ACE AVIATION

Quarter 3 2008
Management's Discussion and Analysis of Results of Operations and Financial Condition

November 11, 2008

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1. Preface

ACE Aviation Holdings Inc. ("ACE"), which was incorporated on June 29, 2004, is a holding company of aviation interests. During the first nine months of 2008, ACE had two reportable segments: Air Canada and CIE. During 2007, in addition to Air Canada and CIE, ACE had the following additional reportable segments: Aeroplan Limited Partnership ("Aeroplan") up to March 14, 2007, Jazz Air LP ("Jazz") up to May 24, 2007 and ACTS LP ("ACTS") up to October 16, 2007.

ACE is listed on the Toronto Stock Exchange ("TSX") where its Class A variable voting shares and Class B voting shares are traded under the symbols ACE.A and ACE.B, respectively.

This Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A") for Quarter 3 2008 should be read in conjunction with ACE's unaudited interim consolidated financial statements and notes for Quarter 3 2008 and its annual audited consolidated financial statements and notes and annual MD&A for 2007. Reference to "Corporation" in this MD&A refers to, as the context may require, ACE and its aviation interests collectively, ACE and one or more of its aviation interests, one or more of ACE's aviation interests, or ACE itself. Except where the context otherwise requires, all monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 16 "Glossary of Terms". Except as otherwise noted, this MD&A is current as of November 11, 2008.

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current period.

The ACE Audit, Finance & Risk Committee has reviewed this MD&A and the Quarter 3 2008 unaudited interim consolidated financial statements and notes and ACE's Board of Directors approved these documents prior to their release. For further information on ACE's public disclosure file, including ACE's Annual Information Form, please consult SEDAR at www.sedar.com, EDGAR at www.sec.gov/edgar.shtml or ACE's website at www.aceaviation.com.

2. Caution Regarding Forward-Looking Information

ACE's communications often contain written or oral forward-looking statements which are included in the MD&A and may be included in filings with securities regulators in Canada and the United States. These forward-looking statements are identified by the use of terms and phrases such as "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "predict", "project", "will", "would", and similar terms and phrases, including references to assumptions. Such statements may involve but are not limited to comments with respect to strategies, expectations, planned operations or future actions.

Forward-looking statements, by their nature, are based on assumptions and are subject to important risks and uncertainties. Any forecasts or forward-looking predictions or statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Results indicated in forward-looking statements may differ materially from actual results for a number of factors, including without limitation, energy prices, general industry, market, credit and economic conditions, war, terrorist acts, changes in demand due to the seasonal nature of the business, the ability to reduce operating costs and employee counts, employee relations, labour negotiations or disputes, pension issues, currency exchange and interest rates, changes in laws, adverse regulatory developments or proceedings, pending litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in the "Risk Factors" section of ACE's 2007 MD&A dated February 7, 2008 and section 11 of this MD&A. The forward-looking statements contained in this discussion represent ACE's expectations as of the date of this MD&A, and are subject to change after such date. However, ACE disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

3. Industry Interests

The following is a listing of ACE's aviation interests as at November 11, 2008.

	Aviation Interests	Ownership
Air Canada (TSX: AC.A, AC.B)	Air Canada is Canada's largest domestic and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada - US transborder market and in the international market to and from Canada. Wholly-owned subsidiaries of Air Canada include: • AC Cargo Limited Partnership ("Air Canada Cargo") which, together with Air Canada, are Canada's largest provider of air cargo services. • ACGHS Limited Partnership ("Air Canada Ground Handling Services") which is a passenger and ground handling service provider. • Touram Limited Partnership ("Air Canada Vacations") which is a major Canadian tour operator offering leisure travel packages.	75.0 %
ACTS Aero	ACTS Aero Technical Support and Services Holdings ("ACTS Aero"), which owns 100% of Aveos Fleet Performance Inc. ("Aveos"), is a global player in the aircraft maintenance, repair and overhaul marketplace. ACTS Aero Technical Support and Services Inc. changed its legal name to Aveos on September 23, 2008.	27.8 %

4. Significant Events

The following significant events occurred during the period January 1, 2008 to November 11, 2008.

Substantial Issuer Bid – January 2008

On January 10, 2008, ACE accepted for purchase and cancellation a total of 40,023,427 Class A variable voting shares and 9,894,166 Class B voting shares at $30.00 per share for an aggregate purchase price of $1,498 million, in accordance with the terms of a substantial issuer bid. No convertible preferred shares of ACE were deposited on an "as converted basis" under the offer.

Jazz

On January 24, 2008, ACE sold 13,000,000 units of Jazz Air Income Fund on an exempt trade basis to certain funds and accounts managed by West Face Capital Inc. and to Sunrise Partners Limited Partnership for total net proceeds to ACE of $97 million.

On June 2, 2008, ACE completed the sale in the market of a total of 11,726,920 units of Jazz Air Income Fund for total net proceeds to ACE of $85 million. ACE retains no further interest in Jazz Air Income Fund after that date.

Aeroplan

On April 21, 2008, ACE completed the sale of 20,400,000 units of Aeroplan Income Fund for total net proceeds to ACE of $343 million.

On June 2, 2008, ACE completed the sale in the market of a total of 19,892,088 units of Aeroplan Income Fund for total net proceeds to ACE of $349 million. ACE retains no further interest in Aeroplan Income Fund after that date.

ACTS Aero

On January 14, 2008, ACE received cash proceeds of $40 million, representing the full balance of funds held in escrow on closing of the monetization of ACTS on October 16, 2007.

In June 2008, an entity related to Grupo TACA exercised its put option and sold its 5% equity interest in ACTS Aero to ACE for $19 million (US$18 million), increasing ACE's ownership interest in ACTS Aero from 22.8% to 27.8%.

Substantial Issuer Bid – June 2008

On June 18, 2008, ACE accepted for purchase and cancellation a total of 12,537,084 Class A variable voting shares and 10,190,187 Class B voting shares at $22.00 per share for an aggregate purchase price of $500 million, in accordance with the terms of a substantial issuer bid. No convertible preferred shares of ACE were deposited on an "as converted basis" under the offer.

5. Accounting Policies

ACE prepares its consolidated financial statements in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

Significant accounting policies and methods used in preparation of ACE's Quarter 3 2008 unaudited interim consolidated financial statements are described in Note 2 to ACE's 2007 audited consolidated financial statements.

ACE's results reflect the consolidation of Aeroplan only up to March 14, 2007, the consolidation of Jazz only up to May 24, 2007 and the consolidation of ACTS only up to October 16, 2007. After those dates, ACE's investments in Aeroplan (up to May 9, 2008), ACTS, and Jazz (up February 7, 2008) are accounted for using the equity method. From May 9, 2008 for Aeroplan and from February 7, 2008 for Jazz, through to June 1, 2008, ACE's investments in these entities were classified as "available-for-sale" investments. Effective June 2, 2008, ACE no longer has an ownership interest in Aeroplan and Jazz. As a result of the above-noted changes, ACE's results of operations for 2008 are not directly comparable to its operating results for 2007.

The preparation of ACE's consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent liabilities and reported amounts of revenues and expenses for the period of the consolidated financial statements. ACE evaluates these estimates and assumptions on a regular basis, based on historical experience and other relevant factors. Actual amounts could differ materially from those estimates and assumptions. For a description of critical accounting estimates utilized in the preparation of ACE's consolidated financial statements, see "Critical Accounting Estimates" in ACE's 2007 MD&A dated February 7, 2008. There have been no significant changes to ACE's critical accounting estimates from those disclosed at that time.

Accounting for Aeroplan

As a result of ACE's special distribution of Aeroplan Income Fund units and the conversion of its remaining units of Aeroplan LP into units of Aeroplan Income Fund on March 14, 2007, for the period March 14, 2007 to May 9, 2008, ACE no longer consolidated the results of operations, assets and liabilities and cash flows of Aeroplan and accounted for its investment using the equity method of accounting. With the reduction of the ownership interest below 20% and the termination of the Securityholders' Agreement between ACE and Aeroplan Income Fund on May 9, 2008, for the period May 9, 2008 to June 1, 2008, ACE no longer equity accounted for Aeroplan and ACE's investment in Aeroplan was classified as an "available-for-sale" investment under financial instruments. Unrealized period changes in fair value were recorded in "other comprehensive income" and distributions from Aeroplan Income Fund were recorded in "equity and other investment income" in non-operating expense income (expense) on ACE's consolidated statement of operations. On June 2, 2008, ACE completed the sale of its remaining units of Aeroplan Income Fund. ACE retains no ownership interest in Aeroplan.

With the reduction of the ownership interest below 20% and the termination of the Securityholders' Agreement between ACE and Aeroplan Income Fund on May 9, 2008, ACE no longer had significant influence over Aeroplan.

Accounting for Jazz

As a result of the special distribution of Jazz Air Income Fund units on May 24, 2007, ACE no longer consolidated the results of operations, assets and liabilities and cash flows of Jazz after that date and accounted for its investment from May 24, 2007 to February 7, 2008 using the equity method of accounting. Subsequent to ACE's sale of Jazz Air Income Fund units on January 24, 2008 and the termination of the Securityholders' Agreement between ACE and Jazz Air Income Fund on February 7, 2008, for the period February 7, 2008 to June 1, 2008, ACE no longer equity accounted for Jazz and ACE's investment in Jazz was classified as an "available-for-sale" investment under financial instruments. Unrealized period changes in fair value were recorded in "other comprehensive income" and distributions from Jazz Air Income Fund were recorded in "equity and other investment income" in non-operating expense income (expense) on ACE's consolidated statement of operations. On June 2, 2008, ACE completed the sale of its remaining units of Jazz Air Income Fund. ACE retains no ownership interest in Jazz.

Accounting for ACTS

As a result of the monetization of ACTS on October 16, 2007, ACE no longer consolidates the results of operations, assets and liabilities and cash flows of ACTS after that date and accounts for its investment in ACTS Aero using the equity method of accounting.

Changes in Accounting Policies

Capital Disclosures and Financial Instruments – Presentation and Disclosure

Effective January 1, 2008, the Corporation adopted three new Canadian Institute Chartered Accountants ("CICA") accounting standards: section 1535, *Capital Disclosures*, section 3862, *Financial Instruments – Disclosures* and section 3863, *Financial Instruments – Presentation*.

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose is to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Sections 3862 and 3863 replace section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements in certain areas, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. Refer to section 10 of this MD&A for information on the Corporation's financial instruments.

For additional information on these new accounting standards, refer to sections 8.8 and 10 of this MD&A.

Inventories

Effective January 1, 2008, the Corporation adopted CICA section 3031, *Inventories*, which replaced section 3030, *Inventories*. Section 3031 provides more extensive guidance on measurement, and expands disclosure requirements to increase transparency. The Corporation's accounting policy for aircraft fuel inventory is consistent with the measurement requirements in the new standard and, as a result, no adjustment was recorded on the transition, however, additional disclosures have been included in ACE's interim unaudited consolidated financial statements commencing in Quarter 1 2008.

Future Accounting Standard Changes

In February 2008, the CICA issued section 3064, *Goodwill and Intangible Assets,* which provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. The standard is effective for fiscal years beginning on or after October 1, 2008, and requires retroactive application to prior period financial statements. The Corporation has evaluated the impact of this new standard for adoption on January 1, 2009 and does not expect any significant impact on its consolidated financial statements.

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

As a result, the Corporation is developing a plan to convert its consolidated financial statements to IFRS. The plan addresses the impact of IFRS on:

- Accounting policies and implementation decisions
- Information technology and data systems
- Internal control over financial reporting
- Disclosure controls and procedures
- Financial reporting expertise
- Business activities

The Corporation has established a cross-functional IFRS team and is providing training to key employees.

The Corporation is currently in the process of assessing the differences between IFRS and the Corporation's current accounting policies, as well as the alternatives available on adoption. This assessment includes the impact of conversion on information technology and data systems, internal control over financial reporting, disclosure controls and procedures and business activities. Changes in accounting policies are likely. These changes may materially impact the Corporation's consolidated financial statements.

6. Results of Operations – Quarter 3 2008

The following table reflects the results of the Corporation, the results of its reportable segments and certain non-GAAP measures for Quarter 3 2008. Segment information has been prepared consistent with how financial information is produced internally for the purposes of making business decisions.

	Quarter 3 2008		
(Canadian dollars in millions)	**Air Canada**	**CIE**	**ACE Total**
Operating revenue			
Passenger revenue	$ 2,766	$ -	$ 2,766
Cargo revenue	139	-	139
Other revenue	170	-	170
	3,075	-	3,075
Operating expenses			
Wages, salaries and benefits	472	7	479
Aircraft fuel	1,064	-	1,064
Aircraft rent	67	-	67
Airport and navigation fees	275	-	275
Aircraft maintenance	127	-	127
Communications and information technology	69	-	69
Food, beverages and supplies	86	-	86
Depreciation, amortization and obsolescence	176	(2)	174
Commissions	54	-	54
Capacity purchase with Jazz	243	-	243
Other operating expenses	330	2	332
	2,963	7	2,970
Operating income (loss)	**112**	**(7)**	**105**
Non-operating income (expense)			
Interest income	13	6	19
Interest expense	(72)	(15)	(87)
Interest capitalized	6	-	6
Loss on financial instruments recorded at fair value	(93)	-	(93)
Equity and other investment loss	-	(19)	(19)
Other non-operating expense	(1)	-	(1)
	(147)	(28)	(175)
Loss before the following items	**(35)**	**(35)**	**(70)**
Non-controlling interest	(2)	32	30
Foreign exchange loss	(87)	-	(87)
Provision for income taxes	(8)	-	(8)
Loss for the period	**(132)**	**(3)**	**(135)**
EBITDAR/EBITDA [1]	**$ 355**	**$ (9)**	**$ 346**

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

The following table reflects the results of the Corporation, the results of its reportable segments and certain non-GAAP measures for Quarter 3 2007.

	Quarter 3 2007			
(Canadian dollars in millions)	**Air Canada**	**ACTS**	**CIE**	**ACE Total**
Operating revenue				
Passenger revenue	$ 2,660	$ -	$ -	$ 2,660
Cargo revenue	132	-	-	132
Other revenue	142	71	17	230
External revenue	2,934	71	17	3,022
Inter-segment revenue	20	173	(193)	-
	2,954	244	(176)	3,022
Operating expenses				
Wages, salaries and benefits	478	83	(3)	558
Aircraft fuel	716	-	-	716
Aircraft rent	66	-	-	66
Airport and navigation fees	284	-	-	284
Aircraft maintenance	155	66	(136)	85
Communications and information technology	70	4	(3)	71
Food, beverages and supplies	88	-	-	88
Depreciation, amortization and obsolescence	144	10	(7)	147
Commissions	54	-	-	54
Capacity purchase with Jazz	234	-	-	234
Other operating expenses	314	76	(11)	379
	2,603	239	(160)	2,682
Operating income (loss)	**351**	**5**	**(16)**	**340**
Non-operating income (expense)				
Interest income	21	-	4	25
Interest expense	(82)	(4)	(10)	(96)
Interest capitalized	24	-	-	24
Gain (loss) on disposal of assets	(2)	-	4	2
Loss on financial instruments recorded at fair value	(2)	-	-	(2)
Equity and other investment income	-	-	27	27
Other non-operating expense	(4)	(2)	(1)	(7)
	(45)	(6)	24	(27)
Income (loss) before the following items	**306**	**(1)**	**8**	**313**
Non-controlling interest	-	-	(69)	(69)
Foreign exchange gain	104	-	-	104
Recovery of (provision for) income taxes	(137)	-	13	(124)
Income (loss) for the period	**$ 273**	**$ (1)**	**$ (48)**	**$ 224**
EBITDAR/EBITDA [(1)]	**$ 561**	**$ 15**	**$ (23)**	**$ 553**

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

ACE's results of operations for Quarter 3 2008 are not directly comparable to its operating results for Quarter 3 2007. Refer to section 5 of this MD&A for additional information on the changes in accounting relating to Aeroplan, Jazz and ACTS.

ACE recorded operating income of $105 million in Quarter 3 2008 compared to operating income of $340 million in Quarter 3 2007. Air Canada reported operating income of $112 million in Quarter 3 2008 compared to operating income of $351 million in Quarter 3 2007, a decrease of $239 million from Quarter 3 2007. The decrease in Air Canada's operating income was mainly due to higher fuel expense of $348 million, representing a 49 per cent increase in Quarter 3 2008 when compared to the same quarter in 2007. This increase in fuel expense was partly offset by an increase in Air Canada's operating revenues of $121 million resulting from higher fares and fuel surcharges to partially offset higher fuel prices compared to Quarter 3 2007. ACE's consolidated results for Quarter 3 2007 included operating income of $5 million from ACTS.

EBITDAR of $346 million was recorded in Quarter 3 2008 compared to EBITDAR of $553 million in the same period in 2007. In Quarter 3 2008, Air Canada recorded EBITDAR of $355 million compared to EBITDAR of $561 million in the same period in 2007, a decrease of $206 million from Quarter 3 2007. In Quarter 3 2007, ACTS recorded EBITDAR of $15 million.

ACE recorded operating revenues of $3,075 million and operating expenses of $2,970 million in Quarter 3 2008. In the same period in 2007, ACE recorded operating revenues of $3,022 million and operating expenses of $2,682 million. As a result of the deconsolidation of ACTS, ACE's Quarter 3 2008 operating revenues and expenses are not directly comparable to its operating revenues and expenses for Quarter 3 2007.

Non-operating expense amounted to $175 million in Quarter 3 2008 compared to non-operating expense of $27 million in Quarter 3 2007. Losses on financial instruments recorded at fair value amounted to $93 million in Quarter 3 2008 compared to losses on financial instruments of $2 million in Quarter 3 2007. Refer to section 10 of this MD&A for additional information on financial instruments.

An equity investment loss of $19 million was recorded in Quarter 3 2008 compared to equity investment income of $27 million in Quarter 3 2007. The equity investment loss in Quarter 3 2008 represented ACE's proportionate share of losses recorded by ACTS Aero. The equity investment income recorded in Quarter 3 2007 represented equity accounting for ACE's investments in Aeroplan and Jazz. Effective June 2, 2008, ACE no longer has ownership interest in Aeroplan and Jazz. In Quarter 3 2007, ACTS' operating results were consolidated within ACE's operating results. Refer to section 5 of this MD&A for additional information on changes in accounting policies.

Non-controlling interest in Quarter 3 2008 was income of $30 million compared to non-controlling interest expense of $69 million in Quarter 3 2007. Quarter 3 2008 reflected the deterioration in Air Canada's net results when compared to Quarter 3 2007.

Net losses on foreign currency monetary items amounted to $87 million in Quarter 3 2008 compared to gains of $104 million in Quarter 3 2007. The losses in Quarter 3 2008 were attributable to a weaker Canadian dollar at September 30, 2008 compared to June 30, 2008, partially offset by gains of $70 million related to foreign currency derivatives. The September 30, 2008 noon day exchange rate was $1US = Cdn $1.0599 while the June 30, 2008 noon day exchange rate was $1US = Cdn $1.0186.

ACE recorded a provision for income taxes of $8 million in Quarter 3 2008. ACE recorded a provision for income taxes of $124 million for the same period in 2007 on a pre-tax income of $348 million.

The net loss in Quarter 3 2008 amounted to $135 million or $3.86 per diluted share. Net income in Quarter 3 2007 amounted to $224 million or $1.84 per diluted share.

6.1. Air Canada

In Quarter 3 2008, Air Canada reported operating income of $112 million compared to operating income of $351 million in Quarter 3 2007, a decrease of $239 million. An increase in operating revenues of $121 million or 4% was more than offset by a fuel expense increase of $348 million or 49%.

In Quarter 3 2008, EBITDAR amounted to $355 million compared to EBITDAR of $561 million in the same period in 2007, a decrease of $206 million.

Passenger revenues increased $106 million or 4.0% to $2,766 million in Quarter 3 2008. In Quarter 3 2008, Air Canada reduced overall capacity by 3.5% through fewer frequencies on existing routes and through the use of smaller aircraft. A traffic decline of 2.2% in Quarter 3 2008 was less than the capacity decrease resulting in a 1.0 percentage point improvement in passenger load factor from Quarter 3 2007. RASM increased 7.5% due to a 6.2% growth in yield and, to a lesser extent, the passenger load factor improvement. The yield improvement was mainly due to higher fares and increased fuel surcharges to partially offset higher fuel prices. A higher average fare in both the Executive First and Hospitality cabins was also a factor in the yield improvement. A stronger Canadian dollar in Quarter 3 2008, which lowers the Canadian dollar value of sales in foreign countries, had a negative impact on foreign currency denominated revenues, accounting for a decrease of $23 million to Quarter 3 2008 passenger revenues when compared to Quarter 3 2007.

Operating expenses were $2,963 million in Quarter 3 2008, an increase of $360 million or 14% from Quarter 3 2007, reflecting a significant fuel expense increase of $348 million and an operating expense increase of $12 million (excluding fuel expense) when compared to the same period in 2007.

Including fuel expense, CASM increased 17.9% from Quarter 3 2007. Excluding fuel expense, CASM increased 4.3% from Quarter 3 2007. More than half of the increase in CASM, excluding fuel expense, was attributable to ownership reflecting Air Canada's investment in new aircraft and the aircraft interior refurbishment program. The unit cost savings related to the Boeing 777 aircraft and, to a lesser extent, a stronger Canadian dollar versus the US dollar partially offset the overall unit cost increase, excluding fuel expense, from Quarter 3 2007.

Non-operating expense amounted to $147 million in Quarter 3 2008 compared to non-operating expense of $45 million in Quarter 3 2007. Losses relating to fair value adjustments on derivatives instruments amounted to $93 million in Quarter 3 2008 versus losses of $2 million in the same quarter of 2007. Refer to section 10 of this MD&A for additional information on Air Canada's derivative instruments. Net interest expense increased $16 million from Quarter 3 2007. A lower amount of capitalized interest related to new aircraft and a decrease in interest income due to both lower cash balances and interest rates more than offset the $10 million decrease in interest expense. The decrease in interest expense was driven by lower financing costs on the Boeing 777 aircraft commitments due to the favourable impact of the pre-delivery financing arranged in the fourth quarter of 2007, lower interest rates on floating rate debt, and the favourable impact of a stronger Canadian dollar versus the US dollar in Quarter 3 2008 compared Quarter 3 2007, partially offset by the financing of additional aircraft year-over-year.

Net losses on foreign currency monetary items amounted to $87 million in Quarter 3 2008 compared to gains of $104 million in Quarter 3 2007. The losses in Quarter 3 2008 were attributable to a weaker Canadian dollar at September 30, 2008 compared to June 30, 2008, partially offset by gains of $70 million related to foreign currency derivatives. The September 30, 2008 noon day exchange rate was $1US = Cdn $1.0599 while the June 30, 2008 noon day exchange rate was $1US = Cdn $1.0186.

Air Canada recorded a provision for income taxes of $8 million in Quarter 3 2008. The tax provision reflects future income tax that has been reclassified from other comprehensive income to income for realized gains on fuel derivatives. The recovery of future income taxes on the current year loss has been offset by a valuation allowance of $37 million. This compared to a provision for income taxes of $137 million, at an effective income tax rate of 33%, for the same period in 2007.

A segment loss of $132 million was recorded in Quarter 3 2008 compared to segment income of $273 million in Quarter 3 2007.

6.2. Corporate Items and Eliminations ("CIE")

CIE includes the corporate, financing and investing activities of ACE. As previously discussed, the accounting for ACE's investment in ACTS was changed in October 2007 from consolidation to the equity method of accounting reported under the CIE segment. Up until the time of deconsolidating ACTS, the CIE segment also included certain consolidation adjustments related to revenue recognition differences for maintenance services provided by ACTS (completed contract basis of accounting for engine and component maintenance services versus the expense recognition basis in Air Canada and Jazz, which is as the work is completed). In addition, consolidation adjustments were previously made related to the timing of revenue and expense recognition pertaining to power-by-the-hour contracts. Subsequent to the change in the accounting for ACE's investment in ACTS, these consolidation adjustments are no longer required.

CIE recorded an operating loss of $7 million in Quarter 3 2008 compared to an operating loss of $16 million in Quarter 3 2007. Negative EBITDAR of $9 million was recorded in Quarter 3 2008 compared to negative EBIDTAR of $23 million in Quarter 3 2007.

An equity investment loss of $19 million was recorded in Quarter 3 2008 compared to equity investment income of $27 million in Quarter 3 2007, a decrease of $46 million from Quarter 3 2007. The equity investment loss in Quarter 3 2008 represented ACE's proportionate share of losses recorded by ACTS Aero. The equity investment income recorded in Quarter 3 2007 represented equity accounting for ACE's investments in Aeroplan and Jazz.

Non-controlling interest in Quarter 3 2008 was income of $32 million compared to non-controlling interest expense of $69 million in Quarter 3 2007.

In Quarter 3 2007, ACE realized a gain of $4 million ($3 million after tax) relating to the sale of its remaining 0.251 million shares in US Airways.

7. Results of Operations – First Nine Months of 2008

The following table reflects the results of the Corporation, the results of its reportable segments and certain non-GAAP measures for the first nine months of 2008. Segment information has been prepared consistent with how financial information is produced internally for the purposes of making business decisions.

	First Nine Months of 2008		
(Canadian dollars in millions)	**Air Canada**	**CIE**	**ACE Total**
Operating revenue			
Passenger revenue	$ 7,531	$ -	$ 7,531
Cargo revenue	402	-	402
Other revenue	650	1	651
External revenue	8,583	1	8,584
Inter-segment revenue	1	(1)	-
	8,584	-	8,584
Operating expenses			
Wages, salaries and benefits	1,433	29	1,462
Aircraft fuel	2,627	-	2,627
Aircraft rent	199	-	199
Airport and navigation fees	771	-	771
Aircraft maintenance	502	-	502
Communications and information technology	214	-	214
Food, beverages and supplies	244	-	244
Depreciation, amortization and obsolescence	520	(6)	514
Commissions	154	-	154
Capacity purchase with Jazz	711	-	711
Other operating expenses	1,102	8	1,110
	8,477	31	8,508
Operating income (loss) before under-noted item	**107**	**(31)**	**76**
Provision for cargo investigations	(125)	-	(125)
Operating loss	**(18)**	**(31)**	**(49)**
Non-operating income (expense)			
Interest income	46	21	67
Interest expense	(231)	(39)	(270)
Interest capitalized	31	-	31
Gain (loss) on disposal of assets	(29)	990	961
Gain on financial instruments recorded at fair value	60	-	60
Equity and other investment loss	-	(2)	(2)
Other non-operating income (expense)	(3)	1	(2)
	(126)	971	845
Income (loss) before the following items	**(144)**	**940**	**796**
Non-controlling interest	(8)	70	62
Foreign exchange loss	(128)	-	(128)
Provision for income taxes	(18)	(199)	(217)
Income (loss) for the period	**(298)**	**811**	**513**
EBITDAR/EBITDA before the provision for cargo investigations (1)	**$ 826**	**$ (37)**	**$ 789**
EBITDAR/EBITDA (1)	**$ 701**	**$ (37)**	**$ 664**

(1) Refer to section 15 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR before the provision for cargo investigations to operating income (loss) and EBITDAR/EBITDA to operating income (loss).

The following table reflects the results of the Corporation, the results of its reportable segments and certain non-GAAP measures for the first nine months of 2007.

(Canadian dollars in millions)	First Nine Months of 2007 Air Canada	Aeroplan [(1)]	Jazz [(2)]	ACTS	CIE	ACE Total
Operating revenue						
Passenger revenue	$ 7,133	$ -	$ -	$ -	$ 15	$ 7,148
Cargo revenue	407	-	-	-	-	407
Other revenue	479	198	3	184	(113)	751
External revenue	8,019	198	3	184	(98)	8,306
Inter-segment revenue	114	3	610	571	(1,298)	-
	8,133	**201**	**613**	**755**	**(1,396)**	**8,306**
Operating expenses						
Wages, salaries and benefits	1,452	17	139	259	15	1,882
Aircraft fuel	1,937	-	125	-	(124)	1,938
Aircraft rent	220	-	57	-	(16)	261
Airport and navigation fees	784	-	80	-	(81)	783
Aircraft maintenance	584	-	50	224	(510)	348
Communications and information technology	208	7	2	12	(13)	216
Food, beverages and supplies	246		6		-	252
Depreciation, amortization and obsolescence	408	3	9	30	(8)	442
Commissions	164	-	-	-	-	164
Capacity purchase with Jazz	696	-	-	-	(386)	310
Special charge for labour restructuring	-	-	-	15	-	15
Other operating expenses	1,073	134	83	198	(200)	1,288
	7,772	161	551	738	(1,323)	7,899
Operating income (loss)	**361**	**40**	**62**	**17**	**(73)**	**407**
Non-operating income (expense)						
Interest income	70	3	2	-	11	86
Interest expense	(259)	(3)	(3)	(14)	(36)	(315)
Interest capitalized	88	-	-	-	-	88
Gain on disposal of assets	19	-	-	-	8	27
Gain on financial instruments recorded at fair value	26	-	-	-	-	26
Equity and other investment income [(3)]	-	-	-	-	54	54
Other non-operating income (expense)	(14)	(1)	1	(2)	8	(8)
	(70)	(1)	-	(16)	45	(42)
Income (loss) before the following items	**291**	**39**	**62**	**1**	**(28)**	**365**
Non-controlling interest	(6)	-	-	-	(142)	(148)
Foreign exchange gain (loss)	297	-	-	(1)	(1)	295
Provision for income taxes	(188)	-	-	-	(54)	(242)
Income (loss) for the period	**$ 394**	**$ 39**	**$ 62**	**$ -**	**$ (225)**	**$ 270**
EBITDAR/EBITDA[(4)]	**$ 989**	**$ 43**	**$ 128**	**$ 47**	**$ (97)**	**$ 1,110**

(1) *Reflects the consolidation of Aeroplan results from January 1 to March 13, 2007.*
(2) *Reflects the consolidation of Jazz results from January 1 to May 23, 2007.*
(3) *Reflects ACE's investment in Aeroplan (from March 14, 2007 to September 30, 2007) and for Jazz (from May 24, 2007 to September 30, 2007) using the equity method of accounting.*
(4) *Refer to section 15 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR/EBITDA to operating income (loss).*

ACE's results of operations for the first nine months of 2008 are not directly comparable to its operating results for the first nine months of 2007. Refer to section 5 of this MD&A for additional information on the changes in accounting relating to Aeroplan, Jazz and ACTS.

ACE recorded operating income of $76 million, before a provision for cargo investigations, in the first nine months of 2008 compared to operating income of $407 million in the first nine months of 2007. Air Canada reported operating income of $107 million, before a provision for cargo investigations, in the first nine months of 2008 compared to operating income of $361 million in the first nine months of 2007, a decrease of $254 million compared to the same period in 2007. In the first nine months of 2008, Air Canada recorded a provision for cargo investigations of $125 million relating to alleged anti-competitive cargo pricing activities. ACE's consolidated results for the first nine months of 2007 included operating income from Aeroplan, Jazz and ACTS of $40 million, $62 million and $17 million, respectively.

EBITDAR of $789 million, before the provision for cargo investigations, was recorded in the first nine months of 2008 compared to EBITDAR of $1,110 million in the same period in 2007. In the first nine months of 2008, Air Canada recorded EBITDAR of $826 million, before the provision for cargo investigations, compared to EBITDAR of $989 million in the same period in 2007, a decrease of $163 million. In the first nine months of 2007, Aeroplan, Jazz and ACTS recorded EBITDAR of $43 million, $128 million and $47 million, respectively.

ACE recorded operating revenues of $8,584 million and operating expenses of $8,508 million in the first nine months of 2008. In the same period in 2007, ACE recorded operating revenues of $8,306 million and operating expenses of $7,899 million. As a result of the deconsolidation of Aeroplan, Jazz and ACTS, ACE's operating revenues and expenses for the first nine months of 2008 are not directly comparable to its operating revenues and expenses for the first nine months of 2007.

Non-operating income amounted to $845 million in the first nine months of 2008 compared to non-operating expense of $42 million in the first nine months of 2007. Included in the first nine months of 2008 were gains totalling $830 million on ACE's sale of Aeroplan Income Fund units and gains of $167 million on ACE's sale of Jazz Air Income Fund units. In the first nine months of 2008, Air Canada recorded an impairment charge of $38 million related to the planned retirement of its fleet of Boeing 767-200 aircraft. In the first nine months of 2007, ACE recorded pre-tax gains amounting to $8 million ($6 million after tax) on the sale of its remaining 0.5 million shares in US Airways. ACE recorded an equity and other investment loss of $2 million in the first nine months of 2008 compared to equity investment income of $54 million in the first nine months of 2007. Gains on financial instruments recorded at fair value amounted to $60 million in the first nine months of 2008 compared to gains of $26 million in the first nine months of 2007. Refer to section 10 of this MD&A for additional information on financial instruments.

Net losses on foreign currency monetary items amounted to $128 million in the first nine months of 2008 versus net gains of $295 million in the first nine months of 2007. The losses in the first nine months of 2008 were attributable to a weaker Canadian dollar at September 30, 2008 compared to December 31, 2007, partially offset by gains of $153 million related to foreign currency derivatives. The September 30, 2008 noon day exchange rate was $1US = Cdn $1.0599 while the December 31, 2007 noon day exchange rate was $1US = Cdn $0.9881.

Non-controlling interest was an income of $62 million in the first nine months of 2008 compared to non-controlling interest expense of $148 million in the first nine months of 2007, a decrease of $210 million from the first nine months of 2007. Non-controlling interest mainly reflected the deterioration in Air Canada's net results and, to a lesser extent, the change in accounting methodology for Aeroplan and Jazz.

A provision for income taxes of $217 million was recorded in the first nine months of 2008 on pre-tax income of $730 million. A provision for income taxes of $242 million was recorded in the first nine months of 2007 and included $44 million related to special distributions of Aeroplan and Jazz units.

Net income in the first nine months of 2008 amounted to $513 million or $7.43 per diluted share. Net income in the first nine months of 2007 amounted to $270 million or $2.48 per diluted share. The net income in the first nine months of 2008 included the significant gains on disposal of the remaining units of Aeroplan Income Fund and Jazz Air Income Fund partially offset by a deterioration in Air Canada's segment results including the provision for cargo investigations of $125 million recorded in Quarter 1 2008.

7.1. Air Canada

In the first nine months of 2008, Air Canada reported operating income of $107 million, before a provision for cargo investigations of $125 million, compared to operating income of $361 million in the first nine months of 2007, a decrease of $254 million versus the same period in 2007.

In the first nine months of 2008, EBITDAR amounted to $826 million, before the provision for cargo investigations of $125 million, compared to EBITDAR of $989 million in the same period in 2007, a decrease of $163 million.

Passenger revenues increased $398 million or 5.6% to $7,531 million in the first nine months of 2008 due to growth in both system yield and traffic. System yield improved 4.2%, largely reflecting higher fares and increased fuel surcharges to offset higher fuel prices. An increase in the proportion of higher-yielding travelers was also a factor in the yield growth. Traffic increased 1.3% on a capacity increase of 0.8%, resulting in a passenger load factor improvement of 0.3% from the first nine months of 2007. A stronger Canadian dollar in the first nine months of 2008, which lowers the Canadian dollar value of sales in foreign countries, had a negative impact on foreign currency denominated revenues, accounting for a decrease of $146 million in passenger revenues for the first nine months of 2008. A RASM improvement of 4.6% in the first nine months of 2008 mainly reflected the growth in yield.

Operating expenses were $8,477 million in the first nine months of 2008, an increase of $705 million or 9% from the first nine months of 2007, reflecting a significant increase in fuel expense. Excluding the increase in fuel expense of $690 million in the first nine months of 2008, operating expenses increased $15 million versus the same period in 2007.

Including fuel expense, CASM increased 8.2% from the first nine months of 2007. Excluding fuel expense, CASM declined 0.6% from the first nine months of 2007. A significant reduction in aircraft maintenance expense, the stronger Canadian dollar versus the US dollar and unit cost savings related to the Boeing 777 aircraft were important factors in the overall unit cost decrease, excluding fuel expense, from the first nine months of 2007. Higher unit cost of ownership reflected Air Canada's investment in new aircraft and the aircraft interior refurbishment program.

Non-operating expense amounted to $126 million in the first nine months of 2008 compared to non-operating expense of $70 million in the first nine months of 2007. Gains relating to fair value adjustments on derivatives instruments amounted to $60 million in the first nine months of 2008 versus gains of $26 million in the first nine months of 2007. Net interest expense increased $53 million over the same period in 2007. A lower amount of capitalized interest related to new aircraft and a decrease in interest income largely due to lower cash balances more than offset the $28 million decrease in interest expense. In Quarter 1 2008, Air Canada recorded an impairment charge of $38 million related to the planned retirement of its fleet of Boeing 767-200 aircraft. In the second quarter of 2008, Air Canada recorded gains amounting to $7 million pertaining to the sale of aircraft-related inventory. In Quarter 1 2007, Air Canada recorded gains amounting to $7 million pertaining to the sale of one real estate property and to the sale of parked aircraft. In the second quarter of 2007, Air Canada recorded a gain on disposal of $14 million from insurance proceeds relating to a CRJ-100 aircraft owned by Air Canada and leased to Jazz which was damaged beyond repair.

Net losses on foreign currency monetary items amounted to $128 million in the first nine months of 2008 versus net gains of $297 million in the first nine months of 2007. The losses in the first nine months of 2008 were attributable to a weaker Canadian dollar at September 30, 2008 compared to December 31, 2007, partially offset by gains of $153 million related to foreign currency derivatives. The September 30, 2008 noon day exchange rate was $1US = Cdn $1.0599 while the December 31, 2007 noon day exchange rate was $1US = Cdn $0.9881.

Air Canada recorded a provision for income taxes of $18 million in the first nine months of 2008 on a pre-tax loss of $280 million, as the recovery of future income taxes has been offset by a valuation allowance of $56 million. Future income tax expense of $17 million was recorded for tax that has been reclassified from other comprehensive income to income for realized gains on fuel derivatives. This compared to a provision for income taxes of $188 million, at an effective income tax rate of 32%, for the same period in 2007.

A segment loss of $298 million was recorded in the first nine months of 2008 compared to segment income of $394 million in the first nine months of 2007. The segment loss in the first nine months of 2008 included the provision for cargo investigations of $125 million.

7.2. Corporate Items and Eliminations ("CIE")

CIE includes the corporate, financing and investing activities of ACE. As a result of the change in the accounting for ACE's investment in Aeroplan, effective March 14, 2007, certain consolidation adjustments relating to Aeroplan are no longer recorded in CIE. As previously discussed, the accounting for ACE's investment in ACTS/ACTS Aero was changed in October 2007 from consolidation to the equity method of accounting reported under the CIE segment. Up until the time of deconsolidating ACTS, the CIE segment also included certain consolidation adjustments related to revenue recognition differences for maintenance services provided by ACTS (completed contract basis of accounting for engine and component maintenance services versus the expense recognition basis in Air Canada and Jazz, which is as the work is completed). In addition, consolidation adjustments were previously made related to the timing of revenue and expense recognition pertaining to power-by-the-hour contracts. Subsequent to the change in the accounting for ACE's investment in ACTS, these consolidation adjustments are no longer required.

CIE recorded an operating loss of $31 million in the first nine months of 2008 compared to an operating loss of $73 million in the first nine months of 2007. Negative EBITDAR of $37 million was recorded in the first nine months of 2008 compared to negative EBIDTAR of $97 million in the first nine months of 2007.

CIE results for the first nine months reflected an equity and other investment loss of $2 million compared to equity investment income of $54 million in the same period in 2007. The equity investment loss in the first nine months of 2008 represented ACE's proportionate share of losses recorded by ACTS Aero largely offset by equity and other investment income from Aeroplan and Jazz up to June 2008. On June 2, 2008, ACE completed the sale of its remaining units of Aeroplan Income Fund and Jazz Air Income Fund and retains no ownership interest in Aeroplan and Jazz after that date. The equity investment income recorded in Quarter 3 2007 represented equity accounting for ACE's investments in Aeroplan (from March 14, 2007 to September 30, 2007) and Jazz (from May 24, 2007 to September 30, 2007).

The following gains on disposals were recorded in CIE during the first nine months of 2008:

- A gain on sale of $89 million ($71 million after tax) from the sale by ACE of 13,000,000 units of Jazz Air Income Fund in Quarter 1 2008.
- A gain on sale of $413 million ($340 million after tax) from the sale by ACE of 20,400,000 units of Aeroplan Income Fund in Quarter 2 2008.
- A gain of $417 million ($344 million after tax) from the sale by ACE of 19,892,088 units of Aeroplan Income Fund in Quarter 2 2008.
- A gain of $78 million ($62 million after tax) from the sale by ACE of 11,726,920 units of Jazz Air Income Fund in Quarter 2 2008.

The first nine months of 2007 included pre-tax gains amounting to $8 million ($6 million after tax) relating to ACE's sale of its remaining 0.5 million shares in US Airways.

8. Financial and Capital Management

The following table summarizes ACE's consolidated statement of financial position as at September 30, 2008 and as at December 31, 2007.

Condensed Consolidated Statement of Financial Position (Canadian dollars in millions)	**September 30, 2008**	**December 31, 2007**
Assets		
Cash, cash equivalents and short-term investments	$ 1,938	$ 3,139
Other current assets	1,308	1,465
Current assets	3,246	4,604
Property and equipment	7,463	7,925
Intangible assets	669	647
Deposits and other assets	548	578
	$ 11,926	**$ 13,754**
Liabilities		
Current liabilities	$ 3,251	$ 3,235
Long-term debt and capital lease obligations	4,245	4,006
Pension and other benefits liabilities	1,460	1,824
Other long-term liabilities	617	715
	9,573	**9,780**
Non-controlling interest	**695**	**757**
Shareholders' equity	**1,658**	**3,217**
	$ 11,926	**$ 13,754**

8.1. Analysis of Financial Position

At September 30, 2008, ACE consolidated cash, cash equivalents and short-term investments amounted to $1,938 million, a decrease of $1,201 million from December 31, 2007. ACE's unconsolidated cash, cash equivalents and short-term investments amounted to $824 million, a decrease of $1,076 million from December 31, 2007. The change in ACE's unconsolidated cash balances was mainly the result of substantial issuer bids in 2008 aggregating $1,998 million, partially offset by proceeds of $874 million from the sale of ACE's remaining investments in Aeroplan Income Fund and Jazz Air Income Fund. Air Canada's cash, cash equivalents and short-term investments amounted to $1,114 million at September 30, 2008, a decrease of $125 million from December 31, 2007. The decrease in Air Canada's cash position was largely due to the repayment of long-term debt and capital expenditures, net of the related aircraft financing, and additions to capital assets, partly offset by the favourable impact of the sale and leaseback of five Boeing 777 aircraft in the first nine months of 2008. The decline of $364 million in pension and other benefits liabilities from December 31, 2007 was mainly due to pension funding of $333 million exceeding pension expense and the reclassification of $132 million from pension and other benefits liabilities to current liabilities.

ACE's shareholders' equity amounted to $1,658 million at September 30, 2008, a reduction of $1,559 million from December 31, 2007. The change in shareholders' equity was mainly due to the substantial issuer bids partly offset by net income recorded in the first nine months of 2008.

8.2. Air Canada Liquidity

A principal source of liquidity for Air Canada is cash generated from operations. In response to volatility in fuel prices and a growing slowdown in global travel and their effects on cash from operations, Air Canada reduced capacity levels. In Quarter 3 2008, Air Canada reduced its overall capacity by 3.5% when compared to Quarter 3 2007. Air Canada plans to reduce total system capacity between 7% and 8% in Quarter 4 2008 and Quarter 1 2009 compared to the same period a year earlier. At September 30, 2008, Air Canada had cash, cash equivalents and short-term investments of $1,114 million.

Though Air Canada has a secured revolving credit facility of $400 million, as further described in Note 11 to the 2007 annual consolidated financial statements of ACE, it is no longer available to Air Canada until and unless Air Canada and the lenders conclude amendments satisfactory to each of them relating to a financial covenant and other business terms. During Quarter 3 2008, Air Canada and the lenders entered into an amending agreement pursuant to which the parties undertake to negotiate such further amendments to the facility and Air Canada agrees not to request any funding under the facility until such further amendments are agreed.

The rapid drop in fuel prices subsequent to Quarter 3 2008 has resulted in a negative mark-to-market value for Air Canada's portfolio of fuel hedges. This has required Air Canada to post significant cash collateral with hedging counterparties which, as at October 31, 2008, amounted to $275 million (nil at September 30, 2008). This collateral requirement has put additional pressure on liquidity in the short-term even though the lower fuel prices will provide material cash savings over time. Refer to section 10 of this MD&A for a discussion on fuel price risk.

On October 28, 2008, Air Canada arranged for and received financing amounting to $92 million (US$75 million). This financing has a term to December 15, 2009 and is repayable prior to then provided the Corporation has received certain additional alternate financing. The financing bears interest at one month LIBOR plus 5.98% (currently 9.10%) and is secured by a security interest and a movable hypothec in the principal amount of $200 million. The financing can be repaid at any time prior to maturity, in whole or in part, without penalty.

At October 31, 2008, Air Canada had cash, cash equivalents and short-term investments of approximately $1,025 million.

On October 30, 2008, Air Canada and the lenders of the $400 million secured revolving credit facility entered into a further amendment agreement pursuant to which the commitment was reduced to $200 million and Air Canada agreed to suspend the obligation of the lenders to consider any amendments in exchange for additional flexibility under the facility to permit Air Canada to seek alternative financing arrangements. Discussions with the lenders are not currently taking place and there can be no assurance that amendments satisfactory to the parties will be concluded, that amounts under the facility will ever be available to Air Canada, that Air Canada will not decide to terminate the facility, or that a replacement facility or alternative financing arrangements will be concluded.

8.3. Consolidated Cash flows

As previously discussed, ACE's results reflect the consolidation of Aeroplan's operations only up to March 14, 2007, the consolidation of Jazz's operations only up to May 24, 2007 and the consolidation of ACTS' operations only up to October 16, 2007. Consequently, ACE's consolidated statement of cash flows for Quarter 3 2008 and the first nine months of 2008 is not comparable to its consolidated statement of cash flows for Quarter 3 2007 and the first nine months of 2007.

The following table summarizes ACE's consolidated statement of cash flows for the indicated periods.

	Quarter 3			First Nine Months		
(Canadian dollars in millions)	**2008**	**2007**	**$ Change**	**2008**	**2007**	**$ Change**
Cash from (used for) operating activities	$ (265)	$ 123	$ (388)	$ 181	$ 570	$ (389)
Cash from (used for) financing activities	(67)	312	(379)	(2,364)	746	(3,110)
Cash from (used for) investing activities	172	(498)	670	1,204	(2,192)	3,396
Net change in cash and cash equivalents during the period	**(160)**	**(63)**	**(97)**	**(979)**	**(876)**	**(103)**
Cash and cash equivalents - Beginning of period	**1,481**	**1,041**	**440**	**2,300**	**1,854**	**446**
Cash and cash equivalents - End of period	**$ 1,321**	**$ 978**	**$ 343**	**$ 1,321**	**$ 978**	**$ 343**

ACE unconsolidated

The following summarizes significant transactions or factors which impacted ACE's unconsolidated cash, cash equivalents and short-term investments in Quarter 2 2008:

- On April 21, 2008, ACE completed the sale of 20,400,000 units of Aeroplan Income Fund at a price of $17.50 per unit for total net proceeds to ACE of $343 million.
- On June 2, 2008, ACE completed the sale in the market of a total of 11,726,920 units of Jazz Air Income Fund for total net proceeds to ACE of $85 million.
- On June 2, 2008, ACE completed the sale in the market of a total of 19,892,088 units of Aeroplan Income Fund for total net proceeds to ACE of $349 million.
- On June 18, 2008, ACE accepted for purchase and cancellation a total of 12,537,084 Class A variable voting shares and 10,190,187 Class B voting shares at $22.00 per share for an aggregate purchase price of $500 million, in accordance with the terms of a substantial issuer bid.
- In June 2008, an entity related to Grupo TACA exercised its put option and sold its 5% equity interest in ACTS Aero to ACE for $19 million.

The following summarizes significant transactions or factors which impacted ACE's unconsolidated cash, cash equivalents and short-term investments in Quarter 1 2008:

- On January 10, 2008, ACE accepted for purchase and cancellation a total of 40,023,427 Class A variable voting shares and 9,894,166 Class B voting shares at $30.00 per share for an aggregate purchase price of $1,498 million, in accordance with the terms of a substantial issuer bid.
- On January 14, 2008, cash proceeds of $40 million representing the full balance of funds held in escrow on closing of the monetization of ACTS on October 16, 2007 were received by ACE.
- On January 24, 2008, ACE completed the sale of 13,000,000 units of Jazz Air Income Fund at a price of $7.45 per unit for net proceeds of approximately $97 million.

In Quarter 2 2007, cash flows used for investing activities included the Jazz cash of $138 million which was removed from ACE's consolidated statement of financial position as a result of the deconsolidation of Jazz effective May 24, 2007.

In Quarter 1 2007, cash flows used for investing activities included cash payments of $53 million in connection with the acquisition of Aeroman and the Aeroplan cash of $231 million which was removed from ACE's consolidated statement of financial position as a result of the deconsolidation of Aeroplan effective March 14, 2008.

Air Canada Segment

The following summarizes significant transactions or factors which impacted Air Canada's consolidated cash, cash equivalents and short-term investments in Quarter 3 2008 and in the first nine months of 2008:

- Cash flows used for operating activities amounted to $268 million in Quarter 3 2008 compared to cash flows from operating activities of $70 million in Quarter 3 2007. In the first nine months of 2008, cash flows from operating activities amounted to $176 million compared to cash flows from operating activities of $420 million in the first nine months of 2007, a decrease of $244 million. The decrease in operating cash flows versus the same periods in 2007 was primarily driven by a deterioration in Air Canada's operating results and the impact of higher past service cost contributions under Air Canada's pension plans.
- Cash used for financing activities amounted to $59 million in Quarter 3 2008 compared to cash flows from financing activities of $311 million in Quarter 3 2007. There were no aircraft-related borrowings in Quarter 3 2008 compared to aircraft-related borrowings of $449 million in Quarter 3 2007. In the first nine months of 2008, cash flows used for operating activities amounted to $387 million compared to cash flows from financing activities of $752 million in the first nine months of 2007. In the first nine months of 2008, Air Canada had a reduction of long-term debt and capital lease obligations of $708 million which more than offset its aircraft-related borrowings of $313 million. In the first nine months of 2007, Air Canada had aircraft-related borrowings of $1,093 million which more than offset repayments on its long-term debt and capital lease obligations of $305 million.
- Cash flows used for investing activities in Quarter 3 2008 amounted to $105 million. Additions to capital assets at Air Canada amounted to $105 million in Quarter 3 2008. In the first nine months of 2008, proceeds from the sale and leaseback of five Boeing 777 aircraft totaled $708 million while additions to capital assets, including the expenditures relating to the five Boeing 777 aircraft which were sold and leased back, amounted to $733 million. Other additions to capital assets at Air Canada included two additional Boeing 777 aircraft, three Embraer ERJ-190 aircraft, expenditures related to the aircraft interior refurbishment program and inventory and spare engines.

8.4. Contractual Obligations

The table below provides the Corporation's current contractual obligations for the remainder of 2008, for the next four years and after 2012. All obligations are related to Air Canada, with the exception of the convertible senior notes which are an ACE unconsolidated obligation.

(Canadian dollars in millions)	Remainder of 2008	2009	2010	2011	2012	Thereafter	Total
Convertible senior notes (1)	$ 7	$ 14	$ 330	$ -	$ -	$ -	$ 351
Long-term debt obligations (1)	84	310	288	294	298	2,091	3,365
Debt consolidated under AcG-15 (1)	76	107	156	349	93	192	973
Capital lease obligations (1)	93	167	163	157	200	625	1,405
Operating lease obligations (2)	78	317	307	240	221	774	1,937
Committed capital expenditures (3)	51	149	86	87	471	3,897	4,741
Total contractual obligations (4)	**$ 389**	**$ 1,064**	**$ 1,330**	**$ 1,127**	**$ 1,283**	**$ 7,579**	**$ 12,772**
Pension funding obligations (5)	$ 122	$ 462	$ 469	$ 476	$ 483	N/A	N/A

(1) *Includes both the principal and the interest component of the payment obligations and is based on interest rates and the applicable foreign exchange rates effective as at September 30, 2008.*

(2) *Mainly related to US dollar aircraft operating leases.*

(3) *Mainly related to US dollar aircraft-related expenditures. Also includes purchases relating to system development costs, facilities and leasehold improvements.*

(4) *Excludes commitments for goods and services required in the ordinary course of business. Also excluded are future income taxes and other long-term liabilities mainly due to reasons of uncertainty of timing of cash flows and items which are non-cash in nature.*

(5) *Refer to section 8.5 of this MD&A for additional information on Air Canada's pension plan funding obligations.*

8.5. Air Canada Pension Funding Obligations

Air Canada's pension cash funding obligations are updated from those disclosed in ACE's annual 2007 MD&A dated February 7, 2008.

As at January 1, 2008, the solvency deficit in the registered domestic plans was $1,175 million compared to $542 million at January 1, 2007. The increase in the solvency deficit of the plans represents a deterioration in the financial position of the plans with the solvency ratio for all plans, on a combined basis, decreasing from 95% to 90%. This decrease resulted mainly from a below target return on fund assets of (0.5%) on the Master Trust, net of expenses.

Changes in the economic conditions, mainly the return on fund assets and the change in interest rates, will impact projected required contributions. The required contributions and solvency deficit disclosed below assume no future gains and losses on plan assets and liabilities over the projection period and do not reflect the economic experience of 2008 to date.

The pension funding requirements disclosed below are in respect of the Corporation's pension arrangements. For domestic registered pension plans, the funding requirements are based on the minimum past service contributions disclosed in the January 1, 2008 actuarial valuations plus a projection of the current service contributions.

Based on the January 1, 2008 actuarial valuation, Air Canada's projected pension cash funding obligations for the remainder of 2008, and for the full year 2008 are, and for the next four years would be, as follows:

(Canadian dollars in millions)	**Remainder of 2008**	**2008**	**2009**	**2010**	**2011**	**2012**
Past service domestic registered plans	$ 60	$ 194	$ 223	$ 223	$ 223	$ 223
Current service domestic registered plans	45	170	174	178	184	189
Other pension arrangements (1)	17	92	65	68	69	71
Projected pension funding obligations	**$ 122**	**$ 456**	**$ 462**	**$ 469**	**$ 476**	**$ 483**

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

If recent market conditions persist, Air Canada expects its January 1, 2009 valuation to result in significant increases in funding obligations starting in the second half of 2009.

8.6. Air Canada Capital Expenditures and Related Financing Arrangements

Boeing

As at September 30, 2008, 14 of the 16 Boeing 777 firm aircraft under the purchase agreement with Boeing had been delivered, with the remaining two firm deliveries expected in 2009. These two firm aircraft were originally scheduled for delivery during Quarter 3 2008. Air Canada's capital expenditure projections have been amended to reflect this expected delay. The seven aircraft delivered in 2007 were financed under a loan guarantee facility with the Export-Import Bank of the United States ("EXIM"). In January 2008, the Corporation received a commitment for loan guarantee support from EXIM for all nine 2008 Boeing 777 firm aircraft deliveries. The loan guarantee, subject to certain conditions, covers a 12-year loan term for 85% of the capital expenditure at an interest rate based on a floating rate. As at November 6, 2008, seven of the nine 2008 Boeing 777 aircraft had been delivered, two of these aircraft were financed using the EXIM facility and the other five aircraft were, concurrently with their purchase, sold by and leased back to Air Canada. The five leases are accounted for as operating leases with 12-year terms. All leases are at market rates at their inception date. These sale and leaseback transactions replace an equivalent number of aircraft loan guarantee commitments provided by EXIM. The table below assumes that Air Canada's remaining two Boeing 777 firm aircraft expected for delivery in 2009 will be financed under the loan guarantee facility with EXIM. The Corporation continues to review alternative financing options including sale and leaseback transactions for the remaining two Boeing 777 aircraft.

In Quarter 1 2008, Boeing notified Air Canada that its first Boeing 787 aircraft originally scheduled for delivery in February 2010 was rescheduled for delivery in January 2012, with additional deliveries, originally scheduled for completion between 2010 and 2014, being delayed by approximately two to two and a half years. Air Canada will be seeking compensation from Boeing. Air Canada is evaluating alternatives to mitigate any potential impact of this delay.

Projected Planned and Committed Capital Expenditures

The table below provides Air Canada's current projected planned and committed capital expenditures for the full year 2008, for the next four years and after 2012.

(Canadian dollars in millions)	2008	2009	2010	2011	2012	Thereafter
Projected committed expenditures	$ 596	$ 149	$ 86	$ 87	$ 471	$ 3,897
Projected planned but uncommitted expenditures	38	127	151	116	85	
Total projected expenditures (1) (2) (3)	634	276	237	203	556	
Projected financing on committed expenditures	(313)	(231)	-	-	(416)	
Total projected expenditures, net of financing	**$ 321**	**$ 45**	**$ 237**	**$ 203**	**$ 140**	

(1) *US dollar amounts are converted using the September 30, 2008 noon day exchange rate of 1US$ = Cdn$1.0599. Final aircraft delivery prices include estimated escalation and interest on deferred delivery payments, which is calculated based on the 90-day USD LIBOR rate at September 30, 2008.*

(2) *The dollar amounts reflected above do not include obligations pertaining to day-to-day operations.*

(3) *Total projected expenditures in 2008 exclude $187 million related to the five sale and leaseback transactions executed during the first nine months of 2008.*

8.7. Air Canada Fleet

Air Canada has taken delivery of 15 Boeing 777 aircraft to date, including one Boeing 777-300 aircraft under lease with the International Lease Finance Corporation ("ILFC"). At the same time as the new aircraft are being added to its fleet, Air Canada is removing older and less efficient aircraft. In Quarter 1 2008, Air Canada took the decision to retire its fleet of Boeing 767-200 aircraft, consisting of 10 aircraft, by the end of 2008. These older aircraft are high unit cost aircraft from both a fuel consumption and maintenance perspective.

In response to record high fuel prices, on June 17, 2008, Air Canada announced a reduction in capacity which will impact fleet and staffing levels effective with the implementation of its fall and winter schedule. Air Canada is continually evaluating its fleet requirements and planned aircraft events may be subject to further review and change.

Pursuant to the Jazz CPA, Jazz operates an operating fleet of 133 aircraft.

Aircraft Interior Refurbishment Program

Air Canada commenced a refurbishment program of the interiors of its existing aircraft (Boeing 767-300, Airbus A330-300, A321, A320 and A319 aircraft) in 2006 in order to offer its customers a world class product. As at November 6, 2008, Air Canada had completed the refurbishment of all Airbus A321, A320 and A319 aircraft and 26 of its Boeing 767-300 aircraft, for a total of 112 aircraft to date. Air Canada expects the nine operating aircraft in its fleet yet to be refurbished to have their refurbishment completed by mid-2009. The Embraer and Boeing 777 aircraft are delivered with the new seats and entertainment systems already installed.

8.8. Capital Management

Each of the ACE and Air Canada Boards of Directors approves the ACE or Air Canada objectives and policies for managing capital as the case may be. Capital management is discussed separately for each entity below.

ACE

ACE views capital as the sum of parent company capital consisting of convertible senior notes, convertible preferred shares, non-controlling interest and shareholders' equity. This definition of capital used by management may not be comparable to measures presented by other public companies. Capital managed by ACE, summarized from the consolidated statement of financial position, follows:

(Canadian dollars in millions)	September 30, 2008	December 31, 2007
Convertible senior notes	$ 283	$ 273
Convertible preferred shares	200	182
Non-controlling interest	695	757
Shareholders' equity	1,658	3,217
Capital	**$ 2,836**	**$ 4,429**

Since December 31, 2007, ACE's capital declined $1,593 million to $2,836 million mainly as a result of the purchase and cancellation of common shares by way of substantial issuer bids partially offset by net income recorded in the first nine months of 2008.

Air Canada

Air Canada views capital as the sum of long-term debt, non-controlling interest, capitalized operating leases and shareholders' equity. Air Canada currently has pre-delivery financing arranged, which is related to future deliveries, and, as the aircraft have not yet been delivered, this debt is excluded from the capital base. Air Canada includes capitalized operating leases which is a measure commonly used in the industry to ascribe a value to obligations under operating leases. The value is based on annualized aircraft rent expense multiplied by 7.5, which is a factor commonly used in the airline industry. The measure used may not necessarily reflect the fair value or net present value related to the future minimum lease payments as the measure is not based on the remaining contractual payments and the factor may not recognize discount rates implicit in the actual leases or current rates for similar obligations with similar terms and risks. This definition of capital is used by management and may not be comparable to similar measures presented by other public companies.

Air Canada also monitors its ratio of adjusted net debt to net debt plus equity, with equity defined as shareholders' equity. Adjusted net debt is calculated as the sum of long-term debt, non-controlling interest and capitalized operating leases less cash, cash equivalents and short-term investments.

At September 30, 2008, adjusted net debt and non-controlling interest, including capitalized operating leases, and excluding the pre-delivery payment ("PDP") financing, increased $308 million from December 31, 2007. Net debt was significantly impacted by the weakening of the Canadian dollar versus the US dollar. The adjusted net debt to net debt plus equity ratio for Air Canada increased to 72.0% at September 30, 2008 from 67.0% at December 31, 2007. The 5.0 percentage point deterioration from December 31, 2007 was mainly due to a decrease in shareholders' equity recorded in the first nine months of 2008.

8.9. Share Information

At October 31, 2008, the issued and outstanding common shares of ACE, along with common shares potentially issuable, pursuant to convertible preferred shares, convertible senior notes and stock options were as follows:

Number of shares (000)	October 31, 2008	December 31, 2007
Issued and outstanding common shares		
Class A variable voting shares	24,967	82,229
Class B voting shares	9,940	23,709
Total issued and outstanding common shares	**34,907**	**105,938**
Common shares potentially issuable		
Convertible preferred shares	11,765	11,291
Convertible senior notes	13,133	12,210
Stock options	70	1,682
Total common shares potentially issuable	**24,968**	**25,183**
Total outstanding and potentially issuable common shares	**59,875**	**131,121**

Substantial Issuer Bid – January 2008

On January 10, 2008, ACE accepted for purchase and cancellation a total of 40,023,427 Class A variable voting shares and 9,894,166 Class B voting shares at $30.00 per share for an aggregate purchase price of $1,498 million under the terms of a substantial issuer bid. No convertible preferred shares of ACE were deposited on an "as converted basis" under the offer.

In connection with the share purchase and cancellation by ACE, the conversion rate of ACE's 4.25% Convertible Senior Notes due 2035 was adjusted from 37.6879 to 39.0341 Class A variable voting shares or Class B voting shares per $1,000 principal amount of convertible senior notes. The adjustment was effective January 11, 2008 and was determined in accordance with the terms of the indenture governing the convertible senior notes.

Substantial Issuer Bid – June 2008

On June 18, 2008, ACE accepted for purchase and cancellation a total of 12,537,084 Class A variable voting shares and 10,190,187 Class B voting shares at $22.00 per share for an aggregate purchase price of $500 million, in accordance with the terms of a substantial issuer bid. No convertible preferred shares of ACE were deposited on an "as converted basis" under the offer.

In connection with the share purchase and cancellation by ACE, the conversion rate of ACE's 4.25% Convertible Senior Notes due 2035 was adjusted from 39.0341 to 40.6917 Class A variable voting shares or Class B voting shares per $1,000 principal amount of convertible senior notes. The adjustment was effective June 19, 2008 and was determined in accordance with the terms of the indenture governing the convertible senior notes.

9. Related Party Transactions

At September 30, 2008, ACE held a 75% ownership interest in Air Canada. Air Canada has various related party transactions with ACTS Aero, an ACE-related entity.

The related party balances resulting from the application of the related party agreements were as follows:

(Canadian dollars in millions)	September 30, 2008	December 31, 2007
Accounts receivable		
ACTS Aero (Air Canada)	**$ 88**	**$ 75**
Prepaid Maintenance		
ACTS Aero (Air Canada)	**$ 7**	**$ 24**
Accounts payable and accrued liabilities		
ACTS Aero (Air Canada)	**$ 45**	**$ 88**

The related party revenues and expenses with ACTS Aero are summarized as follows:

(Canadian dollars in millions)	Quarter 3 2008	First Nine Months 2008
Revenues		
Property rental revenues (ACTS Aero)	$ 4	$ 22
Revenues from information technology services (ACTS Aero)	4	11
Revenues from corporate services and other (ACTS Aero)	3	20
	$ 11	**$ 53**
Expenses		
Maintenance expense for services (ACTS Aero)	$ 93	$ 368
Recovery of wages, salary and benefit expense for employees assigned to ACTS Aero	(57)	(192)
	$ 36	**$ 176**

Air Canada and Aveos, which is a related-party to ACE, entered into an agreement dated October 28, 2008 pursuant to which Air Canada has agreed to temporarily extend payment terms to Aveos under certain related-party agreements. In exchange for the extended payment terms, certain letters of credit related to the Pension and Benefits Agreement, as described in Note 22 of the 2007 annual consolidated financial statements of the Corporation, were cancelled. The cancellation of the letters of credit will provide cash to Air Canada of approximately $40 million and is offset by the impact of extended payment terms to Aveos of $22 million, for a net cash flow benefit of approximately $18 million to Air Canada. The extended payment terms to Aveos are reduced over the course of one year, with the first reduction starting approximately six months from the date of the agreement, and with a corresponding return of the letters of credit to Aveos, such that, by October 2009, the letters of credit would be re-instated to the levels then required under the Pension and Benefits Agreement between the two parties.

In Quarter 3 2008, ACTS LP settled certain contracts with Air Canada for $8 million relating to the monetization which was completed on October 16, 2007. These contracts were accounted for as equity transactions, with a resulting dilution loss of $2 million recorded in non-controlling interest.

In 2007, ACE sold its 49% interest in Air Canada Vacations to Air Canada for proceeds of $10 million causing Air Canada Vacations to be 100% owned by Air Canada. As a result of this sale, ACE recorded a dilution gain of $3 million related to the non-controlling interest in Air Canada in other non-operating income (expense).

10. Financial Instruments and Risk Management

As described in section 5 of this MD&A, the Corporation adopted CICA sections 3862 and 3863 effective January 1, 2008. These new standards enhance disclosures with respect to financial instruments.

Risk Management

The Corporation is exposed to the following risks as a result of holding financial instruments: credit risk, fuel price risk, interest rate risk, foreign exchange risk, liquidity risk and market risk. The following is a description of these risks and how they are managed.

Credit Risk

In order to manage its exposure to credit risk, the Corporation reviews counterparty credit ratings on a regular basis. In Quarter 3 2008, a counterparty defaulted under a number of derivative agreements with the Corporation. As a result, the Corporation recorded a loss of $6 million and $2 million related to foreign exchange and fuel derivatives, respectively. The loss was recorded in non-operating income (expense).

Fuel Price Risk

To manage its exposure to jet fuel prices and help mitigate volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries.

As at September 30, 2008, Air Canada had hedged 54% of its fuel requirement for Quarter 4 2008, 24% of its projected fuel requirement for 2009 and 9% of its projected fuel requirement for 2010. Quarter 4 2008 was hedged at prices that fluctuate between an average of US$109 to US$114 per barrel for jet-fuel based contracts, an average of US$99 to US$103 per barrel for heating oil-based contracts and an average of US$110 to US$119 per barrel for West Texas Intermediate ("WTI") crude-oil based contracts**.** On an equivalent WTI basis, Quarter 4 2008 was hedged at prices that fluctuate between an average of US$94 to US$99 per barrel.

Since September 30, 2008, Air Canada has entered into new hedging positions, using costless collar option structures. As at November 6, 2008, Air Canada had hedged 56% of its projected fuel requirement for Quarter 4 2008, 31% of its projected fuel requirement for 2009 and 14% of its projected fuel requirement for 2010. With these new hedging positions, Quarter 4 2008 is hedged at prices that can fluctuate between an average of US$109 to US$114 per barrel for jet-fuel based contracts, an average of US$99 to US$104 per barrel for heating oil-based contracts and an average of US$107 to US$115 per barrel for WTI crude-oil based contracts. On an equivalent WTI basis, Quarter 4 2008 is hedged at prices that fluctuate between an average of US$90 to US$95 per barrel and 2009 is hedged at prices that fluctuate between an average of US$95 to US$102 per barrel.

At September 30, 2008, the fair value of the outstanding fuel derivatives was $16 million in favour of the counterparties. The total decrease in the fair value of Air Canada's fuel derivatives, including derivatives under hedge accounting and not under hedge accounting, amounted to $440 million in Quarter 3 2008 (a gain of $128 million in the first nine months of 2008). Of the fair value loss, $328 million was recorded in other comprehensive income ("OCI") in Quarter 3 2008 as a reversal of previous gains ($73 million to be applied as a reduction to fuel expense recorded in the first nine months of 2008), and the remaining $112 million was recorded as a loss in non-operating income (expense) in Quarter 3 2008 (a gain of $55 million in the first nine months of 2008). The accounting treatment in either OCI or non-operating expense, as described further below, does not alter the economic impact of the Air Canada's fuel hedging program. At October 31, 2008, the fair value of the outstanding fuel derivatives was $380 million in favour of the counterparties.

Fuel derivatives include both derivatives designated and not designated under fuel hedge accounting. The current portion of the derivative asset of $12 million is included in fuel derivatives, the current liability of $30 million is included in accounts payable and accrued liabilities and the long-term asset of $2 million is included in deposits and other assets on Air Canada's consolidated statement of financial position.

The following information summarizes the financial statement impact of derivatives designated under fuel hedge accounting:

- The fair value of outstanding fuel derivatives under hedge accounting at September 30, 2008 was $6 million in favour of the counterparties.
- The change in fair value of fuel derivatives under hedge accounting in Quarter 3 2008 was ($386) million ($97 million in the first nine months of 2008):
    - The unrealized effective change in the fair value of derivatives recorded in OCI in Quarter 3 2008 was a loss of $280 million (a gain of $67 million in the first nine months of 2008). The realized effective change in the fair value of derivatives recorded in OCI in Quarter 3 2008 was a loss of $48 million (a gain of $6 million in the first nine months of 2008). OCI amounts for Quarter 3 2008 and for the first nine months of 2008 of ($244) million and $29 million, respectively, are presented net of tax expense on Air Canada's consolidated statement of comprehensive income.
    - The ineffective change in the fair value of derivatives recorded in non-operating income (expense) in Quarter 3 2008 was a loss of $58 million (a gain of $24 million in the first nine months of 2008). The ineffective portion is calculated as the difference between the change in the intrinsic value and the change in the fair market value of the derivatives over the period as well as the difference between the Air Canada proxy derivative value and the counterparty derivative value. The loss in non-operating income (expense) was due to the decrease in the fair market value of the derivatives being larger than the decrease in the intrinsic value.
- In Quarter 3 2008, fuel derivative contracts matured with fair values in favour of Air Canada for $74 million.
- In Quarter 3 2008, the benefit to fuel expense was $64 million ($190 million in the first nine months of 2008). This benefit was recognized through the removal of the amount from AOCI, which is reported as a reclassification of net realized gains of $44 million net of tax for Quarter 3 2008 ($129 million net of tax for the first nine months of 2008).
- In Quarter 3 2008, the net impact to AOCI was a decrease of $392 million before tax of $104 million ($117 million before tax of $17 million in the first nine months of 2008). As at September 30, 2008, the balance in AOCI was ($44) million. The estimated net amount of existing gains and losses reported in AOCI that is expected to be reclassified to net income (loss) in the following 12 months is $18 million before tax.

The following information summarizes the financial statement impact of derivatives not designated under fuel hedge accounting, but held as economic hedges:

- In Quarter 3 2008, fuel derivative contracts matured in favour of Air Canada for $2 million ($21 million in favour of Air Canada in the first nine months of 2008).
- The fair value of outstanding fuel derivatives not under hedge accounting at September 30, 2008 was $10 million in favour of the counterparties.
- The change in fair value of the derivative contracts in Quarter 3 2008 was a loss of $54 million (a gain of $31 million in the first nine months of 2008) and was recorded in non-operating income (expense).

Refer to section 8.2 for a discussion of cash collateral requirements under fuel hedge positions as at October 31, 2008.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Air Canada enters into both fixed and floating rate debt and also leases certain assets where the rental amount fluctuates based on changes in short-term interest rates. Air Canada manages interest rate risk on a portfolio basis and seeks financing terms in individual arrangements that are most advantageous taking into account all relevant factors, including credit margin, term and basis. The risk management objective is to minimize the potential for changes in interest rates causing adverse changes in cash flows to the Corporation. The temporary investment portfolio which earns a floating rate of return is an economic hedge for a portion of the floating rate debt.

The ratio of fixed to floating rate debt outstanding is designed to maintain flexibility in the Air Canada's capital structure and is based upon a long-term objective of 60% fixed and 40% floating. The ratio at September 30, 2008 was 56% fixed and 44% floating, including the effects of interest rate swap positions. The cross-currency interest rate swap positions were terminated on October 1, 2008, with a fair value of $4 million in favour of Air Canada. The adjusted ratio at October 1, 2008 was 61% fixed and 39% floating.

The following are the current derivatives employed in interest rate risk management activities and the adjustments recorded in the first nine months of 2008:

- As at September 30, 2008, Air Canada had entered into three cross-currency interest rate swap agreements with terms of March 2019, May 2019, and June 2019 respectively, relating to Boeing 777 aircraft financing, with an aggregate notional value of $300 million (US$283 million). These swaps convert US denominated debt principal and interest payments into Canadian denominated debt at a foreign exchange rate of par (US$1/CAD$1) and convert from a fixed rate of 5.208% to a floating rate. The fair value of these contracts as at September 30, 2008 was $5 million in favour of Air Canada. These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. In Quarter 3 2008, a gain of $19 million was recorded in gain (loss) on financial instruments recorded at fair value related to these derivatives (a gain of $6 million in the first nine months of 2008). As noted above, these swaps were terminated on October 1, 2008, with a fair value of $4 million in favour of Air Canada.

- As at September 30, 2008, Air Canada had entered into two interest rate swap agreements with terms of July 2022 and January 2024 relating to two Boeing 767 aircraft financing agreements with an aggregate notional value of $103 million (US$97 million). These swaps convert the lease payments on the two aircraft leases from fixed to floating rates. The fair value of these contracts as at September 30, 2008 was $9 million in favour of Air Canada. These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. In Quarter 3 2008, a gain of $1 million was recorded in gain (loss) on financial instruments recorded at fair value (a gain of $2 million in the first nine months of 2008) (a gain of $3 million in Quarter 3 2007 and a loss of $1 million in the first nine months of 2007).

- In Quarter 1 2008, the Corporation's one remaining Embraer 190 aircraft interest rate swap contract matured, with a fair value of $2 million in favour of the counterparty. No gain or loss was recorded during the period.

Foreign Exchange Risk

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The majority of the Corporation's outstanding debt is denominated in US dollars. The US dollar debt acts as an economic hedge against the related aircraft, which is routinely purchased and sold by Air Canada in US dollars. The Corporation is also exposed to foreign exchange risk on foreign currency denominated trade receivables and foreign currency denominated net cash flows. The Corporation's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

The following are the current derivatives employed in foreign risk management activities and the adjustments recorded in the first nine months of 2008.

- At as September 30, 2008, Air Canada had entered into foreign currency forward contracts and option agreements converting US dollars and Euros into Canadian dollars on $1,482 million (US$1,398 million) and $4 million (EUR 3 million) which mature in 2008, 2009 and 2010. The fair value of these foreign currency contracts as at September 30, 2008 was $56 million in favour of Air Canada (December 31, 2007 - $124 million in favour of third parties on $2,132 million (US$2,158 million) and $26 million (EUR 18 million) which mature in 2008 and 2009). Net cash US outflows for 2008 are 100% covered at an average foreign exchange rate of US$1/CAD 1.0255. Net cash US outflows for 2009 are 29% covered at an average foreign exchange rate of US$1/CAD 1.0004 and net cash US outflows for 2010 are 2.6% covered at an average foreign exchange rate of US$1/CAD 0.9691. The entire US portfolio is covered at an average rate of US$1/CAD 1.0125. These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. In Quarter 3 2008, a gain of $70 million was recorded in foreign exchange gain (loss) related to these derivatives (a gain of $153 million in the first nine months of 2008) (a loss of $117 million in Quarter 3 2007 and a loss of $212 million in the first nine months of 2007).

- At as October 31, 2008, the Corporation had entered into foreign currency forward contracts and option agreements converting US dollars and Euros into Canadian dollars on $963 million (US$795 million) and $5 million (EUR 3 million) which mature in 2008, 2009 and 2010. The fair value of these foreign currency contracts as at October 31, 2008 was $142 million in favour of the Corporation. Net cash US outflows for 2008 are 94% covered at an average foreign exchange rate of US$1/CAD 1.0355. Net cash US outflows for 2009 are 24% covered at an average foreign exchange rate of US$1/CAD 1.0000 and net cash US outflows for 2010 are 4% covered at an average foreign exchange rate of US$1/CAD 0.9784. The entire US portfolio is covered at an average rate of US$1/CAD 1.0164.

- The cross-currency swap as described above under interest rate risk acts as an economic hedge of the foreign exchange risk on the financing related to two Boeing 777 aircraft with a principal amount of $300 million (US$283 million) as at September 30, 2008.

- Air Canada had also entered into currency swap agreements for 11 CRJ aircraft. These agreements matured in January 2008 with a nominal fair value. No gain or loss was recorded during the period.

Liquidity risk

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities. The long-term debt issued by the Corporation generally has fixed principal and interest repayment requirements over the term of the instrument.

The Corporation monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as security in financing arrangements, and maintaining flexibility in financing arrangements.

Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: foreign exchange risk, interest rate risk and other price risk, which includes commodity price risk. Refer to the section "Asset-Backed Commercial Paper" below for information regarding these instruments held by the Corporation.

The Corporation is exposed to market risks through the derivative instruments entered into. The Corporation uses derivative instruments only for risk management purposes and not for generating trading profit. As such, any change in cash flows associated with derivative instruments due to their exposure to market risks is designed to be offset by changes in cash flows related to the risk being hedged.

Asset-Backed Commercial Paper ("ABCP")

Air Canada holds $37 million ($29 million, net of a fair value adjustment) in non-bank sponsored ABCP which has been recorded in deposits and other assets. The carrying value as at September 30, 2008 was based on a number of assumptions as to the fair value of the investments including factors such as estimated cash flow scenarios and risk adjusted discount rates. The assumptions used in estimating the fair value of the investments are subject to change, which may result in further adjustments to non-operating results in the future. No adjustment to the carrying value was recorded during the first nine months of 2008.

11. Risk Factors

For a detailed description of the risk factors associated with the Corporation, refer to the section entitled "Risk Factors" in ACE's 2007 MD&A dated February 7, 2008. Certain risk factors in ACE's 2007 MD&A are revised to provide for the following updates:

The European Commission, the United States Department of Justice and the Competition Bureau in Canada, among other competition authorities, are investigating alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including the Corporation, a number of whom, including the Corporation, have received a statement of objections from the European Commission that sets out the European Commission's preliminary assessment in relation to such matter. The Corporation has provided its reply to the statement of objections. Competition authorities have sought or requested information from the Corporation as part of their investigations. The Corporation is cooperating with these investigations, which are likely to lead to proceedings against the Corporation and a number of airlines and other cargo operators in certain jurisdictions. The Corporation is also named as a defendant in a number of class action lawsuits that have been filed before the United States District Court and in Canada in connection with these allegations.

During Quarter 1 2008, the Corporation recorded a provision of $125 million as a preliminary estimate. This estimate is based upon the current status of the investigations and proceedings and the Corporation's assessment as to the potential outcome for certain of them. This provision does not address the proceedings in all jurisdictions, but only where there is sufficient information to do so. Management has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings. Additional material provisions may be required.

The risk factor describing the Air Canada Pilots Association ("ACPA") claim under Current Legal Proceedings is withdrawn following the Ontario Court of Appeal's decision, on June 27, 2008, to reject ACPA's appeal of the order dismissing its claim, and the expiry of the time during which an appeal may be made without ACPA having filed any appeal.

The description of the risk factor related to Regulatory Matters is expanded to reference legislation being considered or enacted by governments (and which may apply to the airline industry), in relation to carbon emission trading schemes (such as the European Union's emissions trading scheme legislation), aimed at reducing carbon emissions.

12. Quarterly Financial Information

The quarterly information presented below may not be directly comparable as a result of changes in accounting policies relating to Aeroplan, Jazz and ACTS. Refer to section 5 of this MD&A for additional information.

($ millions, except per share amounts)	Q4 2006	Q1 2007(1)	Q2 2007(2)	Q3 2007	Q4 2007(3)	Q1 2008	Q2 2008	Q3 2008
Operating revenues	$ 2,544	$ 2,625	$ 2,659	$ 3,022	$ 2,520	$ 2,726	$ 2,783	$ 3,075
Operating expenses	(2,471)	(2,654)	(2,563)	(2,682)	(2,474)	(2,753)	(2,785)	(2,970)
Operating income (loss) before under-noted item(4)	**73**	**(29)**	**96**	**340**	**46**	**(27)**	**(2)**	**105**
Provision for cargo investigations(5)	-	-	-	-	-	(125)	-	-
Operating income (loss)	**73**	**(29)**	**96**	**340**	**46**	**(152)**	**(2)**	**105**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax(6)	(122)	(43)	22	(116)	1,082	(30)	832	(240)
Net income (loss)	**$ (49)**	**$ (72)**	**$ 118**	**$ 224**	**$ 1,128**	**$ (182)**	**$ 830**	**$ (135)**
Earnings (loss)(7)								
Per share – basic	**$ (0.48)**	**$ (0.70)**	**$ 1.14**	**$ 2.17**	**$ 10.81**	**$ (2.96)**	**$ 15.46**	**$ (3.86)**
Per share – diluted	**$ (0.48)**	**$ (0.70)**	**$ 0.98**	**$ 1.84**	**$ 8.88**	**$ (2.96)**	**$ 10.76**	**$ (3.86)**

(1) *ACE ceased consolidating Aeroplan's results effective March 14, 2007.*
(2) *ACE ceased consolidating Jazz's results effective May 24, 2007.*
(3) *ACE ceased consolidating ACTS' results effective October 16, 2007.*
(4) *Quarter 1 2007 and Quarter 2 2007 include special charges for labour restructuring of $9 million and $6 million, respectively.*
(5) *Air Canada recorded a provision for cargo investigations of $125 million in Quarter 1 2008.*
(6) *Quarter 4 2006 includes a dilution gain of $25 million and a tax expense of $4 million related to the Air Canada initial public offering. Quarter 2 2007 includes a gain of $4 million and a tax provision of $1 million relating to the sale of 0.249 million shares of its holdings in US Airways. Quarter 3 2007 includes a gain of $4 million and a tax provision of $1 million relating to the sale of 0.251 million shares of its holdings in US Airways. Quarter 4 2007 includes an aggregate gain on disposal of $1,339 million and a tax provision of $214 million mainly comprised of a gain on disposal of $565 million and a tax provision of $82 million related to the monetization of ACTS which was completed on October 16, 2007, a gain on disposal of $539 million and a tax provision of $91 million related to the secondary offering of 22,000,000 trust units of Aeroplan Income Fund and a gain on disposal of $233 million and a tax provision of $41 million related to the secondary offering of 35,500,000 trust units of Jazz Air Income Fund. Quarter 1 2008 includes a gain of $89 million ($71 million, net of tax) on ACE's sale of 13,000,000 units of Jazz Air Income Fund and an impairment provision of $38 million recorded by Air Canada related to its fleet of Boeing 767-200 aircraft. Quarter 2 2008 includes a gain of $413 million ($340 million, net of tax) on ACE's sale of 20,400,000 units of Aeroplan Income fund, a gain of $417 million ($344 million, net of tax) on ACE's sale of 19,892,088 units of Aeroplan Income Fund and a gain on of $78 million ($62 million, net of tax) on ACE's sale of 11,726,920 units of Jazz Air Income Fund.*
(7) *Includes the impact of a substantial issuer bid completed by ACE on January 10, 2008 whereby ACE accepted for purchase and cancellation a total of 40,023,427 Class A variable voting shares and 9,894,166 Class B voting shares and a substantial issuer bid completed by ACE on June 18, 2008 whereby ACE accepted for purchase and cancellation a total of 12,537,084 Class A variable voting shares and 10,190,187 Class B voting shares.*

13. Off-Balance Sheet Arrangements

There were no significant changes to ACE's off-balance sheet arrangements from what was disclosed in ACE's 2007 MD&A dated February 7, 2008.

14. Controls and Procedures

Disclosure Controls and Procedures

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

ACE's 2007 Annual Report contains a statement that the Chairman, President and Chief Executive Officer and the Executive Vice President and Chief Financial Officer have concluded that ACE's disclosure controls and procedures are effective based upon an evaluation of these controls and procedures conducted at December 31, 2007.

Changes in Internal Controls over Financial Reporting

There were no changes to ACE's internal controls over financial reporting during the three months ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

15. Non-GAAP Financial Measures

EBITDAR/EBITDA

EBITDAR (earnings before interest, taxes, depreciation, amortization, obsolescence and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before aircraft rent, depreciation, obsolescence and amortization, as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. For businesses without aircraft rent, such as Aeroplan and ACTS, EBITDA (earnings before interest, taxes, depreciation, amortization and obsolescence) is used to view operating results before depreciation, amortization and obsolescence, as these costs can vary significantly among companies due to differences in the way companies finance their assets. The Corporation presents EBITDAR before and after the provision for cargo investigations as this item could potentially distort the analysis of trends in business performance. EBITDAR and EBITDA are not recognized measures for financial statement presentation under GAAP and do not have a standardized meaning and are therefore not likely to be comparable to similar measures presented by other public companies.

ACE's EBITDAR for Quarter 3 2008 and for the first nine months of 2008 is not directly comparable to its EBITDAR for Quarter 3 2007 and for the first nine months of 2007. Refer to section 5 of this MD&A for additional information.

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

(Canadian dollars in millions)	Quarter 3 2008	Quarter 3 2007	Quarter 3 $ Change	First Nine Months 2008	First Nine Months 2007	First Nine Months $ Change
Air Canada						
GAAP operating income before the provision for cargo investigations	$ 112	$ 351	$ (239)	$ 107	$ 361	$ (254)
Add back:						
Aircraft rent	67	66	1	199	220	(21)
Depreciation and amortization	176	144	32	520	408	112
EBITDAR before the provision for cargo investigations	**355**	**561**	**(206)**	**826**	**989**	**(163)**
Provision for cargo investigations	-	-	-	(125)	-	(125)
EBITDAR	**$ 355**	**$ 561**	**$ (206)**	**$ 701**	**$ 989**	**$ (288)**
Aeroplan						
GAAP operating income	$ -	$ -	$ -	$ -	$ 40	$ (40)
Add back:						
Depreciation and amortization	-	-	-	-	3	(3)
EBITDA	**$ -**	**$ -**	**$ -**	**$ -**	**$ 43**	**$ (43)**
Jazz						
GAAP operating income	$ -	$ -	$ -	$ -	$ 62	$ (62)
Add back:						
Aircraft rent	-	-	-	-	57	(57)
Depreciation and amortization	-	-	-	-	9	(9)
EBITDAR	**$ -**	**$ -**	**$ -**	**$ -**	**$ 128**	**$ (128)**
ACTS						
GAAP operating income	$ -	$ 5	$ (5)	$ -	$ 17	$ (17)
Add back:						
Depreciation and amortization	-	10	(10)	-	30	(30)
EBITDA	**$ -**	**$ 15**	**$ (15)**	**$ -**	**$ 47**	**$ (47)**
ACE Consolidated (1)						
GAAP operating income before the provision for cargo investigations	$ 105	$ 340	$ (235)	$ 76	$ 407	$ (331)
Add back:						
Aircraft rent	67	66	1	199	261	(62)
Depreciation and amortization	174	147	27	514	442	72
EBITDAR before the provision for cargo investigations	**346**	**553**	**(207)**	**789**	**1,110**	**(321)**
Provision for cargo investigations	-	-	-	(125)	-	(125)
EBITDA/EBITDAR	**$ 346**	**$ 553**	**$ (207)**	**$ 664**	**$ 1,110**	**$ (446)**

(1) ACE ceased consolidating the results of Aeroplan, Jazz and ACTS effective March 14, 2007, May 24, 2007 and October 16, 2007, respectively.

16. Glossary of Terms

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

CASM — Operating expense per ASM;

EBITDA — EBITDA is earnings before interest, taxes, depreciation, amortization and obsolescence and is a non-GAAP financial measure;

EBITDAR — EBITDAR is earnings before interest, taxes, depreciation, amortization, obsolescence and aircraft rent and is a non-GAAP financial measure;

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

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

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

Yield — Average passenger revenue per RPM.