AIR CANADA

THIRD QUARTER 2009
Management's Discussion and Analysis of Results of Operations and Financial Condition

November 6, 2009

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1. Highlights

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

(Canadian dollars in millions except per share figures)	Third Quarter			First Nine Months		
	2009	2008	Change $	2009	2008 (1)	Change $
Financial						
Operating revenues	2,670	3,075	(405)	7,391	8,584	(1,193)
Operating income (loss) before a special provision (1)	68	112	(44)	(233)	107	(340)
Operating income (loss)	68	112	(44)	(233)	(18)	(215)
Non-operating expense	(83)	(147)	64	(272)	(126)	(146)
Loss before non-controlling interest, foreign exchange and income taxes	(15)	(35)	20	(505)	(144)	(361)
Income (loss) for the period	277	(132)	409	32	(298)	330
Operating margin before a special provision % (1)	2.5%	3.6%	(1.1) pp	-3.2%	1.2%	(4.4) pp
Operating margin %	2.5%	3.6%	(1.1) pp	-3.2%	-0.2%	(3.0) pp
EBITDAR before a special provision (1)(2)	320	355	(35)	512	826	(314)
EBITDAR (2)	320	355	(35)	512	701	(189)
EBITDAR margin before a special provision % (1)(2)	12.0%	11.5%	0.5 pp	6.9%	9.6%	(2.7) pp
EBITDAR margin % (2)	12.0%	11.5%	0.5 pp	6.9%	8.2%	(1.3) pp
Cash, cash equivalents and short-term investments	1,209	1,114	95	1,209	1,114	95
Free cash flow	(268)	(373)	105	(347)	(557)	210
Adjusted debt/equity ratio %	84.7%	72.0%	12.7 pp	84.7%	72.0%	12.7 pp
Earnings (loss) per share - basic	$2.77	($1.32)	$4.09	$0.32	($2.98)	$3.30
Earnings (loss) per share - diluted	$2.44	($1.32)	$3.76	$0.30	($2.98)	$3.28
Operating Statistics			Change %			Change %
Revenue passenger miles (millions) (RPM)	14,153	14,458	(2.1)	36,999	39,674	(6.7)
Available seat miles (millions) (ASM)	16,946	17,515	(3.3)	45,502	48,503	(6.2)
Passenger load factor %	83.5%	82.5%	1.0 pp	81.3%	81.8%	(0.5) pp
Passenger revenue per RPM (cents)	16.9	19.0	(11.2)	17.4	18.9	(7.8)
Passenger revenue per ASM (cents)	14.1	15.7	(10.2)	14.2	15.5	(8.4)
Operating revenue per ASM (cents)	15.8	17.6	(10.3)	16.2	17.7	(8.2)
Operating expense per ASM ("CASM") (cents)	15.4	16.9	(9.2)	16.8	17.5	(4.1)
CASM, excluding fuel expense (cents)	11.3	10.8	4.5	12.7	12.1	5.3
Average number of full-time equivalent (FTE) employees (thousands) (3)	23.2	24.5	(5.3)	23.1	24.4	(5.5)
Aircraft in operating fleet at period end (4)	335	341	(1.8)	335	341	(1.8)
Average fleet utilization (hours per day) (5)	9.9	10.2	(3.0)	9.4	9.9	(5.1)
Average aircraft flight length (miles) (5)	883	894	(1.2)	854	873	(2.2)
Fuel price per litre (cents) (6)	68.6	101.0	(32.1)	68.4	88.9	(23.1)
Fuel litres (millions)	988	1,048	(5.7)	2,685	2,941	(8.7)

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

2. Introduction

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

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

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

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of the risks relating to Air Canada, see section 15 "Risk Factors" of this MD&A.

The Corporation issued a news release dated November 6, 2009 reporting on its results for the third quarter of 2009. This news release is available on SEDAR at **sedar.com** and at **aircanada.com**.

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

CAUTION REGARDING FORWARD-LOOKING INFORMATION

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

Forward-looking statements, by their nature, are based on assumptions, including those described herein and are subject to important risks and uncertainties. Forward-looking statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including without limitation, industry, market, credit and economic conditions, the ability to reduce operating costs and secure financing, pension issues, energy prices, currency exchange and interest rates, employee and labour relations, competition, war, terrorist acts, epidemic diseases, insurance issues and costs, changes in demand due to the seasonal nature of the business, supply issues, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in section 15 “Risk Factors" of this MD&A. The forward-looking statements contained in this MD&A represent Air Canada's expectations as of the date of this MD&A and are subject to change after such date. However, Air Canada disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

Assumptions were made by Air Canada in preparing and making forward-looking statements. Air Canada assumes that the North American economy will remain weak for the fourth quarter. In addition, Air Canada expects that the Canadian dollar will trade, on average, at C$1.07 per U.S. dollar in the fourth quarter of 2009 and C$1.15 per U.S. dollar for the full year 2009 and that the price of fuel will average 71 cents per litre in the fourth quarter of 2009 and will average 69 cents per litre for the full year 2009 (both net of fuel hedging positions).

3. Overview

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

Air Canada recorded net income of $277 million or $2.44 per diluted share in the third quarter of 2009 compared to a net loss of $132 million or $1.32 per diluted share in the third quarter of 2008. The net income recorded in the third quarter of 2009 included foreign exchange gains of $295 million which were primarily attributable to a stronger Canadian dollar at September 30, 2009 versus June 30, 2009. The September 30, 2009 noon day exchange rate was US$1 = C$1.0722 while the June 30, 2009 noon day exchange rate was US$1 = C$1.1625.

In the third quarter of 2009, Air Canada recorded operating income of $68 million, a deterioration of $44 million from the operating income of $112 million recorded in the third quarter of 2008. EBITDAR amounted to $320 million in the third quarter of 2009 compared to EBITDAR of $355 million in the same period in 2008, a decrease of $35 million.

In the third quarter of 2009, Air Canada recorded operating revenues of $2,670 million, a decrease of $405 million or 13% from the operating revenues of $3,075 million recorded in the third quarter of 2008. The decrease in operating revenues was mainly due to a passenger revenue decline of $366 million or 13% from the same period in 2008. The passenger revenue decline was due to lower yield and, to a lesser extent, reduced traffic. Yield declined 11.2% from the third quarter of 2008. Traffic decreased 2.1% on a capacity reduction of 3.3%, resulting in a passenger load factor improvement of 1.0 percentage point. RASM decreased 10.2% over the same period in 2008 due to the yield decline. In the third quarter of 2009, a weaker Canadian dollar, which increases the Canadian dollar value of sales in foreign countries, had a positive impact on foreign currency denominated revenues, accounting for an increase of $54 million to third quarter 2009 passenger revenues compared to the third quarter of 2008.

In the third quarter of 2009, Air Canada recorded operating expenses of $2,602 million, a decrease of $361 million or 12% from the operating expenses of $2,963 million recorded in the third quarter of 2008. The decrease in operating expenses was achieved in spite of $60 million in additional expenses related to the weaker Canadian dollar versus the U.S. dollar. Reduced fuel expense of $382 million or 36% versus the same period in 2008 was the main factor in the decrease in operating expenses. A decline in wages, salaries and benefits expenses of $35 million or 7% was also a factor. These decreases were partly offset by growth in aircraft maintenance expense of $56 million which was in large part due to an increase in the number and level of airframe events compared to the same period in 2008.

The weaker Canadian dollar had a positive impact on passenger revenues of $54 million and a negative impact of $60 million on operating expenses. Passenger sales are generally made 45-60 days in advance of travel dates whereas operating expenses are generally paid on or after receipt of goods and services and, as a result, the impact of currency movements on revenues may not be directly related to currency movements on expenses. During the third quarter of 2009, a large proportion of passenger revenues pertained to sales made during the second quarter of 2009 when the Canadian dollar was weaker versus other currencies, particularly the U.S. dollar, resulting in a favourable currency impact on revenues.

In the third quarter of 2009, CASM decreased 9.2% from the third quarter of 2008. Excluding fuel expense, CASM increased 4.5% from the third quarter of 2008. Higher aircraft maintenance expenses were the largest factor in the CASM growth (excluding fuel expense) in the third quarter of 2009. A weaker Canadian dollar versus the U.S. dollar in the third quarter of 2008 was also a factor in the CASM increase (excluding fuel expense) year-over-year. These increases were partly offset by a reduction in employee benefits expense as a result of revised actuarial assumptions.

As disclosed in the Corporation's news release dated August 7, 2009, in the second quarter of 2009, Air Canada launched a major cost transformation program ("CTP") pursuant to which a total of over 100 revenue generating and cost saving initiatives were identified, the majority of which relate to cost reduction initiatives. Air Canada views the CTP as one of its most important priorities over the next several years and, as a result, has invested in dedicated resources to monitor and execute existing initiatives.

4. Significant Events

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

In October 2009

On October 27, 2009, Air Canada completed a public offering for 160,500,000 units at a price of $1.62 per unit with each unit comprised of one Class B voting share or Class A variable voting share and one-half of a warrant for gross proceeds of $260 million (net proceeds of $248 million after expenses and underwriter fees of $12 million).

In addition, the underwriters have been granted an over-allotment option to purchase up to an additional 24,075,000 shares and/or 12,037,500 warrants at a price of $1.50 per share and $0.12 per each half warrant and otherwise on the same terms and conditions as the offering, exercisable in whole or in part at any time until November 27, 2009.

Refer to section 8.8 for additional information on Air Canada's outstanding and potentially issuable shares as at October 31, 2009.

During the third quarter of 2009

- A secured term credit facility (the "Credit Facility") for financing proceeds of $600 million, less fees of $20 million. On or before the first anniversary and subject to satisfaction of certain conditions, Air Canada may request the increase of the facility by up to an additional $100 million by obtaining new commitments from either the existing or new lenders. The Credit Facility is a five-year facility with the first principal repayment due in August 2010, and bears interest at 12.75%. Air Canada's obligations under the Credit Facility are secured by a first priority security interest and hypothec over substantially all the present and after-acquired property of Air Canada and its subsidiaries. The Credit Facility also provides for warrants entitling the debt holders to acquire up to 10% of the shares of the Corporation, which at the time of the issuance of the warrants represented 10 million shares in the Corporation. For additional information pertaining to these warrants, refer to section 8.8 of this MD&A. As part of the transactions related to the closing of the Credit Facility, existing financing arrangements of $166 million were repaid as follows:
    - The revolving credit facility was repaid in full in the amount of $49 million. The rights of the lender under this facility were assigned to the lenders under the Credit Facility;
    - The spare engine financing was partially repaid in the amount of $38 million. This represented the repayment related to 22 engines under the spare engine financing agreement, with 10 engines remaining under the agreement with a loan value of $76 million as at September 30, 2009;
    - The Aeroplan Canada Inc. ("Aeroplan") loan was repaid in the amount of $79 million, which was the maximum available amount at that time. Aeroplan is a participating lender under the Credit Facility.
- Extended or renewed labour agreements for 21 months with all of the Corporation's Canadian-based unions became effective. The agreements provide for no increases to wage rates, no changes to group insurance coverage or benefits, or pension benefit levels during the contract extension or renewal periods;
- Pension funding agreements with all of the Corporation's Canadian-based unions (the "Pension MOUs") and the adoption of the Air Canada Pension Funding Regulations, 2009 (the "Air Canada 2009 Pension Regulations"). The Air Canada 2009 Pension Regulations relieve Air Canada from making any special (past service cost) payments for the period beginning April 1, 2009 and ending December 31, 2010. Thereafter, in respect of the period from January 1, 2011 to December 31, 2013, the aggregate annual past service contributions shall equal the lesser of (i) $150 million, $175 million, and $225 million in respect of 2011, 2012, and 2013, respectively and (ii) the maximum past service contributions permitted under the Income Tax Act. Pursuant to the Pension MOUs, on October 26, 2009, the Corporation issued, to a trust, 17,647,059 Class B voting shares. This number of shares represented 15% of the shares of Air Canada issued and outstanding as at the date of the Pension MOUs and the

date of issuance (after taking into account such issuance). All net proceeds of sale of such shares by the trust are to be contributed to the pension plans;

- An agreement with a supplier for non-refundable proceeds of $230 million in consideration of various contractual commitments. For accounting purposes, the recognition of these proceeds was deferred and will be applied to reduce the cost of these contractual commitments;
- Amendments to credit card processing agreements (initiated in the second quarter and completed in July 2009) with one of its principal credit card processors revising the levels of unrestricted cash (as defined per the agreement and generally based on the balances as reported in cash, cash equivalents and short-term investments) required to be maintained as further described in section 8.3 of this MD&A;
- An extension to a short-term loan of $82 million (US$75 million) entered into in 2008, which was originally due in 2009, to 2013;
- A memorandum of understanding with GE Capital Aviation Services (the "GECAS MOU") for the sale and leaseback of three Boeing 777 aircraft. The sale and leaseback transactions were substantially completed in early November 2009 and provided initial net cash proceeds of $95 million (net of deposits), with additional net proceeds of $20 million to be received upon completion of a remaining part of the transaction, which is expected to occur later in the fourth quarter of 2009; and
- An agreement amending the terms related to Air Canada's capacity purchase agreement with Jazz, effective August 1, 2009, which provides for a reduction to rates paid under the agreement.

During the second quarter of 2009

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

During the first quarter of 2009

- Financing arrangements secured by spare parts, spare engines and a Boeing 777 aircraft for aggregate proceeds of $267 million, net of fees of $5 million. The spare engine financing was partially repaid in July 2009, as described above;
- The sale and leaseback of one Boeing 777 aircraft for aggregate proceeds of $172 million and the required repayment of a debt obligation related to the aircraft of $128 million, which included a prepayment fee of $14 million;
- Inventory financing arrangement under which Air Canada acquired certain spare parts inventories expected to be consumed over the next 12 months in exchange for the issuance of bills of exchange due in February 2010. Subsequent to the initial transaction, Air Canada settled or holds as collateral certain of the bills and, as a result, the expected final payment in 2010 is $18 million (US$17 million) as at October 31, 2009;
- Repayment of pre-delivery financing of $83 million on the Boeing 777 aircraft received during the first quarter of 2009; and
- Net return of collateral deposits on fuel derivatives in the amount of $147 million more than offset by the settlement of fuel derivative contracts in favour of counterparties in the amount of $217 million.

At October 31, 2009, Air Canada had cash and cash equivalents and short-term investments of $1,460 million ($1,005 million at December 31, 2008 and $1,209 million as at September 30, 2009).

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

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

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

	Third Quarter		Change	
(Canadian dollars in millions except per share figures)	**2009**	**2008**	**$**	**%**
Operating revenues				
Passenger	$ 2,400	$ 2,766	$ (366)	(13)
Cargo	92	139	(47)	(34)
Other	178	170	8	5
	2,670	**3,075**	**(405)**	**(13)**
Operating expenses				
Aircraft fuel	682	1,064	(382)	(36)
Wages, salaries, and benefits	437	472	(35)	(7)
Airport and navigation fees	272	275	(3)	(1)
Capacity purchase with Jazz	246	243	3	1
Depreciation and amortization	171	176	(5)	(3)
Aircraft maintenance	183	127	56	44
Food, beverages and supplies	82	86	(4)	(5)
Communications and information technology	70	69	1	1
Aircraft rent	81	67	14	21
Commissions	51	54	(3)	(6)
Other	327	330	(3)	(1)
	2,602	**2,963**	**(361)**	**(12)**
Operating income	**68**	**112**	**(44)**	
Non-operating income (expense)				
Interest income	2	13	(11)	
Interest expense	(87)	(72)	(15)	
Interest capitalized	1	6	(5)	
Gain on assets	1	-	1	
Gain (loss) on financial instruments recorded at fair value	4	(93)	97	
Other	(4)	(1)	(3)	
	(83)	(147)	64	
Loss before the following items	**(15)**	**(35)**	**20**	
Non-controlling interest	(3)	(2)	(1)	
Foreign exchange gain (loss)	295	(87)	382	
Provision for income taxes	-	(8)	8	
Income (loss) for the period	**$ 277**	**$ (132)**	**$ 409**	
EBITDAR [(1)]	**$ 320**	**$ 355**	**$ (35)**	
Earnings (loss) per share - Basic	**2.77**	**(1.32)**	**4.09**	
Earnings (loss) per share - Diluted	**$ 2.44**	**$ (1.32)**	**$ 3.76**	

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

System passenger revenues decreased 13.2% from the third quarter of 2008

Compared to the third quarter of 2008, passenger revenues decreased $366 million or 13.2% to $2,400 million in the third quarter of 2009 due to reduced yields and, to a lesser extent, lower passenger traffic. In the third quarter of 2009, passenger revenues from the premium cabin declined $77 million from the third quarter of 2008 and accounted for over 21% of the total decrease in system passenger revenues. The decrease in premium cabin revenues was driven by a 19.7% decline in yield as premium cabin traffic grew 5.2% year-over-year.

In the third quarter of 2009, Air Canada reduced its overall capacity by 3.3% from the third quarter of 2008. Capacity in the North American and International markets was reduced by 3.7% and 2.9%, respectively, from the same quarter in 2008. Components of the year-over-year change in third quarter system passenger revenues included:

- A system traffic decrease of 2.1% on a system capacity reduction of 3.3%, which resulted in a system passenger load factor improvement of 1.0 percentage point from the third quarter of 2008. The system ASM capacity reduction of 3.3% in the third quarter of 2009 compared to the third quarter of 2008 was in line with the 3.0% to 4.0% ASM capacity reduction projected in Air Canada's news release dated August 7, 2009.
- A system yield decline of 11.2% from the third quarter of 2008, which was due to a weak economy and greater fare discounting in an effort to stimulate traffic, particularly in the premium cabin. As a result of declining corporate demand for Executive Class travel, a number of commercial initiatives for the consumer and trade partners were introduced in an effort to mitigate the decline in premium share, as well as stimulate new high yield leisure demand. The economy cabin reflected a yield decline of 10.4% while the premium cabin reflected a yield decline of 19.7% from the third quarter of 2008.
- A weaker Canadian dollar in the third quarter of 2009 versus the third quarter of 2008, which increases the Canadian dollar value of sales in foreign countries, which had a positive impact on passenger revenues, accounting for an increase of $54 million to third quarter 2009 passenger revenues compared to the third quarter of 2008.
- A RASM decrease of 10.2% from the third quarter of 2008, which was due to the yield decline.

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

Third Quarter 2009 Versus Third Quarter 2008	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	(13.3)	(1.5)	0.7	1.8	(13.6)	(11.7)
U.S. transborder	(13.1)	(8.8)	(8.0)	0.7	(5.4)	(4.6)
Atlantic	(6.7)	6.8	5.9	(0.8)	(11.8)	(12.6)
Pacific	(21.9)	(14.8)	(12.6)	2.1	(10.6)	(8.4)
Other	(20.1)	(7.2)	(7.6)	(0.4)	(13.5)	(13.9)
System	**(13.2)**	**(3.3)**	**(2.1)**	**1.0**	**(11.2)**	**(10.2)**

Domestic passenger revenues decreased 13.3% from the third quarter of 2008

Domestic passenger revenues of $998 million in the third quarter of 2009 decreased $152 million or 13.3% from the third quarter of 2008 due to a lower yield. In the third quarter of 2009, Air Canada reduced its domestic capacity by 1.5% from the third quarter of 2008. Capacity was reduced on all services with the exception of services to the Maritimes and between central and western Canada. Components of the year-over-year change in third quarter domestic passenger revenues included:

- A traffic growth of 0.7% on a capacity reduction of 1.5%, which resulted in a 1.8 percentage point improvement in passenger load factor. Although domestic traffic in the economy cabin was essentially unchanged from the third quarter of 2008, the premium cabin experienced appreciable traffic growth year-over-year.
- A yield decrease of 13.6% from the third quarter of 2008, which reflected the continued weak economic environment and greater fare discounting in an effort to stimulate traffic, particularly in the premium

cabin. In addition, domestic fuel surcharges were in effect from May to September 2008 whereas no such fuel surcharges were in effect in 2009.

- A weaker Canadian dollar in the third quarter of 2009 versus the third quarter of 2008, which had a positive impact on foreign currency denominated revenues of $11 million in the third quarter of 2009.
- A RASM decline of 11.7% from the third quarter of 2008, which was due to the lower yield.

U.S. transborder passenger revenues decreased 13.1% from the third quarter of 2008

U.S. transborder passenger revenues of $406 million in the third quarter of 2009 decreased $61 million or 13.1% from the third quarter of 2008 due to both lower traffic and yield. In the third quarter of 2009, U.S. transborder capacity was reduced by 8.8% from the third quarter of 2008 with decreases reflected on all U.S. transborder services with the exception of Florida. Components of the year-over-year change in third quarter U.S. transborder passenger revenues included:

- A traffic decline of 8.0% on a capacity reduction of 8.8%, which resulted in a passenger load factor improvement of 0.7 percentage points from the third quarter of 2008.
- A year-over-year capacity reduction on the Hawaii service was achieved through reduced frequencies. In addition, the Toronto-San Diego and Vancouver-Sacramento routes were suspended in the second quarter of 2009 while these routes operated in the third quarter of 2008. Partly offsetting these capacity decreases was increased capacity to Florida, in order to capitalize on more stable leisure demand to Florida, and the introduction of services from Calgary to Portland and to San Diego.
- A yield decrease of 5.4% from the third quarter of 2008, which reflected the continued weak economic environment and increased fare discounting in an effort to stimulate traffic. While yield growth occurred on U.S. short-haul routes, U.S. sun and U.S. long-haul routes continued to reflect yield declines year-over-year.
- A weaker Canadian dollar in the third quarter of 2009 versus the third quarter of 2008, which had a positive impact on foreign currency denominated revenue of $16 million in the third quarter of 2009.
- A RASM decrease of 4.6% from the third quarter of 2008, which was due to the yield decline.

Atlantic passenger revenues decreased 6.7% from the third quarter of 2008

Atlantic passenger revenues of $588 million in the third quarter of 2009 decreased $43 million or 6.7% from the third quarter of 2008 due to a lower yield. In the third quarter of 2009, Atlantic capacity was increased by 6.8% from the third quarter of 2008. Capacity was increased on services to France, Germany, Switzerland and Italy while capacity was reduced on services to the United Kingdom and Tel Aviv. Components of the year-over-year change in third quarter Atlantic passenger revenues included:

- A traffic increase of 5.9% on the capacity growth of 6.8%, which resulted in a passenger load factor deterioration of 0.8 percentage points from the third quarter of 2008.
- A yield decline of 11.8% from the third quarter of 2008, which reflected the continued weak economic environment and increased fare discounting to stimulate traffic. Although both the economy and premium cabins reflected yield declines, the premium cabin reflected a more pronounced decrease as pricing actions were taken to offer additional discounted Executive First fares in an effort to stimulate premium traffic.
- A weaker Canadian dollar in the third quarter of 2009 versus the third quarter of 2008, which had a positive impact on foreign currency denominated revenues of $6 million in the third quarter of 2009.
- A RASM decrease of 12.6% from the third quarter of 2008, which was primarily due to the lower yield but was also due to the lower passenger load factor.

Pacific passenger revenues decreased 21.9% from the third quarter of 2008

Pacific passenger revenues of $256 million in the third quarter of 2009 decreased $72 million or 21.9% from the third quarter of 2008 due to both lower traffic and yield. In the third quarter of 2009, capacity was reduced by 14.8% from the third quarter of 2008 with decreases reflected on all Pacific services with the exception of Hong Kong. Components of the year-over-year change in third quarter Pacific passenger revenues included:

- A traffic decrease of 12.6% on the capacity reduction of 14.8%, which resulted in passenger load factor improvement of 2.1 percentage points from the third quarter of 2008. Air Canada increased its capacity to Hong Kong through the use of a larger aircraft (from an Airbus A340 aircraft to a Boeing 777 aircraft).
- A yield decline of 10.6% from the third quarter of 2008, which reflected the continued weak economic environment and increased fare discounting in an effort to stimulate traffic. Although both the economy and premium cabins reflected yield declines, the premium cabin reflected a more pronounced decrease as pricing actions were taken to offer additional discounted Executive First fares in an effort to stimulate premium traffic. A decrease in fuel surcharges year-over-year also adversely impacted Pacific yield.
- A weaker Canadian dollar in the third quarter of 2009 versus the third quarter of 2008, which had a positive impact on foreign currency denominated revenues of $17 million in the third quarter of 2009.
- A RASM decrease of 8.4% from the third quarter of 2008, which was due to the decline in yield.

Other passenger revenues decreased 20.1% from the third quarter of 2008

Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of $152 million in the third quarter of 2009 decreased $38 million or 20.1% from the third quarter of 2008 due to both lower yield and traffic. In the third quarter of 2009, capacity was reduced by 7.2% from the third quarter of 2008. Capacity reductions were reflected on services to South America and Mexico while capacity increases were reflected on services to other traditional leisure destinations and on services to the South Pacific. Components of the year-over-year change in third quarter other passenger revenues included:

- A traffic decrease of 7.6% on the capacity reduction of 7.2%, which resulted in a passenger load factor decrease of 0.4 percentage points versus the same period in 2008.
- A yield decline of 13.5% from the third quarter of 2008, which reflected a weak economic environment and increased fare discounting to stimulate traffic. Although both the economy and premium cabins reflected yield declines, the premium cabin reflected a more pronounced decrease as pricing actions were taken to offer additional discounted Executive First fares in an effort to stimulate premium traffic.
- A weaker Canadian dollar in the third quarter of 2009 versus the third quarter of 2008, which had a positive impact on foreign currency denominated revenues of $4 million in the third quarter of 2009.
- A RASM decrease of 13.9% from the third quarter of 2008, which was primarily due to the decline in yield but was also due to the lower passenger load factor.

Cargo revenues decreased 34% from the third quarter of 2008

Third quarter 2009 cargo revenues amounted to $92 million and were $47 million or 34% below the third quarter of 2008. More than half of the revenue decline was due to reduced fuel surcharges in the third quarter of 2009. Weak economic conditions, increased competitive pressure on rates and reduced traffic volumes also contributed to the revenue decline.

Cargo traffic declined 6% in the third quarter of 2009 over the same period last year. This represented a less pronounced decline than over the first half of the year 2009 where the year-over-year decline in non-freighter traffic averaged 20%. System cargo yield per revenue ton mile (RTM) was down 30% mainly due to lower fuel surcharges and competitive pressure on rates.

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

- A decrease in domestic cargo revenues of 39% on 21% less traffic and a 22% decline in yield per RTM. The termination of the Canada Post contract in September 2008 accounted for more than three quarters of the traffic decrease. Domestic capacity was down 13% versus 2008.
- A decrease in Atlantic revenues of 39% on 7% less traffic and a 35% lower yield per RTM. Atlantic capacity was up 9%.
- A decrease in Pacific revenues of 29% on 2% less traffic and a 28% lower yield per RTM. Pacific capacity was down 13%.
- A weaker Canadian dollar versus the third quarter of 2008, which had a positive impact on foreign currency denominated revenues of $4 million in the third quarter of 2009.

Other revenues increased 5% from the third quarter of 2008

Other revenues of $178 million in the third quarter of 2009 increased $8 million or 5% from the third quarter of 2008, primarily due to a $12 million increase in third party revenues at Air Canada Vacations, which was mainly driven by higher passenger volumes.

CASM decreased 9.2% from the third quarter of 2008. Excluding fuel expense, CASM increased 4.5% from the third quarter of 2008

Operating expenses were $2,602 million in the third quarter of 2009, a decrease of $361 million or 12% from the third quarter of 2008. In the third quarter of 2009, a weaker Canadian dollar versus the U.S. dollar compared to the third quarter of 2008 resulted in additional operating expenses of $60 million.

Unit cost in the third quarter of 2009, as measured by operating expense per available seat mile (CASM), decreased 9.2% over the third quarter of 2008. Excluding fuel expense, CASM increased 4.5% year-over-year mainly due to higher maintenance costs versus the same period in 2008. In the third quarter of 2009, the unfavourable impact of a weaker Canadian dollar versus the U.S. dollar was also a factor in the CASM growth (excluding fuel expense) year-over-year. These increases were partly offset by a reduction in employee benefits expense as a result of revised actuarial assumptions.

The 4.5% increase in CASM (excluding fuel expense) for the third quarter of 2009 was less than the projected CASM increase (excluding fuel expense) provided in Air Canada's news release dated August 7, 2009 in which CASM (excluding fuel expense) was projected to increase between 5.5% and 6.5% compared to the same period in 2008. The difference is primarily attributable to the fact that certain expenses recorded in the third quarter of 2009 were lower than anticipated. These expenses included aircraft maintenance, capacity purchase fees paid to Jazz and information technology costs.

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

	Third Quarter		Change	
(cents per ASM)	**2009**	**2008**	**cents**	**%**
Wages and salaries	2.23	2.22	0.01	0.5
Benefits	0.35	0.48	(0.13)	(27.1)
Ownership (DAR) (1)	1.48	1.39	0.09	6.5
Airport user fees	1.60	1.57	0.03	1.9
Capacity purchase with Jazz	1.45	1.39	0.06	4.3
Aircraft maintenance	1.08	0.72	0.36	50.0
Food, beverages and supplies	0.48	0.49	(0.01)	(2.0)
Communications and information technology	0.41	0.40	0.01	2.5
Commissions	0.30	0.31	(0.01)	(3.2)
Other	1.95	1.87	0.08	4.3
Operating expense, excluding fuel expense (2)	**11.33**	**10.84**	**0.49**	**4.5**
Aircraft fuel	4.03	6.08	(2.05)	(33.7)
Total operating expense	**15.36**	**16.92**	**(1.56)**	**(9.2)**

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

Fuel expense decreased 36% from the third quarter of 2008

Fuel expense amounted to $682 million in the third quarter of 2009, a decrease of $382 million or 36% from the third quarter of 2008. Factors contributing to the year-over-year change in third quarter fuel expense included:

- A lower base fuel price, which accounted for a decrease of $515 million.
- A volume-related decrease of $66 million.

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

- Fuel hedging losses of $94 million in the third quarter of 2009 versus fuel hedging gains of $64 million in the third quarter of 2008, an unfavourable variance of $158 million compared to the third quarter of 2008.
- The unfavourable impact of a weaker Canadian dollar versus the U.S. dollar, which accounted for an increase of $41 million to fuel expense in the third quarter of 2009.

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

	Third Quarter		Change	
(Canadian dollars in millions except where indicated)	**2009**	**2008**	**$**	**%**
Aircraft fuel expense - GAAP [(1)]	$ 678	$ 1,059	$ 381	36
Add: *Fuel hedging gains (losses) included in aircraft fuel expense*	(94)	64	158	247
Add: Net cash settlements on maturing fuel derivatives (designated under hedge accounting and economic hedges)	14	(76)	(90)	118
Economic cost of fuel - Non-GAAP [(2)]	**$ 598**	**$ 1,047**	**$ 449**	**43**
Fuel consumption (thousands of litres)	988,015	1,048,047	(60,032)	(5.7)
Fuel costs per litre (cents) - GAAP	68.6	101.0	(32.4)	(32.1)
Fuel costs per litre (cents) - excluding fuel hedges	59.1	107.1	(48.0)	(44.8)
Economic fuel costs per litre (cents) - Non-GAAP	60.5	99.9	(40.0)	(40.0)

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

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

Wages, salaries and benefits expense amounted to $437 million in the third quarter of 2009, a decrease of $35 million or 7% from the third quarter of 2008.

Wages and salaries expense totaled $377 million in the third quarter of 2009, a decrease of $11 million or 3% from the third quarter of 2008. The decrease in wages and salaries was mainly due to a reduction of an average of 1,310 full-time equivalent ("FTE") employees or 5.3% versus the same period in 2008. The impact of a year-over-year increase of 1.3% in average wages partly offset this reduction. In addition, in the third quarter of 2008, Air Canada reversed previously recorded stock-based compensation expense of $8 million. No such reversal occurred in the third quarter of 2009.

Employee benefits expense amounted to $60 million in the third quarter of 2009, a decrease of $24 million or 29% from the third quarter of 2008. The decrease was mainly due to reduced pension and post-employment benefits expenses as a result of revised actuarial assumptions. The actuarial assumptions used for recording pension expense under GAAP differ from those used in determining the solvency deficit. Refer to section 8.7 of this MD&A for a discussion related to Air Canada's pension funding obligations.

Airport and navigation fees decreased 1% from the third quarter of 2008

In the third quarter of 2009, airport and navigation fees of $272 million decreased $3 million or 1% from the third quarter of 2008, on a 2.9% reduction in aircraft frequencies. Effective January 1, 2010, the Greater Toronto Airports Authority (GTAA) has reduced both landing fees and terminal charges by 10% at Toronto Pearson International Airport. Based on current levels of activity, Air Canada estimates that this rate reduction would result in annual savings of $30 million. Savings realized from the rate reduction will be included in the CTP.

Capacity purchase costs with Jazz increased 1% from the third quarter of 2008

Capacity purchase costs with Jazz, pursuant to the Jazz CPA, amounted to $246 million in the third quarter of 2009 compared to $243 million in the third quarter of 2008, an increase of $3 million or 1%. This year-over-year increase in capacity purchase costs was mainly due to the unfavourable impact of foreign exchange on U.S. denominated Jazz CPA expenses reimbursed by Air Canada under the Jazz CPA, which accounted for an increase of $6 million, and an increase in Jazz CPA rates of $12 million, of which $8 million was related to additional maintenance costs due to the aging of Jazz's fleet. Partially offsetting these increases was the impact of the reduction to the mark-up reimbursed by Air Canada under the Jazz CPA, pursuant to an amendment to the Jazz CPA which became effective on August 1, 2009, which accounted for a decrease of $6 million, as well as the impact of reduced flying which accounted for a decrease of $9 million compared to the third quarter of 2008.

Ownership costs increased 4% from the third quarter of 2008

Ownership costs, comprised of depreciation and amortization, and aircraft rent expense, of $252 million in the third quarter of 2009 increased $9 million or 4% from the third quarter of 2008. Factors contributing to the year-over-year change in the third quarter ownership costs included:

- The addition of three new Boeing 777 aircraft to Air Canada's operating fleet, which accounted for an increase of $7 million.
- The impact of a weaker Canadian dollar versus the U.S. dollar, which accounted for an increase of $6 million to aircraft rent expense.

Aircraft maintenance expense increased 44% from the third quarter of 2008

In the third quarter of 2009, aircraft maintenance expense of $183 million increased $56 million or 44% from the third quarter of 2008. Factors contributing to the year-over-year change in third quarter aircraft maintenance expense included:

- A net increase of $37 million in airframe maintenance, which was largely the result of an increase in the number and the level of airframe events related to the Airbus A319, A320 and Boeing 767-300 aircraft. In particular, the Airbus A319 aircraft which were delivered in the mid-1990s require heavy overhaul maintenance this year.
- A net increase of $9 million in engine maintenance, which was mainly due to a higher volume of engine events related to narrow-body Airbus A320 aircraft.
- The impact of a weaker Canadian dollar versus the U.S. dollar on U.S. denominated maintenance expenses, mainly engine and component maintenance, which accounted for an increase of $6 million to aircraft maintenance expense compared to the third quarter of 2008.

Food, beverages and supplies expense decreased 5% from the third quarter of 2008

In the third quarter of 2009, food, beverages and supplies expense of $82 million decreased $4 million or 5% from the third quarter of 2008, on a 2.1% decrease in passenger traffic and reduced rates year-over-year.

Commission expense decreased 6% from the third quarter of 2008

In the third quarter of 2009, commission expense of $51 million decreased $3 million or 6% from the third quarter of 2008, on a passenger revenue decrease of 13%. In June 2009, Air Canada introduced a 7% commission for Canadian travel agents to sell Tango fares for flights within Canada. Although this initiative has resulted in additional commission expense, overall, management believes that the benefits of this initiative have outweighed the costs in terms of capturing incremental passenger revenues.

Other operating expenses decreased 1% from the third quarter of 2008

Other operating expenses amounted to $327 million in the third quarter of 2009, a decrease of $3 million or 1% from the third quarter of 2008. Factors contributing to the year-over-year change in third quarter other expenses included:

- A reduction in credit card fees of $8 million compared to the same period in 2008, which was primarily the result of lower passenger sales.
- An increase in expenses related to ground packages at Air Canada Vacations of $6 million, which was mainly due to higher passenger volumes compared to the same period in 2008.

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

(Canadian dollars in millions)	Third Quarter 2009	Third Quarter 2008	Change $	Change %
Credit card fees	$ 42	$ 50	$ (8)	(16)
Building rent and maintenance	33	34	(1)	(2)
Air Canada Vacations' land costs	31	25	6	24
Terminal handling	50	46	4	8
Crew expenses (meals, transportation and hotels)	31	29	2	7
Miscellaneous fees and services	30	28	2	9
Remaining other expenses	110	118	(8)	(7)
	$ 327	**$ 330**	**$ (3)**	**(1)**

Non-operating expense amounted to $83 million in the third quarter of 2009

Non-operating expense amounted to $83 million in the third quarter of 2009 compared to non-operating expense of $147 million in the third quarter of 2008. Factors contributing to the year-over-year change in third quarter non-operating expense included:

- Gains related to fair value adjustments on derivative instruments amounted to $4 million in the third quarter of 2009 versus losses of $93 million in the same quarter of 2008. The mark-to-market gains on financial instruments recorded in the third quarter of 2009 were mainly related to a change in the fair value of fuel derivatives. Refer to section 12 of Air Canada's 2008 MD&A dated February 13, 2009 and section 10 of this MD&A for additional information on Air Canada's derivative instruments.
- Net interest expense increased $31 million from the third quarter of 2008 due to:
  - A decrease in interest income of $11 million due to both lower cash balances and lower rates of interest.
  - An increase in interest expense of $15 million, in large part due to new financing transactions completed since the third quarter of 2008 and the unfavourable impact of foreign exchange on interest expense. These increases were partly offset by the impact of lower average interest rates year-over-year.
  - A lower amount of capitalized interest of $5 million compared to the third quarter of 2008.

Gains on foreign exchange amounted to $295 million in the third quarter of 2009

Gains on foreign exchange amounted to $295 million in the third quarter of 2009 compared to losses of $87 million in the third quarter of 2008. The gains in the third quarter of 2009 were mainly attributable to a stronger Canadian dollar at September 30, 2009 compared to June 30, 2009. The September 30, 2009 noon day exchange rate was US$1 = C$1.0722 while the June 30, 2009 noon day exchange rate was US$1 = C$1.1625.

Income taxes of nil in the third quarter of 2009

Air Canada recorded income taxes of nil on pre-tax income of $277 million in the third quarter of 2009. Income tax expense for the third quarter of 2009 was offset by a reversal of valuation allowance. A provision for income taxes of $8 million was recorded in the third quarter of 2008.

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

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

	First Nine Months		Change	
(Canadian dollars in millions except per share figures)	**2009**	**2008**	**$**	**%**
Operating revenues				
Passenger	$ 6,469	$ 7,531	$ (1,062)	(14)
Cargo	248	402	(154)	(38)
Other	674	651	23	4
	7,391	**8,584**	**(1,193)**	**(14)**
Operating expenses				
Aircraft fuel	1,847	2,627	(780)	(30)
Wages, salaries, and benefits	1,333	1,433	(100)	(7)
Airport and navigation fees	743	771	(28)	(4)
Capacity purchase with Jazz	746	711	35	5
Depreciation and amortization	495	520	(25)	(5)
Aircraft maintenance	557	502	55	11
Food, beverages and supplies	222	244	(22)	(9)
Communications and information technology	229	214	15	7
Aircraft rent	250	199	51	26
Commissions	140	154	(14)	(9)
Other	1,062	1,102	(40)	(4)
	7,624	**8,477**	**(853)**	**(10)**
Operating income (loss) before the undernoted item	**(233)**	**107**	**(340)**	
Provision for cargo investigations		(125)	125	
Operating loss	**(233)**	**(18)**	**(215)**	
Non-operating income (expense)				
Interest income	12	46	(34)	
Interest expense	(286)	(231)	(55)	
Interest capitalized	4	31	(27)	
Loss on assets	(70)	(29)	(41)	
Gain on financial instruments recorded at fair value	73	60	13	
Other	(5)	(3)	(2)	
	(272)	(126)	(146)	
Loss before the following items	**(505)**	**(144)**	**(361)**	
Non-controlling interest	(11)	(8)	(3)	
Foreign exchange gain (loss)	549	(128)	677	
Provision for income taxes	(1)	(18)	17	
Income (loss) for the period	**$ 32**	**$ (298)**	**$ 330**	
EBITDAR before the provision for cargo investigations (1)	**$ 512**	**$ 826**	**$ (314)**	
EBITDAR (1)	**$ 512**	**$ 701**	**$ (189)**	
Earnings (loss) per share - Basic	**$ 0.32**	**$ (2.98)**	**$ 3.30**	
Earnings (loss) per share - Diluted	**$ 0.30**	**$ (2.98)**	**$ 3.28**	

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

System passenger revenues decreased 14.1% from the first nine months of 2008

Compared to the first nine months of 2008, passenger revenues decreased $1,062 million or 14.1% to $6,469 million in the first nine months of 2009 due to lower yield and traffic. A decline in passenger revenues from the premium cabin accounted for $370 million or almost 35% of the total decrease in system passenger revenues.

In the first nine months of 2009, Air Canada reduced its overall capacity by 6.2% from the first nine months of 2008, comprised of a year-over-year capacity reduction of 10.3% in the first quarter, a year-over-year capacity reduction of 5.4% in the second quarter and a year-over-year capacity reduction of 3.3% in the third quarter. Components of the year-over-year change in first nine months system passenger revenues included:

- A traffic decline of 6.7% exceeded the capacity decrease of 6.2%, resulting in a deterioration in passenger load factor of 0.5 percentage points from the first nine months of 2008, comprised of year-over-year passenger load factor decrease of 0.5 percentage points in the first quarter, a year-over-year passenger load factor decrease of 2.2 percentage points in the second quarter, and a year-over-year passenger load factor increase of 1.0 percentage point in the third quarter.
- A system yield decrease of 7.8% from the first nine months of 2008, comprised of a year-over-year yield decrease of 2.3% in the first quarter, a year-over-year yield decrease of 8.9% in the second quarter, and a year-over-year yield decrease of 11.2% in the third quarter. The system yield decline reflected a weak economy, reduced high-yield business travel and increased competitive pricing activities. To retain Air Canada's share of premium cabin traffic as well as to stimulate new high-end leisure demand, pricing actions were taken to offer additional discounted Executive and Executive First fares.
- A weaker Canadian dollar in the first nine months of 2009 versus the first nine months of 2008 had a positive impact on foreign currency denominated revenues of $186 million in the first nine months of 2009.
- A RASM decrease of 8.4% from the first nine months of 2008, comprised of a year-over-year RASM decline of 3.0% in the first quarter, a year-over-year RASM decline of 11.3% in the second quarter, and a year-over-year decline of 10.2% in the third quarter. The RASM decrease in the first nine months of 2009 was primarily due to the yield decline as passenger load factor decreased only 0.5 percentage points from the first nine months of 2008.

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

First Nine Months of 2009 Versus First Nine Months of 2008	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	(14.0)	(4.6)	(4.9)	(0.3)	(9.4)	(9.7)
U.S. transborder	(15.0)	(9.4)	(10.9)	(1.3)	(4.6)	(6.1)
Atlantic	(9.6)	-	(1.4)	(1.2)	(8.4)	(9.6)
Pacific	(18.7)	(17.4)	(15.9)	1.5	(3.4)	(1.6)
Other	(17.2)	(2.2)	(3.9)	(1.4)	(13.9)	(15.4)
System	**(14.1)**	**(6.2)**	**(6.7)**	**(0.5)**	**(7.8)**	**(8.4)**

The following discussion illustrates the main contributing factors in the year-over-year change in passenger revenues for the first nine months of 2009:

Domestic passenger revenues decreased 14.0% from the first nine months of 2008

Domestic passenger revenues of $2,708 million in the first nine months of 2009 decreased $440 million or 14.0% from the first nine months of 2008 due to a 9.4% decline in yield and a 4.9% decrease in traffic. All three quarters in 2009 were impacted by year-over-year reductions in traffic and capacity. In the first nine months of 2009, domestic capacity was reduced by 4.6% from the same period in 2008. A year-over-year decline of 1.0 percentage point in domestic passenger load factor in the first quarter of 2009 deteriorated to a year-over-year decline of 2.1 percentage points in the second quarter of 2009 and improved to a year-over-year increase of 1.8 percentage points in the third quarter of 2009. Domestic yield deteriorated year-over-year from a decline of 3.3% in the first quarter of 2009 to a decline of 9.5% in the second quarter of 2009 and a decline of 13.6% in the third quarter of 2009. In the first nine months of 2009, RASM decreased 9.7% from the first nine months of

2008. A year-over-year RASM decline of 4.4% in the first quarter of 2009 deteriorated to a year-over-year decline of 11.9% in the second quarter of 2009 and to a less pronounced decline of 11.7% in the third quarter of 2009.

A weaker Canadian dollar in the first nine months of 2009 versus the first nine months of 2008 had a positive impact on foreign currency denominated revenues of $38 million in the first nine months of 2009.

U.S. transborder passenger revenues decreased 15.0% from the first nine months of 2008

U.S. transborder passenger revenues of $1,236 million in the first nine months of 2009 decreased $219 million or 15.0% from the first nine months of 2008 due to a 10.9% decrease in traffic and a 4.6% decline in yield. All three quarters in 2009 reflected year-over-year reductions in traffic and capacity. In the first nine months of 2009, U.S. capacity was reduced by 9.4% from the same period in 2008. A year-over-year decline of 0.7 percentage points in U.S. transborder passenger load factor in the first quarter of 2009 deteriorated to a year-over-year decline of 3.9 percentage points in the second quarter of 2009 and improved to a year-over-year increase of 0.7 percentage points in the third quarter of 2009. U.S. transborder yield deteriorated year-over-year from a decline of 3.4% in the first quarter of 2009 to a decline of 5.4% in the second quarter of 2009 and remained at a 5.4% year-over-year decline in the third quarter of 2009. In the first nine months of 2009, RASM decreased 6.1% from the first nine months of 2008. A year-over-year RASM decline of 4.1% in the first quarter of 2009 deteriorated to a year-over-year decline of 10.2% in the second quarter of 2009 and improved to a year-over-year decline of 4.6% in the third quarter of 2009.

A weaker Canadian dollar in the first nine months of 2009 versus the first nine months of 2008 had a positive impact on foreign currency denominated revenues of $61 million in the first nine months of 2009.

Atlantic passenger revenues decreased 9.6% from the first nine months of 2008

Atlantic passenger revenues of $1,345 million in the first nine months of 2009 decreased $144 million or 9.6% from the first nine months of 2008 due to an 8.4% decline in yield and a 1.4% decrease in traffic. In the first nine months of 2009, Atlantic capacity was unchanged from the same period in 2008. A year-over-year decline of 2.7 percentage points in passenger load factor in the first quarter of 2009 was followed by less pronounced year-over-year declines of 1.3 percentage points in the second quarter of 2009 and 0.8 percentage points in the third quarter of 2009. A year-over-year yield growth of 0.1% in the first quarter of 2009 deteriorated to a year-over-year decline of 9.7% in the second quarter of 2009 and further deteriorated to a year-over-year decline of 11.8% in the third quarter of 2009. In the first nine months of 2009, RASM decreased 9.6% from the first nine months of 2008. A year-over-year RASM decline of 3.4% in the first quarter of 2009 deteriorated to a year-over-year decline of 11.0% in the second quarter of 2009 and further deteriorated to a year-over-year decline of 12.6% in the third quarter of 2009.

A weaker Canadian dollar in the first nine months of 2009 versus the first nine months of 2008 had a positive impact on foreign currency denominated revenues of $27 million in the first nine months of 2009.

Pacific passenger revenues decreased 18.7% from the first nine months of 2008

Pacific passenger revenues of $630 million in the first nine months of 2009 decreased $145 million or 18.7% from the first nine months of 2008 due to a 15.9% decrease in traffic and a 3.4% decline in yield. In the first nine months of 2009, Pacific capacity was reduced by 17.4% from the same period in 2008. A year-over-year improvement of 6.2 percentage points in passenger load factor in the first quarter of 2009 deteriorated to a year-over-year decline of 3.1 percentage points in the second quarter of 2009 and improved to a year-over-year increase of 2.1 percentage points in the third quarter of 2009. A year-over-year yield growth of 10.2% in the first quarter of 2009 deteriorated to a year-over-year decline of 4.9% in the second quarter of 2009 and further deteriorated to a year-over-year decline of 10.6% in the third quarter of 2009. In the first nine months of 2009, RASM decreased 1.6% from the first nine months of 2008. A year-over-year RASM increase of 18.5% in the first quarter of 2009 deteriorated to a year-over-year decrease of 8.3% in the second quarter of 2009 and remained at essentially the same level in the third quarter of 2009, down 8.4% year-over-year.

A weaker Canadian dollar in the first nine months of 2009 versus the first nine months of 2008 had a positive impact on foreign currency denominated revenues of $43 million in the first nine months of 2009.

Other passenger revenues decreased 17.2% from the first nine months of 2008

Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of $550 million in the first nine months of 2009 decreased $114 million or 17.2% from the first nine months of 2008 due mainly to a 13.9% decline in yield but also to a 3.9% decline in traffic. In the first nine months of 2009, Other capacity was reduced by 2.2% from the same period in 2008. A year-over-year decline of 2.2% in passenger load factor in the first quarter of 2009 improved to a year-over-year decline of 1.2 percentage points in the second quarter of 2009 and further improved to a year-over-year decline of 0.4 percentage points in the third quarter of 2009. The second and third quarters of 2009 reflected overall capacity reductions of 6.6% and 7.2%, respectively, while the first quarter of 2009 reflected capacity growth of 4.2%. A year-over-year yield decline of 12.4% in the first quarter of 2009 deteriorated to a year-over-year decline of 16.7% in the second quarter of 2009 and improved to a year-over-year decline of 13.5% in the third quarter of 2009. A year-over-year RASM decline of 14.8% in the first quarter of 2009 deteriorated to a year-over-year decline of 17.9% in the second quarter of 2009 and improved to a year-over-year decline of 13.9% in the third quarter of 2009.

A weaker Canadian dollar in the first nine months of 2009 versus the first nine months of 2008 had a positive impact on foreign currency denominated revenues of $17 million in the first nine months of 2009.

Cargo revenues decreased 38% from the first nine months of 2008

Cargo revenues amounted to $248 million in the first nine months of 2009 and were $154 million or 38% below the first nine months of 2008, on a 10% reduction to cargo capacity. One half of the revenue decline in the first nine months of 2009 was due to significantly reduced fuel surcharges and the cancellation, in 2008, of freighter flying. Weak economic conditions resulting in reduced traffic volumes and increased competitive pressure on rates also contributed to the revenue decline.

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

Non-freighter revenues decreased $125 million or 34%, reflecting a system-wide traffic reduction of 15%. System cargo yield decreased 22% from the first nine months of 2008 due to lower fuel surcharges and competitive pressure on rates.

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

- A decrease in domestic cargo revenues of 41% on 37% less traffic and a 5% decline in yield per RTM. The termination of the Canada Post contract in September 2008 accounted for more than one half of the traffic decrease. Domestic capacity was down 15% versus 2008.
- A decrease in Atlantic non-freighter revenues of 36% on 13% less traffic and a 26% lower yield per RTM.
- A decrease in Pacific revenues of 33% on 12% less traffic and a 24% lower yield per RTM. Pacific capacity was down 14%.
- A system traffic decline of 22% (including the impact of the freighter termination in June 2008) in the first nine months compared to 2008 and a yield per RTM decline of 22%.
- A weaker Canadian dollar versus the same period in 2008, which had a positive impact on foreign currency denominated revenues of $15 million in the first nine months of 2009.

Other revenues increased 4% from the first nine month of 2008

Other revenues of $674 million in the first nine months of 2009 increased $23 million or 4% from the first nine months of 2008, primarily due to an increase of $28 million in third party revenues at Air Canada Vacations, mainly the result of higher passenger volumes, and growth of $20 million in aircraft sublease revenues. Various factors amounting to a net decrease of $25 million partly offset these increases.

CASM decreased 4.1% from the first nine months of 2008. Excluding fuel expense, CASM increased 5.3% from the first nine months of 2008

Operating expenses were $7,624 million in the first nine months of 2009, a decrease of $853 million or 10% from the first nine months of 2008. A weaker Canadian dollar versus the U.S. dollar compared to the first nine months of 2008 resulted in additional operating expenses of $335 million in the first nine months of 2009.

CASM in the first nine months of 2009 decreased 4.1% over the first nine months of 2008. Excluding fuel expense, CASM increased 5.3% year-over-year.

The unfavourable impact of a weaker Canadian dollar versus the U.S. dollar accounted for over 50% of the CASM growth (excluding fuel expense) in the first nine months of 2009. In addition to the impact of foreign exchange, other factors accounting for the CASM growth included: increased Jazz CPA rates; growth in aircraft maintenance expenses, higher unit costs of ownership; and the impact of the capacity reduction. The capacity reduction impacts CASM (excluding fuel expense) disproportionately as Air Canada's cost structure is such that its fixed costs do not fluctuate proportionately with changes in capacity in the short term. Partly offsetting these increases to CASM (excluding fuel expense) was a reduction in employee benefits expense, the result of revised actuarial assumptions.

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

	First Nine Months		Change	
(cents per ASM)	**2009**	**2008**	**cents**	**%**
Wages and salaries	2.48	2.39	0.09	3.8
Benefits	0.45	0.56	(0.11)	(19.6)
Ownership (DAR) [(1)]	1.64	1.48	0.16	10.8
Airport user fees	1.63	1.59	0.04	2.5
Capacity purchase with Jazz	1.64	1.47	0.17	11.6
Aircraft maintenance	1.22	1.03	0.19	18.4
Food, beverages and supplies	0.49	0.50	(0.01)	(2.0)
Communications and information technology	0.50	0.44	0.06	13.6
Commissions	0.31	0.32	(0.01)	(3.1)
Other	2.34	2.28	0.06	2.6
Operating expense, excluding fuel expense [(2)]	**12.70**	**12.06**	**0.64**	**5.3**
Aircraft fuel	4.06	5.42	(1.36)	(25.1)
Total operating expense	**16.76**	**17.48**	**(0.72)**	**(4.1)**

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

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

Fuel expense decreased 30% from the first nine months of 2008

Fuel expense amounted to $1,847 million in the first nine months of 2009, a decrease of $780 million or 30% from the first nine months of 2008. Factors contributing to the year-over-year change in first nine months' fuel expense included:

- A lower base fuel price, which accounted for a decrease of $1,250 million.
- A volume-related decrease of $237 million, including the impact of the termination of freighter flying in June 2008.

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

- Fuel hedging losses of $334 million in the first nine months of 2009 versus fuel hedging gains of $190 million in the first nine months of 2008, an unfavourable variance of $524 million compared to the first nine months of 2008.
- The unfavourable impact of a weaker Canadian dollar versus the U.S. dollar, which accounted for an increase of $183 million to fuel expense in the first nine months of 2009.

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

	First Nine Months		Change	
(Canadian dollars in millions except where indicated)	2009	2008	$	%
Aircraft fuel expense - GAAP (1)	$ 1,838	$ 2,613	$ (775)	(30)
Add: *Fuel hedging gains (losses) included in aircraft fuel expense*	(334)	190	(524)	(276)
Add: Net cash settlements on maturing fuel derivatives (designated under hedge accounting and economic hedges) (2)	76	(220)	296	(135)
Economic cost of fuel - Non-GAAP (3)	**$ 1,580**	**$ 2,583**	**$ (1,003)**	**(39)**
Fuel consumption (thousands of litres)	2,685,032	2,940,688	(255,656)	(8.7)
Fuel costs per litre (cents) - GAAP	68.4	88.9	(20.5)	(23.1)
Fuel costs per litre (cents) - excluding fuel hedges	56.0	95.3	(39.3)	(41.2)
Economic fuel costs per litre (cents) - Non-GAAP	58.8	87.8	(29.0)	(33.0)

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

(2) Excluding early terminated hedging contracts in Q1 2009 for $172 million covering 2009 and 2010 fuel consumption.

(3) Economic cost of fuel is Air Canada's best estimate of the cash cost of fuel; it is a non-GAAP measure used by the Corporation and is not likely to be comparable to measures presented by other public companies.

Wages, salaries and benefits expense amounted to $1,333 million in the first nine months of 2009, a decrease of $100 million or 7% from the first nine months of 2008.

Wages and salaries expense totaled $1,130 million in the first nine months of 2009, a decrease of $29 million or 3% from the first nine months of 2008. A decrease of an average of 1,339 full-time equivalent ("FTE") employees or 5.5%, primarily the result of the 6.2% reduction in ASM capacity, was partly offset by the impact of a year-over-year increase in average wages of 2.2% over the first nine months of 2008.

Employee benefits expense amounted to $203 million in the first nine months of 2009, a decrease of $71 million or 26**%** from the first nine months of 2008, mainly due to reduced pension and post-employment benefits expenses as a result of revised actuarial assumptions.

Capacity purchase costs with Jazz increased 5% from the first nine months of 2008

Capacity purchase costs with Jazz, pursuant to the Jazz CPA, amounted to $746 million in the first nine months of 2009 compared to $711 million in the first nine months of 2008, an increase of $35 million or 5%. This year-over-year increase in capacity purchase costs was mainly due to the unfavourable impact of foreign exchange on U.S. denominated Jazz CPA expenses which accounted for an increase of $36 million and an increase in Jazz CPA rates of $26 million compared to the same period in 2008, which included savings of $6 million resulting from the reduction of the mark-up effective August 1, 2009. Partially offsetting these increases was the impact of reduced flying which accounted for a decrease of $27 million to capacity purchase costs compared to the first nine months of 2008.

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

Ownership costs, comprised of depreciation and amortization, and aircraft rent expense, of $745 million in the first nine months of 2009 increased $26 million or 4% from the first nine months of 2008. Factors contributing to the year-over-year change in first nine months ownership costs included:

- The addition of new Boeing 777 aircraft to Air Canada's operating fleet, which accounted for an increase of $35 million.
- The impact of a weaker Canadian dollar versus the U.S. dollar, which accounted for an increase of $32 million to aircraft rent expense.

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

- Changes in aircraft residual values, the result of a weaker Canadian dollar versus the U.S. dollar, which accounted for a decrease of $35 million to depreciation expense.
- A decrease of $10 million to aircraft rent expense as a result of reduced MD-11 freighter flying as no MD-11 freighter aircraft were operated in the first nine months of 2009 versus one MD-11 freighter operated in the first six months of 2008.

Aircraft maintenance expense increased 11% from the third quarter of 2008

In the first nine months of 2009, aircraft maintenance expense of $557 million increased $55 million or 11% from the first nine months of 2008, of which $47 million was due to the impact of a weaker Canadian dollar versus the U.S. dollar on U.S. denominated maintenance expenses, mainly engine and component maintenance. A volume increase in aircraft heavy maintenance events, primarily related to the narrow-body Airbus aircraft, was offset by a decrease in engine maintenance events and by less activity on the Airbus A340 aircraft due to the removal of these aircraft from Air Canada's operating fleet.

Other operating expenses decreased 4% from the first nine months of 2008

Other operating expenses amounted to $1,062 million in the first nine months of 2009, a decrease of $40 million or 4% from the first nine months of 2008. Factors contributing to the year-over-year change in first nine months other expenses included:

- A reduction in credit card fees compared to the same period in 2008, which was primarily the result of lower passenger sales.
- An increase in expenses related to ground packages at Air Canada Vacations of $29 million, which was mainly due to higher passenger volumes compared to the first nine months of 2008.
- A decrease in "remaining other expenses" of $52 million, which represented the result of various cost reduction initiatives and the impact of the capacity reduction. It also included favourable rate adjustments on foreign currency transactions of $21 million.

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

	First Nine Months		Change	
(Canadian dollars in millions)	**2009**	**2008**	**$**	**%**
Credit card fees	$ 130	$ 153	$ (23)	(15)
Building rent and maintenance	96	102	(6)	(6)
Air Canada Vacations' land costs	203	174	29	17
Terminal handling	143	135	8	6
Crew expenses (meals, transportation and hotels)	89	87	2	2
Miscellaneous fees and services	84	82	2	3
Remaining other expenses	317	369	(52)	(14)
	$ 1,062	**$ 1,102**	**$ (40)**	**(4)**

Non-operating expense amounted to $272 million in the first nine months of 2009

Non-operating expense amounted to $272 million in the first nine months of 2009 compared to non-operating expense of $126 million in the first nine months of 2008. Factors contributing to the year-over-year change in first nine months non-operating expense included:

- Gains related to fair value adjustments on derivative instruments amounted to $73 million in the first nine months of 2009 versus gains of $60 million in the same quarter of 2008. The mark-to-market gains on financial instruments recorded in the first nine months of 2009 were mainly related to the change in the fair value of fuel derivatives.
- Net interest expense increased $116 million from the first nine months of 2008 due to:
  - A decrease in interest income of $34 million due to both lower cash balances and lower rates of interest;
  - An increase in interest expense of $55 million, mainly due to the impact of new financing transactions completed in the first nine months of 2009 and the unfavourable impact of foreign exchange on interest expense. These increases were partly offset by the impact of lower average interest rates year-over-year. In addition, in the first nine months of 2009, Air Canada recorded a charge of $17 million related to a sale and leaseback transaction of one Boeing 777 aircraft and a charge of $9 million related to the termination of the capital leases of two Airbus A340 aircraft and the subsequent sale of these aircraft. These increases were partly offset by a reduction of interest expense on aircraft pre-delivery payments related to Boeing 777 aircraft versus the same period in 2008;
  - A lower amount of capitalized interest of $27 million compared to the same period in 2008.
- In the first nine months of 2009, Air Canada recorded an impairment charge of $67 million related to previously capitalized costs incurred pertaining to the development of a new reservation system, referred to as Polaris. Air Canada is currently working towards the implementation of certain components of the solution such as web and fare technology but has suspended activity relating to the implementation of the reservation system.
- In the first nine months of 2008, Air Canada recorded an impairment charge of $38 million relating to the retirement of its fleet of Boeing 767-200 aircraft and gains amounting to $7 million pertaining to the sale of aircraft-related inventory.

Gains on foreign exchange amounted to $549 million in the first nine months of 2009

Gains on foreign exchange amounted to $549 million in the first nine months of 2009 compared to losses of $128 million in the first nine months of 2008. The gains in the first nine months of 2009 were mainly attributable to a stronger Canadian dollar at September 30, 2009 compared to December 31, 2008. The September 30, 2009 noon day exchange rate was US$1 = C$1.0722 while the December 31, 2008 noon day exchange rate was US$1 = C$1.2246.

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

Air Canada recorded a provision for income taxes of $1 million on pre-tax income of $33 million in the first nine months of 2009, which reflected the favourable impact of the capital portion of certain foreign exchange gains which are tax affected at 50% of the income tax rate. The benefit of future income tax assets arising in 2009 has been offset by a valuation allowance. A provision for income taxes of $18 million was recorded in the first nine months of 2008 on a pre-tax loss of $280 million as the recovery of future income taxes had been offset by a valuation allowance.

7. Fleet

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

	Actual						Planned						
Fleet Plan	**December 31, 2008**	**New Deliveries**	**Sublease toThird Party**	**Lease Returns**	**Parked**	**September 30, 2009**	**New Deliveries**	**Sublease toThird Party**	**Lease Returns**	**Parked**	**December 31, 2009**	**2010 Fleet Changes**	**December 31, 2010**
Boeing 777-300	**10**	2	-	-	-	**12**	-	-	-	-	**12**	-	**12**
Boeing 777-200	**6**	-	-	-	-	**6**	-	-	-	-	**6**	**-**	**6**
Boeing 767-300	**30**	-	-	-	-	**30**	-	-	-	-	**30**	-	**30**
Airbus A330-300	**8**	-	-	-	-	**8**	-	-	-	-	**8**	**-**	**8**
Airbus A321	**10**	-	-	-	-	**10**	-	-	-	-	**10**	**-**	**10**
Airbus A320	**41**	-	-	-	-	**41**	-	-	-	-	**41**	**-**	**41**
Airbus A319	**35**	-	-	-	-	**35**	-	-	-	-	**35**	**-**	**35**
EMBRAER 190	**45**	-	-	-	-	**45**	-	-	-	-	**45**	**-**	**45**
EMBRAER 175	**15**	-	-	-	-	**15**	-	-	-	-	**15**	**-**	**15**
Total	**200**	2	-	-	-	**202**	-	-	-	-	**202**	-	**202**
Average age (years)	**8.8**					**9.5**					**9.7**		**10.7**

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

Aircraft interior refurbishment program

Air Canada commenced a refurbishment program of the interiors of its existing aircraft (Boeing 767-300, Airbus A330-300, A321, A320 and A319 aircraft) in 2006 in order to offer its customers a superior product. Air Canada has completed the refurbishment of all its planned operating aircraft with the exception of three Boeing 767-300ER aircraft. The Corporation will complete a light aircraft interior renovation of the three remaining Boeing 767-300 aircraft by the end of 2009. The EMBRAER and Boeing 777 aircraft have been delivered with the new seats and entertainment systems already installed. The capital expenditures associated with this program are amortized over a five-year period.

8. Financial and Capital Management

8.1 Financial Position

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

(Canadian dollars in millions)	September 30, 2009		December 31, 2008	
Assets				
Cash, cash equivalents and short-term investments	$	1,209	$	1,005
Other current assets		1,246		1,398
Current assets		2,455		2,403
Property and equipment		6,899		7,469
Intangible assets		920		997
Deposits and other assets		500		495
	$	**10,774**	**$**	**11,364**
Liabilities				
Current liabilities	$	3,098	$	3,678
Long-term debt and capital leases		4,496		4,691
Pension and other benefit liabilities		1,262		1,585
Other long-term liabilities		552		458
		9,408		**10,412**
Non-controlling interest		**197**		**190**
Shareholders' equity		**1,169**		**762**
	$	**10,774**	**$**	**11,364**

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

Property and equipment amounted to $6,899 million at September 30, 2009, a reduction of $570 million from December 31, 2008. The reduction was mainly due to the impact of depreciation expense of $446 million in the first nine months of 2009 and the sale of two Airbus A340 aircraft partly offset by additions to capital assets.

Long-term debt and capital leases, including the current portion, amounted to $4,996 million at September 30, 2009, a decrease of $358 million from December 31, 2008. The decrease in long-term debt and capital leases was mainly due to the appreciation of the Canadian dollar and the resulting favourable impact of $602 million on Air Canada's U.S. dollar debt and capital leases. Additional borrowings of $930 million, including those under the Credit Facility described in section 4 of this MD&A, were largely offset by long-term debt and capital lease repayments of $856 million. In addition, the sale and leaseback of a Boeing 777 aircraft was accounted for as a capital lease which resulted in an increase to total long-term debt of $158 million.

The decline in pension and other benefits liabilities of $323 million from December 31, 2008 was primarily due to pension funding of $315 million in excess of pension expense in the first nine months of 2009. Refer to section 9.6 of Air Canada's 2008 MD&A dated February 13, 2009 and section 8.7 of this MD&A for a discussion related to Air Canada's pension funding obligations.

8.2 Adjusted Net Debt

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

(Canadian dollars in millions)	September 30, 2009	December 31, 2008	Change $
Total long-term debt and capital leases	$ 4,496	$ 4,691	$ (195)
Current portion of long-term debt and capital leases	500	663	(163)
Total long-term debt and capital leases including current portion	4,996	5,354	(358)
Non-controlling interest	197	190	7
Less cash, cash equivalents and short-term investments	(1,209)	(1,005)	(204)
Net debt and non-controlling interest	**3,984**	**4,539**	**(555)**
Capitalized operating leases (1)	2,475	2,093	382
Adjusted net debt and non-controlling interest	**6,459**	**6,632**	**(173)**
Less pre-delivery (PDP) financing included in long-term debt	-	(81)	81
Adjusted net debt and non-controlling interest, excluding PDP financing	**$ 6,459**	**$ 6,551**	**$ (92)**
Shareholders' equity	**$ 1,169**	**$ 762**	**$ 407**
Adjusted net debt to net debt plus equity ratio, excluding PDP financing	**84.7%**	**89.6%**	**-4.9 pp**

(1) Adjusted net debt is a non-GAAP measure used by the Corporation and is not likely to be comparable to measures presented by other public companies. The Corporation includes capitalized operating leases which is a measure commonly used in the industry to ascribe a value to obligations under operating leases. Common industry practice is to multiply annualized aircraft rent expense by 7.5. This definition of capital is used by the Corporation and may not be comparable to similar measures presented by other public companies. Aircraft rent was $330 million for the twelve months ended September 30, 2009 and $279 million for the twelve months ended December 31, 2008. Aircraft rent expense includes aircraft rent associated with aircraft subleased to third parties. The sublease revenue associated with these aircraft leases is included in Other revenues on Air Canada's consolidated statement of operations.

At September 30, 2009, adjusted net debt and non-controlling interest, including capitalized operating leases and excluding PDP financing, decreased $92 million from December 31, 2008. The value of capitalized operating leases increased primarily as a result of an increase in aircraft rent expense, mainly due to the impact of a weaker Canadian dollar during the twelve months ended September 30, 2009 versus the twelve months ended December 31, 2008, and the sale and leaseback transactions of the Boeing 777 aircraft completed in 2008 and in the first quarter of 2009. This was more than offset by a decrease in net debt. Net debt was favourably impacted by a stronger Canadian dollar as at September 30, 2009 versus the exchange rate as at December 31, 2008.

The adjusted net debt to net debt plus equity ratio for Air Canada decreased to 84.7% at September 30, 2009 from 89.6% at December 31, 2008.

The change in shareholders' equity was mainly due to foreign exchange gains of $549 million recorded in the first nine months of 2009.

8.3 Liquidity

At October 31, 2009, cash, cash equivalents and short-term investments amounted to $1,460 million, or 15% of the four preceding quarters operating revenues, which includes the net proceeds under the offering as described in section 4 of this MD&A. Refer to section 10 of this MD&A for a discussion on Air Canada's liquidity risks.

Working capital

The following table provides additional information on Air Canada's working capital balances at September 30, 2009 as compared to December 31, 2008.

(Canadian dollars in millions)	September 30, 2009	December 31, 2008	Change $
Cash and short-term investments	$ 1,209	$ 1,005	$ 204
Accounts receivable	736	702	34
Collateral deposits for fuel derivatives	105	328	(223)
Other current assets	405	368	37
Accounts payable and accrued liabilities	(1,240)	(1,262)	22
Fuel derivatives in current liabilities	(94)	(420)	326
Advance ticket sales	(1,264)	(1,333)	69
Current portion of long-term debt and capital leases	(500)	(663)	163
	$ **(643)**	**$ (1,275)**	**$ 632**

The working capital deficiency of $643 million has improved by $632 million from December 31, 2008 largely due to the financing activities undertaken by Air Canada, as described in section 4 of this MD&A. This was partly offset by pension funding payments of $330 million and the impact of capital expenditures of $190 million in the first nine months of 2009.

Collateral deposits for fuel derivatives

The Corporation currently holds swaps and put options within collar structures which could expose the Corporation to the potential of posting cash collateral deposits. Once the fair value in favour of the counterparties of certain fuel derivatives exceeds certain agreed credit thresholds with those counterparties, the Corporation is responsible for extending collateral to the counterparties to cover their exposure.

As at October 31, 2009, the total cash collateral deposits held by counterparties amounted to $83 million ($105 million as at September 30, 2009 and $328 million at December 31, 2008). If oil prices remain at their current levels for the remainder of 2009 and for 2010, the collateral extended would cover the expected losses on existing fuel hedging contracts maturing in 2009 and 2010 and would not generate additional cash outflows to the Corporation. Refer to section 12 of Air Canada's 2008 MD&A dated February 13, 2009 and section 10 of this MD&A for a discussion on fuel price risk.

8.4 Consolidated Cash Flow Movements

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

	Third Quarter			First Nine Months		
(Canadian dollars in millions)	**2009**	**2008**	**Change $**	**2009**	**2008**	**Change $**
Net cash from (used for) operating activities	$ 124	$ 122	$ 2	$ (184)	$ 194	$ (378)
Fuel hedge collateral deposits, net	(3)	-	(3)	206	-	206
Changes in non-cash working capital	(355)	(390)	35	(179)	(18)	(161)
Cash flows from (used for) operating activities	(234)	(268)	34	(157)	176	(333)
Additions to capital assets	(34)	(105)	71	(190)	(733)	543
Free cash flow (1)	**(268)**	**(373)**	**105**	**(347)**	**(557)**	**210**
Proceeds from sale leaseback transactions	-	-	-	172	708	(536)
Proceeds from contractual commitment	230	-	230	230	-	230
Short-term investments	252	161	91	339	95	244
Other	9	49	(40)	75	111	(36)
Cash flows from investing activities (excluding additions to capital assets)	**491**	**210**	**281**	**816**	**914**	**(98)**
Borrowings	587	-	587	930	313	617
Reduction of long-term debt and capital lease obligations	(256)	(67)	(189)	(856)	(708)	(148)
Other	-	8	(8)	-	8	(8)
Cash flows from (used) for financing activities	**331**	**(59)**	**390**	**74**	**(387)**	**461**
Net increase (decrease) in cash and cash equivalents	554	(222)	776	543	(30)	573
Net increase (decrease) in short-term investments	(252)	(161)	(91)	(339)	(95)	(244)
Net increase (decrease) in cash, cash equivalents and short-term investments	**$ 302**	**$ (383)**	**$ 685**	**$ 204**	**$ (125)**	**$ 329**

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

Air Canada's free cash flow for the third quarter of 2009 improved by $105 million from the third quarter of 2008. The improvement in free cash flow was mainly due to the impact of reduced capital expenditures, favourable changes in non-cash working capital balances and the impact of lower past service cost contributions as a result of the adoption of new pension funding regulations in July 2009. Refer to section 8.7 of this MD&A for additional information on Air Canada's pension funding obligations.

8.5 Capital Expenditures and Related Financing Arrangements

In the third quarter of 2009, Air Canada and The Boeing Company ("Boeing") agreed to amend the purchase agreement for Boeing 787 aircraft to reduce the number of options for Boeing 787 aircraft by ten, from 23 to 13, and to provide for purchase rights for ten Boeing 787 aircraft. Air Canada continues to have 37 firm orders for Boeing 787 aircraft. Air Canada and Boeing also agreed to amend certain commercial terms, including revisions to delivery dates. Air Canada's first Boeing 787 aircraft is now scheduled for delivery in the second half of 2013. Air Canada continues to hold purchase rights for 18 Boeing 777 aircraft.

The table below provides Air Canada's current projected, planned and committed capital expenditures for the remainder of 2009, for the next four years and after 2013.

(Canadian dollars in millions)	Remainder of 2009	2010	2011	2012	2013	Thereafter
Projected committed expenditures	$ 11	$ 60	$ 53	$ 137	$ 753	$ 3,912
Projected planned but uncommitted expenditures	31	75	76	94	108	
Total projected expenditures [(1) (2)]	42	135	129	231	861	
Projected financing on committed expenditures	-	-	-	-	(580)	
Total projected expenditures, net of financing	**$ 42**	**$ 135**	**$ 129**	**$ 231**	**$ 281**	

(1) U.S. dollar amounts are converted using the September 30, 2009 noon day exchange rate of US$1 = C$1.0722 Final aircraft delivery prices include estimated escalation and interest on deferred delivery payments.
(2) The dollar amounts reflected above do not include obligations pertaining to day-to-day operations.

8.6 Contractual Obligations

The table below provides Air Canada's current contractual obligations for the remainder of 2009, for the next four years and after 2013.

(Canadian dollars in millions)	Remainder of 2009	2010	2011	2012	2013	Thereafter	Total
Long-term debt, capital leases and interest repayment obligations [(1)]	$ 193	$ 826	$ 1,071	$ 792	$ 830	$ 2,882	$ 6,594
Operating lease obligations [(2)]	94	359	319	298	264	776	2,110
Committed capital expenditures [(3)]	11	60	53	137	753	3,912	4,926
Total contractual obligations [(4)]	**$ 298**	**$ 1,245**	**$ 1,443**	**$ 1,227**	**$ 1,847**	**$ 7,570**	**$ 13,630**

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

8.7 Pension Funding Obligations

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

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

The Air Canada 2009 Pension Regulations were adopted in coordination with the Pension MOUs identified in section 4 of this MD&A. Pursuant to the Pension MOUs, on October 26, 2009, Air Canada issued to a trust, 17,647,059 Class B voting shares. This number of shares represented 15% of the shares of Air Canada issued and outstanding as at the date of the Pension MOUs and the date of issuance (after taking into account such issuance). All net proceeds of sale of such shares by the trust are to be contributed to the pension plans. For so long as the trust continues to hold at least 2% of Air Canada's issued and outstanding shares of Air Canada, the trustee will have the right to designate one nominee (who shall not be a member or officer of any of Air Canada's Canadian-based unions) to Air Canada's board of directors, subject to completion of Air Canada's usual governance process for selection and confirmation of director nominees. Current service contributions will continue to be made in the normal course while the Air Canada 2009 Pension Regulations are in effect.

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

The following table provides an estimate of Air Canada's pension funding obligations, on a cash basis, based on the Air Canada 2009 Pension Regulations as described above, as at September 30, 2009, for the remainder of 2009, for the full year 2009 and for the next four years. These funding obligations are based on a number of factors, including the Air Canada 2009 Pension Regulations described above for past service, the assumptions used in the last filed actuarial valuation reports for current service including a discount rate of 6.25%, the plan demographics at the valuation date, the existing plan provisions and current pension legislation. Actual contributions will be determined on the basis of future valuation reports which will be filed annually. In addition to changes in plan demographics and experience, actuarial assumptions may be changed from one valuation to the next because of changes in plan experience, financial markets, expectations about the future, changes in legislation and other factors. As of 2014, the Air Canada 2009 Pension Regulations will cease to have effect and Air Canada's pension funding obligations may vary significantly based on several factors, including regulatory developments, assumptions and methods used and changes in the economic conditions, mainly the return on fund assets and changes in interest rates.

(Canadian dollars in millions)	Remainder of 2009	Full Year 2009	2010	2011	2012	2013
Past service domestic registered plans	$ -	$ 140	$ -	$ 138	$ 173	$ 221
Current service domestic registered plans	42	188	161	165	170	175
Other pension arrangements (1)	35	79	78	79	81	83
Projected pension funding obligations	**$ 77**	**$ 407**	**$ 239**	**$ 382**	**$ 424**	**$ 479**

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

In May 2009, Air Canada and Aeroplan reached an agreement with the Canadian Auto Workers (CAW) Local 2002 providing for a process for approximately 750 Air Canada employees working in the Aeroplan contact centres to choose to transition to employment at Aeroplan, effective June 1, 2009, or to remain employees of Air Canada. The transition process has now been completed. For those employees who chose to transition to Aeroplan, their service, which largely determines benefit levels under the Air Canada pension and other employee benefit plans, ceased to accrue on the date of their employment with Aeroplan.

8.8 Share Information

An aggregate of 278,147,059 Class A variable voting shares and Class B voting shares in the capital of Air Canada are issued and outstanding. The issued and outstanding shares of Air Canada, along with shares potentially issuable, are as follows:

	Number of Shares	
	At October 31, 2009	At December 31, 2008
Issued and outstanding shares		
Class A variable voting shares	47,487,397	15,475,659
Class B voting shares	230,659,662	84,524,341
Total issued and outstanding shares	**278,147,059**	**100,000,000**
Class A variable voting and Class B voting shares potentially issuable		
Warrants	90,250,000	-
Stock options	3,967,962	1,701,447
Performance share units	535,673	559,885
Total shares potentially issuable	**94,753,635**	**2,261,332**
Total outstanding and potentially issuable shares	**372,900,694**	**102,261,332**

Under the Credit Facility identified in section 4 of this MD&A, Air Canada issued to the lenders, concurrently with the first drawdown, warrants for the purchase of Air Canada's Class A variable voting shares or Class B voting shares representing an aggregate of 5% or five million of the total issued and outstanding shares as at the closing date of the Credit Facility, allocated among the lenders based on their pro-rata lending commitments under the Credit Facility. These initial 5% warrants have an exercise price of $1.51 per share, are exercisable at any time and expire four years after the date of issuance. In the event that Air Canada did not grant additional security over certain assets within 90 days of closing, Air Canada was required to issue to the lenders additional warrants representing up to an additional 5% or five million of the total issued and outstanding shares (determined at the time of issuance of such additional warrants) with an average exercise price established based on a volume weighted average price five days before issuance, exercisable at any time and expiring four years after the date of issuance. These additional warrants were issued on October 19, 2009 and have an exercise price of $1.44 per share.

Pursuant to the Pension MOUs, on October 26, 2009, Air Canada issued to a trust, 17,647,059 Class B voting shares. This number of shares represented 15% of the shares of Air Canada issued and outstanding as at the date of the Pension MOUs and the date of issuance (after taking into account such issuance). All net proceeds of sale of such shares by the trust are to be contributed to the pension plans. For so long as the trust continues to hold at least 2% of the issued and outstanding shares of Air Canada, the trustee will have the right to designate one nominee (who shall not be a member or officer of any of Air Canada's Canadian-based unions) to Air Canada's board of directors, subject to completion of Air Canada's usual governance process for selection and confirmation of director nominees.

On October 27, 2009 Air Canada completed a previously announced bought deal public offering pursuant to which it sold to an underwriting syndicate 160,500,000 units (the "Units") of Air Canada at a price of $1.62 per Unit for aggregate gross proceeds to Air Canada of $260 million (net proceeds of $248 million after expenses and underwriter fees). Each Unit is comprised of one Class A variable voting share (the "Variable Voting Shares") or one Class B voting share (the "Voting Shares", and, together with the Variable Voting Shares, the "Shares") of Air Canada, and one-half of one share purchase warrant. Each whole share purchase warrant is defined as a "Warrant". Each Warrant will entitle the holder thereof to acquire one Variable Voting Share or one Voting Share (each, a "Warrant Share") at an exercise price of $2.20 per Warrant Share, at any time prior to 36 months following October 27, 2009. In the event that, prior to the time of expiry of the Warrants, the 20-day volume weighted average trading price of the Variable Voting Shares on the Toronto Stock Exchange ("TSX") is equal to or greater than $4.00 or the 20-day volume weighted average trading price of the Voting Shares on the TSX is equal to or greater than $4.00 (each, an "Acceleration Event"), Air Canada shall have the right, at its option, within ten (10) business days after the Acceleration Event, to accelerate the time of expiry of the Warrants. In addition to the amounts reported above, the underwriters have been granted an over-allotment option to purchase up to an additional 24,075,000 shares and/or 12,037,500 warrants at a price of $1.50 per share and $0.12 per each half warrant and otherwise on the same terms and conditions as the offering, exercisable in whole or in part at any time until November 27, 2009.

9. Quarterly Financial Data

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

($ millions, except per share figures)	Q4 2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Operating revenues	**$ 2,513**	**$ 2,727**	**$ 2,782**	**$ 3,075**	**$ 2,498**	**$ 2,391**	**$ 2,330**	**$ 2,670**
Aircraft fuel	615	715	848	1,064	792	593	572	682
Ownership (DAR) (1)	202	234	242	243	254	245	248	252
Other operating expenses	1,624	1,790	1,685	1,656	1,598	1,741	1,623	1,668
Operating expenses	**2,441**	**2,739**	**2,775**	**2,963**	**2,644**	**2,579**	**2,443**	**2,602**
Operating income (loss) before the undernoted item	**72**	**(12)**	**7**	**112**	**(146)**	**(188)**	**(113)**	**68**
Provision for cargo investigations (2)	-	(125)	-	-	-	-	-	-
Operating income (loss)	**72**	**(137)**	**7**	**112**	**(146)**	**(188)**	**(113)**	**68**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax	(37)	(151)	115	(244)	(581)	(212)	268	209
Net income (loss)	**$ 35**	**$ (288)**	**$ 122**	**$ (132)**	**$ (727)**	**$ (400)**	**$ 155**	**$ 277**
Revenue passenger miles (millions)	11,446	12,331	12,884	14,458	10,845	10,984	11,862	14,153
Available seat miles (millions)	14,715	15,407	15,581	17,515	13,571	13,821	14,735	16,946
Passenger load factor (%)	77.8	80.0	82.7	82.5	79.9	79.5	80.5	83.5
RASM (cents)	14.7	15.0	15.7	15.7	16.0	14.5	13.9	14.1
CASM (cents)	16.6	17.8	17.8	16.9	19.5	18.7	16.6	15.4
CASM, excluding fuel expense (cents)	12.4	13.1	12.4	10.8	13.6	14.4	12.7	11.3
Fuel price per litres (cents) (3)	67.5	75.2	89.2	101.0	95.8	71.4	65.4	68.6
EBITDAR before the provision for cargo investigations (4)	**$ 274**	**$ 222**	**$ 249**	**$ 355**	**$ 108**	**$ 57**	**$ 135**	**$ 320**
EBITDAR (4)	**$ 274**	**$ 97**	**$ 249**	**$ 355**	**$ 108**	**$ 57**	**$ 135**	**$ 320**
Earnings (loss) per share								
- Basic	**$ 0.35**	**$ (2.88)**	**$ 1.22**	**$ (1.32)**	**$ (7.27)**	**$ (4.00)**	**$ 1.55**	**$ 2.77**
- Diluted	**$ 0.35**	**$ (2.88)**	**$ 1.22**	**$ (1.32)**	**$ (7.27)**	**$ (4.00)**	**$ 1.55**	**$ 2.44**

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

10. Financial Instruments and Risk Management

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

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

	Third Quarter		First Nine Months	
(Canadian dollars in millions)	**2009**	**2008**	**2009**	**2008**
Ineffective portion of fuel hedges	$ -	$ (58)	$ -	$ 24
Fuel derivatives not under hedge accounting	2	(54)	78	31
Cross-currency interest rate swaps	-	19	-	6
Other	2	0	(5)	(1)
Gain (loss) on financial instruments recorded at fair value	**$ 4**	**$ (93)**	**$ 73**	**$ 60**

Risk Management

Liquidity Risk

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities and other contractual obligations. The Corporation monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. The Corporation's principal objective in managing liquidity risk is to maintain a minimum unrestricted cash balance in excess of a target liquidity level of 15% of annual operating revenues. As at September 30, 2009, the cash and cash equivalents and short-term investments were 12% of the preceding four quarters operating revenues and 15% as at October 31, 2009, which includes the net proceeds under the offering completed on October 27, 2009.

Management believes that the significant events as described in section 4 of this MD&A improve the Corporation's current liquidity position. However, certain risks remain such as those related to the current economic environment, including risks related to market volatility in the price of fuel, foreign exchange and interest rates and increased competitive pressures as well as risks relating to restrictive terms under the Corporation's financing, credit card processing and other arrangements and other risk identified in section 9.3 of Air Canada's 2008 MD&A dated February 13, 2009. The H1N1 influenza virus may also continue to impact demand for air travel. The Corporation is continuing to monitor the H1N1 influenza virus risk. While the Corporation has developed contingency plans related to the H1N1 influenza virus risk, it is unable to predict the likelihood of this risk materializing or the impact on the Corporation to the extent this risk does materialize. This section updates the Corporation's year-end disclosures and should be read in conjunction with section 9.3 of Air Canada's 2008 MD&A dated February 13, 2009. Refer to section 8.6 of this MD&A for information on Air Canada's contractual obligations.

Pension funding obligations

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

Covenants in credit card agreements

The Corporation has various agreements for the processing of customer credit card transactions, as further described in section 9.3 of Air Canada's 2008 MD&A dated February 13, 2009. During the third quarter of 2009, the Corporation entered into amendments with one of its principal credit card processors to amend certain credit card processing agreements under which the levels of unrestricted cash (as defined per the agreement and generally based on the balances as reported in cash, cash equivalents and short-term investments) required to be maintained by Air Canada is reduced to $800 million (versus $1,300 million prior to the amendments) and Air Canada provides the processor with deposits, to be accumulated over time, and security. The triggering event (which would require deposits of cash) based on a debt service coverage ratio is no longer applicable under the amended agreements. The agreements provide that should Air Canada maintain unrestricted cash of more than $1,200 million for two consecutive months, the unrestricted cash requirement increases to $1,100 million at which time the processor will return to Air Canada all deposits and security previously provided by Air Canada. This occurred in July and August of 2009 upon which all deposits were returned to Air Canada. As long as unrestricted cash remains at or above $1,100 million at each month-end, Air Canada will have no obligation to provide deposits or security to the processor. Pursuant to the amendments entered into, should the Corporation's unrestricted cash be less than $1,100 million at any month-end, its obligation to provide deposits to the processor would be capped at an amount not to exceed $75 million, provided unrestricted cash is not less than $800 million. The amended credit card processing agreements discussed above expire in May 2010.

Cargo investigations and proceedings

The Corporation is exposed to potential liabilities related to the proceedings and investigations of alleged anti-competitive cargo pricing activities, as described in section 15 of this MD&A. This preliminary estimate recorded by the Corporation during 2008 is based upon the current status of the investigations and proceedings and the Corporation's assessment as to the potential outcome for certain of them. This provision does not address the proceedings in all jurisdictions, but only where there is sufficient information to do so. Management has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings. Additional material provisions may be required. Amounts could become payable within the year and may be materially different than management's preliminary estimate.

Fuel price risk

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

There were no derivative contracts entered into during the first nine months of 2009. Air Canada continues to view hedging as an important method to manage fuel price volatility risk. Over the past several months, the increase in the value of the Canadian dollar versus the U.S. dollar has acted as a natural hedge for the increase in the price of crude oil. The Corporation is currently reviewing different derivative products in order to balance liquidity issues with fuel price volatility risk mitigation.

As at September 30, 2009, approximately 32% of Air Canada's anticipated purchases of jet fuel for the remainder of 2009 are hedged at an average West Texas Intermediate ("WTI")-equivalent capped price of US$105 per barrel, and 18% is subject to an average WTI-equivalent floor price of US$85 per barrel. Air Canada has also hedged approximately 13% of its 2010 anticipated jet fuel purchases in crude oil-based contracts hedged at an average capped price of US$110 per barrel, and 12% is subject to an average floor price of US$101 per barrel.

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

Outstanding at September 30, 2009				
Derivative Instruments	**Term**	**Volume (BBLs)**	**WTI-equivalent Average Floor Price (US$ per barrel)**	**WTI-equivalent Average Capped Price (US$ per barrel)**
Call Options (1)	2009	750,000	n/a	121
	2010	400,000	n/a	134
Swaps (1)	2009	285,000	99	99
	2010	1,070,000	99	99
Collars (1)	2009	620,000	79	90
	2010	1,560,000	102	112

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

In the third quarter of 2009, fuel derivative contracts cash settled with a fair value of $14 million in favour of the counterparties ($76 million in favour of the counterparties in the first nine months of 2009) ($76 million in favour of the Corporation in the third quarter of 2008 and $220 million in favour of the Corporation in the first nine months of 2008). As fuel hedging contracts with unfavourable fair values are settled, the Corporation can recall the offsetting cash collateral deposits from counterparties.

In the first quarter of 2009, in order to reduce its exposure to declining oil prices, the Corporation terminated fuel derivative contracts with a fair market value of $172 million in favour of the counterparties. The collateral held by the counterparties covered the majority of the settlement amount, therefore minimal additional cash outflows resulted. The value of the AOCI balance recognized in connection with these derivatives while designated under hedge accounting will be taken into fuel expense in the period where the derivative was scheduled to mature.

During the third quarter of 2009, $94 million of existing losses under AOCI, representing net realized losses on fuel derivative contracts while designated under hedge accounting, were reclassified into fuel expense (losses of $334 million in the first nine months of 2009) (gains of $64 million in the third quarter of 2008 and gains of $190 million in the first nine months of 2008).

As at September 30, 2009, the net amount of existing losses reported in AOCI that is expected to be reclassified to net income (loss) during the following 12 months was $236 million (before tax). Due to the discontinuation of hedge accounting, the AOCI balance related to fuel hedging contracts will be fully depleted by December 31, 2010.

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

		Third Quarter		First Nine Months	
(Canadian dollars in millions)		**2009**	**2008**	**2009**	**2008**
Consolidated Statement of Operations					
Operating expense					
Aircraft fuel	Realized effective gain (loss) – derivatives designated under hedge accounting	$ (94)	$ 64	$ (334)	$ 190
Non-operating income (expense)					
Gain (loss) on financial instruments recorded at fair value	Ineffective gain (loss) – derivatives designated under hedge accounting	n/a	(58)	-	24
	Fair market value gain (loss) – economic hedges	$ 2	$ (54)	$ 78	$ 31
Consolidated Statement of Comprehensive Income (Loss)					
	Effective gain (loss) – derivatives designated under hedge accounting	n/a	(328)	(1)	73
	Tax expense on effective gain	n/a	84	-	(44)
	Reclassification of net realized (gain) loss on fuel derivatives designed under hedge accounting to aircraft fuel expense	$ 94	$ (64)	$ 334	$ (190)
	Tax on reclassification	$ -	$ 20	$ 4	$ 61

		September 30, 2009	December 31, 2008
Consolidated Statement of Financial Position			
Current assets	Collateral deposits for fuel derivatives	$ 105	$ 328
Current liabilities*	Fair market value of fuel derivatives designated under hedge accounting	$ -	$ (405)
	Fair market value of fuel derivatives – economic hedges	$ (94)	$ (15)
Shareholders' equity (AOCI)	Net loss from fuel derivatives designated under hedge accounting	$ (269)	$ (606)

** The balance is reflected within Current liabilities on the Consolidated Statement of Financial Position due to the counterparty's ability to terminate the derivatives at fair value at any time prior to maturity.*

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

11. Accounting Policies

11.1 Changes in Accounting Policies

Stock-based compensation plans

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

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

Goodwill and intangible assets

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

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

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

11.2 Future Accounting Standard Changes

Business combinations, consolidated financial statements and non-controlling interests

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

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

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

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

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

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

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

12. Off-Balance Sheet Arrangements

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

13. Related Party Transactions

At September 30, 2009, ACE Aviation Holdings Inc. ("ACE") held a 75% ownership interest in Air Canada. Air Canada has various related party transactions with Aveos Fleet Performance Inc. ("Aveos") and ACE. ACE is a participant lender in the Credit Facility as described in section 4 of this MD&A. ACE's participation in the Credit Facility represents $150 million of the outstanding loan of $600 million as at September 30, 2009. The participant lenders participate on a pro-rata basis with respect to any warrants and principal and interest payments. ACE's pro-rata share of interest expense reported during the period amounted to $3 million.

The agreements between Air Canada and Aveos and between Air Canada and ACE are summarized in section 14 of Air Canada's 2008 MD&A dated February 13, 2009. Except as described below, there have been no material changes to the Corporation's related party agreements.

In relation to the offering described in section 4 of this MD&A, ACE agreed to postpone its right under a registration rights agreement to require Air Canada to file a prospectus and otherwise assist with a public offering of shares that ACE holds in specified circumstances during the 90-day period from the commencement of the public distribution pursuant to the offering, during which period ACE shall retain its Air Canada shares.

Air Canada and Aveos entered into an agreement dated October 28, 2008 pursuant to which Air Canada has agreed to temporarily extend payment terms to Aveos under certain related party agreements. In exchange for the extended payment terms, certain letters of credit related to the Pension and Benefits Agreement were cancelled. The extended payment terms to Aveos were originally scheduled to begin reducing in May 2009 with a corresponding return of the letters of credit to Aveos.

As a result of amendments during the year, the payment terms were extended. The extended payment terms will be reduced starting in November 2009 with the expiration of the extended payment terms to be completed over the following six months. During April 2010, following expiration of the extended payment terms, the letters of credit are to be reinstated to the levels then required under the Pension and Benefits Agreement between the two parties.

14. Critical Accounting Estimates

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

15. Risk Factors

The risks described herein may not be the only risks faced by Air Canada. Other risks of which the Air Canada is not aware or which Air Canada currently deems to be immaterial may surface and have a material adverse impact on Air Canada, its business, results from operations and financial condition.

Risks Relating to Air Canada

Operating Results

Prior to emergence from its restructuring under the Companies Creditors Arrangement Act, as amended ("CCAA") on September 30, 2004, Air Canada had sustained significant losses and Air Canada may sustain significant losses in the future. In 2008, Air Canada recorded an operating loss before a provision for cargo investigations and proceedings of $39 million. During the period from January 1, 2009 to September 30, 2009, Air Canada recorded an operating loss of $233 million. Current economic conditions may result in significant losses for Air Canada. Despite ongoing business initiatives and efforts at securing cost reductions, revenue improvements and additional sources of financing, Air Canada may not be able to successfully achieve positive net profitability or realize the objectives of any or all of its initiatives, including those which seek to improve yield or offset or mitigate risks facing Air Canada, including those relating to economic conditions, liquidity, pension funding, unexpected volatility in fuel costs and other expenses.

Leverage

Air Canada has, and is expected to continue to have and incur, a significant amount of indebtedness, including substantial fixed obligations under aircraft leases and financings, and as a result of challenging economic or other conditions affecting Air Canada, Air Canada may incur greater levels of indebtedness than currently exist. The amount of indebtedness that Air Canada currently has and which it may incur in the future could have a material adverse effect on Air Canada, for example, by (i) limiting Air Canada's ability to obtain additional financing, (ii) requiring Air Canada to dedicate a substantial portion of its cash flow from operations to payments on its indebtedness and fixed cost obligations, thereby reducing the funds available for other purposes, (iii) making Air Canada more vulnerable to economic downturns, and (iv) limiting Air Canada's flexibility in planning for, or reacting to, competitive pressures or changes in its business environment.

The ability of Air Canada to make scheduled payments under its indebtedness will depend on, among other things, its future operating performance and its ability to refinance its indebtedness, if necessary. In addition, as Air Canada incurs indebtedness which bears interest at fluctuating interest rates, to the extent these interest rates increase, its interest expense will increase. There can be no assurance that Air Canada will be able to generate sufficient cash from its operations to pay its debts and lease obligations. Each of these factors is, to a large extent, subject to economic, financial, competitive, regulatory, operational and other factors, many of which are beyond Air Canada's control.

Need for Additional Capital and Liquidity

Air Canada faces a number of challenges in its business, including in relation to economic conditions, pension plan funding, volatile fuel prices, contractual covenants which could require Air Canada to deposit cash collateral with third parties, foreign exchange rates and increased competition from international, transborder and low-cost domestic carriers. Air Canada's liquidity levels may be adversely impacted by these as well as by other factors and risks identified in this MD&A. As part of Air Canada's efforts to meet such challenges and to support Air Canada's business strategy, significant liquidity and significant operating and capital expenditures are, and will in the future be, required. There can be no assurance that Air Canada will continue to be able to obtain on a timely basis sufficient funds on terms acceptable to Air Canada to provide adequate liquidity and to finance the operating and capital expenditures necessary to overcome challenges and support its business strategy if cash flows from operations and cash on hand are insufficient.

Failure to generate additional funds, whether from operations or additional debt or equity financings, could require Air Canada to delay or abandon some or all of its anticipated expenditures or to modify its business strategy and could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Furthermore, competitors with greater liquidity or their ability to raise money more easily and on less onerous terms could create a competitive disadvantage for Air Canada.

Air Canada's credit ratings influence its ability to access capital markets and its liquidity. There can be no assurance that Air Canada's credit ratings will not be downgraded, which would add to Air Canada's borrowing and insurance costs, hamper its ability to attract capital, adversely impact its liquidity, and limit its ability to operate its business, all of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Economic and Geopolitical Conditions

Airline operating results are sensitive to economic and geopolitical conditions which can have a significant impact on Air Canada. For example, economic and geopolitical conditions may impact demand for air transportation in general or to or from certain destinations, as well as Air Canada's operating costs, pension plan contributions and costs and availability of capital and supplies required by Air Canada. Especially in light of Air Canada's substantial fixed cost structure, any prolonged or significant impact arising from economic and geopolitical conditions, including weakness of the Canadian, U.S. or world economies could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Airline fares and passenger demand have fluctuated significantly in the past and are likely to fluctuate significantly in the future. Air Canada is not able to predict with certainty market conditions and the fares that Air Canada may be able to charge. Customer expectations can change rapidly and the demand for lower fares may limit revenue opportunities. Travel, especially leisure travel, is a discretionary consumer expense. Depressed economic conditions in North America and other areas served by Air Canada, as well as geopolitical instability in various areas of the world, concerns about the environmental impacts of air travel and tendencies towards "green" travel initiatives where consumers reduce their travel activities, could have the effect of reducing demand for air travel in Canada and abroad and could materially adversely impact Air Canada's profitability.

Pension Plans

Canadian federal pension legislation requires that the funded status of registered pension plans be determined periodically, on both a going concern basis (essentially assuming indefinite plan continuation) and a solvency basis (essentially assuming immediate plan termination).

Pension plan solvency valuations are influenced primarily by long-term interest rates and by the investment return on plan assets, which in turn may be dependent on a variety of factors, including economic conditions. The interest rate used to calculate benefit obligations for solvency purposes is a prescribed rate derived from the interest rates on long-term Government of Canada bonds. Deteriorating economic conditions may result in significant increases in Air Canada's funding obligations, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Refer to section 9.6 of the 2008 MD&A and section 8.7 of this MD&A for a description relating to Air Canada's pension funding obligations. In particular, as of 2014, the Air Canada 2009 Pension Regulations will cease to have effect and Air Canada's pension funding obligations may vary significantly based on several factors, including regulatory developments, assumptions and methods used and changes in the economic conditions (mainly the return on fund assets and changes in interest rates). Underfunded pension plans or a failure or inability by Air Canada to make required cash contributions to its registered pension plans could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Fuel Costs

Fuel costs constituted the largest percentage of the total operating costs of Air Canada in 2008. Fuel prices fluctuate widely depending on many factors including international market conditions, geopolitical events and the Canada/U.S. dollar exchange rate. Air Canada cannot accurately predict fuel prices. During 2006, 2007 and 2008, fuel prices increased and fluctuated near or at historically high levels. Should fuel prices fluctuate significantly or increase significantly above current levels, fuel costs could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Due to the competitive nature of the airline industry, Air Canada may not be able to pass on increases in fuel prices to its customers by increasing its fares. Based on volumes for the twelve-month period ended September 30, 2009, management estimates that a US$1 per barrel movement in the average price of WTI crude oil would have resulted in an approximate $26 million change in fuel expense for Air Canada for such 12-month period (excluding any impact of fuel surcharges, foreign exchange rates and fuel hedging), assuming flying capacity remained unchanged and that refining spreads between WTI crude oil and jet fuel as well as foreign exchange rates remained constant.

Foreign Exchange

Air Canada's financial results are sensitive to the fluctuating value of the Canadian dollar. In particular, Air Canada has a significant annual net outflow of U.S. dollars and is affected by fluctuations in the Canada/U.S. dollar exchange rate. Management estimates that during the period from October 2008 to September 2009, a $0.01 increase in the U.S. dollar/Cdn exchange rate (i.e., $1.08 to $1.09 per U.S. dollar) would have had an estimated $27 million unfavourable impact on operating income. Conversely, an opposite change in the exchange rate would have had the opposite effect. Air Canada incurs significant expenses in U.S. dollars for such items as fuel, aircraft rental and maintenance charges, interest payments, debt servicing and computerized reservations system fees, while a substantial portion of its revenues are generated in Canadian dollars. A significant deterioration of the Canadian dollar relative to the U.S. dollar would increase the costs of Air Canada relative to its U.S. competitors and could have a material adverse effect on Air Canada, its business, results from operations and financial condition. In addition, Air Canada may be unable to appropriately hedge the risks associated with fluctuations in exchange rates.

Labour Costs and Labour Relations

Labour costs constitute one of Air Canada's largest operating cost items. There can be no assurance that Air Canada will be able to maintain such costs at levels which do not negatively affect its business, results from operations and financial condition. There can be no assurance that future agreements with employees' unions or the outcome of arbitrations will be on terms consistent with Air Canada's expectations or comparable to agreements entered into by Air Canada's competitors. Any future agreements or outcome of negotiations, mediations or arbitrations including in relation to wages or other labour costs or work rules may result in increased labour costs or other charges which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Most of Air Canada's employees are unionized. The collective agreements with the International Brotherhood of Teamsters (representing certain airport and call centre employees in the United States) and the most recent collective agreements with the unions representing Air Canada's Canadian-based employees were renewed or extended and will now expire in 2011. No strikes or lock-outs may lawfully occur during the term of the collective agreements, nor during the negotiations of their renewal until a number of pre-conditions, in respect of the unions for Canadian-based employees, prescribed by the Canada Labour Code, have been satisfied. There can be no assurance that collective agreements will be further renewed without labour conflict or action or that there will not be a labour conflict that could lead to a dispute or to an interruption or stoppage in Air Canada's service or otherwise adversely affect the ability of Air Canada to conduct its operations, any of which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

If there is a labour disruption or work stoppage by any of the unionized work groups of Jazz, there would also likely be a material adverse effect on Air Canada, its business, results from operations and financial condition. In addition, labour conflicts at Air Canada's Star Alliance® partners could result in lower demand for connecting traffic with Air Canada and, ultimately, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Airline Industry Characterized by Low Gross Profit Margins and High Fixed Costs

The airline industry is characterized by low gross profit margins and high fixed costs. The costs of operating any particular flight do not vary significantly with the number of passengers carried and, therefore, a relatively small change in the number of passengers or in fare pricing or traffic mix would have a significant effect on Air Canada's operating and financial results. This condition has been exacerbated by aggressive pricing by low-cost carriers, which has had the effect of driving down fares in general. Accordingly, a shortfall from expected revenue levels could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Air Canada incurs substantial fixed costs which do not meaningfully fluctuate with overall capacity. As a result, should Air Canada be required to reduce its overall capacity or the number of flights operated, it may not be able to successfully reduce certain fixed costs in the short term and may be required to incur important termination or other restructuring costs, which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Competition

Air Canada operates within a highly competitive industry. Over the past few years, several carriers have entered or announced their intention to enter or expand into the domestic, the U.S. transborder and international markets in which Air Canada operates.

Canadian low-cost and other carriers have entered and/or expanded or announced their intention to compete in many of Air Canada's key domestic markets and, along with some U.S. carriers have also entered and/or expanded their operations in the U.S. transborder and leisure-oriented markets. Carriers against which Air Canada may compete, including U.S. carriers, may undergo (and some of whom who have undergone) substantial reorganizations (including by way of merger with or acquisition by another carrier), creating reduced levels of indebtedness and lower operating costs and may be in a position to more effectively compete with Air Canada. Air Canada is also facing increasing competition in international markets as carriers increase their international capacity, both by expansion and by shifting existing domestic capacity to international operations to avoid low-cost domestic competition.

If Canadian low-cost and other carriers are successful in entering or expanding into Air Canada's domestic and the U.S. transborder markets, if additional U.S. or other carriers against which Air Canada competes are successful in entering Air Canada's transborder market or if carriers are successful in their expansion in international markets of Air Canada, Air Canada's business results from operations and financial condition could be materially adversely affected.

Air Canada also encounters substantial price competition. The expansion of low-cost carriers in recent years, along with the advent of Internet travel websites and other travel products distribution channels, has resulted in a substantial increase in discounted and promotional fares initiated by Air Canada's competitors. The decision to match competitors' fares, to maintain passenger traffic, results in reduced yields which, in turn, could have a material adverse effect on Air Canada, its business, results from operations and financial condition. Furthermore, Air Canada's ability to reduce its fares in order to effectively compete with other carriers is dependent on Air Canada's ability to achieve acceptable operating margins and may also be limited by government policies to encourage competition. Likewise, competitors continue to pursue commission/incentive actions and, in many cases, increase these payments. The decision to modify Air Canada's current programs in order to remain competitive and maintain passenger traffic could result in increased costs to Air Canada's business.

In addition, consolidation in the airline industry could result in increased competition as some airlines emerging from such consolidations may be able to compete more effectively against Air Canada which could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Limitations Due to Restrictive Covenants

Some of the financing and other major agreements to which Air Canada is a party contain restrictive, financial (including in relation to liquidity, minimum EBITDAR, fixed charge coverage ratio and debt coverage ratios) and other covenants which affect and, in some cases, significantly limit or prohibit, among other things, the manner in which Air Canada may structure or operate its business, including by reducing Air Canada's liquidity, limiting Air Canada's ability to incur indebtedness, create liens, sell assets, pay dividends, make capital expenditures, and engage in acquisitions, mergers or restructurings or a change of control. Future financing and other major agreements may also be subject to similar covenants which limit Air Canada's operating and financial flexibility, which could materially and adversely affect Air Canada's ability to operate its business and its profitability.

A failure by Air Canada to comply with its contractual obligations (including restrictive, financial and other covenants), or to pay its indebtedness and fixed costs could result in a variety of material adverse consequences, including the acceleration of its indebtedness, the withholding of credit card proceeds by the credit card service providers and the exercise of remedies by its creditors and lessors, and such defaults could trigger additional defaults under other indebtedness or agreements. In such a situation, it is unlikely that Air Canada would be able to repay the accelerated indebtedness or fulfill its obligations under certain contracts, make required aircraft lease payments or otherwise cover its fixed costs. Also, the lenders under the financing arrangements could foreclose upon all or substantially all of the assets of Air Canada which secure Air Canada's obligations.

Refer to section 8.3 of this MD&A for a description of restrictive covenants relating to one of Air Canada's credit card processing agreements.

Airport User Fees and Air Navigation Fees

With the privatization of airports and air navigation authorities over the last decade in Canada, new airport and air navigation authorities have imposed significant increases in their fees. If authorities in Canada or elsewhere continue to increase their fees at the rate at which they have increased them in the recent past, Air Canada, its business, results from operations and financial condition could be materially adversely affected.

Strategic, Business, Technology and Other Important Initiatives

In order to operate its business, achieve its goals and remain competitive, Air Canada continuously seeks to identify and devise, invest in and implement strategic, business, technology and other important initiatives, such as those relating to the aircraft fleet restructuring program, the aircraft refurbishment program, the new revenue model, business process initiatives, information technology initiatives and others. These initiatives, including activities relating to their development and implementation, may be adversely impacted by a wide range of factors, many of which are beyond Air Canada's control. Such factors include the performance of third parties, including suppliers, the implementation and integration of such initiatives into Air Canada's other activities and processes as well as the adoption and acceptance of initiatives by Air Canada's customers, suppliers and personnel. A delay or failure to sufficiently and successfully identify and devise, invest in or implement these initiatives could adversely affect Air Canada's ability to operate its business, achieve its goals and remain competitive and could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

For instance, a key component of Air Canada's business plan is the completion of Air Canada's fleet restructuring program through the acquisition of new and more efficient Boeing 787 aircraft. A delay or failure in the completion of Air Canada's fleet restructuring, including further delays by the manufacturers in the delivery of the wide-body aircraft, or an inability to remove, as planned, certain aircraft from the fleet in coordination with the planned entry into service of new aircraft, could adversely affect the implementation of Air Canada's business plan which may, in turn, have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Dependence on Technology

Air Canada relies heavily on technology, including computer and telecommunications equipment and software and Internet-based systems, to operate its business, increase its revenues and reduce its costs. These systems include those relating to Air Canada's telecommunications, websites, computerized airline reservations and airport customer services and flight operations.

These technology systems may be vulnerable to a variety of sources of failure, interruption or misuse, including by reason of third party suppliers' acts or omissions, natural disasters, terrorist attacks, telecommunications failures, power failures, computer viruses, unauthorized or fraudulent users, and other operational and security issues. While Air Canada continues to invest in initiatives, including security initiatives and disaster recovery plans, these measures may not be adequate or implemented properly. Any such technology systems failure, interruption or misuse could materially and adversely affect Air Canada's operations and could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Key Supplies and Suppliers

Air Canada is dependent upon its ability to source, on favourable terms and costs, sufficient quantities of goods and services in a timely manner, including those available at airports or from airport authorities or otherwise required for Air Canada's operations such as fuel, aircraft and related parts and aircraft maintenance services (including maintenance services obtained from Aveos). In certain cases, goods and services may only be available from a limited number of suppliers and transition to new suppliers may take significant amounts of time and require significant resources. A failure, refusal or inability of a supplier may arise as a result of a wide range of causes, many of which are beyond Air Canada's control. In addition, in the context of the current economic climate, there can be no assurance as to the continued viability of any of Air Canada's suppliers. Any failure or inability of Air Canada to successfully source goods and services, including by reason of a failure, refusal or inability of a supplier, or to source goods and services on terms and pricing and within the timeframes acceptable to Air Canada, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Aeroplan

Through its commercial agreement with Aeroplan LP ("Aeroplan"), Air Canada is able to offer its customers who are Aeroplan members the opportunity to earn Aeroplan miles. Based on customer surveys, Management believes that rewarding customers with Aeroplan miles is a significant factor in customers' decision to travel with Air Canada and Jazz and contributes to building customer loyalty. The failure by Aeroplan to adequately fulfill its obligations towards Air Canada under the Aeroplan Commercial Participation and Services Agreement and in connection with the Aeroplan program, or other unexpected interruptions of Aeroplan services which are beyond Air Canada's control, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Jazz

Under the CPA, Jazz provides Air Canada's customers service in lower density markets and higher density markets at off-peak times throughout Canada and to and from certain destinations in the United States and also provides valuable traffic feed to Air Canada's mainline routes. Pursuant to the terms of the Jazz CPA, Air Canada pays Jazz a number of fees which are determined based upon certain costs incurred by Jazz. Air Canada also reimburses Jazz, without mark-up, for certain pass-through costs incurred directly by Jazz, such as fuel, navigation, landing and terminal fees and certain other costs. Significant increases in such pass-through costs, the failure by Jazz to adequately fulfill its obligations towards Air Canada under the Jazz CPA, or other unexpected interruptions or cessation of Jazz's services which are beyond Air Canada's control could have a material adverse effect on Air Canada, its business, results from operations and financial condition. In addition, the Jazz CPA requires that Jazz maintain a minimum fleet size and contains a minimum average daily utilization guarantee which requires that Air Canada make certain minimum payments to Jazz regardless of the amount of flying done on its behalf by Jazz.

Star Alliance®

The strategic and commercial arrangements with Star Alliance® members provide Air Canada with important benefits, including codesharing, efficient connections and transfers, reciprocal participation in frequent flyer programs and use of airport lounges from the other members. Should a key member leave Star Alliance® or otherwise fail to meet its obligations thereunder, Air Canada, its business, results from operations and financial condition could be materially adversely affected.

Interruptions or Disruptions in Service

Air Canada's business is significantly dependent upon its ability to operate without interruption at a number of hub airports, including Toronto Pearson International Airport. Delays or disruptions in service, including those due to security or other incidents, weather conditions, labour conflicts with airport workers, baggage handlers, air traffic controllers and other workers not employed by Air Canada or other causes beyond the control of Air Canada could have a material adverse impact on Air Canada, its business, results from operations and financial condition.

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 Air Canada. Competition authorities have sought or requested information from Air Canada as part of their investigations. Air Canada is cooperating with these investigations, which are likely to lead, or have led, to proceedings against Air Canada and a number of airlines and other cargo operators in certain jurisdictions including in the European Union where all formal procedural steps preceding a decision have been completed. Air Canada 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.

During 2008, Air Canada recorded a provision of $125 million as a preliminary estimate. This is only an estimate based upon the current status of the investigations and proceedings and Air Canada's assessment as to the potential outcome for certain of them. This provision does not address the proceedings and investigations in all jurisdictions, but only where there is sufficient information to do so. Management has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings and investigations. Additional material provisions may be required and such provisions could have a material adverse effect on Air Canada's financial position.

In February 2006, Jazz commenced proceedings before the Ontario Superior Court of Justice against Porter Airlines Inc. ("Porter") and other defendants (collectively the "Porter Defendants") after Jazz became aware that it would be excluded from operating flights from Toronto City Centre (Island) Airport (the "TCCA"). On October 26, 2007, the Porter Defendants counter-claimed against Jazz and Air Canada alleging various violations of competition law, including that Jazz and Air Canada's commercial relationship contravenes Canadian competition laws, and claiming $850 million in damages. Concurrently with the Ontario Superior Court of Justice proceedings, Jazz commenced judicial review proceedings against the Toronto Port Authority ("TPA") before the Federal Court of Canada relating to Jazz's access to the TCCA. The Porter Defendants were granted intervener and party status in these proceedings. In January of 2008, Porter filed a defence and counterclaim against Jazz and Air Canada making allegations and seeking conclusions similar to those in the Ontario Superior Court counterclaim. On October 16, 2009, Jazz discontinued its suit in the Ontario Superior Court against Porter. However, Jazz is continuing its proceedings in the Federal Court of Canada against the TPA, to which Porter intervened. The counterclaim filed by Porter in the Ontario Court against Jazz and Air Canada has been stayed pending the outcome of the mirror counterclaim in the Federal Court. Management views Porter's counterclaims in both jurisdictions as being without merit.

The Canadian Union of Public Employees ("CUPE"), which represents Air Canada's flight attendants, has filed a complaint before the Canadian Human Rights Commission where it alleges gender-based wage discrimination. CUPE claims the predominantly female flight attendant group should be paid the same as the predominantly male pilot and mechanics groups because their work is of equal value. The complaint dates from 1991 but has not been investigated on the merits because of a legal dispute over whether the three groups work in the same "establishment" within the meaning of the Canadian Human Rights Act. On January 26, 2006, the Supreme Court of Canada ruled that they do work in the same "establishment" and sent the case back to the Canadian Human Rights Commission, which may now proceed to assess the merits of CUPE's complaint. On March 16, 2007, the Canadian Human Rights Commission referred the complaint against Air Canada for investigation. Air Canada considers that any investigation will show that it is complying with the equal pay provisions of the Canadian Human Rights Act, however, Management has determined that it is not possible at this time to predict with any degree of certainty the final outcome of the Commission's investigation.

Future Legal proceedings

Airlines are susceptible to various claims and litigation, including class action claims, in the course of operating their business or with respect to the interpretation of existing agreements. Any future claims or litigation could also have a material adverse effect on Air Canada, its business and results from operations.

Key Personnel

Air Canada is dependent on the experience and industry knowledge of its executive officers and other key employees to execute its business plan. If Air Canada were to experience a substantial turnover in its leadership or other key employees, Air Canada's business, results from operations and financial condition could be materially adversely affected. Additionally, Air Canada may be unable to attract and retain additional qualified key personnel as needed in the future.

Risks Relating to the Airline Industry

Terrorist Attacks and Security Measures

The September 11, 2001 terrorist attacks and subsequent terrorist activity, notably in the Middle East, Southeast Asia and Europe, caused uncertainty in the minds of the traveling public. The occurrence of a terrorist attack (whether domestic or international and whether involving Air Canada or another carrier or no carrier at all) and increasingly restrictive security measures, such as the current restrictions on the content of carry-on baggage and current or proposed passenger identification document requirements, could have a material adverse effect on passenger demand for air travel and on the number of passengers traveling on Air Canada's flights. It could also lead to a substantial increase in insurance, airport security and other costs. Any resulting reduction in passenger revenues and/or increases in insurance, security or other costs could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Epidemic Diseases (Severe Acute Respiratory Syndrome (SARS), H1N1 Influenza or Other Epidemic Diseases)

As a result of the international outbreaks of Severe Acute Respiratory Syndrome (SARS) in 2003, the World Health Organization (the "WHO") issued on April 23, 2003 a travel advisory, which was subsequently lifted on April 30, 2003, against non-essential travel to Toronto, Canada. The seven-day WHO travel advisory relating to Toronto, the location of Air Canada's primary hub, and the international SARS outbreak had a significant adverse effect on passenger demand for air travel in Air Canada's markets and resulted in a major negative impact on traffic on the entire network. The WHO warns that there is a serious risk of an influenza pandemic. Air Canada is continuing to monitor the H1N1 influenza virus risk. While Air Canada has developed contingency plans related to the H1N1 influenza virus risk, it is unable to predict the likelihood of this risk materializing or the impact on its operations to the extent this risk does materialize. An outbreak of influenza, SARS, H1N1 influenza virus or of another epidemic disease (whether domestic or international) or a further WHO travel advisory (whether relating to Canadian cities or regions or other cities, regions or countries) could have a material adverse effect on passenger demand for air travel. Any resulting reduction in traffic in the markets served by Air Canada could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Casualty Losses

Due to the nature of its core operating business, Air Canada may be subject to liability claims arising out of accidents or disasters involving aircraft on which Air Canada's customers are traveling or involving aircraft of other carriers maintained or repaired by Air Canada, including claims for serious personal injury or death. There can be no assurance that Air Canada's insurance coverage will be sufficient to cover one or more large claims and any shortfall may be material. Additionally, any accident or disaster involving one of Air Canada's aircraft or an aircraft of another carrier receiving line maintenance services from Air Canada may significantly harm Air Canada's reputation for safety, which would have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Seasonal Nature of the Business, Other Factors and Prior Performance

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

As described elsewhere, demand for and cost of air travel is also affected by factors such as geopolitical and economic conditions, war or the threat of war or terrorist attacks, fare levels and weather conditions. Due to these and other factors, operating results for an interim period are not necessarily indicative of operating results for an entire year, and operating results for a historical period are not necessarily indicative of operating results for a future period.

Regulatory Matters

The airline industry is subject to extensive Canadian and foreign government regulations relating to, among other things, security, safety, privacy, licensing, competition, environment (including noise levels and carbon emissions) and, in some measure, pricing. Additional laws and regulations may be proposed, and decisions rendered, from time to time which could impose additional requirements or restrictions on airline operations. For example, new and proposed legislation have been considered or adopted concerning carbon emissions emanating from the aviation industry; such legislative initiatives include, for example, market-based mechanisms called emissions trading systems which are being proposed and implemented to reduce the amount of pollutants in the atmosphere through the trading of emissions credits. The implementation of additional regulations or decisions, including those relating to carbon emissions, and others, whether by Transport Canada, the Competition Bureau and/or the Competition Tribunal, the Canadian Transportation Agency or other domestic or foreign governmental entities, may have a material adverse effect on Air Canada, its business, results from operations and financial condition. Air Canada cannot give any assurances that new regulations or revisions to the existing legislation, or decisions, will not be adopted or rendered. The adoption of such new laws and regulations or revisions, or the rendering of such decisions, could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

The availability of international routes to Canadian air carriers is regulated by agreements between Canada and foreign governments. Changes in Canadian or foreign government aviation policy could result in the alteration or termination of these agreements and could adversely affect Air Canada, its international operations.

Air Canada is subject to domestic and foreign laws regarding privacy of passenger and employee data, including advance passenger information and access to airline reservation systems, which are not consistent in all countries in which Air Canada operates. The need to comply with these regulatory regimes is expected to result in additional operating costs and could have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Increased Insurance Costs

Since September 11, 2001 the aviation insurance industry has been continually reevaluating the terrorism risks that it covers, and this activity may adversely affect some of Air Canada's existing insurance carriers or Air Canada's ability to obtain future insurance coverage. To the extent that Air Canada's existing insurance carriers are unable or unwilling to provide it with insurance coverage, and in the absence of measures by the Government of Canada to provide the required coverage, Air Canada's insurance costs may increase further and may result in Air Canada being in breach of regulatory requirements or contractual arrangements requiring that specific insurance be maintained, which may have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Third Party War Risk Insurance

There is a risk that the Government of Canada may not continue to provide an indemnity for third party war risk liability coverage, which it currently provides to Air Canada and certain other carriers in Canada. In the event that the Government of Canada does not continue to provide such indemnity or amends such indemnity, Air Canada and other industry participants would have to turn to the commercial insurance market to seek such coverage. Air Canada estimates that such coverage would cost Air Canada approximately $10 million per year. Alternative solutions, such as those envisioned by the International Civil Aviation Organization ("ICAO") and the International Air Transport Association ("IATA"), have not developed as planned, due to actions taken by other countries and the recent availability of supplemental insurance products. ICAO and IATA are continuing their efforts in this area, however, the achievement of a global solution is not likely in the immediate or near future. The U.S. federal government has set up its own facility to provide war risk coverage to U.S. carriers, thus removing itself as a key component of any global plan.

Furthermore, the London aviation insurance market has introduced a new standard war and terrorism exclusion clause which is applicable to aircraft hull and spares war risk insurance, and intends to introduce similar exclusions to airline passenger and third party liability policies. Such clause excludes claims caused by the hostile use of a dirty bomb, electromagnetic pulse device, or biochemical materials. The Government of Canada's indemnity program is designed to address these types of issues as they arise, but the Government of Canada has not yet decided to extend the existing indemnity to cover this exclusion. Unless and until the Government of Canada does so, the loss of coverage exposes Air Canada to this new uninsured risk and may result in Air Canada being in breach of certain regulatory requirements or contractual arrangements, which may have a material adverse effect on Air Canada, its business, results from operations and financial condition.

Risks Related to Air Canada's Relationship with ACE

Control of Air Canada and Related Party Relationship

As at September 30, 2009, ACE owned Class B voting shares representing 75% of the shares issued and outstanding. This voting control enabled ACE to determine substantially all matters requiring security holder approval as a result of its voting interest in Air Canada. Accordingly, ACE would exercise control over corporate transactions that must be submitted to Air Canada's security holders for approval and effectively has sufficient voting power to effect or prevent a change in control of Air Canada. Following completion of the offering, as described in section 4 of this MD&A, and the issuance of shares under the Pension MOUs, ACE's ownership is reported to represent 27% of the shares issued and outstanding, however, ACE remains the largest shareholder of Air Canada. The extent of ACE's shareholdings in Air Canada may discourage transactions involving shares in Air Canada, including as a result, transactions in which the public shareholders of Air Canada might otherwise receive a premium for their shares over the then-current market price. The interests of ACE may conflict with those of other shareholders. The exercise, if any, by lenders other than ACE of the initial warrants and additional warrants under the Credit Agreement would further dilute ACE's shareholdings in Air Canada.

Future Sales of Shares by or for ACE

ACE generally has the right at any time to spin-off the Air Canada shares that it owns or to sell a controlling interest in Air Canada to a third party, in either case without the approval of the public shareholders of Air Canada and without providing for a purchase of such shareholders' shares of Air Canada, subject to compliance with applicable securities laws. Sales of substantial amounts of Air Canada's shares by ACE (including through a distribution of Air Canada's shares to ACE shareholders), or the possibility of those sales by ACE, could adversely affect the market price of the shares and impede Air Canada's ability to raise capital through the issuance of equity securities.

Except as described in section 13 of this MD&A, ACE has no contractual obligation to retain any of its Air Canada shares. The Registration Rights Agreement that Air Canada entered into with ACE concurrently with its initial public offering granted ACE the right to require Air Canada to file a prospectus and otherwise assist with a public offering of shares that ACE holds in specified circumstances. Such right will not apply during the 90-day period from the commencement of the public distribution pursuant to the offering, during which period ACE shall retain its Air Canada shares. Any sale by ACE of shares in the public market, or the perception that sales could occur could adversely affect the prevailing market prices of the shares.

16. Controls and Procedures

Disclosure controls and procedures and internal controls over financial reporting

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

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

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

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

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

Management's report on disclosure controls and procedures

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

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

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

Management's report on internal controls over financial reporting

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

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

Changes in internal controls over financial reporting

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

17. Non-GAAP Financial Measures

EBITDAR

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

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

	Third Quarter			First Nine Months		
(Canadian dollars in millions)	**2009**	**2008**	**Change $**	**2009**	**2008**	**$ Change**
GAAP operating income (loss) before the provision for cargo investigations	$ 68	$ 112	$ (44)	$ (233)	$ 107	$ (340)
Add back:						
Aircraft rent	81	67	14	250	199	51
Depreciation and amortization	171	176	(5)	495	520	(25)
EBITDAR before the provision for cargo investigations	**$ 320**	**$ 355**	**$ (35)**	**$ 512**	**$ 826**	**$ (314)**
Add back:						
Provision for cargo investigations	-		-	-	(125)	125
EBITDAR	**$ 320**	**$ 355**	**$ (35)**	**$ 512**	**$ 701**	**$ (189)**

Operating expense excluding fuel expense

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

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

	Third Quarter			First Nine Months		
(Canadian dollars in millions)	**2009**	**2008**	**Change $**	**2009**	**2008**	**$ Change**
GAAP operating expense	$ 2,602	$ 2,963	$ (361)	$ 7,624	$ 8,477	$ (853)
Remove:						
Aircraft fuel	(682)	(1,064)	382	(1,847)	(2,627)	780
Operating expense, excluding fuel expense	**$ 1,920**	**$ 1,899**	**$ 21**	**$ 5,777**	**$ 5,850**	**$ (73)**

18. Glossary

Available Seat Miles or ASMs — A measure of passenger capacity calculated by multiplying the total number of seats available for passengers by the miles flown.

CASM — Operating expense per ASM.

EBITDAR — EBITDAR is earnings before interest, taxes, depreciation and amortization, and aircraft rent and is a non-GAAP financial measure commonly used in the airline industry to view operating results before depreciation and amortization, and aircraft rent as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. Refer to section 17 of this MD&A for additional information.

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

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

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

Yield — Average passenger revenue per RPM.