AIR CANADA

First Quarter 2010

Interim Unaudited

Consolidated Financial Statements and Notes

May 6, 2010

Consolidated Statement of Operations

Unaudited (Canadian dollars in millions except per share figures)		Three Months Ended March 31 2010	2009
Operating revenues			
Passenger		$ 2,095	$ 2,011
Cargo		104	80
Other		320	300
		2,519	2,391
Operating expenses			
Aircraft fuel		619	593
Wages, salaries and benefits		470	458
Airport and navigation fees		226	230
Capacity purchase with Jazz	Note 7	226	246
Depreciation and amortization		176	159
Aircraft maintenance		200	189
Food, beverages and supplies		74	67
Communications and information technology		80	79
Aircraft rent		88	86
Commissions		60	49
Other		426	423
		2,645	2,579
Operating loss		**(126)**	**(188)**
Non-operating income (expense)			
Interest income		2	6
Interest expense		(78)	(105)
Interest capitalized		-	1
Loss on assets	Note 2	(1)	-
Gain (loss) on financial instruments recorded at fair value	Note 5	2	(10)
Other		-	(1)
		(75)	(109)
Loss before the following items		**(201)**	**(297)**
Non-controlling interest		(3)	(4)
Foreign exchange gain (loss)		100	(101)
Recovery of (provision for) income taxes			
Current		1	3
Future		18	(1)
Loss for the period		**$ (85)**	**$ (400)**
Loss per share			
Basic and diluted		$ (0.31)	$ (4.00)

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

Consolidated Statement of Financial Position

Unaudited (Canadian dollars in millions)		March 31 2010	December 31 2009
ASSETS			
Current			
Cash and cash equivalents		$ 1,085	$ 1,115
Short-term investments		536	292
		1,621	1,407
Restricted cash		39	78
Accounts receivable		799	701
Aircraft fuel inventory		60	63
Spare parts and supplies		73	64
Prepaid expenses and other current assets	Note 5	294	338
		2,886	2,651
Property and equipment		6,222	6,369
Intangible assets		908	916
Deposits and other assets	Note 8	402	470
		$ 10,418	**$ 10,406**
LIABILITIES			
Current			
Accounts payable and accrued liabilities	Note 5	$ 1,231	$ 1,246
Advance ticket sales		1,514	1,288
Current portion of long-term debt and capital leases	Note 2	677	468
		3,422	3,002
Long-term debt and capital leases	Note 2	3,694	4,054
Future income taxes		85	85
Pension and other benefit liabilities		1,136	1,163
Other long-term liabilities		491	455
		8,828	8,759
Non-controlling interest		171	201
SHAREHOLDERS' EQUITY			
Share capital		532	532
Contributed surplus		1,825	1,825
Deficit		(812)	(727)
Accumulated other comprehensive loss	Note 5	(126)	(184)
		1,419	1,446
		$ 10,418	**$ 10,406**

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

Consolidated Statement of Changes in Shareholders' Equity

Unaudited (Canadian dollars in millions)	Three Months Ended March 31 2010	2009
Share capital		
Common shares	$ 532	$ 274
Total share capital	532	274
Contributed surplus	1,825	1,797
Deficit		
Balance, beginning of period	(727)	(703)
Loss for the period	(85)	(400)
Deficit	(812)	(1,103)
Accumulated other comprehensive income (loss)		
Balance, beginning of period	(184)	(606)
Other comprehensive income	58	128
Total accumulated other comprehensive loss	(126)	(478)
Total deficit and accumulated other comprehensive loss	(938)	(1,581)
Total shareholders' equity	**$ 1,419**	**$ 490**

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

Consolidated Statement of Comprehensive Loss

Unaudited (Canadian dollars in millions)		Three Months Ended March 31 2010	2009
Comprehensive loss			
Loss for the period		$ (85)	$ (400)
Other comprehensive income (loss), net of taxes:			
Net losses on fuel derivatives under hedge accounting, net of taxes	Note 5	-	(1)
Reclassification of net realized losses on fuel derivatives to income, net of taxes	Note 5	58	129
		58	128
Total comprehensive loss		**$ (27)**	**$ (272)**

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

Consolidated Statement of Cash Flow

Unaudited (Canadian dollars in millions)		Three Months Ended March 31 2010	2009
Cash flows from (used for)			
Operating			
Loss for the period		$ (85)	$ (400)
Adjustments to reconcile to net cash from operations			
Depreciation and amortization		176	159
Loss on assets	Note 2	1	-
Foreign exchange (gain) loss		(111)	143
Future income taxes		(18)	1
Excess of employee future benefit funding over expense		(25)	(103)
Non-controlling interest		3	4
Fuel and other derivatives	Note 5	35	(82)
Fuel hedge collateral deposits, net	Note 5	23	147
Changes in non-cash working capital balances		257	289
Other		3	10
		259	**168**
Financing			
Borrowings	Note 2	100	267
Reduction of long-term debt and capital lease obligations		(131)	(423)
Other		(35)	-
		(66)	**(156)**
Investing			
Short-term investments		(244)	19
Additions to capital assets		(44)	(107)
Proceeds from sale-leaseback transactions	Note 2	20	172
Funding of Aveos letter of credit	Note 8	23	-
Other		22	5
		(223)	**89**
Increase (decrease) in cash and cash equivalents		**(30)**	**101**
Cash and cash equivalents, beginning of period		1,115	499
Cash and cash equivalents, end of period		**$ 1,085**	**$ 600**
Cash payments of interest		$ 73	$ 94
Cash payments (recoveries) of income taxes		$ 3	$ (3)

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

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

1. BASIS OF PRESENTATION

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

The unaudited interim consolidated financial statements for the Corporation are based on the accounting policies consistent with those disclosed in Note 2 to the 2009 annual consolidated financial statements of the Corporation.

In accordance with generally accepted accounting principles in Canada ("GAAP"), these interim financial statements do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the 2009 annual consolidated financial statements of the Corporation. In management's opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim periods presented.

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

2. FINANCING AND INVESTING ACTIVITIES

Term Credit Facility

During the first quarter of 2010, the Corporation entered into arrangements with a new lender, comprised of a group of entities that are related to each other, to obtain a $100 increase to the $600 secured term credit facility which is further described in Note 6 to the 2009 annual consolidated financial statements of the Corporation. The addition to the facility increases, on a pro rata basis, the scheduled repayments, including the final payment. The Corporation received financing proceeds of $100, less financing fees of $2, in February 2010. No additional warrants were issued as a result of the increase to the credit facility.

Sale-leaseback

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

Aveos Restructuring Plan

During the first quarter of 2010, Aveos completed its recapitalization plan. As part of this recapitalization, Air Canada and Aveos entered into agreements to settle certain issues and modify the terms of certain contractual arrangements in exchange for Air Canada receiving a minority equity interest in Aveos as further described in Note 8.

3. PENSION AND OTHER BENEFIT LIABILITIES

Pension and Other Benefit Expense

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

	Three Months Ended March 31			
	2010		2009	
Pension benefit expense	$	27	$	3
Other employee future benefits expense		22		20
		49		23
Amount charged to ACE, Aveos and Aeroplan		(6)		(7)
Net pension and other employee future benefits expense	$	**43**	**$**	**16**

As described in Note 18 to the 2009 annual consolidated financial statements of the Corporation, Air Canada and Aveos are parties to a Pension and Benefits Agreement covering the future transfer of certain pension and benefit assets and obligations to Aveos. During the first quarter of 2010, the Office of the Superintendent of Financial Institutions ("OSFI") provided its approval for the transfer of pension assets and liabilities from the Air Canada pension plans to the Aveos pension plan for certain non-unionized employees of Air Canada who became employees of Aveos effective October 16, 2007. The amount of the asset transfer was established as a pro-rata share, based on solvency liabilities, of assets in the Air Canada pension plans as at October 16, 2007. The resulting amount is adjusted by investment returns and benefit payments until the actual date funds are transferred. The asset transfer is expected to be completed during the second quarter of 2010.

4. LABOUR RELATED PROVISIONS

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

	Three Months Ended March 31			
	2010		2009	
Beginning of period	$	61	$	54
Interest accretion		1		1
Charges recorded in wages, salaries, and benefits		1		11
Amounts disbursed		(6)		(5)
End of period		57		61
Current portion in Accounts payable and accrued liabilities		(26)		(27)
	$	**31**	**$**	**34**

The Corporation offers severance programs to certain employees from time to time. The cost of these programs is recorded within Operating expenses.

5. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Gain (Loss) on Financial Instruments Recorded at Fair Value

	Three Months Ended March 31	
	2010	2009
Fuel derivatives not under hedge accounting	$ 1	$ (9)
Interest rate swaps	1	(1)
Gain (loss) on financial instruments recorded at fair value [(1)]	**$ 2**	**$ (10)**

(1) See Fuel Price Risk for a discussion of losses on fuel derivatives recorded in Other comprehensive income ("OCI").

Risk Management

<u>Liquidity risk</u>

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities and other contractual obligations. Refer to Note 15 and Note 17 to the 2009 annual consolidated financial statements of the Corporation for information regarding liquidity risks and contingencies, including investigations and proceedings relating to alleged anti-competitive cargo pricing activities.

Covenants in Credit Card Agreements

The Corporation has various agreements with companies that process customer credit card transactions, as further described in Note 15 to the 2009 annual consolidated financial statements of the Corporation. Under the terms of its credit card processing agreements with one of its principal credit card processors, the credit card processing company may withhold payment of funds to Air Canada or require Air Canada to provide the processor with deposits and security upon the occurrence of certain events ("triggering events"). During 2009, the Corporation entered into amendments with this processor to amend certain credit card processing agreements under which the triggering events were revised. In May 2010, the Corporation entered into a set of further amendments, extending these agreements to the end of November 2010 on the same terms and providing options for the Corporation, on certain terms, to further extend these agreements for a period of up to two years, on revised terms. The Corporation continues to explore other options to source these services from other third parties.

<u>Fuel Price Risk</u>

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

The fuel derivative contracts have not been designated under hedge accounting. As at March 31, 2010, the fair market value of the fuel derivatives was $8 in favour of the counterparties and is recorded within Accounts payable and accrued liabilities ($31 in favour of the counterparties as at December 31, 2009).

During the first quarter of 2010:

- The Corporation recorded a gain of $1 in Gain on financial instruments recorded at fair value related to fuel derivatives (first quarter of 2009 - $9 loss).
- The Corporation purchased crude-oil call options. The premium related to these contracts was $8.
- Fuel derivative contracts cash settled with a fair value of $14 in favour of the counterparties ($45 in favour of the counterparties in the first quarter of 2009).

As of March 31, 2010, approximately 22% of the Corporation's anticipated purchases of jet fuel for the remainder of 2010 are hedged at an average West Texas Intermediate ("WTI") capped price of USD$91 per barrel and approximately 9% is subject to an average floor price of US$95 per barrel. The Corporation's contracts to hedge anticipated jet fuel purchases over the 2010 period are comprised of crude-oil and jet fuel based contracts.

The following table outlines the notional volumes per barrel along with the WTI weighted average floor and capped price for each year currently hedged by type of derivative instruments as at March 31, 2010.

Derivative Instruments	Term	Volume (bbls)	WTI Weighted Average Floor Price (US$/bbl)	WTI Weighted Average Capped Price (US$/bbl)
Call options (a)	2010	2,340,000	n/a	$ 88
Swaps (a) and (b)	2010	785,000	$ 99	$ 99
Collars (a)	2010	805,000	$ 91	$ 94

(a) The Corporation is expected to generate fuel hedging gains if oil prices increase above the average capped price and is exposed to fuel hedging losses if prices decrease below the average floor price.
(b) The Corporation also has 249,000 bbls of jet fuel crack swaps fixing the spread between jet fuel price and WTI crude oil price at an average of US$8/bbl for the second quarter of 2010.

The Corporation may adjust or restructure its hedging portfolio in light of market conditions. Subsequent to March 31, 2010, the Corporation modified its fuel hedge portfolio with the termination of swap and collar contracts for $5, in favour of the counterparty. The collateral held by the counterparty was in excess of the settlement amount, and such excess was returned, resulting in a cash inflow for the Corporation.

The Corporation discontinued applying hedge accounting effective the third quarter of 2009. Amounts that were deferred to Accumulated Other Comprehensive Loss ("AOCL") for derivatives previously designated under hedge accounting will be taken into fuel expense in the period where the derivative was scheduled to mature. During the first quarter of 2010, $58 was reclassified from AOCL to Aircraft fuel expense. As at March 31, 2010, the net amount of existing losses reported in AOCL that are expected to be reclassified to net income during the following 9 months is $125 before tax. The AOCL balance related to fuel hedging contracts will be completely depleted as of December 31, 2010.

The types of derivative instruments used by the Corporation within its hedging program, such as swaps and put options within collar structures, expose the Corporation to the potential of providing collateral deposits to its counterparties. When a decrease in fuel prices causes the Corporation's derivative position to be in a liability position below the set credit thresholds with counterparties, the Corporation is responsible for extending collateral to the counterparties. As at March 31, 2010, the Corporation had extended, to counterparties, $19 of collateral which is recorded within Prepaid expenses and other current assets (December 31, 2009 – $43).

The following information summarizes the financial statement impact of fuel derivatives:

		Three Months Ended March 31 2010	2009
Consolidated Statement of Operations			
Operating expenses			
Aircraft fuel	Realized effective loss on derivatives designated under hedge accounting	$ (58)	$ (127)
Non-operating income (expense)			
Gain (loss) on financial instruments recorded at fair value	Ineffective gain (loss) on derivatives designated under hedge accounting	n/a	$ -
	Fair market value gain (loss) on economic hedges	$ 1	$ (9)
Consolidated Statement of Comprehensive Income (Loss)			
	Effective loss on derivatives designated under hedge accounting	n/a	$ (1)
	Tax expense on effective gain	n/a	$ -
	Reclassification of net realized loss on fuel derivatives designated under hedge accounting to Aircraft fuel expense	$ 58	$ 127
	Tax on reclassification	$ -	$ 2

		March 31 2010	December 31 2009
Consolidated Statement of Financial Position			
Prepaid expenses and other currents assets	Collateral deposits for fuel derivatives	$ 19	$ 43
Accounts payable and accrued liabilities	Fair market value of fuel derivatives	$ (8)	$ (31)
Shareholders' equity (AOCL)	Net loss from fuel derivatives designated under hedge accounting (net of tax 2010 - $1 and 2009 - $1)	$ (126)	$ (184)

6. SEGMENT INFORMATION

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

	Three Months Ended March 31	
Passenger revenues	**2010**	**2009**
Canada	$ 829	$ 817
US Transborder	465	439
Atlantic	344	323
Pacific	206	180
Other	251	252
	$ 2,095	**$ 2,011**

	Three Months Ended March 31	
Cargo revenues	**2010**	**2009**
Canada	$ 16	$ 15
US Transborder	4	4
Atlantic	38	32
Pacific	32	20
Other	14	9
	$ 104	**$ 80**

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

7. JAZZ CAPACITY PURCHASE AGREEMENT

Air Canada and Jazz Air LP (“Jazz”) are parties to a capacity purchase agreement (“Jazz CPA”) pursuant to which Air Canada purchases substantially all of Jazz’s fleet capacity based on predetermined rates, in addition to reimbursing Jazz, without mark-up, for certain pass-through costs as defined in the Jazz CPA which costs include fuel, airport and user fees and other costs. The fees include both a variable component that is dependent on Jazz aircraft utilization and a fixed component and are recorded in the applicable category within the operating expenses in the results of Air Canada.

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

	Three Months Ended March 31	
	2010	**2009**
Expenses from Jazz CPA	$ 226	$ 246
Pass-through fuel expense from Jazz CPA	66	57
Pass-through airport expense from Jazz CPA	46	47
Pass-through other expense from Jazz CPA	14	15
	$ 352	**$ 365**

Effective August 1, 2009, the Corporation reached an agreement amending the terms related to the Corporation’s capacity purchase agreement with Jazz which provides for a reduction to rates paid under the agreement as further described in Note 2D to the 2009 annual consolidated financial statements of the Corporation.

8. RELATED PARTY TRANSACTIONS

ACE Aviation Holdings Inc. ("ACE") reported holding, as of March 31, 2010, a 27% ownership interest in Air Canada. Air Canada has various related party transactions with ACE and Aveos. See Note 18 to the 2009 annual consolidated financial statements of the Corporation for additional information. As a result of the Aveos Restructuring Plan, Air Canada and Aveos are no longer related parties.

Aveos Restructuring Plan

During the first quarter of 2010, Aveos reached an agreement with its lenders and equity holders on the terms of a consensual restructuring plan to recapitalize the company. As part of this recapitalization, Air Canada and Aveos entered into agreements to settle certain issues and modify the terms of certain contractual arrangements in exchange for Air Canada receiving a minority equity interest in Aveos. This restructuring modified the terms of certain commercial agreements between Air Canada and Aveos, including terms of the Pension and Benefits Agreement and the Agreement with Aveos on Revised Payment Terms described in the 2009 annual consolidated financial statements of the Corporation and below. The modified terms relating to the maintenance agreements are not expected to have a material impact on maintenance expense over their terms.

As part of these agreements, the Corporation also agreed to extend repayment terms on $22 of receivables (as further described in Note 18 to the 2009 annual consolidated financial statements of the Corporation under *Agreement with Aveos on Revised Payment Terms*), due in 2010, over six years with annual repayments on a non-interest bearing basis, with such payments subject to satisfaction of certain conditions. This agreement is now referred to as the Term Note.

The terms of the Pension and Benefits Agreement were also modified to defer the determination of pension assets and related solvency deficiencies of transferring unionized employees performing airframe maintenance services to April 2011. This has the result of Air Canada assuming changes in the solvency deficiency for those affected employees from the date of the Pension and Benefits Agreement, which was entered into as of October 16, 2007, to the date of their transfer to Aveos, scheduled for April 2011. As part of the amendment, all letters of credit issued under the Pension and Benefits Agreement were cancelled and a new letter of credit in the amount of $20 was issued by Air Canada in favour of Aveos to secure the payment of all compensation payments owing by Air Canada to Aveos in respect of pension, disability, and retiree liabilities for which Air Canada would be liable under the Pension and Benefits Agreement. This modification resulted in a reduction to the outstanding deposit under Air Canada's letter of credit facility of $23 during the first quarter of 2010. Until such future time as the assets and obligations under the Air Canada pension and other employee and retiree benefit arrangements pertaining to unionized employees may be transferred to Aveos, the current service pension cost and the current service and interest costs for other employee benefits in respect of Air Canada employees providing services to Aveos are charged by Air Canada to Aveos, and as such, the modifications to the Pension and Benefits Agreement have no accounting consequence in the current period. Refer to Note 18 to the 2009 annual consolidated financial statements for further information on the Pension and Benefits Agreement.

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

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

The investment in Aveos common shares is recorded in Deposits and other assets and will be carried at cost going forward. The Term Note is also recorded in Deposits and other assets and is carried at amortized cost. As a result of the restructuring and the change in equity interests in Aveos, Aveos and Air Canada are no longer related parties.