THIRD QUARTER 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

For the period ended September 30, 2005

(Unaudited)

NOVEMBER 2, 2005

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1. 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 September 30, 2005 and the nine months ended September 30, 2005 and the financial information of Air Canada for the three months ended September 30, 2004 and the nine months ended September 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 September 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 September 30, 2005 and the nine months ended September 30, 2005 reflects the results of operations of the Successor Company; the three months ended September 30, 2004 and the nine months ended September 30, 2004 reflects the results of operations of the Predecessor Company.

The Interim Unaudited Consolidated Third 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 Third Quarter 2005 Financial Statements under "Accounting Policies" and page 38 of this MD&A under the section entitled "Accounting Policies".

In accordance with Canadian Generally Accepted Accounting Principles (GAAP), the Interim Unaudited Consolidated Third 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 November 2, 2005.

See Note 1 to the Interim Unaudited Third 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 November 2, 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.

2. EXPLANATORY NOTES

2.1. 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.

2.2. 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.

2.3. 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**		**Successor Company ACE**	**Predecessor Company Air Canada**	
($ millions)	**Three Months Ended September 30, 2005**	**Three Months Ended September 30, 2004**	**$ Change**	**Nine Months Ended September 30, 2005**	**Nine Months Ended September 30, 2004**	**$ Change**
GAAP operating income before reorganization and restructuring items (1)	320	243	77	487	120	367
Add back:						
Depreciation, amortization and obsolescence	118	114	4	357	312	45
Aircraft rent	112	157	(45)	300	521	(221)
EBITDAR, before reorganization and restructuring items (1)	550	514	36	1,144	953	191
EBITDAR margin (%) (2)	19.4	20.6	(1.2) pp	15.3	13.9	1.4 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.

2.4. Seasonality

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.

2.5. Loyalty Program

As described in Note 1 to the Interim Unaudited Third 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 air travel on Air Canada and Jazz Air Limited Partnership ("Jazz") are included in Passenger revenue and Miles redeemed for other than air travel are included in Other revenue. 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 revenue.

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. The following table summarizes the amounts recorded under the current and previous accounting policies:

($ millions)	Three months Ended September 30, 2005	Nine Months Ended September 30, 2005
Successor Company Accounting Policy		
Aeroplan Miles redeemed for air travel on Air Canada and Jazz		
Miles earned through Air Transportation Services	$ 47	$ 123
Miles earned through loyalty program partners	86	229
	133	352
Less the deferral of the fair value of Miles issued	(43)	(131)
Net recorded in Passenger revenue	$ 90	$ 221
	Three months Ended September 30, 2004	Nine Months Ended September 30, 2004
Predecessor Company Accounting Policy Miles earned through loyalty program partners and redeemed for air travel on Air Canada and Jazz (recorded in Other revenue)	$ 50	$ 173

3. THIRD QUARTER RESULTS OF OPERATIONS – 2005 VERSUS 2004

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

Consolidated Statement of Operations

($ millions, except per share figures) (Unaudited)	Successor Company ACE Three Months Ended September 30, 2005	Predecessor Company Air Canada Three Months Ended September 30, 2004	$ Change	% Change
Operating revenues				
Passenger	2,461	2,123	338	16
Cargo	162	142	20	14
Other	210	231	(21)	(9)
	2,833	2,496	337	14
Operating expenses				
Salaries, wages and benefits	636	630	6	1
Aircraft fuel	675	462	213	46
Aircraft rent	112	157	(45)	(29)
Airport and navigation fees	259	206	53	26
Aircraft maintenance, materials and supplies	80	80	-	-
Communications and information technology	75	73	2	3
Food, beverages and supplies	94	98	(4)	(4)
Depreciation, amortization and obsolescence	118	114	4	4
Commissions	68	78	(10)	(13)
Other	396	355	41	12
	2,513	2,253	260	12
Operating income before reorganization and restructuring items	320	243	77	
Reorganization and restructuring items	-	(313)	313	
Non-operating income (expense)				
Interest income	20	2	18	
Interest expense	(76)	(62)	(14)	
Interest capitalized	2	-	2	
Gain (loss) on sale of and provisions on assets	2	(62)	64	
Other	14	(11)	25	
	(38)	(133)	95	
Income (loss) before the following items:	282	(203)	485	
Non-controlling interest	(9)	-	(9)	
Foreign exchange gain	125	123	2	
Provision for income taxes	(128)	(1)	(127)	
Income (loss) for the period	270	(81)	351	
Earnings (loss) per share				
- Basic	2.66	(0.67)		
- Diluted	2.33	(0.67)		

Operating Statistics

Revenue Passenger Miles (millions)	13,981	12,853	1,128	9
Available Seat Miles (millions)	16,961	15,993	968	6
Passenger Load Factor (%)	82.4	80.4	2.0 pp	

3.1. Comparison of Third Quarter Results

In the third quarter of 2005, ACE reported an operating income of $320 million, an improvement of $77 million compared to the Predecessor Company's operating income before reorganization and restructuring items of $243 million recorded in the same quarter of 2004. EBITDAR improved $36 million over the 2004 quarter. Refer to "Non-GAAP Financial Measure" on page 4 of this MD&A for additional information on EBITDAR.

In the third quarter of 2005, total operating revenues increased $337 million or 14 per cent compared to the third quarter of 2004. Passenger revenues were up $338 million or 16 per cent reflecting increases in all markets due to both a traffic improvement of 9 per cent as well as an increase in yield per RPM of 7 per cent. Such increase included the transfer of Aeroplan passenger revenues of $90 million into the Passenger revenue category. For additional information on Aeroplan passenger revenues, refer to page 5 of this MD&A.

Operating expenses increased $260 million or 12 per cent versus the third quarter of 2004, including a significant increase in fuel expense of $213 million or 46 per cent over the third quarter of 2004. Capacity, as measured in available seat miles (ASM) increased 6 per cent. Unit cost for the third quarter of 2005, as measured by operating expense per ASM, increased 5 per cent from the third quarter of 2004. Excluding fuel expense, unit cost was down 3 per cent compared to the 2004 quarter. Unit cost reductions over the 2004 quarter included aircraft rent, benefits and commissions. Unit cost increases over the 2004 quarter, other than fuel expense, included airport user fees, legal and advisory fees and credit card fees on passenger sales.

In the third quarter of 2004, reorganization and restructuring items amounted to $313 million. As Air Canada emerged from CCAA proceedings on September 30, 2004, reorganization and restructuring items were not recorded after that date.

In the third quarter of 2005, non-operating expense amounted to $38 million, a decrease of $95 million from the third quarter of 2004. The third quarter of 2004 non-operating expense included provisions totaling $62 million for loss on sale of assets relating mainly to inactive aircraft and inventory. There were no provisions of this nature recorded in the 2005 quarter.

Gains from revaluation of foreign currency monetary items and the impact of foreign currency derivative contracts amounted to $125 million in the third quarter of 2005 and were mainly attributable to a stronger Canadian dollar versus the US dollar at September 30, 2005 compared to June 30, 2005. This compared to foreign exchange gains of $123 million in the third quarter of 2004.

The provision for income taxes amounted to $128 million during the third quarter of 2005.

Net income for the third quarter of 2005 was $270 million compared to the net loss of $81 million recorded in the third quarter of 2004, an improvement of $351 million.

3.2. Revenue Performance – Third Quarter

Passenger Revenues

As a result of the inclusion of Aeroplan passenger revenues in passenger revenues starting in October 2004 as defined on page 5 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, excluding the impact of the policy change related to Aeroplan passenger revenues.

Passenger Revenue % Change Year-over-Year by Quarter

	Predecessor Company Air Canada				Successor Company ACE			
	Quarter 4 2003	Quarter 1 2004	Quarter 2 2004	Quarter 3 2004	Quarter 4 2004	Quarter 1 2005	Quarter 2 2005	Quarter 3 2005
Canada	(13)	(9)	8	3	0	1	13	17
US	(19)	(13)	5	(1)	(17)	(13)	0	6
Atlantic	(5)	(5)	6	6	4	8	10	9
Pacific	(13)	15	162	113	35	14	11	5
Other	18	24	38	25	22	17	18	18
System (excluding Aeroplan)	(12)	(5)	15	12	1	1	10	12
System (including Aeroplan)	(12)	(5)	15	12	4	5	14	16

The table below describes, by major market and excluding the impact of the policy change related to Aeroplan passenger revenues, quarter-over-quarter percentage changes in passenger revenues, capacity as measured by available seat miles (ASMs), traffic as measured by 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 3, 2005 versus Quarter 3, 2004

	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield per RPM % Change	RASM % Change
Canada	17	6	11	3.6	6	11
US	6	(2)	5	5.3	1	8
Atlantic	9	7	9	1.9	0	2
Pacific	5	9	5	(3.5)	1	(4)
Other	18	14	17	2.3	1	4
System (excluding Aeroplan)	12	6	9	2.0	3	5
System (including Aeroplan)	16	6	9	2.0	7	9

As compared to the third quarter of 2004, system passenger revenues, which included Aeroplan passenger revenues of $90 million in the 2005 quarter, were up $338 million or 16 per cent. The passenger revenue growth versus the 2004 quarter was due to both passenger traffic and yield per RPM increases and to the inclusion of Aeroplan passenger revenues, as explained on page 5 of this MD&A, in the Passenger revenue category. In the third quarter of 2005, system passenger traffic grew 9 per cent, reflecting a strong market demand for the Air Canada and Jazz products, on an increase of 6 per cent in ASM flying capacity. As a result, system passenger load factor improved 2.0 percentage points to 82.4 per cent, a record high load factor for the third quarter. Excluding Aeroplan passenger revenues, yield per RPM improved 3 per cent and reflected yield per RPM increases in all markets with the exception of the Atlantic market which remained unchanged. The higher yields were primarily due to the Corporation increasing fare levels in the domestic and US transborder markets in addition to increasing fuel surcharges to and from most international destinations to cover higher fuel costs. System RASM, excluding Aeroplan passenger revenues, rose 5 per cent over the third quarter of 2004, reflecting both the improvement in passenger load factor and the increase in yield per RPM.

Domestic passenger revenues, which included Aeroplan passenger revenues of $50 million in the 2005 quarter, were up $191 million or 24 per cent versus the third quarter of 2004. Domestic traffic grew 11 per cent while ASM capacity was increased by 6 percent resulting in a passenger load factor improvement of 3.6 percentage points. Domestic yield per RPM increased 6 per cent, excluding Aeroplan passenger revenues, mainly due to higher fare levels to cover higher fuel costs, the Corporation's improved domestic competitive position, as well as a stronger market demand for the higher-priced Tango Plus product. Reflecting both the improvement in passenger load factor and the yield per RPM improvement, excluding Aeroplan passenger revenues, domestic RASM rose 11 per cent above the 2004 level.

US transborder passenger revenues, which included Aeroplan passenger revenues of $14 million in the 2005 quarter, rose $35 million or 10 per cent from the 2004 level. In response to increased capacity from US carriers, US transborder ASM capacity was reduced by 2 per cent. In spite of the ASM capacity reduction, traffic increased 5 per cent resulting in a passenger load factor improvement of 5.3 percentage points. Despite increased fare levels to cover higher fuel costs, the US transborder yield per RPM increased only 1 per cent, excluding Aeroplan passenger revenues, reflecting the Corporation's response to an aggressive pricing environment as a result of higher capacity on the transborder market from Canadian low-cost carriers, as well as the weakening of the US dollar versus the third quarter of 2004 for sales denominated in US dollars. Excluding Aeroplan passenger revenues, US transborder RASM was up 8 per cent due to the significant improvement in passenger load factor and, to a much lesser extent, the yield per RPM increase.

Atlantic passenger revenues, which included Aeroplan passenger revenues of $23 million in the 2005 quarter, increased $75 million or 13 per cent due to a traffic increase of 9 per cent from the 2004 quarter. Despite increased fuel surcharges to cover higher fuel costs, Atlantic yield per RPM (excluding Aeroplan passenger revenues) was essentially unchanged reflecting a competitive pricing environment due to growth in charter capacity to Europe and the United Kingdom, as well as the weakening of foreign currencies for sales denominated in Euro and Sterling Pound. Traffic rose 9 per cent reflecting a strong

market demand in the United Kingdom and the France markets and the addition of the route to Rome, Italy. Capacity increased 7 per cent largely due to the addition of the route to Rome, Italy and additional frequencies to the United Kingdom and the continent. As a result of the traffic increase, the Atlantic passenger load factor improved 1.9 percentage points. Excluding Aeroplan passenger revenues, RASM increased 2 per cent reflecting the passenger load factor improvement.

Pacific passenger revenues, which included Aeroplan passenger revenues of $2 million in the 2005 quarter, were up $15 million or 5 per cent from the third quarter of 2004. Despite increased fuel surcharges to cover higher fuel costs, excluding Aeroplan passenger revenues, yield per RPM rose only 1 per cent over the third quarter of 2004 reflecting yield per RPM improvements in the Hong Kong and Korea markets, partially offset by a competitive pricing environment in the China market due to significant increases in capacity from both Canadian and foreign carriers, as well as the weakening of Asian currencies versus the third quarter of 2004. Pacific passenger traffic grew 5 per cent on a 9 per cent increase in ASM capacity resulting in a 3.5 percentage point deterioration in the passenger load factor compared to the 2004 quarter. As a result of the reduction in the passenger load factor, RASM decreased 4 per cent, excluding Aeroplan passenger revenues.

South Pacific, Caribbean, Mexico and South America passenger revenues, which included Aeroplan passenger revenues of $1 million in the 2005 quarter, increased $22 million or 21 per cent from the third quarter of 2004. Traffic grew 17 per cent on an ASM capacity increase of 14 per cent resulting in a 2.3 percentage point improvement in passenger load factor compared to the 2004 quarter. Excluding Aeroplan passenger revenues, yield per RPM rose 1 per cent over the third quarter of 2004 and RASM increased 4 per cent primarily as a result of the increase in passenger load factor. The growth in these markets is largely from additional flying primarily to South America and, to a lesser extent, from increased service to traditional leisure destinations.

Cargo Revenues

Cargo revenues increased $20 million or 14 per cent mainly due to a higher volume of cargo carried largely in the Pacific market. Revenues from freighter operations increased $34 million over the third quarter of 2004 while revenues from non-freighter operations declined by $14 million. Cargo freighter operations commenced in the international market in November 2004 following the retirement of the Boeing 747-400 Combi aircraft. Yield per revenue ton mile was essentially unchanged from the 2004 quarter as the favourable impact of increased fuel surcharges was offset by an unfavourable mix of lower-yielding freight express traffic versus the third quarter of 2004.

Other Revenues

Other non-transportation revenues were down $21 million or 9 per cent mainly as a result of the change in accounting policy for the loyalty program (Aeroplan) as described on page 5 of this MD&A. For the three months ended September 30, 2004, Aeroplan revenues from Miles earned by members through the loyalty program partners amounted to $50 million and were recorded in the Other revenue category. For the three months ended September 30, 2005, Aeroplan revenues from Miles redeemed for air travel on Air Canada and Jazz are recorded in the Passenger revenue category. Partly offsetting the reduction from the change in accounting policy for the loyalty program is an increase in third party technical services revenues as well as other factors including higher cancellation and change fees.

3.3. Cost Performance – Third Quarter

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 Third Quarter 2005 Consolidated Financial Statements or to page 38 of this MD&A for additional information on the adoption of AcG-15. In the third quarter of 2005, the net impact of adopting AcG-15 on the Corporation's results was a pre-tax income of $38 million or $0.38 per share, basic. The impact of the adoption of AcG-15 was a reduction to aircraft rent expense of $30 million, an increase to depreciation expense of $20 million, an increase to net interest expense of $24 million, a foreign exchange gain of $55 million and a non-controlling interest charge of $3 million compared to financial results had AcG-15 not been effective.

Operating Expenses

In the third quarter of 2005, total operating expenses increased $260 million or 12 per cent compared to the third quarter of 2004 and included a fuel expense increase of $213 million or 46 per cent. Unit cost rose 5 percent over the 2004 level (excluding fuel expense, unit cost declined 3 per cent).

Salaries and wages expense totaled $503 million in the third quarter of 2005, an increase of $29 million from the third quarter of 2004. Included in salaries and wages expense in the third quarter of 2005 was approximately $13 million relating to an employee profit sharing program and a $5 million charge related to a voluntary severance program. No expenses related to the profit sharing program were recorded in 2004. Partly offsetting these increases to salaries and wages expense is a reduction in average salaries reflecting employees being hired at lower wage scales. Average full-time equivalent (FTE) employees increased 2 per cent on a capacity increase of 6 per cent over the 2004 quarter. Employee productivity, as measured by ASM per FTE employee, grew 4 per cent over the third quarter of 2004.

Employee benefits expense amounted to $133 million in the third quarter of 2005, a decrease of $23 million or 15 per cent from the third quarter of 2004. The decrease was largely due to lower pension and employee future benefits expenses as a result of the elimination of unamortized actuarial losses and prior service costs resulting from fresh start reporting.

Fuel expense was up $213 million or 46 per cent, on a capacity increase of 6 per cent, reflecting continuing record high fuel prices. The average base fuel price increase of $234 million and the volume increase of $36 million were partially offset by a reduction of $57 million due to the favourable impact of

a stronger Canadian dollar versus the US dollar during the quarter when compared to the third quarter of 2004. On a unit cost basis, fuel expense per ASM rose 38 per cent.

Aircraft rent expense was reduced by $45 million or 29 per cent. As a result of the adoption of AcG-15 combined with the impact of fresh start reporting, aircraft rent expense declined $37 million versus the same period last year. Other factors in the remaining decrease included the impact of lease renegotiations, as well as the impact of a stronger Canadian dollar versus the US dollar for leases denominated in US dollars. Partially offsetting this decrease in aircraft rent expense is the impact of aircraft additions to the fleet, net of aircraft lease terminations and returns.

Airport and navigation fees rose $53 million or 26 per cent over the 2004 quarter. 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, higher landing and general terminal fees, primarily at Toronto's Pearson International Airport, as well as a 5 per cent increase in aircraft departures versus the 2004 quarter were the main factors in the increase. In addition, in the third quarter of 2004, the Corporation recorded a favourable adjustment of $22 million to navigation fees relating to Federal Aviation Administration (FAA) over flight fees.

Aircraft maintenance, materials and supplies expense was unchanged from the 2004 quarter.

Communications and information technology expense was up $2 million or 3 per cent largely due to increased volume for communication services for web and Global Distribution System (GDS) as well a an increase in information technology projects. The increase resulting from higher volumes was largely offset by renegotiated contract rates for information technology and communications services and by the impact of a stronger Canadian dollar versus the US dollar in the quarter when compared to the third quarter of 2004.

Food, beverage and supplies expense decreased $4 million or 4 per cent versus the 2004 quarter on a passenger traffic increase of 9 per cent. The impact of cost reduction initiatives offset the volume-related increase. In the third quarter of 2004, the Corporation recorded an unfavourable adjustment of $4 million relating to an inventory provision.

Depreciation, amortization and obsolescence expense rose $4 million or 4 per cent. As a result of the adoption of AcG-15, depreciation expense increased $20 million. Amortization of intangible assets amounted to $24 million compared to $8 million in the same period last year. These increases were largely offset by declines mainly as a result of fresh start reporting.

Commission expense was down $10 million or 13 per cent on combined passenger and cargo revenue growth of 12 per cent, excluding Aeroplan passenger revenues. The main reason for the decrease in commission expense was the impact of a new commission structure for web and GDS bookings as well as lower international commissions which more than offset the volume-related increase. The impact of a stronger Canadian dollar versus the US dollar in the quarter when compared to the third quarter of 2004 was also a factor in the decrease.

The other operating expense category was up $41 million or 12 per cent over the same period of 2004 and included increases in credit card fees, legal and advisory fees, and other categories of expenses mainly related to the 6 per cent increase in ASM capacity.

Non-Operating Expense

Non-operating expense totaled $38 million in the third quarter of 2005, a $95 million decrease from the third quarter of 2004. The third quarter of 2004 non-operating expense was impacted by the recording of provisions totaling $62 million by the Predecessor Company for loss on sale of assets relating mainly to inactive aircraft and inventory. There were no provisions of this nature recorded in the 2005 quarter. Net interest expense amounted to $54 million, a decrease of $6 million from the 2004 quarter comprised primarily of $18 million in higher interest income reflecting higher cash balances and an increase in average interest rates, partially offset by an increase in interest expense of $24 million as a result of the adoption of AcG-15. Interest income of $4 million in the third quarter of 2004 was allocated to reorganization and restructuring items. Other non-operating income totaled $14 million in the 2005 quarter, and related mainly to a settlement of interest rate swaps on aircraft leases that were terminated as a result of Air Canada's filing under CCAA on April 1, 2003. Refer to "Financial Instruments" on page 23 of this MD&A for additional information on the interest rate swaps settlement.

Non-controlling interest

Non-controlling interest charge amounted to $9 million in the third quarter of 2005 and was related to distributions to the non-controlling interest holders of Aeroplan and to the adoption of AcG-15.

Foreign Exchange Gains

Gains from revaluation of foreign currency monetary items amounted to $125 million in the third quarter of 2005 attributable to a stronger Canadian dollar versus the US dollar at September 30, 2005 compared to June 30, 2005. These gains included $73 million related to capital lease obligations and $55 million as a result of the adoption of AcG-15. In the third quarter of 2004, foreign exchange gains on non-compromised monetary items amounted to $123 million.

Future Income Taxes

Provision for income taxes amounted to $128 million in the third quarter of 2005. No tax recovery was recorded on the loss in the third quarter of 2004. Refer to Note 14 of the 2004 Annual Consolidated Financial Statements of ACE for additional information.

4. 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)	**Nine Months Ended September 30, 2005**	**Nine Months Ended September 30, 2004**	**$ Change**	**% Change**
Operating revenues				
Passenger	6,300	5,628	672	12
Cargo	444	405	39	10
Other	724	805	(81)	(10)
	7,468	6,838	630	9
Operating expenses				
Salaries, wages and benefits	1,872	1,989	(117)	(6)
Aircraft fuel	1,620	1,174	446	38
Aircraft rent	300	521	(221)	(42)
Airport and navigation fees	702	616	86	14
Aircraft maintenance, materials and supplies	263	265	(2)	(1)
Communications and information technology	230	236	(6)	(3)
Food, beverages and supplies	253	264	(11)	(4)
Depreciation, amortization and obsolescence	357	312	45	14
Commissions	206	240	(34)	(14)
Other	1,178	1,101	77	7
	6,981	6,718	263	4
Operating income before reorganization and restructuring items	487	120	367	
Reorganization and restructuring items	-	(871)	871	
Non-operating income (expense)				
Dilution gain	190	-	190	
Interest income	47	6	41	
Interest expense	(228)	(169)	(59)	
Interest capitalized	8	-	8	
Gain (loss) on sale of and provisions on assets	2	(75)	77	
Other	(16)	(10)	(6)	
	3	(248)	251	
Income (loss) before the following items:	490	(999)	1,489	
Non-controlling interest	(16)	-	(16)	
Foreign exchange gain	57	106	(49)	
Provision for income taxes	(170)	(2)	(168)	
Income (loss) for the period	361	(895)	1,256	
Earnings (loss) per share				
- Basic	3.73	(7.45)		
- Diluted	3.37	(7.45)		

Operating Statistics

Revenue Passenger Miles (millions)	36,180	33,746	2,434	7
Available Seat Miles (millions)	45,014	43,722	1,292	3
Passenger Load Factor (%)	80.4	77.2	3.2 pp	

4.1. Comparison of Year-to-date Results

For the nine months ended September 30, 2005, ACE reported operating income of $487 million, an improvement of $367 million over the same period in 2004, in spite of a fuel expense increase of $446 million or 38 percent. EBITDAR improved $191 million over the nine months ended September 30, 2004. Refer to "Non-GAAP Financial Measure" on page 4 of this MD&A for additional information on EBITDAR.

For the nine months ended September 30, 2005, total operating revenues increased $630 million or 9 per cent compared to the nine months ended September 30, 2004. Passenger revenues were up $672 million or 12 per cent reflecting increases in all markets and included the transfer of Aeroplan passenger revenues of $221 million into the Passenger revenue category. For additional information on Aeroplan passenger revenues, refer to page 5 of this MD&A.

Operating expenses were up $263 million versus the nine months ended September 30, 2004 and included an increase in fuel expense of $446 million or 38 per cent over the same period of 2004. ASM capacity increased 3 per cent when compared to the same period of 2004. Unit cost for the nine months ended September 30, 2005, as measured by operating expense per ASM, increased 1 per cent from the nine months ended September 30, 2004. Excluding fuel expense, unit cost was down 6 per cent. Unit cost reductions were achieved in aircraft rent, benefits expense, commissions and food, beverages and supplies expense.

For the nine months ended September 30, 2004, reorganization and restructuring items amounted to $871 million. As Air Canada emerged from CCAA proceedings on September 30, 2004, reorganization and restructuring items were not recorded after that date.

For the nine months ended September 30, 2005, non-operating expense improved $251 million and included a dilution gain of $190 million (before tax) relating to the Aeroplan transaction as further described in ACE's Second Quarter 2005 Management's Discussion and Analysis of Results dated August 4, 2005. Also, included in other non-operating expenses was a charge of $29 million relating to the repayment of the GE exit credit facility. For the nine months ended September 2004, a provision for loss on sale of assets of $75 million was recorded related mainly to inactive aircraft and inventory.

Gains from revaluation of foreign currency monetary items amounted to $57 million for the nine months ended September 30, 2005 attributable to a stronger Canadian dollar versus the US dollar at September 30, 2005 compared to December 31, 2004. This compared to foreign exchange gains on non-compromised monetary items of $106 million recorded for the nine months ended September 30, 2004.

The provision for income taxes amounted to $170 million during the nine months ended September 30, 2005.

Net income for the nine months ended September 30, 2005 was $361 million compared to a net loss of $895 million for the nine months ended September 30, 2004, an improvement of $1,256 million.

4.2. Revenue Performance – Year-to-date

Passenger Revenues

The table below describes, by major market and excluding the impact of the policy change related to Aeroplan passenger revenues, year-to-date over year-to-date percentage changes in passenger revenues, capacity as measured by ASMs, traffic as measured by 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

Nine months ended September 30, 2005 versus nine months ended September 30, 2004

	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield per RPM % Change	RASM % Change
Canada	11	3	8	4.1	3	8
US	(3)	(7)	3	7.0	(5)	4
Atlantic	9	5	7	2.1	2	4
Pacific	9	6	5	(0.8)	4	3
Other	18	14	17	1.8	1	3
System (excluding Aeroplan)	8	3	7	3.2	1	5
System (including Aeroplan)	12	3	7	3.2	5	9

As compared to the nine months ended September 30, 2004, system passenger revenues, which included Aeroplan passenger revenues of $221 million in the 2005 period, were up $672 million or 12 per cent. As a result of higher fuel costs, domestic and US transborder fare levels have been increased over the nine months ended September 30, 2004 and fuel surcharges have been significantly increased to and from most international destinations.

For the nine months ended September 30, 2005, system passenger traffic increased 7 per cent on an increase of 3 per cent in ASM flying capacity producing a 3.2 percentage point improvement in passenger load factor versus the 2004 level. Increases in yield per RPM for the domestic and other international markets were partly offset by a significant decrease in yield per RPM 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, mainly reflecting the major improvement in passenger load factor.

For the nine months ended September 30, 2005, domestic passenger revenues, which included Aeroplan passenger revenues of $108 million in the 2005 period, were up $357 million or 16 per cent from the same period of 2004. Domestic passenger traffic grew 8 per cent and capacity was increased by 3 per cent resulting in a passenger load factor improvement of 4.1 percentage points over the 2004 level. Domestic yield per RPM increased 3 per cent, excluding Aeroplan passenger revenues. Reflecting both the increase in yield per RPM and the improvement in passenger load factor, excluding Aeroplan passenger revenues, domestic RASM rose 8 per cent above the 2004 level.

US transborder passenger revenues, which included Aeroplan passenger revenues of $49 million in the 2005 period, increased $16 million or 1 per cent from the same period in 2004. In response to increased capacity from US carriers, US transborder ASM capacity was reduced by 7 per cent. In spite of the ASM capacity reduction, traffic increased 3 per cent resulting in a passenger load factor improvement of 7.0 percentage points. Excluding Aeroplan passenger revenues, yield per RPM declined 5 per cent reflecting the Corporation's response to an aggressive pricing environment resulting from increased capacity in the transborder market by Canadian low-cost carriers, as well as the weakening of the US dollar for sales denominated in US dollars. Excluding Aeroplan passenger revenues, US transborder RASM was up 4 per cent as the significant improvement in passenger load factor more than offset the yield per RPM decrease.

Compared to the nine months ended September 30, 2004, Atlantic passenger revenues, which included Aeroplan passenger revenues of $42 million in the 2005 period, increased $153 million or 13 per cent. This passenger revenue increase was due to a 2 per cent increase in yield per RPM, in part due to increased fuel surcharges to cover higher fuel costs, and to a passenger load factor improvement of 2.1 percentage points. Atlantic ASM capacity was increased by 5 per cent. Excluding Aeroplan passenger revenues, RASM was up 4 per cent reflecting both the yield per RPM increase and the improvement in the passenger load factor.

Pacific passenger revenues, which included Aeroplan passenger revenues of $6 million for the nine months ended September 30, 2005, were up $65 million or 10 per cent versus the same period in 2004. Excluding Aeroplan passenger revenues, yield per RPM improved 4 per cent from the nine months ended September 30, 2004 in part due to increased fuel surcharges to cover higher fuel costs. Pacific traffic grew 5 per cent on a 6 per cent increase in ASM capacity resulting in a 0.8 percentage point decrease in passenger load factor as compared to the nine months ended September 30, 2004. Excluding Aeroplan passenger revenues, RASM increased 3 per cent as a result of the yield per RPM increase.

South Pacific, Caribbean, Mexico and South America passenger revenues, which included Aeroplan passenger revenues of $16 million in the 2005 period, increased $81 million or 22 per cent from the same period in 2004. Traffic grew 17 per cent on an ASM capacity increase of 14 per cent resulting in a 1.8 percentage point improvement in passenger load factor as compared to the nine months ended September 30, 2004. Excluding Aeroplan passenger revenues, yield per RPM was up 1 per cent over the 2004 level. Fuel surcharges were increased to cover higher fuel costs. RASM increased 3 per cent reflecting both the passenger load factor improvement and the yield per RPM improvement. The growth in these markets is largely from additional flying to South and Latin America.

Cargo Revenues

Cargo revenues increased $39 million or 10 per cent mainly due to a higher volume of cargo carried in the Pacific market. Revenues from freighter operations increased $75 million over the nine months ended September 30, 2004 while revenues from non-freighter operations declined by $36 million. Cargo freighter operations commenced in the international market in November 2004 following the retirement of the Boeing 747-400 Combi aircraft. Yield per revenue ton mile was only 1 per cent above the nine months ended September 20, 2004 as the favourable impact of increased fuel surcharges was largely offset by an unfavourable mix of lower-yielding freight express traffic versus the same period in 2004.

Other Revenues

Other non-transportation revenues were down $81 million or 10 per cent mainly as a result of the change in accounting policy for the loyalty program (Aeroplan) as described in page 5 of this MD&A. For the nine months ended September 30, 2004, Aeroplan revenues from Miles earned by members through the loyalty program partners amounted to $173 million and were recorded in the Other revenue category. For the nine months ended September 30, 2005, Aeroplan revenues from Miles redeemed for air travel on Air Canada and Jazz are recorded in the Passenger revenue category. Partly offsetting the reduction from the change in accounting policy for the loyalty program is increased third party technical services revenues and cancellation and change fees, as well as higher revenues from Air Canada Vacations related to growth in the Mexico and Cuba markets.

4.3. Cost Performance – Year-to-date

Impact of the Adoption of AcG-15

For the nine months ended September 30, 2005, the net impact of adopting AcG-15 on the Corporation's results was a pre-tax charge of $25 million or $0.26 per share, basic. The impact of the adoption of AcG-15 was a reduction to aircraft rent expense of $87 million, an increase to depreciation expense of $66 million, an increase to net interest expense of $69 million, a foreign exchange gain of $34 million and a non-controlling interest charge of $11 million compared to financial results had AcG-15 not been effective.

Operating Expenses

For the nine months ended September 30, 2005, total operating expenses increased $263 million compared to the nine months ended September 30, 2004 and included a fuel expense increase of $446 million or 38 per cent versus the nine months ended September 30, 2004. Unit cost increased 1 per cent versus the 2004 level (excluding fuel expense, unit cost declined 6 per cent).

The following discussion summarizes those categories with significant variances for the considered periods:

Salaries and wage expense totaled $1,459 million for the nine months ended September 30, 2005, essentially unchanged from the same period in 2004. The reduction of an average of 419 full-time equivalent (FTE) employees or 1 per cent from the nine months ended September 30, 2004, as well as salary reductions for unionized and non-unionized labour groups was offset by the expense of approximately $39 million relating to an employee profit sharing program. Employee productivity, as measured by ASM per FTE employee, grew 4 per cent compared to the nine months ended September 30, 2004.

Employee benefits expense amounted to $413 million in the nine months of 2005, a decrease of $118 million or 22 per cent from the nine months ended September 30, 2004. The decrease was largely due to lower pension and employee future benefits expenses as a result of the elimination of unamortized actuarial losses and prior service costs resulting from fresh start reporting.

Fuel expense increased $446 million or 38 per cent, on a capacity increase of 3 per cent, reflecting continuing record high fuel prices. The average base fuel price increase of $530 million and the volume-related increase of $47 million were partially offset by a reduction of $131 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 34 per cent.

Aircraft rent expense decreased $221 million or 42 per cent. As a result of the adoption of AcG-15 combined with the impact of fresh start reporting, aircraft rent expense decreased $107 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 nine months ended September 30, 2004. These decreases were partly offset by aircraft additions to the fleet, net of aircraft returns or terminations.

Airport and navigation fees increased $86 million or 14 per cent. 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. In addition, in the third quarter of 2004, the Corporation recorded a favourable adjustment of $22 million to airport and navigation fees relating to Federal Aviation Administration (FAA) over flight fees.

Depreciation, amortization and obsolescence expense was up $45 million or 14 per cent over the same period in 2004 and included $66 million related to the adoption of AcG-15.

Commission expense was down $34 million or 14 per cent on combined passenger and cargo revenue growth of 8 per cent, excluding Aeroplan passenger revenues. The impact of a new commission structure introduced for web and GDS bookings as well as lower international commissions more than offset the volume-related increase.

The other operating expense category rose $77 million or 7 per cent which included increased credit card fees, higher expenses relating to a higher volume and an increase in the cost of tour packages by Air Canada Vacations. Other increases were miscellaneous fees and services expense, Aeroplan non-air redemption expenses, customer maintenance materials, terminal handling expense as well as other factors partly offset by a reduction in advertising and promotion expense.

Non-Operating Income (Expense)

Non-operating income amounted to $3 million for the nine months ended September 30, 2005, a $251 million improvement 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 $173 million, an increase of $10 million from the same period in 2004 and included the impact of the adoption of AcG-15 of $69 million. Interest income amounted to $47 million for the nine months ended September 30, 2005 compared to $6 million for 2004. In the nine months ended September 30, 2004, interest income of $17 million was allocated to reorganization and restructuring items. In the first nine months of 2004, provisions for loss on sale of assets of $75 million were recorded mainly related to non-operating aircraft and inventory.

Non-controlling interest

Non-controlling interest amounted to $16 million and was related to distributions to the non-controlling interest holders of Aeroplan and to the adoption of AcG-15.

Foreign Exchange

Gains from revaluation of foreign currency monetary items amounted to $57 million in the period attributable to a stronger Canadian dollar versus the US dollar at September 30, 2005 compared to December 31, 2004. The foreign exchange gains recorded in the nine months ended September 30, 2005 included gains of $45 million related to capital lease obligations and $34 million resulting from the adoption of AcG-15. This compared to foreign exchange gains on non-compromised monetary items of $106 million recorded in the same period of 2004.

Future Income Taxes

Provision for income taxes amounted to $170 million in the nine months ended September 30, 2005, of which $28 million related to the Aeroplan transaction which took place in the second quarter of 2005. No tax recovery was recorded on the loss in the first nine months of 2004. Refer to Note 14 of the 2004 Annual Consolidated Financial Statements of ACE for additional information.

5. ANALYSIS OF THE STATEMENT OF FINANCIAL POSITION

Consolidated Statement of Financial Position

Unaudited ($ millions)	September 30, 2005	December 31, 2004
ASSETS		
Current		
Cash, cash equivalents and short-term investments	2,481	1,632
Other current assets	1,265	1,063
	3,746	2,695
Property and equipment	5,163	3,696
Deferred charges	144	167
Intangible assets	2,467	2,691
Other assets	373	137
	11,893	**9,386**
LIABILITIES		
Current liabilities	3,041	2,491
Long-term debt and capital lease obligations	3,400	2,328
Convertible preferred shares	144	132
Future income taxes	229	243
Pension and other benefit liabilities	2,233	2,344
Non-controlling interest	200	-
Other long-term liabilities	1,388	1,645
	10,635	9,183
Share capital and other equity	736	187
Contributed surplus	4	1
Retained earnings	518	15
SHAREHOLDERS' EQUITY	1,258	203
	11,893	**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 September 30, 2005, additional property and equipment of $1,350 million, long-term debt, including current portion, of $1,178 million, other assets of $111 million, and non-controlling interest of $200 million are consolidated under AcG-15. The impact of the adoption of AcG-15 on the Consolidated Statement of Financial Position is described in further detail under the section entitled "Accounting Policies" on page 38 of this MD&A.

5.1. Share Capital and Other Equity

As at September 30, 2005, the issued and outstanding common shares of ACE, along with common shares potentially issuable, which are comprised of convertible preferred shares, convertible notes and stock options, are as follows:

		Successor Company	
		September 30, 2005	December 31, 2004
	Authorized	Outstanding (000)	
Issued and outstanding common shares			
Class A variable voting shares	Unlimited	76,919	74,813
Class B voting shares	Unlimited	24,294	8,813
Shares held in escrow		87	5,189
Total issued and outstanding common shares		**101,300**	**88,815**

	Successor Company September 30, 2005	 December 31, 2004
	Outstanding (000)	
Common shares potentially issuable		
Convertible preferred shares	10,102	9,259
Convertible notes	6,875	-
Stock options	3,692	3,028
Total common shares potentially issuable	**20,669**	**12,287**

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

($ millions)	Successor Company September 30, 2005	 December 31, 2004
Common shares	$ 2,220	$ 1,778
Convertible preferred shares	117	117
Convertible notes	92	-
	2,429	1,895
Adjustment to shareholders' equity	(1,693)	(1,708)
Share capital and other equity	**$ 736**	**$ 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 ($442 million, net of fees).

In the same period, the Corporation issued $330 million of 4.25% 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 4b to the Interim Unaudited Third 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 on May 30, 2005 confirming that all remaining disputed unsecured claims had been resolved and recommended to the Ontario Superior Court of Justice that it authorize the Monitor to proceed with the final distribution of shares held by the Monitor in escrow in accordance with the restructuring plan. The shares were distributed with the exception of 86,926 shares that continue to be held in escrow by the Monitor pending resolution of tax obligations with governmental authorities.

5.2. Debt Obligations

As at September 30, 2005, ACE had long-term debt of $3.7 billion, including capital lease obligations of $1.4 billion and $1.2 billion recorded as a result of the adoption of AcG-15. Cash, cash equivalents and short-term investments totaled $2.5 billion.

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 $2.8 billion as at September 30, 2005 compared to $3.0 billion at December 31, 2004. Refer to the table on page 31 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, the Corporation no longer has any residual value guarantees under any of its aircraft leasing agreements accounted for as operating leases. The entire debt balance under these leasing agreements is now on the Consolidated Statement of Financial Position of the Corporation and, as a result, the residual value support previously disclosed in the 2004 Annual Consolidated Financial Statements of ACE is no longer characterized as a guarantee of the Corporation.

Financial Instruments

Foreign Exchange Contracts

As at September 30, 2005, the Company had entered into foreign currency forward contracts and option agreements on US$470 million of purchases. The fair value of these foreign currency contracts as at September 30, 2005 is $13 million in favour of third parties. These derivative instruments have not been designated as hedges for accounting purposes. The unrealized loss has been recorded in foreign exchange.

Fuel Contracts

Air Canada, like all airline operators, depends upon jet fuel to operate and, therefore, is impacted by changes in jet fuel prices. Jet fuel and oil represent a growing percentage of Air Canada's operating expenses reaching 27 per cent during the three months ended September 30, 2005 compared to 21 per cent for the same period in 2004. The Corporation endeavors to acquire jet fuel at the lowest possible cost. Because jet fuel is not traded on an organized futures exchange, liquidity for hedging this commodity is mostly limited to a shorter time horizon. Crude oil and heating oil contracts are effective commodities for hedging jet fuel and the Corporation will use these commodities for medium to longer term hedges. The Corporation currently holds paper positions in derivative financial instruments for hedging purposes only.

In order to minimize the Corporation's exposure to the volatility of fuel prices, a systematic fuel risk management strategy has been implemented using financial instruments to build up the Corporation's hedge position in increments of approximately 4 per cent per month to a target level of approximately 50 per cent of its anticipated jet fuel requirements for a 24-month period beginning in September 2005.

As at September 30, 2005, the Corporation had collar option structures in place for all of its current fuel hedges. All of the Corporation's fourth quarter 2005 hedges are effectively jet fuel-based contracts. The Corporation has hedged 7 per cent of its fourth quarter 2005 jet fuel requirements at prices that can fluctuate between an average of US$73.00 to US$92.00 per barrel. For 2006, the majority of the Corporation's hedge positions are effectively in the form of heating oil-based contracts. The Corporation has hedged 8 per cent of its 2006 requirements at prices that can fluctuate between an average of US$74.00 to US$89.00 per barrel. For the first three quarters of 2007, the majority of the hedge positions are crude oil-based contracts. The Corporation has hedged 3 per cent of its 2007 requirements at prices that can fluctuate between an average of US$56.00 to US$72.00 per barrel. For all heating and crude oil fuel hedges, the prices disclosed above do not include the jet fuel premium.

In the third quarter of 2005, these financial instruments had not been designated as hedges for accounting purposes. Hedge accounting will be applied prospectively from October 1, 2005. As at September 30, 2005, the unrealized gain on these contracts is $2 million and is recorded in other non-operating expense.

Other

During the third quarter 2005, the Corporation reached a settlement with a third party related to interest rates swaps, covering two Boeing 767 aircraft leases, that were terminated as a result of Air Canada's filing for CCAA on April 1, 2003. A dispute arose following termination between Air Canada and the unrelated third party with respect to replacement arrangements for the swaps. The settlement agreement provides for a payment to Air Canada of US$8 million related to a portion of the net payments the Corporation would have received had the swaps not been terminated. The replacement swaps that were put in place with another unrelated third party have a fair value of $9 million in favour of the Corporation on inception. As a result of these transactions, the Corporation recorded a gain of $17 million, net of transaction fees of $3 million. The swaps have a term to January, 2024 and convert lease payments related to two Boeing 767 aircraft leases consolidated under AcG-15, from fixed to floating interest rates.

6. FINANCIAL MANAGEMENT

Consolidated Statement of Cash Flow

Cash flows from (used for)	Successor Company ACE Three and Nine Months periods ended September 30, 2005		Predecessor Company Air Canada Three and Nine Months periods ended September 30, 2004	
Operating				
Income (loss) for the period	270	361	(81)	(895)
Adjustments to reconcile to net cash provided by operations				
Reorganization and restructuring items	-	-	281	786
Depreciation, amortization and obsolescence	118	357	114	312
Gain (loss) on sale of and provisions on assets	(2)	(2)	62	75
Dilution gain	-	(190)	-	-
Foreign exchange	(149)	(94)	(123)	(106)
Future income taxes	125	161	1	(5)
Employee future benefit funding (more than) less than expense	(33)	(47)	34	126
Decrease (increase) in accounts receivable	(131)	(330)	(15)	(191)
Decrease (increase) in spare parts, materials and supplies	3	(2)	(7)	-
Increase (decrease) in accounts payable and accrued liabilities	(7)	53	49	34
Increase (decrease) in advance ticket sales, net of restricted cash	(208)	230	(138)	196
Aircraft lease payments (in excess of) less than rent expense	(6)	(7)	(3)	(31)
Other	8	151	9	59
	(12)	641	183	360
Financing				
Issue of share capital	(1)	442	-	-
Issue of convertible notes	-	319	-	-
Issue of subsidiary units	-	232	-	-
GE DIP financing	-	-	-	300
Aircraft related borrowings	213	213	116	233
Credit facility borrowings	(18)	300	-	80
Reduction of long-term debt and capital lease obligations	(67)	(834)	(49)	(358)
Distributions paid to non-controlling interest	(3)	(3)	-	-
Other	1	(4)	(2)	(2)
	125	665	65	253
Investing				
Short-term investments	136	(1,219)	78	186
Sale of subsidiary units	-	35	-	-
Additions to capital assets	(316)	(411)	(142)	(328)
Proceeds from sale of assets	4	41	1	2
Cash collaterization of letters of credit	(15)	(35)	-	-
Investment in US Airways	(87)	(87)	-	-
	(278)	(1,676)	(63)	(140)
Increase (decrease) in cash and cash equivalents	(165)	(370)	185	473
Cash and cash equivalents, beginning of period	1,276	1,481	772	484
Cash and cash equivalents, transferred to the Successor Company	-	-	(957)	(957)
Cash and cash equivalents, end of period	**1,111**	**1,111**	**-**	**-**

Cash and cash equivalents exclude short-term investments of $1,370 million as at September 30, 2005 ($151 million as at December 31, 2004).

The cash and cash equivalents of $957 million transferred from the Predecessor Company to the Successor Company combined with the net impact of the equity, financing and other transactions consummated for cash proceeds totaling $982 million upon the implementation of the Plan on September 30, 2004 resulted in cash and cash equivalents of $1,939 million in the Successor Company as at September 30, 2004.

6.1. Cash Flows from (used for) Operations

The third quarter of 2005 cash flows used for operations was $12 million. This compared to cash flows from operations of $183 million in the third quarter of 2004, a decrease of $195 million. Further components of the cash flow change are described below:

- Advance ticket sales was a use of funds of $208 million, largely reflecting the seasonal decrease in advance ticket sales (2004 - $138 million use of funds). Despite this decline, advance ticket sales, excluding loyalty program deferred revenues, amounted to $788 million at September 30, 2005 as compared to $585 million as a September 30, 2004, an increase of $203 million year-over-year, reflecting the significant increase in advance ticket sales leading into the third quarter of 2005.
- Accounts receivable was a use of funds of $131 million in the third quarter of 2005. This compared to a use of funds of $15 million in the third quarter of 2004, an increase of $116 million. The main factor in the use of funds was an increase in commodity tax receivables on aircraft which will be collected in the fourth quarter of 2005. Other factors in the use of funds included increases in passenger-related receivables from other airlines and maintenance service receivables.
- Employee future benefit funding was a use of funds of $33 million in the third quarter of 2005, versus a source of funds of $34 million from the third quarter of 2004. This change was mainly as a result of pension funding of $85 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.

The first nine months of 2005 cash flows from operations amounted to $641 million. This compared to cash flows from operations of $360 million in the same period of 2004, an improvement of $281 million. Improved operating results contributed significantly to the cash flow improvement.

6.2. Cash Flows from (used for) Financing Activities

Aircraft-related borrowings amounted to $213 million in the third quarter of 2005 and related to the acquisition of nine Embraer 175 aircraft. Credit facility repayments totaled $18 million in the third quarter of 2005 and related to the repayment of Aeroplan's Revolving Term Credit Facility, as described below.

Reduction of long-term debt and capital lease obligations amounted to $67 million in the third quarter of 2005 ($834 million in the first nine months of 2005). During the third quarter of 2005 scheduled payments of $33 million ($120 million in the first nine months of 2005) were made on capital lease obligations and scheduled payments of $7 million ($43 million in the first nine months of 2005) were made on the secured non-revolving term credit facility with Amex Bank of Canada Inc. Other mandatory scheduled payments made in the third quarter of 2005 amounted to $27 million ($102 million in the first nine months of 2005). During the nine months ended September 30, 2005, ACE repaid all of its outstanding debt of $540 million under the exit credit facility with GE and proceeds of $29 million resulting from the sale of one Boeing 747-400 aircraft were used to repay the GECC Limited Recourse Loan.

For the nine months ended September 30, 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 ($442 million, net of fees). The Corporation also issued $330 million of 4.25% Convertible Senior Notes due 2035 ("Convertible Notes") for net proceeds of $319 million. During the period ended September 30, 2005, ACE and Aeroplan Income Fund (the 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 for the nine months ended September 30, 2005 and $35 million is included in investing activities for the nine months ended September 30, 2005. 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.

Also during the nine months ended September 30, 2005, Aeroplan LP arranged for senior secured credit facilities in the amount of $475 million. The credit facilities consist of one $300 million (or the U.S. dollar equivalent there of) term facility (the "Term A Facility"), a $100 million (or the U.S. dollar equivalent there of) acquisition facility (the "Term B Facility") and a $75 million (or the U.S. dollar equivalent there of) revolving term credit 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, which was repaid during the third quarter of 2005. At September 30, 2005, there were no amounts drawn under this facility. Refer to Note 4c to the Interim Unaudited Consolidated Third Quarter 2005 Financial Statements for additional information on the Aeroplan LP credit facilities.

During the nine months ended September 30, 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. As at September 30, 2005, the amount available under the Credit Facility was $300 million, and no amounts had been drawn.

6.3. Cash Flows from (used for) Investing Activities

In the third quarter of 2005, short-term investments decreased by $136 million, with an accumulated net increase of $1,219 million in the first nine 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 third quarter of 2005, additions to capital assets amounted to $316 million ($411 million in the first nine months of 2005) and related mainly to the purchase of nine Embraer 175 aircraft. In the 2005 quarter, refunds of deposits on Bombardier aircraft of which the company has taken delivery, amounted to $34 million. Other additions to capital assets included inventory and spare engines, ground equipment and facilities and system development costs.

On September 27, 2005, the Corporation invested $87 million (US$75 million) in the merged US Airways carrier in conjunction with US Airways' exit from US bankruptcy proceedings. The Corporation's investment represented approximately 7 per cent of the equity of the merged entity at the closing date. In connection with the equity investment, Air Canada and Technical Services continue to develop their commercial relationships with US Airways. Thus far, Technical Services has signed five-year contracts covering a range of activities including heavy maintenance of US Airways' Airbus A330 fleet, landing gear overhaul and work on a variety of engine and flight control components. These contracts will provide approximately $50 million in annual revenues to Technical Services. Ongoing discussions continue between US Airways and Technical Services on further contracts covering a wide variety of maintenance work. The dollar value and scope of contracts entered into is anticipated to grow further. In the area of airport services, meaningful cost reductions are expected as the Corporation and US Airways finalize agreements providing for the Corporation's relocation to more attractive airport facilities than currently utilized in a number of US cities.

The equity investment is subject to a six-month holding period from the closing date. This investment has been accounted for using the cost method. In connection with the equity investment, ACE also received options to purchase additional common stock in US Airways. On closing of the transaction, ACE sold these options for proceeds of $1 million.

7. RECENT DEVELOPMENTS

7.1. Update on the initial public offering of Jazz Air Limited Partnership

On August 4, 2005, ACE announced its intention to proceed with an initial public offering of Jazz Air Limited Partnership ("Jazz") through an income trust structure, with ACE retaining a majority interest in Jazz. ACE is pursuing an initial public offering as a means to maximize the value of its investment in Jazz for the benefit of ACE shareholders. A preliminary prospectus in respect of the offering was expected to be filed in the third quarter of 2005.

On September 30, 2005, the Corporation provided an update on its intention to proceed with an initial public offering of Jazz stating that the preparatory work to file a preliminary prospectus had been completed, and the document was ready for submission. However, given conditions in the income trust market subsequent to the launch by the Department of Finance of consultations on the economic and fiscal implications of publicly listed flow-through entities (FTEs), including income trusts, and the decision by the Minister of National Revenue to postpone providing advance rulings respecting FTE structures, ACE management felt it appropriate to refrain from proceeding with the filing. ACE will proceed with a Jazz offering as market conditions warrant.

8. LIQUIDITY

As at September 30, 2005, ACE had cash, cash equivalents and short-term investments of $2.5 billion and positive working capital of $705 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 September 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.

The Corporation 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.

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 September 30, 2005

The table below summarizes ACE's principal repayment requirements as at September 30, 2005 through to 2009 on long-term debt, capital lease obligations, and aircraft, engine and fuel facility debt consolidated as variable interest entities under AcG-15, as well as the Corporation's future minimum lease payments under existing operating leases as at September 30, 2005, as further described in Notes 4 and 9 to the Interim Unaudited Third 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 4)	14	40	41	60	338
Debt consolidated under AcG-15 (Note 4)	11	72	114	112	55
Capital lease principal obligations (Note 4)	45	140	173	171	84
Total Long-Term Debt and Capital Lease Obligations	70	252	328	343	477
Operating Leases (excluding leases accounted for as VIEs under AcG-15)					
-Future minimum lease payments under existing operating leases of aircraft (Note 9)	111	438	387	305	252
-Future minimum lease payments under existing leases for other property	25	57	48	46	33
	136	495	435	351	285

(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 September 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 $3.5 billion compared to approximately $12 billion at December 31, 2002, prior to filing for creditor protection under CCAA.

Capital Expenditures

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 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. No commitments have been made at this time on these exercisable options and conversion rights. Deliveries of the Embraer 175 series aircraft began in July 2005, with the Embraer 190 series deliveries scheduled to commence in November 2005. As of September 30, 2005, nine of the Embraer 175 series firm aircraft orders have been completed and, of the remaining six deliveries, two aircraft were delivered in October and four are to be received by the end of 2005. By the end of 2005, four Embraer 190 series firm aircraft are scheduled to be delivered.

The agreement with Bombardier covers firm orders for 15 Bombardier CRJ700 Series 705 aircraft and 30 Bombardier CRJ200 aircraft of which one Bombardier CRJ200 aircraft was cancelled on November 1, 2005 and of which 14 Bombardier CRJ200 aircraft may be cancelled, all without penalty. The purchase agreement also contains options for an additional 45 aircraft. Deliveries of the 50-seat Bombardier CRJ200 15 firm aircraft orders have been completed. No commitments have been made at this time on these cancellable orders and additional options. Deliveries of the 75-seat CRJ700 Series 705 deliveries began in May 2005. As of September 30, 2005, twelve of the CRJ700 Series 705 firm aircraft orders have been delivered and the remaining three deliveries are to be received by the end of 2005. The Corporation has received financing commitments from the manufacturers or a third party covering all firm aircraft orders.

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
Past service registered plans	27	198	211	206	209
Current service registered plans	33	133	135	140	145
Other pension arrangements	16	52	56	61	65
Projected pension funding obligations	76	383	402	407	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 changes in the economic conditions, mainly the return of the fund and the change in 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 per cent at January 1, 2005 was unchanged from the ratio at January 1, 2004, reflecting an increase in both pension assets and obligations.

9. QUARTERLY RESULTS

The table below describes quarterly financial results of Air Canada for the last quarter of 2003 and the first three quarters of 2004 and the financial results of ACE for the fourth quarter of 2004 and the first three 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		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Passenger revenues	1,615	1,661	1,844	2,123	1,681	1,739	2,100	2,461
Cargo revenues	131	126	137	142	151	135	147	162
Other revenues	231	334	240	231	230	303	211	210
Operating revenues	1,977	2,121	2,221	2,496	2,062	2,177	2,458	2,833
Operating expenses	2,054	2,266	2,199	2,253	2,065	2,187	2,281	2,513
Operating income (loss) before reorganization and restructuring items	(77)	(145)	22	243	(3)	(10)	177	320
Reorganization and restructuring items	(560)	(132)	(426)	(313)	-	-	-	-
Non-operating income (expense)	(132)	(43)	(72)	(133)	(67)	(66)	100	(38)
Gain (loss) before foreign exchange on non- compromised monetary items and income taxes	(769)	(320)	(476)	(203)	(70)	(76)	277	282
Non-controlling interest	-	-	-	-	-	-	-	(9)
FX gain (loss) on non-compromised monetary items	(7)	17	(34)	123	98	(15)	(53)	125
Income (loss) before income taxes	(776)	(303)	(510)	(80)	28	(91)	224	398
Recovery of (provision for) income taxes	8	(1)	-	(1)	(13)	14	(56)	(128)
Net income (loss)	(768)	(304)	(510)	(81)	15	(77)	168	270
Earnings (loss) (1) Per share – basic	(6.39)	(2.53)	(4.24)	(0.67)	0.17	(0.87)	1.67	2.66
Per share - diluted	(6.39)	(2.53)	(4.24)	(0.67)	0.17	(0.87)	1.49	2.33
Revenue passenger miles (millions)	9,289	10,057	10,836	12,853	9,681	10,586	11,613	13,981
Available seat miles (millions)	13,115	13,797	13,931	15,993	12,815	13,566	14,487	16,961
Passenger load factor (%)	70.8	72.9	77.8	80.4	75.5	78.0	80.2	82.4
Operating expense per available seat mile (CASM) (cents)	15.7	16.4	15.8	14.1	16.1	16.1	15.7	14.8
Operating expense per available seat mile excl. fuel expense (cents)	13.5	14.0	13.1	11.2	12.7	13.1	12.1	10.8

(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.

10. 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 page 5 of this MD&A, 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 ACE Aviation Three Months Ended September 30, 2005					
	Transportation Services (a)	**Loyalty Program (b)**	**Technical Services**	**Regional Operations (c)**	**Inter-Segment Elimination**	**ACE Consolidated**
Passenger revenue	2,461	-	-	-	-	2,461
Cargo revenue	162	-	-	-	-	162
Other revenue	(8)	154	62	2	-	210
External revenue	2,615	154	62	2	-	2,833
Inter-segment revenue	59	2	124	271	(456)	-
Total revenue	2,674	156	186	273	(456)	2,833
Aircraft rent	91	-	-	23	(2)	112
Amortization of capital assets	104	2	8	4	-	118
Other operating expenses	2,219	134	175	209	(454)	2,283
Total operating expenses	2,414	136	183	236	(456)	2,513
Operating income	260	20	3	37	-	320
Total non-operating income (expense), non-controlling interest, foreign exchange and income taxes	(46)	(1)	(3)	-	-	(50)
Segment Results	214	19	-	37	-	270
Operating Margin %	9.7	12.8	1.6	13.5	-	11.3
EBITDAR	455	22	11	64	(2)	550

Results for the third quarter 2005 for the Technical Services segment were negatively impacted by the annual cyclical nature of the Air Canada maintenance program which created temporary underutilized capacity in the Montreal and Winnipeg maintenance centres. In addition, the increase in the Technical Services operating expenses, compared to the first half of the year, is due to the opening of additional maintenance lines in Montreal and start-up costs required for customers other than Air Canada and to

expenses relating to an employee profit sharing program which were not recorded in the Technical Services segment for the first half of the year.

Segment results for Technical Services for the nine months ended September 30, 2005 reflect an income of $41 million.

	Successor Company ACE Aviation Nine Months Ended September 30, 2005					
	Transportation Services (a)	**Loyalty Program (b)**	**Technical Services**	**Regional Operations (c)**	**Inter-Segment Elimination**	**ACE Consolidated**
Passenger revenue	6,299	-	-	1	-	6,300
Cargo revenue	444	-	-	-	-	444
Other revenue	92	478	148	6	-	724
External revenue	6,835	478	148	7	-	7,468
Inter-segment revenue	160	8	414	710	(1,292)	-
Total revenue	6,995	486	562	717	(1,292)	7,468
Aircraft rent	251	-	-	54	(5)	300
Amortization of capital assets	313	6	24	14	-	357
Other operating expenses	6,160	408	487	556	(1,287)	6,324
Total operating expenses	6,724	414	511	624	(1,292)	6,981
Operating income	271	72	51	93	-	487
Total non-operating income (expense), non-controlling interest, foreign exchange and income taxes	(108)	(1)	(10)	(7)	-	(126)
Segment Results	163	71	41	86	-	361
Operating Margin %	3.9	14.8	9.1	13.0	-	6.5
EBITDAR	835	78	75	161	(5)	1,144

Going forward from the date of the Aeroplan offering, as described in Note 5 to the Interim Unaudited Third Quarter 2005 Consolidated Financial Statements, a non-controlling interest charge is recorded upon the consolidation of Aeroplan LP. As Aeroplan LP's non-controlling interest capital is in a deficit position, the non-controlling interest charge is equal to the greater of the non-controlling interest holders' share of the Aeroplan LP earnings for the period or the amount of distributions to the non-controlling interest holder during the period.

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 eCommerce Group LP, ACGHS Limited Partnership (doing business as Air Canada Groundhandling), Touram Limited Partnership (doing business as Air Canada Vacations), and ACE. Destina eCommerce Group LP is a successor to Destina.ca Inc. and AC Online Limited Partnership, all assets of the latter entities have been transferred to Destina eCommerce Group LP as of July 1, 2005. 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 certain entities included in Transportation Services.

Certain adjustments related to transactions between Air Canada and the Loyalty Program segment are recorded within the Transportation Services segment. These adjustments relate mainly to the revenue recognition timing difference from when Aeroplan records revenues, at the time a Mile is redeemed for air travel, to the consolidated accounting policy of revenue recognition at the time reward transportation is provided. In addition, the Loyalty Program segment records revenue from the redemption of Miles in Other revenue, whereas on the consolidated financial statements, Miles redeemed for air travel on Air Canada and Jazz are recorded in Passenger revenue. In the Loyalty Program segment information, the cost to Aeroplan of purchasing rewards is recorded in other operating expenses. The adjustment for these items in the three months ended September 30, 2005 is an add back of $96 million to Other revenue and Other operating expenses ($296 million for the nine months ended September 30, 2005).

b) Other revenue includes revenue recognized on redemption of points accumulated through both air and third party contracts. Inter-segment revenue of $2 million ($8 million for the nine months ended September 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.

11. ACCOUNTING POLICIES

The Interim Unaudited Consolidated Third 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

Effective September 30, 2004, Miles redeemed for air travel on Air Canada and Jazz are included in Passenger revenue and Miles redeemed for other than travel are included in Other revenue. For additional information on Aeroplan passenger revenues, refer to page 5 of this MD&A.

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)
Cumulative effect of change in accounting policy		90
	1,366	1,366

The increase to other assets represents restricted cash held in the VIEs and the fair value of a currency swap arrangement of $7 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
Decrease to other long-term liabilities		2
Cumulative effect of change in accounting policy		52
	113	113

The remaining five Fuel Facilities Corporations in Canada that have not been consolidated have assets of approximately $103 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 third quarter of 2005, the net impact of adopting AcG-15 on the Corporation's results was a pre-tax income of $38 million or $0.38 per share, basic. The impact of the adoption of AcG-15 was a reduction to aircraft rent expense of $30 million, an increase to depreciation expense of $20 million, an increase to net interest expense of $24 million, a foreign exchange gain of $55 million and a non-controlling interest charge of $3 million compared to financial results had AcG-15 not been effective.

For the nine months ended September 30, 2005, the net impact of adopting AcG-15 on the Corporation's results was a pre-tax charge of $25 million or $0.26 per share, basic. The impact of the adoption of AcG-15 was a reduction to aircraft rent expense of $87 million, an increase to depreciation expense of $66 million, an increase to net interest expense of $69 million, a foreign exchange gain of $34 million and a non-controlling interest charge of $11 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.

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.

Investments

Investments not subject to significant influence are carried at cost and any declines in value that are determined to be other than temporary are included in earnings. Earnings from such investments are recognized only to the extent received or receivable.

Future Accounting Standard Changes

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 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.

12. MATERIAL CHANGES

There have been no material changes in debt and lease obligations from the disclosures included in ACE's 2004 Management's Discussion and Analysis of Results dated March 18, 2005, 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 ACE's Second Quarter 2005 Management's Discussion and Analysis of Results. 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.

13. 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.