ACE Aviation Holdings Inc.
Consolidated Statement of Operations and Retained Earnings (Deficit)

(in millions except per share figures - Canadian dollars)
(unaudited)

	Successor Company - ACE (note 1)		Predecessor Company - Air Canada (note 1)	
	Three Months Ended June 30, 2005	**Six Months Ended June 30, 2005**	**Three Months Ended June 30, 2004**	**Six Months Ended June 30, 2004**
Operating revenues				
Passenger	$ 2,100	$ 3,839	$ 1,844	$ 3,505
Cargo	147	282	137	263
Other	211	514	240	574
	2,458	4,635	2,221	4,342
Operating expenses				
Salaries, wages and benefits	623	1,236	672	1,359
Aircraft fuel	530	945	374	712
Aircraft rent (note 1)	98	188	170	364
Airport and navigation fees	230	443	207	410
Aircraft maintenance, materials and supplies	89	183	82	185
Communications and information technology	78	155	75	163
Food, beverages and supplies	81	159	87	166
Depreciation, amortization and obsolescence (note 2)	119	239	103	198
Commissions	73	138	82	162
Other	360	782	347	746
	2,281	4,468	2,199	4,465
Operating income (loss) before reorganization and restructuring items	177	167	22	(123)
Reorganization and restructuring items (note 11)	-	-	(426)	(558)
Non-operating income (expense)				
Dilution gain (note 4)	190	190	-	-
Interest income	15	27	-	4
Interest expense	(77)	(152)	(60)	(107)
Interest capitalized	3	6	-	-
Loss on sale of and provisions on assets	-	-	(10)	(13)
Non-controlling interest	(4)	(7)	-	-
Other	(27)	(30)	(2)	1
	100	34	(72)	(115)
Income (loss) before foreign exchange on non-compromised monetary items and income taxes	277	201	(476)	(796)
Foreign exchange loss	(53)	(68)	(34)	(17)
Income (loss) before income taxes	224	133	(510)	(813)
Provision for income taxes	(56)	(42)	-	(1)
Income (loss) for the period	**$ 168**	**$ 91**	**$ (510)**	**$ (814)**
Retained earnings (deficit), beginning of period as originally reported		15		(5,147)
Adjustment related to a change in accounting policy (note 1)		142		-
Retained earnings (deficit), beginning of period as restated		157		(5,147)
Retained earnings (deficit), end of period		**$ 248**		**$ (5,961)**
Earnings (loss) per share				
- Basic	$ 1.67	$ 0.96	$ (4.24)	$ (6.77)
- Diluted	$ 1.49	$ 0.92	$ (4.24)	$ (6.77)

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

ACE Aviation Holdings Inc.
Consolidated Statement of Financial Position

(in millions of Canadian dollars) (unaudited)	Successor Company - ACE (note 1) June 30 2005	December 31 2004
ASSETS		
Current		
Cash and cash equivalents (note 4)	$ 1,276	$ 1,481
Short-term investments (note 1)	1,506	151
	2,782	1,632
Restricted cash	31	118
Accounts receivable	740	547
Spare parts, materials and supplies	239	237
Prepaid expenses	95	161
	3,887	2,695
Property and equipment (note 2)	4,942	3,696
Deferred charges	127	167
Intangible assets	2,572	2,691
Other assets	255	137
	$ 11,783	**$ 9,386**
LIABILITIES		
Current		
Accounts payable and accrued liabilities	$ 1,275	$ 1,197
Advance ticket sales and loyalty program deferred revenues	1,664	1,076
Current portion of long-term debt and capital lease obligations (note 3)	262	218
	3,201	2,491
Long-term debt and capital lease obligations (note 3)	3,422	2,328
Convertible preferred shares	139	132
Future income taxes	243	243
Pension and other benefit liabilities	2,296	2,344
Non-controlling interest (note 1)	196	-
Other long-term liabilities	1,313	1,645
	10,810	9,183
Commitments (note 8) and Guarantees (note 9)		
SHAREHOLDERS' EQUITY		
Share capital and other equity (note 6)	722	187
Contributed surplus	3	1
Retained earnings	248	15
	973	203
	$ 11,783	**$ 9,386**

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

ACE Aviation Holdings Inc.
Consolidated Statement of Cash Flow

(in millions of Canadian dollars)
(unaudited)

	Successor Company - ACE (note 1)		Predecessor Company - Air Canada (note 1)	
Cash flows from (used for)	**Three Months Ended June 30, 2005**	**Six Months Ended June 30, 2005**	**Three Months Ended June 30, 2004**	**Six Months Ended June 30, 2004**
Operating				
Income (loss) for the period	$ 168	$ 91	$ (510)	$ (814)
Adjustments to reconcile to net cash provided by operations				
Reorganization and restructuring items (note 11)	-	-	396	505
Depreciation, amortization and obsolescence	119	239	103	198
Loss on sale of and provisions on assets	-	-	10	13
Dilution gain (note 4)	(190)	(190)	-	-
Foreign exchange	40	55	34	17
Future income taxes	53	36	(4)	(6)
Employee future benefit funding (more than) less than expense	(6)	(14)	32	92
Decrease (increase) in accounts receivable	(108)	(199)	(122)	(176)
Decrease (increase) in spare parts, materials and supplies	(19)	(5)	10	7
Increase (decrease) in accounts payable and accrued liabilities	(40)	60	(77)	(15)
Increase in advance ticket sales, net of restricted cash	219	438	194	334
Aircraft lease payments (in excess of) less than rent expense	3	(1)	16	(28)
Other	100	143	32	50
	339	653	114	177
Financing				
Issue of share capital (note 6)	443	443	-	-
Issue of convertible notes (note 3)	319	319	-	-
Issue of subsidiary units (note 4)	232	232	-	-
GE DIP financing	-	-	-	300
Aircraft related borrowings	-	-	117	117
Credit facility borrowings (note 3)	318	318	-	80
Reduction of long-term debt and capital lease obligations	(627)	(767)	(95)	(309)
Other	(5)	(5)	-	-
	680	540	22	188
Investing				
Short-term investments	(680)	(1,355)	(78)	108
Sale of subsidiary units (note 4)	35	35	-	-
Additions to capital assets	(57)	(95)	(150)	(186)
Proceeds from sale of assets	-	37	-	1
Cash collaterization of letters of credit	-	(20)	-	-
	(702)	(1,398)	(228)	(77)
Increase (decrease) in cash and cash equivalents	317	(205)	(92)	288
Cash and cash equivalents, beginning of period	959	1,481	864	484
Cash and cash equivalents, end of period	**$ 1,276**	**$ 1,276**	**$ 772**	**$ 772**
Cash payments of interest	**$ 71**	**$ 109**	**$ 55**	**$ 90**
Cash payments of income taxes	**$ 5**	**$ 9**	**$ -**	**$ -**

Cash and cash equivalents exclude short-term investments of $1,506 as at June 30, 2005 ($151 as at December 31, 2004)

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(currencies in millions – Canadian dollars)

SECOND QUARTER 2005

1. Nature of Operations and Accounting Policies

Nature of Operations

ACE Aviation Holdings Inc. (“ACE” or the “Corporation”) was incorporated on June 29, 2004 for the purpose of becoming the parent company of Air Canada and its subsidiaries upon the implementation of the consolidated plan of reorganization, compromise and arrangement (“the Plan”) on September 30, 2004 as further described in the 2004 annual consolidated financial statements of ACE.

The Corporation has historically experienced considerably greater demand for its services in the second and third quarters of the calendar year and significantly lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the spring and summer months.

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

In accordance with Section 1625 of the CICA Handbook, Comprehensive Revaluation of Assets and Liabilities (“CICA 1625”), ACE adopted fresh start reporting on September 30, 2004. References to "Predecessor Company" in these consolidated financial statements and notes thereto refer to Air Canada and its subsidiaries prior to September 30, 2004. References to "Successor Company" refer to ACE and its subsidiaries on and after June 29, 2004. In accordance with CICA 1625, prior period financial information has not been restated to reflect the impact of the fair value adjustments, and accordingly certain amounts in the Predecessor Company’s results are not directly comparable with those of the Successor Company.

The consolidated statement of financial position as of June 30, 2005 and December 31, 2004 represent the accounts of the Successor Company. The consolidated statement of operations for the three months ended June 30, 2005 and the six months ended June 30, 2005 reflect the results of operations of the Successor Company; the three months ended June 30, 2004 and the six months ended June 30, 2004 reflect the results of operations of the Predecessor Company. The consolidated statement of cash flow for the three months ended June 30, 2005 and the six months ended June 30, 2005 reflect the cash flows of the Successor Company; the three months ended June 30, 2004 and the six months ended June 30, 2004 reflect the cash flows of the Predecessor Company.

Accounting Policies

For the period from April 1, 2003 through to September 30, 2004, while Air Canada and certain of its subsidiaries (the “Applicants”) operated under the Companies’ Creditors Arrangement Act (Canada) (“CCAA”) proceedings, the Predecessor Company followed accounting policies, including disclosures, applicable to entities under creditor protection. In addition to Canadian generally accepted accounting principles applicable, the Predecessor Company applied the guidance in American Institute of Certified Public Accountant Statement of Position 90-7, "Financial Reporting by Entities in Reorganization under the Bankruptcy Code" (SoP 90-7). Accordingly, revenues, expenses (including professional fees),

realized gains and losses and provisions for losses directly associated with the reorganization and restructuring of the business were reported separately as reorganization items.

For the period April 1, 2003 to September 30, 2004, interest expense on compromised liabilities was reported only to the extent that it would be paid under the Plan or that it was probable that it would be an allowed claim. Cash flows related to reorganization items have been disclosed separately in the consolidated statement of cash flow. Consolidated financial statements that include one or more entities in reorganization proceedings and one or more entities not in reorganization proceedings include disclosure of condensed combined financial statements of the entities in reorganization proceedings. This information is presented in note 12.

The unaudited interim consolidated financial statements for the Successor Company are based on the accounting policies consistent with those disclosed for the Successor Company in Note 4 to the 2004 annual consolidated financial statements of ACE with the exception of the adoption of the accounting policies described further in this note under New Accounting Policies. The accounting policies of the Successor Company were consistent with those of the Predecessor Company, with the exception of the fair value adjustments applied under fresh start reporting and the accounting policies noted below:

Property and Equipment

On the application of fresh start accounting effective September 30, 2004, the estimated useful lives of buildings was extended to periods not exceeding 50 years. The Predecessor Company depreciated buildings over their useful lives not exceeding 30 years.

Air Transportation Revenues and Loyalty Program

As a result of the application of fresh start reporting, the outstanding loyalty program mileage credits ("Miles") were adjusted to reflect the estimated fair value of Miles to be redeemed in the future. As a consequence of this fair value adjustment and the evolving nature of the Aeroplan loyalty program, the Successor Company changed the accounting policy as of September 30, 2004 for the recognition of its obligations relating to the loyalty program. The Predecessor Company recognized the obligation related to Miles earned through transportation services based on the incremental cost of providing future transportation services. On a prospective basis from the date of fresh start reporting, Miles earned by members through transportation services provided by the Corporation and the transportation services are treated as multiple elements. Miles are recorded at fair values with the residual allocated to transportation services. Consistent with the accounting policy of the Predecessor Company, the proceeds from the sale of Miles to loyalty program partners are deferred.

Effective September 30, 2004, Miles redeemed for travel on Air Canada and Jazz are included in passenger revenue and Miles redeemed for other than travel are included in Other revenues. Under the previous accounting policy in the Predecessor Company, Aeroplan redemption revenues from Miles earned by members through loyalty program partners were included in Other revenues. These revenues amounted to $53 for the three months ended June 30, 2004 ($123 for the six months ended June 30, 2004). For the three months ended June 30, 2005, Aeroplan revenues from Miles redeemed for air travel on Air Canada and Jazz amount to $118, of which approximately $78 relate to Miles earned by members through loyalty program partners and are included in passenger revenues ($219 for the six months ended June 30, 2005, of which approximately $143 relate to Miles earned by members through loyalty program partners).

Non-transportation Revenues

Non-transportation revenues include certain loyalty program revenues, as described in Loyalty Program, as well as revenues from technical services, maintenance and other airline related services. The Predecessor Company recorded all loyalty program revenues under non-transportation revenues prior to September 30, 2004.

Segment Reporting

As a result of the corporate restructuring, the segment reporting structure for the Successor Company reflects four reportable segments consistent with the current management of the business: transportation services, loyalty program, technical services, and regional operations. In the Predecessor Company, there was one reportable segment.

Other

In accordance with Canadian generally accepted accounting principles, 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 2004 annual consolidated financial statements of ACE. In our opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim periods presented. All such adjustments are of a normal recurring nature.

Certain of the prior year's figures have been reclassified to conform to the current year's presentation.

Short-term investments with original maturities greater than ninety days were previously included in Cash and cash equivalents. Because of increased significance, they are now separately presented as Short-term investments. Short-term investments have original maturities over ninety days, but not more than one year.

New Accounting Policies:

a) Consolidation of Variable Interest Entities

Accounting Guideline 15 – Consolidation of Variable Interest Entities (AcG-15) is effective for periods beginning on or after November 1, 2004; as a result, ACE adopted this standard effective January 1, 2005. AcG-15 relates to the application of consolidation principles to certain entities that are subject to control on a basis other than ownership of voting interests. The purpose of AcG-15 is to provide guidance for determining when an enterprise includes the assets, liabilities and results of activities of such an entity (a "variable interest entity") in its consolidated financial statements. Restatement of comparative financial information is not required by AcG-15.

An entity falls under the guidance in AcG-15 and is classified a variable interest entity ("VIE") if it has (1) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties; or (2) equity investors that cannot make significant decisions about the entity's operations, or that do not absorb the expected losses or receive the expected returns of the entity. A VIE is consolidated by its primary beneficiary, which is the party involved with the VIE that will absorb a majority of the expected losses or will receive the majority of the expected residual returns or both, as a result of ownership, contractual or other financial interests in the VIE.

Aircraft and Engine Leasing Transactions

Prior to the adoption of AcG-15, Air Canada entered into aircraft and engine leasing transactions with a number of special purpose entities that are referred to as VIEs under AcG-15. As a result of the adoption of AcG-15 and Air Canada being the primary beneficiary of these VIEs, the Corporation consolidated leasing entities covering 51 aircraft and 22 engines previously accounted for as operating leases. The following adjustments to the consolidated statement of financial position as at January 1, 2005 result from consolidating these lease structures on initial adoption of AcG-15:

	Assets	Liabilities and Shareholders' Equity
Increase to property and equipment	$1,304	
Decrease to deferred charges	(45)	
Decrease to intangible assets	(6)	
Increase to other assets	113	
Increase to current portion of long-term debt		$77
Increase to long-term debt		1,173
Increase to non-controlling interest		181
Decrease to other long-term liabilities		(155)
Cumulative effect of change in accounting policy		90
	$1,366	$1,366

The increase to other assets represents restricted cash held in the VIEs and the fair value of a currency swap arrangement of $7 in favour of the Corporation, taking into account foreign exchange rates in effect as at December 31, 2004. This currency swap was put in place on the inception of the leases for 11 Canadair Regional Jet aircraft. This currency swap has not been designated as a hedge for accounting purposes.

Fuel Facilities Arrangements

Air Canada and Jazz participate in fuel facilities arrangements, along with other airlines to contract for fuel services at various domestic airports. The Fuel Facilities Corporations are organizations incorporated under federal or provincial business corporations acts in order to acquire, finance and lease assets used in connection with the fuelling of aircraft and ground support equipment. The Fuel Facilities Corporations operate on a cost recovery basis.

Under AcG-15, the Corporation is the primary beneficiary of certain of the Fuel Facilities Corporations. On January 1, 2005 the Corporation consolidated three Fuel Facilities Corporations, resulting in the following adjustments:

	Assets	Liabilities and Shareholders' Equity
Increase to property and equipment	$113	
Increase to long-term debt		$51
Increase to non-controlling interest		8
Increase to other long-term liabilities		2
Cumulative effect of change in accounting policy		52
	$113	$113

The remaining five Fuel Facilities Corporations in Canada that have not been consolidated have assets of approximately $103 and debt of approximately $90, which is the Corporation’s maximum exposure to loss

without taking into consideration any cost sharing that would occur amongst the other contracting airlines. The Corporation views this loss potential as remote.

Effect in Current Period

During the three months ended June 30, 2005, the net impact of adopting AcG-15 was a before tax charge of $33 ($0.28 per share, diluted). This impact is a result of depreciation expense of $21, net interest expense of $22, foreign exchange loss of $16 and non-controlling interest of $4 offset by reduced aircraft rent of $30. For the six months ended June 30, 2005, the net impact is $63, ($0.58 per share, diluted) resulting from depreciation expense of $46, net interest expense of $46, foreign exchange loss of $22 and non-controlling interest of $7 offset by reduced aircraft rent of $58.

Prior Periods

Restatement of comparative financial information is not required by AcG-15. The cumulative effect to retained earnings on the adoption of AcG-15 as at January 1, 2005 is an increase of $142.

b) Foreign Currency Translation of Financial Statements of Integrated Foreign Operations

The majority of the VIEs are not Canadian based entities and monetary assets and liabilities of the VIEs are denominated in foreign currencies, principally US dollars. The Corporation applies the temporal method for the translation of the financial statements of the VIEs denominated in foreign currencies. Monetary assets and liabilities of the VIEs are translated at rates of exchange in effect at the date of the consolidated statement of financial position. Non monetary items are translated at historical exchange rates. Expense items are translated at the average rate of exchange for the period, which results in substantially the same reporting currency amounts that would have resulted had the underlying transactions been translated on the dates they occurred. Depreciation of assets translated at historical exchange rates are translated at the same exchange rates as the assets to which they relate.

c) Asset Retirement Obligations

As a result of the consolidation of certain Fuel Facilities Corporations, the Corporation has applied the Canadian Institute of Chartered Accountants Section 3110, "Accounting for Asset Retirement Obligations", which requires the Corporation to record an asset and related liability for the costs associated with the retirement of long-lived tangible assets when a legal liability to retire such assets exists. Under Section 3110, the fair value of a liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and then amortized over its estimated useful life. In subsequent periods, the asset retirement obligation is adjusted for the passage of time and any changes in the amount of the underlying cash flows through charges to earnings. A gain or loss may be incurred upon settlement of the liability.

Under the terms of its land leases, the Fuel Facilities Corporations have the obligation to restore the land to vacant condition at the end of the lease and to rectify any environmental damage for which is it responsible. If it was found that the Fuel Facilities Corporations had to contribute to any remediation costs, each contracting airline would share pro rata, based on system usage, in the costs. For Fuel Facilities Corporations that are consolidated under AcG-15, the Corporation has recorded an obligation of $2 ($12 undiscounted) representing the present value of the estimated decommissioning and remediation obligations at the end of the lease, with lease term expiry dates ranging from 2032 to 2039. This estimate is based on numerous assumptions including the overall cost of decommissioning and remediation and the selection of alternative decommissioning and remediation approaches.

Future Accounting Standard Changes:

a) Financial Instruments and Comprehensive Income

The Accounting Standards Board has issued three new standards dealing with financial instruments: (i) Financial Instruments – Recognition and Measurement (ii) Hedges and (iii) Comprehensive Income. The key principles under these standards are all financial instruments, including derivatives, are to be included on a company's statement of financial position and measured, either at their fair values or, in limited circumstances when fair value may not be considered most relevant, at cost or amortized cost. Financial instruments intended to be held-to-maturity should be measured at amortized cost. Existing requirements for hedge accounting are extended to specify how hedge accounting should be performed. Also, a new location for recognizing certain gains and losses – other comprehensive income – has been introduced. This provides an ability for certain gains and losses arising from changes in fair value to be temporarily recorded outside the income statement but in a transparent manner. The new standards are effective for the Corporation beginning January 1, 2007 and will be applied prospectively. As the Corporation has financial instruments, implementation planning will be necessary to review the new standards to determine the impact on the Corporation.

2. Property and Equipment

	Successor Company June 30, 2005	Successor Company December 31, 2004
Cost (1)		
Flight equipment	$ 1,167	$ 1,179
Flight equipment consolidated under AcG-15	1,304	-
Capital leases	1,758	1,758
Buildings and leasehold improvements	530	520
Buildings consolidated under AcG-15	113	-
Ground equipment and other	152	176
Computer equipment	4	1
	5,028	3,634
Accumulated depreciation and amortization		
Flight equipment	61	18
Flight equipment consolidated under AcG-15	44	-
Capital leases	76	22
Buildings and leasehold improvements	31	10
Buildings consolidated under AcG-15	3	-
Ground equipment and other	16	5
Computer equipment	1	-
	232	55
	4,796	3,579
Purchase deposits	146	117
Property and equipment at net book value	$ 4,942	$ 3,696

During the three months ended June 30, 2005, the Corporation recorded total depreciation, amortization and obsolescence expense of $119 ($239 for the six months ended June 30, 2005; $103 for the three months ended June 30, 2004 and $198 for the six months ended June 30, 2004 recorded in Predecessor Company) which included amortization expense related to intangible assets of $24 ($50 for the six months ended June 30, 2005; $10 for the three months ended June 30, 2004 and $23 for the six months ended June 30, 2004 recorded in Predecessor Company).

1) In accordance with Section 1625 of the CICA Handbook, Comprehensive Revaluation of Assets and Liabilities (“CICA 1625”), on the application of fresh start reporting effective September 30, 2004, the cost of property and equipment was adjusted to fair value.

3. Long-Term Debt and Capital Lease Obligations

	Final Maturity	Current Interest Rate (%)	Successor Company June 30, 2005	Successor Company December 31, 2004
GECC Exit Financing (a)	2011	6.853	$ -	$ 540
Convertible Senior Notes due 2035 (b)	2035	4.25	240	-
Aeroplan Term Credit Facility (c)	2009	4.20	300	-
Aeroplan Revolving Term Credit Facility (c)	2008	4.10	18	-
Air Canada - Lufthansa Cooperation Agreement (d)	2009	6.495	70	76
GECC Limited Recourse Loan (e)	2014	6.306	-	30
GECC Loan (f)	2015	9.39	54	55
Amex Financing (g)	2006	4.25	7	43
Other (h)	2007-2019	4.5 - 6.85%	228	232
			917	976
Debt consolidated under AcG 15 - Aircraft leases (i)			1,210	-
Debt consolidated under AcG-15 - Fuel Facilities Corporations (j)			50	-
Capital lease obligations (k)			1,507	1,570
			3,684	2,546
Current portion			(262)	(218)
Long-term debt and capital lease obligations			$ 3,422	$ 2,328

Principal repayment requirements as at June 30, 2005 on long-term debt, capital lease obligations, and aircraft, engine and fuel facility debt consolidated as variable interest entities under AcG-15 through to 2009 are as follows:

	Remainder of 2005	2006	2007	2008	2009
Long-term debt	$ 24	$ 33	$ 33	$ 71	$ 333
Capital lease principal obligations	77	147	182	179	87
Debt consolidated under AcG-15	34	74	118	117	57
Total	$ 135	$ 254	$ 333	$ 367	$ 477

a) Non-revolving term loan in the amount of US$425 or CDN equivalent, bears interest at a BA rate plus a margin. The loan was drawn in Canadian dollars as at September 30, 2004 in the amount of $540. The margin was set at 4.25% at March 31, 2005. The loan was secured by a first priority security interest on all of the existing and after acquired property of the Successor Company, other than leased assets, assets financed by other parties, and certain other excluded property of ACE and its subsidiaries. The loan was repaid in full prior to maturity on April 6, 2005, including an early payment fee of $16. The Corporation recorded a charge for $29 in other non-operating expenses for this transaction in the three months ended June 30, 2005, including $13 for the write-off of deferred financing charges.

b) During the second quarter, 2005 the Corporation issued $330 of Convertible Senior Notes due 2035 ("Convertible Notes") for net proceeds of $319. For accounting purposes, the Convertible Notes are presented as a compound instrument. At the date of issuance, the value ascribed to the holders' conversion option, which is presented as equity, was $94 less allocated fees of $2; the value ascribed to the financial liability was $236. The financial liability was calculated by discounting the stream of future payments of interest and principal at the prevailing rate for a similar liability that does not have an associated conversion feature. The financial liability will increase to the face value of the debt over a five year period to June 1, 2010, the first date on which the holder can require ACE to purchase all or a portion of the Convertible Notes, as described further below.

   The Convertible Notes bear interest at a rate of 4.25% per annum payable semi-annually in arrears on June 1 and December 1 in each year commencing December 1, 2005. The December 1, 2005 interest payment will represent accrued interest for the period from Closing to December 1, 2005. Holders may convert their Convertible Notes into Class B Voting Shares (if the holder is Canadian) or into Class A Variable Voting Shares (if the holder is not a Canadian) prior to maturity based on an initial conversion rate of 20.8333 Shares per $1,000.00 principal amount of Convertible Notes. Upon notice of conversion, ACE will have the option to deliver cash, Shares or a combination of cash and Shares for the Convertible Notes surrendered.

   At any time on or after June 6, 2008, ACE may redeem all or a portion of the Convertible Notes at a redemption price equal to 100% of the principal amount of the Convertible Notes, plus accrued and unpaid interest. Holders may require ACE to purchase all or a portion of the Convertible Notes on June 1, 2010; June 1, 2015; June 1, 2020; June 1, 2025 and June 1, 2030 at a purchase price equal to 100% of the principal amount of the Notes to be purchased, plus accrued and unpaid interest. Upon specified change of control events, holders of Convertible Notes will have the option to require ACE to purchase all or any portion of the Convertible Notes at a price equal to 100% of the principal amount of the Convertible Notes to be purchased, plus accrued and unpaid interest.

   ACE may, at its option and subject to certain conditions, elect to satisfy its obligation to repay all or any portion of the principal amount of the Convertible Notes that are to be redeemed, purchased or that are to be repaid at maturity, by issuing and delivering Class A Variable Voting Shares (if the holder is not a Canadian) and Class B Voting Shares (if the holder is Canadian). The number of Shares a holder will receive in respect of each Convertible Note will be determined by dividing the principal amount of the Convertible Notes that are to be redeemed, purchased or repaid at maturity, as the case may be, and that are not paid in cash, by 95% of the average Closing Price (defined as the weighted average, by volume, of the reported last sale price of each class of Shares) of the Shares on the TSX for the ten consecutive trading days ending on the third trading day preceding the date fixed for redemption, purchase or maturity date, as the case may be.

c) Aeroplan LP has arranged for senior secured credit facilities in the amount of $475. The credit facilities consist of one $300 (or the U.S. dollar equivalent thereof) term facility (the ''Term A Facility''), a $100 (or the US dollar equivalent thereof) Acquisition facility (the ''Term B Facility'')

and a $75 (or the U.S. dollar equivalent thereof) revolving term facility (the ''Revolving Facility'').

The Term A Facility matures on June 29, 2009, or earlier at the option of Aeroplan and bears interest at rates ranging from Canadian prime rate and U.S. base rate to Canadian prime rate and U.S. base rate plus 0.75% and the Bankers' Acceptance rate and LIBOR plus 1.0% to 1.75%, with the effective interest rate at June 30, 2005 being 4.2%. The Term A Facility was drawn on June 29, 2005 in the amount of $300, in order to fund a portion of the $400 Aeroplan Miles Redemption Reserve (refer to Note 4).

The Revolving Facility matures on June 29, 2008, or earlier at the option of Aeroplan and bears interest at rates ranging from Canadian prime rate and U.S. base rate to Canadian prime rate and U.S. base rate plus 0.75% and the Bankers' Acceptance rate and LIBOR plus 1.0% to 1.75% with the effective interest rate at June 30, 2005 being 4.1%. Under the Revolving Facility, $18 was drawn on June 29, 2005 for general corporate and working capital purposes.

The senior secured credit facilities are secured by a first priority security interest and hypothec over the present and after-acquired personal property of Aeroplan LP, subject to certain exclusions and permitted liens. Aeroplan LP's obligations in respect of the senior secured credit facilities will also be guaranteed by each of Aeroplan LP's general partner (Aeroplan GP) and the Aeroplan Trust, with the Trust providing a first priority security interest over its present and after-acquired personal property, subject to certain exclusions and permitted liens, as security for its guarantee obligations, and with Aeroplan GP providing a pledge of its interests in Aeroplan LP as security for its guarantee obligations. The Aeroplan Trust is an unrelated third party to ACE, and is wholly owned by the Aeroplan Income Fund. The terms of the New Credit Facilities include certain covenants. The credit facilities are subject to Aeroplan's ability to maintain certain leverage, debt service and interest coverage covenants, as well as other affirmative and negative covenants.

d) US$57 borrowing maturing in 2009, with semi annual repayments, at a fixed interest rate of 4.495% plus an annual 2.0% guarantee fee.

e) US$25 borrowing, secured by one B747-400 aircraft, maturing in 2014 at an interest rate equal to the one month LIBOR rate plus a margin of 4.0% and was accrued in arrears at the end of each LIBOR period. Air Canada completed a sales agreement with a third party in January 2005. Consistent with the terms of the loan agreement, the proceeds were used to repay this borrowing. No gain or loss was recorded on this sale.

f) US$44 borrowing maturing in 2015, with quarterly repayments, at a floating interest rate equal to the six month LIBOR rate plus 5.75% pre-payable on any interest payment date after December 23, 2007 secured by certain flight training equipment with a carrying value of $73.

g) The Amex Financing requires monthly principal and interest payments over the term of the Canadian dollar loan which extends to January 5, 2006 and may be extended in six month intervals by mutual consent. Under the terms of the agreement, cash principal payments under the facility are made as loyalty points are purchased and as amounts may be due to Air Canada or Aeroplan under various Amex agreements. The facility bears interest at the Bank of Montreal's prime lending rate (4.25% as at June 30, 2005) and is secured by all accounts due to Amex under the agreements and all of the present and future licenses, trademarks and design marks owned by Air Canada and Aeroplan and used by Amex in connection with the agreement.

h) Other mainly includes financings secured by two A340-500 aircraft. These aircraft purchases were financed through conditional sales agreements for an initial value of US$174. Principal and interest is paid quarterly until maturity in 2019. The purchase price instalments bear interest at a three month LIBOR rate plus 2.9% (6.38% as at June 30, 2005).

i) Air Canada entered into aircraft and engine lease transactions with several special purpose entities that qualify as VIEs. As a result of the adoption of AcG-15 as described in Note 1, the Corporation has consolidated leasing entities covering 51 aircraft and 22 engines previously accounted for as operating leases. The debt has a weighted average effective interest rate of approximately 8%. The aircraft are charged as collateral against the debt by the owners thereof. The creditors under these leasing arrangements have recourse to Air Canada, as lessee, in the event of default or early termination of the lease. The majority of the VIEs are not Canadian based entities and hold debt amounting to US$987.

Aircraft related debt consolidated under AcG-15 is summarized as follows:

	Final Maturity	June 30, 2005
Canadair Regional Jet	2007-2011	$ 344
Boeing 767-300	2011-2016	252
Engines	2008	84
Airbus A319	2011-2014	361
Airbus A321	2017	169
		$ 1,210

j) Under AcG-15, the Corporation is the primary beneficiary of certain of the Fuel Facilities Corporations. As a result of the adoption of AcG-15 as described in Note 1, the Corporation consolidated three Fuel Facilities Corporations. The debt is secured by a general security agreement covering all assets of the Fuel Facilities Corporations.

k) Capital lease obligations, related to computer equipment, facilities and 35 aircraft, total $1,507 ($90 and US$1,156). Future minimum lease payments are $2,219, which includes $712 of interest.

Air Canada revolving credit facility

On April 6, 2005, Air Canada entered into a senior secured syndicated revolving credit facility ("the Credit Facility") in an aggregate amount of up to $300 or the US dollar equivalent. The Credit Facility has a two-year term which can be extended at Air Canada's option for additional one-year periods on each anniversary of closing, subject to prior approval by a majority of the lenders. Included in the aggregate amount is a swing line facility of up to $20 provided for cash management and working capital purposes. The amount available to be drawn by Air Canada under the Credit Facility is limited to the lesser of $300 and the amount of a borrowing base determined with reference to certain eligible accounts receivable of Air Canada and certain eligible owned and leased real property of Air Canada. As at June 30, 2005, the amount available under the Credit Facility was $300, and no amounts had been drawn. The Credit Facility is secured by a first priority security interest and hypothec over the present and after-acquired property of Air Canada, subject to certain exclusions and permitted encumbrances.

4. Aeroplan Transaction

On June 29, 2005, Aeroplan Limited Partnership ("the Predecessor LP") transferred substantially all of its assets and liabilities into a newly created Aeroplan Limited Partnership ("Aeroplan LP") in exchange for the issuance of 175 million units of Aeroplan LP and the issuance of two promissory notes (the Acquisition Promissory Note in the amount of $125 and the Working Capital Note in the amount of $186). The Predecessor LP was liquidated into ACE at closing. The Acquisition Promissory Note was settled on June 29, 2005 from the proceeds of the offering. The Working Capital Note is due October 31, 2005.

On June 29, 2005, the Aeroplan Income Fund ("the Fund") sold 25 million units at a price of $10.00 per unit for net proceeds of $232. On June 30, 2005 the underwriters exercised in full their over-allotment option to purchase an additional 3.75 million units at a price of $10.00 per unit for proceeds of $38. With the proceeds from the over-allotment option, the Fund purchased 3.75 million units from ACE at a cost of $38, reducing the number of units held by ACE to 171.25 million. Issue costs of $3 incurred in connection with the exercise of the over-allotment option were borne by ACE. The Fund is an unincorporated, open-ended trust established under the laws of the Province of Ontario, created to indirectly acquire and hold an interest in the outstanding units of Aeroplan LP. As of June 30, 2005 the Fund, through the Aeroplan Trust, holds 14.4% of the outstanding limited partnership units of Aeroplan LP and ACE holds the remaining 85.6% of the outstanding limited partnership units of Aeroplan LP.

Pursuant to the limited partnership agreement, 20% of Aeroplan's units are subordinated, representing 40 million units held by ACE in favour of the Fund until December 31, 2006. Distributions on the subordinated units will only be paid by Aeroplan to the extent that Aeroplan has met and paid its distributable cash target to the Fund as the holder of non-subordinated units.

Under the terms of an investor liquidity agreement dated June 29, 2005, the non-subordinated units held by ACE in Aeroplan are exchangeable for Fund units on a one-to-one basis. The Fund has reserved 171.25 million units for the exercise of the exchange right. The subordinated units of Aeroplan held by ACE will become exchangeable after December 31, 2006. The exchange right expires once all units of Aeroplan held by ACE have been exchanged. In addition, ACE also has liquidity rights, which require the Trust, on a best efforts basis, to purchase a number of non-subordinated (exchangeable) Aeroplan units for a cash payment equal to the net proceeds of an offering of an equivalent number of units of the Fund. The investor liquidity agreement also provides for registration and piggy-back rights subject to certain restrictions.

ACE has recorded a dilution gain of $190 as a result of this transaction. The dilution gain is the net proceeds of the offering in excess of ACE's proportionate carrying value of its investment in Aeroplan LP, including fair value adjustments recorded on consolidation. In addition, a future income tax expense of $28 was recorded.

In conjunction with the issuance of Units to the Aeroplan Income Fund and the bank financing (refer to Note 3c) entered into on June 29, 2005, Aeroplan LP established the Aeroplan Miles Redemption reserve ("the Reserve"). As at June 30, 2005, the Reserve was established at $400 and is included in cash and cash equivalents. The amount to be held in the Reserve, as well as the types of securities it may be invested in, are based on policies established by management of Aeroplan LP, which will be reviewed periodically. The Reserve may be used to supplement cash flows generated from operations in order to pay for rewards during unusually high redemption activity associated with Aeroplan Miles. Under the terms of the term facility, described in Note 3c, Aeroplan LP was required to deposit the borrowed funds of $300 into the Reserve. Any deposits of funds in non-Canadian dollar denominated investments have to be hedged.

5. Post-Employment Benefits and Labor Related Provisions

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

	Successor Company		Predecessor Company	
	Three months ended June 30, 2005	Six months ended June 30, 2005	Three months ended June 30, 2004	Six months ended June 30, 2004
Pension benefit expense	$47	$78	$76	$153
Other employee future benefit expense	26	65	39	79
Total	$73	$143	$115	$232

Canadian federal pension legislation applicable to the Corporation requires that the funded status of registered pension plans be determined annually. In June 2005, the Corporation received new pension valuations as at January 1, 2005. As a result, the total 2005 employer contribution to the Company's pension plans is estimated to be $274. The estimate previously disclosed in the consolidated financial statements for the year ended December 31, 2004 was $259.

The following table outlines the changes to the labour related provisions:

	Successor Company		Predecessor Company	
	Three months ended June 30, 2005	Six months ended June 30, 2005	Three months ended June 30, 2004	Six months ended June 30, 2004
Beginning of period	$185	$192	$109	$122
Charges recorded	3	4	1	1
Amounts disbursed	(10)	(18)	(12)	(25)
End of period	$178	$178	$98	$98
Current portion	50	50	33	33
Long-term employee liabilities	$128	$128	$65	$65

The current portion of the liability is included in Accounts payable and accrued liabilities. The long-term portion is included in Other long-term liabilities.

6. Share Capital and Other Equity

The number of issued and outstanding common shares of ACE, along with potential common shares, are as follows:

		Successor Company	
		June 30, 2005	December 31, 2004
	Authorized	Outstanding (000)	
Issued and outstanding common shares			
Class A variable voting shares	unlimited	79,084	74,813
Class B voting shares	unlimited	22,095	8,813
Shares held in escrow		121	5,189
Total issued and outstanding common shares		101,300	88,815

	Successor Company	
	June 30, 2005	December 31, 2004
Potential common shares		
Convertible preferred shares	9,609	9,259
Convertible notes	6,875	-
Stock options	2,955	3,028
	19,439	12,287

During the second quarter, 2005, ACE completed the public offering of an aggregate of 12,485,000 Class A Variable Voting Shares and Class B Voting Shares at a price of $37.00 per share for gross proceeds of approximately $462 ($443 net of fees).

Together with the proceeds from the issue of the Convertible Notes (refer to Note 3b), ACE used approximately $557 of the aggregate net cash proceeds of the offerings to repay all of its outstanding debt under the exit credit facility with General Electric Capital Corporation, including $16 for early payment. The Corporation recorded a charge of $29 in other non-operating expenses for this transaction in the three months ended June 30, 2005, including $13 for the write-off of deferred financing charges.

Shares Held in Escrow

The Court-appointed Monitor for the restructuring of the Predecessor Company under CCAA completed its report certifying that all remaining disputed unsecured claims have been resolved. On May 30, 2005, the Monitor recommended to the Ontario Superior Court of Justice that it authorize the Monitor to proceed with the final distribution of shares in accordance with the restructuring plan. The shares were distributed with the exception of 121,419 shares that continue to be held in escrow by the Monitor pending resolution of tax obligations with governmental authorities.

Share capital and other equity summary (net of issue costs):

	Successor Company June 30, 2005	Successor Company December 31, 2004
Common shares	$ 2,221	$ 1,778
Convertible preferred shares	117	117
Convertible notes	92	-
	2,430	1,895
Adjustment to shareholders' equity [(1)]	(1,708)	(1,708)
Share capital and other equity [(2)]	$ 722	$ 187

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

(2) As described in Note 3b, for accounting purposes, the Convertible Notes are presented as a compound instrument. At the date of issuance, the value ascribed to the holders' conversion option, which is presented as equity, was $94 less allocated fees of $2.

7. Segment Information

As a result of the corporate restructuring, the segment reporting structure has been adjusted to reflect four reportable segments consistent with the current management of the business: transportation services, loyalty program, technical services, and regional operations. In the Predecessor Company, Technical Services was a cost centre within Air Canada and discrete financial information is not available. A capacity purchase agreement between Air Canada and Jazz Air Limited Partnership ("Jazz") came into effect on September 30, 2004. The Regional Operations segment information in the Successor Company is not directly comparable as a result of this new agreement.

As described in note 1, the Corporation changed the accounting as of September 30, 2004 for the recognition of its revenues relating to the loyalty program. As a result, Loyalty Program results are not comparable to prior periods.

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 segment to the applicable amounts in the consolidated financial statements follows:

	Successor Company Three months ended June 30, 2005					
	Transportation Services (a)	Loyalty Program (b)	Technical Services	Regional Operations (c)	Inter-Segment Elimination	ACE Consolidated Total
Passenger revenue	$ 2,099	$ -	$ -	$ 1	$ -	$ 2,100
Cargo revenue	147	-	-	-	-	147
Other revenue	7	155	47	2	-	211
External revenue	2,253	155	47	3	-	2,458
Inter-segment revenue	52	2	149	228	(431)	-
Total revenue	2,305	157	196	231	(431)	2,458
Aircraft rent	84	-	-	16	(2)	98
Amortization of capital assets	104	2	8	5	-	119
Other operating expenses	2,016	130	163	184	(429)	2,064
Total operating expenses	2,204	132	171	205	(431)	2,281
Operating income	101	25	25	26	-	177
Total non-operating income (expense), foreign exchange and income taxes	(1)	-	(4)	(4)	-	(9)
Segment Results	$ 100	$ 25	$ 21	$ 22	$ -	$ 168

	Successor Company					
	Six months ended June 30, 2005					
	Transportation Services (a)	Loyalty Program (b)	Technical Services	Regional Operations (c)	Inter-Segment Elimination	ACE Consolidated Total
Passenger revenue	$ 3,838	$ -	$ -	$ 1	$ -	$ 3,839
Cargo revenue	282	-	-	-	-	282
Other revenue	100	324	86	4	-	514
External revenue	4,220	324	86	5	-	4,635
Inter-segment revenue	102	5	290	439	(836)	-
Total revenue	4,322	329	376	444	(836)	4,635
Aircraft rent	160	-	-	31	(3)	188
Amortization of capital assets	209	4	16	10	-	239
Other operating expenses	3,941	274	312	347	(833)	4,041
Total operating expenses	4,310	278	328	388	(836)	4,468
Operating income	12	51	48	56	-	167
Total non-operating income (expense), foreign exchange and income taxes	(62)	-	(7)	(7)	-	(76)
Segment Results	$ (50)	$ 51	$ 41	$ 49	$ -	$ 91

a) Includes revenues and costs for Air Canada operations, Jazz transportation revenues and fees to Air Canada for Jazz operations under the capacity purchase agreement, as well as AC Cargo Limited Partnership (doing business as Air Canada Cargo), Destina.ca Inc., AC Online Limited Partnership, ACGHS Limited Partnership (doing business as Air Canada Groundhandling), Touram Limited Partnership (doing business as Air Canada Vacations), and ACE. Inter-segment revenue includes management fees and costs and operating services charged to the other segments. Foreign exchange is included by management in the Transportation Services segment. Interest expense in the Transportation Services segment represents interest on third party debt. Interest expense included in other segments represents interest on intercompany debt and third party debt. Management reflects all income taxes within the Transportation Services segment including any income taxes that may be applicable to amounts earned in the other segments because the activities of the other segments are carried out as limited partnerships and the income is taxable in one of the entities included in Transportation Services.

b) Other revenue includes revenue recognized on redemption of points accumulated through both air and third party contracts. Inter-segment revenue of $2 ($5 for the six months ended June 30, 2005) represents the management fee charged to Air Canada by Aeroplan relating to the redemption of points accumulated prior to January 1, 2002. The value of points earned through air travel, charged by Aeroplan to Air Canada, is recorded in Aeroplan's accounts as deferred revenues.

c) Includes Jazz operations under the capacity purchase agreement effective September 30, 2004. Renegotiation of service agreements with Air Canada was completed in June, 2005 and applied retroactively to January 1, 2005, resulting in an adjustment of $3, in Air Canada's favour, which was recorded in the three months ended June 30, 2005.

	Predecessor Company Three months ended June 30, 2004				
	Transportation Services	Loyalty Program	Regional Operations (d)	Inter-Segment Elimination	ACE Consolidated Total
Passenger revenue	$ 1,637	$ -	$ 207	$ -	$ 1,844
Cargo revenue	133	-	4	-	137
Other revenue	112	125	3	-	240
External revenue	1,882	125	214	-	2,221
Inter-segment revenue	123	16	3	(142)	-
Total revenue	2,005	141	217	(142)	2,221
Aircraft rent	160	-	11	(1)	170
Amortization of capital assets	94	1	8	-	103
Other operating expenses	1,762	108	197	(141)	1,926
Total operating expenses	2,016	109	216	(142)	2,199
Operating income (loss) before reorganization and restructuring items	(11)	32	1	-	22
Reorganization and restructuring items	(407)	-	(19)	-	(426)
	(418)	32	(18)	-	(404)
Total non operating income (expense), foreign exchange, and income taxes	(103)	-	(3)	-	(106)
Segment Results	$ (521)	$ 32	$ (21)	$ -	$ (510)

	Predecessor Company Six months ended June 30, 2004				
	Transportation Services	Loyalty Program	Regional Operations (d)	Inter-Segment Elimination	ACE Consolidated Total
Passenger revenue	$ 3,118	$ -	$ 387	$ -	$ 3,505
Cargo revenue	255	-	8	-	263
Other revenue	323	244	7	-	574
External revenue	3,696	244	402	-	4,342
Inter-segment revenue	243	40	5	(288)	-
Total revenue	3,939	284	407	(288)	4,342
Aircraft rent	346	-	21	(3)	364
Amortization of capital assets	180	2	16	-	198
Other operating expenses	3,591	209	388	(285)	3,903
Total operating expenses	4,117	211	425	(288)	4,465
Operating income (loss) before reorganization and restructuring items	(178)	73	(18)	-	(123)
Reorganization and restructuring items	(517)	-	(41)	-	(558)
	(695)	73	(59)	-	(681)
Total non operating income (expense), foreign exchange and income taxes	(124)	1	(10)	-	(133)
Segment Results	$ (819)	$ 74	$ (69)	$ -	$ (814)

d) Includes Jazz transportation revenues and costs from Jazz operations as reported prior to implementation of the capacity purchase agreement on September 30, 2004.

Geographic Information of Passenger Revenue

	Successor Company		Predecessor Company	
	Three months ended June 30, 2005	Six months ended June 30, 2005	Three months ended June 30, 2004	Six months ended June 30, 2004
Passenger revenue				
Canada	$ 916	$ 1,593	$ 780	$ 1,427
US Transborder	399	778	382	797
Atlantic	437	730	382	652
Pacific	224	413	199	363
Other	124	325	101	266
Total passenger revenue	$ 2,100	$ 3,839	$ 1,844	$ 3,505

Passenger revenues for Canada are based on the actual flown revenue for flights with an origin and destination in Canada. Passenger revenues for US Transborder and other international destinations are based on the actual flown revenue for flights with an origin or destination outside of Canada.

Property and Equipment

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

8. Commitments

As a result of the adoption of AcG-15 as described in Note 1, the Corporation has consolidated leasing entities covering aircraft and engine leasing agreements previously accounted for as operating leases. The consolidation of these aircraft leasing agreements impacts the operating lease commitments previously disclosed in the 2004 annual consolidated financial statements of ACE. The future principal repayments under these aircraft agreements are now disclosed in Note 3, Long-term Debt and Capital Lease Obligations. Future minimum lease payments under existing operating leases of aircraft, excluding leases accounted for as VIEs, using period end exchange rates are:

remainder of 2005	$	217
2006		426
2007		374
2008		289
2009		238
Thereafter		991
	$	2,535

Planned Investment in Merged US Airways-America West Carrier

On May 19, 2005, the Corporation announced its conditional commitment to invest US$75 in the merged US Airways-America West carrier. The Corporation's investment will be made at the time of US Airways' exit from bankruptcy and in connection with a broad set of commercial and other arrangements. The Corporation's investment will represent approximately 7 per cent of equity of the merged entity, at closing, depending on the total amount of new equity capital raised by the merged entity.

As a condition of its equity investment, the Corporation requires commitments which are expected to result in commercial agreements with the newly-merged entity regarding maintenance services, ground handling, regional jet flying, network, training, and other areas of cooperation. These commitments are subject to the closing of the equity investment.

The equity investment is also subject to, among other closing conditions, bankruptcy court approval and the closing of the US Airways-America West merger, including receipt of all applicable regulatory approvals relating thereto.

Fleet Renewal Plan

On April 25, 2005, the Corporation announced a wide-body fleet renewal plan that included firm orders for 18 Boeing 777s, plus purchase rights for an additional 18 aircraft. The renewal plan also included firm orders for 14 Boeing 787 Dreamliners, plus options and purchase rights for an additional 46 aircraft. The order was subject to several conditions including the negotiation of satisfactory terms by Air Canada with its pilots. On June 18, 2005, the Corporation cancelled its wide-body order with Boeing following a vote by the Air Canada Pilots Association (ACPA) union membership rejecting the tentative agreement on costs and other issues relating to the order. The order was subject to cancellation without penalty if the Corporation did not conclude an agreement with its pilots by June 19, 2005.

9. Guarantees

As a result of the adoption of AcG-15 as described in Note 1, the Corporation no longer has any residual value guarantees under any of its aircraft leasing agreements accounted for as operating leases. The entire debt balance under these leasing agreements is now on the consolidated statement of financial position of the Corporation, and as a result the residual value support previously disclosed in the 2004 annual consolidated financial statements of ACE is no longer characterized as a guarantee of the Corporation.

10. Financial Instruments

As at June 30, 2005, the Company had entered into foreign currency forward contracts that have the effect of fixing the exchange rate on US$230 of fiscal 2005 purchases**.** The fair value of these foreign currency forward contracts as at June 30, 2005 is less than $1 in favour of the third parties. Hedge accounting has not been applied to these foreign currency forward contracts. The loss has been recorded in foreign exchange.

11. Reorganization and Restructuring Items

Cash expenditures related to reorganization and restructuring items for the three months ended June 30, 2004 amounted to $30 ($53 for the six months ended June 30, 2004) and related mainly to the payment of professional fees. Reorganization and restructuring items are nil in the current period as no charges have been recorded in the Successor Company. The table below summarizes reorganization and restructuring charges recorded by the Predecessor Company:

	Predecessor Company	
	Three Months Ended June 30, 2004	Six Months Ended June 30, 2004
Repudiated and renegotiated leases and contracts (a)	$ 245	$ 331
Labour related items (b)	123	123
Foreign exchange adjustments on compromised debt	36	59
Professional fees	28	52
Interest income on accumulated cash (c)	(6)	(13)
Other	-	6
Reorganization and restructuring items, net	$ 426	$ 558

a) Repudiated and renegotiated contracts, including aircraft lease agreements, represented the estimated allowable claim resulting from contracts that had been terminated and the amortization of deferred charges related to deficiency claims on renegotiated contracts.

b) Labour related items relate to the amortization of the estimated compromised claim related to the Predecessor Company's employee groups.

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

12. Condensed Combined Financial Statements of the Applicants of the Predecessor Company

Consolidated financial statements of an entity under creditor protection that include one or more entities in reorganization proceedings and one or more entities not in reorganization proceedings should include disclosure of condensed combined financial statements of the entities in reorganization proceedings. The following are the condensed combined Statement of Operations and Statement of Cash Flow of the entities of the Predecessor Company that were in CCAA for the period ended June 30, 2004. Included in the Statement of Operations for the three months ended June 30, 2004 are intercompany revenues of $92 ($222 for the six months ended June 30, 2004) and expenses of $63 ($129 for the six months ended June 30, 2004) with non-Applicants.

Condensed Combined Statement of Operations

	Predecessor Company	
	Three Months Ended June 30, 2004	Six Months Ended June 30, 2004
Operating revenues	$ 2,156	$ 4,133
Operating expenses	2,180	4,358
Operating loss before reorganization and restructuring items	(24)	(225)
Reorganization and restructuring items (note 11)	(426)	(558)
Net interest expense	(56)	(107)
Loss on sale of assets	(9)	(12)
Other non-operating income, including equity income of non-applicants	37	104
Loss before foreign exchange on non-compromised long-term monetary items and income taxes	(478)	(798)
Foreign exchange on non-compromised long-term monetary items	(34)	(17)
Loss before income taxes	(512)	(815)
Provision for income taxes	2	1
Loss for the period	$ (510)	$ (814)

Condensed Combined Statement of Cash Flow

	Predecessor Company	
	Three Months Ended June 30, 2004	Six Months Ended June 30, 2004
Net cash provided by operating activities	$ 107	$ 152
Financing		
Aircraft related borrowings	117	117
Reduction of long-term debt and capital lease obligations	(70)	(189)
Drawdown on GE DIP financing	-	300
Other credit facility borrowings	-	80
Credit facility repayments	(25)	(120)
	22	188
Investing		
Additions to property and equipment	(147)	(181)
Proceeds from sale of assets	-	1
	(147)	(180)
Increase (decrease) in cash and cash equivalents	(18)	160
Cash and cash equivalents, beginning of period	875	697
Cash and cash equivalents, end of period	$ 857	$ 857

13. ACE Aviation Holdings Inc. / Air Canada

Differences Between Generally Accepted Accounting Principles in Canada and the United States

(Canadian dollars – millions except per share data)

The consolidated financial statements of the Corporation (and Predecessor Company) have been prepared in accordance with Canadian generally accepted accounting policies ("Canadian GAAP"), which differ in certain respects from accounting principles generally accepted in the United States (US GAAP). The following represents the principal differences affecting statements of operations and retained earnings (deficit), financial position, and cash flows as well as additional disclosures required by US GAAP.

	Successor Company - ACE (note 1)		Predecessor Company - Air Canada (note 1)	
	Three months ended June 30	Six months ended June 30	Three months ended June 30	Six months ended June 30
	2005	2005	2004	2004
Income (loss) for the period in accordance with Canadian GAAP	$ 168	$ 91	$ (510)	$ (814)
Aircraft introduction costs (1)	-	-	1	3
Derivative instruments (2)	-	-	(1)	(2)
Residual value guarantee adjustment (3)	-	-	5	9
Pension valuation allowance (4)	-	-	(2)	(4)
Pre-operating costs (5)	-	-	-	1
Convertible securities (6)	(24)	(42)	-	-
Variable interest entity adjustment (7)	-	-	-	(50)
Amortization of intangible assets (8)	(1)	(1)	-	-
Income adjustments for the period before the following	(25)	(43)	3	(43)
Cumulative effect of change in accounting policy - Variable interest entity adjustment (7)	-	-	-	(178)
Income tax adjustment	(1)	(2)	-	-
Non-controlling interest - Variable interest entity adjustment (7)	-	-	2	3
Respective period income adjustments	(26)	(45)	5	(218)
Income (loss) for the period in accordance with US GAAP	142	46	(505)	(1,032)
Minimum pension liability adjustment (4)	(335)	(359)	11	103
Comprehensive income (loss) for the period in accordance with US GAAP	$ (193)	$ (313)	$ (494)	$ (929)
Earnings (loss) per share - US GAAP				
- Basic	$ 1.37	$ 0.41	$ (4.20)	$ (8.59)
- Diluted	$ 1.24	$ 0.41	$ (4.20)	$ (8.59)

	Successor Company - ACE (note 1)	
	June 30, 2005	December 31, 2004
Property and equipment		
Balance under Canadian GAAP	$ 4,942	$ 3,696
Variable interest entity adjustment (7)	-	1,417
Balance under US GAAP	$ 4,942	$ 5,113
Deferred charges		
Balance under Canadian GAAP	$ 127	$ 167
Deferred finance charges (6)	(3)	(6)
Variable interest entity adjustment (7)	-	(15)
Balance under US GAAP	$ 124	$ 146
Goodwill		
Balance under Canadian GAAP	$ -	$ -
Goodwill (8)	1,545	1,583
Balance under US GAAP	$ 1,545	$ 1,583
Intangible Assets		
Balance under Canadian GAAP	$ 2,572	$ 2,691
Variable interest entity adjustment (7)	-	(39)
Goodwill (8)	46	11
Balance under US GAAP	$ 2,618	$ 2,663
Other assets		
Balance under Canadian GAAP	$ 255	$ 137
Variable interest entity adjustment (7)	-	111
Balance under US GAAP	$ 255	$ 248
Current portion of long-term debt		
Balance under Canadian GAAP	$ 262	$ 218
Variable interest entity adjustment (7)	-	77
Balance under US GAAP	$ 262	$ 295
Long-term debt and capital lease obligations		
Balance under Canadian GAAP	$ 3,422	$ 2,328
Variable interest entity adjustment (7)	-	1,230
Convertible securities (6)	24	-
Balance under US GAAP	$ 3,446	$ 3,558
Convertible preferred shares		
Balance under Canadian GAAP	$ 139	$ 132
Reclassification of preferred shares (6)	(139)	(132)
Balance under US GAAP	$ -	$ -
Pension and other benefit liabilities		
Balance under Canadian GAAP	$ 2,296	$ 2,344
Minimum pension liability adjustment (4)	361	2
Balance under US GAAP	$ 2,657	$ 2,346

	Successor Company - ACE (note 1)	
	June 30, 2005	December 31, 2004
Other long-term liabilities		
Balance under Canadian GAAP	$ 1,313	$ 1,645
Convertible preferred shares - embedded derivative (6)	217	180
Convertible notes - embedded derivative (6)	83	-
Variable interest entity adjustment (7)	-	(156)
Balance under US GAAP	$ 1,613	$ 1,669
Minority interest		
Balance under Canadian GAAP	$ 196	$ -
Variable interest entity adjustment (7)	-	178
Balance under US GAAP	$ 196	$ 178
Temporary equity		
Balance under Canadian GAAP	$ -	$ -
Reclassification of convertible preferred shares (6)	174	167
Balance under US GAAP	$ 174	$ 167
Shareholders' equity		
Balance under Canadian GAAP	$ 973	$ 203
Convertible securities (6)	(12)	(5)
Reclassification of convertible preferred shares and convertible notes (6)	(209)	(117)
Variable interest entity adjustment (7)	-	112
Goodwill recorded at fresh start (8)	1,596	1,596
Current year income adjustments	(45)	(68)
Current year adjustments for comprehensive income		
Minimum pension liability adjustment (4)	(359)	(2)
Cumulative prior year adjustments for:		
Future income tax	(2)	-
Convertible securities	(99)	-
Comprehensive income		
Minimum pension liability adjustment	(2)	-
Balance under US GAAP	$ 1,841	$ 1,719

1. Aircraft Introduction Costs

Under Canadian GAAP, the Predecessor Company deferred and amortized aircraft introduction costs. Under US GAAP, these costs are expensed as incurred. The Successor Company expenses aircraft introduction costs as incurred. Under Canadian GAAP, the Predecessor Company recorded amortization expense of $1 for the three months ended June 30, 2004 ($3 for the six months ended June 30, 2004).

2. Derivative Financial Instruments

Under US GAAP, all derivatives are recorded on the balance sheet at fair value. The Corporation and Predecessor Company have elected not to designate any derivatives as hedging instruments for US GAAP purposes and as such, changes in the fair value of all derivative instruments are recorded in income.

Effective January 1, 2004 under Canadian GAAP, derivative instruments that are not part of a designated hedging relationship are recorded at fair value, with changes in fair value recognized currently in income. The opening deferred credit related to the fair value adjustment of the Predecessor Company is amortized over the life of the related derivative instruments. Under US GAAP, this deferred credit is reversed to income. As a result of the application of fresh start reporting, this deferred credit was valued at nil in the Successor Company.

3. Residual Value Guarantees under Operating Leased Aircraft

Under Canadian GAAP, the portion of the gain on sale-leasebacks that includes a residual value guarantee is deferred until the end of the lease term for leases entered into after September 1999, whereas under US GAAP, the amount would be deferred until the end of the lease term for leases entered into after September 1986. Further, under Canadian GAAP, the expected deficiency under a residual value guarantee is accrued over the remaining lease term irrespective of the end of lease term options for leases entered into after September 1999; however, under US GAAP, the accrual of an expected deficiency is required for leases entered into after September 1996. In the Successor Company, all aircraft lease agreements with residual value guarantees are consolidated under the Variable Interest Entity adjustment described under note 7. The adjustment for the three months ended June 30, 2004 relates to the amortization of the previous accrual of the residual value guarantee on renegotiated leases where the residual value guarantee has been removed.

4. Employee Future Benefits

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

5. Pre-operating Costs

Under Canadian GAAP, eligible pre-operating costs are deferred and amortized. Under US GAAP, these costs are expensed as incurred. Under Canadian GAAP, the Predecessor Company recorded amortization expense of $1 for the six months ended June 30, 2004.

6. Convertible Preferred Shares
Under US GAAP, the convertible preferred shares issued by the Successor Company contain an embedded derivative which has been reported separately as an other long-term liability at its fair value of $217 as at June 30, 2005 ($201 as at March 31, 2005 and $180 as at December 31, 2004). The convertible preferred shares were initially recorded at $162 which is the proceeds received less direct costs of issuance and the fair value of the embedded derivative, as of the date of issuance, and is included in temporary equity as the conditions of redemption are not solely within the control of the Successor Company. The adjustment to deferred charges reflects applying the direct costs of issuance, recorded in deferred charges under Canadian GAAP, against the amount recorded in temporary equity.

For the convertible preferred shares, the changes in the fair value of the embedded derivative are included in income and the accretion of the temporary equity to the redemption value over the period to redemption is reflected as a charge to retained earnings.

The adjustment reflects the reversal of interest expense under Canadian GAAP of $4 ($7 for the six months ended June 30, 2005); change in the fair values of the embedded derivative amounting to $16 ($37 for the six months ended June 30, 2005); and the amount charged to retained earnings under US GAAP of $4 ($7 for the six months ended June 30, 2005).

Convertible Notes
Under Canadian GAAP the convertible notes issued in April 2005 are presented as a compound instrument. At the date of issuance, the value ascribed to the holders' conversion option, which is presented as equity, was $94 less allocated fees of $2; the value ascribed to the financial liability was $236. Under US GAAP the convertible notes were initially recorded at $260 which is the proceeds received before costs of issuance and the fair value of the embedded derivative, as of the date of issuance, of $71. The direct costs of issuance of $11 are recorded in deferred charges. The adjustment also reflects the change in the fair value of the embedded derivative for the three months ended of $12 to $83 as at June 30, 2005.

7. Variable Interest Entities
As discussed in note 1, under Canadian GAAP, Accounting Guideline 15 – Consolidation of Variable Interest Entities ("AcG-15") was adopted on January 1, 2005. There are no significant differences between AcG-15 and Interpretation No. 46R – Consolidation of Variable Interest Entities ("FIN 46R"), issued by the Financial Accounting Standards Board and adopted effective January 1, 2004 under US GAAP that affect the Corporation's GAAP reconciliation. As a result, this reconciling difference is no longer applicable.

The adjustment for the three months ended June 30, 2004 of $3 ($(42) for the six months ended June 30, 2004), reflects depreciation expense of $22 ($46 for the six months ended June 30, 2004), interest expense of $27 ($53 for the six months ended June 30, 2004), a foreign exchange loss of $31 ($50 for the six months ended June 30, 2004) and a non-controlling interest charge of $2 ($3 for the six months ended June 30, 2004) offset by the reversal of aircraft rent expense of $85 ($110 for the six months ended June 30, 2004). Under Canadian GAAP, aircraft rent expense recorded in reorganization items in the three months ended June 30, 2004 included a reorganization expense of $60.

8. Goodwill

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

Under Canadian GAAP, the benefit of future income tax assets that exist at fresh start, and for which a valuation allowance is recorded against, will be recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to shareholders' equity. Under US GAAP the benefit of future income tax assets that exist at fresh start will be recognized first to reduce to nil any goodwill, then intangibles with any remaining amount taken to income. As a result, the adjustment at June 30, 2005 reflects a cumulative increase to intangible assets of $46, net of additional amortization expense of $1 for the three and six months ended June 30, 2005, a cumulative reduction of $51 to goodwill, a tax expense of $1 for the three months ended June 30, 2005 ($2 for the six months ended June 30, 2005) and a cumulative retained earnings adjustment of $(2).

9. Comprehensive Income

Under US GAAP, comprehensive income must be reported which is defined as all changes in equity other than those resulting from investments by owners and distributions to owners. Cumulative other comprehensive income (loss) as at June 30, 2005 is $(361), ($(2) at December 31, 2004). For the periods presented, under Canadian GAAP, the Predecessor and the Successor were not permitted to use the concept of comprehensive income. The adjustments to cumulative other comprehensive income relate mainly to the minimum pension liability adjustment described under item 4.

10. Pension and Other Benefit Plans

The components of US GAAP net periodic cost of defined benefit plans include the following:

	Three Months Ended June 30			
	Pension Benefits		Other Benefits	
	2005	2004	2005	2004
Service cost	$ 55	$ 46	$ 21	$ 23
Interest cost	165	162	13	13
Expected return on plan assets	(174)	(163)	-	-
Amortization of prior service cost	-	23	-	1
Amortization of net transition obligation	-	(2)	-	-
Amortization of experience (gains) losses	-	13	(1)	1
	$ 46	$ 79	$ 33	$ 38

	Six Months Ended June 30			
	Pension Benefits		Other Benefits	
	2005	2004	2005	2004
Service cost	$ 99	$ 92	$ 42	$ 46
Interest cost	326	324	25	27
Expected return on plan assets	(347)	(326)	-	-
Amortization of prior service cost	-	45	-	1
Amortization of net transition obligation	-	(3)	-	-
Amortization of experience (gains) losses	-	25	(2)	3
	$ 78	$ 157	$ 65	$ 77

As of June 30, 2005 the Corporation had contributed $123 to its defined benefit pension plans. The Corporation expects to contribute an additional $151 during the remainder of 2005.

New Accounting Policies

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"). This standard replaces SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") and supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). It requires that the compensation cost of share-based payment transactions be recognized in financial statements based on the fair value of the equity or liability instruments issued. SFAS 123R is effective for public companies beginning with the first annual period that begins after June 15, 2005. The Corporation will adopt this statement as of the beginning the first quarter 2006. The

Corporation has not completed its evaluation of the impact of SFAS 123R on its financial statements. Under Canadian GAAP as described in note 4t) to the 2004 annual consolidated financial statements of ACE, the fair value of stock options granted is recognized as a charge to salary and wage expense on a straight line basis over the applicable vesting period, with an offset to contributed surplus. The amount of compensation cost recognized at any date at least equals the value of the vested portion of the options at that date. When stock options are exercised, the consideration paid by employees, together with the amount in contributed surplus, is credited to share capital.

FASB has issued FIN 47 - Asset retirement obligations. This Interpretation clarifies that the term "conditional asset retirement obligation" as used in FASB Statement No. 143, Accounting for Asset Retirement Obligations, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. This Interpretation is effective no later than the end of fiscal years ending after December 15, 2005; the Corporation will apply FIN 47 in the fourth quarter 2005. The Corporations is reviewing the impact that FIN 47 may have on its financial statements.

14. Subsequent Event

Jazz Air Limited Partnership

As announced on August 4, 2005, ACE intends to proceed with an initial public offering of Jazz Air Limited Partnership through an income trust structure. A preliminary prospectus in respect of the offering is expected to be filed in the third quarter of 2005 and ACE will retain a majority interest in Jazz.