AIR CANADA

Quarter 1 2007
Management's Discussion and Analysis of Results of Operations and Financial Condition

May 10, 2007

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1. PREFACE

The following Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A") should be read in conjunction with the interim Quarter 1 2007 unaudited consolidated financial statements and notes of Air Canada, a majority-owned subsidiary of ACE Aviation Holdings Inc. ("ACE"), and Air Canada's annual audited combined consolidated financial statements and notes and its annual MD&A for 2006. Management prepared the interim audited consolidated financial statements in accordance with Generally Accepted Accounting Principles in Canada ("GAAP"). These interim unaudited consolidated financial statements are based on accounting policies consistent with those disclosed in Note 2 to Air Canada's annual audited combined consolidated financial statements for 2006, with the exception of the adoption, on January 1, 2007, of certain accounting policies relating to financial instruments, hedging derivatives and comprehensive income which are described in Note 1 to Air Canada's interim unaudited consolidated financial statements for Quarter 1 2007 and summarized in section 11 of this MD&A. Except where the context otherwise requires, all monetary amounts are stated in millions of Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 2 "Glossary". Except as otherwise noted, this MD&A is current as of May 10, 2007.

As described in Note 1 to Air Canada's 2006 annual combined consolidated financial statements, for periods prior to the initial public offering of shares of Air Canada which closed on November 24, 2006 (the "Air Canada IPO"), the financial statements of Air Canada are combined to include the financial position, results of operations and cash flows of a number of entities that subsequently became subsidiaries of Air Canada in conjunction with the Air Canada IPO. In this MD&A, the term "Corporation" refers to, as the context may require, Air Canada and/or Jazz Air LP ("Jazz") and/or one or more of Air Canada's subsidiaries.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward Looking Statements" in this MD&A for a discussion of risks, uncertainties and assumptions relating to these statements. For a detailed description of the risks affecting the business of Air Canada, refer to the "Risk Factors" section in Air Canada's 2006 annual MD&A dated February 14, 2007.

Air Canada has two business segments: Air Canada Services and Jazz. Air Canada Services is the passenger and cargo transportation services business operated by Air Canada and related ancillary services. The Jazz segment represents the results of Jazz operating under the capacity purchase agreement effective January 1, 2006 between Air Canada and Jazz (the "Jazz CPA"). Jazz is consolidated within Air Canada's consolidated financial statements under Accounting Guideline 15 – Consolidation of Variable Interest Entities ("ACG-15"). Air Canada consolidates Jazz as Air Canada has certain contractual interests in Jazz through the Jazz CPA which may require Air Canada to absorb certain variability in the operations of Jazz and make certain payments to Jazz. Notwithstanding the consolidation of Jazz by Air Canada, Air Canada does not hold any of the limited partnership units of Jazz Air LP or any of the shares of its general partner, Jazz Air Holding GP Inc. The segment information provided herein is useful information to readers as it enables them to distinguish between the results of operations, cash and other assets and liabilities of each of the two segments. This is significant as Air Canada does not have access to the cash and other assets of Jazz, nor is there any recourse to Air Canada for any of the recognized liabilities of Jazz, unless otherwise specifically agreed to by Air Canada. However, Air Canada is required to pay fees to Jazz for Jazz services and may be required to assume certain obligations if such services are cancelled.

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

Caution Regarding Forward-Looking Information

This MD&A includes forward-looking statements within the meaning of applicable securities laws. These statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to strategies, expectations, planned operations or future actions.

These forward-looking statements are identified by the use of terms and phrases such as "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "predict", "project", "will", "would", and similar terms and phrases, including references to assumptions.

Forward-looking statements, by their nature, are based on assumptions and are subject to important risks and uncertainties. Any forecasts or forward-looking predictions or statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Results indicated in forward-looking statements may differ materially from actual results due to a number of factors, including without limitation, energy prices, general industry, market and economic conditions, war, terrorist attacks, changes in demand due to the seasonal nature of the business, the ability to reduce operating costs and employee counts, employee relations, labour negotiations or disputes, pension issues, currency exchange and interest rates, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in the "Risk Factors" section of Air Canada's 2006 annual MD&A dated February 14, 2007. The forward-looking statements contained in this MD&A represent the Corporation's expectations as of the date of this MD&A and are subject to change after such date. However, the Corporation disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

2. GLOSSARY

Available Seat Miles or ASMs — A measure of passenger capacity calculated by multiplying the total number of seats available for passengers by the miles flown;
CASM — Operating expense per ASM;
EBITDAR — EBITDAR is earnings before interest, taxes, depreciation, amortization and obsolescence and aircraft rent. EBITDAR is a non-GAAP financial measure commonly used in the airline industry to view operating results before aircraft rent and depreciation, amortization and obsolescence as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets;
Passenger Load Factor — A measure of passenger capacity utilization derived by expressing Revenue Passenger miles as a percentage of Available Seat Miles;
Passenger Revenue per Available Seat Mile or RASM — Average passenger revenue per ASM;
Revenue Passenger Miles or RPMs — A measure of passenger traffic calculated by multiplying the total number of revenue passengers carried by the miles they are carried;
Yield — Average passenger revenue per RPM.

3. OVERVIEW AND GENERAL BUSINESS SUMMARY

For an overview of the Air Canada business and a detailed description of Air Canada's business objectives and strategies, refer to Air Canada's AIF dated March 27, 2007 and its 2006 Annual Report which can be found on SEDAR at www.sedar.com. The following summarizes Air Canada's progress made in the first three months of 2007 towards meeting Air Canada's business objectives and strategies.

3.1. Air Canada's Business Strategy

Air Canada's business model is designed to allow it to compete more effectively on multiple levels against the low-pricing structures offered by low-cost carriers and the extensive services and networks of leading international full service carriers. Air Canada's strategy is based on the following components:

- ***Leverage its Innovative Customer Driven Revenue Model***
  Air Canada first implemented its simplified passenger fare pricing structure in the North American market in 2003. During 2006, certain features of the simplified pricing structure have been phased into most of Air Canada's European markets. Since its introduction, the revenue model has contributed to higher passenger load factors, higher yields per RPM and improved RASM. Air Canada's passenger load factor for Quarter 1 2007 was 80.2%, the highest passenger load factor for the first quarter in Air Canada's history.

- ***Developments in its Innovative Strategy***
  In the drive for innovation, Air Canada continues to expand the offering of "passes", "subscriptions" and "à la carte" pricing options tailored to different segments of the marketplace. In Quarter 1 2007, revenues from pass products increased 105% over Quarter 1 2006.

- ***High Degree of Web Penetration***
  Web penetration in Canada reached 61% in Quarter 1 2007, a 12.8 percentage point increase from Quarter 1 2006 whereas system-wide web penetration reached 31%, an increase of 5.9 percentage points from Quarter 1 2006. These figures do not include sales from Air Canada call centres that employ the Air Canada host platform. Including sales from call centres, Air Canada's direct penetration for Canada was 73% for Quarter 1 2007. The increase in web penetration in Quarter 1 2007 from Quarter 1 2006 has generated $2.8 million in cost savings to Air Canada.

- ***Potential for International Route Expansion***
  Air Canada expects to expand its existing services to international destinations, including by leveraging capacity growth using the Star Alliance® network, and to serve new international destinations in order to benefit from the higher margins available in these markets. In March, Air Canada added 22 more non-stop flights per week from Canada to Mexico bringing the total weekly flights to Mexico to 59. In addition, Air Canada introduced 5 more non-stop flights from Canada to the Caribbean bringing the total weekly flights to the Caribbean to 104.

- ***Multi-hub Strategy and Seamless Transfers at Toronto***
  Air Canada's three main hubs (Toronto, Montreal and Vancouver) are geographically well positioned in relative proximity to the Canada-US border. Air Canada believes that all three hubs provide inherent advantages to serve customers traveling to or from the U.S to Asia and Europe. Prior to January 31, 2007, passengers traveling between Europe and Asia and the U.S. via Pearson endured inconveniences and longer connection times at Toronto Pearson International Airport. However, since that date, as Air Canada's Toronto operations are consolidated into Pier F at Terminal 1 of Toronto Pearson International Airport, Air Canada has the ability to more seamlessly transfer passengers to and from the U.S. to Europe and Asia. This consolidation improves customer experience by providing greater convenience, reduced distances between gates and easier connections. This consolidation is also expected to generate additional traffic for Air Canada from its various international destinations to its U.S. destinations.

- ***Major Steps in Network Redesign on the Domestic, US Transborder and International Fronts***
  Air Canada is achieving its network redesign in the North American market through the increased use of large regional jet aircraft which have lower trip costs than conventional narrow-body aircraft. In North America, Air Canada has increased the number of its 93 seat Embraer 190 aircraft by 15 aircraft in Quarter 1 2007. By early 2008, Air Canada is scheduled to operate a total of 45 Embraer 190 aircraft. In the quarter, the Embraer 190 aircraft produced 20% less direct operating costs than the Airbus A319 aircraft on a per trip basis. The Embraer 190 aircraft also provides for a more efficient aircraft use by helping generate higher load factors on routes which do not require the capacity of the Airbus 319 family of aircraft.

  In order to support the expansion of its international operations and deliver a superior aircraft product in the international market to and from Canada, Air Canada has initiated an important program, introducing into commercial service Air Canada's first Boeing 777 aircraft in April 2007. Air Canada expects to operate 8 Boeing 777 aircraft by the end of 2007 and 17 by the end of 2008. On April 23, 2007, Air Canada amended agreements with The Boeing Company ("Boeing") to increase by 23 its firm order for Boeing 787 aircraft, bringing its total firm order to 37 Boeing 787 aircraft, and to reduce its firm order of Boeing 777 aircraft by two scheduled for delivery in 2009. The new Boeing 777 and Boeing 787 aircraft will replace older and less fuel efficient aircraft such as the Airbus A340 and A330, as well as the Boeing 767-300 and 767-200 and will provide Air Canada with the flexibility to expand its international fleet. Refer to section 3.2 of this MD&A for additional information on Air Canada's fleet strategy.

  As part of its ongoing focus to provide a superior in-flight experience to its passengers, Air Canada continued the refurbishment of the interior of its existing aircraft fleet initiated in 2006 and has now completed the refurbishment of 27 Airbus A320 aircraft, 6 Boeing 767-300 aircraft and 5 Airbus A319 aircraft. All new aircraft since the start of this initiative are delivered equipped with state-of-the-art in-flight entertainment systems and seats. The aircraft refurbishment process is scheduled to be completed by the middle of 2008.

- ***Leveraging Technology for Enhanced Customer Service and Cost Containment***
  Air Canada is developing a new web-enabled computer system, named POLARIS, to replace Air Canada's legacy systems for passenger reservation and airport customer service. The new technology is designed to be innovative, flexible and cost effective and to allow Air Canada to facilitate and streamline the reservation and travel processes for both its customers and employees. The new system is expected to be deployed in a phased manner commencing in late 2007 and running through a major part of 2008.

- ***Continue to Improve its Cost Structure***
  Despite the recent upward pressures on unit costs such as wages and salaries and aircraft maintenance, materials and supplies which are further discussed in section 4.1 of this MD&A, Air Canada's business strategy remains focused on continuously evaluating and seeking means of improving its cost structure to remain highly competitive. Aircraft fuel continues to be the Corporation's largest expense. The Corporation continues to pursue efforts under its fuel efficiency program established in 2006 in order to improve fuel efficiency across the Corporation. Air Canada's increased web penetration coupled with its innovative strategy of pass and subscription products generate cost savings through reduced sales, distribution and servicing costs. In addition, and besides offering superior comfort, Air Canada's fleet renewal will also contribute to the improvement of its cost structure through improved fuel efficiency and lower maintenance costs.

- ***Maintaining Positive Employee and Labour Relations***
  In January 2007, Air Canada launched a leadership and employee relationship training initiative for all management employees entitled "Relationship Matters". At the end of Quarter 1, 2007, 47% of the entire management group at Air Canada had completed the two-day program. It is expected that all management will have completed the program by the end of Quarter 3, 2007. Air Canada and some of its unions have also introduced new grievance procedures that provide for expedited resolution of grievances and are designed to facilitate the labour-management relationship and increase accountability on both sides. On April 10, 2007, Air Canada announced that the wage review process agreed to with all labour groups in 2003 had concluded. In February, Air Canada was approached by third party providers in London, England to provide, at an appreciably lower cost, all ground handling

services which were being performed by Air Canada unionized personnel. Management worked together with Amicus and the Transportation & General Workers Union (TGWU) to review the business case and considered and agreed upon an alternative proposal that permitted Air Canada to keep the work in-house. The positive result arrived at is a clear example of what can be achieved through a more collaborative approach between Management and its unions.

3.2. Fleet Strategy

On April 23, 2007, Air Canada amended agreements with Boeing to increase by 23 its firm order for Boeing 787 aircraft, bringing its total firm order to 37 Boeing 787 aircraft. In addition, the parties agreed to reduce the firm order of Boeing 777 aircraft by two scheduled for delivery in 2009. The deliveries of the Boeing 787 aircraft committed to by Air Canada are scheduled to be completed by 2014. These amendments also provide for 23 Boeing 787 options aircraft, bringing the total order for Boeing 787 aircraft to 60 aircraft. The new Boeing 777 and Boeing 787 aircraft will replace older and less fuel efficient aircraft such as the Airbus A340 and A330, as well as the Boeing 767-300 and 767-200. The Boeing 787 aircraft also features better operational performance in terms of speed and flight range and will provide Air Canada with the ability to serve new markets that could not be previously served efficiently.

On April 19, 2007, Air Canada received a final commitment for loan guarantee support, subject to the fulfillment of certain terms and conditions, from the Export-Import Bank of the United States ("EXIM") covering the first seven Boeing 777 aircraft, including the first two aircraft delivered in March and April 2007, respectively. Air Canada has also received a preliminary commitment from EXIM, subject to the fulfillment of certain terms and conditions, for the remaining Boeing 777 aircraft which are scheduled for delivery in 2008 and 14 Boeing 787 aircraft which are scheduled for delivery in 2010 and 2011. Once implemented, the EXIM loan guarantee support is expected to lower the Corporation's aircraft financing costs relating to the Boeing aircraft orders.

In line with Air Canada's business plan to remove from service approximately 25 aircraft in 2007, consisting of 10 wide-body and 15 narrow-body aircraft, Air Canada has agreements or letters of intent for the sublease to other airlines, with delivery in 2007, of three Airbus A340-300 aircraft, four Airbus A319 aircraft and two Airbus A340-500 aircraft. One of the A340-300 and three of the A319s have been delivered to their sublessees. Air Canada has letters of intent for the sublease of five additional A340-300 aircraft for delivery in 2008. Air Canada has returned to lessors one narrow-body and one wide-body aircraft in 2007 and is in the process of returning, following lease expiry, four more narrow-body and two more wide-body aircraft later in 2007. In addition, Air Canada has retired one wide-body aircraft from service in 2007 and plans to retire another wide-body aircraft from service later in 2007. Air Canada is actively pursuing subleasing and retirement alternatives for the remaining six narrow-body and one wide-body aircraft planned to be removed from service in 2007. By year-end 2007, Air Canada combined with Jazz expects to operate a fleet of 356 aircraft.

3.3. Fuel Risk Management

In order to manage the airline's exposure to the volatility of jet fuel prices, Air Canada has hedged a portion of its 2007 anticipated jet fuel requirements using mostly swap and collar option structures.

As at March 31, 2007, Air Canada had hedged 39% of the remainder of its projected fuel requirement for 2007 and 3% of its projected fuel requirement for 2008. The remainder of 2007 is hedged at prices that can fluctuate between an average of US$82 to US$86 per barrel for jet-fuel based contracts, an average of US$73 to US$81 per barrel for its heating oil-based contracts and an average of US$58 to US$69 per barrel for its WTI crude oil-based contracts. Air Canada has hedged its projected fuel requirements for 2007 as follows: 43% for Quarter 2, 35% for Quarter 3 and 38% for Quarter 4. At May 10, 2007, Air Canada's hedging positions remained essentially unchanged from its hedging positions at March 31, 2007.

Refer to section 7 of this MD&A for information on Air Canada's reporting of fuel hedging derivative instruments.

3.4. Conclusion of wage review process

Air Canada has completed negotiation, mediation and arbitration with the Canadian Union of Public Employees ("CUPE"), which represents approximately 6,000 flight attendants based in Canada. The arbitrator awarded CUPE-represented flight attendants wage increases of 2% effective July 2006, 1.75% effective July 2007 and 1.75% effective July 2008. With the receipt of this decision, the wage review process agreed to with all Air Canada's labour groups in 2003 has concluded. The average of the wage adjustment awards granted represents an increase of approximately 5% over the three-year period 2006-2009.

4. RESULTS OF OPERATIONS – QUARTER 1 2007 VERSUS QUARTER 1 2006

The following table reflects the consolidated results of the Corporation, the results of its reportable segments and certain non-GAAP measures for Quarter 1 2007.

Unaudited Quarter 1 2007	Air Canada Services	Jazz	Inter-segment eliminations	Consolidated Total
Operating revenues				
Passenger	$ 2,137	-	-	$ 2,137
Cargo	141	-	-	141
Other	230	2	-	232
External revenue	2,508	2	-	2,510
Inter-segment revenue	26	362	(388)	-
	2,534	**364**	**(388)**	**2,510**
Operating expenses				
Wages, salaries and benefits	499	83	-	582
Aircraft fuel	585	71	(71)	585
Aircraft rent	73	35	(4)	104
Airport and navigation fees	243	47	(47)	243
Aircraft maintenance, materials and supplies	224	30	(5)	249
Communications and information technology	71	1	(1)	71
Food, beverages and supplies	80	4	(1)	83
Depreciation, amortization and obsolescence	128	5	-	133
Commissions	59	-	-	59
Capacity purchase fees paid to Jazz	230	-	(230)	-
Other	420	52	(29)	443
	2,612	**328**	**(388)**	**2,552**
Operating income (loss)	**(78)**	**36**	**-**	**(42)**
Non-operating income (expense)				
Interest income	26	1	-	27
Interest expense	(91)	(2)	-	(93)
Interest capitalized	36	-	-	36
Gain on sale of assets	7	-	-	7
Gain on financial instruments recorded at fair value	34	-	-	34
Other	(4)	-	-	(4)
	8	(1)	-	7
Income (loss) before the following items	**(70)**	**35**	**-**	**(35)**
Non-controlling interest	(2)	-	(35)	(37)
Foreign exchange gain	33	-	-	33
Recovery of income taxes	5	-	-	5
Income (loss) for the period	**$ (34)**	**$ 35**	**$ (35)**	**$ (34)**
EBITDAR[(1)]	**123**	**76**	**(4)**	**195**

1. *See section 14 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income (loss).*

The following table reflects the consolidated results of the Corporation, the results of its reportable segments and certain non-GAAP measures for Quarter 1 2006.

Unaudited Quarter 1 2006	**Air Canada Services**	**Jazz**	**Inter-segment eliminations**	**Consolidated Total**
Operating revenues				
Passenger	$ 2,002	-	-	$ 2,002
Cargo	151	-	-	151
Other	221	2	-	223
External revenue	2,374	2	-	2,376
Inter-segment revenue	20	318	(338)	-
	2,394	**320**	**(338)**	**2,376**
Operating expenses				
Wages, salaries and benefits	463	74	-	537
Aircraft fuel	569	59	(59)	569
Aircraft rent	83	32	(2)	113
Airport and navigation fees	230	40	(40)	230
Aircraft maintenance, materials and supplies	207	23	(6)	224
Communications and information technology	74	2	(1)	75
Food, beverages and supplies	76	3	1	80
Depreciation, amortization and obsolescence	115	4	-	119
Commissions	68	-	-	68
Capacity purchase fees paid to Jazz	206	-	(206)	-
Special charge for labour restructuring	28	-	-	28
Other	399	48	(26)	421
	2,518	**285**	**(339)**	**2,464**
Operating income (loss)	**(124)**	**35**	**1**	**(88)**
Non-operating income (expense)				
Interest income	17	1	(1)	17
Interest expense	(71)	(2)	1	(72)
Interest capitalized	10	(1)	-	9
Gain on sale of assets	2	-	-	2
Other	2	-	(1)	1
	(40)	(2)	(1)	(43)
Income (loss) before the following items	**(164)**	**33**	**-**	**(131)**
Non-controlling interest	(4)	-	(33)	(37)
Foreign exchange gain	13	-	-	13
Recovery of income taxes	29	-	-	29
Income (loss) for the period	**$ (126)**	**$ 33**	**$ (33)**	**$ (126)**
EBITDAR[(1)]	**74**	**71**	**(1)**	**144**
EBITDAR[(1)], excluding special charges	**102**	**71**	**(1)**	**172**

1. See section 14 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income (loss) and EBITDAR, excluding special charges to operating income (loss).

The following table compares the results of the Corporation's reportable segments for Quarter 1 2007 to Quarter 1 2006. The amounts in the table below include inter-segment revenues and expenses.

Unaudited	Air Canada Services				Jazz			
	Quarter 1		Change		Quarter 1		Change	
	2007	2006	$	%	2007	2006	$	%
Operating revenues								
Passenger	2,137	2,002	135	7	-	-	-	n/a
Cargo	141	151	(10)	(7)	-	-	-	n/a
Other	230	221	9	4	2	2	-	-
External revenue	2,508	2,374	134	6	2	2	-	-
Inter-segment revenue	26	20	6	30	362	318	44	14
	2,534	**2,394**	**140**	**6**	**364**	**320**	**44**	**14**
Operating expenses								
Wages, salaries and benefits	499	463	36	8	83	74	9	12
Aircraft fuel	585	569	16	3	71	59	12	20
Aircraft rent	73	83	(10)	(12)	35	32	3	9
Airport and navigation fees	243	230	13	6	47	40	7	18
Aircraft maintenance, materials and supplies	224	207	17	8	30	23	7	30
Communications and information technology	71	74	(3)	(4)	1	2	(1)	(50)
Food, beverages and supplies	80	76	4	5	4	3	1	33
Depreciation, amortization and obsolescence	128	115	13	11	5	4	1	25
Commissions	59	68	(9)	(13)	-	-	-	n/a
Capacity purchase fees paid to Jazz	230	206	24	12	-	-	-	n/a
Special charge for labour restructuring	-	28	(28)	(100)	-	-	-	n/a
Other	420	399	21	5	52	48	4	8
	2,612	**2,518**	**94**	**4**	**328**	**285**	**43**	**15**
Operating income (loss)	**(78)**	**(124)**	**46**		**36**	**35**	**1**	
Non-operating income (expense)								
Interest income	26	17	9		1	1	-	
Interest expense	(91)	(71)	(20)		(2)	(2)	-	
Interest capitalized	36	10	26		-	(1)	1	
Gain on sale of assets	7	2	5		-	-	-	
Gain on financial instruments recorded at fair value	34	-	34		-	-	-	
Other	(4)	2	(6)		-	-	-	
	8	(40)	48		(1)	(2)	1	
Income (loss) before the following items	**(70)**	**(164)**	**94**		**35**	**33**	**2**	
Non-controlling interest	(2)	(4)	2		-	-	-	
Foreign exchange gain	33	13	20		-	-	-	
Recovery of income taxes	5	29	(24)		-	-	-	
Income (loss) for the period	**(34)**	**(126)**	**92**		**35**	**33**	**2**	
EBITDAR[(1)]	**123**	**74**	**49**		**76**	**71**	**5**	
EBITDAR[(1)], excluding special charges	**123**	**102**	**21**		**76**	**71**	**5**	

1. *See section 14 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income (loss) and EBITDAR, excluding special charges to operating income (loss).*

4.1. Summary of Air Canada Services Segment Results

The Air Canada Services segment reported an operating loss of $78 million in Quarter 1 2007, an improvement of $46 million from the operating loss of $124 million recorded in Quarter 1 2006. EBITDAR increased $49 million over Quarter 1 2006. In Quarter 1 2006, the Air Canada Services segment recorded special charges for labour restructuring of $28 million. Excluding the special charges for labour restructuring in 2006, EBITDAR increased $21 million over Quarter 1 2006.

Passenger Revenues

Passenger revenues in Quarter 1 2007 increased $135 million or 7% over Quarter 1 2006, reflecting traffic and yield improvements due to stronger market demand and increased fuel surcharges implemented in 2006. Effective January 1, 2007, certain ancillary passenger fees, such as change fees, seat selection fees and unaccompanied minor fees, which were previously included in "other" revenues, are included in "passenger" revenues. These ancillary passenger fees amounted to $11 million in Quarter 1 2007.

The system yield improvement of 2% in Quarter 1 2007 over the same period in 2006 was principally due to increased fuel surcharges implemented in 2006. In Quarter 1 2007, traffic grew 5% on a capacity increase of 3% over Quarter 1 2006, resulting in a passenger load factor increase of 1.5 percentage points. RASM rose 4% compared to Quarter 1 2006 due equally to the improvement in system passenger load factor and the growth in yield.

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

Quarter 1 2007 Versus Quarter 1 2006	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	9	2	7	3.8	1	6
US transborder	4	8	6	(1.8)	(1)	(4)
Atlantic	7	2	5	2.0	2	5
Pacific	8	1	3	1.9	5	7
Other	4	2	3	1.0	1	2
System	**7**	**3**	**5**	**1.5**	**2**	**4**

In Quarter 1 2007, domestic passenger revenues increased $68 million or 9% mainly due to traffic growth. Traffic grew 7% on a capacity increase of 2% resulting in a passenger load factor improvement of 3.8 percentage points. Capacity increases were mainly recorded in services to the Maritimes. Domestic RASM increased 6% compared to Quarter 1 2006 largely due to the improvement in domestic passenger load factor. Yield increased 1% from the same period in 2006, largely as a result of the reclassification of the ancillary passenger fees.

In Quarter 1 2007, US transborder passenger revenues increased $20 million or 4% due to a 6% growth in traffic on an 8% increase in capacity, which resulted in a passenger load factor decrease of 1.8 percentage points. The growth in passenger traffic was largely as a result of the introduction of services in addition to increased capacity to Florida, California and Las Vegas, Nevada. Yield decreased 1% in Quarter 1 2007, reflecting a growth over 2006 in longer-haul flying to key leisure destinations. The average stage length increased approximately 5% over Quarter 1 2006. Long-haul flights generally have a lower yield per revenue passenger mile than short-haul flights. When measured on a per mile basis, the average fare paid on long-haul flights is relatively lower than on short-haul flights. At the same time, since the costs of ground handling, take-off and landing are similar for both short and long-haul flights, unit costs per ASM are normally lower for long-haul flights due to distance flown. US transborder RASM decreased 4% over Quarter 1 2006, mainly due to the passenger load factor deterioration and partially to the decline in yield.

In Quarter 1 2007, Atlantic passenger revenues increased $23 million or 7%. The growth in Atlantic passenger revenues was mainly due to increased traffic and, to a lesser extent, to yield improvement as a result of increased fuel surcharges implemented in 2006 and the favourable impact of a stronger Canadian dollar on foreign currencies. Traffic grew 5% on a capacity increase of 2% resulting in a passenger load factor improvement of 2.0 percentage points. Traffic growth was mainly reflected in the United Kingdom market as a result of increased frequencies on the Vancouver – London route and the introduction of new services to London from Edmonton and Halifax. Atlantic RASM increased 5% due to the passenger load factor and yield improvements.

In Quarter 1 2007, Pacific passenger revenues increased $15 million or 8% due to yield and traffic improvements. Yield improved 5% largely due to increased fuel surcharges implemented in 2006. Pacific RASM increased 7% due to yield growth and a 1.9 percentage point improvement in passenger load factor.

In Quarter 1 2007, other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) increased $9 million or 4% due to traffic and yield improvements. Traffic grew 3% on a capacity increase of 2% resulting in a passenger load factor improvement of 1.0 percentage points. Traffic growth in these markets mainly reflected increased capacity to traditional leisure destinations. Yield rose 1% as a result of increased fuel surcharges implemented in 2006. In Quarter 1 2007, RASM increased 2% due primarily to the improvement in passenger load factor and partly to the yield increase.

Cargo Revenues

In Quarter 1 2007, cargo revenues declined $10 million or 7% from Quarter 1 2006, mainly as a result of reduced freighter flying to Asia. System cargo traffic was down 11% while cargo yield per revenue ton mile improved 5% in part due to the effect of stronger foreign currencies on international revenues.

In 2006, Air Canada reduced its chartered MD-11 freighter fleet from three to two aircraft. Freighter flying to Asia was reduced due to the directional nature of the Asia market and inadequate financial returns. For Quarter 1 2007, freighter revenues declined $7 million from Quarter 1 2006, however freighter expenses were down by a greater amount resulting in an improved financial result.

Air Canada plans to introduce approximately 2,000 new light weight and durable aircraft baggage and cargo containers in 2007 and 2008. When fully implemented, these containers are expected to produce sustainable cost savings by decreasing fuel consumption, maintenance and replacement costs.

Other Revenues

In Quarter 1 2007, other external revenues increased $9 million or 4% over the same period in 2006, largely the result of an increase in sales of ground packages by Air Canada Vacations partly offset by the reclassification of certain ancillary passenger fees, such as change fees, seat selection fees and unaccompanied minor fees, to "passenger" revenues effective January 1, 2007.

Operating Expenses

In Quarter 1 2007, operating expenses rose $94 million or 4% over the corresponding period in 2006. Unit cost, as measured by operating expense per ASM, increased 1% over Quarter 1 2006. Excluding fuel expense and special charges, unit cost increased 2% over the same period in 2006.

The following table compares Air Canada Services' operating expenses per ASM for Quarter 1 2007 to Air Canada Services' operating expenses per ASM to the corresponding period in 2006.

	Quarter 1		Change	
($ cents per ASM)	**2007**	**2006**	**$**	**%**
Wages and salaries	2.58	2.44	0.14	6
Benefits	0.80	0.80	-	-
Ownership (DAR) [(1)]	1.36	1.38	(0.02)	(1)
Airport and navigation fees	1.65	1.61	0.04	2
Aircraft maintenance, materials and supplies	1.52	1.45	0.07	5
Communications and information technology	0.48	0.52	(0.04)	(8)
Food, beverages and supplies	0.54	0.53	0.01	2
Commissions	0.40	0.47	(0.07)	(15)
Capacity purchase fees paid to Jazz	1.56	1.44	0.12	8
Other	2.86	2.82	0.04	1
Operating expense, excluding fuel expense and the special charge for labour restructuring [(2)]	**13.75**	**13.46**	**0.29**	**2**
Aircraft fuel	3.97	3.98	(0.01)	-
Special charge for labour restructuring	-	0.19	(0.19)	(100)
Total operating expense	**17.72**	**17.63**	**0.09**	**1**

1. *DAR refers to the combination of Aircraft rent and Depreciation, amortization and obsolescence.*
2. *Refer to section 14 "Non-GAAP Financial Measures" in this MD&A for additional information.*

Wages and salaries expense totaled $381 million in Quarter 1 2007, an increase of $33 million or 9% from Quarter 1 2006 largely due to higher average wages, increased overtime expenses of $6 million, which were in part weather-related, and expenses related to performance-based incentive plans in 2007. Partly offsetting these increases was a reduction of an average of 501 full-time equivalent ("FTE") employees or 2% over Quarter 1 2006. The higher average wages were largely attributable to arbitrated and negotiated average wage increases of approximately 1.5% and salary progression based on additional seniority. In addition, seniority-based and other staff reductions increased the proportion of employees in 2007 at the senior end of the wage scale versus 2006 resulting in an increase from Quarter 1 2007 to Quarter 1 2006 in the average salary per FTE.

A workforce reduction plan was announced in February 2006 to reduce the number of non-unionized employees by 20%. A special charge for labour restructuring of $28 million was recorded in Quarter 1 2006 relating to this program. This charge was reduced by $8 million In Quarter 4 2006 with the total for the year 2006 amounting to $20 million. As at May 10, 2007, approximately 79% of the planned reductions had been completed.

Fuel expense increased $16 million or 3% in Quarter 1 2007, mainly due to an ASM capacity increase of 3% over Quarter 1 2006. Fuel expense on a unit cost basis was unchanged from Quarter 1 2006. The volume-related increase of $25 million was partly offset by a $3 million decrease due to a reduction in MD-11 freighter operations. Increased realized hedging losses and a slightly weaker Canadian dollar versus the US dollar added additional fuel expenses of $5 million and $3 million, respectively. Refer to section 7 of this MD&A for information on Air Canada's reporting of fuel hedging derivative instruments. These increases were partly offset by a decrease of 2% in the average base fuel price which reduced fuel expense by $14 million.

Ownership costs, comprised of aircraft rent, depreciation, amortization and obsolescence expenses, increased $3 million in Quarter 1 2007. Factors in the increase were: the addition of 15 Embraer aircraft to Air Canada's operating fleet; depreciation expense related to the aircraft interior refurbishment program; and the reclassification of certain operating leases to capital leases. Largely offsetting these increases were: the reduction to two chartered MD-11 freighters operating in Quarter 1 2007 as compared to three MD-11 freighters in Quarter 1 2006; the effect of aircraft returns and lease terminations; the transfer of CRJ-100 aircraft to Jazz in

2006, which shifts the ownership cost to the capacity purchase expense category; and a decrease in amortization expense for intangible assets.

Airport and navigation fees increased $13 million or 6% in Quarter 1 2007, mainly due to an increase of 6% in aircraft departures and increased rates for landing and general terminal fees, primarily at Toronto's Pearson International Airport. At Pearson, general terminal charges rose 6% per seat for domestic and international arrivals. These increases were partly offset by a rate reduction for navigation fees in Canada which became effective in September 2006.

Aircraft maintenance, materials and supplies increased $17 million or 8% over Quarter 1 2006 due to an increase in Airbus narrow-body maintenance costs, primarily as a result of the Airbus A320 aircraft which are currently in a work cycle which requires replacement of engine life limited parts. Higher maintenance expenses related to satisfying minimum return conditions on aircraft leases and provisions for future return to lessor expenses on short-term leases were also significant factors in the increase. Reduced Boeing 767 engine activity partly offset these increases. Air Canada expects increases in aircraft maintenance, materials and supplies expenses in Quarter 2 2007 primarily as a result of satisfying the conditions on a number of aircraft leases scheduled for return to lessor. Aircraft maintenance expenses for the second half of 2007 are expected to track close to 2006 levels.

Food, beverage and supplies expense increased $4 million or 5% versus Quarter 1 2006 on a passenger traffic growth of 5%.

Commission expense decreased $9 million or 13% in Quarter 1 2007 on combined passenger and cargo revenue growth of 6% over Quarter 1 2006. The decrease in commission expense was mainly driven by the impact of a new commission structure at Air Canada Vacations in 2007and by commercial initiatives implemented by Air Canada to lower commission costs, which more than offset the volume-related increase. Commissions, as a percent of passenger and cargo revenues, declined to 2.6% in Quarter 1 2007 from 3.2% in Quarter 1 2006.

In Quarter 1 2007, capacity purchase fees paid to Jazz, pursuant to the Jazz CPA, amounted to $230 million compared to capacity fees paid to Jazz of $206 million in Quarter 1 2006. The 12% increase was mainly driven by a growth of six covered aircraft in Jazz's operating fleet, five of them transferred from Air Canada to Jazz, resulting in a 12% increase in block hours over Quarter 1 2006. ASM capacity for flights operated by Jazz increased 13% over Quarter 1 2006.

Other operating expense increased $21 million or 5% in Quarter 1 2007 largely due to a growth in expenses related to ground packages as a result of higher passenger volumes at Air Canada Vacations.

Non-operating income amounted to $8 million in Quarter 1 2007 compared to non-operating expense of $40 million for Quarter 1 2006. In Quarter 1 2007, net interest expense decreased $15 million. A $20 million increase in interest expense, largely driven by the financing of additional aircraft, was more than offset by a higher amount of capitalized interest relating to the acquisition of the Boeing 777 and 787 aircraft and growth in interest income due to higher cash balances and higher average interest rates. Capitalized interest includes interest on funds used to finance the acquisition of new flight equipment and other property and equipment for periods prior to the dates that the assets are available for service. In Quarter 1 2007, the Air Canada Services segment recorded gains of $7 million pertaining to the sale of one real estate property and to the sale of parked aircraft. Included in non-operating income in Quarter 1 2007 was a $34 million gain relating to fair value adjustments on certain derivative instruments entered into by Air Canada to manage its exposure to changes in fuel prices. Under CICA accounting section 3865, the ineffective portion of the realized and unrealized hedging gains or losses are recorded in non-operating income. Refer to section 7 in this MD&A for additional information.

Gains from the revaluation of foreign currency monetary items amounted to $33 million in Quarter 1 2007, attributable to a stronger Canadian dollar at March 31, 2007 compared to December 31, 2006. This compared to gains of $13 million in Quarter 1 2006.

A segment loss of $34 million was recorded in Quarter 1 2007 compared to a segment loss of $126 million in Quarter 1 2006, a $92 million improvement.

4.2. Summary of Jazz Segment Results

The Jazz segment reported operating income of $36 million in Quarter 1 2007, an improvement of $1 million from the operating income of $35 million recorded in Quarter 1 2006. EBITDAR increased $5 million over Quarter 1 2006, mainly due to a 13% increase in ASM capacity.

In Quarter 1 2007, operating revenues increased $44 million or 14% over Quarter 1 2006, reflecting a growth of six covered aircraft in Jazz's operating fleet, five of them transferred from Air Canada to Jazz, resulting in a 12% increase in the block hours flown, as well as a 19% increase in pass-through costs charged to Air Canada under the Jazz CPA.

In Quarter 1 2007, operating expenses rose $43 million or 15% over the corresponding period in 2006. Increased pass-through costs under the Jazz CPA, which include aircraft fuel, airport and navigation fees, certain terminal handling and other expenses, represented $21 million of the total increase in operating expenses while increases in controllable costs reflected the remainder of the increase. Unit cost, as measured by operating expense per ASM, increased 4% over Quarter 1 2006. The unit cost increase is reflective of a change in fleet mix. Excluding fuel expense, unit cost in Quarter 1 2007 was unchanged from the corresponding period in 2006.

Segment income of $35 million was recorded in Quarter 1 2007 compared to segment income of $33 million in Quarter 1 2006, a $2 million improvement.

4.3. Summary of Consolidated Results

The Corporation recorded a consolidated operating loss of $42 million for Quarter 1 2007, an improvement of $46 million from the operating loss of $88 million recorded in the same period in 2006. Excluding the special charges for labour restructuring of $28 million in 2006, operating loss improved $18 million over Quarter 1 2006.

Gains from the revaluation of foreign currency monetary items amounted to $33 million in Quarter 1 2007 attributable to a stronger Canadian dollar at March 31, 2007 compared to December 31, 2006. This compared to gains of $13 million in Quarter 1 2006.

A net loss of $34 million or $0.34 per diluted share was recorded in Quarter 1 2007 compared to a net loss of $126 million or $1.43 per diluted share in Quarter 1 2006.

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5. FINANCIAL AND CAPITAL MANAGEMENT

5.1. Financial Position

The Corporation's consolidated statement of financial position includes the accounts of certain entities which are not controlled by Air Canada, including Jazz and certain aircraft and engine leasing entities and fuel facility corporations. While the assets and liabilities of these entities are included in Air Canada's consolidated financial statements, there is no recourse to Air Canada for the liabilities of the separate legal entities, including Jazz, except to the extent of any existing obligations specifically agreed by Air Canada under agreements such as the Jazz CPA or guarantees. The information in the discussion of financial position has been presented on a consolidated basis.

As described in Note 1 to Air Canada's Quarter 1 2007 interim unaudited consolidated financial statements and as summarized in section 11 of this MD&A, Air Canada adopted certain accounting policies on January 1, 2007 which resulted in adjustments to Air Canada consolidated statement of financial position.

Consolidated Summary

Cash, cash equivalents and short-term investments decreased $144 million mainly due to the funding of the first Boeing 777 aircraft, which is expected to be financed pursuant to the loan guarantee supported financing as discussed in section 5.6 of this MD&A. Property and equipment increased $264 million mainly due to additions, primarily aircraft, offset by depreciation.

As at March 31, 2007, current assets have decreased $597 million since December 31, 2006, largely due to a decrease in future income tax of $337 million, resulting from a tax loss utilization strategy that was planned in conjunction with the Air Canada IPO and corporate restructuring. A current tax payable of $345 million was created in 2006 prior to the Air Canada IPO. This tax payable arose upon a transaction to transfer tax assets from Air Canada to ACE. This tax payable was recovered from Air Canada's future income tax assets during Quarter 1 2007.

As at March 31, 2007, current liabilities have decreased $194 million, largely reflecting a decrease in current taxes payable partly offset by a $173 million increase in advance ticket sales.

The following provides an overview of the consolidated financial position and its two reportable segments for the period indicated.

Unaudited	March 31, 2007			
	Air Canada Services	Jazz	Inter-segment elimination	Consolidated Total
ASSETS				
Current				
Cash and cash equivalents	$ 1,044	$ 132	-	$ 1,176
Short-term investments	925	-	-	925
	1,969	**132**	**-**	**2,101**
Restricted cash	51	-	-	51
Accounts receivable	788	80	(130)	738
Spare parts, materials and supplies	84	30	-	114
Prepaid expenses and other current assets	157	11	-	168
Prepaid maintenance to ACTS	417	-	-	417
Future income taxes	8	-	-	8
	3,474	**253**	**(130)**	**3,597**
Property and equipment	6,008	202	-	6,210
Deferred charges	61	28	-	89
Intangible assets	1,184	8	-	1,192
Deposits and other assets	294	1	-	295
	$ 11,021	**$ 492**	**$ (130)**	**$ 11,383**
LIABILITIES				
Current				
Accounts payable and accrued liabilities	$ 1,530	$ 221	$ (130)	$ 1,621
Advance ticket sales	1,192	-	-	1,192
Aeroplan Miles obligation	57	-	-	57
Current portion of long-term debt and capital leases	358	-	-	358
Note payable to ACTS	417	-	-	417
Current taxes payable	6	-	-	6
	3,560	**221**	**(130)**	**3,651**
Long-term debt and capital leases	3,082	113	-	3,195
Future income taxes	134	-	-	134
Pension and other benefit liabilities	1,805	9	-	1,814
Other long-term liabilities	367	59	-	426
	8,948	**402**	**(130)**	**9,220**
NON-CONTROLLING INTEREST	**177**	**-**	**168**	**345**
SEGMENT EQUITY	**1,896**	**90**	**(168)**	**1,818**
	$ 11,021	**$ 492**	**$ (130)**	**$ 11,383**

5.2. Liquidity and Working Capital

Air Canada Services

At March 31, 2007, Air Canada Services had cash, cash equivalents and short-term investments of $1,969 million and negative working capital of $86 million. Compared to December 31, 2006, cash, cash equivalents and short-term investments have decreased $141 million. As disclosed in section 5.6 of this MD&A, on April 19, 2007, Air Canada received a commitment for loan guarantee support, subject to fulfillment of certain terms and conditions, from EXIM for its first seven Boeing 777 aircraft including the first two Boeing 777 aircraft delivered in March and April 2007, respectively. The March delivered aircraft was temporarily funded from cash pending completion of the loan guarantee supported financing discussed above which resulted in a decrease in cash and cash equivalents of approximately $159 million at March 31, 2007.

At March 31, 2007, Air Canada Services had an unused secured syndicated revolving credit facility of $400 million on which no amounts have been drawn.

Jazz

At March 31, 2007, Jazz had cash and cash equivalents of $132 million and positive working capital of $32 million. Compared to December 31, 2006, cash and cash equivalents have decreased $3 million while working capital has increased $1 million.

Consolidated Summary

At March 31, 2007, the Corporation had cash, cash equivalents and short-term investments of $2,101 million and $54 million negative working capital. Compared to December 31, 2006, cash, cash equivalents and short-term investments and working capital have decreased $144 million and $403 million, respectively. The decrease in working capital was largely attributable to the additions to capital assets of $397 million and the reductions to long-term debt and capital lease obligations of $78 million, partially offset by aircraft borrowings of $112 million.

5.3. Cash flows for Quarter 1 2007 and Quarter 1 2006

The following table provides an overview of the consolidated cash flows and its two reportable segments for the periods indicated:

	Three months ended March 31, 2007			
	Air Canada Services	Jazz	Inter-segment elimination	Consolidated total
Cash from (used for) operating activities				
Loss for the period	$ (34)	$ 35	$ (35)	**$ (34)**
Adjustments to reconcile to net cash provided by operations				
Depreciation, amortization and obsolescence	128	5	-	**133**
Loss on sale of assets	(7)	-	-	**(7)**
Foreign exchange gain	(33)	-	-	**(33)**
Future income taxes	(11)	-	-	**(11)**
Employee future benefit funding more than expense	(69)	-	-	**(69)**
Decrease (increase) in accounts receivable	(49)	(9)	8	**(50)**
Decrease (increase) in spare parts, materials and supplies	34	(1)	-	**33**
Increase (decrease) in accounts payable and accrued liabilities	123	8	(8)	**123**
Increase (decrease) in advance ticket sales, net of restricted cash	231	-	-	**231**
Decrease in Aeroplan miles obligation	(25)	-	-	**(25)**
Non-controlling Interest	2	-	35	**37**
Special charge for Aeroplan miles				**-**
Allocation of corporate expenses	-	-	-	**-**
Aircraft lease payments (in excess of) less than rent expense	(7)	-	-	**(7)**
Unrealized period change in fair value of derivatives	(40)	-	-	**(40)**
Capitalized interest	(36)	-	-	**(36)**
Other	-	(1)	-	**(1)**
	207	**37**	**-**	**244**
Cash from (used for) financing activities				
Aircraft-related borrowings	112	-	-	**112**
Distributions paid to non-controlling interest	-	(33)	-	**(33)**
Reduction of long-term debt and capital lease obligations	(78)	-	-	**(78)**
Reduction of non-controlling interest	(36)	-	-	**(36)**
	(2)	**(33)**	**-**	**(35)**
Cash from (used for) investing activities				
Short-term investments	(127)	-	-	**(127)**
Additions to capital assets	(390)	(7)	-	**(397)**
Proceeds from sale of assets	44	-	-	**44**
Cash management with related parties	(13)	-	-	**(13)**
Cash collateralization of letters of credit	13	-	-	**13**
	(473)	**(7)**	**-**	**(480)**
Increase (decrease) in cash and cash equivalents	(268)	(3)	-	(271)
Cash and cash equivalents, end of period	**$ 1,044**	**$ 132**		**$ 1,176**

	Three months ended March 31, 2006			
	Air Canada Services	Jazz	Inter-segment elimination	Consolidated total
Cash from (used for) operating activities				
Income (loss) for the period	$ (126)	$ 33	$ (33)	**$ (126)**
Adjustments to reconcile to net cash provided by operations				
Depreciation, amortization and obsolescence	115	4	-	**119**
Gain on sale of assets	(2)	-	-	**(2)**
Foreign exchange loss	3	-	-	**3**
Future income taxes	(29)	-	-	**(29)**
Employee future benefit funding more than expense	(23)	-	-	**(23)**
Decrease (increase) in accounts receivable	(11)	128	(123)	**(6)**
Decrease (increase) in spare parts, materials and supplies	61	2	-	**63**
Increase (decrease) in accounts payable and accrued liabilities	116	(154)	123	**85**
Increase (decrease) in advance ticket sales, net of restricted cash	222	-	-	**222**
Decrease in Aeroplan miles obligation	(31)	-	-	**(31)**
Non-controlling Interest	-	-	37	**37**
Allocation of corporate expenses	3	-	-	**3**
Aircraft lease payments (in excess of) less than rent expense	(5)	-	-	**(5)**
Unrealized period change in fair value of derivatives	10	-	-	**10**
Capitalized interest	(9)	-	-	**(9)**
Other	(3)	20	(4)	**13**
	291	**33**	**-**	**324**
Cash from (used for) financing activities				
Issue of Jazz units	-	218	-	**218**
Transfer of Jazz investment to ACE	400	-	-	**400**
Acquisition promissory note paid by Jazz to ACE	-	(424)	-	**(424)**
Jazz - Credit facility borrowings	-	113	-	**113**
Aircraft-related borrowings	124	-	-	**124**
Distributions paid to non-controlling interest	-	(8)	-	**(8)**
Reduction of long-term debt and capital lease obligations	(74)	(14)	-	**(88)**
Other	(2)	-	-	**(2)**
	448	**(115)**	**-**	**333**
Cash from (used for) investing activities				
Short-term investments	(147)	-	-	**(147)**
Additions to capital assets	(270)	(4)		**(274)**
Decrease (increase) in amount receivable from Air Canada	(138)	138	-	**-**
Cash management with related parties	(8)	-	-	**(8)**
Cash collateralization of letters of credit	(4)	-	-	**(4)**
	(567)	**134**	**-**	**(433)**
Increase (decrease) in cash and cash equivalents	172	52	-	224
Cash and cash equivalents, end of period	**$ 1,172**	**$ 86**		**$ 1,258**

Cash Flows from Operating Activities

In Quarter 1 2007, cash flows from operations for the Air Canada Services segment were $207 million, a decrease of $84 million over Quarter 1 2006, primarily due to an increase in pension plan funding of $45 million over Quarter 1 2006, as well as unfavourable variances in working capital items affecting cash, mainly related to the timing of fuel inventory purchases.

The Jazz segment delivered cash flows from operations of $37 million in Quarter 1 2007, consistent with Jazz's positive operating results.

Cash Flows used for Financing Activities

Cash flows used for financing activities amounted to $2 million.

Aircraft-related borrowings for the Air Canada Services segment amounted to $112 million in Quarter 1 2007 and related mainly to the delivery of four Embraer aircraft in Quarter 1 2007. Scheduled and other debt and capital lease payments in Quarter 1 2007 amounted to $78 million. Reduction of non-controlling interest of $36 million during Quarter 1 2007 related to the refinancing of five CRJ aircraft. The refinancing included the payment of the non-controlling interest portion of the leasing arrangement to third parties.

Cash used for financing activities for the Jazz segment of $33 million in Quarter 1 2007 related to distributions paid to the non-controlling interest.

Cash Flows used for Investing Activities

In Quarter 1 2007, additions to capital assets totaled $390 million for the Air Canada Services segment. These additions included $159 million related to the Boeing 777 aircraft, $134 million related to four Embraer aircraft and $49 million related to the aircraft interior refurbishment program and other aircraft betterments. Other additions to capital assets related to ground equipment and facilities, inventory and spare engines as well as systems development projects.

Proceeds from sale of assets in Quarter 1 2007 of $44 million were mainly related to the sale of an Air Canada real estate property.

Cash used for investing activities for the Jazz segment amounted to $7 million in Quarter 1 2007, primarily related to aircraft leasehold improvements.

5.4. Share Information

An aggregate of 100 million Class A variable voting shares and Class B voting shares in the capital of Air Canada are issued and outstanding.

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

	Number of shares (000)	
	At March 31, 2007	**At January 31, 2007**
Issued and outstanding shares		
Class A variable voting shares	17,290,243	17,572,543
Class B voting shares	82,709,757	82,427,457
Total issued and outstanding shares	**100,000,000**	**100,000,000**
Class A variable voting and Class B voting shares potentially issuable		
Stock options	1,738,735	1,695,035
Total shares potentially issuable	**1,738,735**	**1,695,035**
Total outstanding and potentially issuable shares	**101,738,735**	**101,695,035**

5.5. Debt and Lease Obligations

Information on Air Canada's debt and lease obligations is provided in section 9.5 of Air Canada's 2006 annual MD&A dated February 14, 2007 and in Note 3 to Air Canada's 2006 annual combined consolidated financial statements.

With the exception of the debt related to the four Embraer aircraft deliveries in Quarter 1 2007, there were no other material changes to debt and lease obligations in Quarter 1 2007.

5.6. Capital Expenditures

Details on Air Canada's planned and committed capital expenditures are provided in section 9.6 of Air Canada's 2006 annual MD&A dated February 14, 2007.

On April 23, 2007, Air Canada amended agreements with Boeing to increase its firm orders for Boeing 787 aircraft from 14 to 37. In addition, the parties agreed to reduce the firm orders of Boeing 777 aircraft by two scheduled for delivery in 2009. The deliveries of the 37 firm aircraft are scheduled to commence in 2010 and be completed by 2014. In addition, these amendments also provide for an additional 23 Boeing 787 option aircraft, for a total of up to 60 Boeing 787 aircraft.

In conjunction with the amended agreements with Boeing, Air Canada received additional financing commitments from Boeing for an additional seven Boeing 787 aircraft on the same terms and conditions as previously disclosed. Should Air Canada not utilize any of the previously disclosed financing commitments on the Boeing 777 aircraft, the financing commitments for the Boeing 787 aircraft will be increased to 31 of which the terms of 28 would be revised such that 80% of the aircraft delivery price would be covered and the term to maturity would be reduced to 12 years from 15 years, with straight-line principal repayments over the term to maturity.

On April 19, 2007, Air Canada received a commitment for loan guarantee support, subject to the fulfillment of certain terms and conditions, from EXIM covering the first seven Boeing 777 aircraft, including the first two aircraft delivered in March and April 2007, respectively. The remaining five supported Boeing 777 aircraft are scheduled for delivery in 2007. The commitment for loan guarantee support covers a 12-year loan term for approximately 80% of the aircraft delivery price at an interest rate of approximately 5.35% based on interest rates as at March 31, 2007. Air Canada has also received a preliminary commitment from EXIM for the remaining Boeing 777 aircraft which are scheduled to be delivered in 2008 and 14 Boeing 787 aircraft which are scheduled to be delivered in 2010 and 2011.

The impact of the amendments by year on committed capital expenditures and financing from the amounts disclosed in Air Canada's 2006 annual MD&A dated February 14, 2007 is as follows:

Air Canada Services(1)	2007	2008	2009	2010	2011	Thereafter(2)
Increase (decrease) in total committed expenditures	30	(10)	(317)	78	285	3,052
Decrease (increase) in committed financing on on committed expenditures	51	-	299	-	(122)	(748)
Increase (decrease) in total committed expenditures, net of financing	81	(10)	(18)	78	163	2,304

1. *US dollar amounts are converted using the March 31, 2007 noon day rate of $1.1529. Final aircraft delivery prices include estimated escalation and deferred price delivery payment interest calculated based on the 90-day USD LIBOR rate at December 31, 2007.*
2. *As described above, the additional committed financing is for an additional seven Boeing 787 aircraft. Should Air Canada not use the financing available from Boeing and the engine manufacturer for all the Boeing 777 aircraft, the number of aircraft with committed financing will increase to a total of 31 on the terms described above. As the delivery period approaches, Management expects to enter into financing commitments for the remaining firm deliveries.*

The impact of the amendments by year on debt repayments from the amounts disclosed in Air Canada's 2006 annual MD&A dated February 14, 2007, is as follows:

Air Canada Services	2007	2008	2009	2010	2011
Increase in principal repayment on aircraft-related long-term debt	13	30	19	13	10

There were no other material changes to capital expenditures that were outside the ordinary course of business.

5.7. Pension Plan Cash Funding Obligations

Information on Air Canada's pension plan cash funding obligations is provided in section 9.7 of Air Canada's 2006 annual MD&A dated February 14, 2007.

For domestic registered pension plans, the information provided was based on the January 1, 2006 actuarial valuation. Air Canada expects to disclose projections based on the January 1, 2007 actuarial valuation for its cash pension plan funding obligations for the years 2007 through to 2011 in its Quarter 2 2007 MD&A. As a result of favourable investment experience and funding of past service contributions in 2006, the solvency deficit on the registered pension plans at January 1, 2007 is expected to have decreased compared to January 1, 2006 and, as a result, employer contributions determined in accordance with regulations are expected to decline by $90 million in 2007 and $120 million each year thereafter.

6. QUARTERLY FINANCIAL DATA

The tables below summarize quarterly financial results and major operating statistics for the Corporation and its two reportable segments for the last eight quarters. The amounts in the tables below include inter-segment revenues and expenses.

Consolidated Total	Q2 2005	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007
Operating revenues	2,363	2,742	2,256	2,376	2,559	2,837	2,395	2,510
Special charge for Aeroplan miles [(1)]	-	-	-	-	-	(102)	-	-
Operating revenues	**2,363**	**2,742**	**2,256**	**2,376**	**2,559**	**2,735**	**2,395**	**2,510**
Ownership (DAR) [(2)]	(203)	(216)	(227)	(232)	(239)	(237)	(247)	(237)
Other operating expenses	(2,041)	(2,217)	(2,086)	(2,232)	(2,171)	(2,329)	(2,119)	(2,315)
Operating expenses [(3)]	**(2,244)**	**(2,433)**	**(2,313)**	**(2,464)**	**(2,410)**	**(2,566)**	**(2,366)**	**(2,552)**
Operating income (loss)	**119**	**309**	**(57)**	**(88)**	**149**	**169**	**29**	**(42)**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(129)	(68)	(78)	(38)	3	(125)	(173)	8
Net income (loss)	**(10)**	**241**	**(135)**	**(126)**	**152**	**44**	**(144)**	**(34)**
Earning (loss) per share								
- Basic	**(0.12)**	**2.73**	**(1.53)**	**(1.43)**	**1.72**	**0.50**	**(1.55)**	**(0.34)**
- Diluted	**(0.12)**	**2.73**	**(1.53)**	**(1.43)**	**1.72**	**0.50**	**(1.55)**	**(0.34)**
Revenue passenger miles (millions)	11,613	13,981	10,584	11,240	12,248	14,346	11,160	11,814
Available seat miles (millions)	14,487	16,961	13,808	14,287	14,926	17,529	14,343	14,735
Passenger load factor (%)	80.2	82.4	76.7	78.7	82.1	81.8	77.8	80.2

1. *Quarter 3 2006 includes a special charge of $102 million in connection with Air Canada's obligation for the redemption of pre-2002 Aeroplan miles.*
2. *DAR refers to the combination of Aircraft rent and Depreciation, amortization and obsolescence.*
3. *Quarter 1 2006 includes a special charge for labour restructuring of $28 million. In Quarter 4, 2006, this charge was reduced by $8 million to $20 million.*

Seasonality

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

	Q2 2005	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007
Air Canada Services								
Operating revenues	2,373	2,757	2,271	2,394	2,576	2,854	2,415	2,534
Special charge for Aeroplan miles (1)	-	-	-	-	-	(102)	-	-
Operating revenues	**2,373**	**2,757**	**2,271**	**2,394**	**2,576**	**2,752**	**2,415**	**2,534**
Ownership (DAR) (2)	(184)	(191)	(196)	(198)	(200)	(199)	(210)	(201)
Other operating expenses	(2,097)	(2,294)	(2,166)	(2,320)	(2,263)	(2,423)	(2,210)	(2,411)
Operating expenses (3)	**(2,281)**	**(2,485)**	**(2,362)**	**(2,518)**	**(2,463)**	**(2,622)**	**(2,420)**	**(2,612)**
Operating income (loss)	**92**	**272**	**(91)**	**(124)**	**113**	**130**	**(5)**	**(78)**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(101)	(32)	(44)	(2)	39	(86)	(139)	44
Segment income (loss)	**(9)**	**240**	**(135)**	**(126)**	**152**	**44**	**(144)**	**(34)**
Revenue passenger miles (millions)	11,612	13,980	10,584	11,240	12,248	14,345	11,160	11,814
Available seat miles (millions)	14,486	16,960	13,807	14,287	14,925	17,528	14,343	14,735
Passenger load factor (%)	80.2	82.4	76.7	78.7	82.1	81.8	77.8	80.2
Operating expense per available seat mile (CASM) (cents)	15.8	14.7	17.1	17.6	16.5	15.0	16.9	17.7
CASM, excluding fuel expense (cents) (4)	12.1	10.7	12.9	13.7	12.3	10.6	12.8	13.8
CASM, excluding fuel expense and the special charge for labour restructuring (cents) (4)	12.1	10.7	12.9	13.5	12.3	10.6	12.9	13.8
Jazz								
Operating revenues	**232**	**274**	**304**	**320**	**340**	**369**	**352**	**364**
Ownership (DAR) (2)	(21)	(26)	(32)	(36)	(40)	(40)	(39)	(40)
Other operating expenses	(184)	(210)	(238)	(249)	(263)	(290)	(280)	(288)
Operating expenses	**(205)**	**(236)**	**(270)**	**(285)**	**(303)**	**(330)**	**(319)**	**(328)**
Operating income	**27**	**38**	**34**	**35**	**37**	**39**	**33**	**36**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(4)	(1)	(2)	(2)	(1)	-	(1)	(1)
Segment income	**23**	**37**	**32**	**33**	**36**	**39**	**32**	**35**

1. *Quarter 3 2006 includes a special charge of $102 million in connection with Air Canada's obligation for the redemption of pre-2002 Aeroplan miles.*
2. *DAR refers to the combination of Aircraft rent and Depreciation, amortization and obsolescence.*
3. *Quarter 1 2006 includes a special charge for labour restructuring of $28 million. In Quarter 4, 2006, this charge was reduced by $8 million to $20 million.*
4. *See section 14 "Non-GAAP Financial Measures" in this MD&A for additional information.*

7. DERIVATIVES AND FINANCIAL INSTRUMENTS

Air Canada manages its exposure to changes in interest rates, foreign exchange rates and jet fuel prices through the use of various derivative financial instruments.

Fuel Price Risk Management

To manage its exposure to jet fuel prices, Air Canada enters into derivative contracts with financial intermediaries for the purpose of managing volatility in operating cash flows. As at March 31, 2007, Air Canada had mainly collar options and swap structures in place to hedge a portion of its anticipated jet fuel requirement over the 2007 and 2008 periods. Since jet fuel is not traded on an organized futures exchange, liquidity for hedging this commodity is relatively limited in the long-term. Crude oil and heating oil are other commodities that are used by Air Canada for hedging its exposure to jet fuel price volatility. Air Canada does not purchase or hold any derivative financial instruments for trading purposes. Refer to section 3.3 of this MD&A for Air Canada's hedging position as at March 31, 2007 and as at May 10, 2007.

Air Canada elects to apply hedge accounting and designates its fuel derivatives as cash flow hedges as prescribed under CICA accounting section 3865, Hedges. Under hedge accounting, effective portions of gains or losses on fuel hedging contracts are recognized in aircraft fuel expense when the underlying jet fuel being hedged is consumed. Under Air Canada's current fuel hedging policy, effectiveness is defined as the extent to which changes in the intrinsic value of the hedging instrument offset the changes in the intrinsic value of the hedged item. Air Canada assesses whether the hedges are highly effective both at the inception of each hedge and on an on-going basis. As a result of the effectiveness assessment made at March 31, 2007, Air Canada's fuel hedge contracts were and are expected to continue to be effective in helping offset changes in cash flows.

Commencing January 1, 2007, designated hedging items are presented on the statement of financial position at fair value and all periodic changes in their fair value that are considered effective are recorded in Accumulated Other Comprehensive Income ("AOCI") until the underlying jet fuel is consumed. Upon maturity of the fuel derivatives, the effective gains and losses previously recorded in AOCI are recorded in fuel expense. The ineffective portion of the periodic change in fair value is recorded in non-operating income (expense).

Air Canada is exposed to the risk that periodic changes in fair value will not be perfectly effective. As defined by Air Canada's fuel hedging policy, ineffectiveness results when the change in the derivative's fair value does not perfectly offset the change in the intrinsic value of the anticipated jet fuel purchase. The ineffective portion relating to the change in the derivative intrinsic value is calculated by comparing it to the change in intrinsic value of a proxy perfect hedge based on Air Canada jet fuel weighted average price. As Air Canada's current policy does not take into account variables affecting fair value such as volatility and time value of money, a significant component of the change in fair value of outstanding fuel derivatives has been recorded as ineffective. Management is considering amending its fuel hedging policy on future designated hedging relationships to include fair value components to reduce the occurrence of hedge ineffectiveness.

Ineffectiveness is inherent in hedging diversified jet fuel purchases with derivative positions in crude oil and related commodities and in the differences between intrinsic values and fair values of the derivative instruments, especially given the magnitude of volatility observed in oil market prices. Air Canada is unable to predict the amount of ineffectiveness that could be recorded for each period. This may result, and has resulted, in increased volatility in the accounting results of Air Canada but has no impact on the underlying cash flows.

If the hedge ceases to qualify for hedge accounting, any period change in fair value of the fuel derivative instrument is recorded in non-operating income. For those fuel derivatives that do not qualify for hedge accounting, the period changes in fair value of the fuel derivative is recorded in non-operating income.

The net fair value of derivatives maturing during Quarter 1 2007 that were settled with counterparties was $14 million in favour of counterparties. A charge of $8 million was recorded in fuel expense representing the effective portion of the net fair value, consisting of $7 million, net of nil tax, that was recorded within AOCI as at January 1, 2007 and $1 million, net of nil tax, for the period change in fair value during Quarter 1 2007. As at January 1, 2007, a charge of $6 million was recorded in retained earnings pertaining to the ineffective portion of the derivatives settled during Quarter 1 2007.

As at March 31, 2007, the fair value of Air Canada's outstanding fuel derivative instruments under hedge accounting was $35 million in favour of Air Canada ($18 million in favour of counterparties as at December 31, 2006). During Quarter 1, 2007, the change in fair value of outstanding derivatives under hedge accounting resulted in an unrealized gain of $39 million of which $6 million, net of tax of $3 million, was recorded in AOCI and $30 million in other non-operating expense.

As at March 31, 2007, a net loss of $12 million, net of tax of $3 million, relating to unrealized gains and losses on outstanding fuel derivative instruments is included in AOCI. The net unrealized losses are expected to be realized as the contracts mature during the remainder of 2007 and at the beginning of 2008.

The change in fair value of outstanding derivative instruments is recorded at each reporting period and, due to the accounting basis of measuring, it is expected that there will be continued variability recorded in the consolidated statements of operations and comprehensive income. This is due to small differences in correlation of crude oil related commodities and Air Canada's weighted average jet fuel cost being leveraged over large dollar volumes and to differences between changes in the derivatives' intrinsic value and fair value.

Foreign Exchange Risk Management

During Quarter 1 2007, currency swaps for five CRJ leases with third parties were settled at their fair value of $10 million (which was equal to the carrying value) upon the expiry of the lease term.

8. OFF-BALANCE SHEET ARRANGEMENTS

Information on Air Canada's off-balance sheet arrangements is provided in Air Canada's 2006 annual MD&A dated February 14, 2007.

With the exception of the fuel derivative instruments discussed in section 7 of this MD&A, there have been no material changes to off-balance sheet arrangements from those disclosed in Air Canada's 2006 annual MD&A dated February 14, 2007.

9. RELATED PARTY TRANSACTIONS

Both at March 31, 2007 and at May 10, 2007, the Corporation has various related party transactions with ACE (the Corporation's principal shareholder which has a 75% ownership interest in Air Canada and a 58.8% indirect ownership interest in Jazz through its holding of Jazz Air Income Fund units) and other ACE related entities. ACE holds a 40.1% indirect ownership interest in Aeroplan through its holding of Aeroplan Income Fund units and a 100% direct ownership in ACTS. These transactions are recorded at the exchange amount.

There have been no material changes to significant related party agreements in Quarter 1 2007.

At March 31, 2007, the related party balances resulting from the application of the commercial and contractual practices were as follows:

	March 31, 2007	December 31, 2006
Accounts receivable		
ACE	11	-
Aeroplan	32	6
ACTS	106	97
	149	**103**
Accounts payable and accrued liabilities		
ACE	-	12
ACTS	144	111
	144	**123**

Revenues and expenses with related parties are summarized as follows:

	Quarter 1 2007	Quarter 1 2006
Revenues		
Revenues from Aeroplan related to Aeroplan rewards	97	77
Revenue offset from purchase of Aeroplan miles	(64)	(61)
Property rental revenues from related parties	10	12
Revenues from information technology services	6	7
Revenues from corporate services and other	6	4
Cargo revenues from related parties	1	1
	56	**40**
Expenses		
Maintenance expense for services from ACTS	188	161
Call centre management and marketing fees for services from Aeroplan	4	3
Other expenses	-	9
Recovery of wages, salary and benefit expense for employees assigned to related parties	(99)	(89)
	93	**84**
Net interest expense from related parties	**-**	**2**

Refer to Note 8 to Air Canada's Quarter 1 2007 interim unaudited consolidated financial statements for additional information.

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. These critical accounting estimates require management to make certain judgments and estimates, some of which may relate to matters that are uncertain. Actual results could differ from those estimates under different assumptions and conditions.

Information on Air Canada's critical accounting estimates, including assumptions made for pension and other benefits plans, is provided in Air Canada's 2006 annual MD&A dated February 14, 2007. There have been no material changes to critical accounting estimates since that time.

11. CHANGES IN ACCOUNTING POLICIES

Financial Instruments

On January 1, 2007, Air Canada adopted CICA accounting handbook section 3855, *Financial Instruments – Recognition and Measurement*, section 3861, *Financial Instruments and Presentation*, section 3865, *Hedges*, section 1530, *Comprehensive Income* and section 3251*, Equity*. Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. The purpose of the section is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows.

The changes to Air Canada's consolidated financial statements are described in Note 1 to Air Canada's Quarter 1 2007 interim unaudited consolidated financial statements.

The adopted sections establish standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. Under this standard, all financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods is dependent upon the classification of the financial instrument as held-for-trading, available-for-sale, held-to-maturity, loans and receivables, or other financial liabilities.

With the exception of investment securities classified as available-for-sale and derivatives designated as cash flow hedges, changes in the fair values over the reporting period are reported in net income. The changes in fair values of investment securities classified as available-for-sale and derivatives designated as cash flow hedges are reported in other comprehensive income.

The standards also provide guidance on accounting for derivatives in hedging relationships. In addition to requiring all derivatives to be fair valued on the consolidated statement of financial position, the standards require the effectiveness of the hedging relationships for the reporting period to be quantified. The effective portion of the change in the fair value of the hedging derivative is recognized in other comprehensive income ("OCI") while the ineffective portion is recognized in non-operating income. Upon maturity of fuel derivatives, the effective gains and losses previously recognized in Accumulated OCI ("AOCI") are recorded in fuel expense.

Impact upon Adoption

In accordance with the transitional provisions of the standards, prior periods have not been restated for the adoption of these new accounting standards.

The transition adjustments attributable to the remeasurement of financial assets and financial liabilities at fair value, other than financial assets classified as available-for-sale and hedging instruments designated as cash flow hedges, were recognized in the opening deficit of the Corporation as at January 1, 2007.

For the Corporation's fuel hedging relationship classified as cash flow hedges, which qualify for hedge accounting under the new standards, the effective portion of any gain or loss on the hedging instruments was recognized in AOCI and the cumulative ineffective portion was included in the opening deficit of the Corporation as at January 1, 2007.

Upon adoption, the Corporation recorded the following adjustments to the consolidated statement of financial position:

Increase (decrease)	
Deferred charges	(14)
Future income taxes ($6 million, net of a valuation allowance of $6 million)	-
Accounts payable and accrued liabilities	18
Long-term debt and capital leases	(14)
Deficit, net of nil tax	8
Accumulated other comprehensive income (loss), net of nil tax	(26)

Future Accounting Changes

Capital Disclosures and Financial Instruments – Presentation and Disclosure

The CICA issued three new accounting standards: section 1535, *Capital Disclosures*, section 3862, *Financial Instruments – Disclosures*, and section 3863, *Financial Instruments – Presentation*. These new standards will be effective for fiscal years beginning on or after October 1, 2007 and the Corporation will adopt them on January 1, 2008. The Corporation is in the process of evaluating the consequences of the new standards which may have a material impact on the Corporation's financial statements.

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

Sections 3862 and 3863 will replace section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections will place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

Employee Future Benefits

The Accounting Standards Board ("AcSB") has issued an exposure draft to amend section 3461, Employee Future Benefits. The exposure draft addresses, in a limited manner, recognition, measurement, presentation and disclosure requirements of accounting for employee future benefits. Specifically, in its current draft form, it will require:

- recognition of the funded status (the difference between the plan assets and obligations) of an entity's post-retirement defined benefit plans on the statement of financial position;
- recognition of the changes in the funded status in comprehensive income in the year in which the changes occur;
- recognition of corresponding adjustments from accumulated other comprehensive income to components of benefit cost in net income to maintain the same reported net income as under current section 3461; and
- measurement of plan assets and the accrued benefit obligation at the statement of financial position date, instead of allowing a date that is up to three months before the end of an entity's fiscal year.

The AcSB expects to issue its final amendments to section 3461 in the second half of 2007. The recognition and related disclosure provisions will be effective for fiscal years ending on or after December 31, 2007 for publicly accountable enterprises. The measurement date provisions will be effective for fiscal years ending on or after December 31, 2008.

12. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Air Canada's Audit, Finance and Risk Committee reviewed the Quarter 1 2007 MD&A and the interim unaudited consolidated financial statements and Air Canada's Board of Directors reviewed and approved these documents prior to their release.

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

Air Canada's 2006 Annual Report contains a statement that the President and Chief Executive Officer ("CEO") and the Executive Vice President and Chief Financial Officer ("CFO") have concluded that Air Canada's disclosure controls and procedures are effective based upon an evaluation of these controls and procedures conducted at December 31, 2006.

Changes in Internal Controls over Financial Reporting

There were no changes to Air Canada's internal controls over financial reporting during the quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

13. RISK FACTORS

For a detailed description of the risk factors associated with Air Canada and/or its subsidiaries, refer to the section entitled "Risk Factors" in Air Canada's 2006 annual MD&A dated February 14, 2007. The Corporation is not aware of any significant changes to the Corporation's risk factors from those disclosed at that time.

14. NON-GAAP FINANCIAL MEASURES

EBITDAR

EBITDAR (earnings before interest, taxes, depreciation, amortization and obsolescence and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before aircraft rent and depreciation, amortization and obsolescence 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 Canadian GAAP and does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies.

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

	Quarter 1 2007	Quarter 1 2006	$ Change
Air Canada Services			
GAAP operating loss	(78)	(124)	46
Add back:			
Aircraft rent	73	83	(10)
Depreciation, amortization and obsolescence	128	115	13
EBITDAR	**123**	**74**	**49**
Add back:			
Special charge for labour restructuring	-	28	(28)
EBITDAR excluding special charges	**123**	**102**	**21**
Jazz			
GAAP operating income	36	35	1
Add back:			
Aircraft rent	35	32	3
Depreciation, amortization and obsolescence	5	4	1
EBITDAR	**76**	**71**	**5**
Consolidated Total			
GAAP operating loss	(42)	(88)	46
Add back:			
Aircraft rent	104	113	(9)
Depreciation, amortization and obsolescence	133	119	14
EBITDAR	**195**	**144**	**51**
Add back:			
Special charge for labour restructuring	-	28	(28)
EBITDAR excluding special charges	**195**	**172**	**23**

Operating Loss excluding the Special Charge for Labour Restructuring

The Air Canada Services segment uses operating loss excluding the special charge for labour restructuring to assess the operating performance of its ongoing business without the effects of this special charge. This item is excluded from Air Canada Services' segment results as it could potentially distort the analysis of trends in business performance. The special charge for labour restructuring is the total cost of the 20% non-unionized workforce reduction plan announced in February 2006. The special charge for labour restructuring is not reflective of the underlying financial performance of the Air Canada Services segment from ongoing operations.

The following measure is not a recognized measure for financial statement presentation under Canadian GAAP and does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies.

Operating loss excluding the special charge for labour restructuring is reconciled to operating loss as follows:

	Quarter 1 2007	Quarter 1 2006	$ Change
Air Canada Services			
GAAP operating loss	(78)	(124)	46
Add back:			
Special charge for labour restructuring	-	28	(28)
Operating loss, excluding the special charges for labour restructuring	**(78)**	**(96)**	**18**

	Quarter 1 2007	Quarter 1 2006	$ Change
Consolidated Total			
GAAP operating loss	(42)	(88)	46
Add back:			
Special charge for labour restructuring	-	28	(28)
Operating loss, excluding the special charges for labour restructuring	**(42)**	**(60)**	**18**

Operating Expense excluding Fuel Expense and the Special Charge for Labour Restructuring

The Air Canada Services segment uses operating expense excluding fuel expense and the special charge for labour restructuring to assess the operating performance of its ongoing business without the effects of fuel expense and the special charge for labour restructuring. These items are excluded from Air Canada Services' results as they could potentially distort the analysis of trends in business performance. Fuel expense has increased significantly year-over-year and excluding this expense from GAAP results allows Air Canada Services to compare its operating performance on a consistent basis. The special charge for labour restructuring is not reflective of the underlying financial performance of the Air Canada Services segment from ongoing operations.

The following measure is not a recognized measure for financial statement presentation under Canadian GAAP and does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies.

Operating expense excluding fuel expense and the special charge for labour restructuring is reconciled to operating expense as follows:

	Quarter 1 2007	Quarter 1 2006	$ Change
Air Canada Services			
GAAP operating expense	2,612	2,518	94
Remove:			
Aircraft fuel	(585)	(569)	(16)
Operating expense, excluding fuel expense	**2,027**	**1,949**	**78**
Remove:			
Special charge for labour restructuring	-	(28)	-
Operating expense, excluding fuel expense and the special charge for labour restructuring	**2,027**	**1,921**	**106**