

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(currencies in millions)

THIRD QUARTER 2004

1. Nature of Operations

ACE Aviation Holdings Inc. ("ACE") was incorporated on June 29, 2004 for the purpose of becoming the parent company of Air Canada and its subsidiaries upon the implementation of the consolidated plan of reorganization, compromise and arrangement ("the Plan") as further described in note 2.

In accordance with the implementation of the Plan involving Air Canada, as the predecessor company, and certain subsidiaries, pursuant to the provisions of the Companies' Creditors Arrangement Act (Canada) ("CCAA"), on September 30, 2004, ACE became the successor and parent holding company of the reorganized Air Canada and its subsidiaries. In addition to Aeroplan Limited Partnership ("Aeroplan"), Jazz Air Inc. ("Jazz"), Destina.ca Inc. ("Destina") and Touram Inc. ("Air Canada Vacations"), which were already established as separate legal entities, Air Canada Technical Services ("ACTS"), Air Canada Cargo, Air Canada Groundhandling and AC Online were established as separate legal entities. Air Canada is Canada's largest domestic and international full-service airline and the largest provider of scheduled passenger services in the domestic market, the Canada-U.S. market as well as in the Canada-Europe, the Canada-Pacific, Canada-Caribbean and Canada-Latin America markets. Supporting the airline business, the Corporation also provides airline related services. ACTS provides aircraft and engine maintenance services to third parties. Aeroplan, Air Canada's loyalty program, rewards members both for flying on Air Canada and its airline partners, and for purchasing services from other program participants. Air Canada Vacations, a Canadian tour operator, provides packaged vacation solutions. Destina.ca provides online travel services. ACE also provides cargo and ground handling services to airlines and other customers through Air Canada Cargo and Air Canada Groundhandling respectively.

2. The Plan and Other Restructuring Arrangements

The Plan

As described in note 1 to the 2003 annual consolidated financial statements of Air Canada, on April 1, 2003, Air Canada obtained an order from the Ontario Superior Court of Justice (the "Court") providing creditor protection under CCAA. On April 1, 2003, Air Canada, through its Court-appointed Monitor, also made a concurrent petition for recognition and ancillary relief under Section 304 of the U.S. Bankruptcy Code. The CCAA and U.S. proceedings covered Air Canada and the following of its wholly-owned subsidiaries: Jazz, ZIP Air Inc., 3838722 Canada Inc., Air Canada Capital Ltd., Manoir International Finance Inc., Simco Leasing Ltd., and Wingco Leasing Inc. (collectively, the "Applicants"). Aeroplan, Air Canada Vacations, Maple Leaf Holdings USA Inc. and Destina were not included in the filings. During the proceedings, the Applicants continued to operate under Court protection.

On August 17, 2004, the creditors approved the Plan and on August 23, 2004, the Plan was confirmed pursuant to an order of the Court. The Plan was implemented through a series of steps which were completed on September 30, 2004. Accordingly, on September 30, 2004, the Applicants emerged from the CCAA and US proceedings and ACE became the parent company of Air Canada and various subsidiaries.

The confirmed plan provided for the following:

- A corporate reorganization of Air Canada and its subsidiaries into separate business units resulting in the following subsidiaries of ACE: Air Canada, Aeroplan LP, Air Canada Jazz LP, Destina.ca Inc., Touram Inc., Air Canada Technical Services LP, Air Canada Cargo LP, Air Canada Groundhandling LP, AC Online LP, Air Canada Capital Ltd. and Maple Leaf Holdings USA Inc.
- The affected unsecured creditors' claims accepted, amounting to approximately \$8,094, were settled, compromised and released in exchange for 38,569,635 shares in ACE and rights to acquire further shares pursuant to a rights offering (the "Rights Offering"). In accordance with the Plan, 7,680,365 shares are being held in escrow pending resolution of disputed unsecured claims. As of October 31, 2004, \$571 of disputed unsecured claims remained unresolved. As claims are resolved, the disbursing agent will distribute the shares in accordance with the provisions of the Plan. None of these shares held in escrow will return to ACE or any of its subsidiaries.
- All issued and outstanding options of Air Canada, including the conversion feature in the convertible subordinated debentures, and warrants were cancelled without payment or consideration.
- Holders of Air Canada's Class A non-voting common shares received a nominal number of ACE Class A Variable Voting Shares and holders of Air Canada's common shares received a nominal number of ACE Class B Voting Shares representing approximately 0.01% of the fully diluted equity of ACE. In total, 10,104 shares were issued to the holders of Air Canada's common shares.
- Air Canada's Class A Convertible Participating Non-Voting Convertible Preferred Shares (Series 1) were converted into Air Canada Redeemable Shares which were redeemed for an aggregate consideration of one dollar.

Global Restructuring Agreement

The Global Restructuring Agreement (“GRA”) with General Electric Capital Corporation and its affiliates (“GECC”) became effective on September 30, 2004.

Under the GRA, leases related to 106 operating, parked and undelivered aircraft were restructured resulting in a reduction of lease rates for 47 aircraft, termination of obligations for 20 parked aircraft, the cancellation of four future aircraft lease commitments and the restructuring of the overall obligations with respect to six aircraft.

As described in note 2 to the 2003 annual consolidated financial statements of Air Canada, on September 30, 2004, Air Canada acquired two previously leased aircraft from GECC for an aggregate amount of \$353. GECC provided financing in the amount of \$63. Terms and conditions of these loans are set out in note 9. The difference of \$290 was paid to GECC on September 30, 2004, under the terms of the GRA. This one-time payment of \$290 has been classified as a cash flow used for the operating activities of ACE.

GECC provided ACE with an Exit Facility in the amount of \$540 before fees of \$13. The terms and conditions of this Exit Facility are set out in note 9. Cash proceeds received under the Exit Facility have been reduced by the amount drawn under the DIP Loan Agreement as at September 30, 2004 of \$300. In addition, ACE provided cash collateralization of certain outstanding letters of credit totaling \$21. This amount is recorded under other assets. ACE further paid an amount of \$45 to GECC in consideration for damages suffered by GECC under certain leases. As a result of this payment, the warrants as outlined in the GRA were not issued. This amount has been charged to the deficit of ACE.

Rights Offering and Standby Purchase Agreement

As part of the Plan, the affected unsecured creditors were entitled to subscribe for up to 42,500,000 ACE Class B Voting Shares and/or ACE Class A Variable Voting Shares or approximately 42.06% of the Fully Diluted Equity of ACE as of September 30, 2004 pursuant to the Rights Offering. In accordance with a Standby Purchase Agreement (the “Standby Purchase Agreement”) entered into with Deutsche Bank Securities Inc. (“DB”), ACE completed the issuance of 42,500,000 shares under its rights offering for proceeds of \$865 before fees of \$13. As at September 30, 2004, DB and its participants had acquired, as standby purchasers, 9,829,339 Class A Variable Voting Shares relating to unexercised rights.

Investment Agreement

In accordance with the Investment Agreement (the “Investment Agreement”) with Cerberus ACE Investment, LLC and Promontoria Holding III B.V., affiliates of Cerberus Capital Management L.P. (collectively, “Cerberus”), ACE issued 12,500,000 Convertible Preferred Shares for an aggregate consideration of \$250 before fees of \$12. See note 11 for further details related to the Convertible Preferred Shares. The proceeds of the Investment Agreement were used, in part, to pay an amount of \$45 to GECC as described above.

Pension Plan Arrangements

On September 30, 2004, with the agreement of the Office of the Superintendent of Financial Institutions, Air Canada issued a series of subordinated security promissory notes in the aggregate amount of approximately \$347 in favour of its pension plan sponsors. See note 14 for further details on these notes.

Claims Status

By order of the Court on September 18, 2003, the Applicants established procedures for affected creditors and other prescribed parties to file claims against the Applicants arising from obligations incurred prior to April 1, 2003, and any claim arising on or after April 1, 2003 as a result of the restructuring, repudiation or termination of any contract, lease, employment agreement, collective agreement or other agreement.

As is typical in reorganization cases, there are significant differences between amounts filed by affected creditors and amounts of claims accepted through the claims resolution process. Total claims remaining in dispute amount to \$571 as at October 31, 2004.

3. Basis of Presentation

The consolidated balance sheet as of September 30, 2004 includes the accounts of ACE and its subsidiaries. The consolidated balance sheet as of December 31, 2003 includes the accounts of Air Canada and its subsidiaries. The consolidated statement of operations for the three months and nine months ended September 30, 2004 and 2003 reflect the results of operations of Air Canada and its subsidiaries as well as the results of operations for ACE on September 30, 2004. The consolidated statement of cash flow for the three and nine months ended September 30, 2004 and 2003 reflect the cash flows of Air Canada and its subsidiaries as well as cash flows of ACE on September 30, 2004 on implementation of the Plan.

In accordance with Section 1625 of the CICA Handbook, Comprehensive Revaluation of Assets and Liabilities, ACE adopted fresh start reporting on September 30, 2004. References in these consolidated financial statements and notes thereto to "Predecessor Company" refer to Air Canada and its subsidiaries prior to September 30, 2004. References to "Successor Company" refer to ACE and its subsidiaries on September 30, 2004. See note 5 for information related to fresh start reporting.

For the period from April 1, 2003 through to September 30, 2004, while Air Canada and certain of its subsidiaries operated under CCAA proceedings, the Predecessor Company followed accounting policies, including disclosures, applicable to entities under creditor protection. In addition to generally accepted accounting principles applicable in Canada, the Predecessor Company applied the guidance in American Institute of Certified Public Accountant Statement of Position 90-7, "Financial Reporting by Entities in Reorganization under the Bankruptcy Code" (SoP 90-7). Accordingly, revenues, expenses (including professional fees), realized gains and losses and provisions for losses directly associated with the reorganization and restructuring of the business were reported separately as reorganization items. In addition, the consolidated balance sheet of the Predecessor Company distinguished between liabilities subject to compromise and post-filing liabilities. Liabilities subject to compromise were reported at the amounts expected to be allowed, even if they were settled for lesser amounts.

4. Accounting Policies

The financial statements of the Successor and Predecessor Companies are expressed in Canadian dollars and are prepared in accordance with Canadian generally accepted accounting policies (“GAAP”).

These interim consolidated financial statements have been prepared in accordance with Canadian GAAP applicable to a going concern, which assumes that the Successor Company will be able to realize its assets and discharge its liabilities in the normal course of business in the foreseeable future.

These interim financial statements for the Successor and Predecessor Companies do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the audited financial statements of Air Canada for the year ended December 31, 2003.

Except for the following, the unaudited interim consolidated financial statements are based on the accounting policies consistent with those used by Air Canada and disclosed in note 2 to the 2003 annual consolidated financial statements of Air Canada.

Basis of Valuation

All assets and liabilities, except for future income taxes, are reported at fair values as further described in note 5. In addition, the estimated useful lives of certain assets were also adjusted, including buildings where useful lives were extended to periods not exceeding 50 years.

Intangible Assets

As a result of the application of fresh start reporting, significant values related to intangible assets have been recorded over those previously carried. Therefore, the related accounting policy previously described in note 2w to the 2003 annual consolidated financial statements of Air Canada is expanded upon as below.

Intangible assets are carried at their established estimated fair values at September 30, 2004. Indefinite life assets are not amortized while assets with finite lives are amortized to nil over their estimated useful lives.

	<u>Estimated Useful Life</u>
International airport slots and route rights	Indefinite
Air Canada trade name	Indefinite
Aeroplan trade name	Indefinite
Other marketing based trade names	Indefinite
Aeroplan contracts	30 years
Star Alliance membership	25 years
Other contract and customer based	Up to 15 years
Technology based	Up to 10 years

Hedging Relationships

Accounting Guideline 13 – Hedging Relationships (AcG 13), as issued and amended by the Canadian Institute of Chartered Accountants (“CICA”), has been adopted by the Predecessor Company beginning January 1, 2004. The new guideline concerns the identification, designation, documentation and effectiveness of hedging relationships, for the purpose of applying hedge accounting; and the discontinuance of hedge accounting. The guideline establishes the conditions that need to be met before

hedge accounting can be applied and also establishes the requirement for the testing of hedge effectiveness throughout the term of the hedging relationship. AcG 13 is not intended to specify how hedge accounting is applied and, accordingly, it does not deal with hedge accounting techniques.

Concurrent with the adoption of AcG 13, the Predecessor Company adopted the Emerging Issues Committee ("EIC") Abstract 128 – Accounting for Trading, Speculative, or Non-Hedging Derivative Financial Instruments. For derivative financial instruments that do not qualify for hedge accounting or are entered into for trading or speculative purposes, EIC 128 requires that these derivative financial instruments be measured at fair value, with changes in fair value recognized currently in income. Derivative financial instruments are used only for risk management purposes, not for generating trading profits. To the extent that a derivative financial instrument does not qualify for hedge accounting or to the extent of hedge ineffectiveness, changes in the fair value of derivative financial instruments are recorded in non-operating income (expense).

As a result of the CCAA filing, the majority of outstanding derivative contracts were terminated. As such, the adoption of AcG 13 did not have a significant impact in the nine months ended September 30, 2004. Notwithstanding, currency swaps for five Canadair Regional Jet operating leases until lease terminations in 2007 and for three Airbus A330 operating leases were in effect as of January 1, 2004, as disclosed in note 20 to the 2003 annual consolidated financial statements. These currency swaps, with unrelated creditworthy third parties, were put in place on the inception of the leases and, after review in accordance with AcG 13, Management elected not to apply hedge accounting with respect to these swaps. As a result, the fair value of these swaps of \$12 was recorded as at January 1, 2004, in other assets with the offset being a deferred credit, which is amortized over the remaining term of the related aircraft leases. During the quarter ended September 30, 2004, the swaps for three Airbus A330 operating leases were terminated, resulting in a gain of \$2 recorded in reorganization and restructuring items. During the quarter ended September 30, 2004, a loss of \$3 was recorded in other non-operating income (expense) (\$5 for the nine months ended September 30, 2004) representing the amortization of the opening deferred credit and the change in the fair value of the remaining swaps. As a result of the application of fresh start reporting, the deferred credit has been eliminated.

Generally Accepted Accounting Principles

Effective January 1, 2004, the Predecessor Company adopted CICA 1100 - Generally Accepted Accounting Principles. CICA 1100 establishes standards for financial reporting in accordance with generally accepted accounting principles. It describes what constitutes Canadian GAAP and its sources. This Section also provides guidance on sources to consult when selecting accounting policies and determining appropriate disclosures when a matter is not dealt with explicitly in the primary sources of GAAP. There have been no changes in accounting policies as a result of the adoption of CICA 1100.

Impairment of Long-Lived Assets

CICA 3063 - Impairment of Long-Lived Assets has been adopted by the Predecessor Company effective January 1, 2004. CICA 3063 establishes standards for the recognition, measurement and disclosure of the impairment of long-lived assets held for use. It does not deal with long-lived assets to be disposed of. Under the new standard, an impairment loss is recognized when the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. The recoverability test is based on a comparison of the carrying amount of the long-lived asset to the future net cash flows that are directly associated with, and that are expected to arise as a direct result of, its use and eventual disposition. An impairment loss is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value. The new section provides guidance on when to test for recoverability; a long-lived asset should be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. CICA 3063 is applied prospectively. The Predecessor Company did not record any impairment loss as a direct result of the transition to CICA 3063.

Aeroplan Loyalty Program

As described in note 5, ACE adopted fresh start reporting on September 30, 2004. As a result, the outstanding loyalty program mileage credits ("Miles") were adjusted to reflect the estimated fair market value of Miles to be redeemed in the future. As a consequence of this fair value adjustment and the evolving nature of the Aeroplan loyalty program, the Successor Company will adopt a deferred revenue accounting policy going forward to replace the previous incremental cost policy on Miles earned through air travel. In addition, the estimated percentage of Miles that will never be redeemed, defined as breakage, is deferred and amortized over the average estimated life of a Mile. There is no change to the policy related to the sale of Miles to third parties where revenues were already deferred and recognized as Miles were redeemed. The current portion of Aeroplan deferred revenues of \$512 (\$192 at December 31, 2003 as recorded under the previous accounting policy) is included in advance ticket sales.

Segment Information

As a result of the corporate reorganization as called for under the Plan, the Corporation is reviewing its operations in accordance with the guidance under CICA 1701 - Segment Disclosures.

5. Fresh Start Reporting

As explained in note 3, ACE adopted fresh start reporting on September 30, 2004. As a result, all assets and liabilities of the Successor Company have been reported at fair values, except for future income taxes which are reported in accordance with the requirements of Section 3465 of the CICA Handbook, Income Taxes. As a result of the implementation of the Plan and the adoption of fresh start reporting, a revaluation adjustment of \$4,439 has been recorded as a credit to Shareholders' Equity and the deficit of Air Canada as at September 30, 2004 has been reclassified to Shareholders' Equity, resulting in a capital deficiency of \$611.

The fair values of the assets and liabilities of the Successor Company have been based on Management's best estimates as of September 30, 2004. The determination of the fair values of the assets and liabilities of the Successor Company has not been finalized as at the date of preparing this interim consolidated balance sheet. The Successor Company is continuing to finalize its valuation of assets and liabilities, primarily property and equipment, intangible assets and employee future benefit arrangements. Management expects to complete this valuation by the date the financial statements of the Successor Company are prepared for the period ended December 31, 2004. Any adjustments will be made to the balance sheet as of September 30, 2004. The determination of fair values involves certain estimates and assumptions which are inherently subject to significant uncertainties and contingencies. Accordingly, there can be no assurance that the estimates, assumptions, and values reflected in the consolidated balance sheet of ACE as at September 30, 2004 will be realized, and actual results could vary materially.

	Air Canada Predecessor Company - September 30, 2004 (unaudited)	Plan of Arrangement (a) (unaudited)	Equity and Other Financing Transactions (unaudited)	Fresh Start Reporting (e) (unaudited)	ACE Successor Company - September 30, 2004 (unaudited)
ASSETS					
Current assets					
Cash and cash equivalents	\$ 957	\$ -	(63) ^(b) 852 ^(c) 193 ^(d)	\$ -	\$ 1,939
Restricted cash	62	-	-	-	62
Accounts receivable	732	-	-	-	732
Spare parts, materials and supplies	190	-	-	12	202
Prepaid expenses	129	-	-	11	140
	<u>2,070</u>	<u>-</u>	<u>982</u>	<u>23</u>	<u>3,075</u>
Property and equipment	3,749	-	64 ^(b)	(148)	3,665
Deferred charges	3,175	-	19 ^(b & c)	(3,083)	111
Goodwill	510	-	-	(510)	-
Intangible assets	158	-	-	1,717	1,875
Other assets	443	-	-	(337)	106
TOTAL ASSETS	<u>\$ 10,105</u>	<u>\$ -</u>	<u>\$ 1,065</u>	<u>\$ (2,338)</u>	<u>\$ 8,832</u>
LIABILITIES					
Liabilities not subject to compromise					
Current liabilities					
Accounts payable and accrued liabilities	\$ 1,199	\$ -	\$ -	\$ 116	\$ 1,315
Advance ticket sales	861	-	-	268	1,129
Current portion of long-term debt and capital lease obligations	558	-	-	(319)	239
	<u>2,618</u>	<u>-</u>	<u>-</u>	<u>65</u>	<u>2,683</u>
Long-term debt and capital lease obligations	1,425	-	303 ^(b)	823	2,551
Convertible preferred shares	-	-	127 ^(d)	-	127
Future income taxes (g)	8	-	-	426	434
Pension and other benefit liabilities (f)	1,072	-	-	1,296	2,368
Other long-term liabilities	776	-	-	504	1,280
Deferred credits	1,266	-	(132) ^(b)	(1,134)	-
	<u>7,165</u>	<u>-</u>	<u>298</u>	<u>1,980</u>	<u>9,443</u>
Liabilities subject to compromise (h)	7,990	(7,990)	-	-	-
	<u>15,155</u>	<u>(7,990)</u>	<u>298</u>	<u>1,980</u>	<u>9,443</u>
SHAREHOLDERS' EQUITY					
Share capital and other equity	967	925 (125) (25)	852 ^(c) 117 ^(d)	(3,322)	(611)
Contributed surplus	25	150	-	(175)	-
Deficit	(6,042)	7,065	(157) ^(b) (45) ^(d)	(821)	-
	<u>(5,050)</u>	<u>7,990</u>	<u>767</u>	<u>(4,318)</u>	<u>(611)</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 10,105</u>	<u>\$ -</u>	<u>\$ 1,065</u>	<u>\$ (2,338)</u>	<u>\$ 8,832</u>

The following legend describes the adjustments made to the Predecessor accounts resulting from the implementation of the Plan and consummation of the various agreements described in note 2:

- a) Implementation of the Plan.
- b) Implementation of the GRA.
- c) Issuance of shares for cash under the Rights Offering and the Standby Purchase Agreement.
- d) Issuance of Convertible Preferred Shares for cash under the Investment Agreement.
- e) Comprehensive revaluation of assets and liabilities.
- f) The effect of the issuance of the subordinated security promissory notes described in note 14 is included within the fair value of the obligation for pension benefits as at September 30, 2004.
- g) Future income taxes have been adjusted to reflect the tax effects of differences between the fair value of identifiable assets and liabilities and their estimated tax bases and the benefits of any unused tax losses and other deductions to the extent that these amounts are more likely than not to be realized. The resulting future income tax amounts have been measured based on the rates substantively enacted that are expected to apply when the temporary differences reverse or the unused tax losses and other deductions are realized. It has been assumed that certain intangibles with a fair value of approximately \$1,285, with no underlying tax cost, have indefinite lives and accordingly, the associated future income tax liability of \$434 is not expected to reverse until the intangible asset is disposed of or becomes amortizable. This future income tax liability does not represent an actual cash tax liability of ACE.

On a consolidated basis, ACE has certain future tax assets in the amount of approximately \$2,400 against which a valuation allowance has been applied as the assets are not considered to be more likely than not to be realized as of September 30, 2004. The estimated future income tax assets are based on numerous assumptions and dependent upon complex tax issues including the ultimate quantum of claims settled. Consequently, the actual future income tax assets may vary from the ones disclosed herein. If such future tax assets are recognized in the future, the benefit will be recognized first to reduce to nil any remaining intangible assets that were recorded upon fresh start reporting with any remaining amount as a credit to shareholders equity.

- h) Liabilities subject to compromise as accrued by the Applicants totaled \$7,990. Differences from the minimum potential claims of \$8,205 as reported by the Monitor arise primarily from the difference in foreign exchange rates as at April 1, 2003, the rates used in the claims resolution process, and the current rates as at September 30, 2004.

6. Reorganization and Restructuring Items

Cash expenditures related to reorganization and restructuring items for the quarter ended September 30, 2004, amounted to \$32 (\$85 for the nine months ended September 30, 2004); \$18 for the three months ended September 30, 2003 (\$32 for the nine months ended September 30, 2003) and relate mainly to the payment of professional fees. The table below summarizes reorganization and restructuring charges recorded.

	Three Months Ended September 30		Nine Months Ended September 30	
	2004	2003	2004	2003 ⁽¹⁾
Repudiated and renegotiated leases and contracts (a)	198	156	529	405
Labour related items (b)	156	38	279	59
Foreign exchange adjustments on compromised debt	(143)	45	(84)	(165)
Professional fees	106	15	158	29
Interest income on accumulated cash (c)	(4)	(5)	(17)	(8)
Other	-	24	6	170
Reorganization and restructuring items, net	<u>\$ 313</u>	<u>\$ 273</u>	<u>\$ 871</u>	<u>\$ 490</u>

⁽¹⁾ Since filing for creditor protection on April 1, 2003

a) Repudiated and renegotiated contracts, including aircraft lease agreements, represents the estimated allowable claim resulting from contracts that have been terminated and the amortization of deferred charges related to deficiency claims on renegotiated contracts. Further claims may arise as a consequence of the ongoing adjudication of the \$571 of disputed claims outstanding as at October 31, 2004.

b) Labour related items during the quarter ended September 30, 2004 relate to voluntary and involuntary severance programs as well as to the amortization of the estimated compromised claim related to the Predecessor Company's employee groups. Labour related items of \$38 recorded during the quarter ended September 30, 2003 represents the accrual related to accepted voluntary separation packages ("VSP") offers, net of the reversal of the contractual severance that was recorded in the second quarter 2003, and adjustments to the severance accrual recorded in the second quarter of 2003.

An involuntary severance program pertaining to the Predecessor Company's workforce reduction plan with respect to non-unionized employees was approved by Management in 2003. Implementation of the plan began in May 2003 and is expected to continue into 2005.

Implementation of the workforce reduction plan pertaining to the Predecessor Company's unionized employees commenced in the second quarter of 2003 as a result of agreed modifications to all collective agreements between employee unions and the Company. Further agreed modifications to all collective agreements were reached in July, 2004. The modifications to certain collective agreements include VSP's. For those VSP's which will be offered to the members of the affected employee unions over the next several years, the estimated cost of the VSP is approximately an additional \$71 and will be recorded as a liability and an expense as the affected employees accept the offer.

The following table outlines the changes to the labour provisions related to the restructuring.

	Three Months Ended September 30, 2004		Nine Months Ended September 30, 2004	
	Involuntary Severance	Voluntary Separation	Involuntary Severance	Voluntary Separation
Opening balance	\$ 29	\$ 45	\$ 55	\$ 43
Charges recorded	10	107	5	112
Amounts disbursed	(4)	(3)	(25)	(6)
Provision as at September 30, 2004	<u>\$ 35</u>	<u>\$ 149</u>	<u>\$ 35</u>	<u>\$ 149</u>

c) Interest income earned by an entity under creditor protection, that it would not have earned but for the proceedings, should be reported as a reorganization and restructuring item. The interest income recorded in reorganization items is due mainly to the cash balances retained by the Predecessor Company as a result of the moratorium on aircraft lease payments and the stay on actions to collect pre-filing indebtedness, including trade payables.

7. Property and Equipment

	Successor Company September 30, 2004	Predecessor Company December 31, 2003
Cost		
Flight equipment	\$ 1,211	\$ 2,021
Buildings and leasehold improvements	517	781
Ground equipment and other	150	565
	<hr/> 1,878	<hr/> 3,367
Accumulated depreciation and amortization	-	(2,175)
	<hr/> 1,878	<hr/> 1,192
Capital leases (a)	1,758	349
Purchase deposits	29	159
Property and equipment at net book value	<hr/> <hr/> \$ 3,665	<hr/> <hr/> \$ 1,700

In accordance with the application of fresh start reporting, property and equipment values, net of accumulated depreciation, are adjusted to fair value in the Successor Company.

a) As a result of renegotiated lease terms, 35 leases previously classified as operating leases have been converted to capital leases, five leases previously classified as capital leases have been converted to operating leases, one aircraft has been returned and one aircraft under capital lease has been purchased. Included in capital leases are 35 aircraft with a fair value of \$1,685, computer equipment with a fair value of \$28 and facilities with a fair value of \$45.

During the quarter ended September 30, 2004, the Predecessor Company recorded provisions of \$62 relating mainly to non-operating aircraft and spare parts (\$75 for the nine months ended September 30, 2004). The provisions reflect the excess of net book value over the expected net recoverable amount. As a result of the provisions in the quarter, all non-operating aircraft are being carried at an aggregate salvage value of \$6.

During the quarter ended September 30, 2003, the Predecessor Company recorded provisions of \$28 related to the write down of non-operating aircraft, spare parts and other investments (\$79 for the nine months ended September 30, 2003). Also in the third quarter 2003, the Predecessor Company received proceeds and recorded a gain of \$29 related to an earn out provision on the sale of Galileo Canada. The sale of Galileo Canada occurred in 1998 and contained an earn out provision related to volumes recorded through the Galileo distribution system.

8. Intangible Assets

The services of an independent business valuation firm were retained to provide an opinion as to the fair value of the identifiable intangible assets of the Successor Company for the purposes of financial reporting under the fresh start requirements as described in note 5.

	Successor Company September 30, 2004	Predecessor Company December 31, 2003 (a)
Indefinite life assets		
International airport slots and route rights	\$ 562	\$ 84
Air Canada trade name	516	-
Aeroplan trade name	125	-
Other marketing based trade names	82	-
	<u>1,285</u>	<u>84</u>
Finite life assets		
Aeroplan contracts	238	-
Star Alliance membership	120	-
Other contract and customer based	126	9
Technology based	106	71
	<u>590</u>	<u>80</u>
	<u>\$ 1,875</u>	<u>\$ 164</u>

a) Previously recorded in property and equipment and other asset categories before being reclassified to conform to the financial statement presentation adopted in the current period.

9. Long-Term Debt and Capital Lease Obligations

	Final Maturity	Interest Rate (%)	September 30, 2004	December 31, 2003
GECC Exit Financing (a)	2011	6.6	\$ 569	\$ -
Air Canada - Lufthansa Cooperation Agreement (b)	2009	6.495	88	98
GECC Limited Recourse Loan (c)	2014	5.84	63	-
GECC Loan (d)	2015	7.17	58	65
Amex Financing (e)	2006	3.75	55	-
CIBC Financing	2004	4.5	-	105
Other (f)	2007 - 2019	4.32 - 4.85	245	-
			<u>1,078</u>	<u>268</u>
Capital lease obligations (g)	2004-2027	8.0	<u>1,712</u>	<u>237</u>
			2,790	505
Current portion			<u>(239)</u>	<u>(173)</u>
Long-term debt and capital lease obligations			<u>\$ 2,551</u>	<u>\$ 332</u>

For a discussion on the financing transactions effective on September 30, 2004, please refer to note 2.

Other financing transactions for the quarter ended September 30, 2004 include the repayments of \$49 made on mainly on credit facilities and capital lease obligations. Other financing transactions for the quarter ended September 30, 2003, include repayments of \$26 made on the credit facility with CIBC through the offset of Aeroplan Miles purchased by CIBC. In addition, cash payments of principal in the amount of \$64 were paid during the third quarter, 2003.

Principal repayment requirements on long-term debt and capital lease obligations through to 2009 are as follows:

	Remainder					
	2004	2005	2006	2007	2008	2009
Long-term debt	\$ 24	\$ 76	\$ 33	\$ 101	\$ 189	\$ 168
Capital lease principal obligations	\$ 63	\$ 149	\$ 151	\$ 188	\$ 188	\$ 90

- a) Tranche A, a non-revolving term loan in the amount of US\$425, bears interest at the 30 day BA rate plus an applicable margin. The applicable margin is to be initially set at 4.25% subject to a later adjustment based upon ACE's credit rating, or, if not available, based on EBITDAR (defined as operating income(loss) before non-recurring labour expenses and reorganization and restructuring items, adding back depreciation, amortization and obsolescence and aircraft rent) performance. The term is seven years with no principal payments required for the first three years. Equal quarterly principal payments are required for the four years thereafter. Interest payments are required at the end of each BA period from the date of issue. The loan may be prepaid at ACE's option at any time after 180 days from closing, upon the payment of a fee. The loan is secured by a first priority security interest on all of the existing and after acquired property of the Successor Company, other than leased assets, assets financed by other parties, and certain other excluded property of ACE and its subsidiaries. In accordance with the application of fresh start reporting, the loan has been adjusted to a fair value of \$569, resulting in an effective interest rate of 5.3%.
- b) US\$69 borrowing maturing in 2009 at a fixed interest rate of 4.495% plus an additional 2.0% guarantee fee.
- c) US\$50 borrowing, secured by two B747-400 aircraft, maturing in 2014 at an interest rate equal to the one month LIBOR rate plus a margin of 4.0% and is accrued in arrears at the end of each LIBOR period. Prior to the maturity date of this loan, Air Canada will be required to apply the proceeds from any sale or lease of the two aircraft against the principal amount plus accrued interest. Air Canada has entered into sales agreements with a third party which, when completed, are expected to result in the full settlement of the obligation. The sales transactions are expected to be finalized in the fourth quarter.
- d) US\$46 borrowing maturing in 2015 at a floating interest rate equal to the six month LIBOR rate plus 5.75% redeemable on any interest payment date secured by assets with a carrying value of \$73.
- e) Monthly principal and interest payments are required for the term of the Canadian dollar loan which extends to January 5, 2006 which may be extended in six month intervals at the request of either party and subject to consent by the non-requesting party. Under the terms of the Amex agreements, the facility may be repaid, at Amex's option, as loyalty points are purchased and as amounts are due to Air Canada and Aeroplan under the Amex agreement. The facility bears interest at the Bank of Montreal's prime lending rate (3.75% as at September 30, 2004) and is secured by all accounts receivable due by Amex under the agreement and all of the present and future licenses, trademarks and design marks owned by Air Canada and Aeroplan and used by Amex in connection with the agreement.
- f) Other includes mainly asset backed financings related to two A340-500 aircraft. These aircraft purchases were financed through conditional sales agreements for an aggregate value of US\$174. Principal and interest is paid quarterly until maturity in 2019. The loans bear interest at a three month LIBOR rate plus 2.9% (4.85% as at September 30, 2004).
- g) Capital lease obligations, related to computer equipment, facilities and a total of 35 aircraft, total \$1,712(\$96 and US\$1,279). Future minimum lease payments are \$2,558, which includes \$846 of interest.

10. Stock Based Compensation

Pursuant to the Plan, a stock option plan of ACE has been established as an on-going program and will comprise a maximum of 5% of the fully diluted equity of ACE (with a maximum of 3% of the fully diluted equity of ACE pursuant to options granted upon the emergence by the Applicants from the CCAA Proceedings). On October 3, 2004, options to purchase 3,027,509 shares were granted pursuant to the plan at an exercise price of \$20 per share. The new board of directors of ACE or a committee selected by, and made up of members of, the new board of directors of ACE will designate, from time to time, eligible directors, officers, senior managers and other employees of ACE to whom options will be granted and will determine the number of underlying shares to which such options relate. Participation in the plan will be limited to employees holding positions that, in view of the board or the committee, as the case may be, have a significant impact on ACE's long-term results. The fair value of stock options granted is recognized as a charge to salary and wage expense over the applicable vesting period, with an offset to contributed surplus. When stock options are exercised, the consideration paid by employees, together with the amount in contributed surplus, is credited to share capital.

11. Share Capital and Other Equity

The issued and outstanding common shares of the Successor Company as at September 30, 2004, along with other equity instruments, are as follows:

	<u>Authorized (000)</u>	<u>Outstanding (000)</u>
Issued and outstanding common shares		
Class A variable voting shares (a)	unlimited	69,655
Class B voting shares (b)	unlimited	11,480
Retained shares held by Monitor		<u>7,680</u>
 Total issued and outstanding common shares as at September 30, 2004		 <u>88,815</u>
 Issued and outstanding		
Convertible preferred shares conversion option (c)		9,259
Stock options granted on October 3, 2004		<u>3,028</u>
		 <u>12,287</u>

5,000 Class A Variable Voting Shares and 50,000 Class B Voting Shares were subscribed for by Directors of ACE on September 30, 2004 at the subscription price under the rights offering. No options are exercisable, and no stock issued to Directors may be sold, before the expiry of one year following September 30, 2004.

Share capital and other equity summary as at September 30, 2004 (net of issue costs)

Common shares ⁽¹⁾	\$ 1,777
Convertible preferred shares (c)	<u>117</u>
	1,894
Adjustment to shareholders' equity (unrecorded goodwill) ⁽²⁾	<u>(2,505)</u>
Share capital (capital deficiency)	<u>\$ (611)</u>

(1) The fair value of outstanding common shares includes the net proceeds received under the Rights Offering and Standby Purchase Agreement of \$852 and the fair value of common shares issued to creditors under the Plan of \$925.

(2) Under fresh start reporting, in situations where there is a negative balance in shareholders' equity after the comprehensive revaluation, share capital is disclosed at a nominal value and the balance is disclosed as a capital deficiency resulting from the financial reorganization. CICA 1625 - Comprehensive Revaluation of Assets and Liabilities, does not permit goodwill to be recorded even if the fair value of net assets is less than the fair value of the enterprise as a whole. This presentation differs from US GAAP for fresh start reporting where goodwill is recorded as the excess of the fair value of the Successor Company

over the fair value of net assets. For US GAAP reporting, goodwill is recorded as \$2,717, which results in a share capital balance of \$1,777.

a) Class A Variable Voting Shares

The Class A Variable Voting Shares may be held only by persons who are not Canadians and are entitled to one vote per Class A Variable Voting Share unless (i) the number of Class A Variable Voting Shares outstanding (including the Convertible Preferred Shares, on an as-converted basis), as a percentage of the total number of votes attaching to voting shares outstanding exceeds 25% or (ii) the total number of votes cast by or on behalf of holders of Class A Variable Voting Shares (including the Convertible Preferred Shares on an as-converted basis) at any meeting exceeds 25% of the total number of votes that may be cast at such meeting. If either of the above noted thresholds would otherwise be surpassed at any time, the vote attached to each Class A Variable Voting Share will decrease proportionately such that (i) the Class A Variable Voting Shares as a class (including the Convertible Preferred Shares on an as-converted basis) do not carry more than 25% of the aggregate votes attached to all issued and outstanding voting shares of ACE and (ii) the total number of votes cast by or on behalf of holders of Class A Variable Voting Shares (including the Convertible Preferred Shares on an as-converted basis) at any meeting do not exceed 25% of the votes that may be cast at such meeting.

Each issued and outstanding Class A Variable Voting Share shall be converted into one Class B Voting Share, automatically and without any further act of ACE or of the holder, if (i) such Class A Variable Voting Share becomes held, beneficially owned and controlled, directly or indirectly, otherwise than by way of security only, by a Canadian; or (ii) the provisions contained in the Canada Transportation Act (the "CTA") relating to foreign ownership restrictions are repealed and not replaced with similar provisions.

b) Class B Voting Shares

Each Class B Voting Share shall confer the right to one (1) vote in person or by proxy at all meetings of shareholders of the ACE.

Subject to the foreign ownership restrictions of the CTA, an issued and outstanding Class B Voting Share shall be converted into one Class A Variable Voting Share, automatically and without any further act of the ACE or of the holder, if such Class B Voting Share becomes held, beneficially owned and controlled, directly or indirectly, otherwise than by way of security only, by a person who is not a Canadian.

c) Convertible Preferred Shares

As at September 30, 2004, 12,500 Convertible Preferred Shares were issued to and affiliate of Cerberus Capital Management L.P. for consideration of \$250 before fees of \$12. These Convertible Preferred Shares are convertible into 9,259 common shares.

For accounting purposes, the Convertible Preferred Shares are presented as a compound instrument. The value ascribed to the holders' conversion option, which is presented as equity, is \$123 less allocated fees of \$6. The value ascribed to the financial liability as at September 30, 2004, is \$127. The total value will increase by 5% per annum, compounded semi-annually from the date of issuance ("Fully Accreted Value").

Each preferred share shall confer on its holder the right to that number of votes as is equal to the number of ACE shares into which each preferred share held by such holder could be converted on the date for determination of shareholders entitled to vote at the meeting or on the date of any written consent, based on the conversion ratio in effect on such date; provided, however, that if any Convertible Preferred Shares are held by persons who are not Canadians, such Convertible Preferred Shares shall be subject to the same proportionate reduction in voting percentage as described for Class A Variable Voting Shares above as if, for voting purposes only, such Convertible Preferred Shares had been converted into Class A Variable Voting Shares.

The Convertible Preferred Shares may be converted at any time, at the option of the holder thereof, into fully paid and nonassessable Class B Voting Shares (if the holder is a Canadian) or fully paid and nonassessable Class A Variable Voting Shares (if the holder is not a Canadian) at the conversion ratio applicable upon the date of conversion. The conversion price is initially equal to 135% of the subscription price of each Class B Voting Share under the rights offering. The conversion price is adjusted automatically downward on the first anniversary of the issuance date of the Convertible Preferred Shares to 130% of the subscription price of each ACE Class B Voting Share.

The holders of ACE Convertible Preferred Shares will be required to convert the ACE Convertible Preferred Shares into fully paid and nonassessable common shares at the conversion ratio applicable upon the date of conversion, if:

- i) at any time during the period between the effective date until and including the first anniversary thereof, the closing price of the ACE shares on the principal market for each of thirty consecutive trading days exceeds 200% of the then applicable conversion price; or
- ii) at any time during the period following the first anniversary of the effective date, the closing price of the ACE shares on the principal market for each of thirty consecutive trading days exceeds 175% of the then applicable conversion price.

The Convertible Preferred Shares will be subject to mandatory conversion into fully paid and nonassessable common shares within ten days of each mandatory conversion date, at the conversion ratio applicable upon the date of conversion, upon the following terms and conditions:

- i) if the closing price of the ACE shares on the principal market exceeds the Fully Accreted Value of a preferred share on at least thirty of the one hundred trading days immediately prior to a particular mandatory conversion date; or
- ii) if the closing price of the ACE shares on the principal market does not exceed the Fully Accreted Value of a preferred share on at least thirty of the one hundred trading days immediately prior to a particular mandatory conversion date, (i) the holders of the Convertible Preferred Shares will not be required to convert their Convertible Preferred Shares into ACE shares and (ii) as of such mandatory conversion date, the then applicable conversion price shall be automatically reduced by 3.75%; and

- iii) if the closing price of the ACE shares on the principal market does not exceed the Fully Accreted Value of a preferred share on at least thirty of the one hundred trading days immediately prior to the final maturity date, then holders of Convertible Preferred Shares will be entitled, upon written notice to ACE given within ten days following the final maturity date, to require ACE to redeem each of the Convertible Preferred Shares in cash at a redemption price equal to the Fully Accreted Value as of the final maturity date.

The Convertible Preferred Shares (including the shares into which they are convertible) may not be sold, assigned or in any way transferred by Cerberus (other than to its affiliates) including pursuant to hedging transactions, swaps or other arrangements transferring any of the economic consequences of the ownership of the Convertible Preferred Shares acquired by Cerberus for a period of 24 months after the closing; provided that, if at any time during such 24 month period Cerberus is required to convert the Convertible Preferred Shares, then the restrictions on transfer with respect to 50% of the Convertible Preferred Shares (and any shares into which they are converted or convertible) shall be of no force and effect and the restrictions on transfer with respect to the remaining 50% of the Convertible Preferred Shares (and any shares into which they are converted or convertible) shall be limited only to sales of beneficial ownership of the Convertible Preferred Shares (and any shares into which they are convertible) to third parties. Notwithstanding the foregoing, the transfer restrictions shall cease to be in effect as to all Convertible Preferred Shares (and any shares into which they are convertible) in the event of a tender offer for any of the shares of ACE, any change in control transaction, any liquidation, dissolution, bankruptcy or other similar proceedings of ACE.

Subject to the rights, privileges, restrictions and conditions attaching to the shares of ACE ranking prior to the Convertible Preferred Shares, upon the liquidation, dissolution or winding-up or distribution of the assets of ACE, the holders of the Convertible Preferred Shares will be entitled to receive, prior to and in preference to the holders of ACE shares, an amount equal to the Fully Accreted Value of the Convertible Preferred Shares as of the date of the liquidation, dissolution, winding-up or distribution.

12. Segment Information

	Three Months Ended			Nine Months Ended		
	September 30			September 30		
	2004	2003	%	2004	2003	%
Passenger revenue						
Canada	\$ 809	\$ 786	3	\$ 2,236	\$ 2,222	1
US Transborder	363	368	(1)	1,160	1,206	(4)
Atlantic	560	529	6	1,212	1,173	3
Pacific	287	135	113	650	353	84
Other	104	83	25	370	289	28
	<u>2,123</u>	<u>1,901</u>	<u>12</u>	<u>5,628</u>	<u>5,243</u>	<u>7</u>
Cargo revenue	142	122	16	405	388	4
Non-transportation revenue						
Aeroplan	96	75	28	293	234	25
Technical Services	49	31	58	127	130	(2)
Other	86	99	(13)	385	396	(3)
	<u>231</u>	<u>205</u>	<u>13</u>	<u>805</u>	<u>760</u>	<u>6</u>
Total operating revenue	<u>\$ 2,496</u>	<u>\$ 2,228</u>	<u>12</u>	<u>\$ 6,838</u>	<u>\$ 6,391</u>	<u>7</u>

For passenger, the allocation to service is determined based on flight destination. Cargo revenues are not allocated by service as the amounts by service are not significant. Non-transportation revenues are almost exclusively attributable to Canada.

Property and Equipment

Air Canada is a Canadian based domestic and international carrier and while the Corporation's flight equipment is used on various routes internationally, for purposes of segment reporting, the Corporation attributes the location of flight equipment to Canada. As a consequence, substantially all of the Corporation's property and equipment and goodwill are related to operations in Canada.

13. Commitments

Air Canada has signed definitive purchase agreements with Empresa Brasileira de Aeronautica S.A. (“Embraer”), and Bombardier Inc (“Bombardier”). The agreement with Embraer covers firm orders for 45 Embraer 190 series aircraft. The purchase agreement also contains rights to exercise options for up to 45 additional Embraer 190 series aircraft as well as providing for conversion rights to other Embraer models. Deliveries are scheduled to commence in November 2005. The agreement with Bombardier Aerospace covers firm orders for 15 Bombardier CRJ700 Series 705 aircraft and 30 Bombardier CRJ200 aircraft of which 15 may be cancelled without penalty. The purchase agreement also contains options for an additional 45 aircraft. Deliveries of the 50-seat Bombardier CRJ200 commenced in October 2004, with the 75-seat CRJ700 Series 705 deliveries scheduled to begin in May 2005. The estimated aggregate cost of the firm aircraft orders approximates US\$2 billion. Confirmation of financing on satisfactory terms to the Successor Company has been received from the manufacturers.

Other purchase commitments for the remainder of 2004 and 2005 for property, ground equipment and spare parts, amount to approximately \$66.

Future minimum lease payments under existing operating leases of aircraft and other property amount to \$2,954 (December 31, 2003 \$5,417; December 31, 2002 \$7,697) using period end exchange rates.

	Aircraft	Other Property
remainder of 2004	\$ 120	\$ 25
2005	496	84
2006	452	50
2007	426	47
2008	319	46
2009	315	33
Thereafter	424	117
	<u>\$ 2,552</u>	<u>\$ 402</u>

Lease payments for aircraft classified as capital leases for accounting purposes are disclosed in note 9 “Long-Term Debt and Capital Lease Obligations”.

Operating lease commitments include currency swaps to convert a significant portion of US dollar lease rentals into Canadian dollar lease rentals for five Canadair Regional Jet operating leases until lease terminations in 2007. These currency swaps, with unrelated creditworthy third parties, were put in place on the inception of the leases and have a fair value at September 30, 2004 of \$9 in favour of the third parties (2003 \$7 in favour of the third parties) taking into account foreign exchange rates in effect at that time.

14. Pension and Other Benefit Plans

The Predecessor Company has recorded pension and other employee future benefits expense as follows:

	Three months ended		Nine months ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
Pension benefit expense	\$ 51	\$ 61	\$ 202	\$ 183
Other employee future benefit expense	48	33	127	101
	<u>\$ 99</u>	<u>\$ 94</u>	<u>\$ 329</u>	<u>\$ 284</u>

Pension and other employee future benefit obligations are adjusted to reflect the net accrued benefit obligation based on management's best estimate assumptions on a going forward basis. The liability recorded is as follows:

	Pension Benefits		Other Benefits		Total	
	Successor Company September 30, 2004	Predecessor Company December 31, 2003	Successor Company September 30, 2004	Predecessor Company December 31, 2003	Successor Company September 30, 2004	Predecessor Company December 31, 2003 (a)
Benefit obligation	\$ 10,783	\$ 10,873	\$ 866	\$ 819	\$ 11,649	\$ 11,692
Fair value of plan assets	9,149	9,022	10	10	9,159	9,032
Net benefit obligation	1,634	1,851	856	809	2,490	2,660
Unrecognized net actuarial gain (loss)	-	(1,167)	-	(193)	-	(1,360)
Unrecognized prior service cost	-	(672)	-	(35)	-	(707)
Unrecognized net transition obligation	-	7	-	-	-	7
Accrued benefit liability	1,634	19	856	581	2,490	600
Current portion	110	-	12	11	122	11
Pension and other benefit liabilities	<u>\$ 1,524</u>	<u>\$ 19</u>	<u>\$ 844</u>	<u>\$ 570</u>	<u>\$ 2,368</u>	<u>\$ 589</u>

(a) Pension and other benefit liabilities for the Predecessor Company as at December 31, 2003, is shown net of prepaid pension asset of \$375 recorded under other assets.

On August 9, 2004, the Government of Canada adopted the Air Canada Pension Plan Solvency Deficiency Funding Regulations (the "Pension Regulations"). The Pension Regulations allow Air Canada to fund the solvency deficiencies in its ten Canadian defined benefit registered pension plans as of January 1, 2004 over ten years, rather than the five years required under the ordinary rules, and to pay down such deficiencies by way of an agreed schedule of variable annual contributions rather than by way of equal annual contributions as required under the ordinary rules. The Pension Regulations came into force upon Air Canada's emergence from CCAA protection on September 30, 2004, on which date the Company issued subordinated secured promissory notes in an aggregate amount of approximately \$347 in favour of the pension plan trustee. Such notes will be reduced as the principal amount of the solvency

deficiencies is paid down, and will only be called on the occurrence of certain specified events of default. Also on September 30, 2004, the Superintendent of Financial Institutions delivered to the Company a letter stating that the directions he had issued to Air Canada on March 21, 2003 in respect of the funding and administration of the pension plans had now been satisfied or were otherwise of no further force or effect. The effect of the issuance of the subordinated security promissory notes is included within the fair value of the obligation for pension benefits as at September 30, 2004 as reflected in the Successor Company's balance sheet.

15. Condensed Combined Financial Statements

As described in note 2 to the 2003 annual consolidated financial statements of Air Canada, consolidated financial statements that include one or more entities in reorganization proceedings and one or more entities not in reorganization proceedings should include disclosure of condensed combined financial statements of the entities in reorganization proceedings, including disclosure of the amount of intercompany receivables and payables therein. The following are the condensed combined financial statements of the Applicants as at and for the period ended September 30, 2004. Included in current assets are intercompany receivables with non-Applicants of \$142. Included in current liabilities are intercompany payables with non-Applicants of \$628. Included in other assets are long-term receivables of \$205 from non-Applicants. Included in the Statement of Operations for the quarter ended September 30, 2004 are intercompany revenues of \$79 (\$301 for the nine months ended September 30, 2004) and expenses of \$55 (\$184 for the nine months ended September 30, 2004) with non-Applicants. The nine months ended September 30, 2003 figures below relate only to the period since filing for CCAA on April 1, 2003.

Condensed Combined Statement of Operations

(\$ millions)	Three Months Ended September 30		Nine Months Ended September 30	
	2004	2003	2004	2003
Operating revenues	\$ 2,448	\$ 2,158	\$ 6,581	\$ 4,046
Operating expenses	2,238	2,213	6,596	4,414
Operating loss before reorganization and restructuring items	210	(55)	(15)	(368)
Reorganization and restructuring items (note 6)	(313)	(273)	(871)	(490)
Net interest expense	(64)	(17)	(171)	(18)
Loss on sale of assets	(62)	(1)	(74)	(47)
Other non-operating income, including equity income of non-applicants	25	70	129	91
Loss before foreign exchange on non-compromised long-term monetary items and income taxes	(204)	(276)	(1,002)	(832)
Foreign exchange on non-compromised long-term monetary items	124	16	107	12
Loss before income taxes	(80)	(260)	(895)	(820)
Provision for income taxes	(1)	(3)	-	(9)
Loss for the period	\$ (81)	\$ (263)	\$ (895)	\$ (829)

Condensed Combined Statement of Financial Position

	September 30		December 31	
	2004		2003	
(\$ millions)				
ASSETS				
Current assets	\$	2,184	\$	1,489
Property and equipment		3,713		1,614
Deferred charges		3,175		2,346
Goodwill		510		510
Intangible assets		158		164
Other assets		1,127		1,256
	\$	10,867	\$	7,379
LIABILITIES				
Current liabilities	\$	3,132	\$	2,744
Long-term debt and capital lease obligations		1,425		332
Future income taxes		8		11
Pension and other benefit liabilities		1,072		964
Other long-term liabilities		514		298
Deferred credits		1,266		1,364
Liabilities subject to compromise		7,990		5,313
SHAREHOLDERS' DEFICIENCY		(4,540)		(3,647)
	\$	10,867	\$	7,379

Condensed Combined Statement of Cash Flow

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2004	2003	2004	2003
(\$ millions)				
Net cash provided by operating activities	\$	168	\$	33
Financing (note 9)		-		-
Drawdown on GE DIP financing	-	-	300	-
Credit facility borrowings	-	-	80	315
Aircraft related borrowings	116	-	233	-
Reduction of long-term debt and capital lease obligations	(49)	(64)	(358)	(64)
DIP financing fees	-	-	-	(62)
Other	-	(11)	-	(10)
	67	(75)	255	179
Investing		0		0
Additions to property and equipment	(139)	(6)	(320)	(20)
Investments and advances	-	-	-	(15)
Proceeds from sale of assets	-	30	1	34
	(139)	24	(319)	(1)
Increase (decrease) in cash and cash equivalents	96	(18)	256	383
Cash and cash equivalents, beginning of period	857	830	697	429
Cash and cash equivalents, end of period	\$	953	\$	812
	\$	953	\$	812

16. Seasonal Nature of Business

The Corporation has historically experienced considerably greater demand for its services in the second and third quarters of the calendar year and significantly lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the spring and summer months, however, in the current operating environment, these historical patterns may no longer be applicable.

The Corporation has substantial fixed costs in its cost structure that do not meaningfully fluctuate with passenger demand in the short-term. Seasonally low passenger demand normally results in significantly lower operating cash flow and margins in the first and fourth quarters of each calendar year compared to the second and third quarters.

17. ACE Aviation Holdings Inc. / Air Canada Schedule of Differences Between Generally Accepted Accounting Principles in Canada and the United States For the periods ended September 30, 2004 and 2003 (Canadian dollars – millions except per share data) - Amended

The interim unaudited consolidated financial statements of ACE Aviation Holdings Inc. (the “Successor Company”) and Air Canada (the “Predecessor Company”) have been prepared in accordance with generally accepted accounting principles in Canada (Canadian GAAP) which differ in certain respects from accounting principles generally accepted in the United States (US GAAP). The following represents the principal differences affecting net income, the statements of financial position, shareholders’ equity and cash flows as well as additional disclosures required by US GAAP. This Schedule should be read in conjunction with the interim unaudited consolidated financial statements of the Successor and Predecessor.

As outlined in notes 1, 2, 3 and 5 of the interim unaudited consolidated financial statements, Air Canada emerged from creditor protection on September 30, 2004 and became a subsidiary of ACE Aviation Holdings Inc. The Successor did not have any significant operations for the period ended September 30, 2004, accordingly, a reconciliation of net income has not been provided for the Successor.

Consolidated Statement of Operations and Comprehensive Loss
(unaudited)

	Predecessor Company - Air Canada			
	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2004	2003	2004	2003
Loss for the period in accordance with Canadian GAAP	(81)	(263)	(895)	(1,099)
Aircraft introduction costs (1)	2	3	5	8
Derivative instruments (2)	(30)	3	(32)	37
Aircraft lease adjustment (3)	-	4	-	54
Residual value guarantee adjustment (4)	5	120	14	84
Pension valuation allowance (5)	(2)	(1)	(6)	(1)
Pre-operating costs (6)	5	1	6	5
Convertible debentures (7)	-	-	-	19
Variable interest entity adjustment (8)	35		(13)	
Gain on discharge of compromised liabilities (9)	7,065		7,065	
Fresh start reporting (9)	(1,502)	-	(1,502)	-
Income adjustments for the period before the following	5,578	130	5,537	206
Cumulative effect of change in accounting policy - Variable interest entity adjustment (8)	-	-	(42)	-
Current year income adjustments	5,578	130	5,495	206
Income (loss) for the year in accordance with US GAAP	5,497	(133)	4,600	(893)
Minimum pension liability adjustment (5)	(105)	61	(2)	(246)
Adjustment related to derivative instruments (2)	-	12	-	12
Fresh start reporting (9)	491		491	
Comprehensive income (loss) for the period in accordance with US GAAP	5,883	(60)	5,089	(1,127)
Earnings (loss) per share - US GAAP				
- Basic	\$ 46.85	\$ (1.11)	\$ 39.38	\$ (7.44)
- Diluted	\$ 40.45	\$ (1.11)	\$ 33.99	\$ (7.44)

Consolidated Statement of Financial Position (unaudited)	September 30, 2004	December 31, 2003
	Successor Company	Predecessor Company
Property and equipment		
Balance under Canadian GAAP	\$ 3,665	\$ 1,771
Aircraft lease adjustment (3)		358
Variable interest entity adjustment (8)	1,562	-
Fresh start adjustment related to variable interest entities (9)	(336)	
Balance under US GAAP	<u>\$ 4,891</u>	<u>\$ 2,129</u>
Deferred charges		
Balance under Canadian GAAP	\$ 111	\$ 2,332
Aircraft lease adjustment (3)	-	(136)
Derivative instruments (2)	-	(13)
Aircraft introduction costs (1)	-	(12)
Pre-operating costs (6)	-	(6)
Balance under US GAAP	<u>\$ 111</u>	<u>\$ 2,165</u>
Goodwill		
Balance under Canadian GAAP	\$ -	\$ 510
Pension valuation allowance (5)	-	(75)
Employee severance costs (10)	-	(100)
Amortization adjustment (10)	-	9
CAIL equity accounting adjustment (10)	-	(124)
Goodwill on fresh start (9)	2,717	-
Balance under US GAAP	<u>\$ 2,717</u>	<u>\$ 220</u>
Other assets		
Balance under Canadian GAAP	\$ 106	\$ 586
Derivative instruments (2)	-	27
Minimum pension liability adjustment (5)	-	446
Pension valuation allowance (5)	-	144
Balance under US GAAP	<u>\$ 106</u>	<u>\$ 1,203</u>
Current portion of long-term debt		
Balance under Canadian GAAP	\$ 239	\$ 173
Variable interest entity adjustment (8)	89	-
Balance under US GAAP	<u>\$ 328</u>	<u>\$ 173</u>
Long-term and subordinated perpetual debt		
Balance under Canadian GAAP	\$ 2,551	\$ 332
Aircraft lease adjustment (3)	-	241
Variable interest entity adjustment (8)	1,139	
Balance under US GAAP	<u>\$ 3,690</u>	<u>\$ 573</u>
Convertible preferred shares		
Balance under Canadian GAAP	\$ 127	\$ -
Reclassification of preferred shares (7)	(127)	-
Balance under US GAAP	<u>\$ -</u>	<u>\$ -</u>
Pension and other benefit liabilities		
Balance under Canadian GAAP	\$ 2,368	\$ 964
Minimum pension liability adjustment (5)	-	930
Balance under US GAAP	<u>\$ 2,368</u>	<u>\$ 1,894</u>
Other long-term liabilities		
Balance under Canadian GAAP	\$ 1,280	\$ 679
Convertible preferred shares - embedded derivative (7)	123	-
Balance under US GAAP	<u>\$ 1,403</u>	<u>\$ 679</u>

Consolidated Statement of Financial Position
(unaudited)

	September 30, 2004 Successor Company	December 31, 2003 Predecessor Company
Deferred credits		
Balance under Canadian GAAP	\$ -	\$ 1,364
Residual value guarantee adjustment (4)	-	156
Balance under US GAAP	<u>\$ -</u>	<u>\$ 1,520</u>
Minority Interest		
Balance under Canadian GAAP	\$ -	-
Variable interest entity adjustment (8)	210	-
Balance under US GAAP	<u>\$ 210</u>	<u>\$ -</u>
Temporary equity		
Balance under Canadian GAAP	\$ -	-
Reclassification of preferred shares (7)	121	125
Balance under US GAAP	<u>\$ 121</u>	<u>\$ 125</u>
Shareholders' equity		
Balance under Canadian GAAP	\$ (611)	\$ (4,155)
Convertible debentures (7)		(25)
Reclassification of preferred shares (7)		(125)
Current year income adjustments		214
Fresh start differences		
Convertible preferred shares (7)	(117)	
Variable interest entity adjustment (8)	(212)	
Goodwill on fresh start (9)	2,717	
Current year adjustments for comprehensive income		
Derivative instruments adjustment (2)		12
Minimum pension liability adjustment (5)		(284)
Cumulative prior year adjustments for:		
Convertible debentures (7)		6
CAIL equity accounting adjustment (10)		(124)
Goodwill amortization adjustment (10)		9
Aircraft introduction costs (1)		(21)
Derivative instruments (2)		(27)
Aircraft lease adjustment (3)		(89)
Residual value guarantee adjustment (4)		(222)
Future income tax		108
Pension valuation allowance (5)		15
Employee severance costs (10)		(173)
Pre-operating costs (6)		(11)
Comprehensive income		
Minimum pension liability adjustment (5)		(187)
Derivative instruments (2)		(10)
Balance under US GAAP	<u>\$ 1,777</u>	<u>\$ (5,089)</u>

**Consolidated Statement of Cash Flow
(unaudited)**

	Predecessor Company - Air Canada (note 1)			
	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2004	2003	2004	2003
Cash flows from (used for)				
Operating - Canadian GAAP	\$ 183	\$ 27	\$ 360	\$ 159
Addback: principal repayments on leases accounted for as owned aircraft under US GAAP	-	-	-	-
Operating - US GAAP	183	27	360	159
Financing - Canadian GAAP	65	(76)	253	125
Less: principal repayments on leases accounted for as owned aircraft under US GAAP	-	-	-	-
Financing - US GAAP	65	(76)	253	125
Investing	(141)	21	(326)	(32)
Increase (decrease) in cash and cash equivalents	107	(28)	287	252
Cash and cash equivalents, beginning of period	850	838	670	558
Cash and cash equivalents transferred to the Successor Company	(957)	-	(957)	-
Cash and cash equivalents, end of period	\$ -	\$ 810	\$ -	\$ 810

There are no GAAP differences on the consolidated statement of cash flow of the Successor Company on September 30, 2004.

1. Aircraft Introduction Costs

Under Canadian GAAP, aircraft introduction costs are deferred and amortized. Under US GAAP, these costs are expensed as incurred.

2. Derivative Financial Instruments

Prior to January 1, 2004, under Canadian GAAP, the nature and fair value of derivative instruments qualifying as hedges in accordance with Canadian GAAP at that time were disclosed. The Predecessor Company applied hedge accounting to derivative financial instruments and anticipated transactions identified as hedging items as explained in note 2 to the audited financial statements of Air Canada for the year ended December 31, 2003 for the period from January 1, 2003 to April 1, 2003. On April 1, 2003 as a result of the creditor protection proceedings, all derivative instruments were terminated by third parties with the exception of certain derivatives instruments related to operating lease commitments.

Effective in 2001 under US GAAP, all derivatives are recorded on the balance sheet at fair value. Opening adjustments are recorded as a cumulative adjustment to income for fair value hedges and as a cumulative adjustment to other comprehensive income for cash flow hedges. As opening January 1, 2001 cash flow hedges are settled, the amount recorded in other comprehensive income is allocated to income. Going forward, the Corporation has elected not to designate any derivatives as hedging instruments for US GAAP purposes and as such, changes in the fair value of all derivative instruments are recorded in income. Further, under US GAAP, anticipated transactions may not be designated as hedges.

As described in note 4 to the unaudited interim consolidated financial statements of the Predecessor Company, effective January 1, 2004 under Canadian GAAP, the Predecessor Company records the fair value of derivative instruments that are not part of a designated hedging relationship, with changes in fair value recognized currently in income. The opening deferred credit related to the fair value adjustment of the Predecessor Company is amortized over the life of the related derivative instruments. Under US GAAP, this deferred credit is reversed to income.

3. Lease Accounting

Under Canadian GAAP, certain of the Corporation's aircraft leases are accounted for as operating leases. Under US GAAP, for periods prior to January 1, 2004, these aircraft would be accounted for as if they were owned, with the assets, liabilities, expenses and cash flows related to these aircraft reported as such in the Corporation's financial statements. Effective with the adoption of FIN 46R – Consolidation of Variable Interest Entities on January 1, 2004, the previous US GAAP guidance under EITF 96-21 that resulted in the consolidation of these entities has been nullified (see footnote 8).

4. Residual Value Guarantees under Operating Leased Aircraft

Under Canadian GAAP, the portion of the gain on sale-leasebacks that includes a residual value guarantee is deferred until the end of the lease term for leases entered into after September 1999 whereas for US GAAP, the amount would be deferred until the end of the lease term for leases entered into after September 1986. Further under Canadian GAAP, the expected deficiency under a residual value guarantee is accrued over the remaining lease term irrespective of the end of lease term options for leases entered into after September 1999; however, under US GAAP, the accrual of an expected deficiency is required for leases entered into after September 1996.

5. Employee Future Benefits

Under Canadian GAAP, a minimum pension liability is not recognized if the accumulated benefit obligation related to employee pensions exceeds the fair value of plans assets; however, a pension valuation allowance is required to limit the pension asset to the amount that can be realized in the future. Under US GAAP, a minimum pension liability has been recorded including the recognition of an intangible asset related to prior period services; however, a pension valuation allowance is not permitted.

6. Pre-operating Costs

Under Canadian GAAP, eligible pre-operating costs are deferred and amortized. Under US GAAP, these costs are expensed as incurred.

7. Convertible Securities

Under Canadian GAAP, proceeds from the issue of convertible securities are split between their liability and equity components, resulting in a discount that is amortized to expense over the term of the security. In addition, under Canadian GAAP, the direct costs of issuing the securities are split with costs related to the liability component included in deferred charges and the costs related to the equity component netted against the equity component. Under US GAAP, the convertible securities issued by the Predecessor Company are treated as long-term debt in their entirety. Under US GAAP, the convertible preferred shares issued by the Successor Company contain an embedded derivative which has been reported separately as an other long-term liability at its fair value. The convertible preferred shares have been recorded at the proceeds received less direct costs of issuance and the fair value of the embedded derivative and included in temporary equity as the conditions of redemption are not solely within the control of the Successor Company.

As described in note 11 to the 2003 annual audited consolidated financial statements of the Predecessor Company, the Predecessor Company recorded a reorganization and restructuring charge of \$19 in order to reflect the debenture balance at the anticipated claim amount. This charge is reversed under US GAAP as the convertible securities are treated as long-term debt in their entirety.

8. FIN46R – Consolidation of Variable Interest Entities

On January 1, 2004, the Predecessor Company adopted the provisions of Interpretation No. 46R – Consolidation of Variable Interest Entities (“FIN 46R”), issued by the Financial Accounting Standards Board. An entity is subject to FIN 46 and is called a variable interest entity (“VIE”) if it has (1) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties; or (2) equity investors that cannot make significant decisions about the entity's operations, or that do not absorb the expected losses or receive the expected returns of the entity. A VIE is consolidated by its primary beneficiary, which is the party involved with the VIE that will absorb a majority of the expected losses or will receive the majority of the expected residual returns or both, as a result of ownership, contractual or other financial interests in the VIE.

Air Canada entered into aircraft and engine lease transactions with several special purpose entities, referred to as VIEs under FIN46R. As a result of the adoption of FIN 46R, the Predecessor Company has consolidated leasing entities covering 47 aircraft and 22 engines accounted for as operating leases under Canadian GAAP. On initial adoption of FIN46R, the consolidation of VIEs where the Predecessor Company was the primary beneficiary for the period has resulted in the following changes to the consolidated statement of financial position under US GAAP:

Increase to Property and equipment	\$ 1,561
Decrease to Deferred charges	(464)
Increase to Current portion of long-term debt	53
Increase to Long-term debt	1,193
Increase to Non-controlling interest	202
Decrease to Deferred credits	(297)
Cumulative effect of change in accounting policy	\$ (54)

The following disclosure relates to the arrangements in existence in the VIEs; consolidation of these VIEs under FIN46R does not alter the underlying contractual arrangements between Air Canada, as lessee and the VIE, as lessor. The long-term debt in the VIEs has maturities ranging from 2007 to 2017 at interest

rates ranging from 3.0-8.7%. The aircraft are charged as collateral against the debt by the owners thereof. The creditors under these leasing arrangements have recourse to Air Canada, as lessee, in the event of default or early termination of the lease and in certain other circumstances. The events of default are customary in aircraft lease arrangements.

Principal repayment requirements on aircraft and engine debt consolidated under FIN46 through to 2009 are as follows:

	Remainder 2004	2005	2006	2007	2008	2009
Total payments	37	173	157	196	196	117
Less applied to interest	28	89	118	114	107	99
Principal reduction	9	84	39	82	89	18

These commitments, under Canadian GAAP, are included as operating lease commitments (note 13).

Air Canada participates in fuel facilities arrangement, along with other airlines that contract for fuel services at various airports. The Fuel Facilities Corporations in Canada are not-for-profit organizations incorporated under federal or provincial business corporations acts in order to acquire, finance and lease assets used in connection with the fuelling of aircraft and ground support equipment. The Fuel Facilities Corporations operate on a cost recovery basis.

Under FIN46R, where Air Canada uses more than 50% of the services, based on the cost sharing formulas, of the Fuel Facilities Corporation it is deemed to be the primary beneficiary. As a result Air Canada has consolidated three Fuel Facilities Corporations, resulting in an opening January 1, 2004 increase to property and equipment of \$67, long term debt of \$47, minority interest of \$8 and a cumulative effect of a change in accounting policy of \$12. The long-term debt has an average stated interest rate of 5%, with varying maturities.

The remaining five fuel facilities in Canada that are not consolidated have aviation facilities assets recorded of \$103 and debt of \$90, which is Successor Company's maximum exposure to loss without taking into consideration any cost sharing that would occur amongst the other contracting airlines. The Successor Company views this loss potential as remote.

For entities consolidated under FIN46, depreciation expense of \$66 and interest expense of \$87 was recorded for the nine months ended September 20, 2004 (\$22 and \$29 for the three months ended September 30, 2004, respectively).

9. Fresh Start Reporting

Under Canadian GAAP, the effects of the fresh start reporting adjustments, including the settlement of the compromised debt, are accounted for as a capital transaction and recorded within shareholders' equity. Under US GAAP, the effect of the fresh start reporting adjustments, including the settlement of the compromised debt, are reflected in the income statement. See item 12 c) below for additional disclosures regarding fresh start reporting.

Under Canadian GAAP, upon emergence from creditor protection, the identifiable assets and liabilities of an enterprise are revalued based on the fair values of such assets and liabilities in a manner similar to that used for a business combination. The difference between the fair value of the Successor as a whole over the fair value of the net identifiable assets (goodwill) is not permitted to be recorded under Canadian GAAP. Under US GAAP, the reorganization value is allocated to the assets in conformity with the procedures used for business combinations; liabilities are recorded at present values and deferred taxes in conformity with GAAP. US GAAP does not prohibit the recognition of goodwill to the extent that the reorganization value exceeds the fair value of the specific tangible and identifiable intangibles of the Successor. The resulting goodwill under US GAAP is not amortized and is subject to an impairment test on an annual basis or earlier if an event occurs or circumstances change that would more likely than not reduce of the fair value of the respective reporting unit below the carrying amount.

10. Goodwill Amortization and Employee Severance Costs

Under Canadian GAAP, for business combinations prior to January 1, 2003, liabilities assumed on the purchase of a business may include benefits to be paid to employees for their voluntary termination provided certain criteria are met. The treatment of these costs as an assumed liability results in an increase in goodwill recognized on the acquisition. Under US GAAP, a liability and expense for such benefits is required to be expensed by the acquirer in the period employees accept the offer rather than as an adjustment of goodwill. For periods subsequent to January 1, 2001, there is no GAAP difference related to the statement of operations as goodwill is no longer amortized for both Canadian and US GAAP.

Under Canadian GAAP, investments accounted for by the cost method are not restated retroactively to the equity method when the investor acquires control of the business and thus consolidates the investment. US GAAP requires this restatement. As a result of the retroactive application of the equity method under US GAAP in 2000, goodwill reported for the acquisition under Canadian GAAP differs from that reported for US GAAP.

11. Comprehensive Income

Under US GAAP, comprehensive income must be reported which is defined as all changes in equity other than those resulting from investments by owners and distributions to owners. Cumulative other comprehensive income (loss) as at September 30, 2004 is nil, as a result of fresh start reporting (December 31, 2003 was \$(489)). For the periods presented, under Canadian GAAP, the Predecessor and the Successor were not permitted to use the concept of comprehensive income.

12. Supplementary Information under US GAAP

In the opinion of management, the unaudited interim consolidated financial statements prepared in accordance with Canadian GAAP and the US GAAP information included in this schedule reflect adjustments, consisting of normal recurring accruals, except for adjustments referred to above under FIN 46R – Consolidation of Variable Interest Entities and Fresh Start Reporting, which are necessary to present fairly the Successor and Predecessor Companies' financial position, results of operations and cash flows for the periods indicated.

a) Earnings per Share

The following table outlines the calculation of basic and diluted loss per share under US GAAP (in million, except per share amounts):

	Predecessor Company - Air Canada (note 1)			
	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2004	2003	2004	2003
Numerator:				
Numerator for basic earnings per share:				
Income (loss)	\$ 5,497	\$ (133)	\$ 4,600	\$ (893)
Settlement of convertible debentures	125		125	
Adjusted numerator for income (loss) per share	5,622	(133)	4,725	(893)
Effect of potential dilutive securities:				
After tax income from convertible subordinated debentures	-	-	-	3
Add back anti-dilutive impact	-			(3)
Adjusted income (loss) for diluted earnings per share	\$ 11,244	\$ (266)	\$ 9,450	\$ (1,786)
Denominator:				
Denominator for basic earnings per share:				
Weighted-average shares	120	120	120	120
Effect of potential dilutive securities:				
Class A non-voting preferred shares	10	10	10	10
Convertible subordinated debentures	9	9	9	9
	19	19	19	19
Add back anti-dilutive impact	-	(19)	-	(19)
Denominator for diluted earnings per share:				
Adjusted weighted-average shares	139	120	139	120
Basic earnings (loss) per share	\$ 46.85	\$ (1.11)	\$ 39.38	\$ (7.44)
Diluted earnings (loss) per share	\$ 40.45	\$ (1.11)	\$ 33.99	\$ (7.44)
Income (loss) per share before cumulative effect of change in accounting principle	\$ 46.85	\$ (1.11)	\$ 39.73	\$ (7.44)
Impact of cumulative effect of change in accounting principle	-	-	(0.35)	-
Income (loss) per share	\$ 46.85	\$ (1.11)	\$ 39.38	\$ (7.44)
Income (loss) per share, assuming dilution, before cumulative effect of change in accounting principle	\$ 40.45	\$ (1.11)	\$ 34.29	\$ (7.44)
Impact of cumulative effect of change in accounting principle	-	-	(0.30)	-
Income (loss) per share, assuming dilution	\$ 40.45	\$ (1.11)	\$ 33.99	\$ (7.44)

For all periods presented above, approximately 9 million potential dilutive shares were not included in the calculation of diluted earnings per share. These potential dilutive securities were excluded because the exercise price of the stock options was greater than the average trading value of the shares.

b) Pension and Other Benefit Plans

The components of US GAAP net periodic cost of defined benefit plans include the following (in millions):

	Three Months Ended September 30			
	Pension Benefits		Other Benefits	
	2004	2003	2004	2003
Service cost	\$ 46	\$ 42	\$ 23	\$ 19
Interest cost	143	155	13	11
Expected return on plan assets	(160)	(160)	-	-
Amortization of prior service cost	22	24	4	1
Amortization of net transition obligation	(3)	(5)	-	-
Amortization of experience (gains) losses	5	6	8	2
	<u>\$ 53</u>	<u>\$ 62</u>	<u>\$ 48</u>	<u>\$ 33</u>

	Nine Months Ended September 30			
	Pension Benefits		Other Benefits	
	2004	2003	2004	2003
Service cost	\$ 136	\$ 124	\$ 71	\$ 57
Interest cost	466	466	40	34
Expected return on plan assets	(485)	(480)	-	-
Amortization of prior service cost	67	72	5	4
Amortization of net transition obligation	(6)	(16)	-	-
Amortization of experience (gains) losses	30	18	11	6
	<u>\$ 208</u>	<u>\$ 184</u>	<u>\$ 127</u>	<u>\$ 101</u>

As of September 30, 2004 the Predecessor Company had contributed \$129 to its defined benefit pension plans. The Successor Company expects to contribute an additional \$79 during the remainder of 2004.

c) Fresh start reporting

Note 5 of the interim unaudited consolidated financial statements describes the impact of fresh start reporting under Canadian GAAP.

For US GAAP, it was determined that the Successor Company's reorganization value was \$12,775. The reorganization value represents the fair value of the entity before considering liabilities and approximates the amount a willing buyer would pay for the assets of the entity immediately after the restructuring. The reorganization value does not include proceeds received from new investors outlined in Note 2 of the interim unaudited consolidated financial statements. The reorganization value was determined with the assistance of financial advisors and after taking into account financial projections of the Company.

The fair values of the assets and liabilities of the Successor Company have been based on Management's best estimates as of September 30, 2004. The determination of the fair values of the assets and liabilities of the Successor Company has not been finalized as at the date of preparing the interim unaudited consolidated balance sheet information under US GAAP. The Successor Company is continuing to finalize its valuation of assets and liabilities, primarily property and equipment, intangible assets,

employee future benefit arrangements and certain other long-term debt and asset retirement obligations. Management expects to complete this valuation by the date the financial statements of the Successor Company are prepared for the period ended December 31, 2004. Any adjustments will be made to the balance sheet as of September 30, 2004. The determination of fair values involves certain estimates and assumptions which are inherently subject to significant uncertainties and contingencies. Accordingly, there can be no assurance that the estimates, assumptions, and values reflected in the consolidated balance sheet of ACE as at September 30, 2004 will be realized, and actual results could vary materially.

The effect of the Plan and other transactions on the Predecessor Company's consolidated balance sheet, as of September 30, 2004, is outlined in the table below and consists of the following components:

- **Plan of Arrangement:**
Extinguishment of compromised liabilities of approximately \$7,990 by the issuance of common shares of the Successor Company with a value of \$925, resulting in a gain on extinguishment of debt in the amount \$7,065 included in the statement of operations under US GAAP.

Certain preferred shares with a carrying value of \$125 were settled for a nominal amount resulting in a gain of \$125 included as a credit to deficit.

Exchange of the existing common shares of the Predecessor for new common stock of the Successor resulting in a reduction of common stock by \$817 and an increase in contributed surplus by \$817.

- **Financing and Other Post-Emergence Transactions:**
The Rights Offering and Standby Purchase Agreement generated net proceeds of \$852 in exchange for share capital. The Investment Agreement provided net cash proceeds of \$238. As the convertible preferred shares include an embedded derivatives, \$123 was included in liabilities and \$121 in temporary equity, with a deferred charge of \$6 recorded related to the fees on the embedded derivative. Additional funds were received under the Exit Facility as described under the Global Restructuring Agreement providing cash of \$227, net of costs of \$13. Implementation of components of the Global Restructuring Agreement (other than the Exit Financing) resulting in a net cash outlay of \$323, issuance of additional debt amounting to \$63, acquisition of aircraft for \$64 and settlement of certain obligations related to leases totaling \$334. In addition, fees to the Corporation's advisors of \$12 were paid on emergence.
- **Fresh Start Reporting:**
Fresh start adjustments were recorded to reflect the fair values of assets and liabilities and the elimination of the contributed surplus and deficit.

	Air Canada Predecessor Company - September 30, 2004	Plan of Arrangement	Equity and Other Financing Transactions	Fresh Start Reporting	ACE Successor Company - September 30, 2004
	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)
ASSETS					
Current assets					
Cash and cash equivalents	\$ 957	\$ -	227	\$ -	\$ 1,939
			238		
			(335)		
			852		
Restricted cash	62	-	-	-	62
Accounts receivable	732	-	-	-	732
Spare parts, materials and supplies	190	-	-	12	202
Prepaid expenses	129	-	-	11	140
	<u>2,070</u>	<u>-</u>	<u>982</u>	<u>23</u>	<u>3,075</u>
Property and equipment	5,369	-	64	(542)	4,891
Deferred charges	2,692	-	19	(2,600)	111
Goodwill	220	-	-	2,497	2,717
Intangible assets	158	-	-	1,717	1,875
Other assets	1,059	-	-	(953)	106
TOTAL ASSETS	<u>\$ 11,568</u>	<u>\$ -</u>	<u>\$ 1,065</u>	<u>\$ 142</u>	<u>\$ 12,775</u>
LIABILITIES					
Liabilities not subject to compromise					
Current liabilities					
Accounts payable and accrued liabilities	\$ 1,288	\$ -	\$ -	\$ 27	\$ 1,315
Advance ticket sales	861	-	-	268	1,129
Current portion of long-term debt and capital lease obligations	558	-	-	(230)	328
	<u>2,707</u>	<u>-</u>	<u>-</u>	<u>65</u>	<u>2,772</u>
Long-term debt and capital lease obligations	2,578	-	303	809	3,690
Future income taxes	8	-	-	426	434
Pension and other benefit liabilities	2,036	-	-	332	2,368
Other long-term liabilities	776	-	123	504	1,403
Minority interest	210	-	-	-	210
Deferred credits	1,192	-	(334)	(858)	-
	<u>9,507</u>	<u>-</u>	<u>92</u>	<u>1,278</u>	<u>10,877</u>
Liabilities subject to compromise	7,990	(7,990)	-	-	-
	<u>17,497</u>	<u>(7,990)</u>	<u>92</u>	<u>1,278</u>	<u>10,877</u>
Temporary equity	125	(125)	121	-	121
SHAREHOLDERS' EQUITY					
Share capital and other equity	817	108	852	-	1,777
Contributed surplus	25	942	-	(967)	-
Deficit	(6,405)	7,065	-	(660)	-
Other Comprehensive Loss	(491)	-	-	491	-
	<u>(6,054)</u>	<u>8,115</u>	<u>852</u>	<u>(1,136)</u>	<u>1,777</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 11,568</u>	<u>\$ -</u>	<u>\$ 1,065</u>	<u>\$ 142</u>	<u>\$ 12,775</u>