AIR CANADA

Second Quarter 2010

Management's Discussion and Analysis of Results and Financial Condition

August 5, 2010

TABLE OF CONTENTS

1. Highlights

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

(Canadian dollars in millions, except per share figures or where otherwise indicated)	Second Quarter			First Six Months		
	2010	2009	Change $	2010	2009	Change $
Financial						
Operating revenues	2,625	2,330	295	5,144	4,721	423
Operating income (loss)	75	(113)	188	(51)	(301)	250
Non-operating expense	(147)	(80)	(67)	(222)	(189)	(33)
Loss before non-controlling interest, foreign exchange and income taxes	(72)	(193)	121	(273)	(490)	217
Income (loss) for the period	(203)	155	(358)	(288)	(245)	(43)
Operating margin %	2.9%	(4.8%)	7.7 pp	(1.0%)	(6.4%)	5.4 pp
EBITDAR [(1)]	333	135	198	471	192	279
EBITDAR margin % [(1)]	12.7%	5.8%	6.9 pp	9.2%	4.1%	5.1 pp
Cash, cash equivalents and short-term investments	1,815	907	908	1,815	907	908
Free cash flow [(2)]	297	(140)	437	512	(79)	591
Adjusted debt/equity ratio % [(3)]	81.0%	89.7%	(8.7) pp	81.0%	89.7%	(8.7) pp
Net income (loss) per share - basic and diluted	($0.72)	$1.55	($2.27)	($1.03)	($2.45)	$1.42
Operating Statistics			**Change %**			**Change %**
Revenue passenger miles (millions) (RPM)	12,896	11,862	8.7	24,588	22,846	7.6
Available seat miles (millions) (ASM)	15,523	14,735	5.3	30,250	28,557	5.9
Passenger load factor %	83.1%	80.5%	2.6 pp	81.3%	80.0%	1.3 pp
Passenger revenue per RPM (cents)	17.9	17.3	3.3	17.9	17.8	0.6
Passenger revenue per ASM (cents)	14.8	13.9	6.6	14.5	14.2	2.2
Operating revenue per ASM (cents)	16.9	15.8	7.0	17.0	16.5	2.9
Operating expense per ASM ("CASM") (cents)	16.4	16.6	(0.9)	17.2	17.6	(2.3)
CASM, excluding fuel expense (cents)	12.2	12.7	(4.2)	12.9	13.5	(4.2)
Average number of full-time equivalent (FTE) employees (thousands) [(4)]	23.1	23.2	(0.8)	23.0	23.0	-
Aircraft in operating fleet at period end [(5)]	328	334	(1.8)	328	334	(1.8)
Average fleet utilization (hours per day) [(6)]	9.7	9.2	5.4	9.6	9.2	4.9
Average aircraft flight length (miles) [(6)]	853	837	1.9	855	839	1.9
Fuel price per litre (cents) [(7)]	71.1	65.4	8.7	70.9	68.3	3.8
Fuel litres (millions)	924	870	6.2	1,796	1,697	5.8

(1) *EBITDAR (earnings before interest, taxes, depreciation and amortization, and aircraft rent) is a non-GAAP Financial Measure. See section 15 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income (loss).*

(2) *Free cash flow (cash flows from (used for) operating activities plus additions to capital assets) is a non-GAAP financial measure. See section 7.5 of this MD&A for additional information.*

(3) *Adjusted net debt (total debt less cash, cash equivalents and short-term investments plus capitalized operating leases) is a non-GAAP financial measure. See section 7.2 of this MD&A for additional information.*

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

(5) *Includes Jazz aircraft covered under the Jazz CPA.*

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

(7) *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 second 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 second quarter of 2010 and for the first six months of 2010. This MD&A should be read in conjunction with Air Canada's interim unaudited consolidated financial statements and notes for the second 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 second quarter of 2010 are based on accounting policies consistent with those disclosed in Note 2 to Air Canada'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 16 "Glossary" of this MD&A. Except as otherwise noted, this MD&A is current as of August 4, 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 13 "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 **aircanada.com** or on SEDAR at **www.sedar.com**.

Air Canada issued a news release dated August 5, 2010, reporting on its results for the second quarter of 2010. This news release is available on Air Canada's website at **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 **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 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 Air Canada's 2009 MD&A and Second Quarter 2010 MD&A and, in particular, those identified in section 13 "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 (or as of the date they are otherwise stated to be made), and are subject to change after such date. However, Air Canada disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

Assumptions were made by Air Canada in preparing and making forward-looking statements. Air Canada assumes that the 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$1.04 per U.S. dollar in the third quarter of 2010 and for the full year 2010 and that the price of fuel will average 67 cents per litre for the third quarter of 2010 and will average 69 cents for the full year 2010 (both net of fuel hedging positions).

3. Overview

Air Canada's results of operations for the second 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 second quarter of 2010 compared to the second quarter of 2009.

Air Canada recorded a net loss of $203 million or $0.72 per diluted share in the second quarter of 2010 compared to a net income of $155 million or $1.55 per diluted share in the second quarter of 2009. Air Canada's net loss in the second quarter of 2010 included a charge of $54 million in interest expense relating to its secured term credit facility, and foreign exchange losses of $156 million which were primarily attributable to a weaker Canadian dollar at June 30, 2010 versus March 31, 2010. The June 30, 2010 noon day exchange rate was US$1 = C$1.0606 while the March 31, 2010 noon day exchange rate was US$1 = C$1.0156. Net income in the second quarter of 2009 included foreign exchange gains of $355 million.

In the second quarter of 2010, Air Canada recorded operating income of $75 million, an improvement of $188 million from the operating loss of $113 million recorded in the second quarter of 2009. Air Canada experienced disruptions to its transatlantic flying schedule following the closure of European airspace from April 15th to April 20th due to volcanic ash resulting from the volcanic eruption in Iceland. Air Canada estimates that the negative impact on its second quarter operating income to have been approximately $20 million. EBITDAR amounted to $333 million in the second quarter of 2010 compared to EBITDAR of $135 million in the second quarter of 2009, an increase of $198 million. See section 15 "Non-GAAP Financial Measures" of this MD&A for additional information. Air Canada's EBITDAR of $333 million and operating income of $75 million were in line with the preliminary range of $320 million to $340 million and the range of $60 million to $80 million, respectively, announced in Air Canada's news release dated July 20, 2010.

In the second quarter of 2010, Air Canada recorded operating revenues of $2,625 million, an increase of $295 million or 12.7% from the operating revenues of $2,330 million recorded in the second quarter of 2009. The increase in operating revenues was due to passenger and cargo revenue growth of $295 million or 13.8% from the second quarter of 2009, partly driven by revenue generating initiatives relating to the airline's cost transformation program (the "CTP"), and a $12 million increase in revenues from the sale of the ground portion of vacation packages at Air Canada Vacations. The year-over-year system passenger revenue growth of $256 million or 12.4% was due to an 8.7% increase in system passenger traffic and a 3.3% improvement in system yield. The passenger traffic growth in the second quarter of 2010 was greater than the capacity increase of 5.3% which resulted in a 2.6 percentage point improvement in system passenger load factor from the second quarter of 2009. A system yield improvement of 3.3% in the second quarter of 2010 was achieved despite a negative impact of $102 million relating to the stronger Canadian dollar on foreign currency denominated passenger revenues, which are estimated at 30% of total second quarter 2010 passenger revenues. System RASM in the second quarter of 2010 increased 6.6% year-over-year due to both the yield growth and the passenger load factor improvement. Air Canada estimates that the stronger Canadian dollar as compared to the second quarter of 2009 reduced the RASM improvement by 4.8 percentage points in the second quarter of 2010. Excluding the unfavourable impact of foreign exchange, Air Canada estimates that RASM would have reflected a year-over-year increase of 11.4% in the second quarter of 2010. The 6.6% increase in system RASM for the second quarter of 2010 was as announced in Air Canada's news release dated July 20, 2010. Cargo revenue growth of $39 million or 51.3% from the second quarter of 2009 was due to an increase in cargo traffic as yield per revenue ton mile was essentially unchanged from the second quarter of 2009.

In the second quarter of 2010, Air Canada recorded operating expenses of $2,550 million, an increase of $107 million or 4.4% from the operating expenses of $2,443 million recorded in the second quarter of 2009. The increase in operating expenses in the second quarter of 2010 was largely driven by the capacity growth of 5.3%, higher fuel prices year-over-year, as well as increases in pension and commission expenses from the second quarter of 2009. Partially offsetting operating expense increases was the impact of a stronger Canadian dollar on foreign currency denominated operating expenses (mainly U.S. dollars) compared to the second quarter of 2009, which is estimated to have reduced operating expenses by $151 million from the same period in 2009, and a reduction in aircraft maintenance expense, which was largely due to an extension of time to perform airframe maintenance activities. CTP initiatives to date have had a favourable impact on various operating expense categories including in relation to wages and salaries, capacity purchase fees with Jazz Air Inc. ("Jazz"), airport user fees, information technology, terminal handling, advertising and promotion, and "other" operating expenses

In mid-2009, Air Canada launched the CTP, identifying and implementing initiatives with a goal of generating annualized revenue gains and cost savings, including through contract and operating process improvements and productivity gains. To date, Air Canada achieved, on a run-rate basis, $275 million of the CTP target for 2010 and $300 million of the overall CTP target for the end of 2011. Air Canada views the CTP as one of its most important priorities.

CASM decreased 0.9% from the second quarter of 2009. Excluding fuel expense, CASM decreased 4.2% from the second quarter of 2009. The 4.2% decrease in CASM (excluding fuel expense) for the second quarter of 2010 was as announced in Air Canada's news release dated July 20, 2010.

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

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

	Second Quarter		Change	
(Canadian dollars in millions, except per share figures)	**2010**	**2009**	**$**	**%**
Operating revenues				
Passenger	$ 2,314	$ 2,058	$ 256	12
Cargo	115	76	39	51
Other	196	196	-	-
	2,625	**2,330**	**295**	**13**
Operating expenses				
Aircraft fuel	660	572	88	15
Wages, salaries, and benefits	474	438	36	8
Airport and navigation fees	236	241	(5)	(2)
Capacity purchase with Jazz	230	254	(24)	(9)
Depreciation and amortization	172	165	7	4
Aircraft maintenance	146	185	(39)	(21)
Food, beverages and supplies	75	73	2	3
Communications and information technology	79	80	(1)	(1)
Aircraft rent	86	83	3	4
Commissions	62	40	22	55
Other	330	312	18	6
	2,550	**2,443**	**107**	**4**
Operating income (loss)	**75**	**(113)**	**188**	
Non-operating income (expense)				
Interest income	4	4	-	
Interest expense	(133)	(94)	(39)	
Interest capitalized	-	2	(2)	
Loss on assets	-	(71)	71	
Gain (loss) on financial instruments recorded at fair value	(18)	79	(97)	
Other	-	-	-	
	(147)	(80)	(67)	
Loss before the following items	**(72)**	**(193)**	**121**	
Non-controlling interest	(3)	(4)	1	
Foreign exchange gain (loss)	(156)	355	(511)	
Recovery of (provision for) income taxes	28	(3)	31	
Net income (loss) for the period	**$ (203)**	**$ 155**	**$ (358)**	
EBITDAR (1)	**$ 333**	**$ 135**	**$ 198**	
Net income (loss) per share - Basic and diluted	**$ (0.72)**	**$ 1.55**	**$ (2.27)**	

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

System passenger revenues increased 12.4% from the second quarter of 2009

Compared to the second quarter of 2009, system passenger revenues increased $256 million or 12.4% to $2,314 million in the second quarter of 2010 due to system traffic growth and a system yield improvement.

In the second quarter of 2010, premium cabin revenue growth accounted for almost half of the total increase in system passenger revenues. This year-over-year growth in system premium cabin revenues in the second quarter of 2010 was driven by a 15.8% increase in premium traffic and a 12.9% improvement in premium yield. Although the premium cabin revenue and yield growth in the second quarter of 2010, on a system-wide basis, reflected significant year-over-year improvements, premium cabin revenue and yield remained below the second quarter of 2008 level.

In the second quarter of 2010, Air Canada's overall capacity was 5.3% higher than the second quarter of 2009, with capacity growth reflected in all markets with the exception of the domestic market which was slightly below the second quarter of 2009 level. This growth is consistent with one of Air Canada's 2010 key priorities to expand its international operations and to leverage its Toronto hub at Pearson International Airport as a global transfer point for international travelers en route to domestic, U.S. transborder and international destinations. Components of the year-over-year change in second quarter system passenger revenues included:

- A system traffic increase of 8.7% on capacity growth of 5.3%, which resulted in a system passenger load factor improvement of 2.6 percentage points from the second quarter of 2009. The system capacity growth of 5.3% in the second quarter of 2010 compared to the second quarter of 2009 was as announced in Air Canada's news release dated July 20, 2010.

- A system yield improvement of 3.3% from the second quarter of 2009, which reflected a modest improvement in the economic environment as well as the impact of Air Canada's renewed focus on improving the quality of its revenues and promoting its business class services. The year-over-year second quarter yield improvement was achieved in spite of an unfavourable impact relating to the stronger Canadian dollar on foreign currency denominated passenger revenues. The stronger Canadian dollar in the second quarter of 2010 versus the second quarter of 2009 decreased the Canadian dollar value of sales in foreign countries and had a negative impact of $102 million on system passenger revenues.

- A system RASM increase of 6.6% from the second quarter of 2009, which was due to both the passenger load factor improvement and the yield growth. Excluding the unfavourable impact of foreign exchange, RASM would have reflected a year-over-year increase of 11.4% in the second quarter of 2010. RASM in the premium cabin increased 24.1% year-over-year but remained below the second quarter of 2008 level. When compared to the second quarter of 2008, second quarter 2010 premium RASM decreased 2.9 per cent. However, this was an improvement when compared to the decline experienced in the first quarter of 2010 where RASM decreased 5.2% versus the first quarter of 2008.

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

Second Quarter 2010 Versus Second Quarter 2009	**Passenger Revenue % Change**	**Capacity (ASMs) % Change**	**Traffic (RPMs) % Change**	**Passenger Load Factor pp Change**	**Yield % Change**	**RASM % Change**
Canada	6.8	(0.2)	2.9	2.5	3.7	7.0
U.S. transborder	11.3	7.3	10.3	2.0	0.8	3.6
Atlantic	12.8	2.4	3.2	0.7	9.2	10.0
Pacific	37.3	17.5	27.0	6.7	8.1	16.9
Other	15.3	10.1	12.7	1.8	2.2	4.5
System	**12.4**	**5.3**	**8.7**	**2.6**	**3.3**	**6.6**

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 second quarter 2010 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
System	**Q2'09**	**Q3'09**	**Q4'09**	**Q1'10**	**Q2'10**
Passenger Revenues	(16.1)	(13.2)	(7.0)	4.2	12.4
Capacity (ASMs)	(5.4)	(3.3)	2.0	6.6	5.3
Traffic (RPMs)	(7.9)	(2.1)	0.4	6.4	8.7
Passenger Load Factor (pp Change)	(2.2)	1.0	(1.3)	(0.1)	2.6
Yield	(8.9)	(11.2)	(7.3)	(2.2)	3.3
RASM	(11.3)	(10.2)	(8.8)	(2.3)	6.6

Domestic passenger revenues increased 6.8% from the second quarter of 2009

Domestic passenger revenues of $954 million in the second quarter of 2010 increased $61 million or 6.8% from the second quarter of 2009 due to yield and traffic growth. In the second quarter of 2010, capacity decreases on transcontinental routes were offset by a capacity increase on routes to the Maritimes which resulted in domestic capacity being only slightly below the second quarter of 2009 level. Capacity reductions on transcontinental routes came, for the most part, from frequency reductions on Toronto-Vancouver and, to a lesser extent, on Toronto-Calgary, as well as the use of smaller aircraft on Toronto-Edmonton and Ottawa-Vancouver. In the Maritimes, the incremental capacity was mainly due to new year-round services, including Ottawa to St. John's (May 2009), as well as larger aircraft deployed on several routes including Toronto-Moncton-Halifax and increased frequencies to Charlottetown from Ottawa, Montreal and Toronto. Components of the year-over-year change in second quarter domestic passenger revenues included:

- A traffic increase of 2.9% on capacity reduction of 0.2%, which resulted in a 2.5 percentage point improvement in passenger load factor.

- A yield increase of 3.7% from the second quarter of 2009, which reflected significantly stronger yields, particularly on Rapidair routes, linking Toronto and Montreal/Ottawa, and on transcontinental routes. The second quarter 2010 yields reflected year-over-year improvements in both the economy cabin and the premium cabin. The year-over-year second quarter yield improvement was achieved in spite of a $17 million unfavourable impact of a stronger Canadian dollar on domestic passenger revenues. Yields on Rapidair routes were positively impacted by the return of the Formula 1 Grand Prix to Montreal, Quebec.

- Domestic RASM increased 7.0% from the second quarter of 2009, which was due to both the yield growth and the passenger load factor improvement.

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 second quarter 2010 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Canada	**Q2'09**	**Q3'09**	**Q4'09**	**Q1'10**	**Q2'10**
Passenger Revenues	(17.0)	(13.3)	(7.9)	1.5	6.8
Capacity (ASMs)	(5.8)	(1.5)	(0.6)	2.6	(0.2)
Traffic (RPMs)	(8.2)	0.7	(1.3)	0.8	2.9
Passenger Load Factor (pp Change)	(2.1)	1.8	(0.5)	(1.4)	2.5
Yield	(9.5)	(13.6)	(6.7)	0.6	3.7
RASM	(11.9)	(11.7)	(7.3)	(1.1)	7.0

U.S. transborder passenger revenues increased 11.3% from the second quarter of 2009

U.S. transborder passenger revenues of $436 million in the second quarter of 2010 increased $45 million or 11.3% from the second quarter of 2009 due to traffic growth and, to a lesser extent, a yield improvement. In the second quarter of 2010, U.S. transborder capacity increased 7.3% from the second quarter of 2009, largely the result of increases in connecting traffic from the U.S. in support of Air Canada's international expansion initiatives. Components of the year-over-year change in second quarter U.S. transborder passenger revenues included:

- A traffic increase of 10.3% on capacity growth of 7.3%, which resulted in a passenger load factor improvement of 2.0 percentage points from the second quarter of 2009. The capacity growth reflected the introduction of new daily services from Toronto to seven American cities in the second quarter of 2010, including: Orange County (Santa Ana) and San Diego, California; Portland, Oregon; Memphis, Tennessee; Cincinnati, Ohio; Portland, Maine; and Syracuse, New York. In addition, Air Canada also introduced Calgary-Honolulu, Calgary-Maui, Calgary-Portland (Oregon), and Montreal-Houston, and increased its capacity on routes to Florida with more frequencies between Toronto and Fort Lauderdale and with the use of larger aircraft between Toronto and Miami. Capacity was also significantly increased in Eastern Seaboard markets (New York, Boston, Washington). The suspension of Air Canada's services on Toronto-Austin and Halifax-New York in the second half of 2009, as well as the suspension of Edmonton-Los Angeles in May 2010 partly offset these increases.

- A yield increase of 0.8% from the second quarter of 2009, which reflected yield growth in the premium cabin. The year-over-year second quarter U.S. transborder yield improvement was achieved in spite of a $27 million unfavourable impact of a stronger Canadian dollar on U.S. transborder passenger revenues. Yields improved on Eastern Canada to California routes despite the capacity growth in these markets, and on Western Canada to Western U.S. routes, driven in part by reduced capacity on these routes. The impact of a higher proportion of international traffic flowing to and from the U.S. produced lower yields on the U.S. transborder segment, thereby negatively impacting the overall U.S. transborder yield while increasing revenues in the international market. In addition, competitive pricing activities on routes to Florida and Hawaii also negatively impacted U.S. transborder yields in the second quarter of 2010.

- U.S. transborder RASM increased 3.6% from the second quarter of 2009, which was due to the passenger load factor improvement and, to a lesser extent, to the higher yield.

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 second quarter 2010 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
U.S. transborder	**Q2'09**	**Q3'09**	**Q4'09**	**Q1'10**	**Q2'10**
Passenger Revenues	(14.4)	(13.1)	(3.7)	6.0	11.3
Capacity (ASMs)	(4.7)	(8.8)	(1.8)	2.8	7.3
Traffic (RPMs)	(9.5)	(8.0)	(5.0)	3.4	10.3
Passenger Load Factor (pp Change)	(3.9)	0.7	(2.5)	0.5	2.0
Yield	(5.4)	(5.4)	1.4	2.5	0.8
RASM	(10.2)	(4.6)	(1.9)	3.1	3.6

Atlantic passenger revenues increased 12.8% from the second quarter of 2009

Atlantic passenger revenues of $489 million in the second quarter of 2010 increased $55 million or 12.8% from the second quarter of 2009 due to traffic and yield growth. In the second quarter of 2010, Atlantic capacity increased 2.4% from the second quarter of 2009. Capacity increases were reflected on all major Atlantic services with the exception of routes to the U.K., France and, to a lesser extent, Spain. Air Canada, Continental Airlines, Lufthansa and United Airlines are in the process of finalizing a transatlantic joint venture, referred to as A++. Upon completion, this transatlantic joint venture would be expected to further increase Air Canada's market presence and traffic volume between North America and Europe. Components of the year-over-year change in second quarter Atlantic passenger revenues included:

- A traffic increase of 3.2% on the capacity growth of 2.4%, which resulted in a passenger load factor increase of 0.7 percentage points from the second quarter of 2009. Traffic growth came from both U.S. originating traffic to Europe, as well as an increase in European originating traffic traveling both to Canada and the U.S., a result of Air Canada's participation in the A++ transatlantic joint venture.

- The capacity growth in the second quarter of 2010 reflected the addition of new routes including the following services which started in June 2010: Toronto-Montreal-Brussels and Toronto-Copenhagen which are year-round services, and Montreal-Barcelona, Toronto-Barcelona, Toronto-Athens and Montreal-Athens which are summer services. The capacity increase also reflected the introduction of a year-round service from Toronto-Montreal-Geneva in June 2009, the introduction of a summer service from St. John's, Newfoundland to London, U.K. in May 2010, an earlier start on Air Canada's seasonal services from Montreal to Rome, as well as additional frequencies on Toronto-Tel Aviv. These capacity increases were partly offset by capacity decreases caused by the airport closures associated with the volcanic eruption in April 2010 and reductions on certain routes to the U.K. and France, mostly related to the use of smaller capacity aircraft and certain frequency reductions.

- A yield improvement of 9.2% from the second quarter of 2009, which reflected improvements on all major Atlantic services. The yield growth was achieved through a greater proportion of higher-yield traffic, a notable return in business travel demand and the airline's strong focus on promoting premium class services. The second quarter 2010 yields reflected year-over-year improvements in both the economy cabin and the premium cabin. The year-over-year second quarter Atlantic yield improvement was achieved in spite of a $33 million unfavourable impact of a stronger Canadian dollar on Atlantic passenger revenues.

- Atlantic RASM increased 10.0% from the second quarter of 2009, which was due to the yield growth and, to a lesser extent, the passenger load factor improvement.

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 second quarter 2010 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Atlantic	**Q2'09**	**Q3'09**	**Q4'09**	**Q1'10**	**Q2'10**
Passenger Revenues	(11.1)	(6.7)	(4.8)	6.5	12.8
Capacity (ASMs)	(0.1)	6.8	6.7	6.2	2.4
Traffic (RPMs)	(1.6)	5.9	2.4	5.8	3.2
Passenger Load Factor (pp Change)	(1.3)	(0.8)	(3.3)	(0.3)	0.7
Yield	(9.7)	(11.8)	(7.0)	0.5	9.2
RASM	(11.0)	(12.6)	(10.8)	0.1	10.0

Pacific passenger revenues increased 37.3% from the second quarter of 2009

Pacific passenger revenues of $267 million in the second quarter of 2010 increased $73 million or 37.3% from the second quarter of 2009 due to traffic and yield growth. In the second quarter of 2010, capacity was increased by 17.5% from the second quarter of 2009 with growth reflected on all major Pacific services. Components of the year-over-year change in second quarter Pacific passenger revenues included:

- A traffic increase of 27.0% on capacity growth of 17.5%, which resulted in a passenger load factor improvement of 6.7 percentage points from the second 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 Beijing and Shanghai, China. Year-over-year traffic gains came from passengers originating in Canada and the U.S., as Air Canada's domestic and transborder networks have been more closely aligned with its international departures, combined with an additional focus on capturing connecting traffic.

- A yield increase of 8.1% from the second quarter of 2009, which reflected yield improvements on all major Pacific services. The second quarter 2010 yields reflected year-over-year improvements in both the economy cabin and the premium cabin. The year-over-year second quarter Pacific yield improvement was achieved despite a $19 million unfavourable impact of a stronger Canadian dollar on Pacific passenger revenues.

- Pacific RASM increased 16.9% from the second quarter of 2009, which was due to both the yield growth and the passenger load factor improvement.

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 second quarter 2010 and each of the previous four quarters.

	Year-over-Year by Quarter (% Change)				
Pacific	**Q2'09**	**Q3'09**	**Q4'09**	**Q1'10**	**Q2'10**
Passenger Revenues	(19.8)	(21.9)	(9.7)	14.5	37.3
Capacity (ASMs)	(12.6)	(14.8)	6.5	25.6	17.5
Traffic (RPMs)	(15.7)	(12.6)	4.2	23.6	27.0
Passenger Load Factor (pp Change)	(3.1)	2.1	(1.8)	(1.4)	6.7
Yield	(4.9)	(10.6)	(13.4)	(7.4)	8.1
RASM	(8.3)	(8.4)	(15.2)	(8.8)	16.9

Other passenger revenues increased 15.3% from the second quarter of 2009

Other passenger revenues (comprised of Australia, Caribbean, Mexico and South America) of $168 million in the second quarter of 2010 increased $22 million or 15.3% from the second quarter of 2009 mainly due to traffic growth but also to a higher yield. The year-over-year capacity growth in the second quarter of 2010 was largely driven by increased frequencies to the Caribbean and Mexico and, starting in June 2010, increased frequencies to Caracas and Bogotá. In the second quarter of 2009, capacity to and from Mexico was significantly reduced as a result of reduced flying relating to concerns of the H1N1 influenza virus. Components of the year-over-year change in second quarter Other passenger revenues included:

- A traffic increase of 12.7% on capacity growth of 10.1%, which resulted in a passenger load factor improvement of 1.8 percentage points versus the same quarter of 2009.

- A yield increase of 2.2% from the second quarter of 2009, which reflected yield improvements on routes to Australia and South America. Yields on routes to traditional leisure destinations, such as the Caribbean and Mexico, were negatively impacted by aggressive competitive pricing activities.

- A stronger Canadian dollar in the second quarter of 2010 versus the second quarter of 2009, which had a negative impact of $6 million on Other passenger revenues.

- RASM in the Other markets increased 4.5% from the second quarter of 2009, which was due to both the yield growth and the passenger load factor improvement.

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 second quarter 2010 and each of the previous four quarters.

Other	Year-over-Year by Quarter (% Change)				
	Q2'09	Q3'09	Q4'09	Q1'10	Q2'10
Passenger Revenues	(23.3)	(20.1)	(10.8)	(0.5)	15.3
Capacity (ASMs)	(6.6)	(7.2)	(0.1)	4.3	10.1
Traffic (RPMs)	(8.0)	(7.6)	3.3	6.6	12.7
Passenger Load Factor (pp Change)	(1.2)	(0.4)	2.6	1.7	1.8
Yield	(16.7)	(13.5)	(13.7)	(6.6)	2.2
RASM	(17.9)	(13.9)	(10.7)	(4.6)	4.5

Cargo revenues increased 51% from the second quarter of 2009

Cargo revenues of $115 million in the second quarter of 2010 increased $39 million or 51% from the second quarter of 2009 due to a 51% increase in cargo traffic. Traffic growth was reflected in all markets. Traffic in the second quarter of 2009 had been adversely affected by the economic slowdown and the resulting reduction in air cargo demand. System cargo yield per revenue ton mile (RTM) was slightly above the second quarter of 2009 level, primarily due to the yield growth in the Pacific market. Excluding the unfavourable impact of foreign exchange of $13 million relating to the stronger Canadian dollar on foreign currency denominated cargo revenues, yield per RTM would have reflected a 5% increase from the second quarter of 2009. Factors contributing to the year-over-year change in second quarter cargo revenues included:

- An increase in domestic cargo revenues of 24% on a cargo traffic increase of 36% and a 9% decline in cargo yield per RTM. Domestic cargo capacity decreased 2% from the second quarter of 2009.

- An increase in Atlantic cargo revenues of 39% on a cargo traffic increase of 52% and a 9% decline in cargo yield per RTM. Atlantic cargo capacity increased 1% from the second quarter of 2009.

- An increase in Pacific cargo revenues of 98% on a cargo traffic increase of 64% and a 21% increase in cargo yield per RTM. Pacific cargo capacity increased 17% versus the second quarter of 2009.

- An increase in cargo revenues in the Other markets of 27% on a cargo traffic increase of 29% and a 2% decline in cargo yield per RTM. Other cargo capacity increased 8% from the second quarter of 2009.

- A stronger Canadian dollar versus the second quarter of 2009 which had a negative impact on foreign currency denominated cargo revenues of $13 million in the second quarter of 2010.

Other revenues were unchanged from the second 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 $196 million in the second quarter of 2010 were unchanged from the second quarter of 2009. An increase of $12 million or 21% in third party revenues at Air Canada Vacations in the second quarter of 2010 was offset by the impact of lower aircraft sublease revenues from the same quarter in 2009. The increase in third party revenues at Air Canada Vacations was largely driven by an increase in passenger volumes reflecting increased capacity year-over-year. The decrease in aircraft sublease revenues was mainly due to the unfavourable impact of a stronger Canadian dollar on U.S. denominated aircraft lease revenues.

CASM decreased 0.9% from the second quarter of 2009. Excluding fuel expense, CASM decreased 4.2% from the second quarter of 2009

Operating expenses of $2,550 million in the second quarter of 2010, increased $107 million or 4% from the second quarter of 2009, with the more notable increases reflected in aircraft fuel, pension and commission expenses. These increases were partly offset by expense reductions in aircraft maintenance and capacity purchase fees paid to Jazz. In the second quarter of 2010, a stronger Canadian dollar versus foreign currencies (mainly U.S. dollars) compared to the second quarter of 2009 is estimated to have reduced operating expenses by $151 million from the second quarter of 2009.

Unit cost in the second quarter of 2010, as measured by operating expense per available seat mile (CASM), decreased 0.9% from the second 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) was the main contributing factor to the CASM decrease year-over-year. The capacity growth, which results in the airline's fixed costs being allocated over a greater number of ASMs, the impact of CTP initiatives, including cost reduction initiatives relating to the capacity purchase agreement between Jazz and Air Canada ("Jazz CPA"), as well as increases in aircraft utilization and average stage length from the second quarter of 2009 were also contributing factors to the CASM decrease year-over-year. Partly offsetting these decreases were increases in pension and commission expenses.

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

	Second Quarter		Change	
(cents per ASM)	**2010**	**2009**	**cents**	**%**
Wages and salaries	2.41	2.55	(0.14)	(5.5)
Benefits	0.65	0.42	0.23	54.8
Ownership (DAR) (1)	1.66	1.68	(0.02)	(1.2)
Airport and navigation fees	1.52	1.64	(0.12)	(7.3)
Capacity purchase with Jazz	1.48	1.73	(0.25)	(14.5)
Aircraft maintenance	0.94	1.26	(0.32)	(25.4)
Food, beverages and supplies	0.48	0.50	(0.02)	(4.0)
Communications and information technology	0.51	0.55	(0.04)	(7.3)
Commissions	0.40	0.27	0.13	48.1
Other	2.12	2.10	0.02	1.0
Operating expense, excluding fuel expense (2)	**12.17**	**12.70**	**(0.53)**	**(4.2)**
Aircraft fuel	4.26	3.88	0.38	9.8
Total operating expense	**16.43**	**16.58**	**(0.15)**	**(0.9)**

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

(2) Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

Fuel expense increased 15% from the second quarter of 2009

Fuel expense amounted to $660 million in the second quarter of 2010, an increase of $88 million or 15% from the second quarter of 2009. Factors contributing to the year-over-year change in second quarter fuel expense included:

- A higher base fuel price, which accounted for a fuel expense increase of $207 million.
- A higher volume of fuel litres consumed, which accounted for a fuel expense increase of $28 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 fuel expense decrease of $86 million.
- In the second quarter of 2010, fuel hedging losses amounting to $52 million were reclassified from Accumulated Other Comprehensive Loss ("AOCL") into fuel expense. In the second quarter of 2009, fuel hedging losses amounting to $113 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.

	Second Quarter		Change	
(Canadian dollars in millions, except where otherwise indicated)	**2010**	**2009**	**$**	**%**
Aircraft fuel expense - GAAP (1)	$ 657	$ 569	$ 88	15
Remove: *Fuel hedging losses reclassified from AOCL into fuel expense*	(52)	(113)	61	54
Add: *Net cash payments on fuel derivatives(2)*	13	17	(4)	(24)
Economic cost of fuel - Non-GAAP (3)	**$ 618**	**$ 473**	**$ 145**	**31**
Fuel consumption (thousands of litres)	924,489	869,727	54,762	6
Fuel costs per litre (cents) – GAAP	71.1	65.4	5.7	9
Fuel costs per litre (cents) - excluding fuel hedging losses	65.4	52.4	13.0	25
Economic fuel costs per litre (cents) - Non-GAAP (3)	66.8	54.4	12.4	23

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

(2) Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives. Excludes early terminated hedging contracts of $5 million in the second quarter of 2010 covering 2010 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 its cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period and premium costs associated with those derivatives. It excludes non-cash accounting gains and losses from fuel derivative instruments.

Wages, salaries and benefits expense amounted to $474 million in the second quarter of 2010, an increase of $36 million or 8% from the second quarter of 2009

Wages, salaries and benefits expense amounted to $474 million in the second quarter of 2010, an increase of $36 million or 8% from the second quarter of 2009, due to an increase in employee benefits expense. Employee benefits expense amounted to $100 million in the second quarter of 2010, an increase of $38 million or 61% from the second 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 7.8 of this MD&A.

Capacity purchase costs with Jazz decreased 9% from the second quarter of 2009

Capacity purchase costs with Jazz, pursuant to the Jazz CPA, amounted to $230 million in the second quarter of 2010 compared to $254 million in the second quarter of 2009, a decrease of $24 million or 9%. 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 $13 million, the impact of the CTP-related amendment to the Jazz CPA effective August 1, 2009, which accounted for a decrease of $10 million and which was primarily due to a 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 $6 million, including $2 million related to additional maintenance costs due to the aging of Jazz's fleet.

Ownership costs increased 4% from the second quarter of 2009

Ownership costs, comprised of depreciation and amortization, and aircraft rent expense, of $258 million in the second quarter of 2010 increased $10 million or 4% from the second quarter of 2009. Factors contributing to the year-over-year change in the second quarter ownership costs included:

- Decreases in aircraft residual values, which accounted for an increase of $12 million to depreciation expense.
- The impact of the sale and leaseback of three Boeing 777 aircraft and the addition of one Boeing 777 aircraft to Air Canada's operating fleet in July 2009, which together accounted for an increase of $13 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 $13 million to aircraft rent expense.

Aircraft maintenance expense decreased 21% from the second quarter of 2009

In the second quarter of 2010, aircraft maintenance expense of $146 million decreased $39 million or 21% from the second quarter of 2009. Factors contributing to the year-over-year change in second quarter aircraft maintenance expense included:

- A net decrease of $26 million in airframe maintenance, which was largely due to an extension of time to perform heavy maintenance activities related to Airbus A319 and A320 aircraft.
- 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 $17 million to aircraft maintenance expense compared to the second quarter of 2009.

Commission expense increased 55% from the second quarter of 2009

In the second quarter of 2010, commission expense of $62 million increased $22 million or 55% from the second quarter of 2009, due to passenger and cargo revenue growth of 13.8% and the introduction of a 7% commission for Canadian travel agents to sell Tango fares for flights within Canada. A higher proportion of premium traffic, which generally generates higher commission rates, was also a factor in the increase in passenger commission expense in the second quarter of 2010.

Other operating expenses increased 6% from the second quarter of 2009

Other operating expenses amounted to $330 million in the second quarter of 2010, an increase of $18 million or 6% from the second quarter of 2009. The increase in other operating expenses included the impact of the capacity growth, an increase in credit card fees, the result of higher passenger volumes, and an increase in expenses related to a greater volume of ground packages at Air Canada Vacations. The growth in expenses at Air Canada Vacations was mainly driven by higher passenger volumes. In addition, a favourable rate adjustment of $20 million on foreign currency transactions recorded in the second quarter of 2009 with no corresponding amount in the second quarter of 2010 created an unfavourable variance in "remaining other expenses".

Other operating expense increases were partly offset by reversals of various capital tax-related accruals which amounted to $9 million and which were related to prior years and by the favourable impact of CTP initiatives.

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

	Second Quarter		Change	
(Canadian dollars in millions)	**2010**	**2009**	**$**	**%**
Air Canada Vacations' land costs	$ 50	$ 45	$ 5	11
Credit card fees	50	43	7	16
Terminal handling	44	46	(2)	(4)
Building rent and maintenance	31	30	1	3
Crew cycle	28	30	(2)	(7)
Miscellaneous fees and services	27	29	(2)	(7)
Remaining other expenses	100	89	11	12
Total other operating expenses	**$ 330**	**$ 312**	**$ 18**	**6**

Non-operating expense amounted to $147 million in the second quarter of 2010

Non-operating expense amounted to $147 million in the second quarter of 2010 compared to non-operating expense of $80 million in the second quarter of 2009. Factors contributing to the year-over-year change in second quarter non-operating expense included:

- In the second quarter of 2010, interest expense increased $39 million from the second quarter of 2009. Factors contributing to the year-over-year increase in second quarter interest expense included:
  - A charge of $54 million in interest expense related to its secured term credit facility, including early payment fees of $29 million and $25 million for adjustments related to the unamortized portion of transaction costs and debt discounts. Refer to section 7.3 of this MD&A for additional information relating to this transaction.
  - The net impact of financing transactions completed in the last twelve months.

These increases were partly offset by the following:

- In the second quarter of 2009, Air Canada recorded 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. There was no such charge recorded in the second quarter of 2010.

- 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 substantially completed in the fourth quarter of 2009.

- Lower average interest rates year-over-year.

- In the second quarter of 2009, Air Canada recorded an impairment charge of $67 million related to previously capitalized costs incurred in the development of a new reservation system and a loss on sale of $2 million related to the sale of the two Airbus A340 aircraft referred to above.
- Losses related to fair value adjustments on derivative instruments amounted to $18 million in the second quarter of 2010 versus gains of $79 million in the second quarter of 2009. The mark-to-market losses on financial instruments recorded in the second quarter of 2010 were mainly related to the change in the fair value of fuel derivatives.

Losses on foreign exchange amounted to $156 million in the second quarter of 2010

Losses on foreign exchange, which were mainly related to U.S. denominated long-term debt, amounted to $156 million in the second quarter of 2010 compared to gains of $355 million in the second quarter of 2009. The losses in the second quarter of 2010 were mainly attributable to a weaker Canadian dollar at June 30, 2010, compared to March 31, 2010. The June 30, 2010, noon day exchange rate was US$1 = C$1.0606 while the March 31, 2010, noon day exchange rate was US$1 = C$1.0156.

Income tax recovery of $28 million in the second quarter of 2010

Air Canada recorded an income tax recovery of $28 million on a pre-tax loss of $231 million in the second quarter of 2010, representing an effective income tax rate of 12%. The effective income tax rate is affected by the reclassification of losses on fuel derivatives from Accumulated Other Comprehensive Loss ("AOCL") to income of $52 million, which do not attract any net tax recovery due to the reversal of valuation allowance from prior years, and certain non-deductible expenses. 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. Results of Operations – First Six Months of 2010 versus First Six Months of 2009

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

	First Six Months		Change	
(Canadian dollars in millions, except per share figures)	**2010**	**2009**	**$**	**%**
Operating revenues				
Passenger	$ 4,409	$ 4,069	$ 340	8
Cargo	219	156	63	40
Other	516	496	20	4
	5,144	**4,721**	**423**	**9**
Operating expenses				
Aircraft fuel	1,279	1,165	114	10
Wages, salaries, and benefits	944	896	48	5
Airport and navigation fees	462	471	(9)	(2)
Capacity purchase with Jazz	456	500	(44)	(9)
Depreciation and amortization	348	324	24	7
Aircraft maintenance	346	374	(28)	(7)
Food, beverages and supplies	149	140	9	6
Communications and information technology	159	159	-	-
Aircraft rent	174	169	5	3
Commissions	122	89	33	37
Other	756	735	21	3
	5,195	**5,022**	**173**	**3**
Operating loss	**(51)**	**(301)**	**250**	
Non-operating income (expense)				
Interest income	6	10	(4)	
Interest expense	(211)	(199)	(12)	
Interest capitalized	-	3	(3)	
Loss on assets	(1)	(71)	70	
Gain (loss) on financial instruments recorded at fair value	(16)	69	(85)	
Other	-	(1)	1	
	(222)	(189)	(33)	
Loss before the following items	**(273)**	**(490)**	**217**	
Non-controlling interest	(6)	(8)	2	
Foreign exchange gain (loss)	(56)	254	(310)	
Recovery of (provision for) income taxes	47	(1)	48	
Loss for the period	**$ (288)**	**$ (245)**	**$ (43)**	
EBITDAR (1)	**$ 471**	**$ 192**	**$ 279**	
Loss per share - basic and diluted	**$ (1.03)**	**$ (2.45)**	**$ 1.42**	

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

System passenger revenues increased 8.4% from the first six months of 2009

Compared to the first six months of 2009, passenger revenues increased $340 million or 8.4% to $4,409 million in the first six months of 2010 largely due to higher traffic. An increase in passenger revenues from the premium cabin accounted for $177 million or approximately 52% of the total increase in system passenger revenues.

In the first six months of 2010, Air Canada increased its overall capacity by 5.9% from the first six months of 2009, comprised of a year-over-year capacity increase of 6.6% in the first quarter of 2010 and a year-over-year capacity increase of 5.3% in the second quarter of 2010. Components of the year-over-year change in first six months system passenger revenues included:

- A capacity increase of 5.9% which was below the traffic increase of 7.6%, which resulted in a higher passenger load factor of 1.3 percentage points from the first six months of 2009, comprised of year-over-year passenger load factor decrease of 0.1 percentage points in the first quarter of 2010 and a year-over-year passenger load factor increase of 2.6 percentage points in the second quarter of 2010.
- A system yield increase of 0.6% from the first six months of 2009, which was comprised of a year-over-year yield decrease of 2.2% in the first quarter of 2010 and a year-over-year yield increase of 3.3% in the second quarter of 2010.
- A stronger Canadian dollar in the first six months of 2010 versus the first six months of 2009, which had a negative impact on foreign currency denominated revenues of $163 million in the first six months of 2010.
- A RASM increase of 2.2% from the first six months of 2009, which was comprised of a year-over-year RASM decrease of 2.3% in the first quarter and a year-over-year RASM increase of 6.6% in the second quarter. The RASM increase in the first six months of 2010 was due to both the passenger load factor increase and the yield improvement.

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

First Six Months 2010 Versus First Six Months 2009	**Passenger Revenue % Change**	**Capacity (ASMs) % Change**	**Traffic (RPMs) % Change**	**Passenger Load Factor pp Change**	**Yield % Change**	**RASM % Change**
Canada	4.3	1.1	1.9	0.7	2.2	3.1
U.S. transborder	8.5	4.9	6.5	1.2	1.8	3.4
Atlantic	10.1	4.1	4.2	0.1	5.5	5.7
Pacific	26.4	21.0	25.5	3.1	0.7	4.4
Other	5.3	6.6	8.9	1.7	(3.3)	(1.2)
System	**8.4**	**5.9**	**7.6**	**1.3**	**0.6**	**2.2**

Domestic passenger revenues increased 4.3% from the first six months of 2009

Domestic passenger revenues of $1,783 million in the first six months of 2010 increased $73 million or 4.3% from the first six months of 2009 due to a 2.2% improvement in yield and a 1.9% increase in traffic. In the first six months of 2010, domestic capacity increased by 1.1% from the same period in 2009. A year-over-year decrease of 1.4 percentage points in domestic passenger load factor in the first quarter of 2010 improved to a year-over-year increase of 2.5 percentage points in the second quarter of 2010. Domestic yield improved year-over-year from an increase of 0.6% in the first quarter of 2010 to an increase of 3.7% in the second quarter of 2010. In the first six months of 2010, RASM increased 3.1% from the first six months of 2009 mainly due to the higher yield but also to the passenger load factor improvement. A year-over-year RASM decrease of 1.1% in the first quarter of 2010 improved to a year-over-year increase of 7.0% in the second quarter of 2010.

A stronger Canadian dollar in the first six months of 2010 versus the first six months of 2009 had a negative impact on foreign currency denominated revenues of $28 million in the first six months of 2010.

U.S. transborder passenger revenues increased 8.5% from the first six months of 2009

U.S. transborder passenger revenues of $901 million in the first six months of 2010 increased $71 million or 8.5% from the first six months of 2009 due to a 6.5% increase in traffic and a 1.8% improvement in yield. In the first six months of 2010, U.S. capacity increased by 4.9% from the same period in 2009. A year-over-year increase of 0.5 percentage points in U.S. transborder passenger load factor in the first quarter of 2010 improved to a year-over-year increase of 2.0 percentage points in the second quarter of 2010. U.S. transborder yield declined from a year-over-year increase of 2.5% in the first quarter of 2010 to a year-over-year increase of 0.8% in the second quarter of 2010. In the first six months of 2010, RASM increased 3.4% from the first six months of 2009 due to both a yield improvement and an increase in passenger load factor. A year-over-year RASM increase of 3.1% in the first quarter of 2010 improved to a year-over-year increase of 3.6% in the second quarter of 2010.

A stronger Canadian dollar in the first six months of 2010 versus the first six months of 2009 had a negative impact on foreign currency denominated revenues of $45 million in the first six months of 2010.

Atlantic passenger revenues increased 10.1% from the first six months of 2009

Atlantic passenger revenues of $833 million in the first six months of 2010 increased $76 million or 10.1% from the first six months of 2009 due to a 5.5% increase in yield and a 4.2% increase in traffic. In the first six months of 2010, Atlantic capacity increased 4.1% from the same period in 2009. A year-over-year decrease of 0.3 percentage points in passenger load factor in the first quarter of 2010 was followed by a year-over-year increase of 0.7 percentage points in the second quarter of 2010. A year-over-year yield growth of 0.5% in the first quarter of 2010 improved to a year-over-year yield growth of 9.2% in the second quarter of 2010. In the first six months of 2010, RASM increased 5.7% from the first six months of 2009 due to the yield growth. A year-over-year RASM increase of 0.1% in the first quarter of 2010 improved to a year-over-year increase of 10.0% in the second quarter of 2010.

A stronger Canadian dollar in the first six months of 2010 versus the first six months of 2009 had a negative impact on foreign currency denominated revenues of $48 million in the first six months of 2010.

Pacific passenger revenues increased 26.4% from the first six months of 2009

Pacific passenger revenues of $473 million in the first six months of 2010 increased $99 million or 26.4% from the first six months of 2009 mainly due to a 25.5% increase in traffic but also to a yield improvement of 0.7%. In the first six months of 2010, Pacific capacity increased by 21.0% from the same period in 2009. A year-over-year decline of 1.4 percentage points in passenger load factor in the first quarter of 2010 was followed by a year-over-year increase of 6.7 percentage points in the second quarter of 2010. A year-over-year yield decline of 7.4% in the first quarter of 2010 improved to a year-over-year increase of 8.1% in the second quarter of 2010. In the first six months of 2010, RASM increased 4.4% from the first six months of 2009 due mainly to the passenger load factor improvement but also to the yield growth. A year-over-year RASM decrease of 8.8% in the first quarter of 2010 improved to a year-over-year increase of 16.9% in the second quarter of 2010.

A stronger Canadian dollar in the first six months of 2010 versus the first six months of 2009 had a negative impact on foreign currency denominated revenues of $30 million in the first six months of 2010.

Other passenger revenues increased 5.3% from the first six months of 2009

Other passenger revenues (comprised of Australia, Caribbean, Mexico and South America) of $419 million in the first six months of 2010 increased $21 million or 5.3% from the first six months of 2009 due to an 8.9% increase in traffic. In the first six months of 2010, Other capacity increased by 6.6% from the same period in 2009. A year-over-year improvement of 1.7 percentage points in passenger load factor in the first quarter of 2010 improved to a year-over-year increase of 1.8 percentage points in the second quarter of 2010. A year-over-year yield decrease of 6.6% in the first quarter of 2010 improved to a year-over-year increase of 2.2% in the second quarter of 2010. In the first six months of 2010, RASM decreased 1.2% due to a yield decline of 3.3%. A year-over-year RASM decrease of 4.6% in the first quarter of 2010 improved to a year-over-year increase of 4.5% in the second quarter of 2010.

A stronger Canadian dollar in the first six months of 2010 versus the first six months of 2009 had a negative impact on foreign currency denominated revenues of $12 million in the first six months of 2010.

Cargo revenues increased 40% from the first six months of 2009

Cargo revenues in the first six months of 2010 amounted to $219 million and were $63 million or 40% higher than the first six months of 2009 on higher traffic. Cargo traffic increased 55% compared to the same period last year on strong traffic growth in all markets. System cargo yield per revenue ton mile (RTM) declined 9% versus the same six-month period 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 six months cargo revenues included:

- An increase in domestic cargo revenues of 17% on a 31% cargo traffic increase and a 12% decline in cargo yield per RTM. Domestic cargo capacity increased 1% versus the first six months of 2009.

- An increase in Atlantic cargo revenues of 28% on 48% more cargo traffic and a 14% lower cargo yield per RTM. Atlantic cargo capacity increased 3% versus the first six months of 2009.

- An increase in Pacific cargo revenues of 82% on 70% more cargo traffic and 7% higher cargo yield per RTM. Pacific cargo capacity increased 20% versus the first six months of 2009.

- An increase in cargo revenues in the Other markets of 38% on 60% more cargo traffic and a 14% lower cargo yield per RTM. Other cargo capacity increased 6% versus the first six months of 2009.

- A stronger Canadian dollar versus the first six months of 2009 which had a negative impact on foreign currency denominated cargo revenues of $21 million in the first six months of 2010.

Other revenues increased 4% from the first six months 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 $516 million in the first six months of 2010 increased $20 million or 4% from the first six months of 2009 due to a $48 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 a decrease in aircraft sublease revenues which was mainly due to the sale of two Airbus A340-300 aircraft in April 2009 which were previously subleased to a third party as well as the unfavourable impact of a stronger Canadian dollar on U.S. denominated aircraft lease revenues.

CASM decreased 2.3% from the first six months of 2009. Excluding fuel expense, CASM decreased 4.2% from the first six months of 2009

Operating expenses were $5,195 million in the first six months of 2010, an increase of $173 million or 3% from the first six months of 2009, with the more notable increases reflected in aircraft fuel, pension, commission and depreciation and amortization expenses. These increases were partly offset by expense reductions in aircraft maintenance, capacity purchase fees paid to Jazz as well as wages and salaries. In the first six months of 2010, a stronger Canadian dollar versus foreign currencies (mainly U.S. dollars) compared to the first six months of 2009 is estimated to have reduced operating expenses by $313 million from the first six months of 2009.

Unit cost in the first six months of 2010, as measured by operating expense per available seat mile (CASM), decreased 2.3% over the first six months 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) was the main contributing factor in the CASM decrease year-over-year. The capacity growth, which results in the airline's fixed costs being allocated over a greater number of ASMs, the impact of CTP initiatives, including cost reduction initiatives relating to the Jazz CPA, as well as increases in aircraft utilization and average stage length from the first six months of 2009 were also contributing factors to the CASM decrease year-over-year. Partly offsetting these decreases were increases in pension and commission expenses.

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

	First Six Months		Change	
(cents per ASM)	**2010**	**2009**	**cents**	**%**
Wages and salaries	2.44	2.64	(0.20)	(7.6)
Benefits	0.68	0.50	0.18	36.0
Ownership (DAR) [1]	1.73	1.73	-	-
Airport and navigation fees	1.53	1.65	(0.12)	(7.3)
Capacity purchase with Jazz	1.51	1.75	(0.24)	(13.7)
Aircraft maintenance	1.15	1.31	(0.16)	(12.2)
Food, beverages and supplies	0.49	0.49	-	-
Communications and information technology	0.53	0.56	(0.03)	(5.4)
Commissions	0.40	0.31	0.09	29.0
Other	2.48	2.57	(0.09)	(3.5)
Operating expense, excluding fuel expense [2]	**12.94**	**13.51**	**(0.57)**	**(4.2)**
Aircraft fuel	4.24	4.08	0.16	3.9
Total operating expense	**17.18**	**17.59**	**(0.41)**	**(2.3)**

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

(2) Refer to section 15 "Non-GAAP Financial Measures" of this MD&A for additional information.

Fuel expense increased 10% from the first six months of 2009

Fuel expense amounted to $1,279 million in the first six months of 2010, an increase of $114 million or 10% from the first six months of 2009. Factors contributing to the year-over-year change in first six months fuel expense included:

- A higher base fuel price, which accounted for a fuel expense increase of $361 million.
- A higher volume of fuel litres consumed, which accounted for a fuel expense increase of $52 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 fuel expense decrease of $169 million.
- In the first six months of 2010, fuel hedging losses amounting to $110 million were reclassified from Accumulated Other Comprehensive Loss ("AOCL") into fuel expense. In the first six months of 2009, fuel hedging losses amounting to $240 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.

(Canadian dollars in millions, except where otherwise indicated)		First Six Months 2010	First Six Months 2009	Change $	Change %
Aircraft fuel expense - GAAP [(1)]		$ 1,273	$ 1,159	$ 114	10
Remove:	*Fuel hedging losses reclassified from AOCL into fuel expense*	(110)	(240)	130	54
Add:	*Net cash payments on fuel derivatives*[(2)]	31	62	(31)	(50)
Economic cost of fuel - Non-GAAP [(3)]		**$ 1,194**	**$ 981**	**$ 213**	**22**
Fuel consumption (thousands of litres)		1,796,031	1,697,017	99,014	6
Fuel costs per litre (cents) - GAAP		70.9	68.3	2.6	4
Fuel costs per litre (cents) - excluding fuel hedging losses		64.8	54.2	10.6	20
Economic fuel costs per litre (cents) - Non-GAAP [(3)]		66.5	57.8	8.7	15

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

(2) Includes net cash settlements on maturing fuel derivatives and premium costs associated with those derivatives. Excludes early terminated hedging contracts of $172 million in the first quarter of 2009 covering 2009 and 2010 fuel consumption and $5 million in the second quarter of 2010 covering 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 its cash cost of fuel. It includes the actual net cash settlements from maturing fuel derivative contracts during the period and premium costs associated with those derivatives. It excludes non-cash accounting gains and losses from fuel derivative instruments.

Wages, salaries and benefits expense amounted to $944 million in the first six months of 2010, an increase of $48 million or 5% from the first six months of 2009

Wages and salaries expense totaled $739 million in the first six months of 2010, a decrease of $14 million or 2% from the first six months of 2009, mainly due to a decrease in expenses related to employee reduction programs from the same period in 2009.

Employee benefits expense amounted to $205 million in the first six months of 2010, an increase of $62 million or 43% from the first six months of 2009. The increase in employee benefits expense was mainly due to higher pension expense as a result of changes in actuarial assumptions.

Capacity purchase costs with Jazz decreased 9% from the first six months of 2009

Capacity purchase costs with Jazz, pursuant to the Jazz CPA, amounted to $456 million in the first six months of 2010 compared to $500 million in the first six months of 2009, a decrease of $44 million or 9%. 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 $25 million, the impact of the CTP-related amendment to the Jazz CPA effective August 1, 2009, which accounted for a decrease of $19 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 $14 million. Partly offsetting these decreases was a year-over-year increase in Jazz CPA rates of $14 million, including $3 million due to one-time maintenance credits in 2009 and $4 million related to additional maintenance costs for Jazz's fleet.

Ownership costs increased 6% from the first six months of 2009

Ownership costs, comprised of depreciation and amortization, and aircraft rent expense, of $522 million in the first six months of 2010 increased $29 million or 6% from the first six months of 2009. Factors contributing to the year-over-year change in ownership costs in the first six months included:

- Decreases in aircraft residual values, which accounted for an increase of $29 million to depreciation expense.

- The impact of the sale and leaseback of three Boeing 777 aircraft and the addition of one Boeing 777 aircraft in July 2009 to Air Canada's operating fleet, which together accounted for an increase of $25 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 $25 million to aircraft rent expense.

Aircraft maintenance expense decreased 7% from the first six months of 2009

In the first six months of 2010, aircraft maintenance expense of $346 million decreased $28 million or 7% from the first six months of 2009. Factors contributing to the year-over-year change in aircraft maintenance expense in the first six months included:

- The favourable 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 $36 million to aircraft maintenance expense compared to the first six months of 2009.

- A decrease of $10 million in airframe maintenance mainly due to the deferral of maintenance events on Airbus A319 and A320 aircraft.

- A decrease of $9 million due to fewer aircraft lease returns in the first six months of 2010 compared to the first six months of 2009.

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

- An increase in component maintenance of $14 million due to a higher level of components maintenance activity.

- An increase of $13 million in engine maintenance due to a higher volume of events and increased flying year-over-year.

Commission expense increased 37% from the first six months of 2009

In the first six months of 2010, commission expense of $122 million increased $33 million or 37% from the first six months of 2009, due to passenger and cargo revenue growth of 10% and the introduction of a 7% commission for Canadian travel agents to sell Tango fares for flights within Canada. A higher proportion of premium traffic, which generally generates higher commission rates, and an increase in commission expense of $5 million at Air Canada Vacations in the first six months of 2010 were also factors in the increase in passenger commission expense in the first six months of 2010. The increase in commission expense at Air Canada Vacations was mainly driven by an increase in passenger volumes and higher yields, and a change in the commission structure versus the same six-month period in 2009.

Other operating expenses increased 3% from the first six months of 2009

Other operating expenses amounted to $756 million in the first six months of 2010, an increase of $21 million or 3% from the first six months of 2009. The year-over-year increase in other operating expenses from the first six months of 2009 was primarily related to the capacity growth, an increase in expenses at Air Canada Vacations, which was largely due to higher passenger and cargo revenues, and an increase in credit card fees, which was also related to higher passenger volumes. Other operating expense increases were partly offset by reversals of various capital tax-related accruals which amounted to $9 million and which were related to prior years and by the favourable impact of CTP initiatives.

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

(Canadian dollars in millions)	First Six Months 2010	First Six Months 2009	Change $	Change %
Air Canada Vacations' land costs	$ 185	$ 172	$ 13	8
Credit card fees	101	88	13	15
Terminal handling	92	93	(1)	(1)
Building rent and maintenance	65	63	2	3
Crew cycle	57	58	(1)	(2)
Miscellaneous fees and services	50	54	(4)	(7)
Remaining other expenses	206	207	(1)	-
Total other operating expenses	**$ 756**	**$ 735**	**$ 21**	**3**

Non-operating expense amounted to $222 million in the first six months of 2010

Non-operating expense amounted to $222 million in the first six months of 2010 compared to non-operating expense of $189 million in the first six months of 2009. Factors contributing to the year-over-year change in non-operating expense in the first six months included:

- In the first six months of 2010, interest expense increased $12 million from the first six months of 2009. Factors contributing to the year-over-year change in interest expense in the first six months included:

  - A charge of $54 million in interest expense related to its secured term credit facility, including early payment fees of $29 million and $25 million for adjustments related to the unamortized portion of transaction costs and debt discounts. Refer to section 7.3 of this MD&A for additional information relating to this transaction.

  - The net impact of financing transactions completed in the last twelve months.

  These increases were largely offset by the following:

  - A charge of $17 million in the first quarter of 2009 related to a sale and leaseback transaction. There was no such charge recorded in the first six months of 2010.

  - A charge of $9 million in the first quarter of 2009 related to the termination of the capital leases of two Airbus A340 aircraft and the subsequent sale of these aircraft. There was no such charge recorded in the first six months of 2010.

  - 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 substantially completed in the fourth quarter of 2009.

  - Lower average interest rates year-over-year.

- In the first six months of 2009, Air Canada recorded an impairment charge of $67 million related to previously capitalized costs incurred in the development of a new reservation system and a loss on sale of $2 million related to the sale of the two Airbus A340 aircraft referred to above. There were no significant disposals or provisions during the first six months of 2010.

- Losses related to fair value adjustments on derivative instruments amounted to $16 million in the first six months of 2010 versus gains of $69 million in the first six months of 2009. The mark-to-market losses on financial instruments recorded in the first six months of 2010 were mainly related to the change in the fair value of fuel derivatives.

Losses on foreign exchange amounted to $56 million in the first six months of 2010

Losses on foreign exchange, which were mainly related to U.S. denominated long-term debt, amounted to $56 million in the first six months of 2010 compared to gains of $254 million in the first six months of 2009. The losses in the first six months of 2010 were mainly attributable to a stronger Canadian dollar at June 30, 2010, compared to December 31, 2009. The June 30, 2010, noon day exchange rate was US$1 = C$1.0606 while the December 31, 2009, noon day exchange rate was US$1 = C$1.0466.

Income tax recovery of $47 million in the first six months of 2010

Air Canada recorded an income tax recovery of $47 million on a pre-tax loss of $335 million in the first six months of 2010, representing an effective income tax rate of 14%. The effective income tax rate is affected by the reclassification of losses on fuel derivatives from AOCL to income of $110 million, which do not attract any net tax recovery due to the reversal of valuation allowance from prior years, and certain non-deductible expenses. 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.

6. 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):

	Actual				Planned			
	December 31, 2009	**March 31, 2010**	**Second Quarter 2010 Fleet Changes**	**June 30, 2010**	**Remainder of 2010 Fleet Changes**	**December 31, 2010**	**2011 Fleet Changes**	**December 31, 2011**
Boeing 777-300	**12**	**12**	-	**12**	-	**12**	-	**12**
Boeing 777-200	**6**	**6**	-	**6**	-	**6**	-	**6**
Boeing 767-300 (1)	**30**	**30**	-	**30**	-	**30**	(3)	**27**
Airbus A330-300	**8**	**8**	-	**8**	-	**8**	-	**8**
Airbus A321	**10**	**10**	-	**10**	-	**10**	-	**10**
Airbus A320	**41**	**41**	-	**41**	-	**41**	-	**41**
Airbus A319	**35**	**35**	1	**36**	-	**36**	-	**36**
EMBRAER 190	**45**	**45**	-	**45**	-	**45**	-	**45**
EMBRAER 175	**15**	**15**	-	**15**	-	**15**	-	**15**
Total	**202**	**202**	1	**203**	-	**203**	(3)	**200**
Average age (years)	**9.7**	**10.0**		**10.2**		**10.7**		**11.6**

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

In the second quarter of 2010, Air Canada re-introduced an A319 aircraft into its operating fleet. This aircraft was previously subleased to a third party.

At June 30, 2010, pursuant to the Jazz CPA, Jazz's operating fleet was comprised of 123 aircraft, a decrease of seven aircraft from December 31, 2009. Jazz's covered fleet had an average age of 15.4 years at June 30, 2010, comprised of the following aircraft:

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

7. Financial and Capital Management

7.1 Financial Position

The following table provides a condensed statement of financial position of Air Canada as at June 30, 2010, and as at December 31, 2009.

(Canadian dollars in millions)	June 30, 2010	December 31, 2009
Assets		
Cash, cash equivalents and short-term investments	$ 1,815	$ 1,407
Other current assets	1,238	1,244
Current assets	3,053	2,651
Property and equipment	6,054	6,369
Intangible assets	906	916
Deposits and other assets	427	470
	$ 10,440	**$ 10,406**
Liabilities		
Current liabilities	$ 3,339	$ 3,002
Long-term debt and capital leases	3,972	4,054
Pension and other benefit liabilities	1,117	1,163
Other long-term liabilities	569	540
	8,997	**8,759**
Non-controlling interest	**174**	**201**
Shareholders' equity	**1,269**	**1,446**
	$ 10,440	**$ 10,406**

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

Property and equipment amounted to $6,054 million at June 30, 2010, a reduction of $315 million from December 31, 2009. The reduction was mainly due to the impact of depreciation expense of $318 million in the first six months of 2010 partly offset by additions to capital assets of $55 million and the impact of the remaining part of a sale and leaseback transaction completed in the first quarter of 2010.

Long-term debt and capital leases, including the current portion, amounted to $4,495 million at June 30, 2010, a decrease of $27 million from December 31, 2009. The decrease in long-term debt and capital leases from December 31, 2009 was mainly due to long-term debt and capital lease repayments of $227 million. Partly offsetting this reduction was the unfavourable impact of a weaker Canadian dollar on Air Canada's foreign denominated dollar debt (mainly U.S. dollars) and capital leases which accounted for an increase of $58 million, as well as borrowings of $100 million.

7.2 Adjusted Net Debt

The table reflects Air Canada's adjusted net debt balances and net debt to net debt plus equity ratio as at June 30, 2010, and as at December 31, 2009.

(Canadian dollars in millions, except where otherwise indicated)	June 30, 2010	December 31, 2009	Change $
Total long-term debt and capital leases	$ 3,972	$ 4,054	$ (82)
Current portion of long-term debt and capital leases	523	468	55
Total long-term debt and capital leases, including current portion	4,495	4,522	(27)
Less cash, cash equivalents and short-term investments	(1,815)	(1,407)	(408)
Net debt	**$ 2,680**	**$ 3,115**	**(435)**
Capitalized operating leases (1)	2,550	2,513	37
Adjusted net debt	**5,230**	**5,628**	**(398)**
Non-controlling interest	174	201	(27)
Adjusted net debt and non-controlling interest	**$ 5,404**	**$ 5,829**	**$ (425)**
Shareholders' equity	**$ 1,269**	**$ 1,446**	**$ (177)**
Adjusted net debt and non-controlling interest to adjusted net debt and non-controlling interest plus equity ratio	**81.0%**	**80.1%**	**0.9 pp**

(1) Adjusted net debt is a non-GAAP measure used by Air Canada and may not be comparable to measures presented by other public companies. Air Canada includes capitalized operating leases which is a measure commonly used in the industry to ascribe a value to obligations under operating leases. Common industry practice is to multiply annualized aircraft rent expense by 7.5. This definition of capital is used by Air Canada and may not be comparable to similar measures presented by other public companies. Aircraft rent was $340 million for the twelve months ended June 30, 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 June 30, 2010, adjusted net debt and non-controlling interest, including capitalized operating leases, decreased $425 million from December 31, 2009. This decrease in adjusted net debt and non-controlling interest was mainly due to an increase in cash, cash equivalents and short-term investments of $408 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 in the first six months of 2010. Refer to section 7.4 of this MD&A for additional information.

The adjusted net debt and non-controlling interest to adjusted net debt and non-controlling interest plus equity ratio for Air Canada at June 30, 2010 was 81.0%, a decline of 0.9 percentage points from December 31, 2009. This deterioration was mainly due to a decline in shareholders' equity in the six months ended June 30, 2010, which was mainly attributable to the loss of $288 million recorded in the first six months of 2010.

7.3 Liquidity

At June 30, 2010, cash, cash equivalents and short-term investments amounted to $1,815 million, or almost 18% of 12-month trailing operating revenues, which is in excess of Air Canada's minimum target liquidity level of 15% of 12-month trailing operating revenues. At July 31, 2010, Air Canada's cash balances amounted to approximately $1.8 billion. For additional information on Air Canada's liquidity risks, refer to section 10.3 of Air Canada's 2009 MD&A dated February 10, 2010.

Financing commitment

In June 2010, Air Canada received a commitment from GE Japan Corporation for a senior secured term loan facility in the amount of up to approximately US$171 million to refinance amounts related to sixteen aircraft currently operated by Air Canada and leased from special purpose leasing entities which are consolidated by Air Canada. Completion of the financing is subject to certain customary terms and conditions. On a consolidated basis, the draws on this loan facility will be accounted for as a settlement of the special purpose leasing entities' debt related to these aircraft. This loan facility, once concluded, will be available in 2011 to refinance up to US$129 million of the amount related to eight Airbus A319 aircraft and four Boeing B767-300ER aircraft, with terms of seven and four years respectively. This loan facility, once concluded, will also be available in 2012 to refinance up to US$42 million of the amount related to four Airbus A319 aircraft, with a term of five years. As a result of this financing commitment, the amounts due under the existing loan within the next 12 months that will be refinanced by the commitment on a long-term basis have been classified as long-term at June 30, 2010.

Term Credit Facility

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 addition to the facility increased, on a pro-rata basis, the scheduled repayments, including the final payment. Air Canada received net financing proceeds of $98 million in February 2010.

On August 3, 2010, Air Canada completed private note offerings which are described below. Air Canada used approximately $729 million of the net proceeds of the offerings to repay all of the outstanding debt under the secured term credit facility. Air Canada recorded a charge of $54 million in interest expense during the second quarter of 2010, including early payment fees of $29 million and $25 million for the adjustment related to the unamortized portion of transaction costs and debt discounts.

Private Note Offering

On August 3, 2010, Air Canada completed a private offering of two series of senior secured notes, consisting of US$600 million senior secured first lien notes due 2015 (the "U.S. Dollar First Lien Notes") and $300 million senior secured first lien notes due 2015 (the "Canadian Dollar First Lien Notes" and, collectively with the U.S. Dollar First Lien Notes, the “First Lien Notes”). On August 3, 2010, Air Canada also completed a private offering of US$200 million senior secured second lien notes due 2016 (the "Second Lien Notes" and, together with the First Lien Notes, the "Notes"). Air Canada received net proceeds of $1,075 million after deduction of fees, expenses and discounts. Air Canada used approximately $729 million of the net proceeds of the offerings to repay all of the outstanding debt under the secured term credit facility, including $29 million for early payment fees.

The U.S. Dollar First Lien Notes bear interest at a rate of 9.250% per annum, the Canadian Dollar First Lien Notes bear interest at a rate of 10.125% per annum, and the Second Lien Notes bear interest at a rate of 12.000% per annum, in each case payable February 1 and August 1 of each year, beginning on February 1, 2011. Air Canada is required to pay additional special interest of 2% per annum on the Notes if (i) the priority lien debt value ratio (appraised value of collateral / priority lien debt) is less than 1.7:1.0, or (ii) the total appraised value ratio (total appraised value of collateral / secured debt) is less than 1.25:1.0.

Air Canada may redeem some or all of the First Lien Notes at any time on or after August 1, 2012 at certain established redemption prices, plus accrued and unpaid interest. At any time prior to August 1, 2012, Air Canada may redeem some or all of the First Lien Notes at a price equal to 100% of their principal amount plus a “make-whole” premium and accrued and unpaid interest. At any time prior to August 1, 2012, Air Canada may redeem up to 35% of the aggregate principal amount of each issue of First Lien Notes with the proceeds of certain equity offerings, at established redemption prices, plus accrued and unpaid interest. In addition, at any time and from time to time prior to August 1, 2014, Air Canada may redeem, during any 12-month period, up to 10% of the original aggregate principal amount of each issue of First Lien Notes at a redemption price of 103% of the principal amount, plus accrued and unpaid interest.

Air Canada may redeem some or all of the Second Lien Notes at any time on or after February 1, 2013 at certain established redemption prices, plus accrued and unpaid interest. At any time prior to February 1, 2013, Air Canada may redeem some or all of the Second Lien Notes at a price equal to 100% of their principal amount plus a “make-whole” premium and accrued and unpaid interest. At any time prior to February 1, 2013, Air Canada may redeem up to 35% of the aggregate principal amount of the Second Lien Notes, with the proceeds of certain equity offerings and by paying a redemption price equal to 112% of the principal amount of the Second Lien Notes being redeemed, plus accrued and unpaid interest thereon.

Upon specified change of control events or upon certain sales of assets, Air Canada must offer to repurchase the Notes.

The Notes are senior secured obligations of Air Canada, (i) secured on a first-lien basis (in the case of the First Lien Notes) or on a junior lien basis (in the case of the Second Lien Notes), subject to certain permitted liens, by accounts receivable, certain real estate interests, certain spare engines, ground equipment, certain airport slots and gate leaseholds, and Air Canada's licenses to operate its Pacific routes and the airport slots and gate leaseholds utilized in connection with these Pacific routes and (ii) guaranteed on a senior secured basis by certain subsidiaries of Air Canada, subject to certain thresholds and exclusions.

As discussed above, Air Canada recorded a charge of $54 million in interest expense during the second quarter of 2010 which was related to its secured term credit facility.

As a result of the notes offering discussed above, both Standard & Poor's Rating Services ("S&P") and Moody's Investor Service ("Moody's") took rating actions. S&P raised its long-term corporate credit rating on Air Canada to B- with a stable outlook from CCC+. Moody's initiated coverage of Air Canada providing a corporate family rating of B3 with a stable outlook.

7.4 Working capital

The following table provides information on Air Canada's working capital balances at June 30, 2010 and at December 31, 2009.

(Canadian dollars in millions)	June 30, 2010	December 31, 2009	Change $
Cash and short-term investments	$ 1,815	$ 1,407	$ 408
Accounts receivable	768	701	67
Other current assets	470	543	(73)
Accounts payable and accrued liabilities	(1,218)	(1,246)	28
Advance ticket sales	(1,598)	(1,288)	(310)
Current portion of long-term debt and capital leases	(523)	(468)	(55)
Net working capital deficiency	$ **(286)**	**$ (351)**	**$ 65**

The net working capital deficiency of $286 million at June 30, 2010 represented an improvement of $65 million from December 31, 2009, mainly due to positive net cash from operating activities and net proceeds of $98 million related to an increase to Air Canada's secured term credit facility. This improvement was partially offset by scheduled repayments of long-term debt and capital lease obligations of $227 million, the impact of capital expenditures of $67 million and pension funding payments amounting to $105 million in the first six months of 2010.

Collateral deposits for fuel derivatives

Air Canada currently holds, within its derivative portfolio, swaps and put option contracts within collar structures 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 June 30, 2010, the total cash collateral deposits held by counterparties amounted to $13 million ($43 million at December 31, 2009). If oil prices remain at the June 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.

As at July 31, 2010, the total cash collateral deposits held by counterparties amounted to $8 million.

7.5 Consolidated Cash Flow Movements

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

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2010**	**2009**	**Change $**	**2010**	**2009**	**Change $**
Net cash from operating activities, before the under noted items	$ 192	$ 96	$ 96	$ 218	$ 148	$ 70
Cash used for fuel hedge settlements, terminations and premiums	(24)	(27)	3	(46)	(244)	198
Fuel hedge collateral deposits, net	7	62	(55)	30	209	(179)
Excess of employee future benefit funding over expense	(15)	(109)	94	(40)	(212)	172
Changes in non-cash working capital	160	(113)	273	417	176	241
Cash flows from operating activities	320	(91)	411	579	77	502
Additions to capital assets	(23)	(49)	26	(67)	(156)	89
Free cash flow [1]	**297**	**(140)**	**437**	**512**	**(79)**	**591**
Proceeds from sale and leaseback transactions	-	-	-	20	172	(152)
Funding of Aveos letter of credit	-	-	-	23	-	23
Short-term investments	(174)	68	(242)	(418)	87	(505)
Other	(7)	61	(68)	15	66	(51)
Cash flows from (used for) investing activities (excluding additions to capital assets)	**(181)**	**129**	**(310)**	**(360)**	**325**	**(685)**
Borrowings	-	76	(76)	100	343	(243)
Reduction of long-term debt and capital lease obligations	(96)	(177)	81	(227)	(600)	373
Other	-	-	-	(35)	-	(35)
Cash flows used for financing activities	**(96)**	**(101)**	**5**	**(162)**	**(257)**	**95**
Net increase (decrease) in cash and cash equivalents	20	(112)	132	(10)	(11)	1
Net increase (decrease) in short-term investments	174	(68)	242	418	(87)	505
Net increase (decrease) in cash, cash equivalents and short-term investments	**$ 194**	**$ (180)**	**$ 374**	**$ 408**	**$ (98)**	**$ 506**

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

An increase in free cash flow in the second quarter of 2010 of $437 million was largely due to an improvement in non-cash working capital primarily related to higher advance ticket sales and the absence of the negative impact of the expiry of the Aeroplan pre-payment agreement which was in effect in the second quarter of 2009. Advance ticket sales in the second quarter of 2009 were impacted by the weak economy which resulted in a significant decrease in advance ticket sales in that period. The improvement in Air Canada's cash operating results year-over-year of $96 million and the impact of no past service pension cost contributions in the second quarter of 2010, as a result of the adoption of the Air Canada Pension Plan Funding Regulations, 2009, in July 2009, also factored in to the free cash flow improvement. Similar factors supported the improvement in free cash flow in the first six months of 2010 of $591 million versus the first six months of 2009.

7.6 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.

7.7 Contractual Obligations

Information on Air Canada's contractual obligations is described in section 10.5 of Air Canada's 2009 MD&A dated February 10, 2010.

The table below provides updated information on Air Canada's long-term debt and capital lease obligations, including interest repayment obligations. There have been no material changes to other contractual obligation amounts from what was disclosed in Air Canada's 2009 MD&A dated February 10, 2010.

The table below includes the impact of the financing commitment from GE Japan Corporation assuming the full commitment will be drawn upon. The loan facility, once concluded, will reduce the net cash flows by the amount of the related debt maturities refinanced in 2011 and 2012 of $134 million and $44 million, respectively, and will be offset by the principal and interest repayments made under the committed loan facility. The table also includes the principal and interest repayments on the US$600 million and the $300 million senior secured notes due 2015, as well as the US$200 million senior secured second lien notes due 2016, and is after the repayment in full of the indebtedness of the secured term credit facility on August 3, 2010. For additional information on these transactions, refer to section 7.3 of this MD&A.

(Canadian dollars in millions)	**Remainder of 2010**	**2011**	**2012**	**2013**	**2014**	**Thereafter**	**Total**
Long-term debt, capital leases and interest repayment obligations, as at June 30, 2010	$ 424	$ 1,049	$ 772	$ 801	$ 635	$ 2,067	$ 5,748
Add: Net impact of GE Japan financing commitment	-	(107)	(9)	36	36	88	44
Add: Net impact of senior secured notes, senior secured second lien notes and scheduled repayments under the secured term credit facility	(65)	(96)	(78)	(60)	(107)	1,222	816
Total	**$ 359**	**$ 846**	**$ 685**	**$ 777**	**$ 564**	**$ 3,377**	**$ 6,608**

Principal and interest repayments are based on interest rates and applicable foreign exchange rates effective at June 30, 2010.

7.8 Pension Funding Obligations

Air Canada maintains several pension plans including defined benefit and defined contribution pension plans and plans providing other retirement and post-employment benefits to its employees. As at December 31, 2009, Air Canada reported that, based on preliminary actuarial valuations as at January 1, 2010, the preliminary estimate of the aggregate solvency deficit in the registered pension plans was estimated to be between $2,500 million and $2,700 million. As a result of final actuarial valuations, including the annuity rate applied in discounting the pension obligations, the solvency deficit as at January 1, 2010 is $2,728 million. The reduction of $107 million in the aggregate solvency deficit versus the aggregate deficit of $2,835 million as at January 1, 2009, includes the impact of the actual return on plan assets partially offset by a decrease in the discount rate used to value the benefit obligation, which has the effect of increasing the benefit obligation. As described below, the January 1, 2010, valuations will not impact the 2010 pension funding obligations.

Air Canada's pension funding obligations, on a cash basis, for 2010 and its projected estimate of those obligations for the next three years are provided in the table below. Actual funding obligations are dependent on a number of factors, including the Air Canada Pension Plan Funding Regulations, 2009 described in Air Canada's 2009 MD&A dated February 10, 2010, the assumptions used in the most recently filed actuarial valuation reports for current service (including the applicable discount rate), the plan demographics at the valuation date, the existing plan provisions, existing pension legislation and changes in economic conditions, mainly the return on fund assets and changes in interest rates. Actual contributions that are determined on the basis of future valuation reports filed annually may vary significantly from projections. In addition to changes in plan demographics and experience, actuarial assumptions and methods may be changed from one valuation to the next, including by reason of changes in plan experience, financial markets, future expectations, changes in legislation and other factors. As of 2014, the Air Canada Pension Plan Funding Regulations, 2009 will cease to have effect and Air Canada's pension funding obligations may vary significantly based on a wide variety of 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 2010	Full Year 2010	2011	2012	2013
Past service domestic registered plans	$ -	$ -	$ 138	$ 173	$ 221
Current service domestic registered plans	98	174	180	186	191
Other pension arrangements[(1)]	49	87	79	81	83
Projected pension funding obligations	**$ 156**	**$ 261**	**$ 397**	**$ 440**	**$ 495**

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

7.9 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	
	July 31, 2010	**December 31, 2009**
Issued and outstanding shares		
Class A variable voting shares	62,567,891	56,586,112
Class B voting shares	215,579,168	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	3,983,628	3,963,474
Performance share units	206,416	561,846
Total shares potentially issuable	**94,440,044**	**94,775,320**
Total outstanding and potentially issuable shares	**372,587,103**	**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.

8. 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 or where otherwise indicated)

	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010	Q2 2010
Operating revenues	**$ 3,075**	**$ 2,498**	**$ 2,391**	**$ 2,330**	**$ 2,670**	**$ 2,348**	**$ 2,519**	**$ 2,625**
Aircraft fuel	1,064	792	593	572	682	601	619	660
Ownership (DAR)(1)	243	254	245	248	252	250	264	258
Other operating expenses	1,656	1,598	1,741	1,623	1,668	1,580	1,762	1,632
Operating expenses	**2,963**	**2,644**	**2,579**	**2,443**	**2,602**	**2,431**	**2,645**	**2,550**
Operating income (loss)	**112**	**(146)**	**(188)**	**(113)**	**68**	**(83)**	**(126)**	**75**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and tax	(244)	(581)	(212)	268	209	27	41	(278)
Net income (loss)	**$ (132)**	**$ (727)**	**$ (400)**	**$ 155**	**$ 277**	**$ (56)**	**$ (85)**	**$ (203)**
Revenue passenger miles (millions)	14,458	10,845	10,984	11,862	14,153	10,885	11,692	12,896
Available seat miles (millions)	17,515	13,571	13,821	14,735	16,946	13,841	14,727	15,523
Passenger load factor (%)	82.5	79.9	79.5	80.5	83.5	78.6	79.4	83.1
RASM (cents)	15.7	16.0	14.5	13.9	14.1	14.6	14.2	14.8
CASM (cents)	16.9	19.5	18.7	16.6	15.4	17.6	18.0	16.4
CASM, excluding fuel expense (cents)	10.8	13.6	14.4	12.7	11.3	13.2	13.8	12.2
Fuel price per litre (cents)(2)	101.0	95.8	71.4	65.4	68.6	72.6	70.7	71.1
EBITDAR(3)	**$ 355**	**$ 108**	**$ 57**	**$ 135**	**$ 320**	**$ 167**	**$ 138**	**$ 333**
Net income (loss) per share								
- Basic	**$ (1.32)**	**$ (7.27)**	**$ (4.00)**	**$ 1.55**	**$ 2.77**	**$ (0.25)**	**$ (0.31)**	**$ (0.72)**
- Diluted	**$ (1.32)**	**$ (7.27)**	**$ (4.00)**	**$ 1.55**	**$ 2.44**	**$ (0.25)**	**$ (0.31)**	**$ (0.72)**

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

9. 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.

As of July 31, 2010, approximately 34% 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$89 per barrel and approximately 8% is subject to an average floor price of US$89 per barrel. Air Canada's contracts to hedge anticipated jet fuel purchases over the 2010 period are comprised of crude-oil based contracts. Air Canada has also hedged approximately 3% of its 2011 anticipated jet fuel purchases in crude-oil based contracts hedged at an average capped price of US$92 per barrel.

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 July 31, 2010.

Derivative Instruments	Term	Volume (bbls)	WTI Weighted Average Floor Price (US$/bbl)	WTI Weighted Average Capped Price (US$/bbl)
Call options	2010	2,495,000	$ n/a	$ 87
Call options	2011	750,000	$ n/a	$ 92
Swaps	2010	305,000	$ 100	$ 100
Collars	2010	485,000	$ 82	$ 90

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

The fuel derivative contracts have not been designated under hedge accounting. As at June 30, 2010, the fair market value of the fuel derivatives in favour of Air Canada was $4 million (nil as at December 31, 2009), which is recorded within prepaid expenses and other current assets on Air Canada's Consolidated Statement of Financial Position, and the fair market value of the fuel derivatives in favour of the counterparties was $11 million (which is recorded within accounts payable and accrued liabilities on Air Canada's Consolidated Statement of Financial Position) ($31 million in favour of the counterparties as at December 31, 2009).
During the second quarter of 2010:

- Air Canada recorded a loss of $22 million in gain (loss) on financial instruments recorded at fair value related to fuel derivatives ($21 million in the first six months of 2010) ($85 million gain in the second quarter of 2009 and $76 million gain in the first six months of 2009).
- Air Canada purchased crude-oil call options. The premium related to these contracts was $13 million in the second quarter of 2010 ($21 million in the first six months of 2010).
- Fuel derivative contracts cash settled with a fair value of $5 million in favour of the counterparties ($19 million in the first six months of 2010) ($17 million in favour of the counterparties in the second quarter of 2009 and $62 million in favour of the counterparties in the first six months of 2009).

From time to time, Air Canada may choose to adjust or restructure its hedging portfolio in light of market conditions. During the second quarter of 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.

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 second quarter of 2010, $52 million was reclassified from AOCL to aircraft fuel expense ($110 million in the first six months of 2010). As at June 30, 2010, the net amount of existing losses reported in AOCL that are expected to be reclassified to net income during the following six months is $73 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 June 30, 2010, Air Canada had extended, to counterparties, $13 million of collateral which is recorded within "prepaid expenses and other current assets" on Air Canada's Consolidated Statement of Financial Position (December 31, 2009 – $43 million).

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.

		Second Quarter		First Six Months	
(Canadian dollars in millions)		**2010**	**2009**	**2010**	**2009**
Consolidated Statement of Operations					
Operating expense					
Aircraft fuel	Realized effective loss on derivatives designated under hedge accounting	$ (52)	$ (113)	$ (110)	$ (240)
Non-operating income (expense)					
Gain (loss) on financial instruments recorded at fair value	Ineffective gain (loss) on derivatives designated under hedge accounting	n/a	$ -	n/a	$ -
	Fair market value gain (loss) on economic hedges	$ (22)	$ 85	$ (21)	$ 76
Consolidated Statement of Comprehensive Income (Loss)					
	Effective loss on derivatives designated under hedge accounting	n/a	$ -	n/a	$ -
	Tax expense on effective gain	n/a	$ -	n/a	$ -
	Reclassification of net realized loss on fuel derivatives designed under hedge accounting to aircraft fuel expense	$ 52	$ 113	$ 110	$ 240
	Tax on reclassification	$ -	$ 2	$ -	$ 4

(Canadian dollars in millions)		June 30, 2010	December 31, 2009
Consolidated Statement of Financial Position			
Prepaid expenses and other current assets	Collateral deposits for fuel derivatives	$ 13	$ 43
	Fair market value of fuel derivatives	$ 4	$ -
Accounts payable and accrued liabilities	Fair market value of fuel derivatives	$ (11)	$ (31)
Shareholders' equity (AOCL)	Net loss from fuel derivatives designated under hedge accounting (net of tax 2010 - $1 million and 2009 - $1 million)	$ (74)	$ (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:

	Second Quarter		First Six Months	
(Canadian dollars in millions)	2010	2009	2010	2009
Fuel derivatives not under hedge accounting	$ (22)	$ 85	$ (21)	$ 76
Other	4	(6)	5	(7)
Gain (loss) on financial instruments recorded at fair value	**$ (18)**	**$ 79**	**$ (16)**	**$ 69**

Liquidity Risk

Liquidity risk is the risk that Air Canada will encounter difficulty in meeting obligations associated with its financial liabilities, contractual and other obligations. Refer to section 13 of Air Canada's 2009 MD&A dated February 10, 2010 for additional information on Air Canada's liquidity risk.

Covenants in credit card agreements

Air Canada 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, Air Canada entered into amendments with this processor to amend certain credit card processing agreements under which the triggering events were revised. In May 2010, Air Canada entered into a set of further amendments, extending these agreements to the end of November 2010 on the same terms and providing options for Air Canada, on certain terms, to further extend these agreements for a period of up to two years, on revised terms.

Air Canada has not exercised any of the options under the agreements described above. Air Canada has accepted a proposal from a new service provider for the provision of its principal credit card processing services requirements in North America for Visa and MasterCard, for a five year term beginning at the expiry of the current agreements being replaced. Air Canada and the credit card processor have agreed to triggering events upon which Air Canada would be required to provide the credit card processor with deposits. The obligation to provide, and the amount of, deposits required would be based upon a matrix measuring, on a quarterly basis, both a fixed charge coverage ratio and unrestricted cash of Air Canada. Agreement between Air Canada and the credit card processor is subject to certain conditions, including conclusion of formal documentation.

Cargo investigations and proceedings

Air Canada 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.

10. Accounting Policies

10.1 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, Air Canada 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 Air Canada'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.

11. 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.

12. Related Party Transactions

ACE Aviation Holdings Inc. ("ACE") reported holding, as of June 30, 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 dated February 10, 2010 and below. The modified terms relating to maintenance agreements are not expected to have a material impact on maintenance expense over their terms.

As part of these agreements, Air Canada also agreed to extend repayment terms on $22 million of receivables (as further described in section 15 of Air Canada's 2009 MD&A dated February 10, 2010 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 dated February 10, 2010.

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. The accounting treatment recorded in the first quarter of 2010 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.

13. Risk Factors

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

In addition, the risk factors in Air Canada's 2009 MD&A dated February 10, 2010 related to *Current Legal Proceedings* is updated to account for the fact that, on May 14, 2010, Porter filed a discontinuance of its counterclaim before the Federal Court of Canada; however, the counterclaim filed by Porter in the Ontario Superior Court remains.

The *Current Legal Proceedings* risk factors in Air Canada's 2009 MD&A dated February 10, 2010 also refer to class action lawsuits that have been filed before the United States District Court and in Canada in connection with alleged anti-competitive cargo pricing activities, where Air Canada is named defendant. Air Canada has been or may be named as a defendant or may otherwise be implicated in these or other lawsuits or proceedings in connection with these allegations.

14. Controls and Procedures

Disclosure controls and procedures and internal controls over financial reporting

Disclosure controls and procedures within Air Canada 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 Air Canada'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 Air Canada's financial reporting and its preparation of financial statements for external purposes in accordance with GAAP.

In Air Canada's 2009 filings, Air Canada's CEO and CFO certified, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design and effectiveness of Air Canada's disclosure controls and procedures, and the design and effectiveness of internal controls over financial reporting.

In Air Canada's second quarter 2010 filings, Air Canada's CEO and CFO certify, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design of Air Canada's disclosure controls and procedures, and the design of internal controls over financial reporting.

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

Management's report on disclosure controls and procedures

Management, with the participation of Air Canada's CEO and CFO, concluded, as at June 30, 2010, that such disclosure controls and processes were designed to provide reasonable assurance that:

- material information relating to Air Canada was made known to its Disclosure Policy Committee by others; and

- information required to be disclosed by Air Canada in its annual filings, interim filings and other reports filed or submitted by Air Canada 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 Air Canada's CEO and CFO, concluded, as at June 30, 2010, that Air Canada'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 Air Canada's control framework.

Changes in internal controls over financial reporting

There have been no changes to Air Canada's internal controls over financial reporting during the second quarter of 2010 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

15. 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:

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2010**	**2009**	**Change $**	**2010**	**2009**	**Change $**
GAAP operating income (loss)	$ 75	$ (113)	$ 188	$ (51)	$ (301)	$ 250
Add back:						
Aircraft rent	86	83	3	174	169	5
Depreciation and amortization	172	165	7	348	324	24
EBITDAR	**$ 333**	**$ 135**	**$ 198**	**$ 471**	**$ 192**	**$ 279**

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:

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2010**	**2009**	**Change $**	**2010**	**2009**	**Change $**
GAAP operating expense	$ 2,550	$ 2,443	$ 107	$ 5,195	$ 5,022	$ 173
Remove:						
Aircraft fuel	(660)	(572)	(88)	(1,279)	(1,165)	(114)
Operating expense, excluding fuel expense	**$ 1,890**	**$ 1,871**	**$ 19**	**$ 3,916**	**$ 3,857**	**$ 59**

16. Glossary

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

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

CASM — Operating expense per ASM.

EBITDAR — EBITDAR is earnings before interest, taxes, depreciation 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 15 of this MD&A for additional information.

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

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

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

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

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.