AIR CANADA

First Quarter 2010

Management's Discussion and Analysis
of Results and Financial Condition

May 6, 2010

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1. Highlights

The financial and operating highlights for Air Canada for the periods indicated are as follows.

	First Quarter		
(Canadian dollars in millions, except per share figures)	**2010**	**2009**	**Change $**
Financial			
Operating revenues	2,519	2,391	128
Operating loss	(126)	(188)	62
Non-operating expense	(75)	(109)	34
Loss before non-controlling interest, foreign exchange and income taxes	(201)	(297)	96
Loss for the period	(85)	(400)	315
Operating margin %	(5.0%)	(7.9%)	2.9 pp
EBITDAR (1)	138	57	81
EBITDAR margin % (1)	5.5%	2.4%	3.1 pp
Cash, cash equivalents and short-term investments	1,621	1,087	534
Free cash flow	215	61	154
Adjusted debt/equity ratio %	79.3%	93.3%	(14.0) pp
Loss per share - Basic and diluted	($0.31)	($4.00)	$3.69
Operating Statistics			**Change %**
Revenue passenger miles (millions) (RPM)	11,692	10,984	6.4
Available seat miles (millions) (ASM)	14,727	13,821	6.6
Passenger load factor %	79.4%	79.5%	(0.1) pp
Passenger revenue per RPM (cents)	17.9	18.2	(2.2)
Passenger revenue per ASM (cents)	14.2	14.5	(2.3)
Operating revenue per ASM (cents)	17.1	17.3	(1.1)
Operating expense per ASM ("CASM") (cents)	18.0	18.7	(3.7)
CASM, excluding fuel expense (cents)	13.8	14.4	(4.2)
Average number of full-time equivalent (FTE) employees (thousands) (2)	22.9	22.7	0.7
Aircraft in operating fleet at period end (3)	327	334	(2.1)
Average fleet utilization (hours per day) (4)	9.4	9.1	3.1
Average aircraft flight length (miles) (4)	856	841	1.9
Fuel price per litre (cents) (5)	70.7	71.4	(1.0)
Fuel litres (millions)	872	827	5.4

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

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

(3) Includes Jazz aircraft covered under the Jazz CPA.

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

(5) 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, as the context may require, to Air Canada and/or one or more of Air Canada's subsidiaries.

Air Canada's first quarter 2010 MD&A provides the reader with a view and analysis, from the perspective of management, of Air Canada's financial results for the first quarter of 2010. This MD&A should be read in conjunction with Air Canada's interim unaudited consolidated financial statements and notes for the first quarter of 2010 and its annual audited consolidated financial statements and notes and its annual MD&A for 2009. 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 first quarter of 2010 are based on accounting policies consistent with those disclosed in Note 2 to the Corporation's annual audited consolidated financial statements for 2009. 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 15 "Glossary" of this MD&A. Except as otherwise noted, this MD&A is current as of May 5, 2010.

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, refer to section 12 "Risk Factors" of this MD&A and section 19 "Risk Factors" of Air Canada's 2009 MD&A. which can be found on Air Canada's website at **www.aircanada.com** or on SEDAR at **www.sedar.com**.

The Corporation issued a news release dated May 6, 2010, reporting on its results for the first quarter of 2010. This news release is available on Air Canada's website at **www.aircanada.com** or on SEDAR at **www.sedar.com**.

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

CAUTION REGARDING FORWARD-LOOKING INFORMATION

Air Canada's public communications may include written or oral forward-looking statements within the meaning of applicable securities laws. Such statements are included in this MD&A and may be included in other communications, including filings with regulatory authorities and securities regulators. Forward-looking statements 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, environmental factors (including weather systems and other natural phenomena, such as volcanic eruptions, and factors arising from man-made sources), insurance issues and costs, changes in demand due to the seasonal nature of the business, supply issues, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in section 12 "Risk Factors" of this MD&A and section 19 "Risk Factors" of Air Canada's 2009 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 continue to slowly recover in 2010. In addition, Air Canada expects that the Canadian dollar will trade, on average, at C$1.02 per U.S. dollar in the second quarter of 2010 and for the full year 2010 and that the price of fuel will average 72 cents per litre for the second quarter of 2010 and for the full year 2010 (both net of fuel hedging positions).

3. Overview

Air Canada's results of operations for the first quarter of 2010 are discussed in section 4 of this MD&A.

The following is an overview of Air Canada's results of operations for the first quarter of 2010 compared to the first quarter of 2009.

Air Canada recorded a net loss of $85 million or $0.31 per diluted share in the first quarter of 2010 compared to a net loss of $400 million or $4.00 per diluted share in the first quarter of 2009. The net loss recorded in the first quarter of 2010 included foreign exchange gains of $100 million which were primarily attributable to a stronger Canadian dollar at March 31, 2010 versus December 31, 2009. The March 31, 2010 noon day exchange rate was US$1 = C$1.0156 while the December 31, 2009 noon day exchange rate was US$1 = C$1.0466.

In the first quarter of 2010, Air Canada recorded an operating loss of $126 million, an improvement of $62 million from the operating loss of $188 million recorded in the first quarter of 2009. EBITDAR amounted to $138 million in the first quarter of 2010 compared to EBITDAR of $57 million in the first quarter of 2009, an increase of $81 million. See section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

In mid-2009, Air Canada launched a Cost Transformation Program (the "CTP"), implementing initiatives in an effort to generate cost savings and additional revenue, including through contract improvements, operating process improvements and productivity gains. As of the date of the MD&A, Air Canada achieved, on a run-rate basis, $255 million of the $270 million CTP target for 2010 and $281 million of the overall $500 million CTP target for the end of 2011. The CTP and these targets were disclosed in Air Canada's news release dated February 10, 2010. Air Canada views the CTP as one of its most important priorities.

In the first quarter of 2010, Air Canada recorded operating revenues of $2,519 million, an increase of $128 million or 5.4% from the operating revenues of $2,391 million recorded in the first quarter of 2009. The increase in operating revenues was due to passenger and cargo revenue growth of $108 million or 5.2% from the first quarter of 2009, the impact of CTP revenue generating initiatives, as well as higher third party revenues at Air Canada Vacations when compared to the first quarter of 2009. The system passenger revenue growth was primarily due to a 6.4% increase in system passenger traffic reflecting a strengthening economy and a 6.6% growth in system capacity year-over-year. System yield declined 2.2% from the first quarter of 2009 due mainly to the negative impact of a stronger Canadian dollar on foreign currency denominated passenger revenues, reduced fuel surcharges, greater fare discounting in an effort to stimulate traffic in order to fill additional capacity, and increased competitive pricing activities, particularly in the Caribbean. The unfavourable impact of the stronger Canadian dollar on foreign currency denominated passenger revenues accounted for a decrease of $61 million to system passenger revenues in the first quarter of 2010. RASM in the first quarter of 2010 decreased 2.3% from the first quarter of 2009 primarily due to the yield decline as passenger load factor was essentially unchanged from the same quarter in 2009.

In the first quarter of 2010, Air Canada recorded operating expenses of $2,645 million, an increase of $66 million or 2.6% from the operating expenses of $2,579 million recorded in the first quarter of 2009. The impact of a stronger Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) compared to the first quarter of 2009 reduced operating expenses by approximately $162 million from the same period in 2009. The CTP had a favourable impact on various operating expense categories in the first quarter of 2010, including fuel, wages and salaries, capacity purchase fees with Jazz, airport user fees, information technology, terminal handling, advertising and promotion, and miscellaneous fees and services. Operating expense decreases were more than offset by volume-related increases related to Air Canada's 6.6% capacity growth versus the same period in 2009, higher fuel prices year-over-year, as well as increases in pension and depreciation expenses.

CASM decreased 3.7% from the first quarter of 2009. Excluding fuel expense, CASM decreased 4.2% from the first quarter of 2009. The 4.2% decrease in CASM (excluding fuel expense) for the first quarter of 2010 was in line with the 3.5% to 4.5% CASM (excluding fuel expense) decrease projected in Air Canada's news release dated February 10, 2010.

4. Results of Operations – First Quarter of 2010 versus First Quarter of 2009

The following table and discussion compares the results of Air Canada for the first quarter of 2010 versus the first quarter of 2009.

	First Quarter		Change	
(Canadian dollars in millions, except per share figures)	**2010**	**2009**	**$**	**%**
Operating revenues				
Passenger	$ 2,095	$ 2,011	$ 84	4
Cargo	104	80	24	30
Other	320	300	20	7
	2,519	**2,391**	**128**	**5**
Operating expenses				
Aircraft fuel	619	593	26	4
Wages, salaries, and benefits	470	458	12	3
Airport and navigation fees	226	230	(4)	(2)
Capacity purchase with Jazz	226	246	(20)	(8)
Depreciation and amortization	176	159	17	11
Aircraft maintenance	200	189	11	6
Food, beverages and supplies	74	67	7	10
Communications and information technology	80	79	1	1
Aircraft rent	88	86	2	2
Commissions	60	49	11	22
Other	426	423	3	1
	2,645	**2,579**	**66**	**3**
Operating loss	**(126)**	**(188)**	**62**	
Non-operating income (expense)				
Interest income	2	6	(4)	
Interest expense	(78)	(105)	27	
Interest capitalized	-	1	(1)	
Loss on assets	(1)	-	(1)	
Gain (loss) on financial instruments recorded at fair value	2	(10)	12	
Other	-	(1)	1	
	(75)	(109)	34	
Loss before the following items	**(201)**	**(297)**	**96**	
Non-controlling interest	(3)	(4)	1	
Foreign exchange gain (loss)	100	(101)	201	
Recovery of income taxes	19	2	17	
Loss for the period	**$ (85)**	**$ (400)**	**$ 315**	
EBITDAR [(1)]	**$ 138**	**$ 57**	**$ 81**	
Loss per share - Basic and diluted	**$ (0.31)**	**$ (4.00)**	**$ 3.69**	

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

System passenger revenues increased 4.2% from the first quarter of 2009

Compared to the first quarter of 2009, system passenger revenues increased $84 million or 4.2% to $2,095 million in the first quarter of 2010 due to traffic growth. This was partly offset by the impact of a reduced system yield year-over-year.

In the first quarter of 2010, system passenger revenues from the premium cabin accounted for almost 70% of the total increase in system passenger revenues. This growth in first quarter premium cabin revenues was driven by a 10.6% increase in premium traffic and a 3.9% premium yield improvement. Premium cabin yield improvements were recorded in all markets. Although the premium cabin revenue growth reflected a significant improvement from the first quarter of 2009, premium cabin revenues remained below the first quarter of 2008 level. The economy cabin reflected a year-over-year yield decline of 4.7% while traffic increased 6.0% in the economy cabin from the same quarter in 2009.

In the first quarter of 2010, Air Canada increased its overall capacity by 6.6% from the first quarter of 2009, comprised of a capacity increase of 2.7% in the North American markets and a capacity increase of 10.5% in the international markets. Components of the year-over-year change in first quarter system passenger revenues included:

- A system traffic increase of 6.4% on capacity growth of 6.6%, which resulted in system passenger load factor being essentially unchanged from the first quarter of 2009. The system capacity growth of 6.6% in the first quarter of 2010 compared to the first quarter of 2009 was slightly above the 5.5% to 6.5% ASM capacity increase projected in Air Canada's news release dated February 10, 2010. The slightly greater than forecasted capacity growth was primarily attributable to greater than expected flying during the Winter Olympic Games.

- A system yield decline of 2.2% from the first quarter of 2009, which was due to the unfavourable impact of a stronger Canadian dollar on foreign currency denominated passenger revenues, reduced fuel surcharges year-over-year, increased competitive pricing activities, especially in the Caribbean, and greater fare discounting in an effort to stimulate traffic, particularly in the Pacific market where capacity was increased 25.6% year-over-year. In the first quarter of 2010, the economy cabin reflected a yield decline of 4.7% while the premium cabin reflected yield growth of 3.9% compared to the same quarter in 2009.

- A stronger Canadian dollar in the first quarter of 2010 versus the first quarter of 2009, which decreases the Canadian dollar value of sales in foreign countries, and which had a negative impact on passenger revenues, accounting for a decrease of $61 million to first quarter 2010 passenger revenues compared to the first quarter of 2009.

- A RASM decrease of 2.3% from the first quarter of 2009, which was due to the yield decline.

The table below provides year-over-year percentage changes from 2009 to 2010 first quarter passenger revenues, capacity, traffic, passenger load factor, yield and RASM**.**

First Quarter 2010 Versus First Quarter 2009	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	1.5	2.6	0.8	(1.4)	0.6	(1.1)
U.S. transborder	6.0	2.8	3.4	0.5	2.5	3.1
Atlantic	6.5	6.2	5.8	(0.3)	0.5	0.1
Pacific	14.5	25.6	23.6	(1.4)	(7.4)	(8.8)
Other	(0.5)	4.3	6.6	1.7	(6.6)	(4.6)
System	**4.2**	**6.6**	**6.4**	**(0.1)**	**(2.2)**	**(2.3)**

The table below provides year-over-year percentage changes in system passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the first quarter 2010 and each of the previous four quarters.

System	Year-over-Year by Quarter (% Change)				
	Q1'09	Q2'09	Q3'09	Q4'09	Q1'10
Passenger Revenues	(13.0)	(16.1)	(13.2)	(7.0)	4.2
Capacity (ASMs)	(10.3)	(5.4)	(3.3)	2.0	6.6
Traffic (RPMs)	(10.9)	(7.9)	(2.1)	0.4	6.4
Passenger Load Factor (pp Change)	(0.5)	(2.2)	1.0	(1.3)	(0.1)
Yield	(2.3)	(8.9)	(11.2)	(7.3)	(2.2)
RASM	(3.0)	(11.3)	(10.2)	(8.8)	(2.3)

Domestic passenger revenues increased 1.5% from the first quarter of 2009

Domestic passenger revenues of $829 million in the first quarter of 2010 increased $12 million or 1.5% from the first quarter of 2009 due to both traffic growth and a higher yield. In the first quarter of 2010, Air Canada increased its domestic capacity by 2.6% from the first quarter of 2009. Capacity increases were mainly reflected on transcontinental routes and on routes within western Canada, driven by the 2010 Winter Olympic Games, and on routes to the Maritimes. Components of the year-over-year change in first quarter domestic passenger revenues included:

- A traffic increase of 0.8% on capacity growth of 2.6%, which resulted in a 1.4 percentage point decline in passenger load factor.

- A yield increase of 0.6% from the first quarter of 2009, which was in part due to higher-yielding traffic driven by the Olympic Games. In addition, Rapidair routes, linking Toronto and Montreal/Ottawa, also reflected significantly stronger yields year-over-year due in part to several fare increases. Partly offsetting these increases was the impact of lower yields on routes to the Maritimes, the result of greater fare discounting to stimulate traffic in an attempt to fill additional capacity. On the Maritimes, the incremental capacity was due to the new service between Ottawa and St. John's (which started in May 2009), as well as larger aircraft deployed on several routes including Toronto – Moncton and Ottawa – Halifax. The unfavourable impact of a stronger Canadian dollar on domestic passenger revenues and reduced fuel surcharges year-over-year negatively impacted domestic yield in the first quarter of 2010.

- A stronger Canadian dollar in the first quarter of 2010 versus the first quarter of 2009, which had a negative impact on domestic passenger revenues, accounting for a decrease of $11 million to first quarter 2010 passenger revenues compared to the first quarter of 2009.

- A RASM decline of 1.1% from the first quarter of 2009, which was due to the decrease in passenger load factor.

The table below provides year-over-year percentage changes in domestic passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the first quarter 2010 and each of the previous four quarters.

Canada	Year-over-Year by Quarter (% Change)				
	Q1'09	Q2'09	Q3'09	Q4'09	Q1'10
Passenger Revenues	(11.4)	(17.0)	(13.3)	(7.9)	1.5
Capacity (ASMs)	(7.3)	(5.8)	(1.5)	(0.6)	2.6
Traffic (RPMs)	(8.3)	(8.2)	0.7	(1.3)	0.8
Passenger Load Factor (pp Change)	(1.0)	(2.1)	1.8	(0.5)	(1.4)
Yield	(3.3)	(9.5)	(13.6)	(6.7)	0.6
RASM	(4.4)	(11.9)	(11.7)	(7.3)	(1.1)

U.S. transborder passenger revenues increased 6.0% from the first quarter of 2009

U.S. transborder passenger revenues of $465 million in the first quarter of 2010 increased $26 million or 6.0% from the first quarter of 2009 due to both traffic growth and a yield improvement. In the first quarter of 2010, U.S. transborder capacity increased by 2.8% from the first quarter of 2009. Components of the year-over-year change in first quarter U.S. transborder passenger revenues included:

- A traffic increase of 3.4% on capacity growth of 2.8%, which resulted in a passenger load factor improvement of 0.5 percentage points from the first quarter of 2009. The capacity growth reflected mainly the introduction of services from Calgary to Portland, as well as services from Calgary to Honolulu, to Maui and to San Diego. Air Canada also introduced new service between Montreal and Houston and increased its capacity on routes to Florida with new service between Montreal and Fort Myers and between Ottawa and Orlando. The suspension of Air Canada's Toronto – Austin, Calgary – Chicago and Halifax – LaGuardia in the second half of 2009 partly offset these increases. Service was also reduced on Toronto – Los Angeles and San Francisco as well as on Montreal and Toronto to Fort Lauderdale.

- A yield increase of 2.5% from the first quarter of 2009, which reflected yield improvements on all major U.S. transborder services with the exception of routes to Hawaii and on routes between Western Canada and the Western U.S. where additional capacity and very competitive pricing adversely impacted yields. Overall, U.S. transborder premium cabin yield showed meaningful improvements from the first quarter of 2009.

- A stronger Canadian dollar in the first quarter of 2010 versus the first quarter of 2009, which had a negative impact on U.S. transborder passenger revenues, accounting for a decrease of $18 million to first quarter 2010 passenger revenues compared to the first quarter of 2009.

- A RASM increase of 3.1% from the first quarter of 2009, which was mainly due to the higher yield but also to the passenger load factor improvement.

The table below provides year-over-year percentage changes in U.S. transborder passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the first quarter 2010 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
U.S. transborder	**Q1'09**	**Q2'09**	**Q3'09**	**Q4'09**	**Q1'10**
Passenger Revenues	(17.2)	(14.4)	(13.1)	(3.7)	6.0
Capacity (ASMs)	(13.7)	(4.7)	(8.8)	(1.8)	2.8
Traffic (RPMs)	(14.4)	(9.5)	(8.0)	(5.0)	3.4
Passenger Load Factor (pp Change)	(0.7)	(3.9)	0.7	(2.5)	0.5
Yield	(3.4)	(5.4)	(5.4)	1.4	2.5
RASM	(4.1)	(10.2)	(4.6)	(1.9)	3.1

Atlantic passenger revenues increased 6.5% from the first quarter of 2009

Atlantic passenger revenues of $344 million in the first quarter of 2010 increased $21 million or 6.5% from the first quarter of 2009 mainly due to traffic growth but also to a higher yield. In the first quarter of 2010, Atlantic capacity was increased by 6.2% from the first quarter of 2009. Capacity was increased on all major Atlantic services with the exception of routes to the U.K. where capacity was reduced year-over-year. A transatlantic joint venture, which is in the process of being implemented, among Air Canada, Lufthansa, Continental and United Airlines, is increasing Air Canada's market presence, specifically in several U.S. and international markets. Creating all encompassing fare structures on several new destinations and leveraging the reach of Air Canada's partners has increased the volume of U.S. – Europe traffic while also improving yield due to capturing a better mix of traffic. Components of the year-over-year change in first quarter Atlantic passenger revenues included:

- A traffic increase of 5.8% on the capacity growth of 6.2%, which resulted in a passenger load factor decrease of 0.3 percentage points from the first quarter of 2009.

- The capacity growth in the first quarter of 2010 mainly reflected the addition of new routes, such as Montreal – Geneva and additional frequencies on Calgary – Frankfurt and Toronto – Tel Aviv. These capacity increases were partly offset by a capacity decrease on routes to the U.K.

- A yield improvement of 0.5% from the first quarter of 2009, which was in part due to higher-yielding traffic driven by the 2010 Winter Olympic Games, particularly on routes to/from the U.K. and Switzerland. Yields also improved on Toronto – Tel Aviv. Partly offsetting these increases were lower yields on routes to France, Germany and Rome, the result of greater fare discounting to stimulate traffic in an attempt to fill additional capacity. The unfavourable impact of a stronger Canadian dollar on Atlantic passenger revenues and lower fuel surcharges year-over-year also adversely impacted Atlantic yield in the first quarter of 2010.

- A stronger Canadian dollar in the first quarter of 2010 versus the first quarter of 2009, which had a negative impact on Atlantic passenger revenues, accounting for a decrease of $15 million to first quarter 2010 passenger revenues compared to the first quarter of 2009.

- RASM was essentially unchanged from the first quarter of 2009.

The table below provides year-over-year percentage changes in Atlantic passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the first quarter 2010 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Atlantic	**Q1'09**	**Q2'09**	**Q3'09**	**Q4'09**	**Q1'10**
Passenger Revenues	(12.7)	(11.1)	(6.7)	(4.8)	6.5
Capacity (ASMs)	(9.7)	(0.1)	6.8	6.7	6.2
Traffic (RPMs)	(12.9)	(1.6)	5.9	2.4	5.8
Passenger Load Factor (pp Change)	(2.7)	(1.3)	(0.8)	(3.3)	(0.3)
Yield	0.1	(9.7)	(11.8)	(7.0)	0.5
RASM	(3.4)	(11.0)	(12.6)	(10.8)	0.1

Pacific passenger revenues increased 14.5% from the first quarter of 2009

Pacific passenger revenues of $206 million in the first quarter of 2010 increased $26 million or 14.5% from the first quarter of 2009 due to traffic growth. In the first quarter of 2010, capacity was increased by 25.6% from the first quarter of 2009 with growth reflected on all major Pacific services. Components of the year-over-year change in first quarter Pacific passenger revenues included:

- A traffic increase of 23.6% on capacity growth of 25.6%, which resulted in passenger load factor decline of 1.4 percentage points from the first quarter of 2009. Air Canada increased its capacity on the Pacific with the re-introduction of the Toronto – Narita non-stop service with a Boeing 777 aircraft in November 2009, the introduction of Calgary – Narita non-stop service with a Boeing 767 aircraft in March 2010, and additional frequencies from Vancouver to China.

- A yield decline of 7.4% from the first quarter of 2009, which reflected greater fare discounting in an effort to stimulate traffic in attempt to fill additional capacity. The unfavourable impact of a stronger Canadian dollar on Pacific passenger revenues and lower fuel surcharges year-over-year also adversely impacted Pacific yield in the first quarter of 2010.

- A stronger Canadian dollar in the first quarter of 2010 versus the first quarter of 2009 had a negative impact on Pacific passenger revenues, accounting for a decrease of $11 million to first quarter 2010 passenger revenues compared to the first quarter of 2009.

- A RASM decrease of 8.8% from the first quarter of 2009, which was primarily due to the decline in yield but also to the decrease in passenger load factor.

The table below provides year-over-year percentage changes in Pacific passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the first quarter 2010 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Pacific	**Q1'09**	**Q2'09**	**Q3'09**	**Q4'09**	**Q1'10**
Passenger Revenues	(12.3)	(19.8)	(21.9)	(9.7)	14.5
Capacity (ASMs)	(26.0)	(12.6)	(14.8)	6.5	25.6
Traffic (RPMs)	(20.5)	(15.7)	(12.6)	4.2	23.6
Passenger Load Factor (pp Change)	6.2	(3.1)	2.1	(1.8)	(1.4)
Yield	10.2	(4.9)	(10.6)	(13.4)	(7.4)
RASM	18.5	(8.3)	(8.4)	(15.2)	(8.8)

Other passenger revenues decreased 0.5% from the first quarter of 2009

Other passenger revenues (comprised of South Pacific, Caribbean, Mexico and South America) of $251 million in the first quarter of 2010 decreased $1 million or 0.5% from the first quarter of 2009 due to reduced yields as overall traffic increased 6.6% year-over-year. Capacity growth was reflected on all major routes with the exception of routes to Mexico. Components of the year-over-year change in first quarter Other passenger revenues included:

- A traffic increase of 6.6% on capacity growth of 4.3%, which resulted in a passenger load factor improvement of 1.7 percentage points versus the same quarter of 2009.

- A yield decline of 6.6% from the first quarter of 2009, which reflected increased fare discounting to stimulate traffic, competitive pricing activities, particularly on routes to the Caribbean, reduced fuel surcharges year-over-year and the negative effect of a stronger Canadian dollar on Other passenger revenues. Yield decreases were reflected on all major services with the exception of routes to South America which improved year-over-year.

- A stronger Canadian dollar in the first quarter of 2010 versus the first quarter of 2009, which had a negative impact on Other passenger revenues, accounting for a decrease of $6 million to first quarter 2010 passenger revenues compared to the first quarter of 2009.

- A RASM decrease of 4.6% from the first quarter of 2009, which was due to the decline in yield.

The table below provides year-over-year percentage changes in Other passenger revenues, capacity, traffic, passenger load factor, yield and RASM by quarter for the first quarter 2010 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Other	**Q1'09**	**Q2'09**	**Q3'09**	**Q4'09**	**Q1'10**
Passenger Revenues	(11.2)	(23.3)	(20.1)	(10.8)	(0.5)
Capacity (ASMs)	4.2	(6.6)	(7.2)	(0.1)	4.3
Traffic (RPMs)	1.4	(8.0)	(7.6)	3.3	6.6
Passenger Load Factor (pp Change)	(2.2)	(1.2)	(0.4)	2.6	1.7
Yield	(12.4)	(16.7)	(13.5)	(13.7)	(6.6)
RASM	(14.8)	(17.9)	(13.9)	(10.7)	(4.6)

Cargo revenues increased 30% from the first quarter of 2009

First quarter 2010 cargo revenues amounted to $104 million and were $24 million or 30% higher than the first quarter of 2009. Cargo traffic increased 59% compared to the same period last year on strong traffic growth in all markets notably South America, Pacific and Atlantic markets. Traffic in the 2009 quarter had been adversely affected by the economic slowdown and reduced air cargo demand. System cargo yield per revenue ton mile (RTM) declined 18% versus the same quarter in 2009 mainly due to increased competitive pressure on rates and the unfavourable impact of a stronger Canadian dollar on foreign denominated currencies. Factors contributing to the year-over-year change in first quarter cargo revenues included:

- An increase in domestic cargo revenues of 10% on a 28% traffic increase and a 14% decline in yield per RTM. Domestic capacity increased 4% versus the first quarter of 2009.

- An increase in Atlantic revenues of 18% on 43% more traffic and an 18% lower yield per RTM. Atlantic capacity increased 5% versus the first quarter of 2009.

- An increase in Pacific revenues of 63% on 79% more traffic and 9% lower yield per RTM. Pacific capacity increased 24% versus the first quarter of 2009.

- An increase in revenues in the Other markets of 49% on 95% more traffic and a 23% lower yield per RTM. Other capacity increased 5% versus the first quarter of 2009.

- A stronger Canadian dollar versus the first quarter of 2009 which had a negative impact on foreign currency denominated revenues of $8 million in the first quarter of 2010.

Other revenues increased 7% from the first quarter of 2009

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

Other revenues of $320 million in the first quarter of 2010 increased $20 million or 7% from the first quarter of 2009, due to a $36 million or 22% increase in third party revenues at Air Canada Vacations, driven by a higher selling price of tour packages and an increase in passenger volumes reflecting increased capacity year-over-year. This increase was partly offset by lower aircraft sublease revenues in the quarter mainly due to the sale of two Airbus A340-300 aircraft which were subleased to third parties in the first quarter of 2009, and the unfavourable impact of a stronger Canadian dollar on U.S. denominated aircraft lease revenues.

CASM decreased 3.7% from the first quarter of 2009. Excluding fuel expense, CASM decreased 4.2% from the first quarter of 2009

Operating expenses were $2,645 million in the first quarter of 2010, an increase of $66 million or 3% from the first quarter of 2009, with the more notable increases reflected in aircraft fuel, employee benefits, depreciation, aircraft maintenance and commissions. These increases were partly offset by expense reductions in capacity purchase fees paid to Jazz and wages and salaries. In the first quarter of 2010, a stronger Canadian dollar versus foreign currency denominated operating expenses (mainly U.S. dollars) compared to the first quarter of 2009 reduced operating expenses by approximately $162 million from the first quarter of 2009.

Unit cost in the first quarter of 2010, as measured by operating expense per available seat mile (CASM), decreased 3.7% over the first quarter of 2009. Excluding fuel expense, CASM decreased 4.2% year-over-year. The favourable impact of a stronger Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) accounted for approximately 87% of the CASM decrease (excluding fuel expense). The capacity growth, which results in the airline's fixed costs being allocated over a greater number of ASMs, the impact of CTP initiatives, as well as increases in aircraft utilization and average stage length from the first quarter of 2009 were also contributing factors to the CASM decrease year-over-year. Partly offsetting these decreases was a $24 million increase in employee benefits expenses mainly due to higher pension expense, the result of changes in the actuarial assumptions used to calculate pension expense, and higher depreciation expenses.

The 4.2% decrease in CASM (excluding fuel expense) for the first quarter of 2010 was in line with the 3.5% to 4.5% CASM (excluding fuel expense) decrease projected in Air Canada's news release dated February 10, 2010.

The following table compares Air Canada's operating expenses per ASM for the first quarter of 2010 to Air Canada's operating expenses per ASM for the corresponding period in 2009.

	First Quarter		Change	
(cents per ASM)	**2010**	**2009**	**cents**	**%**
Wages and salaries	2.48	2.73	(0.25)	(9.2)
Benefits	0.71	0.58	0.13	22.4
Ownership (DAR) (1)	1.79	1.77	0.02	1.1
Airport user fees	1.53	1.66	(0.13)	(7.8)
Capacity purchase with Jazz	1.54	1.78	(0.24)	(13.5)
Aircraft maintenance	1.36	1.36	-	-
Food, beverages and supplies	0.50	0.49	0.01	2.0
Communications and information technology	0.55	0.57	(0.02)	(3.5)
Commissions	0.41	0.36	0.05	13.9
Other	2.89	3.07	(0.18)	(5.9)
Operating expense, excluding fuel expense (2)	**13.76**	**14.37**	**(0.61)**	**(4.2)**
Aircraft fuel	4.21	4.29	(0.08)	(1.9)
Total operating expense	**17.97**	**18.66**	**(0.69)**	**(3.7)**

(1) DAR refers to the combination of Depreciation and amortization, and Aircraft rent expenses.

(2) Refer to section 14 "Non-GAAP Financial Measures" of this MD&A for additional information.

Fuel expense increased 4% from the first quarter of 2009

Fuel expense amounted to $619 million in the first quarter of 2010, an increase of $26 million or 4% from the first quarter of 2009. Factors contributing to the year-over-year change in first quarter fuel expense included:

- A higher base fuel price, which accounted for an increase of $154 million.
- A volume-related increase, which accounted for $24 million.

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

- The favourable impact of a stronger Canadian dollar versus the U.S. dollar, which accounted for a decrease of $83 million.
- In the first quarter of 2010, fuel hedging losses amounting to $58 million were reclassified from Accumulated Other Comprehensive Loss ("AOCL") into fuel expense. In the first quarter of 2009, fuel hedging losses amounting to $127 million were reclassified from AOCL into fuel expense.

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

	First Quarter		Change	
(Canadian dollars in millions, except where indicated)	**2010**	**2009**	**$**	**%**
Aircraft fuel expense - GAAP (1)	$ 616	$ 591	$ 25	4
Remove: *Fuel hedging gains (losses) reclassified from AOCL into fuel expense*	(58)	(127)	69	54
Add: *Net cash settlements on maturing fuel derivatives - Realized losses (gains) (2)*	14	44	(30)	(68)
Economic cost of fuel - Non-GAAP (3)	**$ 572**	**$ 508**	**$ 64**	**13**
Fuel consumption (thousands of litres)	871,542	827,290	44,252	5
Fuel costs per litre (cents) – GAAP	70.7	71.4	(0.7)	(1)
Fuel costs per litre (cents) - excluding fuel hedging gains (losses)	64.1	56.1	8.0	14
Economic fuel costs per litre (cents) - Non-GAAP	65.7	61.5	4.2	7

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

(2) Excludes early terminated hedging contracts in the first quarter of 2009 of $172 million covering 2009 and 2010 fuel consumption.

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

Wages, salaries and benefits expense amounted to $470 million in the first quarter of 2010, an increase of $12 million or 3% from the first quarter of 2009

Wages and salaries expense totaled $365 million in the first quarter of 2010, a decrease of $12 million or 3% from the first quarter of 2009. A decrease of $10 million in expenses related to employee reduction programs was the main contributing factor in the decline in wages and salaries expense year-over-year. Partially offsetting this decrease was an increase of an average of 166 full-time equivalent ("FTE") employees or 0.7% versus the same period in 2009, reflecting the airline's capacity growth.

Employee benefits expense amounted to $105 million in the first quarter of 2010, an increase of $24 million or 30% from the first quarter of 2009. The increase in employee benefits expense was mainly due to higher pension expense as a result of changes in actuarial assumptions. The actuarial assumptions used for recording pension expense under GAAP differ from those used in determining the solvency deficit. For information on Air Canada's pension funding obligations, refer to section 10.6 of Air Canada's 2009 MD&A dated February 10, 2010.

Capacity purchase costs with Jazz decreased 8% from the first quarter of 2009

Capacity purchase costs with Jazz, pursuant to the capacity purchase agreement (the "Jazz CPA") between Air Canada and Jazz Air LP ("Jazz"), amounted to $226 million in the first quarter of 2010 compared to $246 million in the first quarter of 2009, a decrease of $20 million or 8%. This year-over-year decrease in capacity purchase costs was mainly due to the favourable impact of foreign exchange on U.S. denominated Jazz CPA charges paid by Air Canada, which accounted for a decrease of $12 million, the impact of the amendment to the Jazz CPA effective August 1, 2009 , which accounted for a decrease of $9 million and which was primarily due to the reduction to the mark-up on Jazz CPA rates, and the impact of reduced flying, which accounted for a decrease of $7 million. Partly offsetting these decreases was a year-over-year increase in Jazz CPA rates of $8 million, including $3 million due to one-time maintenance credits in 2009 and $2 million related to additional maintenance costs due to the aging of Jazz's fleet.

Ownership costs increased 8% from the first quarter of 2009

Ownership costs, comprised of depreciation and amortization, and aircraft rent expense, of $264 million in the first quarter of 2010 increased $19 million or 8% from the first quarter of 2009. Factors contributing to the year-over-year change in the first quarter ownership costs included:

- Changes in aircraft residual values, which accounted for an increase of $17 million to depreciation expense. The change in aircraft residual values was in large part driven by the appreciation of the Canadian dollar and its impact on residual values which are denominated in U.S. dollars.

- The impact of the sale and leaseback of Boeing 777 aircraft and the addition of one Boeing 777 aircraft to Air Canada's operating fleet, which together accounted for an increase of $12 million.

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

- The impact of a stronger Canadian dollar versus the U.S. dollar, which accounted for a decrease of $12 million to aircraft rent expense.

Aircraft maintenance expense increased 6% from the first quarter of 2009

In the first quarter of 2010, aircraft maintenance expense of $200 million increased $11 million or 6% from the first quarter of 2009. Factors contributing to the year-over-year change in first quarter aircraft maintenance expense included:

- A net increase of $15 million in airframe maintenance, which was largely due to timing of scheduled heavy maintenance events related to the fleet of Airbus A319 aircraft. In addition, expenses related to Boeing 777 aircraft amounted to $7 million in the first quarter of 2010 versus less than $1 million in the first quarter of 2009, mainly due to the first major airframe events required on these aircraft in the first quarter of 2010. These increases were partly offset by a lower volume of airframe events related to the Airbus A320, Airbus A330, Boeing 767-300 and Embraer aircraft.

- A net increase of $10 million in components maintenance, which was largely due to a higher level of components maintenance activity related to the Airbus A320 aircraft, which was primarily driven by an increase in flying hours and frequencies.

- A net increase of $10 million in engine maintenance, which was mainly due to a higher volume of engine events related to Airbus A330 and Embraer E175 aircraft. These increases were partly offset by a lower volume of engine events related to Boeing 767-300 and Boeing 777 aircraft.

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

- The impact of a stronger Canadian dollar versus the U.S. dollar on U.S. denominated maintenance expenses, mainly engine and component maintenance, which accounted for a decrease of $19 million to aircraft maintenance expense compared to the first quarter of 2009.

Food, beverages and supplies expense increased 10% from the first quarter of 2009

In the first quarter of 2010, food, beverages and supplies expense of $74 million increased $7 million or 10% from the first quarter of 2009 reflecting passenger traffic growth. An increase in premium class traffic as well as more international flying were factors in the increase in food, beverage and supplies expense year-over-year.

Commission expense increased 22% from the first quarter of 2009

In the first quarter of 2010, commission expense of $60 million increased $11 million or 22% from the first quarter of 2009, reflecting in part the 4% increase in passenger revenues year-over-year. In addition, an increase in commission expense of $4 million at Air Canada Vacations in the first quarter of 2010 was mainly due to the impact of increased passenger volumes and higher yields as well as a change in the commission structure. The introduction of a 7% commission for Canadian travel agents to sell Tango fares for flights within Canada has resulted in additional commission expense however, overall, based on management's analysis, the benefits of this initiative has outweighed the costs by enabling Air Canada to generate increased passenger revenues.

Other operating expenses increased 1% from the first quarter of 2009

Other operating expenses amounted to $426 million in the first quarter of 2010, an increase of $3 million or 1% from the first quarter of 2009. Volume-related expense increases related to Air Canada's capacity growth, and an increase in expenses at Air Canada Vacations were largely offset by the impact of favourable rate adjustments on foreign currency transactions (which are included in "remaining other expenses" below) and the impact of CTP initiatives on various other operating expenses. A growth in credit card fees of $6 million or 13% reflected a year-over-year increase in average rates and higher passenger sales volumes. The increase in expenses at Air Canada Vacations was largely driven by higher passenger volumes partly offset by a decrease in the cost of ground packages.

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

	First Quarter		Change	
(Canadian dollars in millions)	**2010**	**2009**	**$**	**%**
Air Canada Vacations' land costs	$ 135	$ 127	$ 8	6
Credit card fees	51	45	6	13
Terminal handling	48	47	1	2
Building rent and maintenance	34	33	1	3
Crew cycle	29	28	1	4
Miscellaneous fees and services	23	25	(2)	(8)
Remaining other expenses	106	118	(12)	(10)
	$ 426	**$ 423**	**$ 3**	**1**

Non-operating expense amounted to $75 million in the first quarter of 2010

Non-operating expense amounted to $75 million in the first quarter of 2010 compared to non-operating expense of $109 million in the first quarter of 2009. Factors contributing to the year-over-year change in first quarter non-operating expense included:

- Net interest expense decreased $22 million from the first quarter of 2009 mainly due to:

  - A $27 million decrease in interest expense. In the first quarter of 2009, Air Canada recorded a charge of $17 million related to a sale and leaseback transaction. There was no such charge recorded in the first quarter of 2010. The decrease in interest expense was also attributable to the favourable impact of a stronger Canadian dollar on U.S. denominated interest expense, the impact of sale and leaseback transactions of Boeing 777 aircraft completed in the last twelve months, as well as lower average interest rates year-over-year. These decreases were partly offset by the net impact of financing transactions completed in the last twelve months.

  The above-noted decrease was partially offset by the following:

  - A $4 million decrease in interest income, which was driven by lower rates of interest.

- Gains related to fair value adjustments on derivative instruments amounted to $2 million in the first quarter of 2010 versus losses of $10 million in the first quarter of 2009.

Gains on foreign exchange amounted to $100 million in the first quarter of 2010

Gains on foreign exchange, which were mainly related to U.S. denominated long-term debt, amounted to $100 million in the first quarter of 2010 compared to losses of $101 million in the first quarter of 2009. The gains in the first quarter of 2010 were mainly attributable to a stronger Canadian dollar at March 31, 2010, compared to December 31, 2009. The March 31, 2010, noon day exchange rate was US$1 = C$1.0156 while the December 31, 2009, noon day exchange rate was US$1 = C$1.0466.

Income tax recovery of $19 million in the first quarter of 2010

Air Canada recorded an income tax recovery of $19 million on a pre-tax loss of $104 million in the first quarter of 2010, representing an effective income tax rate of 18%. Future income tax assets have been recognized to the extent that it is considered more likely than not that they will be realized in the current year.

5. Fleet

The following table provides the number of aircraft in Air Canada's current operating fleet and planned changes to its operating fleet (excluding aircraft operated by Jazz under the Jazz CPA):

	Current			Planned			
	December 31, 2009	First Quarter 2010 Fleet Changes	March 31, 2010	Remainder of 2010 Fleet Changes	December 31, 2010	2011 Fleet Changes	December 31, 2011
Boeing 777-300	12	-	12	-	12	-	12
Boeing 777-200	6	-	6	-	6	-	6
Boeing 767-300 (1)	30	-	30	-	30	(3)	27
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	202	-	202	-	202	(3)	199
Average age (years)	9.7		10.0		10.7		11.6

(1) The three Boeing 767-300 aircraft planned to be removed from Air Canada's operating fleet in 2011 will likely be replaced with three other widebody aircraft.

At March 31, 2010, pursuant to the Jazz CPA, Jazz operated an operating fleet of 125 aircraft, a decrease of five aircraft from December 31, 2009. Jazz's covered fleet had an average age of 14.9 years at March 31, 2010, comprised of the following aircraft:

- 22 Bombardier CRJ-100 aircraft;
- 27 Bombardier CRJ-200 aircraft;
- 16 Bombardier CRJ-705 aircraft;
- 34 Dash 8-100 aircraft; and
- 26 Dash 8-300 aircraft.

Air Canada entered into an agreement amending the terms of the Jazz CPA effective August 1, 2009. This amending agreement provides, among other things, for a reduction in Air Canada's commitment to Jazz's minimum fleet from 133 to 125 aircraft. On February 9, 2010, Jazz announced that it had signed a Letter of Intent with Bombardier Commercial Aircraft for the purchase, subject to the satisfaction of customary conditions and finalizing a binding purchase agreement, for a firm order of 15 Q400 NextGen aircraft with options for an additional 15 aircraft. Aircraft deliveries are planned to commence in May 2011.

6. Financial and Capital Management

6.1 Financial Position

The following table provides a condensed statement of financial position of Air Canada as at March 31, 2010, and as at December 31, 2009.

(Canadian dollars in millions)	March 31, 2010	December 31, 2009
Assets		
Cash, cash equivalents and short-term investments	$ 1,621	$ 1,407
Other current assets	1,265	1,244
Current assets	2,886	2,651
Property and equipment	6,222	6,369
Intangible assets	908	916
Deposits and other assets	402	470
	$ 10,418	**$ 10,406**
Liabilities		
Current liabilities	$ 3,422	$ 3,002
Long-term debt and capital leases	3,694	4,054
Pension and other benefit liabilities	1,136	1,163
Other long-term liabilities	576	540
	8,828	**8,759**
Non-controlling interest	**171**	**201**
Shareholders' equity	**1,419**	**1,446**
	$ 10,418	**$ 10,406**

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

Property and equipment amounted to $6,222 million at March 31, 2010, a reduction of $147 million from December 31, 2009. The reduction was mainly due to the impact of depreciation expense of $160 million in the first quarter of 2010 partly offset by additions to capital assets of $38 million and the impact of the remaining part of a sale and leaseback transaction completed during the first quarter of 2010.

Long-term debt and capital leases, including the current portion, amounted to $4,371 million at March 31, 2010, a decrease of $151 million from December 31, 2009. The decrease in long-term debt and capital leases from December 31, 2009 was mainly due to the appreciation of the Canadian dollar and the resulting favourable impact of $102 million on Air Canada's foreign denominated dollar debt (mainly U.S. dollars) and capital leases. In the first quarter of 2010, long-term debt and capital lease repayments of $131 million were partially offset by borrowings of $100 million.

6.2 Adjusted Net Debt

The table reflects Air Canada's adjusted net debt balances and net debt to net debt plus equity ratio as at March 31, 2010, and as at December 31, 2009.

(Canadian dollars in millions)	March 31, 2010	December 31, 2009	Change $
Total long-term debt and capital leases	$ 3,694	$ 4,054	$ (360)
Current portion of long-term debt and capital leases	677	468	209
Total long-term debt and capital leases, including current portion	4,371	4,522	(151)
Non-controlling interest	171	201	(30)
Less cash, cash equivalents and short-term investments	(1,621)	(1,407)	(214)
Net debt and non-controlling interest	**2,921**	**3,316**	**(395)**
Capitalized operating leases (1)	2,528	2,513	15
Adjusted net debt and non-controlling interest	**5,449**	**5,829**	**(380)**
Shareholders' equity	**$ 1,419**	**$ 1,446**	**$ (27)**
Adjusted net debt and non-controlling interest to adjusted net debt and non-controlling interest plus equity ratio	**79.3%**	**80.1%**	**(0.8) pp**

(1) Adjusted net debt is a non-GAAP measure used by the Corporation and may not 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 $337 million for the twelve months ended March 31, 2010, and $335 million for the twelve months ended December 31, 2009. Aircraft rent expense includes aircraft rent associated with aircraft subleased to third parties. The sublease revenue associated with these aircraft subleases is included in Other revenues on Air Canada's consolidated statement of operations.

At March 31, 2010, adjusted net debt and non-controlling interest, including capitalized operating leases, decreased $380 million from December 31, 2009. This decrease in adjusted net debt and non-controlling interest was mainly due to the favourable impact of a stronger Canadian dollar as at March 31, 2010 versus the exchange rate as at December 31, 2009 on foreign currency denominated long-term debt (mainly U.S. dollars) and capital leases, which accounted for a decrease of $102 million, and an increase in cash, cash equivalents and short-term investments of $214 million. The increase in cash, cash equivalents and short-term investments can be largely explained by seasonal factors favourably impacting changes in non-cash working capital balances during the first quarter of 2010.

The adjusted net debt and non-controlling interest to adjusted net debt and non-controlling interest plus equity ratio for Air Canada decreased to 79.3% at March 31, 2010, from 80.1% at December 31, 2009, an improvement of 0.8 percentage points.

6.3 Liquidity

At March 31, 2010, cash, cash equivalents and short-term investments amounted to $1,621 million, or 16% of twelve month trailing operating revenues. For additional information on Air Canada's liquidity risks, refer to section 8 of this MD&A and section 10.3 of Air Canada's 2009 MD&A dated February 10, 2010.

In the first quarter of 2010, Air Canada entered into arrangements with a new lender, comprised of a group of entities that are related to each other, to obtain a $100 million increase to its $600 million secured term credit facility. The Corporation received financing proceeds of $100 million, less financing fees of $2 million, in February 2010. In addition, in the first quarter of 2010, Air Canada received net proceeds of $20 million upon completion of the remaining part of the sale and leaseback transaction of three Boeing 777 aircraft, which was substantially completed in the fourth quarter of 2009. For additional information on these transactions, refer to section 6 of Air Canada's 2009 MD&A dated February 10, 2010.

6.4 Working capital

The following table provides information on Air Canada's working capital balances at March 31, 2010 and at December 31, 2009.

(Canadian dollars in millions)	March 31, 2010	December 31, 2009	Change $
Cash and short-term investments	$ 1,621	$ 1,407	$ 214
Accounts receivable	799	701	98
Other current assets	466	543	(77)
Accounts payable and accrued liabilities	(1,231)	(1,246)	15
Advance ticket sales	(1,514)	(1,288)	(226)
Current portion of long-term debt and capital leases	(677)	(468)	(209)
	$ **(536)**	**$ (351)**	**$ (185)**

The working capital deficiency of $536 million at March 31, 2010 deteriorated $185 million from December 31, 2009, mainly due to the reclassification of debt obligations from long-term to current, scheduled repayments of long-term debt and capital lease obligations of $131 million, the impact of capital expenditures of $44 million and pension funding payments amounting to $51 million in the first quarter of 2010. The reclassification of debt obligations relates to an increase in aircraft-related debt obligations that are scheduled to mature in 2011. In the first quarter of 2010, working capital was favourably impacted by net proceeds of $98 million related to an increase to Air Canada's secured term credit facility and by additional net proceeds of $20 million relating to the sale and leaseback of three Boeing 777 aircraft in the third quarter of 2009.

Collateral deposits for fuel derivatives

Air Canada currently holds, within its derivative portfolio, swaps and put option contracts which could expose Air Canada 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, Air Canada could be required to extend collateral to the counterparties to cover their exposure.

As at March 31, 2010, the total cash collateral deposits held by counterparties amounted to $19 million ($43 million at December 31, 2009). If oil prices remain at the March 31, 2010 levels for the remainder of 2010, the collateral extended would cover the expected losses on existing fuel hedging contracts maturing in the remainder of 2010 and would not generate additional cash outflows to Air Canada.

Subsequent to March 31, 2010, Air Canada modified its fuel hedge portfolio with the termination of swap and collar contracts for $5 million, in favour of the counterparty. The collateral deposits held by the counterparty covered more than the settlement amount, therefore resulting in a cash inflow for Air Canada. As at April 30, 2010, there were no outstanding collateral deposits held with the counterparties.

6.5 Consolidated Cash Flow Movements

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

	First Quarter		
(Canadian dollars in millions)	**2010**	**2009**	**Change $**
Net cash from operating activities before the following items:	$ 26	$ 52	$ (26)
Cash used for fuel hedge settlements, terminations and premiums	(22)	(217)	195
Fuel hedge collateral deposits, net	23	147	(124)
Excess of employee future benefit funding over expense	(25)	(103)	78
Changes in non-cash working capital	257	289	(32)
Cash flows from operating activities	259	168	91
Additions to capital assets	(44)	(107)	63
Free cash flow [1]	**215**	**61**	**154**
Proceeds from sale and leaseback transactions	20	172	(152)
Funding of Aveos letter of credit	23	-	23
Short-term investments	(244)	19	(263)
Other	22	5	17
Cash flows from (used for) investing activities (excluding additions to capital assets)	**(179)**	**196**	**(375)**
Borrowings	100	267	(167)
Reduction of long-term debt and capital lease obligations	(131)	(423)	292
Other	(35)	-	(35)
Cash flows used for financing activities	**(66)**	**(156)**	**90**
Net increase (decrease) in cash and cash equivalents	(30)	101	(131)
Net increase (decrease) in short-term investments	244	(19)	263
Net increase in cash, cash equivalents and short-term investments	**$ 214**	**$ 82**	**$ 132**

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

Air Canada's free cash flow improved $154 million from the first quarter of 2009. The increase in free cash flow was mainly due to the impact of no past service cost contributions in the first quarter of 2010, as a result of the adoption of new pension funding regulations in July 2009, as well as the impact of reduced capital expenditures year-over-year. In addition, in the first quarter of 2009, fuel derivatives settled in favour of counterparties in the amount of $217 million were partly offset by a net return of collateral deposits on fuel derivatives of $147 million.

6.6 Capital Expenditures and Related Financing Arrangements

Information on Air Canada's capital expenditures and related financing agreements is described in section 10.4 of Air Canada's 2009 MD&A dated February 10, 2010. There have been no material changes to Air Canada's capital expenditures and related financing agreements from what was disclosed at that time.

6.7 Contractual Obligations

Information on Air Canada's contractual obligations and related financing agreements is described in section 10.5 of Air Canada's 2009 MD&A dated February 10, 2010. There have been no material changes to Air Canada's contractual obligations and related financing agreements from what was disclosed at that time.

Air Canada's current portion of long-term debt as at March 31, 2010 includes certain aircraft-related financings with final balloon maturities in early 2011. Air Canada is currently working on refinancing and extending these commitments however no refinancing commitments have been completed at this time.

6.8 Pension Funding Obligations

Information on Air Canada's pension funding obligations is described in section 10.6 of Air Canada's 2009 MD&A dated February 10, 2010. There have been no material changes to Air Canada's pension funding obligations from what was disclosed at that time.

6.9 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	
	April 30, 2010	**December 31, 2009**
Issued and outstanding shares		
Class A variable voting shares	62,741,074	56,586,112
Class B voting shares	215,405,985	221,560,947
Total issued and outstanding shares	**278,147,059**	**278,147,059**
Class A variable voting and Class B voting shares potentially issuable		
Warrants	90,250,000	90,250,000
Stock options	3,958,628	3,963,474
Performance share units	3,775,511	561,846
Total shares potentially issuable	**97,984,139**	**94,775,320**
Total outstanding and potentially issuable shares	**376,131,198**	**372,922,379**

Additional information on Air Canada's issued and outstanding shares and its potentially issuable shares, is disclosed in section 10.7 of Air Canada's 2009 MD&A dated February 10, 2010.

7. Quarterly Financial Data

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

(Canadian dollars in millions, except per share figures)	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010
Operating revenues	**$ 2,782**	**$ 3,075**	**$ 2,498**	**$ 2,391**	**$ 2,330**	**$ 2,670**	**$ 2,348**	**$ 2,519**
Aircraft fuel	848	1,064	792	593	572	682	601	619
Ownership (DAR)(1)	242	243	254	245	248	252	250	264
Other operating expenses	1,685	1,656	1,598	1,741	1,623	1,668	1,580	1,762
Operating expenses	**2,775**	**2,963**	**2,644**	**2,579**	**2,443**	**2,602**	**2,431**	**2,645**
Operating income (loss)	**7**	**112**	**(146)**	**(188)**	**(113)**	**68**	**(83)**	**(126)**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and taxes	115	(244)	(581)	(212)	268	209	27	41
Net income (loss)	**$ 122**	**$ (132)**	**$ (727)**	**$ (400)**	**$ 155**	**$ 277**	**$ (56)**	**$ (85)**
Revenue passenger miles (millions)	12,884	14,458	10,845	10,984	11,862	14,153	10,885	11,692
Available seat miles (millions)	15,581	17,515	13,571	13,821	14,735	16,946	13,841	14,727
Passenger load factor (%)	82.7	82.5	79.9	79.5	80.5	83.5	78.6	79.4
RASM (cents)	15.7	15.7	16.0	14.5	13.9	14.1	14.6	14.2
CASM (cents)	17.8	16.9	19.5	18.7	16.6	15.4	17.6	18.0
CASM, excluding fuel expense (cents)	12.4	10.8	13.6	14.4	12.7	11.3	13.2	13.8
Fuel price per litres (cents)(2)	89.2	101.0	95.8	71.4	65.4	68.6	72.6	70.7
EBITDAR(3)	**$ 249**	**$ 355**	**$ 108**	**$ 57**	**$ 135**	**$ 320**	**$ 167**	**$ 138**
Earnings (loss) per share								
- Basic	**$ 1.22**	**$ (1.32)**	**$ (7.27)**	**$ (4.00)**	**$ 1.55**	**$ 2.77**	**$ (0.25)**	**$ (0.31)**
- Diluted	**$ 1.22**	**$ (1.32)**	**$ (7.27)**	**$ (4.00)**	**$ 1.55**	**$ 2.44**	**$ (0.25)**	**$ (0.31)**

(1) DAR refers to the combination of Depreciation and amortization, and Aircraft rent expenses.
(2) Includes fuel handling and is net of fuel hedging results.
(3) See section 14 "Non-GAAP Financial Measures" in this MD&A for additional information.

8. Financial Instruments and Risk Management

Risk Management

Fuel price risk

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

The fuel derivative contracts have not been designated under hedge accounting. As at March 31, 2010, the fair market value of the fuel derivatives was $8 million in favour of the counterparties (which is recorded within accounts payable and accrued liabilities on Air Canada's Statement of Financial Position) ($31 million in favour of the counterparties as at December 31, 2009).

During the first quarter of 2010:

- Air Canada recorded a gain of $1 million in gain (loss) on financial instruments recorded at fair value related to fuel derivatives (a loss of $9 million in the first quarter of 2009).

- Air Canada purchased crude oil call options. The premium related to these contracts was $8 million.

- Fuel derivative contracts cash settled with a fair value of $14 million in favour of the counterparties ($45 million in favour of the counterparties in the first quarter of 2009).

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

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

As of April 30, 2010, approximately 22% of Air Canada's anticipated purchases of jet fuel for the remainder of 2010 are hedged at an average West Texas Intermediate ("WTI") capped price of US$90 per barrel and approximately 7% is subject to an average floor price of US$92 per barrel. Air Canada's contracts to hedge anticipated jet fuel purchases over the 2010 period are comprised of crude oil and jet fuel based contracts.

The following table outlines the notional volumes per barrel along with the WTI weighted average floor and capped price for each year currently hedged by type of derivative instruments as at April 30, 2010.

Outstanding at April 30, 2010				
Derivative Instruments	**Term**	**Volume (barrels)**	**WTI-weighted Average Floor Price (US$ per barrel)**	**WTI-weighted Average Capped Price (US$ per barrel)**
Call Options (1)	2010	2,325,000	n/a	88
Swaps (1) (2)	2010	440,000	98	98
Collars (1)	2010	650,000	88	91

(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.

(2) Air Canada also has 166,000 barrels of jet fuel crack swaps fixing the spread between jet fuel price and WTI crude oil price at an average of US$8 per barrel for the second quarter of 2010.

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

The types of derivative instruments used by Air Canada within its hedging program, such as swaps and put options within collar structures, expose Air Canada to the potential of providing collateral deposits to its counterparties. When a decrease in fuel prices causes Air Canada's derivative position to be in a liability position below the set credit thresholds with counterparties, Air Canada is responsible for extending collateral to the counterparties. As at March 31, 2010, Air Canada had extended, to counterparties, $19 million of collateral (which is recorded within prepaid expenses and other current assets on Air Canada's Statement of Financial Position) ($43 million as at December 31, 2009). There were no outstanding collateral deposits at April 30, 2010.

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

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

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

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:

	First Quarter	
(Canadian dollars in millions)	**2010**	**2009**
Fuel derivatives not under hedge accounting	$ 1	$ (9)
Interest rates swaps	1	(1)
Gain (loss) on financial instruments recorded at fair value	**$ 2**	**$ (10)**

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. Refer to section 13 of Air Canada's 2009 MD&A for additional information on Air Canada's liquidity risk.

Covenants in credit card agreements

The Corporation has various agreements with companies that process customer credit card transactions, as further described in section 13 of Air Canada's 2009 MD&A dated February 10, 2010. Under the terms of its credit card processing agreements with one of its principal credit card processors, the credit card processing company may withhold payment of funds to Air Canada or require Air Canada to provide the processor with deposits and security upon the occurrence of certain events ("triggering events"). During 2009, the Corporation entered into amendments with this processor to amend certain credit card processing agreements under which the triggering events were revised. In May 2010, the Corporation entered into a set of further amendments, extending these agreements to the end of November 2010 on the same terms and providing options for the Corporation, on certain terms, to further extend these agreements for a period of up to two years, on revised terms. The Corporation continues to explore other options to source these services from other third parties.

Cargo investigations and proceedings

The Corporation is exposed to potential liabilities related to the investigations and proceedings of alleged anti-competitive cargo pricing activities, as further described in section 19 of Air Canada's 2009 MD&A dated February 10, 2010.

9. Accounting Policies

9.1 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, Information Technology and Data Systems, Internal Control and Processes, Planning, Compensation, Treasury, Investor Relations and Law. 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 17.2 "Future Accounting Standard Changes" of Air Canada's 2009 MD&A dated February 10, 2010. The IFRS changeover plan is progressing as outlined and no significant changes to the plan have been made from what was disclosed at that time.

10. Off-Balance Sheet Arrangements

Information on Air Canada's off-balance sheet arrangements is disclosed in section 14 of Air Canada's 2009 MD&A dated February 10, 2010. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

11. Related Party Transactions

ACE Aviation Holdings Inc. ("ACE") reported holding, as of March 31, 2010, a 27% ownership interest in Air Canada. For a summary of significant related party transactions, refer to section 15 "Related Party Transactions" of Air Canada's 2009 MD&A dated February 10, 2010. Air Canada had various related party transactions with ACE and Aveos. As a result of the Aveos Restructuring Plan, Air Canada and Aveos are no longer related parties.

Aveos Restructuring Plan

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

As part of these agreements, the Corporation also agreed to extend repayment terms on $22 million of receivables (as further described in section 15 of Air Canada's 2009 MD&A under Agreement with Aveos on Revised Payment Terms), due in 2010, over six years with annual repayments on a non-interest bearing basis, with such payments subject to satisfaction of certain conditions. This agreement is now referred to as the Term Note.

The terms of the Pension and Benefits Agreement were also modified to defer the determination of pension assets and related solvency deficiencies of transferring unionized employees performing airframe maintenance services to April 2011. This has the result of Air Canada assuming changes in the solvency deficiency for those affected employees from the date of the Pension and Benefits Agreement, which was entered into as of October 16, 2007, to the date of their transfer to Aveos, scheduled for April 2011. As part of the amendment, all letters of credit issued under the Pension and Benefits Agreement were cancelled and a new letter of credit in the amount of $20 million was issued by Air Canada in favour of Aveos to secure the payment of all compensation payments owing by Air Canada to Aveos in respect of pension, disability, and retiree liabilities for which Air Canada would be liable under the Pension and Benefits Agreement. This modification resulted in a reduction to the outstanding deposit under Air Canada's letter of credit facility of $23 million during the first quarter of 2010. Until such future time as the assets and obligations under the Air Canada pension and other employee and retiree benefit arrangements pertaining to unionized employees may be transferred to Aveos, the current service pension cost and the current service and interest costs for other employee benefits in respect of Air Canada employees providing services to Aveos are charged by Air Canada to Aveos, and as such, the modifications to the Pension and Benefits Agreement have no accounting consequence in the current period. For additional information on the Pension and Benefits Agreement, refer to section 15 of Air Canada's 2009 MD&A.

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

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

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

12. Risk Factors

For a detailed description of risk factors associated with the Corporation, refer to the section 19 "Risk Factors" of Air Canada's 2009 MD&A dated February 10, 2010. The Corporation is not aware of any significant changes to the Corporation's risk factors from those disclosed at that time. However, the risk factors in Air Canada's 2009 MD&A dated February 10, 2010 relating to *Interruptions or Disruptions in Service* and *Seasonal Nature of the Business and Other Factors and Prior Performance* are expanded as follows.

Interruptions and disruptions in service may be caused by, and the demand and cost of air travel may be adversely impacted by, environmental conditions and factors in addition to those relating to the weather. Environmental conditions and factors, such as those arising from volcanic eruptions or other natural phenomena, as well as those arising from man-made sources, could cause interruptions and disruptions in service, increase Air Canada's costs or adversely impact demand for air travel, any of which could have a material adverse impact on Air Canada, its business, results from operations and financial condition.

13. 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 2009 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 first quarter 2010 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 March 31, 2010, that such disclosure controls and processes were designed to provide reasonable assurance that:

- material information relating to the Corporation was made known to its Disclosure Policy Committee by others; and
- 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 March 31, 2010, 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 first quarter of 2010 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

14. 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. 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 for Air Canada are reconciled to operating income (loss) as follows:

	First Quarter		
(Canadian dollars in millions)	**2010**	**2009**	**Change $**
GAAP operating loss	$ (126)	$ (188)	$ 62
Add back:			
Aircraft rent	88	86	2
Depreciation and amortization	176	159	17
EBITDAR	**$ 138**	**$ 57**	**$ 81**

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:

	First Quarter		
(Canadian dollars in millions)	**2010**	**2009**	**Change $**
GAAP operating expense	$ 2,645	$ 2,579	$ 66
Remove:			
Aircraft fuel	(619)	(593)	(26)
Operating expense, excluding fuel expense	**$ 2,026**	**$ 1,986**	**$ 40**

15. 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 14 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.