



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



August 8, 2008

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1. Highlights

Prior to May 24, 2007, Air Canada had two reportable segments: Air Canada Services (which is now referred to as Air Canada) and Jazz Air LP ("Jazz"). The following table provides the reader with financial and operating highlights for Air Canada for the second quarter of 2008 and for the first six months of 2008 and the financial and operating highlights for the Air Canada Services segment, which excluded the consolidation of Jazz, for the second quarter of 2007 and for the first six months of 2007.

(Canadian dollars in millions except per share figures)	Second Quarter			First Six Months		
	2008	2007	Change \$	2008	2007	Change \$
Financial						
Operating revenues	2,782	2,639	143	5,509	5,179	330
Operating income (loss) before a special provision ⁽¹⁾	7	88	(81)	(5)	10	(15)
Operating income (loss)	7	88	(81)	(130)	10	(140)
Non-operating income (expense)	128	(33)	161	21	(25)	46
Income (loss) before non-controlling interest, foreign exchange and income taxes	135	55	80	(109)	(15)	(94)
Income (loss) for the period	122	155	(33)	(166)	121	(287)
Operating margin before a special provision % ⁽¹⁾	0.3%	3.3%	(3.0) pp	-0.1%	0.2%	(0.3) pp
Operating margin %	0.3%	3.3%	(3.0) pp	-2.4%	0.2%	(2.6) pp
EBITDAR before a special provision ⁽¹⁾⁽²⁾	249	299	(50)	471	428	43
EBITDAR ⁽²⁾	249	299	(50)	346	428	(82)
EBITDAR margin before a special provision % ⁽¹⁾⁽²⁾	9.0%	11.3%	(2.3) pp	8.5%	8.3%	0.2 pp
EBITDAR margin % ⁽²⁾	9.0%	11.3%	(2.3) pp	6.3%	8.3%	(2.0) pp
Cash, cash equivalents and short-term investments	1,497	1,751	(254)	1,497	1,751	(254)
Free cash flow	(11)	(621)	610	(184)	(807)	623
Adjusted debt/equity ratio	65.9%	68.2%	(2.3) pp	65.9%	68.2%	(2.3) pp
Earnings (loss) per share - basic and diluted ⁽³⁾	\$1.22	\$1.55	(\$0.33)	(\$1.66)	\$1.21	(\$2.87)
Operating Statistics			Change %			Change %
Revenue passenger miles (millions) (RPM)	12,884	12,580	2.4	25,215	24,394	3.4
Available seat miles (millions) (ASM)	15,581	15,220	2.4	30,988	29,955	3.4
Passenger load factor	82.7%	82.7%	-	81.4%	81.4%	-
Passenger revenue per RPM (cents) ⁽⁴⁾	19.0	18.5	2.5	18.8	18.4	2.4
Passenger revenue per ASM (cents) ⁽⁴⁾	15.7	15.3	2.6	15.3	15.0	2.3
Operating revenue per ASM (cents) ⁽⁴⁾	17.9	17.3	3.0	17.8	17.4	2.2
Operating expense per ASM ("CASM") (cents)	17.8	16.8	6.3	17.8	17.3	3.1
CASM, excluding fuel expense (cents)	12.4	12.6	(1.7)	12.8	13.2	(3.3)
Average number of full-time equivalent (FTE) employees (thousands)	24.6	24.3	1.5	24.3	23.8	2.1
Aircraft in operating fleet at period end ⁽⁵⁾	343	329	4.3	343	329	4.3
Average fleet utilization (hours per day) ⁽⁶⁾	9.5	9.6	(1.3)	9.7	9.6	0.6
Average aircraft flight length (miles) ⁽⁶⁾	847	855	(1.0)	862	865	(0.3)
Fuel price per litre (cents) ⁽⁷⁾	89.2	67.2	32.6	82.2	65.1	26.2
Fuel litres (millions)	946	941	0.5	1,893	1,866	1.4

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

(2) See section 15 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR before the provision for cargo investigations to operating income (loss) and EBITDAR to operating income (loss).

(3) Earnings (loss) per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.

(4) A revenue adjustment of \$26 million relating to a change in accounting estimates was recorded in the fourth quarter of 2007 of which \$29 million pertained to the first quarter of 2007. For comparative purposes, yield and RASM percentage changes were adjusted to include the impact of adding back \$29 million to the first quarter of 2007.

(5) Excludes chartered freighters in 2008 and 2007. Includes Jazz aircraft covered under the Jazz CPA.

(6) Excludes third party carriers operating under capacity purchase arrangements. Includes Jazz aircraft covered under the Jazz CPA.

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

2. Introduction

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), "we", "us", "our", "Air Canada" and "Corporation" refer to Air Canada and/or one or more of Air Canada's subsidiaries, unless indicated otherwise.

This MD&A for the second quarter of 2008 provides the reader with a view of Air Canada from the perspective of management as well as an analysis of Air Canada's financial results for the second quarter of 2008 and for the first six months of 2008 and includes a discussion on our controls and procedures. This MD&A should be read in conjunction with Air Canada's second quarter 2008 interim unaudited consolidated financial statements and notes and its annual audited consolidated financial statements and notes and its annual MD&A for 2007. All financial information has been prepared in accordance with Generally Accepted Accounting Principles in Canada ("GAAP"), unless indicated otherwise. Air Canada's unaudited consolidated financial statements are based on accounting policies consistent with those disclosed in Note 2 to the Corporation's annual audited consolidated financial statements for 2007, with the exception of the changes in accounting policies described in section 10 of this MD&A.

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

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

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

Except where the context otherwise requires, all monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 16 "Glossary". Except as otherwise noted, this MD&A is current as of August 7, 2008.

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

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

CAUTION REGARDING FORWARD-LOOKING INFORMATION

Air Canada's public communications may include written or oral forward looking statements within the meaning of applicable securities laws. Such statements are included in this MD&A and may be included in other filings with regulatory authorities and securities regulators. Forward-looking statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to strategies, expectations, planned operations or future actions. These forward-looking statements are identified by the use of terms and phrases such as "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "predict", "project", "will", "would", and similar terms and phrases, including references to assumptions.

Forward-looking statements, by their nature, are based on assumptions, including those described below, and are subject to important risks and uncertainties. Any forecasts or forward-looking predictions or statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Results indicated in forward-looking statements may differ materially from actual results due to a number of factors, including without limitation, energy prices, general industry, market and economic conditions, currency exchange and interest rates, competition, war, terrorist acts, epidemic diseases, insurance issues and costs, changes in demand due to the seasonal nature of the business, the ability to reduce operating costs, employee and labour relations, pension issues, supply issues, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in the "Risk Factors" section of Air Canada's 2007 MD&A dated February 6, 2008 and section 13 of this MD&A. The forward-looking statements contained in this MD&A represent the Corporation's expectations as of the date of this MD&A and are subject to change after such date. However, the Corporation disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

Assumptions were made by Air Canada in preparing and making forward-looking statements. In addition to other assumptions contained in this MD&A, Air Canada assumes that growth in North America and globally will slow in 2008 and that a mild economic recession will take place in the United States. Air Canada also assumes that the Canadian dollar will trade, on average, at Cdn \$1.01 per US dollar in the third quarter of 2008 and for the full year 2008 and that the price of fuel will average 1.00 dollar per litre in the third quarter of 2008 and 90 cents per litre for the full year 2008 (both net of fuel hedging positions).

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

Air Canada recorded operating income of \$7 million and net income of \$122 million in the second quarter of 2008. In the same period of 2007, Air Canada, including the consolidation of Jazz's operations, recorded consolidated operating income of \$114 million and net income of \$155 million. **The following table and discussion compares the results of Air Canada for the second quarter of 2008, which no longer includes the consolidation of Jazz, and the results of the Air Canada Services segment (except where indicated), which excluded the consolidation of Jazz, for the second quarter of 2007.**

(Canadian dollars in millions except per share figures)	Second Quarter		Change	
	2008	2007 ⁽³⁾	\$	%
Operating revenues				
Passenger	\$ 2,454	\$ 2,336	\$ 118	5
Cargo	139	135	4	3
Other	189	168	21	13
	2,782	2,639	143	5
Operating expenses				
Wages, salaries and benefits	480	475	5	1
Aircraft fuel	848	636	212	33
Aircraft rent	69	75	(6)	(8)
Airport and navigation fees	255	257	(2)	(1)
Aircraft maintenance, materials and supplies	172	205	(33)	(16)
Communications and information technology	72	67	5	7
Food, beverages and supplies	81	78	3	4
Depreciation and amortization	173	136	37	27
Commissions	47	51	(4)	(8)
Capacity purchase with Jazz	233	232	1	0
Other	345	339	6	2
	2,775	2,551	224	9
Operating income	7	88	(81)	
Non-operating income (expense)				
Interest income	15	23	(8)	
Interest expense	(78)	(86)	8	
Interest capitalized	8	28	(20)	
Gain on capital assets	7	14	(7)	
Gain (loss) on financial instruments recorded at fair value	176	(6)	182	
Other	-	(6)	6	
	128	(33)	161	
Income before the following items	135	55	80	
Non-controlling interest	(3)	(4)	1	
Foreign exchange gain	48	160	(112)	
Provision for income taxes	(58)	(56)	(2)	
Income for the period	\$ 122	\$ 155	\$ (33)	
EBITDAR⁽¹⁾	\$ 249	\$ 299	\$ (50)	
Earnings per share, basic and diluted⁽²⁾	\$ 1.22	\$ 1.55	\$ (0.33)	

(1) See section 15 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income (loss).

(2) Earnings (loss) per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.

(3) Reflects the results of the Air Canada Services segment, which excluded the consolidation of Jazz, for the second quarter of 2007. Refer to section 2 of this MD&A for additional information on Air Canada's reportable segments prior to May 24, 2007.

In the second quarter of 2008, Air Canada reported operating income of \$7 million compared to operating income of \$88 million in the second quarter of 2007, a decrease of \$81 million. An increase in operating revenues of \$143 million or 5% was more than offset by a fuel expense increase of \$212 million or 33%.

In the second quarter of 2008, EBITDAR amounted to \$249 million compared to EBITDAR of \$299 million in the same period in 2007, a decrease of \$50 million.

System passenger revenues increased 5.1% over the second quarter of 2007

Passenger revenues increased \$118 million or 5.1% to \$2,454 million in the second quarter of 2008 due to growth in both system traffic and yield. The following factors contributed to the year-over-year change in second quarter system passenger revenues:

- A system yield improvement of 2.5% reflecting higher fares and increased fuel surcharges to partially offset higher fuel prices. All markets with the exception of the Pacific reflected yield growth. An increase in the proportion of higher-yielding business travelers in the international markets was also a factor in the yield growth.
- A RASM increase of 2.6% due to the growth in yield.
- Traffic growth of 2.4% on a capacity increase of 2.4%, resulting in a passenger load factor unchanged from the second quarter of 2007.
- A stronger Canadian dollar in the second quarter of 2008, which lowers the Canadian dollar value of sales in foreign countries, had a negative impact on foreign currency denominated revenues, accounting for a decrease of \$61 million to second quarter 2008 passenger revenues compared to the second quarter of 2007.

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

Second Quarter 2008 Versus Second Quarter 2007	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	6.4	2.3	2.2	-	4.1	4.0
US transborder	(2.5)	(5.8)	(7.7)	(1.6)	5.5	3.5
Atlantic	2.4	0.8	0.7	-	1.6	1.6
Pacific	2.6	2.5	3.5	0.9	(0.9)	0.1
Other	33.1	25.0	28.8	2.3	3.4	6.5
System	5.1	2.4	2.4	-	2.5	2.6

Domestic passenger revenues increased 6.4% from the second quarter of 2007

Domestic passenger revenues of \$1,076 million in the second quarter of 2008 increased \$65 million or 6.4% from the second quarter of 2007 due to both yield and traffic growth. The following factors contributed to the year-over-year change in second quarter domestic passenger revenues:

- A yield increase of 4.1% mainly due to fare increases and the introduction of a fuel surcharge to partially offset higher fuel prices which drove the RASM growth of 4.0%.
- Passenger load factor was essentially unchanged from the second quarter of 2007. Traffic increased 2.2% in line with a capacity increase of 2.3%. Capacity increases were largely reflected on the Atlantic Canada services, between central and western Canada and on Intra-Ontario and Quebec services.

US transborder passenger revenues decreased 2.5% from the second quarter of 2007

US transborder passenger revenues were \$458 million in the second quarter of 2008, a decrease of \$11 million or 2.5% from the second quarter of 2007 due to a decrease in traffic. The traffic decrease was partly offset by an increase in yield. The following factors contributed to the year-over-year change in second quarter US transborder passenger revenues:

- Capacity decreased 5.8% in the quarter. Capacity reductions were largely reflected on routes to San Diego and Los Angeles, California and Las Vegas, Nevada. In addition, there was a capacity reduction on the Hawaiian service as a result of the introduction of a Vancouver – Sydney non-stop flight which was previously a one-stop over Hawaii. The Vancouver – Sydney is recorded in the Other passenger revenue category.
- A passenger load factor decrease of 1.6 percentage point as the traffic decline of 7.7% was greater than the capacity reduction. Overall, the US transborder market was, in part, negatively impacted by the softening economy in the United States.
- A yield improvement of 5.5% due to fare increases and the introduction of a fuel surcharge to partially offset higher fuel prices.
- The stronger Canadian dollar had a negative impact on foreign currency denominated revenues. The impact accounted for a decrease of \$20 million to second quarter 2008 passenger revenues compared to the second quarter of 2007.
- RASM growth of 3.5% due to the yield improvement.

Atlantic passenger revenues increased 2.4% from the second quarter of 2007

Atlantic passenger revenues of \$488 million in the second quarter of 2008 increased \$11 million or 2.4% from the second quarter of 2007, due to yield growth and, to a lesser extent, traffic growth. The following factors contributed to the year-over-year change in second quarter Atlantic passenger revenues:

- Overall traffic growth of 0.7% on a capacity increase of 0.8%, resulting in a passenger load factor essentially unchanged from the second quarter of 2007. Traffic growth was reflected in the France and German markets as a result of the capacity growth driven by the addition of Boeing 777 aircraft. Traffic on the United Kingdom service decreased 4.3% on a capacity reduction of 5.3%, while yield improved 3.5%. Air Canada reduced frequencies on existing United Kingdom routes to better match capacity with demand.
- A yield increase of 1.6% largely due to increased fuel surcharges to partially offset higher fuel prices. Yield declined on the Western Canada to Germany service as a result of a reduction of premium seat availability on Air Canada. Strong yield performance, however, was achieved on the Italy service, in part attributable to the introduction of Executive First on the Toronto – Rome route. An overall increase in the proportion of higher-yielding business travelers was also a factor in the yield growth in the Atlantic market reflecting in part the attractiveness of Air Canada's new Executive First product.
- A RASM increase of 1.6% due to the growth in yield.
- The stronger Canadian dollar had a negative impact on foreign currency denominated revenues. The impact accounted for a decrease of \$16 million to second quarter 2008 passenger revenues compared to the second quarter of 2007.

Pacific passenger revenues increased 2.6% from the second quarter of 2007

Pacific passenger revenues of \$242 million in the second quarter of 2008 increased \$6 million or 2.6% from the second quarter of 2007, due to an increase in traffic. The following factors contributed to the year-over-year change in second quarter Pacific passenger revenues:

- An overall traffic growth of 3.5% on a capacity increase of 2.5%, resulting in an improvement in passenger load factor of 0.9 percentage points. A 15.2% increase in Canada – China capacity was largely offset by the impact of a capacity reduction in the Japan market and the suspension of service to India. The leisure traffic from Japan to Canada is under pressure from other global destinations that are alternative places to travel for the Japanese. The rising Canadian dollar versus the declining Japanese Yen has also had an adverse impact on market demand in Japan.

- An overall yield decrease of 0.9% reflecting yield declines in the Japan, Hong Kong and Korea markets largely offset by a yield increase in the China market. Yield decreased despite an increase in fuel surcharges and an increase in the proportion of higher-yielding business travelers. The yield decrease was in part due to growth in longer-haul flying. The average stage length increased 10.5% from the same period in 2007. Long-haul flights generally have a lower yield than short-haul flights. When measured on a per mile basis, the average fare paid on long-haul flights is relatively lower than short-haul flights. An increase in the proportion of higher-yielding business travelers partly offset the yield decrease.
- The stronger Canadian dollar had a negative impact on foreign currency denominated revenues. The impact accounted for a decrease of \$7 million to second quarter 2008 passenger revenues from the second quarter of 2007.
- RASM was essentially unchanged from the same period in 2007, up 0.1%, as the growth in passenger load factor was offset by the decrease in yield.

Other passenger revenues increased 33.1% from the second quarter of 2007

Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of \$190 million in the second quarter of 2008 increased \$47 million or 33.1% from the second quarter of 2007 due to traffic growth and, to a lesser extent, to yield growth. The following factors contributed to the year-over-year change in second quarter other passenger revenues:

- Traffic growth of 28.8% on a capacity increase of 25.0% resulting in a passenger load factor improvement of 2.3 percentage points. Traffic growth in these markets mainly reflected higher capacity to traditional leisure destinations and to South America. Additional frequencies in the South American market included Santiago, Chile, Buenos Aires, Argentina and Lima, Peru. The capacity increase in the South Pacific reflected the addition of a new non-stop service from Vancouver to Sydney, Australia.
- An overall yield increase of 3.4% due in part to increased fuel surcharges to partially offset higher fuel prices. An increase in the proportion of higher-yielding business travelers was also a factor in the yield growth reflecting in part the attractiveness of Air Canada's new Executive First product. The higher yield was achieved in spite of a 6.9% increase in average stage length compared to the same period in 2007.
- The stronger Canadian dollar had a negative impact on foreign currency denominated revenues. The impact accounted for a decrease of \$6 million to second quarter 2008 passenger revenues from the second quarter of 2007.
- A RASM increase of 6.5% due to the growth in both yield and passenger load factor.

Cargo revenues increased 3% from the second quarter of 2007

Second quarter 2008 cargo revenues amounted to \$139 million and were \$4 million or 3% above the second quarter of 2007. Non-freighter revenues increased \$17 million or 15% largely reflecting greater revenues in international markets. Freighter revenues were down \$13 million, primarily as a result of operating one MD-11 freighter aircraft in the second quarter of 2008 versus two MD-11 freighters in the same period in 2007. System cargo yield per revenue ton mile improved 13% and mostly reflected increased fuel surcharges to partially offset higher fuel prices. The following factors contributed to the year-over-year change in second quarter cargo revenues:

- System traffic declined 9%, largely as a result of reduced MD-11 freighter operations. Traffic on non-freighter aircraft increased by 5% in part due to increased Boeing 777 deployment in certain international markets.
- In the 2008 quarter, one chartered MD-11 freighter aircraft was operated to Europe while in the 2007 quarter two MD-11 freighters were operated, one to Europe and one to China. Freighter operations to China were terminated at the end of June 2007. Freighter operations to Europe were terminated effective June 30, 2008. This Atlantic freighter termination coincides with increased cargo capacity being offered in Europe through greater use of new Boeing 777 passenger aircraft which have a greater cargo capacity than the Airbus aircraft they are replacing.
- In the second quarter of 2008, a stronger Canadian dollar (with corresponding weaker foreign currencies) had a negative impact of \$3 million on the value of foreign currency denominated revenues.

Other revenues were up 13% from the second quarter of 2007

Other revenues of \$189 million in the second quarter of 2008 increased \$21 million or 13% from the second quarter of 2007. The following factors contributed to the year-over-year change in second quarter other revenues:

- A \$16 million increase in aircraft sublease revenues.
- A \$6 million increase in revenues from customers at Air Canada Vacations.

Excluding fuel expense, CASM declined 1.7% from the second quarter of 2007

Operating expenses were \$2,775 million in the second quarter of 2008, an increase of \$224 million or 9% from the second quarter of 2007, reflecting a significant increase in fuel expense. Excluding the fuel expense increase of \$212 million in the second quarter 2008, operating expenses increased only \$12 million, when compared to the same period in 2007, on a capacity increase of 2.4%.

Including fuel expense, CASM increased 6.3% from the second quarter of 2007. Excluding fuel expense, CASM declined 1.7% from the second quarter of 2007. The 1.7% decrease in CASM, excluding fuel expense, was in line with the projected CASM, excluding fuel expense, provided in our news release dated June 17, 2008 where we projected CASM to be up to 2.0% lower in the second quarter of 2008 when compared to the same period in 2007. The airline is aggressively managing the costs of all controllable parts of its operation and continues in its efforts to mitigate the significant increase in its fuel expense.

The following table compares Air Canada's operating expenses per ASM for the second quarter of 2008 to Air Canada's operating expenses per ASM for the corresponding period in 2007. Unit cost reductions were recorded in all major categories with the exception of fuel expense, ownership costs and communications and information technology expense. The stronger Canadian dollar versus the US dollar, unit cost savings related to the Boeing 777 aircraft and other cost reductions programs were among the more important factors in the overall unit cost decrease, excluding fuel expense, from the second quarter of 2007. The higher unit cost of ownership reflects Air Canada's investment in new aircraft and the aircraft interior refurbishment program.

(cents per ASM)	Second Quarter		Change	
	2008	2007	cents	%
Wages and salaries	2.49	2.50	(0.01)	(0.4)
Benefits	0.60	0.62	(0.02)	(3.2)
Ownership (DAR) ⁽¹⁾	1.55	1.39	0.16	11.5
Airport and navigation fees	1.64	1.69	(0.05)	(3.0)
Aircraft maintenance, materials and supplies	1.11	1.34	(0.23)	(17.2)
Communications and information technology	0.46	0.44	0.02	4.5
Food, beverages and supplies	0.52	0.52	-	-
Commissions	0.30	0.33	(0.03)	(9.1)
Capacity purchase with Jazz	1.50	1.52	(0.02)	(1.3)
Other	2.21	2.24	(0.03)	(1.3)
Operating expense, excluding fuel expense ⁽²⁾	12.38	12.59	(0.21)	(1.7)
Aircraft fuel	5.44	4.18	1.26	30.1
Total operating expense	17.82	16.77	1.05	6.3

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

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

Wages, salaries and benefits expense amounted to \$480 million in the second quarter of 2008, an increase of \$5 million or 1% from the second quarter of 2007.

Wages and salaries expense totaled \$387 million in the second quarter of 2008, an increase of \$6 million or 2% from the second quarter of 2007. Factors contributing to the year-over-year second quarter change in wages and salaries expense included:

- A year-over-year second quarter increase of 1.5% or an average of 353 full-time equivalent ("FTE") employees, mainly reflecting growth in ground handling personnel and pilots. The increase was required to support the 2.4% growth in ASM capacity.
- The average salary increased 1% over the second quarter of 2007 as a result of last year's adjustments.
- In response to record high fuel prices, on June 17, 2008, Air Canada announced a reduction in capacity which will impact fleet and staffing levels effective with the implementation of its fall and winter schedule. The expected reduction in flying will require fewer employees to operate the airline resulting in a decrease in staff levels of up to 2,000 positions across all levels of the organization. Air Canada recorded an expense of \$8 million related to the reduction of non-unionized employees under this plan in the second quarter of 2008. Costs related to the planned unionized staff reductions are not yet determinable.
- Reduced overtime expenses of \$3 million largely as a result of the growth in FTE employees and an increased focus on reducing overtime costs.
- Other factors amounting to a net decrease of \$7 million.

Employee benefits expense amounted to \$93 million in the second quarter of 2008, a decrease of \$1 million or 1% from the second quarter of 2007. Factors contributing to the year-over-year second quarter change in employee benefits expense included:

- Revised pension actuarial estimates accounting for a decrease of \$7 million to pension expense.
- An increase of \$3 million in post-retirement and post-employment benefit expense due to a favourable adjustment recorded in the second quarter of 2007 which related to the first six months of 2007. This favourable adjustment was the result of revised actuarial assumptions. No such adjustment was required in the second quarter of 2008.
- A net increase in other benefits amounting to \$3 million.

Fuel expense increased 33% from the second quarter of 2007

Fuel expense amounted to \$848 million in the second quarter of 2008, an increase of \$212 million or 33% from the second quarter of 2007. Factors contributing to the year-over-year second quarter change in fuel expense included:

- A higher base fuel price which accounted for an increase of \$396 million.
- A volume-related increase of \$3 million. The impact of the 2.4% increase in ASM capacity was partly offset by the replacement of the Airbus A340 aircraft with more fuel efficient Boeing 777 aircraft and a reduction in flying from MD-11 freighter aircraft.

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

- The favourable impact of a stronger Canadian dollar versus the US dollar which accounted for a decrease of \$97 million.
- Fuel hedging gains of \$92 million in the second quarter of 2008 versus fuel hedging gains of \$2 million in the second quarter of 2007, a favourable variance of \$90 million.

Ownership costs increased 15% from the second quarter of 2007

Ownership costs, comprised of aircraft rent, depreciation and amortization expenses, of \$242 million in the second quarter of 2008 increased \$31 million or 15% from the second quarter of 2007. Factors contributing to the year-over-year second quarter change in ownership costs included:

- The addition of aircraft to Air Canada's operating fleet which accounted for an increase of \$28 million.

- An increase in depreciation expenses of \$19 million related to Air Canada's aircraft interior refurbishment program.
- Other factors accounting for a net increase of \$6 million.

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

- The removal of aircraft from Air Canada's fleet which accounted for a decrease of \$11 million in aircraft rent and depreciation and amortization expenses.
- The impact of reduced MD-11 freighter flying, due to Air Canada operating one MD-11 freighter aircraft in the second quarter of 2008 versus two MD-11 freighter aircraft in the second quarter of 2007, accounted for a decrease of \$7 million to aircraft rent expense.
- The impact of a stronger Canadian dollar versus the US dollar which accounted for a decrease of \$4 million to aircraft rent expense.

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

Airport and navigation fees of \$255 million decreased \$2 million or 1% from the second quarter of 2007 on a 2% decrease in aircraft frequencies. Factors contributing to the year-over-year second quarter change in these fees included:

- Lower rates for landing and general terminal fees. Landing fees at Pearson Airport were reduced by 3.1% and terminal charges were reduced by 4.7% effective January 1, 2008.
- Navigation fees in Canada were reduced by 4% effective August 2007.
- Changes in schedule and aircraft types being operated to certain destinations resulted in an increase in airport user fees.

Aircraft maintenance, materials and supplies expense decreased 16% from the second quarter of 2007

Aircraft maintenance, materials and supplies expense of \$172 million in the second quarter of 2008 decreased \$33 million or 16% from the second quarter of 2007. Factors contributing to the year-over-year second quarter change in aircraft maintenance, materials and supplies expense included:

- A decrease of \$12 million in engine maintenance expenses mainly due to fewer aircraft and maintenance events for the Airbus A340 and Airbus A320 versus the same period in 2007 as well as reduced expenses relating to the Boeing 767-200 aircraft in anticipation of withdrawing this aircraft type from the operating fleet at the end of 2008. Partly offsetting these decreases was an increase in maintenance expenses for the Airbus A321 aircraft due to timing of maintenance activity versus the second quarter of 2007.
- In the second quarter of 2007, Air Canada recorded an expense of \$11 million related to the return to lessor of five Airbus A320 aircraft. There were no expenses of this nature in the second quarter of 2008.
- The impact of a stronger Canadian dollar versus the US dollar accounted for a decrease of \$11 million to aircraft maintenance, materials and supplies expense.
- A decrease of \$6 million relating to a reduction in third party supply chain management fees as a result of the insourcing of these activities.

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

- An increase of \$5 million in airframe maintenance expenses relating to Boeing 777 and Embraer ERJ-190 aircraft in the second quarter of 2008 versus nil in the second quarter of 2007.
- Other factors amounting to a net increase of \$2 million.

Communications and information technology expense increased 8% from the second quarter of 2007

Communications and information technology expense of \$72 million in the second quarter of 2008 increased \$5 million or 8% from the second quarter of 2007, largely driven by timing of information technology expenses versus the same period in 2007 and other miscellaneous increases.

Food, beverages and supplies expense increased 4% from the second quarter of 2007

Food, beverages and supplies of \$81 million in the second quarter of 2008 increased \$3 million or 4% from the second quarter of 2007, largely driven by a passenger traffic growth of 2.4%.

Commission expense decreased 8% from the second quarter of 2007

Despite a combined passenger and cargo revenue growth of 5% over the second quarter of 2007, commission expense of \$47 million in the second quarter of 2008 decreased \$4 million or 8% from the second quarter of 2007. Factors contributing to the year-over-year second quarter change in commission expense included:

- The favourable impact of a new commission structure at Air Canada Vacations in 2008.
- Commercial initiatives implemented by Air Canada to lower commission costs.
- An increase in web penetration which lowers distribution and commission costs. Web penetration for domestic sales in the second quarter of 2008 was 65% (63% in the second quarter of 2007) while web penetration for combined Canada and US transborder sales was 53% (50% in the second quarter of 2007). 63% of Canada and US sales in the second quarter of 2008 (61% in the second quarter of 2007) were made directly with Air Canada, either on-line or through call centres.

Capacity purchase fees paid to Jazz increased \$1 million from the second quarter of 2007

Capacity purchase fees paid to Jazz, pursuant to the capacity purchase agreement between Jazz and Air Canada ("Jazz CPA"), amounted to \$233 million in the second quarter of 2008 compared to capacity fees paid to Jazz of \$232 million in the second quarter of 2007, an increase of \$1 million. The impact of increased CPA rates over the second quarter of 2007 was largely offset by the favourable impact of foreign exchange on US denominated Jazz CPA expenses and a lower performance incentive payout in the second quarter of 2008.

Air Canada and Jazz are parties to the Jazz CPA pursuant to which Air Canada purchases substantially all of Jazz's fleet capacity based on predetermined rates, in addition to reimbursing Jazz, without mark-up, for certain pass-through costs as defined in the Jazz CPA which include fuel, airport and user fees and other expenses. The fees include both a variable component that is dependent on Jazz aircraft utilization and a fixed component. The pass-through costs recorded by Air Canada pursuant to the Jazz CPA are reflected in Air Canada's respective income statement line categories.

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

Other operating expenses amounted to \$345 million in the second quarter of 2008, an increase of \$6 million or 2% from the second quarter of 2007. Factors contributing to the year-over-year second quarter change in other expense included increased credit card fees, mainly driven by higher passenger sales, and growth in the cost of ground packages at Air Canada Vacations as a result of higher passenger volumes.

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

(Canadian dollars in millions)	Second Quarter		Change	
	2008	2007	\$	%
Credit card fees	\$ 54	\$ 49	\$ 5	10
Terminal handling	44	43	1	2
Air Canada Vacations' land costs	39	35	4	11
Building rent and maintenance	33	33	-	-
Crew expenses (meals, transportation and hotels)	30	30	-	-
Miscellaneous fees and services	28	25	3	12
Remaining other expenses	117	124	(7)	(6)
	\$ 345	\$ 339	\$ 6	2

Non-operating income amounted to \$128 million in the second quarter of 2008

Non-operating income amounted to \$128 million in the second quarter of 2008 compared to non-operating expense of \$33 million in the second quarter of 2007. Factors contributing to the year-over-year second quarter change in non-operating expense included:

- Gains relating to fair value adjustments on derivatives instruments amounted to \$176 million in the second quarter of 2008 versus losses of \$6 million in the same quarter of 2007. Refer to section 8 of this MD&A for additional information on the gains on financial instruments recorded in the second quarter of 2008.
- An increase in net interest expense of \$20 million. A lower amount of capitalized interest related to new aircraft and a decrease in interest income due to lower cash balances more than offset the \$8 million decrease in interest expense. The decrease in interest expense was driven by a reduced level of aircraft-related debt, lower aircraft financing rates and the favourable impact of a stronger Canadian dollar versus the US dollar in the second quarter of 2008 compared to the second quarter of 2007, partially offset by the financing of additional aircraft year-over-year.
- In the second quarter of 2008, Air Canada recorded gains amounting to \$7 million pertaining to the sale of aircraft-related inventory.
- In the second quarter of 2007, Air Canada recorded a gain on disposal of \$14 million from insurance proceeds relating to a CRJ-100 aircraft owned by Air Canada and leased to Jazz which was damaged beyond repair.

Net gains on foreign currency monetary items amounted to \$48 million in the second quarter of 2008

Net gains on foreign currency monetary items amounted to \$48 million in the second quarter of 2008, mainly attributable to a stronger Canadian dollar at June 30, 2008 compared to March 31, 2008. The June 30, 2008 noon day exchange rate was \$1US = Cdn \$1.0186 while the March 31, 2008 noon day exchange rate was \$1US = Cdn \$1.0279. Net gains of \$160 million were recorded in the second quarter of 2007.

Provision for income taxes of \$58 million in the second quarter of 2008

Air Canada recorded a provision for income taxes of \$58 million in the second quarter of 2008, representing an effective income tax rate of 32%, compared to a provision for income taxes of \$56 million, at an effective income tax rate of 27%, for the same period in 2007. The 2007 effective income tax rate was favourably impacted by the capital portion of certain foreign exchange gains which were tax-effected at 50% of the income tax rate and which were higher in the second quarter of 2007 compared to the same period in 2008.

4. Results of Operations – First Six Months of 2008 versus First Six Months of 2007

Air Canada recorded an operating loss of \$5 million, before a provision for cargo investigations of \$125 million, and a net loss of \$166 million in the first six months of 2008. In the same period of 2007, Air Canada, including the consolidation of Jazz's operations up to May 24, 2007, reported consolidated operating income of \$72 million and net income of \$121 million. **The following table and discussion compares the results of Air Canada for the first six months of 2008, which no longer includes the consolidation of Jazz, and the results of the Air Canada Services segment (except where indicated), which excluded the consolidation of Jazz, for the first six months of 2007.**

(Canadian dollars in millions except per share figures)	First Six Months		Change	
	2008	2007 ⁽³⁾	\$	%
Operating revenues				
Passenger	\$ 4,765	\$ 4,473	\$ 292	7
Cargo	263	276	(13)	(5)
Other	481	430	51	12
	5,509	5,179	330	6
Operating expenses				
Wages, salaries and benefits	961	974	(13)	(1)
Aircraft fuel	1,563	1,221	342	28
Aircraft rent	132	154	(22)	(14)
Airport and navigation fees	496	500	(4)	(1)
Aircraft maintenance, materials and supplies	375	429	(54)	(13)
Communications and information technology	145	138	7	5
Food, beverages and supplies	158	158	-	-
Depreciation and amortization	344	264	80	30
Commissions	100	110	(10)	(9)
Capacity purchase with Jazz	468	462	6	1
Other	772	759	13	2
	5,514	5,169	345	7
Operating income (loss) before the undernoted item	(5)	10	(15)	
Provision for cargo investigations	(125)	-	(125)	
Operating income (loss)	(130)	10	(140)	
Non-operating income (expense)				
Interest income	33	49	(16)	
Interest expense	(159)	(177)	18	
Interest capitalized	25	64	(39)	
Gain (loss) on capital assets	(29)	21	(50)	
Gain on financial instruments recorded at fair value	153	28	125	
Other	(2)	(10)	8	
	21	(25)	46	
Loss before the following items	(109)	(15)	(94)	
Non-controlling interest	(6)	(6)	-	
Foreign exchange gain (loss)	(41)	193	(234)	
Provision for income taxes	(10)	(51)	41	
Income (loss) for the period	\$ (166)	\$ 121	\$ (287)	
EBITDAR before the provision for cargo investigations⁽¹⁾	\$ 471	\$ 428	\$ 43	
EBITDAR⁽¹⁾	\$ 346	\$ 428	\$ (82)	
Earnings (loss) per share, basic and diluted⁽²⁾	\$ (1.66)	\$ 1.21	\$ (2.87)	

(1) See section 15 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR before the provision for cargo investigations to operating income (loss) and EBITDAR to operating income (loss).

(2) Earnings (loss) per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.

(3) Reflects the results of the Air Canada Services segment, which excluded the consolidation of Jazz, for the first six months of 2007. Refer to section 2 of this MD&A for additional information on Air Canada's reportable segments prior to May 24, 2007.

In the first six months of 2008, Air Canada reported an operating loss of \$5 million, before a provision for cargo investigations of \$125 million, compared to operating income of \$10 million in the first six months of 2007, a deterioration of \$15 million versus the same period in 2007.

In the first six months of 2008, EBITDAR amounted to \$471 million, before the provision for cargo investigations of \$125 million, compared to EBITDAR of \$428 million in the same period in 2007, an improvement of \$43 million, despite an increase in fuel expense of \$342 million when compared to the first six months of 2007.

System passenger revenues increased 6.5% over the first six months of 2007

Passenger revenues increased \$292 million or 6.5% to \$4,765 million in the first six months of 2008 due to growth in both system traffic and yield. The following factors contributed to the year-over-year change in system passenger revenues for the first six months:

- A system yield improvement of 2.4% largely reflecting higher fares and increased fuel surcharges to offset higher fuel prices. An increase in the proportion of higher-yielding business travelers in the international markets was also a factor in the yield growth. The year-over-year yield growth of 2.5% in the second quarter of 2008 improved from the 2.2% year-over-year growth reflected in the first quarter of 2008.
- Traffic growth of 3.4% on a capacity increase of 3.4%, resulting in a passenger load factor unchanged from the first six months of 2007. The year-over-year capacity growth slowed to 2.4% in the second quarter of 2008 from a 4.6% increase in the first quarter of 2008. The year-over-year system passenger traffic growth decreased from 4.4% in the first quarter of 2008 to 2.4% in the second quarter of 2008. The passenger load factor for both quarters remained essentially unchanged from the same periods in 2007.
- A stronger Canadian dollar in the first six months of 2008, which lowers the Canadian dollar value of sales in foreign countries, had a negative impact on foreign currency denominated revenues, accounting for a decrease of \$123 million in passenger revenues for the first six months of 2008.
- A RASM improvement of 2.3% in the first six months of 2008 reflecting the growth in yield. The year-over-year growth in system RASM of 2.0% in the first quarter of 2008 increased to 2.6% in the second quarter of 2008, primarily due to higher yield growth. When compared to the first quarter of 2008, year-over-year RASM improvements were reflected in all markets with the exception of the US transborder market.

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

First Six Months of 2008 Versus First Six Months of 2007	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	7.5	3.7	3.5	(0.2)	3.8	3.6
US transborder	3.1	(3.7)	(3.8)	(0.2)	7.2	7.0
Atlantic	2.8	3.3	1.6	(1.4)	1.2	(0.5)
Pacific	(0.1)	2.2	2.2	-	(2.3)	(2.3)
Other	26.9	17.7	22.1	2.9	4.0	7.8
Other ⁽¹⁾	17.7	17.7	22.1	2.9	(3.6)	(0.0)
System	6.5	3.4	3.4	-	3.0	3.0
System⁽¹⁾	5.8	3.4	3.4	-	2.4	2.3

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

The following were the main contributing factors in the year-over-year change in passenger revenues for the first six months:

- Domestic passenger revenues of \$1,998 million in the first six months of 2008 increased \$139 million or 7.5% from the first six months of 2007, due to both yield and traffic growth. Traffic increased 3.5% in line with a capacity increase of 3.7%. The RASM growth of 3.6% in the first six months of 2008 was driven by the increase in yield. Year-over-year domestic capacity and traffic growth were slowed in the second quarter of 2008 when compared to the first quarter of 2008. A year-over-year RASM growth of 3.1% in the first quarter of 2008 increased to 4.0% in the second quarter of 2008, mainly as a result of a higher yield growth.
- US transborder passenger revenues of \$988 million in the first six months of 2008 increased \$30 million or 3.1% from the first six months of 2007, due to yield growth. Traffic decreased 3.8% in line with a capacity decrease of 3.7%. The RASM growth of 7.0% in the first six months of 2008 was driven by an increase in yield compared to the same period in 2007. Year-over-year US transborder capacity and traffic growth were slowed in the second quarter of 2008 when compared to the first quarter of 2008. A year-over-year RASM growth of 10.5% in the first quarter of 2008 decreased to a rate of 3.5% in the second quarter of 2008, as a result of a lower yield growth and a passenger load factor deterioration.
- Atlantic passenger revenues of \$858 million in the first six months of 2008 increased \$23 million or 2.8% from the first six months of 2007, due to growth in traffic and yield. Traffic growth was reflected in the France and German markets as a result of an increase in capacity driven by the addition of Boeing 777 aircraft. Partly offsetting this growth was a traffic decrease of 3.0% on the United Kingdom service on a capacity reduction of 1.1%. Atlantic RASM decreased 0.5% from the first six months of 2007 as the yield growth was more than offset by a passenger load factor decline of 1.4 percentage points. Year-over-year Atlantic capacity and traffic growth was slowed significantly in the second quarter of 2008 when compared to the first quarter of 2008. A year-over-year RASM decrease of 3.0% in the first quarter of 2008 improved to a year-over-year growth of 1.6% in the second quarter of 2008 as a result of a passenger load factor improvement and a higher yield growth.
- Pacific passenger revenues of \$447 million in the first six months of 2008 decreased \$1 million from the first six months of 2007 as the traffic growth was more than offset by a lower yield. The yield decrease was in part due to growth in longer-haul flying. In addition, the stronger Canadian dollar had a negative impact on foreign currency denominated revenues. Traffic increased 2.2% in line with a capacity increase of 2.2%. The RASM decrease of 2.3% in the first six months of 2008 compared to the same period in 2007 was due to a lower yield. Year-over-year Pacific capacity and traffic growth accelerated in the second quarter of 2008 when compared to the first quarter of 2008. A year-over-year RASM decrease of 5.0% in the first quarter of 2008 improved to a year-over-year growth of 0.1% in the second quarter of 2008 as a result of a stronger passenger load factor and yield.
- Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of \$474 million in the first six months of 2008 increased \$101 million from the first six months of 2007, due to traffic growth. Traffic increased 22.1% on a capacity increase of 17.7% resulting in a passenger load factor improvement of 2.9 percentage points. RASM was unchanged from the same period in 2007 as a yield decline of 3.6% was offset by the increase in passenger load factor. Year-over-year capacity and traffic grew in the second quarter of 2008 when compared to the first quarter of 2008. A year-over-year RASM decrease of 3.5% in the first quarter of 2008 improved to a year-over-year growth of 6.5% in the second quarter of 2008 as a result of a stronger yield.

Cargo revenues declined 5% from the first six months of 2007

For the first six months of 2008, cargo revenues amounted to \$263 million and were \$13 million or 5% below the first six months of 2007. Non-freighter revenues increased \$14 million or 7%, largely reflecting higher revenues in international markets. Freighter revenues were down \$27 million, primarily as a result of operating one MD-11 freighter aircraft in the first six months of 2008 versus two MD-11 freighters in 2007. System cargo yield per revenue ton mile improved 9% and reflected increased fuel surcharges to partially offset higher fuel prices. A stronger Canadian dollar (with corresponding weaker foreign currencies) had a negative impact on the value of foreign currency denominated revenues.

Other revenues were up 12% from the first six months of 2007

Other revenues of \$481 million in the first six months of 2008 increased \$51 million or 12% from the first six months of 2007. The following factors contributed to the year-over-year change in other revenues:

- A \$28 million increase in aircraft sublease revenues.
- A \$14 million increase in revenues from customers at Air Canada Vacations.
- Other factors amounting to a net increase of \$9 million.

Excluding fuel expense, CASM declined 3.3% from the first six months of 2007

Operating expenses were \$5,514 million in the first six months of 2008, an increase of \$345 million or 7% from the first six months of 2007, reflecting a significant increase in fuel expense. Excluding the increase in fuel expense of \$342 million in the first six months of 2007, operating expenses increased only \$3 million versus the same period in 2007 on a capacity increase of 3.4%.

Including fuel expense, CASM increased 3.1% from the first six months of 2007. Excluding fuel expense, CASM declined 3.3% from the first six months of 2007. Unit cost reductions were recorded in all major categories with the exception of fuel expense, ownership costs and communications and information technology expense. The stronger Canadian dollar versus the US dollar, unit cost savings related to the Boeing 777 aircraft and various cost reductions programs were among the more important factors in the overall unit cost decrease, excluding fuel expense, from the first six months of 2007. The higher unit cost of ownership reflects Air Canada's investment in new aircraft and the aircraft interior refurbishment program.

The following table compares Air Canada's operating expenses per ASM for the first six months of 2008 to Air Canada's operating expenses per ASM for the corresponding period in 2007.

(cents per ASM)	First Six Months		Change	
	2008	2007	cents	%
Wages and salaries	2.49	2.54	(0.05)	(2.0)
Benefits	0.61	0.71	(0.10)	(14.1)
Ownership (DAR) ⁽¹⁾	1.53	1.39	0.14	10.1
Airport and navigation fees	1.60	1.67	(0.07)	(4.2)
Aircraft maintenance, materials and supplies	1.21	1.43	(0.22)	(15.4)
Communications and information technology	0.47	0.46	0.01	2.2
Food, beverages and supplies	0.51	0.53	(0.02)	(3.8)
Commissions	0.32	0.37	(0.05)	(13.5)
Capacity purchase with Jazz	1.51	1.54	(0.03)	(1.9)
Other	2.50	2.54	(0.04)	(1.6)
Operating expense, excluding fuel expense ⁽²⁾	12.75	13.18	(0.43)	(3.3)
Aircraft fuel	5.04	4.08	0.96	23.5
Total operating expense	17.79	17.26	0.53	3.1

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

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

The following summarizes the main factors in the year-over-year change in operating expenses in the first six months:

- Wages, salaries and benefits amounted to \$961 million in the first six months of 2008, a decrease of \$13 million or 1% from the first six months of 2007. Wages and salaries increased \$9 million, largely reflecting an increase of 2% or an average of 508 FTE employees versus the same period in 2007. The increase in FTE employees was required to support the growth in ASM capacity. A higher average salary over the first six months of 2007 was also a factor in the increase. In addition, Air Canada recorded an expense of \$8 million related to the reduction of non-unionized employees under a staff reduction plan in the second quarter of 2008. Partly offsetting these wage and salary increases were reduced overtime expenses. The increase in wages and salaries was more than offset by lower employee benefit expenses of \$22 million, largely the result of lower pension expenses driven by revised actuarial estimates.
- Fuel expense amounted to \$1,563 million in the first six months of 2008, an increase of \$342 million or 28% from the first six months of 2007. A higher base fuel price which accounted for an increase of \$672 million was partly offset by the favourable impact of a stronger Canadian dollar versus the US dollar which accounted for a decrease of \$214 million and favourable hedging results versus the same period in 2007 which accounted for a decrease of \$132 million.
- Ownership costs, comprised of aircraft rent, depreciation and amortization expenses, of \$476 million in the first six months of 2008 increased \$58 million or 14% from the first six months of 2007. The increase was largely driven by the impact of the addition of aircraft to the fleet which accounted for an increase of \$51 million and expenses related to Air Canada's aircraft interior refurbishment program which accounted for an increase of \$39 million. These increases were partly offset by the removal of aircraft from Air Canada's fleet which accounted for a decrease of \$21 million, the impact of reduced MD-11 freighter flying which accounted for a decrease of \$13 million and the favourable impact of foreign exchange which accounted for a decrease of \$12 million.
- Aircraft maintenance, materials and supplies of \$375 million in the first six months of 2008 decreased \$54 million or 13% from the first six months of 2007. The decrease was partly due to timing of maintenance activities in engine and airframe maintenance as well as an overall reduction in maintenance expenses due to the sale, sublease to third parties or lease returns of certain aircraft previously in Air Canada's fleet. The impact of a stronger Canadian dollar versus the US dollar was also a factor in the decline versus the same period in 2007, accounting for a decrease of \$30 million to aircraft maintenance, materials and supplies expense. Partly offsetting these decreases were expenses of \$10 million relating to Boeing 777 and Embraer ERJ-190 aircraft in the first six months of 2008. No maintenance expenses for these aircraft types were recorded in the first six months of 2007.

Non-operating income amounted to \$21 million in the first six months of 2008

Non-operating income amounted to \$21 million in the first six months of 2008 compared to non-operating expense of \$25 million in the first six months of 2007. Gains relating to fair value adjustments on derivatives instruments amounted to \$153 million in the first six months of 2008 versus gains of \$28 million in the first six months of 2007. Net interest expense increased \$37 million over the same period in 2007. A lower amount of capitalized interest related to new aircraft and a decrease in interest income due to lower cash balances more than offset the \$18 million decrease in interest expense. In the first quarter of 2008, Air Canada recorded an impairment charge of \$38 million (\$26 million net of tax) related to the planned retirement of its fleet of Boeing 767-200 aircraft. In the second quarter of 2007, Air Canada recorded a gain on disposal of \$14 million from insurance proceeds relating to a CRJ-100 aircraft owned by Air Canada and leased to Jazz which was damaged beyond repair.

Net losses on foreign currency monetary items amounted to \$41 million in the first six months of 2008

Net losses on foreign currency monetary items amounted to \$41 million in the first six months of 2008 versus net gains of \$193 million in the first six months of 2007. The loss in the first six months of 2008 was largely attributable to a weaker Canadian dollar at June 30, 2008 compared to December 31, 2007, partially offset by gains of \$83 million related to foreign currency derivatives. The June 30, 2008 noon day exchange rate was \$1US = Cdn \$1.0186 while the December 31, 2007 noon day exchange rate was \$1US = Cdn \$0.9881.

Provision for income taxes of \$10 million in the first six months of 2008

Air Canada recorded a provision for income taxes of \$10 million in the first six months of 2008 on a pre-tax loss of \$156 million, as no tax recovery was recorded on the provision for cargo investigations. This compared to a provision for income taxes of \$51 million, at an effective income tax rate of 30%, for the same period in 2007.

5. Our Fleet

In response to record high fuel prices, on June 17, 2008, Air Canada announced a reduction in capacity which will impact fleet and staffing levels effective with the implementation of its fall and winter schedule. The Corporation is continually evaluating its fleet requirements and planned aircraft events may be subject to further review and change.

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

Fleet Plan	Actual						Planned						2009 fleet changes	Year End 2009	
	Year End 2007	New Deliveries	Sublease to Third Party	Lease returns	Sales	Parked	June 30, 2008	New Deliveries	Sublease/lease to Third Party / Sale by Air Canada	Lease returns	Sales	Parked			Year End 2008
B777-300	5	4	-	-	-	-	9	2	-	-	-	-	11	1	12
B777-200	3	3	-	-	-	-	6	-	-	-	-	-	6	-	6
B767-300	31	-	-	(1)	-	-	30	-	(3)	-	-	-	27	-	27
B767-200	10	-	-	-	-	(1)	9	-	-	-	(9)	-	-	-	-
A340-300	5	-	(3)	-	-	-	2	-	(2)	-	-	-	-	-	-
A330-300	8	-	-	-	-	-	8	-	-	-	-	-	8	-	8
A321	10	-	-	-	-	-	10	-	-	-	-	-	10	-	10
A320	41	-	-	-	-	-	41	-	-	-	-	-	41	-	41
A319	37	-	-	(2)	-	-	35	-	-	-	-	-	35	-	35
ERJ-190	42	3	-	-	-	-	45	-	-	-	-	-	45	-	45
ERJ-175	15	-	-	-	-	-	15	-	-	-	-	-	15	-	15
Total	207	10	(3)	(3)	-	(1)	210	2	(5)	-	-	(9)	198	1	199
Average age (years)	9.0						8.9						8.7		9.6

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

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

Aircraft Interior Refurbishment Program

Air Canada commenced a refurbishment program of the interiors of its existing aircraft (Boeing 767-300, Airbus A330-300, A321, A320 and A319 aircraft) in 2006 in order to offer its customers a world class product. As at August 7, 2008, Air Canada has completed the refurbishment of 26 Boeing 767-300, 10 Airbus A321, 39 Airbus A320 and 35 Airbus A319, for a total of 110 aircraft to date. Air Canada expects all remaining operating aircraft in its fleet to be refurbished by the end of February 2009.

6. Financial and Capital Management
6.1 Financial Position

The following table provides the financial position of Air Canada as at June 30, 2008 and as at December 31, 2007.

Condensed Statement of Financial Position (Canadian dollars in millions)	June 30, 2008	December 31, 2007
Assets		
Cash, cash equivalents and short-term investments	\$ 1,497	\$ 1,239
Other current assets	1,615	1,222
Current assets	3,112	2,461
Property and equipment	7,496	7,919
Intangible assets	962	952
Other assets	617	488
	\$ 12,187	\$ 11,820
Liabilities		
Current liabilities	\$ 3,332	\$ 2,939
Long-term debt and capital leases	3,863	4,006
Pension and other benefits liabilities	1,738	1,824
Other long-term liabilities	597	424
	9,530	9,193
Non-controlling interest	190	184
Shareholders' equity	2,467	2,443
	\$ 12,187	\$ 11,820

6.2 Adjusted Net Debt

The table reflects Air Canada's adjusted net debt balances and net debt to net debt plus equity ratio as at June 30, 2008 and as at December 31, 2007.

(Canadian dollars in millions)	June 30, 2008	December 31, 2007	Change
Total long-term debt and capital lease obligations	\$ 3,863	\$ 4,006	\$ (143)
Current portion of long debt and capital lease obligations	396	413	(17)
	4,259	4,419	(160)
Non-controlling interest	190	184	6
Less cash, cash equivalents and short-term investments	(1,497)	(1,239)	(258)
Net debt and non-controlling interest	2,952	3,364	(412)
Capitalized operating leases ⁽¹⁾	1,950	2,115	(165)
Adjusted net debt and non-controlling interest	4,902	5,479	(577)
Less pre-delivery (PDP) financing included in long-term debt	(135)	(521)	386
Adjusted net debt and non-controlling interest, excluding PDP financing	4,767	4,958	(191)
Shareholders' equity	\$ 2,467	\$ 2,443	\$ 24
Adjusted net debt to net debt plus equity ratio, excluding PDP financing	65.9%	67.0%	(1.1) pp

(1) Adjusted net debt is a non-GAAP measure used by the Corporation and is not likely to be comparable to measures presented by other public companies. The Corporation includes capitalized operating leases which is a measure commonly used in the industry to ascribe a value to obligations under operating leases. Common industry practice is to multiply annualized aircraft rent expense by 7.5. This definition of capital is used by the Corporation and may not be comparable to similar measures presented by other public companies. Aircraft rent was \$260 million for the twelve months ended June 30, 2008 and \$282 million for the twelve months ended December 31, 2007. Aircraft rent expense includes aircraft rent associated with aircraft subleased to third parties. The sublease revenue associated with these aircraft leases is included in Other revenues on Air Canada's statement of operations.

At June 30, 2008, adjusted net debt and non-controlling interest, including capitalized operating leases, and excluding the pre-delivery payment ("PDP") financing, decreased \$191 million from December 31, 2007. The adjusted net debt to net debt plus equity ratio for Air Canada decreased to 65.9% at June 30, 2008 from 67.0% at December 31, 2007. The 1.1 percentage point improvement from December 31, 2007 was in part attributable to a stronger cash position.

6.3 Liquidity

The Corporation's principal source of liquidity is cash generated from operations. Such cash generation fluctuates within any given year based on seasonal demand patterns.

Given the high fuel price environment, the Corporation is highly focused on preserving cash and identifying sources of cash inflows. To preserve cash, the Corporation has reduced capacity and the associated expenses as well as adjusted its capital expenditure programs where appropriate. The delay in the delivery of the Boeing 787 aircraft also reduces capital expenditures and preserves cash in the short-term. Cash inflows have been positively impacted by the financing of a number of Boeing 777 deliveries through sale and leaseback transactions (instead of debt financing transactions) and the improvement in the Corporation's working capital. The Corporation will seek to enter into long-term financing transactions on owned assets as necessary and when appropriate to maintain sufficient liquidity. Refer to Air Canada's 2007 MD&A dated February 6, 2008 for additional information on the Corporation's monitoring and management of liquidity.

At June 30, 2008, Air Canada had cash, cash equivalents and short-term investments of \$1,497 million. Cash, cash equivalents and short-term investments increased \$258 million from December 31, 2007, largely due to positive cash flows from operations of \$444 million, the sale and leaseback of five Boeing 777 aircraft in the first six months of 2008 partly offset by additions to capital assets.

Air Canada owns or retains equity in a wide range of aircraft-related assets such as nine Boeing 777 aircraft, 60 Embraer aircraft and inventory. These assets could permit Air Canada to increase its liquidity by approximately \$800 million.

Air Canada has a secured revolving credit facility of \$400 million, as further described in Note 8 to the 2007 annual consolidated financial statements of the Corporation, which is not available to the Corporation until and unless the Corporation and the lenders conclude amendments satisfactory to each of them relating to a financial covenant and other business terms. Subsequent to June 30, 2008, the Corporation and the lenders have entered into an amending agreement pursuant to which the parties undertake to negotiate such further amendments to the facility and the Corporation agrees not to request any funding under the facility until such further amendments are agreed. The outcome of the negotiations remain uncertain such that there can be no assurance that amendments satisfactory to the parties will be concluded, that amounts under the facility will ever be available to the Corporation, that the Corporation will not decide to terminate the facility, or that a replacement facility will be concluded. In the event of termination of the credit facility, the assets previously securing the credit facility would be expected to generate a similar level of liquidity as they do under the credit facility.

Actively managing working capital is key to ensuring cash is available to partially support funding of the Corporation's fleet renewal and refurbishment. The following table provides additional information on Air Canada's working capital balances at June 30, 2008 as compared to December 31, 2007.

(Canadian dollars in millions)	June 30, 2008	December 31, 2007	Change in working capital
Cash and short-term investments	\$ 1,497	\$ 1,239	\$ 258
Accounts receivable	943	750	193
Other current assets	672	472	200
Accounts payable and accrued liabilities	(1,159)	(1,226)	67
Other current liabilities	(2,173)	(1,713)	(460)
	\$ (220)	\$ (478)	\$ 258

The improvement in working capital was largely attributable to cash from operations. In addition, cash was favourably impacted by net proceeds of \$144 million, from the sale and leaseback of five Boeing 777 aircraft, which is derived from the proceeds from the sale and leaseback transactions of \$708 million less the final delivery payments on the aircraft and the repayment of the related pre-delivery financing. In the first six months of 2008, additions to capital assets, excluding the sale and leaseback transactions, amounted to \$441 million and included three Embraer ERJ-190 aircraft, two Boeing 777 aircraft, expenditures related to the aircraft interior refurbishment program and inventory and spare engines and is net of the return of certain Boeing 787 pre-delivery deposits. New financing amounted to \$313 million and was mainly related to committed delivery financing and additional pre-delivery financing. Refer to section 6.3 of this MD&A for a discussion on Air Canada's liquidity.

Fuel derivatives are comprised of both derivatives designated and not designated under fuel accounting. The current portion of the derivative asset of \$382 million (included in fuel derivatives in Air Canada's consolidated statement of financial position) and the long-term portion of the derivative asset of \$118 million (included in deposits and other assets in Air Canada's consolidated statement of financial position) are included in other current assets in the table above. Refer to section 8 for additional information on Air Canada's fuel derivative instruments.

6.4 Consolidated Cash Flow Movements

For comparative purposes, the following table and discussion provides the reader with the results of Air Canada for the second quarter of 2008 and for the first six months of 2008 and the results of the Air Canada Services segment, which excluded the consolidation of Jazz, for the second quarter of 2007 and for the first six months of 2007.

Air Canada's free cash flow for the second quarter of 2008 improved \$610 million from the second quarter of 2007 and \$623 million in the first six months of 2008 versus the same period in 2007. The improvement in free cash flow was largely related to a reduction in capital expenditures, due to fewer aircraft deliveries in the second quarter of 2008 compared to second quarter of 2007, and a favourable change in non-cash working capital items. The favourable change in non-cash working capital items was mainly attributable to an increase in advance ticket sales.

(Canadian dollars in millions)	Second Quarter			First Six Months		
	2008	2007	Change \$	2008	2007	Change \$
Net cash provided by operating activities	\$ 65	\$ 128	\$ (63)	\$ 43	\$ 33	\$ 10
Changes in non-cash working capital	149	(18)	167	401	317	84
Cash flows from operating activities	214	110	104	444	350	94
Additions to capital assets	(225)	(731)	506	(628)	(1,157)	529
Free cash flow ⁽¹⁾	(11)	(621)	610	(184)	(807)	623
Proceeds from sale and leaseback transactions	297	-	297	708	-	708
Short-term investments	(165)	44	(209)	(66)	(83)	17
Other	10	(38)	48	62	9	53
Cash flows from (used for) investing activities (excluding additions to capital assets)	142	6	136	704	(74)	778
Aircraft-related borrowings	126	532	(406)	313	644	(331)
Reduction of long-term debt and capital lease obligations	(319)	(89)	(230)	(641)	(167)	(474)
Other	-	-	-	-	(36)	36
Cash flows from (used for) financing activities	(193)	443	(636)	(328)	441	(769)
Net increase (decrease) in cash and cash equivalents	(62)	(172)	110	192	(440)	632
Net increase (decrease) in short-term investments	165	(44)	209	66	83	(17)
Net increase (decrease) in cash, cash equivalents and short term investments	\$ 103	\$ (216)	\$ 319	\$ 258	\$ (357)	\$ 615

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

6.5 Contractual Obligations

The table below provides Air Canada's current contractual obligations for the remainder of 2008, for the next four years and after 2012.

(Canadian dollars in millions)	Remainder						Total
	of 2008	2009	2010	2011	2012	Thereafter	
Long-term debt obligations ⁽¹⁾	\$ 153	\$ 299	\$ 278	\$ 283	\$ 287	\$ 2,009	\$ 3,309
Debt consolidated under AcG-15 ⁽¹⁾	101	106	153	338	93	304	1,095
Capital lease obligations ⁽¹⁾	119	161	157	151	192	604	1,384
Operating lease obligations ⁽²⁾	148	300	289	226	208	718	1,889
Committed capital expenditures ⁽³⁾	195	75	84	83	453	3,745	4,635
Total contractual obligations ⁽⁴⁾	\$ 716	\$ 941	\$ 961	\$ 1,081	\$ 1,233	\$ 7,380	\$ 12,312
Pension funding obligations ⁽⁵⁾	\$ 302	\$ 462	\$ 469	\$ 476	\$ 483	N/A	N/A

(1) Includes both the principal and the interest component of the payment obligations on long-term debt and capital leases and is based on interest rates and the applicable foreign exchange rate effective as at June 30, 2008.

(2) Mainly related to US dollar aircraft operating leases.

(3) Mainly related to US dollar aircraft-related expenditures. Also includes purchases relating to system development costs, facilities and leasehold improvements.

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

(5) See section 6.6 of this MD&A for additional information on Air Canada's pension plan funding obligations.

6.6 Pension Funding Obligations

Air Canada's pension cash funding obligations are updated from those disclosed in Air Canada's annual 2007 MD&A dated February 6, 2008.

As at January 1, 2008, the solvency deficit in the registered domestic plans was \$1,175 million compared to \$542 million at January 1, 2007. The increase in the solvency deficit of the plans represents a deterioration in the financial position of the plans with the solvency ratio for all plans, on a combined basis, decreasing from 95% to 90%. This decrease resulted mainly from a below target return on fund assets of (0.5%) on the Master Trust, net of expenses.

Changes in the economic conditions, mainly the return on fund assets and the change in interest rates, will impact projected required contributions. The required contributions and solvency deficit disclosed below assume no future gains and losses on plan assets and liabilities over the projection period and especially do not reflect the economic experience of 2008 to date.

Based on the January 1, 2008 actuarial valuation, Air Canada's projected pension cash funding obligations for the remainder of 2008, for the full year 2008 and for the next four years are as follows:

(Canadian dollars in millions)	Remainder					
	of 2008	2008	2009	2010	2011	2012
Past service domestic registered plans	\$ 148	\$ 194	\$ 223	\$ 223	\$ 223	\$ 223
Current service domestic registered plans	89	170	174	178	184	189
Other pension arrangements ⁽¹⁾	65	92	65	68	69	71
Projected pension funding obligations	\$ 302	\$ 456	\$ 462	\$ 469	\$ 476	\$ 483

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

The above pension funding requirements are in respect of the Corporation's pension arrangements. For domestic registered pension plans, the funding requirements are based on the minimum past service contributions disclosed in the January 1, 2008 actuarial valuations plus a projection of the current service contributions. The next actuarial valuations are due on January 1, 2009.

6.7 Capital Expenditures and Related Financing Arrangements

Boeing

In November 2005, Air Canada concluded agreements with The Boeing Company ("Boeing") for the acquisition of Boeing 777 and Boeing 787 aircraft.

As at June 30, 2008, 14 of the 16 Boeing 777 firm aircraft under the purchase agreement with Boeing had been delivered, with the remaining two firm deliveries expected by the end of 2008. The seven aircraft delivered in 2007 were financed under a loan guarantee facility with the Export-Import Bank of the United States ("EXIM"). In January 2008, the Corporation received a commitment for loan guarantee support from EXIM for all nine 2008 Boeing 777 firm aircraft deliveries. The loan guarantee, subject to certain conditions, covers a 12-year loan term for 85% of the capital expenditure at an interest rate based on a floating rate. As at August 7, 2008, seven of the nine 2008 Boeing 777 aircraft had been delivered, two of these aircraft were financed using the EXIM facility and the other five aircraft were, concurrently with their purchase, sold by and leased back to Air Canada. The five leases are accounted for as operating leases with 12-year terms. All leases are at market rates at their inception date. These sale and leaseback transactions replace an equivalent number of aircraft loan guarantee commitments provided by EXIM. The table below assumes that Air Canada's remaining two Boeing 777 firm aircraft scheduled for delivery by the end of 2008 will be financed under the loan guarantee facility with EXIM. The Corporation continues to review alternative financing options including sale and leaseback transactions for the remaining two Boeing 777 aircraft.

In the first quarter of 2008, Boeing notified Air Canada that its first Boeing 787 aircraft originally scheduled for delivery in 2010 was rescheduled for delivery in 2012, with additional deliveries, originally scheduled for completion between 2010 and 2014, being delayed by approximately two to two and a half years. Air Canada will be seeking compensation from Boeing. Air Canada is evaluating alternatives to mitigate any potential impact of this delay.

Projected Planned and Committed Capital Expenditures

The table below provides Air Canada's current projected planned and committed capital expenditures for the full year 2008, for the next four years and after 2012.

(Canadian dollars in millions)	2008	2009	2010	2011	2012	Thereafter
Projected committed expenditures	\$ 471	\$ 75	\$ 84	\$ 83	\$ 453	\$ 3,745
Projected planned but uncommitted expenditures	222	127	151	116	85	
Total projected expenditures ^{(1) (2)}	693	202	235	199	538	
Projected financing on committed expenditures	(493)	-	-	-	(400)	
Total projected expenditures, net of financing	\$ 200	\$ 202	\$ 235	\$ 199	\$ 138	

(1) US dollar amounts are converted using the June 30, 2008 noon day exchange rate of 1US\$ = Cdn\$1.0186. Final aircraft delivery prices include estimated escalation and interest on deferred delivery payments, which is calculated based on the 90-day USD LIBOR rate at June 30, 2008.

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

6.8 Share Information

An aggregate of 100 million Class A variable voting shares and Class B voting shares in the capital of Air Canada are issued and outstanding. The issued and outstanding shares of Air Canada, along with shares potentially issuable, are as follows:

	Number of shares	
	July 31, 2008	December 31, 2007
Issued and outstanding shares		
Class A variable voting shares	17,130,759	16,654,049
Class B voting shares	82,869,241	83,345,951
Total issued and outstanding shares	100,000,000	100,000,000
Class A variable voting and Class B voting shares potentially issuable		
Stock options	1,705,378	1,720,092
Total shares potentially issuable	1,705,378	1,720,092
Total outstanding and potentially issuable shares	101,705,378	101,720,092

7. Quarterly Financial Data

Prior to May 24, 2007, Air Canada had two reportable segments: Air Canada Services (which is now referred to as Air Canada) and Jazz. Segment information provided useful information to shareholders as it enabled them to distinguish between the results of operations, cash and other assets and liabilities of the two segments. Effective May 24, 2007, Air Canada no longer consolidates the operations of Jazz. **For comparative purposes, the following table summarizes quarterly financial results and major operating statistics for Air Canada, excluding the consolidation of Jazz operations, for the last eight quarters.**

(\$ millions, except per share figures)	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
	2006	2006	2007	2007	2007	2007	2008	2008
Operating revenues	\$ 2,861	\$ 2,423	\$ 2,540	\$ 2,639	\$ 2,954	\$ 2,513	\$ 2,727	\$ 2,782
Special charge for Aeroplan miles ⁽¹⁾	(102)	-	-	-	-	-	-	-
Operating revenues	2,759	2,423	2,540	2,639	2,954	2,513	2,727	2,782
Ownership (DAR) ⁽²⁾	(205)	(218)	(207)	(211)	(210)	(202)	(234)	(242)
Other operating expenses	(2,424)	(2,210)	(2,411)	(2,340)	(2,393)	(2,239)	(2,505)	(2,533)
Operating expenses	(2,629)	(2,428)	(2,618)	(2,551)	(2,603)	(2,441)	(2,739)	(2,775)
Operating income (loss) before the under-noted item	130	(5)	(78)	88	351	72	(12)	7
Provision for cargo investigations ⁽³⁾	-	-	-	-	-	-	(125)	-
Operating income (loss)	130	(5)	(78)	88	351	72	(137)	7
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(86)	(139)	44	67	(78)	(37)	(151)	115
Net income (loss)	\$ 44	\$ (144)	\$ (34)	\$ 155	\$ 273	\$ 35	\$ (288)	\$ 122
Revenue passenger miles (millions)	14,345	11,160	11,814	12,580	14,789	11,446	12,331	12,884
Available seat miles (millions)	17,528	14,343	14,735	15,220	18,144	14,715	15,407	15,581
Passenger load factor (%)	81.8	77.8	80.2	82.7	81.5	77.8	80.0	82.7
Operating expense per available seat mile (CASM) (cents)	15.0	16.9	17.7	16.8	14.3	16.6	17.8	17.8
CASM, excluding fuel expense (cents) ⁽⁴⁾	10.7	12.9	13.8	12.6	10.4	12.4	13.1	12.4
EBITDAR before the provision for cargo investigations ⁽⁴⁾	\$ 335	\$ 213	\$ 129	\$ 299	\$ 561	\$ 274	\$ 222	\$ 249
EBITDAR ⁽⁴⁾, excluding the special charges for Aeroplan miles and labour restructuring	\$ 437	\$ 205	\$ 129	\$ 299	\$ 561	\$ 274	\$ 97	\$ 249
EBITDAR ⁽⁴⁾	\$ 335	\$ 213	\$ 129	\$ 299	\$ 561	\$ 274	\$ 97	\$ 249
Earnings (loss) per share								
- Basic and diluted ⁽⁵⁾	\$ 0.50	\$ (1.55)	\$ (0.34)	\$ 1.55	\$ 2.73	\$ 0.35	\$ (2.88)	\$ 1.22

(1) The third quarter of 2006 includes a special charge of \$102 million in connection with Air Canada's obligation for the redemption of pre-2002 Aeroplan miles.

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

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

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

(5) Earnings (loss) per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.

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

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

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

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

(\$ millions, except per share figures)	Q3 2006	Q4 2006	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Q2 2008
Consolidated Total								
Operating revenues	\$ 2,837	\$ 2,395	\$ 2,510	\$ 2,622	\$ 2,954	\$ 2,513	\$ 2,727	\$ 2,782
Special charge for Aeroplan miles ⁽¹⁾	(102)	-	-	-	-	-	-	-
Operating revenues	2,735	2,395	2,510	2,622	2,954	2,513	2,727	2,782
Ownership (DAR) ⁽²⁾	(237)	(247)	(237)	(231)	(210)	(202)	(234)	(242)
Other operating expenses	(2,329)	(2,119)	(2,315)	(2,277)	(2,393)	(2,239)	(2,505)	(2,533)
Operating expenses	(2,566)	(2,366)	(2,552)	(2,508)	(2,603)	(2,441)	(2,739)	(2,775)
Operating income (loss) before the under-noted item	169	29	(42)	114	351	72	(12)	7
Provision for cargo investigations ⁽³⁾	-	-	-	-	-	-	(125)	-
Operating income (loss)	169	29	(42)	114	351	72	(137)	7
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(125)	(173)	8	41	(78)	(37)	(151)	115
Net income (loss)	\$ 44	\$ (144)	\$ (34)	\$ 155	\$ 273	\$ 35	\$ (288)	\$ 122
Earnings (loss) per share								
- Basic and diluted ⁽⁴⁾	\$ 0.50	\$ (1.55)	\$ (0.34)	\$ 1.55	\$ 2.73	\$ 0.35	\$ (2.88)	\$ 1.22

(1) The third quarter of 2006 includes a special charge of \$102 million in connection with Air Canada's obligation for the redemption of pre-2002 Aeroplan miles.

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

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

(4) Earnings (loss) per share – basic and diluted are the consolidated Air Canada figures as reported under GAAP.

8. Financial Instruments and Risk Management

As described in section 10 of this MD&A, the Corporation adopted CICA sections 3862 and 3863 effective January 1, 2008. These new standards enhance disclosures with respect to financial instruments.

Risk Management

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

Fuel Price Risk

To manage its exposure to jet fuel prices and minimize volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries.

As at June 30, 2008, Air Canada had hedged 40% of its fuel requirement for the second quarter of 2008, 43% of its projected fuel requirement for the remainder of 2008, 20% of its projected fuel requirement for 2009 and 7.5% of its projected fuel requirement for 2010. The remainder of 2008 was hedged at prices that fluctuate between an average of US\$108 to US\$116 per barrel for jet-fuel based contracts, an average of US\$95 to US\$99 per barrel for heating oil-based contracts and an average of US\$111 to US\$125 per barrel for West Texas Intermediate ("WTI") crude-oil based contracts. On an equivalent WTI basis, the remainder of 2008 was hedged at prices that fluctuate between an average of US\$91 to US\$97 per barrel.

Since June 30, 2008, Air Canada has entered into new hedging positions, using costless collar option structures. As at August 7, 2008, Air Canada had hedged 49% of its projected fuel requirement for the remainder of 2008, 24% of its projected fuel requirement for 2009 and 9.4% of its projected fuel requirement for 2010. With these new hedging positions, the remainder of 2008 is hedged at prices that can fluctuate between an average of US\$108 to US\$116 per barrel for jet-fuel based contracts, an average of US\$98 to US\$102 per barrel for heating oil-based contracts and an average of US\$116 to US\$129 per barrel for WTI crude-oil based contracts. On an equivalent WTI basis, the remainder of 2008 is hedged at prices that fluctuate between an average of US\$94 to US\$101 per barrel.

The total increase in the fair value of the Corporation's fuel derivatives, including derivatives under hedge accounting and not under hedge accounting, amounted to \$449 million in the second quarter of 2008 (\$568 million in the first six months of 2008). Of the fair value gain, \$255 million was deferred in other comprehensive income ("OCI") in the second quarter of 2008 to be applied as a reduction to fuel expense in the future as the contracts mature (\$401 million in the first six months of 2008), and the remaining \$194 million was recorded as a gain in non-operating income in the second quarter of 2008 (\$167 million in the first six months of 2008). The accounting treatment in either OCI or non-operating expense, as described further below, does not alter the economic impact of the Corporation's fuel hedging program.

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

- The fair value of outstanding fuel derivatives under hedge accounting at June 30, 2008 was \$463 million in favour of the Corporation. At July 30, 2008, the fair value of the outstanding fuel derivatives was \$281 million.
- The change in fair value of derivatives in the second quarter of 2008 was \$370 million (\$483 million in the first six months of 2008):
 - The unrealized effective change in the fair value of derivatives recorded in OCI in the second quarter of 2008 was \$213 million before tax expense of \$68 million (\$347 million before tax expense of \$110 million in the first six months of 2008). The realized effective change in the fair value of derivatives recorded in OCI in the second quarter of 2008 was \$42 million before tax expense of \$14 million (\$54 million before tax expense of \$18 million in the first six months of 2008). OCI amounts for the three and six months ended June 30, 2008 of \$173 million and \$273 million, respectively, are presented net of this tax expense on Air Canada's consolidated statement of comprehensive income.

- The ineffective change in the fair value of derivatives recorded in non-operating income (expense) in the second quarter of 2008 was a gain of \$115 million (\$82 million in the first six months of 2008). The ineffective portion is calculated as the difference between the change in the intrinsic value and the change in the fair market value of the derivatives over the period as well as the difference between the Air Canada proxy derivative value and the counterparty derivative value. The gain in non-operating income (expense) was due to the change in the fair market value of the derivatives being higher than the change in the intrinsic value.
- In the first quarter of 2008, hedge accounting was discontinued for certain fuel hedge contracts, with a fair value of \$8 million, where the hedging relationship ceased to satisfy the conditions for hedge accounting. Certain of these contracts were re-designated under hedge accounting in the second quarter of 2008. The Corporation still continues to hold these derivatives as it believes they continue to be good economic hedges in managing its exposure to jet fuel prices. The value of the accumulated other comprehensive income ("AOCI") balance recognized in connection with these derivatives will be taken into fuel expense upon the maturity of the contracts. No further de-designations were required in the second quarter of 2008.
- In the second quarter of 2008, fuel derivative contracts matured with fair values in favour of the Corporation for \$93 million.
- In the second quarter of 2008, the benefit to fuel expense was \$92 million before tax expense of \$30 million (\$126 million before tax expense of \$41 million in the first six months of 2008). This benefit was recognized through the removal of the amount from AOCI. The after tax amount of \$62 million in the second quarter of 2008 was reflected in "reclassification of net realized (gains) losses on fuel derivatives to income" on Air Canada's consolidated statement of comprehensive income (\$85 million in the first six months of 2008).
- In the second quarter of 2008, the net impact to AOCI was an increase of \$163 million before tax expense of \$52 million (\$275 million before tax expense of \$87 million in the first six months of 2008). As at June 30, 2008, the balance in AOCI was \$359 million before tax. The estimated net amount of existing gain and losses reported in AOCI that is expected to be reclassified to net income (loss) in the following 12 months is \$308 million before tax.

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

- In the second quarter of 2008, fuel derivative contracts matured in favour of the Corporation for \$12 million (\$19 million in the first six months of 2008).
- The fair value of outstanding fuel derivatives not under hedge accounting at June 30, 2008 was \$37 million in favour of the Corporation.
- The change in fair value of the derivative contracts in the second quarter of 2008 was a gain of \$79 million (\$85 million in the first six months of 2008) and was recorded in non-operating income (expense).

Interest Rate Risk

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

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

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

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

- The Corporation entered into three cross-currency interest rate swap agreements with terms of March 2019, May 2019, and June 2019 respectively, relating to Boeing 777 aircraft financing with an aggregate notional value of \$294 million (US\$289 million) as at June 30, 2008. These swaps convert US denominated debt principal and interest payments into Canadian denominated debt at a foreign exchange rate of par (US\$1/CAD\$1) and convert from a fixed rate of 5.208% to a floating rate. These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. As at June 30, 2008, the fair value of these contracts was \$13 million in favour of the counterparty. The Corporation recorded a loss of \$19 million in the second quarter of 2008.
- In the first quarter of 2008, the Corporation's one remaining Embraer 190 aircraft interest rate swap contract matured, with a fair value of \$2 million in favour of the counterparty. No gain or loss was recorded during the period.

Foreign Exchange Risk

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

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

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

The Corporation's risk management objective is to reduce cash flow risk related to foreign denominated cash flows. To help manage this risk, the Corporation enters into certain foreign exchange forward contracts or currency swaps to manage the risks associated with foreign currency exchange rates. As at June 30, 2008, the Corporation had entered into foreign currency forward contracts and option agreements converting US dollars and Euros into Canadian dollars on \$1,993 million (US\$1,958 million) and \$30 million (EUR 19 million) which mature in 2008, 2009 and 2010. The fair value of these foreign currency contracts as at June 30, 2008 was \$1 million in favour of the Corporation (December 31, 2007 - \$124 million in favour of third parties on \$2,132 million (US\$2,158 million) and \$26 million (EUR 18 million) which mature in 2008 and 2009). In the second quarter of 2008, a gain of \$4 million (a gain of \$83 million in the first six months of 2008) was recorded in foreign exchange gain (loss) related to these derivatives. These derivative instruments have not been designated as hedges for accounting purposes.

The cross-currency swap as described above under interest rate risk acts as an economic hedge of the foreign exchange risk on the financing related to two Boeing 777 aircraft with a principal amount of \$294 million (US\$289 million) as at June 30, 2008.

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

Liquidity risk

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

The Corporation monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as security in financing arrangements, and maintaining flexibility in financing arrangements.

Market Risk

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

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

Asset-Backed Commercial Paper ("ABCP")

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

The carrying value as at June 30, 2008 was based on a number of assumptions as to the fair value of the investments including factors such as estimated cash flow scenarios and risk adjusted discount rates. The assumptions used in estimating the fair value of the investments are subject to change, which may result in further adjustments to non-operating results in the future. No adjustment to the carrying value was recorded during the first six months of 2008.

9. Related Party Transactions

At June 30, 2008, ACE had a 75% ownership interest in Air Canada. Air Canada has various related party transactions with ACE and ACTS Aero Technical Support & Services Inc. ("ACTS Aero"). The relationship between Air Canada and ACTS Aero and between Air Canada and ACE are described in Air Canada's 2007 MD&A dated February 6, 2008.

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

(Canadian dollars in millions)	June 30, 2008	December 31, 2007
Accounts receivable		
ACE	\$ 4	\$ 9
ACTS Aero	91	75
	\$ 95	\$ 84
Prepaid Maintenance		
ACTS Aero	\$ 8	\$ 24
	\$ 8	\$ 24
Accounts payable and accrued liabilities		
ACTS Aero	\$ 37	\$ 88
	\$ 37	\$ 88

Revenues and expenses with related parties are summarized as follows:

(Canadian dollars in millions)	Second Quarter		First Six Months	
	2008	2007	2008	2007
Revenues				
Property rental revenues from ACE and ACTS Aero	\$ 9	\$ 12	\$ 18	\$ 21
Revenues from information technology services to ACTS Aero	4	4	7	7
Revenues from corporate services and other to ACE and ACTS Aero	6	5	19	10
Cargo revenues from ACTS Aero	-	1	-	1
	\$ 19	\$ 22	\$ 44	\$ 39
Expenses				
Maintenance expense for services from ACTS Aero	\$ 134	\$ 187	\$ 275	\$ 375
Recovery of wages, salary and benefit expense for employees assigned to ACE and ACTS Aero	(73)	(111)	(155)	(196)
	\$ 61	\$ 76	\$ 120	\$ 179

10. Changes in Accounting Policies

Capital Disclosures and Financial Instruments – Presentation and Disclosure

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

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

Sections 3862 and 3863 replace section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements in certain areas, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. Refer to section 8 of this MD&A for information on the Corporation's financial instruments.

Inventories

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

Future Accounting Standard Changes

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

In February 2008, the Canadian Accounting Standards Board confirmed January 1, 2011 as the changeover date for Canadian publicly accountable enterprises to start using International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosures.

As a result, the Corporation is developing a plan to convert its consolidated financial statements to IFRS. The plan addresses the impact of IFRS on:

- Accounting policies and implementation decisions
- Information technology and data systems
- Internal control over financial reporting
- Disclosure controls and procedures
- Financial reporting expertise
- Business activities

The Corporation has established a cross-functional IFRS team and is providing training to key employees.

The Corporation is currently in the process of assessing the differences between IFRS and the Corporation's current accounting policies, as well as the alternatives available on adoption. This assessment includes the impact of conversion on information technology and data systems, internal control over financial reporting, disclosure controls and procedures and business activities.

Changes in accounting policies are likely. These changes may materially impact the Corporation's consolidated financial statements.

11. Off-Balance Sheet Arrangements

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

12. Critical Accounting Estimates

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

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

13. Risk Factors

For a detailed description of the risk factors associated with the Corporation, refer to the section entitled "Risk Factors" in Air Canada's 2007 MD&A dated February 6, 2008. Certain risk factors in Air Canada's 2007 MD&A are revised to provide for the following updates:

The European Commission, the United States Department of Justice and the Competition Bureau in Canada, among other competition authorities, are investigating alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including the Corporation, a number of whom, including the Corporation, have received a statement of objections from the European Commission that sets out the European Commission's preliminary assessment in relation to such matter. The Corporation has provided its reply to the statement of objections. Competition authorities have sought or requested information from the Corporation as part of their investigations. The Corporation is cooperating with these investigations, which are likely to lead to proceedings against the Corporation and a number of airlines and other cargo operators in certain jurisdictions. The Corporation is also named as a defendant in a number of class action lawsuits that have been filed before the United States District Court and in Canada in connection with these allegations.

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

The risk factor describing the Air Canada Pilots Association ("ACPA") claim under Current Legal Proceedings is amended to reflect the Ontario Court of Appeal's decision, on June 27, 2008, to reject ACPA's appeal of the order dismissing its claim.

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

14. Controls and Procedures**Disclosure Controls and Procedures**

Air Canada's Audit, Finance and Risk Committee reviewed the Second Quarter 2008 MD&A and the Second Quarter 2008 Interim Unaudited Consolidated Financial Statements and Air Canada's Board of Directors reviewed and approved these documents prior to their release.

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

Air Canada's 2007 Annual Report contains a statement that the President and Chief Executive Officer and the Executive Vice President and Chief Financial Officer have concluded that Air Canada's disclosure controls and procedures are effective based upon an evaluation of these controls and procedures conducted at December 31, 2007.

Changes in Internal Controls over Financial Reporting

There were no changes to Air Canada's internal controls over financial reporting during the three months ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

15. Non-GAAP Financial Measures
EBITDAR

EBITDAR (earnings before interest, taxes, depreciation, amortization and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before aircraft rent and depreciation and amortization as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. Air Canada presents EBITDAR before and after the provision for cargo investigations as this item could potentially distort the analysis of trends in business performance. EBITDAR is not a recognized measure for financial statement presentation under Canadian GAAP and does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies.

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

(Canadian dollars in millions)	Second Quarter			First Six Months		
	2008	2007	\$ Change	2008	2007	\$ Change
GAAP operating income (loss) before the provision for cargo investigations	\$ 7	\$ 88	\$ (81)	\$ (5)	\$ 10	\$ (15)
Add back:						
Aircraft rent	69	75	(6)	132	154	(22)
Depreciation and amortization	173	136	37	344	264	80
EBITDAR before the provision for cargo investigations	\$ 249	\$ 299	\$ (50)	\$ 471	\$ 428	\$ 43
Add back:						
Provision for cargo investigations	-	-	-	(125)	-	(125)
EBITDAR	\$ 249	\$ 299	\$ (50)	\$ 346	\$ 428	\$ (82)

Operating Expense excluding Fuel Expense

Air Canada uses operating expense excluding fuel expense to assess the operating performance of its ongoing business without the effects of fuel expense. This item is excluded from Air Canada's results as it could potentially distort the analysis of trends in business performance. Fuel expense fluctuate widely depending on many factors including international market conditions, geopolitical events and the Canada/US exchange rate and excluding this expense from GAAP results allows Air Canada to compare its operating performance on a consistent basis. The following measure is not a recognized measure for financial statement presentation under Canadian GAAP and does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies.

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

(Canadian dollars in millions)	Second Quarter			First Six Months		
	2008	2007	\$ Change	2008	2007	\$ Change
GAAP operating expense	\$ 2,775	\$ 2,551	\$ 224	\$ 5,514	\$ 5,169	\$ 345
Remove:						
Aircraft fuel	(848)	(636)	(212)	(1,563)	(1,221)	(342)
Operating expense, excluding fuel expense	\$ 1,927	\$ 1,915	\$ 12	\$ 3,951	\$ 3,948	\$ 3

16. Glossary

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

CASM — Operating expense per ASM;

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

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

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

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

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

Yield — Average passenger revenue per RPM.