AUGUST 4, 2005

SECOND QUARTER 2005
MANAGEMENT'S DISCUSSION AND ANALYSIS

ACE AVIATION HOLDINGS INC.

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PREFACE

ACE Aviation Holdings Inc. (ACE) was incorporated on June 29, 2004 for the purpose of becoming the parent company of Air Canada and its subsidiaries upon the implementation of the consolidated plan of reorganization, compromise and arrangement (the Plan) on September 30, 2004, as further described in the 2004 Annual Consolidated Financial Statements of ACE.

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” 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 fair value adjustments and, accordingly, certain amounts in the Predecessor Company’s results are not directly comparable with those of the Successor Company.

As a result of the application of fresh start reporting, the application of new accounting policies, the effectiveness of certain lease contracts on emergence from creditor protection under the Companies’ Creditors Arrangement Act (CCAA) and the debt and equity transactions that occurred on September 30, 2004, the Successor Company’s financial statements are not directly comparable to those prepared for the Predecessor Company. The presentation of the financial information of ACE for the three months ended June 30, 2005 and the six months ended June 30, 2005 and the financial information of Air Canada for the three months ended June 30, 2004 and the six months ended June 30, 2004 are not directly comparable because the financial statements of Air Canada for periods prior to October 1, 2004 and the financial statements of ACE for periods on and after October 1, 2004 are those of different reporting entities and are prepared using different bases of accounting and different accounting policies.

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 and the consolidated statement of cash flow for the three months ended June 30, 2005 and the six months ended June 30, 2005 reflects the results of operations of the Successor Company; the three months ended June 30, 2004 and the six months ended June 30, 2004 reflects the results of operations of the Predecessor Company.

The Interim Unaudited Consolidated Second Quarter 2005 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 in Note 1 to the Interim Unaudited Consolidated Second Quarter 2005 Financial Statements under "New Accounting Policies" and page 50 of this MD&A under the section entitled "Accounting Policies".

In accordance with Canadian Generally Accepted Accounting Principles (GAAP), the Interim Unaudited Consolidated Second Quarter 2005 Financial Statements do not include all of the disclosures required for annual financial statements and should be read in conjunction with the 2004 Annual Consolidated Financial Statements of ACE. All amounts are expressed in Canadian currency unless indicated otherwise. This Management's Discussion and Analysis is as of August 4, 2005.

See Note 1 to the Interim Unaudited Second Quarter 2005 Consolidated Financial Statements for additional information on the nature of operations and accounting policies.

For further information on ACE's and Air Canada's public disclosure file, please consult www.sedar.com.

CAUTION REGARDING FORWARD-LOOKING INFORMATION

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

Forward-looking statements, by their nature, are based on assumptions and are subject to important risks and uncertainties. Any forecasts or forward-looking predictions or statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Results indicated in forward-looking statements may differ materially from actual results for a number of reasons, including without limitation, energy prices, general industry, market and economic conditions, war, terrorist attacks, changes in demand due to the seasonal nature of the business, the ability to reduce operating costs and employee counts, employee relations, labour negotiations or disputes, restructuring, pension issues, currency exchange and interest rates, changes in laws, adverse regulatory developments or proceedings, pending litigation and actions by third parties. The forward-looking statements contained in this discussion represent ACE's expectations as of August 4, 2005, and are subject to change after such date. However, ACE disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

ACE AVIATION HOLDINGS INC.
SECOND QUARTER 2005
MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS

EXPLANATORY NOTES

Glossary of Terms

Revenue Passenger Miles (RPMs)

A measure of passenger traffic calculated by multiplying the total number of revenue passengers carried by the miles they are carried.

Available Seat Miles (ASMs)

A measure of passenger capacity calculated by multiplying the total number of seats available for revenue traffic by the miles flown.

Passenger Load Factor

A measure of passenger capacity utilization derived by expressing revenue passenger miles as a percentage of available seat miles.

Passenger Revenue per Revenue Passenger Mile (yield per RPM)

Average passenger revenue per revenue passenger mile.

Passenger Revenue per Available Seat Mile (RASM)

Average passenger revenue per available seat mile.

"Corporation" refers to, as the context may require, ACE and its subsidiaries collectively, ACE and one or more of its subsidiaries, one or more of ACE's subsidiaries, or ACE itself.

"Subsidiary" or "subsidiaries" refers to, in relation to ACE, any entity, including a corporation or a limited partnership, which is controlled, directly or indirectly, by ACE.

Comparative Figures

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 presented separately as short-term investments. Short-term investments have original maturities over 90 days, but not more than one year. These investments can be readily converted to cash and are with institutions that have high credit ratings.

Non-GAAP Financial Measure

EBITDAR (earnings before interest, taxes, depreciation, amortization and obsolescence and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before aircraft rent and ownership costs as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other asset acquisitions.

EBITDAR is not a recognized measure for financial statement presentation under GAAP and does not have a standardized meaning and is therefore not likely to be comparable to similar measures presented by other public companies. EBITDAR, before reorganization and restructuring items, is reconciled to operating income (loss) before reorganization and restructuring items, as follows:

	Successor Company ACE	**Predecessor Company Air Canada**	
($ millions)	**Three Months Ended June 30, 2005**	**Three Months Ended June 30, 2004**	**Change**
GAAP operating income before reorganization and restructuring items (1)	177	22	155
Add back:			
Depreciation, amortization and obsolescence	119	103	16
Aircraft rent	98	170	(72)
EBITDAR, before reorganization and restructuring items (1)	394	295	99
EBITDAR margin (%) (2)	16.0	13.3	2.7 pp

($ millions)	Successor Company ACE Six Months Ended June 30, 2005	Predecessor Company Air Canada Six Months Ended June 30, 2004	Change
GAAP operating income before reorganization and restructuring items (1)	167	(123)	290
Add back:			
Depreciation, amortization and obsolescence	239	198	41
Aircraft rent	188	364	(176)
EBITDAR, before reorganization and restructuring items (1)	594	439	155
EBITDAR margin (%) (2)	12.8	10.1	2.7 pp

(1) Reorganization and restructuring items were recorded while the Predecessor Company was under creditor protection from April 1, 2003 through to September 30, 2004. As the Successor Company emerged from CCAA proceedings on September 30, 2004, reorganization and restructuring items were not recorded after that date.

(2) EBITDAR margin is calculated as EBITDAR divided by operating revenues.

Loyalty Program

As described in Note 1 to the Interim Unaudited Second Quarter 2005 Consolidated Financial Statements, ACE implemented a loyalty program accounting policy as of September 30, 2004 that was different from the policy employed by the Predecessor Company.

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 Air Limited Partnership ("Jazz") are included in passenger revenues 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.

The sum of passenger revenues from Miles redeemed for air travel on Air Canada and Jazz and the above-noted deferred revenues are referred to as "Aeroplan passenger revenues" in this MD&A. For additional information on the Loyalty Program, refer to the section entitled "Accounting Policies" on page 50 of this MD&A.

In the second quarter of 2005, Aeroplan revenues from Miles redeemed for air travel on Air Canada and Jazz amounted to $118 million ($219 million for the six months ended June 30, 2005), of which approximately $78 million related to Aeroplan redemption revenues from Miles earned by members through the loyalty program partners (approximately $143 million for the six months ended June 30, 2005). These redemption revenues were partly offset by the deferral of revenues of $44 million ($88 for the six months ended June 30, 2005) related to the fair value of Miles earned by members through transportation services provided by the Corporation, resulting in net Aeroplan passenger revenues of $74 million ($131 million for the six months ended June 30, 2005). For the three months ended June 30, 2004, Aeroplan revenues from Miles earned by members through the loyalty program partners amounted to $53 million ($123 million for the six months ended June 30, 2004).

SECOND QUARTER RESULTS OF OPERATIONS – 2005 VERSUS 2004

The following table sets out the second quarter 2005 results of operations for ACE, the Successor Company, as compared to the second quarter 2004 results of operations for Air Canada, the Predecessor Company.

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 that do not meaningfully fluctuate with passenger demand in the short-term. Seasonably low passenger demand normally results in significantly lower operating cash flow in the first and fourth quarters for each calendar year compared to the second and third quarters.

ACE Aviation Holdings Inc.
Consolidated Statement of Operations

($ millions, except per share figures) (Unaudited)	Successor Company ACE Three Months Ended June 30, 2005	Predecessor Company Air Canada Three Months Ended June 30, 2004	$Change	%Change
Operating revenues				
Passenger	2,100	1,844	256	14
Cargo	147	137	10	7
Other	211	240	(29)	(12)
	2,458	2,221	237	11
Operating expenses				
Salaries, wages and benefits	623	672	(49)	(7)
Aircraft fuel	530	374	156	42
Aircraft rent	98	170	(72)	(42)
Airport and navigation fees	230	207	23	11
Aircraft maintenance, materials and supplies	89	82	7	9
Communications and information technology	78	75	3	4
Food, beverages and supplies	81	87	(6)	(7)
Depreciation, amortization and obsolescence	119	103	16	16
Commissions	73	82	(9)	(11)
Other	360	347	13	4
	2,281	2,199	82	4
Operating income (loss) before reorganization and restructuring items	177	22	155	
Reorganization and restructuring items	-	(426)	426	
Non-operating income (expense)				
Dilution gain	190	-	190	
Interest income	15	-	15	
Interest expense	(77)	(60)	(17)	
Interest capitalized	3	-	3	
Loss on sale of and provisions on assets	-	(10)	10	
Non-controlling interest	(4)	-	(4)	
Other	(27)	(2)	(25)	
	100	(72)	172	
Income (loss) before foreign exchange on non-compromised monetary items and income taxes	277	(476)	753	
Foreign exchange loss	(53)	(34)	(19)	
Income (loss) before income taxes	224	(510)	734	
Provision for income taxes	(56)	-	(56)	
Income (loss) for the period	168	(510)	678	
Earnings (loss) per share				
- Basic	1.67	(4.24)		
- Diluted	1.49	(4.24)		
Operating Statistics				
Revenue Passenger Miles (millions)	11,613	10,836	777	7
Available Seat Miles (millions)	14,487	13,931	556	4
Passenger Load Factor (%)	80.2	77.8	2.4 pp	

Comparison of Second Quarter Results

In the second quarter of 2005, ACE reported an operating income of $177 million, an improvement of $155 million compared to Air Canada's operating income before reorganization and restructuring items of $22 million recorded in the same quarter of 2004. EBITDAR improved $99 million over the 2004 quarter. Refer to "Non-GAAP Financial Measure" on page 6 of this MD&A for additional information on EBITDAR.

In the second quarter of 2005, total operating revenues increased $237 million or 11 per cent compared to the second quarter of 2004. Passenger revenues increased $256 million or 14 per cent reflecting increases in all markets including the transfer of Aeroplan passenger revenues of $74 million into the passenger revenue category. For additional information on Aeroplan passenger revenues, refer to page 7 of this MD&A.

Operating expenses increased $82 million or 4 per cent versus the second quarter of 2004 and included an increase in fuel expense of $156 million or 42 per cent over the second quarter of 2004. The fuel expense increase over the 2004 level more than offset the continued cost reductions achieved in other expense categories. Capacity, as measured in available seat miles (ASM) increased 4 per cent. Unit cost for the second quarter of 2005, as measured by operating expense per ASM, was essentially unchanged from the second quarter of 2004. Excluding fuel expense, unit cost was down 8 per cent compared to the 2004 quarter. Unit cost reductions were achieved in salaries, wages and benefits, aircraft rent, food, beverages and supplies and commission expense.

While under creditor protection from April 1, 2003 through to September 30, 2004, the Applicants, as defined in Note 2 to the 2004 Consolidated Financial Statements, recorded significant reorganization and restructuring items directly associated with the rearranging of their business affairs. In the second quarter of 2004, reorganization and restructuring items amounted to $426 million. These mainly non-cash items related primarily to lease deficiency claims, labour-related items, foreign exchange adjustments on compromised debt and professional fees. As the Applicants emerged from CCAA proceedings on September 30, 2004, reorganization and restructuring items were not recorded after that date.

In the second quarter of 2005, non-operating expenses decreased $172 million. The second quarter of 2005 included a dilution gain of $190 million (before tax) relating to the Aeroplan transaction as further described below. In June, ACE and the Aeroplan Income Fund completed an initial public offering (IPO) of the Aeroplan Income Fund, which constituted a 14.4 per cent divesture of Aeroplan LP with ACE holding the balance of 85.6 per cent interest in

Aeroplan LP. The aggregate gross proceeds from the IPO (including the full exercise of the underwriters' over-allotment options) totaled $287.5 million (refer to Recent Developments for additional information on this transaction). Also included in other non-operating expenses in the 2005 quarter was a charge of $29 million relating to the repayment of the GE Canada Finance Holding Company ("GE") exit credit facility.

Losses from revaluation of foreign currency monetary items amounted to $53 million in the second quarter of 2005 attributable to a weaker Canadian dollar versus the US dollar at June 30, 2005 compared to March 31, 2005. This compared to foreign exchange losses on non-compromised monetary items of $34 million in the second quarter of 2004.

Net income for the second quarter of 2005 was $168 million compared to a net loss of $510 million in the second quarter of 2004, an improvement of $678 million. The second quarter of 2004 included reorganization and restructuring items amounting to $426 million.

RASM
Passenger revenue per available seat mile (RASM) is a common industry measure of passenger revenue performance providing a yardstick of revenue generation per unit of capacity offered. RASM is influenced by two key components: • Load factor • Yield per RPM The first component is load factor which represents passenger traffic expressed in relation to the capacity offered (i.e. revenue passenger miles (RPMs) to available seat miles (ASMs)). The second component is the yield per revenue passenger mile (or average fare paid per occupied seat mile flown). If an airline can improve its load factor on a particular flight (i.e. the number of revenue passengers) or its yield per revenue passenger mile (i.e. the average fare per mile paid by each passenger) then the passenger revenue per available seat mile (RASM) will increase leading to greater operating profitability on that flight. Depending on market conditions, airlines may periodically have a greater focus on improving load factor or yield, however, the interaction of both these factors will determine RASM. The higher the RASM, the more revenue is generated by the airline for each available seat. Long-haul flights generally have a lower yield per RPM than short-haul flights. When measured on a per mile basis, the average fare paid on long-haul flights is relatively lower than on short-haul flights. Because the costs of ground handling and fees for take-off and landing are similar for both short and long-haul flights, unit costs per ASM are normally lower for long-haul flights due to the distance flown.

REVENUE PERFORMANCE

Passenger Revenues

As a result of the inclusion of Aeroplan passenger revenues in passenger revenues starting in October 2004 as defined on page 7 of this MD&A, passenger revenues, RASM and yield per RPM are not directly comparable to previous years. For comparative purposes, the following discussion and tables will provide the reader with passenger revenue, RASM and yield per RPM variances that exclude the impact of the policy change related to Aeroplan passenger revenues. However, the discussion will also provide passenger revenue, RASM and yield per RPM information including the impact of the policy change related to Aeroplan passenger revenues.

The table below describes, by major market, the percentage change from the prior year in passenger revenues for the eight most recent quarters.

Passenger Revenue % Change Year-over-Year by Quarter

	Predecessor Company Air Canada					Successor Company ACE		
	Quarter 3 2003	**Quarter 4 2003**	**Quarter 1 2004**	**Quarter 2 2004**	**Quarter 3 2004**	**Quarter 4 2004**	**Quarter 1 2005**	**Quarter 2 2005**
Canada (1)	(17)	(13)	(9)	8	3	0	1	13
US (1)	(24)	(19)	(13)	5	(1)	(17)	(13)	0
Atlantic (1)	(4)	(5)	(5)	6	6	4	8	10
Pacific (1)	(52)	(13)	15	162	113	35	14	11
Other (1)	3	18	24	38	25	22	17	18
System (1) (excluding Aeroplan)	(19)	(12)	(5)	15	12	1	1	10
System (including Aeroplan)	(19)	(12)	(5)	15	12	4	5	14

(1) The calculation of percentage change year-over-year does not include Aeroplan passenger revenues for the fourth quarter of 2004 and the first and second quarters of 2005.

The table below describes, by major market, quarter-over-quarter percentage changes in passenger revenues, capacity as measured by available seat miles (ASMs), traffic as measured by revenue passenger miles (RPMs), passenger load factor as measured by RPMs divided by ASMs, yield as measured by passenger revenue per RPM, and RASM as measured by passenger revenue per ASM.

Operating Statistics – Quarter 2, 2005 versus Quarter 2, 2004

	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield per RPM % Change	RASM % Change
Canada (1)	13	4	9	3.6	4	9
US (1)	0	(5)	5	6.8	(5)	5
Atlantic (1)	10	8	8	(0.1)	3	3
Pacific (1)	11	4	4	0.0	7	7
Other (1)	18	14	13	(0.7)	4	3
System (1) (excluding Aeroplan)	10	4	7	2.4	3	6
System (including Aeroplan)	14	4	7	2.4	6	10

(1) The calculation of percentage change quarter-over-quarter does not include Aeroplan passenger revenues for the first and second quarters of 2005.

Passenger revenues were up $256 million or 14 per cent from 2004 and included Aeroplan passenger revenues of $74 million in the second quarter of 2005. As a result of higher fuel costs, surcharges have been significantly increased to and from most international destinations.

In the second quarter of 2005, system passenger traffic increased 7 per cent on an increase of 4 per cent in ASM flying capacity producing a 2.4 percentage point improvement in load factor. Passenger traffic is measured by revenue passenger miles which is calculated by multiplying the number of revenue passengers carried by the miles they are carried. Excluding Aeroplan passenger revenues, yield per RPM, as measured by average passenger revenue per revenue passenger mile, increased 3 per cent. Yield per RPM increases were reflected in all markets with the exception of the US transborder market. The yield per RPM increases were mainly due to higher fare levels and an increase in fuel surcharges. System RASM, excluding Aeroplan passenger revenues, rose 6 per cent over the second quarter of 2004 reflecting both the improvement in load factor and the increase in yield per RPM.

Second quarter domestic passenger revenues were up $136 million or 17 per cent and included Aeroplan passenger revenues of $34 million in the 2005 quarter. Domestic passenger traffic was up 9 per cent and capacity was increased by 4 percent resulting in a passenger load factor improvement of 3.6 percentage points. Domestic yield per RPM increased 4 per cent excluding Aeroplan passenger revenues, mainly due to higher fare levels to cover increased fuel costs. Reflecting both the improvement in passenger load factor and the yield per RPM improvement, excluding Aeroplan passenger revenues, domestic RASM rose 9 per cent above the 2004 level.

US transborder passenger revenues were up $17 million or 4 per cent and included Aeroplan passenger revenues of $17 million in the 2005 quarter. In response to increased capacity from US carriers, US transborder ASM capacity was reduced by 5 per cent. In spite of the ASM capacity reduction, traffic increased 5 per cent resulting in a passenger load factor improvement of 6.8 percentage points. Excluding Aeroplan passenger revenues, yield per RPM declined 5 per cent reflecting increased capacity on the transborder market by Canadian low-cost carriers. An aggressive pricing environment as well as the weakening of the US dollar versus the second quarter of 2004 for sales denominated in US dollars were also factors in the yield per RPM decrease. Excluding Aeroplan passenger revenues, US transborder RASM was up 5 per cent as the significant improvement in passenger load factor offset the yield per RPM decrease.

Atlantic revenues, including Aeroplan passenger revenues of $16 million, increased $55 million or 14 per cent. This reflected a 3 per cent increase in yield per RPM, excluding Aeroplan passenger revenues, reflecting in part growth in higher-yield business traffic as well as increased fuel surcharges. Traffic rose 8 per cent on a similar capacity increase which reflected an earlier start of seasonal services and the new service to Rome. Excluding Aeroplan passenger revenues, RASM increased 3 per cent reflecting the yield per RPM increase.

Pacific revenues were up $25 million or 12 per cent and included Aeroplan passenger revenues of $2 million in the 2005 quarter. Excluding Aeroplan passenger revenues, yield per RPM increased 7 per cent over the second quarter of 2004, reflecting in part strong premium traffic due to the introduction of non-stop Toronto-Hong Kong and Toronto-Beijing services, higher capacity in the Toronto-Shanghai and Vancouver-Seoul services as well as increased fuel surcharges. Traffic increased 4 per cent on a 4 per cent increase in ASM capacity resulting in a similar passenger load factor to the 2004 quarter. As a result of the yield per RPM increase, RASM increased 7 per cent, excluding Aeroplan passenger revenues.

South Pacific, Caribbean, Mexico and South America revenues increased $23 million or 22 per cent and included Aeroplan passenger revenues of $5 million in the 2005 quarter. Traffic increased 13 per cent on an ASM capacity increase of 14 per cent resulting in a similar passenger load factor as the 2004 quarter. Excluding Aeroplan passenger revenues, yield per RPM increased 4 per cent over the second quarter of 2004 and RASM increased 3 per cent in part due to increased fuel surcharges. The growth in these markets is largely from additional flying to South America.

Cargo Revenues

Cargo revenues increased $10 million or 7 per cent mainly due to an increase in the volume of cargo carried largely in the Pacific market.

Other Revenues

Other non-transportation revenues were down $29 million or 12 per cent mainly as a result of the change in accounting policy for the loyalty program (Aeroplan) as described on page 7 of this MD&A. For the three months ended June 30, 2004, Aeroplan revenues from Miles earned by members through the loyalty program partners amounted to $53 million and were recorded in other revenues. For the three months ended June 30, 2005, Aeroplan revenues from Miles redeemed for air travel on Air Canada and Jazz are recorded in passenger revenues. Partly offsetting the reduction from the change in accounting policy for the loyalty program is an increase in third party maintenance revenues, higher cancellation and change fees and higher revenues from Air Canada Vacations primarily as a result of a stronger presence in the Latin Caribbean market.

COST PERFORMANCE SECOND QUARTER OF 2005

Impact of the Adoption of AcG-15

Effective January 1, 2005, the Corporation adopted Accounting Guideline 15 – Consolidation of Variable Interest Entities (AcG-15). Refer to Note 1 to the Interim Unaudited Second Quarter 2005 Consolidated Financial Statements or to page 51 of this MD&A for additional information on the adoption of AcG-15. In the second quarter of 2005, the net impact of adopting AcG-15 on the Corporation's results was a pre-tax charge of $33 million or $0.28 per share, diluted. The impact of the adoption of AcG-15 was a reduction to aircraft rent expense of $30 million, an increase to depreciation expense of $21 million, an increase to net interest expense of $22 million, a foreign exchange loss of $16 million and non-controlling interest of $4 million compared to financial results had AcG-15 not been effective.

Operating Expenses

In the second quarter of 2005, total operating expenses increased $82 million or 4 per cent compared to the second quarter of 2004 and included a fuel expense increase of $156 million or 42 per cent versus the 2004 quarter. Unit cost remained at the 2004 level (excluding fuel expense, unit cost declined 8 per cent). The fuel expense increase of $156 million or 42 per cent more than offset the continued cost reductions achieved in other expense categories.

Salaries and wage expense totaled $487 million in the second quarter of 2005, a decrease of $2 million from the second quarter of 2004. This mainly reflected a reduction of an average of 468 full-time equivalent (FTE) employees or 1 per cent from the second quarter of 2004 as well as salary reductions for unionized and non-unionized labour groups. The decrease in salaries and wages expense was partly offset by the expense of approximately $15 million relating to an employee profit sharing program. No expenses related to this program were recorded in 2004. Salaries and wages expense per ASM was reduced by 4 per cent from the second quarter of 2004.

Employee benefits expense amounted to $136 million in the second quarter of 2005, a decrease of $47 million or 26 per cent from the second quarter of 2004. The decrease was largely due to lower pension expense as a result of the elimination of unamortized actuarial losses and prior service costs resulting from fresh start reporting. However, the 2005 annual pension expense is expected to increase $30 million versus amounts previously estimated by the Corporation's actuaries in January 2005, on the basis of new pension valuation results and revised demographic pension assumptions received by the Corporation in June 2005. As a

result, the Corporation recorded $15 million in additional expense during the quarter pertaining to the first half of 2005. This increase in pension expense in the quarter was largely offset by a reduction of employee future benefits expense of $14 million recorded in the quarter pertaining to the first half of 2005. As a result of revised estimates, the 2005 annual employee future benefits expense is expected to decrease $28 million versus amounts previously estimated. The net impact of the revised valuations for pension expense and employee future benefits expense discussed above will be an expense increase of $2 million annually.

On a capacity increase of 4 per cent, fuel expense increased $156 million or 42 per cent reflecting continuing record high fuel prices. The average base fuel price increase of $186 million or 53 per cent was partially offset by a reduction of $41 million due to the favourable impact of a stronger Canadian dollar versus the US dollar during the quarter when compared to the second quarter of 2004. On a unit cost basis, fuel expense per ASM increased 36 per cent.

Aircraft rent expense decreased $72 million or 42 per cent. As discussed above, as a result of the adoption of AcG-15, aircraft rent expense decreased $36 million versus the same period last year. Other factors in the remaining decrease to aircraft rent expense included the impact of fair value adjustments as a result of fresh start reporting, the termination of the 747-400 leases, the net reclassification of certain aircraft leases from operating to capital leases, lease renegotiations, as well as a stronger Canadian dollar versus the US dollar for leases denominated in US dollars during the quarter when compared to the second quarter of 2004.

Airport and navigation fees increased during the quarter $23 million or 11 per cent. Aircraft frequencies were essentially unchanged from the second quarter 2004. Higher fees for air navigation services as a result of a 10 per cent average unit rate increase which came into effect in September 2004 and higher landing and general terminal fees, primarily at Toronto's Pearson International Airport, were the main reasons for the increase.

Aircraft maintenance, materials and supplies expense increased $7 million or 9 per cent largely related to increased volume of maintenance activity and provisions on short term lease returns in the 2005 quarter which did not occur in 2004. This increase was partly offset by the retirement of the British Aerospace Bae146, Boeing 737-200 and Boeing 747-400 fleets as well as decreased maintenance activities on the CRJ100 Canadair Regional Jets.

Communications and information technology expense was up $3 million or 4 per cent largely due to increased volume for communication services for web and Global Distribution System (GDS). The increase was largely offset by renegotiated contract rates for information

technology and communications services and the impact of a stronger Canadian dollar versus the US dollar in the quarter when compared to the second quarter 2004.

Food, beverage and supplies expense decreased $6 million or 7 per cent despite an increase of 7 per cent in passenger traffic as measured by RPMs. The decrease was mainly due to the impact of cost reduction initiatives and renegotiated contract rates.

Depreciation, amortization and obsolescence expense increased $16 million or 16 per cent. As discussed above, as a result of the adoption of AcG-15, depreciation expense increased $21 million. Amortization of intangible assets amounted to $24 million compared to $10 million in the same period last year, reflecting the impact of fresh start on the amortization of intangible assets. Amortization of intangible assets prior to fresh start related mainly to the systems development projects. Favorable variances of $19 million included fair value adjustments as a result of fresh start reporting.

Commission expense was down $9 million or 11 per cent on passenger and cargo revenue growth of 14 per cent. The impact of a new commission structure introduced in July 2004 for web and GDS bookings as well as lower international commissions more than offset the volume-related increase.

The other operating expense category increased $13 million or 4 per cent over the same period of 2004 and included increases in customer maintenance materials, credit card fees, Aeroplan non-air redemption expenses and higher expenses relating to a higher volume and an increase in the cost of tour packages by Air Canada Vacations. These increases were partially offset by decreases in advertising and promotion expense and joint venture settlements as well as various other expense reductions.

Non-Operating Income

Non-operating income amounted to $100 million in the second quarter of 2005, a $172 million increase from the second quarter of 2004. In the second quarter of 2005, ACE recorded a dilution gain of $190 million (before tax) related to the Aeroplan transaction (refer to Recent Developments on page 39 of this MD&A for additional detail). "Other" non-operating expense amounted to $27 million in the quarter and related mainly to an early payment fee and the write-off of deferred charges on the repayment of the exit financing facility with GE. Net interest expense amounted to $59 million, a decrease of $1 million from the 2004 quarter. As discussed above, as a result of the adoption of AcG-15, interest expense increased $22 million. This increase in net interest expense was partly offset by interest income of $15 million in the second

quarter of 2005. Interest income in the second quarter of 2004 was allocated to reorganization and restructuring items.

Foreign Exchange

Losses from revaluation of foreign currency monetary items amounted to $53 million in the second quarter of 2005 attributable to a weaker Canadian dollar versus the US dollar at June 30, 2005 compared to March 31, 2005. The foreign exchange losses recorded in the 2005 quarter included $21 million related to capital lease obligations and $16 million as a result of the adoption of AcG-15. This compared to foreign exchange loss on non-compromised monetary items of $34 million recorded in the second quarter of 2004.

Future Income Taxes

Provision for income taxes amounted to $56 million in the second quarter of 2005, of which $28 million related to the Aeroplan transaction.

YEAR-TO-DATE RESULTS OF OPERATIONS – 2005 VERSUS 2004

The following table sets out 2005 year-to-date results of operations for ACE, the Successor Company, as compared to 2004 year-to-date results of operations for Air Canada, the Predecessor Company.

Consolidated Statement of Operations	**Successor Company ACE**	**Predecessor Company Air Canada**		
($ millions, except per share figures) (Unaudited)	**Six Months Ended June 30, 2005**	**Six Months Ended June 30, 2004**	**$Change**	**%Change**
Operating revenues				
Passenger	3,839	3,505	334	10
Cargo	282	263	19	7
Other	514	574	(60)	(10)
	4,635	4,342	293	7
Operating expenses				
Salaries, wages and benefits	1,236	1,359	(123)	(9)
Aircraft fuel	945	712	233	33
Aircraft rent	188	364	(176)	(48)
Airport and navigation fees	443	410	33	8
Aircraft maintenance, materials and supplies	183	185	(2)	(1)
Communications and information technology	155	163	(8)	(5)
Food, beverages and supplies	159	166	(7)	(4)
Depreciation, amortization and obsolescence	239	198	41	21
Commissions	138	162	(24)	(15)
Other	782	746	36	5
	4,468	4,465	3	0
Operating income (loss) before reorganization and restructuring items	167	(123)	290	
Reorganization and restructuring items	-	(558)	558	
Non-operating income (expense)				
Dilution gain	190	-	190	
Interest income	27	4	23	
Interest expense	(152)	(107)	(45)	
Interest capitalized	6	-	6	
Loss on sale of and provisions on assets	-	(13)	13	
Non-controlling interest	(7)	-	(7)	
Other	(30)	1	(31)	
	34	(115)	149	
Income (loss) before foreign exchange on non-compromised monetary items and income taxes	201	(796)	997	
Foreign exchange loss	(68)	(17)	(51)	
Income (loss) before income taxes	133	(813)	946	
Provision for income taxes	(42)	(1)	(41)	
Income (loss) for the period	91	(814)	905	
Earnings (loss) per share				
- Basic	0.96	(6.77)		
- Diluted	0.92	(6.77)		

Operating Statistics				
Revenue Passenger Miles (millions)	22,199	20,893	1,306	6
Available Seat Miles (millions)	28,053	27,729	324	1
Passenger Load Factor (%)	79.1	75.3	3.8 pp	

Comparison of Year-to-date Results

For the six months ended June 30, 2005, ACE reported operating income of $167 million, an improvement of $290 million compared to the Predecessor Company's operating loss before reorganization and restructuring items of $123 million recorded for the six months ended June 30, 2004. EBITDAR improved $155 million over the six months ended June 30, 2004. Refer to "Non-GAAP Financial Measure" on page 6 of this MD&A for additional information on EBITDAR.

For the six months ended June 30, 2005, total operating revenues increased $293 million or 7 per cent compared to the six months ended June 30, 2004. Passenger revenues increased $334 million or 10 per cent reflecting increases in all markets with the exception of the US transborder market including the transfer of Aeroplan passenger revenues of $131 million into the passenger revenue category. For additional information on Aeroplan passenger revenues, refer to page 7 of this MD&A.

Operating expenses only increased $3 million versus the six months ended June 30, 2004 despite an increase in fuel expense of $233 million or 33 per cent over the same period of 2004. ASM capacity increased 1 per cent when compared to the same period of 2004. Unit cost for the six months ended June 30, 2004, as measured by operating expense per ASM, was reduced 1 per cent from the six months ended June 30, 2004. Excluding fuel expense, unit cost was down 7 per cent. Unit cost reductions were achieved in salaries, wages and benefits, aircraft rent, communications and information technology, food, beverages and supplies and commission expense.

For the six months ended June 30, 2004, reorganization and restructuring items amounted to $558 million. As Air Canada emerged from CCAA proceedings on September 30, 2004, reorganization and restructuring items were not recorded after that date.

For the six months ended June 30, 2005, non-operating expenses decreased $149 million and included a dilution gain of $190 million (before tax) relating to the Aeroplan transaction as further described on page 39 of this MD&A. Also, included in other non-operating expenses was a charge of $29 million relating to the repayment of the GE exit credit facility.

Losses from revaluation of foreign currency monetary items amounted to $68 million for the six months ended June 30, 2005 attributable to a weaker Canadian dollar versus the US dollar at June 30, 2005 compared to December 31, 2004. This compared to foreign exchange losses on non-compromised monetary items of $17 million recorded in the six months ended June 30, 2004.

Net income for the six months ended June 30, 2005 was $91 million compared to a net loss of $814 million for the first six months of 2004, an improvement of $905 million. The six months ended June 30, 2004 included reorganization and restructuring items amounting to $558 million.

REVENUE PERFORMANCE

As a result of the inclusion of Aeroplan passenger revenues in passenger revenues starting in October 2004 as defined on page 7 of this MD&A, passenger revenues, RASM and yield per RPM are not directly comparable to previous years. For comparative purposes, the following discussion and tables will provide the reader with passenger revenue, RASM and yield per RPM variances that exclude the impact of the policy change related to Aeroplan passenger revenues. The discussion will also provide passenger revenue, RASM and yield per RPM information including the impact of the policy change related to Aeroplan passenger revenues.

The table below describes, by major market, year-to-date over year-to-date percentage changes in passenger revenues, capacity as measured by available seat miles (ASMs), traffic as measured by revenue passenger miles (RPMs), passenger load factor as measured by RPMs divided by ASMs, yield as measured by passenger revenue per RPM, and RASM as measured by passenger revenue per ASM.

Operating Statistics
Six months ended June 30, 2005 versus six months ended June 30, 2004

	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield per RPM % Change	RASM % Change
Canada (1)	8	1	7	4.3	1	7
US (1)	(7)	(9)	1	7.7	(8)	3
Atlantic (1)	9	3	6	2.2	3	6
Pacific (1)	12	5	6	0.8	6	7
Other (1)	17	14	16	1.6	1	3
System (1) (excluding Aeroplan)	6	1	6	3.8	0	5
System (including Aeroplan)	10	1	6	3.8	3	8

(1) The calculation of percentage change year-to-date-over-year-to-date does not include Aeroplan passenger revenues for the six months ended June 30, 2005.

Passenger revenues were up $334 million or 10 per cent from the 2004 level and included Aeroplan passenger revenues of $131 million for the six months ended June 30, 2005. As a result of higher fuel costs, surcharges have been significantly increased to and from most international destinations. Year-to-date results were comprised significantly of a strong second quarter of 2005 in comparison to the first quarter of 2005. Capacity was down 2 per cent in the first quarter of 2005 versus the 2004 level while capacity increased 4 per cent in the second

quarter of 2005 versus the 2004 level. Yield per RPM decreased 4 per cent, excluding Aeroplan passenger revenues, in the first quarter of 2005 versus the 2004 level while yield per RPM increased 3 per cent, excluding Aeroplan passenger revenues, in the second quarter of 2005 versus the 2004 level.

For the six months ended June 30, 2005, system passenger traffic increased 6 per cent on an increase of 1 per cent in ASM flying capacity producing a 3.8 percentage point improvement in load factor. Excluding Aeroplan passenger revenues, system yield per RPM was essentially unchanged from the 2004 level. Increases in yield per RPM for the domestic and other international markets were offset by a significant decrease in the US transborder market. The yield per RPM increase was in part due to higher fare levels and to increased fuel surcharges. System RASM, excluding Aeroplan passenger revenues, rose 5 per cent over the 2004 level reflecting the major improvement in load factor.

For the six months ended June 30, 2005, domestic passenger revenues were up $166 million or 12 per cent from the same period of 2004 and included Aeroplan passenger revenues of $58 million for the six months ended June 30, 2005. Domestic passenger traffic was up 7 per cent and capacity was increased by 1 percent resulting in a passenger load factor improvement of 4.3 percentage points over the 2004 level. Domestic yield per RPM increased 1 per cent, excluding Aeroplan passenger revenues, mainly due to higher fare levels to cover increased fuel costs. Reflecting both the improvement in passenger load factor and, to a lesser extent, the yield per RPM improvement, excluding Aeroplan passenger revenues, domestic RASM rose 7 per cent above the 2004 level.

US transborder passenger revenues were down $19 million or 2 per cent and included Aeroplan passenger revenues of $35 million for the six months ended June 30, 2005. In response to increased capacity from US carriers, US transborder ASM capacity was reduced by 9 per cent. In spite of the ASM capacity reduction, traffic increased 1 per cent resulting in a passenger load factor improvement of 7.7 percentage points. Excluding Aeroplan passenger revenues, yield per RPM declined 8 per cent reflecting increased capacity in the transborder market by Canadian low-cost carriers. An aggressive pricing environment resulting from increased capacity in the US transborder market, as well as the weakening of the US dollar for sales denominated in US dollars were also factors in the yield per RPM decrease. Excluding Aeroplan passenger revenues, US transborder RASM was up 3 per cent as the significant improvement in passenger load factor more than offset the yield per RPM decrease.

Atlantic revenues, including Aeroplan passenger revenues of $19 million for the six months ended June 30, 2005, increased $78 million or 12 per cent. This reflected a 3 per cent increase in yield per RPM, excluding Aeroplan passenger revenues, reflecting in part growth in higher-yield business traffic and increased fuel surcharges. Traffic rose 6 per cent on a capacity increase of 3 per cent resulting in a 2.2 percentage point improvement in passenger load factor from the 2004 level. The increase in capacity reflected the earlier start of seasonal services and a new service to Rome. Excluding Aeroplan passenger revenues, RASM increased 6 per cent reflecting both the yield per RPM increase and the improvement in passenger load factor.

Pacific revenues were up $50 million or 14 per cent and included Aeroplan passenger revenues of $4 million for the six months ended June 30, 2005. Excluding Aeroplan passenger revenues, yield per RPM increased 6 per cent from the six months ended June 30, 2004, reflecting in part strong premium traffic due to the introduction of non-stop Toronto-Hong Kong and Toronto-Beijing services, higher capacity in the Toronto-Shanghai and Vancouver-Seoul services as well as increased fuel surcharges. Traffic increased 6 per cent on 5 per cent increase in ASM capacity resulting in a slightly higher passenger load factor as compared to the six months ended June 30, 2004. Excluding Aeroplan passenger revenues, RASM increased 7 per cent mainly as a result of the yield per RPM increase.

South Pacific, Caribbean, Mexico and South America revenues increased $59 million or 22 per cent and included Aeroplan passenger revenues of $15 million for the six months ended June 30, 2005. Traffic increased 16 per cent on an ASM capacity increase of 14 per cent resulting in a 1.6 percentage point improvement in passenger load factor as compared to the six months ended June 30, 2004. Excluding Aeroplan passenger revenues, yield per RPM increased 1 per cent over the 2004 level in part due to the increase in fuel surcharges. RASM increased 3 per cent reflecting both the passenger load factor improvement and the yield per RPM increase. The growth in these markets is largely from additional flying to South America.

Cargo Revenues

Cargo revenues increased $19 million or 7 per cent mainly due to an increase in the volume of cargo carried largely in the Pacific market and, to a lesser extent, an increase in yield per RPM as a result of higher cargo rates and surcharges.

Other Revenues

Other non-transportation revenues were down $60 million or 10 per cent mainly as a result of the change in accounting policy for the loyalty program (Aeroplan) as described on page 7 of this MD&A. For the six months ended June 30, 2004, Aeroplan revenues from Miles earned by members through the loyalty program partners amounted to $123 million and were recorded in other revenues. For the six months ended June 30, 2005, Aeroplan revenues from Miles redeemed for air travel on Air Canada and Jazz are recorded in passenger revenues. Partly offsetting the reduction from the change in accounting policy for the loyalty program is an increase in cancellation and change fees, higher revenues from Air Canada Vacations primarily as a result of a stronger presence in the Latin Caribbean market and an increase in third party maintenance revenues.

COST PERFORMANCE YEAR-TO-DATE

Impact of the Adoption of AcG-15

For the six months ended June 30, 2005, the net impact of adopting AcG-15 on the Corporation's results was a pre-tax charge of $63 million or $0.58 per share, diluted. The impact of the adoption of AcG-15 was a reduction to aircraft rent expense of $58 million, an increase to depreciation expense of $46 million, an increase to net interest expense of $46 million, a foreign exchange loss of $22 million and non-controlling interest of $7 million compared to financial results had AcG-15 not been effective.

Operating Expenses

For the six months ended June 30, 2005, total operating expenses only increased $3 million compared to the six months ended June 30, 2004 despite a fuel expense increase of $233 million or 33 per cent versus the six months ended June 30, 2004. Unit cost was reduced by 1 per cent versus the 2004 level (excluding fuel expense, unit cost declined 7 per cent).

Salaries and wage expense totaled $955 million for the six months ended June 30, 2005, a decrease of $29 million or 3 per cent from the same period in 2004. This mainly reflected a reduction of an average of 915 full-time equivalent (FTE) employees or 3 per cent from the six months ended June 30, 2004, as well as salary reductions for unionized and non-unionized labour groups. This decrease in salaries and wage expense was partly offset by the expense of approximately $27 million relating to an employee profit sharing program. No expenses related to this program were recorded in 2004.

Employee benefits expense amounted to $281 million in the second quarter of 2005, a decrease of $94 million or 25 per cent from the six months ended June 30, 2004. The decrease was largely due to lower pension expense as a result of the elimination of unamortized actuarial losses and prior service costs resulting from fresh start reporting.

On a capacity increase of 1 per cent, fuel expense increased $233 million or 33 per cent reflecting continuing record high fuel prices. The average base fuel price increase of $297 million was partially offset by a reduction of $74 million due to the favourable impact of a stronger Canadian dollar versus the US dollar during the period. On a unit cost basis, fuel expense per ASM increased 31 per cent.

Aircraft rent expense decreased $176 million or 48 per cent. As discussed above, as a result of the adoption of AcG-15, aircraft rent expense decreased $70 million versus the same period last year. Other factors in the remaining decrease to aircraft rent expense included the impact of fair value adjustments as a result of fresh start reporting, the termination of the 747-400 leases, the net reclassification of certain aircraft leases from operating to capital leases, lease renegotiations, as well as a stronger Canadian dollar versus the US dollar for leases denominated in US dollars when compared to the six months ended June 30, 2004.

Airport and navigation fees increased $33 million or 8 per cent despite a 4 per cent reduction in aircraft frequencies from the same period in 2004. Higher fees for air navigation services as a result of a 10 per cent average unit rate increase which came into effect in September 2004 and higher landing and general terminal fees, primarily at Toronto's Pearson International Airport, were the main reasons for the increase.

Depreciation, amortization and obsolescence expense increased $41 million or 21 per cent over the same period in 2004 of which $46 million was related to the adoption of AcG-15.

Commission expense was down $24 million or 15 per cent on passenger and cargo revenue growth of 9 per cent. The impact of a new commission structure introduced in July 2004 for web and GDS bookings as well as lower international commissions more than offset the volume-related increase. In the first quarter of 2005, the Corporation recorded a favorable adjustment of $11 million relating to changes in estimates on commission expense on corporate contracts.

The other operating expense category increased $36 million or 5 per cent and included increased expenses relating to a higher volume and an increase in the cost of tour packages by

Air Canada Vacations. Other increases included credit card fees, Aeroplan non-air redemption expenses, customer maintenance materials as well as other factors.

Non-Operating Income

Non-operating income amounted to $34 million in the six months ended June 30, 2005, a $149 million increase from the same period in 2004. In the second quarter of 2005, ACE recorded a dilution gain of $190 million (before tax) related to the Aeroplan transaction and a charge of $29 million related to the repayment of the GE exit credit facility. Net interest expense amounted to $119 million, an increase of $16 million from the same period in 2004 and included the impact of the adoption of AcG-15.

Foreign Exchange

Losses from revaluation of foreign currency monetary items amounted to $68 million in the period attributable to a weaker Canadian dollar versus the US dollar at June 30, 2005 compared to December 31, 2004. The foreign exchange losses recorded in the six months ended June 30, 2005 included $28 million related to capital lease obligations and $22 million resulting from the adoption of AcG-15. This compared to foreign exchange loss on non-compromised monetary items of $17 million recorded in the same period of 2004.

Future Income Taxes

Provision for income taxes amounted to $42 million in the six months ended June 30, 2005, of which $28 million related to the Aeroplan transaction.

ANALYSIS OF THE STATEMENT OF FINANCIAL POSITION

ACE Aviation Holdings Inc.
Consolidated Statement of Financial Position

Unaudited **($ millions)**	**June 30, 2005**	**December 31, 2004**
ASSETS		
Current		
Cash, cash equivalents and short-term Investments	2,782	1,632
Other current assets	1,105	1,063
	3,887	2,695
Property and equipment	4,942	3,696
Deferred charges	127	167
Intangible assets	2,572	2,691
Other assets	255	137
	11,783	9,386
LIABILITIES		
Current liabilities	3,201	2,491
Long-term debt and capital lease obligations	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	196	-
Other long-term liabilities	1,313	1,645
	10,810	9,183
SHAREHOLDERS' EQUITY	973	203
	11,783	9,386

As a result of the adoption of AcG-15 effective January 1, 2005, the Corporation consolidated the financial statements of certain aircraft and engine leasing entities and fuel facilities corporations. As at June 30, 2005, additional property and equipment of $1,370 million, long-term debt, including current portion, of $1,260 million, other assets of $109 million, and non-controlling interest of $196 million are consolidated under AcG-15. The impact of the adoption of this guideline on the Consolidated Statement of Financial Position is described in further detail under the section entitled "Accounting Policies" on page 50 of this MD&A.

Share Capital and Other Equity

As at June 30, 2005, the 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

Share Capital and Other Equity Summary (net of issue costs):

(in millions)	Successor Company	
	June 30, 2005	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	(1,708)	(1,708)
Share capital and other equity	$ 722	$ 187

During the second quarter of 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 million ($443 million net of fees).

In the same period, the Corporation issued $330 million of Convertible Senior Notes due 2035 ("Convertible Notes") for net proceeds of $319 million. At the date of issuance, the value ascribed to the holders' conversion option, which is presented as equity, was $94 million less allocated fees of $2 million; the value ascribed to the financial liability was $236 million. Refer

to Note 3b to the Interim Unaudited Second Quarter 2005 Consolidated Financial Statements for additional information.

ACE used approximately $557 million of the aggregate net cash proceeds of the offerings to repay all of its outstanding debt under the exit credit facility with GE, including $16 million for early payment fees. The Corporation recorded a charge of $29 million in other non-operating expenses for this transaction in the three months ended June 30, 2005, including $13 million for the write-off of deferred financing charges.

The Court-appointed Monitor for the restructuring of the Predecessor Company under the 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. Refer to Note 6 to the Interim Unaudited Second Quarter 2005 Consolidated Financial Statements for additional information.

Debt Obligations

As at June 30, 2005, ACE had long-term debt and capital lease obligations of $3.7 billion, including current portion, with cash, cash equivalents and short-term investments of $2.8 billion. These long-term debt obligations included $1.3 billion recorded as a result of the adoption of AcG-15. Refer to Note 3 to the Interim Unaudited Second Quarter 2005 Consolidated Financial Statements and to the table on page 43 of this MD&A for additional information on ACE's 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 (VIEs) under AcG-15.

Lease Obligations

As a result of the adoption of AcG-15, 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. Future minimum lease payments under existing operating leases of aircraft, excluding leases accounted for as VIEs, amounted to $2.5 billion as at June 30, 2005 compared to $3.0 billion at December 31, 2004. Refer to Note 8 of the Interim Unaudited Second Quarter 2005

Consolidated Financial Statements and to the table on page 43 of this MD&A for additional information on ACE's future minimum lease payments under existing operating leases.

Guarantees

As a result of the adoption of AcG-15 as further described in Note 9 to the Interim Unaudited Second Quarter 2005 Consolidated Financial Statements, the Corporation no longer has any residual value guarantees under any of its aircraft leasing agreements. 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.

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 million of fiscal 2005 purchases. The fair value of these foreign currency forward contracts as at June 30, 2005 is less than $1 million in favour of the third parties. Hedge accounting has not been applied to these foreign currency forward contracts. As the contracts will settle in 2005, there was no concern for earnings volatility. The loss has been recorded in foreign exchange.

FINANCIAL MANAGEMENT

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 4)	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 million as at June 30, 2005 ($151 million as at December 31, 2004)

Cash Flows from (used for) Operations

The second quarter of 2005 cash flows from operations amounted to $339 million. This compared to cash flows from operations of $114 million in the second quarter of 2004, an improvement of $225 million. Improved operating results contributed significantly to the cash flow improvement. Further components of the cash flow change are described below:

- Advance ticket sales was a source of funds of $219 million partially offset by a use of funds of $108 million from an increase in accounts receivable, largely reflecting the seasonal increase in passenger sales into the third quarter (2004 - $194 million source and $122 million use respectively).

- Accounts payable and accrued liabilities was a use of funds of $40 million in the second quarter of 2005. This compared to a use of funds of $77 million in the second quarter of 2004, a decrease of $37 million.

- Aircraft lease payments in excess of rent expense was a source of funds of $3 million in the second quarter of 2005 versus a source of funds of $16 million in the second quarter of 2004.

- Employee future benefit funding was a use of funds of $6 million in the second quarter of 2005, an increase of $38 million from the second quarter of 2004. This increase was mainly as a result of pension funding of $61 million in the quarter following the implementation of the Plan and the adoption of the Air Canada Pension Plan Solvency Deficiency Funding Regulations, as well as the application of fresh start reporting on September 30, 2004. In June 2005, the Corporation received new pension valuations. Refer to Note 5 to the Interim Unaudited Second Quarter 2005 Consolidated Financial Statements for additional information.

- Change in spare parts, materials and supplies was a use of funds of $19 million in the second quarter of 2005 versus a source of funds of $10 million in the second quarter of 2004. This change was largely due to higher fuel inventories in the second quarter of 2005 and the impact of higher fuel prices on fuel inventories.

- Other cash from operations was a source of funds of $100 million in the second quarter of 2005 versus a source of funds of $32 million in the second quarter of 2004. The main factor in the source of funds was a pension prepayment obligation with a financial

institution that was imposed while the Corporation was under creditor protection that was lifted, resulting in a decrease in prepaid expenses of $61 million. Other factors include a decrease in prepaid expenses related to vacation packages at Air Canada Vacations of $7 million.

The first six months of 2005 cash flows from operations amounted to $653 million. This compared to cash flows from operations of $177 million in the same period of 2004, an improvement of $476 million. Improved operating results contributed significantly to the cash flow improvement.

Cash Flows used for Financing Activities

During the second quarter of 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 million ($443 million net of fees). In the same quarter, the Corporation also issued $330 million of Convertible Senior Notes due 2035 ("Convertible Notes") for net proceeds of $319 million. Refer to Notes 6 and 3 to the Interim Unaudited Consolidated Second Quarter 2005 Financial Statements for additional information on the issues of shares and Convertible Notes.

In June, as noted above, ACE and Aeroplan Income Fund completed an Initial Public Offering (IPO) of the Aeroplan Income Fund for aggregate net proceeds of $267 million, of which $232 million is included in financing activities and $35 million is included in investing activities. The amount of $35 million included in investing activities relates to the net over-allotment proceeds which were the sale to the Fund of units held by ACE.

Aeroplan LP has arranged for senior secured credit facilities in the amount of $475 million. The credit facilities consist of one $300 million facility (or the U.S. dollar equivalent there of) Acquisition facility (the "Term A Facility"), a $100 million (or the U.S. dollar equivalent there of) term facility (the "Term B Facility") and a $75 million (or the U.S. dollar equivalent there of) revolving term facility. The Term A Facility was drawn on June 29, 2005 in the amount of $300 million. The Term B Facility will be available for multiple drawings to fund permitted acquisitions. Under the Revolving Facility, $18 million was drawn on June 29, 2005 for general corporate and working capital purposes. Refer to Note 3c to the Interim Unaudited Consolidated Second Quarter 2005 Financial Statements for additional information on the Aeroplan LP credit facilities.

Reduction of long-term debt and capital lease obligations amounted to $627 million in the second quarter of 2005 ($767 million in the first six months of 2005). ACE repaid all of its outstanding debt of $540 million under the exit credit facility with GE. In addition, during the second quarter of 2005 scheduled payments of $55 million ($87 million in the first six months of 2005) were made on capital lease obligations and scheduled payments of $18 million ($36 million in the first six months of 2005) were made on the secured non-revolving term credit facility with Amex Bank of Canada Inc. In the first quarter of 2005, proceeds of $29 million resulting from the sale of one Boeing 747-400 aircraft were used to repay the GECC Limited Recourse Loan. Other mandatory scheduled payments made in the second quarter of 2005 amounted to $14 million ($75 million in the first six months of 2005).

In the second quarter of 2005, Air Canada also entered into a senior secured syndicated revolving credit facility in an aggregate amount of up to $300 million or the US dollar equivalent. The revolving 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. As at June 30, 2005, the amount available under the Credit Facility was $300 million, and no amounts had been drawn. Refer to Note 3 to the Interim Unaudited Consolidated Second Quarter 2005 Financial Statements for additional information on the revolving credit facility.

Cash Flows used for Investing Activities

In the second quarter of 2005, short-term investments increased by $680 million ($1,355 million in the first six months of 2005). Short-term investments have original maturities over 90 days, but not more than one year. These investments can be readily converted to cash and are with institutions that have high credit ratings.

In the second quarter of 2005, additions to capital assets amounted to $57 million ($95 million in the first six months of 2005) and related mainly to spare engines, aircraft-related expenditures, system development costs, and ground equipment and facilities.

RECENT DEVELOPMENTS

Planned investment in Merged US Airways-America West Carrier

On May 19, 2005, the Corporation announced its conditional commitment to invest US$75 million 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.

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 million and the Working Capital Note in the amount of $186 million). 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 million. 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 million. With the proceeds from the over-allotment option, the Fund purchased 3.75 million units from ACE at a cost of $38 million, reducing the number of units held by ACE to 171.25 million. Issue costs of $3 million 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 million 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 million was recorded.

In conjunction with the issuance of Units to the Aeroplan Income Fund and the bank financing (refer to Note 3c to the Interim Unaudited Second Quarter 2005 Consolidated Financial Statements for additional information) 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 million 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 to the Interim Unaudited Second Quarter 2005 Consolidated Financial Statements for additional information, Aeroplan LP was required to deposit the borrowed funds of $300 million into the Reserve. Any deposits of funds in non-Canadian dollar denominated investments have to be hedged.

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 will be filed in the third quarter of 2005 and ACE will retain a majority interest in Jazz.

LIQUIDITY

As at June 30, 2005, ACE had cash, cash equivalents and short-term investments of $2.8 billion and positive working capital of $686 million.

On April 6, 2005, Air Canada entered into a senior secured syndicated revolving credit facility in an aggregate amount of up to $300 million or the US dollar equivalent. The revolving 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 million provided for cash management and working capital purposes. The amount available to be drawn by Air Canada under the revolving credit facility is limited to the lesser of $300 million 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 facilities was $300 million 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.

As at August 2, 2005, ACE's consolidated cash balance, measured on the basis of unrestricted cash in its bank accounts and short-term investments, amounted to approximately $2.5 billion.

The Corporation is expected to have positive cash flows from operations in 2005 and, as described above, has a senior secured syndicated revolving credit facility in an aggregate amount of up to $300 million or the US dollar equivalent. Debt repayment obligations in the future are expected to be met from cash flows from operations. Future aircraft deliveries have committed financing from the manufacturers or a third party.

Consistent with the Aeroplan transaction described above, the Corporation could potentially realize additional funding through the monetization of or sale of interests in certain divisions or subsidiaries.

Summary of Principal Repayment and Future Minimum Lease Payment Requirements as at June 30, 2005

The table below summarizes ACE's principal repayment requirements 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, as well as the Corporation's future minimum lease payments under existing operating leases as at June 30, 2005, as further described in Notes 3 and 8 to the Interim Unaudited Second Quarter 2005 Consolidated Financial Statements.

($ millions)	Remainder of 2005	2006	2007	2008	2009
Long-Term Debt and Capital Lease Obligations (1)					
Long-term debt principal obligations (Note 3)	24	33	33	71	333
Principal obligation on debt consolidated under AcG-15 (Note 3)	34	74	118	117	57
Capital lease principal obligations (Note 3)	77	147	182	179	87
Total Long-Term Debt and Capital Lease Obligations	135	254	333	367	477
Operating Leases (excluding leases accounted for as VIEs under AcG-15)					
-Future minimum lease payments under existing operating leases of aircraft (Note 8)	217	426	374	289	238
-Future minimum lease payments under existing leases for other property	48	58	48	46	34
	265	484	422	335	272

(1) Includes end of lease debt principal payments due on aircraft and engine leasing entities consolidated under AcG-15, before taking into account the anticipated fair value of the aircraft and engines at the time of lease expiry. In 2007, amounts due of approximately US$39 million relate to end of lease obligations with current aircraft fair values of approximately US$43 million. In 2008, amounts due of approximately US$50 million relate to end of lease obligations with current aircraft fair values of approximately US$98 million. In these leasing transactions, Air Canada has the option either to refinance the aircraft on lease expiry or to return the aircraft to the lessor. On a lease return, Air Canada may be required to make a residual value payment in the event aircraft sale proceeds are less than amounts outstanding under the lease.

Long-term debt and capital lease obligations as at June 30, 2005 combined with the estimated present value of committed future aircraft lease payments for the period to the end of the lease term and estimated future purchase options, net of cash and short term investments, amounted to approximately $3 billion compared to approximately $12 billion at December 31, 2002, prior to filing for creditor protection under CCAA.

Projected Capital Expenditures, Net of Aircraft Financing

As disclosed in ACE's 2004 Management's Discussion and Analysis of Results, in 2004, Air Canada signed definitive purchase agreements with Embraer Empresa Brasileira de Aeronautica S.A. (Embraer) and Bombardier Inc. (Bombardier).

The table below provides projections for aircraft expenditures for firm Bombardier and Embraer aircraft orders, net of aircraft financing, as well as planned and committed expenditures for aircraft engines, inventory, property and equipment expenditures over the next five years:

($ millions) (1)	**Remainder of 2005**	**2006**	**2007**	**2008**	**2009**
Projected Committed Capital Expenditures					
Projected aircraft expenditures – Bombardier and Embraer aircraft	845	537	777	30	-
Projected aircraft financing	(777)	(456)	(707)	(30)	-
Projected committed aircraft expenditures, net of aircraft financing	68	81	70	-	-
Planned and committed expenditures for aircraft engines, inventory, modifications and refurbishments	94	293	93	21	38
Other planned and committed expenditures for property and equipment	82	157	160	133	120
Total planned and committed expenditures	176	450	253	154	158

(1) US dollar amounts are converted using the June 30, 2005 noon day rate of CDN$1.2256. Projected aircraft expenditures are based on escalated aircraft delivery prices.

The agreement with Embraer covers firm orders for 45 Embraer 190 series aircraft as well as 15 Embraer 175 series aircraft. The purchase agreement also contains rights to exercise options for up to 60 additional Embraer 190 series aircraft as well as providing for conversion rights to other Embraer models. Deliveries of the Embraer 175 series aircraft began in July 2005, with the Embraer 190 series deliveries scheduled to commence in November 2005. By the end of 2005, 15 of the Embraer 175 series firm aircraft and four Embraer 190 series firm aircraft will be delivered. The agreement with Bombardier covers firm orders for 15 Bombardier CRJ700 Series 705 aircraft and 30 Bombardier CRJ200 aircraft of which 15 of the Bombardier CRJ200 may be cancelled without penalty. The purchase agreement also contains options for an additional 45 aircraft. Deliveries of the 50-seat Bombardier CRJ200 firm aircraft orders have been completed. Deliveries of the 75-seat CRJ700 Series 705 deliveries began in May 2005. As of June 30, 2005, four of the CRJ700 Series 705 firm aircraft orders have been

delivered and the remaining 11 deliveries are to be received by the end of 2005. The Corporation has received financing commitments from the manufacturers and a third party covering all firm orders.

On April 25, 2005, Air Canada announced the conclusion of a tentative agreement with The Boeing Company (Boeing) for a wide-body fleet renewal plan that included firm orders for 18 Boeing 777 aircraft, plus purchase rights for an additional 18 aircraft. The renewal plan also included firm orders for 14 new Boeing 787 Dreamliners, plus options and purchase rights for an additional 46 aircraft. The tentative agreement contemplated a financing commitment for the firm aircraft deliveries from the manufacturer. The order was subject to several conditions including the negotiation of satisfactory terms by Air Canada with its pilots. On June 18, 2005, Air Canada cancelled its wide-body aircraft 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 Air Canada did not conclude an agreement with its pilots by June 19, 2005.

Projected Debt Payments, Operating Leases Payments and Aircraft Depreciation Expense for Committed Aircraft Deliveries (Debt and Lease Financed Aircraft)

($ millions) (1)	**2005**	**2006**	**2007**	**2008**	**2009**
Principal repayment on aircraft-related long-term debt	-	21	43	67	72
Interest payments on aircraft-related long-term debt	-	43	83	120	117
Future minimum aircraft lease payments	-	30	30	30	30
Projected debt payments and operating lease payments for committed aircraft deliveries	-	94	156	217	219
Aircraft depreciation expense (non-cash)	6	31	57	72	72

(1) Based on 10-year US treasury rate and swap rate as at June 30, 2005. US dollar amounts for projected committed aircraft expenditures are converted using the June 30, 2005 noon day rate of CDN $1.2256. Projected aircraft expenditures are based on escalated aircraft delivery prices.

Projected Pension Funding Obligations

The table below provides projections for the Corporation's pension funding obligations over the next five years:

($ millions)	Remainder of 2005	2006	2007	2008	2009
Projected pension funding obligations	160	382	403	406	419

The above pension funding requirements are in respect of the Corporation's pension arrangements. For domestic registered pension plans, the funding requirements are based on the minimum past service contributions revealed by the January 1, 2005 actuarial valuations plus a projection of the current service contributions. The required contributions above assume no future gains and losses on plan assets and liabilities over the projection period. The evolution of economic conditions, mainly the return of the fund and the evolution of interest rates used for solvency valuations, will impact on projected required contributions.

As at January 1, 2005 the solvency deficit in the registered domestic plans was $1,416 million compared to $1,254 million at January 1, 2004. Notwithstanding the increase in the deficit, the solvency ratio of 87% at January 1, 2005 was unchanged from the ratio at January 1, 2004, reflecting an increase in both pension assets and obligations.

QUARTERLY RESULTS

The table below describes quarterly financial results of Air Canada for the last two quarters of 2003 and the first three quarters of 2004 and the financial results of ACE for the fourth quarter of 2004 and the first and second quarters of 2005 as well as major operating statistics:

Quarterly Financial Data – Condensed Consolidated

$ millions (except per share figures)	Predecessor Company Air Canada					Successor Company ACE		
	2003		2004				2005	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Passenger revenues	1,901	1,615	1,661	1,844	2,123	1,681	1,739	2,100
Cargo revenues	122	131	126	137	142	151	135	147
Other revenues	207	231	334	240	231	230	303	211
Operating revenues	2,230	1,977	2,121	2,221	2,496	2,062	2,177	2,458
Operating expenses	2,212	2,054	2,266	2,199	2,253	2,065	2,187	2,281
Operating income (loss) before reorganization and restructuring items	18	(77)	(145)	22	243	(3)	(10)	177
Reorganization and restructuring items	(274)	(560)	(132)	(426)	(313)	-	-	-
Non-operating income (expense)	(21)	(132)	(43)	(72)	(133)	(67)	(66)	100
Loss before foreign exchange on non- compromised long-term monetary items and income taxes	(277)	(769)	(320)	(476)	(203)	(70)	(76)	277
FX gain (loss) on non-compromised long-term monetary items	17	(7)	17	(34)	123	98	(15)	(53)
Income (loss) before income taxes	(260)	(776)	(303)	(510)	(80)	28	(91)	224
Recovery of (provision for) income taxes	(3)	8	(1)	-	(1)	(13)	14	(56)
Net income (loss)	(263)	(768)	(304)	(510)	(81)	15	(77)	168
Earnings (loss) (1) Per share – basic	(2.18)	(6.39)	(2.53)	(4.24)	(0.67)	0.17	(0.87)	1.67
Per share - diluted	(2.18)	(6.39)	(2.53)	(4.24)	(0.67)	0.17	(0.87)	1.49
Revenue passenger miles (millions)	11,617	9,289	10,057	10,836	12,853	9,681	10,586	11,613
Available seat miles (millions)	15,156	13,115	13,797	13,931	15,993	12,815	13,566	14,487
Passenger load factor (%)	76.6	70.8	72.9	77.8	80.4	75.5	78.0	80.2
Operating expense per available seat mile (CASM) (cents)	14.6	15.7	16.4	15.8	14.1	16.1	16.1	15.7
Operating expense per available seat mile excl. fuel expense (cents)	12.5	13.5	14.0	13.1	11.2	12.7	13.1	12.1

(1) Pursuant to the Plan as further described in Note 2 to the 2004 Annual Consolidated Financial Statements, all issued and outstanding options of Air Canada and warrants were cancelled without payment or consideration. In addition, a new share capital was established under ACE, as further described in Notes 19 and 20 to the 2004 Annual Consolidated Financial Statements.

SEGMENT INFORMATION

As a result of the corporate restructuring, the Corporation's businesses are operated through four reporting segments: 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 came into effect on September 30, 2004. The Regional Operations segment information in the Successor Company is not comparable to that of the Predecessor Company as a result of this new agreement.

As described in Note 1 to the Interim Unaudited Consolidated Second Quarter 2005 Financial Statements, the Corporation changed the accounting policy as of September 30, 2004 for the recognition of its revenues relating to the Loyalty Program. As a result, Loyalty Program results are not directly 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 with 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 (loss)	101	25	25	26	-	177
Total non-operating income (expense), foreign exchange and income taxes	(1)	-	(4)	(4)	-	(9)
Aeroplan minority interest						
Segment Results	$ 100	$ 25	$ 21	$ 22	$ -	$ 168
Operating margin %	4.4%	15.9%	12.8%	11.3%	0.0%	7.2%
EBITDAR	$ 289	$ 27	$ 33	$ 47	$ (2)	$ 394

	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 (loss)	12	51	48	56	-	167
Total non-operating income (expense), foreign exchange and income taxes	(62)	-	(7)	(7)	-	(76)
Aeroplan minority interest						
Segment Results	$ (50)	$ 51	$ 41	$ 49	$ -	$ 91
Operating margin %	0.3%	15.5%	12.8%	12.6%	0.0%	3.6%
EBITDAR	$ 381	$ 55	$ 64	$ 97	$ (3)	$ 594

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 million ($5 million for the three 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 million, in Air Canada favour, which was recorded in the three months ended June 30, 2005.

ACCOUNTING POLICIES

The Interim Unaudited Consolidated Second Quarter 2005 Financial Statements for the Successor Company are based on the accounting policies consistent with those disclosed in Note 4 to the 2004 Annual Consolidated Financial Statements of ACE with the exception of the adoption of the accounting policies as further described below under “New 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. In the second quarter of 2005, Aeroplan revenues from Miles redeemed for air travel on Air Canada and Jazz amounted to $118 million ($219 for the six months ended June 30, 2005), of which approximately $78 million related to Aeroplan

redemption revenues from Miles earned by members through the loyalty program partners (approximately $143 for the six months ended June 30, 2005). These redemption revenues were partly offset by the deferral of revenues of $44 million ($88 for the six months ended June 30, 2005) related to the fair value of Miles earned by members through transportation services provided by the Corporation, resulting in net Aeroplan passenger revenues of $74 million ($131 million for the six months ended June 30, 2005). For the three months ended June 30, 2004, Aeroplan revenues from Miles earned by members through the loyalty program partners amounted to $53 million ($123 million for the six months ended June 30, 2004).

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.

New Policies

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 under 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.

The adoption of AcG-15 and the consolidation of the variable interest entities (VIEs) does not alter the underlying contractual arrangements between Air Canada, as lessee, and its lessors, nor the cash payments from Air Canada to the lessors. Over the life of the lease, the accounting expense is consistent between an operating lease and an aircraft leasing entity consolidated under AcG-15. However, there may be timing differences in any given period between net expense recorded under an operating lease versus an aircraft leasing entity consolidated under AcG-15. The main reason for the difference is due to the fact that lease expense under operating leases is straight-lined over the term of the lease whereas the interest expense under the debt obligation in the variable interest entities is based on the effective interest rate method. The effective interest rate method results in interest expense being recorded proportionate to the amount of the outstanding debt, which declines over time. In addition, foreign currency adjustments are recorded on the outstanding debt obligations of the VIEs; changes in foreign exchange rates are straight-lined over the term of the lease under operating lease accounting.

Aircraft and Engine Leasing Transactions

Prior to the adoption of AcG-15, Air Canada entered into aircraft and engine lease 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 in its financial statements 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:

$ millions	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)
Increase to retained earnings as result of the cumulative effect of this 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 million 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 in its financial statements three fuel facilities corporations, resulting in the following adjustments:

$ millions	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
Increase to retained earnings as result of the cumulative effect of this 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 million and debt of approximately $90 million, 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

In the second quarter of 2005, the net impact of adopting AcG-15 on the Corporation's results was a pre-tax charge of $33 million or $0.28 per share, diluted. The impact of the adoption of AcG-15 was a reduction to aircraft rent expense of $30 million, an increase to depreciation expense of $21 million, an increase to net interest expense of $22 million, a foreign exchange loss of $16 million and non-controlling interest of $4 million compared to financial results had AcG-15 not been effective.

For the six months ended June 30, 2005, the net impact of adopting AcG-15 on the Corporation's results was a pre-tax charge of $63 million or $0.58 per share, diluted. The impact of the adoption of AcG-15 was a reduction to aircraft rent expense of $58 million, an increase to depreciation expense of $46 million, an increase to net interest expense of $46 million, a foreign exchange loss of $22 million and non-controlling interest of $7 million compared to financial results had AcG-15 not been effective.

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 million.

The adoption of AcG-15 and the consolidation of the VIEs does not alter the underlying contractual arrangements between Air Canada, as lessee, and its lessors, nor the cash payments from Air Canada to the lessors. Over the life of the lease, the accounting expense is consistent between an operating lease and an aircraft leasing entity consolidated under AcG-15. However, there may be timing differences in any given period between net expense recorded under an operating lease versus an aircraft leasing entity consolidated under AcG-15. The main reason for the difference is due to the fact that lease expense under operating leases is straight-lined over the term of the lease whereas the interest expense under the debt obligation in the variable interest entities is based on the effective interest rate method. The effective interest rate method results in interest expense being recorded proportionate to the amount of the outstanding debt, which declines over time. In addition, foreign currency adjustments are recorded on the outstanding debt obligations of the VIEs; changes in foreign exchange rates are straight-lined over the term of the lease under operating lease accounting.

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.

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 million ($12 million 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.

<u>Future Accounting Standard Changes</u>

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 balance sheet 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 are 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.

MATERIAL CHANGES

There have been no material changes in debt and lease obligations with the exception of the impact of the adoption of AcG-15, the financial offerings completed in April 2005 and the Aeroplan transaction as described in the "Recent Developments" section of this MD&A. In addition, there have been no material changes in critical accounting estimates, tax, risk management and outlook from the disclosures included in ACE's 2004 Management's Discussion and Analysis of Results dated March 18, 2005.

RISK FACTORS

For a detailed description of the possible risk factors associated with ACE and/or its subsidiaries, refer to the section entitled "Risk Factors" in ACE's 2004 Management's Discussion and Analysis of Results dated March 18, 2005. There have been no material changes to the risk factors disclosed at that time.