AIR CANADA

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

November 7, 2008

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1. Highlights

The following table provides the reader with financial and operating highlights for the Corporation for the periods indicated:

(Canadian dollars in millions except per share figures)	Third Quarter 2008	Third Quarter 2007	Third Quarter Change $	First Nine Months (1) 2008	First Nine Months (1) 2007	First Nine Months (1) Change $
Financial						
Operating revenues	3,075	2,954	121	8,584	8,133	451
Operating income before a special provision (2)	112	351	(239)	107	361	(254)
Operating income (loss)	112	351	(239)	(18)	361	(379)
Non-operating expense	(147)	(45)	(102)	(126)	(70)	(56)
Income (loss) before non-controlling interest, foreign exchange and income taxes	(35)	306	(341)	(144)	291	(435)
Income (loss) for the period	(132)	273	(405)	(298)	394	(692)
Operating margin before a special provision % (2)	3.6%	11.9%	(8.3) pp	1.2%	4.4%	(3.2) pp
Operating margin %	3.6%	11.9%	(8.3) pp	-0.2%	4.4%	(4.6) pp
EBITDAR before a special provision (2)(3)	355	561	(206)	826	989	(163)
EBITDAR (2)	355	561	(206)	701	989	(288)
EBITDAR margin before a special provision % (2)(3)	11.5%	19.0%	(7.5) pp	9.6%	12.2%	(2.6) pp
EBITDAR margin % (3)	11.5%	19.0%	(7.5) pp	8.2%	12.2%	(4.0) pp
Cash, cash equivalents and short-term investments	1,114	1,502	(388)	1,114	1,502	(388)
Free cash flow	(373)	(534)	161	(557)	(1,341)	784
Adjusted debt/equity ratio	72.0%	66.9%	5.1 pp	72.0%	66.9%	5.1 pp
Earnings (loss) per share - basic and diluted	($1.32)	$2.73	($4.05)	($2.98)	$3.94	($6.92)
Operating Statistics			**Change %**			**Change %**
Revenue passenger miles (millions) (RPM)	14,458	14,789	(2.2)	39,674	39,183	1.3
Available seat miles (millions) (ASM)	17,515	18,144	(3.5)	48,503	48,099	0.8
Passenger load factor	82.5%	81.5%	1.0 pp	81.8%	81.5%	0.3 pp
Passenger revenue per RPM (cents) (4)	19.0	17.9	6.2	18.9	18.2	3.8
Passenger revenue per ASM (cents) (4)	15.7	14.6	7.5	15.5	14.8	4.2
Operating revenue per ASM (cents) (4)	17.6	16.3	7.8	17.7	17.0	4.3
Operating expense per ASM ("CASM") (cents)	16.9	14.3	17.9	17.5	16.2	8.2
CASM, excluding fuel expense (cents)	10.8	10.4	4.3	12.1	12.1	(0.6)
Average number of full-time equivalent (FTE) employees (thousands)	24.5	24.1	1.6	24.4	23.9	2.0
Aircraft in operating fleet at period end (5)	341	338	0.9	341	338	0.9
Average fleet utilization (hours per day) (6)	10.2	10.7	(4.7)	9.9	10.0	(1.0)
Average aircraft flight length (miles) (6)	894	911	(1.9)	873	881	(0.9)
Fuel price per litre (cents) (7)	101.0	64.7	56.1	88.9	65.0	36.8
Fuel litres (millions)	1,048	1,102	(4.9)	2,941	2,968	(0.9)

(1) Reflects the financial and operating highlights for Air Canada for the first nine months of 2008 and the financial and operating highlights for the Air Canada Services segment, which excluded the consolidation of Jazz, for the first nine months of 2007. Refer to section 2 of this MD&A for additional information.

(2) A provision for cargo investigations of $125 million was recorded in the first quarter of 2008. Refer to section 13 of this MD&A for additional information.

(3) 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).

(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

On June 17, 2008, Air Canada announced a reduction in capacity and staffing levels in anticipation of a growing slowdown in global travel. In the third quarter of 2008, Air Canada reduced its overall capacity by 3.5% when compared to the third quarter of 2007. The capacity reductions were mainly achieved through fewer frequencies on existing routes and through the use of smaller aircraft.

Although we experienced a rapid drop in fuel prices subsequent to the third quarter of 2008, the impact of increased fares and fuel surcharges and the contracting economy had negative effects on travel demand in North America in the third quarter of 2008. Our international markets performed well, reflecting significant yield and passenger load factor improvements versus the same period in 2007.

In the third quarter of 2008, we recorded operating income of $112 million compared to operating income of $351 million in the third quarter of 2007. Our passenger revenues increased $106 million or 4% over the same period in 2007 mainly due to increased fares and fuel surcharges to partially offset substantially higher fuel prices when compared to the third quarter of 2007. Operating expenses increased $360 million or 14% from the third quarter of 2007, mainly reflecting a significant fuel expense increase of $348 million. In the third quarter of 2008, EBITDAR amounted to $355 million compared to EBITDAR of $561 million in the same period in 2007, a decrease of $206 million.

To manage the challenge of softening travel demand, we continue to focus on productivity and cost control, sound capacity management and on earning our customers' loyalty.

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 third 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 third quarter of 2008 and for the first nine months of 2008 and includes a discussion on our controls and procedures. This MD&A should be read in conjunction with Air Canada's third 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 Air LP ("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 third 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 November 6, 2008.

The Corporation issued a news release dated November 7, 2008 reporting on its results for the third 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, credit 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. The current instability in the world's financial system and the possibility that the US and global economies are currently in recession make the economic landscape in Canada uncertain and forecasting difficult. However, in addition to other assumptions contained in this MD&A, Air Canada assumes that Canada's economy will contract in the fourth quarter of 2008 and will show no meaningful growth in the first quarter of 2009. Air Canada also assumes that the Canadian dollar will trade, on average, at Cdn $1.18 per US dollar in the fourth quarter of 2008 and Cdn $1.05 per US dollar for the full year 2008 and that the price of fuel will average 91 cents per litre in the fourth quarter of 2008 and 89 cents per litre for the full year 2008 (both net of fuel hedging positions).

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

The following table and discussion compares the results of Air Canada for the third quarter of 2008 to its results for the third quarter of 2007.

	Third Quarter		Change	
(Canadian dollars in millions except per share figures)	2008	2007	$	%
Operating revenues				
Passenger	$ 2,766	$ 2,660	$ 106	4
Cargo	139	132	7	5
Other	170	162	8	5
	3,075	**2,954**	**121**	**4**
Operating expenses				
Wages, salaries and benefits	472	478	(6)	(1)
Aircraft fuel	1,064	716	348	49
Aircraft rent	67	66	1	2
Airport and navigation fees	275	284	(9)	(3)
Aircraft maintenance	127	155	(28)	(18)
Communications and information technology	69	70	(1)	(1)
Food, beverages and supplies	86	88	(2)	(2)
Depreciation and amortization	176	144	32	22
Commissions	54	54	-	-
Capacity purchase with Jazz	243	234	9	4
Other	330	314	16	5
	2,963	**2,603**	**360**	**14**
Operating income	**112**	**351**	**(239)**	
Non-operating income (expense)				
Interest income	13	21	(8)	
Interest expense	(72)	(82)	10	
Interest capitalized	6	24	(18)	
Loss on capital assets	-	(2)	2	
Loss on financial instruments recorded at fair value	(93)	(2)	(91)	
Other	(1)	(4)	3	
	(147)	(45)	(102)	
Income (loss) before the following items	**(35)**	**306**	**(341)**	
Non-controlling interest	(2)	-	(2)	
Foreign exchange gain (loss)	(87)	104	(191)	
Provision for income taxes	(8)	(137)	129	
Income (loss) for the period	**$ (132)**	**$ 273**	**$ (405)**	
EBITDAR (1)	**$ 355**	**$ 561**	**$ (206)**	
Earnings (loss) per share, basic and diluted	**$ (1.32)**	**$ 2.73**	**$ (4.05)**	

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

In the third quarter of 2008, Air Canada reported operating income of $112 million compared to operating income of $351 million in the third quarter of 2007, a decrease of $239 million. An increase in operating revenues of $121 million or 4% was more than offset by a fuel expense increase of $348 million or 49%.

In the third quarter of 2008, EBITDAR amounted to $355 million compared to EBITDAR of $561 million in the same period in 2007, a decrease of $206 million.

System passenger revenues increased 4.0% over the third quarter of 2007

Passenger revenues increased $106 million or 4.0% to $2,766 million in the third quarter of 2008 when compared to the third quarter of 2007 mainly due to increased fares and fuel surcharges to partially offset higher fuel prices. The following factors contributed to the year-over-year change in third quarter system passenger revenues:

- In the third quarter of 2008, system yield improved 6.2% from the third quarter of 2007, reflecting yield growth in all markets. The yield improvement was mainly due to higher fares and increased fuel surcharges to partially offset higher fuel prices. A higher average fare in both the Executive First and Hospitality cabins was also a factor in the yield improvement from the third quarter of 2007.
- In the third quarter of 2008, Air Canada reduced overall capacity through fewer frequencies on existing routes and through the use of smaller aircraft. The capacity reductions in the North American market were mainly on longer-haul transcontinental services and US transborder routes, which have a lower average yield. Air Canada made significant adjustments to international capacity. These adjustments were achieved through the reduction of frequencies on existing routes and the reallocation of capacity from weaker markets such as the United Kingdom and China to stronger markets such as Germany.
- In the third quarter of 2008, the traffic decline of 2.2% was less than the capacity decrease of 3.5% resulting in a 1.0 percentage point improvement in passenger load factor from the third quarter of 2007. Passenger load factor improvements were recorded in the international markets while decreases in passenger load factor were recorded in the domestic and US transborder markets. The domestic and US transborder markets were adversely impacted by a softening economy and US carrier competitive capacity growth.
- In the third quarter of 2008, RASM increased 7.5% from the third quarter of 2007 due to the growth in yield and, to a lesser extent, the passenger load factor improvement. RASM improvements were reflected in all markets.
- A stronger Canadian dollar in the third 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 $23 million to third quarter 2008 passenger revenues compared to the third quarter of 2007.

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

Third Quarter 2008 Versus Third Quarter 2007	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	1.0	(3.1)	(4.4)	(1.1)	5.3	3.8
US transborder	(0.6)	(7.5)	(10.0)	(2.1)	10.2	7.2
Atlantic	5.6	(7.3)	(1.0)	5.7	6.7	13.9
Pacific	5.9	(4.1)	(2.5)	1.3	8.6	10.3
Other	32.3	20.4	20.7	0.1	9.6	9.9
System	**4.0**	**(3.5)***	**(2.2)**	**1.0**	**6.2**	**7.5**

*The ASM capacity decrease of 3.5% in the third quarter of 2008 compared to the third quarter of 2007 was in line with the 2.5% to 3.5% ASM reduction projected in the Corporation's news release dated August 8, 2008.

Domestic passenger revenues increased 1.0% from the third quarter of 2007

Domestic passenger revenues of $1,150 million in the third quarter of 2008 increased $11 million or 1.0% from the third quarter of 2007 due to yield growth. The positive impact of the higher yield was, for the most part, offset by a decrease in traffic. The following factors contributed to the year-over-year change in third quarter domestic passenger revenues:

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- In the third quarter of 2008, yield increased 5.3% from the third quarter of 2007 largely due to fare increases and fuel surcharges to partially offset higher fuel prices, which drove the RASM growth of 3.8%.

- In the third quarter of 2008, traffic decreased 4.4% on a capacity reduction of 3.1% resulting in a passenger load factor decrease of 1.1 percentage points from the third quarter of 2007. The traffic decline was in part due to a softening economy in Canada, particularly in Eastern Canada. Increased fares and fuel surcharges and competitive capacity growth also had a negative impact on demand in the domestic market.
- The capacity decreases were primarily reflected on the transcontinental services and were mainly achieved through the reduction of frequencies on existing routes and through the use of smaller aircraft.
- A stronger Canadian dollar in the third 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 $4 million to third quarter 2008 domestic passenger revenues compared to the third quarter of 2007.

US transborder passenger revenues decreased 0.6% from the third quarter of 2007

US transborder passenger revenues of $467 million in the third quarter of 2008 decreased $3 million or 0.6% from the third quarter of 2007. The impact of a 10.0% traffic decline was largely offset by an increase in yield of 10.2%. The following factors contributed to the year-over-year change in third quarter US transborder passenger revenues:

- In the third quarter of 2008, capacity was reduced by 7.5% from the third quarter of 2007. Capacity decreases were achieved mainly through the reduction of frequencies on existing routes as well as the use of smaller aircraft. In anticipation of the leisure discretionary traffic being impacted by the softening economy and increased fares and fuel surcharges, Air Canada reduced capacity on routes to California, Nevada and Florida. In addition, there was a capacity reduction on the Hawaiian service as a result of the introduction of a Vancouver – Sydney non-stop route which was previously operated as a one-stop via Hawaii. The Vancouver – Sydney route is recorded in "other" passenger revenues.
- In the third quarter of 2008, passenger load factor decreased 2.1 percentage points from the third quarter of 2007 as the traffic decline of 10.0% was greater than the capacity reduction. Overall, the US transborder market was negatively impacted by the softening economy in the United States. The impact of increased fares and fuel surcharges also had negative effect on demand in the US transborder market.
- In the third quarter of 2008, yield improved 10.2% from the third quarter of 2007 largely due to fare increases and fuel surcharges to partially offset higher fuel prices. In addition, the capacity reductions, mostly impacting longer-haul and more leisure-oriented lower-yielding routes, resulted in an overall higher average yield in the US market when compared to the third quarter of 2007.
- The stronger Canadian dollar had a negative impact on foreign currency denominated revenues. The impact accounted for a decrease of $9 million to third quarter 2008 US transborder passenger revenues compared to the third quarter of 2007.
- In the third quarter of 2008, RASM increased 7.2% from the third quarter of 2007 due to the yield improvement.

Atlantic passenger revenues increased 5.6% from the third quarter of 2007

Atlantic passenger revenues of $631 million in the third quarter of 2008 increased $34 million or 5.6% from the third quarter of 2007, due to significant yield growth combined with only a small decrease in traffic. The following factors contributed to the year-over-year change in third quarter Atlantic passenger revenues:

- In the third quarter of 2008, capacity was reduced by 7.3% from the third quarter of 2007. Capacity reductions were largely reflected on United Kingdom ("U.K.") routes and were mainly achieved through the reduction of frequencies on existing routes.
- In the third quarter of 2008, traffic decreased only 1.0% on a capacity reduction of 7.3% resulting in a passenger load factor improvement of 5.7 percentage points from the third quarter of 2007. Traffic on the U.K. service decreased 6.9%, which was less than the capacity reduction of 15.5%, resulting in a passenger load factor improvement of 8.2 percentage points. The suspension of ZOOM's operations at the end of August 2008 had a favourable impact on U.K. traffic in the third quarter of 2008.

- In the third quarter of 2008, yield improved 6.7% from the third quarter of 2007, reflecting yield improvements on all Atlantic services. The overall Atlantic yield improvement was largely due to increased fares and fuel surcharges to partially offset higher fuel prices. In addition, the capacity reductions in the Atlantic market led to an improvement in passenger mix and hospitality cabin yields.
- In the third quarter of 2008, RASM increased 13.9% from the third quarter of 2007 due to both the growth in yield and the passenger load factor improvement.
- The stronger Canadian dollar had a negative impact on foreign currency denominated revenues. The impact accounted for a decrease of $5 million to third quarter 2008 Atlantic passenger revenues compared to the third quarter of 2007.

Pacific passenger revenues increased 5.9% from the third quarter of 2007

Pacific passenger revenues of $328 million in the third quarter of 2008 increased $18 million or 5.9% from the third quarter of 2007, due to yield growth. The following factors contributed to the year-over-year change in third quarter Pacific passenger revenues:

- In the third quarter of 2008, capacity was reduced by 4.1% from the third quarter of 2007, mainly reflecting capacity reductions in the Chinese market.
- In the third quarter of 2008, traffic decreased 2.5% on a capacity reduction of 4.1% resulting in passenger load factor improvement of 1.3 percentage points from the third quarter of 2007.
- In the third quarter of 2008, yield increased 8.6% from the third quarter of 2007 largely due to increased fares and fuel surcharges to partially offset higher fuel prices. Yield improvements were experienced in the Chinese, Japanese and Hong Kong markets while the Korean market reflected a yield decline. The Korean market was negatively impacted by local currency devaluation. Yield in the Chinese market was positively impacted by the Olympic games where Air Canada was able to favourably price fares as a result of strong market demand.
- The stronger Canadian dollar had a negative impact on foreign currency denominated revenues. The impact accounted for a decrease of $3 million to third quarter 2008 Pacific passenger revenues compared to the third quarter of 2007.
- In the third quarter of 2008, RASM increased 10.3% from the third quarter of 2007 primarily due to the growth in yield and, to a lesser extent, the passenger load factor improvement.

Other passenger revenues increased 32.3% from the third quarter of 2007

Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of $190 million in the third quarter of 2008 increased $46 million or 32.3% from the third 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 third quarter other passenger revenues:

- In the third quarter of 2008, traffic increased 20.7% on a capacity growth of 20.4% resulting in a passenger load factor slightly up from the third quarter of 2007. Traffic growth in these markets mainly reflected the addition of a new non-stop service from Vancouver to Sydney, Australia which is now being operated with a Boeing 777-200 aircraft. In the third quarter of 2007, this one-stop service via Hawaii was operated through the use of a Boeing 767-300 aircraft and the Vancouver-Hawaii segment was recorded in US transborder passenger revenues. Higher capacity to traditional leisure destinations and to South America was also a factor in the traffic growth versus the same period in 2007.
- In the third quarter of 2008, yield improved 9.6% from the third quarter of 2007 largely due to fare increases 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 a greater demand for Air Canada's new Executive First product. The higher yield was achieved in spite of an 8.6% 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 $2 million to third quarter 2008 "other" passenger revenues compared to the third quarter of 2007.
- In the third quarter of 2008, RASM increased 9.9% from the third quarter of 2007 mainly due to the growth in yield.

Cargo revenues increased 7% from the third quarter of 2007

Third quarter 2008 cargo revenues amounted to $139 million and were $7 million or 5% above the third quarter of 2007, mainly due to an increase in fuel surcharges to partially offset higher fuel prices. Non-freighter revenues increased $19 million or 15%, reflecting higher revenues in international markets. Freighter revenues were down $12 million as no MD-11 freighter aircraft were operated in the third quarter of 2008 versus one MD-11 freighter operated in the same period in 2007. System cargo yield per revenue ton mile improved 20% and mostly reflected increased fuel surcharges to partially offset higher fuel prices. The following factors contributed to the year-over-year change in third quarter cargo revenues:

- In the third quarter of 2008, system traffic declined 13% from the third quarter of 2007 largely as a result of terminated MD-11 freighter operations. Traffic on non-freighter aircraft decreased by 4% due to reduced cargo volumes in the domestic and transborder markets and in part due to the termination of the Canada Post contract in mid-September 2008.
- Freighter operations to Europe were terminated effective June 30, 2008. In the third quarter of 2007, one MD-11 freighter was operated to Europe.

The Corporation is actively seeking replacement Cargo business in domestic and international markets in order to compensate for the expected reduction in revenues from the termination of the Canada Post contract.

Other revenues were up 5% from the third quarter of 2007

Other revenues of $170 million in the third quarter of 2008 increased $8 million or 5% from the third quarter of 2007. The following factors contributed to the year-over-year change in third quarter other revenues:

- A $12 million increase in aircraft sublease revenues.
- A $3 million increase in revenues at Air Canada Vacations.
- Other factors amounting to a net decrease of $7 million.

Excluding fuel expense, CASM increased 4.3% from the third quarter of 2007

Operating expenses were $2,963 million in the third quarter of 2008, an increase of $360 million or 14% from the third quarter of 2007, reflecting a significant fuel expense increase of $348 million and an operating expense increase of $12 million (excluding fuel expense) when compared to the same period in 2007.

Including fuel expense, CASM increased 17.9% from the third quarter of 2007. Excluding fuel expense, CASM increased 4.3% from the third quarter of 2007. The 4.3% increase in CASM, excluding fuel expense, was in line with the projected CASM (excluding fuel expense) provided in the Corporation's news release dated August 8, 2008 where CASM (excluding fuel expense) was projected to increase between 4 to 5% when compared to the same period in 2007.

The following table compares Air Canada's operating expenses per ASM for the third quarter of 2008 to Air Canada's operating expenses per ASM for the corresponding period in 2007. More than half of the increase in CASM, excluding fuel expense, was attributable to ownership reflecting Air Canada's investment in new aircraft and the aircraft interior refurbishment program. The unit cost savings related to the Boeing 777 aircraft and, to a lesser extent, a stronger Canadian dollar versus the US dollar, partially offset the overall unit cost increase, excluding fuel expense, from the third quarter of 2007.

	Third Quarter		Change	
(cents per ASM)	**2008**	**2007**	**cents**	**%**
Wages and salaries	2.22	2.13	0.09	4.2
Benefits	0.48	0.50	(0.02)	(4.0)
Ownership (DAR) (1)	1.39	1.15	0.24	20.9
Airport and navigation fees	1.57	1.57	-	-
Aircraft maintenance	0.72	0.85	(0.13)	(15.3)
Communications and information technology	0.40	0.38	0.02	5.3
Food, beverages and supplies	0.49	0.48	0.01	2.1
Commissions	0.31	0.30	0.01	3.3
Capacity purchase with Jazz	1.39	1.29	0.10	7.8
Other	1.87	1.74	0.13	7.5
Operating expense, excluding fuel expense (2)	**10.84**	**10.39**	**0.45**	**4.3**
Aircraft fuel	6.08	3.95	2.13	53.9
Total operating expense	**16.92**	**14.34**	**2.57**	**17.9**

(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 $472 million in the third quarter of 2008, a decrease of $6 million or 1% from the third quarter of 2007.

Wages and salaries expense totaled $388 million in the third quarter of 2008, an increase of $2 million or 1% from the third quarter of 2007. Factors contributing to the year-over-year third quarter change in wages and salaries expense included:

- A year-over-year third quarter increase of 1.6% or an average of 397 full-time equivalent ("FTE") employees, mainly reflecting growth in ground handling personnel and pilots on an ASM capacity reduction of 3.5%. The growth in FTE employees from the third quarter of 2007 also reflected the insourcing of supply chain management in the Aircraft Maintenance division. On June 17, 2008, Air Canada announced a reduction in capacity combined with a decrease in staff levels of up to 2,000 positions across all levels of Air Canada. These reductions are planned to occur by November 2008.
- An overall average salary increase of approximately 1% over the third quarter of 2007.
- In the third quarter of 2008, Air Canada reversed previously recorded stock-based compensation expense of $8 million.

Employee benefits expense amounted to $84 million in the third quarter of 2008, a decrease of $8 million or 9% from the third quarter of 2007. A reduction of $11 million in pension expense as a result of revised pension actuarial estimates made as of January 1, 2008 was the main factor for the decrease in employee benefits expense. The reduction in pension expense was largely driven by an increase in the discount rate. Refer to section 6.6 of this MD&A for information on Air Canada's pension obligations.

Fuel expense increased 49% from the third quarter of 2007

Fuel expense amounted to $1,064 million in the third quarter of 2008, an increase of $348 million or 49% from the third quarter of 2007. Factors contributing to the year-over-year third quarter change in fuel expense included:

- A higher base fuel price which accounted for an increase of $472 million.

The above-noted increase was partially offset by the following:

- Fuel hedging gains of $64 million in the third quarter of 2008 versus fuel hedging gains of $8 million in the third quarter of 2007, a favourable variance of $56 million from the third quarter of 2007.
- A volume-related decrease of $34 million, including the reduction from the removal of one MD-11 freighter aircraft. Freighter operations to Europe were terminated effective June 30, 2008. In the third quarter of 2007, one MD-11 freighter was operated to Europe.
- The favourable impact of a stronger Canadian dollar versus the US dollar which accounted for a decrease of $33 million to fuel expense.

Ownership costs increased 16% from the third quarter of 2007

Ownership costs, comprised of aircraft rent, depreciation and amortization expenses, of $243 million in the third quarter of 2008 increased $33 million or 16% from the third quarter of 2007. Factors contributing to the year-over-year third quarter change in ownership costs included:

- The addition of aircraft to Air Canada's operating fleet which accounted for an increase of $23 million.
- An increase in depreciation expenses of $18 million related to Air Canada's aircraft interior refurbishment program.
- Other factors accounting for a net increase of $5 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 $7 million in aircraft rent and depreciation and amortization expenses.
- A decrease of $4 million to aircraft rent expense as a result of reduced MD-11 freighter flying.
- The impact of a stronger Canadian dollar versus the US dollar which accounted for a decrease of $2 million to aircraft rent expense.

Airport and navigation fees decreased 3% from the third quarter of 2007

Airport and navigation fees of $275 million decreased $9 million or 3% from the third quarter of 2007 on a 1% decrease in aircraft frequencies. Factors contributing to the year-over-year third 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 expense decreased 18% from the third quarter of 2007

Aircraft maintenance expense of $127 million in the third quarter of 2008 decreased $28 million or 18% from the third quarter of 2007. Factors contributing to the year-over-year third quarter change in aircraft maintenance expense included:

- A decrease of $12 million in engine maintenance expenses due to fewer aircraft and maintenance events for the Airbus A340 and Airbus A320 versus the same period in 2007. Partly offsetting these decreases was an increase of $9 million in engine maintenance expenses for the Airbus A321 and Boeing 767-300 aircraft due to timing of maintenance activities versus the third quarter of 2007.
- A decrease of $8 million in component maintenance expenses mainly due to an overall reduction in maintenance events in part due to reduced flying.
- In the third quarter of 2007, Air Canada recorded an expense of $5 million related to the return to lessor of five Airbus A320 aircraft. There were no expenses of this nature in the third quarter of 2008.
- The impact of a stronger Canadian dollar versus the US dollar accounted for a decrease of $3 million to aircraft maintenance expense.
- A decrease of $7 million relating to a reduction in third party supply chain management fees as a result of the insourcing of these activities.
- Other factors accounting for a net decrease of $8 million.

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

- An increase of $7 million in airframe maintenance expenses for the Airbus A320 and A321 aircraft due to timing of maintenance activities versus the third quarter of 2007. Partly offsetting this increase was an decrease of $6 million in airframe maintenance expenses for the Boeing 767-300 aircraft due to timing of maintenance activities versus the third quarter of 2007.
- An increase of $5 million in maintenance expenses relating to Embraer ERJ-190 aircraft versus the third quarter of 2007. Air Canada had 45 Embraer ERJ-190 in its operating fleet as at September 30, 2008 versus only 34 Embraer ERJ-190 aircraft as at September 30, 2007.

Capacity purchase costs with Jazz increased 4% from the third quarter of 2007

Capacity purchase costs with Jazz, pursuant to the capacity purchase agreement between Jazz and Air Canada ("Jazz CPA"), amounted to $243 million in the third quarter of 2008 compared to $234 million in the third quarter of 2007, an increase of $9 million or 4%, mainly due to a predetermined contractual increase in Jazz CPA rates of $6 million and other costs amounting to $3 million. Partly offsetting these increases were decreases amounting to $3 million which included the impact of reduced flying and the favourable impact of foreign exchange on US denominated Jazz CPA expenses. Jazz ASM capacity was reduced by 3.4% in the third quarter of 2008 when compared to the third quarter of 2007.

Other operating expenses increased 5% from the third quarter of 2007

Other operating expenses amounted to $330 million in the third quarter of 2008, an increase of $16 million or 5% from the third quarter of 2007. Factors contributing to the year-over-year third quarter change in other expense included:

- Increased miscellaneous fees and services, which was in part higher due to the timing of expenses versus the same period in 2007.
- Increased expenses for ground packages at Air Canada vacations, which was largely the result of higher passenger volumes versus the third quarter of 2007.
- Higher credit card fees, which was largely driven by higher passenger sales and card usage.

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

(Canadian dollars in millions)	Third Quarter 2008	Third Quarter 2007	Change $	Change %
Other expenses				
Credit card fees	$ 50	$ 45	$ 5	11
Terminal handling	46	47	(1)	(2)
Building rent and maintenance	34	31	3	10
Crew expenses (meals, transportation and hotels)	29	32	(3)	(9)
Miscellaneous fees and services	28	21	7	33
Air Canada Vacations' land costs	25	20	5	25
Remaining other expenses	118	118	-	-
	$ 330	**$ 314**	**$ 16**	**5**

Non-operating expense amounted to $147 million in the third quarter of 2008

Non-operating expense amounted to $147 million in the third quarter of 2008 compared to non-operating expense of $45 million in the third quarter of 2007. Factors contributing to the year-over-year third quarter change in non-operating expense included:

- Losses relating to fair value adjustments on derivatives instruments which amounted to $93 million in the third quarter of 2008 versus losses of $2 million in the same quarter of 2007. The non-cash mark-to-market loss on financial instruments of $93 million recorded in the third quarter of 2008 represented a loss of $112 million related to the fair value of fuel derivatives partly offset by a gain of $19 million related to the fair value of cross-currency interest rate swaps. Refer to section 8 of this MD&A for additional information on the losses on financial instruments recorded in the third quarter of 2008.
- An increase in net interest expense of $16 million. A lower amount of capitalized interest related to new aircraft and a decrease in interest income due to both lower cash balances and interest rates more than offset the $10 million decrease in interest expense. The decrease in interest expense was driven by lower financing costs on the Boeing 777 aircraft commitments due to the favourable impact of the pre-delivery financing arranged in the fourth quarter of 2007, lower interest rates on floating rate debt, and the favourable impact of a stronger Canadian dollar versus the US dollar in the third quarter of 2008 compared to the third quarter of 2007, partially offset by the financing of additional aircraft year-over-year.

Net losses on foreign currency monetary items amounted to $87 million in the third quarter of 2008

Net losses on foreign currency monetary items amounted to $87 million in the third quarter of 2008 compared to gains of $104 million in the third quarter of 2007. The losses in the third quarter of 2008 were attributable to a weaker Canadian dollar at September 30, 2008 compared to June 30, 2008, partially offset by gains of $70 million related to foreign currency derivatives. The September 30, 2008 noon day exchange rate was $1US = Cdn $1.0599 while the June 30, 2008 noon day exchange rate was $1US = Cdn $1.0186.

Provision of income taxes of $8 million in the third quarter of 2008

Air Canada recorded a provision for income taxes of $8 million in the third quarter of 2008. The tax provision reflects future income tax that has been reclassified from other comprehensive income to income for realized gains on fuel derivatives. The recovery of future income taxes on the current year loss has been offset by a valuation allowance of $37 million. This compared to a provision for income taxes of $137 million, at an effective income tax rate of 33%, for the same period in 2007.

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

Air Canada recorded operating income of $107 million, before a provision for cargo investigations of $125 million, and a net loss of $298 million in the first nine 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 $423 million and net income of $394 million. **The following table and discussion compares the results of Air Canada for the first nine months of 2008, which no longer includes the consolidation of Jazz, and the results of the Air Canada Services segment, which excluded the consolidation of Jazz, for the first nine months of 2007.**

	First Nine Months		Change	
(Canadian dollars in millions except per share figures)	**2008**	**2007 (1)**	**$**	**%**
Operating revenues				
Passenger	$ 7,531	$ 7,133	$ 398	6
Cargo	402	408	(6)	(1)
Other	651	592	59	10
	8,584	**8,133**	**451**	**6**
Operating expenses				
Wages, salaries and benefits	1,433	1,452	(19)	(1)
Aircraft fuel	2,627	1,937	690	36
Aircraft rent	199	220	(21)	(10)
Airport and navigation fees	771	784	(13)	(2)
Aircraft maintenance	502	584	(82)	(14)
Communications and information technology	214	208	6	3
Food, beverages and supplies	244	246	(2)	(1)
Depreciation and amortization	520	408	112	27
Commissions	154	164	(10)	(6)
Capacity purchase with Jazz	711	696	15	2
Other	1,102	1,073	29	3
	8,477	**7,772**	**705**	**9**
Operating income before the undernoted item	**107**	**361**	**(254)**	
Provision for cargo investigations	(125)	-	(125)	
Operating income (loss)	**(18)**	**361**	**(379)**	
Non-operating income (expense)				
Interest income	46	70	(24)	
Interest expense	(231)	(259)	28	
Interest capitalized	31	88	(57)	
Gain (loss) on capital assets	(29)	19	(48)	
Gain on financial instruments recorded at fair value	60	26	34	
Other	(3)	(14)	11	
	(126)	(70)	(56)	
Income (loss) before the following items	**(144)**	**291**	**(435)**	
Non-controlling interest	(8)	(6)	(2)	
Foreign exchange gain (loss)	(128)	297	(425)	
Provision for income taxes	(18)	(188)	170	
Income (loss) for the period	**$ (298)**	**$ 394**	**$ (692)**	
EBITDAR before the provision for cargo investigations (2)	**$ 826**	**$ 989**	**$ (163)**	
EBITDAR (2)	**$ 701**	**$ 989**	**$ (288)**	
Earnings (loss) per share, basic and diluted	**$ (2.98)**	**$ 3.94**	**$ (6.92)**	

(1) Reflects the results of the Air Canada Services segment, which excluded the consolidation of Jazz, for the first nine 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.
(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).

In the first nine months of 2008, Air Canada reported operating income of $107 million, before a provision for cargo investigations of $125 million, compared to operating income of $361 million in the first nine months of 2007, a decrease of $254 million versus the same period in 2007.

In the first nine months of 2008, EBITDAR amounted to $826 million, before the provision for cargo investigations of $125 million, compared to EBITDAR of $989 million in the same period in 2007, a decrease of $163 million.

System passenger revenues increased 5.6% over the first nine months of 2007

Passenger revenues increased $398 million or 5.6% to $7,531 million in the first nine months of 2008 due to growth in both system yield and traffic. The following factors contributed to the year-over-year change in system passenger revenues for the first nine months of 2008 versus 2007:

- System yield improved 3.8%, largely reflecting higher fares and increased fuel surcharges to offset higher fuel prices. Yield growth was reflected in all markets. An increase in the proportion of higher-yielding travelers was also a factor in the yield growth. The year-over-year yield growth of 6.2% in the third quarter of 2008 improved from the 2.5% year-over-year growth in the second quarter and from the 2.2% year-over-year of the first quarter of 2008. The higher year-over-year yield growth in the third quarter of 2008 versus the year-over-year growth reflected in the first and second quarters of 2008 was mainly driven by increases in fares and fuel surcharges implemented by Air Canada during the second quarter of 2008.
- Traffic increased 1.3% on a capacity increase of 0.8%, resulting in a passenger load factor slightly above the first nine months of 2007. Year-over-year capacity was reduced by 3.5% in the third quarter of 2008 from a 2.4% year-over-year growth in the second quarter and a 4.6% growth in the first quarter of 2008. Year-over-year system passenger traffic in the third quarter of 2008 was 2.2% lower than the same period in 2007 versus a year-over-year growth of 2.4% in the second quarter of 2008 and a year-over-year growth of 4.4% in the first quarter of 2008. The passenger load factor for the first two quarters remained essentially unchanged from the same periods in 2007 however the third quarter showed a one percentage improvement from the third quarter of 2007. The domestic and US transborder markets were impacted by the softening economy especially in the third quarter.
- A stronger Canadian dollar in the first nine months of 2008 had a negative impact on foreign currency denominated revenues, accounting for a decrease of $146 million in passenger revenues for the first nine months of 2008.
- A RASM improvement of 4.2% in the first nine months of 2008 mainly reflected 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 and to 7.5% in the third quarter of 2008, largely due to higher yield growth.

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

First Nine Months of 2008 Versus First Nine Months of 2007	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	5.0	1.1	0.4	(0.6)	4.4	3.7
US transborder	1.8	(4.9)	(5.8)	(0.7)	8.1	7.0
Atlantic	4.0	(1.1)	0.5	1.4	3.4	5.1
Pacific	2.4	(0.3)	0.3	0.6	2.0	2.7
Other	28.4	18.5	21.7	2.1	5.6	8.4
Other(1)	28.4	18.5	21.7	2.1	(0.1)	2.6
System	**5.6**	**0.8**	**1.3**	**0.3**	**4.2**	**4.6**
System(1)	**5.2**	**0.8**	**1.3**	**0.3**	**3.8**	**4.2**

(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 nine months:

- Domestic passenger revenues of $3,148 million in the first nine months of 2008 increased $150 million or 5.0% from the first nine months of 2007, mainly due to a 4.4% increase in yield. Traffic increased 0.4% on a capacity increase of 1.1% resulting in a passenger load factor deterioration of 0.6 percentage points. The RASM growth of 3.7% in the first nine months of 2008 was driven by the yield growth. The third quarter of 2008 reflected a year-over-year reduction in traffic and capacity while the first and second quarters of 2008 reflected capacity and traffic growth. 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 and to 5.3% in the third quarter of 2008, as a result of a higher yield growth.

- US transborder passenger revenues of $1,455 million in the first nine months of 2008 increased $27 million or 1.8% from the first nine months of 2007, due to yield growth. Traffic decreased 5.8% on a capacity reduction of 4.9% resulting in a passenger load factor deterioration of 0.7 percentage points. The RASM growth of 7.0% in the first nine 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 slowed in the third quarter of 2008 when compared to the first and second quarters 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 but increased to a rate of 7.2% in the third quarter of 2008, as a result of an improved yield growth.

- Atlantic passenger revenues of $1,489 million in the first nine months of 2008 increased $57 million or 4.0% from the first nine months of 2007, due to 3.4% growth in yield and a 0.5% increase in traffic. Atlantic RASM increased 5.1% from the first nine months of 2007 driven by both the yield growth and 1.4 percentage point improvement in passenger load factor. Year-over-year Atlantic capacity was reduced significantly in the third quarter of 2008. The third quarter of 2008 reflected a capacity reduction of 7.3% versus the same period in 2007 while the first and second quarters of 2008 reflected capacity growth of 6.6% and 0.8%, respectively, versus the same periods in 2007. 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 and further improved to a year-over-year growth of 13.9% in the third quarter of 2008, mainly as a result of a higher yield growth.

- Pacific passenger revenues of $775 million in the first nine months of 2008 increased $17 million or 2.4% from the first nine months of 2007, mainly due to a 2.0% growth in yield. Traffic increased 0.3% on a capacity reduction of 0.3%. The RASM increase of 2.7% in the first nine months of 2008 compared to the same period in 2007 was due to the yield growth and to a 0.6 percentage point improvement in passenger load factor. Year-over-year Pacific capacity was reduced significantly in the third quarter of 2008. The third quarter of 2008 reflected a capacity reduction of 4.1% versus the same period in 2007 while the first and second quarters of 2008 reflected capacity growth of 1.9% and 2.5%, respectively, versus the same periods in 2007. 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 and to a year-over-year growth of 10.3% in the third quarter of 2008, mainly as a result of an improved yield but also due to a higher passenger load factor.

- Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of $664 million in the first nine months of 2008 increased $147 million or 28.4% from the first nine months of 2007, due to traffic growth. Traffic increased 21.7% on a capacity increase of 18.5% resulting in a passenger load factor improvement of 2.1 percentage points. Yield was essentially unchanged from the first nine months of 2007. RASM improved 4.2% from the same period in 2007 as a result of the increase in passenger load factor. Year-over-year capacity and traffic grew in the third quarter of 2008 when compared to the first and second quarters 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 and to a year-over-year growth of 9.9% in the third quarter of 2008, as a result of a stronger yield.

Cargo revenues declined 1% from the first nine months of 2007

For the first nine months of 2008, cargo revenues amounted to $402 million and were $6 million or 1% below the first nine months of 2007. Non-freighter revenues increased $33 million or 10%, reflecting higher revenues in international markets. Freighter revenues were down $39 million. Air Canada operated one MD-11 freighter aircraft in the first six months of 2008 and all freighter operations were terminated on June 30, 2008. Two MD-11 freighters were operated in the first six months of 2007 and one in the last six months of 2007. System cargo yield per revenue ton mile improved 13% and reflected increased fuel surcharges to partially offset higher fuel prices. In the first nine months of 2008, a stronger Canadian dollar (with corresponding weaker foreign currencies) had a negative impact on the value of foreign currency denominated revenues.

Other revenues increased 10% from the first nine months of 2007

Other revenues of $651 million in the first nine months of 2008 increased $59 million or 10% from the first nine months of 2007. The following factors contributed to the year-over-year change in other revenues:

- A $40 million increase in aircraft sublease revenues.
- A $18 million increase in revenues at Air Canada Vacations.
- Other factors amounting to a net increase of $1 million.

Excluding fuel expense, CASM declined 0.6% from the first nine months of 2007

Operating expenses were $8,477 million in the first nine months of 2008, an increase of $705 million or 9% from the first nine months of 2007, reflecting a significant increase in fuel expense. Excluding the increase in fuel expense of $690 million in the first nine months of 2008, operating expenses increased $15 million versus the same period in 2007.

Including fuel expense, CASM increased 8.2% from the first nine months of 2007. Excluding fuel expense, CASM declined 0.6% from the first nine months of 2007. A significant reduction in aircraft maintenance expense, the stronger Canadian dollar versus the US dollar and unit cost savings related to the Boeing 777 aircraft were important factors in the overall unit cost decrease, excluding fuel expense, from the first nine months of 2007. Higher unit cost of ownership reflected 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 nine months of 2008 to Air Canada's operating expenses per ASM for the corresponding period in 2007.

	First Nine Months		Change	
(cents per ASM)	**2008**	**2007**	**cents**	**%**
Wages and salaries	2.39	2.39	-	-
Benefits	0.56	0.63	(0.07)	(11.1)
Ownership (DAR) (1)	1.48	1.30	0.18	13.8
Airport and navigation fees	1.59	1.63	(0.04)	(2.5)
Aircraft maintenance	1.03	1.21	(0.18)	(14.9)
Communications and information technology	0.44	0.43	0.01	2.3
Food, beverages and supplies	0.50	0.51	(0.01)	(2.0)
Commissions	0.32	0.34	(0.02)	(5.9)
Capacity purchase with Jazz	1.47	1.45	0.02	1.4
Other	2.28	2.24	0.04	1.8
Operating expense, excluding fuel expense (2)	**12.06**	**12.13**	**(0.07)**	**(0.6)**
Aircraft fuel	5.42	4.03	1.39	34.5
Total operating expense	**17.48**	**16.16**	**1.32**	**8.2**

(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 nine months:

- Wages, salaries and benefits amounted to $1,433 million in the first nine months of 2008, a decrease of $19 million or 1% from the first nine months of 2007. Wages and salaries increased $11 million, largely reflecting an increase of 2% or an average of 471 FTE employees versus the same period in 2007. Higher average wages and salaries over the first nine months of 2007 as a result of the unionized wage review were also factors in the increase. In addition, in the first nine months of 2008, Air Canada recorded an expense of $8 million related to the reduction of non-unionized employees under a staff reduction plan announced on June 17, 2008. The Corporation expects that the costs related to the planned unionized staff reduction under this plan will be determinable and recorded in the fourth quarter of 2008, but the costs are not expected to be significant due to the impact of attrition and leave of absence programs. Partly offsetting these increases were a favourable adjustment of $8 million related to stock-based compensation and reduced overtime expenses of $7 million. The increase in wages and salaries was more than offset by lower employee benefit expenses of $30 million or 10%, largely the result of lower pension expense driven by revised actuarial estimates made on January 1, 2008.

- Fuel expense amounted to $2,627 million in the first nine months of 2008, an increase of $690 million or 36% from the first nine months of 2007. A higher base fuel price which accounted for an increase of $1,144 million was partly offset by the favourable impact of a stronger Canadian dollar versus the US dollar which accounted for a decrease of $248 million, favourable hedging results versus the same period in 2007 which accounted for a decrease of $188 million and a volume-related decrease of $18 million.

- Ownership costs, comprised of aircraft rent, depreciation and amortization expenses, of $719 million in the first nine months of 2008 increased $91 million or 14% from the first nine 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 $74 million and expenses related to Air Canada's aircraft interior refurbishment program which accounted for an increase of $57 million. These increases were partly offset by the removal of aircraft from Air Canada's fleet which accounted for a decrease of $30 million, the impact of reduced MD-11 freighter flying which accounted for a decrease of $17 million and the favourable impact of foreign exchange which accounted for a decrease of $15 million to aircraft rent expense.

- Aircraft maintenance expense of $502 million in the first nine months of 2008 decreased $82 million or 14% from the first nine months of 2007. The decrease was partly due to timing of maintenance activities in engine and component 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 $33 million to aircraft maintenance expense. Partly offsetting these decreases were expenses of $18 million relating to Boeing 777 and Embraer ERJ-190 aircraft in the first nine months of 2008. Air Canada had 45 Embraer ERJ-190 and 15 Boeing 777 aircraft in its operating fleet as at September 30, 2008 versus only 34 Embraer ERJ-190 and 7 Boeing 777 aircraft as at September 30, 2007. In addition, the insourcing of supply chain management also had a positive impact on aircraft maintenance expense, accounting for a decrease of $18 million to aircraft maintenance expense.

Non-operating expense amounted to $126 million in the first nine months of 2008

Non-operating expense amounted to $126 million in the first nine months of 2008 compared to non-operating expense of $70 million in the first nine months of 2007. Gains relating to fair value adjustments on derivatives instruments amounted to $60 million in the first nine months of 2008 versus gains of $26 million in the first nine months of 2007. Net interest expense increased $53 million over the same period in 2007. A lower amount of capitalized interest related to new aircraft and a decrease in interest income largely due to lower cash balances more than offset the $28 million decrease in interest expense. In the first quarter of 2008, Air Canada recorded an impairment charge of $38 million related to the planned retirement of its fleet of Boeing 767-200 aircraft. In the second quarter of 2008, Air Canada recorded gains amounting to $7 million pertaining to the sale of aircraft-related inventory. In the first quarter of 2007, Air Canada recorded gains amounting to $7 million pertaining to the sale of one real estate property and to the sale of parked aircraft. 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 $128 million in the first nine months of 2008

Net losses on foreign currency monetary items amounted to $128 million in the first nine months of 2008 versus net gains of $297 million in the first nine months of 2007. The losses in the first nine months of 2008 were attributable to a weaker Canadian dollar at September 30, 2008 compared to December 31, 2007, partially offset by gains of $153 million related to foreign currency derivatives. The September 30, 2008 noon day exchange rate was $1US = Cdn $1.0599 while the December 31, 2007 noon day exchange rate was $1US = Cdn $0.9881.

Provision for income taxes of $18 million in the first nine months of 2008

Air Canada recorded a provision for income taxes of $18 million in the first nine months of 2008 on a pre-tax loss of $280 million, as the recovery of future income taxes has been offset by a valuation allowance of $56 million. Future income tax expense of $17 million was recorded for tax that has been reclassified from other comprehensive income to income for realized gains on fuel derivatives. This compared to a provision for income taxes of $188 million, at an effective income tax rate of 32%, 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):

	Actual							Planned							
Fleet Plan	**Year End 2007**	**New Deliveries**	**Sublease to Third Party**	**Lease returns**	**Sales**	**Parked**	**September 30, 2008**	**New Deliveries**	**Sublease toThird Party**	**Lease returns**	**Sales**	**Parked**	**Year End 2008**	**2009 fleet changes**	**Year End 2009**
B777-300	**5**	4	-	-	-	-	**9**	-	-	-	-	-	**9**	3	**12**
B777-200	**3**	3	-	-	-	-	**6**	-	-	-	-	-	**6**	-	**6**
B767-300	**31**	-	-	(1)	-	-	**30**	-	-	-	-	-	**30**	(3)	**27**
B767-200	**10**	-	-	-	-	(3)	**7**	-	-	-	-	(7)	**-**	-	**-**
A340-300	**5**	-	(3)	-	-	-	**2**	-	-	-	-	-	**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)	(1)	-	(5)	**208**	-	-	-	-	(7)	**201**	(2)	**199**
Average age (years)	**9.0**						**9.1**						**8.9**		**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 November 6, 2008, Air Canada had completed the refurbishment of all Airbus A321, A320 and A319 aircraft and 26 of its Boeing 767-300 aircraft, for a total of 112 aircraft to date. Air Canada expects the nine operating aircraft in its fleet yet to be refurbished to have their refurbishment completed by mid-2009. The Embraer and Boeing 777 aircraft are delivered with the new seats and entertainment systems already installed.

6. Financial and Capital Management

6.1 Financial Position

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

Condensed Statement of Financial Position (Canadian dollars in millions)	September 30, 2008	December 31, 2007
Assets		
Cash, cash equivalents and short-term investments	$ 1,114	$ 1,239
Other current assets	1,316	1,222
Current assets	2,430	2,461
Property and equipment	7,457	7,919
Intangible assets	968	952
Deposits and other assets	484	488
	$ 11,339	**$ 11,820**
Liabilities		
Current liabilities	$ 3,224	$ 2,939
Long-term debt and capital leases	3,962	4,006
Pension and other benefits liabilities	1,460	1,824
Other long-term liabilities	452	424
	9,098	**9,193**
Non-controlling interest	**192**	**184**
Shareholders' equity	**2,049**	**2,443**
	$ 11,339	**$ 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 September 30, 2008 and as at December 31, 2007.

(Canadian dollars in millions)	September 30, 2008	December 31, 2007	Change
Total long-term debt and capital lease obligations	$ 3,962	$ 4,006	$ (44)
Current portion of long-debt and capital lease obligations	408	413	(5)
	4,370	4,419	(49)
Non-controlling interest	192	184	8
Less cash, cash equivalents and short-term investments	(1,114)	(1,239)	125
Net debt and non-controlling interest	**3,448**	**3,364**	**84**
Capitalized operating leases (1)	1,958	2,115	(157)
Adjusted net debt and non-controlling interest	**5,406**	**5,479**	**(73)**
Less pre-delivery (PDP) financing included in long-term debt	(140)	(521)	381
Adjusted net debt and non-controlling interest, excluding PDP financing	**5,266**	**4,958**	**308**
Shareholders' equity	**$ 2,049**	**$ 2,443**	**$ (394)**
Adjusted net debt to net debt plus equity ratio, excluding PDP financing	**72.0%**	**67.0%**	**5.0 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 $261 million for the twelve months ended September 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 September 30, 2008, adjusted net debt and non-controlling interest, including capitalized operating leases, and excluding the pre-delivery payment ("PDP") financing, increased $308 million from December 31, 2007. Net debt was adversely impacted by the weakening of the Canadian dollar versus the US dollar. The adjusted net debt to net debt plus equity ratio for Air Canada increased to 72.0% at September 30, 2008 from 67.0% at December 31, 2007. The 5.0 percentage point deterioration from December 31, 2007 was mainly due to a decrease in shareholders' equity recorded during the nine months ended September 30, 2008.

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 significant volatility in fuel prices and the current recessionary pressures, 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 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. The Corporation continues to seek to enter into long-term financing transactions on 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 September 30, 2008, Air Canada had cash, cash equivalents and short-term investments of $1,114 million. Cash, cash equivalents and short-term investments decreased $125 million from December 31, 2007, largely due to the repayment of long-term debt and capital expenditures, net of the related aircraft financing, and additions to capital assets, partly offset by the favourable impact of the sale and leaseback of five Boeing 777 aircraft in the first nine months of 2008.

At October 31, 2008, Air Canada had cash, cash equivalents and short-term investments of approximately $1,025 million. The decline of $89 million from the September balance is explained in large part by the cash collateral provided to counterparties under the Corporation's portfolio of fuel hedges offset by a new financing arrangement, both described further below.

The rapid drop in fuel prices subsequent to the third quarter of 2008 has resulted in a negative mark-to-market value for the Corporation's portfolio of fuel hedges. This has required the Corporation to post significant cash collateral with hedging counterparties which, as at October 31, 2008, amounted to $275 million (nil at September 30, 2008). This collateral requirement has put additional pressure on liquidity in the short-term even though the lower fuel prices will provide material cash savings over time. Refer to section 8 of this MD&A for a discussion on fuel price risk.

The Canadian dollar has recently depreciated substantially against the US dollar which, given the Corporation's large currency hedge position, provides for a significant positive mark-to-market value. The potential source of cash related to the foreign exchange contracts would partially offset the cash collateral associated with the fuel hedge contracts discussed above, should the Corporation decide to terminate these positions. Refer to section 8 of this MD&A for a discussion on foreign exchange risk.

Though 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, it is no longer 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. During the third quarter of 2008, the Corporation and the lenders 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. On October 30, 2008, the Corporation and the lenders entered into a further amendment agreement pursuant to which the commitment was reduced to $200 million and the Corporation agreed to suspend the obligation of the lenders to consider any amendments in exchange for additional flexibility under the facility to permit the Corporation to seek alternative financing arrangements. Discussions with the lenders are not currently taking place and 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 or alternative financing arrangements will be concluded. In the event of termination of the credit facility, the assets previously securing the credit facility might normally be expected to generate a similar level of liquidity as they do under the credit facility. In addition, 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 are available to support financing transactions which might normally be expected to increase the Corporation's liquidity by approximately $800 million. However, given the current instability of credit markets and economic conditions, there can be no assurance that the Corporation will be able to conclude such transactions, including on favourable terms or that the Corporation's assets will generate the expected levels of liquidity.

On October 28, 2008, the Corporation arranged for and received financing amounting to $92 million (US$75 million). This financing has a term to December 15, 2009 and is repayable prior to then provided the Corporation has received certain additional alternate financing. The financing bears interest at one month LIBOR plus 5.98% (currently 9.10%) and is secured by a security interest and a movable hypothec in the principal amount of $200 million. The financing can be repaid at any time prior to maturity, in whole or in part, without penalty.

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 September 30, 2008 as compared to December 31, 2007.

(Canadian dollars in millions)	September 30, 2008	December 31, 2007	Change in working capital
Cash and short-term investments	$ 1,114	$ 1,239	$ (125)
Accounts receivable	994	750	244
Other current assets	322	472	(150)
Accounts payable and accrued liabilities	(1,364)	(1,226)	(138)
Other current liabilities	(1,860)	(1,713)	(147)
	$ (794)	**$ (478)**	**$ (316)**

The working capital deficiency of $794 million has deteriorated by $316 million from December 31, 2007, reflecting, in part, the scheduled repayment of long-term debt, the impact of capital expenditures, net of the related aircraft financing, significant contributions to the Corporation's pension plans, and a decrease in the fair market value of outstanding derivatives. The deterioration in the working capital deficiency at September 30, 2008 from December 31, 2007 was partly offset by net cash provided by operating activities (excluding pension funding). The deterioration of $574 million in the working capital deficiency from June 30, 2008 to September 30, 2008 was largely driven by a decrease in the fair value of fuel derivatives and increase in contributions to the Corporation's pension plans. This deterioration in the working capital deficiency from June 30, 2008 to September 30, 2008 was partly offset by net cash provided by operating activities (excluding pension funding)

In the first nine months of 2008, cash was favourably impacted by net proceeds of $144 million, from the sale and leaseback of five Boeing 777 aircraft. This 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 nine months of 2008, additions to capital assets, excluding the sale and leaseback transactions, amounted to $546 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 $314 million and was mainly related to committed delivery financing and additional pre-delivery financing.

6.4 Consolidated Cash Flow Movements

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

(Canadian dollars in millions)	Third Quarter 2008	Third Quarter 2007	Third Quarter Change $	First Nine Months (2) 2008	First Nine Months (2) 2007	First Nine Months (2) Change $
Net cash provided by operating activities	**$ 121**	$ 393	$ (272)	**$ 193**	$ 472	$ (279)
Changes in non-cash working capital	**(389)**	(323)	(66)	**(17)**	(52)	35
Cash flows from (used for) operating activities	**(268)**	70	(338)	**176**	420	(244)
Additions to capital assets	**(105)**	(604)	499	**(733)**	(1,761)	1,028
Free cash flow(1)	**(373)**	**(534)**	**161**	**(557)**	**(1,341)**	**784**
Proceeds from sale and leaseback transactions	**-**	-	-	**708**	-	708
Short-term investments	**161**	171	(10)	**95**	88	7
Other	**49**	(27)	76	**111**	(19)	130
Cash flows from investing activities (excluding additions to capital assets)	**210**	**144**	**66**	**914**	**69**	**845**
Aircraft-related borrowings	**-**	449	(449)	313	1,093	(780)
Reduction of long-term debt and capital lease obligations	**(67)**	(138)	71	**(708)**	(305)	(403)
Other	8	-	8	8	(36)	44
Cash flows from (used for) financing activities	**(59)**	**311**	**(370)**	**(387)**	**752**	(1,139)
Net decrease in cash and cash equivalents	**(222)**	**(79)**	**(143)**	**(30)**	**(520)**	**490**
Net decrease in short-term investments	**(161)**	(171)	10	**(95)**	(88)	(7)
Net decrease in cash, cash equivalents and short-term investments	**$ (383)**	**$ (250)**	**$ (133)**	**$ (125)**	**$ (608)**	**$ 483**

(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.

(2) Reflects the results of Air Canada for the first nine months of 2008 and the results of the Air Canada Services segment, which excluded the consolidation of Jazz, for the first nine months of 2007.

Air Canada's use of free cash for the third quarter of 2008 improved $161 million from the third quarter of 2007 and $784 million in the first nine months of 2008 versus the same period in 2007. The improvement in free cash flow was related to a reduction in capital expenditures, due to fewer aircraft deliveries in 2008, largely offset by an unfavourable change in operating cash flows. The decrease in operating cash flows versus the same periods in 2007 was primarily driven by a deterioration in Air Canada's operating results and the impact of higher past service cost contributions under the Corporation's pension plans.

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 of 2008	2009	2010	2011	2012	Thereafter	Total
Long-term debt obligations (1)	$ 84	$ 310	$ 288	$ 294	$ 298	$ 2,091	$ 3,365
Debt consolidated under AcG-15 (1)	76	107	156	349	93	192	973
Capital lease obligations (1)	93	167	163	157	200	625	1,405
Operating lease obligations (2)	78	317	307	240	221	774	1,937
Committed capital expenditures (3)	51	149	86	87	471	3,897	4,741
Total contractual obligations (4)	**$ 382**	**$ 1,050**	**$ 1,000**	**$ 1,127**	**$ 1,283**	**$ 7,579**	**$ 12,421**
Pension funding obligations (5)	$ 122	$ 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 rates effective as at September 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 do not reflect the economic experience of 2008 to date.

The pension funding requirements disclosed below 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.

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

(Canadian dollars in millions)	Remainder of 2008	2008	2009	2010	2011	2012
Past service domestic registered plans	$ 60	$ 194	$ 223	$ 223	$ 223	$ 223
Current service domestic registered plans	45	170	174	178	184	189
Other pension arrangements (1)	17	92	65	68	69	71
Projected pension funding obligations	**$ 122**	**$ 456**	**$ 462**	**$ 469**	**$ 476**	**$ 483**

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

If recent market conditions persist, the Corporation expects its January 1, 2009 valuation to result in significant increases in funding obligations starting in the second half of 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 September 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 in 2009. These two firm aircraft were originally scheduled for delivery during the third quarter of 2008. Air Canada's capital expenditure projections have been amended to reflect this expected delay. 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 November 6, 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 expected for delivery in 2009 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 February 2010 was rescheduled for delivery in January 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	$ 596	$ 149	$ 86	$ 87	$ 471	$ 3,897
Projected planned but uncommitted expenditures	38	127	151	116	85	
Total projected expenditures (1) (2)	634	276	237	203	556	
Projected financing on committed expenditures	(313)	(231)	-	-	(416)	
Total projected expenditures, net of financing	**$ 321**	**$ 45**	**$ 237**	**$ 203**	**$ 140**	

(1) US dollar amounts are converted using the September 30, 2008 noon day exchange rate of 1US$ = Cdn$1.0599. 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 September 30, 2008.
(2) The dollar amounts reflected above do not include obligations pertaining to day-to-day operations.
(3) Total projected expenditures in 2008 exclude $187 million related to the five sale and leaseback transactions executed during the first nine months of 2008.

6.8 Share Information

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

	Number of shares	
	At October 31, 2008	**At December 31, 2007**
Issued and outstanding shares		
Class A variable voting shares	16,588,959	16,654,049
Class B voting shares	83,411,041	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	1,701,447	1,720,092
Total shares potentially issuable	**1,701,447**	**1,720,092**
Total outstanding and potentially issuable shares	**101,701,447**	**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)	Q4 2006	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008
Operating revenues	**$ 2,423**	**$ 2,540**	**$ 2,639**	**$ 2,954**	**$ 2,513**	**$ 2,727**	**$ 2,782**	**$ 3,075**
Ownership (DAR) (1)	(218)	(207)	(211)	(210)	(202)	(234)	(242)	(243)
Other operating expenses	(2,210)	(2,411)	(2,340)	(2,393)	(2,239)	(2,505)	(2,533)	(2,720)
Operating expenses	**(2,428)**	**(2,618)**	**(2,551)**	**(2,603)**	**(2,441)**	**(2,739)**	**(2,775)**	**(2,963)**
Operating income (loss) before the under-noted item	**(5)**	**(78)**	**88**	**351**	**72**	**(12)**	**7**	**112**
Provision for cargo investigations (2)	-	-	-	-	-	(125)	-	-
Operating income (loss)	**(5)**	**(78)**	**88**	**351**	**72**	**(137)**	**7**	**112**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(139)	44	67	(78)	(37)	(151)	115	(244)
Net income (loss)	**$ (144)**	**$ (34)**	**$ 155**	**$ 273**	**$ 35**	**$ (288)**	**$ 122**	**$ (132)**
Revenue passenger miles (millions)	11,160	11,814	12,580	14,789	11,446	12,331	12,884	14,458
Available seat miles (millions)	14,343	14,735	15,220	18,144	14,715	15,407	15,581	17,515
Passenger load factor (%)	77.8	80.2	82.7	81.5	77.8	80.0	82.7	82.5
Operating expense per available seat mile (CASM) (cents)	16.9	17.7	16.8	14.3	16.6	17.8	17.8	16.9
CASM, excluding fuel expense (cents) (3)	12.9	13.8	12.6	10.4	12.4	13.1	12.4	10.8
EBITDAR before the provision for cargo investigations (3)	**$ 213**	**$ 129**	**$ 299**	**$ 561**	**$ 274**	**$ 222**	**$ 249**	**$ 355**
EBITDAR (3)	**$ 213**	**$ 129**	**$ 299**	**$ 561**	**$ 274**	**$ 97**	**$ 249**	**$ 355**
Earnings (loss) per share								
- Basic and diluted (4)	**$ (1.55)**	**$ (0.34)**	**$ 1.55**	**$ 2.73**	**$ 0.35**	**$ (2.88)**	**$ 1.22**	**$ (1.32)**

(1) DAR refers to the combination of Aircraft rent and Depreciation and amortization expenses.
(2) A provision for cargo investigations of $125 million was recorded in the first quarter of 2008.
(3) See section 15 "Non-GAAP Financial Measures" in this MD&A for additional information.
(4) 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 fourth quarter of 2006 to the second quarter of 2007. Effective May 24, 2007, Jazz results are not consolidated within Air Canada.

($ millions)	Q4 2006	Q1 2007	Q2 2007
Jazz			
Operating revenues	**$ 352**	**$ 364**	**$ 249**
Ownership (DAR) (1)	(39)	(40)	(26)
Other operating expenses	(280)	(288)	(197)
Operating expenses	**(319)**	**(328)**	**(223)**
Operating income	**33**	**36**	**26**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(1)	(1)	1
Net income	**$ 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 for the last eight quarters. The results below reflect the consolidation of Jazz only up to May 24, 2007. Refer to section 2 of this MD&A for additional information.

($ millions, except per share figures)	Q4 2006	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008
Consolidated Total								
Operating revenues	**$ 2,395**	**$ 2,510**	**$ 2,622**	**$ 2,954**	**$ 2,513**	**$ 2,727**	**$ 2,782**	**$ 3,075**
Ownership (DAR) (1)	(247)	(237)	(231)	(210)	(202)	(234)	(242)	(243)
Other operating expenses	(2,119)	(2,315)	(2,277)	(2,393)	(2,239)	(2,505)	(2,533)	(2,720)
Operating expenses	**(2,366)**	**(2,552)**	**(2,508)**	**(2,603)**	**(2,441)**	**(2,739)**	**(2,775)**	**(2,963)**
Operating income (loss) before the under-noted item	**29**	**(42)**	**114**	**351**	**72**	**(12)**	**7**	**112**
Provision for cargo investigations (2)	-	-	-	-	-	(125)	-	-
Operating income (loss)	**29**	**(42)**	**114**	**351**	**72**	**(137)**	**7**	**112**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(173)	8	41	(78)	(37)	(151)	115	(244)
Net income (loss)	**$ (144)**	**$ (34)**	**$ 155**	**$ 273**	**$ 35**	**$ (288)**	**$ 122**	**$ (132)**
Earnings (loss) per share								
- Basic and diluted	**$ (1.55)**	**$ (0.34)**	**$ 1.55**	**$ 2.73**	**$ 0.35**	**$ (2.88)**	**$ 1.22**	**$ (1.32)**

(1) DAR refers to the combination of Aircraft rent and Depreciation and amortization expenses.
(2) A provision for cargo investigations of $125 million was recorded in the first quarter of 2008.

8. Financial Instruments and Risk Management

As described in section 10 of this MD&A, the Corporation adopted Canadian Institute of Chartered Accountants ("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: credit risk, 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.

Credit Risk

In order to manage its exposure to credit risk, the Corporation reviews counterparty credit ratings on a regular basis. In the third quarter of 2008, a counterparty defaulted under a number of derivative agreements with the Corporation. As a result, the Corporation recorded a loss of $6 million and $2 million related to foreign exchange and fuel derivatives, respectively. The loss was recorded in gain (loss) on financial instruments recorded at fair value.

Fuel Price Risk

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

As at September 30, 2008, Air Canada had hedged 54% of its fuel requirement for the fourth quarter of 2008, 24% of its projected fuel requirement for 2009 and 9% of its projected fuel requirement for 2010. The fourth quarter of 2008 was hedged at prices that fluctuate between an average of US$109 to US$114 per barrel for jet-fuel based contracts, an average of US$99 to US$103 per barrel for heating oil-based contracts and an average of US$110 to US$119 per barrel for West Texas Intermediate ("WTI") crude-oil based contracts**.** On an equivalent WTI basis, the fourth quarter of 2008 was hedged at prices that fluctuate between an average of US$94 to US$99 per barrel.

Since September 30, 2008, Air Canada has entered into new hedging positions, using costless collar option structures. As at November 6, 2008, Air Canada had hedged 56% of its projected fuel requirement for the fourth quarter of 2008, 31% of its projected fuel requirement for 2009 and 14% of its projected fuel requirement for 2010. With these new hedging positions, the fourth quarter of 2008 is hedged at prices that can fluctuate between an average of US$109 to US$114 per barrel for jet-fuel based contracts, an average of US$99 to US$104 per barrel for heating oil-based contracts and an average of US$107 to US$115 per barrel for WTI crude-oil based contracts. On an equivalent WTI basis, the fourth quarter of 2008 is hedged at prices that fluctuate between an average of US$90 to US$95 per barrel and 2009 is hedged at prices that fluctuate between an average of US$95 to US$102 per barrel.

At September 30, 2008, the fair value of the outstanding fuel derivatives was $16 million in favour of the counterparties. The total decrease in the fair value of the Corporation's fuel derivatives, including derivatives under hedge accounting and not under hedge accounting, amounted to $440 million in the third quarter of 2008 (a gain of $128 million in the first nine months of 2008). Of the fair value loss, $328 million was recorded in other comprehensive income ("OCI") in the third quarter of 2008 as a reversal of previous gains ($73 million to be applied as a reduction to fuel expense recorded in the first nine months of 2008), and the remaining $112 million was recorded as a loss in non-operating income (expense) in the third quarter of 2008 ($55 million in the first nine 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. At October 31, 2008, the fair value of the outstanding fuel derivatives was $380 million in favour of the counterparties.

Fuel derivatives include both derivatives designated and not designated under fuel hedge accounting. The current portion of the derivative asset of $12 million is included in fuel derivatives, the current liability of $30 million is included in accounts payable and accrued liabilities and the long-term asset of $2 million is included in deposits and other assets on Air Canada's consolidated statement of financial position.

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

- The fair value of outstanding fuel derivatives under hedge accounting at September 30, 2008 was $6 million in favour of the counterparties.
- The change in fair value of fuel derivatives under hedge accounting in the third quarter of 2008 was ($386) million ($97 million in the first nine months of 2008):
    - The unrealized effective change in the fair value of derivatives recorded in OCI in the third quarter of 2008 was a loss of $280 million (a gain of $67 million in the first nine months of 2008). The realized effective change in the fair value of derivatives recorded in OCI in the third quarter of 2008 was a loss of $48 million (a gain of $6 million in the first nine months of 2008). OCI amounts for the third quarter of 2008 and for the first nine months of 2008 of ($244) million and $29 million, respectively, are presented net of 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 third quarter of 2008 was a loss of $58 million (a gain of $24 million in the first nine 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 loss in non-operating income (expense) was due to the decrease in the fair market value of the derivatives being larger than the decrease in the intrinsic value.
- In the third quarter of 2008, fuel derivative contracts matured with fair values in favour of the Corporation for $74 million.
- In the third quarter of 2008, the benefit to fuel expense was $64 million ($190 million in the first nine months of 2008). This benefit was recognized through the removal of the amount from AOCI, which is reported as a reclassification of net realized gains of $44 million net of tax for the third quarter of 2008 ($129 million net of tax for the first nine months of 2008).
- In the third quarter of 2008, the net impact to AOCI was a decrease of $392 million before tax of $104 million ($117 million before tax of $17 million in the first nine months of 2008). As at September 30, 2008, the balance in AOCI was ($44) million. The estimated net amount of existing gains and losses reported in AOCI that is expected to be reclassified to net income (loss) in the following 12 months is $18 million before tax.

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

- In the third quarter of 2008, fuel derivative contracts matured in favour of the Corporation for $2 million ($21 million in favour of the Corporation in the first nine months of 2008).
- The fair value of outstanding fuel derivatives not under hedge accounting at September 30, 2008 was $10 million in favour of the counterparties.
- The change in fair value of the derivative contracts in the third quarter of 2008 was a loss of $54 million (a gain of $31 million in the first nine months of 2008) and was recorded in non-operating income (expense).

Refer to section 6.3 for a discussion of cash collateral requirements under fuel hedge positions as at October 31, 2008.

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 ratio at September 30, 2008 was 56% fixed and 44% floating, including the effects of interest rate swap positions. The cross-currency interest rate swap positions were terminated on October 1, 2008 with a fair value of $4 million in favour of the Corporation. The adjusted ratio at October 1, 2008 was 61% fixed and 39% floating.

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

- As at September 30, 2008, the Corporation had 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 $300 million (US$283 million). These swaps convert US denominated debt principal and interest payments into Canadian denominated debt at a foreign exchange rate of par (US$1/CAD$1) and convert from a fixed rate of 5.208% to a floating rate. The fair value of these contracts as at September 30, 2008 was $5 million in favour of Air Canada. These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. In the third quarter of 2008, a gain of $19 million was recorded in gain (loss) on financial instruments recorded at fair value related to these derivatives (a gain of $6 million in the first nine months of 2008). As noted above, these swaps were terminated on October 1, 2008, with a fair value of $4 million in favour of the Corporation.

- As at September 30, 2008, the Corporation had entered into two interest rate swap agreements with terms of July 2022 and January 2024 relating to two Boeing 767 aircraft financing agreements with an aggregate notional value of $103 million (US$97 million). These swaps convert the lease payments on the two aircraft leases from fixed to floating rates. The fair value of these contracts as at September 30, 2008 was $9 million in favour of the Corporation. These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. In the third quarter of 2008, a gain of $1 million was recorded in gain (loss) on financial instruments recorded at fair value (a gain of $2 million in the first nine months of 2008) (a gain of $3 million in the third quarter of 2007 and a loss of $1 million in the first nine months of 2007).

- 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.

The following are the current derivatives employed in foreign exchange risk management activities and the adjustments recorded in the first nine months of 2008:

- At as September 30, 2008, the Corporation had entered into foreign currency forward contracts and option agreements converting US dollars and Euros into Canadian dollars on $1,482 million (US$1,398 million) and $4 million (EUR 3 million) which mature in 2008, 2009 and 2010. The fair value of these foreign currency contracts as at September 30, 2008 was $56 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). Net cash US outflows for the remainder of 2008 are 100% covered at an average foreign exchange rate of US$1/CAD 1.0255. Net cash US outflows for 2009 are 29% covered at an average foreign exchange rate of US$1/CAD 1.0004 and net cash US outflows for 2010 are 2.6% covered at an average foreign exchange rate of US$1/CAD 0.9691. The entire US portfolio is covered at an average rate of US$1/CAD 1.0125. These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. In the third quarter of 2008, a gain of $70 million was recorded in foreign exchange gain (loss) related to these derivatives (a gain of $153 million in the first nine months of 2008) (a loss of $117 million in the third quarter of 2007 and a loss of $212 million in the first nine months of 2007).

- At as October 31, 2008, the Corporation had entered into foreign currency forward contracts and option agreements converting US dollars and Euros into Canadian dollars on $963 million (US$795 million) and $5 million (EUR 3 million) which mature in 2008, 2009 and 2010. The fair value of these foreign currency contracts as at October 31, 2008 was $142 million in favour of the Corporation. Net cash US outflows for the remainder of 2008 are 94% covered at an average foreign exchange rate of US$1/CAD 1.0355. Net cash US outflows for 2009 are 24% covered at an average foreign exchange rate of US$1/CAD 1.0000 and net cash US outflows for 2010 are 4% covered at an average foreign exchange rate of US$1/CAD 0.9784. The entire US portfolio is covered at an average rate of US$1/CAD 1.0164.

- 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 $300 million (US$283 million) as at September 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 it enters 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. The carrying value as at September 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 in the first nine months of 2008.

9. Related Party Transactions

At September 30, 2008, ACE had a 75% ownership interest in Air Canada. Air Canada has various related party transactions with ACE and Aveos Fleet Performance Inc. ("Aveos") (formerly called ACTS Aero Technical Support & Services Inc. ("ACTS Aero")). Aveos conducts the business previously operated by ACTS LP ("ACTS") prior to the sale of ACTS announced by ACE and completed on October 16, 2007. The relationship between Air Canada and Aveos and between Air Canada and ACE are described in Air Canada's 2007 MD&A dated February 6, 2008.

In the third quarter of 2008, ACTS LP settled certain contracts with Air Canada for $8 million relating to the monetization which was completed on October 16, 2007. These contracts were accounted for as equity transactions and resulted in an increase of $8 million to contributed surplus on Air Canada's consolidated statement of financial position.

Air Canada and Aveos entered into an agreement dated October 28, 2008 pursuant to which Air Canada has agreed to temporarily extend payment terms to Aveos under certain related-party agreements. In exchange for the extended payment terms, certain letters of credit related to the Pension and Benefits Agreement, as described in Note 20 of the 2007 annual consolidated financial statements of the Corporation, were cancelled. The cancellation of the letters of credit will provide cash to Air Canada of approximately $40 million and is offset by the impact of extended payment terms to Aveos of $22 million, for a net cash flow benefit of approximately $18 million to Air Canada. The extended payment terms to Aveos are reduced over the course of one year, with the first reduction starting approximately six months from the date of the agreement, and with a corresponding return of the letters of credit to Aveos, such that, by October 2009, the letters of credit would be re-instated to the levels then required under the Pension and Benefits Agreement between the two parties.

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)	September 30, 2008	December 31, 2007
Accounts receivable		
ACE	$ 9	$ 9
Aveos	88	75
	$ 97	**$ 84**
Prepaid Maintenance		
Aveos	$ 7	$ 24
	$ 7	**$ 24**
Accounts payable and accrued liabilities		
Aveos	$ 45	$ 88
	$ 45	**$ 88**

Revenues and expenses with related parties are summarized as follows:

	Third Quarter		First Nine Months	
(Canadian dollars in millions)	2008	2007	2008	2007
Revenues				
Property rental revenues from ACE and Aveos	$ 4	$ 10	$ 22	$ 31
Revenues from information technology services to Aveos	4	4	11	11
Revenues from corporate services and other to ACE and Aveos	3	6	22	17
	$ 11	**$ 20**	**$ 55**	**$ 59**
Expenses				
Maintenance expense for services from Aveos	$ 93	$ 130	$ 368	$ 505
Recovery of wages, salary and benefit expense for employees assigned to ACE and Aveos	(64)	(80)	(219)	(276)
	$ 29	**$ 50**	**$ 149**	**$ 229**

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 has evaluated the impact of this new standard for adoption on January 1, 2009 and does not expect any significant impact on its consolidated financial statements.

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

As a result, the Corporation 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.

Refer to section 6.6 of this MD&A "Pension Funding Obligations" for an update on the Corporation's pension funding obligations.

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 withdrawn following the Ontario Court of Appeal's decision, on June 27, 2008, to reject ACPA's appeal of the order dismissing its claim, and the expiry of the time during which an appeal may be made without ACPA having filed any appeal.

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 Third Quarter 2008 MD&A and the Third 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 September 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:

	Third Quarter			First Nine Months		
(Canadian dollars in millions)	**2008**	**2007**	**$ Change**	**2008**	**2007**	**$ Change**
GAAP operating income before the provision for cargo investigations	$ 112	$ 351	$ (239)	$ 107	$ 361	$ (254)
Add back:						
Aircraft rent	67	66	1	199	220	(21)
Depreciation and amortization	176	144	32	520	408	112
EBITDAR before the provision for cargo investigations	**$ 355**	**$ 561**	**$ (206)**	**$ 826**	**$ 989**	**$ (163)**
Add back:						
Provision for cargo investigations	-	-	-	(125)	-	(125)
EBITDAR	**$ 355**	**$ 561**	**$ (206)**	**$ 701**	**$ 989**	**$ (288)**

Operating Expense excluding Fuel Expense

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

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

	Third Quarter			First Nine Months		
(Canadian dollars in millions)	**2008**	**2007**	**$ Change**	**2008**	**2007**	**$ Change**
GAAP operating expense	$ 2,963	$ 2,603	$ 360	$ 8,477	$ 7,772	$ 705
Remove:						
Aircraft fuel	(1,064)	(716)	(348)	(2,627)	(1,937)	(690)
Operating expense, excluding fuel expense	**$ 1,899**	**$ 1,887**	**$ 12**	**$ 5,850**	**$ 5,835**	**$ 15**

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;

Yield — Average passenger revenue per RPM.