ACE AVIATION

Second Quarter 2009
Interim Unaudited
Consolidated Financial Statements and Notes

August 7, 2009

Consolidated Statement of Operations

Unaudited (Canadian dollars in millions except per share figures)		Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
Operating revenues					
Passenger		$ 2,058	$ 2,454	$ 4,069	$ 4,765
Cargo		76	139	156	263
Other		196	190	496	481
		2,330	2,783	4,721	5,509
Operating expenses					
Aircraft fuel		572	848	1,165	1,563
Wages, salaries and benefits		440	487	900	983
Airport and navigation fees		241	255	471	496
Capacity purchase with Jazz	Note 10	254	233	500	468
Depreciation and amortization		163	171	320	340
Aircraft maintenance		185	172	374	375
Food, beverages and supplies		73	81	140	158
Communications and information technology		80	72	159	145
Aircraft rent		83	69	169	132
Commissions		40	47	89	100
Other		314	350	741	778
		2,445	2,785	5,028	5,538
Operating loss before under-noted item		**(115)**	**(2)**	**(307)**	**(29)**
Provision for cargo investigations		-	-	-	(125)
Operating loss		**(115)**	**(2)**	**(307)**	**(154)**
Non-operating income (expense)					
Interest income		3	23	11	48
Interest expense	Note 2	(97)	(87)	(205)	(183)
Interest capitalized		2	8	3	25
Gain (loss) on assets	Note 2	(71)	915	(71)	961
Loss on repurchase of ACE convertible senior notes and preferred shares	Note 2	-	-	(33)	-
Gain on financial instruments recorded at fair value	Note 6	79	176	69	153
Equity and other investment income		-	5	-	17
Other		-	-	(1)	(1)
		(84)	1,040	(227)	1,020
Income (loss) before the following items		**(199)**	**1,038**	**(534)**	**866**
Non-controlling interest		(44)	(32)	52	32
Foreign exchange gain (loss)		355	48	254	(41)
Recovery of (provision for) income taxes	Note 7				
Current		(1)	(1)	2	(1)
Future		(1)	(223)	(8)	(208)
Net income (loss) for the period		**$ 110**	**$ 830**	**$ (234)**	**$ 648**
Net income (loss) per share					
Basic		$ 3.16	$ 15.46	$ (6.68)	$ 11.24
Diluted		$ 2.68	$ 10.76	$ (6.68)	$ 8.18

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statement of Financial Position

Unaudited (Canadian dollars in millions)		June 30 2009	December 31 2008
ASSETS			
Current			
Cash and cash equivalents		$ 851	$ 1,307
Short-term investments		419	506
		1,270	1,813
Restricted cash		22	45
Accounts receivable		748	700
Aircraft fuel inventory		40	97
Spare parts and supplies	Note 2	80	20
Collateral deposits for fuel derivatives	Note 6	109	328
Prepaid expenses and other current assets		194	206
		2,463	3,209
Property and equipment	Note 2	7,180	7,469
Intangible assets		632	698
Deposits and other assets		507	495
		$ 10,782	**$ 11,871**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		$ 1,292	$ 1,288
Fuel derivatives	Note 6	110	420
Advance ticket sales		1,548	1,333
Current portion of long-term debt and capital leases		623	663
		3,573	3,704
Long-term debt and capital leases		4,438	4,980
Convertible preferred shares		57	206
Future income taxes		50	50
Pension and other benefit liabilities		1,368	1,585
Other long-term liabilities		362	370
		9,848	10,895
Non-controlling interest		456	512
SHAREHOLDERS' EQUITY			
Share capital and other equity		152	307
Contributed surplus		323	163
Retained earnings		366	600
Accumulated other comprehensive loss		(363)	(606)
		478	464
		$ 10,782	**$ 11,871**

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity

Unaudited (Canadian dollars in millions)		Six Months Ended June 30 2009	Year Ended December 31 2008	Six Months Ended June 30 2008
Share capital				
Common shares, beginning of period		$ 100	$ 243	$ 243
Repurchase and cancellation of common shares		-	(180)	(180)
Issue of shares through stock options exercised		4	37	37
Total share capital		104	100	100
Other equity				
Convertible senior notes	Note 5	18	90	90
Convertible preferred shares	Note 5	30	117	117
Total share capital and other equity		152	307	307
Contributed surplus				
Balance, beginning of period		163	504	504
Repurchase and cancellation of common shares		-	(329)	(329)
Repurchase and cancellation of ACE convertible senior notes and preferred shares	Note 5	159	-	-
Fair value of stock options recognized as compensation expense (recovery)		1	(5)	2
Fair value of exercised stock options to share capital		-	(7)	(7)
Total contributed surplus		323	163	170
Retained earnings				
Balance, beginning of period		600	2,209	2,209
Repurchase and cancellation of common shares		-	(1,489)	(1,489)
		600	720	720
Net income (loss) for the period		(234)	(120)	648
Total retained earnings		366	600	1,368
Accumulated other comprehensive income (loss)				
Balance, beginning of period		(606)	54	54
Other comprehensive income (loss)		243	(660)	188
Total accumulated other comprehensive income (loss)		(363)	(606)	242
Total retained earnings and accumulated other comprehensive income (loss)		3	(6)	1,610
Total shareholders' equity		**$ 478**	**$ 464**	**$ 2,087**

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statement of Comprehensive Income

Unaudited (Canadian dollars in millions)		Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
Comprehensive income					
Net income (loss) for the period		$ 110	$ 830	$ (234)	$ 648
Other comprehensive income (loss), net of taxes:					
Net change in unrealized gain on Jazz Air Income Fund		-	(6)	-	65
Reclassification of net realized gains on Jazz Air Income Fund to income		-	(65)	-	(65)
Net change in unrealized gain on Aeroplan Income Fund		-	331	-	331
Reclassification of net realized gains on Aeroplan Income Fund to income		-	(331)	-	(331)
Net gains (losses) on fuel derivatives under hedge accounting, net of taxes	Note 6	-	173	(1)	273
Reclassification of net realized losses (gains) on fuel derivatives to income, net of taxes	Note 6	115	(62)	244	(85)
		115	40	243	188
Total comprehensive income		**$ 225**	**$ 870**	**$ 9**	**$ 836**

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statement of Cash Flow

Unaudited (Canadian dollars in millions)		Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
Cash flows from (used for)					
Operating					
Net Income (loss) for the period		$ 110	$ 830	$ (234)	$ 648
Adjustments to reconcile to net cash from operations					
Depreciation and amortization		163	171	320	340
Loss (gain) on assets		71	(915)	71	(961)
Loss on repurchase of ACE convertible senior notes and preferred shares		-	-	33	-
Foreign exchange (gain) loss		(355)	(64)	(212)	1
Future income taxes		1	223	8	208
Excess of employee future benefit funding over expense		(109)	(31)	(212)	(82)
Provision for cargo investigations	Note 1D	-	-	-	125
Non-controlling interest		44	36	(52)	(32)
Fuel and other derivatives	Note 6	19	(161)	(63)	(142)
Fuel hedge collateral deposits, net	Note 6	62	-	209	-
Equity investment income		-	(2)	-	(12)
Changes in non-cash working capital balances		(123)	135	158	380
Other		13	(5)	25	(27)
		(104)	**217**	**51**	**446**
Financing					
Issue of common shares		-	29	-	30
Repurchase and cancellation of common shares		-	(500)	-	(1,998)
Borrowings	Note 2	76	126	343	313
Repurchase of ACE convertible senior notes	Note 2	-	-	(233)	-
Repurchase of ACE preferred shares	Note 2	-	-	(186)	-
Reduction of other long-term debt and capital lease obligations		(177)	(319)	(600)	(642)
		(101)	**(664)**	**(676)**	**(2,297)**
Investing					
Short-term investments		68	(165)	87	(4)
Proceeds from sale of Aeroplan units		-	692	-	692
Proceeds from sale of Jazz units		-	85	-	182
Exercise of ACTS Aero put option		-	(19)	-	(19)
Proceeds from escrow related to sale of ACTS		-	-	-	40
Additions to capital assets		(49)	(225)	(156)	(628)
Proceeds from sale of assets	Note 2	93	-	93	27
Proceeds from sale lease-back transactions	Note 2	-	297	172	708
Other		(33)	9	(27)	34
		79	**674**	**169**	**1,032**
Increase (decrease) in cash and cash equivalents		**(126)**	**227**	**(456)**	**(819)**
Cash and cash equivalents, beginning of period		977	1,254	1,307	2,300
Cash and cash equivalents, end of period		**$ 851**	**$ 1,481**	**$ 851**	**$ 1,481**
Cash payments of interest		$ 87	$ 81	$ 181	$ 154
Cash payments (recoveries) of income taxes		$ -	$ 1	$ (2)	$ 3

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

The accompanying notes are an integral part of the consolidated financial statements.

Notes to the Interim Consolidated Financial Statements (unaudited)
(currencies in millions – Canadian dollars)

1. BASIS OF PRESENTATION, CHANGES IN ACCOUNTING POLICIES, AND LIQUIDITY RISK

ACE Aviation Holdings Inc. ("ACE"), which was incorporated on June 29, 2004, is a holding company of aviation interests. Reference to the "Corporation" in the following notes to the financial statements 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.

As at June 30, 2009, ACE holds:

- a 75.0% direct ownership interest in Air Canada; and
- a 28.4% direct interest in Aero Technical Support & Services Holdings sarl ("ACTS Aero"), which owns 100% of Aveos Fleet Performance Inc. ACTS Aero Technical Support and Services Inc. changed its legal name to Aveos Fleet Performance Inc. ("Aveos") on September 23, 2008.

A) BASIS OF PRESENTATION

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

Therefore, these 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.

The unaudited interim consolidated financial statements for the Corporation are based on the accounting policies consistent with those disclosed in Note 2 to the 2008 annual consolidated financial statements of the Corporation, with the exception of the changes in accounting policies described below in part B) Changes in Accounting Policies.

In accordance with Canadian generally accepted accounting principles ("GAAP"), these interim financial statements do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the 2008 annual consolidated financial statements of the Corporation. In management's opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim periods presented.

Air Canada has historically experienced greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the spring and summer months. Air Canada has substantial fixed costs in its cost structure that do not meaningfully fluctuate with passenger demand in the short-term. This seasonality, however, is being affected by the current economic conditions.

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

B) 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 the 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 does not have acquired goodwill reported on its balance sheet. The Corporation's accounting policy for intangible assets 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.

The following is an overview of accounting standard changes that the Corporation will be required to adopt in future years:

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.

C) SIGNIFICANT EVENTS

Air Canada has entered into the following transactions in 2009, in an effort to mitigate Air Canada's liquidity risks as described in D below and in Note 1D to the 2008 annual consolidated financial statements of the Corporation (refer to Note 2 for additional detail on these financing activities):

During July 2009

- A secured term credit facility (the "Credit Facility") for financing proceeds of $600, less fees of approximately $20. ACE's participation in the Air Canada Credit Facility amounted to $150. The Credit Facility is a five-year facility with the first principal repayment due in August 2010, and currently bears interest at 12.75%. 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. Refer to Note 2 for a detailed description of the Credit Facility. As part of the transactions related to the closing of the Credit Facility, existing financing arrangements of $166 were repaid as follows:
  - The revolving credit facility, as further described in Note 9 (j) of the 2008 annual consolidated financial statements of the Corporation, was repaid in the amount of $49. The rights of the lender under this facility were assigned to the lenders under the Credit Facility;
  - The spare engine financing agreement, as further described in Note 2, was partially repaid in the amount of $38. 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 as at July 31, 2009;
  - The Aeroplan Canada Inc. ("Aeroplan") loan, as further described in Note 2, was repaid in the amount of $79. 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 benefits, or pension 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, $175, and $225 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 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 required to be maintained as described further below;

- An extension to a short-term loan of $82 (US$75) entered into in 2008, which was originally due in 2009, to 2013. This loan is described in Note 9 (l) of the 2008 annual consolidated financial statements of the Corporation, except for the amendment to extend the repayment to 2013;

- A memorandum of understanding (the "GECAS MOU") with GE Capital Aviation Services 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; and;

- A memorandum of understanding for amended terms related to the capacity purchase agreement with Jazz Air LP ("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. 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 partially offset by the settlement of fuel derivative contracts in favour of counterparties in the amount of $17.

During the first quarter of 2009

- Financing arrangements secured by spare parts, spare engines and a Boeing 777 aircraft for aggregate proceeds of $267, net of fees of $5. 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 and the required repayment of a debt obligation related to the aircraft of $128, which included a prepayment fee of $14;

- 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 and final payment of $115 in 2010, based on the foreign exchange rate as at March 31, 2009;

- Repayment of pre-delivery financing of $83 on the Boeing 777 aircraft received during the first quarter; and;

- Net return of collateral deposits on fuel derivatives in the amount of $147 offset by the settlement of fuel derivative contracts in favour of counterparties in the amount of $217.

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

D) AIR CANADA LIQUIDITY RISK

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. As at July 31, Cash and cash equivalents and Short-term investments were 13% of 2008 annual operating revenues.

Air Canada management believes that the significant events as described above 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 above, 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 Note

11 for a listing of commitments and the Corporation's maturity analysis, updated to July 31, 2009 taking into account the events as described above, excluding the GECAS MOU.

To date in 2009 including the significant events as described above, 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 described above, 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

Air Canada maintains several defined benefit pension plans as described in Note 11 to the 2008 annual consolidated financial statements of the Corporation. 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.

As described above, 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, $175, and $225 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 (the "Pension MOUs")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 per cent 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, a decrease of $49 versus 2008.

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 further amended 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 and cash equivalents and Short-term investments) required to be maintained by Air Canada is reduced to $800 (versus $1,300 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 for two consecutive months, the unrestricted cash requirement increases to $1,100 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, 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, its obligation to provide deposits to the processor would be capped at an amount not in excess of $75, provided unrestricted cash is not less than $800. As at June 30, 2009 a deposit in the amount of $27 had accumulated under these processing agreements, which has further increased to the above-referenced cap of $75 as at July 31, 2009. Deposits under these processing agreements are reported in Prepaid expenses and other current assets.

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 Note 20 to the 2008 annual consolidated financial statements of the Corporation. 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 management's preliminary estimate.

2. FINANCING AND INVESTING ACTIVITIES

ACE Convertible Senior Notes and Convertible Preferred Shares

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. On January 21, 2009, the Corporation paid an aggregate purchase price of $233 for the notes tendered.

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 for the shares tendered.

A Loss on repurchase of the convertible senior notes and preferred shares has been recorded within Non-operating expense in the amount of $33. 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 being recorded. The residual equity components of the instruments amounting to $159 have been transferred directly to Contributed surplus in the consolidated statement of changes in shareholders' equity.

AIR CANADA FINANCING

Revolving Credit Facility

As at June 30, 2009, Air Canada had $49 outstanding under the revolving credit facility (December 31, 2008 - $50) drawn at a rate of prime plus 13.00% (June 30, 2009 – 15.25%), which is further described in Note 9(j) of the 2008 annual consolidated financial statements of the Corporation. During the second quarter the financial covenant that required Air Canada to maintain as of the last business day of each month a minimum cash level of $900 including the unused and available commitment under the facility was reduced to $800.

As discussed in Note 1C, as a result of receiving the Credit Facility the revolving credit facility was repaid in full subsequent to June 30, 2009.

Spare Parts Financing

During the first quarter of 2009, Air Canada received an additional $92 (US$75) principal under the original secured spare parts financing agreement, which is further described in Note 9(g) of the 2008 annual consolidated financial statements of the Corporation. This financing bears interest at a rate of three month LIBOR plus the lenders incremental cost of funds rate and a margin of 3.00% (June 30, 2009 – 6.49%) and matures in 2014. The balance of the loan at June 30, 2009 of $163 is secured by spare parts and other assets with a carrying value of $287. Financing fees totaling $6 were recorded for these borrowings.

The following table summarizes the principal and interest repayment requirements (in CDN$), based upon the foreign exchange rate and interest rate as at June 30, 2009:

	Remainder of 2009	2010	2011	2012	2013	Thereafter	Total
Spare parts financing							
Principal	$ 9	$ 17	$ 17	$ 18	$ 18	$ 4	$ 83
Interest	3	4	3	2	1	-	13
	$ 12	**$ 21**	**$ 20**	**$ 20**	**$ 19**	**$ 4**	**$ 96**

The principal and interest above have been included in the maturity analysis in Note 11 – Commitments.

Spare Engine Financing

During the first quarter of 2009, Air Canada obtained an additional $46 (US$37) principal and included an additional 22 engines under the original secured financing agreement, which is further described in Note 9 (f) of the 2008 annual consolidated financial statements of the Corporation. This financing bears interest at a rate of three month LIBOR plus 3.40% (June 30, 2009 – 4.01%) and matures in 2013. The balance of the loan at June 30, 2009 of $125 is secured by 32 engines with a carrying value of $162. Financing fees totaling $2 were recorded for these borrowings.

As discussed in Note 1C, as a result of receiving the Credit Facility the spare engine financing was partially repaid in the amount of $38. There are now 10 engines remaining in the agreement with a loan value of $81 as at July 31, 2009.

The principal and interest for the remaining spare engine financing is included in the maturity table in Note 11 – Commitments.

Pre-delivery Financing

During the first quarter of 2009, as a result of the delivery of a Boeing 777 aircraft, Air Canada made repayments of $83 (US$66) on the pre-delivery financing as described in Note 9 (m) to the 2008 annual consolidated financial statements of the Corporation. This was the final repayment on the pre-delivery financing.

Aeroplan Financing

During the second quarter of 2009 Air Canada and Aeroplan entered into a financing agreement. The loan and security agreement is a one year term revolving loan with a maximum amount of the lower of $100 and the dollar amount equal to the aggregate of the previous 60 days accumulated purchases by Aeroplan from Air Canada of reward seats. As at June 30, 2009 the principal outstanding under the revolving loan was $79, which was the maximum available amount at that time. This financing bears interest at a rate of 12% per annum and the balance of the revolving loan is secured by Air Canada's equity interest in Air Canada Vacations. This loan was arranged following the expiry of the accelerated payment agreement as described in Note 2 (e) to the 2008 annual consolidated financial statements of the Corporation and the reinstating of trade terms between Air Canada and Aeroplan to those that existed prior to the accelerated payment agreement.

As discussed in Note 1C, as a result of receiving the Credit Facility the Aeroplan financing was repaid in full and terminated subsequent to June 30, 2009.

Boeing Aircraft

During the first quarter of 2009, Air Canada took delivery of a Boeing 777 aircraft. The aircraft was financed with guarantee support from the Export-Import Bank of the United States ("EXIM"). The initial principal of $136 (US$109) bears interest at a rate of three month LIBOR (June 30, 2009 – 0.93%) and matures in 2021. The loan is secured by the delivered aircraft with a carrying value of $141. Financing fees of $4 were recorded for this borrowing.

The following table summarizes the principal and interest repayment requirements (in CDN$), based upon the foreign exchange rate and interest rate as at June 30, 2009:

	Remainder of 2009	2010	2011	2012	2013	Thereafter	Total
Boeing 777 financing							
Principal	$ 5	$ 10	$ 10	$ 11	$ 11	$ 77	$ 124
Interest	1	1	1	1	1	3	8
	$ 6	**$ 11**	**$ 11**	**$ 12**	**$ 12**	**$ 80**	**$ 132**

The principal and interest above have been included in the maturity analysis in Note 11 – Commitments.

Sale Lease-back

During the first quarter of 2009, Air Canada entered into a sale lease-back transaction for a Boeing 777 aircraft, which was originally delivered in 2007 and debt financed. The proceeds from the transaction of $172 were used to repay the outstanding loan of $114. Air Canada recorded a charge of $17 in interest expense for this transaction including a prepayment fee of $14 and $3 for the write off of deferred financing charges. The gain on sale of the aircraft of $26 has been deferred and will be recognized in Depreciation and amortization over the term of the lease. The lease is accounted for as a capital lease with a 12 year term, with monthly lease payments.

Spare Parts Inventory

During the first quarter of 2009, Air Canada purchased $103 of spare parts inventory. Consideration for the purchase was in the form of the issuance of bills of exchange due in February 2010. The bills of exchange, which are recorded in Accounts payable and accrued liabilities as an other financial liability at amortized cost, are non-interest bearing and were initially recorded at estimated fair value based upon market rates of interest. Subsequent to this transaction, Air Canada repurchased two bills of exchange with a book value of $21 (US$17) recognizing a decrease to the carrying value of the related inventory of $8 (US$6).

Term Credit Facility

In July 2009, Air Canada received financing proceeds of $600, less fees of approximately $20 under a secured term credit facility (the “Credit Facility”). 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 by obtaining new commitments from either the existing or new lenders. The Credit Facility is repayable in sixteen (16) consecutive quarterly installments commencing in August 2010 of $30 with the final installment of $120 due in July 2014. Any increase to the facility would increase, on a pro rata basis, the scheduled repayments, including the final payment.

The Credit Facility bears interest at a rate based upon the greater of the bankers’ acceptance rate (minimum 3.00%) plus 9.75% (12.75% as at July 31, 2009). The Credit Facility can be repaid at any time, in whole or in part subject to a minimum repayment of $10 and the payment of a repayment fee which is applicable if the repayment occurs on or prior to the third anniversary of the Credit Facility.

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, subject to certain exclusions and permitted liens. The Credit Facility contains customary representations and warranties and is subject to customary terms and conditions (including negative covenants, financial covenants and events of default). Financial covenants require Air Canada to maintain, as of the last business day of each month, a minimum liquidity level (as defined per the Credit Facility and generally based upon the balances as reported in Cash and cash equivalents and Short-term investments) of $800 and a minimum EBITDAR (earnings before interest, income taxes, depreciation, amortization, aircraft rentals, certain non-operating income (expense) and special items) and an interest coverage ratio test determined as at the end of each fiscal quarter

A requirement of the Credit Facility is that Air Canada maintain securities of $800 in accounts subject to securities control agreements. The securities in such accounts would become restricted if Air Canada defaults on certain terms of the agreement.

Under the Credit Facility, Air Canada issued to the lenders, concurrently with the first drawdown, 5 million warrants for the purchase of Air Canada's Class A variable voting shares or Class B voting shares representing an aggregate of 5% of the total issued and outstanding shares as at the closing date of the Credit Facility, allocated among the lenders based on their pro rata lending commitments under the Credit Facility. ACE's share is 1.25 million warrants. These initial 5% warrants have an exercise price of $1.51 per share, will be exercisable at any time and will expire four years after the date of issuance. Subject to the terms of the Credit Facility, 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 5% of the total issued and outstanding shares (determined at the time of issuance of such additional warrants) with an average exercise price established based on a volume weighted average price 5 days before issuance, exercisable at any time and expiring four years after the date of issuance.

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

Disposals of and Provisions for Assets

During the second quarter of 2009:

- Air Canada recorded an impairment charge of $67 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.

- Air Canada sold two A340 aircraft for proceeds of $91 with a book value of $93, resulting in a loss on sale of $2. Air Canada made a repayment of $82 for the associated debt.

There were no significant disposals or provisions during the first quarter of 2009.

There were no significant disposals or provisions during the second quarter of 2008.

During the first quarter of 2008:

- Air Canada recorded an impairment charge of $38 on its fleet of B767-200 aircraft due to the revised retirement date of the aircraft.

- Air Canada sold an A319 aircraft for proceeds of $23 with a book value of $21, resulting in a gain on sale of $2.

3. PENSION AND OTHER BENEFITS

Pension and Other Benefit Expense

Air Canada maintains several defined benefit and defined contribution plans providing pension, other postretirement and post-employment benefits to its employees, including those employees of Air Canada who are contractually assigned to work at Aeroplan and ACTS Aero.

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

	Three Months Ended June 30		Six Months Ended June 30	
	2009	**2008**	**2009**	**2008**
Pension benefit expense	$ (5)	$ 28	$ (2)	$ 45
Other employee future benefits expense	20	26	40	52
	15	**54**	**38**	**97**
Amount charged to Aveos and Aeroplan	(10)	(11)	(17)	(20)
Net pension benefit and other employee future benefits expense	**$ 5**	**$ 43**	**$ 21**	**$ 77**

Employee benefits expense is reduced from 2008 levels as a result of revised actuarial assumptions. The actuarial assumptions used for recording pension expense under GAAP differ from those used in determining the solvency deficit.

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.

4. LABOUR RELATED PROVISIONS

Air Canada offers certain severance programs to certain employees from time to time. The cost of these programs is recorded within Operating expenses.

The following table outlines the changes to labour related provisions which are included in long-term employee liabilities:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	**2008**	**2009**	**2008**
Beginning of period	$ 61	$ 58	$ 54	$ 66
Interest accretion	1	1	2	2
Charges recorded in wages, salaries, and benefits	13	13	24	13
Amounts disbursed	(7)	(10)	(12)	(19)
End of period	68	62	68	62
Current portion in Accounts payable and accrued liabilities	(27)	(25)	(27)	(25)
	$ 41	**$ 37**	**$ 41**	**$ 37**

5. SHARE INFORMATION

The issued and outstanding common shares of ACE as at June 30, 2009, along with potential common shares, are as follows:

Outstanding shares (000)	June 30 2009	December 31 2008
Issued and outstanding		
Class A variable voting shares	25,816	25,614
Class B voting shares (1)	9,875	9,293
Total issued and outstanding	**35,691**	**34,907**
Potential common shares		
Convertible preferred shares (2)	3,112	11,863
Convertible senior notes (3)	2,600	13,133
Stock options (1) (4)	58	61
Total potential common shares	**5,770**	**25,057**

(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 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 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. On January 21, 2009, the Corporation paid an aggregate purchase price of $233 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.

6. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Aeroplan

On April 21, 2008 ACE sold a total of 20.4 million trust units of Aeroplan Income Fund (“AIF”) at a price of $17.50 per unit representing total net proceeds to ACE of $343 and realized a gain on sale of $413 ($340 after tax). Following the sale, ACE held 9.9% of the issued and outstanding units of AIF.

On June 2, 2008, ACE sold the remaining trust units of AIF for total net proceeds to ACE of $349, and realized a gain on sale of $417 ($344 after tax). ACE no longer has an ownership interest in Aeroplan.

With the reduction of the ownership interest below 20% and the termination of the Securityholders’ Agreement on May 9, 2008, ACE no longer had significant influence over Aeroplan. The equity investment ACE had in

Aeroplan was classified as available-for-sale and the investment was adjusted to fair value. The adjustment to fair value recorded to OCI was $331, net of tax of $72, which was subsequently realized into income on June 2, 2008 as part of the final sale.

Jazz

On January 24, 2008 ACE sold a total of 13 million trust units of Jazz Air Income Fund ("JAIF") at a price of $7.45 per unit representing total net proceeds to ACE of $97 and realized a gain on sale of $89 ($71 net of taxes). Following the sale, ACE held 9.5% of the issued and outstanding units of JAIF.

On June 2, 2008, ACE sold its remaining trust units of JAIF for total net proceeds to ACE of $85, and realized a gain on sale of $78 ($62 net of taxes). Net realized gains of $65, net of tax of $14, were taken into income from OCI. ACE no longer has an ownership interest in Jazz.

With the reduction of the ownership interest below 20% and the termination of the Securityholders' Agreement on February 7, 2008, ACE no longer had significant influence over Jazz. The equity investment ACE had in Jazz was classified as available-for-sale and unrealized period changes in fair value were recorded in OCI. The adjustment to fair value recorded in OCI amounted to $71, net of tax of ($15) during Quarter 1, 2008. During Quarter 2, 2008, the period change in fair value of ($6), net of tax of $1, was recorded in OCI.

Summary of Gain on Financial Instruments Recorded at Fair Value

	Three Months Ended June 30		Six Months Ended June 30	
	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 (1)	**$ 79**	**$ 176**	**$ 69**	**$ 153**

(1) See Fuel Price Risk for a discussion of losses on fuel derivatives recorded in Other comprehensive income ("OCI").

Risk Management

Liquidity risk

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities and other contractual obligations.

Refer to Note 1C and D above and Note 1D of the 2008 annual consolidated financial statements for a further discussion on liquidity risk.

Fuel Price Risk

In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries. Air Canada uses derivative contracts on jet fuel and other crude oil-based commodities, heating oil and crude oil. Heating oil and crude oil commodities are used due to the relative limited liquidity of jet fuel derivative instruments on a medium to long-term horizon since jet fuel is not traded on an organized futures exchange. Air Canada does not purchase or hold any derivative financial instrument for speculative purposes. Air Canada designates certain of its fuel derivatives as cash flow hedges and applies hedge accounting as prescribed under CICA section 3865, Hedges. There were no fuel derivative contracts entered into during the first six months of 2009.

The types of derivative instruments used by Air Canada within its hedging program, such as swaps and the put options within collar structures, expose Air Canada to the potential to have to make collateral deposits. When fuel prices decrease causing Air Canada's derivative position to be in a liability position below the set credit thresholds with counterparties, Air Canada is responsible for extending collateral to the counterparties. As at June 30, 2009 Air Canada had extended $109 of collateral to counterparties (December 31, 2008 – $328).

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 along with the weighted average floor and capped price for each year currently hedged by type of derivative instrument. 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.

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

(a) 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 prices decrease below the average floor price.

The following information summarizes the financial statement impact of fuel derivatives:

		Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
Consolidated Statement of Operations					
Operating expenses					
Aircraft fuel	Realized effective gain (loss) on derivatives designated under hedge accounting	$ (113)	$ 92	$ (240)	$ 126
Non-operating income (expense)					
Gain (loss) 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 designated 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*	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)

* The balance is reflected within Current liabilities on the Consolidated Statement of Financial Position due to the counterparty's ability to terminate the derivatives at fair value at any time prior to maturity.

The Fuel and other derivatives line on the Consolidated Statement of Cash Flow includes adjustments for non-cash items impacting fuel expense as well as adjustments for cash items not affecting net income during the period.

During the second quarter of 2009, fuel derivative contracts cash settled with a fair value of $17 in favour of the counterparties ($62 in favour of the counterparties in the first six months of 2009) ($105 in favour of Air Canada in the second quarter of 2008 and $144 in favour of Air Canada in the first six months of 2008).

During the first quarter of 2009, Air Canada modified its fuel hedge portfolio with the termination of swap and put option contracts for $172, in favour of the counterparties. The collateral held by the counterparties covered the majority of the settlement amount therefore minimal additional cash outflows resulted. Certain of these contracts were previously designated under hedge accounting. The value of the AOCI balance recognized in connection with these derivatives while designated under hedge accounting will be taken into fuel expense in the period where the derivative was scheduled to mature.

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

7. INCOME TAXES

Components of the provision for income taxes in the Corporation's consolidated statement of operations are as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Recovery of (provision for) income taxes before under noted items	$ (2)	$ (57)	$ 2	$ (9)
Repurchase of ACE convertible senior notes	-	-	(8)	-
Disposal of Aeroplan units	-	(146)	-	(146)
Disposal of Jazz units	-	(16)	-	(34)
Valuation allowance on tax assets of ACE	-	(5)	-	(20)
Provision for income taxes	**$ (2)**	**$ (224)**	**$ (6)**	**$ (209)**

Refer to Note 6 for future income taxes recorded in other comprehensive income related to fuel derivatives designated under hedge accounting.

8. SEGMENT INFORMATION

Composition of Business Segments

ACE has two reportable segments: Air Canada and Corporate Items and Eliminations ("CIE").

CIE includes the corporate, financing and investing activities of ACE. ACE's investments in Aeroplan, Jazz and ACTS were changed in 2007 from the consolidation to equity method of accounting reported under the CIE segment. As of May 9, 2008 and February 7, 2008, ACE no longer equity accounts for Aeroplan and Jazz, respectively, but distributions from Aeroplan and Jazz are recorded in the CIE segment. Since June 2, 2008, subsequent to the sale of all remaining AIF and JAIF units, ACE has no ownership interest in Aeroplan or Jazz. Future income taxes are recorded within the applicable taxable entities and are not allocated to non-taxable entities.

Segment financial information has been prepared consistent with how financial information is produced internally for the purposes of making operating decisions. Segments negotiate transactions between each other as if they were unrelated parties.

A reconciliation of the total amounts reported by each business segment to the applicable amounts in the consolidated financial statements follows:

	Three Months Ended June 30					
	2009			2008		
	Air Canada	CIE	Total ACE	Air Canada	CIE	Total ACE
Passenger revenue	$ 2,058	$ -	$ 2,058	$ 2,454	$ -	$ 2,454
Cargo revenue	76	-	76	139	-	139
Other revenue	196	-	196	189	1	190
External revenue	2,330	-	2,330	2,782	1	2,783
Inter-segment revenue	-	-	-	-	-	-
Total revenues	**2,330**	**-**	**2,330**	**2,782**	**1**	**2,783**
Aircraft fuel	572	-	572	848	-	848
Wages, salaries and benefits	438	2	440	480	7	487
Airport and navigation fees	241	-	241	255	-	255
Capacity purchase with Jazz	254	-	254	233	-	233
Depreciation and amortization	165	(2)	163	173	(2)	171
Aircraft maintenance	185	-	185	172	-	172
Food, beverages and supplies	73	-	73	81	-	81
Communications and information technology	80	-	80	72	-	72
Aircraft rent	83	-	83	69	-	69
Commissions	40	-	40	47	-	47
Other	312	2	314	345	5	350
Total operating expenses	**2,443**	**2**	**2,445**	**2,775**	**10**	**2,785**
Operating income (loss) before under noted item	**(113)**	**(2)**	**(115)**	**7**	**(9)**	**(2)**
Provision for cargo investigation	-	-	-	**-**	**-**	**-**
Operating income (loss)	**(113)**	**(2)**	**(115)**	**7**	**(9)**	**(2)**
Interest income	4	(1)	3	15	8	23
Interest expense	(94)	(3)	(97)	(78)	(9)	(87)
Interest capitalized	2	-	2	8	-	8
Gain (loss) on assets	(71)	-	(71)	7	908	915
Loss on repurchase of ACE convertible senior notes and preferred shares	-	-	-	-	-	-
Gain on financial instruments recorded at fair value	79	-	79	176	-	176
Equity and other investment income	-	-	-	-	5	5
Other non-operating income (expense)	-	-	-	-	-	-
Non-controlling interest	(4)	(40)	(44)	(3)	(29)	(32)
Foreign exchange gain	355	-	355	48	-	48
Provision for income taxes	(3)	1	(2)	(58)	(166)	(224)
Segment income (loss)	**$ 155**	**$ (45)**	**$ 110**	**$ 122**	**$ 708**	**$ 830**

** Aeroplan and Jazz equity investment income is recorded up to May 9, 2008 and February 7, 2008 respectively. Subsequent to these effective dates, distribution income from Aeroplan and Jazz is recorded within CIE until June 2, 2008. Equity income of nil relating to ACE's equity investments is included in Equity and other investment income (loss) ($2 for the period ended June 30, 2008).*

	Six Months Ended June 30					
	Air Canada	CIE	2009 Total ACE	Air Canada	CIE	2008 Total ACE
Passenger revenue	$ 4,069	$ -	$ 4,069	$ 4,765	$ -	$ 4,765
Cargo revenue	156	-	156	263	-	263
Other revenue	496	-	496	480	1	481
External revenue	4,721	-	4,721	5,508	1	5,509
Inter-segment revenue	-	-	-	1	(1)	-
Total revenues	**4,721**	**-**	**4,721**	**5,509**	**-**	**5,509**
Aircraft fuel	1,165	-	1,165	1,563	-	1,563
Wages, salaries and benefits	896	4	900	961	22	983
Airport and navigation fees	471	-	471	496	-	496
Capacity purchase with Jazz	500	-	500	468	-	468
Depreciation and amortization	324	(4)	320	344	(4)	340
Aircraft maintenance	374	-	374	375	-	375
Food, beverages and supplies	140	-	140	158	-	158
Communications and information technology	159	-	159	145	-	145
Aircraft rent	169	-	169	132	-	132
Commissions	89	-	89	100	-	100
Other	735	6	741	772	6	778
Total operating expenses	**5,022**	**6**	**5,028**	**5,514**	**24**	**5,538**
Operating income (loss) before under noted item	**(301)**	**(6)**	**(307)**	**(5)**	**(24)**	**(29)**
Provision for cargo investigation	-	-	-	(125)	-	(125)
Operating income (loss)	**(301)**	**(6)**	**(307)**	**(130)**	**(24)**	**(154)**
Interest income	10	1	11	33	15	48
Interest expense	(199)	(6)	(205)	(159)	(24)	(183)
Interest capitalized	3	-	3	25	-	25
Gain (loss) on assets	(71)	-	(71)	(29)	990	961
Loss on repurchase of ACE convertible senior notes and preferred shares	-	(33)	(33)	-	-	-
Gain on financial instruments recorded at fair value	69	-	69	153	-	153
Equity and other investment income	-	-	-	-	17	17
Other non-operating income (expense)	(1)	-	(1)	(2)	1	(1)
Non-controlling interest	(8)	60	52	(6)	38	32
Foreign exchange gain (loss)	254	-	254	(41)	-	(41)
Provision for income taxes	(1)	(5)	(6)	(10)	(199)	(209)
Segment income (loss)	**$ (245)**	**$ 11**	**$ (234)**	**$ (166)**	**$ 814**	**$ 648**

** Aeroplan and Jazz equity investment income is recorded up to May 9, 2008 and February 7, 2008 respectively. Subsequent to these effective dates, distribution income from Aeroplan and Jazz is recorded within CIE until June 2, 2008. Equity income of nil relating to ACE's equity investments is included in Equity and other investment income (loss) ($12 for the period ended June 30, 2008).*

Included within Depreciation and amortization is depreciation of property and equipment for Quarter 2 2009 of $147 (2008 - $161) related to the Air Canada segment.

A reconciliation of the total amounts reported for Passenger revenue and Cargo revenue on the Consolidated Statement of Operations is as follows:

Passenger revenues	Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
Canada	$ 893	$ 1,076	$ 1,710	$ 1,998
US Transborder	391	458	830	988
Atlantic	434	488	757	858
Pacific	194	242	374	447
Other	146	190	398	474
	$ 2,058	**$ 2,454**	**$ 4,069**	**$ 4,765**

Cargo revenues	Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
Canada	$ 15	$ 27	$ 30	$ 50
US Transborder	3	4	7	9
Atlantic	27	60	59	118
Pacific	22	36	42	64
Other	9	12	18	22
	$ 76	**$ 139**	**$ 156**	**$ 263**

Passenger and cargo revenues are based on the actual flown revenue for flights with an origin and destination in a specific country or region. Atlantic refers to flights that cross the Atlantic Ocean with origins and destinations principally in Europe. Pacific refers to flights that cross the Pacific Ocean with origins and destinations principally in Asia. Other passenger and cargo revenues refer to flights with origins and destinations principally in South America, South Pacific, and the Caribbean. Other operating revenues are principally derived from customers located in Canada.

Segment Asset Information

	June 30, 2009 Air Canada	June 30, 2009 CIE	June 30, 2009 Total
Cash and cash equivalents	$ 488	$ 363	$ 851
Short-term investments	419	-	419
	$ 907	**$ 363**	**$ 1,270**
Additions to capital assets for the three months	$ 49	$ -	$ 49
Total assets	**$ 10,713**	**$ 69**	**$ 10,782**

	December 31, 2008 Air Canada	December 31, 2008 CIE	December 31, 2008 Total
Cash and cash equivalents	$ 499	$ 808	$ 1,307
Short-term investments	506	-	506
	$ 1,005	**$ 808**	**$ 1,813**
Additions to capital assets for the twelve months	$ 883	$ -	$ 883
Total assets	**$ 11,364**	**$ 507**	**$ 11,871**

The total assets of CIE are net of the inter-company eliminations between each of the segments.

9. RELATED PARTY TRANSACTIONS

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, as described in Note 21 of the 2008 annual consolidated financial statements of the Corporation, 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.

During 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.

ACE is a participant lender in the Credit Facility as described in Note 2. ACE's participation in the Credit Facility represents $150 of the outstanding loan of $600 as at July 31, 2009. The participant lenders participate on a pro-rata basis with respect to any warrants and principal and interest payments.

10. JAZZ CAPACITY PURCHASE AGREEMENT

Air Canada and Jazz are parties to a capacity purchase agreement ("Jazz CPA") pursuant to which Air Canada purchases substantially all of Jazz's fleet capacity based on predetermined rates, in addition to reimbursing Jazz, without mark-up, for certain pass-through costs as defined in the Jazz CPA which include fuel, airport and user fees and other costs. The fees include both a variable component that is dependent on Jazz aircraft utilization and a fixed component and are recorded in the applicable category within the operating expenses in the results of Air Canada.

The following table outlines Jazz CPA and pass-through costs for the period:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Expenses from Jazz CPA	$ 254	$ 233	$ 500	$ 468
Pass through fuel expense from Jazz CPA	60	115	117	208
Pass through airport expense from Jazz CPA	50	50	97	100
Pass through other expense from Jazz CPA	5	6	20	21
	$ 369	**$ 404**	**$ 734**	**$ 797**

Refer to Note 1C for a discussion of the memorandum of understanding relating to amended terms to the Jazz CPA concluded subsequent to June 30, 2009.

11. COMMITMENTS

Boeing

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, 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.

For the firm aircraft orders, Air Canada has financing commitments from Boeing and the engine manufacturer covering 31 of the 37 Boeing 787 aircraft. The financing terms for 28 out of the 31 covered aircraft is for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments. For the remaining three out of the 31 covered aircraft the financing under the commitment covers up to 90% of the capital expenditure and the term to maturity is 15 years with principal payments made on a mortgage style basis resulting in equal installment payments of principal and interest over the term to maturity.

Embraer

During the first six months of 2009, all remaining Embraer 190 series exercisable options expired (December 31, 2008 – 7 exercisable options remaining).

Aircraft Interior Refurbishment Program

In addition to acquiring new aircraft, Air Canada commenced a major refurbishment of the interior of its existing aircraft in April 2006, completing the refurbishment program during the second quarter of 2009. Air Canada has completed the refurbishment of all its Airbus A319, A320, A321 and A330 aircraft, and 27 of its 30 Boeing 767-300 aircraft, for a total of 121 aircraft. The Embraer and Boeing 777 aircraft have been delivered with the new seats and entertainment systems already installed. The capital expenditures associated with this program are amortized over a five-year period.

Capital Commitments

The estimated aggregate cost of the future firm deliveries and other capital purchase commitments as at July 31, 2009 approximates $4,840 including the effects of the financing transactions subsequent to June 30, 2009 as discussed in Note 1C above (of which $3,213 is subject to committed financing, subject to the fulfillment of certain terms and conditions). US dollar amounts are converted using the July 31, 2009 noon day rate of CDN$1.0790. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest.

Remainder of 2009	2010	2011	2012	2013	Thereafter	Total
$ 26	$ 53	$ 49	$ 115	$ 733	$ 3,864	$ 4,840

Operating Lease Commitments

As at July 31, 2009 the future minimum lease payments under existing operating leases of aircraft and other property amount to $2,225 using the July 31, 2009 noon day rate of CDN$1.0790.

	Remainder of 2009	2010	2011	2012	2013	Thereafter	Total
Aircraft	$ 136	$ 324	$ 287	$ 270	$ 246	$ 687	$ 1,950
Other property	23	41	37	34	23	117	275
Total	**$ 159**	**$ 365**	**$ 324**	**$ 304**	**$ 269**	**$ 804**	**$ 2,225**

The above minimum lease payments include residual value guarantees, except for those for which Air Canada has obtained residual value support.

Maturity Analysis

ACE

ACE's principal and interest repayment requirements as at June 30, 2009 on Long-term debt obligations consist of its Convertible Senior Notes repayable on June 1, 2010 in the amount of $64. This date 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. Interest repayment obligations associated with the Convertible Senior Notes amount to $1 for the remainder of 2009 and $1 in 2010.

Air Canada

Principal and interest repayment requirements as at July 31, 2009 on Long-term debt and capital leases, including the effects of the financing arrangements finalized subsequent to June 30, 2009 as described in Note 1C, are as follows:

	Remainder of 2009	2010	2011	2012	2013	Thereafter	Total
Principal	$ 154	$ 512	$ 806	$ 574	$ 661	$ 2,445	$ 5,152
Interest	136	322	273	228	185	485	1,629
	$ 290	**$ 834**	**$ 1,079**	**$ 802**	**$ 846**	**$ 2,930**	**$ 6,781**

The maturity analysis is based on contractual undiscounted cash flows and is based on interest rates and the applicable foreign exchange rate effective as at July 31, 2009.

Principal repayments in the table above exclude transaction costs which are offset against Long-term debt and capital leases in the Consolidated Statement of Financial Position.