AIR CANADA

SECOND QUARTER 2009

Management's Discussion and Analysis of Results of Operations and Financial Condition

August 7, 2009

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1. Highlights

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

(Canadian dollars in millions except per share figures)	Second Quarter			First Six Months		
	2009	2008	Change $	2009	2008 [1]	Change $
Financial						
Operating revenues	2,330	2,782	(452)	4,721	5,509	(788)
Operating income (loss) before a special provision [1]	(113)	7	(120)	(301)	(5)	(296)
Operating income (loss)	(113)	7	(120)	(301)	(130)	(171)
Non-operating income (expense)	(80)	128	(208)	(189)	21	(210)
Income (loss) before non-controlling interest, foreign exchange and income taxes	(193)	135	(328)	(490)	(109)	(381)
Net income (loss) for the period	155	122	33	(245)	(166)	(79)
Operating margin before a special provision % [1]	-4.8%	0.3%	(5.1) pp	-6.4%	-0.1%	(6.3) pp
Operating margin %	-4.8%	0.3%	(5.1) pp	-6.4%	-2.4%	(4.0) pp
EBITDAR before a special provision [1][2]	135	249	(114)	192	471	(279)
EBITDAR [2]	135	249	(114)	192	346	(154)
EBITDAR margin before a special provision % [1][2]	5.8%	9.0%	(3.1) pp	4.1%	8.5%	(4.4) pp
EBITDAR margin % [2]	5.8%	9.0%	(3.1) pp	4.1%	6.3%	(2.2) pp
Cash, cash equivalents and short-term investments	907	1,497	(590)	907	1,497	(590)
Free cash flow	(140)	(11)	(129)	(79)	(184)	105
Adjusted debt/equity ratio %	89.7%	65.9%	23.8 pp	89.7%	65.9%	23.8 pp
Earnings (loss) per share - basic and diluted	$1.55	$1.22	$0.33	($2.45)	($1.66)	($0.79)
Operating Statistics			**Change %**			**Change %**
Revenue passenger miles (millions) (RPM)	11,862	12,884	(7.9)	22,846	25,215	(9.4)
Available seat miles (millions) (ASM)	14,735	15,581	(5.4)	28,557	30,988	(7.8)
Passenger load factor %	80.5%	82.7%	(2.2) pp	80.0%	81.4%	(1.4) pp
Passenger revenue per RPM (cents)	17.3	19.0	(8.9)	17.8	18.8	(5.8)
Passenger revenue per ASM (cents)	13.9	15.7	(11.3)	14.2	15.3	(7.3)
Operating revenue per ASM (cents)	15.8	17.9	(11.4)	16.5	17.8	7.0
Operating expense per ASM ("CASM") (cents)	16.6	17.8	(7.0)	17.6	17.8	(1.2)
CASM, excluding fuel expense (cents)	12.7	12.4	2.6	13.5	12.8	5.9
Average number of full-time equivalent (FTE) employees (thousands) [3]	23.2	24.6	(5.7)	23.0	24.3	(5.6)
Aircraft in operating fleet at period end [4]	334	343	(2.6)	334	343	(2.6)
Average fleet utilization (hours per day) [5]	9.2	9.5	(2.8)	9.2	9.7	(5.6)
Average aircraft flight length (miles) [5]	837	847	(1.2)	839	862	(2.7)
Fuel price per litre (cents) [6]	65.4	89.2	(26.7)	68.3	82.2	(16.9)
Fuel litres (millions)	870	946	(8.0)	1,697	1,893	(10.4)

(1) A provision related to investigations of alleged anti-competitive cargo pricing activities of $125 million was recorded in the first quarter of 2008.
(2) See section 17 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR before the provision for cargo investigations to operating income (loss) and EBITDAR to operating income (loss).
(3) Reflects FTE employees at Air Canada. Excludes FTE employees at Jazz.
(4) Includes Jazz aircraft covered under the Jazz CPA.
(5) Excludes charter operations. Also excludes third party carriers operating under capacity purchase arrangements, other than Jazz aircraft covered under the Jazz CPA.
(6) Includes fuel handling and is net of fuel hedging results.

2. Introduction

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

Air Canada's Second Quarter 2009 MD&A provides the reader with a view of Air Canada's financial results from the perspective of management as well as an analysis of Air Canada's financial results for the second quarter of 2009 and for the first six months of 2009. The MD&A also includes a discussion on Air Canada's controls and procedures. This MD&A should be read in conjunction with Air Canada's interim unaudited consolidated financial statements and notes for the second quarter of 2009 and its annual audited consolidated financial statements and notes and its annual MD&A for 2008. All financial information has been prepared in accordance with Generally Accepted Accounting Principles in Canada ("GAAP"), unless indicated otherwise. Air Canada's unaudited consolidated financial statements for the second quarter of 2009 are based on accounting policies consistent with those disclosed in Note 2 of the Corporation's annual audited consolidated financial statements for 2008 with the exception of accounting for awards of stock-based compensation, the adoption, on January 1, 2009, of new Canadian Institute of Charted Accountants ("CICA") accounting standard section 3064, *Goodwill and Intangible Assets,* and the adoption, on January 1, 2009, of the recommendations of the Emerging Issues Committee ("EIC") related to Abstract EIC-173 *Credit Risk and the Fair Value of Financial Assets and Financial Liabilities.* Refer to section 11 of this MD&A for additional information on Air Canada's accounting policies.

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

Except as otherwise noted, all monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 18 "Glossary". Except as otherwise noted, this MD&A is current as of August 6, 2009.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of the risks relating to the Corporation, see section 18 "Risk Factors" of Air Canada's 2008 MD&A dated February 13, 2009 and the Risk Factors section of Air Canada's Annual Information Form ("AIF") dated March 28, 2009, which can be found on SEDAR at **sedar.com** and at **aircanada.com**.

The Corporation issued a news release dated August 7, 2009 reporting on its results for the second quarter of 2009. This news release is available on SEDAR at **sedar.com** and at **aircanada.com**.

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

CAUTION REGARDING FORWARD-LOOKING INFORMATION

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

Forward-looking statements, by their nature, are based on assumptions, including those described below, and are subject to important risks and uncertainties. Any forecasts or forward-looking predictions or statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including without limitation, industry, market, credit and economic conditions, the ability to reduce operating costs and secure financing, pension issues, energy prices, currency exchange and interest rates, employee and labour relations, competition, war, terrorist acts, epidemic diseases, insurance issues and costs, changes in demand due to the seasonal nature of the business, supply issues, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in section 18 "Risk Factors" of Air Canada's 2008 MD&A dated February 13, 2009 and the Risk Factors section of Air Canada's AIF dated March 28, 2009. The forward-looking statements contained in this MD&A represent the Corporation's expectations as of the date of this MD&A and are subject to change after such date. However, the Corporation disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

Assumptions were made by Air Canada in preparing and making forward-looking statements. Air Canada assumes that the North American economy will remain weak for the third quarter and remainder of 2009. In addition, Air Canada expects that the Canadian dollar will trade, on average, at C$1.11 per US dollar in the third quarter of 2009 and C$1.16 per US dollar for the full year 2009 and that the price of fuel will average 64 cents per litre in the third quarter of 2009 and will average 67 cents per litre for the full year 2009 (both net of fuel hedging positions).

3. Overview

Air Canada's results of operations for the second quarter of 2009 are discussed in section 5 of this MD&A and summarized below:

Air Canada recorded net income of $155 million or $1.55 per diluted share in the second quarter of 2009 compared to net income of $122 million or $1.22 per diluted share in the second quarter of 2008. The net income recorded in the second quarter of 2009 included foreign exchange gains of $355 million. The foreign exchange gains were primarily attributable to a stronger Canadian dollar at June 30, 2009 versus March 31, 2009. The June 30, 2009 noon day exchange rate was US$1 = C$1.1625 while the March 31, 2009 noon day exchange rate was US$1 = C$1.2602.

In the second quarter of 2009, Air Canada recorded an operating loss of $113 million, a deterioration of $120 million from the operating income of $7 million recorded in the second quarter of 2008. EBITDAR amounted to $135 million in the second quarter of 2009 compared to EBITDAR of $249 million in the same period in 2008, a decrease of $114 million.

In the second quarter of 2009, operating revenues of $2,330 million decreased $452 million or 16% from the operating revenues of $2,782 million recorded in the second quarter of 2008. The decrease in operating revenues was mainly due to a passenger revenue decline of $396 million or 16% from the same period in 2008. The passenger revenue decline was due to both lower yield and reduced traffic. Yield declined 8.9% from the second quarter of 2008. Traffic decreased 7.9% on a capacity reduction of 5.4%, resulting in a passenger load factor deterioration of 2.2 percentage points. RASM decreased 11.3% over the same period in 2008, mainly due to the yield decline but also to the deterioration in passenger load factor. A weaker Canadian dollar in the second quarter of 2009 versus the second quarter of 2008, which increases the Canadian dollar value of sales in foreign countries, had a positive impact on foreign currency denominated revenues, accounting for an increase of $65 million to second quarter 2009 passenger revenues compared to the second quarter of 2008.

In the second quarter of 2009, operating expenses of $2,443 million decreased $332 million or 12% from the operating expenses of $2,775 million recorded in the second quarter of 2008. The decrease in operating expenses was achieved in spite of $105 million in additional expenses related to the weaker Canadian dollar versus the US dollar. Reduced fuel expense of $276 million versus the same period in 2008 was the main factor in the decrease in operating expenses. All major expense categories reflected decreases over the second quarter of 2008 with the exception of capacity purchase fees paid to Jazz Air LP ("Jazz") pursuant to the Corporation's capacity purchase agreement with Jazz ("Jazz CPA"), aircraft maintenance expense, ownership costs, comprised of depreciation and amortization, and aircraft rent expense, and communications and information technology expenses.

In the second quarter of 2009, CASM decreased 7.0% from the second quarter of 2008. Excluding fuel expense, CASM increased 2.6% from the second quarter of 2008. The unfavourable impact of a weaker Canadian dollar versus the US dollar was the main factor in the CASM growth (excluding fuel expense) in the second quarter of 2009. In addition to the impact of foreign exchange, the higher unit cost of ownership, reflecting Air Canada's investment in new aircraft, increased Jazz CPA expenses and the impact of the capacity reduction were also factors in the increase in CASM (excluding fuel expense). Partly offsetting these increases to CASM (excluding fuel expense) was a reduction in employee benefits expense, the result of revised actuarial assumptions.

4. Significant Events

The Corporation has entered into the following transactions in 2009 in an effort to mitigate the Corporation's liquidity risks as described in section 9.3 of Air Canada's 2008 MD&A dated February 13, 2009 and section 8.3 of this MD&A.

During July 2009

- A secured term credit facility (the "Credit Facility") for financing proceeds of $600 million, less fees of approximately $20 million. On or before the first anniversary and subject to satisfaction of certain conditions, Air Canada may request the increase of the facility by up to an additional $100 million by obtaining new commitments from either the existing or new lenders. The Credit Facility is a five-year facility with the first principal repayment due in August 2010, and bears interest at 12.75%. Air Canada's obligations under the Credit Facility are secured by a first priority security interest and hypothec over substantially all the present and after-acquired property of Air Canada and its subsidiaries. The Credit Facility also provides for warrants entitling the debt holders to acquire up to 5% of the shares in the Corporation or up to 10% if certain conditions are not met. For additional information pertaining to these warrants, refer to section 8.8 of this MD&A. As part of the transactions related to the closing of the Credit Facility, existing financing arrangements of $166 million were repaid as follows:

    - The revolving credit facility was repaid in full in the amount of $49 million. The rights of the lender under this facility were assigned to the lenders under the Credit Facility;

    - The spare engine financing was partially repaid in the amount of $38 million. This represented the repayment related to 22 engines under the spare engine financing agreement, with 10 engines remaining under the agreement with a loan value of $81 million as at July 31, 2009;

    - The Aeroplan Canada Inc. ("Aeroplan") loan was repaid in the amount of $79 million, which was the maximum available amount at that time. Aeroplan is a participating lender under the Credit Facility.

- Extended or renewed labour agreements for 21 months with all of the Corporation's Canadian-based unions became effective. The agreements provide for no increases to wage rates, no changes to group insurance coverage or benefits, or pension benefit levels during the contract extension periods;

- Pension funding agreements with all of the Corporation's Canadian-based unions (the "Pension MOUs") and the adoption of the Air Canada Pension Funding Regulations, 2009 (the "Air Canada 2009 Pension Regulations"). The Air Canada 2009 Pension Regulations relieve the Corporation from making any special (past service cost) payments for the period beginning April 1, 2009 and ending December 31, 2010. Thereafter, in respect of the period from January 1, 2011 to December 31, 2013, the aggregate annual past service contributions shall equal the lesser of (i) $150 million, $175 million, and $225 million in respect of 2011, 2012, and 2013, respectively and (ii) the maximum past service contributions permitted under the Income Tax Act. The Pension MOUs also provide for the Corporation to issue a fully diluted 15% equity ownership of the Corporation, established as of the date of the Pension MOUs, to a trust with all net proceeds of the eventual sale of the shares held by the trust to be contributed to the pension plans;

- An agreement with a supplier for non-refundable proceeds of approximately $220 million in consideration of various contractual commitments;

- Amendments to credit card processing agreements (initiated in the second quarter and completed in July 2009) with one of its principal credit card processors to revise the levels of unrestricted cash (as defined per the agreement and generally based on the balances as reported in cash, cash equivalents and short-term investments) required to be maintained as further described in section 8.3 of this MD&A;

- An extension to a short-term loan of $82 million (US$75 million) entered into in 2008, which was originally due in 2009, to 2013;

- A memorandum of understanding with GE Capital Aviation Services (the "GECAS MOU") for the sale and leaseback of three Boeing 777 aircraft, which is expected to close prior to September 30, 2009, subject to completion of final documents and third party consents, and to provide net cash proceeds of approximately $122 million; and

- A memorandum of understanding for amended terms related to the capacity purchase agreement with Jazz, effective August 1, 2009, subject to formal documentation, which would provide for a reduction to rates paid under the agreement.

During the second quarter of 2009

- A secured loan with Aeroplan for net proceeds of $79 million. This loan, as described above, was terminated in July 2009 pursuant to the transactions relating to the Credit Facility; and
- Net return of collateral deposits on fuel derivatives in the amount of $72 million partially offset by the settlement of fuel derivative contracts in favour of counterparties in the amount of $17 million.

During the first quarter of 2009

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

Taking into account the transactions described above (excluding the GECAS MOU), Air Canada had cash and cash equivalents and short-term investments of $1,320 million ($1,005 million at December 31, 2008, $1,087 million at March 31, 2009 and $907 million as at June 30, 2009).

For a discussion on Air Canada's liquidity risks, refer to section 9.3 of Air Canada's 2008 MD&A dated February 13, 2009 and section 8.3 of this MD&A.

5. Results of Operations – Second Quarter of 2009 versus Second Quarter of 2008

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

	Second Quarter		Change	
(Canadian dollars in millions except per share figures)	**2009**	**2008**	**$**	**%**
Operating revenues				
Passenger	$ 2,058	$ 2,454	$ (396)	(16)
Cargo	76	139	(63)	(45)
Other	196	189	7	4
	2,330	**2,782**	**(452)**	**(16)**
Operating expenses				
Aircraft fuel	572	848	(276)	(33)
Wages, salaries, and benefits	438	480	(42)	(9)
Airport and navigation fees	241	255	(14)	(5)
Capacity purchase with Jazz	254	233	21	9
Depreciation and amortization	165	173	(8)	(5)
Aircraft maintenance	185	172	13	8
Food, beverages and supplies	73	81	(8)	(10)
Communications and information technology	80	72	8	11
Aircraft rent	83	69	14	20
Commissions	40	47	(7)	(15)
Other	312	345	(33)	(10)
	2,443	**2,775**	**(332)**	**(12)**
Operating income (loss)	**(113)**	**7**	**(120)**	
Non-operating income (expense)				
Interest income	4	15	(11)	
Interest expense	(94)	(78)	(16)	
Interest capitalized	2	8	(6)	
Gain (loss) on capital assets	(71)	7	(78)	
Gain on financial instruments recorded at fair value	79	176	(97)	
	(80)	128	(208)	
Income (loss) before the following items	**(193)**	**135**	**(328)**	
Non-controlling interest	(4)	(3)	(1)	
Foreign exchange gain	355	48	307	
Provision for income taxes	(3)	(58)	55	
Net income for the period	**$ 155**	**$ 122**	**$ 33**	
EBITDAR (1)	**$ 135**	**$ 249**	**$ (114)**	
Earnings per share - basic and diluted	**$ 1.55**	**$ 1.22**	**$ 0.33**	

(1) See section 17 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income (loss).

System passenger revenues decreased 16.1% from the second quarter of 2008

Compared to the second quarter of 2008, passenger revenues decreased $396 million or 16.1% to $2,058 million in the second quarter of 2009 due to reduced yields and lower passenger traffic. This decrease in passenger revenues was the result of weak economic conditions and, to a lesser extent, the impact of the H1N1 influenza virus on air travel demand. Air Canada estimated that the H1N1 influenza virus negatively impacted second quarter 2009 passenger revenues by $30 million, primarily driven by the suspension of services to and from Mexico and lower passenger demand in the Pacific. In the second quarter of 2009, passenger revenues from the premium cabin declined $166 million from the second quarter of 2008 and accounted for over 40% of the total decrease in system passenger revenues.

In the second quarter of 2009, Air Canada reduced its overall capacity by 5.4% from the second quarter of 2008. Capacity in the North American and International markets was reduced by 5.5% and 5.4%, respectively, from the same quarter in 2008. Components of the year-over-year change in second quarter system passenger revenues included:

- In the second quarter of 2009, a system traffic decrease of 7.9% exceeded the system capacity reduction of 5.4% for a decline in system passenger load factor of 2.2 percentage points from the second quarter of 2008.
- In the second quarter of 2009, system yield declined 8.9% from the second quarter of 2008. The overall yield decline was due to a weak economy, reduced high-yield business travel, and lower prices. To retain premium cabin traffic, pricing actions were taken to offer additional discounted Executive and Executive First fares.
- A weaker Canadian dollar in the second quarter of 2009 versus the second quarter of 2008, which increases the Canadian dollar value of sales in foreign countries, had a positive impact on foreign currency denominated revenues, accounting for an increase of $65 million to second quarter 2009 passenger revenues compared to the second quarter of 2008.
- In the second quarter of 2009, RASM decreased 11.3% from the second quarter of 2008 largely due to the yield decline but also due to the passenger load factor decrease.

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

Second Quarter 2009 Versus Second Quarter 2008	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	(17.0)	(5.8)	(8.2)	(2.1)	(9.5)	(11.9)
US transborder	(14.4)	(4.7)	(9.5)	(3.9)	(5.4)	(10.2)
Atlantic	(11.1)	(0.1)	(1.6)	(1.3)	(9.7)	(11.0)
Pacific	(19.8)	(12.6)	(15.7)	(3.1)	(4.9)	(8.3)
Other	(23.3)	(6.6)	(8.0)	(1.2)	(16.7)	(17.9)
System	**(16.1)**	**(5.4)**	**(7.9)**	**(2.2)**	**(8.9)**	**(11.3)**

The system ASM capacity reduction of 5.4% in the second quarter of 2009 compared to the second quarter of 2008 was slightly above the 4.0% to 5.0% ASM capacity reduction projected in the Corporation's news release dated May 8, 2009. The greater than forecasted ASM capacity reduction is primarily attributable to the suspension and/or reduction of certain services to Mexico as a result of the outbreak of the H1N1 influenza virus as well as a slight reduction in ASMs to better match capacity with demand.

Domestic passenger revenues decreased 17.0% from the second quarter of 2008

Domestic passenger revenues of $893 million in the second quarter of 2009 decreased $183 million or 17.0% from the second quarter of 2008 due to both lower yield and traffic. A weak economy, a significant reduction in high-yield business travel and competitive pricing activities were factors in the decrease in domestic passenger revenues. In the second quarter of 2009, Air Canada reduced its domestic capacity by 5.8% from the second quarter of 2008, reflecting capacity decreases on all services. Components of the year-over-year change in second quarter domestic passenger revenues included:

- In the second quarter of 2009, a traffic decline of 8.2% exceeded the capacity reduction of 5.8%, resulting in a decrease in passenger load factor of 2.1 percentage points from the second quarter of

2008. The traffic decrease was mainly on routes between Eastern Canada and Western Canada and on services between central and western Canada.

- In the second quarter of 2009, yield decreased 9.5% from the second quarter of 2008, reflecting the continued weak economic environment, a lower proportion of high-yield business traffic and greater fare discounting in an effort to stimulate more leisure traffic in order to compensate for the loss of business demand.
- A weaker Canadian dollar in the second quarter of 2009 versus the second quarter of 2008 had a positive impact on foreign currency denominated revenues of $13 million in the second quarter of 2009.
- In the second quarter of 2009, domestic RASM declined 11.9% from the second quarter of 2008 largely due to the lower yield but also due to the passenger load factor decrease.

US transborder passenger revenues decreased 14.4% from the second quarter of 2008

US transborder passenger revenues of $391 million in the second quarter of 2009 decreased $67 million or 14.4% from the second quarter of 2008 due to both lower traffic and yield. Weak economic conditions, a reduction in high-yield business travel and competitive pricing activities were factors in the decrease in US transborder passenger revenues. In the second quarter of 2009, US transborder capacity was reduced by 4.7% from the second quarter of 2008. Components of the year-over-year change in second quarter US transborder passenger revenues included:

- In the second quarter of 2009, a traffic decrease of 9.5% surpassed the capacity reduction of 4.7% resulting in a passenger load factor decrease of 3.9 percentage points from the second quarter of 2008. Traffic declines mostly impacted the short-haul business routes while on the more leisure-oriented markets such as Florida, Hawaii and Las Vegas, Air Canada was able to essentially maintain overall passenger load factors.
- In the second quarter of 2009, yield decreased 5.4% from the second quarter of 2008, reflecting a weak economic environment, a lower proportion of high-yield business traffic and increased fare discounting. In addition, the largest traffic declines occurred on previously higher-yielding routes which further negatively impacted the overall US transborder yield.
- There was a year-over-year capacity reduction on the Hawaii service as a result of the introduction of a non-stop service from Vancouver to Sydney which was previously operated as a one-stop via Hawaii. The Vancouver-Sydney route is recorded in other passenger revenues. In addition, the Toronto-San Diego and Vancouver-Sacramento routes were suspended in the quarter. Partly offsetting these capacity decreases was increased capacity to Florida, achieved in part by maintaining the winter schedule throughout April, in order to capitalize on more stable leisure demand to Florida.
- A weaker Canadian dollar in the second quarter of 2009 versus the second quarter of 2008 had a positive impact on foreign currency denominated revenue of $22 million in the second quarter of 2009.
- In the second quarter of 2009, US transborder RASM decreased 10.2% from the second quarter of 2008 due to the yield decline and the decrease in passenger load factor.

Atlantic passenger revenues decreased 11.1% from the second quarter of 2008

Atlantic passenger revenues of $434 million in the second quarter of 2009 decreased $54 million or 11.1% from the second quarter of 2008 primarily due to a reduced overall Atlantic yield but also to a drop in traffic. A weak economy, a reduction in high-yield business travel and aggressive pricing activities were factors in the decrease in Atlantic passenger revenues. In the second quarter of 2009, Atlantic capacity was reduced by 0.1% from the second quarter of 2008. Capacity decreases on services to Israel, the United Kingdom and, to a lesser extent, Italy, were almost fully offset by increases on services to France, Germany, Switzerland and Spain. Components of the year-over-year change in second quarter Atlantic passenger revenues included:

- In the second quarter of 2009, traffic decreased 1.6% on the capacity reduction of 0.1% resulting in a passenger load factor decrease of 1.3 percentage points from the second quarter of 2008.
- In the second quarter of 2009, yield declined 9.7% from the second quarter of 2008. Although an overall yield improvement was achieved in the economy cabin as a result of a more favourable fare mix, this yield improvement was more than offset by a significant yield decline in the premium cabin where pricing actions were taken to offer additional discounted Executive First fares in order to retain and stimulate premium traffic.

- A weaker Canadian dollar in the second quarter of 2009 versus the second quarter of 2008 had a positive impact on foreign currency denominated revenues of $11 million in the second quarter of 2009.
- In the second quarter of 2009, RASM decreased 11.0% from the second quarter of 2008 largely due to the lower yield but also to the lower passenger load factor.

Pacific passenger revenues decreased 19.8% from the second quarter of 2008

Pacific passenger revenues of $194 million in the second quarter of 2009 decreased $48 million or 19.8% from the second quarter of 2008 due to both lower traffic and yield. Weak economic conditions, a significant reduction in high-yield business travel, greater fare discounting, the impact of the H1N1 influenza virus on passenger demand in May and June, predominantly on routes to Japan and, to a lesser extent, to China, were factors in the decrease in Pacific passenger revenues. In the second quarter of 2009, capacity was reduced by 12.6% from the second quarter of 2008, reflecting capacity decreases on all Pacific services with the exception of Hong Kong where Air Canada increased its capacity through the use of a larger aircraft (to a Boeing 777 aircraft from an Airbus A340 aircraft). Components of the year-over-year change in second quarter Pacific passenger revenues included:

- In the second quarter of 2009, traffic decreased 15.7% on the capacity reduction of 12.6% resulting in passenger load factor decline of 3.1 percentage points from the second quarter of 2008. Concerns over the H1N1 influenza virus led to a decrease in passenger demand, including a significant drop in student group visits from Japan to Canada.
- In the second quarter of 2009, yield declined 4.9% from the second quarter of 2008. A higher average fare in the economy cabin, as a result of an improvement in fare mix versus the same period in 2008, was more than offset by a decline in yield in the premium cabin.
- A weaker Canadian dollar in the second quarter of 2009 versus the second quarter of 2008 had a positive impact on foreign currency denominated revenues of $14 million in the second quarter of 2009.
- In the second quarter of 2009, RASM decreased 8.3% from the second quarter of 2008 due to both the decline in yield and the passenger load factor decrease.

Other passenger revenues decreased 23.3% from the second quarter of 2008

Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of $146 million in the second quarter of 2009 decreased $44 million or 23.3% from the second quarter of 2008 due to lower yield and traffic, the result of the weak economic environment, and the reduction of services to Mexico as a result of the outbreak of the H1N1 influenza virus. In the second quarter of 2009, capacity was reduced by 6.6% from the second quarter of 2008 reflecting reductions on all services with the exception of routes to traditional leisure destinations. Components of the year-over-year change in second quarter other passenger revenues included:

- In the second quarter of 2009, traffic decreased 8.0% on the capacity reduction of 6.6% for a passenger load factor decrease of 1.2 percentage points versus the same period in 2008. Capacity growth was reflected on routes to traditional leisure destinations, with the exception of Mexico. In response to a significant decrease in traffic to and from Mexico as a result of the H1N1 influenza virus, Air Canada reduced capacity by suspending services to leisure Mexico destinations and maintaining only minimal Mexico City schedules. Air Canada began reinstating its Mexico services in early July.
- In the second quarter of 2009, yield decreased 16.7% from the second quarter of 2008. The weak economic conditions, reduced high-yield business travel, mainly on South Pacific and South American routes, and greater fare discounting in order to stimulate traffic were factors in the yield decrease from the second quarter of 2008.
- A weaker Canadian dollar in the second quarter of 2009 versus the second quarter of 2008 had a positive impact on foreign currency denominated revenues of $5 million in the second quarter of 2009.
- In the second quarter of 2009, RASM decreased 17.9% from the second quarter of 2008 due primarily to the decline in yield.

Cargo revenues decreased 45% from the second quarter of 2008

Second quarter 2009 cargo revenues amounted to $76 million and were $63 million or 45% below the second quarter of 2008 on a 12% reduction to cargo capacity. Almost one half of the revenue decline in the second quarter of 2009 was due to significantly reduced fuel surcharges and the cancellation of freighter flying in 2008. Weak economic conditions resulting in reduced traffic volumes and increased competitive pressure on rates were also major contributing factors to the revenue decline.

Freighter revenues were down $13 million as no MD-11 freighter aircraft were operated in the second quarter of 2009 versus one MD-11 freighter which operated to Europe in the same period in 2008. Freighter operations were terminated in June 2008.

Non-freighter revenues decreased $50 million or 40%, reflecting a system-wide reduction in traffic of 20% and lower yields in most markets except Canada. System cargo yield per revenue ton mile (RTM) decreased 24% due to significantly reduced fuel surcharges and increased competitive pressure on rates, mainly in the Atlantic and Pacific markets.

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

- Domestic cargo revenues were down 46% with 46% less traffic and flat yield per RTM. The termination of the Canada Post contract in September 2008 accounted for more than half of the decrease. Domestic capacity was down 21% versus 2008.
- Atlantic non-freighter revenues were down 43% with 21% less traffic and 28% lower yield per RTM.
- Pacific revenues were down 38% with 15% less traffic and 28% lower yield per RTM. Pacific capacity was down 10%.
- System traffic declined 28% from the second quarter of 2008 (including the impact of the termination of freighter operations in June 2008).
- In the second quarter of 2009, a weaker Canadian dollar had a positive impact of approximately $4 million on the value of foreign currency denominated revenues.

Other revenues increased 4% from the second quarter of 2008

Other revenues of $196 million in the second quarter of 2009 increased $7 million or 4% from the second quarter of 2008 primarily due to an increase in third party revenues at Air Canada Vacations which was mainly driven by higher passenger volumes.

CASM decreased 7.0% from the second quarter of 2008. Excluding fuel expense, CASM increased 2.6% from the second quarter of 2008

Operating expenses were $2,443 million in the second quarter of 2009, a decrease of $332 million or 12% from the second quarter of 2008. A weaker Canadian dollar versus the US dollar compared to the second quarter of 2008 resulted in additional operating expenses of $105 million in the second quarter of 2009.

Unit cost in the second quarter of 2009, as measured by operating expense per available seat mile (CASM), decreased 7.0% over the second quarter of 2008. Excluding fuel expense, CASM increased 2.6% year-over-year.

The unfavourable impact of a weaker Canadian dollar versus the US dollar was the main factor in the CASM growth (excluding fuel expense) in the second quarter of 2009. In addition to the impact of foreign exchange, the higher unit cost of ownership, reflecting Air Canada's investment in new aircraft, increased Jazz CPA rates, and the impact of the capacity reduction were also factors in the increase in CASM (excluding fuel expense). The increase in Jazz CPA rates was largely driven by higher maintenance costs as a result of the aging of Jazz's fleet. The capacity reduction impacts CASM (excluding fuel expense), but disproportionately, as Air Canada's cost structure is such that its fixed costs do not fluctuate proportionately with changes in capacity in the short term. Partly offsetting these increases to CASM (excluding fuel expense) was a reduction in employee benefits expense, the result of revised actuarial assumptions.

The 2.6% increase in CASM (excluding fuel expense) for the second quarter of 2009 was less than the projected CASM increase (excluding fuel expense) provided in the Corporation's news release dated May 8, 2009 in which CASM (excluding fuel expense) was projected to increase between 5% and 6% compared to the same period in 2008. The difference is primarily attributable to a stronger Canadian dollar versus the US dollar (and its impact on US denominated expenses) and lower employee benefits expense, which was the result of revised actuarial assumptions, compared to what was previously assumed in the guidance provided on May 8, 2009.

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

	Second Quarter		Change	
(cents per ASM)	**2009**	**2008**	**cents**	**%**
Wages and salaries	2.55	2.49	0.06	2.4
Benefits	0.42	0.60	(0.18)	(30.0)
Ownership (DAR) [(1)]	1.68	1.55	0.13	8.4
Airport user fees	1.64	1.64	-	-
Capacity purchase with Jazz	1.73	1.50	0.23	15.3
Aircraft maintenance	1.26	1.11	0.15	13.5
Food, beverages and supplies	0.50	0.52	(0.02)	(3.8)
Communications and information technology	0.55	0.46	0.09	19.6
Commissions	0.27	0.30	(0.03)	(10.0)
Other	2.10	2.21	(0.11)	(5.0)
Operating expense, excluding fuel expense [(2)]	**12.70**	**12.38**	**0.32**	**2.6**
Aircraft fuel	3.88	5.44	(1.56)	(28.7)
Total operating expense	**16.58**	**17.82**	**(1.24)**	**(7.0)**

(1) DAR refers to the combination of Depreciation and amortization, and Aircraft rent.
(2) Refer to section 17 "Non-GAAP Financial Measures" in this MD&A for additional information.

Fuel expense decreased 33% from the second quarter of 2008

Fuel expense amounted to $572 million in the second quarter of 2009, a decrease of $276 million or 33% from the second quarter of 2008. Factors contributing to the year-over-year change in second quarter fuel expense included:

- A lower base fuel price which accounted for a decrease of $465 million.
- A volume-related decrease of $77 million, including the impact of the termination of freighter flying in June 2008.

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

- Fuel hedging losses of $113 million in the second quarter of 2009 versus fuel hedging gains of $92 million in the second quarter of 2008, an unfavourable variance of $205 million compared to the second quarter of 2008.
- The unfavourable impact of a weaker Canadian dollar versus the US dollar which accounted for an increase of $61 million to fuel expense in the second quarter of 2009.

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

(Canadian dollars in millions except where indicated)	Second Quarter 2009	Second Quarter 2008	Change $	Change %
Aircraft fuel expense - GAAP (1)	$ 569	$ 843	$ (274)	(33)
Add: *Fuel hedging gains (losses) included in aircraft fuel expense*	(113)	92	(205)	(223)
Add: Net cash settlements on maturing fuel derivatives (designated under hedge accounting and economic hedges)	17	(105)	122	116
Economic cost of fuel - Non-GAAP (2)	**$ 473**	**$ 830**	**$ (357)**	**(43)**
Fuel consumption (thousands of litres)	869,727	945,834	(76,107)	(8)
Fuel costs per litre (cents) - GAAP	65.4	89.2	(23.8)	(27)
Fuel costs per litre (cents) - excluding fuel hedges	52.4	98.9	(46.5)	(47)
Economic fuel costs per litre (cents) - Non-GAAP (2)	54.4	87.8	(33.4)	(38)

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

(2) The economic cost of fuel is a non-GAAP measure used by Air Canada and is not likely to be comparable to measures presented by other public companies. Air Canada uses this measure to calculate Air Canada's cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period for both hedges designated under hedge accounting and economic hedges. It excludes non-cash accounting gains and losses from fuel derivative instruments.

Wages, salaries and benefits expense amounted to $438 million in the second quarter of 2009, a decrease of $42 million or 9% from the second quarter of 2008.

Wages and salaries expense totaled $376 million in the second quarter of 2009, a decrease of $11 million or 3% from the second quarter of 2008. Factors contributing to the year-over-year change in second quarter wages and salaries expense included:

A decrease of an average of 1,406 full-time equivalent ("FTE") employees or 5.7% was primarily the result of the 5.4% reduction in ASM capacity. The insourcing of supply chain management function into the Air Canada aircraft maintenance division resulted in the addition of approximately 200 FTE employees versus the same period in 2008. Partly offsetting the impact of this net decrease in average FTE employees was the impact of higher average wages in the second quarter of 2009 compared to the second quarter of 2008. Average wages for the second quarter of 2009 increased 2.5% year-over-year.

Provisions related to employee profit sharing plans of $8 million were recorded in the second quarter of 2009 relating to the "Sharing Our Success" plan. In the second quarter of 2008, an expense of $8 million was also recorded pursuant to this plan.

Employee benefits expense amounted to $62 million in the second quarter of 2009, a decrease of $31 million or 33**%** from the second quarter of 2008, due to reduced pension and post-employment benefits expenses as a result of revised actuarial assumptions. The actuarial assumptions used for recording pension expense under GAAP differ from those used in determining the solvency deficit. Refer to section 8.7 of this MD&A for a discussion on Air Canada's pension funding obligations.

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

Airport and navigation fees of $241 million in the second quarter of 2009 decreased $14 million or 5% from the second quarter of 2008, mainly due to reduced frequencies. Factors contributing to the year-over-year change in second quarter airport and navigation fees included:

- An overall frequency reduction of 4.3% from the second quarter of 2008, combined with changes in schedule and aircraft types being operated to certain destinations, resulted in a net decrease to airport user fees.
- The impact of a weaker Canadian dollar versus the US dollar compared to the second quarter of 2008 partly offset these reductions, accounting for an increase of $2 million to airport user fees.

Capacity purchase costs with Jazz increased 9% from the second quarter of 2008

Capacity purchase costs with Jazz, pursuant to the Jazz CPA, amounted to $254 million in the second quarter of 2009 compared to $233 million in the second quarter of 2008, an increase of $21 million or 9%. This year-over-year increase in capacity purchase costs was mainly due to the unfavourable impact of foreign exchange on US denominated Jazz CPA expenses, which accounted for an increase of $14 million, and a contractual increase in Jazz CPA rates of $12 million, of which $8 million was related to additional maintenance costs due to the aging of Jazz's fleet. Partially offsetting these increases was the impact of reduced flying which accounted for a decrease of $5 million to capacity purchase costs compared to the second quarter of 2008.

Ownership costs increased 2% from the second quarter of 2008

Ownership costs, comprised of depreciation and amortization, and aircraft rent expenses, of $248 million in the second quarter of 2009 increased $6 million or 2% from the second quarter of 2008. Factors contributing to the year-over-year change in the second quarter ownership costs included:

- The addition of new Boeing 777 aircraft to Air Canada's operating fleet which accounted for an increase of $8 million. At June 30, 2009, Air Canada had 17 Boeing 777 aircraft in its operating fleet versus 12 Boeing 777 aircraft at June 30, 2008.
- The impact of a weaker Canadian dollar versus the US dollar which accounted for an increase of $13 million to aircraft rent expense.
- Other factors which contributed to a net increase of $2 million.

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

- Changes in aircraft residual values, the result of a weaker Canadian dollar versus the US dollar, accounted for a decrease of $12 million to depreciation expense.
- A decrease of $5 million to aircraft rent expense as a result of reduced MD-11 freighter flying as no MD-11 freighter aircraft were operated in the second quarter of 2009 versus one MD-11 freighter operated in the second quarter of 2008. Freighter operations were terminated in June 2008.

Aircraft maintenance expense increased 8% from the second quarter of 2008

In the second quarter of 2009, aircraft maintenance expense of $185 million increased $13 million or 8% from the second quarter of 2008. Factors contributing to the year-over-year change in second quarter aircraft maintenance expense included:

- The impact of a weaker Canadian dollar versus the US dollar on US denominated maintenance expenses, mainly engine and component maintenance, accounted for an increase of $21 million to aircraft maintenance expense compared to the second quarter of 2008.
- A net increase of $18 million in airframe maintenance due to a higher volume of maintenance activities related to the Airbus A319, A320 and Boeing 767-300 aircraft partly offset by a reduced volume of maintenance activities related to the Airbus A321, A330 and A340 aircraft. The volume changes year-over-year are primarily due to timing differences in the maintenance cycle versus the same period in 2008. In addition, in the second quarter of 2008, Air Canada had two Airbus A340 aircraft in its operating fleet versus none in the second quarter of 2009.

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

- A net decrease of $22 million due to a lower volume of engine maintenance activities related to the Airbus A320, A330, A340 and Boeing 767-300 aircraft partly offset by additional engine maintenance activities relating to the Airbus A321, Boeing 777, and Embraer E-190 aircraft.
- A decrease of $3 million relating to the insourcing of supply chain management into the Corporation's aircraft maintenance division. This cost reduction from insourcing was partly offset by the addition of approximately 200 FTE employees, the impact of which is included in wages and salaries.

Food, beverages and supplies expense decreased 10% from the second quarter of 2008

Food, beverages and supplies expense of $73 million in the second quarter of 2009 decreased $8 million or 10% from the second quarter of 2008 on a 7.9% decrease in passenger traffic.

Communications and information technology expense increased 11% from the second quarter of 2008

In the second quarter of 2009, communications and information technology expense of $80 million increased $8 million or 11% from the second quarter of 2008, of which $5 million was due to the unfavourable impact of a weaker Canadian dollar on US denominated communications expense. The remaining increase was mainly due to a higher volume of web transactions.

Commission expense decreased 15% from the second quarter of 2008

Commission expense of $40 million in the second quarter of 2009 decreased $7 million or 15% from the second quarter of 2008 on a passenger revenue decrease of 16%.

Other operating expenses decreased 10% from the second quarter of 2008

Other operating expenses amounted to $312 million in the second quarter of 2009, a decrease of $33 million or 10% from the second quarter of 2008. Factors contributing to the year-over-year change in second quarter other expenses included:

- A decrease in "remaining other expenses" of $28 million which included favourable rate adjustments on foreign currency transactions of $24 million.
- A reduction in credit card fees of $11 million compared to the same period in 2008 which was primarily the result of lower passenger sales.
- An increase in expenses related to ground packages at Air Canada Vacations of $6 million, which was mainly due to higher passenger volumes compared to the same period in 2008 and the impact of a weakening Canadian dollar versus the US dollar on Air Canada Vacations' land costs.

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

	Second Quarter		Change	
(Canadian dollars in millions)	**2009**	**2008**	**$**	**%**
Credit card fees	$ 43	$ 54	$ (11)	(20)
Building rent and maintenance	30	33	(3)	(9)
Air Canada Vacations' land costs	45	39	6	15
Terminal handling	46	44	2	5
Crew expenses (meals, transportation and hotels)	30	30	-	-
Miscellaneous fees and services	29	28	1	4
Remaining other expenses	89	117	(28)	(24)
	$ 312	**$ 345**	**$ (33)**	**(10)**

Non-operating expense amounted to $80 million in the second quarter of 2009

Non-operating expense amounted to $80 million in the second quarter of 2009 compared to non-operating income of $128 million in the second quarter of 2008. Factors contributing to the year-over-year change in second quarter non-operating expense included:

- Gains related to fair value adjustments on derivative instruments amounted to $79 million in the second quarter of 2009 versus gains of $176 million in the same quarter of 2008. The non-cash mark-to-market gains on financial instruments recorded in the second quarter of 2009 were mainly related to a change in the fair value of fuel derivatives. Refer to section 12 of Air Canada's 2008 MD&A dated February 13, 2009 and section 10 of this MD&A for additional information on Air Canada's derivative instruments.
- Net interest expense increased $33 million from the second quarter of 2008 due to:
  - A decrease in interest income of $11 million due to both lower cash balances and lower rates of interest;
  - An increase in interest expense of $16 million, in part due to new financing transactions completed since the second quarter of 2008 and the unfavourable impact of foreign exchange on interest expense. In addition, in the second quarter of 2009, the Corporation recorded a charge of $9 million related to the termination of the capital leases of two Airbus A340 aircraft and the subsequent sale of these aircraft. These increases were partly offset by a reduction of interest expense on aircraft pre-delivery payments related to Boeing 777 aircraft versus the same period in 2008; and
  - A lower amount of capitalized interest of $6 million compared to the second quarter of 2008.
- In the second quarter of 2009, Air Canada recorded an impairment charge of $67 million related to previously capitalized costs incurred pertaining to the development of a new reservation system, referred to as Polaris. The Corporation is currently working towards the implementation of certain components of the solution such as web and fare technology but has suspended activity relating to the implementation of the reservation system.
- In the second quarter of 2009, Air Canada also recorded a $2 million loss on the sale of the two Airbus A340 aircraft referred to above.
- In the second quarter of 2008, Air Canada recorded gains amounting to $7 million pertaining to the sale of aircraft-related inventory.

Gains on foreign exchange amounted to $355 million in the second quarter of 2009

Gains on foreign exchange amounted to $355 million in the second quarter of 2009 compared to gains of $48 million in the second quarter of 2008. The gains in the second quarter of 2009 were attributable to a stronger Canadian dollar at June 30, 2009 compared to March 31, 2009 partly offset by losses of $15 million related to foreign currency derivatives. The June 30, 2009 noon day exchange rate was US$1 = C$1.1625 while the March 31, 2009 noon day exchange rate was US$1 = C$1.2602.

Provision for income taxes of $3 million in the second quarter of 2009

Air Canada recorded a provision for income taxes of $3 million in the second quarter of 2009. Income tax expense for the second quarter was offset by a reversal of valuation allowance. A provision for income taxes of $58 million was recorded in the second quarter of 2008, representing an effective income tax rate of 32%.

6. Results of Operations – First Six Months of 2009 versus First Six Months of 2008

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

	First Six Months		Change	
(Canadian dollars in millions except per share figures)	**2009**	**2008**	**$**	**%**
Operating revenues				
Passenger	$ 4,069	$ 4,765	$ (696)	(15)
Cargo	156	263	(107)	(41)
Other	496	481	15	3
	4,721	**5,509**	**(788)**	**(14)**
Operating expenses				
Aircraft fuel	1,165	1,563	(398)	(25)
Wages, salaries, and benefits	896	961	(65)	(7)
Airport and navigation fees	471	496	(25)	(5)
Capacity purchase with Jazz	500	468	32	7
Depreciation and amortization	324	344	(20)	(6)
Aircraft maintenance	374	375	(1)	-
Food, beverages and supplies	140	158	(18)	(11)
Communications and information technology	159	145	14	10
Aircraft rent	169	132	37	28
Commissions	89	100	(11)	(11)
Other	735	772	(37)	(5)
	5,022	**5,514**	**(492)**	**(9)**
Operating loss before the undernoted item	**(301)**	**(5)**	**(296)**	
Provision for cargo investigations	-	(125)	125	
Operating loss	**(301)**	**(130)**	**(171)**	
Non-operating income (expense)				
Interest income	10	33	(23)	
Interest expense	(199)	(159)	(40)	
Interest capitalized	3	25	(22)	
Loss on capital assets	(71)	(29)	(42)	
Gain on financial instruments recorded at fair value	69	153	(84)	
Other	(1)	(2)	1	
	(189)	21	(210)	
Loss before the following items	**(490)**	**(109)**	**(381)**	
Non-controlling interest	(8)	(6)	(2)	
Foreign exchange gain (loss)	254	(41)	295	
Provision for income taxes	(1)	(10)	9	
Loss for the period	**$ (245)**	**$ (166)**	**$ (79)**	
EBITDAR before the provision for cargo investigations (1)	**$ 192**	**$ 471**	**$ (279)**	
EBITDAR (1)	**$ 192**	**$ 346**	**$ (154)**	
Loss per share - basic and diluted	**$ (2.45)**	**$ (1.66)**	**$ (0.79)**	

(1) See section 17 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR before the provision for cargo investigations to operating income (loss) and EBITDAR to operating income (loss).

System passenger revenues decreased 14.6% from the first six months of 2008

Compared to the first six months of 2008, passenger revenues decreased $696 million or 14.6% to $4,069 million in the first six months of 2009 due to traffic and yield declines. A weak economy, a significant reduction in high-yield business travel and competitive pricing activities were factors in the decrease in system passenger revenues. A decline in passenger revenues from the premium cabin accounted for over 40% of the total decrease in system passenger revenues.

In the first six months of 2009, Air Canada reduced its overall capacity by 7.8% from the first six months of 2008, comprised of a year-over-year capacity reduction of 10.3% in the first quarter and a year-over-year capacity reduction of 5.4% in the second quarter. Components of the year-over-year change in the first six months system passenger revenues included:

- In the first six months of 2009, a traffic decline of 9.4% exceeded the capacity decrease of 7.8% resulting in a decline in passenger load factor of 1.4 percentage points from the first six months of 2008, comprised of year-over-year passenger load factor decrease of 0.5 percentage points in the first quarter and a year-over-year passenger load factor decrease of 2.2 percentage points in the second quarter. The passenger load factor decrease was driven by the decline in demand for air travel as a result of the weak economy.
- In the first six months of 2009, system yield decreased 5.7% from the first six months of 2008, comprised of a year-over-year yield decrease of 2.3% in the first quarter and a year-over-year yield decrease of 8.9% in the second quarter. The system yield decline reflected a weak economy, reduced high-yield business travel and increased competitive pricing activities. To retain Air Canada's share of premium cabin traffic as well as to stimulate new high-end leisure demand, pricing actions were taken to offer additional discounted Executive and Executive First fares.
- A weaker Canadian dollar in the first six months of 2009 versus the first six months of 2008, which increases the Canadian dollar value of sales in foreign countries, had a positive impact on foreign currency denominated revenues, accounting for an increase of $132 million to first six months 2009 passenger revenues compared to the first six months of 2008.
- In the first six months of 2009, RASM decreased 7.3% from the first six months of 2008, comprised of a year-over-year RASM decline of 3.0% in the first quarter and a year-over-year RASM decline of 11.3% in the second quarter. The RASM decrease was primarily due to the yield decline but also due to the passenger load factor decrease.

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

First Six Months of 2009 Versus First Six Months of 2008	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	(14.4)	(6.5)	(8.3)	(1.6)	(6.6)	(8.4)
US transborder	(15.9)	(9.7)	(12.2)	(2.1)	(4.2)	(6.9)
Atlantic	(11.8)	(4.5)	(6.4)	(1.7)	(5.8)	(7.7)
Pacific	(16.4)	(19.0)	(17.9)	1.2	1.9	3.3
Other	(16.0)	(0.2)	(2.4)	(1.8)	(14.0)	(15.9)
System	**(14.6)**	**(7.8)**	**(9.4)**	**(1.4)**	**(5.7)**	**(7.3)**

The following were the main contributing factors in the year-over-year change in passenger revenues for the first six months of 2009:

Domestic passenger revenues decreased 14.4% from the first six months of 2008

Domestic passenger revenues of $1,710 million in the first six months of 2009 decreased $288 million or 14.4% from the first six months of 2008 due to an 8.3% decrease in traffic and a 6.6% decline in yield. Both the first and second quarters of 2009 were impacted by year-over-year reductions in traffic and capacity. In the first six months of 2009, capacity was reduced by 6.5% from the same period in 2008. A year-over-year decline of 1.0 percentage point in domestic passenger load factor in the first quarter of 2009 deteriorated to a year-over-year decline of 2.1 percentage points in domestic passenger load factor in the second quarter of 2009, the result of the continuing weak economic conditions. Domestic yield also deteriorated year-over-year from a decline of 3.3% in the first quarter of 2009 to a decline of 9.5% in the second quarter of 2009, due to a reduction in higher yielding business traffic and increased competitive pricing activities to stimulate traffic. In the first six months of 2009, RASM decreased 8.4% from the first six months of 2008. A year-over-year RASM decline of 4.4% in the first quarter of 2009 deteriorated to a year-over-year decline of 11.9% in the second quarter of 2009, due to a weaker yield and passenger load factor.

A weaker Canadian dollar in the first six months of 2009 versus the first six months of 2008 had a positive impact on foreign currency denominated revenues, accounting for an increase of $27 million to first six months 2009 domestic passenger revenues compared to the first six months of 2008.

US transborder passenger revenues decreased 15.9% from the first six months of 2008

US transborder passenger revenues of $830 million in the first six months of 2009 decreased $158 million or 15.9% from the first six months of 2008, due to a 12.2% decrease in traffic and a 4.2% decline in yield. Both the first and second quarters of 2009 reflected year-over-year reductions in traffic and capacity. In the first six months of 2009, capacity was reduced by 9.7% from the same period in 2008. A year-over-year decrease of 0.7 percentage points in passenger load factor in the first quarter of 2009 declined to a year-over-year decline of 3.9% in passenger load factor in the second quarter of 2009, primarily due to the continuing weak economy. US transborder yield also decreased year-over-year from a decline of 3.4% in the first quarter of 2009 to a decline of 5.4% in the second quarter of 2009, due to a reduction in higher yielding business traffic and increased competitive pricing activities to maintain traffic. In the first six months of 2009, RASM decreased 6.9% from the first six months of 2008. A year-over-year RASM decline of 4.1% in the first quarter of 2009 deteriorated to a year-over-year decline of 10.2% in the second quarter of 2009, due to a weaker yield and passenger load factor.

A weaker Canadian dollar in the first six months of 2009 versus the first six months of 2008 had a positive impact on foreign currency denominated revenues, accounting for an increase of $45 million to first six months 2009 US transborder passenger revenues compared to the first six months of 2008.

Atlantic passenger revenues decreased 11.8% from the first six months of 2008

Atlantic passenger revenues of $757 million in the first six months of 2009 decreased $101 million or 11.8% from the first six months of 2008, due to a 6.4% decrease in traffic and a 5.8% decline in yield. In the first six months of 2009, capacity was reduced by 4.5% from the same period in 2008. A year-over-year decline of 2.7 percentage points in passenger load factor in the first quarter of 2009 improved to a year-over-year decline of 1.3 percentage points in passenger load factor in the second quarter of 2009. A year-over-year yield growth of 0.1% in the first quarter of 2009 decreased to a year-over-year decline of 9.7% in the second quarter of 2009. Although an overall yield improvement was achieved in the economy cabin, this yield improvement was more than offset by a reduction in premium yield, the result of pricing measures taken to stimulate premium traffic. In the first six months of 2009, RASM decreased 7.7% from the first six months of 2008. A year-over-year RASM decline of 3.4% in the first quarter of 2009 deteriorated to a year-over-year decline of 11.0% in the second quarter of 2009, due to the significantly weaker yield.

A weaker Canadian dollar in the first six months of 2009 versus the first six months of 2008 had a positive impact on foreign currency denominated revenues, accounting for an increase of $21 million to first six months 2009 Atlantic passenger revenues compared to the first six months of 2008.

Pacific passenger revenues decreased 16.4% from the first six months of 2008

Pacific passenger revenues of $374 million in the first six months of 2009 decreased $73 million or 16.4% from the first six months of 2008, due to a 17.9% decrease in traffic as yield grew 1.9% from the first six months of 2008. In the first six months of 2009, capacity was reduced by 19.0% from the same period in 2008. A year-over-year improvement of 6.2 percentage points in passenger load factor in the first quarter of 2009 deteriorated to a year-over-year decline of 3.1 percentage points in passenger load factor in the second quarter of 2009, primarily due to the continuing weak economy. A year-over-year yield growth of 10.2% in the first quarter of 2009 decreased to a year-over-year decline of 4.9% in the second quarter of 2009. Although an overall yield improvement was achieved in the economy cabin, this yield improvement was largely offset by a reduction in premium yield, the result of pricing measures to maintain and stimulate premium traffic. A decrease in fuel surcharges year-over-year was also a factor in the yield decline. In the first six months of 2009, RASM increased 3.3% from the first six months of 2008. A year-over-year RASM increase of 18.5% in the first quarter of 2009 deteriorated to a year-over-year RASM decrease of 8.3% in the second quarter of 2009, due to the significantly weaker yield and passenger load factor. In particular, the latter part of the second quarter saw a significant drop in traffic, predominantly on routes to Japan, and to a lesser extent, on routes to China, partly as a result of the H1N1 influenza virus.

A weaker Canadian dollar in the first six months of 2009 versus the first six months of 2008 had a positive impact on foreign currency denominated revenues, accounting for an increase of $26 million to first six months 2009 Pacific passenger revenues compared to the first six months of 2008.

Other passenger revenues decreased 16.0% from the first six months of 2008

Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of $398 million in the first six months of 2009 decreased $76 million or 16.0% from the first six months of 2008, due mainly to a 14.0% decline in yield but also to a 2.4% decline in traffic. In the first six months of 2009, capacity was reduced by 0.2% from the same period in 2008. A year-over-year decline of 2.2% in passenger load factor in the first quarter of 2009 improved to a year-over-year decline of 1.2 percentage points in passenger load factor in the second quarter of 2009. Year-over-year capacity in these markets was reduced significantly in the second quarter of 2009. The second quarter of 2009 reflected an overall capacity reduction of 6.6% while the first quarter of 2009 reflected capacity growth of 4.2%. Yield decreased year-over-year from a decline of 12.4% in the first quarter of 2009 to a decline of 16.7% in the second quarter of 2009, due to increased competitive pricing activities to maintain traffic, particularly in the premium cabin, as well as pressure from competitive growth on key routes such as Chile to Toronto, and the impact of discount carriers from Australia to the US West Coast, feeding Canada on a connecting basis.

A weaker Canadian dollar in the first six months of 2009 versus the first six months of 2008 had a positive impact on foreign currency denominated revenues, accounting for an increase of $13 million to first six months 2009 other passenger revenues compared to the first six months of 2008.

Cargo revenues decreased 41% from the first six months of 2008

First six months 2009 cargo revenues amounted to $156 million and were $107 million or 41% below the first six months of 2008 on a 15% reduction to cargo capacity. Almost one half of the revenue decline in the first six months was due to significantly reduced fuel surcharges and the cancellation, in 2008, of freighter flying. Weak economic conditions resulting in reduced traffic volumes and increased competitive pressure on rates were also major contributing factors to the revenue decline.

Freighter revenues declined $29 million as no MD-11 freighter aircraft were operated in the first six months of 2009 versus one MD-11 freighter which operated to Europe in the same period in 2008. Freighter operations were terminated in June 2008.

Non-freighter revenues decreased $78 million or 33%, reflecting a system-wide reduction in traffic of 20%. System cargo yield per revenue ton mile (RTM) decreased 16% due to significantly reduced fuel surcharges and increased competitive pressure on rates mainly in the Atlantic and Pacific markets, only partly offset by positive currency.

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

- Domestic cargo revenues were down 42% on 45% less traffic and 7% higher yield per RTM. The termination of the Canada Post contract in September 2008 was the main factor for the reduction in cargo traffic compared to the first six months of 2008. Domestic capacity was down 16%.
- Atlantic non-freighter revenues were down 34% on 17% less traffic and 20% lower yield per RTM.
- Pacific revenues were down 35% with 18% less traffic and 21% lower yield per RTM. Pacific capacity was down 16%.
- System traffic declined 30% from the first six months of 2008 (including the impact of the termination of freighter operations in June 2008).
- In the first six months of 2009, a weaker Canadian dollar had a positive impact of approximately $11 million on the value of foreign currency denominated revenues.

Other revenues increased 3% from the first six months of 2008

Other revenues of $496 million in the first six months of 2009 increased $15 million or 3% from the first six months of 2008. The increase was mainly driven by additional aircraft sublease revenues of $16 million, of which $7 million was due to the favourable impact of foreign exchange on US denominated sublease revenues, and higher third party revenues of $15 million at Air Canada Vacations, mainly due to higher passenger volumes. These increases were largely offset by other smaller factors which resulted in a decrease of $16 million.

CASM decreased 1.2% from the first six months of 2008. Excluding fuel expense, CASM increased 5.9% from the first six months of 2008

Operating expenses were $5,022 million in the first six months of 2009, a decrease of $492 million or 9% from the first six months of 2008. A weaker Canadian dollar versus the US dollar compared to the first six months of 2008 resulted in additional operating expenses of $275 million in the first six months of 2009.

Unit cost in the first six months of 2009, as measured by operating expense per available seat mile (CASM), decreased 1.2% over the first six months of 2008. Excluding fuel expense, CASM increased 5.9% year-over-year.

The unfavourable impact of a weaker Canadian dollar versus the US dollar accounted for approximately 60% of the CASM growth (excluding fuel expense) in the first six months of 2009. In addition to the impact of foreign exchange, the higher unit cost of ownership, reflecting Air Canada's investment in new aircraft, increased Jazz CPA rates, and the impact of the capacity reduction were also factors in the increase in CASM (excluding fuel expense).

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

	First Six Months		Change	
(cents per ASM)	**2009**	**2008**	**cents**	**%**
Wages and salaries	2.64	2.49	0.15	6.0
Benefits	0.50	0.61	(0.11)	(18.0)
Ownership (DAR) (1)	1.73	1.53	0.20	13.1
Airport user fees	1.65	1.60	0.05	3.1
Capacity purchase with Jazz	1.75	1.51	0.24	15.9
Aircraft maintenance	1.31	1.21	0.10	8.3
Food, beverages and supplies	0.49	0.51	(0.02)	(3.9)
Communications and information technology	0.56	0.47	0.09	19.1
Commissions	0.31	0.32	(0.01)	(3.1)
Other	2.56	2.50	0.06	2.4
Operating expense, excluding fuel expense (2)	**13.50**	**12.75**	**0.75**	**5.9**
Aircraft fuel	4.08	5.04	(0.96)	(19.0)
Total operating expense	**17.58**	**17.79**	**(0.21)**	**(1.2)**

(1) DAR refers to the combination of Depreciation and amortization, and Aircraft rent.
(2) Refer to section 17 "Non-GAAP Financial Measures" in this MD&A for additional information.

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

Fuel expense decreased 25% from the first six months of 2008

Fuel expense amounted to $1,165 million in the first six months of 2009, a decrease of $398 million or 25% from the first six months of 2008. Factors contributing to the year-over-year change in first six months fuel expense included:

- A lower base fuel price which accounted for a decrease of $735 million.
- A volume-related decrease of $171 million, including the impact of the termination of freighter flying in June 2008.

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

- Fuel hedging losses of $240 million in the first six months of 2009 versus fuel hedging gains of $126 million in the first six months of 2008, an unfavourable variance of $366 million compared to the first six months of 2008.
- The unfavourable impact of a weaker Canadian dollar versus the US dollar which accounted for an increase of $142 million to fuel expense in the first six months of 2009.

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

	First Six Months		Change	
(Canadian dollars in millions except where indicated)	**2009**	**2008**	**$**	**%**
Aircraft fuel expense - GAAP (1)	$ 1,159	$ 1,555	$ (396)	(25)
***Add**: Fuel hedging gains (losses) included in aircraft fuel expense*	(240)	126	(366)	(290)
Add: Net cash settlements on maturing fuel derivatives (designated under hedge accounting and economic hedges)(2)	62	(145)	207	143
Economic cost of fuel - Non-GAAP (3)	**$ 981**	**$ 1,536**	**$ (555)**	**(36)**
Fuel consumption (thousands of litres)	1,697,017	1,892,640	(195,623)	(10)
Fuel costs per litre (cents) - GAAP	68.3	82.2	(13.8)	(17)
Fuel costs per litre (cents) - excluding fuel hedges	54.2	88.8	(34.6)	(39)
Economic fuel costs per litre (cents) - Non-GAAP (3)	57.8	81.2	(23.3)	(29)

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

(2) Excludes early terminated hedging contracts in the first quarter of 2009 for $172 million covering 2009 and 2010 fuel consumption.

(3) The economic cost of fuel is a non-GAAP measure used by Air Canada and is not likely to be comparable to measures presented by other public companies. Air Canada uses this measure to calculate Air Canada's cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period for both hedges designated under hedge accounting and economic hedges. It excludes non-cash accounting gains and losses from fuel derivative instruments.

Wages, salaries and benefits expense amounted to $896 million in the first six months of 2009, a decrease of $65 million or 7% from the first six months of 2008.

Wages and salaries expense totaled $753 million in the first six months of 2009, a decrease of $18 million or 2% from the first six months of 2008. Factors contributing to the year-over-year change in first six months wages and salaries expense included:

- A decrease of an average of 1,353 full-time equivalent ("FTE") employees or 5.6%, primarily the result of the 7.8% reduction in ASM capacity.
- Reduced overtime expenses in airport operations of $5 million versus the same period in 2008, largely due to reduced weather-related events in the first six months of 2009 versus the same period in 2008.

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

- A year-over-year increase in average wages of 2.6% over the first six months of 2008.
- Provisions relating to employee reduction programs, including the "Sharing Our Success" plan, amounted to $24 million in the first six months of 2009 versus $13 million in the first six months of 2008.

Employee benefits expense amounted to $143 million in the first six months of 2009, a decrease of $47 million or 25**%** from the first six months of 2008, due to reduced pension and post-employment benefits expenses as a result of revised actuarial assumptions.

Capacity purchase costs with Jazz increased 7% from the first six months of 2008

Capacity purchase costs with Jazz, pursuant to the Jazz CPA, amounted to $500 million in the first six months of 2009 compared to $468 million in the first six months of 2008, an increase of $32 million or 7%. This year-over-year increase in capacity purchase costs was mainly due to the unfavourable impact of foreign exchange on US denominated Jazz CPA expenses which accounted for an increase of $30 million and a contractual increase in Jazz CPA rates of $20 million compared to the same period in 2008. Partially offsetting these increases was the impact of reduced flying which accounted for a decrease of $18 million to capacity purchase costs compared to the first six months of 2008.

Ownership costs increased 4% from the first six months of 2008

Ownership costs, comprised of depreciation and amortization, and aircraft rent expenses, of $493 million in the first six months of 2009 increased $17 million or 4% from the first six months of 2008. Factors contributing to the year-over-year change in first six months ownership costs included:

- The addition of new Boeing 777 aircraft to Air Canada's operating fleet which accounted for an increase of $28 million.
- The impact of a weaker Canadian dollar versus the US dollar which accounted for an increase of $26 million to aircraft rent expense.

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

- Changes in aircraft residual values, the result of a weaker Canadian dollar versus the US dollar, accounted for a decrease of $23 million to depreciation expense.
- A decrease of $10 million to aircraft rent expense as a result of reduced MD-11 freighter flying as no MD-11 freighter aircraft were operated in the first six months of 2009 versus one MD-11 freighter operated in the first six months of 2008. Freighter operations were terminated in June 2008.
- Expenses of $4 million related to returning one Boeing 767-300 and two Airbus A319 aircraft to lessors in the first six months of 2008. No such expenses were recorded in the first six months of 2009.

Other operating expenses decreased 5% from the first six months of 2008

Other operating expenses amounted to $735 million in the first six months of 2009, a decrease of $37 million or 5% from the first six months of 2008. Factors contributing to the year-over-year change in first six months other expenses included:

- A reduction in credit card fees compared to the same period in 2008 which was primarily the result of lower passenger sales.
- An increase in expenses related to ground packages at Air Canada Vacations of $23 million which was mainly due to higher passenger volumes compared to the first six months of 2008 and the impact of a weakening Canadian dollar versus the US dollar on Air Canada Vacations' land costs.
- A decrease in "remaining other expenses" of $44 million represented the result of various initiatives and included the impact of the capacity reduction. It also included favourable rate adjustments on foreign currency transactions of $14 million.

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

	First Six Months		Change	
(Canadian dollars in millions)	2009	2008	$	%
Credit card fees	$ 88	$ 103	$ (15)	(15)
Building rent and maintenance	63	68	(5)	(7)
Air Canada Vacations' land costs	172	149	23	15
Terminal handling	93	89	4	4
Crew expenses (meals, transportation and hotels)	58	58	-	-
Miscellaneous fees and services	54	54	-	-
Remaining other expenses	207	251	(44)	(18)
	$ 735	**$ 772**	**$ (37)**	**(5)**

Non-operating expense amounted to $189 million in the first six months of 2009

Non-operating expense amounted to $189 million in the first six months of 2009 compared to non-operating income of $21 million in the first six months of 2008. Factors contributing to the year-over-year change in first six months non-operating expense included:

- Gains related to fair value adjustments on derivative instruments amounted to $69 million in the first six months of 2009 versus gains of $153 million in the same quarter of 2008. The non-cash mark-to-market gains on financial instruments recorded in the first six months of 2009 were mainly related to the change in the fair value of fuel derivatives.
- Net interest expense increased $85 million from the first six months of 2008 due to:
  - A lower amount of capitalized interest of $22 million compared to the same period in 2008;
  - A decrease in interest income of $23 million due to both lower cash balances and lower rates of interest;
  - An increase in interest expense of $40 million, in part due to new financing transactions completed since the first six months of 2009 versus the same period in 2008, and the unfavourable impact of foreign exchange on interest expense. In addition, in the first six months of 2009, the Corporation recorded a charge of $17 million related to a sale and leaseback transaction of one Boeing 777 aircraft and a charge of $9 million related to the termination of the capital leases of two Airbus A340 aircraft and the subsequent sale of these aircraft. These increases were partly offset by a reduction of interest expense on aircraft pre-delivery payments related to Boeing 777 aircraft versus the same period in 2008.
- In the first six months of 2009, Air Canada recorded an impairment charge of $67 million related to previously capitalized costs incurred pertaining to the development of a new reservation system, referred to as Polaris. The Corporation is currently working towards the implementation of certain components of the solution such as web and fare technology but has suspended activity relating to the implementation of the reservation system.
- In the first six months of 2008, Air Canada recorded an impairment charge of $38 million relating to the retirement of its fleet of Boeing 767-200 aircraft.

Gains on foreign exchange amounted to $254 million in the first six months of 2009

Gains on foreign exchange amounted to $254 million in the first six months of 2009 compared to losses of $41 million in the first six months of 2008. The gains in the first six months of 2009 were attributable to a stronger Canadian dollar at June 30, 2009 compared to December 31, 2008. The June 30, 2009 noon day exchange rate was US$1 = C$1.1625 while the December 31, 2008 noon day exchange rate was US$1 = C$1.2246.

Provision for income taxes of $1 million in the first six months of 2009

Air Canada recorded a provision for income taxes of $1 million in the first six months of 2009. The benefit of future income tax assets arising on the 2009 loss has been offset by a valuation allowance. A provision for income taxes of $10 million was recorded in the first six months of 2008 on a pre-tax loss of $156 million as no tax recovery was recorded on the provision for cargo investigations.

7. Fleet

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	**December 31, 2008**	**New Deliveries**	**Sublease toThird Party**	**Lease Returns**	**Parked**	**June 30, 2009**	**New Deliveries**	**Sublease toThird Party**	**Lease Returns**	**Parked**	**December 31, 2009**	**2010 Fleet Changes**	**December 31, 2010**
Boeing 777-300	**10**	1	-	-	-	**11**	1	-	-	-	**12**	-	**12**
Boeing 777-200	**6**	-	-	-	-	**6**	-	-	-	-	**6**	-	**6**
Boeing 767-300	**30**	-	-	-	-	**30**	-	-	-	-	**30**	-	**30**
Airbus A330-300	**8**	-	-	-	-	**8**	-	-	-	-	**8**	-	**8**
Airbus A321	**10**	-	-	-	-	**10**	-	-	-	-	**10**	-	**10**
Airbus A320	**41**	-	-	-	-	**41**	-	-	-	-	**41**	-	**41**
Airbus A319	**35**	-	-	-	-	**35**	-	-	-	-	**35**	-	**35**
EMBRAER 190	**45**	-	-	-	-	**45**	-	-	-	-	**45**	-	**45**
EMBRAER 175	**15**	-	-	-	-	**15**	-	-	-	-	**15**	-	**15**
Total	**200**	1	-	-	-	**201**	1	-	-	-	**202**	-	**202**
Average age (years)	**8.8**					**9.3**					**9.7**		**10.7**

In July 2009, Air Canada took delivery of its last planned Boeing 777-300ER addition to its fleet under a 10-year operating lease.

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 superior product. Air Canada has completed the refurbishment of all its planned operating aircraft with the exception of three Boeing 767-300ER aircraft. Air Canada is not planning on refurbishing the interiors of these three Boeing 767 aircraft. The EMBRAER and Boeing 777 aircraft have been delivered with the new seats and entertainment systems already installed.

8. Financial and Capital Management

8.1 Financial Position

The following table provides a condensed statement of financial position of Air Canada as at June 30, 2009 and as at December 31, 2008.

(Canadian dollars in millions)	June 30, 2009	December 31, 2008
Assets		
Cash, cash equivalents and short-term investments	$ 907	$ 1,005
Other current assets	1,193	1,398
Current assets	2,100	2,403
Property and equipment	7,180	7,469
Intangible assets	926	997
Deposits and other assets	507	495
	$ 10,713	**$ 11,364**
Liabilities		
Current liabilities	$ 3,503	$ 3,678
Long-term debt and capital leases	4,438	4,691
Pension and other benefit liabilities	1,368	1,585
Other long-term liabilities	449	458
	9,758	**10,412**
Non-controlling interest	**194**	**190**
Shareholders' equity	**761**	**762**
	$ 10,713	**$ 11,364**

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

Property and equipment amounted to $7,180 million at June 30, 2009, a reduction of $289 million from December 31, 2008. The reduction was mainly due to the impact of depreciation expense of $291 million in the first six months of 2009 and the sale of two Airbus A340 aircraft partly offset by additions to capital assets.

Long-term debt and capital leases, including the current portion, amounted to $5,001 million at June 30, 2009, a decrease of $353 million from December 31, 2008. The decrease in long-term debt and capital leases was mainly due to the appreciation of the Canadian dollar and the resulting favourable impact of $268 million on Air Canada's foreign denominated debt and capital leases. Additional borrowings of $343 million and the sale and leaseback of a Boeing 777 aircraft accounted for as a capital lease, which resulted in an increase to total long-term debt of $158 million, were more than offset by long-term debt and capital lease repayments of $600 million.

The decline in pension and other benefits liabilities of $217 million from December 31, 2008 was primarily due to pension funding of $212 million in excess of pension expense in the first six months of 2009. Refer to section 9.6 of Air Canada's 2008 MD&A dated February 13, 2009 and section 8.7 of this MD&A for a discussion on Air Canada's pension funding obligations.

8.2 Adjusted Net Debt

The table reflects Air Canada's adjusted net debt balances and net debt to net debt plus equity ratio as at June 30, 2009 and as at December 31, 2008.

(Canadian dollars in millions)	June 30, 2009	December 31, 2008	Change $
Total long-term debt and capital leases	$ 4,438	$ 4,691	$ (253)
Current portion of long-term debt and capital leases	563	663	(100)
Total long-term debt and capital leases including current portion	5,001	5,354	(353)
Non-controlling interest	194	190	4
Less cash, cash equivalents and short-term investments	(907)	(1,005)	98
Net debt and non-controlling interest	**4,288**	**4,539**	**(251)**
Capitalized operating leases (1)	2,370	2,093	277
Adjusted net debt and non-controlling interest	**6,658**	**6,632**	**26**
Less pre-delivery (PDP) financing included in long-term debt	-	(81)	81
Adjusted net debt and non-controlling interest, excluding PDP financing	**$ 6,658**	**$ 6,551**	**$ 107**
Shareholders' equity	**$ 761**	**$ 762**	**$ (1)**
Adjusted net debt to net debt plus equity ratio, excluding PDP financing	**89.7%**	**89.6%**	**0.1 pp**

(1) Adjusted net debt is a non-GAAP measure used by the Corporation and is not likely to be comparable to measures presented by other public companies. The Corporation includes capitalized operating leases which is a measure commonly used in the industry to ascribe a value to obligations under operating leases. Common industry practice is to multiply annualized aircraft rent expense by 7.5. This definition of capital is used by the Corporation and may not be comparable to similar measures presented by other public companies. Aircraft rent was $316 million for the twelve months ended June 30, 2009 and $279 million for the twelve months ended December 31, 2008. Aircraft rent expense includes aircraft rent associated with aircraft subleased to third parties. The sublease revenue associated with these aircraft leases is included in Other revenues on Air Canada's consolidated statement of operations.

At June 30, 2009, adjusted net debt and non-controlling interest, including capitalized operating leases, and excluding the pre-delivery payment ("PDP") financing, increased $107 million from December 31, 2008. An increase in capitalized operating leases, due primarily to the unfavourable impact of foreign exchange on US denominated aircraft leases and the sale and leaseback transactions of the Boeing 777 aircraft completed in 2008 and in the first quarter of 2009, was largely offset by a decrease in net debt. Net debt was favourably impacted by the appreciation of the Canadian dollar and resulting decrease on US denominated debt.

The adjusted net debt to net debt plus equity ratio for Air Canada increased to 89.7% at June 30, 2009 from 89.6% at December 31, 2008, essentially unchanged from December 31, 2008.

8.3 Liquidity

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities and other contractual obligations. The Corporation monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. The Corporation's principal objective in managing liquidity risk is to maintain a minimum unrestricted cash balance in excess of a target liquidity level of 15% of annual operating revenues. At July 31, 2009, cash, cash equivalents and short-term investments were $1.32 billion, or 13% of 2008 annual operating revenues.

Management believes that the significant events as described in section 4 of this MD&A improve the Corporation's current liquidity position, however, certain risks remain related to the current economic environment, including risks related to market volatility in the price of fuel, foreign exchange and interest rates as well as increased competitive pressures and restrictive terms under the Corporation's financing and other arrangements. During the first half of 2009, demand for the Corporation's air travel and cargo services continued to weaken in both domestic and international markets. The Corporation expects demand to continue to be a challenge for the remainder of the year. The H1N1 influenza virus may also continue to impact demand for air travel. The Corporation is monitoring the H1N1 influenza virus risk, however, it is unable to predict if the impact on its operations will be significant. While Air Canada has raised financing proceeds, as described in section 4 of this MD&A, and it does not intend on raising further financing of any significance over the course of the next year, the credit markets continue to be constrained. In addition, given the terms and undertakings in the currently outstanding financing arrangements, the Corporation has limited assets which would be available to support additional financings or similar transactions, if required. These factors have had and may continue to have an impact on the liquidity risk of Air Canada. This section updates the Corporation's year-end disclosures and should be read in conjunction with section 9.3 of Air Canada's 2008 MD&A dated February 13, 2009. Refer to section 8.6 of this MD&A for information on Air Canada's contractual obligations.

To date in 2009, including the significant events as discussed in section 4 of this MD&A, management continued to undertake various initiatives and develop plans to manage its operating and liquidity risks, taking into account the prevailing economic conditions, including the financing arrangements discussed in section 4 of this MD&A, cost containment initiatives and capacity adjustments with the objective of matching capacity to passenger demand. However, the nature of the Corporation's cost structure is such that fixed costs may not fluctuate proportionately with changes in capacity in the short term.

Pension funding obligations

Refer to section 9.6 of Air Canada's 2008 MD&A dated February 13, 2009 and section 8.7 of this MD&A for a discussion on Air Canada's pension funding obligations.

Covenants in credit card agreements

The Corporation has various agreements for the processing of customer credit card transactions, as further described in section 9.3 of Air Canada's 2008 MD&A dated February 13, 2009. During the second quarter of 2009 and in July 2009, the Corporation entered into amendments with one of its principal credit card processors to amend certain credit card processing agreements under which the levels of unrestricted cash (as defined per the agreement and generally based on the balances as reported in cash, cash equivalents and short-term investments) required to be maintained by Air Canada is reduced to $800 million (versus $1,300 million prior to the amendments) and Air Canada provides the processor with deposits, to be accumulated over time, and security. The triggering event based on a debt service coverage ratio is no longer applicable under the amended agreement. Should Air Canada maintain unrestricted cash of more than $1,200 million for two consecutive months, the unrestricted cash requirement increases to $1,100 million at which time the processor will return to Air Canada all deposits and security previously provided by Air Canada. As long as unrestricted cash remains at or above $1,100 million, Air Canada will have no obligation to provide deposits or security to the processor. Pursuant to the amendments entered into in July 2009, should the Corporation's unrestricted cash be less than $1,100 million, its obligation to provide deposits to the processor would be capped at an amount not in excess of $75 million, provided unrestricted cash is not less than $800 million. As at June 30, 2009, a deposit in the amount of $27 million had accumulated under these processing agreements, which has further increased to the above-referenced cap of $75 million as at July 31, 2009. Deposits under these processing agreements are reported in prepaid expenses and other current assets on Air Canada's consolidated statement of financial position.

Cargo investigations and proceedings

The Corporation is exposed to potential liabilities related to the proceedings and investigations of alleged anti-competitive cargo pricing activities, as described in section 18 of Air Canada's 2008 MD&A dated February 13, 2009. This preliminary estimate recorded by the Corporation during 2008 is based upon the current status of the investigations and proceedings and the Corporation's assessment as to the potential outcome for certain of them. This provision does not address the proceedings in all jurisdictions, but only where there is sufficient information to do so. Management has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings. Additional material provisions may be required. Amounts could become payable within the year and may be materially different than management's preliminary estimate.

Working capital

Actively managing working capital is a key element in ensuring cash is available to support liquidity growth objectives. The following table provides additional information on Air Canada's working capital balances at June 30, 2009 as compared to December 31, 2008.

(Canadian dollars in millions)	June 30, 2009	December 31, 2008	Change $
Cash and short-term investments	$ 907	$ 1,005	$ (98)
Accounts receivable	748	702	46
Collateral deposits for fuel derivatives	109	328	(219)
Other current assets	336	368	(32)
Accounts payable and accrued liabilities	(1,282)	(1,262)	(20)
Fuel derivatives in current liabilities	(110)	(420)	310
Advance ticket sales	(1,548)	(1,333)	(215)
Current portion of long-term debt and capital leases	(563)	(663)	100
	$ (1,403)	**$ (1,275)**	**$ (128)**

The working capital deficiency of $1,403 million has deteriorated by $128 million from December 31, 2008. The main changes impacting net working capital are:

- Pension funding payments of $221 million in the first six months of 2009;
- Repayment of long-term debt of $486 million in the first six months of 2009, which included $83 million related to the final repayment of the pre-delivery financing of a Boeing 777 aircraft and $73 million related to the termination of capital leases for two Airbus A340 aircraft;
- The impact of capital expenditures of $156 million in the first six months of 2009;
- Net financing proceeds of $267 million, which included financing related to the delivery of one Boeing 777 aircraft, spare parts and spare engines financing agreements;
- Net proceeds of $44 million from a sale and leaseback transaction related to one Boeing 777 aircraft, derived from $172 million in proceeds from the sale and leaseback transaction, less the repayment of the debt obligation related to the aircraft of $128 million, which included a prepayment fee of $14 million;
- Proceeds of $91 million related to the sale of two Airbus A340 aircraft, less the repayments related to the termination of the related capital leases discussed above;
- An extension to a short-term loan of $82 million (US$75 million) entered into in 2008, which was originally due in 2009, to 2013, which resulted in its reclassification from short-term to long-term.

Collateral deposits for fuel derivatives

The types of derivative instruments used by Air Canada within its hedging program, such as swaps and put options within collar structures, expose the Corporation to the potential of posting cash collateral deposits. The drastic decrease in fuel prices observed in the fourth quarter of 2008 resulted in a significant negative fair value for the Corporation's portfolio of fuel hedges. Once the fair value in favour of the counterparty of certain fuel derivatives exceeds the Corporation's credit thresholds with those counterparties, the Corporation is responsible for extending collateral to the counterparties. As at July 31, 2009, the total cash collateral deposits held by counterparties amounted to $99 million ($109 million at June 30, 2009, $181 million at March 31, 2009 and $328 million at December 31, 2008). Refer to section 12 of Air Canada's 2008 MD&A dated February 13, 2009 and section 10 of this MD&A for a discussion on fuel price risk.

8.4 Consolidated Cash Flow Movements

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

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2009**	**2008**	**Change $**	**2009**	**2008**	**Change $**
Net cash from (used for) operating activities	$ (40)	$ 78	$ (118)	$ (308)	$ 72	$ (380)
Fuel hedge collateral deposits, net	62	-	62	209	-	209
Changes in non-cash working capital	(113)	136	(249)	176	372	(196)
Cash flows from (used for) operating activities	(91)	214	(305)	77	444	(367)
Additions to capital assets	(49)	(225)	176	(156)	(628)	472
Free cash flow (1)	**(140)**	**(11)**	**(129)**	**(79)**	**(184)**	**105**
Proceeds from sale leaseback transactions	-	297	(297)	172	708	(536)
Short-term investments	68	(165)	233	87	(66)	153
Other	61	10	51	66	62	4
Cash flows from investing activities (excluding additions to capital assets)	**129**	**142**	**(13)**	**325**	**704**	**(379)**
Borrowings	76	126	(50)	343	313	30
Reduction of long-term debt and capital lease obligations	(177)	(319)	142	(600)	(641)	41
Cash flows used for financing activities	**(101)**	**(193)**	**92**	**(257)**	**(328)**	**71**
Net increase (decrease) in cash and cash equivalents	(112)	(62)	(50)	(11)	192	(203)
Net increase (decrease) in short-term investments	(68)	165	(233)	(87)	66	(153)
Net increase (decrease) in cash, cash equivalents and short-term investments	**$ (180)**	**$ 103**	**$ (283)**	**$ (98)**	**$ 258**	**$ (356)**

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

Air Canada's free cash flow for the second quarter of 2009 decreased $129 million from the second quarter of 2008. The impact of reduced capital expenditures of $176 million in the second quarter of 2009 was more than offset by reduced cash flows from operating activities of $305 million when compared to the second quarter of 2008. The decrease in operating cash flows versus the same period in 2008 was primarily driven by changes in non-cash working capital balances primarily related to lower advance ticket sales, and the expiry of the Aeroplan pre-payment agreement. Air Canada's free cash flow improved $105 million in the first six months of 2009 versus the same period in 2008. The improvement in free cash flow was related to a reduction in capital expenditures due to fewer aircraft deliveries in 2009. The decrease in operating cash flows reflected deterioration in Air Canada's operating results and the impact of higher past service cost contributions under the Corporation's pension plans.

8.5 Capital Expenditures and Related Financing Arrangements

As at June 30, 2009, the Corporation had outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of 37 Boeing 787 aircraft. Subsequent to June 30, 2009, the Corporation and Boeing agreed to amend the purchase agreement for the Boeing 787 aircraft to reduce the number of options for Boeing 787 aircraft by ten, from 23 to 13, and to provide for purchase rights for ten Boeing 787 aircraft. The Corporation continues to have 37 firm orders for Boeing 787 aircraft. The Corporation and Boeing also agreed to amend certain commercial terms, including to revise delivery dates and to provide for certain financial adjustments. The Corporation's first Boeing 787 aircraft is now scheduled for delivery in the second half of 2013. The Corporation continues to hold purchase rights for 18 Boeing 777 aircraft.

The table below provides Air Canada's current projected, planned and committed capital expenditures, including the effects of the financing transactions which occurred subsequent to June 30, 2009, for the remainder of 2009, for the next four years and after 2013.

(Canadian dollars in millions)	Remainder of 2009	2010	2011	2012	2013	Thereafter
Projected committed expenditures	$ 26	$ 53	$ 49	$ 115	$ 733	$ 3,864
Projected planned but uncommitted expenditures	51	77	80	132	112	
Total projected expenditures (1) (2)	77	130	129	247	845	
Projected financing on committed expenditures	-	-	-	-	(584)	
Total projected expenditures, net of financing	**$ 77**	**$ 130**	**$ 129**	**$ 247**	**$ 261**	

(1) US dollar amounts are converted using the July 31, 2009 noon day exchange rate of US$1 = C$1.0790 Final aircraft delivery prices include estimated escalation and interest on deferred delivery payments.
(2) The dollar amounts reflected above do not include obligations pertaining to day-to-day operations.

8.6 Contractual Obligations

The table below provides Air Canada's current contractual obligations, including the effects of the financing transactions which occurred subsequent to June 30, 2009, for the remainder of 2009, for the next four years and after 2013.

(Canadian dollars in millions)	Remainder of 2009	2010	2011	2012	2013	Thereafter	Total
Long-term debt, capital leases and interest repayment obligations (1)	$ 290	$ 834	$ 1,079	$ 802	$ 846	$ 2,930	$ 6,781
Operating lease obligations (2)	159	365	324	304	269	804	2,225
Committed capital expenditures (3)	26	53	49	115	733	3,864	4,840
Total contractual obligations (4)	**$ 475**	**$ 1,252**	**$ 1,452**	**$ 1,221**	**$ 1,848**	**$ 7,598**	**$ 13,846**

(1) The interest repayment obligations relate to long-term debt, debt consolidated under AcG-15 and capital leases.
(2) The operating lease obligations above mainly relate to US dollar aircraft operating leases.
(3) The committed capital expenditures above mainly relate to US dollar aircraft-related expenditures. These expenditures also include purchases relating to system development costs, facilities and leasehold improvements.
(4) Total contractual obligations exclude commitments for goods and services required in the ordinary course of business. Also excluded are other long-term liabilities mainly due to reasons of uncertainty of timing of cash flows and items which are non-cash in nature.

8.7 Pension Funding Obligations

The Corporation maintains several defined benefit pension plans as described in sections 9.6 and 15 of Air Canada's 2008 MD&A dated February 13, 2009. As at December 31, 2008, the Corporation reported that the solvency deficit as at January 1, 2009 in the registered pension plans, which is used to determine funding requirements, was estimated to be approximately $3,200 million. As a result of updated information, including the annuity rate applied in discounting the pension obligations, the solvency deficit as at January 1, 2009 is approximately $2,835 million.

In July 2009, the Federal Government of Canada adopted the Air Canada 2009 Pension Regulations. The Air Canada 2009 Pension Regulations relieve the Corporation from making any special (past service cost) payments in respect of the period beginning April 1, 2009 and ending December 31, 2010. Thereafter, in respect of the period from January 1, 2011 to December 31, 2013, the aggregate annual past service contribution shall equal the lesser of (i) $150 million, $175 million, and $225 million in respect of 2011, 2012, and 2013, respectively and (ii) the maximum past service contribution permitted under the Income Tax Act.

The Air Canada 2009 Pension Regulations were adopted in coordination with pension funding agreements reached with the Corporation's Canadian-based unions and a consultation process with its retirees and non-unionized workforce. The Pension MOUs also provide for the Corporation to issue a 15% equity ownership of the Corporation to a trust, with all net proceeds of sale to be contributed to the pension plans. A seat on the Board of Directors of Air Canada will be allocated for designation by a trustee representing Air Canada's unions while ownership exceeds 2%. Current service payments will continue to be made in the normal course and there will be no change to the defined benefit plans nor a reduction in benefits while these regulations are in effect.

Based upon the effect of the Air Canada 2009 Pension Regulations, pension funding payments during 2009 will be approximately $407 million, a decrease of $49 million versus 2008.

The following table provides Air Canada's pension funding obligations, on a cash basis, based on the Air Canada 2009 Pension Regulations as described above, for the remainder of 2009 as at June 30, 2009, for the full year 2009, for the next four years.

(Canadian dollars in millions)	Remainder of 2009	Full Year 2009	2010	2011	2012	2013
Past service domestic registered plans	$ 29	$ 140	-	$ 138	$ 173	$ 221
Current service domestic registered plans	108	188	161	165	170	175
Other pension arrangements (1)	49	79	78	79	81	83
Projected pension funding obligations	**$ 186**	**$ 407**	**$ 239**	**$ 382**	**$ 424**	**$ 479**

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

In May 2009, Air Canada and Aeroplan reached an agreement with the Canadian Auto Workers (CAW) Local 2002, providing for a process for the approximately 750 Air Canada employees then working in the Aeroplan contact centres to choose to transition to employment at Aeroplan, effective June 1, 2009, or to remain employees of Air Canada. Employees at Air Canada work locations who become surplus to Air Canada's needs, due to employees then working at Aeroplan contact centres who are senior to them, choosing to remain employees of Air Canada, were given the option to transition to employment at Aeroplan. Certain employees at Air Canada work locations transitioning to Aeroplan will continue to work for Air Canada until, at the latest, October 4, 2009, due to Air Canada's operational needs. The date these employees become Aeroplan employees depends on the date they are released from employment with Air Canada. For those employees transitioning to Aeroplan, their service, which largely determines benefit levels under the Air Canada pension and other employee benefit plans, will cease to accrue as of the date of employment with Aeroplan.

8.8 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 July 31, 2009	At December 31, 2008
Issued and outstanding shares		
Class A variable voting shares	12,262,099	15,475,659
Class B voting shares	87,737,901	84,524,341
Total issued and outstanding shares	**100,000,000**	**100,000,000**
Class A variable voting and Class B voting shares potentially issuable		
Stock options	3,964,758	1,701,447
Performance share units	1,671,119	1,671,068
Total shares potentially issuable	**5,635,877**	**3,372,515**
Total outstanding and potentially issuable shares	**105,635,877**	**103,372,515**

As part of the transactions under the Credit Facility identified in section 4 of this MD&A, Air Canada issued to the lenders warrants for the purchase of Air Canada's Class A variable voting shares or Class B voting shares representing an aggregate of 5% of the total issued and outstanding shares. The shares were allocated among the lenders based on their pro-rata lending commitments under the Credit Facility. Subject to the terms of the Credit Facility, in the event that Air Canada does not grant additional security over certain assets within 90 days of closing, Air Canada would be required to issue to the lenders additional warrants representing up to an additional 5% of the total issued and outstanding shares (determined at the time of issuance of such additional warrants). The warrants, representing the initial aggregate of 5% of the total issued and outstanding shares, issued to the lenders have an exercise price of $1.51 per share, exercisable at any time, and expire four years after the date of issuance.

Pursuant to the Pension MOUs described in Section 8.7 of this MD&A, on or before November 1, 2009, Air Canada is required to issue a number of Class B shares equal to 15% of the common shares of Air Canada (as at the date of the Pension MOUs) to a trust to be established for the benefit of the members of the defined benefit pension plans represented by the Corporation's Canadian-based unions. A seat on the Board of Directors of Air Canada will be allocated for designation by a trustee representing Air Canada's unions while ownership exceeds 2%.

9. Quarterly Financial Data

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

($ millions, except per share figures)	Q3 2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009
Operating revenues	**$ 2,954**	**$ 2,513**	**$ 2,727**	**$ 2,782**	**$ 3,075**	**$ 2,498**	**$ 2,391**	**$ 2,330**
Aircraft fuel	(716)	(615)	(715)	(848)	(1,064)	(792)	(593)	(572)
Ownership (DAR) [1]	(210)	(202)	(234)	(242)	(243)	(254)	(245)	(248)
Other operating expenses	(1,677)	(1,624)	(1,790)	(1,685)	(1,656)	(1,598)	(1,741)	(1,623)
Operating expenses	**(2,603)**	**(2,441)**	**(2,739)**	**(2,775)**	**(2,963)**	**(2,644)**	**(2,579)**	**(2,443)**
Operating income (loss) before the undernoted item	**351**	**72**	**(12)**	**7**	**112**	**(146)**	**(188)**	**(113)**
Provision for cargo investigations [2]	-	-	(125)	-	-	-	-	-
Operating income (loss)	**351**	**72**	**(137)**	**7**	**112**	**(146)**	**(188)**	**(113)**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(78)	(37)	(151)	115	(244)	(581)	(212)	268
Net income (loss)	**$ 273**	**$ 35**	**$ (288)**	**$ 122**	**$ (132)**	**$ (727)**	**$ (400)**	**$ 155**
Revenue passenger miles (millions)	14,789	11,446	12,331	12,884	14,458	10,845	10,984	11,862
Available seat miles (millions)	18,144	14,715	15,407	15,581	17,515	13,571	13,821	14,735
Passenger load factor (%)	81.5	77.8	80.0	82.7	82.5	79.9	79.5	80.5
RASM (cents)	14.6	14.7	15.0	15.7	15.7	16.0	14.5	13.9
CASM (cents)	14.3	16.6	17.8	17.8	16.9	19.5	18.7	16.6
CASM, excluding fuel expense (cents)	10.4	12.4	13.1	12.4	10.8	13.6	14.4	12.7
Fuel price per litres (cents) [3]	64.7	67.5	75.2	89.2	101.0	95.8	71.4	65.4
EBITDAR before the provision for cargo investigations [4]	**$ 561**	**$ 274**	**$ 222**	**$ 249**	**$ 355**	**$ 108**	**$ 57**	**$ 135**
EBITDAR [4]	**$ 561**	**$ 274**	**$ 97**	**$ 249**	**$ 355**	**$ 108**	**$ 57**	**$ 135**
Earnings (loss) per share								
- basic and diluted	**$ 2.73**	**$ 0.35**	**$ (2.88)**	**$ 1.22**	**$ (1.32)**	**$ (7.27)**	**$ (4.00)**	**$ 1.55**

(1) DAR refers to the combination of Depreciation and amortization, and Aircraft rent expenses.
(2) A provision for cargo investigations of $125 million was recorded in the second quarter of 2008.
(3) Includes fuel handling and is net of fuel hedging results.
(4) See section 17 "Non-GAAP Financial Measures" in this MD&A for additional information.

10. Financial Instruments and Risk Management

Summary of gain on financial instruments recorded at fair value

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

	Second Quarter		First Six Months	
(Canadian dollars in millions)	**2009**	**2008**	**2009**	**2008**
Ineffective portion of fuel hedges	$ -	$ 115	$ -	$ 82
Fuel derivatives not under hedge accounting	85	79	76	85
Cross-currency interest rate swaps	-	(19)	-	(13)
Other	(6)	1	(7)	(1)
Gain on financial instruments recorded at fair value	**$ 79**	**$ 176**	**$ 69**	**$ 153**

Fuel price risk

As of June 30, 2009, approximately 28% of Air Canada's anticipated purchases of jet fuel for the remainder of 2009 are hedged at an average West Texas Intermediate ("WTI")-equivalent capped price of US$106 per barrel, of which 52% is subject to an average WTI-equivalent floor price of US$83 per barrel. Air Canada has also hedged approximately 13% of its 2010 anticipated jet fuel purchases in crude oil-based contracts hedged at an average capped price of US$110 per barrel, of which 87% is subject to an average floor price of US$101 per barrel.

The following table outlines the notional volumes per barrel outstanding at June 30, 2009, along with the weighted average floor and capped price for each year currently hedged by type of derivative instruments. These average contract prices represent the equivalent price in WTI using the forward prices for WTI, heating oil, and jet fuel as at June 30, 2009.

Outstanding at June 30, 2009				
Derivative Instruments	**Term**	**Volume (BBLs)**	**WTI-equivalent Average Floor Price (US$ per barrel)**	**WTI-equivalent Average Capped Price (US$ per barrel)**
Call Options (1)	2009	1,600,000	n/a	121
	2010	400,000	n/a	134
Swaps (1)	2009	570,000	99	99
	2010	1,070,000	99	99
Collars (1)	2009	1,140,000	75	87
	2010	1,560,000	102	112

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

In the second quarter of 2009, fuel derivative contracts cash settled with a fair value of $17 million in favour of the counterparties ($62 million in favour of the counterparties in the first six months of 2009) ($105 million in favour of the Corporation in the second quarter of 2008 and $144 million in favour of the Corporation in the first six months of 2008). As fuel hedging contracts with unfavourable fair values are settled, the Corporation can recall the offsetting cash collateral deposits from counterparties.

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

The fuel hedging losses recorded under fuel expense were $113 million in the second quarter of 2009 (losses of $240 million in the first six months of 2009) (gains of $92 million in the second quarter of 2008 and gains of $126 million in the first six months of 2008), and were mainly due to the reallocation to fuel expense of the hedging losses accumulated in Other Comprehensive Income ("OCI") in previous periods.

As at June 30, 2009, the estimated net amount of existing losses reported in Accumulated Other Comprehensive Income ("AOCI") that is expected to be reclassified to net income (loss) during the following 12 months is $289 million (before tax).

As a result of a thorough analysis of the costs and benefits specific to the application of hedge accounting, the Corporation has elected to discontinue hedge accounting for all fuel derivatives effective the third quarter of 2009. The derivative instruments will continue to be recorded at fair value in each period with both realized and unrealized changes in fair value recognized immediately in earnings in non-operating income (expense). Amounts deferred to AOCI for derivatives previously designated under hedge accounting will be taken into fuel expense in the period where the derivative is scheduled to mature.

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

		Second Quarter		First Six Months	
(Canadian dollars in millions)		**2009**	**2008**	**2009**	**2008**
Consolidated Statement of Operations					
Operating expense					
Aircraft fuel	Realized effective gain (loss) on derivatives designated under hedge accounting	$ (113)	$ 92	$ (240)	$ 126
Non-operating income (expense)					
Gain on financial instruments recorded at fair value	Ineffective gain on derivatives designated under hedge accounting	-	$ 115	-	$ 82
	Fair market value gain on economic hedges	$ 85	$ 79	$ 76	$ 85
Consolidated Statement of Comprehensive Income (Loss)					
	Effective gain (loss) on derivatives designated under hedge accounting	-	$ 255	$ (1)	$ 401
	Tax expense on effective gain	-	$ (82)	-	$ (128)
	Reclassification of net realized (gain) loss on fuel derivatives designed under hedge accounting to aircraft fuel expense	$ 113	$ (92)	$ 240	$ (126)
	Tax on reclassification	$ 2	$ 30	$ 4	$ 41

		June 30, 2009	December 31, 2008
Consolidated Statement of Financial Position			
Current assets	Collateral deposits for fuel derivatives	$ 109	$ 328
Current liabilities(1)	Fair market value of fuel derivatives designated under hedge accounting	$ 1	$ (405)
	Fair market value of fuel derivatives – economic hedges	$ (111)	$ (15)
Shareholders' equity (AOCI)	Net loss from fuel derivatives designated under hedge accounting	$ (363)	$ (606)

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

For additional information on fuel price risk, refer to section 12 of Air Canada's 2008 MD&A dated February 13, 2009.

11. Accounting Policies

11.1 Changes in Accounting Policies

Stock-based compensation plans

The Corporation changed its accounting policy for awards of stock-based compensation granted to Corporation employees with a graded vesting schedule. Prior to January 1, 2009, the fair value of stock options with a graded vesting schedule was recognized as compensation expense and a credit to contributed surplus on a straight-line basis over the applicable vesting period. Effective January 1, 2009, the fair value of stock options with a graded vesting schedule is determined based on different expected lives for the options that vest each year as it would be if the award is viewed as several separate awards, each with a different vesting date, and it is accounted for on that basis. The new accounting policy provides more reliable and relevant information because it more closely reflects the substance of the expected lives of each option or unit of award.

The impact of the change in accounting policy for awards granted to Corporation employees with a graded vesting schedule was immaterial to the current or any prior periods and therefore was not adjusted.

Goodwill and intangible assets

Effective January 1, 2009, the Corporation adopted new Canadian Institute of Charted Accountants ("CICA") accounting standard section 3064, *Goodwill and Intangible Assets,* which provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. The Corporation's accounting policy for goodwill and intangibles is consistent with the new standard and as a result, no adjustment was recorded on transition.

Credit risk and the fair value of financial assets and financial liabilities

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

11.2 Future Accounting Standard Changes

Business combinations, consolidated financial statements and non-controlling interests

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

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

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

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

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

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

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

12. Off-Balance Sheet Arrangements

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

13. Related Party Transactions

At June 30, 2009, ACE Aviation Holdings Inc. ("ACE") held a 75% ownership interest in Air Canada. Air Canada has various related party transactions with Aveos Fleet Performance Inc. ("Aveos") and ACE. ACE is a participant lender in the Credit Facility as described in section 4 of this MD&A. ACE's participation in the Credit Facility represents $150 million of the outstanding loan of $600 million as at July 31, 2009. The participant lenders participate on a pro-rata basis with respect to any warrants and principal and interest payments.

The agreements between Air Canada and Aveos and between Air Canada and ACE are summarized in section 14 of Air Canada's 2008 MD&A dated February 13, 2009. There have been no material changes to the Corporation's related party agreements from what was disclosed at that time with the exception of ACE's participation in the Credit Facility and changes in payment terms related to related party agreements dated October 28, 2008 between Air Canada and Aveos.

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 were cancelled. The extended payment terms to Aveos were originally scheduled to begin reducing in May 2009 with a corresponding return of the letters of credit to Aveos.

In the second quarter of 2009, the payment terms were further extended with the first reduction expected to begin in August 2009 with the expiration of the extended payment terms over the following six months. By January 2010, the letters of credit would be reinstated to the levels then required under the Pension and Benefits Agreement between the two parties.

14. Critical Accounting Estimates

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

15. Risk Factors

For a detailed description of risk factors associated with the Corporation, refer to the section entitled "Risk Factors" in Air Canada's 2008 MD&A dated February 13, 2009 and the Risk Factors section of Air Canada's AIF dated March 28, 2009. Except as disclosed herein, there have been no material changes to the Corporation's risk factors from what was disclosed at that time.

16. Controls and Procedures

Disclosure controls and procedures and internal controls over financial reporting

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

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

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

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

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

Management's report on disclosure controls and procedures

Management, with the participation of the Corporation's CEO and CFO, concluded, as at June 30, 2009, that such disclosure controls and processes were designed to provide reasonable assurance that:

(i) material information relating to the Corporation was made known to its Disclosure Policy Committee by others; and

(ii) information required to be disclosed by the Corporation in its annual filings, interim filings and other reports filed or submitted by the Corporation under securities legislation was recorded, processed, summarized and reported within the time periods specified in securities legislation.

Management's report on internal controls over financial reporting

Management, with the participation of the Corporation's CEO and CFO, concluded, as at June 30, 2009, that the Corporation's internal controls over financial reporting were designed to provide reasonable assurance regarding the reliability of financial reporting and its preparation of financial statements for external purposes in accordance with GAAP.

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

Changes in internal controls over financial reporting

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

17. Non-GAAP Financial Measures

EBITDAR

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

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

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2009**	**2008**	**Change $**	**2009**	**2008**	**$ Change**
GAAP operating income (loss) before the provision for cargo investigations	$ (113)	$ 7	$ (120)	$ (301)	$ (5)	$ (296)
Add back:						
Aircraft rent	83	69	14	169	132	37
Depreciation and amortization	165	173	(8)	324	344	(20)
EBITDAR before the provision for cargo investigations	**$ 135**	**$ 249**	**$ (114)**	**$ 192**	**$ 471**	**$ (279)**
Add back:						
Provision for cargo investigations	-		-	-	(125)	125
EBITDAR	**$ 135**	**$ 249**	**$ (114)**	**$ 192**	**$ 346**	**$ (154)**

Operating expense excluding fuel expense

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

Operating expense, excluding fuel expense, for Air Canada is reconciled to operating expense as follows:

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2009**	**2008**	**Change $**	**2009**	**2008**	**$ Change**
GAAP operating expense	$ 2,443	$ 2,775	$ (332)	$ 5,022	$ 5,514	$ (492)
Remove:						
Aircraft fuel	(572)	(848)	276	(1,165)	(1,563)	398
Operating expense, excluding fuel expense	**$ 1,871**	**$ 1,927**	**$ (56)**	**$ 3,857**	**$ 3,951**	**$ (94)**

18. 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 depreciation and amortization, and aircraft rent as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. Refer to section 17 of this MD&A for additional information.

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

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

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

Yield — Average passenger revenue per RPM.