AIR CANADA

Third Quarter 2011

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

November 4, 2011

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1. Highlights

Effective January 1, 2011, Air Canada began reporting its financial results in accordance with IFRS, including comparative figures for 2010. The financial and operating highlights for Air Canada for the periods indicated are as follows.

(Canadian dollars in millions, except where indicated)	Third Quarter			First Nine Months		
	2011	2010	Change $	2011	2010	Change $
Financial Performance Metrics						
Operating revenues	3,242	3,026	216	8,913	8,170	743
Operating income	270	306	(36)	277	217	60
Non-operating income (expense)	(394)	11	(405)	(467)	(331)	(136)
Income (loss) before income taxes	(124)	317	(441)	(190)	(114)	(76)
Net income (loss) for the period	(124)	317	(441)	(189)	(113)	(76)
Operating margin %	8.3%	10.1%	(1.8) pp	3.1%	2.7%	0.4 pp
EBITDAR (1)	535	580	(45)	1,080	1,058	22
EBITDAR margin % (1)	16.5%	19.2%	(2.7) pp	12.1%	12.9%	(0.8) pp
Cash, cash equivalents and short-term investments	2,179	2,173	6	2,179	2,173	6
Free cash flow (2)	4	112	(108)	435	624	(189)
Adjusted net debt (3)	4,645	5,138	(493)	4,645	5,138	(493)
Net income (loss) per share – Diluted	($0.45)	$1.10	($1.55)	($0.70)	($0.43)	($0.27)
Adjusted net income (loss) per share - Diluted (4)	$0.55	$0.70	($0.15)	($0.09)	($0.41)	$0.32
Operating Statistics			**Change %**			**Change %**
Revenue passenger miles (millions) (RPM)	16,126	15,531	3.8	42,158	40,119	5.1
Available seat miles (millions) (ASM)	18,799	18,328	2.6	51,170	48,578	5.3
Passenger load factor %	85.8%	84.7%	1.1 pp	82.4%	82.6%	(0.2) pp
Passenger revenue per RPM ("Yield") (cents)	18.1	17.4	3.8	18.5	17.7	4.4
Passenger revenue per ASM ("RASM") (cents)	15.5	14.8	5.1	15.2	14.6	4.2
Operating revenue per ASM (cents)	17.2	16.5	4.5	17.4	16.8	3.6
Operating expense per ASM ("CASM") (cents)	15.8	14.8	6.6	16.9	16.4	3.1
CASM, excluding fuel expense (cents)	10.8	10.8	(0.4)	11.9	12.2	(3.0)
Average number of full-time equivalent (FTE) employees (thousands) (5)	23.9	23.5	1.8	23.7	23.2	2.3
Aircraft in operating fleet at period end (6)	330	326	1.2	330	326	1.2
Average fleet utilization (hours per day) (6)	10.8	10.7	0.8	10.3	10.0	3.6
Revenue frequencies (thousands)	148	145	1.8	418	406	2.9
Average aircraft flight length (miles) (7)	931	909	2.4	903	874	3.3
Economic fuel price per litre (cents) (8)	85.8	64.6	32.8	84.1	65.8	27.8
Fuel litres (millions)	1,103	1,089	1.3	3,025	2,885	4.9

(1) EBITDAR (earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent) is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for a reconciliation of EBITDAR to operating income (loss).

(2) Free cash flow (cash flows from operating activities less additions to property, equipment and intangible assets) is a non-GAAP financial measure. Refer to section 7.4 of this MD&A for additional information.

(3) Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is a non-GAAP financial measure. Refer to section 7.2 of this MD&A for additional information. Reflects adjusted net debt as at September 30, 2011 and as at September 30, 2010.

(4) Adjusted earnings (loss) per share (diluted) is a non-GAAP financial measure. Refer to section 16 for additional information.

(5) Reflects FTE employees at Air Canada. Excludes FTE employees at Jazz Aviation LP ("Jazz") and other third party carriers operating under capacity purchase agreements with Air Canada.

(6) Includes Jazz aircraft covered under a capacity purchase agreement with Jazz (the "Jazz CPA"). Excludes aircraft operated by other third party carriers pursuant to capacity purchase agreements with Air Canada. Refer to section 6 of this MD&A for additional information.

(7) Excludes charter operations. Also excludes third party carriers operating under capacity purchase arrangements, other than Jazz aircraft covered under the Jazz CPA.

(8) Excludes third party carriers, other than Jazz, operating under capacity purchase agreements. Includes fuel handling and is net of fuel hedging results. Economic fuel price per litre is a non-GAAP financial measure. Refer to sections 4 and 5 of this MD&A for additional information.

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.

This MD&A provides the reader with a view and analysis, from the perspective of management, of Air Canada's financial results for the third quarter of 2011. This MD&A should be read in conjunction with Air Canada's interim unaudited condensed consolidated financial statements and notes for the third quarter of 2011 and Air Canada's Canadian GAAP annual audited consolidated financial statements and notes and its annual MD&A for the year ended December 31, 2010. All financial information has been prepared in accordance with generally accepted accounting principles in Canada ("GAAP"), as set out in the Handbook of the Canadian Institute of Chartered Accountants – Part 1 ("CICA Handbook"), except for any financial information specifically denoted otherwise. The CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board, and requires publicly accountable enterprises to apply IFRS effective for years beginning on or after January 1, 2011, and to provide comparative figures for 2010. Accordingly, for periods beginning on or after January 1, 2011, Air Canada commenced reporting on this basis. In preparing its financial statements, Air Canada started from an opening consolidated statement of financial position as at January 1, 2010, Air Canada's IFRS transition date, and made those changes in accounting policies and other adjustments required by IFRS 1 "First-time adoption of International Financial Reporting Standards" ("IFRS 1") for the first time adoption of IFRS. Note 2 of Air Canada's interim unaudited condensed financial statements for the third quarter of 2011 provides additional information on the impact of the transition to IFRS on Air Canada's previously published Canadian GAAP financial statements for the three and nine months ended September 30, 2010.

As a result of the adoption of IFRS, certain trends in operating results previously experienced under Canadian GAAP may no longer be applicable under IFRS. In particular, the accounting rules for pension and other employee benefits, depreciation, amortization and impairment expense, and aircraft maintenance expense are significantly affected by the changeover to IFRS. Refer to section 10 "Accounting Policies" of Air Canada's First Quarter 2011 MD&A dated May 5, 2011 for additional information.

Starting in the first quarter of 2011, Air Canada revised the presentation of certain operating expenses on the statement of operations. These revisions include a new expense line category within operating expenses referred to as "sales and distribution costs" which includes sales commissions, credit card fees and other distribution costs, including fees paid to global distribution system ("GDS") providers. The expense line category related to capacity purchase agreements has been expanded to include fees paid under all capacity purchase arrangements, including those paid to Jazz Aviation LP ("Jazz") pursuant to the Capacity Purchase Agreement between Air Canada and Jazz (the "Jazz CPA") and those paid to other carriers operating flights on behalf of Air Canada under commercial agreements.

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 17 "Glossary" of this MD&A. Except as otherwise noted, this MD&A is current as of November 3, 2011.

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 risks relating to Air Canada, refer to section 18 "Risk Factors" of Air Canada's annual MD&A for 2010 dated February 10, 2011 and section 14 of this MD&A.

Air Canada issued a news release dated November 4, 2011, reporting on its results for the third quarter of 2011. This news release is available on Air Canada's website at **aircanada.com** and on SEDAR's website at **www.sedar.com**. For further information on Air Canada's public disclosures, including Air Canada's Annual Information Form, consult SEDAR at **www.sedar.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 communications, including filings with regulatory authorities and securities regulators. Forward-looking statements may be 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. 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 herein and are subject to important risks and uncertainties. Forward-looking 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, environmental factors (including weather systems and other natural phenomena and factors arising from man-made sources), 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 annual MD&A for 2010 and section 14 of this MD&A. The forward-looking statements contained in this MD&A represent Air Canada's expectations as of November 3, 2011 (or as of the date they are otherwise stated to be made), and are subject to change after such date. However, Air Canada 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 Canadian economy will continue to recover and assumes Canadian GDP growth of 1.5% to 2.0% through to the end of 2012. In addition, Air Canada expects that the Canadian dollar will trade, on average, at C$1.01 per U.S. dollar in the fourth quarter of 2011 and C$0.99 per U.S. dollar for the full year 2011 and that the price of jet fuel will average 87 cents per litre for the fourth quarter of 2011 and 85 cents per litre for the full year 2011.

3. Overview

Air Canada is Canada's largest domestic, U.S. transborder and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-U.S. transborder market and in the international market to and from Canada.

Third Quarter Financial Highlights

- Operating income of $270 million decreased $36 million from the third quarter of 2010. EBITDAR of $535 million decreased $45 million from the same quarter in 2010. On a capacity increase of 2.6%, Air Canada experienced strong revenue growth in the quarter, driven by increased fares and fuel surcharges, however this growth was more than offset by significantly higher fuel prices.

- Operating revenues increased $216 million or 7% from the third quarter of 2010, on passenger revenue growth of 7.9%. The growth in system passenger revenues in the third quarter of 2011 was due to a 3.8% increase in system passenger traffic and a 3.8% improvement in system yield. In the third quarter of 2011, the impact of a stronger Canadian dollar on foreign currency denominated passenger revenues reduced system passenger revenues by $18 million while the impact of the Japan earthquake and its aftermath reduced passenger revenues by $5 million. Overall capacity was 2.6% higher than the same quarter in 2010, reflecting ASM growth in all markets. This system capacity growth was essentially in line with the 1.5% to 2.5% third quarter 2011 ASM capacity increase projected in Air Canada's news release dated August 4, 2011. System RASM increased 5.1% year-over-year on the yield growth and a 1.1 percentage point improvement in passenger load factor.

- Operating expenses increased $252 million or 9% from the third quarter of 2010, due to higher base fuel prices year-over-year, which accounted for an increase of $311 million to fuel expense in the third quarter of 2011, and to the capacity growth of 2.6%. Partially offsetting these increases were the impact of a stronger Canadian dollar on foreign currency denominated expenses, which reduced operating expenses by $96 million in the third quarter of 2011, and the impact of cost reduction initiatives on various operating expense categories.

- A key objective of Air Canada's business strategy is to consistently improve unit revenue and cost productivity. To this end, in early 2009, with the assistance of a leading aviation consultancy firm, Air Canada launched a major company-wide cost transformation program (the "CTP"). As of the date of this MD&A, Air Canada has fully achieved its overall CTP target of $530 million for the end of 2011, on a run-rate basis. Air Canada views continuous cost transformation and improvement as one of its most important priorities, and a critical objective going forward to support ongoing unit cost improvements.

- Cost per available seat mile ("CASM") increased 6.6% from the third quarter of 2010. Excluding fuel expense, CASM decreased 0.4% from the third quarter of 2010. The 0.4% decrease in CASM, excluding fuel expense, was better than the 1.0% to 2.0% increase projected in Air Canada's news release dated August 4, 2011. The improvement was largely due to lower than forecasted aircraft maintenance expense and wages, salaries and benefits expense.

- A net loss of $124 million or $0.45 per diluted share was a deterioration of $441 million from the net income of $317 million or $1.10 per diluted share recorded in the third quarter of 2010. The net loss in the third quarter of 2011 included foreign exchange losses of $281 million while the net income in the third quarter of 2010 included foreign exchange gains of $115 million.

- Free cash flow of $4 million decreased $108 million from the third quarter of 2010, largely due to a decline in net cash from operations, consistent with the decline in third quarter EBITDAR year-over-year, the impact of higher pension payments, and an increase in capital expenditures of $21 million.

- At September 30, 2011, adjusted net debt of $4,645 million decreased $493 million from September 30, 2010, mainly due to net debt repayments of $459 million and the favourable impact of foreign exchange on aircraft rent which lowered capitalized operating lease obligations. Cash, cash equivalents and short-term investments totaled $2,179 million as at September 30, 2011, representing 19% of twelve-month trailing operating revenues.

4. Results of Operations – Third Quarter 2011 versus Third Quarter 2010

The following table and discussion compares the results of Air Canada for the third quarter of 2011 versus the third quarter of 2010.

	Third Quarter		Change	
(Canadian dollars in millions, except per share figures)	**2011**	**2010**	**$**	**%**
Operating revenues				
Passenger	$ 2,937	$ 2,722	$ 215	8
Cargo	121	123	(2)	(2)
Other	184	181	3	2
	3,242	**3,026**	**216**	**7**
Operating expenses				
Aircraft fuel	943	733	210	29
Wages, salaries, and benefits	499	473	26	5
Airport and navigation fees	284	270	14	5
Capacity purchase agreements	261	257	4	2
Depreciation, amortization and impairment	185	185	-	-
Aircraft maintenance	149	157	(8)	(5)
Sales and distribution costs	154	151	3	2
Food, beverages and supplies	82	76	6	8
Communications and information technology	48	47	1	2
Aircraft rent	80	89	(9)	(10)
Other	287	282	5	2
	2,972	**2,720**	**252**	**9**
Operating income	**270**	**306**	**(36)**	
Non-operating income (expense)				
Foreign exchange gain (loss)	(281)	115	(396)	
Interest income	8	4	4	
Interest expense	(81)	(90)	9	
Net financing expense relating to employee benefit liabilities	(4)	(19)	15	
Gain (loss) on financial instruments recorded at fair value	(33)	5	(38)	
Other	(3)	(4)	1	
	(394)	11	(405)	
Income (loss) before income taxes	**(124)**	**317**	**(441)**	
Recovery of (provision for) income taxes	-	-	-	
Net income (loss) for the period	**$ (124)**	**$ 317**	**$ (441)**	
EBITDAR [(1)]	**$ 535**	**$ 580**	**$ (45)**	
Net income (loss) per share - Diluted	**$ (0.45)**	**$ 1.10**	**$ (1.55)**	

(1) See section 16 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income (loss).

System passenger revenues increased 7.9% from the third quarter of 2010

System passenger revenues of $2,937 million in the third quarter of 2011 increased $215 million or 7.9% from the third quarter of 2010, due to traffic and yield growth. Premium cabin revenues increased $38 million or 7.2% from the third quarter of 2010 due to a traffic increase of 5.8% and a yield improvement of 1.3%.

The table below provides passenger revenue by geographic region for the third quarter of 2011 and the third quarter of 2010.

Passenger Revenue	Third Quarter 2011 $ Million	Third Quarter 2010 $ Million	$ Change	% Change
Canada	1,106	1,057	49	4.7
U.S. transborder	508	448	60	13.2
Atlantic	740	685	55	8.2
Pacific	373	353	20	5.8
Other	210	179	31	16.9
System	**2,937**	**2,722**	**215**	**7.9**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the third quarter of 2011 versus the third quarter of 2010**.**

Third Quarter 2011 Versus Third Quarter 2010	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	4.7	0.3	2.1	1.5	2.4	4.3
U.S. transborder	13.2	4.7	9.3	3.4	3.4	8.0
Atlantic	8.2	3.6	4.1	0.5	3.8	4.3
Pacific	5.8	2.0	1.5	(0.5)	4.2	3.6
Other	16.9	5.3	5.8	0.4	10.4	11.0
System	**7.9**	**2.6**	**3.8**	**1.1**	**3.8**	**5.1**

The table below provides year-over-year percentage changes in system passenger revenues and operating statistics for the third quarter 2011 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
System	Q3'10	Q4'10	Q1'11	Q2'11	Q3'11
Passenger Revenues	13.4	11.2	10.3	11.7	7.9
Capacity (ASMs)	8.2	7.8	7.7	6.4	2.6
Traffic (RPMs)	9.7	8.0	5.7	6.1	3.8
Passenger Load Factor (pp Change)	1.2	0.2	(1.5)	(0.2)	1.1
Yield	3.2	2.8	4.2	5.2	3.8
RASM	4.7	3.0	2.2	4.9	5.1

In the third quarter of 2011, Air Canada's overall capacity was 2.6% higher than the third quarter of 2010, with capacity growth reflected in all markets. The system capacity growth was essentially in line with the 1.5% to 2.5% third quarter 2011 ASM capacity increase projected in Air Canada's news release dated August 4, 2011. Components of the year-over-year change in third quarter system passenger revenues included:

- The system traffic increase reflected growth in all markets. Traffic exceeded capacity growth, resulting in a higher passenger load factor.

- The system yield improvement reflected yield growth in all markets and was due to increased fares and fuel surcharges to partly offset higher fuel prices. A gain in premium cabin traffic was also a factor in the yield improvement. The yield improvement was achieved in spite of an unfavourable impact relating to the stronger Canadian dollar on foreign currency denominated passenger revenues. The stronger Canadian dollar in the third quarter of 2011 versus the third quarter of 2010 decreased the

Canadian dollar value of sales in foreign currencies and had a negative impact of $18 million on system passenger revenues.

- The system RASM improvement reflected the higher yield and passenger load factor.

Domestic passenger revenues increased 4.7% from the third quarter of 2010

Domestic passenger revenues of $1,106 million in the third quarter of 2011 increased $49 million or 4.7% from the third quarter of 2010 due to yield and traffic growth.

The table below provides year-over-year percentage changes in domestic passenger revenues and operating statistics for the third quarter 2011 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Canada	**Q3'10**	**Q4'10**	**Q1'11**	**Q2'11**	**Q3'11**
Passenger Revenues	5.9	7.5	8.4	7.9	4.7
Capacity (ASMs)	0.8	0.2	(0.9)	(0.2)	0.3
Traffic (RPMs)	1.7	2.0	(0.5)	(0.6)	2.1
Passenger Load Factor (pp Change)	0.7	1.4	0.4	(0.3)	1.5
Yield	4.1	5.3	8.7	8.4	2.4
RASM	5.0	7.1	9.2	8.0	4.3

Domestic capacity in the third quarter of 2011 was slightly above the third quarter of 2010. On May 1, 2011, Sky Regional Airlines Inc. ("Sky Regional"), on behalf of Air Canada, began operating 15 daily flights from Toronto Island's Billy Bishop Airport to Montreal's Pierre Elliott Trudeau International Airport ("Montreal Trudeau Airport"). The capacity growth driven by this new service was largely offset by a capacity decrease on routes to the Maritimes and within central and western Canada. Components of the year-over-year change in third quarter domestic passenger revenues included:

- Domestic traffic exceeded the capacity growth, resulting in a higher passenger load factor.

- The domestic yield improvement was due to fuel-related fare increases to partly offset higher fuel costs, and to a more favourable fare mix in the economy cabin and, to a lesser extent, the premium cabin. The yield improvement was achieved in spite of a $4 million unfavourable impact of a stronger Canadian dollar on foreign currency denominated domestic passenger revenues.

- The RASM improvement reflected the higher yield and passenger load factor.

U.S. transborder passenger revenues increased 13.2% from the third quarter of 2010

U.S. transborder passenger revenues of $508 million in the third quarter of 2011 increased $60 million or 13.2% from the third quarter of 2010 due to strong traffic growth and a yield improvement.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues and operating statistics for the third quarter 2011 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
U.S. transborder	**Q3'10**	**Q4'10**	**Q1'11**	**Q2'11**	**Q3'11**
Passenger Revenues	10.4	10.7	14.5	20.2	13.2
Capacity (ASMs)	13.3	11.7	10.8	7.8	4.7
Traffic (RPMs)	12.8	12.0	11.5	12.9	9.3
Passenger Load Factor (pp Change)	(0.3)	0.2	0.4	3.5	3.4
Yield	(2.3)	(1.3)	2.5	6.4	3.4
RASM	(2.7)	(1.0)	3.1	11.4	8.0

The year-over-year increase in U.S. transborder capacity in the third quarter of 2011 was largely due to growth in sixth freedom traffic flows from the U.S. (meaning U.S. originating traffic carried through points in Canada to other international destinations) in support of Air Canada's international expansion initiatives. An increase in frequencies on routes to California, Florida and Las Vegas, as well as the addition of the airline's new service to New Orleans drove the capacity growth year-over-year.

Components of the year-over-year change in third quarter U.S. transborder passenger revenues included:

- The U.S. transborder traffic increase reflected growth on all major U.S. transborder services with the exception of U.S. short haul routes. A traffic decline on U.S. short haul routes reflected the cancellation of the airline's Calgary-San Francisco service. Overall traffic exceeded capacity growth, resulting in a higher passenger load factor. Passenger load factors improved on all major U.S. transborder services when compared to the same quarter in 2010.

- The U.S. transborder yield improvement was due to fuel-related fare increases to offset higher fuel prices. A gain in premium cabin traffic was also a factor in the yield improvement. The yield improvement was achieved in spite of an $11 million unfavourable impact of a stronger Canadian dollar on foreign currency denominated U.S. transborder passenger revenues.

- The RASM improvement reflected the higher yield and passenger load factor.

Atlantic passenger revenues increased 8.2% from the third quarter of 2010

Atlantic passenger revenues of $740 million in the third quarter of 2011 increased $55 million or 8.2% from the third quarter of 2010 due to traffic and yield growth.

The table below provides year-over-year percentage changes in Atlantic passenger revenues and operating statistics for the third quarter 2011 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Atlantic	**Q3'10**	**Q4'10**	**Q1'11**	**Q2'11**	**Q3'11**
Passenger Revenues	16.3	7.5	0.8	11.6	8.2
Capacity (ASMs)	12.3	5.5	6.2	12.3	3.6
Traffic (RPMs)	12.3	2.5	(0.8)	8.4	4.1
Passenger Load Factor (pp Change)	-	(2.2)	(5.0)	(3.0)	0.5
Yield	3.5	4.7	1.3	2.7	3.8
RASM	3.4	1.7	(5.4)	(0.8)	4.3

In the third quarter of 2011, the change in capacity year-over-year was mainly due to additional frequencies on summer seasonal routes including Montreal and Toronto to Athens, Toronto to Barcelona and Madrid, and Toronto to Dublin. In addition, in the third quarter of 2011, Air Canada operated an additional Montreal to London Heathrow flight, as well as additional frequencies from Toronto to Copenhagen. In addition, Air Canada operated larger aircraft on flights from Toronto to Munich and Zurich and on its Toronto - Montreal to Brussels service.

Components of the year-over-year change in third quarter Atlantic passenger revenues included:

- The Atlantic traffic increase reflected growth on all major Atlantic services with the exception of routes to France and the United Kingdom. On routes to France, the traffic decrease was less than the capacity decrease, resulting in a higher passenger load factor. On routes to the United Kingdom, the traffic decrease was essentially in line with the capacity decrease.

- The Atlantic yield improvement was due to increased fares, strong passenger demand originating from North America, fuel surcharges to partly offset higher fuel prices, and to gains in premium cabin traffic. The yield improvement was partly moderated by the impact of increased competition year-over-year.

- The RASM improvement reflected the higher yield and passenger load factor.

Pacific passenger revenues increased 5.8% from the third quarter of 2010

Pacific passenger revenues of $373 million in the third quarter of 2011 increased $20 million or 5.8% from the third quarter of 2010, mainly due to yield and traffic growth.

The table below provides year-over-year percentage changes in Pacific passenger revenues and operating statistics for the third quarter 2011 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Pacific	**Q3'10**	**Q4'10**	**Q1'11**	**Q2'11**	**Q3'11**
Passenger Revenues	37.7	31.7	17.0	6.4	5.8
Capacity (ASMs)	10.9	23.0	21.5	7.2	2.0
Traffic (RPMs)	17.1	22.9	16.0	5.9	1.5
Passenger Load Factor (pp Change)	4.8	(0.1)	(4.0)	(1.1)	(0.5)
Yield	17.5	7.2	0.7	0.4	4.2
RASM	24.1	7.0	(3.9)	(0.8)	3.6

The increase in Pacific capacity in the third quarter of 2011 reflected a capacity increase on routes to China largely offset by a capacity decrease on routes to Japan. Air Canada estimates that the impact of the Japan earthquake and its aftermath reduced passenger revenues by $5 million in the third quarter of 2011.

Components of the year-over-year change in third quarter Pacific passenger revenues included:

- Increased Pacific traffic reflected strong growth on routes to China.

- The Pacific yield improvement reflected yield improvements on all major Pacific services with the exception of Hong Kong, where the yield was slightly below the third quarter of 2010. The yield improvement was due to fare increases, gains in premium cabin traffic, and to increased fuel surcharges to partly offset higher fuel prices. The yield improvement was achieved in spite of a $2 million unfavourable impact of a stronger Canadian dollar on foreign currency denominated Pacific passenger revenues.

- The RASM improvement was mainly due to stronger yields on routes to Japan and Korea.

Other passenger revenues increased 16.9% from the third quarter of 2010

Other passenger revenues (comprised of routes to Australia, the Caribbean, Mexico, Central and South America) of $210 million in the third quarter of 2011 increased $31 million or 16.9% from the third quarter of 2010 due to yield and traffic growth.

The table below provides year-over-year percentage changes in Other passenger revenues and operating statistics for the third quarter 2011 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Other	**Q3'10**	**Q4'10**	**Q1'11**	**Q2'11**	**Q3'11**
Passenger Revenues	18.2	15.4	16.4	20.7	16.9
Capacity (ASMs)	10.7	7.2	9.1	8.6	5.3
Traffic (RPMs)	13.8	9.4	7.7	10.9	5.8
Passenger Load Factor (pp Change)	2.3	1.6	(1.1)	1.7	0.4
Yield	3.7	5.4	8.1	9.0	10.4
RASM	6.7	7.5	6.7	11.4	11.0

Components of the year-over-year change in third quarter Other passenger revenues included:

- Traffic and capacity increased on routes to the Caribbean, Mexico, Chile and Argentina. Overall traffic slightly exceeded capacity growth, resulting in a higher passenger load factor.

- The overall yield improvement in the Other markets was due to increased fares and fuel surcharges to partly offset higher fuel prices. A gain in premium cabin traffic was also a factor in the yield improvement. Routes to Australia and South America recorded significant yield improvements year-over-year.

- Higher RASM reflected yield growth and, to a lesser extent, passenger load factor improvements.

Cargo revenues decreased 1.7% from the third quarter of 2010

Cargo revenues of $121 million in the third quarter of 2011 decreased $2 million or 1.7% from the third quarter of 2010 due to a decline in traffic.

The table below provides cargo revenue by geographic region for the third quarter of 2011 and the third quarter of 2010.

Cargo Revenue	Third Quarter 2011 $ Million	Third Quarter 2010 $ Million	$ Change	% Change
Canada	18	18	-	(1.3)
U.S. transborder	4	4	-	(4.9)
Atlantic	50	44	6	12.8
Pacific	37	46	(9)	(18.5)
Other	12	11	1	11.7
System	**121**	**123**	**(2)**	**(1.7)**

The table below provides year-over-year percentage changes in cargo revenues and operating statistics for the third quarter of 2011 versus the third quarter of 2010.

Third Quarter 2011 Versus Third Quarter 2010	Cargo Revenue % Change	Capacity (ETMs) % Change	Rev / ETM % Change	Traffic (RTMs) % Change	Yield / RTM % Change
Canada	(1.3)	(8.5)	7.8	(14.2)	15.0
U.S. transborder	(4.9)	14.0	(16.6)	2.8	(7.5)
Atlantic	12.8	3.2	9.3	(6.2)	20.3
Pacific	(18.5)	2.0	(20.1)	(10.9)	(8.5)
Other	11.7	3.5	8.0	1.8	9.7
System	**(1.7)**	**1.9**	**(3.5)**	**(7.7)**	**6.5**

Components of the year-over-year change in third quarter cargo revenues included:

- Traffic decreased in all markets with the exception of the U.S. transborder market and the Other markets. The traffic decrease was mainly due to increased competition and weaker economic conditions, particularly in the Canadian and Asian markets, and the earthquake in Japan and its aftermath. The decline in domestic cargo traffic was largely due to the capacity reduction in that market.

- Higher cargo yield per revenue ton mile (RTM) reflected growth in all markets with the exception of the Pacific market and the U.S. transborder market. The improvement in cargo yield was mainly due to higher fuel surcharges year-over-year.

Other revenues increased 2% from the third quarter of 2010

Other revenues consist primarily of revenues from the sale of the ground portion of vacation packages, ground handling services, and other airline-related services, as well as revenues related to the lease or sublease of aircraft to third parties.

Other revenues of $184 million in the third quarter of 2011 increased $3 million or 2% from the third quarter of 2010. The growth in other revenues was due to a $10 million increase in third party ground package revenues at Air Canada Vacations. This increase in third party revenues was due to a higher selling price of ground packages and an increase in passenger volumes. Partially offsetting this increase was a decrease in aircraft sublease revenues due to fewer aircraft being subleased to third parties compared to the third quarter of 2010 and to the unfavourable impact of a stronger Canadian dollar on U.S. currency denominated aircraft lease and sublease revenues.

CASM increased 6.6% from the third quarter of 2010. Excluding fuel expense, CASM decreased 0.4% from the third quarter of 2010

CASM increased 6.6% from the third quarter of 2010. Excluding fuel expense, CASM decreased 0.4% from the third quarter of 2010. Factors contributing to the year-over-year change in third quarter CASM, excluding fuel expense, included:

- The favourable impact of a stronger Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars), which reduced operating expenses by $26 million.
- The 2.6% capacity growth, which resulted in Air Canada's fixed costs being allocated over a greater number of ASMs.
- The impact of CTP initiatives, which reduced various operating expense categories, including: wages and salaries, airport user fees, capacity purchase fees, food, beverage and supplies, information technology, terminal handling and other operating expenses.
- An increase of 0.8% in aircraft utilization and an increase of 2.4% in average stage length.

The following table compares Air Canada's operating expenses per ASM for the third quarter of 2011 to Air Canada's operating expenses per ASM for the corresponding period in 2010.

	Third Quarter		Change	
(cents per ASM)	**2011**	**2010**	**cents**	**%**
Wages and salaries	2.08	2.07	0.01	0.5
Benefits	0.57	0.51	0.06	11.8
Airport user fees	1.51	1.48	0.03	2.0
Capacity purchase agreements	1.39	1.40	(0.01)	(0.7)
Ownership (DAR) [(1)]	1.41	1.49	(0.08)	(5.4)
Aircraft maintenance	0.79	0.86	(0.07)	(8.1)
Sales and distribution costs	0.82	0.82	-	-
Food, beverages and supplies	0.44	0.41	0.03	7.3
Communications and information technology	0.26	0.26	-	-
Other	1.52	1.54	(0.02)	(1.3)
Operating expense, excluding fuel expense [(2)]	**10.79**	**10.84**	**(0.05)**	**(0.4)**
Aircraft fuel	5.02	4.00	1.02	25.5
Total operating expense	**15.81**	**14.84**	**0.97**	**6.6**

(1) DAR refers to the combination of depreciation, amortization and impairment, and aircraft rent expenses.

(2) Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Operating expenses increased 9% from the third quarter of 2010

Air Canada recorded operating expenses of $2,972 million, an increase of $252 million or 9% from the operating expenses of $2,720 million recorded in the third quarter of 2010. The more significant variances are discussed below.

Fuel expense increased 29% from the third quarter of 2010

Fuel expense amounted to $943 million in the third quarter of 2011, an increase of $210 million or 29% from the third quarter of 2010. Factors contributing to the year-over-year change in third quarter fuel expense included:

- A higher base fuel price accounted for an increase of $311 million.
- A higher volume of fuel consumed, driven by the additional capacity year-over-year, accounted for an increase of $12 million.

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

- Fuel hedging losses reclassified from Accumulated Other Comprehensive Loss ("AOCL") of $42 million in the third quarter of 2010 versus no fuel hedging losses recorded in fuel expense in the third quarter of 2011, resulting in a favourable variance of $42 million year-over-year.
- The favourable impact of a stronger Canadian dollar versus the U.S. dollar (the primary currency for Air Canada's fuel purchases) accounted for a decrease of $71 million.

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

	Third Quarter		Change	
(Canadian dollars in millions, except where indicated)	**2011**	**2010**	**$**	**%**
Aircraft fuel expense – GAAP [1]	$ 935	$ 729	$ 206	28
Remove: *Fuel hedging losses reclassified from AOCL into fuel expense*	-	(42)	42	100
Add: *Net cash payments on fuel derivatives* [2]	11	17	(6)	(35)
Economic cost of fuel – Non-GAAP [3]	**$ 946**	**$ 704**	**$ 242**	**34**
Fuel consumption (thousands of litres)	1,102,478	1,089,360	13,118	1
Fuel price per litre (cents) – GAAP	84.8	66.9	17.9	27
Fuel price per litre (cents) – excluding fuel hedging losses	84.8	63.1	21.7	34
Economic fuel price per litre (cents) – Non-GAAP	85.8	64.6	21.2	33

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

(2) Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives.

(3) The economic cost of fuel is a non-GAAP measure used by Air Canada and may not be comparable to measures presented by other public companies. Air Canada uses this measure to calculate its cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period and premium costs associated with those derivatives. It excludes non-cash accounting gains and losses from fuel derivative instruments.

Wages, salaries and benefits expense amounted to $499 million in the third quarter of 2011, an increase of $26 million or 5% from the third quarter of 2010

Wages and salaries expense amounted to $390 million in the third quarter of 2011, an increase of $9 million or 2% from the third quarter of 2010 mainly due to higher average salaries and an increase of 1.8% in the average number of full-time equivalent ("FTE") employees year-over-year. Partly offsetting these increases was a

decrease in expenses related to incentive compensation programs, including those linked to Air Canada's operational performance.

Employee benefits expense amounted to $109 million in the third quarter of 2011, an increase of $17 million or 18% from the third quarter of 2010, mainly due to an increase in pension and post-employment benefits expenses resulting from changes in actuarial assumptions year-over-year.

Airport and navigation fees increased 5% from the third quarter of 2010

Airport and navigation fees amounted to $284 million in the third quarter of 2011, an increase of $14 million or 5% from the third quarter of 2010. This increase was mainly due to a 1.8% increase in aircraft departures, the impact of changes in schedule and aircraft types operated to certain destinations, as well as an increase in terminal user fees, effective April 1, 2011, at London Heathrow Airport. Costs associated with Air Canada's new services operated by Sky Regional between Billy Bishop Toronto City Airport and Montreal Trudeau Airport were also a factor in the increase in airport and navigation fees year-over-year.

Capacity purchase costs increased 2% from the third quarter of 2010

Capacity purchase costs amounted to $261 million in the third quarter of 2011 compared to $257 million in the third quarter of 2010, an increase of $4 million or 2%. This increase was mainly due to increases in Jazz CPA rates, and to costs associated with Air Canada's new services operated by Sky Regional between Billy Bishop Toronto City Airport and Montreal Trudeau Airport. Partly offsetting these increases was the favourable impact of foreign exchange on U.S. currency denominated Jazz CPA charges paid by Air Canada, which accounted for a decrease of $5 million to third quarter 2011 capacity purchase costs. In addition, in the third quarter of 2010, Air Canada recorded a charge of $7 million related to Jazz covered aircraft returns while no such charge was recorded in the third quarter of 2011.

Ownership costs decreased 3% from the third quarter of 2010

Ownership costs, which are comprised of depreciation, amortization and impairment, and aircraft rent expenses, of $265 million in the third quarter of 2011 declined $9 million or 3% from the third quarter of 2010. This decrease was mainly due to the favourable impact of a stronger Canadian dollar versus the U.S. dollar on aircraft rent expense, which accounted for a decrease of $6 million, and the impact of lower rates associated with leased Airbus A320 aircraft.

Aircraft maintenance expense decreased 5% from the third quarter of 2010

In the third quarter of 2011, aircraft maintenance expense of $149 million decreased $8 million or 5% from the third quarter of 2010. This reduction was mainly due to the favourable impact of a stronger Canadian dollar on U.S. currency denominated maintenance expenses (mainly engine and component maintenance).

Sales and distribution costs increased 2% from the third quarter of 2010

In the third quarter of 2011, sales and distribution costs of $154 million increased $3 million or 2% from the third quarter of 2010 on passenger revenue growth of 7.9%. Sales and distribution costs are comprised of commissions and incentives paid to passenger and cargo distributors, credit card and GDS transaction fees, as well as sales and distribution costs related to Air Canada Vacations. Factors contributing to the year-over-year change in third quarter sales and distribution costs included:

- The passenger revenue growth of 7.9%;
- An increase in credit card fees was due to higher passenger sales and an increase in the percentage of sales made on credit cards; and
- An increase in sales and distribution costs at Air Canada Vacations was largely due to a change in Air Canada Vacations' commission structure and higher passenger sales.

Food, beverages and supplies expense increased 8% from the third quarter of 2010

In the third quarter of 2011, food, beverages and supplies expense of $82 million increased $6 million or 8% from the third quarter of 2010. This increase was due to growth in passenger traffic, including in the premium class cabin, as well as the impact of certain rate adjustments pursuant to the terms of certain contracts. Partly offsetting these increases was the impact of CTP initiatives, most of which are related to contract and process improvements.

Other operating expenses increased 2% from the third quarter of 2010

Other operating expenses amounted to $287 million in the third quarter of 2011, an increase of $5 million or 2% from the third quarter of 2010.

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

	Third Quarter		Change	
(Canadian dollars in millions)	**2011**	**2010**	**$**	**%**
Terminal handling	$ 54	$ 51	$ 3	6
Air Canada Vacations' land costs	46	38	8	21
Building rent and maintenance	34	30	4	13
Crew cycle	28	32	(4)	(13)
Miscellaneous fees and services	26	27	(1)	(4)
Remaining other expenses	99	104	(5)	(5)
	$ 287	**$ 282**	**$ 5**	**2**

Factors contributing to the year-over-year change in third quarter Other expenses included:

- The 2.6% growth in capacity;
- An increase of $8 million or 6% in expenses related to ground packages at Air Canada Vacations was due to an increase in passenger volumes and a higher cost of ground packages;
- An increase of $3 million or 21% in terminal handling expenses was largely due to costs associated with Air Canada's new service between Billy Bishop Toronto City Airport and Montreal Trudeau Airport and by a 1.8% increase in system frequencies, and
- The favourable impact of CTP initiatives.

Non-operating expense amounted to $394 million in the third quarter of 2011 compared to non-operating income of $11 million in the third quarter of 2010.

The following table provides a breakdown of non-operating expenses for the periods indicated:

	Third Quarter		Change
(Canadian dollars in millions)	**2011**	**2010**	**$**
Foreign exchange gain (loss)	$ (281)	$ 115	$ (396)
Interest income	8	4	4
Interest expense	(81)	(90)	9
Net financing expense relating to employee benefit liabilities	(4)	(19)	15
Gain (loss) on financial instruments recorded at fair value	(33)	5	(38)
Other	(3)	(4)	1
	$ (394)	**$ 11**	**$ (405)**

Factors contributing to the year-over-year change in third quarter non-operating income (expense) included:

- Losses on foreign exchange (mainly related to U.S. currency denominated long-term debt) amounted to $281 million in the third quarter of 2011 compared to gains of $115 million in the third quarter of 2010. The losses in the third quarter of 2011 were mainly attributable to a weaker Canadian dollar at September 30, 2011 when compared to June 30, 2011. The September 30, 2011 closing exchange rate was US$1 = C$1.0482 while the June 30, 2011 closing exchange rate was US$1 = C$0.9645.

- An increase in interest income of $4 million was mainly due to higher rates of interest.

- A decrease in interest expense of $9 million was largely due to the impact of a stronger Canadian dollar on U.S. currency denominated interest expense when compared to the third quarter of 2010.

- A decrease in net financing expense relating to employee benefit liabilities of $15 million was due to a decline in the discount rate used to measure the expense.

- Losses related to fair value adjustments on derivative instruments amounted to $33 million in the third quarter of 2011 versus gains of $5 million in the third quarter of 2010. Refer to section 9 of this MD&A for additional information on Air Canada's derivative instruments.

5. Results of Operations – First Nine Months of 2011 versus First Nine Months 2010

The following table and discussion compares the results of Air Canada for the first nine months of 2011 versus the first nine months of 2010.

	First Nine Months		Change	
(Canadian dollars in millions, except per share figures)	**2011**	**2010**	**$**	**%**
Operating revenues				
Passenger	$ 7,834	$ 7,131	$ 703	10
Cargo	356	342	14	4
Other	723	697	26	4
	8,913	**8,170**	**743**	**9**
Operating expenses				
Aircraft fuel	2,567	2,012	555	28
Wages, salaries, and benefits	1,490	1,426	64	4
Airport and navigation fees	770	732	38	5
Capacity purchase agreements	752	730	22	3
Depreciation, amortization and impairment	554	574	(20)	(3)
Aircraft maintenance	469	490	(21)	(4)
Sales and distribution costs	472	435	37	9
Food, beverages and supplies	225	225	-	-
Communications and information technology	145	145	-	-
Aircraft rent	249	267	(18)	(7)
Other	943	917	26	3
	8,636	**7,953**	**683**	**9**
Operating income	**277**	**217**	**60**	
Non-operating income (expense)				
Foreign exchange gain (loss)	(168)	48	(216)	
Interest income	26	10	16	
Interest expense	(244)	(311)	67	
Net financing expense relating to employee benefit liabilities	(12)	(57)	45	
Loss on financial instruments recorded at fair value	(58)	(11)	(47)	
Other	(11)	(10)	(1)	
	(467)	(331)	(136)	
Loss before income taxes	**(190)**	**(114)**	**(76)**	
Recovery of income taxes	1	1	-	
Net loss for the period	**$ (189)**	**$ (113)**	**$ (76)**	
EBITDAR [(1)]	**$ 1,080**	**$ 1,058**	**$ 22**	
Net loss per share - Diluted	**$ (0.70)**	**$ (0.43)**	**$ (0.27)**	

(1) See section 16 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income (loss).

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System passenger revenues increased 9.9% from the first nine months of 2010

Compared to the first nine months of 2010, system passenger revenues increased $703 million or 9.9% to $7,834 million in the first nine months of 2011 due to traffic and yield growth.

The table below provides passenger revenue by geographic region for the first nine months of 2011 and the first nine months of 2010.

Passenger Revenue	First Nine Months 2011 $ Million	First Nine Months 2010 $ Million	$ Change	% Change
Canada	3,034	2,840	194	6.8
U.S. transborder	1,564	1,349	215	15.9
Atlantic	1,633	1,518	115	7.6
Pacific	898	826	72	8.8
Other	705	598	107	17.8
System	**7,834**	**7,131**	**703**	**9.9**

The table below provides year-over-year percentage changes in passenger revenues and other operating statistics for the first nine months of 2011 versus the third quarter of 2010.

First Nine Months 2011 Versus First Nine Months 2010	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	6.8	(0.2)	0.5	0.6	6.2	6.9
U.S. transborder	15.9	7.8	11.2	2.4	4.1	7.3
Atlantic	7.6	7.0	4.4	(2.0)	2.8	0.4
Pacific	8.8	9.2	7.0	(1.9)	1.6	(0.5)
Other	17.8	7.9	8.1	0.1	9.0	9.2
System	**9.9**	**5.3**	**5.1**	**(0.2)**	**4.4**	**4.2**

Air Canada increased its overall capacity by 5.3% in the first nine months of 2011. Consistent with a key Air Canada strategy of expanding international operations, international capacity (including the U.S. transborder market) increased 7.9% from the first nine months of 2010. Components of the year-over-year change in first nine months system passenger revenues included:

- The system traffic increase was slightly below the capacity growth, resulting in a slightly lower passenger load factor.
- The system yield increase was mainly due to increased fares and fuel surcharges to partly offset higher fuel prices. Gains in premium cabin traffic also contributed to the yield improvement.
- The yield improvement was achieved in spite of a $61 million unfavourable impact of a stronger Canadian dollar on foreign currency denominated passenger revenues.
- The system RASM increase was due to the yield improvement.

Refer to section 4 of this MD&A for year-over-year percentage changes in passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the third quarter 2011 and each of the previous four quarters.

Cargo revenues increased 4.1% from the first nine months of 2010

In the first nine months of 2011, cargo revenues amounted to $356 million, a $14 million or 4.1% increase from the first nine months of 2010 due to a yield improvement.

The table below provides cargo revenue by geographic region for the first nine months of 2011 and the first nine months of 2010.

Cargo Revenue	First Nine Months 2011 $ Million	First Nine Months 2010 $ Million	$ Change	% Change
Canada	50	52	(2)	(5.0)
U.S. transborder	12	12	-	1.3
Atlantic	147	119	28	23.3
Pacific	106	122	(16)	(12.9)
Other	41	37	4	11.7
System	**356**	**342**	**14**	**4.1**

The table below provides year-over-year percentage changes in cargo revenues and operating statistics for the first nine months of 2011 versus the first nine months of 2010.

First Nine Months 2011 Versus First Nine Months 2010	Cargo Revenue % Change	Capacity (ETMs) % Change	Rev / ETM % Change	Traffic (RTMs) % Change	Yield / RTM % Change
Canada	(5.0)	(10.0)	5.6	(13.2)	8.2
U.S. transborder	1.3	16.1	(12.8)	2.5	(1.2)
Atlantic	23.3	6.8	15.4	5.2	17.2
Pacific	(12.9)	9.0	(20.1)	(9.3)	(3.9)
Other	11.7	3.0	8.5	1.3	10.3
System	**4.1**	**5.2**	**(1.1)**	**(2.1)**	**6.2**

Components of the year-over-year change in cargo revenues in the first nine months included:

- The growth in cargo yield was due to increased fuel surcharges year-over-year. Partially offsetting this increase was the unfavourable impact of a stronger Canadian dollar on foreign currency denominated revenues (mainly U.S. dollars), which reduced cargo revenues by $4 million in the first nine months of 2011.

- Cargo traffic increased in all markets with the exception of the domestic and the Pacific. The decline in domestic traffic was largely due to the capacity reduction in that market while the decline in traffic in the Pacific was largely due to the earthquake in Japan and its aftermath.

Other revenues increased 4% from the first nine months of 2010

Other revenues of $723 million in the first nine months of 2011 increased $26 million or 4% from the first nine months of 2010. The growth in other revenues was due to a $27 million increase in third party ground package revenues at Air Canada Vacations, which was mainly due to higher passenger volumes, and by an increase in cancellation and change fees year-over-year. Partly offsetting these increases were a decrease in aircraft sublease revenues due to fewer aircraft being subleased to third parties compared to the first nine months of 2010, and the unfavourable impact of a stronger Canadian dollar on U.S. currency denominated aircraft lease and sublease revenues.

CASM increased 3.1% from the first nine months of 2010. Excluding fuel expense, CASM decreased 3.0% from the first nine months of 2010

CASM increased 3.1% from the first nine months of 2010. Excluding fuel expense, CASM decreased 3.0% from the first nine months of 2010. Factors contributing to the year-over-year change in CASM, excluding fuel expense, in the first nine months included:

- The favourable impact of a stronger Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) reduced operating expenses by $67 million;
- The 5.3% capacity growth resulted in the airline's fixed costs being allocated over a greater number of ASMs;
- The impact of CTP initiatives; and
- An increase of 3.6% in aircraft utilization and an increase of 3.3% in average stage length.

The following table compares Air Canada's operating expenses per ASM for the first nine months of 2011 to Air Canada's operating expenses per ASM for the corresponding period in 2010.

	First Nine Months		Change	
(cents per ASM)	**2011**	**2010**	**cents**	**%**
Wages and salaries	2.23	2.30	(0.07)	(3.0)
Benefits	0.68	0.63	0.05	7.9
Airport user fees	1.50	1.51	(0.01)	(0.7)
Capacity purchase agreements	1.47	1.50	(0.03)	(2.0)
Ownership (DAR) [(1)]	1.57	1.73	(0.16)	(9.2)
Aircraft maintenance	0.92	1.01	(0.09)	(8.9)
Sales and distribution costs	0.92	0.89	0.03	3.4
Food, beverages and supplies	0.44	0.46	(0.02)	(4.3)
Communications and information technology	0.28	0.30	(0.02)	(6.7)
Other	1.85	1.90	(0.05)	(2.6)
Operating expense, excluding fuel expense [(2)]	**11.86**	**12.23**	**(0.37)**	**(3.0)**
Aircraft fuel	5.02	4.14	0.88	21.3
Total operating expense	**16.88**	**16.37**	**0.51**	**3.1**

(1) DAR refers to the combination of depreciation, amortization and impairment, and aircraft rent expenses.

(2) Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Operating expenses increased 9% from the first nine months of 2010

Air Canada recorded operating expenses of $8,636 million, an increase of $683 million or 9% from the operating expenses of $7,953 million recorded in the first nine months of 2010. The more significant variances are discussed below.

Fuel expense increased 28% from the first nine months of 2010

Fuel expense amounted to $2,567 million in the first nine months of 2011, an increase of $555 million or 28% from the first nine months of 2010. Factors contributing to the year-over-year change in fuel expense included:

- A higher base fuel price accounted for an increase of $773 million.
- A higher volume of fuel consumed, driven by the additional capacity year-over-year, accounted for an increase of $91 million.

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

- Fuel hedging losses reclassified from AOCL of $152 million in the first nine months of 2010 versus no fuel hedging losses recorded in fuel expense in the first nine months of 2011, resulting in a favourable variance of $152 million year-over-year.

- The favourable impact of a stronger Canadian dollar versus the U.S. dollar accounted for a decrease of $157 million.

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

		First nine months		Change	
(Canadian dollars in millions, except where indicated)		**2011**	**2010**	**$**	**%**
Aircraft fuel expense - GAAP [1]		$ 2,548	$ 2,002	$ 546	27
Remove:	*Fuel hedging losses reclassified from AOCL into fuel expense*	-	(152)	152	100
Add:	*Net cash payments (receipts) on fuel derivatives* [2]	(3)	48	(51)	(106)
Economic cost of fuel - Non-GAAP [3]		**$ 2,545**	**$ 1,898**	**$ 647**	**34**
Fuel consumption (thousands of litres)		3,024,679	2,885,391	139,288	5
Fuel costs per litre (cents) – GAAP		84.2	69.4	14.8	21
Fuel costs per litre (cents) - excluding fuel hedging losses		84.2	64.1	20.1	31
Economic fuel costs per litre (cents) - Non-GAAP		84.1	65.8	18.3	28

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

(2) Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives. Excludes early terminated hedging contracts of $5 million in the second quarter of 2010 covering 2010 consumption.

(3) The economic cost of fuel is a non-GAAP measure used by Air Canada and may not be comparable to measures presented by other public companies. Air Canada uses this measure to calculate its cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period and premium costs associated with those derivatives. It excludes non-cash accounting gains and losses from fuel derivative instruments.

Wages, salaries and benefits expense amounted to $1,490 million in the first nine months of 2011, an increase of $64 million or 4% from the first nine months of 2010

Wages and salaries expense amounted to $1,141 million in the first nine months of 2011, an increase of $21 million or 2% from the first nine months of 2010 mainly due to higher average salaries and a year-over-year increase in the average number of FTE employees. On capacity growth of 5.3%, the average number of FTE employees, increased 2.3% year-over-year, resulting in a productivity improvement of 3.4%, as measured by ASMs per FTE employee. Partly offsetting these increases was a decrease in expenses related to incentive compensation programs, including those linked to Air Canada's operational performance.

Employee benefits expense amounted to $349 million in the first nine months of 2011, an increase of $43 million or 14% from the first nine months of 2010. The increase in employee benefits expense was mainly due to higher pension and post-employment expenses resulting from changes in actuarial assumptions year-over-year.

Airport and navigation fees increased 5% from the first nine months of 2010

Airport and navigation fees amounted to $770 million in the first nine months of 2011, an increase of $38 million or 5% from the first nine months of 2010. This increase was mainly due to a 2.9% increase in aircraft departures, the impact of changes in schedule and aircraft types operated to certain destinations and, to a lesser extent, an increase in terminal user fees, effective April 1, 2011, at London Heathrow Airport. Costs associated with Air Canada's new services operated by Sky Regional between Billy Bishop Toronto City Airport and Montreal Trudeau Airport were also a factor in the increase in airport and navigation fees year-over-year.

Capacity purchase costs increased 3% from the first nine months of 2010

Capacity purchase costs amounted to $752 million in the first nine months of 2011 compared to $730 million in the first nine months of 2010, an increase of $22 million or 3%. This increase was mainly due to increases in Jazz CPA rates, increased flying by Jazz, and to costs associated with Air Canada's new services operated by Sky Regional between Billy Bishop Toronto City Airport and Montreal Trudeau Airport. Partly offsetting these increases was the favourable impact of foreign exchange on U.S. currency denominated Jazz CPA charges paid by Air Canada, which accounted for a decrease of $13 million in capacity purchase costs in the first nine months of 2011. In addition, in the first nine months of 2010, Air Canada recorded a charge of $7 million related to Jazz covered aircraft returns while no such charge was recorded in the first nine months of 2011.

Ownership costs decreased 5% from the first nine months of 2010

Ownership costs, which are comprised of depreciation, amortization and impairment, and aircraft rent expenses, of $803 million in the first nine months of 2011 decreased $38 million or 5% from the same period in 2010. The decrease included the favourable impact of a stronger Canadian dollar versus the U.S. dollar on aircraft rent expense, which accounted for a reduction of $15 million, the impact of lower rates associated with leased Airbus A320 aircraft, as well as decreases in software amortization costs and depreciation expense on rotable inventory. Costs associated with the airline's new services between Billy Bishop Toronto City Airport and Montreal Trudeau Airport partly offset these decreases.

Aircraft maintenance expense decreased 4% from the first nine months of 2010

In the first nine months of 2011, aircraft maintenance expense of $469 million decreased $21 million or 4% from the first nine months of 2010. The reduction in maintenance expense was largely due to a decrease in engine, airframe and components maintenance activity, largely due to timing of maintenance events, the favourable impact of a stronger Canadian dollar on U.S. currency denominated maintenance expenses, and by a decrease in Air Canada's share of maintenance cost obligations on engines leased to third parties. Partially offsetting these decreases were overall price increases and the impact of changes in the flying schedule on Air Canada's power-by-hour maintenance agreements.

Sales and distribution costs increased 9% from the first nine months of 2010

In the first nine months of 2011, sales and distribution costs of $472 million increased $37 million or 9% from the first nine months of 2010 on passenger revenue growth of 9.9%. Factors contributing to the year-over-year change in sales and distribution costs in the first nine months included:

- The passenger revenue growth of 9.9%;
- An increase in credit card fees was due to higher passenger sales and an increase in the percentage of sales made on credit cards;
- A growth in GDS fees was mainly the result of a higher volume of transactions and rate increases; and
- An increase in sales and distribution costs at Air Canada Vacations was largely due to a change in commission structure and higher passenger sales.

Food, beverages and supplies expense was unchanged from the first nine months of 2010

In the first nine months of 2011, food, beverages and supplies expense of $225 million was unchanged from the first nine months of 2010. The impact of growth in passenger traffic, including in the premium class cabin, was offset by the favourable impact of cost reduction initiatives, most of which are related to contract and process improvements.

Other operating expenses increased 3% from the first nine months of 2010

Other operating expenses amounted to $943 million in the first nine months of 2011, an increase of $26 million or 3% from the first nine months of 2010.

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

(Canadian dollars in millions)	First Nine Months 2011	First Nine Months 2010	Change $	Change %
Air Canada Vacations' land costs	$ 250	$ 223	$ 27	12
Terminal handling	150	141	9	6
Building rent and maintenance	98	95	3	3
Crew cycle	85	89	(4)	(4)
Miscellaneous fees and services	76	77	(1)	(1)
Remaining other expenses	284	292	(8)	(3)
	$ 943	**$ 917**	**$ 26**	**3**

Factors contributing to the year-over-year change in Other expenses in the first nine months included:

- The 5.3% growth in capacity;
- An increase of $27 million or 12% in expenses related to ground packages at Air Canada Vacations was due to increased passenger volumes and, to a lesser extent, a higher cost of ground packages;
- An increase of $9 million or 6% in terminal handling expenses was largely due to a 2.9% increase in system frequencies and, to a lesser extent, to costs associated with Air Canada's new service between Billy Bishop Toronto City Airport and Montreal Trudeau Airport; and
- The favourable impact of CTP initiatives.

Non-operating expense amounted to $467 million in the first nine months of 2011 compared to non-operating expense of $331 million in the first nine months of 2010.

The following table provides a breakdown of non-operating expenses for the periods indicated:

(Canadian dollars in millions)	First Nine Months 2011	First Nine Months 2010	Change $
Foreign exchange gain (loss)	$ (168)	$ 48	$ (216)
Interest income	26	10	16
Interest expense	(244)	(311)	67
Net financing expense relating to employee benefit liabilities	(12)	(57)	45
Loss on financial instruments recorded at fair value	(58)	(11)	(47)
Other	(11)	(10)	(1)
	$ (467)	**$ (331)**	**$ (136)**

Factors contributing to the year-over-year increase in non-operating expense in the first nine months included:

- Losses on foreign exchange (mainly related to U.S. currency denominated long-term debt) amounted to $168 million in the first nine months of 2011 compared to gains of $48 million in the first nine months of 2010. The losses in 2011 were mainly attributable to a weaker Canadian dollar at September 30, 2011 compared to December 31, 2010. The September 30, 2011 closing exchange rate was US$1 = C$1.0482 while the December 31, 2010 closing exchange rate was US$1 = C$0.9946.
- An increase in interest income of $16 million was due to higher rates of interest and, to a lesser extent, higher cash balances.

- A decrease in interest expense of $67 million was mainly due to Air Canada having recorded a charge of $54 million related to its secured term credit facility in the first nine months of 2010, while no such charge was recorded in the first nine months of 2011. The impact of a stronger Canadian dollar on U.S. currency denominated interest expense in the first nine months of 2011 was also a factor in the decrease in interest expense.

- A decrease in net financing expense relating to employee benefit liabilities of $45 million was due to a decline in the discount rate used to measure the expense.

- Losses related to fair value adjustments on derivative instruments amounted to $58 million in the first nine months of 2011 versus losses of $11 million in the first nine months of 2010. Refer to section 9 of this MD&A for additional information on Air Canada's derivative instruments.

6. Fleet

The following table provides the number of aircraft in Air Canada's operating fleet as at September 30, 2011, as well as planned changes to its operating fleet (excluding aircraft operated by Jazz under the Jazz CPA and other airlines operating flights on behalf of Air Canada under commercial agreements with Air Canada).

	Actual (As at September 30, 2011)			Planned (As at September 30, 2011)			
	December 31, 2010	First Nine Months Fleet Changes	September 30, 2011	Remainder of 2011 Fleet Changes	December 31, 2011	2012 Fleet Changes	December 31, 2012
Boeing 777-300	**12**	-	**12**	-	**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	**38**	-	**38**	-	**38**	-	**38**
EMBRAER 190	**45**	-	**45**	-	**45**	**-**	**45**
EMBRAER 175	**15**	-	**15**	-	**15**	**-**	**15**
Total	**205**	-	**205**	-	**205**	-	**205**
Average age (years)	**10.7**		**11.4**		**11.6**		**12.6**

On May 1, 2011, Sky Regional, on behalf of Air Canada and pursuant to a capacity purchase agreement between the parties, commenced service between Toronto Island's Billy Bishop Airport and Montreal's Trudeau Airport.

The following table provides, as at September 30, 2011, the number of aircraft operated by Jazz under the Jazz CPA and other airlines operating flights under the Air Canada Express banner on behalf of Air Canada pursuant to commercial agreements with Air Canada.

	As at September 30, 2011			
	Jazz	Sky Regional	Other	Total
CRJ-100	20	-	-	20
CRJ-200	25	-	-	25
CRJ-705	16	-	-	16
Dash 8-100	34	-	-	34
Dash 8-300	26	-	-	26
Dash 8-400	4	5	-	9
Beech 1900	-	-	18	18
Total	**125**	**5**	**18**	**148**

7. Financial and Capital Management

In its 2010 MD&A, Air Canada reported that it had accepted a proposal from a new service provider for the provision of its principal credit card processing services requirements in North America for Visa and MasterCard. The agreement between Air Canada and that credit card processor was subject to certain conditions, including the conclusion of final documentation. In the third quarter of 2011, Air Canada decided to cease negotiating with that credit card processor and entered into agreements to extend, until May 2012, its North American Visa and MasterCard processing agreements with its incumbent credit card processor. Air Canada continues to negotiate a longer-term arrangement.

7.1 Financial Position

The following table provides a condensed statement of financial position of Air Canada as at September 30, 2011 and as at December 31, 2010.

(Canadian dollars in millions)	September 30, 2011	December 31, 2010	Change $
Assets			
Cash, cash equivalents and short-term investments	$ 2,179	$ 2,192	$ (13)
Other current assets	1,238	1,155	83
Current assets	3,417	3,347	70
Property and equipment	5,230	5,629	(399)
Intangible assets	308	317	(9)
Goodwill	311	311	-
Deposits and other assets	596	549	47
Total assets	**$ 9,862**	**$ 10,153**	**$ (291)**
Liabilities			
Current liabilities	$ 3,119	$ 3,124	$ (5)
Long-term debt and finance leases	4,050	4,028	22
Pension and other benefit liabilities	3,848	3,328	520
Maintenance provisions	565	493	72
Other long-term liabilities	451	468	(17)
Total liabilities	**12,033**	**11,441**	**592**
Total equity	**(2,171)**	**(1,288)**	**(883)**
Total liabilities and equity	**$ 9,862**	**$ 10,153**	**$ (291)**

Movements in current assets and liabilities are described in section 7.3 of this MD&A. Long-term debt and finance leases are discussed in section 7.2 of this MD&A.

Property and equipment amounted to $5,230 million at September 30, 2011, a reduction of $399 million from December 31, 2010. The reduction was mainly due to the impact of depreciation expense of $525 million in the first nine months of 2011, partly offset by additions to property and equipment, consisting largely of capitalized aircraft maintenance events.

7.2 Adjusted Net Debt

The following table reflects Air Canada's adjusted net debt balances as at September 30, 2011 and as at December 31, 2010.

(Canadian dollars in millions)	September 30, 2011	December 31, 2010	Change $
Total long-term debt and finance leases	$ 4,050	$ 4,028	$ 22
Current portion of long-term debt and finance leases	429	567	(138)
Total long-term debt and finance leases, including current portion	4,479	4,595	(116)
Less cash, cash equivalents and short-term investments	(2,179)	(2,192)	13
Net debt	**$ 2,300**	**$ 2,403**	**$ (103)**
Capitalized operating leases [(1)]	2,345	2,471	(126)
Adjusted net debt	**$ 4,645**	**$ 4,874**	**$ (229)**

(1) Adjusted net debt is a non-GAAP measure used by Air Canada and may not be comparable to measures presented by other public companies. Air Canada 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 7.0. This definition of capitalized operating leases is used by Air Canada and may not be comparable to similar measures presented by other public companies. Aircraft rent was $335 million for the twelve months ended September 30, 2011 and $353 million for the twelve months ended December 31, 2010.

Total debt and finance leases, including current portion, amounted to $4,479 million at September 30, 2011, a decrease of $116 million from December 31, 2010. The reduction in long-term debt and finance leases from December 31, 2010 was mainly due to repayments of $484 million, including balloon maturities totaling $221 million, as further described under section 7.4 of this MD&A. This decrease was partly offset by the unfavourable impact of a weaker Canadian dollar at September 30, 2011 compared to December 31, 2010 on Air Canada's foreign currency denominated debt (mainly U.S. dollars), which accounted for an increase of $213 million, and by proceeds from borrowings of $125 million.

At September 30, 2011, adjusted net debt decreased $229 million from December 31, 2010. Positive free cash flow of $435 million recorded in the first nine months of 2011, which was derived largely from increases in advance ticket sales and operating earnings, was largely used to fund debt repayments in excess of the GE Japan refinancing proceeds, as described under section 7.4 of this MD&A.

7.3 Working Capital

The following table provides information on Air Canada's working capital balances at September 30, 2011 and at December 31, 2010.

(Canadian dollars in millions)	September 30, 2011	December 31, 2010	Change $
Cash and short-term investments	$ 2,179	$ 2,192	$ (13)
Accounts receivable	760	641	119
Other current assets	478	514	(36)
Accounts payable and accrued liabilities	(1,161)	(1,182)	21
Advance ticket sales	(1,529)	(1,375)	(154)
Current portion of long-term debt and finance leases	(429)	(567)	138
Net working capital	**$ 298**	**$ 223**	**$ 75**

The net positive working capital of $298 million at September 30, 2011 represented an improvement of $75 million from December 31, 2010. Positive net cash from operating activities of $614 million was partially offset by cash flows required to retire certain balloon maturities on debt, as described in section 7.4 of this MD&A, the impact of capital expenditures of $164 million, and the excess of employee benefit funding over expense of $96 million in the first nine months of 2011.

7.4 Consolidated Cash Flow Movements

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

	Third Quarter			First Nine Months		
(Canadian dollars in millions)	**2011**	**2010**	**Change $**	**2011**	**2010**	**Change $**
Net cash from operating activities, before the under noted items	$ 416	$ 469	$ (53)	$ 614	$ 655	$ (41)
Net cash from (used for) fuel hedge settlements, premiums and collateral deposits	(1)	(5)	4	8	(21)	29
Excess of employee benefit funding over expense	(38)	(21)	(17)	(96)	(15)	(81)
Change in maintenance provisions	10	11	(1)	42	42	-
Changes in non-cash working capital balances	(323)	(303)	(20)	31	114	(83)
Cash flows from operating activities	64	151	(87)	599	775	(176)
Additions to property, equipment and intangible assets	(60)	(39)	(21)	(164)	(151)	(13)
Free cash flow [(1)]	**4**	**112**	**(108)**	**435**	**624**	**(189)**
Proceeds from sale and leaseback transactions	-	-	-	-	20	(20)
Reduction to Aveos letter of credit	-	-	-	-	23	(23)
Short-term investments	86	48	38	(103)	(370)	267
Other	(11)	(21)	10	(37)	(6)	(31)
Cash flows from (used for) investing activities (excluding additions to property, equipment and intangible assets)	**75**	**27**	**48**	**(140)**	**(333)**	**193**
Proceeds from borrowings	-	1,075	(1,075)	125	1,175	(1,050)
Reduction of long-term debt and finance lease obligations	(73)	(799)	726	(484)	(1,059)	575
Distributions related to aircraft special purpose leasing entities	-	(9)	9	(52)	(11)	(41)
Cash flows from (used for) financing activities	**(73)**	**267**	**(340)**	**(411)**	**105**	**(516)**
Net increase (decrease) in cash and cash equivalents	6	406	(400)	(116)	396	(512)
Net increase (decrease) in short-term investments	(86)	(48)	(38)	103	370	(267)
Net increase (decrease) in cash, cash equivalents and short-term investments	**$ (80)**	**$ 358**	**$ (438)**	**$ (13)**	**$ 766**	**$ (779)**

(1) Free cash flow is a non-GAAP measure used by Air Canada and may not 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, including repaying debt, meeting ongoing financial obligations and reinvesting in Air Canada.

Free cash flow amounted to $4 million in the third quarter of 2011 compared to free cash flow of $112 million in the third quarter of 2010, a year-over-year decrease of $108 million. This decrease in free cash flow from the third quarter of 2010 was largely due to a decline in net cash from operations, consistent with the decline in third quarter EBITDAR, the impact of higher pension payments, and an increase in capital expenditures of $21 million.

When compared to the first nine months of 2010, free cash flow of $435 million declined $189 million. This decrease in free cash flow from September 30, 2010 was largely due to a decline in net cash from operations, unfavourable changes in non-cash working capital balances and an increase in pension funding due to the funding obligation related to past service costs. As described in section 9.8 of Air Canada's 2010 MD&A dated February 10, 2011, starting on January 1, 2011, Air Canada resumed making past service contributions to its domestic registered plans pursuant to the terms of the Air Canada 2009 Pension Regulations, whereas no such contributions were required or made in 2010.

In the third quarter of 2011, long-term debt and finance lease obligations increased $266 million. The increase in long-term debt and finance lease obligations was caused by foreign exchange losses of $331 million, partly offset by scheduled debt repayments of $73 million. In the first nine months of 2011, a reduction of long-term debt and finance lease obligations of $116 million included scheduled end of lease balloon payments of $221 million.

Air Canada received net financing proceeds of $125 million (U.S. $128 million) in the first nine months of 2011 through draws on a secured term loan facility (the "Facility") with GE Japan Corporation, PK Air Finance Japan ("GE Japan") to refinance special purpose aircraft leasing entities' debt. The draws on the Facility were utilized to refinance amounts related to eight Airbus A319 aircraft and four Boeing 767-300ER aircraft, operated by Air Canada and previously leased from special purpose leasing entities, with refinanced terms of seven and four years, respectively. The Facility will also be available in 2012 to refinance up to US$42 million of the amount related to four Airbus A319 aircraft.

In the third quarter of 2011, Air Canada entered into an agreement for the financing of jet fuel purchases, consisting of a Canadian dollar denominated revolving facility in the amount of $50 million and a U.S. dollar denominated revolving facility in the amount of $100 million. Amounts charged under the revolving facilities are repayable on a monthly basis. Interest under the facilities is currently charged at an annual effective interest rate of 8.75%, subject to increase based on increases in U.S. and Canadian LIBOR rates. The agreement expires on January 31, 2015. Financial covenants under the agreement require Air Canada to maintain certain minimum operating results and cash balance tests. Terms of the agreement require that Air Canada maintain at all times unrestricted cash in accounts, subject to securities control agreements (which generally permit the creditor to control the accounts upon the occurrence of certain defined events) equal to $50 million and US$100 million, subject to a phase in period not exceeding three months. The securities in such accounts would become restricted if Air Canada were to default on certain terms of the credit facility. There was no balance outstanding under the facility at September 30, 2011.

7.5 Capital Expenditures and Related Financing Arrangements

Air Canada has outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of 37 Boeing 787 aircraft. Refer to section 9.6 of Air Canada's 2010 MD&A dated February 10, 2011 for additional information.

Air Canada expects that the first seven deliveries of its Boeing 787 aircraft, which were previously scheduled to be delivered in the fourth quarter of 2013 and the first half of 2014, will be delivered during 2014. Boeing has indicated that it continues to evaluate the schedule for deliveries of Air Canada's remaining 30 firm orders for Boeing 787 aircraft, and would provide Air Canada with an update when available. The impact of the delay is that capital expenditures previously forecast to occur in 2013 are now moved to 2014. The resulting impact of this delay on the remaining Boeing 787 capital commitments by year is not yet determinable. However, the aggregate cost of the current commitments for Boeing 787 aircraft is unchanged.

7.6 Contractual Obligations

Information on Air Canada's contractual obligations is described in section 9.7 of Air Canada's 2010 MD&A dated February 10, 2011.

The table below provides updated information on Air Canada's long-term debt and finance lease obligations, including interest and principal repayment obligations as at September 30, 2011. The updates from the information provided in the 2010 MD&A relate mainly to the impact of the changeover to IFRS. Under IFRS, Air Canada consolidates certain aircraft leasing special purpose entities ("SPEs") that were not consolidated under Canadian GAAP. In addition, certain aircraft previously classified as finance leases have been reclassified to SPE debt on a consolidated basis.

(Canadian dollars in millions)	**Remainder of 2011**	**2012**	**2013**	**2014**	**2015**	**Thereafter**	**Total**
Principal							
Long-term debt obligations	$ 89	$ 358	$ 564	$ 261	$ 1,255	$ 1,549	$ 4,076
Finance lease obligations	15	63	68	64	58	204	472
	104	421	632	325	1,313	1,753	4,548
Interest							
Long-term debt obligations	67	254	227	202	150	130	1,030
Finance lease obligations	12	43	36	29	23	84	227
	79	297	263	231	173	214	1,257
Total long-term debt, finance lease and interest repayment obligations[(1)]	**183**	**718**	**895**	**556**	**1,486**	**1,967**	**5,805**
Net impact of GE Japan loan facility	-	(35)	9	9	10	14	7
Total long-term debt, finance lease and interest repayment obligations, including net impact of GE Japan loan facility	**$ 183**	**$ 683**	**$ 904**	**$ 565**	**$ 1,496**	**$ 1,981**	**$ 5,812**

(1) The interest repayment obligations relate to long-term debt, debt consolidated under special purpose entities and finance leases.

7.7 Pension Funding Obligations

Air Canada maintains several pension plans, including defined benefit and defined contribution pension plans and plans providing other retirement and post-employment benefits to its employees. Based on actuarial valuations, the aggregate solvency deficit in the registered pension plans as at January 1, 2011 was $2,166 million whereas the aggregate deficit in the registered pension plans as at January 1, 2010 was $2,728 million. The reduction of $562 million in the aggregate solvency deficit as at January 1, 2011 versus the aggregate solvency deficit as at January 1, 2010 was mainly the result of the positive return on plan assets. The discount rate used to value the benefit obligation was essentially unchanged from the discount rate used for the January 1, 2010 valuations. As described below, the January 1, 2011 valuations will not increase pension past service cost funding obligations projected for 2011 to 2013.

In July 2009, the Government of Canada adopted the Air Canada 2009 Pension Regulations. The Air Canada 2009 Pension Regulations relieved Air Canada from making any past service contributions (i.e. special payments to amortize the plan solvency deficits) to its ten domestic defined benefit registered pension plans 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 2011, 2012, and 2013, respectively, on an accrued basis, and (ii) the maximum past service contribution permitted under the Canadian Income Tax Act.

Pension and Benefits Agreement with Aveos

As described in section 14 of Air Canada's 2010 MD&A dated February 10, 2011, Air Canada and Aveos are parties to a Pension and Benefits Agreement covering the transfer of certain pension and benefit assets and obligations to Aveos. On July 14, 2011 (the "Certification Date"), certain unionized employees of Air Canada elected to become employees of Aveos. Under the terms of the Pension and Benefits Agreement and subject to regulatory approval where required, the assets and obligations under the pension, other post-retirement and post-employment benefits plans pertaining to the transferred unionized employees will be transferred to Aveos.

The terms of the Pension and Benefits Agreement relating to transferred unionized employees provide for the determination of solvency liabilities and pension assets as at July 14, 2011, in respect of unionized employees transferred to Aveos employed in the airframe function and, as at October 16, 2007 in respect of unionized employees transferred to Aveos employed in all other functions. The determination of the accounting liability in respect of other post-retirement and post-employment benefits for all transferred unionized employees is as at July 14, 2011.

Under the terms of the Pension and Benefits Agreement, Air Canada will compensate Aveos for the solvency deficiency in the defined benefit pension plans as of July 14, 2011 for transferring unionized employees performing airframe maintenance services. For other unionized employees transferring to Aveos, the compensation is based on amounts as of October 16, 2007. Air Canada will compensate Aveos for the present value of the accounting liability in respect of other post-retirement and post-employment liabilities as at July 14, 2011. These compensation amounts will be paid by Air Canada through quarterly payments to Aveos over a period not exceeding five years after the transfer. Airframe employees represent approximately half of the approximate 2,200 transferred employees.

Until the Certification Date, the current service pension cost and the current service and interest costs for other employee benefits, in respect of employees assigned to Aveos, were expensed by Air Canada with a full recovery recorded as an amount charged to Aveos. From the Certification Date, transferred employees accrue employee benefits in the Aveos defined benefit plans. Pension and other benefit liabilities as at September 30, 2011 and the "net gain (loss) on employee benefit liabilities" as recorded in "other comprehensive income" on Air Canada's statement of operations for the nine months ended September 30, 2011 reflect an experience gain for the periods including changes in actuarial assumptions resulting from members transferring to Aveos. Air Canada's financial statements do not reflect the determination of the solvency liabilities to be transferred to Aveos, the determination of amount of assets to be transferred to Aveos, and the resulting compensation amount to be paid by Air Canada to Aveos, as these amounts are not yet determined. Based on the January 1, 2011 actuarial valuation, compensation amounts are not expected to be material.

Labour agreement with Canadian Auto Workers

In June 2011, Air Canada reached an agreement with the Canadian Auto Workers union ("CAW") Local 2002 who represent Air Canada's approximately 4,000 airport check-in and gate agents employed by Air Canada. The agreement includes amendments to the defined benefit pension plans of CAW members which are subject to regulatory approval and will be accounted for at the time this approval has been received. Under the terms of the agreement, an arbitration process was established for the resolution of the issue of pension arrangements applicable to employees hired after the date of ratification. The arbitrator ruled that a hybrid pension regime consisting of part defined contribution plan and part defined benefit plan would apply to new hires represented by the CAW.

Refer to section 9.8 of Air Canada's 2010 MD&A dated February 10, 2011 for additional information on Air Canada's pension funding obligations.

7.8 Share Information

The issued and outstanding shares of Air Canada, along with shares potentially issuable, are, as of the dates indicated below, as follows:

	Number of Shares at	
	October 31, 2011	**December 31, 2010**
Issued and outstanding shares		
Class A variable voting shares	46,654,626	64,275,209
Class B voting shares	230,848,363	214,697,175
Total issued and outstanding shares	**277,502,989**	**278,972,384**
Class A variable voting and Class B voting shares potentially issuable		
Warrants	89,430,300	89,430,300
Shares held in trust	1,645,020	-
Stock options	6,690,677	3,287,931
Performance share units	2,500	2,500
Total shares potentially issuable	**97,768,497**	**92,720,731**
Total outstanding and potentially issuable shares	**375,271,486**	**371,693,115**

Stock-based compensation

In the first quarter of 2011, Air Canada's Board of Directors approved a special one-time Employee Recognition Award in the form of Air Canada shares granted to all eligible unionized and certain non-unionized employees worldwide, where permitted. Under the award, eligible employees were granted an aggregate of approximately 3.3 million shares with a grant date fair value of $11 million. Half of these shares vested immediately upon issuance and the other half will vest over three years. Pursuant to the award, Air Canada purchased approximately 3.3 million shares for $11 million, of which half were distributed to the eligible employees and the other half are held in trust over the vesting period. The shares held in trust are excluded from the outstanding shares total and shown separately as potentially issuable shares. Compensation expense for these shares will be recognized over the vesting period.

Shareholder rights plan

In May 2011, following approval by the Board of Directors, the shareholders of Air Canada ratified a shareholder rights plan agreement (the "Plan") designed to foster fair treatment of all shareholders in connection with any take-over bid for Air Canada.

The Plan is scheduled to expire at the close of business on the date immediately following the date of Air Canada's annual meeting of shareholders to be held in 2014, unless terminated earlier in accordance with the terms of the Plan.

8. Quarterly Financial Data

The following tables summarize quarterly financial results and major operating statistics for Air Canada for the last eight quarters. The information for the fourth quarter of 2009 is reported on a Canadian GAAP basis (prior to the adoption of IFRS), while the information for 2010 and 2011 is reported on an IFRS basis. Accordingly, the financial information for the fourth quarter of 2009 is not directly comparable to subsequent periods.

(Canadian dollars in millions)	**Q4 2009**	**Q1 2010**	**Q2 2010**	**Q3 2010**	**Q4 2010**	**Q1 2011**	**Q2 2011**	**Q3 2011**
	CGAAP	**IFRS**	**IFRS**	**IFRS**	**IFRS**	**IFRS**	**IFRS**	**IFRS**
Operating revenues	**$ 2,348**	**$ 2,519**	**$ 2,625**	**$ 3,026**	**$ 2,616**	**$ 2,753**	**$ 2,918**	**$ 3,242**
Aircraft fuel	601	619	660	733	640	742	882	943
Ownership (DAR) [1]	250	286	281	274	313	273	265	265
Other operating expenses	1,580	1,750	1,637	1,713	1,648	1,804	1,698	1,764
Operating expenses	**2,431**	**2,655**	**2,578**	**2,720**	**2,601**	**2,819**	**2,845**	**2,972**
Operating income (loss) before the undernoted item	**(83)**	**(136)**	**47**	**306**	**15**	**(66)**	**73**	**270**
Provision adjustment for cargo investigations, net [2]	-	-	-	-	46	-	-	-
Operating income (loss)	**(83)**	**(136)**	**47**	**306**	**61**	**(66)**	**73**	**270**
Total non-operating income (expense)	**25**	**23**	**(365)**	**11**	**28**	**47**	**(120)**	**(394)**
Non-controlling interest	(4)	-	-	-	-	-	-	-
Recovery of income taxes	6	1	-	-	-	-	1	-
Net income (loss)	**$ (56)**	**$ (112)**	**$ (318)**	**$ 317**	**$ 89**	**$ (19)**	**$ (46)**	**$ (124)**

(1) DAR refers to the combination of depreciation, amortization and impairment, and aircraft rent expense.
(2) In the first quarter of 2008, Air Canada recorded a provision for cargo investigations of $125 million. In the fourth quarter of 2010, Air Canada recorded a net reduction of $46 million to this provision.

(Canadian dollars in millions)	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011
	CGAAP	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
Revenue passenger miles (millions)	10,885	11,692	12,896	15,531	11,756	12,355	13,677	16,126
Available seat miles (millions)	13,841	14,727	15,523	18,328	14,918	15,859	16,512	18,799
Passenger load factor (%)	78.6	79.4	83.1	84.7	78.8	77.9	82.8	85.8
RASM (cents) (1)	14.6	14.2	14.8	14.8	15.1	14.5	15.6	15.5
CASM (cents)	17.6	18.0	16.6	14.8	17.4	17.8	17.2	15.8
CASM, excluding fuel expense (cents)	13.2	13.8	12.3	10.8	13.2	13.1	11.9	10.8
Economic fuel price per litre (cents) (2)	63.7	66.2	66.8	64.6	67.5	78.2	87.9	85.1
EBITDAR before the provision adjustment for cargo investigations, net (3)	**$ 167**	**$ 150**	**$ 328**	**$ 580**	**$ 328**	**$ 207**	**$ 338**	**$ 535**
EBITDAR	**$ 167**	**$ 150**	**$ 328**	**$ 580**	**$ 374**	**$ 207**	**$ 338**	**$ 535**
Earnings (loss) per share								
- Basic	**$ (0.25)**	**$ (0.41)**	**$ (1.14)**	**$ 1.13**	**$ 0.31**	**$ (0.07)**	**$ (0.17)**	**$ (0.45)**
- Diluted	**$ (0.25)**	**$ (0.41)**	**$ (1.14)**	**$ 1.10**	**$ 0.27**	**$ (0.07)**	**$ (0.17)**	**$ (0.45)**

(1) System RASM excludes the impact of a $40 million favourable adjustment recorded in the fourth quarter of 2010.
(2) Includes fuel handling and is net of fuel hedging results.
(3) See section 16 "Non-GAAP Financial Measures" in this MD&A for additional information.

9. Financial Instruments and Risk Management

Summary of "gain (loss) on financial instruments recorded at fair value"

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

	Third Quarter		First Nine Months	
(Canadian dollars in millions)	**2011**	**2010**	**2011**	**2010**
Fuel derivatives	$ (18)	$ (1)	$ (27)	$ (22)
Interest rate swaps	(11)	3	(21)	10
Share forward contracts	(4)	3	(7)	3
Other	-	-	(3)	(2)
Gain (loss) on financial instruments recorded at fair value	**$ (33)**	**$ 5**	**$ (58)**	**$ (11)**

Risk Management

Under its risk management policy, Air Canada manages its interest rate risk, foreign exchange risk, share-based compensation risk and market risk through the use of various interest rate, foreign currency, fuel and other derivative financial instruments.

Interest rate risk management

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Commencing in the second quarter of 2011, certain payments based upon aircraft rental amounts are based on medium-term U.S. interest rates at the time of delivery. To hedge against the exposure to increases in interest rates until the expected delivery date, in the first quarter of 2011, Air Canada entered into forward starting interest rate swaps with an aggregate notional value of US$234 million. The swaps have contractual terms of maturity that coincide with the term of the rental agreements. However, the derivatives will be settled on each expected delivery date of the aircraft with maturities to July 2012. The aggregate notional value outstanding at September 30, 2011 was US$156 million. The fair value of these contracts as at September 30, 2011 was $17 million in favour of the counterparties, with the loss recorded in "gain (loss) on financial instruments recorded at fair value" on Air Canada's consolidated statement of operations.

Fuel price risk management

Fuel price risk is the risk that future cash flows relating to jet fuel purchases will fluctuate because of changes in jet fuel prices. In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries.

During the third quarter of 2011:

- Air Canada purchased crude-oil option contracts covering a portion of 2011 and 2012 fuel exposure for which the cash premium related to these contracts was $3 million ($9 million in the third quarter of 2010).
- Fuel derivative contracts cash settled with a net fair value of less than $1 million in favour of Air Canada ($7 million in favour of the counterparties in the third quarter of 2010).

As of September 30, 2011, approximately 34% of Air Canada's anticipated purchases of jet fuel for the remainder of 2011 are hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US$110 per barrel and approximately 10% is subject to an average floor price of US$86 per barrel. Air Canada's contracts to hedge anticipated jet fuel purchases over the 2011 period are heating oil and crude-oil based contracts, comprised of call options, collars, call spreads and 3-way option structures. Air Canada has also hedged approximately 9% of its 2012 anticipated jet fuel purchases in heating oil and crude-oil based contracts hedged at an average WTI equivalent capped price of US$112 per barrel. The fair value of the fuel derivatives portfolio at September 30, 2011 is $1 million in favour of the counterparties ($33 million in favour of

Air Canada as at December 31, 2010) and is recorded within "accounts payable and accrued liabilities" on Air Canada's consolidated statement of financial position.

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 September 30, 2011.

Derivative Instruments	Term	Volume (bbls)	WTI Weighted Average Floor Price (US$/bbl)	WTI Weighted Average Capped Price (US$/bbl)
Call options	2011	1,202,142	n/a	110
Call options	2012	1,989,996	n/a	113
Call spreads (1)	2011	252,858	n/a	112
Call spreads (1)	2012	360,000	n/a	107
Collars	2011	315,000	87	105
3-way options (1)	2011	240,000	85	110

(1) Call spreads and 3-way options are subject to an average maximum price protection of US$139 per barrel.

The following information summarizes the impact of fuel derivatives on Air Canada's consolidated statement of operations and consolidated statement of comprehensive income.

		Third Quarter		First Nine Months	
(Canadian dollars in millions)		**2011**	**2010**	**2011**	**2010**
Consolidated Statement of Operations					
Operating expenses					
Aircraft fuel	Realized effective loss on fuel derivatives previously designated under hedge accounting	n/a	$ (42)	n/a	$ (152)
Non-operating income (expense)					
Loss on financial instruments recorded at fair value					
	Fair market value loss – economic hedges	$ (18)	$ (1)	$ (27)	$ (22)
Consolidated Other Comprehensive Income					
	Reclassification of net realized loss on fuel derivatives previously designated under hedge accounting to aircraft fuel expense	n/a	$ 42	n/a	$ 152
	Tax on reclassification	n/a	$ -	n/a	$ -

10. Critical Accounting Estimates

Critical accounting estimates are those that are most important to the portrayal of Air Canada's financial condition and results of operations. Information on Air Canada's critical accounting estimates is disclosed in section 15 of Air Canada's 2010 MD&A dated February 10, 2011. The following updates are provided for those areas that contain critical accounting estimates utilized in the preparation of Air Canada's consolidated financial statements that have changed as a result of adopting IFRS on January 1, 2011.

Employee future benefits

The cost and related liabilities of Air Canada's pensions, other post-retirement and post-employment benefit programs are determined using actuarial valuations. The actuarial valuations involve assumptions, including in relation to discount rates, expected rates of return on assets, future salary increases, mortality rates and future benefit increases. Also, due to the long-term nature of these programs, such estimates are subject to significant uncertainty.

Sensitivity Analysis

Sensitivity analysis on 2011 employee benefits expense and on net financing expense relating to employee benefit liabilities, based on different actuarial assumptions with respect to discount rate and expected return on plan assets, is as follows:

	0.25 Percentage Point	
(Canadian dollars in millions)	**Decrease**	**Increase**
Discount rate on obligation assumption		
Employee benefits expense	$ 15	$ (15)
Net financing expense relating to employee benefit liabilities	(11)	11
	4	**(4)**
Long-term rate of return on plan assets assumption		
Net financing expense relating to employee benefit liabilities	28	(28)
	$ 28	**$ (28)**

Impairment of long-lived assets

Long-lived assets include property and equipment, definite lived intangible assets, indefinite lived intangible assets and goodwill. Assets that have an indefinite useful life, including goodwill are tested annually for impairment or when events or circumstances indicate that the carrying value may not be recoverable. Assets that are subject to depreciation or amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment test is performed by comparing the carrying amount of the asset or cash generating unit to their recoverable amount. Recoverable amount is calculated as the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or CGUs). Management has determined that the appropriate level for assessing impairments in accordance with IFRS is at the North American and international fleet levels for aircraft and related assets supporting the operating fleet. Parked aircraft not used in operations and aircraft leased or subleased to third parties are assessed for impairment at the individual asset level. Value in use is calculated based upon a discounted cash flow analysis. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

Property and equipment

In accordance with IFRS 1, Air Canada elected to value its aircraft and spare engines at the date of transition to IFRS on January 1, 2010 at their fair value and to use this fair value as deemed cost. Subsequent to transition, property and equipment is recognized using the cost method.

Air Canada makes estimates about the expected useful lives of long-lived assets and the expected residual values of the assets based on the estimated current fair value of the assets, Air Canada's fleet plans and the cash flows they generate. Changes to these estimates, which can be significant, could be caused by changes to maintenance programs, changes in utilization of the aircraft, and changing market prices for new and used aircraft of the same or similar types. These estimates and assumptions are evaluated at least on an annual basis or when events or circumstances indicate a change in assumptions may be warranted. Generally, these adjustments are accounted for on a prospective basis, through depreciation, amortization and impairment expense.

Airframe and engines are depreciated over 20 to 25 years, with 10% to 20% estimated residual values. Cabin interior equipment and modifications are depreciated over the lesser of 5 years or the remaining life of the aircraft. Spare engines and related parts ("rotables") are depreciated over the average remaining life of the fleet to which they relate with 10% to 20% estimated residual values. Cabin interior equipment and modifications to aircraft on operating leases are amortized over the term of the lease. Major maintenance of airframes and engines, including replacement spares and labour costs, are capitalized and amortized over the average expected life between major maintenance events.

Buildings and building leasehold improvements are depreciated on a straight-line basis over their useful lives not exceeding 50 years or the term of any related lease, whichever is less.

Residual values are reviewed at least annually against prevailing market values for equivalently aged assets and depreciation rates adjusted accordingly on a prospective basis.

Lease return provisions

Maintenance and repair costs related to return conditions on aircraft leases are recorded over the term of the lease for the end of lease maintenance return condition obligations within Air Canada's operating leases, offset by a prepaid maintenance asset to the extent of any related power-by-the-hour maintenance service agreements or any recoveries under aircraft subleasing arrangements. The provision is recorded based on management's estimate of the future costs associated with the maintenance events required under the lease return condition and taking into account the expected future maintenance condition of the aircraft at the time of lease expiry. The provision is discounted using a rate specific to the liability. Interest accretion on the provision is recorded in non-operating expense. Any difference in the actual maintenance cost incurred and the amount of the provision is recorded in aircraft maintenance expense in the period.

11. Accounting Policies

11.1 Future Accounting Standards

The following is an overview of accounting standard changes that Air Canada will be required to adopt in future years. The standards are effective for Air Canada's annual periods beginning on or after January 1, 2013, with earlier application permitted. Air Canada continues to evaluate the impact of these standards on its consolidated statement of operations and financial position.

IFRS 9 – Financial Instruments

IFRS 9 introduces new requirements for the classification and measurement of financial assets. IFRS 9 requires all recognized financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement to be subsequently measured at amortized cost or fair value. Specifically, financial assets that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. All other financial assets including equity investments are measured at their fair values at the end of subsequent accounting periods. Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, Financial Instruments – Recognition and Measurement, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income.

IFRS 10 – Consolidation

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 Consolidation – Special Purpose Entities and parts of IAS 27 Consolidated and Separate Financial Statements.

IFRS 11 - Joint Arrangements

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, Interests in Joint Ventures, and SIC-13, Jointly Controlled Entities – Non-monetary Contributions by Venturers.

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities.

IFRS 13 - Fair Value Measurement

Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements. IFRS 13 is a more comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement.

Amendments to Other Standards

In addition, there have been amendments to existing standards, including IAS 27, Separate Financial Statements and IAS 28, Investments in Associates and Joint Ventures. IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

Amendments to IAS 19 - Employee Benefits

The amendments to IAS 19 make significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to enhance the disclosures for all employee benefits. Actuarial gains and losses are renamed 'remeasurements' and will be recognized immediately in other comprehensive income ("OCI"). Remeasurements recognized in OCI will not be recycled through profit or loss in subsequent periods. The amendments also accelerate the recognition of past service costs whereby they are recognized in the period of a plan amendment. The annual expense for a funded benefit plan will be computed based on the application of the discount rate to the net defined benefit asset or liability. The amendments to IAS 19 will also impact the presentation of pension expense as benefit cost will be split between (i) the cost of benefits accrued in the current period (service cost) and benefit changes (past-service cost, settlements and curtailments); and (ii) finance expense or income.

A number of other amendments have been made to recognition, measurement and classification, including those re-defining short-term and other long-term benefits guidance on the treatment of taxes related to benefit plans, guidance on risk/cost sharing factors and expanded disclosures.

Air Canada's current accounting policy for employee benefits for the presentation of pension expense and the immediate recognition of actuarial gains and losses in OCI is consistent with the requirements in the new standard, however, additional disclosures and the computation of annual expense based on the application of the discount rate to the net defined benefit asset or liability will be required in relation to the revised standard.

Amendments to IAS 1 - Financial Statement Presentation

The amendments to IAS 1 require entities to separate items presented in OCI into two groups based on whether or not they may be recycled to profit or loss in the future. Items that will not be recycled, such as remeasurements resulting from the amendments to IAS 19, will be presented separately from items that may be recycled in the future, such as deferred gains and losses on cash flow hedges. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately.

Carbon Emissions Accounting Policy

The European Union passed legislation for an Emissions Trading System which will include carbon emissions from aviation commencing in January 2012, including for flights operated between Canada and countries within the European Union. The legislation will require aircraft operators to monitor and report on fuel use and emissions data.

Air Canada will adopt the terms of the Emissions Trading Scheme commencing in January 2012. Effective January 1, 2012 Air Canada intends to adopt a cost of settlement accounting model whereby emission allowances granted by the European Union are recorded as an intangible asset and are measured at fair value at the date of initial recognition with an offset to deferred income as a government grant. Purchased emission allowances will be recorded at cost and also recognized as an intangible asset. The intangible assets will subsequently be measured using the cost model of IAS 38, Intangible Assets and will be de-recognized at the end of each emission compliance period as an offset to the Corporation's provision for emission obligations. The intangible assets will be subject to the Corporation's impairment of long-lived assets accounting policy.

The government grant, measured based on the fair value of emission allowances at the date of initial recognition, will be amortized as an offset to other operating expenses over the emission compliance period based on volume of emissions generated during the period compared to the expected volume of emissions during the emission compliance period.

A provision to deliver emissions allowances will be recognized, with an offset to other operating expense, as carbon emissions are made using a weighted average cost model per unit of emission expected to be incurred for the emission compliance period as a whole. This provision will be presented net of emission allowances on Air Canada's consolidated statement of financial position.

11.2 Transition to International Financial Reporting Standards

Effective January 1, 2011 and as futher described in Air Canada's interim unaudited condensed consolidated financial statements and notes for the first quarter of 2011, Air Canada began reporting its financial results in accordance with International Financial Reporting Standards ("IFRS"). Refer to Air Canada's First Quarter 2011 MD&A dated May 5, 2011 for additional information.

12. Off-Balance Sheet Arrangements

Information on Air Canada's off-balance sheet arrangements is disclosed in section 13 of Air Canada's 2010 MD&A dated February 10, 2011. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

13. Related Party Transactions

At September 30, 2011, Air Canada had no transactions with related parties as defined in the CICA Handbook – Part 1, except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship agreements.

14. Risk Factors

For a detailed description of risk factors associated with Air Canada, refer to section 18 "Risk Factors" of Air Canada's 2010 MD&A dated February 10, 2011. Air Canada is not aware of any significant changes to Air Canada's risk factors from those disclosed at that time.

However, the risk factors in Air Canada's 2010 MD&A dated February 10, 2011 related to *Current Legal Proceedings* is updated to account for the following:

- The lapse, on February 14, 2011, of the usual five-year statute of limitations period during which the U.S. Department of Justice could seek the indictment of a party for a violation in respect of alleged anti-competitive cargo pricing activities, without any such proceedings having been instituted against Air Canada.

- The investigation ordered by the Canadian Human Rights Commission was completed following which the Commission determined that the complaint will not be referred to the Canadian Human Rights Tribunal for inquiry.

15. 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 President and Chief Executive Officer ("CEO"), its Executive Vice President and Chief Financial Officer ("CFO") and 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, under the supervision of and with the participation of the Corporation's CEO and 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 2010 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 third quarter 2011 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 financial report, and the Corporation's Board of Directors approved these documents prior to their release.

Changes in internal controls over financial reporting

There have been no changes to Air Canada's internal controls over financial reporting that occurred during the third quarter of 2011 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

16. Non-GAAP Financial Measures

EBITDAR

EBITDAR (earnings before interest, taxes, depreciation, amortization and impairment, and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before depreciation, amortization and impairment, and aircraft rent as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. EBITDAR is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, and is therefore not likely to be comparable to similar measures presented by other public companies.

EBITDAR for Air Canada is reconciled to operating income (loss) as follows:

	Third Quarter			First Nine Months		
(Canadian dollars in millions)	**2011**	**2010**	**Change $**	**2011**	**2010**	**Change $**
GAAP operating income (loss)	$ 270	$ 306	$ (36)	$ 277	$ 217	$ 60
Add back:						
Aircraft rent	80	89	(9)	249	267	(18)
Depreciation, amortization and impairment	185	185	-	554	574	(20)
EBITDAR	**$ 535**	**$ 580**	**$ (45)**	**$ 1,080**	**$ 1,058**	**$ 22**

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/U.S. currency exchange rate, and excluding this expense from GAAP results analysis allows Air Canada to compare its operating performance on a consistent basis. Operating expense, excluding fuel expense, is not a recognized measure for financial statement presentation under GAAP, 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:

	Third Quarter			First Nine Months		
(Canadian dollars in millions)	**2011**	**2010**	**Change $**	**2011**	**2010**	**Change $**
GAAP operating expense	$ 2,972	$ 2,720	$ 252	$ 8,636	$ 7,953	$ 683
Remove:						
Aircraft fuel	(943)	(733)	(210)	(2,567)	(2,012)	(555)
Operating expense, excluding fuel expense	**$ 2,029**	**$ 1,987**	**$ 42**	**$ 6,069**	**$ 5,941**	**$ 128**

Adjusted net income (loss) per share - diluted

Air Canada uses adjusted net income (loss) per share – diluted to assess the performance of its business without the effects of foreign exchange and non-recurring items. Such measure is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies.

	Third Quarter			First Nine Months		
(Canadian dollars in millions)	**2011**	**2010**	**Change $**	**2011**	**2010**	**Change $**
Net income (loss) for the period	$ (125)	$ 315	$ (440)	$ (193)	$ (120)	$ (73)
Remove:						
Foreign exchange (gain) loss	281	(115)	396	168	(48)	216
Interest expense charge on repayment of term credit facility	-	-	-	-	54	(54)
Adjusted net income (loss)	**$ 156**	**$ 200**	**$ (44)**	**$ (25)**	**$ (114)**	**$ 89**
Adjusted weighted average number of outstanding shares used in computing diluted loss per share (in millions)	282	286	(4)	278	278	-
Adjusted net income (loss) per share - Diluted	**$0.55**	**$0.70**	**($0.15)**	**($0.09)**	**($0.41)**	**$0.32**

17. Glossary

Atlantic passenger and cargo revenues — Refers to revenues from flights that cross the Atlantic Ocean with origins and destinations principally in Europe.

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, amortization and impairment, and aircraft rent and is a non-GAAP financial measure commonly used in the airline industry to view operating results before depreciation, amortization and impairment, 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 16 of this MD&A for additional information.

Effective Ton Miles or ETMs — Refers to the mathematical product of tonnage capacity times distance hauled.

Other passenger and cargo revenues — Refers to revenues from flights with origins and destinations principally in Central and South America, Australia, the Caribbean and Mexico.

Pacific passenger and cargo revenues — Refers to revenues from flights that cross the Pacific Ocean with origins and destinations principally in Asia.

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.

Percentage point (pp) — A measure for the arithmetic difference of two percentages.

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.

Revenue Ton Miles or RTMs — Refers to the mathematical product of weight in tons of a shipment being transported by the number of miles that it is transported.

Yield — Average passenger revenue per RPM.