AIR CANADA

Quarter 2 2007
Management's Discussion and Analysis of Results of Operations and Financial Condition

August 9, 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 Air Canada's Quarter 2 2007 interim unaudited consolidated financial statements and notes and Air Canada's annual audited combined consolidated financial statements and notes and its annual MD&A for 2006. Management prepared the interim unaudited consolidated financial statements in accordance with Generally Accepted Accounting Principles in Canada ("GAAP"). Air Canada's 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. Significant exceptions are the deconsolidation of Jazz Air LP ("Jazz") effective May 24, 2007, which is described below, and the adoption, on January 1, 2007, of certain accounting policies relating to financial instruments, hedging derivatives and comprehensive income, which are described in section 8 of this MD&A. Refer to Note 1 to Air Canada's interim unaudited consolidated financial statements for Quarter 2 2007 for additional information relating to changes in accounting policies. 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 August 9, 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 one or more of Air Canada's subsidiaries and/or, until May 24, 2007, Jazz.

Accounting for Jazz

As a result of the distribution by ACE Aviation Holdings Inc. ("ACE") of units of Jazz Air Income Fund on May 24, 2007, ACE's ownership interest in Jazz Air Income Fund was reduced from 58.8% to 49.0%. Jazz Air Income Fund holds all of the outstanding units of Jazz. The distribution of by ACE gave rise to a reconsideration of what entity should consolidate Jazz and, as a result, Jazz Air Income Fund (and not Air Canada) was deemed to be the primary beneficiary of Jazz under Accounting Guideline 15 – Consolidation of Variable Interest Entities ("AcG-15"). As of the distribution date, Air Canada no longer consolidates Jazz. Prior to the date of deconsolidation, Air Canada had two reportable segments: Air Canada Services and Jazz. The Air Canada segment (previously the "Air Canada Services" segment) represents 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"). As of the deconsolidation date, Air Canada has one reportable segment. Refer to Note 7 to Air Canada's Quarter 2 2007 interim unaudited consolidated financial statements for additional information.

Refer to Note 8 to Air Canada's Quarter 2 2007 interim unaudited consolidated financial statements for a description of the transactions between Air Canada and Jazz and the related accounting presentation in Air Canada.

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 and to section 14 of this MD&A.

For further information on Air Canada's public disclosure file, including Air Canada's Initial Annual Information Form dated March 27, 2007, 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 and section 14 of this MD&A. The forward-looking statements contained in this MD&A represent the Corporation's expectations as of the date of this MD&A and are subject to change after such date. However, the Corporation disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

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, 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. An update on the progress made in the first quarter of 2007 is disclosed in Air Canada's Quarter 1 2007 MD&A. The following summarizes progress made in Quarter 2 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. Air Canada's passenger load factor for Quarter 2 2007 was 82.7%, the highest load factor for the second 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 2 2007, revenues from pass products increased 98% over Quarter 2 2006 and flight passes represented 7.5% of domestic revenues.

- ***High Degree of Web Penetration***
  Air Canada's transparent pricing strategy and its user friendly web platform have contributed to a high level of web penetration. Web penetration in Canada reached 63% in Quarter 2 2007, a 13.0 percentage point increase from Quarter 2 2006 whereas system-wide web penetration of 31% represented an increase of 7.6 percentage points from Quarter 2 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 2 2007 versus 62% for Quarter 2 2006. The increase in web penetration in Quarter 2 2007 from Quarter 2 2006 has generated approximately $3 million in cost savings to Air Canada.

- ***Potential for International Route Expansion***
  Air Canada expects to continue to expand its existing services to international destinations through capacity growth in addition to leveraging the Star Alliance® network to serve new international destinations. This strategy will pave the way for the higher margins available in these markets.

  In Quarter 2 2007, Air Canada continued its expansion in the South Pacific, Caribbean, Mexico and South America market where total non-stop flights increased 12% in comparison to Quarter 2 2006. In particular, Air Canada operated 61% more flights to Mexico and 4% more to the Caribbean compared to Quarter 2 2006. On a year-over-year basis, Air Canada introduced three new routes each to the Mexico and the Caribbean markets, bringing the total weekly flights to 30 and 61, respectively.

  In the first six months of 2007 in comparison to the first six months of 2006, Air Canada has added 6% more flights on international routes, which are mainly driven by new non-stop and expanded services on the Atlantic from western Canada/Maritimes to London and seasonal Montreal – Rome, and by a 13% increase in flights to sun markets such as Cuba and Mexico. Air Canada's Pacific strategy is to operate its new and larger Boeing 777 aircraft on the key routes of Japan and China. In addition to the Vancouver – Shanghai route that Air Canada has been operating, Air Canada has added a second frequency out of Vancouver to Beijing and has increased the Toronto-Shanghai/Beijing services both to daily products, for a total of five daily flights in the summer of 2007. These summer schedule changes result in an increase of almost 50% in ASM capacity over the summer of 2006. Air Canada plans to increase operations to China from 17 weekly frequencies to 21 weekly non-stop flights for the winter 2007-2008 season. This will be accomplished by keeping the Toronto-Shanghai service throughout winter with three weekly flights and by increasing Toronto-Beijing to four weekly frequencies.

- ***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 four aircraft in Quarter 2 2007 bringing the total Embraer 190 aircraft deliveries in 2007 to eight aircraft. Since June 30, 2007, an additional four Embraer 190 aircraft have been added to Air Canada's fleet for a total of 30 aircraft.

  In Quarter 2 2007, Air Canada took delivery of one Boeing 777-200 aircraft and an additional three Boeing 777-300 aircraft, one of which was received on lease from International Lease Finance Corporation ("ILFC"). Since June 30, 2007, an additional Boeing 777-200 aircraft and Boeing 777-300 aircraft have been delivered. Since the start of 2007, Air Canada has taken delivery or received five Boeing 777-300 aircraft and two Boeing 777-200 aircraft.

  Air Canada started nine new routes in Quarter 2 2007 to further expand its domestic, transborder and international presence. Out of these, one is a seasonal international route, three are transborder routes and five are domestic routes.

  Air Canada's total connecting traffic increased 1% over Quarter 2 2006. Air Canada continued to increase connecting traffic at its Montreal and Calgary hubs. Connecting traffic through Montreal was up 12% over Quarter 2 2006 and traffic through Calgary grew 10%. Along with Toronto and Vancouver, Montreal and Calgary are becoming important gateways for traffic flows in Air Canada's growing global network.

  Air Canada continued the planned refurbishment of the interior of its aircraft fleet initiated in 2006 and has now completed the refurbishment of 30 Airbus A320 aircraft, 7 Boeing 767-300 aircraft and 11 Airbus A319 aircraft. Initial customer responses based on internal customer satisfaction surveys are favourable.

- ***Leveraging Technology for Enhanced Customer Service and Cost Containment***
  <u>POLARIS</u>
  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 platform is designed to allow for lower operating costs and enhanced capability to bring new, innovative products to market faster, and greater self-service capabilities for our customers and our employees. POLARIS is designed to integrate reservations and departure control functionalities into a seamless web platform thus generating cost savings and ease of customer support.

  The POLARIS team has completed a thorough review of business requirements and design for the POLARIS system. Several employee groups have been involved in the design of the system and initial feedback is positive. Preliminary application releases have also been received and these are now being tested internally and with a few selected partners. Air Canada is currently focusing on aligning processes and procedures to the new system to ensure a smooth transition. In the fall of 2007, a partial release of POLARIS' customer service operational procedures is expected. Other modules of POLARIS are expected to be deployed through a major part of 2008.

  <u>Self-Service Check-in</u>
  Air Canada continues to take steps to provide passengers their desired self-service products such as mobile check-in, web check-in and self-tagging on Kiosk.

Mobile check-in and Web check-in are available in all Canadian Airports, as well as in 26 international stations and 31 U.S. stations. With Mobile check-in, passengers have now the flexibility to input the number of checked baggage and Advance Passenger Information through a mobile device such as a Blackberry. This product will be expanded across the network in due course. A pilot project to send a bar code to the passenger's mobile device after a Mobile check-in is in progress at Montreal's Pierre Elliott Trudeau International Airport. Mobile check-in with bar code will give the ability to the passenger to go directly to the security checkpoint without going through the traditional and more lengthy check-in procedures.

Self-tagging at kiosks is also partially available at Montreal's Pierre Elliott Trudeau International Airport and Vancouver International Airport. Self-tagging kiosks will be gradually implemented at other airports in the coming months, the next one being Toronto. Self-tagging gives the passengers the flexibility to check-in their baggage without the assistance of a check-in agent, print out their baggage tags, affix their baggage tags to their bags and drop their bags off at the baggage drop-off point at their own convenience.

In Quarter 2 2007, approximately 60% of our passengers used the self service check-in products world wide. These products reduce queue times thus enhancing and simplifying the customer experience.

- ***Continue Focus to improve its Cost Structure***
  Air Canada's business strategy remains focused on continuously evaluating and seeking means to improve its cost structure to remain highly competitive.

  Air Canada has experienced increases relating to satisfying minimum return conditions on aircraft leases, provisions for future return to lessor expenses on short-term leases as well as maintenance expenses related to preparing aircraft to be subleased to third party operators. In Quarter 2, 2007, Air Canada's operating expenses reflect an increase of $18 million relating to these aircraft returns and subleases ($29 million in the first six months of 2007).

  In Quarter 2 2007, revenues from subleasing aircraft to third parties amounted to $6 million ($7 million in the first six months of 2007).

  Air Canada has continued to reduce its fuel burden by negotiating competitive fuel rates from its suppliers and is focusing on its structured fuel hedging program. Air Canada's jet fuel cost per litre for Quarter 2 2007 stood at 62.7 cents versus 67.3 cents for Quarter 2 2006 (65.1 cents for the first six months of 2007 versus 65.5 cents for the first fix months of 2006).

  Air Canada is introducing approximately 2,000 new light weight and durable aircraft baggage and cargo containers in 2007. As at the end of June 2007, approximately 1,000 of these units were in service. When fully implemented, these containers are expected to produce sustainable cost savings by decreasing fuel consumption, container maintenance and replacement costs.

- ***Maintaining Positive Employee and Labour Relations***
  As part of our ongoing objective to improve overall employee relations throughout the organization, Air Canada initiated a two-day training program for substantially all Air Canada management employees, including executive and senior management. Called "Relationship Matters", this is the first of a number of learning initiatives directed to the management team. The program commenced in January of this year and will be completed by the end of the third quarter of 2007. With over 1,400 participants trained, the program focuses on skills training around the principles of leadership, effective communication and taking ownership and accountability for one's own area of responsibility, including employee issues and to do so in a rapidly changing business environment. The Corporation plans to expand the "Relationship Matters" program to include frontline unionized employees in lead functions. Overall feedback has been excellent and plans are underway for a second program focusing on labour relations, with a target roll out of the fourth quarter of this year.

On April 10, 2007, Air Canada announced that the wage review process agreed to with all labour groups in 2003 had concluded. The average of the wage adjustment awards granted represents an increase of approximately 5% over the three-year period 2006 – 2009. In order to support its actual and future route expansions Air Canada has hired additional employees to support its increased operations. Air Canada's flight attendant and pilot groups have increased by an average of 259 and 216 full-time employees, respectively, as compared to Quarter 2 2006.

At the same time, by achieving the monthly operational targets, during Quarter 2 2007, Air Canada's employees received four payments under the "sharing our success" program.

- ***Air Canada ranked best airline in North-America***
  Air Canada has been ranked as "Best Airline in North America" in the world's largest survey of air travelers. The exhaustive passenger survey of over 14 million air travelers was conducted by the independent UK-based research firm Skytrax between August 2006 and June 2007 using 40 different aspects of passenger satisfaction for each airline's product and service standards. It is the second time in three years that Air Canada has been placed first among North American carriers. Star Alliance, of which Air Canada is a founding member, was ranked as Best Airline Alliance.

3.2. Fleet Strategy

Increased Firm Orders for Boeing 787 Aircraft
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.

Air Canada's decision to increase its firm orders for Boeing 787 aircraft to 37 underlines its fleet renewal strategy, introducing new technology and driving down its operating costs. The deliveries of the Boeing 787 aircraft committed to by Air Canada are scheduled to be completed by 2014. The agreements with Boeing, as amended in April 2007, also provide for 23 options for Boeing 787 aircraft, bringing the total order for Boeing 787 aircraft, committed and options, to 60.

Aircraft Financing
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 (excluding the Boeing 777-300 aircraft received under a lease with ILFC). In Quarter 2 2007, Air Canada completed EXIM-guaranteed loan financings for three Boeing 777-300 aircraft and one Boeing 777-200 aircraft. 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. For the delivered aircraft, the EXIM loan guarantee support provides for loans at an average fixed rate of 5.43% over a twelve-year term and an all-in loan rate of approximately 6.10% when adding the EXIM guarantee fee. These loans provided Air Canada with lower aircraft financing costs when compared to other financing alternatives available in the market at the time these aircraft were delivered.

Fleet Status
In the first six months of 2007, Air Canada removed 14 aircraft from its fleet comprised of two Boeing 767-300 aircraft and three Airbus A320 aircraft which were returned to lessors, one Boeing 767-200 aircraft which was retired from service, one Airbus A340 aircraft and four Airbus A319 aircraft which were subleased to other airlines, one Airbus A340 aircraft which was removed from service pending sublease to another airline and two Airbus A320 aircraft which were removed from service pending return to lessors.

Letters of intent have been executed for the disposition of four Airbus A319 aircraft to another airline, which are scheduled for delivery in the remainder of 2007. Letters of intent have also been executed for the lease or sublease of three Airbus A340 aircraft planned for delivery in the remainder of 2007 to other airlines. In addition, five Airbus A340 aircraft are expected to be subleased in 2008. In addition, one Airbus A320 aircraft is planned to be removed from service and returned to the lessor in the fall of 2007, two Airbus A340 aircraft will be returned to lessors in the remainder of 2007 and one Boeing 767-200 aircraft will be retired in 2007.

The following table provides the actual and planned fleet changes to Air Canada's fleet (excluding aircraft operated by Jazz):

		Actual					Planned						
Fleet Plan	**December 2006**	**New Deliveries**	**Sublease from Air Canada**	**Lease returns**	**Parked**	**YTD June 2007**	**New Deliveries**	**Sublease from Air Canada / Sale by Air Canada**	**Lease returns**	**Parked**	**December 2007**	**December 2006**	**Variance**
B777-3	-	4				4	1				**5**	**-**	**5**
B777-2	-	1				1	2				**3**	**-**	**3**
B763	33			(2)		31					**31**	**33**	**(2)**
B762	11				(1)	10				(1)	**9**	**11**	**(2)**
A345	2					2		(2)			**-**	**2**	**(2)**
A343	10		(2)			8		(1)	(2)		**5**	**10**	**(5)**
A333	8					8					**8**	**8**	**-**
A321	10					10					**10**	**10**	**-**
A320	47			(5)		42			(1)		**41**	**47**	**(6)**
A319	45		(4)			41		(4)			**37**	**45**	**(8)**
EMB 190	18	8				26	16				**42**	**18**	**24**
EMB 175	15					15					**15**	**15**	**-**
Total	199	13	(6)	(7)	(1)	198	19	(7)	(3)	(1)	**206**	**199**	**7**

The average age of Air Canada's operating fleet (excluding aircraft operated by Jazz) was 9.3 years at June 30, 2007 compared to 9.7 years at June 30, 2006.

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 June 30, 2007, Air Canada had hedged 48% of the remainder of its projected fuel requirement for 2007 and 3% of its projected fuel requirement for 2008. Since June 30, 2007, Air Canada has entered into new hedging positions, using collar option structures, which have added 4% coverage to 2007 increasing the total hedged volume for the remainder of 2007 to 52%. The remainder of 2007 is hedged at prices that can fluctuate between an average of US$84 to US$88 per barrel for jet-fuel based contracts, an average of US$70 to US$77 per barrel for its heating oil-based contracts and an average of US$61 to US$68 per barrel for its WTI crude oil-based contracts. Using equivalent WTI pricing, Air Canada has hedged the remainder of its projected fuel requirements for 2007 at prices that can fluctuate between an average of US$64 to US$70 per barrel. Air Canada has hedged its projected fuel requirements as follows: 49% for Quarter 3 and 56% for Quarter 4.

Refer to section 8 of this MD&A for information on Air Canada's reporting of fuel hedging derivative instruments.

4. RESULTS OF OPERATIONS – QUARTER 2 2007 VERSUS QUARTER 2 2006

4.1. Summary of Consolidated Results

As a result of the deconsolidation of Jazz effective May 24, 2007, Air Canada's consolidated results for Quarter 2 2007 are not directly comparable to its consolidated results for Quarter 2 2006. Air Canada's consolidated results from operations reflect the consolidation of Jazz's operations only up to May 24, 2007. Air Canada's 2006 results reflect the consolidation of Jazz's operations.

The following table reflects the consolidated results of the Corporation for Quarter 2 2007.

Unaudited **Quarter 2 2007**	**Air Canada**	**Jazz**	**Elimination**	**Consolidated** **Total**
Operating revenues				
Passenger	$ 2,336	-	-	$ 2,336
Cargo	135	-	-	135
Other	150	1	-	151
External revenue	2,621	1	-	2,622
Inter-segment revenue	14	248	(262)	-
	2,635	**249**	**(262)**	**2,622**
Operating expenses				
Wages, salaries and benefits	475	56	-	531
Aircraft fuel	636	54	(53)	637
Aircraft rent	71	22	(2)	91
Airport and navigation fees	257	33	(34)	256
Aircraft maintenance, materials and supplies	205	20	(3)	222
Communications and information technology	67	1	1	69
Food, beverages and supplies	78	2	1	81
Depreciation, amortization and obsolescence	136	4	-	140
Commissions	51	-	-	51
Capacity purchase with Jazz	232	-	(156)	76
Other	339	31	(16)	354
	2,547	**223**	**(262)**	**2,508**
Operating income	**88**	**26**	**-**	**114**
Non-operating income (expense)				
Interest income	23	1	-	24
Interest expense	(86)	(1)	-	(87)
Interest capitalized	28	-	-	28
Gain on disposal of assets	14	-	-	14
Loss on financial instruments recorded at fair value	(6)	-	-	(6)
Other	(6)	1	-	(5)
	(33)	1	-	(32)
Income before the following items	**55**	**27**	**-**	**82**
Non-controlling interest	(4)	-	(27)	(31)
Foreign exchange gain	160	-	-	160
Provision for income taxes	(56)	-	-	(56)
Income for the period	**$ 155**	**$ 27**	**$ (27)**	**$ 155**

The following table reflects the consolidated results of the Corporation for Quarter 2 2006.

Unaudited Quarter 2 2006	**Air Canada**	**Jazz**	**Elimination**	**Consolidated Total**
Operating revenues				
Passenger	$ 2,262	-	-	$ 2,262
Cargo	154	-	-	154
Other	141	2	-	143
External revenue	2,557	2	-	2,559
Inter-segment revenue	19	338	(357)	-
	2,576	**340**	**(357)**	**2,559**
Operating expenses				
Wages, salaries and benefits	449	77	-	526
Aircraft fuel	631	71	(71)	631
Aircraft rent	83	33	(2)	114
Airport and navigation fees	245	43	(43)	245
Aircraft maintenance, materials and supplies	189	22	-	211
Communications and information technology	64	2	-	66
Food, beverages and supplies	79	4	(2)	81
Depreciation, amortization and obsolescence	118	7	-	125
Commissions	59	-	-	59
Capacity purchase with Jazz	215	-	(215)	-
Other	331	45	(24)	352
	2,463	**304**	**(357)**	**2,410**
Operating income	**113**	**36**	**-**	**149**
Non-operating income (expense)				
Interest income	20	1	-	21
Interest expense	(76)	(2)	-	(78)
Interest capitalized	13	-	-	13
Gain on disposal of assets	1	-	-	1
Loss on financial instruments recorded at fair value	(1)	-	-	(1)
Other	(3)	-	1	(2)
	(46)	(1)	1	(46)
Income before the following items	**67**	**35**	**1**	**103**
Non-controlling interest	(3)	-	(36)	(39)
Foreign exchange gain	108	-	-	108
Provision for income taxes	(20)	-	-	(20)
Income for the period	**$ 152**	**$ 35**	**$ (35)**	**$ 152**

The following table compares the results of the Air Canada segment (previously "Air Canada Services") for Quarter 2 2007 to Quarter 2 2006. The amounts in the table below include inter-segment revenues and expenses.

Unaudited	Quarter 2		Change	
	2007	2006	$	%
Operating revenues				
Passenger	2,336	2,262	74	3
Cargo	135	154	(19)	(12)
Other	150	141	9	6
External revenue	2,621	2,557	64	3
Inter-segment revenue	14	19	(5)	(26)
	2,635	**2,576**	**59**	**2**
Operating expenses				
Wages, salaries and benefits	475	449	26	6
Aircraft fuel	636	631	5	1
Aircraft rent	71	83	(12)	(14)
Airport and navigation fees	257	245	12	5
Aircraft maintenance, materials and supplies	205	189	16	8
Communications and information technology	67	64	3	5
Food, beverages and supplies	78	79	(1)	(1)
Depreciation, amortization and obsolescence	136	118	18	15
Commissions	51	59	(8)	(14)
Capacity purchase with Jazz	232	215	17	8
Other	339	331	8	2
	2,547	**2,463**	**84**	**3**
Operating income	**88**	**113**	**(25)**	
Non-operating income (expense)				
Interest income	23	20	3	
Interest expense	(86)	(76)	(10)	
Interest capitalized	28	13	15	
Gain on disposal of assets	14	1	13	
Loss on financial instruments recorded at fair value	(6)	(1)	(5)	
Other	(6)	(3)	(3)	
	(33)	(46)	13	
Income before the following items	**55**	**67**	**(12)**	
Non-controlling interest	(4)	(3)	(1)	
Foreign exchange gain	160	108	52	
Provision for income taxes	(56)	(20)	(36)	
Income for the period	**155**	**152**	**3**	
EBITDAR[(1)]	**295**	**314**	**(19)**	

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

4.2. Summary of the Air Canada Segment Results

The Air Canada segment reported operating income of $88 million in Quarter 2 2007 compared to operating income of $113 million in Quarter 2 2006, a decrease of $25 million. EBITDAR decreased $19 million over Quarter 2 2006.

Passenger Revenues

In Quarter 2 2007, passenger revenues increased $74 million or 3% over Quarter 2 2006, reflecting traffic growth, increased fuel surcharges implemented in 2006 and the inclusion of certain ancillary passenger fees in 2007. 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 $19 million in Quarter 2 2007.

The system yield improvement of 1% in Quarter 2 2007 over the same period in 2006 was principally due to the inclusion of the ancillary passenger fees discussed above. In Quarter 2 2007, traffic grew 3% on a capacity increase of 2% over Quarter 2 2006, resulting in a passenger load factor increase of 0.6 percentage points. RASM rose 1% compared to Quarter 2 2006 due to both 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 2 2007 Versus Quarter 2 2006	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	5	3	6	2.7	(1)	3
US transborder	0	1	2	0.9	(2)	(1)
Atlantic	1	3	1	(1.8)	(1)	(2)
Pacific	5	(2)	(1)	0.9	6	7
Other	6	6	4	(1.9)	2	(1)
System	**3**	**2**	**3**	**0.6**	**1**	**1**

In Quarter 2 2007, domestic passenger revenues increased $51 million or 5% due to traffic growth. Traffic grew 6% on a capacity increase of 3% resulting in a passenger load factor improvement of 2.7 percentage points. Domestic RASM increased 3% compared to Quarter 2 2006 due to the improvement in domestic passenger load factor. Capacity increases were largely reflected on Atlantic Canada services and within western Canada. Yield decreased 1% from the same period in 2006 mainly as a result of aggressive competitive pricing activities largely on Rapidair operations between Toronto and Montreal/Ottawa, and, to a lesser extent, in western Canada.

In Quarter 2 2007, US transborder passenger revenues were unchanged from Quarter 2 2006. Capacity increased 1% in comparison to a growth of 8% in Quarter 1 2007 as Air Canada shifted capacity from the US transborder market to the Canadian domestic market. Traffic grew 2% on the capacity increase of 1% resulting in a passenger load factor improvement of 0.9 percentage points. The growth in passenger traffic was largely as a result of increased capacity to California and Las Vegas, Nevada. Yield decreased 2% mainly due to the effect of the new passport regulation in effect since January 1, 2007 and a slowdown in the US economy, both of which resulted in a downward pressure on demand, and led to efforts to stimulate traffic at lower yields. US transborder RASM decreased 1% over Quarter 2 2006 as the passenger load factor improvement was more than offset by the decrease in yield.

In Quarter 2 2007, Atlantic passenger revenues increased $3 million or 1%. Traffic grew 1% on a capacity increase of 3% resulting in a decrease in passenger load factor of 1.8 percentage points. Traffic growth was mainly reflected in the United Kingdom market as a result of increased capacity on the Vancouver – London route, the newly launched Edmonton – London service and additional capacity from Atlantic Canada to London. Yield decreased 1% due to increased competition as a result of the new service on British Airways from Calgary to London as well as a substantial increase in competitive fare actions due to a significant capacity increase by low-cost carriers in the Canada-United Kingdom market. Atlantic RASM decreased 2% due to the decline in yield and passenger load factor which was mainly due to significantly higher competitive capacity as described above. The United Kingdom market was also impacted by the doubling of the U.K. departure tax.

In Quarter 2 2007, Pacific passenger revenues increased $12 million or 5% due to yield improvement. Pacific traffic decreased 1% on a capacity reduction of 2%. Overall Pacific capacity fell 2% as a 17% increase in China capacity due to an earlier seasonal introduction of Toronto – Shanghai service was more than offset by capacity decreases in the India (where service was suspended on May 1, 2007), Korea and Japan markets. Yield improved 6% largely due to increased fuel surcharges implemented in 2006 and fare increases, Pacific RASM increased 7% primarily due to the yield growth and, to a lesser extent, the 0.9 percentage point improvement in passenger load factor.

In Quarter 2 2007, other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) increased $8 million or 6% due to traffic and yield improvements. Traffic grew 4% on a capacity increase of 6% resulting in a decrease in passenger load factor of 1.9 percentage points. Traffic growth in these markets mainly reflected higher capacity to traditional leisure destinations. Yield rose 2% as a result of increased fuel surcharges implemented in 2006 and fare increases but RASM decreased 1% as the yield improvement was more than offset by the deterioration in passenger load factor.

Cargo Revenues

In Quarter 2 2007, cargo revenues declined $19 million or 12% from Quarter 2 2006. This was mainly due to reduced freighter revenues as a result of a decision to reduce the Corporation's chartered MD-11 freighter fleet from three to two aircraft in late 2006 due to inadequate financial returns from Asian operations. System cargo traffic (freighter and non-freighter) was down 15% on a 7% reduction to available cargo capacity. Reduced freighter operations were responsible for over one half of the system traffic decline and essentially all of the available cargo capacity decline. Cargo yield per revenue ton mile improved 3% from the 2006 quarter, in part due to the favorable impact of stronger foreign currencies on international sales.

Two MD-11 freighters were operated in Quarter 2 2007 quarter versus three freighters in Quarter 2 2006. For Quarter 2 2007, freighter revenues declined $10 million from Quarter 2 2006. However, freighter operating expenses were down by a greater amount resulting in an improved financial result for these aircraft. Freighter revenues per unit of available capacity improved 12% from the 2006 quarter.

Non-freighter cargo revenues from Pacific operations declined 14% as a result of reduced traffic essentially due to generally weaker markets. Canada cargo revenues were down 12% on reduced traffic and 6% lower available cargo capacity.

Effective July 2007, Air Canada reduced its chartered MD-11 freighter fleet from two down to one aircraft. Freighter flying to Frankfurt, Germany and Vitoria, Spain, will continue but operations to Asia are terminated due to inadequate financial returns.

Other Revenues

In Quarter 2 2007, other external revenues increased $9 million or 6% over the same period in 2006 largely as a result of aircraft sublease revenues of $6 million in 2007. These increases were partly offset by the impact of the reclassification of certain ancillary passenger fees to "passenger" revenues effective January 1, 2007.

Operating Expenses

In Quarter 2 2007, operating expenses rose $84 million or 3% over the corresponding period in 2006. Unit cost, as measured by operating expense per ASM, increased 1% over Quarter 2 2006. Excluding fuel expense, unit cost increased 2% over the same period in 2006.

The following table compares Air Canada's operating expenses per ASM for Quarter 2 2007 to Air Canada's operating expenses per ASM for the corresponding period in 2006.

	Quarter 2		Change	
($ cents per ASM)	**2007**	**2006**	**$**	**%**
Wages and salaries	2.50	2.33	0.17	7
Benefits	0.62	0.67	(0.05)	(7)
Ownership (DAR) [1]	1.36	1.34	0.02	1
Airport and navigation fees	1.69	1.64	0.05	3
Aircraft maintenance, materials and supplies	1.35	1.27	0.08	6
Communications and information technology	0.44	0.43	0.01	2
Food, beverages and supplies	0.52	0.53	(0.01)	(2)
Commissions	0.33	0.40	(0.07)	(18)
Capacity purchase with Jazz	1.52	1.44	0.08	6
Other	2.23	2.23	-	-
Operating expense, excluding fuel expense [2]	**12.56**	**12.28**	**0.28**	**2**
Aircraft fuel	4.18	4.23	(0.05)	(1)
Total operating expense	**16.74**	**16.51**	**0.23**	**1**

1. *DAR refers to the combination of Aircraft rent and Depreciation, amortization and obsolescence.*
2. *Refer to section 15 "Non-GAAP Financial Measures" in this MD&A for additional information.*

As discussed in section 3 of this MD&A, Air Canada has experienced cost increases relating to satisfying minimum return conditions on aircraft leases, provisions for future return to lessor expenses on short-term leases as well as maintenance expenses related to preparing aircraft to be subleased to third party operators. In Quarter 2, 2007, Air Canada's operating expenses reflect an increase of $18 million relating to these aircraft returns and subleases ($29 million in the first six months of 2007).

In Quarter 2 2007, revenues from subleasing aircraft to third parties amounted to $6 million ($7 million in the first six months of 2007). Sublease revenues are reflected in the "other" revenue category.

Wages and salaries expense totaled $381 million in Quarter 2 2007, an increase of $32 million or 9% from Quarter 2 2006 largely due to higher average wages and an increase of 447 full-time equivalent ("FTE") employees or 2% over Quarter 2 2006 on growth of 2% in ASM capacity. The growth in FTE employees was mainly related to new pilots and flight attendants required to support the expanded capacity and new fleet. The flight attendant and pilot groups increased an average of 259 and 216 FTE employees, respectively. These FTE increases were partly offset by reductions in other employee groups. Factors in the increase in wages and salaries also included increased provisions for voluntary separation packages of $6 million in Quarter 2 2007; net favorable adjustments in the Quarter 2 2006 of $9 million; and increased overtime expenses of $2 million in Quarter 2 2007. 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 2 2006 to Quarter 2 2007 in the average salary per FTE.

Employee benefits expense amounted to $94 million in Quarter 2 2007, a decrease of $6 million or 6% from Quarter 2 2006, largely attributable to a decline in pension and post-employment benefit expenses as a result of revised actuarial valuations. These decreases were partly offset by increased expenses relating to health benefits for active employees.

Fuel expense increased $5 million or 1% in Quarter 2 2007, mainly due to an ASM capacity increase of 2% over Quarter 2 2006. The volume-related increase of $14 million was partly offset by an $8 million decrease due to a reduction in MD-11 freighter operations. A higher average base fuel price and lower realized hedging gains accounted for $5 million and $2 million, respectively, of the increase. A stronger Canadian dollar in the 2007 quarter versus the US dollar resulted in an $8 million decrease to fuel expense. Refer to section 8 of this MD&A for information on Air Canada's reporting of fuel hedging derivative instruments.

Ownership costs, comprised of aircraft rent, depreciation, amortization and obsolescence expenses, increased $6 million in Quarter 2 2007 from Quarter 2 2006. The increase reflected the addition of aircraft to Air Canada's operating fleet (15 Embraer 190 and four Boeing 777 aircraft) and depreciation expense related to the aircraft interior refurbishment program. Largely offsetting these increases were ownership costs decreases relating to the reduction to two chartered MD-11 freighters operating in Quarter 2 2007 as compared to three MD-11 freighters operating in Quarter 2 2006, the effect of aircraft returns and lease terminations and a decrease in amortization expense for intangible assets.

Airport and navigation fees increased $12 million or 5% in Quarter 2 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 1.7% rate reduction for navigation fees in Canada which became effective in September 2006.

Aircraft maintenance, materials and supplies increased $16 million or 8% over Quarter 2 2006. Higher maintenance expenses related to satisfying minimum return conditions on aircraft leases, provisions for future return to lessor expenses on short-term leases and maintenance expenses related to preparing aircraft to be subleased to third party operators accounted for $18 million of the increase. Quarter 2 2007 also witnessed an increase in Airbus A319/A320 narrow-body maintenance costs as these aircraft are in a work cycle which requires replacement of engine life limited parts. However, this increase was offset by reduced airframe and components maintenance expenses.

Commission expense decreased $8 million or 14% in Quarter 2 2007 on combined passenger and cargo revenue growth of 2% over Quarter 2 2006. The decrease in commission expense was mainly driven by the impact of a new commission structure at Air Canada Vacations in 2007 and 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 2.1% in Quarter 2 2007 from 2.4% in Quarter 2 2006.

In Quarter 2 2007, capacity purchase fees paid to Jazz, pursuant to the Jazz CPA, amounted to $232 million compared to capacity fees paid to Jazz of $215 million in Quarter 2 2006, an increase of $17 million. The 8% increase was mainly driven by a 13% increase in block hours over Quarter 2 2006. ASM capacity for flights operated by Jazz increased 15% over Quarter 2 2006.

Non-operating expense amounted to $33 million in Quarter 2 2007, a decrease of $13 million compared to Quarter 2 2006. In Quarter 2 2007, net interest expense decreased $8 million from Quarter 2 2006. A $10 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 new 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 2 2007, a CRJ-100 aircraft owned by Air Canada and leased to Jazz was damaged beyond repair. Given estimated insurance proceeds, Air Canada has recorded a gain on disposal of $14 million in Quarter 2 2007. In Quarter 2 2007, Air Canada recorded a loss of $6 million 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 8 in this MD&A for additional information.

Gains from the revaluation of foreign currency monetary items amounted to $160 million in Quarter 2 2007, attributable to a stronger Canadian dollar at June 30, 2007 compared to March 31, 2007. This compared to gains of $108 million in Quarter 2 2006.

Segment income of $155 million was recorded in Quarter 2 2007 compared to segment income of $152 million in Quarter 2 2006.

4.3. Summary of Jazz Results

As discussed in section 1 of this MD&A, Air Canada's results from operations reflect the consolidation of Jazz's operations only up to May 24, 2007. The following discussion is based on Jazz's published results for Quarter 2 2007.

Jazz reported operating income of $40 million in Quarter 2 2007, an improvement of $4 million from the operating income of $36 million recorded in Quarter 2 2006. EBITDAR of $78 million was recorded in Quarter 2 2007 compared to EBITDAR of $76 million in the same period in 2006, an increase of $2 million. The improvements in operating income and EBITDAR were mainly due to a 15% increase in ASM capacity.

In Quarter 2 2007, operating revenues increased $35 million or 10% from $340 million in Quarter 2 2006 to $375 million in Quarter 2 2007, reflecting a 13% increase in the block hours flown, as well as a 14% increase in pass-through costs charged to Air Canada under the Jazz CPA.

In Quarter 2 2007, operating expenses rose $32 million or 11% from $303 million in Quarter 2 2006 to $335 million in Quarter 2 2007. Pass-through costs under the Jazz CPA, which include aircraft fuel, airport and navigation fees, certain terminal handling and other expenses, increased $17 million. Controllable costs increased $15 million.

Net income of $41 million was recorded in Quarter 2 2007 compared to net income of $36 million in Quarter 2 2006, an improvement of $5 million.

5. RESULTS OF OPERATIONS – SIX MONTHS ENDED JUNE 30, 2007 AND JUNE 30, 2006

5.1. Summary of Consolidated Results

As a result of the deconsolidation of Jazz effective May 24, 2007, Air Canada's consolidated results for the first six months of 2007 are not directly comparable to its consolidated results for the first six months of 2006. Air Canada's consolidated results from operations reflect the consolidation of Jazz's operations only up to May 24, 2007. Air Canada's 2006 results reflect the consolidation of Jazz's operations.

The following table reflects the consolidated results of the Corporation for the six months ended June 30, 2007.

Unaudited **Six months ended June 30, 2007**	**Air Canada**	**Jazz**	**Elimination**	**Consolidated Total**
Operating revenues				
Passenger	$ 4,473	-	-	$ 4,473
Cargo	276	-	-	276
Other	380	3	-	383
External revenue	5,129	3	-	5,132
Inter-segment revenue	40	610	(650)	-
	5,169	**613**	**(650)**	**5,132**
Operating expenses				
Wages, salaries and benefits	974	139	-	1,113
Aircraft fuel	1,221	125	(124)	1,222
Aircraft rent	144	57	(6)	195
Airport and navigation fees	500	80	(81)	499
Aircraft maintenance, materials and supplies	429	50	(8)	471
Communications and information technology	138	2	-	140
Food, beverages and supplies	158	6	-	164
Depreciation, amortization and obsolescence	264	9	-	273
Commissions	110	-	-	110
Capacity purchase with Jazz	462	-	(386)	76
Other	759	83	(45)	797
	5,159	**551**	**(650)**	**5,060**
Operating income	**10**	**62**	**-**	**72**
Non-operating income (expense)				
Interest income	49	2	-	51
Interest expense	(177)	(3)	-	(180)
Interest capitalized	64	-	-	64
Gain on disposal of assets	21	-	-	21
Gain on financial instruments recorded at fair value	28	-	-	28
Other	(10)	1	-	(9)
	(25)	-	-	(25)
Income (loss) before the following items	**(15)**	**62**	**-**	**47**
Non-controlling interest	(6)	-	(62)	(68)
Foreign exchange gain	193	-	-	193
Provision for income taxes	(51)	-	-	(51)
Income for the period	**$ 121**	**$ 62**	**$ (62)**	**$ 121**

The following table reflects the consolidated results of the Corporation for the six months ended June 30, 2006.

Unaudited Six months ended June 30, 2006	Air Canada	Jazz	Elimination	Consolidated Total
Operating revenues				
Passenger	$ 4,264	-	-	$ 4,264
Cargo	305	-	-	305
Other	362	4	-	366
External revenue	4,931	4	-	4,935
Inter-segment revenue	39	656	(695)	-
	4,970	**660**	**(695)**	**4,935**
Operating expenses				
Wages, salaries and benefits	912	151	-	1,063
Aircraft fuel	1,200	130	(130)	1,200
Aircraft rent	166	65	(4)	227
Airport and navigation fees	475	83	(83)	475
Aircraft maintenance, materials and supplies	396	45	(6)	435
Communications and information technology	138	4	(1)	141
Food, beverages and supplies	155	7	(1)	161
Depreciation, amortization and obsolescence	233	11	-	244
Commissions	127	-	-	127
Capacity purchase with Jazz	421	-	(421)	-
Special charge for labour restructuring	28	-	-	28
Other	730	92	(49)	773
	4,981	**588**	**(695)**	**4,874**
Operating income (loss)	**(11)**	**72**	**-**	**61**
Non-operating income (expense)				
Interest income	37	2	(1)	38
Interest expense	(147)	(4)	1	(150)
Interest capitalized	23	(1)	-	22
Gain on disposal of assets	3	-	-	3
Loss on financial instruments recorded at fair value	(3)			(3)
Other	1	-	-	1
	(86)	(3)	-	(89)
Income (loss) before the following items	**(97)**	**69**	**-**	**(28)**
Non-controlling interest	(7)	-	(69)	(76)
Foreign exchange gain	121	-	-	121
Recovery of income taxes	9	-	-	9
Income for the period	**$ 26**	**$ 69**	**$ (69)**	**$ 26**

The following table compares the results of the Air Canada segment (previously "Air Canada Services") for the six months ended June 30, 2007 to the six months ended June 30, 2006. The amounts in the table below include inter-segment revenues and expenses.

Unaudited	**Six months ended June 30 2007**	**2006**	**Change $**	**%**
Operating revenues				
Passenger	4,473	4,264	209	5
Cargo	276	305	(29)	(10)
Other	380	362	18	5
External revenue	5,129	4,931	198	4
Inter-segment revenue	40	39	1	3
	5,169	**4,970**	**199**	**4**
Operating expenses				
Wages, salaries and benefits	974	912	62	7
Aircraft fuel	1,221	1,200	21	2
Aircraft rent	144	166	(22)	(13)
Airport and navigation fees	500	475	25	5
Aircraft maintenance, materials and supplies	429	396	33	8
Communications and information technology	138	138	-	-
Food, beverages and supplies	158	155	3	2
Depreciation, amortization and obsolescence	264	233	31	13
Commissions	110	127	(17)	(13)
Capacity purchase with Jazz	462	421	41	10
Special charge for labour restructuring	-	28	(28)	(100)
Other	759	730	29	4
	5,159	**4,981**	**178**	**4**
Operating income (loss)	**10**	**(11)**	**21**	
Non-operating income (expense)				
Interest income	49	37	12	
Interest expense	(177)	(147)	(30)	
Interest capitalized	64	23	41	
Gain on disposal of assets	21	3	18	
Gain (loss) on financial instruments recorded at fair value	28	(3)	31	
Other	(10)	1	(11)	
	(25)	(86)	61	
Loss before the following items	**(15)**	**(97)**	**82**	
Non-controlling interest	(6)	(7)	1	
Foreign exchange gain	193	121	72	
Recovery of (provision for) income taxes	(51)	9	(60)	
Income for the period	**121**	**26**	**95**	
EBITDAR[1]	**418**	**388**	**30**	
EBITDAR[1], excluding special charges	**418**	**416**	**2**	

1. *See section 15 "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).*

5.2. Summary of the Air Canada Segment Results

The Air Canada segment reported operating income of $10 million for the six months ended June 30, 2007 compared to an operating loss of $11 million for the same period in 2006, an improvement of $21 million. EBITDAR increased $30 million over the first six months of 2006.

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 the six months ended June 30, 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 August 9, 2007, approximately 84% of the planned reductions have been completed. Excluding the special charges for labour restructuring in 2006, operating income in the six months ended June 30, 2007 decreased $7 million compared to the same period in 2006 and EBITDAR increased $2 million over the first six months of 2006.

Passenger Revenues

In the first six months of 2007, passenger revenues increased $209 million or 5% over the same period in 2006, reflecting a growth in traffic, increased fuel surcharges implemented in 2006 and the inclusion of certain ancillary passenger fees in 2007. Ancillary passenger fees, which were previously recorded in "other" revenues, amounted to $30 million in the first six months of 2007.

The system yield improvement of 1% in the first six months of 2007 over the same period in 2006 was principally due to the inclusion of the ancillary passenger fees discussed above. For the six months ended June 30, 2007, traffic grew 4% on a capacity increase of 3% over the same period in 2006, resulting in a passenger load factor increase of 1.0 percentage points. RASM rose 2% due to both 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.

Six months ended June 30, 2007, versus June 30, 2006	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	7	2	7	3.2	0	4
US transborder	2	5	4	(0.6)	(2)	(2)
Atlantic	3	3	3	(0.1)	1	0
Pacific	7	(1)	1	1.3	5	7
Other	4	3	3	(0.1)	1	1
System	**5**	**3**	**4**	**1.0**	**1**	**2**

For the six months ended June 30, 2007, domestic passenger revenues increased $119 million or 7% mainly due to traffic growth. Traffic grew 7% on a capacity increase of 2% resulting in a passenger load factor improvement of 3.2 percentage points. Capacity increases were largely reflected on Atlantic Canada services and within western Canada. Domestic RASM increased 4% compared to the first six months of 2006 due to the improvement in domestic passenger load factor. Yield was unchanged from the same period in 2006 as the increase in yield, the result of the inclusion of certain ancillary fees in the first six months of 2007, was offset by the impact of aggressive competitive pricing activities largely on Rapidair operations between Toronto and Montreal/Ottawa, and, to a lesser extent, in western Canada in Quarter 2 2007.

For the six months ended June 30, 2007, US transborder passenger revenues increased $20 million or 2% due to a 4% growth in traffic on a 5% increase in capacity, mostly in Quarter 1 2007, which resulted in a passenger load factor decrease of 0.6 percentage points. Capacity increased 1% in Quarter 2 2007 versus Quarter 2 2006 in comparison to capacity growth of 8% in Quarter 1 2007 versus Quarter 1 2006 as Air Canada shifted capacity from the US transborder market to the Canadian domestic market. The growth in passenger traffic was largely the result of the introduction of new routes in addition to increased capacity to Florida, California and Las Vegas, Nevada. Yield decreased 2% in the first six months of 2007 reflecting a growth over 2006 in longer-haul flying to key leisure destinations. Long-haul flights generally have a lower yield per RPM than short-haul flights. In addition, the effect of the new passport regulation in effect since January 1, 2007 and a slowdown in the US economy resulted in a downward pressure on demand and led to efforts to stimulate traffic at lower yields. US transborder RASM decreased 2% over the same period in 2006 due to the decrease in yield and passenger load factor.

For the six months ended June 30, 2007, Atlantic passenger revenues increased $26 million or 3% due to increased traffic and, to a lesser extent, to yield improvement as a result of increased fuel surcharges implemented in 2006. Traffic growth of 3% was mainly reflected in the United Kingdom market as a result of increased capacity on the Vancouver – London route, the newly launched Edmonton – London service and additional capacity from Atlantic Canada to London. Yield increased 1% over the first six months of 2006. The impact of increased fuel surcharges implemented in 2006 was partly offset by the impact of the new service on British Airways from Calgary to London as well as a substantial increase in competitive fare actions due to a significant capacity increase by low-cost carriers in the Canada-United Kingdom market. Atlantic RASM was unchanged from the same period in 2006.

For the six months ended June 30, 2007, Pacific passenger revenues increased $28 million or 7% due to yield and traffic improvements. Traffic grew 1% on a 1% decrease in capacity resulting in a passenger load factor improvement of 1.3 percentage points. An increase of 11% in China capacity was more than offset by capacity decreases in the India, Korea and Japan markets. Yield improved 5% largely due to increased fuel surcharges implemented in 2006 and fare increases. Pacific RASM increased 7% due to the increase in yield and passenger load factor.

For the six months ended June 30, 2007, other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) increased $16 million or 4% due to traffic and yield improvements. Traffic grew 3% on a capacity increase of 3% resulting in a passenger load factor essentially unchanged from the same period in 2006. 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 and fare increases. In the first six months of 2007, RASM increased 1% due to the yield increase.

Cargo Revenues

For the six months ended June 30, 2007, cargo revenues decreased $29 million or 10% from the same period in 2006, mainly as a result of reduced freighter flying. System cargo traffic was down 13% on a 7% reduction in available cargo capacity. Reduced freighter operations were responsible for almost one half of the system traffic decline and for most of the available cargo capacity decline. Cargo yield per revenue ton mile increased 4% due in part to the favourable impact of stronger foreign currencies on international sales during 2007.

With the reduction of its chartered MD-11 freighter fleet from three to two aircraft in late 2006, freighter revenues decreased $17 million for the six months ended June 30, 2007 over the same period in 2006; however freighter operating expenses were down by a greater amount resulting in an improved financial result for these aircraft. Freighter revenues per unit of available capacity improved 13% from 2006.

Non-freighter cargo revenues from Pacific operations declined 9% due primarily to weaker Asian markets while Canada cargo revenues were down 10% on reduced traffic and 6% lower available cargo capacity.

Other Revenues

In the first six months of 2007, other external revenues increased $18 million or 5% compared to the same period in 2006, largely the result of an increase in sales of ground packages by Air Canada Vacations, aircraft sublease revenues in 2007, third party revenues at Air Canada Ground Handling and other miscellaneous revenues. These increases were partly offset by the impact of the reclassification of certain ancillary passenger fees to "passenger" revenues effective January 1, 2007.

Operating Expenses

In the first six months of 2007, operating expenses increased $178 million or 4% over the corresponding period in 2006. Unit cost, as measured by operating expense per ASM, increased 1% over the first six months of 2006. Excluding fuel expense and the special charge for labour restructuring, unit cost increased 2%.

The following table compares Air Canada's operating expenses per ASM for the six months ended June 30, 2007 to Air Canada's operating expenses per ASM for the corresponding period in 2006.

	Six months ended June 30		Change	
($ cents per ASM)	**2007**	**2006**	**$**	**%**
Wages and salaries	2.54	2.39	0.15	6
Benefits	0.71	0.74	(0.03)	(4)
Ownership (DAR) (1)	1.36	1.36	-	-
Airport and navigation fees	1.67	1.62	0.05	3
Aircraft maintenance, materials and supplies	1.43	1.36	0.07	5
Communications and information technology	0.46	0.47	(0.01)	(2)
Food, beverages and supplies	0.53	0.53	-	-
Commissions	0.37	0.43	(0.06)	(14)
Capacity purchase with Jazz	1.54	1.44	0.10	7
Other	2.53	2.50	0.03	1
Operating expense, excluding fuel expense and the special charge for labour restructuring (2)	**13.14**	**12.84**	**0.30**	**2**
Aircraft fuel	4.08	4.11	(0.03)	(1)
Special charge for labour restructuring	-	0.10	(0.10)	(100)
Total operating expense	**17.22**	**17.05**	**0.17**	**1**

1. *DAR refers to the combination of Aircraft rent and Depreciation, amortization and obsolescence.*
2. *Refer to section 15 "Non-GAAP Financial Measures" in this MD&A for additional information.*

Wages and salaries expense totaled $762 million in the first six months of 2007, an increase of $65 million or 9% over the corresponding period in 2006 largely due to higher average wages, net favorable adjustments of $14 million in the 2006 period, increased overtime expenses of $8 million, increased provisions for voluntary separation packages of $8 million and expenses of $9 million related to performance-based incentive plans in 2007. 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 the first six months of 2006 to the first six months of 2007 in the average salary per FTE. The total average number of FTEs in the period was essentially unchanged, down by 27 FTEs compared to the 2006 period, but showing a different composition by employee group. The 2007 period included an increased number of pilots, comparatively at a higher average wage than other groups which showed a reduction in FTEs.

Employee benefits expense amounted to $212 million in the first six months of 2007, a decrease of $3 million or 1% from the same period in 2006, largely attributable to a decline in pension and post-employment benefit expenses as a result of revised actuarial valuations. These decreases were partly offset by increased expenses related to health benefits for active employees.

A special charge for labour restructuring of $28 million was recorded in Quarter 1 2006 relating to a non-unionized workforce reduction program.

Fuel expense increased $21 million or 2% in the first six months of 2007, mainly due to an ASM capacity increase of 3% over the same period in 2006. The volume-related increase of $39 million was partly offset by an $11 million decrease due to a reduction in MD-11 freighter operations from three to two MD-11 aircraft. Increased realized hedging losses added additional fuel expenses of $7 million. These increases were partly offset by a decrease of 2% in the average base fuel price and a slightly stronger Canadian dollar versus the US dollar which reduced fuel expense by $9 million and $5 million respectively.

Ownership costs, comprised of aircraft rent, depreciation, amortization and obsolescence expenses, increased $9 million in the first six months of 2007 compared to the same period in 2006. Factors in the increase were the addition of aircraft to Air Canada's operating fleet and depreciation expense related to the aircraft interior refurbishment program. Largely offsetting these increases were the reduction to two chartered MD-11 freighters operating in the first six months of 2007 as compared to three MD-11 freighters operating in the same period in 2006, the effect of aircraft returns and lease terminations, a decrease in amortization expense for intangible assets, and the progressive transfer of CRJ-100 aircraft to Jazz in 2006 which shifts the ownership cost to the capacity purchase expense category.

Airport and navigation fees increased $25 million or 5% in the six months ended June 30, 2007 compared to the same period in 2006, 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. These increases were partly offset by a 1.7% rate reduction for navigation fees in Canada which became effective in September 2006.

Aircraft maintenance, materials and supplies increased $33 million or 8% in the first six months of 2007 compared to the same period in 2006. Higher maintenance expenses related to satisfying minimum return conditions on aircraft leases, provisions for future return to lessor expenses on short-term leases and maintenance expense related to preparing aircraft to be subleased to third party operators accounted for $29 million of the increase. In addition, the first half of 2007 also reflected an increase in Airbus narrow-body maintenance costs which was largely offset by reduced airframe and components maintenance expenses.

Commission expense decreased $17 million or 13% in the first six months of 2007 on combined passenger and cargo revenue growth of 4% over the first six months of 2006. The decrease in commission expense was mainly driven by the impact of a new commission structure at Air Canada Vacations in 2007 and by commercial initiatives implemented by Air Canada to lower commission costs, which more than offset the volume-related increase.

In the first six months of 2007, capacity purchase fees paid to Jazz increased $41 million or 10% over the same period in 2006, largely driven by a 13% growth in block hours. ASM capacity for flights operated by Jazz increased 14% over the first six months of 2006.

Other operating expense grew $29 million or 4% in the first six months of 2007 largely due to a growth in expenses, mainly in Quarter 1 2007, related to ground packages as a result of higher passenger volumes at Air Canada Vacations.

Non-operating expense amounted to $25 million in the six months ended June 30, 2007 compared to non-operating expense of $86 million in the six months ended June 30, 2006. In the first six months of 2007, net interest expense decreased $23 million from the first half of 2006. A $30 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 new aircraft and growth in interest income due to higher cash balances and higher average interest rates. For the six months ended June 30, 2007, Air Canada recorded gains of $7 million pertaining to the sale of one real estate property and the sale of parked aircraft. In addition, in Quarter 2 2007, Air Canada recorded a gain on disposal of $14 million relating to a damaged aircraft. Included in non-operating income in the first six months of 2007 was a $28 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.

Gains from the revaluation of foreign currency monetary items amounted to $193 million in the first six months of 2007, attributable to a stronger Canadian dollar at June 30, 2007 compared to December 31, 2006. This compared to gains of $121 million in the first six months of 2006.

Segment income of $121 million was recorded in the six months ended June 30, 2007 compared to segment income of $26 million in the six months ended June 30, 2006, an improvement of $95 million.

5.3. Summary of Jazz Results

As discussed in section 1 of this MD&A, Air Canada's results from operations reflect the consolidation of Jazz's operations only up to May 24, 2007. The following discussion is based on Jazz's published results for the six-month period ended June 30, 2007.

Jazz reported operating income of $76 million in the six months ended June 30, 2007, an improvement of $4 million from the operating income of $72 million recorded in the same period in 2006. EBITDAR of $155 million was recorded in the six months ended June 30, 2007 compared to EBITDAR of $148 million for the same period in 2006. The improvements in operating income and EBITDAR were mainly due to a 14% increase in ASM capacity.

In the first six months of 2007, operating revenues increased $79 million or 12% over the corresponding period in 2006, reflecting a 13% increase in the block hours flown, as well as a 16% increase in pass-through costs charged to Air Canada under the Jazz CPA.

In the first six months of 2007, operating expenses rose $75 million or 13% over the corresponding period in 2006. Increased pass-through costs under the Jazz CPA represented $38 million of the total increase in operating expenses. Controllable costs reflected the remainder of the increase.

Net income of $76 million was recorded in the first six months of 2007, an improvement of $7 million over the corresponding period in 2006.

6. FINANCIAL AND CAPITAL MANAGEMENT

6.1. Financial Position

The Corporation's consolidated statement of financial position as at December 31, 2006 included 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. As a result of the deconsolidation of Jazz effective May 24, 2007, Air Canada's consolidated statement of financial position as at June 30, 2007 does not include the financial position of Jazz.

On January 1, 2007, Air Canada adopted certain accounting policies which resulted in adjustments to Air Canada's consolidated statement of financial position.

The following provides an overview of the financial position of the Air Canada segment for the periods indicated.

Condensed Statement of Financial Position	June 30, 2007	December 31, 2006
Assets		
Cash, cash equivalents and short-term investments	1,751	2,110
Other current assets	1,442	1,962
Current assets	3,193	4,072
Property and equipment	6,597	5,747
Intangible assets	1,125	1,185
Other assets	331	384
	11,246	**11,388**
Liabilities		
Current liabilities	3,493	3,754
Long-term debt and capital leases obligations	3,172	3,081
Pension and other benefits liabilities	1,887	1,867
Other long-term liabilities	446	544
	8,998	**9,246**
Non-controlling interest	**181**	**212**
Shareholders' equity	**2,067**	**1,930**
	11,246	**11,388**

6.2. Liquidity and Working Capital

The cash flow impact of Air Canada's deconsolidation of Jazz is $138 million. This reflects the Jazz cash being removed from the consolidated statement of financial position of Air Canada and is classified as a cash outflow from investing activities on the consolidated statement of cash flow.

At June 30, 2007, the Air Canada segment had cash, cash equivalents and short-term investments of $1,751 million and negative working capital of $300 million. Compared to December 31, 2006, cash, cash equivalents and short-term investments have decreased by $359 million primarily due to investing activities. Property and equipment increased by $850 million mainly due to additions, primarily aircraft, offset by depreciation.

At June 30, 2007, Air Canada had an unused secured syndicated revolving credit facility of $400 million on which no amounts have been drawn.

6.3. Cash flows for Quarter 2 2007 and Quarter 2 2006

The following table provides an overview of the consolidated cash flows and its two reportable segments for the periods indicated. As previously discussed, Air Canada's 2007 consolidated results reflect the consolidation of Jazz's operations only up to May 24, 2007.

	Three months ended June 30, 2007			
	Air Canada	Jazz	Elimination	Consolidated total
Cash from (used for) operating activities				
Income for the period	$ 155	$ 27	$ (27)	**$ 155**
Adjustments to reconcile to net cash provided by operations				
Depreciation, amortization and obsolescence	136	4	-	**140**
Gain on disposal of and provisions on assets	(14)	-	-	**(14)**
Foreign exchange (gain) loss	(154)	-	-	**(154)**
Future income taxes	56	-	-	**56**
Employee future benefit funding more than expense	(69)	-	-	**(69)**
Decrease (increase) in accounts receivable	(160)	(3)	13	**(150)**
Decrease (increase) in spare parts, materials and supplies	(16)	(1)	-	**(17)**
Increase (decrease) in accounts payable and accrued liabilities	(55)	4	(13)	**(64)**
Increase (decrease) in advance ticket sales, net of restricted cash	195	-	-	**195**
Increase (decrease) in Aeroplan miles obligation	(21)	-	-	**(21)**
Non-controlling Interest	4	-	27	**31**
Aircraft lease payments (in excess of) less than rent expense	(2)	-	-	**(2)**
Unrealized period change in fair value of derivatives	9	-	-	**9**
Capitalized interest	(28)	-	-	**(28)**
Other	50	(1)	-	**49**
	86	**30**	**-**	**116**
Cash from (used for) financing activities				
Aircraft-related borrowings	532	-	-	**532**
Distributions paid to non-controlling interest	-	(21)	-	**(21)**
Reduction of long-term debt and capital lease obligations	(89)	-	-	**(89)**
	443	**(21)**	**-**	**422**
Cash from (used for) investing activities				
Short-term investments	44	-	-	**44**
Additions to capital assets	(703)	(4)	-	**(707)**
Proceeds from sale of assets	1	-	-	**1**
Deconsolidation of Jazz cash	-	(138)	-	**(138)**
Cash management with related parties	(21)	-	-	**(21)**
Other	(22)	-	-	**(22)**
	(701)	**(142)**	**-**	**(843)**
Decrease in cash and cash equivalents	(172)	(133)	-	(305)
Cash and cash equivalents, end of period	**$ 871**	**-**	**-**	**$ 871**

	Three months ended June 30, 2006			
	Air Canada	Jazz	Elimination	Consolidated total
Cash from (used for) operating activities				
Income (loss) for the period	$ 152	$ 36	$ (36)	**$ 152**
Adjustments to reconcile to net cash provided by operations				
Depreciation, amortization and obsolescence	118	7	-	**125**
Gain on disposal of and provisions on assets	(1)	-	-	**(1)**
Foreign exchange (gain) loss	(133)	-	-	**(133)**
Future income taxes	20	-	-	**20**
Employee future benefit funding more than expense	(45)	-	-	**(45)**
Decrease (increase) in accounts receivable	(150)	(11)	31	**(130)**
Decrease (increase) in spare parts, materials and supplies	(19)	(1)	-	**(20)**
Increase (decrease) in accounts payable and accrued liabilities	(33)	37	(31)	**(27)**
Increase (decrease) in advance ticket sales, net of restricted cash	178	-	-	**178**
Increase (decrease) in Aeroplan miles obligation	(26)	-	-	**(26)**
Non-controlling Interest	-	-	39	**39**
Allocation of corporate expenses	6	-	-	**6**
Aircraft lease payments (in excess of) less than rent expense	(3)	-	-	**(3)**
Unrealized period change in fair value of derivatives	4	-	-	**4**
Capitalized interest	(14)	-	-	**(14)**
Other	24	(3)	(3)	**18**
	78	**65**	**-**	**143**
Cash from (used for) financing activities				
Aircraft-related borrowings	98	-	-	**98**
Distributions paid to non-controlling interest	-	(37)	-	**(37)**
Reduction of long-term debt and capital lease obligations	(61)	-	-	**(61)**
Other	2	-	-	**2**
	39	**(37)**	**-**	**2**
Cash from (used for) investing activities				
Short-term investments	(19)	-	-	**(19)**
Additions to capital assets	(188)	(4)	-	**(192)**
Cash management with related parties	7	-	-	**7**
	(200)	**(4)**	**-**	**(204)**
Increase (decrease) in cash and cash equivalents	(83)	24	-	(59)
Cash and cash equivalents, end of period	**$ 1,089**	**$ 110**	**-**	**$ 1,199**

Cash Flows from Operating Activities

In Quarter 2 2007, cash flows from operations for the Air Canada segment were $86 million, an increase of $8 million over Quarter 2 2006, primarily due to an improvement in cash earnings offset by an increase in pension plan funding of $24 million over Quarter 2 2006.

Cash Flows from (used for) Financing Activities

Cash flows from financing activities for the Air Canada segment amounted to an inflow of $443 million. Aircraft-related borrowings for Air Canada amounted to $532 million in Quarter 2 2007 and related to four Boeing 777 and four Embraer aircraft. Scheduled and other debt and capital lease payments in Quarter 2 2007 amounted to $89 million.

Cash Flows used for Investing Activities

In Quarter 2 2007, additions to capital assets totaled $703 million for the Air Canada segment. These additions included $447 million related to the Boeing 777 aircraft, $124 million related to four Embraer aircraft, $60 million related to rotable inventory and spare engines and $40 million related to the aircraft interior refurbishment program and other aircraft betterments. Other additions to capital assets related to ground equipment, facilities and systems development projects.

6.4. Cash flows for the six months ended June 30, 2007 and June 30, 2006

The following table provides an overview of the consolidated cash flows and its two reportable segments for the periods indicated. As discussed previously, Air Canada's 2007 consolidated results reflect the consolidation of Jazz's operations only up to May 24, 2007.

	Six months ended June 30, 2007			
	Air Canada	Jazz	Elimination	Consolidated total
Cash from (used for) operating activities				
Income for the period	$ 121	$ 62	$ (62)	**$ 121**
Adjustments to reconcile to net cash provided by operations				
Depreciation, amortization and obsolescence	264	9	-	**273**
Gain on disposal of and provisions on assets	(21)	-	-	**(21)**
Foreign exchange (gain) loss	(187)	-	-	**(187)**
Future income taxes	45	-	-	**45**
Employee future benefit funding more than expense	(138)	-	-	**(138)**
Decrease (increase) in accounts receivable	(209)	(12)	21	**(200)**
Decrease (increase) in spare parts, materials and supplies	18	(2)	-	**16**
Increase (decrease) in accounts payable and accrued liabilities	68	12	(21)	**59**
Increase (decrease) in advance ticket sales, net of restricted cash	426	-	-	**426**
Increase (decrease) in Aeroplan miles obligation	(46)	-	-	**(46)**
Non-controlling Interest	6	-	62	**68**
Aircraft lease payments (in excess of) less than rent expense	(9)	-	-	**(9)**
Unrealized period change in fair value of derivatives	(32)	-	-	**(32)**
Capitalized interest	(64)	-	-	**(64)**
Other	51	(2)	-	**49**
	293	**67**	**-**	**360**
Cash from (used for) financing activities				
Aircraft-related borrowings	644	-	-	**644**
Distributions paid to non-controlling interest	-	(54)	-	**(54)**
Reduction of long-term debt and capital lease obligations	(167)	-	-	**(167)**
Reduction of non-controlling interest	(36)	-	-	**(36)**
	441	**(54)**	**-**	**387**
Cash from (used for) investing activities				
Short-term investments	(83)	-	-	**(83)**
Additions to capital assets	(1,093)	(11)	-	**(1,104)**
Proceeds from sale of assets	45	-	-	**45**
Deconsolidation of Jazz cash	-	(138)	-	**(138)**
Cash management with related parties	(34)	-	-	**(34)**
Other	(9)	-	-	**(9)**
	(1,174)	**(149)**	**-**	**(1,323)**
Decrease in cash and cash equivalents	(440)	(136)	-	(576)
Cash and cash equivalents, end of period	**$ 871**	**-**	**-**	**$ 871**

	Six months ended June 30, 2006			
	Air Canada	Jazz	Elimination	Consolidated total
Cash from (used for) operating activities				
Income (loss) for the period	$ 26	$ 69	$ (69)	**$ 26**
Adjustments to reconcile to net cash provided by operations				
Depreciation, amortization and obsolescence	233	11	-	**244**
Gain on disposal of and provisions on assets	(3)	-	-	**(3)**
Foreign exchange (gain) loss	(130)	-	-	**(130)**
Future income taxes	(9)	-	-	**(9)**
Employee future benefit funding more than expense	(68)	-	-	**(68)**
Decrease (increase) in accounts receivable	(161)	117	(92)	**(136)**
Decrease (increase) in spare parts, materials and supplies	42	1	-	**43**
Increase (decrease) in accounts payable and accrued liabilities	83	(117)	92	**58**
Increase (decrease) in advance ticket sales, net of restricted cash	400	-	-	**400**
Increase (decrease) in Aeroplan miles obligation	(57)	-	-	**(57)**
Non-controlling Interest	-	-	76	**76**
Allocation of corporate expenses	9	-	-	**9**
Aircraft lease payments (in excess of) less than rent expense	(8)	-	-	**(8)**
Unrealized period change in fair value of derivatives	4	-	-	**4**
Capitalized interest	(23)	-	-	**(23)**
Other	31	17	(7)	**41**
	369	**98**	**-**	**467**
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	222	-	-	**222**
Distributions paid to non-controlling interest	-	(45)	-	**(45)**
Reduction of long-term debt and capital lease obligations	(135)	(14)	-	**(149)**
	487	**(152)**	**-**	**335**
Cash from (used for) investing activities				
Short-term investments	(166)	-	-	**(166)**
Additions to capital assets	(458)	(8)		**(466)**
Decrease (increase) in amount receivable from Air Canada	(138)	138	-	**-**
Cash management with related parties	(1)	-	-	**(1)**
Cash collateralization of letters of credit	(4)	-	-	**(4)**
	(767)	**130**	**-**	**(637)**
Increase (decrease) in cash and cash equivalents	89	76	-	165
Cash and cash equivalents, end of period	**$ 1,089**	**$ 110**	**-**	**$ 1,199**

Cash Flows from Operating Activities

In the six months ended June 30, 2007, cash flows from operations for the Air Canada segment were $293 million, a decrease of $76 million over the same period in 2006, largely due to an increase in pension plan funding of $70 million over the 2006 period

Cash Flows from (used for) Financing Activities

Cash flows from financing activities for the Air Canada segment amounted to $441 million in the first six months of 2007. Aircraft-related borrowings for Air Canada amounted to $644 million in the six months ended June 30 2007 and related to four Boeing 777 and eight Embraer aircraft. Scheduled and other debt and capital lease payments in the first six months of 2007 amounted to $167 million. Reduction of non-controlling interest of $36 million in 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 Flows used for Investing Activities

In the first six months of 2007, additions to capital assets totaled $1,093 million for the Air Canada segment. These additions included $606 million related to four Boeing 777 aircraft, $258 million related to eight Embraer aircraft, $75 million related to rotable inventory and spare engines and $89 million related to the aircraft interior refurbishment program and other aircraft betterments. Other additions to capital assets related to ground equipment and facilities and systems development projects.

Proceeds from sale of assets in 2007 of $45 million were mainly related to the sale of an Air Canada real estate property.

6.5. 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 June 30, 2007	**At March 31, 2007**
Issued and outstanding shares		
Class A variable voting shares	20,199,243	17,290,243
Class B voting shares	79,800,757	82,709,757
Total issued and outstanding shares	**100,000,000**	**100,000,000**
Class A variable voting and Class B voting shares potentially issuable		
Stock options	1,789,266	1,738,735
Total shares potentially issuable	**1,789,266**	**1,738,735**
Total outstanding and potentially issuable shares	**101,789,266**	**101,738,735**

6.6. 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.

During the first six months of 2007, Air Canada received financing for four Boeing 777 aircraft and eight Embraer aircraft. In addition, one Boeing 777 aircraft was delivered pursuant to an operating lease. Refer to sections 3.2 and 6.7 of this MD&A for additional information.

6.7. 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 Boeing 787 aircraft are scheduled to commence in 2010 and be completed by 2014. In addition, these amendments provide for an additional 23 Boeing 787 option aircraft, for a total of up to 60, committed and option, 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 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 seven Boeing 777 aircraft to be acquired from Boeing 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 5.36% based on interest rates as at June 30, 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 to the Boeing agreements, based on June 30, 2007 exchange rates, 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[(1)]	**2007**	**2008**	**2009**	**2010**	**2011**	**Thereafter**[(2)]
Increase (decrease) in total committed expenditures	28	(9)	(293)	72	263	2,815
Decrease (increase) in committed financing on committed expenditures	47	-	276	-	(113)	(690)
Increase (decrease) in total committed expenditures, net of financing	75	(9)	(17)	72	150	2,125

1. *US dollar amounts are converted using the June 30, 2007 noon day rate of $1.0634. Final aircraft delivery prices include estimated escalation and deferred price delivery payment interest calculated based on the 90-day USD LIBOR rate at June 30, 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 any of the Boeing 777 aircraft, the number of Boeing 787 aircraft with committed financing will increase to a total of 31 on 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 to the Boeing agreements on debt repayments from the amounts disclosed in Air Canada's 2006 annual MD&A dated February 14, 2007, is as follows:

Air Canada	**2007**	**2008**	**2009**	**2010**	**2011**
Increase in principal repayment on aircraft-related long-term debt	12	28	18	12	9

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

6.8. Pension Plan Cash Funding Obligations

Air Canada's pension plan cash funding obligations have been updated from those disclosed in Air Canada's 2006 MD&A dated February 14, 2007.

As at January 1, 2007, the solvency deficit in the domestic registered plans was $542 million compared to $1,655 million at January 1, 2006. This reduction in the solvency deficit of the plans represents a significant improvement in the financial position of the plans with the solvency ratio for all plans on a combined basis increasing from 86% to 95%. Two of the 10 domestic plans now show a surplus position on January 1, 2007. This improvement results from the combination of the following factors:

- A 13.6% return on plan assets, net of expenses;
- Significant company contributions to the plans including $261 million for past service;
- A stable interest rate environment in 2006.

This improvement causes the financial position of the plans as at January 1, 2007 to be ahead of schedule compared to the projected financial position assuming no experience gains or losses and using the initial repayment schedule negotiated with the Office of the Superintendent of Financial Institutions ("OSFI") in 2004.

The schedule of required past service contributions to domestic registered plans, based on the January 1, 2007 actuarial valuations, is reduced compared to the schedule of past service contributions that would have been required based on the January 1, 2006 valuations by approximately $115 million in 2007 and $150 million per annum for the years 2008 to 2013.

The table below provides revised projections for Air Canada's pension funding obligations for the remainder of 2007 and for the full years 2007 through to 2011:

Air Canada	Remainder of 2007	Full year 2007	2008	2009	2010	2011
Past service domestic registered plans	9	134	91	92	93	93
Current service domestic registered plans	90	164	166	171	176	181
Other pension arrangements	57	86	86	65	69	74
Projected pension funding obligations	**156**	**384**	**343**	**328**	**338**	**348**

The above pension funding requirements are in respect of the Corporation's pension arrangements. For domestic registered pension plans, the funding requirements are based on the minimum past service contributions disclosed in the January 1, 2007 actuarial valuation plus a projection of the current service contributions.

Changes in the economic conditions, mainly the return on fund assets and changes in interest rates will impact projected required contributions. The required contributions and solvency deficit disclosed above assume no future gains and losses on plan assets and liabilities over the projection period and do not reflect the economic experience of 2007 to date. The increase in long-term interest rates since the beginning of the year, if maintained, would be expected to further decrease the required contributions and solvency deficit and will be reflected in the January 1, 2008 actuarial valuations.

7. QUARTERLY FINANCIAL DATA

The table below summarizes quarterly financial results and major operating statistics for the Corporation for the last eight quarters. The amounts in the table below include inter-segment revenues and expenses.

Consolidated Total	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 [(4)] 2007
Operating revenues	2,742	2,256	2,376	2,559	2,837	2,395	2,510	2,622
Special charge for Aeroplan miles [(1)]	-	-	-	-	(102)	-	-	-
Operating revenues	**2,742**	**2,256**	**2,376**	**2,559**	**2,735**	**2,395**	**2,510**	**2,622**
Ownership (DAR) [(2)]	(216)	(227)	(239)	(239)	(237)	(247)	(237)	(231)
Other operating expenses	(2,217)	(2,086)	(2,225)	(2,171)	(2,329)	(2,119)	(2,315)	(2,277)
Operating expenses [(3)]	**(2,433)**	**(2,313)**	**(2,464)**	**(2,410)**	**(2,566)**	**(2,366)**	**(2,552)**	**(2,508)**
Operating income (loss)	**309**	**(57)**	**(88)**	**149**	**169**	**29**	**(42)**	**114**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(68)	(78)	(38)	3	(125)	(173)	8	41
Net income (loss)	**241**	**(135)**	**(126)**	**152**	**44**	**(144)**	**(34)**	**155**
Earning (loss) per share								
- Basic	**2.73**	**(1.53)**	**(1.43)**	**1.72**	**0.50**	**(1.55)**	**(0.34)**	**1.55**
- Diluted	**2.73**	**(1.53)**	**(1.43)**	**1.72**	**0.50**	**(1.55)**	**(0.34)**	**1.55**
Revenue passenger miles (millions)	13,981	10,584	11,240	12,248	14,346	11,160	11,814	12,580
Available seat miles (millions)	16,961	13,808	14,287	14,926	17,529	14,343	14,735	15,221
Passenger load factor (%)	82.4	76.7	78.7	82.1	81.8	77.8	80.2	82.6

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. *Quarter 2 2007 consolidated operating results are affected by the change in accounting for Jazz whereby Air Canada's consolidated results from operations and financial condition include the consolidation of Jazz's operations only up to May 24, 2007.*

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.

The table below summarizes quarterly financial results and major operating statistics for the Air Canada segment for the last eight quarters. The amounts in the table below include inter-segment revenues and expenses.

Air Canada	**Q3 2005**	**Q4 2005**	**Q1 2006**	**Q2 2006**	**Q3 2006**	**Q4 2006**	**Q1 2007**	**Q2 2007**
Operating revenues	2,757	2,271	2,394	2,576	2,854	2,415	2,534	2,635
Special charge for Aeroplan miles (1)	-	-	-	-	(102)	-	-	-
Operating revenues	**2,757**	**2,271**	**2,394**	**2,576**	**2,752**	**2,415**	**2,534**	**2,635**
Ownership (DAR) (2)	(191)	(196)	(201)	(200)	(199)	(210)	(201)	(207)
Other operating expenses	(2,294)	(2,166)	(2,317)	(2,263)	(2,423)	(2,210)	(2,411)	(2,340)
Operating expenses (3)	**(2,485)**	**(2,362)**	**(2,518)**	**(2,463)**	**(2,622)**	**(2,420)**	**(2,612)**	**(2,547)**
Operating income (loss)	**272**	**(91)**	**(124)**	**113**	**130**	**(5)**	**(78)**	**88**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(32)	(44)	(2)	39	(86)	(139)	44	67
Segment income (loss)	**240**	**(135)**	**(126)**	**152**	**44**	**(144)**	**(34)**	**155**
Revenue passenger miles (millions)	13,980	10,584	11,240	12,248	14,345	11,160	11,814	12,580
Available seat miles (millions)	16,960	13,807	14,287	14,925	17,528	14,343	14,735	15,220
Passenger load factor (%)	82.4	76.7	78.7	82.1	81.8	77.8	80.2	82.7
Operating expense per available seat mile (CASM) (cents)	14.7	17.1	17.6	16.5	15.0	16.9	17.7	16.7
CASM, excluding fuel expense (cents) (4)	10.7	12.9	13.7	12.3	10.6	12.8	13.8	12.6
CASM, excluding fuel expense and the special charge for labour restructuring (cents) (4)	10.7	12.9	13.5	12.3	10.6	12.9	13.8	12.6

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 15 "Non-GAAP Financial Measures" in this MD&A for additional information.*

The table below summarizes quarterly financial results and major operating statistics for the Jazz segment for the last eight quarters. Quarter 2 2007 shows the consolidation of Jazz only up to May 24, 2007.

Jazz	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 [(1)] 2007
Operating revenues	**274**	**304**	**320**	**340**	**369**	**352**	**364**	**249**
Ownership (DAR) [(2)]	(26)	(32)	(36)	(40)	(40)	(39)	(40)	(26)
Other operating expenses	(210)	(238)	(249)	(264)	(290)	(280)	(288)	(197)
Operating expenses	**(236)**	**(270)**	**(285)**	**(304)**	**(330)**	**(319)**	**(328)**	**(223)**
Operating income	**38**	**34**	**35**	**36**	**39**	**33**	**36**	**26**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(1)	(2)	(2)	-	-	(1)	(1)	1
Segment income	**37**	**32**	**33**	**36**	**39**	**32**	**35**	**27**

1. *Quarter 2 2007 results are affected by the change in accounting for Jazz whereby the Jazz's results from operations and financial condition were consolidated by the Corporation only up to May 24, 2007.*
2. *DAR refers to the combination of Aircraft rent and Depreciation, amortization and obsolescence.*

8. 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 June 30, 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 June 30, 2007 and as at August 9, 2007. Refer to Note 1 to Air Canada's Quarter 2 2007 interim unaudited consolidated financial statements for additional information.

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 a derivative's 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 may be recorded as ineffective under the current policy.

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.

The following table provides the changes in fair value of designated hedging items before the impact of tax during the six month period ended June 30, 2007:

Increase (decrease)	Fair value of outstanding fuel derivatives	OCI / AOCI	Fuel expense	Non-operating income (loss)	Retained earnings	Cash on settlement
January 1, 2007	($18)	($26)	$ -	$ -	$8	$ -
Unrealized period change in fair value	39	9	-	30	-	-
Realized loss on maturing contracts	14	8	8	-	-	(14)
March 31, 2007	$35	($9)	$8	$30	$8	($14)
Unrealized period change in fair value	6	13	-	(7)	-	-
Realized gain on maturing contracts	(5)	3	(3)	(7)	-	4
June 30, 2007	$36	$7	$5	$16	$8	($10)

OCI amounts for the three months ended June 30, 2007 are presented net of tax expense of $6 million in Air Canada's Consolidated Statement of Comprehensive Income ($9 million for the six months ended June 30, 2007).

Foreign Exchange Risk Management

During Quarter 1 2007, currency swaps for five CRJ aircraft 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.

The Corporation enters into certain foreign exchange forward contracts or currency swaps to manage the risks associated with foreign currency exchange rates. As at June 30, 2007, the Corporation had entered into foreign currency forward contracts and option agreements on US$1,574 million of future purchases in 2007 and 2008. The fair value of these foreign currency contracts as at June 30, 2007 is $73 million in favour of the counterparty (December 31, 2006 - $25 million in favour of the Corporation on $503 million of future purchases in 2007). These derivative instruments have not been designated as hedges for accounting purposes. The unrealized loss has been recorded in foreign exchange.

9. 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 8 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.

10. RELATED PARTY TRANSACTIONS

At June 30, 2007, ACE had a 75% ownership interest in Air Canada (also 75% at August 9, 2007). Air Canada has various related party transactions with ACE and other ACE-related entities, including Aeroplan, Jazz and ACTS LP (“ACTS’). These transactions are recorded at the exchange amount. Refer to Note 8 to Air Canada’s Quarter 2 2007 interim unaudited consolidated financial statements for additional information.

On June 22, 2007 ACE announced that it had agreed to sell a 70% interest in ACTS, pursuant to which ACE would retain a 30% equity interest in ACTS. Upon closing of this transaction, which is expected during the third quarter of 2007, it is anticipated that a note receivable recorded by Air Canada from ACTS in the amount of $17 million will be settled in cash to Air Canada, and the sale of a building to ACTS will be completed resulting in sale proceeds of $28 million to Air Canada. No gain or loss will result from this sale.

Pursuant to an amending agreement dated June 22, 2007, Air Canada and ACTS agreed to extend, from October 2009 to October 2011, the expiry date of their agreement for airframe heavy maintenance services dated October 1, 2006.

The related party balances resulting from the application of the commercial and contractual practices were as follows:

	June 30, 2007	December 31, 2006
Accounts receivable		
ACE	15	-
Aeroplan	-	6
ACTS	124	97
Jazz (1)	95	-
	234	**103**
Accounts payable and accrued liabilities		
ACE	-	12
ACTS	127	111
Jazz (1)	74	-
	201	**123**

1. *Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada.*

Revenues and expenses with related parties are summarized as follows:

	Three months ended		Six months ended	
	June 30, 2007 (1)	June 30, 2006	June 30, 2007 (1)	June 30, 2006
Revenues				
Revenues from Aeroplan related to Aeroplan rewards	91	83	188	160
Revenue offset from purchase of Aeroplan miles	(62)	(63)	(126)	(124)
Property rental revenues from related parties	13	13	23	25
Revenues from information technology services to related parties	8	6	14	13
Revenues from corporate services and other	11	3	17	7
Cargo revenues from related parties	-	1	1	2
	61	**43**	**117**	**83**
Expenses				
Maintenance expense for services from ACTS	187	159	375	320
Expense from CPA with Jazz	76	-	76	-
Pass through fuel expense from Jazz(2)	29	-	29	-
Pass through airport expense from Jazz(2)	17	-	17	-
Pass through other expenses from Jazz(2)	2	-	2	-
Call centre management and marketing fees for services from Aeroplan	1	2	5	5
Other expenses	-	13	-	22
Recovery of wages, salary and benefit expense for employees assigned to Aeroplan and ACTS	(123)	(118)	(222)	(207)
	189	**56**	**282**	**140**
Net interest expense from related parties	**-**	**2**	**-**	**4**

1. *Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada. The related party transactions above are for the period post May 24, 2007.*
2. *Pass through costs (which are not marked up) charged to Air Canada from Jazz include fuel, airport and user fees and other costs. These expenses are recorded in the applicable category within operating expenses in the results of Air Canada.*

11. 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 benefit 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.

12. 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 2 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.

13. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Air Canada's Audit, Finance and Risk Committee reviewed the Quarter 2 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 June 30, 2007 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

14. 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. However, the following risk factor relating to investigations on proceedings regarding anti-competitive cargo pricing activities has been updated as follows:

Current Legal Proceedings

The European Commission, the United States Department of Justice and the Competition Bureau in Canada, among other competition authorities, are investigating alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including the Corporation. Competition authorities have sought or requested information from the Corporation as part of their investigations. The Corporation is cooperating with these investigations which may lead to proceedings against the Corporation and a number of airlines and other cargo operators. The Corporation is also named as a defendant in a number of class action lawsuits that have been filed before the United States District Court and in Canada in connection with these allegations. It is not possible at this time to predict with any degree of certainty the outcome of these proceedings, but these proceedings may result in liability to the Corporation, which may be material. It is the Corporation's policy to conduct its business in full compliance with all applicable competition laws.

15. NON-GAAP FINANCIAL MEASURES

EBITDAR

EBITDAR (earnings before interest, taxes, depreciation, amortization, 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 2			Six months ended June 30		
	2007	**2006**	**$ Change**	**2007**	**2006**	**$ Change**
Air Canada						
GAAP operating income (loss)	88	113	(25)	10	(11)	21
Add back:						
Aircraft rent	71	83	(12)	144	166	(22)
Depreciation, amortization and obsolescence	136	118	18	264	233	31
EBITDAR	**295**	**314**	**(19)**	**418**	**388**	**30**
Add back:						
Special charge for labour restructuring	-	-	-	-	28	(28)
EBITDAR excluding special charges	**295**	**314**	**(19)**	**418**	**416**	**2**

Operating Income excluding the Special Charge for Labour Restructuring

Air Canada uses operating income 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's 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 Air Canada 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 income excluding the special charge for labour restructuring is reconciled to operating income (loss) as follows:

	Quarter 2			Six months ended June 30		
	2007	**2006**	**$ Change**	**2007**	**2006**	**$ Change**
Air Canada						
GAAP operating income (loss)	88	113	(25)	10	(11)	21
Add back:						
Special charge for labour restructuring	-	-	-	-	28	(28)
Operating income, excluding the special charges for labour restructuring	**88**	**113**	**(25)**	**10**	**17**	**(7)**

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

Air Canada 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's 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 to compare its operating performance on a consistent basis. The special charge for labour restructuring is not reflective of the underlying financial performance of Air Canada 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 2			Six months ended June 30		
	2007	**2006**	**$ Change**	**2007**	**2006**	**$ Change**
Air Canada						
GAAP operating expense	2,547	2,463	84	5,159	4,981	178
Remove:						
Aircraft fuel	(636)	(631)	(5)	(1,221)	(1,200)	(21)
Operating expense, excluding fuel expense	**1,911**	**1,832**	**79**	**3,938**	**3,781**	**157**
Remove:						
Special charge for labour restructuring	-	-	-	-	(28)	-
Operating expense, excluding fuel expense and the special charge for labour restructuring	**1,911**	**1,832**	**79**	**3,938**	**3,753**	**185**