ACE AVIATION

QUARTER 2 2009

Management's Discussion and Analysis of Results of Operations and Financial Condition

August 7, 2009

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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. 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.

On December 10, 2008, ACE announced its intention to seek court and shareholder approvals for a plan of arrangement pursuant to which it would proceed with a liquidation and its net assets would be distributed, in an orderly fashion, after providing for outstanding liabilities and costs of the transaction.

In accordance with Section 1400 of the Canadian Institute of Chartered Accountants Handbook, General standards of financial statement presentation ("CICA 1400"), effective December 31, 2008, the Corporation changed the basis of preparing its financial statements from going concern to liquidation.

On July 29, 2009, ACE announced that its participation in the Air Canada credit facility of up to $700 million, announced on the same day by Air Canada, amounts to $150 million. Given ACE's participation in the facility, it is not management's intention to liquidate at this time.

Therefore, the financial statements have been prepared on a going concern basis of presentation. Under a going concern basis of presentation, Air Canada is consolidated within ACE's financial statements under accounting policies applicable to a going concern which previously existed. The going concern basis of presentation assumes continuity of operations, realization of assets and satisfaction of liabilities in the ordinary course of business.

This MD&A should be read in conjunction with ACE's interim unaudited consolidated financial statements and notes for Quarter 2 2009 and its annual audited consolidated financial statements and notes and its annual MD&A for 2008. 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 as otherwise noted, all monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 17 "Glossary of Terms". Except as otherwise noted, this MD&A is current as of August 7, 2009. Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current period.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" in section 2 of this MD&A for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of the risks relating to ACE, see section 14 "Risk Factors" of ACE's 2008 MD&A dated August 7, 2009 which can be found on SEDAR at www.sedar.com.

The ACE Audit, Finance & Risk Committee has reviewed this MD&A and the Quarter 2 2009 interim unaudited 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, or ACE's website at www.aceaviation.com.

2. Caution Regarding Forward-Looking Information

ACE's public communications may include written or oral forward-looking statements within the meaning of applicable securities laws. Such statements are included in this MD&A and may be included in other filings with regulatory authorities and securities regulators. Forward-looking statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to strategies, expectations, planned operations or future actions. 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.

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. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including without limitation, industry, market, credit and economic conditions, the ability to reduce operating costs and secure financing, pension issues, energy prices, currency exchange and interest rates, employee and labour relations, competition, war, terrorist acts, epidemic diseases, insurance issues and costs, changes in demand due to the seasonal nature of the business, supply issues, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in section 14 "Risk Factors" of ACE's 2008 MD&A dated August 7, 2009. The forward-looking statements contained in this MD&A 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 August 7, 2009.

	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. * ACE's ownership interest in Air Canada is subject to dilution as a result of certain agreements between Air Canada and its unions and as a result of warrants issued and that may be issued in connection with the Air Canada credit facility (see section 4 of this MD&A).	75.0 %*
ACTS Aero	Aero Technical Support and Services Holdings sarl ("ACTS Aero"), which holds a 100% interest in 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.	28.4 %

4. Significant Events

ACE

The following significant events occurred during the period January 1, 2009 to August 7, 2009:

On January 19, 2009, ACE announced that $259 million principal amount of 4.25% convertible senior notes due 2035 were deposited and taken up under a substantial issuer bid, at a purchase price of $900 for each $1,000 principal amount of notes, for an aggregate purchase price of $233 million. ACE also announced on January 19, 2009 that 8.3 million convertible preferred shares, at a purchase price of $20.00 per preferred share, were deposited and taken up under a substantial issuer bid, for an aggregate purchase price of $166 million.

On March 19, 2009, ACE announced that it had taken up and accepted for purchase and cancellation 1.0 million of its convertible preferred shares, at a purchase price of $20.00 per preferred share, for an aggregate purchase price of $20 million.

On July 29, 2009, ACE announced that its participation in the Air Canada credit facility of up to $700 million described below amounts to $150 million. ACE's $150 million share is repayable in equal consecutive quarterly installments of $7.5 million starting August 1, 2010, with a final payment of $30 million due by the fifth anniversary of the initial drawdown.

Air Canada

Air Canada has entered into the following transactions in 2009 in an effort to mitigate Air Canada's liquidity risks as described in section 9.2 of ACE's 2008 MD&A dated August 7, 2009 and section 8.2 of this MD&A.

During July 2009

- A secured term credit facility (the "Credit Facility") for financing proceeds of $600 million, less fees of approximately $20 million. On or before the first anniversary and subject to satisfaction of certain conditions, Air Canada may request the increase of the facility by up to an additional $100 million by obtaining new commitments from either the existing or new lenders. ACE's participation in the Air Canada credit facility amounted to $150 million. The Credit Facility is a five-year facility with the first principal repayment due in August 2010, and bears interest at 12.75%. Air Canada's obligations under the Credit Facility are secured by a first priority security interest and hypothec over substantially all the present and after-acquired property of Air Canada and its subsidiaries. The Credit Facility also provides for warrants entitling the debt holders to acquire up to 5% of the shares in the Corporation or up to 10% if certain conditions are not met.

  As part of the transactions under the Credit Agreement, Air Canada issued to the lenders, concurrently with the first drawdown, five million warrants at an exercise price of $1.51 with a term of four years to July 2013, for the purchase of Air Canada's Class A variable voting shares or Class B voting shares representing an aggregate of five percent of the total issued and outstanding shares. These warrants have been allocated among the lenders based on their pro rata lending commitments under the Credit Agreement, ACE's share is 1.25 million warrants. Subject to the terms of the Credit Agreement, in the event that Air Canada does not grant additional security over certain assets within 90 days of closing, Air Canada would be required to issue to the lenders additional warrants representing up to an additional five percent of the total issued and outstanding shares (determined at the time of issuance of such additional warrants).

  As a result of the above, ACE's 75.0% direct ownership interest in Air Canada may be diluted in the future.

  As part of the transactions related to the closing of the Credit Facility, existing financing arrangements of $166 million were repaid as follows:

  - The revolving credit facility was repaid in full in the amount of $49 million. The rights of the lender under this facility were assigned to the lenders under the Credit Facility;

- o The spare engine financing was partially repaid in the amount of $38 million. This represented the repayment related to 22 engines under the spare engine financing agreement, with 10 engines remaining under the agreement with a loan value of $81 million as at July 31, 2009;

- o The Aeroplan Canada Inc. ("Aeroplan") loan was repaid in the amount of $79 million, which was the maximum available amount at that time. Aeroplan is a participating lender under the Credit Facility.

- Extended or renewed labour agreements for 21 months with all of Air Canada's Canadian-based unions became effective. The agreements provide for no increases to wage rates, no changes to group insurance coverage or benefit levels during the contract extension periods;

- Pension funding agreements with all of Air Canada's Canadian-based unions (the "Pension MOUs") and the adoption of the Air Canada Pension Funding Regulations, 2009 (the "Air Canada 2009 Pension Regulations"). The Air Canada 2009 Pension Regulations relieve Air Canada from making any special (past service cost) payments for the period beginning April 1, 2009 and ending December 31, 2010. Thereafter, in respect of the period from January 1, 2011 to December 31, 2013, the aggregate annual past service contributions shall equal the lesser of (i) $150 million, $175 million, and $225 million in respect of 2011, 2012, and 2013, respectively and (ii) the maximum past service contributions permitted under the Income Tax Act. The Pension MOUs also provide for Air Canada to issue a fully diluted 15% equity ownership of Air Canada, established as of the date of the Pension MOUs, to a trust with all net proceeds of the eventual sale of the shares held by the trust to be contributed to the pension plans. As a result of the above, ACE's 75.0% direct ownership interest in Air Canada will be diluted;

- An agreement with a supplier for non-refundable proceeds of approximately $220 million in consideration of various contractual commitments;

- Amendments to credit card processing agreements (initiated in the second quarter and completed in July 2009) with one of its principal credit card processors to revise the levels of unrestricted cash (as defined per the agreement and generally based on the balances as reported in cash, cash equivalents and short-term investments) required to be maintained as further described in section 8.2 of this MD&A;

- An extension to a short-term loan of $82 million (US$75 million) entered into in 2008, which was originally due in 2009, to 2013;

- A memorandum of understanding with GE Capital Aviation Services (the "GECAS MOU")for the sale and leaseback of three Boeing 777 aircraft, which is expected to close prior to September 30, 2009, subject to completion of final documents and third party consents, and to provide net cash proceeds of approximately $122 million; and

- A memorandum of understanding for amended terms related to the capacity purchase agreement with Jazz, effective August 1, 2009, subject to formal documentation, which would provide for a reduction to rates paid under the agreement.

During the second quarter of 2009

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

During the first quarter of 2009

- Financing arrangements secured by spare parts, spare engines and a Boeing 777 aircraft for aggregate proceeds of $267 million, net of fees of $5 million. The spare engine financing was partially repaid in July 2009, as described above;
- Sale leaseback of a Boeing 777 aircraft for aggregate proceeds of $172 million and the required repayment of a debt obligation related to the aircraft of $128 million, which included a prepayment fee of $14 million;
- Inventory financing arrangement under which Air Canada acquired certain spare parts inventories expected to be consumed over the next 12 months for a cash payment of $12 million and final payment of $115 million in 2010, based on the foreign exchange rate as at March 31, 2009;
- Repayment of pre-delivery financing of $83 million on the Boeing 777 aircraft received during the first quarter; and
- Net return of collateral deposits on fuel derivatives in the amount of $147 million offset by the settlement of fuel derivative contracts in favour of counterparties in the amount of $217 million.

Taking into account the transactions described above (excluding the GECAS MOU), Air Canada had cash and cash equivalents and short-term investments of $1,320 million ($1,005 million at December 31, 2008, $1,087 million at March 31, 2009 and $907 million as at June 30, 2009).

For a discussion on Air Canada's liquidity risks, refer to section 9.2 of ACE's 2008 MD&A dated August 7, 2009 and section 8.2 of this MD&A.

5. Accounting Policies

This MD&A should be read in conjunction with ACE's interim unaudited consolidated financial statements and notes for the second quarter of 2009 and its annual audited consolidated financial and notes and its annual MD&A for 2008. ACE prepares its financial statements, on a going concern basis of presentation, in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

ACE's interim unaudited financial statements for Quarter 2 2009 are based on accounting policies consistent with those disclosed in Note 2 to ACE's audited consolidated financial statements for 2008.

The preparation of ACE's 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 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. Refer to section 13 of ACE's 2008 MD&A dated August 7, 2009 for a discussion of ACE's critical accounting estimates. There have been no material changes to ACE's critical accounting estimates from those disclosed at that time.

Changes in Accounting Policies

Stock-based compensation plans

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

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

Goodwill and intangible assets

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

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

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

Future Accounting Standard Changes

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

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

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

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

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

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

The plan addresses the impact of IFRS on Accounting policies and implementation decisions, Infrastructure, Business activities and Control activities. A summary status of the key elements of the changeover plan is included in section 6 "Accounting Policies" of ACE's 2008 MD&A dated August 7, 2009. The IFRS changeover plan is progressing as outlined and no significant changes to the plan have been made.

6. Results of Operations – Quarter 2 2009

The following table reflects the results of the Corporation, the results of its reportable segments and certain non-GAAP measures for Quarter 2 2009. Segment information has been prepared consistent with how financial information is produced internally for the purposes of making business decisions.

	Quarter 2 2009		
(Canadian dollars in millions)	**Air Canada**	**CIE**	**ACE Total**
Operating revenue			
Passenger revenue	$ 2,058	$ -	$ 2,058
Cargo revenue	76	-	76
Other revenue	196	-	196
External revenue	2,330	-	2,330
Inter-segment revenue	-	-	-
	2,330	-	2,330
Operating expenses			
Aircraft fuel	572	-	572
Wages, salaries and benefits	438	2	440
Airport and navigation fees	241	-	241
Capacity purchase with Jazz	254	-	254
Depreciation and amortization	165	(2)	163
Aircraft maintenance	185	-	185
Food, beverages and supplies	73	-	73
Communications and information technology	80	-	80
Aircraft rent	83	-	83
Commissions	40	-	40
Other operating expenses	312	2	314
	2,443	2	2,445
Operating loss	**(113)**	**(2)**	**(115)**
Non-operating income (expense)			
Interest income	4	(1)	3
Interest expense	(94)	(3)	(97)
Interest capitalized	2	-	2
Loss on assets	(71)	-	(71)
Gain on financial instruments recorded at fair value	79	-	79
	(80)	(4)	(84)
Loss before the following items	**(193)**	**(6)**	**(199)**
Non-controlling interest	(4)	(40)	(44)
Foreign exchange gain	355	-	355
Recovery of (provision for) income taxes	(3)	1	(2)
Net income (loss) for the period	**$ 155**	**$ (45)**	**$ 110**
EBITDAR (1)	**$ 135**	**$ (4)**	**$ 131**

(1) Refer to section 16 "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 2 2008.

	Quarter 2 2008		
(Canadian dollars in millions)	**Air Canada**	**CIE**	**ACE Total**
Operating revenue			
Passenger revenue	$ 2,454	$ -	$ 2,454
Cargo revenue	139	-	139
Other revenue	189	1	190
	2,782	1	2,783
Operating expenses			
Aircraft fuel	848	-	848
Wages, salaries and benefits	480	7	487
Airport and navigation fees	255	-	255
Capacity purchase with Jazz	233	-	233
Depreciation and amortization	173	(2)	171
Aircraft maintenance	172	-	172
Food, beverages and supplies	81	-	81
Communications and information technology	72	-	72
Aircraft rent	69	-	69
Commissions	47	-	47
Other operating expenses	345	5	350
	2,775	10	2,785
Operating income (loss)	**7**	**(9)**	**(2)**
Non-operating income (expense)			
Interest income	15	8	23
Interest expense	(78)	(9)	(87)
Interest capitalized	8	-	8
Gain on disposal of assets	7	908	915
Gain on financial instruments recorded at fair value	176	-	176
Equity and other investment income (1) (2)	-	5	5
	128	912	1,040
Income before the following items	**135**	**903**	**1,038**
Non-controlling interest	(3)	(29)	(32)
Foreign exchange gain	48	-	48
Provision for income taxes	(58)	(166)	(224)
Net income for the period	**$ 122**	**$ 708**	**$ 830**
EBITDAR (3)	**$ 249**	**$ (11)**	**$ 238**

(1) Reflects ACE's investment in Aeroplan (from April 1, 2008 to May 9, 2008) and ACTS Aero (for Quarter 2 2008) using the equity method of accounting.
(2) Reflects distributions from Aeroplan Income Fund from May 10, 2008 to June 2008 and from Jazz Air Income Fund from April 1, 2008 to June 2008.
(3) Refer to section 16 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income (loss).

ACE recorded an operating loss of $115 million in Quarter 2 2009 compared to an operating loss of $2 million in Quarter 2 2008. Air Canada recorded an operating loss of $113 million, a deterioration of $120 million from the operating income of $7 million recorded in the second quarter of 2008.

ACE recorded EBITDAR of $131 million in Quarter 2 2009 compared to EBITDAR of $238 million in the same period in 2008. Air Canada reported EBITDAR of $135 million in the second quarter of 2009 compared to EBITDAR of $249 million in the same period in 2008, a decrease of $114 million.

ACE recorded operating revenues of $2,330 million and operating expenses of $2,445 million in Quarter 2 2009. In the same period in 2008, ACE recorded operating revenues of $2,783 million and operating expenses of $2,785 million. Air Canada's operating revenues of $2,330 million decreased $452 million from the same period in 2008. An increase of $7 million in other revenues was more than offset by decreases in passenger and cargo revenues of $396 million and $63 million, respectively. The decrease in passenger and cargo revenues was due to both reduced traffic and lower yield. Air Canada's operating expenses of $2,443 million decreased $332 million from the same period in 2008. Reduced fuel expense of $276 million versus the same period in 2008 was the main factor in the decrease in operating expenses.

Non-operating expense amounted to $84 million in Quarter 2 2009 compared to non-operating income of $1,040 million in Quarter 2 2008. Included in Quarter 2 2008 were gains on ACE's sale of Aeroplan Income Fund units amounting to $830 million and a gain on ACE's sale of Jazz Air Income Fund units of $78 million.

Air Canada non-operating expense amounted to $80 million in the second quarter of 2009 compared to non-operating income of $128 million in the second quarter of 2008. Factors contributing to the year-over-year change in the second quarter non-operating expense included:

- Gains related to fair value adjustments on derivative instruments amounted to $79 million in the second quarter of 2009 versus gains of $176 million in the same quarter of 2008. The non-cash mark-to-market gains on financial instruments recorded in the second quarter of 2009 were mainly related to a change in the fair value of fuel derivatives. Refer to section 10 of this MD&A for additional information on Air Canada's derivative instruments.
- Net interest expense increased $33 million from the second quarter of 2008 due to:
    - A decrease in interest income of $11 million due to both lower cash balances and lower rates of interest;
    - An increase in interest expense of $16 million, in part due to new financing transactions completed since the second quarter of 2008 and the unfavourable impact of foreign exchange on interest expense. In addition, in the second quarter of 2009, the Corporation recorded a charge of $9 million related to the termination of the capital leases of two Airbus A340 aircraft and the subsequent sale of these aircraft. These increases were partly offset by a reduction of interest expense on aircraft pre-delivery payments related to Boeing 777 aircraft versus the same period in 2008; and
    - A lower amount of capitalized interest of $6 million compared to the second quarter of 2008.
- In the second quarter of 2009, Air Canada recorded an impairment charge of $67 million related to previously capitalized costs incurred pertaining to the development of a new reservation system, referred to as POLARIS. Air Canada is currently working towards the implementation of certain components of the solution such as web and fare technology but has suspended activity relating to the implementation of the reservation system.
- In the second quarter of 2009, Air Canada also recorded a $2 million loss on the sale of the two Airbus A340 aircraft referred to above.

In Quarter 2 2009, $44 million of the net income was allocated to non-controlling interest compared to $32 million of net income being allocated to non-controlling interest in Quarter 2 2008.

Gains on foreign exchange amounted to $355 million in the second quarter of 2009 compared to gains of $48 million in the second quarter of 2008. The gains in the second quarter of 2009 were attributable to a stronger Canadian dollar at June 30, 2009 compared to March 31, 2009 partly offset by losses of $15 million related to foreign currency derivatives. The June 30, 2009 noon day exchange rate was US$1 = C$1.1625 while the March 31, 2009 noon day exchange rate was US$1 = C$1.2602.

Net income in Quarter 2 2009 amounted to $110 million or $2.68 per diluted share. In Quarter 2 2008, ACE recorded net income of $830 million or $10.76 per diluted share. The net income in Quarter 2 2008 included the significant gains on disposal of the remaining units of Aeroplan Income Fund and Jazz Air Income Fund.

6.1 Air Canada

Air Canada recorded net income of $155 million or $1.55 per diluted share in the second quarter of 2009 compared to net income of $122 million or $1.22 per diluted share in the second quarter of 2008. The net income recorded in the second quarter of 2009 included foreign exchange gains of $355 million. The foreign exchange gains were primarily attributable to a stronger Canadian dollar at June 30, 2009 versus March 31, 2009. The June 30, 2009 noon day exchange rate was US$1 = C$1.1625 while the March 31, 2009 noon day exchange rate was US $1 = C$1.2602.

In the second quarter of 2009, Air Canada recorded an operating loss of $113 million, a deterioration of $120 million from the operating income of $7 million recorded in the second quarter of 2008. EBITDAR amounted to $135 million in the second quarter of 2009 compared to EBITDAR of $249 million in the same period in 2008, a decrease of $114 million.

In the second quarter of 2009, operating revenues of $2,330 million decreased $452 million or 16% from the operating revenues of $2,782 million recorded in the second quarter of 2008. The decrease in operating revenues was mainly due to a passenger revenue decline of $396 million or 16% over the same period in 2008. The passenger revenue decline was due to both lower yield and reduced traffic. Yield declined 8.9% from the second quarter of 2008. Traffic decreased 7.9% on a capacity reduction of 5.4%, resulting in a passenger load factor deterioration of 2.2 percentage points. RASM decreased 11.3% over the same period in 2008, mainly due to the yield decline but also to the deterioration in passenger load factor. A weaker Canadian dollar in the second quarter of 2009 versus the second quarter of 2008, which increases the Canadian dollar value of sales in foreign countries, had a positive impact on foreign currency denominated revenues, accounting for an increase of $65 million to second quarter 2009 passenger revenues compared to the second quarter of 2008.

In the second quarter of 2009, operating expenses of $2,443 million decreased $332 million or 12% from the operating expenses of $2,775 million recorded the second quarter of 2008. The decrease in operating expenses was achieved in spite of $105 million in additional expenses related to the weaker Canadian dollar versus the US dollar. Reduced fuel expense of $276 million versus the same period in 2008 was the main factor in the decrease in operating expenses.

In the second quarter of 2009, CASM decreased 7.0% from the second quarter of 2008. Excluding fuel expense, CASM increased 2.6% from the second quarter of 2008. The unfavourable impact of a weaker Canadian dollar versus the US dollar was the main factor in the CASM growth (excluding fuel expense) in the second quarter of 2009. In addition to the impact of foreign exchange, the higher unit cost of ownership, reflecting Air Canada's investment in new aircraft, increased Jazz CPA expenses and the impact of the capacity reduction were also factors in the increase in CASM (excluding fuel expense). Partly offsetting these increases to CASM (excluding fuel expense) was a reduction in employee benefits expense, the result of revised actuarial assumptions.

6.2 Corporate Items and Eliminations ("CIE")

CIE includes the corporate, financing and investing activities of ACE.

CIE recorded an operating loss of $2 million in Quarter 2 2009 compared to an operating loss of $9 million in Quarter 2 2008. Non-operating expense of $4 million was recorded in Quarter 2 2009 compared to non-operating income of $912 million in Quarter 2 2008.

Factors contributing to the year-over-year change in Quarter 2 2009 included:

- ACE's consolidated statement of operations for Quarter 2 2008 reflected $5 million of equity and other investment income from ACE's investment in Aeroplan and ACTS Aero.
- In Quarter 2 2008, ACE realized a gain of $413 million ($340 million after tax) on the sale of 20,400,000 units of Aeroplan Income Fund in April 2008, a gain of $417 million ($344 million after tax) on the sale of 19,892,088 units of Aeroplan Income Fund in June 2008 and a gain of $78 million ($62 million after tax) on the sale of 11,726,920 units of Jazz Air Income Fund in June 2008. Effective June 2, 2008, ACE no longer retains any ownership interest in Aeroplan and Jazz.

In Quarter 2 2009, $40 million of net income was allocated to non-controlling interest compared to $29 million of the net income being allocated to non-controlling interest in Quarter 2 2008.

7. Results of Operations – First Six Months of 2009

The following table reflects the results of the Corporation, the results of its reportable segments and certain non-GAAP measures for the first six months of 2009. Segment information has been prepared consistent with how financial information is produced internally for the purposes of making business decisions.

	First Six Months of 2009		
(Canadian dollars in millions)	**Air Canada**	**CIE**	**ACE Total**
Operating revenue			
Passenger revenue	$ 4,069	$ -	$ 4,069
Cargo revenue	156	-	156
Other revenue	496	-	496
External revenue	4,721	-	4,721
Inter-segment revenue	-	-	-
	4,721	-	4,721
Operating expenses			
Aircraft fuel	1,165	-	1,165
Wages, salaries and benefits	896	4	900
Airport and navigation fees	471	-	471
Capacity purchase with Jazz	500	-	500
Depreciation and amortization	324	(4)	320
Aircraft maintenance	374	-	374
Food, beverages and supplies	140	-	140
Communications and information technology	159	-	159
Aircraft rent	169	-	169
Commissions	89	-	89
Other operating expenses	735	6	741
	5,022	6	5,028
Operating loss	**(301)**	**(6)**	**(307)**
Non-operating income (expense)			
Interest income	10	1	11
Interest expense	(199)	(6)	(205)
Interest capitalized	3	-	3
Loss on assets	(71)	-	(71)
Loss on repurchase of ACE convertible senior notes and preferred shares	-	(33)	(33)
Gain on financial instruments recorded at fair value	69	-	69
Other	(1)	-	(1)
	(189)	(38)	(227)
Loss before the following items	**(490)**	**(44)**	**(534)**
Non-controlling interest	(8)	60	52
Foreign exchange gain	254	-	254
Provision for income taxes	(1)	(5)	(6)
Net income (loss) for the period	**$ (245)**	**$ 11**	**$ (234)**
EBITDAR (1)	**$ 192**	**$ (10)**	**$ 182**

(1) *Refer to section 16 "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 the first six months of 2008.

(Canadian dollars in millions)	First Six Months of 2008 Air Canada	CIE	ACE Total
Operating revenue			
Passenger revenue	$ 4,765	$ -	$ 4,765
Cargo revenue	263	-	263
Other revenue	480	1	481
External revenue	5,508	1	5,509
Inter-segment revenue	1	(1)	-
	5,509	-	5,509
Operating expenses			
Aircraft fuel	1,563	-	1,563
Wages, salaries and benefits	961	22	983
Airport and navigation fees	496	-	496
Capacity purchase with Jazz	468	-	468
Depreciation and amortization	344	(4)	340
Aircraft maintenance	375	-	375
Food, beverages and supplies	158	-	158
Communications and information technology	145	-	145
Aircraft rent	132	-	132
Commissions	100	-	100
Other operating expenses	772	6	778
	5,514	24	5,538
Operating loss before under-noted item	**(5)**	**(24)**	**(29)**
Provision for cargo investigations	(125)	-	(125)
Operating loss	**(130)**	**(24)**	**(154)**
Non-operating income (expense)			
Interest income	33	15	48
Interest expense	(159)	(24)	(183)
Interest capitalized	25	-	25
Gain (loss) on disposal of assets	(29)	990	961
Gain on financial instruments recorded at fair value	153	-	153
Equity and other investment income (1) (2)	-	17	17
Other non-operating income (expense)	(2)	1	(1)
	21	999	1,020
Income (loss) before the following items	**(109)**	**975**	**866**
Non-controlling interest	(6)	38	32
Foreign exchange loss	(41)	-	(41)
Provision for income taxes	(10)	(199)	(209)
Net income (loss) for the period	**$ (166)**	**$ 814**	**$ 648**
EBITDAR before the provision for cargo investigations (3)	**$ 471**	**$ (28)**	**$ 443**
EBITDAR (3)	**$ 346**	**$ (28)**	**$ 318**

(1) Reflects ACE's investment in Aeroplan (up to May 9, 2008), ACTS Aero (for the first six months of 2008) and Jazz (up to February 7, 2008) using the equity method of accounting.
(2) Reflects distributions from Jazz Air Income Fund from February 8, 2008 to June 2008 and distributions from Aeroplan Income Fund from May 10, 2008 to June 2008.
(3) Refer to section 16 "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 to operating income (loss).

ACE recorded an operating loss of $307 million in the first six months of 2009 compared to an operating loss of $29 million, before the provision for cargo investigations, in the first six months of 2008. Air Canada reported an operating loss of $301 million in the first six months of 2009 compared to an operating loss of $5 million, before a provision for cargo investigations, in the first six months of 2008, a decrease of $296 million versus the same period in 2008. In the first six months of 2008, Air Canada recorded a provision for cargo investigations of $125 million relating to alleged anti-competitive cargo pricing activities.

ACE recorded EBITDAR of $182 million in the first six months of 2009 compared to EBITDAR (before the provision for cargo investigations) of $443 million in the same period in 2008. In the first six months of 2009, Air Canada reported EBITDAR of $192 million compared to EBITDAR (before the provision for cargo investigations) of $471 million in the same period in 2008, a decrease of $279 million.

ACE recorded operating revenues of $4,721 million and operating expenses of $5,028 million in the first six months of 2009. In the same period in 2008, ACE recorded operating revenues of $5,509 million and operating expenses of $5,538 million. Air Canada's operating revenues of $4,721 million decreased $788 million from the same period in 2008. An increase of $15 million in other revenues was more than offset by decreases in passenger and cargo revenues of $696 million and $107 million, respectively. The decrease in passenger and cargo revenues was due to both reduced traffic and lower yield. Air Canada's operating expenses of $5,022 million decreased $492 million from the same period in 2008. Reduced fuel expense of $398 million versus the same period in 2008 was the main factor in the decrease in operating expenses.

Non-operating expense amounted to $227 million in the first six months of 2009 compared to non-operating income of $1,020 million in the first six months of 2008. In the first six months of 2009, ACE recorded a Loss on repurchase of the convertible senior notes and preferred shares within Non-operating expense in the amount of $33 million. The repurchase prices of these instruments, allocated to the liability components of these compound instruments, exceeded the respective carrying values resulting in a loss of $33 million being recorded. The residual equity components of the instruments amounting to $159 million have been transferred directly to Contributed surplus in the consolidated statement of changes in shareholders' equity. Refer to section 8.7 of this MD&A for additional information. Included in the first six months of 2008 were gains totalling $990 million on ACE's sale of Aeroplan Income Fund units and Jazz Air Income Fund units.

Air Canada non-operating expense amounted to $189 million in the first six months of 2009 compared to non-operating income of $21 million in the first six months of 2008. Factors contributing to the year-over-year change in first six months non-operating expense included:

- Gains related to fair value adjustments on derivative instruments amounted to $69 million in the first six months of 2009 versus gains of $153 million in the same quarter of 2008. The non-cash mark-to-market gains on financial instruments recorded in the first six months of 2009 were mainly related to the change in the fair value of fuel derivatives.
- Net interest expense increased $85 million from the first six months of 2008 due to:
    - A lower amount of capitalized interest of $22 million compared to the same period in 2008;
    - A decrease in interest income of $23 million due to both lower cash balances and lower rates of interest;
    - An increase in interest expense of $40 million, in part due to new financing transactions completed since the first six months of 2009 versus the same period in 2008, and the unfavourable impact of foreign exchange on interest expense. In addition, in the first six months of 2009, the Corporation recorded a charge of $17 million related to a sale and leaseback transaction of one Boeing 777 aircraft and a charge of $9 million related to the termination of the capital leases of two Airbus A340 aircraft and the subsequent sale of these aircraft. These increases were partly offset by a reduction of interest expense on aircraft pre-delivery payments related to Boeing 777 aircraft versus the same period in 2008.

- In the first six months of 2009, Air Canada recorded an impairment charge of $67 million related to previously capitalized costs incurred pertaining to the development of a new reservation system, referred to as POLARIS. Air Canada is currently working towards the implementation of certain components of the solution such as web and fare technology but has suspended all activity relating to the implementation of the reservation system.
- In the first six months of 2008, Air Canada recorded an impairment charge of $38 million relating to the retirement of its fleet of Boeing 767-200 aircraft. These losses were partly offset by gains amounting to $7 million pertaining to the sale of aircraft-related inventory.

In the first six months of 2009, $52 million of the net loss was allocated to non-controlling interest compared to $32 million of net loss being allocated to non-controlling interest in the first six months of 2008.

Gains on foreign exchange amounted to $254 million in the first six months of 2009 compared to losses of $41 million in the first six months of 2008. The gains in the first six months of 2009 were attributable to a stronger Canadian dollar at June 30, 2009 compared to December 31, 2008. The June 30, 2009 noon day exchange rate was US$1 = C$1.1625 while the December 31, 2008 noon day exchange rate was US$1 = C$1.2246.

The net loss in the first six months of 2009 amounted to $234 million or $6.68 per diluted share. Net income in the first six months of 2008 amounted to $648 million or $8.18 per diluted share. The net income in the first six 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 the provision for cargo investigations of $125 million recorded by Air Canada.

7.1 Air Canada

Air Canada recorded a loss of $245 million or $2.45 per diluted share in the first six months of 2009 compared to a loss of $166 million or $1.66 per diluted share in the first six months of 2008.

The net income recorded in the first six months of 2009 included foreign exchange gains of $254 million. The gains in the first six months of 2009 were attributable to a stronger Canadian dollar at June 30, 2009 compared to December 31, 2008. The June 30, 2009 noon day exchange rate was US$1 = C$1.1625 while the December 31, 2008 noon day exchange rate was US$1 = C$1.2246.

In the first six months of 2009, Air Canada recorded an operating loss of $301 million, a deterioration of $296 million from the operating loss of $5 million, before the provision for cargo investigations, recorded in the first six months of 2008. EBITDAR amounted to $192 million in the first six months of 2009 compared to EBITDAR, before the provision for cargo investigations, of $471 million in the same period in 2008, a decrease of $279 million.

In the first six months of 2009, operating revenues of $4,721 million decreased $788 million or 14% from the operating revenues of $5,509 million recorded in the second quarter of 2008. The decrease in operating revenues was mainly due to a passenger revenue decline of $696 million or 15% over the same period in 2008. The passenger revenue decline was due to both lower yield and reduced traffic. Yield declined 5.8% from the first six months of 2008. Traffic decreased 9.4% on a capacity reduction of 7.8%, resulting in a passenger load factor deterioration of 1.4 percentage points. RASM decreased 7.3% over the same period in 2008, mainly due to the yield decline but also to the deterioration in passenger load factor.

A weaker Canadian dollar in the first six months of 2009 versus the first six months of 2008 had a positive impact on foreign currency denominated revenues, accounting for an increase of $45 million to first six months 2009 US transborder passenger revenues compared to the first six months of 2008.

In the first six months of 2009, operating expenses of $5,022 million decreased $492 million or 9% from the operating expenses of $5,514 million recorded the first six months of 2008. Reduced fuel expense of $398 million versus the same period in 2008 was the main factor in the decrease in operating expenses.

In the first six months of 2009, CASM decreased 1.2% from the first six months of 2008. Excluding fuel expense, CASM increased 5.9% from the first six months of 2008. The unfavourable impact of a weaker Canadian dollar versus the US dollar accounted for approximately 60% of the CASM growth (excluding fuel expense) in the first six months of 2009. In addition to the impact of foreign exchange, the higher unit cost of ownership, reflecting Air Canada's investment in new aircraft, increased Jazz CPA rates, and the impact of the capacity reduction were also factors in the increase in CASM (excluding fuel expense). Partly offsetting these increases to CASM was a reduction in employee benefits expense, the result of revised actuarial assumptions.

7.2 Corporate Items and Eliminations ("CIE")

CIE includes the corporate, financing and investing activities of ACE.

CIE recorded an operating loss of $6 million in the first six months of 2009 compared to an operating loss of $24 million in the first six months of 2008. Non-operating expense of $38 million was recorded in the first six months of 2009 compared to non-operating income of $999 million in the first six months of 2008.

Factors contributing to the year-over-year change in the first six months of 2009 included:

- In the first six months of 2009, ACE recorded a Loss on repurchase of the convertible senior notes and preferred shares within Non-operating expense in the amount of $33 million related to the January 2009 and March 2009 substantial issuer bids resulting in the purchase for cancellation of 74% or 9.3 million of the 12.5 million Convertible preferred shares and 80% of the Convertible senior notes outstanding as at December 31, 2008. The aggregate principal amount of the repurchased Convertible senior notes was $259 million. The repurchase prices of these instruments, allocated to the liability components of these compound instruments, exceeded the respective carrying values resulting in a loss of $33 million being recorded. The residual equity components of the instruments amounting to $159 million have been transferred directly to Contributed surplus in the consolidated statement of changes in shareholders' equity. Refer to section 8.7 of this MD&A for additional information.

- ACE's consolidated statement of operations in the first six months of 2008 reflected $17 million of equity and other investment income from ACE's investment in Aeroplan, Jazz and ACTS Aero.

- In the first six months of 2008, gains totalling $990 million were recorded in CIE as a result of ACE's sale of Aeroplan Income Fund units and Jazz Air Income Fund units

In the first six months of 2009, $60 million of the net loss was allocated to non-controlling interest compared to $38 million of the net loss being allocated to non-controlling interest in the first six months of 2008.

8. Financial and Capital Management

The following table summarizes ACE's consolidated statement of financial position as at June 30, 2009 and as at December 31, 2008.

Condensed Consolidated Statement of Financial Position (Canadian dollars in millions)	**June 30, 2009**	**December 31, 2008**
Assets		
Cash, cash equivalents and short-term investments	$ 1,270	$ 1,813
Other current assets	1,193	1,396
Current assets	2,463	3,209
Property and equipment	7,180	7,469
Intangible assets	632	698
Deposits and other assets	507	495
	$ 10,782	**$ 11,871**
Liabilities		
Current liabilities	$ 3,573	$ 3,704
Long-term debt and capital leases	4,438	4,980
Convertible preferred shares	57	206
Pension and other benefits liabilities	1,368	1,585
Other long-term liabilities	412	420
	9,848	**10,895**
Non-controlling interest	**456**	**512**
Shareholders' equity	**478**	**464**
	$ 10,782	**$ 11,871**

8.1 Analysis of Financial Position

ACE

Cash, cash equivalents and short-term investments

Refer to section 8.3 of this MD&A for a discussion of the change in unconsolidated Cash, cash equivalents and short-term investments.

Long-term debt and capital leases (including current portion)

Refer to section 8.7 of this MD&A for a discussion of the January 2009 substantial issuer bid resulting in the purchase for cancellation of 80% of ACE's convertible senior notes outstanding as at December 31, 2008, at a purchase price of $900 dollars in cash for each $1,000 dollars principal amount of notes. The aggregate principal amount of the repurchased Convertible senior notes was $259 million. On January 21, 2009, the Corporation paid an aggregate purchase price of $233 for the notes tendered.

Convertible preferred shares

Refer to section 8.7 of this MD&A for a discussion of the January 2009 and March 2009 substantial issuer bids resulting in the purchase for cancellation of 9.3 million of ACE's convertible preferred shares at a purchase price of $20 dollars per preferred share. In Quarter 1 2009, the Corporation paid an aggregate purchase price of $186 million for the shares tendered.

Non-controlling interest

ACE's non-controlling interest amounted to $456 million as at June 30, 2009, a reduction of $56 million from December 31, 2008. The change in non-controlling interest was mainly due to the non-controlling interests' share of the loss experienced by Air Canada in the first six months of 2009. Refer to section 7.1 of this MD&A for a discussion of Air Canada results of operations for the six months ended June 30, 2009.

Air Canada
Property and equipment amounted to $7,180 million at June 30, 2009, a reduction of $289 million from December 31, 2008. The reduction was mainly due to the impact of depreciation expense of $291 million in the first six months of 2009 and the sale of two Airbus A340 aircraft partly offset by additions to capital assets.

Long-term debt and capital leases, including the current portion, amounted to $5,001 million at June 30, 2009, a decrease of $353 million from December 31, 2008. The decrease in long-term debt and capital leases was mainly due to the appreciation of the Canadian dollar and the resulting favourable impact of $268 million on Air Canada's foreign denominated debt and capital leases. Additional borrowings of $343 million and the sale and leaseback of a Boeing 777 aircraft accounted for as a capital lease, which resulted in an increase to total long-term debt of $158 million, were more than offset by long-term debt and capital lease repayments of $600 million.

The decline in pension and other benefits liabilities of $217 million from December 31, 2008 was primarily due to pension funding of $212 million in excess of pension expense in the first six months of 2009. Refer to section 9.4 of ACE's 2008 MD&A dated August 7, 2009 and section 8.5 of this MD&A for a discussion on Air Canada's pension funding obligations.

8.2 Air Canada Liquidity

Liquidity risk is the risk that Air Canada will encounter difficulty in meeting obligations associated with its financial liabilities and other contractual obligations. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. Air Canada's principal objective in managing liquidity risk is to maintain a minimum unrestricted cash balance in excess of a target liquidity level of 15% of annual operating revenues. At July 31, 2009, cash, cash equivalents and short-term investments were $1.32 billion, or 13% of 2008 annual operating revenues.

Air Canada management believes that the significant events as described in section 4 of this MD&A improve Air Canada's current liquidity position, however, certain risks remain related to the current economic environment, including risks related to market volatility in the price of fuel, foreign exchange and interest rates as well as increased competitive pressures and restrictive terms under Air Canada's financing and other arrangements. During the first half of 2009, demand for Air Canada's air travel and cargo services continued to weaken in both domestic and international markets. Air Canada expects demand to continue to be a challenge for the remainder of the year. The H1N1 influenza virus may also continue to impact demand for air travel. Air Canada is monitoring the H1N1 influenza virus risk, however, it is unable to predict if the impact on its operations will be significant. While Air Canada has raised financing proceeds, as described in section 4 of this MD&A, and it does not intend on raising further financing of any significance over the course of the next year, the credit markets continue to be constrained. In addition, given the terms and undertakings in the currently outstanding financing arrangements, Air Canada has limited assets which would be available to support additional financings or similar transactions, if required. These factors have had and may continue to have an impact on the liquidity risk of Air Canada. Refer to section 8.4 of this MD&A for information on Air Canada's contractual obligations.

To date in 2009, including the significant events as discussed in section 4 of this MD&A, Air Canada management continued to undertake various initiatives and develop plans to manage its operating and liquidity risks, taking into account the prevailing economic conditions, including the financing arrangements in section 4 of this MD&A, cost containment initiatives and capacity adjustments with the objective of matching capacity to passenger demand. However, the nature of Air Canada's cost structure is such that fixed costs may not fluctuate proportionately with changes in capacity in the short term.

Pension funding obligations

Refer to section 9.4 of ACE's 2008 MD&A dated August 7, 2009 and section 8.5 of this MD&A for a discussion on Air Canada's pension funding obligations.

Covenants in credit card agreements

Air Canada has various agreements for the processing of customer credit card transactions. During the second quarter of 2009 and in July 2009, Air Canada entered into amendments with one of its principal credit card processors to amend certain credit card processing agreements under which the levels of unrestricted cash (as defined per the agreement and generally based on the balances as reported in cash, cash equivalents and short-term investments) required to be maintained by Air Canada is reduced to $800 million (versus $1,300 million prior to the amendments) and Air Canada provides the processor with deposits, to be accumulated over time, and security. The triggering event based on a debt service coverage ratio is no longer applicable under the amended agreement. Should Air Canada maintain unrestricted cash of more than $1,200 million for two consecutive months, the unrestricted cash requirement increases to $1,100 million at which time the processor will return to Air Canada all deposits and security previously provided by Air Canada. As long as unrestricted cash remains at or above $1,100 million, Air Canada will have no obligation to provide deposits or security to the processor. Pursuant to the amendments entered into in July 2009, should Air Canada's unrestricted cash be less than $1,100 million, its obligation to provide deposits to the processor would be capped at an amount not in excess of $75 million, provided unrestricted cash is not less than $800 million. As at June 30, 2009, a deposit in the amount of $27 million had accumulated under these processing agreements, which has further increased to the above-referenced cap of $75 million as at July 31, 2009. Deposits under these processing agreements are reported in prepaid expenses and other current assets on ACE's consolidated statement of financial position.

Cargo investigations and proceedings

Air Canada is exposed to potential liabilities related to the proceedings and investigations of alleged anti-competitive cargo pricing activities, as described in section 14 of ACE's 2008 MD&A dated August 7, 2009. This preliminary estimate recorded by Air Canada during 2008 is based upon the current status of the investigations and proceedings and Air Canada's assessment as to the potential outcome for certain of them. This provision does not address the proceedings in all jurisdictions, but only where there is sufficient information to do so. Air Canada management has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings. Additional material provisions may be required. Amounts could become payable within the year and may be materially different than Air Canada management's preliminary estimate.

Collateral deposits for fuel derivatives

The types of derivative instruments used by Air Canada within its hedging program, such as swaps and put options within collar structures, expose Air Canada to the potential of posting cash collateral deposits. The drastic decrease in fuel prices observed in the fourth quarter of 2008 resulted in a significant negative fair value for Air Canada's portfolio of fuel hedges. Once the fair value in favour of the counterparty of certain fuel derivatives exceeds Air Canada's credit thresholds with those counterparties, Air Canada is responsible for extending collateral to the counterparties. As at July 31, 2009, the total cash collateral deposits held by counterparties amounted to $99 million ($109 million at June 30, 2009, $181 million at March 31, 2009 and $328 million at December 31, 2008). Refer to section 12 of ACE's 2008 MD&A dated August 7, 2009 and section 10 of this MD&A for a discussion on fuel price risk.

8.3 Consolidated Cash Flows

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

(Canadian dollars in millions)	Quarter 2 2009	Quarter 2 2008	Quarter 2 $ Change	First Six Months 2009	First Six Months 2008	First Six Months $ Change
Cash from (used for) operating activities	$ (104)	$ 217	$ (321)	$ 51	$ 446	$ (395)
Cash from (used for) financing activities	(101)	(664)	563	(676)	(2,297)	1,621
Cash from (used for) investing activities	79	674	(595)	169	1,032	(863)
Net change in cash and cash equivalents during the period	**(126)**	**227**	**(353)**	**(456)**	**(819)**	**363**
Cash and cash equivalents - Beginning of period	**977**	**1,254**	**(277)**	**1,307**	**2,300**	**(993)**
Cash and cash equivalents - End of period	**$ 851**	**$ 1,481**	**$ (630)**	**$ 851**	**$ 1,481**	**$ (630)**

** Cash and cash equivalents exclude Short-term investments of $419 million as at June 30, 2009 (as at June 30, 2008 - $844 million).*

ACE
The following summarizes significant transactions or factors which impacted ACE's unconsolidated cash and cash equivalents in the first six months of 2009:

- In January 2009, the Corporation completed a substantial issuer bid to purchase for cancellation 80% of its convertible senior notes outstanding as at December 31, 2008, at a purchase price of $900 dollars in cash for each $1,000 dollars principal amount of notes. The aggregate principal amount of the repurchased Convertible senior notes was $259 million. On January 21, 2009, the Corporation paid an aggregate purchase price of $233 million for the notes tendered.

- In January 2009, the Corporation completed a substantial issuer bid to purchase for cancellation 8.3 million of its convertible preferred shares at a purchase price of $20 dollars per preferred share. On January 21, 2009, the Corporation paid an aggregate purchase price of $166 million for the shares tendered.

- In March 2009, the Corporation completed a substantial issuer bid to purchase for cancellation 1.0 million of its convertible preferred shares at a purchase price of $20 dollars per preferred share. On March 23, 2009, the Corporation paid an aggregate purchase price of $20 million for the shares tendered.

The following summarizes significant transactions or factors which impacted ACE's unconsolidated cash, cash equivalents and short-term investments in the first six months of 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.

- 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.

- ACE received net proceeds of $97 million related to the sale of Jazz Air Income Fund units on January 24, 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.

Air Canada

The following summarizes significant transactions or factors which impacted Air Canada's consolidated cash, cash equivalents and short-term investments in Quarter 2 2009:

Cash flows used for operating activities amounted to $91 million, a decrease of $305 million from Quarter 2 2008. The decrease in operating cash flows versus the same period in 2008 was primarily driven by changes in non-cash working capital balances primarily related to lower advance ticket sales, and the expiry of the Aeroplan pre-payment agreement. The decrease in operating cash flows also reflected deterioration in Air Canada's operating results and the impact of higher past service cost contributions under the Corporation's pension plans.

Cash used for financing activities amounted to $101 million in Quarter 2 2009. In Quarter 2 2009, Air Canada had new borrowings of $76 million, relating mainly to a secured loan with Aeroplan, which was more than offset by a reduction of long-term debt and capital lease obligations of $177 million.

Cash flows from investing activities in Quarter 2 2009 amounted to $80 million. In Quarter 2 2009, Air Canada sold two A340 aircraft for proceeds of $91 million. Additions to capital assets at Air Canada amounted to $49 million.

The following summarizes significant transactions or factors which impacted Air Canada's consolidated cash, cash equivalents and short-term investments in Quarter 1 2009:

Cash flows from operating activities decreased $62 million from Quarter 1 2008. The decrease in operating cash flows versus the same period in 2008 was primarily driven by the impact of higher past service cost contributions under the Corporation's pension plans and the settlement of fuel derivatives in favour of counterparties of $217 million partly offset by a net return of collateral deposits on fuel derivatives of $147 million.

Cash used for financing activities amounted to $156 million in Quarter 1 2009. In Quarter 1 2009, Air Canada had new aircraft borrowings of $267 million related to financing arrangements secured by spare parts, spare engines and a Boeing 777 aircraft for aggregate proceeds of $267 million, net of fees of $5 million which were more than offset by a reduction of long-term debt and capital lease obligations of $423 million.

Cash flows from investing activities in Quarter 1 2009 amounted to $89 million and included proceeds of $172 million relating to the sale-leaseback of a Boeing 777 aircraft for aggregate proceeds of $172 million and the required repayment of a debt obligation related to the aircraft of $128 million, which included a prepayment fee of $14 million. Additions to capital assets at Air Canada amounted to $107 million.

8.4 Contractual Obligations

ACE

Information on the Corporation's contractual obligations is disclosed in section 9.3 of ACE's 2008 MD&A dated August 7, 2009.

In January, 2009, the Corporation completed a substantial issuer bid to purchase for cancellation 80% of its convertible senior notes outstanding as at December 31, 2008, at a purchase price of $900 dollars in cash for each $1,000 dollars principal amount of notes. The aggregate principal amount of the repurchased Convertible senior notes was $259 million. On January 21, 2009, the Corporation paid an aggregate purchase price of $233 million for the notes tendered.

Following the substantial issuer bid described above, ACE's contractual obligation consists of its Convertible Senior Notes repayable on June 1, 2010 in the amount of $64 million. Reference to June 1, 2010 represents the first date the holders may require ACE to purchase all or a portion of the Convertible Senior Notes at a purchase price equal to 100% of the principal amount of the notes to be purchased. As at June 30, 2009, interest repayment obligations associated with the Convertible Senior Notes amount to $1 million for the remainder of 2009 and $1 million in 2010.

Air Canada

The table below provides Air Canada's current contractual obligations, including the effects of the financing transactions which occurred subsequent to June 30, 2009, for the remainder of 2009, for the next four years and after 2013.

(Canadian dollars in millions)	Remainder of 2009	2010	2011	2012	2013	Thereafter	Total
Long-term debt, capital leases and interest repayment obligations (1)	$ 290	$ 834	$ 1,079	$ 802	$ 846	$ 2,930	$ 6,781
Operating lease obligations (2)	159	365	324	304	269	804	2,225
Committed capital expenditures (3)	26	53	49	115	733	3,864	4,840
Total contractual obligations (4)	**$ 475**	**$ 1,252**	**$ 1,452**	**$ 1,221**	**$ 1,848**	**$ 7,598**	**$ 13,846**

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

8.5 Air Canada Pension Funding Obligations

Information on the Corporation's pension funding obligations is disclosed in section 9.4 of ACE's 2008 MD&A dated August 7, 2009.

Air Canada has reported that the solvency deficit as at January 1, 2009 in the registered pension plans, which is used to determine funding requirements, is $2,835 million.

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

The Air Canada 2009 Pension Regulations were adopted in coordination with pension funding agreements reached with Air Canada's Canadian-based unions and a consultation process with its retirees and non-unionized workforce. The Pension MOUs also provide for Air Canada to issue a fully diluted 15% equity ownership of Air Canada to a trust, with all net proceeds of sale to be contributed to the pension plans. A seat on the Board of Directors of Air Canada will be allocated for designation by a trustee representing Air Canada's unions while ownership exceeds 2%. Current service payments will continue to be made in the normal course and there will be no change to the defined benefit plans nor a reduction in benefits while these regulations are in effect.

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

The following table provides Air Canada's pension funding obligations, on a cash basis, based on the Air Canada 2009 Pension Regulations as described above, for the remainder of 2009 as at June 30, 2009, for the full year 2009, for the next four years.

(Canadian dollars in millions)	Remainder of 2009	Full Year 2009	2010	2011	2012	2013
Past service domestic registered plans	$ 29	$ 140	$ -	$ 138	$ 173	$ 221
Current service domestic registered plans	108	188	161	165	170	175
Other pension arrangements (1)	49	79	78	79	81	83
Projected pension funding obligations	**$ 186**	**$ 407**	**$ 239**	**$ 382**	**$ 424**	**$ 479**

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

In May 2009, Air Canada and Aeroplan reached an agreement with the Canadian Auto Workers (CAW) Local 2002, providing for a process for the approximately 750 Air Canada employees then working in the Aeroplan contact centres to choose to transition to employment at Aeroplan, effective June 1, 2009, or to remain employees of Air Canada. Employees at Air Canada work locations who become surplus to Air Canada's needs, due to employees then working at Aeroplan contact centres who are senior to them, choosing to remain employees of Air Canada, were given the option to transition to employment at Aeroplan. Certain employees at Air Canada work locations transitioning to Aeroplan will continue to work for Air Canada until, at the latest, October 4, 2009, due to Air Canada's operational needs. The date these employees become Aeroplan employees depends on the date they are released from employment with Air Canada. For those employees transitioning to Aeroplan, their service, which largely determines benefit levels under the Air Canada pension and other employee benefit plans, will cease to accrue as of the date of employment with Aeroplan.

Refer to section 4 of this MD&A for additional information.

8.6 Air Canada Capital Expenditures and Related Financing Arrangements

As at June 30, 2009, Air Canada had outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of 37 Boeing 787 aircraft. Subsequent to June 30, 2009, Air Canada and Boeing agreed to amend the purchase agreement for the Boeing 787 aircraft to reduce the number of options for Boeing 787 aircraft by ten, from 23 to 13, and to provide for purchase rights for ten Boeing 787 aircraft. Air Canada continues to have 37 firm orders for Boeing 787 aircraft. Air Canada and Boeing also agreed to amend certain commercial terms, including to revise delivery dates and to provide for certain financial adjustments. Air Canada's first Boeing 787 aircraft is now scheduled for delivery in the second half of 2013. Air Canada continues to hold purchase rights for 18 Boeing 777 aircraft.

The table below provides Air Canada's current projected, planned and committed capital expenditures, including the effects of the financing transactions which occurred subsequent to June 30, 2009, for the remainder of 2009, for the next four years and after 2013.

(Canadian dollars in millions)	Remainder of 2009	2010	2011	2012	2013	Thereafter
Projected committed expenditures	$ 26	$ 53	$ 49	$ 115	$ 733	$ 3,864
Projected planned but uncommitted expenditures	51	77	80	132	112	
Total projected expenditures (1) (2)	77	130	129	247	845	
Projected financing on committed expenditures	-	-	-	-	(584)	
Total projected expenditures, net of financing	**$ 77**	**$ 130**	**$ 129**	**$ 247**	**$ 261**	

(1) US dollar amounts are converted using the July 31, 2009 noon day exchange rate of US$1 = C$1.0790 Final aircraft delivery prices include estimated escalation and interest on deferred delivery payments.
(2) The dollar amounts reflected above do not include obligations pertaining to day-to-day operations.

8.7 Share Information

At July 31, 2009, 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)	July 31, 2009	December 31, 2008
Issued and outstanding common shares		
Class A variable voting shares	25,680	25,614
Class B voting shares	10,011	9,293
Total issued and outstanding common shares	**35,691**	**34,907**
Common shares potentially issuable		
Convertible preferred shares	3,125	11,863
Convertible senior notes	2,600	13,133
Stock options	58	61
Total common shares potentially issuable	**5,783**	**25,057**
Total outstanding and potentially issuable common shares	**41,474**	**59,964**

(1) In May 2009, the Chairman, President and Chief Executive Officer of ACE requested that the after-tax amount of severance and benefits of $4.2 million be paid to him in the form of shares of ACE. As a result, on May 22, 2009, the Chairman, President and Chief Executive Officer's after-tax amount was used to acquire and retain 784,350 Class B voting shares of ACE. Such subscription was effected through a grant of options that were exercised immediately upon the grant at an exercise price of $5.34, which is equal to the market price determined under the terms of the Stock Option Plan.

(2) In January 2009 and March 2009, the Corporation completed two substantial issuer bids to purchase for cancellation 9.3 million of its convertible preferred shares at a purchase price of $20 dollars per preferred share. In Quarter 1 2009, the Corporation paid an aggregate purchase price of $186 million for the shares tendered.

(3) In January 2009, the Corporation completed a substantial issuer bid to purchase for cancellation 80% of its convertible senior notes outstanding as at December 31, 2008, at a purchase price of $900 dollars in cash for each $1,000 dollars principal amount of notes. The aggregate principal amount of the repurchased Convertible senior notes was $259 million. On January 21, 2009, the Corporation paid an aggregate purchase price of $233 million for the notes tendered.

(4) The Corporation's stock option plan is described in Note 13 to the 2008 annual financial statements. At June 30, 2009, a total of 58,063 stock options with a weighted exercise of $14.28 were outstanding (61,230 stock options with a weighted exercise of $14.11 outstanding as at December 31, 2008). The decrease of 3,167 stock options since December 31, 2008 is due to forfeitures experienced in Quarter 1 2009.

9. Quarterly Financial Information

The quarterly information presented below may not be directly comparable as a result of changes in ACE's accounting policies relating to its investments in Jazz and ACTS.

($ millions, except per share amounts)	Q3 2007	Q4 2007[1]	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009
Operating revenues	$ 3,022	$ 2,520	$ 2,726	$ 2,783	$ 3,075	$ 2,496	$ 2,391	$ 2,330
Operating expenses	(2,682)	(2,474)	(2,753)	(2,785)	(2,970)	(2,646)	(2,583)	(2,445)
Operating income (loss) before under-noted item	**340**	**46**	**(27)**	**(2)**	**105**	**(150)**	**(192)**	**(115)**
Provision for cargo investigations[2]	-	-	(125)	-	-	-	-	-
Operating income (loss)	**340**	**46**	**(152)**	**(2)**	**105**	**(150)**	**(192)**	**(115)**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax[3]	(116)	1,082	(30)	832	(240)	(483)	(152)	225
Net income (loss)	**$ 224**	**$ 1,128**	**$ (182)**	**$ 830**	**$ (135)**	**$ (633)**	**$ (344)**	**$ 110**
Earnings (loss)[4]								
Per share – basic	**$ 2.17**	**$ 10.81**	**$ (2.96)**	**$ 15.46**	**$ (3.86)**	**$ (18.12)**	**$ (9.87)**	**$ 3.16**
Per share – diluted	**$ 1.84**	**$ 8.88**	**$ (2.96)**	**$ 10.76**	**$ (3.86)**	**$ (18.12)**	**$ (9.87)**	**$ 2.68**

(1) *ACE ceased consolidating ACTS' results effective October 16, 2007.*
(2) *Air Canada recorded a provision for cargo investigations of $125 million in Quarter 1 2008.*
(3) *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. Quarter 1 2009 includes a loss on repurchase of the convertible senior notes and preferred shares of $33 million relating to the substantial issuer bids completed in January 2009 and March 2009.*
(4) *Earnings (loss) per share 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.*

10. Financial Instruments and Risk Management

Summary of gain on financial instruments recorded at fair value

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

	Second Quarter		First Six Months	
(Canadian dollars in millions)	**2009**	**2008**	**2009**	**2008**
Ineffective portion of fuel hedges	$ -	$ 115	$ -	$ 82
Fuel derivatives not under hedge accounting	85	79	76	85
Cross-currency interest rate swaps	-	(19)	-	(13)
Other	(6)	1	(7)	(1)
Gain on financial instruments recorded at fair value	**$ 79**	**$ 176**	**$ 69**	**$ 153**

Fuel price risk

As of June 30, 2009, approximately 28% of Air Canada's anticipated purchases of jet fuel for the remainder of 2009 are hedged at an average West Texas Intermediate ("WTI")-equivalent capped price of US$106 per barrel, of which 52% is subject to an average WTI-equivalent floor price of US$83 per barrel. Air Canada has also hedged approximately 13% of its 2010 anticipated jet fuel purchases in crude oil-based contracts hedged at an average capped price of US$110 per barrel, of which 87% is subject to an average floor price of US$101 per barrel.

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

Outstanding at June 30, 2009				
Derivative Instruments	**Term**	**Volume (BBLs)**	**WTI-equivalent Average Floor Price (US$ per barrel)**	**WTI-equivalent Average Capped Price (US$ per barrel)**
Call Options (1)	2009	1,600,000	n/a	121
	2010	400,000	n/a	134
Swaps (1)	2009	570,000	99	99
	2010	1,070,000	99	99
Collars (1)	2009	1,140,000	75	87
	2010	1,560,000	102	112

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

In the second quarter of 2009, fuel derivative contracts cash settled with a fair value of $17 million in favour of the counterparties ($62 million in favour of the counterparties in the first six months of 2009) ($105 million in favour of Air Canada in the second quarter of 2008 and $144 million in favour of Air Canada in the first six months of 2008). As fuel hedging contracts with unfavourable fair values are settled, Air Canada can recall the offsetting cash collateral deposits from counterparties.

In the first quarter of 2009, in order to further reduce its exposure to declining oil prices, Air Canada terminated fuel derivative contracts with a fair market value of $172 million (US$146 million) in favour of the counterparties. The collateral held by the counterparties covered the majority of the settlement amount therefore minimal additional cash outflows resulted.

The fuel hedging losses recorded under fuel expense was $113 million in the second quarter of 2009 (losses of $240 million in the first six months of 2009) (gains of $92 million in the second quarter of 2008 and gains of $126 million in the first six months of 2008), mainly due to the reallocation to fuel expense of the hedging losses accumulated in Other Comprehensive Income ("OCI") in previous periods upon consumption of the hedged fuel.

As at June 30, 2009, the estimated net amount of existing losses reported in Accumulated Other Comprehensive Income ("AOCI") that are expected to be reclassified to net income (loss) during the following 12 months is $289 million (before tax).

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

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

		Second Quarter		First Six Months	
(Canadian dollars in millions)		**2009**	**2008**	**2009**	**2008**
Consolidated Statement of Operations					
Operating expense					
Aircraft fuel	Realized effective gain (loss) on derivatives designated under hedge accounting	$ (113)	$ 92	$ (240)	$ 126
Non-operating income (expense)					
Gain on financial instruments recorded at fair value	Ineffective gain on derivatives designated under hedge accounting	$ -	$ 115	$ -	$ 82
	Fair market value gain on economic hedges	$ 85	$ 79	$ 76	$ 85
Consolidated Statement of Comprehensive Income (Loss)					
	Effective gain (loss) on derivatives designated under hedge accounting	$ -	$ 255	$ (1)	$ 401
	Tax expense on effective gain	$ -	$ (82)	$ -	$ (128)
	Reclassification of net realized (gain) loss on fuel derivatives designed under hedge accounting to aircraft fuel expense	$ 113	$ (92)	$ 240	$ (126)
	Tax on reclassification	$ 2	$ 30	$ 4	$ 41

		June 30, 2009	December 31, 2008
Consolidated Statement of Financial Position			
Current assets	Collateral deposits for fuel derivatives	$ 109	$ 328
Current liabilities[(1)]	Fair market value of fuel derivatives designated under hedge accounting	$ 1	$ (405)
	Fair market value of fuel derivatives – economic hedges	$ (111)	$ (15)
Shareholders' equity (AOCI)	Net loss from fuel derivatives designated under hedge accounting	$ (363)	$ (606)

(1) The balance is reflected within current liabilities on the Corporation's consolidated statement of financial position due to the counterparties' ability to terminate the derivatives at fair value at any time prior to maturity.

For additional information on fuel price risk, refer to section 12 of ACE's 2008 MD&A dated August 7, 2009.

11. Off-Balance Sheet Arrangements

Information on the Corporation's off-balance sheet arrangements is disclosed in section 11 of ACE's 2008 MD&A dated August 7, 2009. There have been no material changes to the Corporation's off-balance sheet arrangements from what was disclosed at that time.

12. Related Party Transactions

At August 7, 2009, ACE held a 75% ownership interest in Air Canada and a 28.4% interest in Aero Technical Support and Services Holdings sarl ("ACTS Aero"). ACTS Aero owns 100% of Aveos Fleet Performance Inc. ("Aveos").

ACE is a participant lender in the Credit Facility as described in section 4 of this MD&A. ACE's participation in the Credit Facility amounts to $150 million of the outstanding loan of $600 million as at July 31, 2009. The participant lenders participate on a pro-rata basis with respect to any warrants and principal and interest payments.

Air Canada has various related party transactions with Aveos Fleet Performance Inc. ("Aveos") and ACE. The agreements between Air Canada and Aveos and between Air Canada and ACE are summarized in section 10 of ACE's 2008 MD&A dated August 7, 2009. There have been no material changes to the Corporation's related party agreements from what was disclosed at that time with the exception of ACE's participation in the Credit Facility and changes in payment terms related to related party agreements dated October 28, 2008 between Air Canada and Aveos.

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

In the second quarter of 2009, the payment terms were further extended with the first reduction expected to begin in August 2009 with the expiration of the extended payment terms over the following six months. By

January 2010, the letters of credit would be reinstated to the levels then required under the Pension and Benefits Agreement between the two parties.

13. Critical Accounting Estimates

Information on ACE's critical accounting estimates is disclosed in section 13 of ACE's 2008 MD&A dated August 7, 2009. There have been no material changes to ACE's critical accounting estimates from what was disclosed at that time.

14. Risk Factors

For a detailed description of the risk factors associated with the Corporation, refer to section 14 "Risk Factors" of ACE's 2008 MD&A dated August 7, 2009. There have been no material changes to the Corporation's risk factors from what was disclosed at that time.

15. Controls and Procedures

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

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

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

In the Corporation's Quarter 2 2009 filings, the Corporation's CEO and CFO certify, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design of the Corporation's disclosure controls and procedures and the design of internal controls over financial reporting.

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

Management's Report on Disclosure Controls and Procedures

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

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

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

Management's Report on Internal Controls over Financial Reporting

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

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

Changes in Internal Controls over Financial Reporting

There have been no changes to the Corporation's internal controls over financial reporting during Quarter 2 2009 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

16. Non-GAAP Financial Measures

EBITDAR (earnings before interest, taxes, depreciation, amortization and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before aircraft rent and depreciation and amortization as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other 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 is not a recognized measure for financial statement presentation under Canadian GAAP and does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies.

EBITDAR before the Provision for cargo investigations and EBITDAR for Air Canada are reconciled to operating loss as follows:

	Quarter 2			First Six Months		
(Canadian dollars in millions)	**2009**	**2008**	**$ Change**	**2009**	**2008**	**$ Change**
Air Canada						
GAAP operating loss before the provision for cargo investigations	$ (113)	$ 7	$ (120)	$ (301)	$ (5)	$ (296)
Add back:						
Aircraft rent	83	69	14	169	132	37
Depreciation and amortization	165	173	(8)	324	344	(20)
EBITDAR before the provision for cargo investigations	**135**	**249**	**(114)**	**192**	**471**	**(279)**
Provision for cargo investigations	-	-	-	-	(125)	125
EBITDAR	**$ 135**	**$ 249**	**$ (114)**	**$ 192**	**$ 346**	**$ (154)**
ACE Consolidated						
GAAP operating loss before the provision for cargo investigations	$ (115)	$ (2)	$ (113)	$ (307)	$ (29)	$ (278)
Add back:						
Aircraft rent	83	69	14	169	132	37
Depreciation and amortization	163	171	(8)	320	340	(20)
EBITDAR before the provision for cargo investigations	**131**	**238**	**(107)**	**182**	**443**	**(261)**
Provision for cargo investigations	-	-	-	-	(125)	125
EBITDAR	**$ 131**	**$ 238**	**$ (107)**	**$ 182**	**$ 318**	**$ (136)**

17. 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.

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.