 31 2006
			(note 1)
Operating revenues			
Passenger		$ 2,137	$ 2,002
Cargo		141	151
Other		232	223
		2,510	2,376
Operating expenses			
Wages, salaries and benefits		582	537
Aircraft fuel		585	569
Aircraft rent		104	113
Airport and navigation fees		243	230
Aircraft maintenance, materials and supplies		249	224
Communications and information technology		71	75
Food, beverages and supplies		83	80
Depreciation, amortization and obsolescence	note 7	133	119
Commissions		59	68
Special charge for labour restructuring	note 5	-	28
Other		443	421
		2,552	2,464
Operating loss		**(42)**	**(88)**
Non-operating income (expense)			
Interest income		27	17
Interest expense		(93)	(72)
Interest capitalized		36	9
Gain on sale of assets	note 2	7	2
Gain on financial instruments recorded at fair value	note 6	34	-
Other		(4)	1
		7	(43)
Loss before the following items		(35)	(131)
Non-controlling interest		(37)	(37)
Foreign exchange gain		33	13
Recovery of (provision for) income taxes			
Current	note 1	(6)	-
Future		11	29
Loss for the period		**$ (34)**	**$ (126)**
Loss per share			
Basic and diluted		$ (0.34)	$ (1.43)

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

Consolidated Statement of Financial Position

Unaudited (Canadian dollars in millions)		March 31 2007	December 31 2006
ASSETS			
Current			
Cash and cash equivalents		$ 1,176	$ 1,447
Short-term investments		925	798
		2,101	2,245
Restricted cash		51	109
Accounts receivable		738	688
Spare parts, materials and supplies		114	148
Prepaid expenses and other current assets		168	124
Prepaid maintenance to ACTS		417	535
Future income taxes	note 1	8	345
		3,597	4,194
Property and equipment	note 2	6,210	5,946
Deferred charges		89	103
Intangible assets		1,192	1,194
Deposits and other assets		295	312
		$ 11,383	**$ 11,749**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		$ 1,621	$ 1,521
Advance ticket sales		1,192	1,019
Aeroplan Miles obligation		57	58
Current portion of long-term debt and capital leases		358	367
Note payable to ACTS		417	535
Current taxes payable	note 1	6	345
		3,651	3,845
Long-term debt and capital leases		3,195	3,196
Future income taxes		134	134
Pension and other benefit liabilities		1,814	1,876
Other long-term liabilities		426	472
		9,220	9,523
Non-controlling interest		345	374
SHAREHOLDERS' EQUITY			
Share capital		274	274
Contributed surplus		1,697	1,693
Deficit		(141)	(115)
Accumulated other comprehensive income (loss)	note 1	(12)	-
		1,818	1,852
		$ 11,383	**$ 11,749**

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

Consolidated Statement of Changes in Shareholders' Equity

Unaudited (Canadian dollars in millions)		Three Months Ended March 31 2007	March 31 2006
Share capital			
Common shares (beginning and end of period)		$ 562	$ -
Special common shares (beginning and end of period)		-	325
Adjustment to shareholders' equity (beginning and end of period)		(288)	(303)
Total share capital		274	22
Contributed surplus			
Balance, beginning of period		1,693	1,037
Fair value of stock options issued to Corporation employees recognized as compensation expense		4	1
Contribution from ACE on transfer of investments		-	483
Allocation of corporate costs		-	3
Total contributed surplus		1,697	1,524
Deficit			
Balance, beginning of period		(115)	(41)
Cumulative effect of adopting new accounting policies	note 1	8	-
		(107)	(41)
Net loss for the period		(34)	(126)
		(141)	(167)
Accumulated other comprehensive income (loss)			
Balance, beginning of period		-	-
Cumulative effect of adopting new accounting policies	note 1	(26)	-
Other comprehensive income		14	-
		(12)	-
Total deficit and accumulated other comprehensive income (loss)		(153)	(167)
Total shareholders' equity		**$ 1,818**	**$ 1,379**

Consolidated Statement of Comprehensive Income

Unaudited (Canadian dollars in millions)		Three Months Ended March 31 2007	March 31 2006
Comprehensive income (loss)			
Net loss for the period		$ (34)	$ (126)
Other Comprehensive income, net of taxes:			
Net change in unrealized gains on fuel derivatives under hedge accounting	note 6	6	-
Reclassification of net realized losses on fuel derivatives to income	note 6	8	-
		14	-
Total comprehensive income (loss)		**$ (20)**	**$ (126)**

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

Consolidated Statement of Cash Flows

Unaudited (Canadian dollars in millions)		Three Months Ended March 31 2007	March 31 2006
Cash flows from (used for)			
Operating			
Loss for the period		$ (34)	$ (126)
Adjustments to reconcile to net cash provided by operations			
Depreciation, amortization and obsolescence		133	119
Gain on sale of and provisions on assets		(7)	(2)
Foreign exchange (gain) loss		(33)	3
Future income taxes		(11)	(29)
Employee future benefit funding more than expense		(69)	(23)
Decrease (increase) in accounts receivable		(50)	(6)
Decrease (increase) in spare parts, materials and supplies		33	63
Increase (decrease) in accounts payable and accrued liabilities		123	85
Increase (decrease) in advance ticket sales, net of restricted cash		231	222
Decrease in Aeroplan Miles obligation		(25)	(31)
Non-controlling interest		37	37
Allocation of corporate expenses	note 1	-	3
Aircraft lease payments (in excess of) less than rent expense		(7)	(5)
Unrealized period change in fair value of derivatives	note 6	(40)	10
Capitalized interest		(36)	(9)
Other		(1)	13
		244	**324**
Financing			
Issue of Jazz units		-	218
Transfer of Jazz investment to ACE	note 1	-	400
Promissory note paid by Jazz to ACE		-	(424)
Jazz – Credit facility borrowings		-	113
Aircraft related borrowings	note 7	112	124
Distributions paid to non-controlling interest		(33)	(8)
Reduction of long-term debt and capital lease obligations		(78)	(88)
Reduction of non-controlling interest	note 3	(36)	-
Other		-	(2)
		(35)	**333**
Investing			
Short-term investments		(127)	(147)
Additions to capital assets		(397)	(274)
Proceeds from sale of assets		44	-
Cash management with related parties		(13)	(8)
Cash collaterization of letters of credit		13	(4)
		(480)	**(433)**
Increase (decrease) in cash and cash equivalents		**(271)**	**224**
Cash and cash equivalents, beginning of period		1,447	1,034
Cash and cash equivalents, end of period		**$ 1,176**	**$ 1,258**
Cash payments of interest		**$ 56**	**$ 55**
Cash payments of income taxes		**$ -**	**$ -**

Cash and cash equivalents exclude Short-term investments of $925 as at March 31, 2007 ($798 as at December 31, 2006).
The accompanying notes are an integral part of the interim consolidated financial statements.

Notes to the Interim Consolidated Financial Statements (unaudited)
(currencies in millions – Canadian dollars)

1. BASIS OF PRESENTATION AND NATURE OF OPERATIONS

The accompanying consolidated financial statements are of Air Canada (the "Corporation"), a majority-owned subsidiary of ACE Aviation Holdings Inc. ("ACE").

A) BASIS OF PRESENTATION

The unaudited interim consolidated financial statements for the Corporation are based on the accounting policies consistent with those disclosed in Note 2 to the 2006 annual combined consolidated financial statements of Air Canada, with the exception of the changes in accounting policies described below in part B) Changes in Accounting Policies.

As described in Note 1 to the 2006 annual combined consolidated financial statements of Air Canada, for periods prior to the initial public offering of shares of Air Canada, which closed on November 24, 2006 (the "Air Canada IPO"), the financial statements of Air Canada are combined to include the financial position, results of operations and cash flows of a number of entities that subsequently became subsidiaries of Air Canada in conjunction with the Air Canada IPO.

In accordance with Canadian generally accepted accounting principles ("GAAP"), these interim financial statements do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the 2006 annual combined consolidated financial statements of Air Canada. In management's opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim periods presented.

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

Allocation of Corporate Expenses

For the period prior to November 24, 2006, these consolidated financial statements include an allocation of the general corporate expenses incurred by ACE based upon the proportion of the Corporation's consolidated revenues compared to ACE's consolidated revenues. The allocation of general corporate expenses to the Corporation includes its proportionate share of general corporate expenses incurred by ACE, including executive management, legal, investor relations, treasury, finance, financial reporting, tax, internal audit and human resources services as well as costs of governance, professional fees and regulatory filings, all of which amounted to $3 for Quarter 1 2006. This allocation of corporate expenses was recorded within the Air Canada Services segment. This allocation of corporate expenses was recorded as a credit to contributed surplus. The allocation of general corporate expenses ceased on November 24, 2006.

Excluded Inter-company Investments

Prior to the Air Canada IPO, Air Canada held, for tax planning purposes, certain investments in limited partnerships of which ACE owned directly or indirectly all of the limited partner units. These investments and related income and income tax effects have been excluded from these consolidated statements of financial positions and operations of the Corporation, as these activities did not relate to the operations of the Corporation. These investments were transferred to ACE during 2005 and 2006 in exchange for cash and a note receivable. For purposes of these consolidated financial statements, these exchanges of the investments for cash and a note receivable were recorded as related party transactions resulting in a contribution of cash and notes receivable to the Corporation. These contributions of cash have been reflected as financing activities in the consolidated statement of cash flows.

During Quarter 1 2006 the Corporation received cash from ACE of $400 and a note receivable of $83 for the investments in Jazz and during Quarter 4 2006 the Corporation received cash of $673 for the investments in ACTS and $83 related to the settlement of the note receivable.

<u>Income Taxes</u>

As part of a tax loss utilization strategy that was planned in conjunction with the Air Canada IPO and corporate restructuring, a current tax payable of $345 was created in 2006. This tax payable arose upon a transaction to transfer tax assets from Air Canada to ACE. This tax payable was recoverable from future income tax assets of Air Canada and was settled during Quarter 1 2007. The Corporation recorded interest expense of $6, which was due on the tax balance prior to its recovery during Quarter 1 2007, in Current income taxes on the consolidated statement of operations. Interest expense on the tax liability ceased on April 29, 2007.

B) CHANGES IN ACCOUNTING POLICIES

On January 1, 2007, the Corporation adopted CICA accounting handbook section 3855, *Financial Instruments – Recognition and Measurement*, section 3861, *Financial Instruments – Disclosure and Presentation,* section 3865, *Hedges*, section 1530, *Comprehensive Income*, and section 3251, *Equity*.

<u>Financial Instruments</u>

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. It requires that financial assets and financial liabilities, including derivatives, be 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. Under this standard, all financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods is dependent upon the classification of the financial instrument as held-for-trading, 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. An asset can be classified as available-for-sale when it has not been classified as trading or held-to-maturity. Transaction costs are expensed as incurred for financial instruments classified or designated as held-for-trading. For other financial instruments, transaction costs are capitalized on initial recognition.

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. Financial assets classified as held-to-maturity, loans and receivables, or other financial liabilities are measured at amortized cost using the effective interest method of amortization. Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses, including changes in foreign exchange rates, being recognized in Other Comprehensive Income ("OCI") as described below. 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.

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 values of derivative instruments are recognized in non-operating income (loss) with the exception of derivatives designated in effective cash flow hedges, as further described below.

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 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. It is the Corporation's policy to not remeasure the fair value of the financial guarantee unless it qualifies as a derivative.

The Corporation has implemented the following classifications:

- Cash and cash equivalents are classified as held-for-trading and any period change in fair value is recorded through net income.
- Accounts receivable are classified as loans and receivables and are measured at amortized cost using the effective interest rate method.

- 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.

Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. The purpose of the section is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows.

Hedges

Section 3865 specifies the criteria that must be satisfied in order for hedge accounting to be applied. 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 Corporation has designated 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 OCI while the ineffective portion is recognized in non-operating income. Upon maturity of the fuel derivatives, the effective gains and losses previously recognized in Accumulated OCI ("AOCI") are recorded in Fuel expense. The Corporation has also designated the Jazz interest rate swaps as cash flow hedges.

When hedge accounting is discontinued, the amounts previously recognized in Accumulated OCI ("AOCI") are reclassified to non-operating income (loss) during the periods when the variability in the cash flows of the hedged item affects net income. Gains and losses on derivative hedging items are reclassified to non-operating income (loss) immediately when the hedged item is sold or terminated early.

Comprehensive Income

Section 1530 introduces Comprehensive Income, which consists of Net Income and OCI. OCI represents changes in Shareholders' equity during a period arising from transactions and other events with non-owner sources that are recognized in Comprehensive income, but excluded from net income. Period changes in the fair value of the effective portion of cash flow hedging instruments are recorded in OCI. These interim consolidated financial statements include the consolidated statement of comprehensive income for Quarter 1 2007; items affecting OCI are recorded prospectively commencing from January 1, 2007 including the transition adjustments noted below. Cumulative changes in OCI are included in AOCI, which is presented as a new category within Shareholders' equity on the consolidated statement of financial position. OCI and AOCI are presented net of tax.

Equity

Section 3251 establishes standards for the presentation of equity and the changes in equity during the period.

Impact Upon Adoption

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

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

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

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

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

Future Accounting Changes

Capital Disclosures and Financial Instruments – Presentation and Disclosure

The CICA issued three new accounting standards: section 1535, *Capital Disclosures*, section 3862, *Financial Instruments – Disclosures*, and section 3863, *Financial Instruments – Presentation*. These new standards will be effective for fiscal years beginning on or after October 1, 2007 and the Corporation will adopt them on January 1, 2008. The Corporation is in the process of evaluating all of the consequences of the new standards, which may have a material impact on the Corporation's financial statements.

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

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

Employee Future Benefits

The Accounting Standards Board ("AcSB") has issued an Exposure Draft to amend section 3461, *Employee Future Benefits*. The Exposure Draft addresses, in a limited manner, recognition, measurement, presentation and disclosure requirements of accounting for employee future benefits. Specifically, in its current draft form, it will require:

- recognition of the funded status (the difference between the plan assets and obligations) of an entity's post-retirement defined benefit plans on the statement of financial position;
- recognition of the changes in the funded status in comprehensive income in the year in which the changes occur;
- recognition of corresponding adjustments from accumulated other comprehensive income to components of benefit cost in net income to maintain the same reported net income as under current section 3461; and
- measurement of plan assets and the accrued benefit obligation at the statement of financial position date, instead of allowing a date that is up to three months before the end of an entity's fiscal year.

The AcSB expects to issue its final amendments to section 3461, in the second half of 2007. The recognition and related disclosure provisions will be effective for fiscal years ending on or after December 31, 2007 for publicly accountable enterprises. The measurement date provisions will be effective for fiscal years ending on or after December 31, 2008.

2. DISPOSAL OF PROPERTY

During Quarter 1 2007 the Corporation sold one of its commercial real estate properties for net proceeds of $42 with a carrying value of $37. The gain on sale of $5 ($4 net of tax) has been recorded in the Air Canada Services segment for Quarter 1 2007.

Also during Quarter 1 2007 the Corporation sold 18 parked aircraft for proceeds of $2 with a nil book value. The gain on sale of $2 ($1 net of tax) has been recorded in the Air Canada Services segment for Quarter 1 2007.

3. LONG-TERM DEBT AND CAPITAL LEASES

Embraer Aircraft Financing

The following table summarizes the loans, secured by the delivered aircraft, that Air Canada drew during Quarter 1 2007 to finance the acquisition of Embraer aircraft:

	Number of Aircraft	Interest Rate	Maturity	Original US$ Loan Amount	Original CDN$ Loan Amount
Quarter 1 2007					
Embraer 190	4	6.813%	2019	$ 90	$ 105
Total	**4**			**$ 90**	**$ 105**

The interest rate above represents the weighted average fixed interest rate on the loans.

The following table summarizes the principal repayment requirements of the Embraer aircraft financing obtained during Quarter 1 2007 as at March 31, 2007:

	Remainder of 2007	2008	2009	2010	2011	2012
Embraer aircraft financing	$ 4	$ 5	$ 5	$ 5	$ 5	$ 9

Reduction in Non-controlling Interest

During Quarter 1 2007 the Corporation refinanced five CRJ aircraft and the refinancing included a payment of the non-controlling interest portion of the leasing arrangement to third parties of $36.

4. POST-EMPLOYMENT EXPENSES

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

	Three Months Ended March 31 2007	March 31 2006
Pension benefit expense	$ 38	$ 45
Other employee future benefit expense	30	28
	$ 68	**$ 73**

5. LABOUR RELATED PROVISIONS

The following table outlines the changes to labour related provisions which are included in long-term employee liabilities for balances that existed upon the implementation of fresh start reporting on September 30, 2004 (current portion included in Accounts payable and accrued liabilities):

	Three Months Ended March 31 2007	Three Months Ended March 31 2006
Beginning of period	$ 77	$ 121
Charges recorded in wages, salaries and benefits	-	-
Interest accretion	1	2
Amounts disbursed	(11)	(13)
End of period	67	110
Current portion	(31)	(34)
	$ 36	**$ 76**

The following table outlines the changes to labour related provisions which are included in long-term employee liabilities for balances that have been created subsequent to the implementation of fresh start reporting on September 30, 2004 (current portion included in Accounts payable and accrued liabilities):

	Three Months Ended March 31 2007	Three Months Ended March 31 2006
Beginning of period	$ 29	$ 13
Special charge for labour restructuring:		
2006 non-unionized reduction	-	28
Charges recorded in wages, salaries and benefits	2	-
Amounts disbursed	(3)	(2)
End of period	28	39
Current portion	(17)	(34)
	$ 11	**$ 5**

The Corporation offers severance programs to certain employees from time to time. The cost of these programs is recorded within operating expenses. The Corporation does not have any continuing obligation to offer these programs.

During Quarter 1 2006 a workforce reduction plan was announced to reduce non-unionized employee levels by 20 percent. A special charge of $28 was recorded in the Air Canada Services segment in Quarter 1 2006 relating to this program. During Quarter 4 2006, the estimated cost of this plan to the Air Canada Services segment was revised due to the favourable impact of attrition and other factors which reduced the cost of achieving the target. As a result, the Air Canada Services segment recorded a reduction of $8 in Quarter 4 2006 to the special charge for labour restructuring.

6. DERIVATIVE AND FINANCIAL INSTRUMENTS

Fuel Price Risk Management

The financial results of the Corporation are impacted by changes in jet fuel prices as a result of the Corporation's inherent dependence on energy for its operations. To manage its exposure to jet fuel prices, the Corporation enters into derivative contracts with financial intermediaries for the purpose of managing volatility in operating cash flows. The Corporation uses derivative contracts on jet fuel and also on other crude oil based commodities, such as heating oil and crude oil, due to the relative limited liquidity of jet fuel derivative instruments on a medium to longer term horizon, since jet fuel is not traded on an organized futures exchange. The Corporation does not purchase or hold any derivative financial instruments for trading purposes.

The Corporation designates its fuel derivatives as hedges and applies hedge accounting as prescribed under CICA section 3865, Hedges. Designated hedging items under cash flow hedges result in all period changes in the fair value of the hedging item that are considered effective being recorded in AOCI until the underlying jet fuel is consumed. Upon maturity of the hedging item, the effective gains and losses are recorded in Fuel expense. The ineffective component of the change in fair value is recorded in non-operating income (expense).

Effectiveness is defined as the extent to which changes in the fair value of a hedged item relating to a risk being hedged is offset by changes in the fair value of the corresponding hedging item. The Corporation's accounting policy measures effectiveness based on the change in the intrinsic value of fuel derivatives compared to the change in the intrinsic value of the anticipated jet fuel purchase (based on the Corporation's weighted average price). As the Corporation's current policy does not take into account variables affecting fair value such as volatility and time value of money, a significant component of the change in fair value of outstanding fuel derivatives may be recorded as ineffective under the current policy. Management is considering amending its policy on future designated hedging relationships to reduce the occurrence of hedge ineffectiveness.

Ineffectiveness is inherent in hedging diversified jet fuel purchases with derivative positions in crude oil and related commodities and in the differences between intrinsic values and fair market values of the derivative instruments, especially given the magnitude of volatility observed in oil market prices. As a result the Corporation is unable to predict the amount of ineffectiveness for each period. This may result, and has resulted, in increased volatility in the accounting results of the Corporation, but has no impact on the underlying cash flows.

If the hedge ceases to qualify for hedge accounting, any period change in fair value of the fuel derivative instrument is recorded in non-operating income. For those fuel derivatives that do not qualify for hedge accounting, the period changes in fair value of the fuel derivative is recorded in non-operating income.

The following table provides the changes in fair value of designated hedging items before the impact of tax during Quarter 1 2007:

Increase (decrease)	Fair value of outstanding fuel derivatives	OCI / AOCI	Fuel expense	Non-operating income (loss)	Retained earnings	Cash on settlement
January 1, 2007	$ (18)	$ (26)	$ -	$ -	$ 8	$ -
Unrealized period change in fair value	39	9	-	30	-	-
Realized loss on maturing contracts	14	8	8	-	-	(14)
March 31, 2007	$ 35	$ (9)	$ 8	$ 30	$ 8	$ (14)

The net fair value of derivatives maturing during Quarter 1 2007 and were settled with the counterparties was $14 in favour of the counterparties. A charge of $8 was recorded in Fuel expense representing the effective portion of the net fair value, consisting of $7, net of nil tax, that was recorded within AOCI as at January 1, 2007 and $1, net of nil tax, for the period change during Quarter 1 2007.

As at March 31, 2007, the fair value of the Corporation's outstanding fuel derivative instruments under hedge accounting was net $35 in favour of the Corporation (net $18 in favour of the counterparties as at December 31, 2006). The effective portion of the unrealized period change in fair value recorded in OCI during Quarter 1 2007 was $6, net of tax of $3.

As at March 31, 2007, a net loss of $12, net of tax of $3, relating to unrealized gains and losses on outstanding fuel derivative instruments is included in AOCI. The net unrealized losses are expected to be realized as the contracts mature during the remainder of 2007 and the beginning of 2008.

For those fuel derivative instruments that do not qualify for hedge accounting, the Corporation recorded a net gain of $2 in non-operating income during Quarter 1 2007 representing the period change in fair value. As at March 31, 2007, the fair value of the outstanding derivative not under hedge accounting was less than $1 in favour of the counterparty.

Foreign Exchange Risk Management

During Quarter 1 2007, currency swaps for five CRJ leases with third parties were settled at their fair value of $10 (which was equal to carrying value) upon the expiry of the lease term.

7. SEGMENT INFORMATION

A reconciliation of the total amounts reported by each business segment and geographic region to the applicable amounts in the consolidated statements follows:

	Three Months Ended March 31, 2007			
	Air Canada Services	Jazz	Elimination	Consolidated Total
Passenger revenue	$ 2,137	$ -	$ -	$ 2,137
Cargo revenue	141	-	-	141
Other revenue	230	2	-	232
External revenue	2,508	2	-	2,510
Inter-segment revenue	26	362	(388)	-
Total revenues	**2,534**	**364**	**(388)**	**2,510**
Wages, salaries and benefits	499	83	-	582
Aircraft fuel	585	71	(71)	585
Aircraft rent	73	35	(4)	104
Airport user fees	243	47	(47)	243
Aircraft maintenance materials and supplies	224	30	(5)	249
Communications and information technology	71	1	(1)	71
Food, beverages and supplies	80	4	(1)	83
Depreciation of property and equipment	118	5	-	123
Amortization of intangible assets	9	-	-	9
Obsolescence provisions	1	-	-	1
Commissions	59	-	-	59
Capacity purchase fees paid to Jazz	230	-	(230)	-
Other operating expenses	420	52	(29)	443
Total operating expenses	**2,612**	**328**	**(388)**	**2,552**
Operating income (loss)	**(78)**	**36**	**-**	**(42)**
Interest income	26	1	-	27
Interest expense	(91)	(2)	-	(93)
Interest capitalized	36	-	-	36
Gain on sale of assets	7	-	-	7
Gain on financial instruments recorded at fair value	34	-	-	34
Other non-operating income (expense)	(4)	-	-	(4)
Non-controlling interest	(2)	-	(35)	(37)
Foreign exchange gain	33	-	-	33
Recovery of income taxes	5	-	-	5
Segment results / income (loss)	**$ (34)**	**$ 35**	**$ (35)**	**$ (34)**

	Air Canada Services	Jazz	Elimination	Three Months Ended March 31, 2006 Consolidated Total
Passenger revenue	$ 2,002	$ -	$ -	$ 2,002
Cargo revenue	151	-	-	151
Other revenue	221	2	-	223
External revenue	2,374	2	-	2,376
Inter-segment revenue	20	318	(338)	-
Total revenues	**2,394**	**320**	**(338)**	**2,376**
Wages, salaries and benefits	463	74	-	537
Aircraft fuel	569	59	(59)	569
Aircraft rent	83	32	(2)	113
Airport user fees	230	40	(40)	230
Aircraft maintenance materials and supplies	207	23	(6)	224
Communications and information technology	74	2	(1)	75
Food, beverages and supplies	76	3	1	80
Depreciation of property and equipment	101	4	-	105
Amortization of intangible assets	13	-	-	13
Obsolescence provisions	1	-	-	1
Commissions	68	-	-	68
Capacity purchase fees paid to Jazz	206	-	(206)	-
Special charge for labour restructuring	28	-	-	28
Other operating expenses	399	48	(26)	421
Total operating expenses	**2,518**	**285**	**(339)**	**2,464**
Operating income (loss)	**(124)**	**35**	**1**	**(88)**
Interest income	17	1	(1)	17
Interest expense	(71)	(2)	1	(72)
Interest capitalized	10	(1)	-	9
Gain on sale of assets	2	-	-	2
Other non-operating income (expense)	2	-	(1)	1
Non-controlling interest	(4)	-	(33)	(37)
Foreign exchange gain	13	-	-	13
Recovery of income taxes	29	-	-	29
Segment results / income (loss)	**$ (126)**	**$ 33**	**$ (33)**	**$ (126)**

Geographic Information

Passenger revenues	Three Months Ended March 31 2007	March 31 2006
Canada	$ 848	$ 780
US Transborder	489	469
Atlantic	358	335
Pacific	212	196
Other	230	222
	$ 2,137	**$ 2,002**

Cargo revenues	Three Months Ended March 31 2007	March 31 2006
Canada	$ 26	$ 28
US Transborder	7	8
Atlantic	57	55
Pacific	40	49
Other	11	11
	$ 141	**$ 151**

Passenger and cargo revenues are based on the actual flown revenue for flights with an origin or destination in a specific country or region. Atlantic refers to flights that cross the Atlantic Ocean with origin or destinations principally in Europe. Pacific refers to flights that cross the Pacific Ocean with origin or destinations principally in Asia. Other revenues are principally provided to customers located in Canada.

Segment Asset Information

	March 31 2007			
	Air Canada Services	**Jazz**	**Elimination**	**Consolidated Total**
Cash and cash equivalents	$ 1,044	$ 132	$ -	$ 1,176
Short-term investments	925	-	-	925
	$ 1,969	$ 132	$ -	$ 2,101
Total assets	**$ 11,021**	**$ 492**	**$ (130)**	**$ 11,383**

	December 31 2006			
	Air Canada Services	**Jazz**	**Elimination**	**Consolidated Total**
Cash and cash equivalents	$ 1,312	$ 135	$ -	$ 1,447
Short-term investments	798	-	-	798
	$ 2,110	$ 135	$ -	$ 2,245
Total assets	**$ 11,388**	**$ 483**	**$ (122)**	**$ 11,749**

The Corporation is a domestic and international carrier and for the purposes of segment reporting, flight equipment is attributed to Canada. As a result, substantially all of the Corporation's property and equipment are related to operations in Canada.

Relationship between Air Canada and Jazz

Air Canada has no ownership interest in Jazz Air LP ("Jazz"). Jazz is consolidated in these consolidated financial statements under AcG-15. Air Canada has been determined to be the primary beneficiary. Air Canada and Jazz negotiate transactions between each other as if they were unrelated parties on an arm's length basis.

The Air Canada Services segment is comprised of the passenger and cargo transportation services business operated by Air Canada and related ancillary services.

The Jazz segment is Jazz Air LP operating under the capacity purchase agreement ("Jazz CPA") with Air Canada.

Under the Jazz CPA, Jazz is reimbursed for all pass-through costs (as described below) and Jazz is paid fees by Air Canada on a variety of different metrics based on an estimate of all costs and expenses to be incurred and paid by Jazz for the applicable period with respect to flights operated by Jazz pursuant to the Jazz CPA and other services to aircraft, other than Jazz's pass-through costs marked-up by a specified percentage. The fees include both a variable component that is dependent on Jazz aircraft utilization and a fixed component. The fees charged by Jazz to the Air Canada Services segment are payable on a monthly basis and are broken down between aircraft rent and other operating expenses in the segmented results.

Pass-through costs, which are reimbursed to Jazz, include fuel, airport and navigations fees and other, are recorded within the Other operating expenses in the segment results of Air Canada Services.

The accounting policies for these two segments are as described in Note 2 of the 2006 annual combined consolidated financial statements of Air Canada. In addition, Jazz recognizes its revenue under the Jazz CPA as the services are provided to the Air Canada Services segment.

8. RELATED PARTY TRANSACTIONS

As at March 31, 2007 ACE has a 75% ownership interest in Air Canada and a 58.8% indirect ownership interest in Jazz through its interest in Jazz Air Income Fund. The Corporation has various related party transactions with ACE and other ACE related entities, including Aeroplan, which is under the significant influence of ACE and ACTS, which is under common control of ACE. These transactions are recorded at the exchange amount.

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

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

		March 31 2007		December 31 2006
Accounts receivable				
ACE	$	11	$	-
Aeroplan		32		6
ACTS		106		97
	$	**149**	**$**	**103**
Accounts payable and accrued liabilities				
ACE	$	-	$	12
ACTS		144		111
	$	**144**	**$**	**123**

Revenues and expenses with related parties are summarized as follows:

		Three Months Ended March 31 2007		March 31 2006
Revenues				
Revenues from Aeroplan related to Aeroplan rewards	$	97	$	77
Cost of Aeroplan Miles purchased from Aeroplan		(64)		(61)
Property rental revenues from related parties		10		12
Revenues from information technology services to related parties		6		7
Revenues from corporate services and other		6		4
Cargo revenues from related parties		1		1
	$	**56**	**$**	**40**
Expenses				
Maintenance expenses for services from ACTS	$	188	$	161
Call centre management and marketing fees for services from Aeroplan		4		3
Other expenses		-		9
Recovery of wages, salary and benefit expense for employees assigned to Aeroplan and ACTS		(99)		(89)
	$	**93**	**$**	**84**
Net interest expense from related parties	**$**	**-**	**$**	**2**

Prior to 2007, Air Canada held certain investments in Aeroplan, Jazz and ACTS. During 2006, as described in Note 1, certain cash payments and notes received from ACE on transfer of these investments to ACE have been included in these consolidated financial statements as a contribution from ACE to Shareholders' Equity.

Summary of significant related party agreements

The Relationship between the Corporation and Aeroplan

ACE holds a 40.1% indirect ownership interest in Aeroplan LP. Aeroplan operates a loyalty program which provides loyalty marketing services to its customers.

The transactions between Air Canada and Aeroplan described below are recorded at the exchange amount and, commencing June 29, 2005, are settled by netting amounts payable against amounts receivable in accordance with the inter-company agreements with any outstanding balance paid in the subsequent period. Accordingly, the amounts have been presented in these consolidated financial statements on a net basis as the parties intend to settle on a net basis.

Aeroplan Commercial Participation and Services Agreement (CPSA)

Pursuant to the Aeroplan CPSA, last amended on October 13, 2006, Air Canada continues to allocate 8% of the seat capacity to Aeroplan on the flights operated by Air Canada and Jazz and certain other air carriers under the Air Canada code (collectively, the "AC Flights") at a fixed redemption cost. In addition, Aeroplan can purchase an unlimited number of available seats based on published fares with a variable discount depending on the fare product. Any adjustment to this variable discount is based on an identified set of parameters. The Aeroplan CPSA also provides that Aeroplan will be charged the lowest fares charged to any other loyalty program taking into account Aeroplan's volume purchase of Air Canada's seat inventory. The rates charged for the allocated 8% of the seat capacity on AC Flights are fixed through the end of 2007. Thereafter, any upward or downward adjustments to such rates must maintain aggregate discounts at least as favourable to Aeroplan as those set out in the current rates.

Air Canada is one of Aeroplan's leading partners and it pays a fee to participate in the Aeroplan program, which fee is based on the Aeroplan miles awarded to Air Canada customers who travel on AC Flights. Aeroplan is required to purchase a minimum number of reward travel seats on AC Flights annually, which number is a function of Aeroplan's consumption of seats in the three preceding calendar years (2006 – $170). Moreover, Air Canada is required to purchase a minimum number of Aeroplan miles annually.

The Aeroplan CPSA also provides that Aeroplan shall, in return for a service fee, manage Air Canada's frequent flyer tier membership program for Air Canada Super Elite™, Elite™ and Prestige™ customers, as well as perform certain marketing and promotion services for Air Canada, including call centre services for the frequent flyer tier membership program. These amounts are included in the above table summarizing related party revenue and expenses under call centre management and marketing fees for services from Aeroplan.

Unless otherwise agreed to between Air Canada and Aeroplan, all amounts due and owing by either party to the other pursuant to the CPSA are payable within thirty days of the invoice date.

Aeroplan Database Agreement

Pursuant to the Aeroplan Database Agreement, Aeroplan manages Air Canada's passenger information database. The Aeroplan Database Agreement allows Aeroplan to access and use the Air Canada database information for statistical purposes, as well as for revenue generating and general marketing purposes by using such information to conduct market research for other Aeroplan partners who are not in direct competition with Air Canada. Air Canada is entitled to access and use the Aeroplan database information for certain purposes, including pre-approved targeted marketing activities. The access and usage by each of Aeroplan and Air Canada is subject to adherence with any applicable confidentiality and privacy restrictions and is subject to pre-established fees based on the information access or use, which fees are invoiced on a quarterly basis and are subject to revision annually.

Aeroplan Master Services Agreement (MSA)

Pursuant to the Aeroplan MSA, Air Canada has agreed to provide certain services to Aeroplan in return for a fee based on Air Canada's fully allocated cost of providing such services to Aeroplan plus a mark-up to reflect overhead and administrative costs. Pursuant to the Aeroplan MSA, Air Canada provides Aeroplan with infrastructure support which is mostly administrative in nature, including information technology, human resources, finance and accounting, and legal services. Amounts related to the MSA are included in the above table summarizing related party revenues and expenses under Revenues from corporate services and other.

Aeroplan General Services Agreement (GSA)

Pursuant to the Aeroplan GSA, Air Canada provides Aeroplan with the services of a group of call centre employees of Air Canada. Aeroplan must reimburse Air Canada for all costs, including salary and benefits, related to the call centre employees on a fully allocated basis. With regard to the shortfall in the pension plan maintained by Air Canada which covers, among others, these call centre employees, Aeroplan has agreed to pay an amount not to exceed $16.1 million over the next eight years to compensate Air Canada for call centre employees' share of the unfunded Air Canada pension liability. Amounts related to the GSA are recorded in the above table summarizing related party revenues and expenses under Recovery of wages, salary and benefit expense for employees assigned to Aeroplan, ACTS, and ACE.

Trademark License Agreement

Air Canada and Aeroplan LP have granted each other reciprocal royalty-free, non-exclusive, non-sublicensable, non-assignable rights to use certain of each other's trademarks around the world which incorporate their names or logos, solely in association with the Aeroplan Program.

The Relationship between the Corporation and ACTS

ACTS is a wholly owned subsidiary of ACE that provides full-service maintenance, repair and overhaul services to a wide range of customers.

ACTS Maintenance Agreements

Pursuant to general terms and related services agreements between ACTS and Air Canada (the "ACTS Maintenance Agreements") as well as other maintenance agreements with Jazz, ACTS has agreed to provide the following services to Air Canada and Jazz: engine and auxiliary power unit maintenance services, aircraft heavy maintenance services (excluding line and cabin maintenance services which are provided by Air Canada), component maintenance services, training services, supply chain management services and other ancillary services. ACTS serves as Air Canada's exclusive repair agency to provide certain of these services and Jazz's exclusive repair agency related to component repair and overall work on parts which can be removed from Jazz aircraft. Jazz performs certain of its own aircraft heavy maintenance. The amounts related to the ACTS Maintenance Agreements and other maintenance agreements with Jazz are recorded in the above table summarizing related party revenues and expenses under Maintenance expense for services from ACTS.

ACTS Master Services Agreement (MSA)

Pursuant to the master services agreement between Air Canada and ACTS (the "ACTS MSA"), Air Canada has agreed to provide ACTS with services including infrastructure support and services which are mostly administrative in nature, including information technology, human resources, finance and accounting, and legal services in return for fees to be paid by ACTS to Air Canada.

These amounts are recorded in the above table summarizing related party revenues and expenses under Revenues from corporate services and other.

ACTS Trademark License Agreement

Air Canada has granted ACTS a royalty-free, non-exclusive, non-assignable right to use certain trademarks registered by Air Canada which incorporate the Air Canada name, and/or Air Canada's roundel design, solely in association with the provision of heavy maintenance, component maintenance and supply chain business services in Canada and the United States.

General Services Agreements

Pursuant to general services agreements between Air Canada and ACTS (the "ACTS GSAs"), Air Canada provides ACTS with the services of a group of unionized and non-unionized employees of certain departments/divisions of Air Canada. ACTS must reimburse Air Canada for all costs, including salary and benefits, related to these employees on a fully allocated basis. These amounts are recorded in the above table summarizing related party revenues and expenses under Recovery of wages, salary and benefits expense for employees assigned to ACTS.

Unless otherwise agreed to between Air Canada and ACTS, all amounts due and owing by either party to the other are payable within thirty days of the invoice date.

Building Sale to ACTS

During Quarter 4 2006 Air Canada recorded an impairment loss on the building that is being finalized to sell to ACTS. Upon execution of the sale agreement, the building will be sold to ACTS at the carrying value of $28. Air Canada and ACTS are finalizing the sale of the building from Air Canada to ACTS that is expected to be executed in 2007.

The Relationship between Corporation and ACE

Master Services Agreement

Air Canada provides certain administrative services to ACE in return for a fee. Such services relate to finance and accounting, information technology, human resources and other administrative services.

Cash Management System

Air Canada manages (or managed, as the case may be) the cash for certain related parties, including Aeroplan up to June 2005, Jazz up to February 2006 and ACTS during all periods presented in these consolidated financial statements. All cash collected from billings and sources other than Air Canada is recorded by Air Canada on a daily basis. Any payments to pay obligations related to operating and financing costs and capital expenditures other than obligations to Air Canada and other ACE affiliates were made through the Air Canada cash management system. In addition, certain inter-company transactions for services were not settled within the terms set out in the above noted agreements. Inter-company accounts receivable and payable include any excess cash, (cash proceeds greater than cash expenditures), cash deficiencies (cash expenditures greater than proceeds) or deferrals of receipts of payments. The consolidated statement of cash flows reflects the receipt and repayment of excess cash as a financing activity and the disbursement and repayment of cash deficiencies as investing activities.

9. SUBSEQUENT EVENT

Boeing Commitments

On April 23, 2007, the Corporation amended agreements with Boeing to cancel orders for two Boeing 777 aircraft scheduled for delivery in 2009. In addition, the Corporation increased its order for Boeing 787 aircraft by 23, bringing its total firm orders to 37 Boeing 787 aircraft. Following the amendment, Air Canada has options to acquire 23 Boeing 787 aircraft. The deliveries of the Boeing 787 aircraft committed to by the Corporation are scheduled to be completed by 2014.

In conjunction with the amended agreements, the Corporation received additional financing commitments from Boeing for seven of the additional Boeing 787 aircraft (21 Boeing 787 aircraft in total) on the same terms and conditions as described in Note 15 – Commitments in the 2006 consolidated financial statements. Should the Corporation not utilize any of the financing commitments on the Boeing 777 aircraft, the financing commitments for the Boeing 787 aircraft will be increased to 31 aircraft of which the terms for 28 aircraft would be revised to cover 80% of the aircraft delivery price and the term to maturity would be reduced to 12 years with straight-line principal repayments over the term to maturity.

Based on March 31, 2007 exchange rates, the impact by year on the previously disclosed committed capital expenditures are as follows:

Change in capital commitments Increase (decrease)		
Year ending December 31, 2007	$	30
Year ending December 31, 2008		(10)
Year ending December 31, 2009		(317)
Year ending December 31, 2010		78
Year ending December 31, 2011		285
Thereafter		3,052
	$	**3,118**

Final aircraft delivery prices include estimated escalation and deferred price delivery payment interest calculated based on the 90-day USD LIBOR rate at March 31, 2007.

Boeing 777 Financing

On April 19, 2007, Air Canada received a commitment for loan guarantee support from the Export-Import Bank of the United States covering the first seven Boeing 777 aircraft to be delivered in 2007, including the two aircraft delivered in March and April 2007. The remaining five supported Boeing 777 aircraft are scheduled for delivery later in 2007. The loan guarantee, which is subject to completion of documentation and specified terms and conditions, will cover 80% of the aircraft delivery price with a 12-year loan term and at an interest rate of approximately 5.35%, based on interest rates as at March 31, 2007.